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The Reform of the Corporate Duty of Care in China – From the Introspection of Delaware and Taiwan

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THE REFORM OF THE CORPORATE DUTY OF CARE IN CHINA – FROM THE
INTROSPECTION OF DELAWARE AND TAIWAN

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[Jui-Chien Cheng]
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To my parents and sister, I am the luckiest guy in the world to have you as families. The only thing I can do for you is to share the joy and happiness of the accomplishment of my dissertation.

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Jui-Chien Cheng, so-called Jerry in town, is a very normal but luckist guy who completes a cool degree in a wonderful school, the Maurer School of Law, Indiana University-Bloomington.

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Abstract

The concept of fiduciary duty, derived from common law, was introduced to the Company Law of People's Republic of China in 2005. The fiduciary duty plays an extremely important role in common law, particularly in U.S. corporate law. For this reason, one might have expected dramatic consequences from its introduction to Chinese law. In reality, however, few fiduciary lawsuits have been brought to the courts of China since 2005. There are three main reasons for the rarity of due care lawsuits.

First, Chinese fiduciary law has neither clear content nor a practical enforcement. This is especially true of the body of fiduciary law that deals with the duty of care. This makes it difficult for lawyers to decide whether pursuing a due care lawsuit is worthwhile and for judges to establish a legal doctrine for applying and enforcing the law. Second, the traditionally harmonious culture of China discourages filing lawsuits against directors. Shareholders thus prefer other ways to solve problems, such as simply selling their stocks. Third, Chinese law imposes severe restrictions on derivative lawsuits. One such restriction is the requirement for shareholder(s) to have held at least 1% of company stock for at least 180 consecutive days in order to be eligible for filing a derivative lawsuit.
This dissertation examines China’s problematic duty-of-care law and demonstrates that it is in dire need of revision by introspecting the duty of care in Delaware and the obligation of care of a good administrator in Taiwan. In any case, however, one cannot simply transplant a common law concept to civil law without also making a substantial effort to explain the law and adapt it to fit its new context. Otherwise, the law will inevitably suffer either from vagueness or ambiguity, both of which are sure sources of confusion. Therefore, the ambition of this dissertation is to provide the Chinese world a practical reform of the duty-of-care law that fits in the Chinese society.
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1. Introduction

In 2005, the National People’s Congress of the People’s Republic of China amended Article 148 of the Company Act, which stipulated that directors, supervisors, and senior managements are liable for their obligations of loyalty and diligence. Most scholars believe that these obligations are derived from the duties of loyalty and care in the common law, respectively.

The concept of the fiduciary duty is the foundation of the directors’ liabilities of the common law and the Delaware General Corporate Law (henceforth DGCL). The fiduciary duty contains the duties of loyalty and care, and the parameters of both duties is derived from the concept of gross negligence, which refers to the degree of the negligence in corporate malfeasance and far more reckless behavior, even close to intentional misconduct. If a director’s conducts is not grossly negligent, he or she can be protected by the business judgment rule and its exculpatory provision, which means the directors are only at slight risk for liability for the breach of their duty of care.

However, the Chinese law neglects the spectrum of the fiduciary duty and divides it into the two independent obligations of loyalty and diligence, and monetary damages are the only legal consequence for the breach of such duties. Because Article 148 of the Company Act sets up two different obligations, logically,
their legal consequences and enforcement should be different. Without the
distinction between the obligations of loyalty and care, it would unnecessary to
establish two obligations in one article. Surprisingly, the obligations of loyalty and
diligence have the same legal consequences under the structure of the Chinese
Company Act. However, neither the business judgment rule nor the exculpatory
provision, such as the Delaware General Corporate Law Section 102(b)(7), can be
applied to the current Chinese Company Act.

The discussion leads to the following questions: Why do the two different
obligations share one legal consequence? Does this make sense? Why not just use a
single term to describe the concept of fiduciary duty? There must be some reasons
to split the fiduciary duty to two obligations, so what are they? What are the
differences between the obligations of loyalty and care? What reforms should be
made in Chinese fiduciary duty? How does culture influence law? What are the *ex
ante* consequences of reform?

To answer these questions, one must first understand the spectrum of
fiduciary duty, which refers to the evolution of common law and corporate law in
Delaware’s fiduciary duty during the past 30 years. Fiduciary duty is a legal concept
that contains the duty of loyalty and the duty of care.

Concerning the duty of care, in order to encourage corporate directors to
pursue the company's best interests, they must not be blamed for bad decision-
making that caused the loss of significant company funds; otherwise the directors might become too risk-averse. Hence, protection of the business judgment rule and the exculpatory provision are the main issues around the duty of care in Delaware's interpretations of fiduciary duty. However, the protections to corporate directors, especially the amendment of the exculpatory provision in DGCL Section 102(b)(7), are so strong that they almost eliminate the function of the duty of care. To provide some balance, the Chancellors and Judges of the Delaware Chancery Court and the Supreme Court of Delaware made a series of decisions to limit the applicable scope of the duty of care on the one hand and to expend the content of the duty of loyalty on the other. The role adjusts from time to time in order to fit in the day-by-day growing of the business world and to keep the flexibility in corporate law.

In 2001, an amendment to Article 23, Paragraph 1 of the Company Act of Taiwan stipulated that corporate directors owe an obligation of loyalty and an obligation of care of a good administrator. This amendment is considered the milestone for transplanting (part of) the fiduciary duty from common law to the Chinese world; thus, the design and development of Taiwanese law is always the best reference to Chinese law.

In Taiwan, the obligation of loyalty generally refers to the duty of loyalty in the common law; nevertheless, the derivation of the obligation of care of a good administrator is controversial. Most scholars believe that the content and consequence of the obligation in the Company Act is exactly the same as the
mandatory’s main obligation, which is also named the obligation of care of a good administrator in the Civil Code. This way makes it much easier for judges to apply both the Company Act and the Civil Code because the term of obligation of care of a good administrator already has existed for more than eighty years in Taiwan.

A minority of judges and scholars claim that the obligation of care of a good administrator refers to the duty of care in the common law. This makes sense because fiduciary duty is an integrated concept that is composed by the duty of loyalty and the duty of care, so the legal consequence for the breach of each duty should be different.

The difference between both obligations is little to none under most interpretations of Taiwanese civil law. Moreover, the concept of conflicts of interest between the director and his/her company has already been regulated in Article 209 of the Company Act of Taiwan, so the chance to apply the amendment to Article 23 is very small following the majority’s interpretation. On the other hand, the minority view at least logically keeps open the possibility of the application of the business judgment rule and the exculpatory provision.

The business judgment rule is always the most discussed topic of the obligation of care of a good administrator because this rule has been validated and adapted in Taiwanese legal society by both the minority and the majority. Therefore, it makes sense to claim that Taiwanese corporate society is strongly
influenced by the concept and spectrum of fiduciary duty, so that the interpretation of Article 23 of Paragraph 1 of the Company Act should keep the distinction between the legal consequences of the obligation of loyalty and the obligation of care of a good administrator.

In China, neither the spectrum of the fiduciary duty nor the spirit of the duty of care, which refers to the business judgment rule and its exculpatory provision, is adapted. However, in terms of specific rulings, some verdicts limit the total amount of the monetary damages, whether judges intend to do so or not. This shows the necessity of the exculpatory provision for the smooth functioning of Chinese Company Law.

In the Ding Liye case, the plaintiff, Mr. Ding, was a director of a publicly traded company and was fined approximately $5,000 by the China Securities Regulatory Commission (hereinafter CSRC) because of incomplete and wrongful information stated in the company's annual and semi-annual reports. This kind of wrongdoing was categorized as a breach of the obligation of diligence, as delineated in Paragraph 1 of Article 58 of the Administrative Measures for the Disclosure of Information of Listed Companies. This paragraph stipulates that directors of listed (i.e., traded) companies have to ensure that their companies comply with the legal duties of disclosure, and to ensure the genuineness, accuracy and the completeness of disclosed information. A failure to fulfill these responsibilities can be deemed as a breach of their obligations of diligence.
The ruling was for the CSRC, the defendant, which meant that the court endorsed the legitimacy of the administrative sanctions and agreed with the assumption that the plaintiff was liable for a breach of his obligation of diligence due to the flaws of the disclosed information.

This verdict may push the directors of listed companies to a very dangerous situation that easily to be found liable for breaches of their obligation of diligence. Logically, this verdict can serve as strong evidence for shareholders who file a derivative lawsuit against the directors for the breach of their obligation of diligence, and the monetary damages for such a breach of this obligation can be huge. However, the severe restrictions on filing a derivative lawsuit serve to protect directors, especially those of listed companies, from being liable for the breach of their obligation of diligence. As a result, the $5,000 administrative sanction is Mr. Ding’s only liability for the breach of this obligation, regardless of how great the loss to his company was in fact. Yet in the Wujin case, the judges cut the monetary damages to one-third of the total loss of this limited liability company in order to effectively solve the dispute.

The chairman and several other directors and supervisors had done much work, in terms of the field research they engaged in and the several meetings they held, to establish an aquatic farm. This investment eventually caused a huge loss to
the company, and several shareholders who were aware of the investment from the very beginning, filed a derivative lawsuit against the Chairman.

Unsurprisingly, the chairman eventually lost the case because he never arranged a board or shareholder meeting; however, he did call several chairman meetings to engage in ordinary, and necessary, administrative procedure of decision-making around the aquatic farm. The problem was that the law did not recognize the validation of the chairman’s meetings, i.e., every decision made by a chairman’s meeting could be voided, so that he could be liable for the company’s losses. In fact, this consequence was not in the best interests of both parties, and of the business world in general. Most Chinese LLCs arrange neither shareholder meetings nor board meetings as required by law. This might result in many business activities in China being voidable, but the disobedience of a law cannot be the reason to excuse the Chairman’s liability. Therefore, the judges reduced the monetary damages to one-third of the company’s total losses, a compromise in terms of both parties’ interests. Since reducing the monetary damages is a practical way of solving the dispute, why not introduce this exculpatory provision into the law?

To strike a balance between the protection of the directors and shareholders and to encourage directors to pursue the company’s best interests, this dissertation suggests that the directors’ liabilities for the breach of the obligation of diligence should be limited rather than eliminated. The limited liability should be capped at
60,000 RMB ($10,000) based on the amount of the existing penalty in corporate and security laws and social norms in China. This amount may keep the notion of due care in the directors’ minds and may be bearable by them.

For a limited liability company, judges should have the discretion to set the total amount of monetary damages at a certain amount to correspond to in the maximum liability that a director can reasonably bear. Considering the severe restrictions on a derivative lawsuit for a public company, the administrative sanction made by the CSRC is the only solution to contest directors’ breach of the obligation of diligence.

The Chinese government cares so much about the administrative control, so it is impractical to suggest that CSRC limit its own power. The problem with this approach is that the amount of the penalty for the company is much higher than the amount for its directors; however, the company itself cannot breach the obligation of diligence. In fact, the penalty to the company is the punishment to all of its shareholders. Yet only natural persons, such as directors, should be punished for the breach of their obligations, and the amount of the punishment should be capped at 60,000 RMB ($10,000) as well.

This dissertation contributes to existing scholarship on fiduciary duty laws, especially in the field of the duty of care in Taiwan and China. Currently, most Taiwanese and Chinese Scholars focus on the debate of introduction of the business
judgment rule and almost omit the application and enforcement of the exculpatory provision, which is the main idea of this dissertation.

This rest of this dissertation is organized as follows: Chapter two is an introduction of Delaware law, which focuses on the development of the spectrum of fiduciary duty and the leading cases and laws that mark the evolution of the duty of care. Chapter three introduces the ten-year evolution of the fiduciary obligations in Taiwan. This chapter also asserts that the whole spectrum of fiduciary duty should be adapted to the Chinese corporate world; otherwise there would be no distinction between the obligation of loyalty and the obligation of care of a good administrator. The obligation of fidelity and the obligation of diligence in China face the same problem as well. Chapter four summarizes the poorly regulated obligation of diligence in China and notes the necessity of a practical reform of this obligation and the exculpatory provision in China by analyzing the legal consequences of the Ding Liye case and the Wujin case. Chapter five proposes a practical reform of the obligation of diligence for Chinese society and emphasizes the function of this obligation. It also calls for limiting the total amount of monetary damages for the breach of due care in order to strike a balance between the protection of the directors and the interests of shareholders. Chapter six contains my conclusion and recommendations.
2. The Duty of Care and the Exculpatory Provision in Delaware

2.1. Overview

The duty of care has been evolving rapidly and dramatically in the law of Delaware during recent decades. A significant change began with *Smith v. Van Gorkom*’s (1985) harsh ruling against the directors of the Trans Union Corporation. The ensuing backlash led ultimately to the death of the duty of care in Delaware, thus giving the duty of loyalty more weight. The latter duty’s dominance was further secured when it subsumed the duty of good faith, a consequence of *Stone v. Ritter*. In sum, the balance has now shifted; while the duty of care had been dominant for a brief period following *Smith v. Van Gorkom*, the duty of loyalty is now the most important duty by far. This situation exemplifies the ill effects of giving extra weight to any one fiduciary duty at the expense of the others.

2.2. The Fiduciary Duty of Care in Common Law

2.2.1. The Duty of Care
In common law, nearly all aspects of the relationship between a corporation and its directors are rooted in the fiduciary relationship, which establishes both a standard of loyalty and a standard of care for fiduciaries.\(^1\) When fiduciaries fall short of these standards, they are said to breach the duty of loyalty or the duty of care.\(^2\) The duty of loyalty is “the requirement that a director favor the corporation’s over her own whenever those interests conflict”.\(^3\) The duty of care simply means that such fiduciaries as corporate directors are obligated to operate their business with due care. In other words, directors have to exercise an informed business judgment when making business decisions; otherwise, courts will impose personal liability on directors for gross negligence, the standard of review for the duty of care.\(^4\) A breach of the duty of care always entails an uninformed business decision constituting gross negligence.\(^5\)

\(^1\) Tamara Frankel, *Fiduciary Law* 106 (2011).

\(^2\) It is important to note the distinction between these two duties because the duty of care is protected by the business judgment rule, which “is a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.” See Aronson v. Lewis, 473 A. 2d 805, 812 (Del. 1984).

\(^3\) Charles R.T. O’Kelley & Robert B. Thompson, *Corporations and Other Business Associations* 277 (6th ed. 2010). Claire Hill & Brett McDonnell, “Executive Compensation and the Optimal Penumbra of Delaware Corporation Law,” 4 Va. L. & Bus. Rev. 333, 338-39 (2009). (“Where a conflict of interest exists, courts will scrutinize the relevant corporate decision closely ... in one of the three ways. First, the defendants may try to show that disinterested and independent directors approved the transaction. ... Second, the defendants may try to show that a majority of the disinterested shareholders approved the transaction. ... Third, the defendants may try to show that the transaction was entirely fair to the corporation.”)


\(^5\) See Aronson, 473 A. 2d at 812.
2.2.2. The Business Judgment Rule

However, fiduciaries are to some extent shielded from this liability by the business judgment rule, which places the initial burden of proof on the plaintiff. This rule shields a defendant fiduciary from gross negligence liability until the plaintiff can rebut the rule’s presumption, in which case the shield is “broken,” and the action/transaction in question becomes subject to the entire fairness test\(^6\), just as if there had been a duty of loyalty claim all along. The Supreme Court of Delaware defined the business judgment rule as “[the] presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the corporation.”\(^7\) Thus, the decision-making process is distinguished from the decision itself; i.e., the

\(^6\) The standard of review of the entire fairness test, \textit{See} Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983). (“The concept of fairness has two basic aspects: fair dealing and fair price. The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company’s stock.”)

However, the entire fairness test might not be a good standard for the breach of due care for three reasons. \textit{See} William T. Allen et al., \textit{Realining the Standard of Review of Director Due Care With Delaware Public Policy: A Critique of Van Gorkam And Its Progeny As a Standard of Review Problem}, 96 Nw. U. L. REV. 449, 462-63 (2002). (“First, the basic rationale for [the] entire fairness review--the difficulty in ascertaining, in non-arms-length transactions, the price at which the deal would have been effected in the market--is not applicable in due care cases. … Second, in care cases not involving a specific transaction, an entire fairness analysis would have little or no utility. … Third, the Cede II standard-changing treatment of the duty of care is procedurally unfair to directors accused of breaching that duty, and may diminish the incentive for directors to engage in risk-taking transactions that could serve the best interests of stockholders.”)

\(^7\) Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).
process that leads to a particular decision can be questioned in court, but not
the decision itself.\textsuperscript{8} The business judgment rule is meant to provide directors
with a general discretion in formulating company policy and is designed to
prevent courts and shareholders from assuming the role of corporate
decision-makers.\textsuperscript{9}

2.2.3. The Policy Argument in Favor of Limiting the Reach of the
Liability of Due Care

In \textit{Joy v. North} (1976), the Second Circuit Court of Appeals stated three
reasons for limiting the reach of the duty of care.\textsuperscript{10} First, shareholders who
subscribe to their shares voluntarily submit to the risk of bad business
decisions.\textsuperscript{11} Since shareholders are free to choose any stock on the Market,
the evaluation of a company's management is important information for
individuals who are considering purchasing the corporation's stock.\textsuperscript{12}

\textsuperscript{8} Under the scrutiny of business judgment rule, the judges must consider: "(a) whether or not the
directors do in fact rely upon the expert with good faith; (b) whether or not directors reasonably
believed that the expert's advice was within the expert's realm of professional competence; (c)
whether or not the expert was selected with reasonable care by or on behalf of the corporation; (d)
whether or not the faulty selection process could be attributed to the directors; (e) whether or not
the material and reasonably available subject matter was so obvious that the board considered it to
be grossly negligent regardless of the expert's advice or lack of advice; or (f) whether or not the
decision of the Board constituted waste or fraud." \textit{See Brehm v. Eisner}, 746 A.2d 244, 262 (Del. 2000).

\textsuperscript{9} \textit{DENNIS J. BLOCK, ET AL., THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS} 8-12
(5th ed. 1998).

\textsuperscript{10} \textit{Joy v. North}, 692 F. 2d 880 (2nd Cir. 1976).

\textsuperscript{11} \textit{Id.} at 885.

\textsuperscript{12} \textit{Id.}
(Important material information about publicly traded companies also is easily obtainable from professional advisors.\textsuperscript{13}) Given that shareholders have sufficient information to determine which stocks they want to buy, they in effect voluntarily submit to the risk of bad judgments in the running of the business.

Second, courts should not evaluate corporate decisions in after-the-fact litigation.\textsuperscript{14} Due to time and information limitations, a board of directors must usually make quick decisions based on imperfect information.\textsuperscript{15} It is unreasonable for the courts to challenge the outcome of business decisions years later with the advantage of perfect hindsight in terms of relevant information.\textsuperscript{16} It is also unfair that directors must pay the entire amount of the damages while not enjoying any corresponding opportunity to benefit from all the profits.

Third, courts should not intervene in corporate decisions too much because potential profits are usually accompanied by potential risks.\textsuperscript{17} Because of legal concerns, risk-averse directors might be inclined to make

\textsuperscript{13} Id.
\textsuperscript{14} Id. at 886.
\textsuperscript{15} Id.
\textsuperscript{16} Id.
\textsuperscript{17} Id.
overly cautious business decisions in order to protect themselves from liabilities, and the companies might lose out on numerous significant opportunities to make profits.\textsuperscript{18} If the goal is to allow directors to obtain the greatest potential profit, diversifying shareholder holdings is another reasonable and efficient way to protect shareholders without giving them special protection.\textsuperscript{19} The Second Circuit Court of Appeals believes that shareholders should be liable for their own investment decisions; the Court thus holds that diversifying their holdings is a better way to reduce the volatility of risks than giving them excessive protection under the law.\textsuperscript{20}

\section*{2.3. The Smith v. Van Gorkom Case And the Delaware General Corporate Law Section 102(b)(7)}

\subsection*{2.3.1. Facts}

Following the Delaware Supreme Court’s decision in \textit{Smith v. Van Gorkom,} the issue of the duty of care suddenly caught the public eye.\textsuperscript{21} Jerome W. Van Gorkom was Chairman and Chief Executive Officer of Trans Union, a publicly


\textsuperscript{19} \textit{Id.} ("In the case of the diversified shareholder, the seemingly more risky alternatives may well be the best choice since great losses in some stocks will over time be offset by even greater gains in others.")

\textsuperscript{20} \textit{Id.}

\textsuperscript{21} \textit{Smith v. Van Gorkom,} 488 A. 2d 858 (Del. 1985).}
traded and diversified holding company.\textsuperscript{22} Although “the company had a cash flow of hundreds of millions of dollars annually,” it was unable to make sufficient taxable income to offset its investment tax credits.\textsuperscript{23}

To take advantage of these tax credits, Van Gorkom considered the sale of the business to a third party.\textsuperscript{24} The company’s CFO indicated that a reasonable price for Trans Union would be $50-60 per share.\textsuperscript{25}

Several days after the first meeting, Van Gorkom decided to meet Jay A. Pritzker, a potential acquirer, to agree to sell Trans Union for $55 per share. He did so without consulting any other member of the company’s board or senior management, except Carl Peterson, the Controller;\textsuperscript{26} Van Gorkom simply unilaterally decided the price.\textsuperscript{27} Pritzker eventually agreed to make a cash-out merger offer of $55 per share after another meeting with Van Gorkom.\textsuperscript{28}

\textsuperscript{22} Id. at 864.

\textsuperscript{23} Id.

\textsuperscript{24} Id.

\textsuperscript{25} Id. at 865.

\textsuperscript{26} Id. at 866.

\textsuperscript{27} Id.

\textsuperscript{28} Id. at 867.
Van Gorkom called a special meeting of the Trans Union Board on the following day and also called a meeting of the senior management. 29 The managers’ reaction to the offer was unanimously negative. 30 Despite this rejection, Van Gorkom insisted that the board meeting be held on time that same day. 31 The directors did not receive any written materials prior to this meeting. 32

During the board meeting, Van Gorkom orally presented the proposal and outlined the terms of the offer without explaining how he had arrived at the $55 per share figure. 33 The CFO indicated that a second study suggested a reasonable price was between $55 and $65 per share, noting that "$55 was in the range of a fair price, but at the beginning of the range." 34 Van Gorkom responded that $55 per share was a fair price and that shareholders should have the chance to decide whether to accept it. 35

29 Id.
30 Id.
31 Id. at 868.
32 Id.
33 Id.
34 Id. at 869.
35 Id. at 868.
The Board eventually accepted the merger agreement, and the stockholders of Trans Union approved the acquisition five months after this special meeting.36

2.3.2. Claims and the Verdict

Since the merger was in effect and could not be voided, the plaintiffs attempted to seek monetary damages for a breach of the duty of care. The Chancery Court ruled that the defendants were protected by the business judgment rule for two reasons: (1) The directors acted in an informed manner and (2) The shareholders were also fairly informed by the board before voting.37

At the trial of the Delaware Supreme Court, the defendants argued that the acquisition decision was an informed one for four reasons: (1) the price offered per share was much higher than the market price; (2) the board could accept any better offer during the market test period; (3) the decision had been properly made by both inside and the outside directors; and (4) the

36 Although the shareholders approved the agreement, it could not cleanse the directors' liabilities. See ld. at 873. (“Certainly in the merger context, a director may not abdicate that duty by leaving to the shareholders alone the decision to approve or disapprove the agreement.”)

37 ld. at 864.
directors relied on the legal advice that they might be sued for the breach of the fiduciary duty if they rejected the proposal.\textsuperscript{38}

The Court ruled in favor of the plaintiffs for three reasons: (1) the board’s decision was not an informed business judgment; (2) the board attempted to amend the merger agreement and take other curative actions that were legally and factually ineffectual; and (3) the board failed to disclose all the material facts before the shareholders ratified the merger.\textsuperscript{39}

The business judgment rule was rebutted because: (1) the directors lacked the necessary information for establishing a per share purchase price; (2) they did not know the intrinsic value of their own company; and (3) they approved the merger after only two hours of consideration despite having had no prior notification of the proposal.\textsuperscript{40} In this last point, the court ruled, the directors were grossly negligent.\textsuperscript{41}

\subsection*{2.3.3. The Standard of Review of Gross Negligence}

In the \textit{Van Gorkom} case, the Supreme Court of Delaware did not define the standard of review and the definition of gross negligence; rather, the

\footnotesize{
\textsuperscript{38} \textit{Id.} at 875.

\textsuperscript{39} \textit{Id.}

\textsuperscript{40} \textit{Id.} at 864.

\textsuperscript{41} \textit{Id.} at 874.
}
Court simply enumerated a set of facts and concluded that the defendants’
conduct constituted gross negligence.

Using this approach to decide whether or not the defendants’
constitute gross negligence is not new to common law. In New World v. King,
the Supreme Court of the United States also admitted that three different
degrees of negligence from Roman law (slight, ordinary, and gross) has been
introduced to common law; however, these terms may not be usefully
applicable in practice because there are so many exceptions that it is scarcely
possible to establish the general rule.42

In the field of tort law, Prof. William Prosser concluded that “[t]he
prevailing rule in most situation is that there are no degrees of care or
negligence, as a matter of law; there are different amount of care, as a matter
of fact.”43 In other words, under common-law jurisdiction, a court would
examine the defendants’ conduct case-by-case and fact-by-fact to decide
whether that conduct outraged the general understanding of negligence then
exceeded to gross negligence, as a matter of fact.

42 57 U.S. 469, 474 (1853). (“The theory that there are three degrees of
negligence, described by the terms slight, ordinary, and gross, has been introduced into the
common law from some of the commentators on the Roman law. It may be doubted if these
terms can be usefully applied in practice. … One degree, thus described, not only may be
confounded with another, but it is quite impracticable exactly to distinguish them. Their
signification necessarily vaies according to circumstances, to whose influence the courts
have been forced to yield, until there are so many real exceptions that the rules themselves
can scarcely be said to have a general operation.”)

Take the *Van Gorkom* case, which is the standard of review of due care is gross negligence.\(^{44}\) Although there is no explicit definition of gross negligence in the DGCL, liability under the standard of gross negligence is quite difficult to establish. However, this judgment showed that the directors could easily act in a grossly negligent manner and unexpectedly have to pay a huge amount of compensation; that is, the standard of review of the *Van Gorkom* case might not be defined as gross negligence.\(^{45}\) This standard appears to be similar to a negligence standard or an entirely new standard of review that fits somewhere between negligence and gross negligence. Thus, the directors of companies that were incorporated in Delaware were unwilling to face this more severe liability and were required to work harder to satisfy this new standard of review.\(^{46}\)

As the discussion below of *Van Gorkom*'s consequences and the amendment of Section 102(b)(7) of the DGCL reveal, this case is a bad decision, and its legacy has influenced Delaware's fiduciary duty for nearly 30 years, from 1985 to the present.

### 2.3.4. The Consequences

\(^{44}\) Aronson v. Lewis, *Supra* note 3 at 812.

\(^{45}\) William T. Allen et al., *Supra* note 6 at 458 (2002).

In being found liable for breach of the duty of care, the defendants faced potentially astronomical damages. The court held that if the fair value of the company's stock was determined to be greater than the sale price of $55 per share, the difference would be awarded to the plaintiffs. If, for example, that company's intrinsic value were determined to be $65 per share, the directors would have been personally liable for $10 per share, or $133,577,580. As it happened, the directors actually settled the case for $23,500,000, but this is arguably still an excessive sum.

The Delaware Supreme Court's ruling in this case had lasting problematic consequences in three ways. First, it opened the door for the directors of any company - incorporated in Delaware to be held personally liable for vast sums of money, thus creating a huge disincentive for anyone considering taking on the role of director.

Second, the criteria on which the court based its decision were largely arbitrary. For example, is prior notice of a proposal truly necessary in order

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49 *Id.*

for board members to make an informed decision about it at their board meeting? And why exactly is two hours an insufficient amount of time for making that decision? Would three hours have sufficed? Such arbitrariness leads to a vague of standard of review. The precedent for excessive personal liability, along with the vagueness introduced to the standard of review, created huge disincentives for anyone considering taking on a decision-making role at the corporate level.

Third, following the Van Gorkom decision, it in fact became harder to recruit directors. In addition, the premiums for directors and officers insurance (D&O insurance), which covers personally liability for the breach of due care, surged.

Because the Delaware Supreme Court’s decision increased the potential liability for breaching the duty of care, it in effect increased the importance of the duty of care. All issues of the contours of the substantial review of due care and the boundary between the duty of care and the duty of loyalty are a significant and enduring legacy of this case.

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51 William T. Allen et al., Supra note 6, at 449.
54 Stephen M. Bainbridge, Supra note 50 at 221.
2.4. The Amendment of the Delaware General Corporate Law Section 102(b)(7)

2.4.1. The Policy Argument in Favor of the Exculpatory Provision

The turbulence following the *Van Gorkom* case provoked the Delaware Assembly to attempt to counter the Delaware Supreme Court’s director-unfriendly decision so as to maintain the prevailing status of most of the publicly traded companies that are incorporated there. The state needed to find a way to stop the turbulence that stemmed from *Van Gorkom* since the protection of the business judgment rule is insufficient for a corporation’s directors. This rule is just a legal presumption that focuses only upon shareholders’ and corporations’ best interests due to the function of the fiduciary duty.\(^\text{55}\) Thus, Delaware needed a new law to maintain its director-friendly reputation. In particular, the Delaware Assembly sought to limit the duty of care’s reach by passing Section 102(b)(7) of the Delaware General Corporate Law (henceforth DGCL), the so-called exculpatory provision, in 1986.\(^\text{56}\) This law states that a company’s certificate of incorporation may


\(^{56}\) “Begin with Delaware in 1986, approximately 40 states have now enacted legislation allowing corporations to limit or eliminate directors’ liability for breach of fiduciary duty.” See Charles R.T. O’Kelley & Robert B. Thompson, *Supra* note 3 at 350.
contain a provision that limits or eliminates its directors’ duty-of-care liability, provided this provision is approved at a shareholder meeting.57

2.4.2. No Extra Protection for Corporate Officers

Under Section 142 of the DGCL, officers are endowed with their titles and duties by the corporation’s by-laws, or a resolution of the board of directors. The term “officer” is properly applicable only to those in whom have been administratively and executively entrusted in the field of his/her specialty. Likewise the directors and officers are expected to perform their daily duties with judgment and discretion, i.e., both corporate directors and officers should shoulder the same or similar duties.58

In *Gantler v. Stephens*, the Supreme Court of Delaware held that directors and officers owe the same fiduciary duties to companies; however, the consequences of a fiduciary breach made by directors or officers are not

57 The relevant part of Section 102(b): "In addition to the matters required to be set forth in the certificate of incorporation by subsection (a) of this section, the certificate of incorporation may also contain any or all of the following matters: ... (7) A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under §174 of this title; or (iv) for any transaction from which the director derived an improper personal benefit." See State of Delaware Web—the Official Website of the First State, http://delcode.delaware.gov/title8/c001/sc01/ (last visited Aug. 25 2015).

58 On the other hand, this term does not apply to those without judgment or discretion as to corporate matters such as employees and agents. See A. Gilchrist Sparks, III & Lawrence A. Hamermesh, *Common Law Duties of Non-director Corporate Officers*, 48 BUS. LAW. 215, 215 (1992).
necessarily the same. In footnote 37 of this case, the Court holds that there is no exculpatory provision that currently states that officers can be authorized to eliminate or limit their duty of care by certificate of incorporate.  

2.4.3. The Exculpatory Provision in Practice  

In practice, exculpatory provisions are typically proposed by the directors themselves, who recommend that their liability be eliminated altogether rather than merely limited. Unsurprisingly, shareholders almost always approve such proposals. Thus, the result of DGCL Section 102(b)(7) is that directors of corporations incorporated in Delaware are no longer liable for the breach of the duty of care, regardless of how incompetent or negligent

59 965 A.2d 695, 708-09 (Del. 2009). ("In the past, we have implied that officers of Delaware corporations, like directors, owe fiduciary duties of care and loyalty, and that the fiduciary duties of officers are the same as those of directors.")

60 Id. at 709.

61 The function of the exculpatory provision is that the majority of shareholders believe that this provision benefit the corporation because shareholders permit directors to take greater risk with greater potential rewards under their daily performance. Officers could be applied to the exculpatory provision only if they are decision-makers. The role of officers is strategy-makers because they daily set up business plans for the best interest of a corporation. After that, directors eventually decide the plans/strategies, made by the officers. However, some scholars believes that directors rubber-stamp decisions provided by officers too often. See Claire Hill & Brett McDonnell, Executive Compensation And the Optimal Penumbra of Delaware Corporation Law, 4 Va. L. & Bus. Rev. 333, 335. (2009). ("First, directors of a corporation may be beholden to the corporation’s officers for their jobs. Second, they may abide by a “pernicious golden rule” under which they defer to the officers as they would have directors defer to them in their capacities as officers of other corporations. Third, directors may simply see the world from the same vantage point as the officers do, a vantage point from which the executive compensation packages we have seen are reasonable and appropriate. The result, too often, is that directors rubber-stamp decisions, rather than give them proper consideration.")
their decisions may be. In effect, cases that solely breach the duty of care will be immediately dismissed by the courts, and the directors of Delaware-incorporated companies are now only liable for the breach of the duty of loyalty.

2.5. The Boundary between the Duties of loyalty and Care

Since the directors of Delaware-incorporated corporations are not liable for the breach of the duty of care, plaintiff lawyers thus take care not to let care-based claims be directly dismissed by the court. There are two ways to accomplish this goal, either by creating a new sub-category of fiduciary duty or by limiting the applicable scope of the duty of care.

2.5.1. The New Fiduciary Duties of Good Faith and Oversight

The traditional fiduciary duty contains two sub-duties: of care and of loyalty. Since the traditional duty of loyalty only focused on the company opportunity doctrine and the conflicts of interest, it is almost impossible that a care-based claim could be re-framed as a loyalty claim. However, the

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62 Gagliardi v. Trifoods Int’l, Inc., 683 A.2d 1049, 1051 (Del. Ch. 1996). ("Thus, to allege that a corporation has suffered a loss as a result of a lawful transaction ...... does not state a claim for relief against that fiduciary no matter how foolish the investment may appear in retrospect.")

Delaware Judges created the grey area between the duty of loyalty and the duty of care, i.e., the duties of good faith and oversight.

In 1993, the Supreme Court of Delaware first recognized the three fiduciary duties of loyalty, care and good faith. After that, shareholder plaintiffs can repack the care-based claims as the breach of the duties of care and good faith to avoid the application of the business judgment rule and the DGCL Section 102(b)(7).

In 1996, The Delaware Court of Chancery opened the discussion of the duty of oversight in the Caremark case. Chancellor William T. Allen mentioned that there are two classes of duties that need to receive appropriate attention: “a board decision that results in a loss because that decision was ill advised or negligent” and “an unconsidered failure of the board to act in circumstances in which due attention would, arguably, have prevented the loss.”

The first class of duties (a board decision that result in loss) refers to the traditional duty of care, which is protected by the business judgment rule

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64 Cede v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993).
66 Id. at 967.
and DGCL Section 102(b)(7). The second class (an unconsidered failure to act) is the so-called duty of oversight. This duty requires the directors to establish corporate information and a reporting system in good faith to assure that the corporation is in compliance with applicable legal standards; that is, “in good faith” is the pre-requisite of the duty of oversight. Although Chancellor Allen reviews this case under the standard of the duty of care; whether or not the duty of oversight is part of the duty of care is still open to debate.

2.5.2. The Nature of the Process and Substantial of Due Care

In 2000, the Supreme Court of Delaware interpreted the nature of the duty of care and the contours of the substantial review of the fiduciary duty in *Brehm v. Eisner* (Disney II). The Walt Disney Company (“Disney”) hired Michael S. Ovitz as President by an employment agreement on October 1, 1995. This five-year agreement was negotiated by Michael Eisner, Disney Chairman and CEO, as well as a long-time friend of Ovitz, and was approved

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67 *Id.*

68 Stone v. Ritter, 911 A.2d 362, 369 (Del. 2006). ("[T]he Caremark standard for so-called "oversight" liability draws heavily upon the concept of director failure to act in good faith.")

69 *Id.* at 970.

70 *Id.* ("I now turn to an analysis of the claims asserted with this concept of the directors duty of care, as a duty satisfied in part by assurance of adequate information flows to the board, in mind.")

71 746 A.2d 244 (Del. 2000).

72 *Id.* at 249.
by the Disney board in 1995 (the “Old Board”). In this agreement, Disney gave Ovitiz “a base salary of $1 million per year, a discretionary bonus, and two sets of stock options [A & B]... [that] would enable Ovitiz to purchase 5 million shares of Disney common stock.”

The A option stated that Ovitiz could get three annual increments of $1 million in shares from September 1998 to September 2000 even if Disney granted a non-fault termination of Ovitiz’s employment agreement. On the other hand, Ovitiz would be able to receive the B option ($2 million shares) only if he fulfilled the first five-year term of the agreement and renewed the new agreement.

According to the employment agreement, there were three ways to end Ovitiz’s employment:

1. After serving his five-year term, Disney might decide not to offer him a new contract. In this case, Disney would pay Ovitiz $10 million as a termination payment.

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73 Id. at 249-50.
74 Id. at 250.
75 Id.
76 Id.
77 Id.
2. There would be no additional compensation if the contract were terminated before the end of the five-year term, for “good cause,” i.e., if Ovitz voluntarily resigned or committed gross negligence or malfeasance.  

3. It would lead a great loss for Disney to terminate the employment contract with no cause (a non-fault termination) before the end of the five-year term. The total loss of Disney would be “the present value of his remaining salary payments through September 30, 2000, a $10 million severance payment, an additional $7.5 million for each fiscal year remaining under the agreement, and the immediate vesting of the first 3 million stock options (the A Options).”

During the first year of his work, Ovitz faced many problems, and the situation was getting worse. The deteriorating situation led Ovitz to seek alternative employment and to show his willingness to leave Disney by sending Eisner a letter in September 1996. On December 11, 1996, Ovitz agreed to leave Disney on the non-fault basis after negotiating with Eisner. Eisner then made the Disney board rubber-stamp his decision, which was
implemented on December 27, 1996. The agreement stated that (1) Even though the total amount payable to Ovitiz under the employment agreement was $38,888,230.77, he would only receive all but $1,000,000. (2) The option to purchase 3,000,000 shares of Disney stock (Option A) would vest immediately. Ovitiz eventually received a $1 million salary, the $10 million termination fee, $7.5 million for part of the fiscal year remaining under the agreement, and the immediate vesting of the A Option. In the end, the total payout to Ovitiz did not exceed the original contractual benefits.

The plaintiffs claimed that (1) the board breached the process of due care in approving the employment agreement; (2) it breached requirements of the substantive due care and committed waste with the employment agreement; and (3) the new board that succeeded it committed waste in deciding that the employment agreement was terminated on a non-fault basis.

The Supreme Court of Delaware did not accept these three contentions because they did not rebut the assumption of the business judgment rule. If

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84 Id.
85 Id.
86 Id. at 252-53.
87 Id. at 259.
88 Id. at 262.
89 Id. at 264.
rebutted, the court would have been a kind of super-director, examining matters of degree in decision-making and executive compensation.\textsuperscript{90}

The court rejected the first contention and ruled that the old board did not violate the process of the duty of care because its directors were “to be fully protected (i.e., not held liable) on the basis that they relied in good faith on a qualified expert under Section 141(e) of the Delaware General Corporate Law”\textsuperscript{91} – the business judgment rule.

The Court also rebutted the second contention that the old board committed waste and held that “the size and structure of executive compensation are inherently matters of [business] judgment.”\textsuperscript{92} It cited the interpretation of waste in the Vogelstein case, which construed that “If however, there is any substantial consideration received by the corporation, and if there is a good faith judgment that in the circumstances the transaction is worthwhile, there should be no finding of waste, even if the fact finder would conclude ex post that the transaction was unreasonably risky.”\textsuperscript{93} Moreover, the court interpreted that irrationality was the outer limit of the

\textsuperscript{90} Id. at 266.

\textsuperscript{91} Id. at 261-62.

\textsuperscript{92} Id. at 263.

\textsuperscript{93} Lewis v. Vogelstein, 699 A.2d 327, 336 (Del. Ch. 1997).
business judgment rule and noted that the concept of substantive due care (waste) is foreign to the business judgment rule.94

As for the third contention, the new board's action did not constitute waste in deciding on the non-fault termination of Ovitz's employment contract because this decision did not rebut the assumption of the business judgment rule.95 The court further held that even if the complaint rebutted the business judgment rule, the plaintiffs failed to prove that "no reasonable business person would have made the decision that the New Board made under these circumstances."96

2.5.3. The Nature and the Role of Duty to Act in Good Faith

In 2006, in the In re Walt Disney Company Derivative Litigation (Disney V) 97, the Supreme Court of Delaware interpreted three categories of bad faith corporate fiduciary acts, which basically constitute the content of the duty of care and the duty of good faith.98 The first is "subjective bad faith",

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94 Although the court did not specify the definition of irrationality, it stated that "[i]rrationality may be the functional equivalent of the waste test or it may tend to show that the decision is not made in good faith, which is a key ingredient of the business judgment rule." See Brehm v. Eisner, 746 A.2d at 263.

95 Id. at 264–65.

96 Id. at 266.

97 906 A.2d 27 (Del. Ch. 2006).

98 The definition of good faith is that "[a] state of mind consisting in (1) honesty in belief or purpose, (2) faithfulness to one's duty or obligation, (3) observance of reasonable commercial standards of fair dealing in a given trade or business, or (4) absence of intent to defraud or to seek unconscionable advantage...." See Black's Law Dictionary 713 (8th ed. 2004)
which means the fiduciary has an actual intent to do harm. This category falls into one side of the spectrum closed to the breach of loyalty.

The second category is that the fiduciary conducted affairs with “gross negligence and without any malevolent intent”. This category is at the opposite end of the spectrum, which is equivalent to the breach of process due care. The Court also noted that grossly negligent conduct, without more, does not breach the duty of good faith. The subjective of due care may overlap with the good faith requirement only in a psychological sense, rather than legally. Regarding the legal perspective, the distinction between bad faith and the breach of due care can be found in two provisions of the DGCL, Sections 102(b)(7) Section 145(a)&(b).

Section 102(b)(7) authorizes Delaware corporations to exempt their directors for monetary damages for breach of the duty of care, rather than acts of bad faith. Section 145 states that a director or officer of a

99 In re Walt Disney Company Derivative Litigation, 906 A.2d at 64.
100 Id.
101 Id.
102 Id. at 64-65.
103 Id. at 65.
104 Id. at 65-66.
105 Id.
corporation can be indemnified for the legal expense and liability only he or she acts in good faith.\textsuperscript{106} In other words, the indemnification only can be incurred by breach of the duty of care.

The third category of bad faith behavior is “intentional dereliction of duty, a conscious disregard for one’s responsibilities.”\textsuperscript{107} This liability, which violates the duty to act in good faith, is non-exculpable and non-indemnifiable for two primary reasons:

(1) The circumstance in violation of the fiduciary duty is not limited to classic disloyalty (company opportunity doctrine and conflicts of interest) and gross negligence.\textsuperscript{108}

(2) The wording of Section 102(b)(7)(ii) provides the duty to act in good faith with a position in the spectrum of the fiduciary duty. This provision denies the exculpation of monetary damages for “acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law.”\textsuperscript{109}

In summary, intentional misconduct and knowing violation of the law are typical types of subjective bad faith (category one). On the other hand, acts or

\textsuperscript{106} Id. at 66.

\textsuperscript{107} Id.

\textsuperscript{108} Id. at 66-67.

\textsuperscript{109} Id. at 67.
omissions that are not in good faith fall in the other kind of violations of the
duty to act in good faith: the intentional dereliction of duty, i.e., a conscious
disregard for one’s responsibilities (category three). Thus, categories one
and three constitute assume the duty of good faith, while category two (duty
of care) and the classic duty of loyalty (regarding the company opportunity
doctrine and conflicts of interest), cover the entire spectrum of corporate
fiduciary duty.

2.5.4. The Expansion of the Scope of the Duty of Loyalty

Less than six months after the final decision of the Disney case, the
newly established structure of triad fiduciary duties was broken down
because of Stone v. Ritter, which not only approved the Caremark standard
(the duty of oversight), but also indicated that the duty of good faith is only a
subsidiary element of the duty of loyalty. The court admitted that
directors failed to act in good faith, which constituted the oversight liability
established in the Caremark case. The court further quoted the
requirement of the duty of good faith in Disney by holding that “a failure to
act in good faith requires conduct that is qualitatively different from,
and more culpable than, the conduct giving rise to a violation of the

110 911 A.2d 362 (Del. 2006).
111 Id. at 369.
fiduciary duty of care (i.e., gross negligence)." That is, the pre-requisite for the breach of the duty of oversight is to act in bad faith, which is different from, and more culpable than, gross negligence. Hence, the duty of oversight is subsidiary to the duty of good faith, rather than the duty of care.

On the other hand, the court also held that construing the duty of good faith as a subsidiary of the duty of loyalty results has two additional implications. First, unlike the duty of care and loyalty, the duty to act in good faith is not an independent fiduciary duty. This duty may also result in liability but only indirectly. Second, to the traditional duty of loyalty, the court created a new category: the duty to act in good faith (including the duty of oversight). To support this point of view, the court cited Guttman v. Huang to the effect that “a director cannot act loyally towards the corporation unless she acts in the good faith belief that her actions are

112 Id.
113 Id. at 369-70.
114 Id. ("The failure to act in good faith may result in liability because the requirement to act in good faith is a subsidiary element[,] i.e., a condition of the fundamental duty of loyalty.")
115 Id. at 370. ("Although good faith may be described colloquially as part of a “triad” of fiduciary duties that includes the duties of care and loyalty, the obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty. Only the latter two duties, where violated, may directly result in liability, whereas a failure to act in good faith may do so, but indirectly.")
116 Id. ("The fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest. It also encompasses cases where the fiduciary fails to act in good faith.")
in the corporation's best interest."¹¹⁷ Therefore, today, there are at least four kinds of duties of loyalty, i.e., those that pertain to (1) conflicts of interest; (2) the company’s opportunity doctrine; (3) the duty to act in good faith, and (4) the duty of oversight. In other words, the scope of the duty of care is strictly limited to cases that breach substantially the lack of due care, which constitutes gross negligence.

2.6. The Application to the Current Spectrum of Corporate Fiduciary Duty

2.6.1. The Change-of-control Transaction

In 2009, the Delaware Supreme Court promulgated its ruling in *Lyondell Chemical Company v. Ryan*,¹¹⁸ a case factually reminiscent of *Smith v. Van Gorkom*, in terms of the current spectrum of fiduciary duties under change-of-control transactions.

Dan Smith was Chairman and CEO of the Lyondell Chemical Company (henceforth “Lyondell”), the third largest publicly traded chemical company

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¹¹⁷ 823 A.2d 492, 506 n.34 (Del. Ch. 2003).

¹¹⁸ 970 A.2d 235 (Del. 2009).
in North America. Basell AF (henceforth “Basell”), a company privately owned Leonard Blavatnik, is in the business of polyolefin. In the middle of 2006, Basell officially sent a letter to Lyondell’s board offering $26.50-$28.50 per share for the company. The offer was refused because of the inadequate price.

In May 2007, an affiliate of Basell filed a Schedule 13D with the Securities and Exchange Commission, disclosing its right to acquire 8.3% of Lyondell’s stock from Occidental Petroleum Corporation and revealing Blavatnik’s interest in acquiring Lyondell. The Lyondell’s board immediately convened a special meeting in response to this information and decided to “wait and see,” even though the market might misunderstand that the company was “in play.”

In late June 2007, Basell announced that it entered into a merger agreement with Huntsman Corporation (“Huntsman”), a chemical company. However, a little later, another chemical company made a

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119 Id. at 237.
120 Id.
121 Id.
122 Id.
123 Id.
topping bid for Huntsman.\textsuperscript{124} Due to the competition with Huntsman, Blavatnik were still interested in the merger with Lyondell.\textsuperscript{125} On July 9, 2007, Blavatnik offered $40 per share, but Smith responded that that was too low.\textsuperscript{126} Blavatnik then raised the price to $44-45 per share, and Smith respond that he would discuss this offer with the board; however, he believed that the board would reject it. \textsuperscript{127}

Later in the day, Blavatnik offered to pay $48 per share, but Lyondell had to pay a $400 million break-up fee and to sign the agreement within 7 days.\textsuperscript{128} Smith immediately called a special board meeting to discuss the offer. Board members reviewed the material prepared by management, the offer, the status of the Huntsman merger, and the possibility that another company might be interested in merging with Lyondell.\textsuperscript{129} It ultimately instructed Smith to ask for a written offer and detailed financial information from Basell.\textsuperscript{130}

\textsuperscript{124} Id.
\textsuperscript{125} Id.
\textsuperscript{126} Id. at 237-38.
\textsuperscript{127} Id. at 238.
\textsuperscript{128} Id.
\textsuperscript{129} Id.
\textsuperscript{130} Id.
Blavatnik agreed to make a written offer but asked Lyondell to provide a firm indication of interest in the proposal by the end of July 11th because that was the last day for Basell to make a higher bid for Huntsman. On that day, the Lyondell board met for less than an hour, decided that it was interested in the offer, and authorized the retention of Deutsche Bank Securities, Inc. ("Deutsche Bank") as its financial advisor for the potential transaction. Basell then announced that it would not make a higher offer for Huntsman and started to negotiate the merger agreement with Lyondell from July 12th to the 15th. Meanwhile, the Lyondell board instructed Smith to negotiate better terms, including a higher price, a go-shop provision, and a reduced break-up fee, which Blavatnik eventually reduced to $385 million.

On July 16th, the board considered the new merger agreement and reviewed related reports presented by management and its legal and financial advisors. It believed that given to the no-shop provision,

131 Id.
132 Id.
133 Id.
134 Id.
135 Id.
Lyondell would be able to accept a better offer; moreover, Deutsche Bank concluded that the merger price was fair.\textsuperscript{136} Lyondell’s board voted to approve the merger, and it was approved with more than 99\% of the voted shares at a special shareholder meeting on November 20\textsuperscript{th}.\textsuperscript{137}

The plaintiff asserted that Lyondell’s directors breached their fiduciary duty because the final price was significantly less than the best possible price.\textsuperscript{138} The plaintiff also claimed that the directors’ misconduct, which originally was a breach of due care, rose to the level of bad faith.\textsuperscript{139} This claim was essential because the directors’ liability for solely breaching due care were exculpated by the provision in Lyondell’s certificate of incorporation.\textsuperscript{140} Thus, the issue became whether the directors breached their duty of loyalty by failing to act in good faith.\textsuperscript{141}

\textsuperscript{136} \textit{Id.} The managing director of Deutsche even described the price as “an absolute home run.” \textit{See Id.} at 239.

\textsuperscript{137} \textit{Id.} at 239.

\textsuperscript{138} \textit{Id.}

\textsuperscript{139} \textit{Id.} at 239-40.

\textsuperscript{140} \textit{Id.}

\textsuperscript{141} \textit{Id.} at 240.
When the board of directors of a Delaware incorporated corporation decides to proceed with a change-of-control transaction, it triggers the Revlon duty\textsuperscript{142}, which changes the board’s fiduciary duty “from the preservation of the company as a corporate entity to the maximization of the value of the company at a sale of the benefit of the stockholders.”\textsuperscript{143} However, “there is no single blueprint that a board must to follow to fulfill its [Revlon] duty.”\textsuperscript{144} That is, simply failure to take any step would not breach the duty.\textsuperscript{145} In this case, even though Lyondell’s directors did not conduct an auction or market check, this mistake did not infer that they failed to secure the best price.\textsuperscript{146} “But if directors failed to do all that they should have under the circumstances, they breached their duty of care.”\textsuperscript{147} Furthermore, the Court concluded that “[o]nly if they knowingly and completely failed to undertake their responsibilities would they breach their duty of loyalty.”\textsuperscript{148} In other words, directors have to knowingly and completely fail to fulfill their obligations for their actions to constitute bad faith that cause the breach their


\textsuperscript{144} Lyonell, supra note 118 at 242-43.

\textsuperscript{145} \textit{Id.} at 243.

\textsuperscript{146} \textit{Id.}

\textsuperscript{147} \textit{Id.}

\textsuperscript{148} \textit{Id.} at 244.
duty of loyalty, the breach cannot be protected by the business judgment rule and Section 102(b)(7) of DGCL.\textsuperscript{149}

\textbf{2.6.2. The Directors' Duty to Monitor Business Risk}

In 2009, the \textit{In re Citigroup Inc. Shareholder Derivative Litigation}\textsuperscript{150} focused on corporate directors' duty to monitor business risk. The plaintiffs, shareholders of Citigroup Inc. ("Citigroup"), claimed that the defendant directors and officers "breached their fiduciary duties by failing to monitor and manage the risks the company faced from problems in the subprime lending market."\textsuperscript{151} This resulted in the company suffering billions of dollars of losses when the subprime market collapsed.\textsuperscript{152} The court indicated that this claim was different from the traditional Caremark claim that "the defendants are liable for damages that arise from a failure to properly monitor or oversee employee misconduct or violations of [the federal Anti-Referral Payment] law."\textsuperscript{153}

\textsuperscript{149} Scholars argued that this rule seems to be severely limiting the scope of the duty to act in good faith, within the broader of the duty of loyalty. See Claire Hill & Brett McDonnell, \textit{Executive Compensation And the Optimal Penumbra of Delaware Corporation Law}, 4 Va. L. & Bus. Rev. 333, 335. (2009).

\textsuperscript{150} 964 A.2d 106 (Del. Ch. 2009).

\textsuperscript{151} \textit{Id.} at 111.

\textsuperscript{152} \textit{Id.} at 113.

\textsuperscript{153} \textit{Id.} at 123.
Directors’ responsibilities to monitor a system of oversight do not eviscerate the protection of the business judgment rule, which provides “protections designed to allow corporate managers and directors to pursue risky transactions without the specter of being held personally liable if those decisions turn out poorly.”\textsuperscript{154} Hence, a duty to monitor general business risk would lead to second-guessing of a board’s decisions that the business judgment rule was exactly meant to block.\textsuperscript{155}

In 2011, the Delaware Chancery Court reiterated the opinion of \textit{Citigroup} in the \textit{In re The Goldman Sachs Group, Inc. Shareholder Litigation}.\textsuperscript{156} The Court emphasized that most of the DGCL “provides corporate directors and officers with broad discretion to act as they find appropriate in the conduct of corporate affairs.”\textsuperscript{157} In contrast, the Delaware Court uses case law to set a boundary on the protections of directors and officers provided by the DGCL.\textsuperscript{158} This boundary requires corporate directors and officers to “act as fiduciaries to the corporations and its stockholders.”\textsuperscript{159}

\textsuperscript{154} \textit{Id}. at 125.

\textsuperscript{155} \textit{Id}. at 131.

\textsuperscript{156} 2011 WL 4826104 (Del. Ch. Oct. 12, 2011).

\textsuperscript{157} \textit{Id}. at 1.

\textsuperscript{158} \textit{Id}.

\textsuperscript{159} \textit{Id}.
These fiduciaries are free to pursue corporate opportunities “in any way within the boundary of the fiduciary duty.”\textsuperscript{160} The court also quoted Chancellor Chandler’s opinion in \textit{Citigroup} that “imposing Caremark-type duties on directors to monitor business risk is fundamentally different from imposing on directors a duty to monitor fraud and illegal activity.”\textsuperscript{161} Even if the directors’ duty to monitor business risk exists, a court cannot substantially evaluate a board’s decision of the appropriate amount of risk;\textsuperscript{162} that is, the duty to monitor business risk is protected by the business judgment rule and Section 102(b)(7) of the DGCL, if existed.

\textbf{2.6.3. The Judicial Deference to the Business Climate of Delaware}

In general, common law judges have greater power than civil law judges. However, the impact of a bad decision on the common law is also stronger because it becomes part of case law. Judges of civil law jurisdictions might be more willing to comply with the general rule of law and the ruling’s applicable provisions. Even if judges make a bad decision, the impact on society is limited because that decision is still not part of statutory law; in other words, the law itself does not change. On the contrary, judges of common law jurisdictions would now be more able to justify their ruling in a

\textsuperscript{160} \textit{Id.}

\textsuperscript{161} \textit{Id.} at 22.

\textsuperscript{162} \textit{Id.}
specific case because they dominate relatively stronger law-making powers authorized by their judicial system. Once they make an unreasonable judgment, the impact on society could be so large that the legislature might mitigate the judiciary’s influence by making a new law, such as was the case with *Smith v. Van Gorkom* being followed by DGCL Section 102(b)(7).

As noted previously, to avoid the upheaval of *Smith v. Van Gorkom* from happening again, the Delaware judges became more deferential. Even though they established the duties to act in good faith and oversight, these duties neither functionally deterred the ill conduct of corporate directors nor adequately protected the interests of corporations or shareholders. To the end, the judges eventually defended the interests of the State of Delaware and its incorporated directors.
3. The Obligation of Care of a Good Administrator in Taiwan

3.1. Overview

In 2001, more than half of the articles of the Company Act of Taiwan were amended to give corporate boards more decision-making power. Then, in order to correct the resulting imbalance in the corporate power structure, the Taiwanese Congress introduced an entirely new concept to the Company Act: the obligation of loyalty (忠實義務). In particular, Paragraph 1 of Article 23 stipulates that responsible persons who breach their obligation of loyalty and obligation of care of a good administrator (善良管理人注意義務) may be held liable for monetary damages.

While most Taiwanese legal scholars recognize the obligation of loyalty as a principle derived from common law, the term’s precise meaning in the context of Taiwanese law remains subject to uncertainty and disagreement. At the heart of the debate is the question of this obligation’s specific common-law antecedent. Most Taiwanese scholars believe that a good administrator’s obligation of loyalty and the obligation of care are different in nature. However, the natures of both obligations have been subject to debate, with three primary views emerging.
The first, which I call the narrow interpretation view, is that the obligation of loyalty stems from the duty of loyalty. This view holds that the language of the obligation of care of a good administrator is expressed in Article 535 of the Civil Code, which stipulates that a mandatory should deal with the affair commissioned with the care of a good administrator if he/she has received remuneration.\textsuperscript{163} The second, which is the broad interpretation view, is that the obligation of loyalty refers to the fiduciary duty and that the interpretation of obligation of care is the same as the narrow interpretation view. The third view, the U.S. interpretation view, alleges that the obligations of loyalty and of care are derived from the duty of loyalty and the duty of care, respectively.

In any case, however, one cannot simply transplant a common-law concept to civil law without making a substantial effort to explain the law and to adapt it to fit its new context. Otherwise, the law will inevitably suffer either from vagueness or ambiguity, both of which are sure sources of confusion.

3.2. The 2001 Adoption and the 2012 Amendment to the Obligations of Loyalty and Care of a Good Administrator in the Company Act of Taiwan

\textsuperscript{163} Mingjie Huang (黃銘傑), Gongsi Zhili Yu Dongjian Minshi Zeren Zhi Xianzhuang Yu Keti – Yi Waibu Dongshi Zhidu Ji Zhongshi, Zhuyi Yiwu Wei Zhongxin (公司與董監民事責任之現狀與-課題—以外部董監事制度與忠實注意義務中心) [The Status Quo and Issues of the Civil Liability Between the Company and its Directors and Supervisors – Focusing on the System of Outside Directors and the Obligations of Loyalty and Care of a Good Administrator], 305 LVSHI ZAZHI (律師雜誌) 15, 25 (2005).
Prior to 2001, Article 23 of the Company Act of Taiwan was construed as a no-fault liability of tort. However, in 2001, the Legislative Yuan, the Congress of Taiwan, adopted Paragraph 1 Article 23 of the Company Act. This provision introduced to the Company Act the concepts the obligation of loyalty and the obligation of care of a good administrator. It also made responsible persons, such as corporate directors and officers, liable for monetary damages caused by breaching these obligations.

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164 The old version of Article 23 of Company Act read: “If the responsible person of a company has, in the course of conducting the business operations, violated any provision of the applicable laws and/or regulations and thus caused damage to any other person, he/she shall be liable, jointly and severally, for the damage to such other person.” See Laws and Regulations Database of the Republic of China, http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=J0080001 (last visited Aug. 25 2015).

165 The Article 23 Paragraph 1 of Company Act of Taiwan now states: “The responsible person of a company shall have the loyalty and shall exercise the due care of a good administrator in conducting the business operation of the company; and if he/she has acted contrary to this provision, shall be liable for the damages to be sustained by the company there-from.” See Laws and Regulations Database of the Republic of China, http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=J0080001 (last visited Aug. 25 2015).

166 The translation of Article 8 of the Company Act of Taiwan states that: “The term responsible persons of a company as used in this Act denotes shareholders conducting the business or representing the company in case of an unlimited company or unlimited company with limited liability shareholders; directors of the company in case of a limited company or a company limited by shares. [Paragraph 1] The managerial officer or liquidator of a company, the promoter, supervisor, inspector, reorganizer or reorganization supervisor of a company limited by shares acting within the scope of their duties, are also responsible persons of a company. [Paragraph 2]” See Laws and Regulations Database of the Republic of China, http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=J0080001, (last visited Aug. 25 2015).
The relationship between the company and its directors is regulated in Paragraph 4 Article 192 of the Company Act, which stipulates that “[u]nless otherwise provided for in this Act, the relations between the company and its directors will be governed by the provisions of the Civil Code pertaining to the mandate;”\textsuperscript{167} that is, the relationship between the company and its directors is governed by mandated contracts. Article 528 states that “[a] contract of mandate is a contract whereby the parties agree that one of them commissions his affairs, and the latter agrees to do so.”\textsuperscript{168} The obligation of care of a good administrator originally stipulates in the Article 535 Section Mandate of the Civil Code. It further articulates the different degrees of care of mandatories\textsuperscript{169} that “[t]he mandatory who deals with the affair commissioned, shall do so be in accordance with the principal’s instructions and with the same care as he would deal with his own affairs. If he has received the remuneration, he shall do so with the care of a good administrator.”\textsuperscript{170}

The Supreme Court of Taiwan held that the care of a good administrator is what a well-educated and experienced person would do,


\textsuperscript{169} The mandatory means a person who takes commission to deal with affairs.

acting in good faith from the perspective and with the acknowledgement of
the general public.\textsuperscript{171} Basically, third-party viewpoints equal the general
public’s perspective because the general public is a collective third party.
This interpretation is in accordance with the Model Business Corporation Act,
Section 8.30(b), which shows that directors’ liabilities are considered
discharged if they work with the care that “a person in a like position would
reasonably believe appropriate under similar circumstances.”\textsuperscript{172} Therefore,
the interpretation of the duty of care in the U.S. Modern Business
Corporation Act is similar to the explanation that uses the term “care of a
good administrator” in Taiwan. The main difference is the point that the
fiduciary law and the contract law dominate the relationship between a
company and its directors in the United States and Taiwan, respectively.

3.2.2. The Ambition of the 2001 Adoption

While the obligation of care of a good administrator was already
present in the Civil Code of Taiwan, the term \textit{obligation of loyalty} was new to
Taiwanese law in general; thus, a thorough explanation of its meaning and
source is in order. The official commentary failed to provide such an
explanation, however, stating only that the amendment’s intent was to hold
responsible persons liable for any damages they should cause their

\textsuperscript{171} Zuigao Fayua [Sup. Ct.], Civil Division, 42 Tai Shang No. 865 (1953) (Taiwan).

\textsuperscript{172} Charles R.T. O’Kelley & Robert B. Thompson, Supra note 3 at 78 (2008 ed. 2008).
companies by breaching an administrator’s obligation of loyalty or of care. This official commentary is hardly more than a restatement of the law itself.\textsuperscript{173} Furthermore, the legislative record shows no discussion of the amendment in Congress; rather, the legislators simply agreed to the administrative department’s proposal without debate or comment. Even now, after more than ten years have passed, there are still relatively few judicial opinions or academic discussions that address the issue.

According to one secondary source, the 2001 amendment to Article 23 was intended to counterbalance another 2001 amendment, that to Article 202, which substantially increased the power of corporate boards.\textsuperscript{174} Prior to the 2001 amendments, the shareholder meeting was recognized as the statutory body for making decisions regarding business operations. But the amended Article 202 makes the board of directors the primary decision-making body: “Business operations of a company will be executed pursuant to the resolutions to be adopted by the board of directors; except for the matters the execution of which shall be effected pursuant the resolutions of the shareholders’ meeting as

\textsuperscript{173} ZENG WANRU (曾宛如), \textit{Dongshi Zhuangshi Yiwu Zhi Neihan Ji Shiyong Yiyi} (董事忠實義務之內涵及適用疑義) [\textit{The Content and Application of Directors’ Fiduciary Duties}, in \textit{Guengsi Guanli Yu Zhiben Shichang Fazhi Zuanluen} (公司管理與資本市場法制專論), 1, 5-6 (2007) (Taiwan)].

required by this Act or the Articles of Incorporation of the company.” 175 The 2001 amendment to Article 202 thus greatly enhanced the legal authority of corporate boards, and it did so at the expense of the authority previously enjoyed by shareholder meetings. The amendment to Article 23 can thus be seen as a means of rebalancing the corporate power structure.

3.2.3. The People Subject to the 2001 Adoption – Managerial Officers, Supervisors, and Inside/Outside Directors

According to Paragraph 1 of Article 23 of the Company Act, responsible persons owe an obligation of loyalty and an obligation of care of a good administrator to the corporation. Article 8 of the Company Act defines the responsible persons of a company limited by shares 176 as supervisors, inside and outside directors, and managerial officers.

The board of directors and the shareholders are the critical components of both a U.S. corporation and a company limited by shares in Taiwan. Shareholders are the company’s owners, but are not involved in

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176 The concept of a company limited by shares refers to the concept of a corporation in the United States. The definition of a company limited by shares states in Article 2 of the Company Act of Taiwan. It shows that “Company Limited by Shares: which term denotes a company organized by two or more or one government or corporate shareholder, with the total capital of the company being divided into shares and each shareholder being liable for the company in an amount equal to the total value of values subscribed by him.” See Laws and Regulations Database of the Republic of China, http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=J0080001 (last visited Aug. 25 2015).
making business decisions, while boards typically play oversight roles in the corporation’s operations. The senior managements are people who operate the daily business of a corporation and make most of the decisions based on their functional duties, as authorized by the Board.

The key difference between a U.S. corporation and a Taiwanese one limited by shares in Taiwan is the role of supervisors, which are the third constituent of a Taiwanese company limited by shares.177 As stipulated by Article 217-1 of the Taiwanese Company Act, a supervisory organization is mandated for all companies limited by shares in Taiwan.178 The Company Act only allows such a company to keep operating without supervisors for a period of 30 days (or for 60 days for a publicly traded company). If the supervisors have been discharged, they must be replaced by a vote of shareholders within this time period (30 or 60 days) for the company to continue operating. Therefore, in addition to the shareholders and the board

177 There are four types of companies regulated by Article 2 of the Company Act of Taiwan — an unlimited company, a limited company, an unlimited company with limited liability shareholders, and a company limited by shares. The counterpart of a corporation in the United States is a company limited by shares, which “denotes a company organized by two or more or one government or corporate shareholder, with the total capital of the company being divided into shares and each shareholder being liable for the company in an amount equal to the total value of shares subscribed by him.” See Laws and Regulations Database of the Republic of China, http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=J0080001 (last visited Aug. 25 2015).

178 Article 217-1 of Company Act of Taiwan notes: “In case all supervisors of a company are discharged, the board of directors shall, within 30 days, convene a special meeting of shareholders to elect new supervisors. However, for a company whose shares are issued to the public, the special meeting of shareholders for election of supervisors shall be convened by the board of directors within 60 days.” See Laws and Regulations Database of the Republic of China, http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=J0080001 (last visited Aug. 25 2015).
of directors, supervisors are the third “constituency” to constitute a company limited by shares in Taiwan.

A natural person is eligible to serve as supervisors unless he or she has been found guilty of a crime, committed fraud, misappropriated public funds, adjudicated bankruptcy, or committed some other major corporate offense\textsuperscript{179} Supervisors, who are elected by the shareholders at shareholder meeting,\textsuperscript{180} are powerful individuals who can unilaterally exercise their supervisory powers. \textsuperscript{181} Including executing business operations, investigating financial conditions, examining accounting documents, and asking boards or managers to make reports.\textsuperscript{182}

It is the supervisors’ right and responsibility to audit statements and records prepared by the board for submission to shareholder meeting and to


\textsuperscript{182} The relevant part of Article 218 of Company Act of Taiwan articulates: “Supervisors shall \textit{supervise the execution of business operations} of the company, and may at any time or from time to time \textit{investigate the business and financial conditions} of the company, \textit{examine the accounting books and documents}, and \textit{request the board of directors or managerial personnel to make reports thereon}.” See Laws and Regulations Database of the Republic of China, http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=J0080001 (last visited Aug. 25 2015).
submit their opinions of these statements and records. Supervisors also have the right to attend board meetings and can call a shareholder meeting if they deem it necessary. In contrast, supervisors, who are the responsible persons stipulated in Article 8 of the Company Act, are liable for the breach of the obligations of loyalty and care of a good administrator if they did not attend the board’s meetings.

The independence of supervisors is an important concern that helps make the system of supervisors work. The legislators attempted to ensure the independence of supervisors by amending Article 222 of the Company Act, which regulates that “[a] supervisor shall not be concurrently a director, a managerial officer, or another staff or employee of the company.” However, Article 27 of the Company Act provides government agencies and juristic persons a great favor to evade the requirement of independent supervision to completely control the management and supervision of the corporation. Under the regulations contained Article 27, if a shareholder is a government agency or a juristic person, he or she can also be elected as a supervisor.

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183 The relevant part of Article 219 of Company Act of Taiwan shows: “[s]upervisors shall audit the various statements and records prepared for submission to the shareholders’ meeting by the board of directors, and shall make a report of their findings and opinions at the meeting of shareholders.” See Laws and Regulations Database of the Republic of China, http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=J0080001 (last visited Nov. 13, 2011).


185 WENYU WANG (王文宇), GONGSIFA LUN (公司法論) [CORPORATE LAW] 358 (2nd ed. 2006) (Taiwan).

186 Id.
director or supervisor, as long as that body appoints a natural person as its representative.\textsuperscript{187} Moreover, the government agency or the juristic person can appoint more than one representative to be elected as a director or supervisor;\textsuperscript{188} i.e., the government agency or juristic person could possibly control \textit{all} the supervisors, though this unseen control would clearly violate the spirit of corporate governance.\textsuperscript{189} Being controlled by this unseen controller, supervisors of a company limited by shares might seem quite powerful but in reality have little to no independence to act.\textsuperscript{190}

To solve the above problem, in 2006, the Legislative Yuan amended Article 14-2 of the Securities and Exchange Act of Taiwan to force public

\textsuperscript{187} The relevant part of Article 27 of Company Act of Taiwan notes: \textit{“Where a government agency or a juristic person acts as a shareholder of a company, it may be elected as a director or supervisor of the company provided that it shall designate a natural person as its proxy to exercise, on its behalf, the duties of a shareholder.”} (Paragraph 1) \textit{See} Laws and Regulations Database of the Republic of China, http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=J0080001 (last visited Aug. 25 2015).

\textsuperscript{188} The relevant part of Article 27 of Company Act of Taiwan states: “Where a government agency or a juristic person acts as a shareholder of a company, its authorized representative may also be elected as a director or supervisor of the company; and \textbf{if there is a plural number of such authorized representatives, each of them may be so elected.”} (Paragraph 2) \textit{See} Laws and Regulations Database of the Republic of China, http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=J0080001 (last visited Aug. 25 2015).

\textsuperscript{189} LIU LIANYU (劉連煜), XIANDAI GONGSIFA (現代公司法) [MODERN CORPORATE LAW] 102 (3rd ed. 2008) (Taiwan).

\textsuperscript{190} The existence of Article 27 of the Company Act is the most important reason why the function of supervisor does not work in Taiwan. \textit{See} SHAO QINGPING (邵慶平), Duengshi Fazhi De Yizhi Yu Chuengtu (董事法制的移植與衝突) [The Introduction and Conflict of the Directors’ Legal System], in GUENGLI FA—ZUZI YU QIUE ZHIJIAN (公司法—組織與契約之間) [CORPORATE LAW—BETWEEN THE ORGANIZATION AND THE CONTRACT] 321, 357 (2008) (Taiwan).
companies to appoint outside independent directors. However, their functions, and those of supervisors, are essentially the same: to supervise the company. Ironically, the supervisors can individually engage in supervision, while independent directors only have the right to vote on a board or sub-committee; i.e., supervisors appear to be more powerful than independent directors.

Why does a publicly traded company need a powerless supervision system? The issue is not power. The real problem is whether the supervision system is truly independent.

A government agency or a juristic person cannot control independent directors by means of Article 27 of the Company Act, i.e., the legislators believed outsiders (independent directors) to be more independent than insiders (supervisors). Therefore, the legislators regarded the establishment of independent directors as the solution for the danger of unseen control by a government agency or a juristic person.

191 The relevant part of Article 14-2 of the Security and Exchange Act of Taiwan states: “A company that has issued stock in accordance with this Act may appoint independent directors in accordance with its articles of incorporation. The Competent Authority, however, shall as necessary in view of the company’s scale, shareholder structure, type of operations, and other essential factors, require it to appoint independent directors, not less than two in number and not less than one-fifth of the total number of directors. Independent directors shall possess professional knowledge and there shall be restrictions on their shareholdings and the positions they may concurrently hold. They shall maintain independence within the scope of their directorial duties, and may not have any direct or indirect interest in the company.” See Laws and Regulations Database of the Republic of China, http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=G0400001 (last visited Aug. 25 2015).
Article 14-4 of the Securities and Exchange Act of Taiwan stipulates that a publicly traded company must establish either an audit committee or supervisors.\textsuperscript{192} If it chooses to establish an audit committee, all the committee’s members should be independent directors.

The company, however, does not have the right to choose the system it prefers because it could be forced to establish an audit committee by the Financial Supervisory Commission, which is the governing authority of publicly traded companies.\textsuperscript{193} Legislators thus believe that the supervisory function of an audit committee is stronger than the supervisors’ ability to oversee a company. The establishment of such a committee also protects publicly-traded companies from a government agency’s or juristic person’s unseen control through the audit process.

In June 2010, the Legislative Yuan amended Article 14-6 of the Security and Exchange Act of Taiwan, which took effect in January 2012. The

\textsuperscript{192} The relevant part of Article 14-4 of Security and Exchange Act of Taiwan states: "A company that has issued stock in accordance with this Act shall establish either an audit committee or a supervisor. The Competent Authority may, however, in view of the company’s scale, type of operations, or other essential considerations, order it to establish an audit committee in lieu of a supervisor; the relevant regulations shall be prescribed by the Competent Authority.\textbf{The audit committee shall be composed of the entire number of independent directors.} It shall not be fewer than three persons in number, one of whom shall be convener, and \textbf{at least one of whom shall have accounting or financial expertise.}\n
For a company that has established an audit committee, the provisions regarding supervisors in this Act, the Company Act, and other laws and regulations shall apply mutatis mutandis to the audit committee.” See Laws and Regulations Database of the Republic of China, http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=G0400001 (last visited Aug. 25 2015).

\textsuperscript{193} The advantage of this idea is flexibility. On the contrary, this idea may complicate the application of laws and the governance structures. See WENYU WANG (王文宇), Supra note 185 at 533.
provision states: “A company whose stock is listed on the stock exchange or traded over-the-counter shall establish a remuneration committee. Regulations governing the professional qualifications of its members, the exercise of their powers of office, and related matters shall be prescribed by the competent authority. Remuneration referred to in the preceding paragraph shall include salary, stock options, and any other substantive incentive measures for directors, supervisors, and managerial officers.” In general, all members of sub-committees should be directors, and all members of certain specific sub-committees are required to be independent directors, such as members of the audit committee.

However, members of a remuneration committee should be neither inside directors nor outside independent directors. Rather, the members could be anybody else, such as a law professor or an accountant. However, this raises the question whether a law professor owes any duties to the corporation, such as a fiduciary duty. Article 7 of the Regulations Governing the Appointment and Exercise of Powers by the Remuneration Committee of a Company Whose Stock is Listed on the Stock Exchange or Traded Over the Counter states that “[t]he remuneration committee shall exercise the care of a good administrator in faithfully performing the official powers listed

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This description is substantially equivalent to the content of Article 23 of the Company Act concerning the obligation of loyalty and the obligation of the care of a good administrator, i.e., a law professor or an accountant owes both obligations to the corporation. However, only the responsible persons specified in Article 8 of the Company Act, such as the directors and the supervisions of the company, are liable for the obligations of loyalty and care. Determining whether the members of the remuneration committee owe any fiduciary duties is not the main issue of this dissertation. This example shows the ambiguity of introducing common law concepts to a civil law system.

3.2.4. People Subject to the 2012 Amendment – De Fecto Directors of a Publicly Treaded Company

Until 2012, the Company Act of Taiwan only regulated de jure directors; however, that year, a new amendment to Paragraph 3 Article 8 of the Company Act regulates that a non-director who substantially affects the public functioning of a publicly-traded company is subject to the same civil, criminal, and administrative liabilities as a director, including the liabilities for breaching the obligation of loyalty and the obligation of care of a good administrator.

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This amendment does not change the definition of directors, but simply expands their liability for breaches of the obligations of loyalty and care to non-director persons who substantially influence the operations of a public company. Even though the de facto directors are liable for breaches of the obligations of loyalty and care of a good administrator, the obligations they owe to their publicly traded companies vary from those of de jure directors.

An exception found in this amendment states that newly enacted liabilities do not pertain to directors appointed by the government for the purposes of economic development, promotion of social stability, or other goals that can further the public interest, because the assignment of government-appointed directors may not in accordance with the best interests of the corporation or its shareholders. The goal of this exception becomes immediately clear; however, it provides government-appointed directors

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196 Paragraph 3 Article 8 of the Company Act stipulates that “[f]or a company whose shares have been issued in public, a non-director who de facto conducts business of a director or de facto controls over the management of the personnel, financial or business operation of the company and de facto instructs a director to conduct business shall be liable for the civil, criminal and administrative liabilities as a director in this Act, provided, however, that such liabilities shall not apply to an instruction of the government to the director appointed by the government for the purposes of economic development, promotion of social stability, or other circumstances which can promote public interests.” Laws and Regulations Database of the Republic of China, http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=J0080001 (last visited Aug. 25 2015).


198 Id. at 133.
directors with a rationale to avoid their obligations and liabilities, since the
domain of economic development, social stability, and the public interest is
so broad.

3.2.5. The 2012 Amendment to the Disgorgement and Interested
Director’s Obligation to Explain at the Board Meeting

In 2012, the legislators also adopted the concepts of disgorgement
and the interested director’s obligation to explain at the board meeting
Paragraph 3, Article 23 and Paragraph 2, Article 206 of the Company Act. In
effect, these paragraphs empower the enforcement of the fiduciary duty of
Taiwan, especially in the field of the obligation of loyalty. Paragraph 3 Article
23 of the Company Act stipulates that “[i]n case the responsible person of a
company does anything for himself/herself or on behalf of another person in
violation of the provisions of Paragraph 1, the meeting of shareholders may,
by a resolution, consider the earnings in such an act as earnings of the
company unless one year has lapsed since the realization of such
earnings.” 199 This amendment enhances the enforcement power of
fiduciaries, especially in the field of the duty of loyalty. For example, there
might be no real damages under the circumstances for the violation of the
corporate opportunity theory. The theory means “a director personally takes

199 Laws and Regulations Database of the Republic of China,
advantage of an opportunity that the corporation later asserts rightfully belonged to it.”

There is no actual damage in these sorts of cases, so alleging a disgorgement is the best claim for the company. Taiwanese companies can allege a disgorgement of their interests have been taken by their directors for ten years after the obligation of loyalty was first adopted in 2001. Furthermore, the claim of disgorgement does not conflict with the claim of monetary damages, i.e., a plaintiff can claim both disgorgement and the monetary damages if applicable.

Meanwhile, the interested directors are obligated to explain their potential interests from the transaction at a board meeting, according to the amendment of Paragraph 2 Article 206 of the Company Act, which states that “[a] director who has a personal interest in the matter under discussion at a board meeting shall explain to the board meeting the essential contents of such a personal interest.” This amendment specifies the interested directors’ fiduciary duty because an interested director’s presentation may

200 O’Kelley & Thompson, Supra note 3 at 277.

201 Lianyu Liu (劉連煜), Gongsifa Erlingyier Yu Erlingyiyinian Xinxiuzheng Jiexi Ji (Yi) [The Analysis of the New Amended Company Act in 2011 and 2012] [公司法二零一二與二零一一年新修正解析（一）], 122 Yuedan Faxue Jiaoshi (月旦法學教室) [Taiwan Jurist] 42, 45 (2012) (Taiwan).

not only fulfill his/her own duty of loyalty but may also help other directors to make an informed decision.203

3.3. The Debate Over the Content of the Obligation of Loyalty and the Obligation of Care of a Good Administrator

3.3.1. The Same Nature View and the Opinion of Supreme Court of Taiwan

The wording of the obligation of loyalty was initially stated in a very old precedent in 1920, which stipulated that a business manager owed this obligation to the firm for his running of the business operations. If this obligation was breached without the care of a good administrator, the manager was liable for the damages.204


204 Zuigao Fayuan [Supreme Court], Civil Division, 19 Shang No. 1014 (1920) (China). At that time, the Taiwanese government was still in China. This government moved to Taiwan in 1949.
From the perspective of traditional civil law, there is no difference between an administrator’s obligation of loyalty and obligation of care.\textsuperscript{205} This perspective, which is called the same-nature view, holds that the nature of both obligations is basically the same.\textsuperscript{206} This view believes that the nature of a mandate is a contractual relationship based on the mutual trust of both parties, so the directors are definitely obligated to loyally perform their jobs in the company’s best interests.\textsuperscript{207} Meanwhile, a mandatory’s main obligation is the obligation of care of a good administrator. Hence, the obligation of loyalty is derived from an administrator’s obligation of care rather than from a special obligation of a mandate contract.\textsuperscript{208} In other words, the purpose of this adoption is to specifically copy the mandatory’s obligation of care in the Civil Code to the directors’ obligation in the Company Act, such as the obligation of loyalty.\textsuperscript{209} Today, this perspective is still broadly accepted in practice.

\textsuperscript{205} The similar opinions also can be found in German and Japan. See Daying Liao (廖大穎), \textit{Yingmei Hengping Fayuan Xia Suochuanshe Zhongshi Yiwu De Gainian Yu Oulu Faxyi Siwei Zhi Zhengyi} (英美衡平法院所創設忠實義務的概念與歐陸法系思維之爭議) [The Issue Between the Concept of the Obligation of Loyalty Made by Common Law Equity Court and the Logical Thinking of the Civil Law], 183 \textit{Taiwan Faxue Zazhi} (台灣法學雜誌) [TAIWAN L. J.] 123, 125 (2011).

\textsuperscript{206} Yuanyi Fang (方元沂), \textit{Gongsi Fuzeren Zhi Zhongshi Yiwu Yu Zhuyi Yiwu} (公司負責人之忠實義務與注意義務) [Corporate Director’s Duty of Loyalty and Duty of Care], 197 \textit{Yuedan Faxue Zazhi} (月旦法學雜誌) [TAIWAN JURIST] 182, 186 (2011).

\textsuperscript{207} Daying Liao (廖大穎), \textit{Yingmei Hengping Fayuan Xia Suochuanshe Zhongshi Yiwu De Gainian Yu Oulu Faxyi Siwei Zhi Zhengyi} (英美衡平法院所創設忠實義務的概念與歐陸法系思維之爭議) [The Issue Between the Concept of the Obligation of Loyalty Made by Common Law Equity Court and the Logical Thinking of the Civil Law], 183 \textit{Taiwan Faxue Zazhi} (台灣法學雜誌) [TAIWAN L. J.] 123, 124 (2011).

\textsuperscript{208} Id. at 125.

\textsuperscript{209} Id. at 124. Also See Shao Qingping (邵慶平), \textit{Shangye Panduan Yuanze De Jiase Yu Shiyong – Liandian An De Yianshen Sikao} (商業判斷原則的角色與思考—聯電案的衍生思考) [The Role and
In 2010, in the 99 Taishang 2145 verdict the Supreme Court of Taiwan interpreted the nature of an administrator’s obligation of care to imply that the court follows the same-nature view, positing that there is no distinction between the obligation of loyalty and that of care. In this case, Mega Securities, the plaintiff, was one of the top ten broker-dealers in Taiwan. The defendant was the company’s new recruiting manager for one of its branches but his license was still held by his former employer. Therefore, he factually was the leader of this branch, but the former manager was still legally its representative.

The defendant was sued for breach of the obligation of care, which caused an approximately $5,000,000 loss to the company because of four unauthorized transactions. Four clients, the juristic person of a publicly traded company and its directors, asked their agent to buy their own company’s stocks at an approximate value of $1,330,000 for each. However, the authorization credit of those clients was $1,000,000 per person per day.

In general, when the volume of the transaction exceeds the authorization credit, the branch manager should either refuse the transaction or ask the regional director for permission to execute it. The defendant called the regional director, who was in the middle of a meeting.

When the defendant thus asked the former manager for the transaction history of these four clients, and manager said their credit was good, the defendant decided to authorize the transaction and instructed the agent to work on it. The next day, the regional director also asked the former manager's opinion of these transactions and worked with the defendant and the former manager on the paper work.

These transactions eventually caused a significant loss to the plaintiff because the transactions were uncompleted. Thus, the plaintiff claimed the defendant breached his obligation of care of a good administrator for the unauthorized transactions and sued for monetary damages, based on Article 23 of the Company Act and Articles 544\textsuperscript{210}, 184\textsuperscript{211}, and 113\textsuperscript{212} of the Civil Code.

\textsuperscript{210} Article 544 of the Civil Code states that: “[t]he mandatory shall be liable to the principal for any injury resulting from his negligence in the execution of the affairs commissioned or from such acts as are beyond his authority.” See Laws and Regulations Database of the Republic of China, http://law.moj.gov.tw/Eng/LawClass/LawParaDetail.aspx?Pcode=B0000001&LCNOS=%20528%20%20%20%20%20%20%20%20&LCC=3 (last visited Aug. 25 2015).

\textsuperscript{211} Article 184 of the Civil Code states that: “A person who, intentionally or negligently, has wrongfully damaged the rights of another is bound to compensate him for any injury arising therefrom. The same rule shall be applied when the injury is done intentionally in a manner against the rules of morals. (Paragraph 1) A person, who violates a statutory provision enacted for the protection of others and therefore prejudice to others, is bound to compensate for the injury, except no negligence in his act can be proved. (Paragraph 2)” See Laws and Regulations Database of the Republic of China, http://law.moj.gov.tw/Eng/LawClass/LawParaDetail.aspx?Pcode=B0000001&LCNOS=%20184%20%20%20%20%20%20%20%20&LCC=4 (last visited Aug. 25 2015).

\textsuperscript{212} Article 113 of the Civil Code stipulates that: “When a party made a void juridical act knew or might know that it was void, he shall be liable to recover the status of things to its original condition, or to compensate for any injury arising therefrom.” See Laws and Regulations Database of the Republic of China, (last visited Aug. 25 2015).
The Supreme Court of Taiwan only applied this case to the mandate contract and indicated that a mandatory is liable for the principal’s damages if he or she deals with the commissioned affairs negligently or unauthorized. The mandate contract regulates the internal relationship between the principal and the mandatory. The nature of exceeding one’s authorization is inadequate practice that will be regarded as negligence, and if the mandatory causes the principal’s damages, he or she is liable for the loss according to Article 544 of the Civil Code.

The external relationship describes the relationship between the authorized mandatory and the third party. A contract signed by the mandatory that has exceeded his or her authority or performed unauthorized acts and the third party takes effect if recognized by the principal. However, this recognition of the external relationship does not exempt the mandatory from liability for the principal’s loss caused by the breach of the internal relationship.

The Supreme Court of Taiwan cannot calculate the potential loss of the principal because of the unclear scope of its authorization. The verdict was remanded to the Taiwan High Court to this scope. The Taiwan High Court later ruled that all the transactions was fully authorized because the defendant fulfilled his obligation of care of a good administrator by trying to contact the regional director and by discussing the transactions with his
former manager.\textsuperscript{213} The plaintiff appealed to the Supreme Court again, and the decision was reversed.\textsuperscript{214} The final decision was for the defendant.

In this case, the Supreme Court of Taiwan followed traditional civil law rule that the obligation of care of a good administrator is part of the mandate contract; the court only applied the traditional mandate rule to this case rather than the fiduciary law. In short, the Court believes that the theory of mandate contract/relationship is applicable for resolving this issue; its ruling implies that there is no legal point benefit to distinguishing the obligations of loyalty and care of an administrator.

3.3.2. The Different Nature View and Its Three Sub-Views – the Narrow Interpretation View, the Broad Interpretation View, and the U.S. Interpretation View

In Taiwan, however, many scholars argue that the obligations of loyalty and care of an administrator are different in nature; they thus advocate the “different nature” view. They believe that the fiduciary duty is applicable to the Taiwanese Company Act because one of the reasons given for its adoption in 2001, which mentioned that the obligation of loyalty was derived from Anglo-American law. As for the nature of the obligation of care

\textsuperscript{213} Taiwan Gaodeng Fayuan [Taiwan High Ct.], Civil Division, 99 Jin-Shang-Geng (3) No. 2 (2010) (Taiwan).

\textsuperscript{214} Zuigao Fayuan [Supreme Ct.], Civil Division, 100 Tai-Shang No. 1316 (2011) (Taiwan).
for a good administrator, the different nature view distinguishes the
obligation of loyalty and the obligation of care by the business judgment rule,
only applicable to due care claims. It is not difficult to find advocates of the
business judgment rule in primary and secondary resources in Taiwan. Even
scholars who refused to fully introduce the business judgment rule in Taiwan
may recognize its advantage and suggest that Taiwan can specifically adapt
the spirit of the business judgment rule to the Company Act.215

Although most Taiwanese legal scholars recognize the adoption of
Paragraph 1 Article 23 of the Company Act as a principle that is derived from
U.S. corporate law, the term’s precise meaning in the context of Taiwanese
law remains subject to disagreement. At the heart of the debate is the
question of both the obligations’ common-law antecedents. There are three
main sorts of the different nature view – the narrow interpretation view, the
broad interpretation view, and the U.S. interpretation view.

The narrow interpretation view, held by the majority of academic
scholars, holds that the obligation of loyalty stems from the duty of loyalty in
common law, and the obligation of care is a reiteration of the mandate
relationship in Civil Code. However, these scholars do not explain how to get

215 (“The spirit of business judgment rule could be considered in a trial; however, completely
introducing the corporate legal system of the United States, may not fit in the necessity of Taiwan.”)
See Shao Qingping (邵慶平), Duengshi Fazhi De Yizhi Yu Chuengtu (董事法制的移植與衝突) [The
Introduction and Conflict of the Directors’ Legal System], in GUENGSHI FA—ZUZI YU QIUE ZHIJIAN (公司
there. In my opinion, the narrow interpretation view arises from a more literal reading of Paragraph 1 of Article 23 of the Company Act. In particular, this view is reluctant to read the obligation of loyalty as consisting of any fiduciary duty other than that of loyalty. After all, this obligation does not expressly mention either of the two other fiduciary duties. The question then becomes how we are to decide which duties to ascribe to it.

The narrow interpretation view’s approach is essentially to determine which duties are already regulated by other portions of Taiwanese law, and then to assign the remaining duties to the obligation of loyalty. The Taiwanese obligation of care of a good administrator is a long-established part of mandated law in the Taiwanese Civil Code,\textsuperscript{216} and according to the broad interpretation view, it already adequately covers the duties of good faith and care. This leaves only the duty of loyalty fits in the interpretation of the obligation of loyalty.

The broad interpretation view does not question that an administrator’s obligation of care is mandated by the Civil Code, but it disputes the argument that this pre-existing obligation sufficiently addresses the duties of good faith and care in every case, especially where corporate

\textsuperscript{216} Taiwan Taipei Difang Fayuan [Taiwan Taipei Trial Ct.], Civil Division, 93 Chueng-Su No. 144 (2004) (Taiwan).
law is concerned.\textsuperscript{217} Rather than dismissing the duties of good faith and care as having been dealt with elsewhere, the broad interpretation view interprets the obligation of loyalty as encompassing all three fiduciary duties, including those of faith and care. The broad interpretation view thus equates the obligation of loyalty with the fiduciary duties as it is understood in common law.\textsuperscript{218}

Like the Taiwanese narrow interpretation view, the U.S. interpretation view posits that the obligation of loyalty of Taiwan stems from the duty of loyalty of U.S. corporate law. However, the U.S. interpretation view claims that an administrator’s obligation refers to the duty of care, which is different from the two other views. In other words, the U.S. interpretation view refutes the point that the obligation of care is found in the reiteration of Article 535 of the Civil Code. Thus, the U.S. interpretation view believes that the obligations of loyalty and care of Taiwan refer to the duty of loyalty and the duty of care of the U.S., respectively.

\textbf{3.3.3. Advantages and Disadvantages Among the Three Sub-Views of the Different Nature View}

\textsuperscript{217} \textit{ZENG WANRU (曾宛如)}, \textit{Supra} note 173, at 4-5.

\textsuperscript{218} \textit{ZENG WANRU (曾宛如)}, \textit{Id.} at 4.
Both the advantages and the disadvantages of the narrow interpretation view derive from the same reason – partially introducing the fiduciary duty of loyalty to Taiwanese Company Act apart from the duty of care. The advantage of the narrow interpretation view is that it avoids the vagueness and complication of Delaware’s duty of care law mentioned in Chapter Two. The narrow interpretation view simply adopts the relatively clear duty of loyalty to complete directors’ fiduciary duty and not to transplants the relatively unclear duty of care to avoid the turbulences that Delaware suffered after *Smith v. Van Gorkom* was made.

Following the logic of this viewpoint, it theoretically excludes the application of the business judgment rule because this rule only applies to the duty of care in common law rather than the obligation of care of a good administrator in civil law. However, of many scholars support the majority view also advocate to adopt the business judgment rule to the Taiwanese Company Act. Paradoxically, the majority view totally abandons the duty of care on the one hand but still wants to maintain its core value via the business judgment rule.

The motivation behind the broad interpretation view is to provide public investors with better protection against directors’ breaches of good faith and due care. If the obligation of loyalty were regarded as encompassing all three fiduciary duties, that would give shareholders more
opportunities to sue directors. 219 And in general, the more claims a plaintiff can allege, the more protection he or she has under the law. For example, suppose that director D of company C breaches the fiduciary duties of loyalty, care, and good faith, thus provoking shareholder S to sue D. The question then becomes what exactly S can claim in the suit. The majority view would allow S only to claim breach of loyalty, while the minority view would allow S to claim breaches of all three fiduciary duties, i.e., those of loyalty, care, and good faith.

Meanwhile, the broad interpretation view that the obligation of loyalty includes all three fiduciary duties does not constitute a radical departure from existing Taiwanese law. To the contrary, even before the obligation of loyalty was introduced, the Civil Code of Taiwan already contained statutes regulating mandated relationships in general, including obligations similar to the common-law duties of care220 and good faith.221 Similarly, the notion of conflicts of interest (a major component of the duty of


220 Article 535 of the Civil Code stipulates: “The mandatory who deals with the affair commissioned, shall be in accordance with the instructions of the principal and with the same care as he would deal with his own affairs. If he has received the remuneration, he shall do so with the care of a good administrator.” See Laws and Regulations Database of the Republic of China, http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=B0000001 (last visited Aug. 25 2015).

loyalty) already existed in the Company Act of Taiwan. The broad interpretation view discounts none of these pre-existing laws; it only seeks to supplement them, particularly in their treatment of the duties of good faith and care.

However, the potential problem with the broad interpretation view is that it is difficult to deal with the conflict between the obligation of care and the duty of care. For example, the standard of review of the obligation of care and of the duty of care are, respectively, abstract negligence and gross negligence. No matter which standard of review is chosen by a court, this decision will always be challenged because of the dual standards.

The advantage of the U.S. interpretation is like that of the broad interpretation view; it provides shareholder plaintiffs with better protection against directors’ breaches of good faith and due care. However, the U.S. interpretation may discount the pre-existing obligation of care of an administrator in the Company Act and in the Civil Code. Regardless of the same wording and the plain meaning of the obligation of care of a in both, the U.S. interpretation view simply ignores the pre-existing obligation and construes this obligation as the duty of care in the U.S. corporate law. In

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222 Paragraph 1 of the Company Act shows: “A director who does anything for himself or on behalf of another person that is within the scope of the company's business, shall explain to the meeting of shareholders the essential contents of such an act and secure its approval.” See Laws and Regulations Database of the Republic of China, http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=J0080001 (last visited Aug. 25 2015).
practice, neither judges nor scholars of Taiwan have the authority to change the content of law.

Given the above interpretation, each point of view has its own advantages and disadvantages because the wording and the content of the provision are defective. Hence, Taiwan needs a specific amendment to deal with the unclear nature fiduciary duty in its legal code; otherwise, the progress of fiduciary law will be as slow as it was during the last decade.

3.4. The Taiwanese Fiduciary Duty’s Relationship Between the Contract Law and the Fiduciary Law

3.4.1. The Syncretism of the Civil Code and the Commercial Code

The issues of the origin and definition of the obligations of loyalty and of care are worthy of being discussed in detail. The narrow interpretation view and the broad interpretation view only introduced the duty of loyalty to the Company Act of Taiwan because of the syncretism of the Taiwanese civil and commercial codes, with the former supplementing the latter.

The rules of law of the civil code can apply to a commercial dispute only if there is no other applicable regulation in the commercial code.
Sometimes, the commercial law, especially in the area of corporate law, simply reiterates the rule of law of the civil code. For example, as mentioned, the relationship between a company and its directors is a mandated contract, as regulated in Paragraph 4 of Article 192 of the Company Act. Article 528 of the Civil Code specifies that a mandatory is a person who agrees to deal with other people’s affairs. Article 535 further interprets that if a mandatory has received remuneration, he or she shall deal with commissioned affairs with the care of a good administrator; however, the mandatory only has to follow the instructions of the principal with the same care with which the person deals with his or her own affairs.

Compared Article 535 of the Civil Code to Paragraph 1 Article 23 of the Company Act, which states that the responsible persons of a company have the obligations of loyalty and care, the only change in the area of the directors’ due care standard is that they should perform their responsibilities with the care of a good administrator whether or not they receive remuneration. Some scholars believe that this difference is evidence that the standard of the obligation of care of a good administrator in the Civil Code is different from the standard in the Company Act. However, I believe that this difference only offers evidence that legislators would like to shift the degree of care of non-remunerated directors to the same standard as that of remunerated directors because the wording and standard of the obligation of
care of a good administrator in the Civil Code and the Company Act are the same, i.e., no new legal theory has been made because of the adoption.

3.4.2. The Examination of the Composition of the Taiwanese Fiduciary Duty – the Combination of the Contract Law and the Fiduciary Law

Since the obligation of care of a good administration is the reiteration of the remunerated party’s obligation of due care as stated in the civil code, most Taiwanese judges and scholars believe this reflects the fact that the obligation of loyalty and the obligations of care of a good administrator are not purely derived from U.S. fiduciary laws, but rather from a combination of these fiduciary law and Taiwanese contract law. The issue turns to whether or not this is a good design. I believe it is not because of the indivisibility and the convertibility of the sub-duties in the spectrum of the fiduciary duty that mark the duty as a holistic legal concept.

The spectrum of the fiduciary duty is mainly composed of the duty of loyalty and the duty of care, and the content of both duties sometimes are convertible. For instance, in Delaware, the duty of oversight first was construed as part of the duty of care in the Caremark case; however, twenty years later, the oversight duty was converted to the category of the duty of loyalty in Stone v. Ritter (horizontal interchange). Moreover, after Section
102(b)(7) of the DGCL was amended, the violation of the duty of care became the basis of a bad-faith claim (horizontal interchange).

In 1993, the status of the duty of good faith was initially regarded as an independent claim that shared the same status as the duties of loyalty and care (vertical interchange). Coincidentally, also twenty years after the Section 102(b)(7) of DGCL was amended, the duty to act in good faith was construed as a subsidiary of the duty of loyalty in Stone v. Ritter (vertical interchange). Hence, every sub-duty of the fiduciary duty is potentially being horizontally or vertically interchanged as time goes by.

Moreover, the fiduciary duty is indivisible because of the convertibility of its sub-duties. In the United States, this convertibility is not an issue because these sub-duties are still within the spectrum of the fiduciary duty, no matter how they are horizontally or vertically interchanged.

However, the convertibility issue would be problematic if the holism of the fiduciary duty were broken down. A detailed analysis of Paragraph 1 Article 23 of the Company Act of Taiwan partially reveals that it introduced the fiduciary law (the obligation of loyalty) and partially kept the traditionally contractual liability (the obligation of care of a good
administrator), i.e., that is, the applicable scope of the obligation of loyalty should be equivalent to the content of the duty of loyalty.

In 2001, when Taiwan introduced the duty of loyalty to the Company Act, the content of this duty in Delaware was still the traditional version, which only included the company’s opportunity doctrine and the conflicts of interest. In 2006, after the Stone v. Ritter ruling, the duties of oversight and of good faith were added to the family of the duty of loyalty. Did that mean the content of the obligation of loyalty in Taiwan also contained two new obligations of oversight and good faith? How could Taiwanese legal authority establish the boundary of the obligation of loyalty, since the obligation of care of a good administrator does not have the provision of the business judgment rule or the exculpatory provision? Since there is no substantial difference between the breach of the obligation of loyalty and the obligation of care of a good administrator, what is the benefit of distinguishing between both obligations? These questions indicate that the Taiwanese combination of fiduciary duties may cause systematic problems. The best way to solve them is to establish a holistic concept of fiduciary duty and to examine the necessity of the business judgment rule and the exculpatory provision. To sum up, Taiwan should re-compose its fiduciary laws.
3.5. The Application of the Business Judgment Rule in Taiwan

3.5.1. The Incipient Debate of Applying the Business Judgment Rule to Taiwanese Courts

In practice, some verdicts applied to the business judgment rule even though there was no primary authority of the business judgment rule in Taiwan. For example, in 2004, the Taipei District Court claimed that “when a responsible person’s conduct causes damages, not only Anglo-American law but also Taiwanese law should apply to the so-called business judgment rule.”\(^{223}\) In contrast, in 2003, the Taipei District Court ruled that “there are two dimensions of the business judgment rule – the presumption of procedural law and the rule of substantial law. The former dimension means that the defendants are presumed to act in good faith and with due care during the process of the lawsuit. The latter dimension indicates that within the scope of the authorization, directors are not liable for their good faith and due care conducts even if their conducts cause actual damages or loss to the company. ... In Taiwan, the presumption of eliminating liability should be limited to the circumstances explicitly stated in the law, but there is no such law. ... The corporate directors also apply to the Section Mandate of the Civil

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\(^{223}\) Taiwan Taipei Difang Fayuan [Taiwan Taipei Trial Ct.], Civil Division, 93 Chong-Su No. 144 (2004) (Taiwan).
Code, ...; however, there is no specific article that excludes liability for the breach of the Company Act’s mandate contract. Hence, this case cannot apply to the business judgment rule.”

This verdict correctly interpreted the nature and the application of the business judgment rule. As for the nature of the business judgment rule, the court correctly stipulated that it constitutes a procedural presumption. The substantial consequence that the directors are not liable for due care and good faith is just an effect of this procedural presumption. As for its application, the court’s interpretation makes sense because no provision in any law explicitly provides for the application of the business judgment rule. A verdict that applied to the rule would be considered invalid since this rule has not been adopted by Taiwanese law.

3.5.2. The Relationship Among the Obligations of Loyalty and Care of a Good Administrator and the Business Judgment Rule

In 2009, a verdict of Taiwan High Court, which is the Taiwanese court of appeal, demonstrated the difficulty of determining the relationship

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224 Taiwan Taipei Difang Fayuan [Taiwan Taipei Trial Ct.], Civil Division, 92 Su No. 4844 (2003) (Taiwan).
between the obligations of loyalty and care of a good administrator and the business judgment rule.\textsuperscript{225}

The facts of the case are: The defendant director was the Chairman of the plaintiff’s company. To establish a new branch in Taipei, the defendant signed a lease and a rental car contract without calling a board or a shareholder meeting. The other defendants were the Chairman of two other companies that are the other parties of the lease and the rental car contract, respectively. The co-defendant, who signed the lease and rental car contracts with the defendant, was the manager of one of the companies and the boss of the other.

One month later, without the authorization of the board, the defendant director terminated both the lease and rental car contracts because of the company’s financial problems and a board meeting later approved this decision. However, the defendant director did not honestly disclose his relationship with the co-defendant and their companies during the meeting. If he had, the board would not have approved this decision.

The defendant director’s conduct caused approximately a $160,000 loss to the company. The plaintiff sued the defendant director for monetary

\textsuperscript{225} Taiwan Gaodeng Fayuan [Taiwan High Ct.], Civil Division, 98 Shang No. 1307 (2009) (Taiwan).
damages for breach of the mandate contract and the obligations of loyalty and care of a good administrator.

Here was a classical conflict-of-interest case that obviously fell in the area of the obligation of loyalty. The court should have directly addressed the theory of the duty of loyalty and applied it to the facts of this case. Instead, it explicitly mentioned a series of legal theories including the duties of loyalty and care in Anglo-American law, the obligations of loyalty and care of a good administrator in Taiwanese law, and the business rule.

In my opinion, this implied that the court lacked confidence in deciding which obligation the directors breached, so the court would rather have explicitly enumerated every possibly applicable rule. The court merely enumerated related facts and decided that the defendants were liable for the monetary damages because of the breach of their obligations of loyalty and of care.

I believe the court intentionally sidestepped the distinction between the obligations of loyalty of care by simply asserting that the directors breached both obligations, since the legal consequences for the breach of both are exactly the same under current Taiwanese law. The court also asserted that the defendant director was still liable, even if this case applied to the business judgment rule. I hold that it would be more reasonable if the
court had ruled that the defendant director should be liable under the scrutiny of the entire fairness test, rather than applying the business judgment rule.  

3.6. The Director’s Obligation of Care of A Good Administrator Under the Merger and Acquisition Circumstance – 99 Tai-Shang No. 261 Case

In 2010, in the 99 Tai-Shang No. 261 case, the Supreme Court of Taiwan reaffirmed a verdict of the Taiwan High Court227 and established the standard of directors’ obligation of care of a good administrator under merger and acquisition cases.228. The Taiwan High Court applied the rule of no-fault torts of Paragraph 2, Article 23 of the Company Act and the procedural requirements of Article 5 and 6 of the Merger and Acquisition Act for a care-based merger and acquisition case. The court reviewed this case in a civil-law manner and showed

226 A Taiwanese scholar also indicated the confusion of applying the business judgment rule to this case. Meanwhile, the contribution of this verdict was to claim the importance of director’s duty of disclosure. The defendant director’s proposal without disclosing the conflicts of interest is meaningless. See Wanru Zeng (曾宛如), Erlingyiling Nian Gongsifa Yu Zhengquan Jiaoyi Fa Fazhan Yu Huigu (2010 年公司法與證件交易法發展回顧) [The Development and Review of the Company Act and the Security Act in 2010], 40 NTU LAW JOURNAL (臺大法學論叢) 1877, 1883-84 (2011).

227 Taiwan Gaodeng Fayuan [Taiwan High Ct.], Civil Division, 96 Chong-Shang No. 145 (2007).

228 Zuigao Fayuan [Sup. Ct.], Civil Division, 99 Tai-Shang No. 261 (2010) (Taiwan).
the ambiguity involved in applying the business judgment rule to a civil law matter.

3.6.1. The Facts and the Claims of Both Parties

The facts of this case show that the Taiwan Cooperative Bank (Cooperative Bank) and the Farmers Bank of China (Farmers Bank) agreed to a statutory merger in 2005. The Chairman of the Farmers Bank was appointed by the Ministry of Finance, which was the biggest shareholder of both banks.

On November 7, 2005, the Chairman of Farmers Bank received a report on the share conversion rate, for merger and acquisition purposes, from the KPMG accounting firm. PricewaterhouseCoopers (PwC) in turn provided an original opinion of the reasonableness of the share conversion rate, which stated that a reasonable rate was that 2.29-2.80 Farmers Bank shares could be exchanged for each share of the Cooperative Bank. The next day, November 8th, the Chairman of Farmers Bank called a board meeting to approve the merger proposal and decided upon the rate of 2.45 shares of Farmers Bank in exchange for each share of Cooperative Bank. On December 28th, the shareholder meeting approved the proposal.

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The plaintiff shareholder, who owned 1% of the stock of Farmers Bank, claimed that the defendants, including the bank’s chairman, should send the original KMPG review report concerning the share conversion rate to other experts for review. This plaintiff also filed a claim that argued that the Ministry of Finance should not be a part of the shareholder vote regarding acquisition due to a conflict of interest. Finally, the plaintiff alleged that this case could involve the tort law in the Civil Code and Article 23, Paragraph 2 of the Company Act because the defendants breached the obligation of care of a good faith administrator. The plaintiff sought approximately $5,000,000 in monetary damages.

The Chairman of Farmers Bank, the defendant, argued: (1) The reviewing report of the share conversion rate has been reviewed by KMPG before he was appointed as Chairman of the Farmers Bank; (2) the Board meeting held on November 8th was an emergency case, which is covered by Article 204 of the Company Act; (3) Article 6 of the Business Mergers and

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230 Ministry of Finance is a government agency that applies Article 27 of the Company Act to be elected or to authorize its representative(s) to be elected as directors or supervisors of a company if it is a shareholder of this company.

231 The obligation of care of a good faith administrator is regulated in Article 535 of the Civil Code and Article 23 Paragraph 1 of the Company Code. However, the plaintiff did not mention which Article is preferable.

232 Article 204 of the Company Act stipulates that: “[i]n calling a meeting of the board of directors, a notice setting forth therein the subject(s) to be discussed at the meeting shall be given to each director and supervisor no later than 7 days prior to the scheduled meeting date. However, in the case of emergency, the meeting may be convened at any time. [Paragraph 1] The notice set forth in the preceding Paragraph may be effected by means of electronic transmission,
Acquisition Act did not require that the review report on the share conversion rate should be made by independent experts, or be given to the directors and supervisors before any board meeting;\textsuperscript{233} (4) All Farmers Bank directors participated in the board meeting, and the procedure at this meeting was completely legal; and (5) 91.49\% of the shares voting approved this merger proposal, and the procedure engaged in at the shareholder meeting was legal.

The Ministry of Finance, the co-defendant, argued that (1) according to Article 18, Paragraph 5 of the Mergers and Acquisition Act, the Ministry was not required to avoid voting on the merger proposal during the shareholder meeting;\textsuperscript{234} (2) Article 23, Paragraph 2 of the Company Act and Article 5 of the Mergers and Acquisition Act do not protect individual

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\textsuperscript{233} The relevant part of Article 6 of the Business Mergers And Acquisition Act states: "Before any resolution of merger/consolidation and acquisition by the Board of Directors, a company that has its share certificates publicly issued shall seek opinions from an independent expert on the justification of share exchange ratio or distribution of cash or other assets to shareholders, then report the opinions to the Board of Directors and, if the resolution by the general meeting is required, to the general meeting." See Laws and Regulations Database of the Republic of China, http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=J0080041 (last visited Aug. 25 2015).

\textsuperscript{234} Article 18, Paragraph 5 of the Mergers And Acquisition Act regulates: "Any company holding the shares of other company participating in the merger/consolidation, or the company or its assigned representative is elected as a director to other company participating in the merger/consolidation, then the company or its assigned representative may exercise voting right in the resolution of the merger/consolidation by such other company." See Laws and Regulations Database of the Republic of China, http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=J0080041 (last visited Aug. 25 2015).
shareholders but only all shareholders or the company itself;\(^\text{235}\) and (3) based on Article 23, Paragraph 2 of the Company Act, the company should be liable for the damages at first, followed by the responsible persons who owe the joint liability to the defendant.

3.6.2. The Decision of Taiwan High Court and the Affirmation of the Supreme Court of Taiwan

The Taiwan High Court decided in favor of the defendants for four main reasons: (1) According to other administrative orders, only the merger of a state-owned enterprise is required for a public offering. The Farmers Bank and the Cooperative Bank are not state-owned; thus, a public offering is not required in the case of this merger.\(^\text{236}\)

(2) The incorrect statement regarding the review report on the share conversion rate does not breach the obligation of care of a good

\(^{235}\) The relevant part of Article 5 of the Mergers and Acquisition Act articulates: “When a resolution of merger /consolidation or acquisition is passed, the Board of Directors shall, in the course of conducting the merger /consolidation or acquisition, in the best interest of the shareholders, fulfill its duty of care. Any director involved in decision-making for a merger/consolidation or acquisition shall be liable for any damage to the company as a result of breach of applicable laws, ...” See Laws and Regulations Database of the Republic of China, http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=J0080041 (last visited Aug. 25 2015).

\(^{236}\) However, both of the banks were state-owned banks. Most of the employees are public officers during the mergers. Meanwhile, the biggest shareholder of Farmers Bank and Cooperative Bank were Ministry of Finance, a government agency. Moreover, the Chairmen of Farmers Bank and Cooperative Bank were appointed by Ministry of Finance. Overall, both Farmers Bank and Cooperative Bank were substantial state-owned banks. It is sorrowful that the Supreme Court did not care about this point. However, the “careless” of the court is comprehensible because equity is always not the priority of a civil law court. The court cares more about whether or not the defendants violate any provision.
administrator. The court believes that as long as the opinion about the share conversion rate was made by an independent expert or certified by an accounting firm, the directors were exempted from potential liability. Even if the opinion about the stock exchange ratio involved errors, only an accountant or other expert who made or reviewed this opinion was liable, i.e., since the directors followed the legal requirements, they would pass the examination of the judicial criteria of due care.

(3) The court believed that during the acquisition process, the target company spent a sufficient amount of time discussing the acquisition proposal and the review report of the share conversion rate. The court said that the procedure had no defects because: (A) all the directors, financial consultants, and accountants participated in the board meeting; and (B) consultants and accountants prepared all of the documents, which included an acquisition contract, the opinion of the share conversion rate, opinions by legal consultants, and the review report on the share conversion rate.

(4) The court agreed that calling a Board meeting to discuss and vote on the acquisition proposal was an emergency measure, given that the Chairman of the Farmers Bank believed that this proposal was an emergency issue, which required that a decision be made as soon as possible. The court concluded that this decision was not beyond the reasonable scope of
business judgment. In 2010, the Supreme Court of Taiwan approved this Taiwan High Court judgment.

### 3.6.3. The Strong Power of the Taiwanese Business Judgment Rule

In this case, the court judged an issue that could apply to the business judgment rule in a jurisdiction that did not have this rule, without deliberating over whether or not this rule could be applied to Taiwanese laws. Without the primary resource of the business judgment rule, the court should judge this case either according to the entire fairness test or under the traditional civil-law rule. In contrast, the court mentioned the keywords of “business judgment” to ground its decision and ruled, by only examining the procedural requirements regulated in Article 5 and Article 6 of the Mergers and Acquisition Act, that the defendants’ conduct did not go beyond “the reasonable scope of the business judgment.” This standard of review can be deemed as constituting the Taiwanese business judgment rule.

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237 Whether or not the business judgment rule should be introduced to the Taiwanese legal system is debatable. However, it is rare to see lawsuits against directors in Taiwan. Currently, maybe it is not the good timing to introduce business judgment rule to Taiwanese Company Act. See ZENG WANRU (曾宛如), Dongshi Zhuangshi Yiwu Zhi Neihan Ji Shiyong Yiyi (董事忠實義務之內涵及適用疑義) [The Content and Application of Directors’ Fiduciary Duties], in GUENSI GUANLI YU ZHIBEN SHICHANG FAZHI ZUANLUN (Yi) (公司管理與資本市場法制專論（一）) [The Corporate Governance and Capital Market], 1, 34-5 (2007) (Taiwan).

238 The spirit of business judgment rule could be considered in a trial; however, completely introducing the corporate legal system of the United States, may not fit in the necessity of Taiwan. See Shao Qingping (邵慶平), Duengshi Fuzhi De Yizhi Yu Chuengtu (董事法制的移植與衝突) [The Introduction and Conflict of the Directors’ Legal System], in GUENSHI FA—ZUZI YU QIUE ZHIJIAN (公司法—組織與契約之間) [Corporate Law—Between the Organization and the Contract] 321, 361-62 (2008) (Taiwan).
The protection of this rule is very strong because the procedural requirements of the Mergers and Acquisition Act are quite easy to fulfill. As a result, it is difficult to find an illegal merger-and-acquisition case in Taiwan, a jurisdiction in which the business judgment rule does not apply.

3.6.4. The Claim of Paragraph 2 of Article 23 of the Company Act is Clearer and Stronger than the Claim of Paragraph 1 of Article 23 of the Company Act

Instead of Paragraph 1 of Article 23 of the Company Act, the plaintiff chose to invoke Paragraph of this article. This was because of the unclear definition of Paragraph 1 and the benefit of a direct lawsuit. Paragraph 1 was recently adopted from the common law. This meant that there was no substantial content for the court to apply or for the plaintiff to claim, because there was relatively little specification definition of what the obligations of loyalty and of care constitute.239

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239 Lin Renguang (林仁光), *Common Law Influences in Private Law—Taiwan’s Experiences Related to Corporate Law*, 4 NATIONAL TAIWAN UNIVERSITY L. REV. 107, 125 (2009) (Taiwan). (“[I]n Paragraph 2 of Article 23, which provides that the responsible person shall be jointly and severally liable for the damages caused by the responsible persons during the course of business operations having violated any applicable law or regulation. Because this provision provides a relatively precise standard ‘in violation of the law or regulation during the course of business operation,’ it becomes easier for the court to apply Paragraph 2 rather than Paragraph 1 of Article 23 of the Company Act.”)
As has been noted, codifying the definition and content of fiduciary law should be a priority for the Taiwanese legislature. In contrast, the plaintiff invoked Paragraph 2 Article 23 of the Company Act\(^{240}\) because the Supreme Court had decided that the liability it mentioned was a no-fault liability,\(^{241}\) i.e., that Paragraph 2 provides a stronger claim than Paragraph 1. The plaintiff only had to prove that any of the defendants’ conducts broke the law, and the defendants consequently would be liable for no-fault liability.\(^{242}\)

Although the plaintiff had such a powerful weapon, he eventually lost the case for two reasons: (1) The court strictly applied Paragraph 2 of Article 23 of the Company Act to this case because the amount of the monetary damages of the no-fault torts liability is too huge. Hence, the court examined the case with a looser standard. (2) Perhaps the court realized that the standard of review was too loose, so it borrowed the spirit of the business judgment rule to solidify its reasoning in this case. However, it is unreasonable to mention the business judgment rule in a no-fault torts case since the standard of review of this rule is gross negligence.

\(^{240}\) Article 23 Paragraph 2 of the Company Act of Taiwan notes: “If the responsible person of a company has, in the course of conducting the business operations, violated any provision of the applicable laws and/or regulations and thus caused damage to any other person, he/she shall be liable, jointly and severally, for the damage to such other person.” \(\text{See}\ \text{Laws and Regulations Database of the Republic of China, http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=J0080001}\) (last visited Nov. 29, 2011).

\(^{241}\) \(\text{See}\ \text{Zuigao Fayuan [Sup. Ct.], Civil Division, 73 Tai-Shang No. 4345 (1984) (Taiwan).}\)

\(^{242}\) Scholars have criticized it as bring ridiculous to decide that Paragraph 2 Article 23 is a no-fault tort liability due to the language of Paragraph 2 Article 23 of the Company Act does not mention no-fault liability at all. Zeng Wanru (曾宛如), \text{Dongshi Zhuengshi YiwuYu TaiWan Shiwushang Zhi Shijian (董事忠實義務於台灣實務上之實踐) [The Practice of Directors’ Fiduciary Duty in Taiwan], 29 YUEDAN MINSHANGFA ZAZHI (月旦民商法雜誌) [CROSS-STRAIT L. REV.] 145, 149 (2010) (Taiwan).\}
3.6.5. The Advantages of the Direct Lawsuit and the Disadvantages of the Derivative Lawsuit

A shareholder can file a direct lawsuit against directors as long as his/her shareholder right has been directly infringed. In this case, the court did not mention how the plaintiff’s shareholder right was infringed; rather, it simply recognized the plaintiff’s claim and ruled on the case. The court might recognize that the plaintiff was eligible to file a direct lawsuit against the directors and their “boss” (the Ministry of Finance) because of the wording of Paragraph 1 Article 5 of the Merger and Acquisition Act, which states: “[W]hen a resolution of merger/consolidation or acquisition is passed, the Board of Directors shall, in the course of conducting the merger/consolidation or acquisition, fulfill its duty of care in the best interests of the shareholders.” This in effect posits that the shareholders’ rights have been infringed when the board of directors fails to protect their best interests. Hence, the plaintiff shareholder is eligible to pursue a direct lawsuit against the directors. If the plaintiff wins, all his damages can be reimbursed.

On the other hand, eligibility and the potential benefits are the two biggest differences between a direct and a derivative lawsuit. The procedural restrictions on finding a derivative lawsuit against directors are extremely
hard to overcome. According to Article 214 of the Company Act, only shareholder(s) who have continuously held 3% (or more) of the outstanding shares of a corporation can ask supervisors to sue the director(s), and they must do so in writing.

The shareholder(s) can represent the company and sue the directors only if the supervisor(s) fail to take action within 30 days. Moreover, the court may order plaintiff shareholder(s) to post an appropriate security deposit because of the defendants’ petition. Generally, provided that the defendant(s) asked, the court agrees the plaintiff shareholder(s) must pay the appropriate security deposit, which is equivalent to one-third of the total amount of damages that the plaintiff seeks. Some defendants might be unable to afford the security deposit if the amount is too high.

Furthermore, there are limited incentives and huge risks for shareholder plaintiff(s) in filing a derivative lawsuit against directors. The shareholder plaintiffs are liable for the costs that the company incurs from

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243 Article 214 of the Company Act of Taiwan notes: "Shareholder(s) who has/have been continuously holding 3% or more of the total number of the outstanding shares of the company over one year may request in writing the supervisors of the company to institute, for the company, an action against a director of the company. [Paragraph 1] In case the supervisors fails to institute an action within 30 days after having received the request made under the preceding Paragraph, then the shareholders filing such request under the preceding Paragraph may institute the action for [on behalf of] the company; and under such circumstance, the court may, at the petition of the defendant, order the suing shareholders to furnish an appropriate security. In case the suing shareholders become the loser in that lawsuit and thus causing any damage to the company, the suing shareholders shall be liable for indemnifying the company for such damage. [Paragraph 2]" See Laws and Regulations Database of the Republic of China, http://law.moj.gov.tw/Eng/LawClass/LawAll.aspx?PCode=J0080001 (last visited Aug. 25 2015).
the lawsuit if they should lose the case. Even if the shareholders win the case, they can only obtain damages proportionate to how many shares they own.

Because shareholders represent the company, most damages received from the suit accrue to the company. If the shareholders own 3% of the outstanding shares, they only obtain 3% of the benefits.

Depending upon whether or not the facts determined in the final judgment are deemed to be true, two possible consequences can occur: (1) if the facts are found to be untrue, the shareholders are liable for the directors’ costs caused by the lawsuit; and (2) if the facts are found to be true, the directors are liable for shareholders’ damages caused by the lawsuit.\(^{244}\) i.e., the shareholders in this theoretical case can obtain 3% of the benefits but must pay all of the damages if they should lose the case.

To sum up, shareholders should weigh the costs and benefits of filing a lawsuit for fiduciary violations and then decide whether they want to institute one. A relevant mathematical formula shareholders might consider

\(^{244}\) Article 215 of the Company Act of Taiwan articulates: “Where a lawsuit instituted under paragraph 2 of the preceding article is found by a final judgment to be based on facts apparently untrue, the shareholders who instituted the action shall be liable to compensate the defendant director for loss or damage resulting from such an action. [Paragraph 1]

Where a lawsuit instituted under paragraph 2 of the preceding article is found by a final judgment to be based on facts apparently true, the defendant director shall be liable to compensate the shareholders who instituted the action for loss or damage resulting from such an action. [Paragraph 2]”

is: the amount of \( [(\text{the percentage of winning the litigation}) \times (\text{the percentage of outstanding shares owned by plaintiff shareholders}) \times (\text{the total amount of damages caused by defendant directors})] \) should be greater than the amount of \( [(\text{all the legal costs}) + (\text{the potential damages caused by plaintiff shareholders})] \). Unfortunately, the total proceeds are always less than the total costs.

\[ (\text{the percentage of winning the litigation}) \times (\text{the percentage of outstanding shares owned by plaintiff shareholders}) \times (\text{the total amount of damages caused by defendant directors}) > (\text{all the legal costs}) + (\text{the potential damages caused by plaintiff shareholders}) \]
4. The Obligation of Diligence of China

4.1. Overview

The concept of fiduciary duty, derived from the common law, was established by the Company Law of People’s Republic of China in 2005.246 This duty plays an extremely important role in common law, particularly in American corporate law. For this reason, one might have expected dramatic consequences from its introduction into Chinese law. In reality, however, few fiduciary lawsuits have been brought to the courts of China since 2005.247 This chapter addresses the reasons for the relative absence of such lawsuits.248

There are three main reasons for the rarity of due care lawsuits. First, Chinese fiduciary law has neither a clear content nor a clear standard of review. This is especially true of the body of fiduciary law that deals with the duty of care. This makes it difficult for lawyers to decide whether pursuing a due care lawsuit is worthwhile and for judges to establish a legal doctrine for applying and enforcing the law. Second, the traditionally harmonious culture of China discourages filing lawsuits against directors;

246 The necessity of introducing the duty of care to Chinese corporate law has been advocated by scholars in 1999. See Daoyang Wang & Hua Li (王道阳, 李华), Lun Gongsi Dongshi De Zhuyi Yiwu (论公司董事的注意义务) [Corporate Directors’ Obligation of Diligence], 5 HEBEI FAXUE (河北法学) 50, 52-3 (1999).

247 Before December 1st 2010, only 63 fiduciary cases could be found online; however, only five of them are related to the duty of care. See Jun Wang (王军), Gongsi Jingyingzhe zhongshi Yiwu He Qinmian Yiwu Susong Yanjiou (公司经营者忠实和勤勉义务诉讼研究) [The Research of Lawsuits of Duties of Loyalty and Care against Entrepreneurs of Corporations], 4 BEIFANG FAXUE (北方法学) 24, 28 (2011).

248 The Chinese equivalent to the duty of care is called the obligation of diligence.
shareholders prefer other ways of solving corporate problems, such as simply selling their stocks. Third, Chinese law imposes severe restrictions on derivative lawsuits. One is the requirement for shareholder(s) to have held at least 1% of company stock for at least 180 consecutive days in order to be eligible for filing such a lawsuit. This chapter examines China’s problematic duty of care law and demonstrates that it is in dire need of revision.

4.2. The Fiduciary Duty and its Related Regulations in China

China’s law concerning the fiduciary duty was established in Article 148 of the Company Law of the People’s Republic of China (henceforth, the Company Law), which states that directors, supervisors, and senior managers should bear the obligations of fidelity to the company and diligence in carrying out its affairs.249

The liability for the breach of the fiduciary duty is made enforceable by Article 150250, which states that a director, supervisor, or senior manager who performs her duty in violation of any law, administrative regulation, or charter shall be liable for the

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damages if she caused the company a loss.\textsuperscript{251} The scholarly debate over the origins of the obligations of fidelity and diligence has been settled, since most scholars agree that these obligations are derived from the common law duties of loyalty and care, respectively;\textsuperscript{252} specifically the duties of loyalty and care as they are defined in the DGCL and the Model Business Corporation Act.\textsuperscript{253}

However, the obligations of fidelity and diligence in China are by no means equivalent to the duties of loyalty and care in the United States. The obligation of fidelity is defined in Article 149 of the Company Law, which enumerates eight ways whereby this obligation can be breached:

1. misappropriating the company’s funds;
2. depositing the company’s funds into his/her own account or the account;

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\textsuperscript{251} Combining Article 148 and 150 of the Company Law of China, the structure of the Chinese law is very similar to Paragraph 1 Article 23 of the Company Act of Taiwan, which states “The responsible person of a company shall have the loyalty and shall exercise the due care of a good administrator in conducting the business operation of the company; and if he/she has acted contrary to this provision, shall be liable for the damages to be sustained by the company there-from.” This similarity connects the discussion of Taiwanese and Chinese laws.


\textsuperscript{253} The discussions of Chapter 4 & 5 can be referred back to the discussion of Chapter 2 & 3 since there is no specific distinction among the duty of care, the obligation of care of a good administrator, and the obligation of diligence. Therefore, most of the discussions in Chapter 2&3 may benefit the Chinese scholarship to clarify the application and enforcement of the obligation of diligence.
(3) loaning company funds to others or using them to provide a guarantee to any other person without complying with the charter or without the consent of the shareholders’ meeting, shareholders’ assembly, or the board of directors;

(4) self-dealing without complying with the charter or without the consent of the shareholders’ meeting, shareholders’ assembly, or the board of directors;

(5) using the company’s opportunity without complying with the charter or without the consent of the shareholders’ meeting, shareholders’ assembly, or the board of directors;

(6) taking the commission which belongs to the company into his/her own pocket;

(7) disclosing the company’s confidentiality without its consent; and

(8) other conducts which breach the obligation of fidelity.254

The obligation of diligence, while not mentioned in the Company Law, is indirectly defined in Paragraph 1 Article 58 of Administrative Measures for the Disclosure of Information of Listed Companies (henceforth AMDI), which states that the directors, supervisors, and senior managers of listed companies are liable for any lack of genuineness, accuracy, completeness, timeliness, or fairness in information disclosed by their company, unless sufficient evidence shows that they have fulfilled their

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obligation of diligence.\textsuperscript{255} While this administrative provision does not directly define the obligation of diligence; i.e., it does not say that the obligation of diligence is to be genuine, accurate, or complete, etc., it does give the CSRC the authority to decide whether a director has breached her obligation of diligence. It also gives the CSRC the authority to file an administrative sanction against a director who has signed a fraudulent or deceptive report. The burden of proof in such a case is on the director to show that she has in fact not breached her obligation of diligence.

In contrast, American directors are liable for the breach of the duty of care only if they make an uninformed decision. Furthermore, most are protected by the exculpatory provision, the DGCL Section 102(b)(7). Thus, directors of Chinese listed companies are clearly held to a higher fiduciary standard than their American counterparts, especially where the obligation of diligence is concerned.\textsuperscript{256}

4.3. The Barriers on the Obligation of Diligence for Publicly Traded Companies


\textsuperscript{256} The Chinese legislators intentionally make Chinese directors owe higher level of obligation of diligence than the duty of care of American directors because the plain meaning of diligence implies the pursuing high level of moral spirit. See Hong Zhang & Wenying Lu, Supra note 252 at 6-7.
The enforcement of the fiduciary duty in China is quite different from enforcement in the United States. In theory, directors in China owe a higher level of fiduciary duty to the corporation. In reality, however, they are hardly ever sued by shareholders or punished by the People’s Courts or the China Securities Regulatory Commission (henceforth CSRC).\(^{257}\)

In China, there are two main types of courts where fiduciary law is concerned: the civil and the administrative. The former hears derivative lawsuits, while the latter hears lawsuits in which a company director is contesting a CSRC sanction. The administrative courts see many more cases than the civil courts because of the CSRC’s power and the severe restrictions on derivative lawsuits. Besides both of the factors, the social atmosphere is always one of the biggest problems of Chinese legal society.

4.3.1. The Power of CSRC—the Ding Liye Case

First, the CSRC is authorized to judge that directors of listed companies breach their obligation of diligence and to punish them. After being punished Directors could file administrative lawsuits against the CSRC for judicial relief, but in doing so, they must prove that they have not breached their obligation of diligence. For example, a leading case\(^{258}\) concerning the breach of directors’ obligation of

\(^{257}\) CSRC only owns the supervision power to listed companies.

\(^{258}\) The important status of this case is approved by official medias such as the Leal Daily (法制日报) [Legal Daily] and the Xinhua Wang (新华网) [Xinhua Net]. See Xinhua Net, http://news.xinhuanet.com/legal/2008-12/07/content_10468336.htm (last visited Sept. 30 2013); Xinhua Net, http://news.xinhuanet.com/fortune/2008-12/03/content_10451849.htm (last visited Aug. 25 2015).
diligence is the DingLiye case\(^{259}\) (丁力业案), which was brought to the Beijing No.1 Intermediate People’s Court (北京第一中级人民法院) to dispute an administrative sanction\(^{260}\) made by the CSRC. The CRSC had fined the listed company, ShenXinTaiFong (深信泰丰), and its directors various amounts. Ranging from 300,000 to 30,000 RMB (approximately $50,000 to $5,000)\(^{261}\), because its 2003 annual and semiannual reports contained fraudulent and deceptive information. One director, Liye Ding (丁力业), filed an administrative lawsuit against the CSRC to dispute his fine. He claimed that he was not liable for the fraudulent and deceptive reports because he was absent from the directors’ meetings. However, he had authorized another director to join the board meeting as his surrogate. Since the director signed the report, Liye Ding was responsible for the report as well.

The court ruled against the plaintiff, citing in its decision Paragraph 1 Article 58 of Administrative Measures for the Disclosure of Information of Listed Companies. (上市公司信息披露管理办法) The court held: “The plaintiff, a director of ShenXinTaiFong, has the duty to fulfill the director’s responsibility, to supervise the company for the obedience of its legal duty of disclosure, and to ensure the


\(^{260}\) For the content of the administrative sanction, See China Securities and Regulatory Commission, http://www.csrc.gov.cn/pub/zjhpolicy/G00306212/200804/t20080418_14224.htm?keywords=%E4%B8%81%E5%8A%9B%E4%B8%9A (last visited Aug. 25 2015).

\(^{261}\) The penalty of 300,000 RMB was for the company. The individual director’s penalty was no more than 50,000 RMB in this case.
genuineness, accuracy and completeness of the disclosed information.... Moreover, the plaintiff did not submit the evidence to prove that he has fulfilled his obligation of diligence as a director.... Thus, the plaintiff is liable for the fraudulent and deceptive information in the annual report and the semiannual report.”

This case established the rule that a director’s signature on a fraudulent report is, in and of itself, sufficient to sustain the assumption that the director was not diligent. However, the court did not mention how the director could refute this assumption. The court thus described how the obligation of diligence is breached without describing how it is fulfilled.

The result of the court’s decision in the Ding Liye case is that it is now easier for directors’ liability to be established in administrative courts. In theory, it would also make it easier for shareholders to file and win derivative lawsuits against directors in civil courts, since shareholders would be able to use the decisions of the administrative courts to support their cases. However, as we will see in the next section, Chinese law severely restricts the filing of derivative lawsuits, so it ends up being very difficult for shareholders to derive any practical benefit from the Ding Liye decision.


263 The standard of review for the breach of the obligation of diligence is neither the torts law approach nor the business judgment rule. It depends on whether or not the directors signed the documents. See Feng Deng (邓峰), Yewu Panduan Guize De Jinhua Yu Lixing (业务判断规则的进化和理性) [The Improvement and the Rationality of the Business Judgment Rule], 2 FAXUE (法学) 68, 80 (2008).

264 Smith v. Van Gorkom and most of Taiwanese cases mentioned in Chapter 3 share the similar problem.
4.3.2. The Restrictions on Derivative Lawsuits

Although the amounts of the fines imposed by the administrative court in the Ding Liye case were quite small, the amount of monetary damages that could be awarded in a derivative lawsuit following an administrative sanction is potentially quite large. In actuality, however, very few derivative lawsuits against the directors of publicly traded companies’ for the breach of fiduciary duty are filed in China today. The reason for this is that it is too difficult for minority shareholders to file a derivative lawsuit against directors. That is because Article 152 of the Company Law specifies four conditions that first must be satisfied in order for a shareholder to file a derivative lawsuit against a director:

1. The director’s conduct must violate Article 150 of the Company Law, which states that a director is liable for the company’s loss caused by her if she has violated any law, administrative regulation, or charter while performing her duty to the company.

2. The shareholder(s) in question must continuously hold at least 1% of the company’s total shares more than 180 days.

3. The shareholder(s) must submit a written request to the board of supervisors, asking them to file the lawsuit.

265 Zhejiang Guangxia Konggu Gongsi (浙江广厦控股公司), a famous publicly-traded company, was sued by minority shareholders who held 4.81% and 2.69% of shares of the company in 2007. The total amount of this derivative lawsuit was more than 3 billion RMB. However, the verdict of this case could not be found online. See Xinhua Net, http://news.xinhuane.com/legal/2008-01/11/content_7403108.htm (last visited Aug. 19 2015).

266 The design of the derivative lawsuit in China is very similar to the design of Taiwan. Please refer the advantage and disadvantage of direct lawsuit and derivative lawsuit back to Chapter 3.6.5.
4. After submitting this request, the shareholder(s) may proceed to file the lawsuit only if one of the following is true: (1) the board of supervisors refuses to file the lawsuit, (2) it does not file the lawsuit within 30 days of receiving the written request, or (3) the company is facing an emergency that could lead to unrecoverable loss if the lawsuit is not immediately filed.

If any one of these four constraints is not satisfied, no lawsuit can be filed.267

Due to these restrictions, it is likely that very few fiduciary derivative lawsuits will be filed in contemporary China. Even if shareholders overcome all the restrictions on derivative lawsuits, they face many unexpected problems stemming from the defects in the Chinese legal system. Even if we set aside the substantial problems caused by the ambiguous definition and standard of the fiduciary duty, the problem remains that the court can dismiss a derivative lawsuit during the format examination. For example, Article 152 of the Company Law stipulates that shareholder(s) have to have constantly held at least 1% of the company’s stock for 180 days before starting the process of filing the lawsuit. However, it does not specify what sort of stocks they must be own. Suppose, for instance, that a company issued 1,000,000 shares of common stocks. Then a shareholder would have to hold at least 10,000 shares in order to file a derivative lawsuit. But what if this same company issued another 10,000,000 shares of preferred stocks? How many shares would the shareholder then be required to own for the purposes of filing a lawsuit?

267 For more critiques of derivative lawsuits in China, see Yingshuang Liu (刘迎霜), Gudong Dai Dongshi Susongzhong De Shangye Panduan Guize (股东对董事诉讼的商业判断规则) [The Business Judgment Rule of Shareholders’ Lawsuits against Corporate Directors] 5 FAXUE (法学) 142, 143-44 (2009).
One possibility is that the preferred stock doesn’t count, and 10,000 shares are thus sufficient. Another is that preferred stock does count along with the common, and that the shareholder would therefore need to have held at least 110,000 shares of stocks –100,000 of preferred and 10,000 of common -- for a half year. A court could choose either of these options. Nothing but the biases and inclinations of a particular court would favor one interpretation over the other.

One court, for example, may wish to defend the harmony of society and the market. It could then adopt the latter interpretation and legally dismiss the derivative lawsuit on the grounds that the defendants did not fulfill one of the requirements of a derivative lawsuit, namely that of constantly holding more than 1% of the company’s stock for 180 days. There are many complications in the Company Act. These surprises can either be advantages or disadvantages to the shareholders depending on whether or not they are on the same side of something important or someone powerful.

Thus, despite the assumption of the breach of the obligation of diligence established in Paragraph 1 Article 58 of AMDI, the directors of Chinese-listed companies nonetheless enjoy a degree of protection from shareholder litigation. This protection comes in the form of the restrictions on derivative lawsuits discussed above. Although most shareholder lawsuits would be easily won due to the assumption of the breach of the obligation of diligence, the constraints on
derivative lawsuits prevent such lawsuits from ever reaching the courts in the first place.

4.3.3. The Social Influence to the Number of Lawsuits

The task of introducing a common-law concept to a civil law jurisdiction is always a very big challenge.\textsuperscript{268} However, the challenge of introducing the common-law fiduciary duty to Chinese corporate law is much greater in China than in other countries because of the country’s focus on a harmonious social atmosphere and the defects present in its legislation.

Harmony is a strongly entrenched value in China. From signs at construction sites to the names of trains, slogans containing the word \textit{harmony} (和谐) are everywhere. Although Chinese citizens often make fun of the pervasiveness of this value, they still adhere to it in practice.

In a fiduciary dispute, the spirit of harmony manifests itself in two distinct dimensions, the minority shareholders’ habits and the majority shareholders’ negotiating power. First, minority shareholders may simply sell their own stocks when they are dissatisfied with the company. Chinese people generally see lawsuits as miserable affairs to be avoided at all costs. Most would choose to sell out their stock rather than endure the pain of a lawsuit. Second, majority shareholders have

\begin{footnotesize}
\textsuperscript{268} "As for the research of obligation of diligence, the related foreign legal theories are important; however, introducing these theories to China has to fit in the social situation of China." \textit{See} Hong Zhang \& Wenying Lu, \textit{Supra} note 251 at 9.
\end{footnotesize}
the leverage to negotiate with directors and influence their decisions without having to resort to a lawsuit. Further, they can always sell their stocks if negotiations fail. The directors also have an incentive to pursue harmonious relations with majority shareholders, since the cost (including time and money) of negotiation is always less than the cost of a lawsuit.

4.4. The Unconformable Thinking of Judges and the Unforeseeable Results of Lawsuits—the Wujin Case

Although the shareholders of a limited liability company (LLC) find it much easier to overcome the legal barriers mentioned above, the path for filing a due-care lawsuit against directors is still difficult in China. For example, a case was filed in Chongqing in 2006 that indicated the unpredictable judgments under an opaque legal system whose laws are unclear.269

4.4.1. The Facts

269 The whole content of the case is not open to the public. Only part of the content is mentioned in a law review article published by the Supreme People's Court of the People's Republic of China. See Yan Da (达燕), Youxian Zeren Gudong Daibiao Susong De Xiangguan Falv Wenti (有限责
任公司股东代表诉讼的相关法律问题) [The Related Issues of Filing Derivative Lawsuits Against Directors of a LLC], 8 Renmin Sifa Anli (人民司
The plaintiffs were eleven of the twenty first shareholders of the Wujin Company, which was founded in 2002. The defendant had been the company’s chairman since 2004. The company bylaws stated that the investment proposal should be brought to the board meeting and needed to be approved by more than two-third of directors, and would be valid only after being approved at a shareholder meeting. The supervisors were obligated to correct the directors' and management’s wrongdoing if their conducts hurt the company's interests.

In early October 2004, most directors and supervisors visited the countryside to research whether they should invest in an aquatic farm. On October 13th, the company signed the lease with the county where the aquatic farm is located. On October 16th, four directors and one shareholder joined the “chairman meeting” that was called by the company to discuss detailed arrangement of the aquatic farm. On October 17th, another chairman’s meeting was called to discuss the works of the aquatic farm again; there were six directors, two

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270 Id. at 37.
271 Id.
272 Id.
273 Id.
274 Id.
275 Id.
276 Id.
277 Id. at 37-38.
supervisors, and two shareholders joined the meeting. On December 10th, the local government issued an operating license of the aquatic farm. On August 1, 2005, the aquatic farm officially became part of the company.

On May 1st 2006, several shareholders requested that the company to file a lawsuit against the chairman due to his unauthorized investment in the aquatic farm. Because the company did not sue the chairman, eleven shareholders eventually filed a lawsuit against him and the accountant, who is also a company director, for the loss of the investment. The total amount of the investment was 641,972.02 RMB, a little more than $100,000.

On June 7th, the company called a shareholder meeting to cancel the registration of the aquatic farm and to re-elect a new board of directors. Both defendants were elected to the new board.

4.4.2. Four Trials in Four Different Results

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278 Id. at 38.
279 Id.
280 Id.
281 Id.
282 Id.
283 Id.
284 Id.
4.4.2.1. The Trial Court

In the trial court, the judge stated that in arranging neither a board meeting nor a shareholder meeting, the chairman only called the chairman meeting that was not the valid process of making investment decisions; hence, the Chairman was liable for the loss of the company.\textsuperscript{285} Meanwhile, all other directors that joined the field research in early October or the chairman meeting on October 16\textsuperscript{th} were also liable because they acknowledged the project by not dissenting from it.\textsuperscript{286} Thus, the other defendant director was also liable for the breach of her obligations of loyalty and diligence.\textsuperscript{287}

However, the plaintiff had to take the burden of proof for the total loss of the company, which could not be directly appraised as the total investment of the company;\textsuperscript{288} that is, plaintiffs were obligated to provide the total amount of the loss of the company. Consequently, the plaintiffs lost the case because of distributing of the burden of proof.\textsuperscript{289}

\textsuperscript{285} Id.
\textsuperscript{286} Id.
\textsuperscript{287} Id.
\textsuperscript{288} Id.
\textsuperscript{289} Id.
4.4.2.2. The Appeal to the Intermediate Court

The plaintiff appealed to the intermediate court, rebutting the decision of the trial court that the plaintiffs and other directors who joined the field research in early October or the chairman’s meeting on October 16th were liable.\textsuperscript{290} That is, the chairman and the co-defendant director were liable for the loss of the company because only they were sued. As for the amount of the total loss, almost the entire amount of the investment (614623.92 of 641,972.02 of RMB) was left unreimbursed to the company yet, and the tax document from the local authority showed the loss of the aquatic farm to be 574,924.7 RMB.\textsuperscript{291}

The intermediate court held that the chairman was liable for the loss of the company due to the defects of the required investing process, that the investing proposal should have been agreed by the board meeting and approved by the shareholder meeting.\textsuperscript{292} The chairman argued that all other shareholders acknowledged the investment decision but had not objected the decision.\textsuperscript{293} The court responded that the acknowledgement, and abstaining from participating in

\textsuperscript{290} \textit{Id.}

\textsuperscript{291} \textit{Id.}

\textsuperscript{292} \textit{Id.}

\textsuperscript{293} \textit{Id.}
an act of directors and shareholders could not be deemed as the approval of the investment proposal.294

As for the amount of the total loss of the company, the court held that it should be the loss of the assets that was not being reimbursed to the company due to the wrongful investment procedure.295 The amount of the loss should be 614,623.92 RMB; however, in this trial, the plaintiffs reduced the amount of allegation to 574,924.7 RMB, the same amount as the statement on the tax document of the local authority.296 The chairman rebutted the allegation but not further provided any evidence of the amount of the total loss; therefore, the intermediate court held the chairman was liable for the total loss of the company, which was calculated as 574,924.7 RMB.297 Meanwhile, the court reversed the claim to the co-defendant director because the plaintiffs only asked the supervisors to file a lawsuit against the chairman; hence, the lawsuit against the co-defendant director was deemed illegal.298

4.4.2.3. The First Retrial in the Intermediate Court

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294 Id.

295 Id. at 38-39.

296 Id. at 38.

297 Id. at 39.

298 Id.
The chairman filed an appeal with the high court, which ordered the intermediate court to review the case, making for the third trial of this case.\textsuperscript{299} This trial focused on two issues: (1) whether the chairman had to take the full responsibility of the loss of the company; and (2) how to estimate the total amount of the loss?\textsuperscript{300}

First, the court ruled that the company itself, and its members, such as directors and supervisors, were obligated to obey the bylaws, which required board meetings should be recorded in writing and signed by the attending directors.\textsuperscript{301} Given the evidence, there was no record of a board or shareholder meeting.\textsuperscript{302} The issue of the aquatic farm was only raised in the chairman’s meeting; however, the record of this meeting was not the required process according to the bylaws.\textsuperscript{303} Although most shareholders acknowledged, and had no objection to, the investment of the aquatic farm, it could not be regarded as approved by them or the directors.\textsuperscript{304}
Second, given the amount of the company’s total loss, the court held that the total amount of the unreimbursed investment was not equivalent to the total loss of investment,\textsuperscript{305} for the profit or loss of the aquatic farm should be counted in as well.\textsuperscript{306} Since the plaintiffs claimed for damages, the burden of proof for the total loss was on their shoulders.\textsuperscript{307} Because they could not prove the profit or loss of the aquatic farm, the total loss of the company could not be calculated. Hence, the intermediate court reversed the plaintiffs’ claim.\textsuperscript{308}

4.4.2.4. The Second Retrial in the High Court

The plaintiffs brought the case to the high court again, and its hearing of the case thus meant there was a second retrial of it.\textsuperscript{309} The high court focused on three issues: (1) who assumed to the loss of the company; (2) the amount of the loss of the company; and (3) the degree of causation between the investment decision and the loss.\textsuperscript{310}

\begin{itemize}
  \item \textsuperscript{305} \textit{Id.}
  \item \textsuperscript{306} \textit{Id.}
  \item \textsuperscript{307} \textit{Id.}
  \item \textsuperscript{308} \textit{Id.}
  \item \textsuperscript{309} \textit{Id.}
  \item \textsuperscript{310} \textit{Id.} at 39-40.
\end{itemize}
First, the high court held that all directors and supervisors who joined the decision-making process should be liable for the loss of the investment due to a breach of the bylaws and of their obligations of loyalty and diligence.\textsuperscript{311} The bylaws stated that any investment proposal should be brought by a board meeting and be approved at a shareholder meeting. However, the directors invested the aquatic farm without getting approval at a shareholders meeting, and this decision caused the company to incur a loss of.\textsuperscript{312} Meanwhile, the supervisors were also liable for the loss the company has suffered because of their fiduciary duties, as stated in the bylaws.\textsuperscript{313} These stated that supervisors were obligated to supervise directors’ and managers’ conduct that might violate the bylaws or laws, to correct their conduct that might hurt the company’s interests, and to interim shareholder meetings as needed.\textsuperscript{314} 

The supervisors had acknowledged the investment and understood that the decision-making process had disobeyed the bylaws, but had not arranged a board meeting or shareholder meeting to correct the directors’ conducts that caused the loss of the company.\textsuperscript{315} Hence, the supervisors were also liable for the losses the company suffered.\textsuperscript{316}

\textsuperscript{311} Id. at 39.

\textsuperscript{312} Id.

\textsuperscript{313} Id.

\textsuperscript{314} Id.

\textsuperscript{315} Id.
Second regarding the amount of damages, the plaintiff submitted the detailed appraisal of the loss of the investment, which stated the total figure was 327,172.46 RMB. Yet the plaintiff did not submit new evidence to estimate the total loss of the company but simply rebutting the appraisal. Hence, the high court accepted the appraisal provided by plaintiffs and decided the total loss of the company was 327,172.46 RMB.

Third, the high court held that the wrongful process of decision-making caused the loss of the investment, so the defendant was liable for the damages to the company. However, the court figured out three reasons to limit the amount of the damages: (1) the illegal process of decision-making was just one factor that caused a loss to the company; (2) the lack of shareholders’ approval was not the only decision-making step that might cause a loss to the company; (3) and the chairman and other managements had almost fulfilled their obligations of loyalty and diligence, such as working on field research and arranging two

316 Id.
317 Id.
318 Id.
319 Id.
320 Id. at 39-40.
chairman meetings.\textsuperscript{321} Given these reasons, the court held that the amount of the chairman's monetary damages should not exceed the one-third of the total loss, which is 109057.49 RMB.\textsuperscript{322} The court also held that after reimbursing to the company, the chairman was capable to file the joint liability lawsuits against all other directors and supervisors who joined the decision-making process of the aquatic farm.\textsuperscript{323}

4.4.3. The Reasons to Exculpate the Amount of Monetary Damages

In a law review article, the presiding judge of the second retrial briefly explained why she reduced the monetary damages of the chairman to one-third of the total loss of the company.\textsuperscript{324} Instead of compliance with the law, in reality, the operation of daily business affairs and important decision-making was carried out thanks to the tacit cooperation among shareholders, such as compromising with each other because of the highly overlapping members who attended and board meetings.\textsuperscript{325} Moreover, all of twenty-two shareholders of the company, which

\begin{itemize}
\item \textsuperscript{321} \textit{Id.} at 40.
\item \textsuperscript{322} \textit{Id.}
\item \textsuperscript{323} \textit{Id.}
\item \textsuperscript{324} In the comment of the four trials, she spent most of the pages on the procedure of the derivative lawsuit and the capacity to be parties of the litigation. It seemed that the author intentionally evaded the issue of the exculpation without the authorization of the law. \textit{See Id.} at 40-42.
\item \textsuperscript{325} \textit{Id.} at 42.
\end{itemize}
included all seven directors and three supervisors, owned equal shares.\textsuperscript{326} As for the company's business operations, it never arranged a board meeting or a shareholder meeting when the defendant chairman held his position.\textsuperscript{327} Instead, many major decisions were made at the meetings named “chairman meetings” and “company meetings” that were not the legal institutions recognized by the company law.\textsuperscript{328} If all business operations were void due to an illegal decision-making process, it apparently did not fit in the practices of the real business world in China.\textsuperscript{329}

When it came to the process of investing the aquatic farm, many supervisors and shareholders joined the field research at the farm, calling two chairman meetings to work on arrangements for building the aquatic farm.\textsuperscript{330} This evidence showed that related directors and supervisors acknowledged and participated to the proposal and establishment of the aquatic farm; consequently, directors and supervisors who joined the decision-making process should have been liable for the company's losses.\textsuperscript{331} However, considering their efforts and the company's long-term illegal decision-making process, the monetary damages should be the one-
third of the company's losses. The judge interpreted that this decision was more in accordance with the practices of the Chinese business world and was more effective to solve the contradiction even though it was a bold decision.

4.4.4. The Comment on the Wujin Case

Due to the limited and excerpted contents stated in the law review article, it is difficult to comment on this series of trials from a single legal perspective; however, based on considering it, one can conclude that the multiple systematic problems of the Chinese legal structure are apparently severe. For example, the trial court found that the defendants were liable for the loss of the investment, but the judgment was for the defendants on account of the failure to appraise the amount of the loss of the company. How could the plaintiffs lose a case under this kind of situation? The amount of the loss could be calculated by the plaintiffs under the instruction of the court or by the court itself. Thus, the trial’s outcome was very unforeseeable.

On the contrary, the intermediate court recognized the plaintiffs’ allegation that the chairman should reimburse the company for the loss. Although the impact on the defendant might be too severe, the result of the intermediate court was more likely a legally reasonable judgment. However, the high court reversed the

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332 Id.

333 Id.
judgment, and a retrial was brought to the intermediate court. The article did not mention why the high court thought a retrial was necessary, but, apparently, it believed that the appeal judgment made by the intermediate court was defective. This might imply that following the Company Law was not the applicable approach to make a good decision.

The result of the first retrial that was reviewed by the intermediate court was different from the appeal trial made by the same court. The plaintiffs lost the case because of failing to carry the burden of proof. Meanwhile, the retrial held that the chairman was the only person liable for the losses to the company, rather than all related directors and supervisors. The retrial showed that someone had to be liable for the loss of the company as a matter of law, but no one had to pay for it in reality. This might imply that letting the defendant pay nothing was a better result than mandating them to pay everything.

In the second retrial, the high court held that all related directors and supervisors were liable for the loss of the investment. However, the chairman was the only defendant in this trial. How could other related people be liable without being sued? Moreover, the court ruled that the amount of the monetary damages was one-third of the total loss of the investment. How could the court reduce the amount of monetary damages with no exculpatory provision in the company law?334

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334 Comparing to the WorldCom settlement, ten directors of WorldCom agreed to pay $18 million of their own pocket, which is part of the total $54 million settlement. Coincidentally, the liability of former chairman of Wujin case was also the one-third of the loss of the company. From the worldwide enterprise to a small LLC in
Nevertheless, this might imply that the Company Law of China needs the flexibility of the exculpatory provision to moderate its currently rigid Articles.

As the judge of the second retrial mentioned in her law review article, this result was better suited in the “real world” and was more effective in resolving the paradox between both parties. A judge would rather reduce the monetary damages with no exculpatory provision to justify the judgment. Why not give judges the legal foundation to do that?

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5. The Proposal to the Chinese Due Care Law

5.1. Overview

This chapter starts with the analysis of the Chicago Coliseum Club v. Dempsey case. This case was strongly influenced by the culture, but nothing in the ruling itself referred to the cultural factors that had influenced it.

The context of the Dempsey case is very similar to the Wujin case. Since Chinese Company Law does not have the exculpatory provision, the ruling in the Wujin case would have to have been as sophisticated as in the Dempsey case in order to persuade all interested parties that it was necessary to limit the total amount of monetary damages the defendant had to bear.

The time and resources consuming of such judgments would have been a huge burden to Chinese courts, so that amending the exculpatory provision in the Chinese Company Law might be a better way to save judicial resources and to balance the consequence of the case. This chapter also summarizes U.S. scholars’ proposals for the duty-of-care law as a reference point for suggested reforms of the laws concerning the Chinese obligation of diligence. Finally, this chapter predicts the ex ante consequences of the proposed reform.

335 265 Ill. App. 542 (1932).
5.2. The Influence of Historical Background and the Impact on the Social Atmosphere of a Lawsuit—Chicago Coliseum Club v. Dempsey

The cases introduced in Chapter 3 and Chapter 4 showed that judges in Taiwan and China had to consider the historical background and socio-economic environment to judge the cases at hand. Inevitably, American judges had the same concern as well. As detailed below, the Chicago Coliseum Club v. Dempsey case was, like the *Wujin* case, made given uncertainty about the cause and extent of damages. If the obligation of diligence was derived from Chinese civil law, then judgments made by Chinese courts should be at least as clear and detailed as the *Dempsey* case to gain the respect of both parties and of the general public.

5.2.1. The Fact

The Chicago Coliseum Club, the plaintiff, was an Illinois corporation that conducted boxing and wrestling matches. William Harrison Dempsey, the defendant, held the title of World Heavyweight Champion boxer from 1919 to September 23, 1926.
Both parties signed a contract stating that the plaintiff was to promote a public boxing exhibition to engage Harry Wills to challenge the defendant’s title of the championship. 338 Although the defendant only received $10 as a down-payment, he would earn a total of $800,000 before the date of the match and a sum equal to 50% of the net profits over and above $2,000,000. 339

The defendant, Dempsey, was obligated to have his life and health insured and not to engage in any boxing match from the date of the agreement to the date of the match. 340 The bearing date of the contract was March 6, but it was executed on March 13, 1926. 341

On March 6, 1926, the plaintiff signed a contract with Harry Wills. 342 Wills agreed to engage in a match with Dempsey, and the plaintiff had to deposit $50,000 in escrow to make sure that Wills would be paid ten days prior to the match. 343 However, the money wound up being neither deposited in the bank nor paid to Wills. 344

338 Id. at 545.
339 Id.
340 Id.
341 Id.
342 Id.
343 Id.
On March 8, 1926, the plaintiff had entered into an agreement with Andrew C. Weisberg, an experienced promoter of boxing matches. Weisberg agreed to furnish funds to organize and promote the Dempsey-Willis match and was to be reimbursed from the sale of tickets, along with a certain amount for his services. The amount of monetary damages claimed by the plaintiff was predicated upon these two agreements.

With the match scheduled for September 1926, on July 10, 1926, the plaintiff wired Dempsey stating that the representatives of the insurance company would contact him, asking the defendant to start training no later than August 1, 1926. Dempsey replied by telegram to the plaintiff: “President Chicago Coliseum Club Chgo Entirely too busy training for my coming Tunney match to waste time on insurance representatives stop as you have no contract suggest you stop kidding yourself and me also”.

5.2.2. The Uncertainty of the damages

344 Id. at 546.
345 Id.
346 Id.
347 Id.
348 Id. at 546-47.
349 Id. at 547.
Dempsey signed the document and the amount listed under this document was large enough for the court to hold that there was a contract between the two parties.\textsuperscript{350} Meanwhile, the language of the telegram that Dempsey replied to the plaintiff showed that Dempsey did not want to honor the contract. Hence, if for no other reason, the judgment should have been for the plaintiff,\textsuperscript{351} who should at least have been entitled to nominal damages.

The court further examined possible monetary damages based on four factors that concerned whether the plaintiff’s losses and expenses could be reimbursed:\textsuperscript{352} (1) loss of profit; (2) expenses incurred by the plaintiff prior to the signing of the contract; (3) expenses incurred in attempting to restrain Dempsey from breaching the contract; and (4) expenses incurred from the signing of the contract to the breach. Ultimately, for the reasons explained below, the plaintiff got almost nothing.\textsuperscript{353}

On factor one, loss of profit, the court said that the success or failure of the match might significantly influence the profit arising from it, though this

\textsuperscript{350} \textit{Id.}

\textsuperscript{351} \textit{Id.} at 548.

\textsuperscript{352} \textit{Id.} at 548-49.

\textsuperscript{353} \textit{Id.} at 549.
depended in part on the skill of the promoter, the reputation of both contestants, and even on such other factors as weather conditions and the accessibility of the venue, etc.\textsuperscript{354} After all, profits from sports events were not as stable as those from regular, organized business endeavors.\textsuperscript{355} The court then ascertained the extent of monetary damages “by the usual rules of evidence and to a reasonable degree of certainty.”\textsuperscript{356} The $1,600,000 profit estimated by the plaintiff was deemed purely speculative.\textsuperscript{357}

Concerning factor two, expenses incurred by the plaintiff prior to the signing of the contract, the court determined that any obligations prior to the point when the agreement was consummated were not chargeable to the defendant.\textsuperscript{358} Moreover, there was no evidence that the plaintiff was legally responsible for these expenses.\textsuperscript{359} Even if he had been, this was not an element of damage that could be recovered for breach of a contract.\textsuperscript{360}

\begin{flushleft}
\textsuperscript{354} Id. at 549-50.
\textsuperscript{355} Id. at 550.
\textsuperscript{356} Id.
\textsuperscript{357} Id.
\textsuperscript{358} Id. at 551.
\textsuperscript{359} Id.
\textsuperscript{360} Id.
\end{flushleft}
On factor three, expenses incurred in attempting to restrain Dempsey from breaching the contract; the court only admitted expenses such as filing a bill in the Superior Court of Marion County, Indiana as legitimately incurred.\textsuperscript{361} Any other expenses necessary process, such as trips to Colorado and Philadelphia, or attorney's fees did not incur for the purpose of preventing Dempsey from breaching the contract.\textsuperscript{362} Moreover, neither the reimbursement for attorney's fee nor the required action for specific performance was mentioned in the agreement.\textsuperscript{363} Therefore, the court held that this element of damages was not recoverable.\textsuperscript{364}

Concerning factor four, expenses incurred from the signing of the contract to the breach, the plaintiff documented the expenses incurred for Weisberg's services. However, his compensation depended entirely on the attendance at the match.\textsuperscript{365} The court did hold that special expenses incurred between the date of the signing and the breach of the contract be reimbursed, such as the expenses of Hoffmann in going to Colorado and

\footnotesize
\begin{itemize}
  \item \textsuperscript{361} \textit{Id.}
  \item \textsuperscript{362} \textit{Id.} at 552.
  \item \textsuperscript{363} \textit{Id.}
  \item \textsuperscript{364} \textit{Id.}
  \item \textsuperscript{365} \textit{Id.}
\end{itemize}
physically examining Dempsey for the purpose of insurance. After all, these recoverable expenses would be extremely limited.

5.2.3. The Historical Background of the Dempsey Case

Dempsey did break the agreement. If a person has to pay for not fulfilling his/her own obligation, and thus caused the loss of such a huge amount of money, the amount of the monetary damages should be significant. Nevertheless, Dempsey almost paid nothing for the breach of contract. How could this judgment be fair?

Examining the first factor, the court believed that the success or failure of the contest was influenced by many factors, such as the promoter’s ability, the reputation of both contestants, and even the weather conditions and the accessibility of the venue. While this argument rings true, it does not lead to the conclusion that the amount of the loss of profit is speculative. After all, some estimate can be made of the anticipated profit. Most factors mentioned by the court actually can be controlled by experienced promoters and their teams. Based on the facts in the case, Dempsey had the choice of honoring the agreement or not. It does not make sense that such a huge amount of loss caused by him would only lead to a result that there is nothing

\[366 id. at 553-54.\]
to be reimbursed, just because the amount of lost profit supposedly is speculative.

Is there anything that matters here besides the legal matter at hand? The answer might be that there are larger issues of race and the society. The judgment did not mention that Wills is a black man. However, Dempsey was accused of racial discrimination against Wills because of the color issue, and he argued that “[a]ny promoter who could or would have put up the money for my end of the purse could have had the fight. But no one came forth.” He also said that:

Wills’s fate was hampered by two shadows. First, he was black, and although in the 1920s blacks were permitted to fight for the title in lower divisions, they were not allowed to compete for the heavyweight crown. This situation was an heirloom of Wills’s second shadow: Jack Johnson. Every time a Wills-Dempsey bout was proposed, the image of the gold-toothed, smiling former champion surfaced in the minds of race-conscious promoters. All black heavyweights between 1908 and the mid-1930s were handicapped by the stigma of Jack Johnson. It became so difficult for a black to get a match with a good white fighter that the leading black boxers were forced to fight each other numerous times.


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367 NAT FLEISCHER, JACK DEMPSEY 134 (1972).
Besides the arrogance of white people, the racial violence triggered by Johnson’s successful defense of his championship against James J. Jeffries, a black boxer, on July 4, 1910 led to this result:

Almost as soon as the gloves were cut off, a wave of interracial rioting and violence swept the country. In Little Rock two blacks were killed by whites; in Houston a white cut a black to death; in Roanoke six blacks attacked a white, and whites retaliated with a “lynching bee”; in Atlanta a black ran “amuck” with a knife; in Washington, D.C., two whites were fatally stabbed by blacks; in New York, one black was beaten to death and scores were injured; in Pueblo, Colorado, thirty people were killed by white assailants. Every section of the country experienced the racial violence and the Johnson-Jeffries fight was named as the catalyst....


Considering the gravity of the racial issue, it was understandable that the judges preferred to reduce Dempsey's monetary damages as much as they could. The truth was that the socio-economic atmosphere in 1920s did not allow the contest to be held. Therefore, the damages should not be solely put on Dempsey’s shoulders.

5.2.4. Comparison to the Wujin Case

The legal similarity between the Dempsey case and the Wujin case was that both courts strove to reduce the amount of monetary damages, given the
need to balance the rights of both parties and given the unmentioned but important racial/business atmosphere that overlay both judgments. These are subject matters that cannot be brought to the table but should be considered as part of the “big picture”. In the United States, the whole country had been roiled by the racial violence caused by the boxing contest. Given what happened after the Johnson-Jeffries fight, American society, including Dempsey himself, was too tense to consider any more interracial bouts that might lead to additional hatred and violence.

Moreover, Dempsey did not receive the $5,000 down payment. Therefore, he should not have been the one who had to take the whole responsibility for the fight cancellation. Eventually, the Illinois Court of Appeals almost eliminated Dempsey’s monetary damages under the doctrine of uncertainty, which means the amount of the monetary damages is uncertain so that the plaintiff cannot be reimbursed.

In China, on the other hand, the main problem is that most of the companies, especially the LLCs, are not in compliance with the Company Law. Many companies do not arrange board or shareholder meetings regularly. Moreover, some companies never arrange any meetings that are required by the law. If the directors make a fortune, no one questions whether their decision-making process is proper or not. On the contrary, if the decision-
making leads to the loss of the company, the directors will be questioned no matter how sound a decision they made.

Following the law, the defendants had to take either all or none of the responsibility for the loss of the company, based on whether the decision-making process was legally defective or not. The problem is that judges have to consider the possible impacts of their rulings on society to make their own decisions. In this kind of culturally and socially influential case, the judgment that strictly follows the law may not make sense to the general public, no matter what the ruling was. So in this instance, the judges decided to cut the defendant’s monetary damages to one-third of the total loss that the company suffered.

However, the judges were not empowered to reduce the amount of monetary damages. In order to follow the law, they are not allowed to do that. Therefore, it is difficult for judges to strike a balance between the rule of law and the norms of society. The most reasonable way is to empower the judges to adjust the amount of monetary damages so that they can make fair decisions that also are acceptable for both parties and for the broader society.

The difference was that the Dempsey and the Wujin cases followed the contract law and the corporate law approaches, respectively. Since the exact nature of the obligation of diligence of China has not been determined
yet, following the approach of the contract law to handle a business case is still a possible and reasonable solution.

The only concern is that the theory of uncertainty is not a general rule for calculating damages. To apply this kind of exception, the judges should be much more nuanced about making this kind of decision, i.e., it may be more intellectual and time consuming than other ordinary cases. Introducing the exculpatory provision to the Chinese Company Act might be a reasonable and economic solution that empowers judges to adjust the amount of monetary damages case-by-case so as to monetarily concretes the legitimacy of the judgment and to solve the dispute.

5.3. The U.S. Scholars’ Proposals to the Reform of Delaware’s Due Care Law

Since most of scholars of China recognize that the obligations of loyalty and diligence are derived from common law, the interpretation and application of the fiduciary duty of the United States, especially in the State of Delaware, is an influential source concerning the obligations of loyalty and diligence. The dispute Delaware has created regarding fiduciary duty, a position that gives full weight only to the duty of loyalty, is very similar to the status quo in China, where most fiduciary-based cases and secondary resources are only related to the obligation of loyalty. However, the revival of the duty of care is also a meaningful development that may
enhance the function of the spectrum of the fiduciary duty in Delaware. Therefore, any proposal for reforming the duty of care in Delaware will be relevant to reforming the obligation of diligence in China. We thus now turn to four proposals for improving the situation in Delaware, with an eye to adapting them for the case of the obligation of diligence.

5.3.1. Proposal 1: Modification of the Delaware General Corporate Law Section 102(b)(7)

Professor Elizabeth Nowicki proposes directly changing the language of DGCL Section 102(b)(7) itself. In particular, she argues modifying the law so that it sets a limit to the personal liability faced by a director for breach of the duty of care. In any given case, this upper limit would be whichever of the three following values is greatest: (1) the benefit the director received as a direct result of his/her due-care violation, (2) the director’s compensation during the year(s) in which violation took place, or (3) $80,000.368

The first possibility simply returns the money back to the company without garnishing a director’s personal assets. The second follows from the

368 These features are modified from Elizabeth A. Nowicki, Director Inattention and Director Protection under Delaware General Corporate Law Section 102(b)(7): A Proposal for Legislative Reform, 33 Del. J. Corp. L. 695, 712 (2008). (“A provision limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of a fiduciary duty to the greatest of (i) the benefit received by the director as a result of the fiduciary duty violation, (ii) the compensation received by the director from the corporation in the year or years of the fiduciary duty violation, or (iii) $80,000; provided that such a provision shall not limit a director's liability for willful misconduct, for a knowing violation of the law (including, without limitation, any claim of unlawful insider trading or manipulation of the market for any security), or under section 174 of this title; and provided that the amounts in (i), (ii), or (iii) cannot be indemnified and cannot be insured.”)
faithless servant doctrine, which states that employees do not deserve payment for a period of faithless service.\textsuperscript{369} The third is a specific monetary amount, which, Prof. Nowicki argues, establishes a credible threat of punishment without going so far as to deter directors from serving.\textsuperscript{370}

The primary rationale behind Prof. Nowicki’s proposal is that while personal due-care liability needs to be limited, it should not be eliminated altogether. Directors are more likely to take care in making business decisions if they know that they themselves will face real consequences for negligence or wrongdoing. Without this concern, they are naturally more likely to make reckless decisions.\textsuperscript{371} Therefore, if we want directors to be careful and responsible, we should at least make it possible for them to be held personally liable for breaching their due-care. But we do not want such personal liability to be unlimited, either, especially in light of \textit{Smith v. Van Gorkom} and the fall-out from its excessive damages. Capping directors’ personal liability, as Prof. Nowicki suggests, is thus a reasonable compromise.

5.3.2. Proposal 2: Awarding attorney fees to unsuccessful litigants according the Common Benefit Theory.

\textsuperscript{369} \textit{Id.} at714.

\textsuperscript{370} \textit{Id.} at714-15.

\textsuperscript{371} About the behavior-influencing value of the threat of punishment and the awareness of being monitored, \textit{see Id.} at 702-06.
Attorneys ordinarily may not want to accept contingency fees as remuneration for cases involving due care because such cases are so difficult to win, and so they may not be interested in spending time and effort with no assurance of a reward. Moreover, regardless of whether the derivative plaintiffs win the case, they must pay the attorney fees. In addition, even when derivative plaintiffs win their cases, the financial awards they should receive may flow only to the corporation, not back to the derivative plaintiffs themselves. This uncertainty may discourage shareholders from alleging cases involving the breach of due care even when the breach is blatant.

Derivative plaintiffs who win due-care cases are already awarded attorney fees. In his article, “A Modest Proposal for Fixing Delaware’s Broken Duty of Care,” George P. Miller suggests that these awards be extended to the derivative plaintiffs who lose such cases. This would encourage plaintiffs to file independent lawsuits under duty-of-care law even though they may be unsuccessful in proving the directors’ liability. Miller argues that the Delaware Chancery Court should be given discretion to hold that “[an unsuccessful] plaintiff has performed a service to the corporation by bringing credible allegations of gross negligence to the court for review and should therefore be entitled to reimbursement for the costs of bringing the suit.” In addition, because it encourages due-care litigation, Miller’s proposal would make it easier for shareholders to influence management through external influences, i.e., is, a due-care lawsuit would likely generate

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focused, critical scrutiny of the corporation, especially its directors, which the shareholders could then use as a means of exerting external control on the corporation’s management.

5.3.3. Proposal 3: Avoiding Litigation through Judicial Inquiry

Miller also advocates judicial inquiry as a more economical way to take advantage of legal protections and external controls than the due care claim offers. Judicial inquiry is simple and non-contentious business. Applied to the duty of care, the judicial inquiry process would proceed as follows: 373

1. The corporation’s shareholders would file a petition against the corporation and its directors.
2. The directors would have a reasonable amount of time to respond to the petition and offer an argument for not proceeding.

The chancery judge would then review the materials and decide whether or not to initiate the inquiry. If he/she decides to proceed, the judge would appoint a council to “conduct discovery, including document production and oral depositions under oath of fact and expert witnesses.” 374 Such a procedure might be significantly less expensive and time-consuming than litigation. Moreover, judicial inquiry is an open procedure, i.e. the general public would be able to learn

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373 The procedure of the inquiry is a revised and simplified version from the proposal of Prof. Geoffrey P. Miller. See id. at 336-37.

374 Id. at 337.
about a company’s due-care judicial inquiry and would thus be able to evaluate its stock price accordingly.

5.3.4. Proposal 4: Expanding indemnification powers as an alternative to exculpation

Since statutory provisions give corporations indemnification powers, they can reimburse directors if they are required to pay damages for breaching due care. Indemnification can thus be seen as an alternative to exculpating the breach of due care and in fact eliminates the duty of care; i.e., the existence of indemnification does not prevent directors from being held liable for breaching their duty of care. However, one major disadvantage of indemnification is that it can effectively absolve a director from his/her legal liability if the corporation chooses to pay all of his/her damages. In such a case, shareholders ultimately shoulder the responsibility for damages.


376 *Id.*

377 *Id.* at 442. (“Although at least four other states have changed from exclusive to nonexclusive indemnification statutes, indemnification expansion is an unwise and ineffective method of reform. A shareholder who wishes to sue a board of directors may learn that, although each director owes a duty of care to the corporation, the corporation has indemnified the directors for any breach of that duty. The result of a judgment in such a derivative suit is circular because the corporation must pay itself any damages, and, through the demand process, the board of directors or a special litigation committee of the board would undoubtedly refuse a shareholder demand to bring suit under these circumstances.”)
5.4. Ideas to Fit the Duty of Care in the Chinese Company Law

A legal concept from common law cannot fit in the civil law legal system without being modified. In common-law jurisdictions, the concept of the fiduciary duty has evolved from innumerable precedents. China’s legal system, on the other hand, is based on civil law. Thus, the obligation of diligence is merely a legal term; it lacks the content that a long history of precedents would provide. This is the primary reason for the uncertainty and disagreement over the obligation’s meaning. In China’s legal system, it is not sufficient simply to introduce a foreign legal concept; rather, any legal concept must be codified before it can be applied as law. This would be true whether the obligation of diligence was adopted into the common law or the civil law idea.

Given the choice, however, the common law view is preferable to the civil law view, as it is more beneficial to the overall business community. But it nevertheless requires additional clarification in the form of codification. Moreover, the common-law view is not perfect and could be improved through certain codified adjustments, especially with regard to the duty of care and the exculpation of damages arising from the breach of this duty.

5.4.1. Introducing the Adjusted Spectrum of Fiduciary Duty to Chinese Company Act
Because the definition and content of the obligation of diligence have not yet been fully developed, this is a good time to introduce the spectrum of fiduciary duty to China to provide the Company Law with more flexible ways to solve problems. Since the directors owe two different obligations of loyalty and diligence to the company, the legal consequences of both obligations should be different. It would be unreasonable to establish two obligations that have the same legal effect. The spectrum of fiduciary duty in Delaware provides a moderate model that just needs to partially revive the function of the duty of care in order to fit in with Chinese legal and social tradition.

The first step to revive the function of the duty of care is to construe this duty as an independent claim that can be solely brought to the court. It could provide public investors with additional protection from both the internal and external control perspectives. First, the legal and internal control perspective is that the more claims that can be alleged, the higher the possibility for the plaintiffs to win the case. However, Delaware law currently stipulates that plaintiffs can allege due-care claim only when the defendants have also breached the duty of loyalty. In other words, the defendants are not liable for the breach of duty of care, no matter how incompetent they were, provided that there is no breach of the duty of loyalty. On the contrary, if the duty of care is interpreted as an independent claim, this type of claim could protect shareholders from any losses caused by directors who care little about business operations. It is hard to
prove bad faith or establish a claim of waste, so the due care claim might be shareholders’ last available form of protection.

Second, the supervisory and external control perspective is that once the plaintiffs allege a due-care claim against the directors of a public company, their lawsuit will attract public attention. Under the semi-strong market hypothesis, the influence of positive or negative material information is reflected in the stock price after the information is disclosed. Negative information regarding unlawful or improper conduct on the part of directors is disclosed to the general public as part of the alleged breach of due care as noted in a lawsuit. The market adjusts the stock price to a new price based on this information. However, if the duty of care is not an independent claim, the information will not be disclosed to the general public because no one would like to claim a lawsuit that will definitely be dismissed. Therefore, as long as the duty of care is construed as being an independent claim, the internal functions, fiduciary lawsuits, and external functions, supervision from the securities market, of the duty of care will be fully realized.

5.4.2. A Quasi-Exculpation that only Limits the Liabilities of Public Companies' Directors by Administrative Sanctions

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378 The description of semi-string market hypothesis, See Stephen A. Ross et al., Corporate Finance (2010), reprinted in Foundations of Corporate Law 52, 57 (Roberta Romano ed., 2010). (“A market is semi-strong form efficient if prices reflect (incorporate) all publicly available information, including information such as published accounting statements for the firm, as well as historical price information.”)
After reviving the function of the duty of care, the question remains: How can China avoid the possibly severe impact on its society as happened with as *Smith v. Van Gorkom* (1985). After all, given the turbulence caused by the Van Gorkom case, it is understandable that in 1986, the Delaware General Assembly chose to let the duty-of-care law become defunct.

During almost thirty years, the Chancery Court and the Supreme Court of Delaware made a series of rulings to expand the meaning of fiduciary duty, and many articles have been published that contest the courts’ decisions and tried to reform the expanded meaning of fiduciary duty. By learning the lesson of Delaware, Chinese society should not go through as difficult a time as Delaware did to gain a moderate duty-of-care law.

The U.S. judges and scholars rebuilt the spectrum by limiting the scope of the application and the strong power of provision DGCL 102(b)(7), which specifies the protection of the business judgment rule and reminds directors that they are still obligated in the duty of care to the company and liable to limited monetary damages caused by grossly negligent conduct.

This idea properly fits the Chinese legal system and the social atmosphere for several reasons. First, it does not make sense to adopt a defunct legal concept to a Chinese Company Act because adapting a legal concept must have at least a certain clear goal. Second, the relatively powerless obligation of diligence is
acceptable since its elements do not contain bad faith. Acting in a neglectful way, even grossly so, might be forgivable in Chinese society, though a certain level of punishment is still necessary to strike the balance between retribution against the directors’ for bad corporate behavior and the people’s notion of justice.

The next question is: Where to establish limits to directors’ liability? Professor Nowicki believes a capped liability of no more than $8,000 establishes a credible threat of punishment without going so far as to deter directors from serving. Would such a standard be suitable to contemporary China? There are two possible ways to cap the liability for the breach of obligation of diligence, by a certain limited range of percentage or by a capped amount of monetary damages. For example, Article 199 of the Company Law stipulates that a company or person who submits deceptive information or conceals the material facts, in violation of ensuring the company’s capital adequacy of the company, can be fined in the range of 5-15% of the shortage amount of money or from 50,000RMB to 500,000RMB ($8,200-$82,000). However, capping the liability for the breach of obligation of diligence by a percentage could lead to unforeseeable legal consequences, since the total loss of the company could be extremely large. A certain percentage of the total loss still can be a huge amount of money that is unaffordable for the liable directors. The unaffordable and unforeseeable monetary damages were the key elements that caused the turbulence among directors after the Smith v. Van Gorkom decision. Hence, limiting the
monetary damages to a certain percentage of the total loss may not effectively enhance the function of the obligation of diligence.

On the other hand, limiting the monetary damages for the breach of this obligation might be a more stable way to strike the balance between the interests of directors and shareholders because limited monetary damages will be affordable and predictable. For example, ten directors of WorldCom agreed to pay $18 million of their own pocket, which is part of the total $54 million settlement. This represents somewhat of a compromise between damages so large that they would bankrupt an individual director and full exculpation. However, the Chinese approach is different from the exculpatory provision in Delaware or the settlement in New York. I call it “quasi-exculpation,” an administrative fine to public companies’ directors who have breached their obligation of diligence. Take the Ding Liye case, in which the defendant directors were sanctioned for 30,000 RMB, approximately $5,000, for the breach of the obligation of diligence because of fraudulent information on the company’s annual report.

The directors of China are potentially liable to pay a certain amount of money, so they should be aware of the possible liability for the breach of obligation of diligence. The Chinese approach is an administrative sanction, that also involves a monetary penalty and that is imposed by the CRSC and is

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different from the exculpatory provision regulated in DGCL 102(b)(7), which authorizes Delaware corporations to limit or eliminate the amount of monetary damages. Hence, the Chinese approach is different from Delaware's; however, they seem to share similar legal consequences that try to strike a balance between the protection of directors and shareholders only if the liability for the breach of the duty of care is limited rather than eliminated.

The Chinese approach to limit director's liability for the breach of the obligation of diligence is unique, but it still makes sense under the country's legal and social system. As mentioned in chapter 4, the restrictions on bringing a derivative lawsuit are extremely tight. As a result, it is nearly impossible for a public company's shareholders to file a derivative lawsuit against its directors.

Under the general rule of the distribution of the burden of proof in a civil case, the plaintiffs have to prove that the defendants breached their obligations of diligence. This procedure is similar to the process of the business judgment rule, but the difference is that the demand of the burden of proof is not as high as in Delaware, i.e., the plaintiffs should have a 50-50 chance of winning the case. That would not be a problem if the total amount of monetary damages were not potentially so large that an ordinary director of a public company could not afford to cover a judgment against him or her.
The plaintiff might lose the case because judges would rather choose a relatively less severe way to maintain stable business functioning. Under these circumstances, filing an administrative sanction might be one alternative solution to supervise director’s obligation of diligence.

The legal resource for CSRC to file an administrative sanction in the Ding Liye case was Article 193 of the Security Act, which states that the company and other people involved in promulgating fraudulent information are liable for fines ranging from 300,000-600,000RMB ($50,000-$100,000) and from 30,000-60,000RMB ($5,000-$10,000), respectively. Article 193, when considered along with Article 58 of the AMDI, posits that filing a fraudulent report is a breach of the obligation of diligence. Directors of a public company may become liable quite easily for the breach of this obligation.

However, due to restrictions on the derivative lawsuit, such a case is nearly impossible to bring to court. Even so, directors might lose their case in a civil trial because of the possibly conservative inclination of the judges. Since the main thrust of this dissertation is not to argue for the reform of the derivative lawsuit, all the reforms of the obligation of diligence suggested are based on current law, especially in the area of derivative lawsuits.
Under the current legal system, it is nearly impossible to file a lawsuit against a public company’s directors, so the administrative sanction made by CSRC in fact often is the only way to punish a public company’s directors who breach their obligation of diligence. I do not argue here that this is a good approach, due to my respect for the supervisory authority, especially in a jurisdiction where everybody cares about administrative powers so much. I argue instead that the directors of a public company are sometimes people who actually neglect their obligations to such an extent that they, rather than the company itself, deserve to be punished.

The company cannot engage in gross negligence that may breach the obligation of diligence but the directors can. Meanwhile, the amount of the punishment to a single director is in the range from 30,000-300,000 RMB ($5,000-$50,000), which is far too little to remind a director to fulfill his/her fiduciary duty. On the other hand, the amount of the punishment to a public company falls in the range from 300,000-600,000 RMB ($50,000-$100,000), an amount that seems an effective deterrent to people who breach their obligation of diligence.

There is no record showing how the Chinese legislature derived this range; however, compared to Prof. Nowicki’s proposal that caps the amount of monetary damages to $80,000, taking $100,000 as the highest amount of the administrative sanction in contemporary China is hardly outrageous.
Meanwhile, due to the faithless servant doctrine, directors do not deserve payment for a period of faithless service. That is, the director’s compensation during the year(s) in which violation took place should be reimbursed to the company. Therefore, I suggest that the administrative sanction should be directed at the director who breached the obligation of diligence rather than the company, and the amount of the punishment should be the greater amount of the compensation during the faithless service or 600,000 RMB, approximately $100,000.

5.4.3. A Semi-Exculpation that onlyLimits the Liabilities of Non-Public Companies’ Directors

Based on Article 3 of the Company Law, there are two kinds of non-public companies in China, the limited liability and the joint stock limited company. Their counterparts in the West are, respectively, the LLC and the corporation. Since the CSRC only supervises the publicly traded company, there is still a need for greater private enforcement of fiduciary in China. For the easy access to the private enforcement, the restrictions on triggering the procedure should not be too severe.

According to Article 151 of the Company Law, a single shareholder of a limited liability company is eligible to file a derivative lawsuit against its directors. However, a shareholder(s) of a joint stock limited company has to
separately or aggregately hold more than 1% of the total shares of the company for more than 180 consecutive days to file such a lawsuit. Thus, the severe restrictions on filing a derivative lawsuit against directors in fact only apply to the joint limited stock company, whether the company is publicly traded or not. Moreover, sometimes a non-public joint stock limited company can be as large, or larger, as a public one. Under this circumstance, the directors of a huge non-public joint limited stock company neither can be sued by shareholders nor sanctioned by CSRC, i.e., there is almost no way to punish the directors of a huge non-public joint limited stock company who breach their obligation of diligence. In this case, Prof. Miller’s proposal for a non-contentious inquiry might be a possible solution to fulfill the shareholders’ very basic need to contest the directors.

First, the shareholders of a joint limited stock company would file a petition against the corporation and its directors. Second, the directors would have a reasonable amount of time to respond to the petition and offer an argument for not proceeding. The judge then would review the materials and decide whether or not to initiate the inquiry.380 Such a procedure may be significantly less expensive and time-consuming than litigation procedures.

As for the issue that how to set up the limitation of the amount of the monetary damages, it should be the same as the amount of the publicly

380 Geoffrey P. Miller, Supra note 372 at 336-37.
treaded company, which is the greater amount of the compensation during the faithless service or 600,000RMB ($100,000). As mentioned, this amount could establish a credible threat of punishment without going so far as to deter directors from serving. Moreover, directors of a non-public joint limited stock company are already in too difficult a position to be liable for the breach of their obligation of diligence, so limited monetary damages is neither very costly nor easily to be found liable for them.

However, as for the directors of a limited liability company, they can easily be sued, since any company shareholder can individually file a derivative lawsuit against them. They are exposed to a higher risk of being sued, so they need stronger protection from having claims made against them for a huge amount of monetary damages, which could be incredibly enormous. However, more protections do not mean that the highest amount of the limited liability should be reduced. Since the scale of every limited liability company is quite different, a fixed amount of the capped liability may not be enough to be effective in every kind of situation. Therefore, in the case of directors’ breaching of the obligation of diligence in a limited liability company, the judges should have more discretion in deciding a proper amount of monetary damages that is no more than greater of the compensation during the faithless service or 600,000RMB ($100,000).
This design may give judges in all cases that are like the Wujin case the appropriate rule of law to justify their decisions. Moreover, judges of in China people thoroughly understand country’s legal and social culture and the contradictions of both parties. In the Wujin case, the judges believed that limiting the monetary damages to one-third of the total loss of the company was the most appropriate way to settle the dispute. The proper proportion of the monetary damages might be different in every case with regard to the conducts of directors and the total loss of the company.

5.4.4. Awarding the Attorney Fees as the Complimentary Measure

Since the liability for the breach of the obligation of diligence is limited, attorneys may ordinarily not want to accept contingency fees as remuneration, especially because such cases are so difficult to win. Attorneys may not be interested in spending time and effort with no assurance of a reward. In addition, even when derivative plaintiffs win their cases, the damages may accrue only to the company, not back to the derivative plaintiffs themselves. This uncertainty may discourage shareholders from alleging cases involving the breach of due care even when the breach is blatant. Thus, I suggest that the attorney fees should be awarded to the plaintiffs who bring credible allegations for breach of the obligation of diligence for the court to review.\footnote{Id. at 333.} Without this awarding of additional as a complimentary measure of the limited liability, shareholders might
find little incentive to file a lawsuit or a petition against directors who breached the obligation of diligence.

5.5. **The Proposal and its Ex Ante Consequences**

Based on above suggestions, a whole new article of the obligation of diligence of Chinese Company Law should be developed, as follows:

Paragraph 1: Directors, supervisors, and senior managements owe the obligation of diligence to their company.

Paragraph 2: Directors’ liabilities for the breach of the obligation of diligence should be limited. In a joint limited stock company, the amount of director’s monetary damages should be the greater amount of the compensation during the faithless service or 600,000RMB ($100,000). In a limited liability company, the judges should have the discretion to decide how much money the directors should pay; however, here there should also be a limit of either the compensation during the faithless service or 600,000 RMB.

Paragraph 3: Shareholders of a limited joint stock company are eligible to file a petition against a company and its directors, and the directors should have a reasonable amount of time to respond to the petition and offer an argument for not proceeding. The judge would then review the materials and decide whether to initiate an inquiry, the legal effects of which would be equal to a judgment. The party that
loses the inquiry would be able to ask for a higher-level court to review the inquiry. A public company and its leadership should be supervised by the CSRC.

Paragraph 4: The litigation and attorney fees would be awarded to the plaintiffs, provided that they bring credible allegations of a breach of the obligation of diligence to the court.

If adopted, the proposed changes would give potential plaintiffs more incentives to file lawsuits. Without such incentives, no one would ever bother to file a lawsuit, without which the courts would never be able to make a judgment, i.e., we need to motivate the plaintiff to bring a lawsuit before we can have the discussion of fiduciary duty. The proposed Paragraph 4 above awards litigation and attorney fees to plaintiffs as long as their allegations are reasonable. In contrast, in the current Chinese legal system, the possible reward is too little. Potential plaintiffs first have to weigh the costs and benefits and then decide whether they want to proceed with the suit. The proposed Paragraph 4 would help remedy this problem.

At the same time, this proposal may improve behavior through deterrence and through the expressive function of law. Although the directors would not have to pay a huge amount of money for the breach of their obligation of diligence, other consequences came along with the breach of such duty might cause the loss that the

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382 Based on Article 151 of the Company Law, the formula is as follows: (the percentage of winning the litigation)\(\times\) (the percentage of outstanding shares owned by plaintiff shareholders)\(\times\) (the total amount of damages caused by defendant directors)\(\times\) (all the legal costs) + (the potential damages caused by plaintiff shareholders)
directors could not bear. For example, the former chairman of the Wujin company lost his directorship after the lawsuit. This consequence might push directors of China to consult their lawyers for the issue of fulfilling their obligation of diligence, and the lawyers would list a to do list for directors to follow. As time goes by, for both the directors’ and shareholders’ own good, the Chinese business society may establish a standard of the expressive function of the obligation of diligence that fits in the Chinese culture.

Moreover, this proposal would not significantly increase the amount of litigation in China, since only shareholder(s) who have continuously held 1% (or more) of the outstanding shares of the company for 180 days can ask supervisors to sue the director(s). The proposed amendment would not remove these constraints on filing derivative suits.

The proposed amendment should not have a significant effect on insurance premiums. Since directors would no longer have to pay excessive damages, such premiums would not become as unreasonably expensive as they sometimes have been heretofore. Moreover, the proposed amendment does not make Director & Officer Insurance mandatory.

Finally, the proposed amendment would help judges make better decisions. By creating a precedent for unreasonably harsh damages, the court’s decision in Smith v. Van Gorkom ultimately led to legislation that led to the
elimination of the duty of care in Delaware. The amendment proposed in this chapter would prevent a similar chain of events from occurring in China because it would place a cap on directors’ liability.
6. Conclusion

Since the spectrum of the fiduciary duty is the foundation of U.S. corporate law, “transplanting” this duty to China is a practical way of enhancing that country’s Company Law. However, current Chinese law does not focus on the whole spectrum of the fiduciary duty but only on the duty of loyalty. Without introducing the duty of care, the advantage of transplanting the fiduciary duty would be in vain. Without the business judgment rule or the exculpatory provision, the duty of care is just a legal concept with no spirit. Hence, this dissertation claims that it would be beneficial to introduce the business judgment rule and the exculpatory provision to the Chinese business world. Transplanting the business judgment rule is less important because this rule is close to the doctrine of the burden of proof in civil law, so the top priority now is to introduce the exculpatory provision into Chinese law.

The rulings in the Ding Liye and Wujin cases demonstrate the necessity of the exculpatory provision in Chinese business practices. Particularly in the Wujin case, the judges had to reduce the amount of monetary damages to one-third of the total company losses to balance the result of the hardworking director who make the ill-processed investment.

Amending the applicable duty-of-care law and the exculpatory provision might help Chinese judges to make better verdicts that are more acceptable by both parties. In order to strike the right balance between the protection of directors and
shareholders, and to encourage directors to pursue the best interests of the company, the directors' liabilities for the breach of the obligation of diligence should be limited rather than eliminated. The limited liability should be capped at 60,000 RMB ($10,000), this figure being based on existing corporate and security laws and on Chinese social norms. This amount may keep the notion of due care in directors' minds and may be financially bearable for them.

If adopted, the proposed amendment would give potential plaintiffs more incentives to file a lawsuit. Without such incentives, it is likely that no one would ever bother to file a lawsuit.

At the same time, this proposal would not significantly increase the amount of litigation in China, since only shareholder(s) who have continuously held 1% (or more) of the outstanding shares of the company for six months could ask supervisors to sue the director(s).

The proposed amendment also should not have a significant effect on insurance premiums. Since directors would no longer have to pay excessive damages, such premiums would not become unreasonably expensive. Finally, the proposed amendment would help judges make better decisions and would prevent a similar chain of events as that which happened after Smith v. Van Gorkom from occurring in China because it would place a cap on directors' liability. This cap would enable courts to properly evaluate directors' liability without considering the
affordability of damages and their impact on society. After all, directors’ conduct, not whether they can afford liability judgments, should be the focus of due-care cases.
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