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Rethinking and Constructing the Mechanism of Directors' Exemption from Liability under the Revision of the Chinese Company Law

Abstract. Since its introduction, Chinese Company Law has played a great role in the development of Chinese business system, but with the development of the economy, continuous technological innovation and changes in the world environment, the current Company Law can no longer meet Chinese current economic development and needs to be improved and modified. By examining the current legislative situation in China, the provisions on directors' liability in China are too strict, which seriously affects the directors' business judgment in favor of the company's development in the process of business decision making and does not provide the company directors with the protection they deserve, but instead applies a more stringent standard of liability to directors. At present, there is a double lack of statutory exemption system and intentional exemption system for directors' liability in Chinese corporate legal system, and in the field of practice, there is a misinterpretation of the judgment standard of directors' liability for diligence, which needs to be clarified. By analyzing the value and function of the director's liability exemption system, the article seeks ways to solve the problem of director's liability exemption, protects directors from unfortunate punishment by introducing business judgment rules, reasonably constructs the intentional exemption mechanism of director's liability, and clarifies the judgment standard of director's liability for diligence. The director liability exemption system is reasonably constructed so as to improve the corporate governance problem in China and promote the internationalization level of Chinese company law.

Keywords: Chinese Company Law; Directors; Duty of Care; Duty of Diligence; Directors' Liability; Exemption from Liability; Business Judgment Rule; Statutory Exemption from Liability; Intentional Exemption from Liability; Corporate Governance.

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Переосмысление и формирование механизма освобождения директора компании от ответственности в рамках пересмотренного Закона о компаниях Китая

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Аннотация. С момента своего появления китайское законодательство о компаниях играет большую роль в развитии китайской бизнес-системы, однако с развитием экономики, непрерывными технологическими инновациями и изменениями в мировой среде действующее Законодательство о компаниях больше не соответствует текущему экономическому развитию Китая и нуждается в изменении и совершенствовании. Анализ текущего китайского законодательства, показывает, что нормы об ответственности директора компании в Китае являются слишком строгими, и это серьезно влияет на принятие директором решений,

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связанными с развитием компании. Данные нормы также не обеспечивают директору компанию должную защиту. Вместо этого применяется более строгий подход к определению ответственности директора компании. В настоящее время в корпоративной правовой системе Китая отсутствуют как механизм освобождения от ответственности, так и механизм целенаправленного освобождения от ответственности директора, а в области судебной практики возникает неправильное толкование нормы вынесения судебного решения об ответственности директора за проявление должной заботы, которая нуждается в разъяснении. На основании анализа ценности и назначения принципа освобождения директора от ответственности, в статье рассматриваются пути решения проблемы освобождения директора от ответственности, защиты директора от необоснованного наказания путем введения правила делового суждения, обосновывается формирование механизма целенаправленного освобождения директора от ответственности и разъясняется стандарт принятия судебного решения об ответственности директора за проявление заботы о бизнесе. Система освобождения директора от ответственности должна быть сформирована таким образом, чтобы было возможно решить проблему корпоративного управления в Китае и повысить уровень интернационализации китайского корпоративного права.

Ключевые слова: китайское корпоративное право; директор; обязанность проявлять заботу; обязанность проявлять осмотрительность; ответственность директора; освобождение от ответственности; правило делового суждения; предусмотренное законом освобождение от ответственности; целенаправленное освобождение от ответственности; корпоративное управление.

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In the course of the development of modern company law, the gradual weakening of the powers of the shareholders' meeting and the strengthening of the powers of the board of directors has become a trend… strengthening the powers of the board of directors has become a reality in the legislation of many countries[1]. In the operation of the company, compared to the shareholders in the status of investors (contributors), the directors are responsible for the execution and management of specific affairs of the company and are more knowledgeable about the company, all powers of the company shall be exercised by the board of directors or under the authority of the board of directors, and the business doctor and affairs of the company shall be managed by or under the direction of the board of directors[2]. However, rights and responsibilities are corresponding, directors to manage the company at the same time also have obligations to the company, violation of obligations will need to be responsible for the company or shareholders, strengthen the responsibility of directors to help directors to do their duty to act for the company, is conducive to the construction of corporate governance structure, but is it reasonable to pursue the responsibility of directors? If we do not construct a reasonable system and limit of liability, too strict or too loose liability will cause the imbalance of interests between the company, shareholders, directors and creditors. The Company Law of China provides for the duty of diligence and fidelity of directors, and restrains the behavior of directors in the system, requiring them to actively work for the benefit of the company while maintaining restraint on non-faithful and diligent behavior beyond their duties. However, since the provisions are broad and unspecified, and while strengthening the directors' obligations, the construction of the directors' exemption system is neglected. It is not known whether it is the intention of the legislator to protect the interests of the company and shareholders, or whether the exemption system is not taken into consideration because it is not yet important. It is necessary to examine the legislative status of the company law in foreign countries in order to construct the director's exemption system in China.

I. Discovery of the Problem: Examination of the Legislative Status of Directors' Exemption from Liability

Paragraph 3 of Article 112 of the Company Law of China stipulates that directors shall be liable for the resolutions of the board of directors, but directors may be exempted from liability if they prove that they have expressed dissent when voting when

[1] *Wang Baoshu*. The directors and board of directors of a joint stock company // Translation and review of foreign law. 1994(1). P. 1.

participating in the decision-making. Article 149 stipulates that a director who violates the provisions of laws, administrative regulations or the articles of incorporation and causes damage to the company shall be liable for compensation. From this, we can see the lack of provisions for directors' exemption from liability in China, which mainly has the following problems.

A. The absence of a statutory exemption system

Statutory exemption refers to the exemption of directors from liability by direct provisions of law. This includes the provisions of the Company Law on the exemption of liability for dissenting directors and the provisions of the business judgment rule. The former is too simple and lacks operability and effectiveness, while the latter is not yet available in Chinese company laws.

First, the scope of the exemption from liability is too small. The United States, Japan and other countries not only provide for a statutory exemption system for directors' liability in their corporate laws, but also design the circumstances under which directors can be exempted from liability by the company's resolution authority. Compared with the construction of the director's exemption system in the company law of the United States and Japan, China's director's exemption from liability is only stipulated in Article 112, Paragraph 3 of the Company Law. This paragraph provides: «Directors shall be responsible for the resolutions of the board of directors. If a resolution of the board of directors violates the laws, administrative regulations or the articles of incorporation or the resolution of the general meeting of shareholders and causes the company to suffer serious losses, the directors who participated in the resolution shall be liable to the company for compensation. However, if it is proved that he/she has expressed his/her dissent at the time of voting and recorded in the minutes of the meeting, the director may be exempted from liability. From this, it can be seen that a director can only be exempted from liability if he or she expresses dissent at the time of the resolution of the directors and records it in the minutes of the meeting. Such a provision will inevitably increase the risk of directors' decisions and increase the disinterest of directors' actions. For the company may not promote the company's profitability, the directors fear the harshness of liability will inevitably be fearful, hesitant to make important decisions, but will cause obstacles to the operation of the enterprise. In addition, there is a point worth thinking about, for the dissent of the situation how to provide, what specific circumstances? Our company law does not have detailed provisions. Both the effectiveness and operability are obstacles.

Second, the vacancy of the business judgment rule. «The business judgment rule, as a safe haven for directors' liability, can greatly motivate directors, improve the efficiency of company operation and resist shareholder litigation under the situation of separation of ownership and operation»[3]. The business judgment rule has been stipulated in extraterritorial law and has undergone decades of development in judicial practice. Chinese current company law has not been introduced to the business judgment rules. It is true that system transplantation is not simply the introduction and copying, in order to avoid the embarrassing situation of the southern orange and the northern hedgehog, in-depth investigation of the system, the provision of business judgment rules suitable for our legal environment is more conducive to the reasonable construction of the director system. The business judgment rule is to protect directors from the risk of reasonable and bona fide business decisions. Therefore, the meaning, types and elements of business judgment rules should be clarified in the process of introducing the system to avoid the uncertainty of judicial decisions in practice. The business judgment rule is an incentive for directors, which helps to stimulate the vitality of enterprises and promote their competitive development.

In judicial practice, some courts in China have used the business judgment rule to make decisions, but there is also a great deviation in the application of the judgment standard regarding the directors' duty of diligence. For example, in the case of a compensation dispute of a property company Ltd. heard by the Zhejiang High Court, the Zhejiang Provincial High Court defined the duty of diligence at the time of determination as «The duty of diligence, also known as the duty of care and the duty of good management, means that the directors, supervisors and senior manage-

[2] *Shen Sibao*. The latest U.S. standard corporate law // Law Press. 2006. P. 90.

[3] *Chang Jian, Zhang Qiang*. Business judgment rule: development trend, application limitation and perfection: the perspective of dividend distribution of limited liability companies // Law and Business Research. 2013(3). P. 144.

ment of the public A shall, in the execution of the affairs of the public A, exercise the care, diligence and skill shown by a reasonably prudent person in a similar situation perform their duties»[4]. The Zhejiang High Court found that the duty of care focused on the application of the «reasonably prudent person» standard, which is consistent with the judgment standard of the British company law. In a case heard by the Shanghai Minhang Court in Shanghai, the court held that business judgment rules should be introduced to regulate the protection of corporate autonomy and directors' business judgment[5]. This is obviously focused on the business judgment standard in the U.S. law. The difference in emphasis of the above courts also reflects the difference in practice due to the lack of clarity in the law. The uncertainty of the law has caused the application of deviations in judicial practice, which is likely to bring uncertainty to independent directors' practice risks.

B. The absence of the intended exemption system

Throughout the world's corporate law, most countries recognize that directors can be exempted from liability by intentional means, which mainly include the agreement of the articles of incorporation, the resolution of the shareholders' meeting, the resolution of the board of directors and other means. In China, only Article 112 of the Company Law provides in principle for the exemption of directors from liability, which is too narrow in scope. However, in the spirit of legislation, the legislator has already shown constructive exploration for the exemption of directors from liability. As the business society is complicated and changing, the construction of the intended exemption system is one of the manifestations of respecting the autonomy of the company, and it is entirely possible to leave the institutional arrangement and exemption of liability within the company to the autonomy of the company. The company law belongs to private law in nature, and the company law should be constructed to respect the autonomy of the company to the greatest extent, and the intended exemption of directors from liability is the embodiment of the spirit of autonomy. This will help reduce the risk of directors in making normal business decisions, which is very attractive to directors.

C. The principle of duty of diligence is too broad

The duty of diligence is not clearly stipulated in either legislation or judicial practice, and judicial staffs are also secretive about it and do not give clear explanations about it. In the case of violation of the law, the directors are only punished for violating the duty of diligence. Article 149 of the Company Law of China only provides in principle, but does not elaborate on its specific content, and the provisions are too broad, leaving the determination of the directors' duty of diligence to the discretion of the court.

II. Traceability of the system: the basic concept of directors' exemption system

A. Clarity of implication: Interpretation and jurisprudential basis of the exemption system

Legal responsibility, as a guarantee mechanism for the operation of law, is an indispensable link of the rule of law. «Legal liability is an obligation with direct compulsion that arises from the violation of legal rights or violation of legal obligations and is determined by a special state organ and attributed to the responsible subject of legal relations, i.e. an obligation of second nature incurred as a result of the violation of legal obligations of the first nature»[6]. «Exemption from liability presupposes the existence of legal responsibility, and although the violator has in fact violated the law and has the conditions for legal responsibility, he may be partially or fully exempted from legal responsibility due to certain subjective or objective conditions established by law»[7]. For the exemption of director's liability, scholar Li Hua believes that director's exemption from liability refers to the procedure to relieve the director from the liability that should be admitted by the director when the company's director is held accountable for the management failure, and to mitigate the business risk in the director's management decision[8]. Scholar Zhang

[4] See (2010) Zhejiang (Commercial) Final Appeal No 1 for details.

[5] See (2010) Minhang Civil II (Commercial) Original jurisdiction No 15 for details.

[6] Zhang Wenxian. The general theory of law. Liaoning University Press, 1988. P. 164.

[7] *Zhang Wenxian*. Research on the Scope of Philosophy of Law // Beijing, China University of Political Science and Law Press. 2001. P. 142.

[8] *Li Hua*. Research on Directors' Liability Insurance System // Law Press. 2008. P. 184.

Minan believes that directors' legal responsibility for breach of duty of loyalty, duty of care or statutory obligations can be exempted by various ways[9]. The formation of the system is bound to explore the legal logic behind it, and in the case of the exemption from liability of company directors, there are two points.

Consideration of the principle of fairness. The company is profit-oriented and its essence lies in profit-making. The company carries out commercial activities and the directors, as the main executors of the company, make commercial judgments on the company's investment decisions. If the decision is in line with the business judgment, and the company obtains profit, then the profit will belong to the company, and the company dividends to the shareholders, while if the director makes a business misjudgment, causing losses to the company, thus making the director bear the responsibility, which is against the requirements of the principle of fairness. It is easy to see from the legal norms that the balance of interests of the company is inclined to the shareholders' side, and the protection of directors is poor.

The balance of business risks. Business risks are highly uncertain, which also requires directors to exercise due diligence in making business judgments for the company and to act in accordance with the requirements of the duty of loyalty and diligence. However, the uncertainty of business leads to the inevitable operational errors of the company. Directors are only rational people with specialized knowledge and limited knowledge of the objective world, and will not make every business judgment they make pay off. It is not wise to blame directors when decisions are wrong. Directors should be held accountable if they have failed to exercise diligence and fidelity, but they should not be blamed if the uncertainty of business risk has caused the company's loss. The benefits of a successful decision belong to the company and the risk should not be unduly imposed on the directors.

B. Doctrinal discernment: The relationship with the company as a perspective

The existence and implementation of the legal system is predicated on the organic unity of responsibility, power and benefit. Liability is due to the existence of obligations, the directors who violate the obligations must be responsible for this, and the exemption of liability is predicated on the responsibility. The discussion of directors' liability should first clarify the relationship between directors and the company. In this regard, there are four main doctrines as follows.

First, the appointment relationship theory. The appointment theory is proposed by the civil law countries based on the characteristics of the company law of the civil law countries. The most typical provision is the Japanese Commercial Code, which stipulates in Article 254-1, Paragraph 3, «The relationship between the company and the directors shall be in accordance with the provisions on appointment.» In this legal relationship, the company is the appointor, the director is the appointee, and the management and operation of the company's property is the subject of the appointment. Mr. Shi Shangkuan defines appointment as «a contract in which one party agrees to appoint another party to handle affairs and the other party agrees to do so. The person appointed to handle the affairs is called the appointer. The person who agrees to handle it is called the appointee»[10]. Based on the doctrine of appointment, the company is regarded as an appointee, which appoints the directors to decide the specific affairs of the company and the execution of its business. Professor Zheng Yubo also believes that «directors belong to a kind of paid appointment because of the relationship of remuneration, and thus the execution of their duties should be subject to the attention of the good administrator»[11]. Professor Wang Baoshu also believes that the relationship between the two is an appointment relationship, but this appointment relationship is different from other appointment contracts, that is, it is established only by the resolution of the shareholders' meeting to elect and the directors' agreement to serve. According to the appointment relationship, the director «may acquire the right to make business decisions and execute business on the affairs of the company by virtue of his appointment, and the director may handle the affairs of the company according to his appointment»[12].

Second, the fiduciary relationship theory. The fiduciary relationship theory originates from the case law countries such as England and the United

[9] *Zhang Minan*. Research on the legal status of directors in modern common law // Law Press. 2007. P. 228.

[10] *Shi Shangkuan*. The Law of Debt. China University of Political Science and Law Press, 2000. P. 381.

[11] *Zheng Yubo*. Corporate law. Sanmin Press, 1971. P. 132.

[12] *Wang Baoshu*. Chinese Company Law. China Workers Press, 1995. P. 210.

States, before 1844, most of the joint stock companies in England did not have legal personality, and the company appointed directors as trustees through trust certificates. The trust relationship requires the transfer of ownership of the trust property, but the director is only a manager in the company, and does not own the property of the company, so the fiduciary relationship can not be measured here.

Third, the agency relationship. Agency means «the system that makes it possible to attribute the effects of an act performed by someone other than oneself to oneself is the agency system»[13], German company law considers the relationship between the director and the company as agency relationship, Article 26 (2) of the German Civil Code states: «The board of directors represents the association within and outside the law; the board of directors has the status of legal representative. Representation of the association within and outside the statute; the board of directors has the status of a legal representative. The scope of representation may be limited by the bylaws and its effect may be against third parties». The German Stock Corporation Act further clarifies and specifies the civil law legislation on «the board of directors as the company's agent». Section 78, subparagraph 3 of the Act specifies that «A member of the Board of Directors may be authorized to represent the company alone or jointly with another agent.» Article 82 of the Law states that «In their relations with the Company, the members of the Board of Directors are obliged to comply with the restrictions on the competence to execute the business established by the Articles of Association, the Supervisory Board, the General Meeting of Shareholders and the operational regulations of the Board of Directors and the Supervisory Board, within the limits set by the regulations of the relevant joint stock company». This legislative provision clarifies that the directors are in an agent position in the company in terms of the restrictions on their authority. However, this doctrine has certain limitations, when the directors deal with the affairs of the company, according to the agency theory will be the responsibility of the company, ignoring the directors as managers of the company should assume the duty of fidelity and diligence, in addition, compared to the traditional civil law theory of the agency system, the agent based on the scope of the agent's authorization to engage in activities, while in the company the directors have greater agency authority and independence.

Fourth, the double-layer relationship between agency and commission. This view is that the director's actions can be divided into internal and external actions, internally, the director accepts the company's commission as a trustee; externally, the director represents the company as the company's agent. The agency relationship involves a third party in addition to the agent and the agent, while the principal relationship exists only between the principal and the principal. Therefore, this view is that the company and the director have a two-tier relationship between agency and commission.

Clarifying the relationship between the company and the director is a key factor in the director's responsibility. For the trust relationship, I do not agree, the trust relationship in its trustees can be natural or legal persons, and for the company director's qualifications, only natural persons are allowed to become directors of the company. Moreover, the trust relationship requires the transfer of property ownership, while the director is only the executor of the company's affairs, the company has independence, and all property rights belong to the company. This is not consistent with the traditional trust relationship. For the agency relationship, I also disagree, the agency relationship, the agent in the name of the agent to carry out legal acts, the agent's responsibility for the agent's actions, the agent's scope of authority is limited by the agent's authorization, and does not reflect the agent's personal will. However, in a company, although the director acts according to the authorization of the shareholders' meeting or the board of directors, he or she still has a large discretionary power for the major business decisions of the company. Therefore, I prefer the appointment relationship, and the appointment between the director and the company belongs to the paid appointment. Based on the appointment relationship, the two have mutual obligations, for the company, the obligation to pay compensation, compensation obligations, the intervention of the principal, etc., and similarly, for the director, the obligation to deal with affairs, reporting obligations, transfer obligations, post-contractual obligations and compensation obligations, etc[14]., violation of the above obligations will need to bear the corresponding responsibility to the principal.

[13] *Yamamoto Keizo*. General Principles of Civil Law. Beijing University Press, 2012. P. 276.

[14] *Li Yongjun*. Contract law // Higher Education Press. 2011. P. 368.

III. Necessary Analysis: Analysis of the Construction of Directors' Exemption System

A. One of the necessities: Based on the protection of directors

The corporate governance system and the corporate capital system are the two cornerstones of corporate law and the two pillars that support the entire corporate law system. The market fluctuations and changes also require the company law to be constantly updated and improved, and the company can not survive without the continuous innovation of corporate governance. The development of the legal system of the company in the past 30 years has made certain achievements, but also a great deal of systemic problems, such as the embarrassing situation of the transplantation of the legal system, the patch-type legal repair is not helpful, the Chinese corporate governance system needs a more comprehensive, systematic and profound system change and innovation[15]. From the historical flow of corporate governance in developed capitalist countries in Europe and America, the center of corporate power has shifted from shareholders' meeting centrism to board centrism. If the company pursues the maximization of shareholders' interests, then it corresponds to shareholders' meeting centrism, but if the company pursues the maximization of the company's own interests, then it is board centrism[16]. on China's current corporate governance structure, it seems that the company is still controlled by the shareholders' meeting, but from the historical development, along with the innovation of the company system and the development of economic and social, the separation of ownership and operation control of the two powers will be more obvious, the company power from the shareholders layer down to the directors layer has been revealed, although in theory and legislation emphasizes the shareholders to the company's ownership status, but the directors are the really responsible for the company's operation and management of the subject.

In terms of the current legislation of the Company Law in China, it seems that the power of the company is given to the shareholders' meeting, and the status of the shareholders' meeting is valued but the independent value of the company is ignored, and the legislation shows more to strengthen the shareholders' control over the company. Directors prudently invest in the operation of the company for the sake of the company, but does not give too much power to the directors, for the directors, in addition to the powers attached to the articles of incorporation themselves, their powers and authority at different levels of legal rules are hardly expanded, in the case of limited powers, too much responsibility is placed on the directors[17]. Unfortunately, «there are no formal rules in Chinese law to protect the powers and positions of directors and officers, such as the rules of dismissal, business judgment rules, immunity from liability and even liability insurance in American law, are queer»[18]. Some scholars criticize the difficulty of forming a high level of corporate governance team under our current corporate governance system on the grounds that the knowledge and integrity level of managers is low, but this is not a reason to deny the construction of a director's immunity system. Is it really appropriate to blame directors too harshly and place the blame for the company's business risks on them? The current system of directors' liability exemption in China is queer, and there is a complete mismatch between obligations and responsibilities, so it is entirely necessary to construct a director's exemption system to some extent.

B. Necessity No: Embodiment of the autonomy of the company law

Private law autonomy implies that market subjects conclude legal relations through meaningful autonomy, the essence of which is respect for contracts and trust in the market. At the same time, private law autonomy also emphasizes the law's respect for the will of the parties, allowing them to negotiate their rights and obligations through contracts and to make different regulations for different needs. The company also organizes the factors of production it

[15] *Zhao Xudong*. Innovation of corporate governance system in the revision of company law // China Law Review. 2020(3). P. 119.

[16] *Zhao Yuan*. Board-centeredness and shareholder-centeredness: A discussion of modern American corporate governance doctrines // Comparative Law Research. 2009(4). P. 95.

[17] *Deng Feng.* The representative corporation: power and responsibility in Chinese corporate governance. Peking University Press, 2015. P. 45.

[18] *Deng Feng*. The origin of corporate compliance and the limitations of the Chinese system // Comparative Law Research. 2020(1). P. 44.

needs by means of different contracts. In the view of legal and economic theorists, commercial law is a model law that exists to provide a template for cooperation and a compensation mechanism to fill contractual gaps, and should allow the parties to be autonomous in private law. According to Adam Smith, rational people engage in business activities following the concept of maximizing individual interests. The form of commercial organization should be left to the parties to decide for themselves, rather than replacing individual choice with mandatory legislative regulation. The theory of the economics of law advocates reducing the mandatory norms of law and increasing the arbitrary norms[19]. The economic analysis school of law, which emerged from the University of Chicago, believes that a laissez-faire economic model is the best model, opposes government intervention, and advocates reducing government regulation and using contracts to solve corporate problems. The corporation is not an independent entity, but a network of contracts that connects the rights and obligations between the parties[20].

The autonomy of the company law is one of the explicit features of the company law, which has the color of autonomy from birth. Article 1 of the Company Law stipulates that this Law is enacted to regulate the organization and conduct of companies, protect the legitimate rights and interests of companies, shareholders and creditors, maintain the social and economic order, and promote the development of the socialist market economy. It can be seen here that the current company law in the protection of the subordinate position is to regulate the organization and behavior of the company, that is, to protect the organization and operation of the company and business behavior. As a company law to protect and maintain the operation of the company, from the history of the development of the company, there were first joint-stock companies, i.e. public companies, and then limited liability companies, i.e. private or closed companies. In the early days of corporate legislation, the company law was set up mainly for the operation of the joint stock company, which had a great financing tool, and its operation and functioning was not only about the interests of shareholders, but even affected the economic development of a region or even a country. The shareholders, as investors, are only interested in profitability, not in the management of the company, and the ownership of wealth without control and control of wealth without ownership is the logical conclusion of the development of the joint stock company, which affects not only the shareholders, creditors, executives and operators of the company, but also the regional economy. Therefore, for the joint-stock company, for the protection and balance of public interests, it is inevitable to regulate it through mandatory norms to serve the development of the company while balancing the interests of all parties. In contrast, closed companies are mainly formed for small and medium-sized investors to obtain income, as can be seen in the legislative process of corporate law, which usually treats public companies as ordinary rules for regulation, while closed companies as a special case of corporate law, usually simplified or selective provisions for the special problems of closed companies for special provisions, the purpose of which is to allow closed companies to make their own choices, giving them The purpose is to allow closed companies to make their own choices and give them the ability to operate for profit. According to the economics of law, one of the functions of the existence of arbitrary norms is to fill the gaps in the contract. A company contract can never be perfect, and all laws have loopholes, which are inevitable. Then it needs to be constantly supplemented and improved, and the arbitrary norms play such a role. In addition, the role of arbitrary norms is to provide standard contracts for economic transactions. Standard contracts can reduce transaction costs. When a large number of transactions occur, a standardized text will greatly reduce the transaction costs of subsequent contracts. Standard contracts are continually adjusted and modified until they are optimal to meet the needs of the economy and society.

IV. The path of deciphering: the construction of director's exemption system

The construction of a director's immunity system does not encourage directors to actively make mistakes, engage in risky business transactions,

[19] *Guo Rui*. Mandatory and arbitrary norms in the law of commercial organizations-the example of the board of directors system // Global Law Review. 2016(2). P. 69.

[20] *Huang Hui*. Comparative study of modern company law: international experience and inspiration for China. Tsinghua University Press, 2020. P. 15–16.

and disregard the assets of shareholders and the company, but rather, the construction of a system of immunity from liability that does not arise from the director's intention or failure to exercise diligence and fidelity. The «exemption» is not a simple determination, but is subject to a strict review of the conditions under which the exemption is granted. «The result of strict director liability means that directors may be held liable for large amounts of compensation at any time for mistakes in decision-making, which may seriously discourage directors from taking risks and making bold decisions in their operations.»[21] In the context of the gradual increase of directors' liability, the construction for shareholders' exemption from liability is not only a protection for directors, but also a key part of improving the corporate governance system in China.

A. Introduction of business judgment rules

The Business Judgment Rule was not created by statute, but originated from the practice of case law and was developed in Delaware, USA. In practice, the courts do not want to pursue directors' business decisions after the fact, and American law can be traced back to the Louisiana Supreme Court's decision in Percy v. Millaudon[22] in 1829, where the term «business judgment rule» was first used. In his decision, the judge wrote: «The liability of a director does not depend on whether a wise man would make the mistake, but should be judged by the common sense of man, and it must be proved that the mistake was grossly negligent, which would not be so to a man of common sense to the extent of common sense. This was also discussed by the Rhode Island Supreme Court in 1850 in Hodges v. New England Screw Co[23]. Nowhere is the discussion of the business judgment rule more classic than in the 1984 U.S. case of Aronson v. Lewis[24], where the judge held that the business judgment rule rests on the assumption that directors will act in the best interests of the company on an informed basis and in good faith when exercising their decision-making responsibilities. In the absence of evidence of abuse of discretion by a director, the director's judgment is protected by the court. The burden of proof is on the party alleging a breach of duty on the part of the director to find facts to rebut the foregoing assumptions. 1985 U.S. judge in Smith v. Van Gorkom[25] held that not all actions of directors are protected by the business judgment rule, and that a director can only be protected by the business judgment rule if he or she acted in good faith, with knowledge, and in the honest belief that the decision he or she made was in the best interests of the company and was not The business judgment rule protects directors only if they make decisions in good faith, with knowledge and in the honest belief that they are making decisions in the best interests of the company and without gross negligence.

To introduce the business judgment rule, it is first necessary to clarify the basis of the business judgment rule's argument. There are three main points that need to be clarified: first, to avoid directors from taking excessive business risks. Facing the vagaries of business, directors are not omnipotent and inevitably make mistakes. If a director makes a business decision for the company in good faith and diligently with full knowledge of the business situation, but still suffers from business risks and brings losses to the company in this case, the director cannot be held responsible for the company[26]. Business judgment rules are set to encourage excellent professionals to be used as directors of the company, to maximize the interests of the company to play their personal talents, should not put all the responsibility on the directors. Secondly, to avoid the court to intervene in the management of the company after the fact. The court is not a businessman and does not know enough about the company's operation and business risks, and the judge does not know the business situation compared to the company's operators. It is inevitable that a judge will judge and review the company's business decisions. Therefore, the rules of business judgment requires judicial restraint, respect for the rules

[21] *Cai Yuanqing*. New developments in the system of directors' liability exemption in Japan // Politics and Law. 2003(3). P. 139.

[22] See Percy v. Millaudon & AL, 8 Mart. (n.s.) 68 ;1829 La.

[23] See Hodges v. New England Screw Co.

[24] See Aronson v. Lewis, 473 A. 2d 805 ; 1984 Del.

[25] See Smith v. Van Gorkom, 488 A. 2d 858 ; 1985 Del.

[26] *Lori Mcmillan*. The Business Judgment Rule as An Immunity Doctrine // WM. & Mary Bus. L. Rev. 2013(4). P. 521.

of business judgment, the court should not be excessively involved in the company's business, to avoid falling into the company's business tired[27]. Finally, to avoid excessive shareholder intervention in the company's business decisions. Along with the development of the field of science and technology innovation, new companies are emerging, the capital may not understand the specific situation of the company, the shareholders lack of understanding of the development of high-tech companies, if shareholders can dare to operate the company by requesting the court to review the company's business judgment, it is bound to interfere with the operation of the company. If the shareholders disagree with the directors' business decisions, they can completely dismiss the directors through the procedure[28].

According to Liu Lianyu, a scholar of corporate law in Taiwan, the business judgment rule has five requirements: 1. a business decision; 2. disinterested and independent; 3. reasonable and proper care; 4. Good faith or good faith; 5. No abuse of discretion[29]. Only with the above five requirements can be exempted from liability, otherwise directors will be liable for their actions. Therefore, whether the director's behavior meets the requirements of the business judgment rule, it is necessary to examine the specific behavior of the director with the above five components.

B. Reasonable introduction of intended exemptions

If we look at foreign corporate law, around the 1980s, there were a large number of corporate law cases in the United States involving directors' duty of diligence, and directors' compensation to companies amounted to tens of millions of dollars, and such penalties greatly discouraged directors' work. The directors' business judgment to make investment behavior cannot be «hit all the time», and business investment failure is inevitable, so the increase of directors' liability is not the solution to the problem. In this context, various states in the United States have amended their corporate laws, the most representative being the Delaware General Corporation Law, which allows shareholders to provide for the limitation or exclusion of directors' liability in the articles of incorporation. Section 102(b) of the Delaware General Corporation Law provides for the limitation of director liability, which exempts or limits the personal liability of a director of a corporation to the corporation or its shareholders for breach of the director's fiduciary duties resulting in pecuniary loss, subject to four exceptions: 1. if the director breaches his or her duty of loyalty to the corporation or its shareholders; 2. if the breach is not in good faith or negligence or if the act contains an intentional or unlawful act; 3. if the breach falls within the provisions of this Title 174 (unlawful payment of dividends, unlawful purchase or repurchase of shares); and 4. where the director derives improper personal benefit from the transaction.

In Japan, there are also clear provisions in the Company Law regarding the exemption of directors from liability. Articles 424 through 427 of the Japanese Company Law provide for the limitation and exemption of directors' liability. There are three types of exemptions, the first of which is by resolution of the general meeting of shareholders. The exemption is provided for in Article 424 of the Company Act, which states: «The liability in the first paragraph of the preceding Article shall not be exempted without the consent of all shareholders. Paragraph 1 of Article 423 stipulates that a director, accounting advisor, supervisor, executive officer or independent auditor who neglects his or her duties shall be liable to a joint stock company for damages suffered as a result. In the case of unanimous consent of all shareholders, the directors and related responsible persons may be exempted from liability for negligence in the performance of their duties, but only if the directors acted in a lax manner in the performance of their duties and if they acted in good faith and without gross negligence. Article 425 provides for a partial exclusion of liability. If a director or other officer performs his or her duties in good faith and without gross negligence, the shareholders' meeting may resolve to exclude part of the liability by reducing the amount of compensation payable in the manner prescribed by a decree of the Ministry of Justice. Second, the exemption from liability by resolution of the board of directors after authorization

[27] *Stephen M.* Bainbridge. The Business Judgment Rule as Abstention Doctrine // Vand. L. Rev. 2004(57). P. 83.

[28] *Guo Dawei*. On the application of the principle of business judgment in the legal system of directors' liability: a review, comparison and reflection // Journal of Civil and Commercial Law. 2020(68). P. 26.

[29] *Liu Lianyu*. Directors' Liability and the Law of Business Judgment // Journal of Civil and Commercial Law. 2007(17). P. 186–187.

by the articles of incorporation is detailed in Article 426 of the Company Law of Japan. Although Article 424 provides for an exemption from liability by the shareholders' meeting, it differs in that the exemption by resolution of the board of directors must first be authorized by the shareholders' meeting because the board of directors is suspected of harboring insiders by making the resolution. Paragraph 1 states: «Notwithstanding the provisions of Article 424, in the case of liability under Article 423, paragraph 1, where the manager, etc., is acting in good faith and without gross negligence with respect to his or her duty travel, and where it is deemed necessary to consider the content of the facts constituting the cause of liability, the performance of the duties of the manager, etc., and other circumstances, the company sets up a committee of supervisors, audit, etc., or a nominating committee of the articles of incorporation may provide that, with the consent of a majority of the directors (except for the directors in charge) (if the company sets up a board of directors, a resolution of the board of directors), the provisions of paragraph 1 of the previous article may be exempted from the amount of dangerous exemption from such liability. Third, the exclusion of prior liability provided for in the Articles of Incorporation, Article 427 of the Company Law of Japan stipulates: «A joint stock company may provide in its Articles of Incorporation that it may conclude a liability limitation contract with an independent director, an accounting participant, an independent supervisor or an accounting auditor, etc., with respect to the liability in Article 423, paragraph 1, of the Articles of Incorporation — when such independent director, etc., is responsible for the execution of the duties of the independent director, etc. When the independent director, etc. is acting in good faith and without gross negligence in the performance of his or her duties, the joint stock company may prescribe an amount or choose a minimum amount of liability within the limits set by the Articles of Incorporation, and choose the higher of the two amounts as the limit of the contract. With regard to this legislation, some scholars believe that the prior exemption system is superior to the ex post exemption system, and some scholars even believe that not only independent directors can be exempted from liability through prior exemption, but other directors can also be exempted from limitation and exemption of liability through prior exemption[30].

C. Clarification of the duty of diligence

The exclusion of directors' liability requires the premise that the directors are liable, and liability requires the premise that the directors are in breach of their obligations. The provisions of Article 147 of the Company Law on directors' duty of diligence are all in principle. Paragraph 1 of Article 147 provides that «Directors, supervisors and senior management shall comply with laws, administrative regulations and the articles of association, and shall have the duty of fidelity and diligence to the company. There is no provision on what is the duty of diligence, what is the content of the duty of diligence, and the criteria for judging the breach of the duty of diligence. Therefore, for the construction of the system of directors' liability exemption in China's company law, the specific content of directors' duty of diligence should be clarified first. Moreover, for the introduction of the business judgment rule, the director's duty of diligence should also be considered first, and the director's duty of diligence should be examined, and the director can be exempted from liability only when the business judgment rule is met. In academic circles, the duty of diligence has always existed as two sub-items of the duty of fiduciary duty together with the duty of faithfulness. The duty of diligence, also known as the duty of care, is the duty to exercise due diligence in determining whether an actor has exercised due diligence in dealing with the matters for which he or she is responsible for his or her duties, and to be liable for any failure to exercise sufficient care. The current provisions of the Company Law on the duty of diligence and the duty of fidelity of directors are too broad and difficult to apply in judicial practice. Therefore, is it necessary to refine the duty of diligence and the duty of fidelity to meet the realistic needs of judicial practice? In the author's opinion, it is necessary. In addition, what is diligence for directors' conduct? How to define diligence? Does the duty of diligence need to be refined into specific provisions? All the above questions need to be considered.

Whether the common law system developed the standard of reasonable and prudent rational person, or the civil law system developed the standard of expert, good manager standard, are reflected in the objective abstraction of the

[30] Morita chapter. Public company law. China University of Political Science and Law Press, 2012. P. 208.

unified standard, even in the performance of the differences between countries, but the essence of the convergence. The author believes that the standard of judgment for the duty of care should be objective and lawful, and should make further specific requirements for directors according to the differences of different companies and handling things in specific cases. Uniformity of standards will help to form a consistent judicial decision. From the aforementioned article can be seen, China's current «Company Law» for the duty of care of the sole director of the judgment standard, is still in the state of queue, only from the abstract sense of the provisions, from the practice can be seen, so that the provisions are not conducive to the handling of independent directors set up by the dispute resolution of the case. Since 2005, when the Company Law of China first stipulated the duty of diligence and the duty of fidelity of directors, it has been operating for 16 years in practice, however, there is no provision on how to define whether the duty of care of independent directors is fulfilled or not. Therefore, the key to solving the duty of care of independent directors lies in clarifying the criteria for judging the duty of care. The determination of the standard can help clarify the direction of the work of the independent director, how to meet the requirements of due diligence and meet the elements of the duty of care. First of all, for the establishment of the standard, it should be both the principle function of the abstract general provisions and the specific provisions of the normative role. The first paragraph of Article 147 of the Company Law of China can be the principle provision. However, the experience in judicial practice can be typed and analyzed, and the criteria for judging the specific independent directors' duty of care can be summarized based on typical cases. The combination of abstract provisions and specific provisions will restrain the behavior of independent directors and make them work diligently and conscientiously for the company. At the same time, provisions can also be made in both positive and negative aspects to provide as fine a guidance as possible, while setting up underwriting provisions to protect the discretionary space of the enforcers. Secondly, the standard should be determined in a lenient and strict manner, and should not be overly principled and lax, nor extremely strict. Overly lenient standards will easily create loopholes that will make independent directors neglect their work and hinder the development of the company, while overly strict standards will put great pressure on the work of independent directors, and strict determination of the duty of care of independent directors will lead to excessive work requirements of independent directors, which will easily cause independent directors to bear the risks of the company's operation caused by non-personal factors, and even prevent outstanding professionals from becoming independent directors of the company to provide the company with professional advice and independent supervision. Therefore, for the setting of standards, we insist on reconciling leniency with strictness. Finally, for the setting of obligation standards, the principle of freedom of contract should be adhered to, allowing a combination of legal provisions and agreement. For example, the company's articles of incorporation may make autonomous provisions on the standard of duty of care for independent directors, and the company may negotiate with the independent director when appointing him/her to determine the content of the work and the standard of judgment of the duty, and may also agree on the liability and compensation matters, while the company law only provides the paradigm requirements and may leave the specific requirements to the company and the independent director to agree on themselves.

At the same time, attention should be paid to the culturing of independent directors' obligations. The report issued by the UK Company Law Review Steering Group argues that a culturally developed directors' obligation is essential for three reasons: first, clarity of visibility and accessibility. A codified directors' obligation will be clearer, and such clarity will undoubtedly provide better guidance for directors to act. In addition, codified directors' obligations will make it easier for directors to know the content of their obligations, so that they will not make mistakes out of ignorance. Second, it would allow the new company law to respond to new business practices, for example, in the area of conflicts of interest, where more and more directors are unclear about the specific application of conflicts of interest, and this could be addressed by means of law-making; third, it would address the so-called «scope» issues, such as directors acting in the interests of the company. These issues can also be clearly addressed through the enactment of a law[31].

[31] *Lin Shaowei*. English modern company law // China Legal Publishing House, 2015. P. 433.

V. Conclusion

As to how to construct the director's exemption system and the following issues should be noted, there are three levels of problems to be solved in the introduction and construction of the system, firstly, for the improvement of corporate governance, the role of directors in the operation of the company should be highly valued and given full play. Secondly, at the legislative level, the relief function of the general provisions of the existing law should be brought into play. For example, Article 147 of the Company Law provides for the duty of diligence and fidelity of directors, can this be a general provision, and can the function of the general provision be brought into play to refine the duty of diligence and fidelity of directors? For example, Article 147 of the Company Law provides for the duty of diligence and duty of fidelity of directors. With respect to the provisions on directors' exemption from liability, can Article 112(3) of the Company Law be interpreted as a general provision on exemption from liability, thereby expanding other exemptions from liability? Finally, at the level of judicial application, the court should be given certain discretionary power, for the complex reality of the case, just as no two leaves in the world are the same, for the application of the practice should be more substantive than formal, grasp the balance between judicial intervention and corporate autonomy[32].

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