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Different Strokes for Different Folks: An Appraisal of the Varying Duties of Care Required of the Directing Minds of Chinese Companies

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Abstract
A company is simply an abstract idea that has been personified in the eyes of the law. The legal personification of this abstract idea therefore allows a company to have the capacity for civil rights as well as the capacity for civil conduct. However, because a company is nonetheless an abstraction writ large, it must necessarily act through human agents from its incorporation to its liquidation. These human agents are entrusted with the affairs of the company and they are sometimes called the directing minds of the said company because they must think and act for the company at every stage of its life. Prior to incorporation, the promoters have to think and act for the company. The directors take over after incorporation and the liquidator or liquidation group, in turn, takes over from the directors until the winding up process is completed and the existence of this legal abstraction has been terminated. Stringent rules of the law of trust regulate instances in which one person is entrusted with the handling of another person's property and affairs and China has evinced the desire to stringently regulate trustees when the Standing Committee of the National People's Congress enacted the Trust Law of the People's Republic of China in 2001. This paper argues that the legal regime under the Company Law of the People's Republic of China for the regulation of the conduct of the directing minds of Chinese companies is quite unsatisfactory and discriminatory. The thrust of the argument by this paper is that unlike what pertains in the common law jurisdictions whereby all categories of directing minds of companies are regarded as fiduciaries to the company and are therefore required to obey equitable fiduciary duties, the various directing minds of a company in China are held to different standards of accountability. Consequently, this paper makes the case that the promoters of a company as well as members of a company's liquidation group should be held to the same duty of care as the directors of companies in tandem with the true nature of their positions as nothing less than the directing minds of a company, but only at different stages of the company's life cycle.

Keywords: *Different Strokes, Different Folk, Duties of Care, Directing Minds of Chinese Companies*

I. INTRODUCTION

This paper examines the legal regime in China for the regulation of the directing minds of Chinese companies. A company is an abstraction writ large in the sense that it is an abstract idea to which the law has accorded all the attributes of a natural person as much as it is possible for this abstraction to mimic the human being. Thus in the eyes of the law, a company is an artificial person that:

1. Is given a "certificate of birth" known as its certificate of registration or business licence after it has been incorporated (i.e. After it has been brought into existence);
2. Has capacity for civil rights as well as capacity for civil conduct much like any citizen (natural person) and hence the company can acquire, own and dispose property (e.g. Sell it out or give it out as a gift)[1];
3. Can sue and be sued just like a natural person;
4. Can borrow money or under certain conditions lend out money;
5. Can keep accounts as any natural person;
6. Can "marry" another artificial person of its kind (i.e. Another company) when it goes into amalgamation with another company;
7. Can "give birth" to another company when it creates a subsidiary company; and

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[1] *Compare and contrast articles 9-14 on the one hand to Article 36 on the other hand, all of the General Principles of the Civil Law (GPCL) of the People's Republic of China (promulgated on 12th April, 1986 and effective on 1st January, 1987). The said Articles 9-14 of the GPCL concern the natural person's capacity for civil rights and his capacity for civil conduct whilst Article 36 of the GPCL deals with the artificial person's capacity for civil rights and its capacity for civil conduct as well. Notably, there is a striking similarity between the capacity of the natural person and the capacity of the artificial person in this regard.*

8. Can "die by committing suicide" when it goes into voluntary liquidation[2] or "be sentenced to death" by a court[3] for a one or more reasons.

However, since it is essentially an abstraction albeit dressed up in human cloak, a company is physically incapable of carrying out anything by itself. It must necessarily depend on human agents to think and act for it. It is little wonder that the people who think for and take actions on behalf of a company are therefore referred to as the directing minds of the company. It begins with the promoters as the embryonic directing minds of a company, after which the board of directors take over once the company has been incorporated successfully, and finally the liquidation group steps in as the terminal directing minds of a company in the event that the company has to be wound up. These directing minds can **Justin** either take or implement good decisions that will prosper the company or they may decide on and carry out bad actions that will wreck it. This makes it necessary for the law to set the standards of care with which these human agents must execute the affairs of a company. In the English case of **Aberdeen Railway Co.** v. **Blaikie Brothers**[4], Lord Cranworth explained the legal obligations of the directing minds of companies under English law as follows: "A corporate body can only act by agents, and it is of course the duty of those agents so to act as best to promote the interests of the corporation whose affairs they are conducting."[5]

Also in the celebrated English case of HL Bolton (Engineering) Co Ltd vrs TJ Graham & Sons Ltd[6], Lord Denning explained the concept of the directing mind and will of a company as follows:

"A company may in many ways be likened to a human body. It has a brain and nerve centre which controls what it does. It also has hands which hold the tools and act in accordance with directions from the centre. Some of the people in the company are mere servants and agents who are nothing more than hands to do the work and cannot be said to represent the mind or will. Others are ***directors and managers who represent the directing mind and will of the company, and control what it does****. The state of mind of these managers is the state of mind of the company and is treated by the law as such. So you will find that in cases where the law requires personal fault as a condition of liability in tort, the fault of the manager will be the personal fault of the company. ... So also in the criminal law, in cases where the law requires a guilty mind as a condition of a criminal offence, the guilty mind of the directors or the managers will render the company itself guilty. ... Whether [the] intention is the company's intention depends on the nature of the matter under consideration, the relative position of the officer or agent and other relevant facts and circumstances of the case."*[7]

Of course, the focus of this paper is on Chinese Company Law and not English Company Law but the above quotations are all the same reflective of both global trends and the contents of articles 147, 148 and 149 of the Company Law of China on how directors of companies are required to act in a manner that would promote the best interest of the company. The duties imposed on the directing minds go further than the duties of an agent towards his principal. The duties of the directing minds of companies are akin to the duties of a trustee towards the settlor (i.e. trustor) and the beneficiary and hence mention has always been made of these duties as fiduciary duties much the same as the fiduciary duties that a trustee owes to the settlor in the management of trust property.[8] The law, therefore, requires these agents to execute their duties in a manner similar to how trustees are supposed to execute their duties in the management of trust property. This paper examines the legal regulation of the directing minds of Chinese companies from the cradle to the grave. The gravamen of the argument in this paper is that the legal regulation of the directing minds of Chinese companies is more tolerant of misconduct by promoters and members of the liquidation group than it is of misconduct by the directors, supervisors and senior management personnel of the company yet all of these different categories of people are the directing minds of a company, albeit at different stages in the life cycle of the company and hence their capacity to adversely affect the company and its stakeholders is very much the same.

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[2] See clause 2 of Article 180 of the Company Law of the People's Republic of China (promulgated on December 29, 1993 and amended on 25th December, 1999 as well as 28th August, 2004 and then revised on 27th October, 2005 and again amended on 28th December, 2013)
[3] Ibid, clause 5 of Article 180
[4] See (1854) 1 Macq 461.
[5] Ibid at 471, HL (Sc) per Lord Cranworth LC
[6] See [1957] 1 QB 159
[7] Ibid at p. 172, per Lord Denning LJ
[8] See Rebecca Lee, Fiduciary Duty without Equity: 'Fiduciary Duties' of Directors under the Revised Company Law of the PRC (2007) 47 Virginia Journal of International Law *897 at 905 - 906*

II. PROMOTERS OF COMPANIES AS THE 'DIRECTING MINDS' OF COMPANIES

Before the incorporation of a company, it is absolutely necessary for someone to take action by way of laying the groundwork for the birth and smooth take off of the company. The promoters of a company are the people who conceive the idea of forming a company to go into any line of business after which they undertake all the requisite processes to bring the said idea into fruition as a corporate body. Even if the idea of incorporating a company is not the brainchild of the promoters, the people who take all the necessary actions to give birth to that idea in the form of a company are referred to as the promoters of such a company. Towards 'giving birth' to the corporate body and laying a proper foundation for it to take off smoothly, the promoters necessarily have to contract or act on behalf of the company in several respects such as engaging legal expects to prepare the articles of association[9] of the company and giving the company its name and then filing all the requisite documents for the incorporation of the company and the issuance of its business license to it; engaging other experts or consultants whose expert advice is considered important for laying a proper foundation for the company to have a good start; acquiring lands or offices as the business location of the company and branches of the company if any, and procuring the initial logistics for the easy take off of the company; getting directors and shareholders for the company and deciding how much the stated capital of the company must be as well as how to raise this capital and the classes of shares to be issued. Therefore, the promoters will necessarily have to open a bank account for the company for the receipt of the proceeds of money realized from the sale of the initial shares of the company.[10] The promoters therefore perform a very vital function in the early part of the life cycle of a company much like the parental roles required to be performed by the mother and father of a child. What then is the legal definition of a promoter in Chinese company law?

Because of the varied nature of activities that promoters are required to undertake prior to the inaugural meeting[11] of the company at which a board of directors is required to be formed to take over from the promoters, it has been difficult for a perfect definition of the term "promoter" to be made. English judges had long attempted to define this term in order to offer a rough guide as to who a promoter is. One of the popular English definitions is the one given by Cockburn, CJ in the case of **Twycross v. Grant**[12] wherein he defined a promoter as follows:

"The question as to when one who in the outset was a promoter of a company continues or ceases to be so, becomes, therefore, as it seems to me, one of fact. A promoter, I apprehend, is one who undertakes to form a company with reference to a given project and to set it going, and who takes the necessary steps to accomplish that purpose."[13] *(The emphasis is mine)*

Cockburn, CJ proceeded to throw more light on the endpoint of a promoter's work as follows:

"Of course, if a governing body, in the shape of directors, has once been formed, and they take, as I need not say they may, what remains to be done in the way of forming the company, into their own hands, the functions of the promoter are at an end."[14]

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[9] *See Articles 85 and 86 of the Company Law of China which require the promoters to prepare a prospectus, share subscription forms and articles of association for the company if they are minded to offer shares of the company to members of the public. Obviously, promoters must enter into contracts with other people on behalf of the yet-to-be-formed company in order to engage the services of a number of experts to help them execute these tasks properly.*

[10] *See Articles 87 and 88 of the Company Law of China which require promoters to sign agreements with a securities company and a bank with respect to the receipt and handling of funds from shareholders who subscribe to a company's shares.*

[11] *See Articles 89 and 90 of the Company Law of China which explains when and how an inaugural meeting is to be convened by the promoters and what such a meeting ought to do.*

[12] *(1877) 2 C.P.D. 469*

[13] *Ibid at p. 541*

[14] *Ibid at p. 541*

Indeed, the Company Law of China has not given any definition to the term "promoter". However, Article 1 of the Judicial Interpretation III[15] of the Supreme People's Court on the Company law of the People's Republic of China defines a promoter as follows:

"Whoever concludes the articles of association for the purpose of establishing a company, subscribes to capital contributions or shares and performs the duties of establishing the company shall be deemed as a promoter of the company, including the shareholders at the time of establishment of a limited liability company."[16] *(The emphasis is mine)*

A critical reading of the Company Law of China would reveal that all the rules relating to promoters refer to the establishment of joint stock limited companies. The rules on promoters were all created under Chapter Four of the Company Law which concerns the establishment and structure of joint stock limited companies. More importantly, the content of the rules on promoters leaves no doubt that they were originally meant to apply to the promoters of joint stock limited companies and not limited liability companies. Chapter Two of the Company Law deals with the establishment and structure of limited liability companies. Under this chapter of the Law, clause 3 of Article 23 makes it clear that it is the shareholders of a limited liability company that have the duty to work out the articles of association of the company. This is significantly different from what is stated in Article 76 of the Company law in respect of the establishment of a joint stock limited company whereby that duty is required to be performed by the promoters of a company. Secondly, Article 38 of the Company Law states that the shareholders of a limited liability company must hold the inaugural meeting for the appointment of an executive director or board of directors of a limited liability company to take over the duty of running the business of the company but with respect to the establishment of joint stock limited companies, Article 89 of the Company Law makes it clear that such an inaugural meeting must be called and presided over by the promoters.

When all the provisions of chapters two and four of the Company Law are compared in respect of the functions and powers of promoters, it can only lead to one undeniable conclusion: i.e. the Company Law does not contain rules regulating the use of promoters for the establishment of limited liability companies and that it is expected that the shareholders of a limited liability company must act as the *de facto* promoters of limited liability companies. Truly, the shareholders of a limited liability company are invariably likely to be the people who will act as the promoters of such companies. However, it is equally possible that the shareholders may choose to engage other people to incorporate the company for them. It is, therefore, possible to have promoters of a limited liability company who may not end up being shareholders of that company. It is in this light that one can properly appreciate Article 1 of Judicial Interpretation III of the Supreme People's Court on the Company law of the People's Republic of China. This Article has given a very wide definition of the term "promoter" to cover shareholders of a limited liability company who actually perform the duties of a promoter in the establishment of the said company. The phrase "including the shareholders at the time of establishment of a limited liability company" has successful achieved the purpose of including such shareholders in the definition of the term "promoter". It is also wide enough to include anyone to whom such shareholders have delegated their duty of establishing such a limited liability company for them. The liabilities of promoters as stated in Article 94 of the Company Law can then be applied to all such categories of promoters as long as they have fallen under the definition of the term "promoter". This means that until the said Judicial Interpretation was issued in 2014, promoters of limited liability companies were free to do as they wished because they were not legally exposed to stringent liabilities to force them to behave as conscientiously as possible in the execution of their duties as such.

Much as the above quoted Article 1 of Judicial Interpretation III is very much laudable, it appears to be too wide in the sense that it does not leave out people who have been engaged as experts in their professional capacity to assist the actual promoters to establish a company. In most common law jurisdictions, such professional experts are usually

[15] See the Provisions of the Supreme People's Court on Several Issues concerning the Application of the Company Law of the People's Republic of China (III) as issued on 20th February, 2014 to guide the people's courts in the application of the Company Law with respect to the hearing of disputes over the establishment of companies, capital contributions, confirmation of equities, etc.

[16] Ibid, Article 1

exempted from the definition of the term "promoter".[17] The reason for the exemption of such professional experts is that these experts are usually interested in only their professional fees for doing a professional job and they are not necessarily involved in the affairs of such companies after they have finished giving their professional services and taken their fees. An example could be a lawyer engaged by the promoters to use his specialist knowledge of company law to prepare the articles of association for the incorporation of the company. Such lawyers will only be interested in the legal fees for their services and their relationship with the promoters as well as the future company will come to an end as soon as they accomplish the task for which they have been engaged. Therefore, it would make sense not to burden such lawyers and other such professionals with the same duties towards the company as the actual promoters of such companies.

There is no doubt that the contracts entered into by a promoter prior to the incorporation of the company are often referred to as pre-incorporation contracts. At common law, such contracts were not binding on the company when it eventually became incorporated. Worse still, the company was not even capable of ratifying these contracts after it had been incorporated since it was not in existence when those contracts were made and could, therefore, not be said to have made a valid agreement via an agent at that time since it did not have any capacity for civil rights and a capacity for civil conduct at that time when the contract was made. The case of **Kelner v. Baxter**[18] is illustrative of this common law rule:

In this case, the defendants bought wine on behalf of a hotel company they proposed to form. The company was eventually incorporated and it ratified this wine contract after which the wine was handed over to the company and was consumed. However, the company was wound up before it could pay for the wine. An action was, therefore, brought by the wine seller against the promoters for the unpaid price of the wine. The court decided that although the promoters signed the contract as if they were doing it as agents of the company, no such principal (i.e. the company) existed at that time and thus the defendants were liable to pay this money to the plaintiff because the company could not be said to have properly ratified this contract when it later came into existence and was given the goods which it in fact used. The court observed as follows:

"A promoter is personally liable on contracts made on behalf of a company before it is incorporated. A company cannot have an agent before it comes into existence. Ratification by the company when formed is legally impossible"[19] *(The emphasis mine).*

The problems that the common law had with pre-incorporated contracts were even compounded further by the fact that it seemed almost impossible to get a company bound to a pre-incorporation contract no matter how the promoters ingenuously couched such a contract. For example, in the case of **Newborne v. Sensolid**[20] the promoter of a company (one Leopold Newborne) purportedly signed a contract in the name of the company yet to be formed to sell goods to the defendants. This means that the contract was purportedly made between this future company and the defendants. The market in these goods later fell and the defendants refused to accept delivery of the goods. Leopold Newborne, therefore, issued a writ in the company's name against the defendants but later substituted his own name as the plaintiff seeking to enforce this contract in court. It was held that the company was not bound by this contract since at the time that this contract was made, it was not in existence. Thus, even the company itself could not have sued to get this contract performed. The court observed that the promoter (Leopold Newborne) did not sign the contract as an agent of the company (as in **Kelner v. Baxter**) and thus the contract was void because of the non-existence of the other party to it (i.e. the company) when it was made. Not being a party to the contract and secondly, since the contract was a nullity (void), Leopold Newborne could, therefore, not sue to enforce this contract.

Under English common law, the situation was precarious because it left both the promoters and the newly incorporated companies in a messy situation as far as the validity of pre-incorporation contracts were concerned. Most common

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[17] *For example the Companies Code, 1963 (Act 179) of the Republic of Ghana, exempts professional experts from its definition of the term "promoter" when it states in section 12(1) as follows: "Any person who is or has been engaged or interested in the formation of a company is a promoter of that company: Provided that a person acting in a professional capacity for persons engaged in procuring the formation of a company shall not thereby be deemed to be a promoter." (The emphasis is mine)*

[18] *(1866) L.R. 2 C.P. 174*
[19] *Ibid at 183*
[20] *[1954] 1 Q.B. 45, C.A.*

law jurisdictions therefore used legislative enactments to give legal validity to pre-incorporation contracts provided that such contracts were ratified by the companies concerned after their incorporation.

The Company Law of the People's Republic of China is silent on the issue of the legal validity of pre-incorporation contracts. Article 55 of the General Principles of Civil Law[21] (hereinafter referred to as the GPCL) of the People's Republic of China requires that in order for a civil juristic act to be valid, it must be done by an actor who had legal capacity for civil conduct at the time when such an act was concluded. This is followed by Article 66 of the GPCL which states that a principal can retroactively ratify an act done by an agent on his behalf without his consent. If the civil juristic act is contractual in nature, Article 48 of the Contract Law[22] of the People's Republic of China makes it clear that where a contact is made by an agent in the name of the principal but without express authority, such a contract is not binding on the principal but rather on the agent alone. This would mean that such a contract can become binding on the principal if the principal ratifies it retroactively. However, from a combined reading of all these articles, it is still unclear whether the retroactive ratification can go beyond the period when the principal acquired his capacity for civil conduct. Is it a must for the principal to have had capacity for civil conduct at the time when the act was purportedly done on his behalf before such a principal can ratify it retroactively? Can a principal use the above legal provisions as the basis to retroactively ratify a contract which was made on his behalf at a time when he was not in existence and hence he did not have capacity for civil rights let alone a capacity for civil conduct? Notably, Article 36 of the General Principles of Civil Law (GPCL) of China states as follows:

"A legal person shall be an organization that has capacity for civil rights and capacity for civil conduct and independently enjoys civil rights and assumes civil obligations in accordance with the law.

A legal person's capacity for civil rights and capacity for civil conduct shall begin when the legal person is established *and shall end when the legal person terminates."*[23] *(The emphasis is mine)*

The net effect of all the above articles or provisions of Chinese law would be that under the Chinese law, a pre-incorporation contract would suffer the same enforceability problems that the common law encountered with such contracts years ago until legislation came to the rescue of pre-incorporation contracts in many common law jurisdictions. It is my humble submission that both Article 2 and Article 3, of the Judicial Interpretation III[24] of the Supreme People's Court on the Company law of the People's Republic of China, are aimed at clarifying any doubts in this area of the Company Law of China. Article 2 of the said Judicial Interpretation states as follows:

"Where a promoter concludes a contract with anyone else in his own name for the purpose of establishing a company, if that person claims that the promoter shall bear contractual liabilities, the people's court shall support such claim. (The emphasis is mine)

Where the contract as prescribed in the preceding paragraph is confirmed after the company is established, or the contractual rights have been actually enjoyed or the contractual obligations have been actually performed, if the other party to the contract claims that the company shall bear contractual liabilities, the people's court shall support such claim."[25]

This is followed by Article 3 which also states as follows:

[21] Promulgated on 12th April, 1986 and effective since 1st January, 1987

[22] Promulgated on 15th March, 1999 and effective since 1st October, 1999

[23] *A translated version of Article 36 of the General Principles of Civil Law of the People's Republic of China.*

[24] *See the Provisions of the Supreme People's Court on Several Issues concerning the Application of the Company Law of the People's Republic of China (III) as issued on 20th February, 2014 to guide the people's courts in the application of the Company Law with respect to the hearing of disputes over the establishment of companies, capital contributions, confirmation of equities, etc.*

[25] *Ibid*

"Where a promoter concludes a contract with anyone else in the name of a company being established, if, after the company is established, the other party to the contract claims that the company shall bear contractual liabilities, the people's court shall support such claim. (The emphasis is mine)

Where, after a company is established, there is evidence to prove that the promoter has concluded a contract with anyone else in the name of the company being established for his own interest, if the company claims on this ground that it shall not bear contractual liabilities, the people's court shall support such claim except that the other party concluded the contract for good faith."[26]

It would seem that the legal issues relating to the validity and enforceability of pre-incorporation contracts under Chinese law have been well settled by the above quoted provisions of the judicial interpretation given by the Supreme People's Court since the above quoted Article 2 addresses the kind of problem which the English courts encountered in the case of **Kelner v. Baxter**[27] whilst Article 3 quoted above addresses the kind of problem encountered by the common law in the case of **Newborne v. Sensolid**[28]. However, one may raise legitimate questions about the constitutional propriety of a judicial interpretation by the Supreme People's Court being used to virtually effect an amendment to laws passed by the Standing Committee of the National People's Congress. As noted under Article 36 of the GPCL, a legal person such as a company does not have capacity for civil rights as well as capacity for civil conduct in respect of matters that occurred before that company came into existence. If this is the will or expressed intention of the Standing Committee of the National People's Congress, does the Supreme People's Court have constitutional authority to counter such an expressed intention of the National People's Congress by making an interpretation to the contrary? There is no doubt that the above quoted provisions of the Judicial Interpretation are very much desirable in order to create certainty for the enforcement of pre-incorporation contracts but the issue is whether such a change in the legal rules has been properly done by the constitutional body empowered to do so. Article 88 of the Legislation Law of the People's Republic of China states that only the National People's Congress has the power to amend any law passed by its Standing Committee. This would mean that such a power to amend the law cannot be exercised by the Supreme People's Court through a judicial interpretation. Therefore, it is my submission that much as Article 2 and Article 3 of the Judicial Interpretation III of the Supreme People's Court on the Company Law of the People's Republic of China are desirable provisions, they are capable of being impeached or questioned by a natural or legal person who stands to gain if those provisions were not to apply to his or its situation as far as pre-incorporation contracts are concerned.

Aside the enforceability challenges with pre-incorporation contracts at common law, another problem which the common law grappled with in connection with such contracts was the danger of promoters using the opportunity for making such contracts to take advantage of unsuspecting shareholders as well as other stakeholders who later invest in such companies. In view of the pivotal role which a promoter must play in order to get a company incorporated and to have it start business, a devious promoter can entangle a company in a number of pre-incorporation contracts or arrangements which may cause the company to falter right from the outset and be doomed for failure with the concomitant effect of causing all investors to lose their investments as long as the company is a limited liability company. On the other hand, a conscientious performance of a promoter's duties can place a company on a good footing to succeed and flourish as a profitable enterprise. For these reasons, the common law has saddled promoters of a company with fiduciary duties very much like the fiduciary duties which a trustee owes the settlor (trustor) in a trust relationship. Article 94 of the Company Law of China seeks to discourage devious behaviour of promoters in the way they perform their duties for or on behalf of the company yet-to-be-incorporated. This Article shall be examined later in this paper.

[26] *Ibid*
[27] *Supra note 18*
[28] *Supra note 20*

III. DIRECTORS OF COMPANIES AS THE DIRECTING MINDS OF COMPANIES

Once the inaugural meeting referred to in Article 89 of the Company Law[29] is held and a board of directors is constituted to take over the mantle from the promoters, the said board of directors effectively occupies the driving seat as far as corporate governance of companies in China is concerned. Truly, the term corporate governance is subject to a variety of conceptualizations[30] but this paper uses the phrase "corporate governance" in this context in its narrow sense to mean the control exercised by the directing minds of a company to take decisions and actions on behalf of the company during the period immediately after the board of directors has been established to replace the promoters until a liquidation group has taken over the performance of these functions from the board of directors to stir the affairs of the company till the winding up process is completed.

Under the Company Law of China, every company must have a directing mind or a board of directors that shall act as its directing mind. A joint stock limited company must have a board of directors of between five (5) to nineteen (19) members as its directing mind.[31] The directing mind of limited liability companies in China varies. For a one-person limited liability company, the individual who set up that one-man business as a corporation will invariably be the company's directing mind. Similarly, for limited liability companies having a small number of shareholders or doing business on a small scale, the Company Law allows the shareholders to appoint just one person as its directing mind known as its executive director.[32] For all other limited liability companies, the directing mind of the company must be a board of directors of between three (3) to thirteen (13) members.[33] For all of these types of companies, the directing minds are subject to the oversight of supervisor(s) or a board of supervisors: one or two supervisors in the case of small-scale limited liability companies with a small number of shareholders or a board of supervisors of at least three (3) members in all other cases.[34] The supervisor(s) or board of supervisors are supposed to act as a check on the directing minds of these companies to ensure that they do what is expected of them under the Company Law and hence they are required to attend board meetings and raise queries as well as institute suits upon the requests of shareholders to defend the interest of the company and its stakeholders. Besides the oversight that the supervisor(s) or board of supervisors has over the directing minds of a company, the Company Law also provided elaborate rules from Articles 147 – 149 to regulate the directors of a company much like the fiduciary duties that the common law imposes on the directing minds of a company.

IV. THE LIQUIDATION GROUP AS THE DIRECTING MINDS OF COMPANIES

Except for instances where the dissolution of a company is necessitated by a merger or division of the company, in all other instances of dissolution of a company under the Company Law of China, a liquidation group must be constituted to take over from the executive director or the board of directors as the directing mind of the company until the whole liquidation and dissolution process is completed.[35] In the case of a limited liability company, the Company Law requires that the liquidation group must be made up of the company's shareholders. This means that in the dissolution of a limited liability company, the executive director or members of the board of directors may not be part of the liquidation group unless where they also double as shareholders of the limited liability company or the people's court sets up a liquidation group based upon the application of the company's creditors and the court chooses to include the executive director or members of the board of directors in that group.[36] It is in the case of joint stock limited liability companies that the Company Law requires that the composition of the liquidation group be made up of the directors of the company or such persons as the company's shareholder's assembly shall determine.[37] This would also mean that the membership of the liquidation group of a joint stock limited liability company may not necessarily be the same people that were the directing minds of the company prior to the dissolution of the company. The task of a

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[29] In the case of a limited liability company, Article 38 of the Company Law of the People's Republic of China requires that the shareholder that made the largest capital contribution shall convene a similar meeting known as the first shareholders' meeting to decide on the appointment of director(s) or board of directors to run the company.

[30] See Donald C. Clarke, The Independent Director in Chinese Corporate Governance, 31 Delaware Journal of Corporate Law, 125 at pp. 143-145 (2006)

[31] See Article 108 of the Company Law of the People's Republic of China.

[32] Ibid, Article 50

[33] Ibid, Article 44

[34] Ibid, Article 51

[35] See Article 180 and Article 183 of the Company Law of the People's Republic of China.

[36] Ibid, particularly Article 183

[37] Ibid

company liquidation group is pretty much straight forward: they are to sell off the assets of the company and use the proceeds to pay off the company's creditors and its outstanding taxes after which the company's remaining properties shall be distributed to the shareholders in proportion to their capital contributions, in the case of a limited liability company, or in proportion to the shares held by the shareholders, in the case of a joint stock limited company.[38]

In the performance of their duties as the last directing minds of a company when it is in the throes of being terminated, liquidators of companies are very much in the same position as the promoters and the directors of companies in the sense that they can easily take advantage of their positions to enrich themselves at the expense of the company concerned. Therefore, the common law holds liquidators of companies to the same standard as the promoters and the directors of companies. They are all treated as fiduciaries and hence they must perform their duties to the same standard under the law. Under the Company Law of China, Article 189 holds the members of the liquidation group to a standard of faithfulness in the way they are required to perform their duties towards the company and its stakeholders. Article 23 of the Judicial Interpretation II[39] of the Supreme People's Court of the People's Republic of China further elaborates on the duties of care which the liquidation group is required to adhere to.

V. ACCOUNTABILITY OF DIRECTING MINDS OF COMPANIES

As observed above, a company's directing minds change during the life cycle of every company. The embryonic directing minds of a company are its promoters and once the company is fully incorporated, the executive director or the board of directors of the company takes over this mantle from the company's promoters. The executive director or board of directors stay as a company's directing mind for the whole life of the company but when the company is finally in the throes of dissolution, the mantle must pass over to a liquidator or a liquidation group. Throughout the various stages of a company's life, the common law rules on the directing minds of companies stick to a uniform standard: the rules hold all the different types of directing minds of companies to the same standard of care in respect of how they are supposed to run the affairs of the company. They are all regarded as fiduciaries to the company and its stakeholders. A fiduciary is a person who is required to act only for the benefit of the person reposing confidence in him. Therefore, at common law, all promoters, directors and liquidators of companies are subject to the following fiduciary duties:

i. All fiduciaries must be transparent in their dealings with the company by not withholding any information from the company as long as that information relates to the company's business. A fiduciary cannot withhold information which is beneficial to the company's business and then use that information for his personal gain at the expense of the company;

ii. All fiduciaries must account to the company for any benefit derived by them, without the consent of the company, from any transaction related to the company or from any use by them of the company's property. This means that no fiduciary can make secret profit from his/her position as a promoter or director or liquidator of the company; and

iii. A fiduciary must not engage in any transaction or business activity by which his interest may conflict with that of the company. This includes what is generally known as self-dealing but the concept of not competing with the company as a fiduciary goes far beyond self-dealing. It would include setting up a rival business to undercut the company. For example a director is prohibited from setting up a rival business to unfairly compete with the company in the same area of business whilst he remains a director.

If any promoter, director or liquidator contravenes any of these broad fiduciary duties in his dealings with the company or in relation to the company, the common law makes him liable to account for, and even to pay over to the company, all profits or gains which he has made through such violation of his fiduciary duties to the company.

[38] *Ibid, particularly Article 184 and Article 186*
[39] *See Provisions of the Supreme People's Court on Several Issues concerning the Application of the Company Law of the People's Republic of China (II) (2014 Amendment)*

VI. THE PROMOTERS

Under the Company Law of China, all the directing minds of companies at the various stages of its life cycle are not held to the same standard or duty of care towards the company. Article 94 of the Company Law of China stipulates as follows:

> "The promoters of a joint stock limited company shall bear the following liabilities:
> (1) in the event of failure to establish the company, being jointly and severally liable for the debts and expenses incurred from the activities related to the company establishment;
> (2) in the event of failure to establish the company, being jointly and severally liable for refunding the subscription monies already paid by subscribers plus an interest calculated at the bank deposit interest rate for the same period; and
> (3) if during the course of establishment of the company, **the company's interests are harmed due to the fault of the promoters**, being liable toward the company for compensation."[40] (The emphasis is mine)

Clauses 1 and 2 of the above quoted Article 94 of the Company Law are mere commonsensical provisions. Once the company is not established as planned, it will be tantamount to unjust enrichment and hence contrary to the law[41] for the promoters to be allowed to retain any part of the subscription moneys or any accruals emanating from such moneys[42]. Also, the debts and expenses incurred in the course of the attempt to incorporate such aborted companies should naturally remain the burdens of the promoters else injustice will be done to persons who contracted with the promoters in good faith during that process.[43]

Therefore, clause 3 of Article 94 of the Company Law is the only clause that is worth serious consideration in the nature of the duties of promoters. Much as this clause is commendable, it appears to be limited in scope. It limits the promoters' liability to acts by which "the company's interests are harmed due to the fault of the promoters". When this standard of accountability of promoters under the Company Law of China is compared to the standard of accountability which the common law places on a promoter as a fiduciary of a company, it will be obvious that the Company Law of China limits the accountability of promoters only to the instances in which some harm has been done to the interest of the company due to devious actions of promoters. However, a critical look at the extent of the fiduciary duties outlined above would show that there are many ways in which a fiduciary may violate his duties and make some gains through such violation without necessarily harming the interest of the company. In fact, the company may actually benefit simultaneously with him but under the common law rules, a fiduciary will all the same become liable to pay over or disgorge all such benefits to the company as long as he made such gains through a violation of his fiduciary duties. It would appear from the tenor of the phrase "the company's interests are harmed due to the fault of the promoters" that as long as it cannot be shown that the company's interest has been harmed, it will be permissible for promoters to keep information to themselves, keep secret profit and compete with the company including self-dealing. Admittedly, in many instances where promoters keep information to themselves, keep secret profit or compete with the company, the interest of the company will be harmed by such conduct. However, it is not always in all cases that such behavior by promoters will harm the interest of the company. Must promoters be allowed to be disloyal as long as they do not harm the interest of the company yet-to-be-incorporated?

VII. THE DIRECTORS

The Company Law of China provides for the duty of care and the standard of liability for directors of companies in Articles 147, 148 and 149. Article 147 states that the directors, supervisors and senior management personnel of a company owe the company a duty of loyalty and diligence. Articles 148 and 149 then go further to enumerate specific things which the directors, supervisors and senior management personnel are required not to do in true obedience to their duty of loyalty and diligence towards a company. Essentially, Article 147 of the Company Law imposes that duty on directors, supervisors and senior management personnel as follows:

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[40] *See Article 94 of the Company Law of the People's Republic of China*.
[41] *See Article 92 of the General Principles of the Civil Law of the People's Republic of China.*
[42] *See Article 131 of the Opinions of the Supreme People's Court on certain issues concerning the implementation of the "General Principles of Civil Law of the People's Republic of China". (Generally referred to as the 200 Articles)*
[43] *See Articles 4 and 5 of the Provisions of the Supreme People's Court on Several Issues concerning the Application of the Company Law of the People's Republic of China (III), supra note 24. These articles have further elaborated on the circumstances in which promoters must do justice to the people they have contracted with on behalf of the aborted company which they sought to establish.*

*"Directors, supervisors and senior management personnel shall comply with laws, administrative regulations and the company's articles of association and **shall owe the duties of loyalty and diligence toward the company**.*

Directors, supervisors and senior management personnel shall not take advantage of their functions and powers to accept bribes or other illegal income, nor shall they encroach on the property of the company." (The emphasis is mine)

Though our focus here is on the directors of a company, it is notable that the above quoted article places the same duty of care and standard of care on supervisors and senior management personnel as it does on the directors of a company. This is not surprising because as Professor Donald Clarke has observed, it is "clear that managers cannot be left wholly unaccountable. If they were, they would have no incentive to maximize anyone's interests but their own, and others would therefore have no incentive to commit resources to their management, leading to the collapse of the enterprise."[44] Professor Rebecca Lee has opined that in view of the broad nature of the duty of loyalty and diligence stipulated in these articles, the Company Law of China has equated the duties of Chinese company directors to those of the fiduciary duties of company directors in common law jurisdictions.[45] Regarding the current Company Law of China, Professor Rebecca Lee states as follows:

"Contrary to the provisions in the old Company Law, which merely provide a descriptive understanding of directors' duties, it is submitted that the revised Law introduces a concept of fiduciary loyalty of directors by virtue of the new article 148, and indeed, fiduciary duties of directors manifest themselves in a number of provisions in the revised Law. That the revised Law introduces fiduciary concepts can be illustrated by: (a) the incorporation of a defining obligation of the fiduciary doctrine; (b) the inclusion of various specific directors' duties under the rubric of this defining obligation; and (c) the introduction of remedies conventionally available to fiduciary breaches."[46]
In the same piece of writing, Professor Rebecca Lee appeared a little less confident of her earlier submission quoted above when she vacillated a little bit as follows:

"To sum up, while it is not clear whether the intent of articles 148 and 149 of the revised Company Law is to import Anglo-American fiduciary concepts to China, it is at least arguable that those express stipulations could produce such effect."[47]

This paper very much agrees with the latter quotation above. It may be early days yet for it to be said that articles 147-149 of the Company Law of China have equated the duties of directors of companies in China to the all-encompassing or pervasive nature of the concept of fiduciary duties of directors in common law jurisdictions. Certainly, there is no denying the fact that the duty of loyalty and diligence as stated in those provisions is very broad indeed. However, whether or not they can be equated to the fiduciary duties of directors will all depend on how these provisions are applied practically to cases involving directors, supervisors and senior management personnel in the people's courts in China over a long time. Indeed, Rebecca Lee has argued that more needs to be done by the people's courts to enable the rules in the above article to equate the concept of fiduciary duties. She thus states as follows:

"To recapitulate, describing directors as owing an obligation of loyalty necessitates an investigation into the nature of this obligation. However, the recognition of the obligation's fiduciary nature is inadequate if the concept of fiduciary loyalty is embodied without the application of equitable principles. A fiduciary concept without equity encompasses only some bright-line rules not supported by equity's techniques - techniques that are important if the introduction of fiduciary loyalty under the revised Company Law is not to be condescended into a broad concept devoid of practical significance."[48]

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[44] *See Donald C. Clarke, The Independent Director in Chinese Corporate Governance, 31 Delaware Journal of Corporate Law, 125 at p. 145 (2006)*
[45] *See Rebecca Lee, Fiduciary Duty without Equity: 'Fiduciary Duties' of Directors under the Revised Company Law of the PRC (2007) 47* Virginia Journal of International Law *897*
[46] *Ibid, p. 904*
[47] *Ibid, pp. 909-910*
[48] *Ibid, pp. 913-914*

VIII. THE LIQUIDATORS

Whilst the directors, supervisors and senior management personnel are held to a very high standard of care to such an extent that it approximates that of fiduciary duties in common law jurisdictions, the members of a company's liquidation group are held to a much lower standard. Article 189 of the Company Law stipulates as follows:

"Members of a liquidation group shall be faithful in the discharge of their duties and perform their liquidation obligations according to law.

Members of a liquidation group shall not take advantage of their positions to accept bribes or other illegal income and shall not encroach on company property.

If members of a liquidation group by intention or through gross negligence cause the company or its creditors to suffer loss, they shall be liable for compensation."[49] *(The emphasis is mine)*

From the above quoted provision, it is difficult for one to pinpoint with exactitude the nature of the duty which the Company Law has placed on the members of a liquidation group. In the case of the directors of a company, clause 1 of Article 147 makes it very clear that a duty of loyalty has been placed on them. However, a critical examination of clause 1 of Article 189 shows that the said clause has not necessarily placed any duty of loyalty on the members of a liquidation group. It merely requires them to perform their duties faithfully in accordance with the law. So what exactly are those duties which they must perform faithfully? Clause 2 of Article 189 is exactly the same as clause 2 of Article 147 and these clauses merely forbid the members of the liquidation group as well as the directors, supervisors and senior management personnel from accepting bribes, illegal income or encroaching on the property of the company. Finally, clause 3 of Article 189 forbids the members of the liquidation group from causing losses to the company or its creditors either intentionally or through **gross negligence**. Does it mean that they are not liable where their ordinary negligence causes losses to the company or its creditors? Whatever the case may be, when one compares Article 147 to Article 189 of the Company Law, it will be clear that the Company Law has placed a less stringent duty of care or standard of care on the members of a liquidation group than the duty and standard of care which the same law has placed on the directors, supervisors and senior management personnel of a company. It is difficult for one to understand why this should be so. As noted above, the composition of the members of the liquidation group, in the case of a joint stock limited company, may largely be made up of the directors of the same company[50]. Therefore, why would a more stringent standard of care be required of them when they are acting as the company's directing minds prior to liquidation and then the standard is significantly lessened for them when the company is in the throes of liquidation? The common law holds both directors and liquidators of companies to the same duty of care and standard of care because they are all directing minds of the company and hence they have about the same capability to make personal gains at the expense of the company or its stakeholders. Even if the gains are made in instances where the company's interests are not directly harmed, such gains are nevertheless retrievable by the company and its stakeholders as long as it can be proved that those gains were made by the directing minds in breach of their fiduciary duties.

It is also notable that Article 23 of the Judicial Interpretation II[51] of the Supreme People's Court has stipulated that the prohibition contained in clause 3 of Article 151 of the Company Law equally applies to members of the liquidation group. That clause simply prohibits any third party from acting in a manner that will infringe on the legitimate rights and interests of the company and thereby causing the company to suffer any loss. Article 23 of the said Judicial Interpretation II of the Supreme People's Court, therefore, stipulates that if members of the liquidation group violate clause 3 of Article 151 of the Company Law by acting in a manner that causes losses to the company, they will become liable to pay damages.

Article 23 of the said Judicial Interpretation II states that if "members of the liquidation group violate any laws, administrative regulations or articles of association of the company and thus cause losses to the company or any

[49] *See Article 189 of the Company Law of the People's Republic of China*
[50] *See Article 183 of the Company Law of the People's Republic of China*
[51] *See Article 23 of the Provisions of the Supreme People's Court on Several Issues concerning the Application of the Company Law of the People's Republic of China (II) (2014 Amendment) [Effective date, 20th February, 2014]*

creditors during the course of liquidation", they shall become liable to pay compensation to the company or creditors of the company. It would thus seem that the stipulation in Article 189 of the Company Law that the members of the liquidation group "shall be faithful in the discharge of their duties" simply means that they must be faithful in their obedience to the laws, administrative regulations and articles of association of the company relating to how the liquidation and dissolution of the company ought to be carried out. Such a generalized duty of care goes nowhere near the duty of loyalty required of directors under Article 147 of the Company Law much less the fiduciary duties which are imposed on liquidators of companies in common law jurisdictions.

IX. CONCLUSION

The Company Law of China was promulgated on December 29, 1993. Since then, this Law has been amended three times and revised once. All these amendments and the revision are geared at ensuring that the law would be capable of addressing the many different legal issues that people may encounter in running, managing or dealing with companies in China. The various judicial interpretations done by the Supreme People's Court in 2014 have given further explanation to the provisions of the Company Law and have even sealed certain loopholes in the Company Law as well. It is little wonder therefore that Professor Donald Clarke has observed that "Chinese scholars and policymakers have been searching for new mechanisms of corporate governance and accountability not just for listed companies, but for all concentrations of assets managed by non-owners."[52] It is in that spirit that this paper has examined the duties of the different directing minds of a company at the various stages of its life cycle and has made the case that with respect to the directing minds of Chinese companies, there is still a lot of room left to be covered. This paper takes the view that the duties of care required of promoters and members of a liquidation group have fallen way below that required of the directors of a company yet they are all directing minds of the company albeit at different stages in the company's life. Until the duty of care of all these directing minds is harmonized, shrewd but designing promoters and devious members of a liquidation group will be able to get away with conduct which the directors are prevented by the law from engaging in.

[52] *See Donald C. Clarke, The Independent Director in Chinese Corporate Governance, 31 Delaware Journal of Corporate Law, 125 at p. 130 (2006)*