

Criteria for Determining the Duty of Diligence of Independent Directors Under the Reform of the Single-Level System

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At present, China has not made clear legislative provisions on the specific connotation and determination criteria of the diligence and due diligence of independent directors, and this legislative gap has led to the lack of uniform and operable legal regulations in reality, which in turn has led to the lack of clear guidelines for independent directors to perform their duties diligently and the requirements of due diligence. How exactly should the specific standard of independent directors' duty of diligence be seen in China? This paper analyses the problems and reasons in China's practice and compares them with the relevant system in the United States, so as to answer the standard from several perspectives, including logic, introduction of business judgement rules, and distinction between independent and general directors respectively.

Keywords: independent directors, duty of diligence, single-tier system, business judgment rule

Introduction

Independent directors are often criticized as “vase director”, which is closely related to the “two-tier system” corporate governance structure in China. In 2023, the Chinese Company Law promulgated introduces the “single-tier” system, allowing companies to choose the governance structure, which largely enhances the status of independent directors, and whether the independent directors fulfill the duty of diligence to become the key to the failure of the independent directors, and whether or not the independent directors fulfilled their duty of diligence became the key to the success of the single-tier system. Our country has not yet stipulated the specific standards of the independent directors' diligence obligation standard, a specific standard which not only improves the efficiency of the trial, but also encourages the independent directors to do their duty to fulfill their responsibility to a greater extent. This paper firstly analyzes the irrationality of the domestic system design, and then compares and draws reference from the relevant system design of the United States, respectively, from the logic of determining the standard from the process-oriented to the consequentialism, distinguishing between the independent directors and the general directors of the determination of the standard as well as the introduction of the commercial judgment rules in order to alleviate the burden of proof on the sole director.

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Formulation of the Problem

In recent years, cases of embezzlement of corporate interests and illegal connected transactions have emerged one after another. Since the promulgation of the Company Law in 1993, China has adopted the “two-tier system” corporate governance model with the board of directors, shareholders, and supervisors, and the supervisory committee, as the “two-tier system” corporate governance model, has played a key role in the sound operation of the company by playing its function of supervision. The supervisory committee, as a supervisory body under the “two-tier system” corporate governance model, plays a key role in the benign operation of the company, but in practice, it is obvious that the supervisory committee is unable to perform its supervisory function in the cases of company violations. Under the “two-tier system” governance model, there is a dual supervision mechanism in China to ensure, on the one hand, independent directors enjoy the authority of prior approval of major connected transactions, which plays a role in decision-making, while the supervisory board plays more of an ex post facto supervisory role, but in practice, most of the powers of the independent directors and the supervisory board powers are almost similar in nature, such as the hiring of an external auditor, and the supervisory board can play a key role in the sound operation of the company. Therefore, the governance structure of listed companies is not perfect, and the supervisory board fails to play its role, which also indirectly leads to China’s independent director system “not suited to the soil”. Until December 2023, China’s new Company Law was formally released; the most important change is how to reconfigure the internal power structure of the company, of which Article 121 stipulates that a joint stock limited company may, in accordance with the provisions of the articles of association of the company, set up in the board of directors of the audit committee composed of directors, to act on the supervisory board of the powers and functions. This not only means that the authority of the board of directors has shifted from business decision-making to supervision, and that the limited company can choose a single-tier governance structure, but also means that independent directors are no longer exclusive to listed companies. In order to ensure the independence of the audit committee, it should realize the separation of business decision-making power and supervisory function within the board of directors, and at this time, whether the independent directors perform diligence to become the key to the success or failure of single-tier governance.

Independent director system has been introduced for many years, but often criticized as “vase director”; it is difficult to play its substantive role. Such as Kangmei pharmaceutical counterfeiting case set a precedent for huge compensation for independent directors, at that time, independent directors’ diligence obligations of the determination of the standard has also triggered a wide range of debates. China’s independent director system is at the crossroads of history; based on rational governance, the company can voluntarily choose the single-layer system model, then the sole director in the corporate governance of the task is even more difficult, and at this time to clarify the identification of its duty of diligence standard can prompt the independent directors to better fulfill their obligations to avoid the risk of huge fines, while promoting the benign operation of the company.

The Main Circumstances and Judgment Standard of Independent Directors’ Failure to Fulfill Their Duty of Diligence in China

Diligence obligation is sometimes also known as duty of care. In 2005, China for the first time in the legislation of the director has a statutory duty of diligence. After that time, the academic community launched a

heated discussion, and at the same time in practice a large number of applications, for example, the judge invoked exhaustion of the referee in the reasoning; after continuous development, the academic community in China on the duty of diligence of the independent director of the research has been scaled up, and compared with the previous it has been a huge progress, but what is considered diligence? What is the standard? In the academic community it is still arguing. However, after a long time of development and practice, nowadays there have been more and more cases related to independent directors' failure to fulfill their duty of diligence in China, in which the representative cases have also increased, which also provides reference for the legislative standards.

Main Circumstances Under Which the Independent Directors Failed to Fulfill Their Duty of Diligence

According to China statistics of the analysis report on administrative penalties for independent directors for the year 2023, there were a total of 74 decisions on penalties for independent directors and a cumulative number of 199 people were penalized during the period from 2019 to 2023. According to their violations, the specific cases include: false records in periodic reports, material omissions, failure to disclose in accordance with regulations, and trading within six months of holding the company's shares. Specifically to the relevant cases in each year, in the eight administrative penalty cases in 2023¹, the total number of people punished is 13; the independent directors were punished for listing information disclosure violations, independent directors and their close relatives short-term trading, false records of periodic reports, material omissions, and failure to disclose the external guarantees in accordance with the provisions of the more in the matter of listed company information disclosure violations. According to the reality of the penalty report in 2022², involving a total of nine cases of independent directors administrative penalties, a total of 28 people, the penalty situation in addition to the above false records and material omissions, there are also violations of guarantees, and foreign guarantees are not the old people's approval procedures and information disclosure obligations, etc. In 2021, a total of 18³, the number of penalties for 48 people, from the point of view of the violation of the law, the reason is mostly due to the disclosure of information by listed companies in violation of the law; according to the 2020 independent director administrative penalty analysis report⁴, involving a total of 18 related cases, penalized 53 independent directors, the type of violation of the law involves information disclosure violations and leakage of insider information, insider trading, short-term trading; according to the 2019 independent director administrative penalties, a total of 20 cases, the reasons for its violation of the law page are listed companies disclosure violations of the law, and its specific behavior for "False Records", "Misleading Statements", "Material Omissions", "Improper Disclosure". Therefore, it can be seen from the above data of administrative penalties from 2019 to 2023 that independent directors are subject to administrative penalties mainly because their listed companies' disclosure of information is illegal and they are found to have failed to fulfill their duty of diligence, and all of them are required to bear the corresponding legal liabilities.

¹ 2023 Analysis of Administrative Penalties for Independent Directors in China, link: <https://mp.weixin.qq.com/s/Mbg4A6ekkkSl64eDZm8XtEw>.

² 2022 Analysis of Administrative Sanctions for Independent Directors in China, link: <https://baijiahao.baidu.com/s?id=1758403990780442093&wfr=spider&for=pc>.

³ 2021 Analysis of Administrative Penalties for Independent Directors in China, link: https://www.sohu.com/a/514541146_121123882.

⁴ 2020 Analysis of Administrative Penalties for Independent Directors in China, link: https://mp.weixin.qq.com/s/vgiX_RP9v-bvzwLPDX7uUg.

According to the above administrative penalty data, it can be seen that the specific types of independent directors who are found to have failed to fulfill their duty of diligence have gradually become more complex and diversified from a single type of disclosure violation, but the disclosure violation still accounts for the largest proportion. In 2023, 13 independent directors were punished, of which six shareholders defended themselves and had hearings, and the reasons for defending were argued from the perspective of their own subjective consciousness, but the regulatory body of its opinion is very limited degree of adoption. The degree of adoption is very limited; more is not adopted; according to the “China Listed Companies Independent Director Management Measures” Article 46, if the independent director can prove that has been diligent and conscientious, no subjective fault will not be administrative punishment, and then combined with the specific case can be learned whether the director can prove that “has been faithful, diligent obligations, no fault” is the key to exemption. About the key to exemption from liability and what is diligence, China Securities Regulatory Commission could not give an accurate answer, but through the study of relevant cases can be found, from the practice of specific evidence to prove that the responsibility of diligence has been more difficult.

Criteria for Judging the Duty of Independent Diligence in Practice

In judicial practice, the court’s judgment standard for the independent director’s diligence obligation is also gradually clear and perfect, because of the special nature of the independent director’s identity; whether it violates the duty of diligence needs to be judged in a specific case; on the one hand, it is necessary to consider the case itself, and on the other hand, it is also necessary to analyze the relevant case with the outside director’s case. For example, in the case of *(2019) Shanghai 74 Civil First Instance 2509*, the Shanghai Financial Court held that, for the directors of the company, it can be divided into external directors and internal directors, and the independent director refers to the full-time director who no longer serves as a director in addition to the director, which should belong to the external director, and the duties of the internal director are not the same, so the review of the company’s relevant business information is beyond the duties of the independent director. In the case of *(2021) Shanghai 74 Civil First Instance 349*, the Shanghai Financial Court again clearly pointed out that the independent director’s duty of diligence should be lower than the internal director, the main reason also lies in that the company’s internal information cannot pay attention to factors such as timely. In view of this judicial practice point of view page gradually formed, in January 2022 the Supreme People’s Court of China issued the “On the Trial of Securities Market Misrepresentation Infringement Civil Compensation Cases of a Number of Provisions”, not a complete list of exemptions for independent directors, for independent directors have fulfilled the obligation of diligence and due diligence to provide the basis for a reasonable defense, and on this basis, another exemption situation is proposed, the relevant parties of the listed company conceal it, and the independent directors cannot discover it, in other words, as long as such circumstances exist, it shall be recognized that the independent directors have fulfilled the duty of diligence. This is a great progress for the judgment standard judgment of the duty of diligence, but still for the independent director some special obligations are still not covered.

According to the above relevant administrative penalty cases, independent directors will also put forward their own defense; the most important reason is claiming that they have fulfilled the duty of diligence; such as independent directors have been on time to participate in the shareholders’ meeting, it is actually difficult to prove the process of its fulfillment; however, from another perspective, it can also be seen that China Securities

Regulatory Commission has taken a more stringent regulatory attitude towards the performance of independent directors. To summarize, now for listed information disclosure cases, the responsibility borne by independent directors belongs to a kind of fault presumption of responsibility; if there is a violation of the law, the court generally found that it did not fulfill the duty of diligence, and independent directors can be actively declared to their duty of diligence. However, in practice, the vast majority of cases are not supported by China Securities Regulatory Commission (CSRC), so it can also be seen that independent directors are in a relatively harsh legal environment.

Root Cause Analysis of the Difficulty in Determining the Standard of Diligence Obligations of Independent Directors

The sole director participates in corporate governance as an independent supervisor. The construction of an internal monitoring mechanism is a common demand of companies, not exclusive to listed companies, and non-listed companies can also choose the sole director system to improve their internal governance. After the introduction of the sole director system to non-listed companies in the current Chinese Company Law, it is even more clear that the main direction of setting up the legal obligations of the sole director is how to coordinate the conflict of interests within the company, exert the effect of internal supervision, and optimize the corporate governance. Taking the opportunity of this single-tier system reform, we should return to the basic norms and make specific plans for the standards of obligations in the process of corporate governance, and before that, we need to analyze the solution to the problem of identifying standards.

Lack of Standards Related to the Duty of Diligence of Independent Directors

Regarding the connotation and determination standard of the duty of diligence of independent directors, there is not a clear provision in the legislation, and the duty of diligence of independent directors can be traced back to 2001, when CSRC promulgated the “Guiding Opinions on Establishing the System of Independent Directors in Listed Companies” (hereinafter referred to as the “Guiding Opinions”), which made relevant provisions on the matters related to the independent directors, which stipulated that the independent directors have a duty of good faith and diligence to the listed company and all shareholders. The Guiding Opinions stipulate that independent directors shall have integrity and diligence obligations to the listed company and all shareholders, and point out that an independent director is a director who “does not hold any position other than that of director in the listed company and does not have any relationship with the listed company and its major shareholders that may prevent him from exercising independent and objective judgment”; however, at this time, the standard for diligence obligations of independent directors and the standard for directors in general have not been directly stipulated. Until September 2014, the Association of Chinese Listed Companies issued the “Performance Guidelines”, of which Article 3 stipulates: “Independent directors of listed companies have the general obligations of directors as required by the Company Law, the Securities Law, the Code of Governance for Listed Companies, and other laws, administrative regulations, rules and regulations, and the articles of association of the company. They have the obligations of good faith and diligence to all shareholders of the listed company”. At this time on the independent directors’ obligations and powers, performance requirements made a general provision, but for the connotation of diligence obligations, the standard lack of relatively specific identification of the label, the provisions are too general, in the practice of adjudication in the role of a pivotal. Until after

Kangmei Pharmaceutical Counterfeiting Case, it opens the independent director resignation boom, perhaps to avoid a wide range of independent directors to leave, or perhaps the case of a number of “the first time” to produce a huge impact; in early 2022 the “Several Provisions on Trial of Civil Compensation Cases for Infringement of Misrepresentation in the Securities Market” stipulated five defences for independent directors to be exempted from the duty of diligence, which is a breakthrough in the determination of the standard of the duty of diligence of independent directors, and demonstrates the determination of the legislator to improve the issues.

Along with the maturity of the independent directorship system, more and more rules related to the sole director have been introduced one after another, in which the Company Law and the Securities Law and other relevant laws to form the legal framework of the sole director in China, the Stock Exchange, and other idle industry associations on the sole director of the relevant rules are more specific, thus constituting an important code of conduct for the governance of listed companies. Although a big step is forward, the current provisions of the determination of the standard are still too vague, more or stay in principle, not clear and precise, more “rough” and “macro”, so in practice the determination of the director’s duty of diligence is still a difficulty.

Logical Deviation in Determining the Due Diligence of Independent Directors

In practice, due to the lack of operational norms, it adopts of “signature as penalty” standard for determining whether the duty of diligence has been discharged (Zeng, 2021). For example, in the civil judgment of *The Kangmei Case* and *The Zhonghe Case*, both were found to have failed to fulfill the duty of diligence by failing to object to the misrepresentation report⁵, and the same is also true in the administrative penalty cases; in the above statistics, a number of independent directors were required to bear the legal responsibility for voting in favor of the false annual report or signing the misrepresentation report. Article 82 of China Securities Law stipulates that independent directors have a legal obligation to guarantee information disclosure. As long as the company has misrepresentation behavior, the independent director who signed the written confirmation shall be administratively liable, regardless of whether he or she has expressed reservation, objection, or is unable to express opinion on the misrepresentation. Therefore, in practice, the administrative organs also tend to take this kind of “signature that is punished” punishment standard. It can be seen that, whether in civil cases or administrative penalties, such as the above “signature that is the penalty” there are many cases; the essence of its logic is whether or not to sign on the illegal resolution to directly judge whether or not to fulfil the duty of diligence; once signed, if the independent director cannot adduce evidence to defend, it is determined that it has failed to perform its duty of diligence. This logic is biased, not only ignored the independent directors in the whole decision-making process in other efforts, but also overestimated its role in the disclosure of information in the influence of the independent directors in the case of the process of the subjectivity; often in practice, many independent directors of the business decision-making in the source of information are not comprehensive, which also leads to its subjective difficult to judge whether they violate the law. Independent directors to fulfill the duty of diligence are a dynamic process, by its subjective, objective, and other relevant factors together, such as the use of signature must be punished to determine the logic, which will make the review become too harsh and demanding.

⁵ Kangmei Pharmaceuticals Securities Misrepresentation Liability Dispute, Guangzhou Intermediate People’s Court (2020) Guangdong 01 Minchu 2171 Civil Judgment; Fujian Zhonghe Company Limited Securities Misrepresentation Dispute, Fuzhou Intermediate People’s Court (2019) Min 01 Minchu 1972 Civil Judgment.

Lack of Harmonization of Authority and Responsibility in the Design of the System

In addition to the problematic logic of a single determination of signature-as-penalty, independent directors also face the problem of inconsistency of authority and responsibility. Regulators must not ignore whether independent directors are in the performance of their duties in the process of whether there can be many beyond their ability to perform the duties required to give independent directors too high expectations, too high risk of performance of their duties, but also will create more independent director of the risk of leaving. The original intention of the independent director is to set up a role in the process of corporate governance outside the supervision, not for the company to set up a more executive management, if the burden on the independent director is far more than the internal director, which is likely to lead to an imbalance of power and responsibility. Therefore, in practice, if the powers and responsibilities cannot be unified, it is likely that the real monitoring goal of independent directors will be defeated and they will lose the space for development and growth. Regulators hope that independent directors can be perfect outsiders, observing all the problems in the process of corporate governance in every detail; however, in practice, the difference is far.

In addition to the general powers of directors, independent directors in China also want to have a series of special powers, such as the right to supervise major affiliations; the law gives independent directors a lot of powers at the same time, but there is a lack of certain measures necessary for the protection of the rights of independent directors. Nowadays, the applicable Company Law does not distinguish between independent directors and internal directors' duty of diligence, and the standardized documents of the China Securities Regulatory Commission (CSRC) and the norms of the Stock Exchange are not clear about the legal basis for pursuing independent directors, but special powers are given to the independent directors, which leads to a mismatch between the responsibilities and powers of independent directors. Secondly, because the roles and terms of reference of independent directors are not clear, in practice, little consideration is given to the position of independent directors in participating in the relevant affairs, the amount of information they have about the company, and the amount of energy they put into the company, which also leads to the fact that regulators and the courts, if they adopt the standard of "signing is punishing", do not differentiate between the standards of the diligence obligations of independent directors and those of internal directors, do not take into account the actual and objective criteria, and do not take into account the actual and objective criteria. If regulators and courts use the standard of "sign and punish" without distinguishing between the standard of diligence of independent directors and inside directors and without considering the actual objective and subjective factors, it will only lead to excessive pressure on the responsibility of the independent directors. Therefore, there is no time to lose in refining the criteria for determining the criteria in the legislation.

Institutional Design of the Duty of Care of Independent Directors in the United States

Relying on the "single-tier system" corporate governance framework, due to the more dispersed shareholdings, the United States initially created the independent director's original intention which is to solve the problem of corporate insider control; the independent director's function is mainly to play a positive role in monitoring checks and balances as well as purifying internal conflicts of interest. Compared with China's transition from a "two-tier system" to a "single-tier system", focusing on curbing the abuse of power by controlling shareholders and emphasizing the maximization of the overall shareholders' interests within the listed

company, the role of the independent director's function is to play an independent and impartial role in coordinating. It is precisely because of this difference that the introduction of the independent director system in China is a fragmented transplantation rather than a direct adoption of the whole set.

Legislative: Establishment of a Defined Code of Conduct

The current Company Law on the diligence obligations of directors made in principle, independent directors as a member of the board of directors can refer to the general rules of directors to regulate, but should be differentiated, at present in the country on the legal obligations of independent directors which did not form a more specific norms, but the extraterritoriality of the more mature doctrine has been formed; the U.S. Model Business Corporation Act provides for the standard of independent directors' diligence obligation. Article 8, Paragraph 30, states that (1) each member of the board of directors shall perform his or her duties in a manner that he or she believes in good faith and reasonably to be in the best interests of the company; and (2) a member of the board of directors shall perform his or her decision-making or supervisory duties with such care that a person in a similar position would have reason to believe that it is appropriate under similar circumstances. Among other things, this standard applies to all directors on the board, including independent and inside directors. The standard of directors' duty of diligence under the U.S. Business Corporations Act, whether it is "good faith", "reasonable belief", "best interest of the company" in (1) or "to cause a person in a similar position to believe that it is appropriate to do so" in (2), is not applicable to all directors. In (2), "to enable a person in a similar position to have reason to believe that it is appropriate in similar circumstances" is all criteria for the determination of the duty of diligence, but in fact, the former "good faith", "reasonable belief", and so on are the criteria behind the duty of diligence, but in fact, however, the former "good faith", "reasonable belief", is intended to proof in (2) "to enable a person in a similar position to have reason to believe that it is appropriate in similar circumstances" the former can prove the latter; the former is only auxiliary standards, rather than the substantive standards. Therefore, it can be said that the most important standard for the duty of diligence in the American Business Corporation Act is "to perform the duty with such care that a person in a similar position would have reason to believe it to be appropriate in similar circumstances".

The U.S. Securities and Exchange Commission (SEC) rules also establish a reasonable investigation as the core of the standard of judgment of diligence⁶; if the independent director can prove that he or she has carried out a reasonable investigation, it can be determined that the director has fulfilled the duty of diligence and exemption; the reasonable investigation should be a prudent person in the management of their own property to maintain the standard of duty. The reasonable investigation should be based on the standard of duty of care that a prudent person has to maintain when managing his own property. To sum up, it can be seen that the standard of diligence adopted by the United States is more lenient, even if the independent director violates the duty of diligence and causes losses, as long as there is no simultaneous violation of the duty of diligence and good faith requirements; its responsibility can be mitigated or exempted in accordance with the articles of association of the company (Yuan, 2022).

In Practice: Business Judgment Rule

The U.S. duty of care provides a standard of conduct for directors, which in turn provides a minimum level of care in the performance of their duties, according to which directors are to obtain the best interests of the

⁶ U.S. Code of Federal Regulations 17 §230.176.

company. The judicial practice of the trial rules is business judgment rule (BJR), the core of the director to make business decisions to measure the procedures and judgment, so as to judge whether the director violates the duty of diligence. In the *U.S. Case of Aronson v. Lewis in 1984*, the Delaware Court of Justice described this rule as: the presumption that the director in possession of sufficient information under the premise of good faith to make the relevant business decisions reasonably believes that its behavior and the company's best interests in line with the case, in the case of the plaintiffs cannot be reversed, the director's decision-making will be respected, and the director does not need to take responsibility (Ye, 2018; Aman, 2010). It can be seen that for the allocation of the burden of proof in the business judgment rule, the judge presumes that the director's decision-making is reasonable in advance, and then the plaintiff can overturn it through the facts, so the director does not need to bear the burden of proof, and this kind of burden of proof is favorable to the director. In this way, we can see the "business judgment rule", directors only need to be liable when the degree of gross negligence is reached, and this rule applies to all directors, including independent directors and inside directors. Compared with the "presumption of fault" standard often adopted by China's regulatory agencies when imposing administrative penalties on independent directors, this puts independent directors in a more severe market environment.

The United States in judicial practice by invoking the "business judgment rule" to realize the exemption of the duty of diligence, so as to promote the independent directors can be more active in the performance of their duties, in the back of a certain risk at the same time will not be too heavy; the system is perfect and combined with the corresponding exemption mechanism, combined with the exemption mechanism to ensure the independent directors of the participation in the decision-making and supervision of the enthusiasm. Our country can refer to the practice of the United States to realize the enthusiasm of independent directors to perform their duties.

Improvement Path of the Recognition Standard of Diligence Obligation of Independent Directors in China

This amendment to the Company Law introduces a single-tier board of directors, which has certain advantages over the traditional supervisory board system in overcoming the abuse of power by controlling shareholders. Based on the above analysis, how to establish this standard in the context of the single-tier system is the problem to be solved in this paper, which will then be developed from the following aspects.

Shift in Judgment Criteria From Outcome Orientation to Processualism

Regulators or the court on the independent director trial process, the formation of the "statutory duties—not sufficient diligence—liability" classic trilogy judgment logic, such a high demand, low protection of the logic, urgently need to be changed. Changing the logic of determination from result-oriented to process-oriented should be considered from two aspects. The first is the change of psychological condition in determining whether to fulfill the duty of diligence, i.e., to avoid "signing that is punished". According to the current legal provisions in China, the regulatory authorities in the problems of listed companies in the administrative penalties or the court in the trial of civil cases related to independent directors often already think that the independent directors have not fulfilled the duty of diligence, and on this basis, for the independent director's defense of the relevant evidence to take a rigorous trial of the mental attitude, but in fact, regardless of the regulatory authorities or the court in the trial of cases related to independent directors, should be the mental condition to be determined to change. In

fact, whether the regulator or the court is in the trial of independent director related cases should be determined by the psychological condition to be judged, rather than directly put the independent director in an unfavorable position. At the same time, the standard of “signature is punishment” to a certain extent, also ignored the subjective state of independent directors, ignoring the subjective state, is likely to lead to the determination of the standard unbalanced, thus appearing a paradox: assuming that the director of the existence of the subjective state of malice, but ultimately did not lead to the company to appear the actual damage, so that the director does not need to be responsible for the contrary subjective. On the contrary, the subjective behavior of the good faith of the director leads to the company to produce problems, and therefore bear the corresponding legal responsibility. This is clearly unbalanced.

Secondly, when the regulator and the court determine whether the independent directors have performed their duties diligently, they should avoid post-facto determination, preventing the use of the results to deduce the facts, which will lead to the situation of “after the fact”. In order to solve this situation, I believe that before the regulators and the court to intervene, let the company on whether the independent directors fulfill the obligation of diligence to determine; if the company is that the independent directors have fulfilled the corresponding obligations, at this time the regulators can no longer be punished, compared to internal directors or other management; independent directors of the company’s actions on the damage to the impact of the company are greatly reduced, and therefore can be judged by the company; the regulators and the court can be other major players involved in the company. The regulator and the court may impose penalties on other key participants.

Criteria for Distinguishing the Duty of Diligence of Independent Directors From That of Directors in General

Although both independent directors and inside directors are members of the board of directors in the corporate governance structure and have partly the same authority in China’s legislation, there are differences in the purpose of their establishment, authority, characteristics, and background requirements, which in turn lead to a great difference in the actual rights of the two in reality. At present, China does not have a clear provision on the specific standard of the duty of diligence of independent directors; therefore, the standard should be clearly stipulated in the legislation, and make a distinction between the standard of the independent directors and the general directors, and the different categories of the directors should bear the corresponding responsibility and obligation on their own terms of reference. Specific differentiation criteria can also guide the directors to fulfill their obligations in accordance with the law, each in their own way. Independent directors have the characteristics of externality, independence, and part-time; the legislator expects independent directors to play a supernatural supervisory effect in the company, but does not take into account that it is based on these characteristics in the process of corporate governance that leads to independent directors being at a disadvantage in the investigation of information, and once the insiders concealment will lead to the difficulty of independent directors to perform their duties, while the directors are the permanent employees of the company, and the characteristics of their internal and full-time allow them to participate in the whole process of the company’s management decisions and control the disclosure of the company’s information. In the author’s view, the legislation can take the principle and key enumeration method to set up; firstly, the independent director must meet the “reasonable person” standard to perform the duties, and the standard applies to all directors, requiring all directors without exception,

like a general reasonable person to fulfill the obligations that should be fulfilled, this is a basic principle, and independent directors and general directors respectively enumerate the specific obligations. Secondly, the independent directors and general directors shall list the specific major obligations of diligence, in which the basic obligations of general directors can be listed first, and then the special obligations of independent directors can be listed separately, so that there are not only the principle provisions for the bottom, but also the specific important obligations listed, which will greatly improve the efficiency in practice.

Introducing a Business Judgment Rule to Reduce the Burden of Proof on Sole Directors

The introduction of business judgment rule is to reduce the sole director of the burden of proof, through the above analysis, the business judgment rule to take “no fault presumption”, and the current practice in China’s “presumption of fault” to form two different requirements, compared to the latter on the sole director of the burden of proof requirements stricter. Diligence obligation is to independent directors to participate in business decision-making when for the requirements of positive action, business judgment rule is to review the obligation whether to violate the duty of diligence obligation of comprehensive standards, the two achievements each other. For the application of the business judgment rule, the main considerations are as follows: Firstly, the rule should be applied to business judgment decisions within the director’s scope of authority, and if it is not within his/her scope of authority, the rule cannot be applied; secondly, the director should be in good faith, i.e., he/she should be honest and loyal in performing the relevant authority. Thirdly, the director should have no interest in the disputed matter related to the business decision, and fourthly, the director should put the interests of the company in the first place. From the consideration of the academic community on its judgment rules, we can see the institutional value of the commercial judgment rules; on the one hand, the parties can be incentivized to the parties to the particular commercial decision-making after the defense, safeguard the rights and interests of the parties, and at the same time also incentivize to the directors to more actively perform the obligations, in order to prevent their own incorrect or abnormal commercial judgments leading to the company’s damages and bear the relevant responsibility. Therefore, our country can through the enactment of guiding case mode preliminary introduction of business judgment rule, although our country has not been introduced into the statutory law to change the rules, but the author in the collation of relevant domestic cases found that in our country’s practice, there are courts having been applied to the rules of jurisprudence for reasoning. Through the above theoretical analysis, the introduction of the theory can make our country on the independent director diligence obligation that whether the violation of the rules brought more clear, in the adjudication of the court it can be more clear logic to judge, so as to better supervision.

To sum up, the independent director diligence obligation determination standard should be from the determination of logic, rights, and responsibilities and the burden of proof to consider; the determination of logic from the process-oriented to the results of the logic can be more fair and comprehensive consideration of independent directors in the decision-making process of the state of mind as well as other related factors, so that the nature of its behavior is more clearly identified; rights and responsibilities will directly lead to the independent director’s risk of service, which leads to the social independent director resignation boom, a significant blow to the enthusiasm of the sole director, so it should take into account that the special powers of the sole director should also exist special obligations. Nowadays, China securities regulatory commission in the process of

administrative punishment to take the principle of attribution of responsibility is “fault presumption principle”, that is, if the company has illegal behavior, the presumption of signing the confirmation of the independent director does not diligence obligations. That is, the previously mentioned “presumption of fault” leads to that the practice of independent directors in the trial process of the defense appears very pale, most difficult to be adopted by the regulator or the court, so the introduction of commercial refereeing rules can reduce the burden of proof of the independent director, and can encourage to the independent director in their own terms of reference to better performance of their duties. Nowadays, under the background of China’s single-tier system reform, the role of independent directors will be more and more prominent, so in order to better highlight its independence, its diligence obligation to standardize the standard has been unstoppable.

Conclusion

The introduction of the single-tier corporate governance model in the company law is suffering from the long-standing failure of the supervisory board, and the company’s autonomous choice of governance model has brought a new way of governance for market players. It is foreseeable that independent directors will play a more important role in future corporate governance. Specifically to the independent director system, the core problem is to solve the period of identification criteria. In addition to fulfilling the diligence obligations of general directors of the company, independent directors also need to fulfill the diligence obligations as special directors. However, compared with the internal directors, the independent directors are in a special position in the company, they are not the employees of the company, they are not as familiar with the operation of the company as the internal directors, and they do not have enough time and energy to supervise the internal directors or participate in the operation of the company. Therefore, it is not appropriate to impose heavy legal liability on independent directors, and careful thought should be given to the criteria for recognizing them.

This paper analyzes the status quo of independent director determination standard in China, seizes out the essence of its problems, and puts forward reasonable suggestions. China’s independent director market has not yet matured, to play its due role in the company’s daily management, major decision-making, information disclosure supervision, which is a gradual process; how to set the standard of its duty of diligence and how to specify still need to be explored by the academia and practice.

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