CASE STUDY

RESEARCH INTO THE DUTIES OF DIRECTORS IN THE MERGERS AND ACQUISITIONS OF LISTED COMPANIES: TAKING THE BATTLE FOR VANKE'S CONTROL RIGHTS AS THE BREAKTHROUGH POINT

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I. INTRODUCTION

China Vanke Co., Ltd. (hereinafter referred to as Vanke), which was founded in 1984, developed rapidly in several years and went public successfully listed in the Shenzhen Stock Exchange in 1991, continuing as a listed company till now. Due to the current situation of equity decentralization and the demand of specialized management, Vanke adopts board centralism as its governance model and the directors take the actual control of the company.[1] In 2015, Baoneng Holdings (China) Limited (hereinafter referred to as Baoneng) founded in 1992, bought Vanke's shares consecutively by means of its subsidiaries' continuous lifting, which powerfully attacked the statues of the largest shareholder and triggered a stern counterstrike from Vanke's directors. *Wang Shi*, Chairman of the board of Vanke, alleged Baoneng to be a malicious acquirer and the internal management of Vanke would be seriously threatened if letting Baoneng become the largest shareholders without taking any measures.[2] At first, the directors of Vanke asked China Resources (Holdings) Co., Ltd. (hereinafter referred to as China Resources), the largest shareholder of Vanke, to compete with Baoneng by means of overweighting shares and such attempt narrowly finally succeeded. However, Baoneng did not give up its aim easily; the seesaw battle of mergers and acquisitions was becoming increasingly bitter. When Baoneng became the largest shareholder of Vanke for a second time, Vanke declared an emergency suspension in the trading of its shares. Afterwards, Vanke issued an announcement that it had yet signed a strategic cooperation memorandum with Shenzhen Metro Group Co., Ltd. (hereinafter referred to as

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1 Hu Yu, *"Baoneng Faction" Aims at the Right to Control of Vanke Other than Non-Financial Investment*, Accounting Messenger, Dec. 14, 2015, at D01.

2 Li Hongmei, *The War Protecting the Right to Control Begins, and China Recourses Forestall to Raise Money in Order to Fight Savage Back*, China Real Estate Business, September 7, 2015, at B03.

Shenzhen Metro) and would issue shares to Shenzhen Metro to purchase all or part of shares of Shenzhen Metro's certain subsidiary. Once this deal succeeded, Shenzhen Metro would leap to the first position among the shareholders of Vanke. This pre-arranged planning for reorganization was unanimously rejected by the shareholders including Baoneng and China Resources. What is more, some shareholders even submitted a motion for removing ten persons including the current Chairman of the Board *Wang Shi* and the current President *Yu Liang*. Afterwards, the scramble for the control right of Vanke fermented continuously, but it has transferred from the battle among Baoneng and the directors of Vanke to the battle among the shareholders of Vanke and the directors of Vanke. Thus, it can be seen that the directors, as the core managers of the company, enjoy the right of actual control in the process of listed companies' mergers and acquisitions. If there is not any necessary limitation to the right of the directors, the right may be abused. Up to now, it has not been verified that Baoneng is a malicious acquirer of Vanke. Theoretically speaking, in the link of the mergers and acquisitions, the acquiring company aims at gaining the control right of the target company, but the directors of the target company still want to maintain their core right of control of the company. Therefore, the objective conflict of interests among the related subjects is unavoidable. The conflict of interests may further trigger the moral hazard of the directors and let them make decisions violating the interests of the company, which will harm the interests of the company and shareholders as a result. Therefore, it is certainly necessary to stipulate the duties of directors in the mergers and acquisitions of listed companies and compulsively restrain the behaviors of the directors legally. At present, the mergers and acquisitions of the listed companies lack legal rules on the duties of directors. The unreasonableness of the content of existing rules on duties of directors, the specific connotation of the duties of directors, judging standards in practice and the system of accountability for directors' breach of duties should be improved.

II. A SUMMARY OF DUTIES OF DIRECTORS IN THE MERGERS AND ACQUISITIONS OF LISTED COMPANIES

A. The Precise Understanding of the Role of Directors in the Mergers and Acquisitions of Listed Companies

The mergers and acquisitions of listed companies refer to the actions that the subject outside the listed company gains a proportion of shares of the listed company by means of acquiring shares issued in public etc., in order to gain the actual control of the listed company.[3] The executor of the merger or acquisition of the listed company is called the acquiring company, and the receiver of the action is called the target company. The aim of the acquiring company taking actions of the merger and acquisition is to obtain the actual control of the listed company. Generally speaking, both mergers and acquisitions of listed companies can be named as the mergers and acquisitions of the listed companies, which belong to the methods of disposing listed companies' assets in market competition. The directors, who are the effective decision makers and direct participants, play a role of vital importance in the process of the mergers and acquisitions of listed companies. In order to describe the directors' duties in the process of the mergers and acquisitions, the role of directors should be thoroughly scanned.

Generally, the directors are in the senior management position of a company, which is a significant component of the company's governance structure.[4] The person who is in such position of the senior management is entitled the director and can exercise the rights to control, like the rights of management and making decisions. Accordingly, it means that directors should meet the relevant requirements of qualification, gain expertise in specialized knowledge or professional skills, and thus give reasonable suggestions to the management and decision-making of companies. Based on the jurisprudence of the unification of rights and duties, directors should perform corresponding duties when enjoying the rights in terms of management of the company. In China, laws including the *Company Law* and the *Securities Law*, not only declare the rights of directors, but also stipulate the duties of directors, aiming to well regulate the directors' behaviors of performing duties. Besides, the provisions for directors' duties stipulated in the above laws are the minimum requirements. The autonomous documents like companies' articles can stipulate some supplementary provisions concerning the rights and duties of the directors. With the transformation of company governance model from shareholders centralism to the board centralism, the status of directors, who are accountable for operating business and management, is raising up gradually.

Compared with non-listed companies, the actual rights to control of companies owned by the directors of the listed companies are much more abundant regarding the content and the effective scope. This depends on the listed companies' own features. Directors become the core strength of company management because of the following features of the listed companies: On the one hand, a listed company is large-scale and its ownership structure is

3 Fang Hong, *The Summary of Study on Private Benefits and Performance of Merger and Acquisition*, 2 Securities and Features of China 28, 28 (2011).

4 Zheng Jianing, *Construction of Subjective Criterion for Judging Duty of Loyalty of Directors of Target Company,* 4 Oriental Law 42, 43 (2017).

distributed, which makes it difficult for the minority shareholders to reach a consensus on the management of the company, therefore the development of the listed company is restrained. What is worse, the minority shareholders may presume the growth of their own interests, and however, ignore the maintenance of the company's interests. Thus, it is very difficult for the traditional shareholders centralism governance model to take effect. On the other hand, the operation of listed companies needs professional teams to maintain the smooth operation of the company, or it will be very likely to make decision-making mistakes in the unpredictable market competition, which may harm the stakeholders of companies, shareholders and creditors, or even arouse the furious market disruption. It is obvious that the strict appointment procedure is more helpful to the selection of professional talents. Compared with the shareholders, the position requirements of directors are higher. The directors must have relatively higher professional competence and management skills, while the shareholders gain their status just by the behavior of subscribing shares.

B. The Deep Analysis of the Conflict of Interests in the Process of the Mergers and Acquisitions of Listed Companies

Generally speaking, the conflict of interests refers to the risk existing in the measures that are taken by one party which may reduce the interests of the other party in the process of pursuing its own interests.[5] In mergers and acquisitions, the conflict of interests is unavoidable because of the different goals of different parties. Within the objectively existent range, the conflict of interests in the process of mergers and acquisitions can be separated into two types:

The first type is the conflict of interests between the acquiring company and the target company. Generally speaking, this kind of conflict of interests can be called as the dominant conflict, which is aroused by the disagreement on core interests between the acquiring company and the target company. The essential goal of the acquiring company is to control the rights of operating and decision-making of the target company, through a series of behavior manipulating the assets and shares, so as to realize the actual control of the target company. However, the target company aims at protecting the rights and interests of stakeholders, like shareholders, to the maximum extent and maintaining the sustainable development of the company. Therefore, the targets pursued by either party are hard to tally with each other perfectly, and the game between the two parties is unavoidable. There will be a seesaw battle between the acquiring company and the target company in the process of negotiation. The second type

5 Yao Lushi, He Fang & Wang Lina et al, *Research on Security Analyst Follow-up Behavior under the Conflicts of Interest: An Exemplified Study Based on Panel Data,* 22(6) Chinese Journal of Management Science 43, 44 (2014).

is the conflict of interests between the target company and its directors. This kind of conflict of interest can be treated as potential conflicts, which generates from the dual identities of directors in the market-oriented economy. Directors are not only senior executives of the company, but also independent subjects of economy activities with economic pursuits of their own.[6] The individual interests of directors and the interests of companies are closely connected. To a certain degree, directors' acting in the maximum interests of the companies is to be responsible for themselves. In the process of the mergers and acquisitions, the non-hostile takeover by the acquiring company may be a good opportunity of development for the target company, but the directors are possibly faced with the loss of vested interests including the rights to control the company and high annual salaries. Therefore, the directors are likely to refuse the olive branch stretched out by any acquiring company blindly and resist the mergers and acquisitions with both feet.

Considering that the acquiring company and directors of the target company are both situated in positions of control and are entitled relatively strong power to make decisions on specific affairs in mergers and acquisitions, the risk of directors' abusing rights should be prevented urgently. Although there is some difference in the formation systems and contents between these two kinds of conflicts of interests, regulating directors' duties strictly is the common resolution of these two kinds of conflicts of interests. In the conflicts of interests, the success of the game between the acquiring company and the target company depends on directors' performing duties dedicatedly and proposing advice zealously. The restraint of conflicts of interests between the target company and its directors relies on the firm standpoints of directors as well, which means that directors should give priority to the interests of the company rather than the interests of themselves. Compared with merely expecting directors to perform duties with integrity under their self-discipline, it is better to stipulate the contents of directors' duties clearly, affirm the specific criterion for judging director duties in practice and improve the accountability mechanism when directors breach the duties prescribed by laws and regulations, which can prevent directors from abusing rights in a more reasonable and controllable way.

The origin of directors' duties generates from the relationship between directors and the company. The discussion on the origin of directors' duties has not come to a conclusion up till now, and there exist mainly three types of theory, including the theory of trust, the theory of commitment and the theory of agency.[7] The theory of trust was gradually established by the common law system through

6 Zheng Jianing, *Research on Diversification of Interests between Directors and Target Company*, 4 Jinan Journal (Philosophy and Social Science) 58, 59 (2016).
7 Zhai Yehu, *Non-Competition of Extraterritorial Legal Practice Visits*, 12 Law Science Magazine 69, 69 (2013).

legal precedence. This theory centers on the property of the company which is the trust property. Shareholders of the company are clients as well as beneficiaries, and directors are trustees, thus directors should manage the property of the company prudentially and perform the duties of trustees in the trust relationship. The behavior giving up loyalty to the company just for their own interests and harming the company should be strictly forbidden.[8] The theory of agency was mainly confirmed by the statute law of Germany. This theory holds the opinion that the relationship between directors and their company is an agency relationship. Directors are agents of the company and execute internal and external affairs of the company according to the relationship of agency. The company, who is the principal of the relationship, should undertake the legal consequences aroused by the act of agency performed by directors.[9] The theory of appointment, which can be called as the theory of commitment as well, is a prevailing view in Japan and Taiwan Zone. It holds that the directors and the company are in the relationship of commitment based on commission contracts. The company is the client, and directors are trustees. The directors should fulfill the duty of care of a kindhearted administrator, manage the property and deal with commitment affairs prudentially. Although there are various kinds of theories on the relationship between directors and their company, all these theories reach a consensus on the main content of the directors' duties.

To be specific, directors' duties generally include the duty of care and the duty of loyalty, and these two kinds of duties complement each other. Duty of care of directors refers to the duty that the directors should behave as a prudent person in the same or similar position or situation, which requires the necessary diligence, professional skills and prudent attitude of the directors. Duty of loyalty of directors refers to the duty that directors should perform management responsibilities according to relevant legal norms and bylaws of companies in the process of managing company, and they are not allowed to abuse rights and damage the interests of companies in pursuit of their own interests.[10] To sum up, duty of care and duty of loyalty have separately put forward both positive duties and negative duties to the directors. The former aims at encouraging the directors to perform duties carefully to achieve the maximum interests of the company. The later emphasizes restraining the directors, avoiding damages to the company's interests caused by the abuse of rights.

8 Zhong Kai, *Comparative Comments on Managers System: From the Perspective of the Civil Law Systems*, 4(3) Northern Legal Science 61, 69 (2010).

9 Li Xintian & Sun Congcong, *Study on the Obligation of Loyalty of Corporation Law*, 5-6 Journal of Henan University of Economics and Law 56, 58 (2011).

10 Weng Sunzhe, *An Analysis of Director's Duty of Good Faith*, 10 Commercial Research 105, 105 (2012).

C. The Current Situation of Regulating Directors' Duties in the Mergers and Acquisitions of Listed Companies

Analyzing the existing legal norms is the premise of discovering the crux of the problem, as well as the basis of putting forward constructive opinions. Therefore, this article will tackle the legal norms applied to the directors' duties in the mergers and acquisitions at first. Currently, there have not been norms specifically applied to the directors' duties in the process of mergers and acquisitions of listed companies in China. The provisions which can regulate the directors' duties of the listed companies can be separated into two types: one type is special provisions centering on the directors' duties of listed companies; the other type is the general provisions not centering on the directors' duties of listed companies.

Provisions which are special for directors' duties of listed companies have been prescribed in the *Guidance for the Articles of Listed Companies*, the *Measures for the Administration of the Takeover of Listed Companies*, the *Criteria for the Governance of Listed Companies*, the *Listing Rules of the Shanghai Stock Exchange* and the *Listing Rules of the Shenzhen Stock Exchange* in general. The specific provisions on the duty of care and the duty of loyalty of directors in the documents above, were stipulated in the same article by means of enumeration, like in the *Guidance for the Articles of Listed Companies*,[11] or were stipulated in different articles by means of generalization and summarization, as well as analyzed article by article, like in the *Measures for the Administration of the Takeover of Listed Companies*.[12] Taking the *Guidance for the Articles of Listed Companies* as an example, in article 98, the duty of care assumed by directors to the company is refined into six clauses, one of which is the general stipulation. What is more, in order to satisfy the need of development of listed companies, companies can assert claims to directors respectively in their articles based on their own needs, according to the newly-added comments. Article 97 of the *Guidance for the Articles of Listed Companies* defines the duty of loyalty that directors undertaken to companies through ten clauses, among which there is a general stipulation as well. Moreover, in correspondence with article 98, this article adds a new comment that companies are permitted to assert other types of requirements to their directors in their articles. To a certain extent, the contents of the above documents provide effective guidance for the directors performing duties in the mergers and acquisitions. The directors should deal with affairs in the mergers and acquisitions according to the stipulations on the duty of care and the duty of loyalty in the *Guidance for the*

11 Articles 97 and 98 of the *Guidance for the Articles of Listed Companies*; article 3.1.5 of the *Listing Rules of the Shanghai Stock Exchange*; article 3.1.6 of the *Stock Listing Rules of the Shenzhen Stock Exchange*.

12 Articles 8 and 9 of the *Measures for the Administration of the Takeover of Listed Companies*; articles 33, 34 and 35 of the *Criteria for the Governance of Listed Companies*.

Articles of Listed Companies, the *Measures for the Administration of the Takeover of Listed Companies* and the *Criteria for the Governance of Listed Companies*.

General provisions which are not special for directors' duties of listed companies mainly refer to the universal stipulations of directors' duties in relevant laws of China, namely articles 147 and 148 of the *Company Law*. To be specific, article 147 of the law takes a position that directors should perform the duty of diligence and the duty of loyalty to the companies in general, and prohibits directors from taking advantages of their own authority to gain illegal interests and embezzle assets of the companies in clause 2 of this article. Here, the statutory duty of diligence is regarded as an alternative name of the duty of care in this article. Following article 147, the law illuminates the specific situations in which the directors are prohibited from breaching duties by means of enumeration in the article 148 of the law, such as misappropriating companies' funds without authorization, self-dealing without approval, disclosing business secrets gained in the process of executing authority, usurping companies' opportunities and so on. What is more, it also sets a general stipulation, which has laid the foundation for the openness of the system of the duty of loyalty of directors. Furthermore, article 148 of the *Company Law* stipulates the ownership of the illegal interests gained by directors in the way of violating the duty of loyalty. Clause 2 of the article stipulates that these interests should belong to the companies, according to the principle of warehouse. The *Company Law*, which is a basic law of China, the application scope of whose provisions of directors' duties has universality automatically. Therefore, directors performing the duty of care and the duty of loyalty should obey the provisions as well. To a certain degree, the provisions of directors' duties in the *Company Law* are the minimum requirement for directors' behavior.

The existence of the above provisions has a fairly positive meaning, but objectively speaking, there are still some defects which need to be improved.

Firstly, as for the special documents for directors' duties of listed companies, the drawbacks are shown in the following three aspects: The first one is that the legal hierarchy of such documents is relatively low, which cannot function well. Taking the *Measures for the Administration of the Takeover of Listed Companies* as an example, although the document clearly stipulates the specific content of the duty of care and the duty of loyalty of directors of listed companies, it is just a department regulation rather than a law, in the aspect of legal hierarchy. Hence, it imposes limited binding force upon directors of limited companies. The second one is that the contents and structures are confusing and incomplete. Taking the *Guidance for the Articles of Listed Companies* as an example, when classifying the contents of the duty of care of directors, it treats directors' executing rights diligently, carefully and prudently as an independent type of duty, which causes a logical disorder, for the reason that such stipulation is a principle in nature, namely the connotation of the duty of care of the directors, which should not be put into subtypes. Besides, it is not very reasonable that the timely knowledge about the current situation of the company is treated as a subtype of the duty of care of directors in the *Guidance for the Articles of Listed Companies*. Because such provision is comparatively narrow in content, in order to realize the interests of the company to the largest extent, directors should not only know about the current situation of operation, but also make decisions prudently based on their professional knowledge and skills. The later one should be the core content of the duty of care of directors. Therefore, it constitutes an obvious leakage of the above document.

Secondly, as for the general provisions which are not specified for directors' duties of listed companies, of which the deficiency is that the content is too rough and short of exercisable arrangements which are necessary. In terms of the duty of care of directors, the *Company Law* emphasizes that directors should obey laws and regulations, as well as the articles of the companies actively, perform duties according to the requirements dedicatedly, protect the interests of the companies and fulfill the demands of the duty of diligence. However, the relevant provisions fail to define what the duty of diligence is very clearly, which makes the connotation of the duty of diligence ambiguous. Meanwhile, the provisions of the *Company Law* do not manage to state the criterion for judgment of the duty of diligence, and not to classify the duty of diligence in detail by means of partly enumeration and general stipulations either. In terms of the duty of care of directors, although the *Company Law* has already prescribed relevant provisions of the classified duty of care, these provisions lack operability and their contents are not comprehensive either. For example, in the process of liability investigation when directors violate the duty of loyalty, the law does not stipulate how to distribute the burden of proof between each party in detail, which has increased the difficulty of judicial practice. For another example, when directors trade with shareholders of the company, the duty of disclosure of certain information which should be performed by the directors is not prescribed by the *Company Law*.

III. THE CATEGORIZATION STUDY OF DIRECTORS' DUTIES IN THE MERGERS AND ACQUISITIONS OF LISTED COMPANIES

A. The Value Mechanism of the Categorization Research into Directors' Duties

Categorization is a typical research method of the science of law, whose main meaning can be summarized as the following content, that it classifies some concepts or phenomena according to a certain standard and analyzes the particular formation mechanism and operation procedures of each concept or phenomenon, so as to provide theoretical basis and guiding orientations for their specific practice in the society.[13] Directors' duties is an abstract conception, of which the value of categorization is to identify the fundamental types of directors' duties and the concrete concept of each type, improve the definiteness of directors' duties and increase the applicability of directors' duties. Concretely speaking, the research value of categorization of directors' duties can be expressed as follows:

Firstly, it can guide subjects to abide by laws and improve the efficiency of application of laws. Laws bear the function of guidance to the subjects' behavior, of which the effect depends on the level of subjects' understandings of the provisions to a certain degree. The difficulty of understanding abstract concepts is higher than that of understanding concrete conception obviously. Because of the restrictions on the abilities, living conditions and other factors, it is unavoidable that the understandings to a certain abstract conception vary among different subjects, which may affect the efficiency of law application. Therefore, as for directors' performing duties routinely or judges' reasoning in judgment documents, categorization is a helpful and effective research method, which can connect the abstract concept to the specific behavior and visualize the contents of duties that directors should perform. Meanwhile, it can make the constructive requirements of legal responsibilities of directors when violating their duties become clearer. Certainly, we should realize that categorization is not an enumerative research method which can exhaust all kinds of behavior. Its outcomes still bear the character of abstraction to some extent. The outcome of categorization is just summarization of the similarities of these behaviors because there may be many kinds of ways of behavior corresponding to the same type of directors' duty. It is impossible for laws to stipulate all kinds of directors' duties one by one, which is hardly in consistence with the nature of laws, and not beneficial to keep the openness of concepts. This article contends that the research of categorization can balance the interests of each party in the most efficient way, not only providing a specific model for the subjects, but also reserving necessary free space for their performance.

Secondly, it can complete the specific contents of duties to correspond to the development of the society. As what has been mentioned above, existing laws stipulating the duty of loyalty of directors are too ambiguous, which can only play a role of guidance in practice in general. However, the problems caused by the mergers and acquisitions are complicated. If the principles of laws just guide practice, some behavior which truly violates the duty of loyalty will be hard to

13 Wang Yeyu, *The Theory of Field Law as a New Thinking Methods in Legal Research*, 6 Journal of Political Science and Law 62, 63 (2016).

be included into the adjustment scope of laws. For instance, the *Company Law of China* explicitly stipulates that directors' self-dealing is a kind of self-dealing, such as directors' making contracts with the company without approval.[14] As for the indirect self-dealing, that directors trade with the company in the way of taking advantages of natural persons or legal persons who are in a close relationship of interests with the directors, such as the relatives of the directors, another company in which the directors are acting as actual controllers and so on. There has not been any regulation mentioning this kind of behavior in the *Company Law*.[15] However, in the mergers and acquisitions of listed companies, directors usually harm the interests of listed companies by means of indirect self-dealing, instead of direct self-dealing. Thus, it is hard for the record of illegal interests existing in indirect self-trading to be recognized as the valuable evidence to verify that directors violate the duty of loyalty which they should have performed to the listed company. Therefore, it is of vital importance to stipulate the duty of loyalty of directors of listed companies by the legislative technique of categorization and expand the connotation of self-dealing pointedly.

B. The Content of Categorization of Duty of Care of Directors

This article holds that, when designing the content of duty of care of directors by means of categorization, we should regard the connotation of duty of care as the core idea, regard the key content of duty of care as the emphasis, regard maintaining the openness of duty of care as the guiding principle and regard the specific responsibilities which should be performed by directors as the manifestation. Directors, who are the core force of management in listed companies, as the high-end talents engaged by the shareholders' meetings and specialized for the management of the business of the company, should be diligent, dedicated and responsible for the listed companies as well as for their professional identities. According to the time when the duty of care generates, this article contends that the duty of care of directors of listed companies can be divided into four subtypes below:

The first one is the duty of due diligence of directors of the acquiring company and the target company. This kind of duty stresses that directors of two parties should make a comprehensive investigation of affairs of both parties related to the mergers and acquisitions, collect the relevant information widely and analyze the materials professionally. The content of due diligence should include but not limit to the current situation of company management, the risk

14 Article 148 of the *Company Law of the People's Republic of China*.

15 Sun Hongtao, *On the Duty of Loyalty of Directors,* 14(2) Journal of Southwest Jiaotong University (Social Sciences) 131, 132 (2013).

of market operation and the condition of capital operation.[16] The aim of directors conducting due diligence is to collect the information related to the mergers and acquisitions to the largest extent, which can provide strong support of information for directors to negotiate for the conditions and make plans for the mergers and acquisitions, and reduce the risk of mergers and acquisitions for companies effectively and ultimately. Due to their responsibilities for companies, both directors of acquiring companies and target companies should conduct due diligence, but there are some differences in the contents. With regard to directors of acquiring company, the objects of due diligence include themselves and the target company. The main content of the due diligence is the current situations and prospects of development. The directors of the acquiring company are to know about the information including their company's asset structures, profitability, business processes, development arrangements and others, so as to make a good judgment on its own capability. Apart from that, the more detailed that the acquiring company knows about the current situation of development of the target company, the better the acquiring company strives for favorable conditions for themselves. Thus, the acquiring company can avoid the risks which may appear in the process of mergers and acquisitions effectively, and improve the efficiency of mergers and acquisitions. By contrast, directors of the target company not only should investigate the information like the assets, business and the structure of the acquiring company, but also need to pay attention to the real motivation of the acquiring company, in order to avoid such merger or acquisition, of which the aim is harmful to the continuous development of the company. The judgment on this motivation can be conducted by analyzing the business situation and investment orientation, whose results can be the basis for directors of the target company to decide whether to take countermeasures or not.

The second one is the duty of making judgment prudently of directors of the acquiring company and the target company. The duty of making judgment prudently of directors of the acquiring company is basically the same with that of directors of the target company. To be specific, it refers to the duty that directors give advice or make decisions based on an effective and sufficient support of information, not to be blind or impetuous. In the process of due diligence, directors will collect a large amount of information, whose facticity needs to be discerned by directors. This kind of work should not be in full charge of directors, because in the process of mergers and acquisitions, the information that needs to be checked is professional and in great amount, as well as covering a wide range. Generally speaking, it could not be completed just by directors of the acquiring company and the target company. In addition, even if the

16 Xu Jialin & Sun Yanyang, *Risk of Merger and Acquisition and its Precaution: A Case Study of HP Acquiring Autonomy*, 5 Modern Accounting 12, 14 (2013).

professional skills of directors are qualified for this kind of work, the result may still be doubtful. The directors may practice favoritism and give unfair judgment, motivated by their own interests.[17] Therefore, in order to perform the duty of making judgment prudently, directors should employ independent external professionals to check the relevant materials and information, such as accountants, lawyers, economists and so on. The similar attributes of external professionals can be summarized in three aspects: Firstly, external professionals are not in the interrelationship of interests between the acquiring company and the target company, and can always stick to a position of neutrality. Secondly, external professionals have expertise in their area. Thirdly, external professionals should be able to provide the professional opinions of assessment and checking for the acquiring company and the target company. Of course, directors still need to perform the duty of making judgment prudently. They should avoid blindly believing in or ignoring professional opinions. However, it is very necessary for the directors to analyze these opinions according to the business ability and developing situation of the company, after which the directors can make decisions. Even if the decisions are proved to be wrong, the directors can exempt from the liability due to their full performance of duty.

The third one is the duty of information disclosure of directors of the acquiring company and the target company.[18] This refers to the duty that directors should reveal the real information relevant to the mergers and acquisitions to shareholders and may not conceal them on purpose or omit information of important issues to maintain the integrity of information as a whole. The value of information disclosure is to protect the right to know of shareholders of listed companies, maintain their legal rights and supervise directors' performance of duty in the process of mergers and acquisitions. Shareholders, who are the owners of company, have the rights to know about the operating situations of companies. Directors should report this information to them and be responsible for them. If directors violate laws, regulations or articles of companies, shareholders have the rights to raise objections and start the corresponding system of review, which can form an effective external restriction to directors. Except for the facticity of information, information disclosure should follow the rules below: The first one is a timely disclosure. Most of the management information of companies has timeliness and alters as time goes on or the market changes. What is more, the opportunity of development for the company is also very easy to be missed. Thus, directors should report to shareholders on time after they have judged the facticity of information prudently and may not delay without reason or deliberately. The

17 Wang Shuyuan, *Enlightenment of Measurement Deviation of Consolidated Goodwill and the Phenomenon of Non-devaluation*, 7 Research of Finance and Accounting 24, 25 (2014).

18 Zeng Xiangsheng & Fang Yun, *Theory of Law against Hostile Takeover Behavior of Listed Company Regulation*, 67(3) Wuhan University Journal (Social Science) 23, 24 (2014).

second one is whole-course disclosure. The whole course of mergers and acquisitions of listed companies lasts for a long time. From the acquiring company throwing out intention, to the target company negotiating with the acquiring company, to both parties making an agreement on the mergers and acquisitions and submitting the agreement to respective shareholders' meetings to discuss, information disclosure is necessary for each link. So, directors should reveal relevant information according to the process of mergers and acquisitions. The third one is full disclosure. Directors should judge whether the contents of information disclosure can be deemed as important issues of mergers and acquisitions according to their professional qualities. Directors should fully reveal items related to the operation of the company to the shareholders, not to miss or conceal any single piece of information, which can prevent the shareholders from making judgments just relying on one-sided information and putting the operation of the company at risk.[19]

The fourth one is the duty to endeavor to pursue optimum conditions of directors of the acquiring company and the target company. There are different connotations of optimum conditions for different subjects. For the acquiring company, the optimum condition refers to gaining the right to control the target company at the lowest cost and realizing their own interests to the best. For the target company, the optimum condition refers to obtaining a consideration as high as possible by the merger or acquisition of the acquiring company, in order to improve the current development situation of the target company. To endeavor to pursue optimum conditions, directors need to correct their attitude and take a firm position, and then think over all relative matters. Taking directors of target companies in the mergers and acquisitions as an example, they should treat all the possible acquiring companies equally without discrimination and know about and balance the conditions proposed by each acquiring company objectively and fairly. This article holds that, in order to maintain the continuous operation of the target company, when deciding on the optimum condition, directors should rely on the long-term development plan of the target company other than the highest price instantly, or they can adopt a comprehensive standard to value from the aspects below: Firstly, the price of mergers and acquisitions proposed by the acquiring companies. The price should reflect the current existing value and the future developing value of target companies veritably. Secondly, the current situation of operation and the reputation in the corresponding industry of the acquiring companies. The current situation of operation directly affects the development prospects of target companies, and the reputation in the corresponding field can indirectly reflect their philosophy of operation. Thirdly, the effects caused by the scheme, which is submitted by the acquiring companies,

19 Feng Guo, *Research on the Rules of Prohibition of Usurping Corporate Opportunity*, 1 China Legal Science 96, 103 (2010).

of mergers and acquisitions to the target companies and their directors' development. The aim of the acquiring companies rectifying and reforming the target companies in the future and the plan of operating businesses, will both involve the alteration in interests of the companies and their shareholders. The optimum conditions gained by the target companies should minimize the risk. Fourthly, in the process of operating, the acquiring companies shall not undergo any record of serious violations and administrative punishment, and the whole course of merger and acquisition should correspond with the relevant stipulations of laws and regulations.

C. The Content of Categorization of Duty of Loyalty of Directors

As independent economic subjects, there is no reason to blame directors of listed companies for pursuing their own interests. And it is inevitable for them to face the risk of conflict of interests between the individuals and the company after they hold the post of senior managers of the company. The aim that the law restricts the way in which directors perform their duties through the stipulation of the duty of loyalty is to maintain the interests of the company to the largest extent. In other words, if the behavior of directors performing their duties can benefit the company as well as themselves, the law does not forbid such behavior absolutely. But if their behavior can only benefit themselves and does harm to the interests of the company, the law will intervene into such behavior. This article contends that, in the process of mergers and acquisitions of listed companies, the establishment of duty of loyalty of directors should follow the guidelines below:

The first one is the principle of "corporate interests first". On the one hand, this principle asks directors to take realizing the interests of the company to the largest as the starting point when dealing with affairs related to the mergers and acquisitions of listed companies and making operating decisions, whereas, the practical results of operating the company are not treated as the basis of imposing liabilities upon the directors.[20] On the other hand, according to this principle, when the directors' own interests conflict with the interests of the company, directors should put the interests of the company to the first position and strive for the interest of company. In the process of operating listed companies, high-level business risks are always accompanying, whose potentiality and variability make it difficult for directors to grasp the specific rules to deal with it. Thus, if taking the practical results of operating the company as the standard to judge whether directors have fulfilled their duty of loyalty or not, it will increase the burden of directors unreasonably, which may lead directors to decline and the company

20 Miao Qinghua, *The Path for Improvement of Culture of Board of State-owned Enterprises*, 9 Directors & Boards 84, 85 (2014).

may miss opportunities. Furthermore, as the investors of listed companies, shareholders seek for high-level profits and should undertake the corresponding risks of operating failure. It is unrealistic to separate the risks from the profits.

The second one is the principle of "the balance of each party's interest". Objectively speaking, it is unavoidable that there is divergence between the interests of directors and the interests of the company in the process of mergers and acquisitions of listed companies. It seems to violate the nature of directors, who are independent economic subjects in the market economy, if the law just emphasizes that directors shall forgive their own interests and select the interests of the company. Thus, when establishing the directors' duty of loyalty, we should abandon the over strict idea and adopt an attitude which is more moderate, seeking a balance between the individual interests of directors and the interests of the company, in order to get a win-win. To be specific, the laws prescribing types of directors' duty in the mergers and acquisitions should underline the important issues which must be strictly prohibited, namely the behavior which may seriously harm the mergers and acquisitions of listed companies. As for other kinds of behavior, for example, the profits gained by directors exceeding the profits gained by the company, or the behavior which has little influence to the mergers and acquisitions, they should not be included in types of behavior of directors violating the duty of loyalty, and may not be recognized as the proof that the directors gain illegal profits by means of damaging the interests of the company.

Following the guiding rules above, this article holds the opinion that the duty of loyalty of directors in the mergers and acquisitions of listed companies should include but not limit to the following elements:

Firstly, directors are not allowed to seek illegal profits through taking advantages of the opportunity of mergers and acquisitions of listed companies. The content of this kind of duty is that both directors of the acquiring company and the target company cannot utilize the chance of negotiation in the merger or acquisition of the listed company and gain profits by means of illegal methods or obtain illegal profits under the blanket of legal means, such as raising the price of the merger or acquisition illegally, asking for brokerage from the opposite side, accepting monetary or nonmonetary bribes given by the opposite side, embezzling assets of the company by malicious collusion with the opposite side and so on.

Secondly, directors are not allowed to embezzle assets of their company in the process of mergers and acquisitions of listed companies. In the process of mergers and acquisitions of listed companies, directors of the acquiring company and the target company need to perform the duty of due diligence actively, which makes directors acquire the operating information of both parties to the largest extent and control their company's assets. It is very likely for them to embezzle their company's assets. The company's assets include tangible property of the company, like various kinds of equipment, as well as intangible property like trade secrets.

Thirdly, the directors are not allowed to be absent without permission in the process of mergers and acquisitions of listed companies. This duty stresses that directors of the acquiring company and the target company may not resign without a reasonable cause or leave office without approval. That is because the business related to the mergers and acquisitions of listed companies is complex, and the smooth progress of each piece of work needs the professional management by directors. What is more, each link of mergers and acquisitions is combined together tightly and affects each other. In this regard, as regulators of the company with professional skills and familiar with the business of the company, directors are of vital importance. If the directors resigned or are dismissed improperly, it would cause unrecoverable damage to the company.

Fourthly, directors may not reveal any information related to the mergers and acquisitions of listed companies. For whether the acquiring company or the target company, the mergers and acquisitions of listed companies are vital items of management and their directors should keep the relevant information secret, for not only the leakage of relevant information may influence the existing production and operation and disturb the normal order of the market, but it also may lead to a fluctuation of stock price and influence the development of the company in a long run.

Fifthly, directors' self-dealing is banned in the process of mergers and acquisitions of listed companies. In the context, the expression "self-dealing" should be understood broadly, including direct transaction ways like directors' making contracts with the company and indirect transaction ways like directors' taking advantages of related parties to trade with the company. In the above two kinds of transactions, it is prone for directors to betray the company in order to maintain their own interests, when the directors hope to gain illegal profits which should not belong to them by such transactions.

Sixthly, directors should perform the duty of information disclosure actively in the process of mergers and acquisitions of listed companies. The content of this part of duty of loyalty is the same with the content of duty of information disclosure. It stresses that directors should reveal the relevant information timely, roundly and truly in the whole course, making the shareholders know about the fact of the target company and the acquiring company. Directors' behavior of information disclosure can be seemed as the performance of directors' loyalty, as well as a way to maintain the interests of the company. For example, if directors have already reported existing opportunities to the company and given advice on how to take these opportunities, but the shareholder's meeting gives up these opportunities after a resolution, the directors can take the opportunities themselves after the relevant approval procedures, which could not be identified as usurping the company's opportunities.

Furthermore, in the process of mergers and acquisitions of listed companies, directors of the target company may adopt anti-takeover measures. The anti-takeover measures are the measures taken by the target company in order to resist the malicious acquiring company, protect itself, and to prevent the acquiring company with harmful intention from obtaining the right to control of the target company.[21] In this process, the directors should still perform the corresponding duty of loyalty without a doubt. The methods used may vary, but the principle is the same. This article holds the opinion that the specific content still needs to extend according to the above study of categorization. Of course, the content of law should rely on the specific procedures of anti-takeover as well. For example, directors should not take advantages of anti-takeover measures to obtain illegal profits, embezzle the assets of the company without approval as well as damage the interests of the company by malicious collusion. Meanwhile, the directors still need to perform the duty of information disclosure.

IV. THE CONSTRUCTION OF THE CRITERION FOR JUDGING DIRECTORS' DUTIES IN THE MERGERS AND ACQUISITIONS

A. The Theoretical Basis of Construction of the Criterion for Judging Directors' Duties

The essence of the criterion for judging directors' duties is a gauge to weigh whether the behavior of directors violates the duties they should perform, the construction of which is beneficial to provide a basis for identifying the legal responsibilities of directors. The criterion for judging directors' duties in the mergers and acquisitions can not only improve the predictability, instruct directors to perform duties correctly, but also improve the efficiency of investigating and imposing legal liabilities upon violators when directors violate duties. This article will show the positive influence of the construction of the criterion for judging directors' duties in the following text:

Firstly, it guides directors to perform duties in a proper way. The establishment of the criterion for judging directors' duties means the materialization of the factors which should be taken into consideration in the process of investigating and affixing the responsibilities to directors violating their duties which can improve the predictability of the results of directors' daily

21 Xiao Rui, *Observation of the Application of Anti-Takeover Measures in China, from the Perspective of the Battle between Baoneng and Vanke*, 5 Marketing Research 59, 59 (2016).

management behavior and prevent themselves from falling into unpredictable responsibilities. Moreover, this criterion can help the directors take effective measures to maintain their legal rights and interests on time under the system of responsibility investigation. Furthermore, under the criterion for judging directors' duties, the directors will recognize the focus of their duty of care and the main basis of their duty of loyalty clearly, which can help them select a proper mode of behavior to realize the interests of the company, as well as balance their own interests and the interests of the company at the same time.

Secondly, it improves the efficiency of responsibility investigation when directors violate their duties. If directors violate the duties they should perform, they must undertake the corresponding unfavorable results for their behavior, whose externality is legal responsibilities. To be specific, the mechanism can be the non-litigant way inside the company, or the litigant way conducted by the court. No matter what kind of way they take, the criterion for judging whether the directors violate their duties or not is the core of the process. If the criterion for judging directors' duties is ambiguous, it is probable to make the subject investigating and affixing responsibilities and the subject being investigated and affixed responsibilities argue back and forth, which may prolong the duration improperly, reduce the efficiency largely, or even waste the judicial resources. Thus, constructing the criterion for judging directors' duties in a scientific and definite way can provide a direct basis of judgment and avoid the risks.

After clarifying the significance of constructing the criterion for judging directors' duties in the mergers and acquisitions of listed companies, we further expound the basic train of thought that we should follow when we construct the specific criterion for judgment. Thus, this article contends that the construction of the criterion for judging directors' duties should reflect the pursuit of efficiency and fairness. The specific contents are stated below.

Firstly, the establishment of the criterion for judgment should reflect the pursuit to the value of efficiency. The value of efficiency is one of the basic values that the law pursues, which needs to be reflected in the aspect of economy as well as society. The former emphasizes the promotive productivity function of law, and the latter focuses on the protection that the law gives to the rights and the regulation that the law imposes upon the powers. Thus, we should take the value of efficiency into consideration when establishing the criterion for judging directors' duties, which contributes to connect the law with the development of market economy and utilize the legal source efficiently as possible.[22] The establishment of directors' duties should have good operability, which can be invoked by directors in the process of performing duties, referenced by the

22 Shao Liuyi, *Introspection of Knowledge of Legal Science as a Subject of Social Science: Focusing on Research Methods*, 2 ZUEL Law Journal 111, 116 (2015).

company when investigating and affixing responsibilities to directors and used to help the court save resources in the judicial judgment.

Secondly, the establishment of the criterion for judgment should reflect the pursuit to the value of fairness. The value of fairness emphasizes the state of balance between the subjects of rights and duties. In the process of mergers and acquisitions of listed companies, the rights and the risks of responsibilities of directors need to come in to the state of balance. If the criterion for judging directors' duties are too rigorous, it means the possibility that directors undertake risks of responsibilities is very high, which may restrain the motivation of directors making decisions independently. On the contrary, if the criterion for judging directors' duties are too loose, it means the possibility that directors undertake risks of responsibilities is low, which may not be able to urge directors to perform duties properly. Thus, the content of criterion for judging directors' duties should combine with the rights of actual control owned by directors, and express a proper attitude to investigate and ascertain the responsibility.

B. The Selection from the Subjective, Objective, or Other Criterion Judging the Duty of Care

The criterion for judging duty of care of directors has changed from the subjective criterion to the objective criterion, finally to the combined criterion. Each kind of criterion above has different connotations, characteristics and drawbacks. This article holds that, after clarifying the contents above, we should choose the combined subjective and objective criterion as the basis for judging duty of care of directors in the process of mergers and acquisitions of listed companies. Furthermore, we suggest introducing the rule of "business judgment" into the mechanism to mitigate the negative influence of the imposition of duty of care of directors, whose application should be restrained.

To be specific, the criterion for judging duty of care of directors can be described respectively as below:[23] The subjective criterion means that based on the personal abilities of directors, if directors fully utilize their knowledge, skills and experience and show their talents to the largest extent, it will be identified that directors fulfill the duty of care properly. The objective criterion exceeds subjective judgment in individualism, and chooses the duty of care which should be performed by an ordinary person in the same or similar circumstance as the scale for judging the situation of the performance of duty of care of directors. The content of subjective criterion for judgment substantially includes three parts, which respectively are to perform duties out of good faith, achieve the degree of duty of care of ordinary people under the similar circumstance, and make the

23 Liu Shuhua, *Discussion on the Duty of Care of Directors,* 18 China Journal of Commerce 255, 255 (2011).

specific modes of behavior reasonable and easy to realize the interests of companies. The subjective and objective criterion for judgment is a combination of the subjective criterion and the objective criterion. It emphasizes that if the personal ability of directors is not obviously higher than the ordinary people in the society, their duty of care should be judged under the objective criterion. Otherwise, it should be judged under the subjective criterion. From the perspective of value, all of the criteria above have advantages and disadvantages. The subjective criterion fully respects personal abilities of directors, but it is very easy to be caught in the situation where the ability of directors is lower, the responsibility of directors is smaller, thus the average capability of directors will be dragged down. The objective criterion can prevent the person with lower abilities from holding the post of directors, but its force of constraint is not enough for the directors with higher abilities. The subjective and objective criterion is the most scientific one, which can not only show respect for the objective differences in the personal ability among directors, but also leave room for the talents of directors.

Furthermore, this article insists that the criterion for judging the duty of care of directors of listed companies in the mergers and acquisitions should take the subjective and objective criterion. As for this kind of criterion, there is doubt that the criterion will unreasonably increase the duty of directors whose personal abilities are higher and aggravate their professional risks, which is not fair. If things continue in this way, the application of this criterion will restrain these directors' passion to perform duties actively and impede the step of development of listed companies.[24] This article has some reservations to the doubt above. Apparently, it seems unfair to ask the directors whose personal abilities are higher to undertake the duty of care to a certain extent exceeding that of ordinary people, but it is unavoidable for all kinds of criteria. Furthermore, according to the principle of the unity of right and duty, these directors enjoy a relatively more powerful right to control the management and decision-making of listed companies, so it is reasonable to ask them to undertake a higher risk, which is the embodiment of substantial fairness.

After establishing the criterion for judgment, this article indicates that conditions applying the criterion should be emphasized at the same time. The significant rule closely related to the criterion comes into the center of the public. That is the rule of business judgment. This is an examining rule formed gradually by the US case law, which has not been made into statutory laws up to now. Nowadays, how to precisely define the connotation of this rule remains unsettled. However, its nature can be expressed as below: The rule is a kind of assumption

24 Fang Yun & Xiong Xianzhong, *Study on the Criterion for Judging the Duty of Care of Directors in the Management of Company*, 5 Jiangxi Social Sciences 194, 196 (2010).

in nature. The content of this rule is that when making decisions, if directors rely on abundant materials, act in good faith and believe the decision can realize the interests of companies to the best while not being the stakeholders on the event waiting for a resolution, the directors will not be deemed as violating duty of care. The way to overturn this assumption is to prove that a director has really conducted behavior violating duty of care and has caused damage to the company.[25] This rule reflects the court's negative attitude to review the operation and decision-making of companies, expecting to fully respect the self-governance of companies, which is also considered a reasonable arrangement of process of utilizing judicial recourses without any doubt. When the shareholders present evidence to overturn the assumption above, the court will start a substantial examination to the content or procedure of decision-making according to the specific criterion for judging the duty of care of directors, and decide whether directors violated the duty of care thus ought to undertake the corresponding liability or not at last.

In the market-oriented economy, the business risk appears and disappears from time to time. The decision-making of companies is unavoidable to be frequently challenged. The shareholders should have a clear knowledge of this situation and bear risks bravely. Imposing the duty of care to directors properly and tolerating their faults to some extent are the necessary choice for the company to maintain vitality and make progress. The core function of the rule of business judgment is to protect the interests and rights of directors, coordinate the interests between directors and shareholders and clarify the specific index for judging duties of directors, which can exempt shareholders from the confusion of junk lawsuits and promote the execution of decisions made by directors.[26] Thus, as far as this article mentions, it is indeed necessary to introduce the rule of business judgment. However, it is unavoidable that the duty of care of directors will generate some negative influence, which needs to be resolved by specific rules. On the one hand, the connotation of the subjective and objective criterion for judging duty of care is hard to be quantified absolutely and needs to be analyzed in each case, in order to prevent directors from being caught into the unknown risks of taking liability. On the other hand, under the background of ownership separating from the right of operating, it will vastly lower the efficiency of operating if the effectiveness of each operating decision needs to be judged substantially at first. Currently, the *Company Law of China* only stipulates the duty of care of directors, but it does not mention the rule of business judgment at all. Moreover, there is not any other relevant rule to deal

25 Li Zhongli, *Director's Liability When Duty of Care Is Not Fulfilled*, 35(2) Journal of Hebei University (Philosophy and Social Science) 75, 77 (2010).

26 Li Zhongli, *Director's Liability When Duty of Care Is Not Fulfilled, Take the Business Judgment of Law of American as an Example*, 3 Hubei Social Sciences 162, 164 (2010).

with the negative influence brought by the duty of care of directors above, which is not beneficial to protect the performance of duties of directors. In the future, relying on the tradition of statutory law, we can put this rule into the relevant judicial interpretation to guide the practice.

What needs to be noticed is that there need to be some restrictions applying the rule of business judgment in the process of mergers and acquisitions of listed companies. That is, the rule cannot be applied in anti-takeover measures which are taken by directors of the target company because in the situation of anti- takeover, there are implicit conflicts of interests between the target company and its directors. It is obviously unreasonable to adhere to the principle of business judgment sequentially. The problem attracted the attention of American courts, so the rule has been amended by American case law. The content of assumption of this rule has been adjusted. The court presumes that directors have already violated the duty of care of directors when they make decisions of taking anti-takeover measures. If directors want to overturn this assumption, they must undertake the burden of proof. Thereafter, American courts define the specific content of the burden of proof of directors. On the one hand, anti-takeover measures should be taken by directors according to a reasonable basis. That is, there is evidence that the takeover action of the acquiring company may imperil the current situation of the target company. On the other hand, anti-takeover measures taken by directors are appropriate. That is, these measures should be closely related to preventing the potential risks. The development of this rule has maintained the balance of interests of each party effectively, which should be affirmed. This article suggests that, we should take the practice above as an example, apply this rule to the directors of the target company who take anti-takeover measures similarly and reverse the burden of proof at the same time. The directors should be asked to demonstrate that their initial motivation is to maintain the interests of the company and the decisions should be made out of due diligence and prudential analysis.

C. The Determination of the Criterion of Overall Fairness for Duty of Loyalty

Based on the core connotation of duty of loyalty of directors, performing duties in accordance with laws, forbidding misuse of rights and safeguarding the interests of the company go forward one by one. From the perspective of the aim of legal norms, restraining directors' nature of seeking personal gains and realizing the interests of the company to the largest extent are a typical aim of the duty. Combining the above content, this article suggests that the establishment of the criterion for judging the duty of loyalty of directors should follow the below principles:

Firstly, strictness combines with looseness.[27] On the one hand, this principle aims at emphasizing that the criterion for judging the duty of loyalty should not be too strict and directors should not bear too much risk. In the process of performing duties, directors have already taken relatively high risk. If the law still requires directors to undertake a strict liability for their performance of duties rather than protects them, it seems unfair. On the other hand, the criterion should not be too loose, or it cannot function well as supposed. Under the loose criterion for judgment, a large amount of risk will transfer to the shareholders of the company directly, directors, however, who enjoy the right to control of the company, lack effective and strong restrictions. What is worse, directors may evade legal liabilities after violating their duties, which may seriously affect the governance of the company.

Secondly, abstraction combines with concreteness. This principle means that the criterion judging duty of loyalty should be constituted by abstract principles and concrete indices for judging. The former can be applied broadly, whose function is to instruct the judgment of single cases. The latter has particularity, whose main function is to improve the efficiency of judgment. The reason for establishing this principle is that the duty of loyalty is an abstract concept, whose criterion for judgment is hard to be precise as well. The concrete criterion for judging needs to be abstracted from legal norms, social practice and the common value of society little by little, and then be applied by judges by means of necessary discretion in judicial practice. Therefore, the criterion for judgment of abstraction combining with concreteness conforms to the legal practice, which in turn promotes the connotation of the criterion to become more abundant and keep pace with the times sustainably.

Thirdly, statues combine with promises. This principle emphasizes that the company can supplement some other items through the bylaw of the company based on the statutory criterion for judging the duty of loyalty of directors. Generally speaking, the criterion for judging the statutory duty of loyalty is the criterion of the lowest level, and directors should perform the minimum duty of loyalty according to these stipulations. While fully respecting the self-governance of companies, the law should not forbid the shareholders of listed companies to propose a higher-level criterion for their directors under statutory procedures, given that the content of the criterion does not violate the stipulations of laws and regulations. Furthermore, the content of statutory duty of care can be universally applied to various listed companies. However, it is not particular for a certain listed company. Under this circumstance, the criterion for judging the duty of care of directors proposed by the bylaws of the company or other ways, which

27 Li Changbing, *Improvement of Criterion for Judicial Review of Duty of Loyalty of Directors*, 8 Legal and Economic 66, 66 (2012).

combines the structure of management and the business situation, is obviously more specific and can better fit the development of the company.

Under the guidance of the principles above, this article regards the overall fairness as the criterion for judging the duty of loyalty of directors. It refers to analyzing the whole transaction process in the mergers and acquisitions of listed companies, judging whether items like the specific transaction procedures and the transaction outcomes conform to the value of fairness so as to forbid directors to gain illegal profits from each kind of transaction.[28] To be specific, the fairness that the criterion for judgment of fairness of the entity focuses on should be understood from three aspects: firstly, the fairness of transaction procedures; secondly, the fairness of transaction contents; thirdly, the fairness of transaction outcomes.

The fairness of transaction procedures means that the transaction should progress according to the statutory procedures, and directors should perform the duty of loyalty stipulated by laws actively and avoid from topics associated with them in interests. The transactions involved by the mergers and acquisitions of listed companies usually need a long period to negotiate and involve subject matters large in amount. When dealing with relevant matters, directors should perform the duty of loyalty actively in accordance with the laws, such as revealing relevant information to shareholders on time, keeping business secrets which they know in the process of performing duties and avoiding embezzling assets of the company without approval by means of taking advantages of duties. If directors do not perform the statutory duty of loyalty above, it can be regarded as the defect of transaction procedure which may affect fairness of the transaction, and directors will be judged as violating the duty of loyalty. Furthermore, the function of avoidance of interest-related directors is to remove the basis of directors’ abusing of power for personal gains and to prevent directors from acting wrongly out of personal considerations when making decisions, so as to avoid harm to the interests and rights of shareholders and other stakeholders of companies.

The fairness of transaction contents means that the content of relevant transactions approved by directors should benefit the realization of interests of the company. The range of transaction content is rather extensive, so the fairness of its specific content cannot be judged just by a single criterion. However, it should take many kinds of factors into consideration. Taking the price of transaction approved by directors as an example, when judging the price is fair or not, factors like current situation of assets, the prospect of the company, the market value of the company and the trend of stock price need to be taken into consideration and analyzed comprehensively, avoiding making false decisions according to one-sided information. For another example, when judging the fairness of the time limit of the transaction agreed on by both parties, we should

28 Zhao Shuwen, *The Legislation and Modification of Duty of Care of Directors,* 1 Theoretical Exploration 141, 144 (2012).

not just pay attention to the length of duration. However, we should consider the company's actual ability to perform the contract, allocation of duties and rights between two parties, the specific place of performance of the transaction and so on, thus come into a relatively reasonable conclusion at last.

The fairness of transaction outcomes means that the outcomes of transactions conducted by companies increase interests or decrease interests with a reasonable cause. Due to the risk of business operation itself, we cannot critically require directors to make profits for the company in any transaction they conduct, but the directors are not allowed to gain profits when the company's interest is damaged. It is relatively easy to recognize the situation that the company's interests are improperly damaged because of transactions, such as a sharp slide of stock price after transactions, the operation of the company being seriously blocked because of transactions, and the assets of the company improperly decreasing in the process of transactions. When the situations above occur, there is no doubt that directors violate the duty of loyalty. Absolutely, the interest here is the interest of companies in the long run, rather than the exterior interests like dividends of shareholders. In some situations, although the interests of shareholders have not increased through transactions, the continuing operation interest of the company increases.

V. THE IMPROVEMENT OF MECHANISM OF ACCOUNTABILITY FOR DIRECTORS' VIOLATING DUTIES IN THE PROCESS OF MERGERS AND ACQUISITIONS OF LISTED COMPANIES

We should explicitly stipulate responsibilities taken by directors when they violate duties prescribed by the law, which should be operable rather than merely be explained simply. When directors violate duties, the specific subjects should exercise their rights of claiming to cease on time, in order to reduce the loss of the company to the minimum. If the loss of the company has already generated, the company should exercise the right of recourse to directors violating duties for the illegal profits they gained in a reasonable time limit. As for the relief of the loss of company other than the illegal profits above and to the loss of the third party, we should emphasize the liability of compensation of relevant directors. To be specific, this article will give advice to the improvement of system of accountability when directors violate duties from the three aspects below.

A. Entitling the Right to Claim to Cease to the Specific Subjects

In the process of mergers and acquisitions of listed companies, the right to claim to cease aiming at the directors who violate directors' duties, means that when the directors violate laws, regulations or bylaws of companies and are likely to damage the company, the shareholders of the company who hold shares to a certain percentage alone or in total or the supervisors of the company, can exercise the right of claiming to cease to the directors, in order to protect the interests of the company. The function of the right of claiming to cease is to prevent directors from taking illegal actions and avoid unrecovered damage to the company. Thus, its main function can be summed up as preventing risks. The responsibility stipulated in the *Company Law of China* emphasizes the compensation for the existing damage, when directors violate duties. As the provisions of this law stipulate, if the company suffers loss because of directors' violating relevant provisions when performing duties, the conductor should take the responsibility of compensation to the company.[29] Additionally, although there are measures like shareholder direct action and shareholder derivative action in the *Company Law*, acting as the measures of accountability in terms of directors' violations, the right of claiming to cease has not been clearly stipulated by the law.[30] This article contends that this right should be included into the *Company Law*, coordinate with other systems of accountability and prompt the healthy development of the company together. Considering the design for the specific content, this article suggests that the constructive requirements of the right to claim to cease should include these aspects below. Firstly, the director conducts the violation of duty of directors. The scope of application of right to claim to cease determines that this constructive requirement is indispensable. The type and the criterion for judgment of directors violating duties can refer to the relevant exposition of duty of care and duty of loyalty in this article. When the right holders exercise the right to claim to cease, they should present powerful evidence to prove that the directors have indeed violated their duties, otherwise they might bear the negative effect caused by the abuse of rights, for the reason that the exercise of the right to claim to cease may restrict the right of directors and impede the process of directors' performing duties. Secondly, the violation of duty of directors has not finished. Only for the unfinished behavior, the cease is necessary and meaningful. As for the behavior that has already finished, it is impossible for it to cease in the half way. Therefore, the exercise of the right of claiming to cease only exists in the situation where the violation of duty of directors has not finished, whose nature is a measure to protect the company from suffering serious damages and prevent the directors from abusing rights.[31] The combining of the prevention beforehand and relief afterwards can strengthen the protection of the interest of the company. For the existing damage which has

29 Article 149 of the *Company Law of the People's Republic of China.*

30 *Id.*, articles 151 and 152.

31 Zhao Yingjie, *Capital Reductions and Protection Bondholder Interest*, 11 Financial Market Research 60, 69 (2016).

already been caused by the violation of duty of directors, the relevant shareholders and supervisors can take advantage of the corresponding system of accountability to ask the directors for compensation, in order to maintain the interest of the company.

Thirdly, the violation of duty of directors may cause irreparable damage to the company. The irreparable damage refers to the damage cannot be recovered in fact, including the irreparable damage in law, for example, the damage suffered by the company caused by the violation of duty of directors is hard to be recovered by system of accountability or the recovery afterwards is meaningless for the company. The constructive requirement of the right of claiming to cease should be judged by the subject of the right independently, and there is not an objective standard for them. Even though it has been proved that the violation of duty of directors would not cause irreparable damages to the company, but the cease in fact caused damages to the company, the subjects do not need to take responsibility, once they do not have any fault subjectively when exercising the rights, for the reason that the exercise of the right is a caution to the directors in good faith, which cannot transfer risks on the level of legal effects.

B. Improving the System for Companies to Exercise the Right of Disgorgement

If the company suffers losses due to directors' violating duty of care and duty of loyalty, directors should undertake the liability of compensation, which has been reflected as a basic attitude in the law of China. Meanwhile, the law also stipulates that the director should return the illegal profits they gained to the company, which is the company exercising the right of disgorgement. To be precise, the company's right of disgorgement means that the company has the right to take back the overflowing profits, if other subjects violate the provisions of relevant laws or the bylaws of the company and gain the premium at the cost of damaging the interest of the company.[32] However, the discussion on the nature of disgorgement has not come to a conclusion. There is not any provision on whether it is necessary to stipulate a proper duration for the exercise of this right or not. In this situation, this article supposes that the law should set a reasonable scheduled duration on the basis of affirming the disgorgement as a right of formation, in order to encourage the company to exercise rights timely and stabilize the relationships in the society as early as possible.

There is a debate on the nature of disgorgement of company. One is the

32 Wang Jianmin & Shi Cheng, *Establishment and Improvement of Disgorgement of Company Law*, 1 Theory Journal 69, 69 (2014).

theory of right of claim, which treats this kind of right as a kind of right to claim. The other one is the theory of right of formation, which treats this kind of right as a kind of right of formation. Both two kinds of theory have their theoretical basis.[33] The main idea supporting the theory of right to claim is that the exercising of companies' rights to disgorge needs the performance of directors who violate duties. Only if the directors hand over the illegal profits they gained, the company can fulfill the legal effect of disgorgement via acceptance. Thus, the exercise of disgorgement refers to the process that the company asks directors who violate duties to conduct certain behavior. The theoretical basis for the theory of right of formation is as follows: Firstly, as for the execution of right, the execution of disgorgement of company is a kind of unilateral legal act and does not need the assistance from the directors who violate duties. The behavior of directors handing over illegal profits to the company is only a kind of duty generating from the legal effect of exercising the right of formation. Secondly, the company enjoys ownership of this part of overflow interest is not the premise of exercising disgorgement. This feature of the right of formation is very different from that of the right to claim. The obligee of the right to claim must enjoy the fundamental right. Only under this circumstance, they can ask the counterpart to perform the duty of positive action or negative omission. For this question, this article supports the theory of right of formation, which suggests that the disgorgement of company is a kind of right of company unilaterally, and the company can form and modify the relationship with the directors who violate duties by means of exercising the right. The specific process can be described as below: After directors gain illegal profits because of their violation of duty of directors, they become the owner of illegal profits. When the company exercises disgorgement, the illegal profits transfer between two parties, which do not need the assistance from directors.[34]

Based on this theory, the application rule of companies' right to disgorge should be included in the legislation arrangement. In this arrangement, the duration of exercising rights is of vital importance, which is directly related to the existence of substantive rights. Accordingly, the scheduled period which is particularly designed for the right of formation should be reflected in the application rule of right of disgorgement of company. The scheduled period is a kind of time limitation for obligee to exercise rights, during which, if the obligee does not exercise their rights, the right will be eradicated.[35] Adding the

33 Wang Ruyan, *Analysis on the System of Regulating Short-swing Transactions of the Securities Law*, 8(1) Journal of Southwest Agricultural University (Social Science Edition) 53, 54 (2010).
34 Wang Jianmin & Yuan Jin, *Research on the Disgorgement of Company*, 12 Shandong Social Sciences 147, 148 (2010).
35 Jiao Yanling, *Discussion on the Conflict and Solution between the Scheduled Period and the After-sale Duty of Caution*, 8 Lanzhou Academic Journal 171, 171 (2012).

scheduled period to application rules of disgorgement, can not only urge the shareholders who process shares of the company to a certain percentage and the supervisors to exercise right actively and avoid the social relationship remaining uncertain in a relatively long period, but can also strengthen the connection among internal systems of accountability like the supervisor action and the shareholder derivative action, improving the efficiency of the operation of the company. According to the common sense of the scheduled period, the length of the scheduled period can reflect the force of protection of laws to a certain right of formation, so the scheduled period of companies' right of disgorgement should be designed by the legislative body prudently. As far as this article is concerned, a one-year period is relatively reasonable. The reason is that the procedure of mergers and acquisitions of listed companies is complex and takes a long time, which will influence many relevant parties generally. Therefore the scheduled period of disgorgement should not be set too short, or it cannot protect the interest of the company effectively. Meanwhile, the period should not be set too long either, or it will make social relationships remain in an uncertain state. As for the starting point of the scheduled period, this article takes the traditional objective criterion, namely it starts from the day when the right generates. But this criterion may be doubted that it is inconsiderate, because it does not take the subjective factors of the company's exercising rights into consideration.[36] However, this article contends that the subjective criterion of the starting point shows the position taken by the legislation after weighing the value of protecting the interest of the company and the value of maintaining the stabilization of social relationship, which should be affirmed.

C. Improving the Content of Civil Compensation Liability

The result of exercising disgorgement by the company is that the directors return the illegal profits gained by directors who violate the duty of care or the duty of loyalty to the company, which is limited to the illegal profits they gained, not involving the full compensation for the damage of the company. However, in the process of mergers and acquisitions of listed companies, the loss of directors violating statutory or promissory duties cannot be fully filled up just by the directors' returning the illegal profits they gained. Under this circumstance, the company should be reimbursed by the system of civil compensation. Thus, the company's exercising right of disgorgement and the directors' undertaking civil liability of compensation are not contradictory. Furthermore, the violation of duties of directors may

36 Zhang Jing, *Rediscussion on Criterion for Distinguishing the Limitation of Action and the Scheduled Period*, 28(1) Graduate Law Review 22, 29 (2013).

harm the third party directly or indirectly, but there is not any stipulation about the compensation to the third party in current laws and regulations of China. There is not any specific regulation of methods for directors to take responsibility after violating duties in the *Civil Law*. The *Measures for the Administration of the Takeover of Listed Companies* emphasizes the administrative punishment taken by the CSRC[37] and ignores the civil liability of compensation of directors, which has resulted that the cost of violation is relatively low and it is not beneficial for encouraging the directors to perform duties actively.

This article holds that it is very necessary to improve the system of civil liability of compensation for directors' violation of duties in the mergers and acquisitions of listed companies in laws and regulations. Compared with the administrative liability and the criminal liability, the civil liability has its irreplaceable value. Firstly, it corresponds to the needs of development of listed companies. The violations are different, but the results are the same, which does harm to the interest of companies. Thus, asking the relevant directors to take civil responsibility for the company can recover the interest of the company to the largest extent. If just requiring directors to undertake administrative or criminal liabilities, it is not valuable for the recovery of the interest of the company and the company's nature of profit-making cannot be satisfied. Secondly, it can reimburse the loss suffered by the company timely.[38] The main function of administrative liability is to urge directors who violate duties to correct their behavior, while the main function of criminal liability is to punish directors who violate duties strictly. They cannot reimburse the damage the company has suffered, and they may cost a long time or have to go through a complex procedure. The civil liability of compensation can overcome the drawbacks above and protect the interest of the company timely. Thirdly, it can punish the involved directors. Compared with the administrative liability and criminal liability, the public power is less involved in the civil liability and the main function of civil liability of compensation is not punishment. However, the liability of compensation can play a role of punishment. Because the civil liability of compensation can not only make the directors lose the existing interest, but also demand the directors to pay punitive compensation exceeding the existing interest to the company under certain circumstance.

In regard to the obligee of liability of compensation, there is no doubt that the company is included. However, it remains to be discussed that whether the third party can ask the relevant directors to take responsibility for

37 Article 75 of the *Measures for the Administration of the Takeover of Listed Companies*.
38 Chen Jie, *The Civil Liability of a Securities Company in Violation of the Principle of Suitability*, 2 Securities Market Herald 50, 59 (2012).

them directly or not. In the mergers and acquisitions of listed companies, the victim of directors violating duties may not only include the company that the directors belong to, but also include other economic subjects. As far as this article is concerned, the law should affirm that when the directors damage the interest of the third party through violation of duty, they should take civil liability of compensation for the third party directly, on condition that the directors violate duties out of intention or gross negligence. To be specific, this article holds that the theoretical basis that the directors take responsibility for the third party includes: Firstly, to deal with the expansion of rights of directors, restrictions require strengthening. Under the trend of board centralism, as professionals, directors' actual control of the company increase gradually; directors' personal wills can influence every aspect of development of the company. With the extension of rights, directors should undertake more duties accordingly, or it will be unfair. If the right of directors can only be restricted by the internal system of accountability of the company, it is unavoidable that the cost of directors violating duties will decrease, which is not beneficial for the directors to perform duties legally and make decisions prudently. If the law affirms that the director should take responsibility to the third party directly, it will recover the drawbacks of the internal system of accountability of the company stated above and strengthen the restrictions to the right of directors exteriorly, which can prevent the directors from abusing rights. Secondly, with the connotation of the interest of the company deepening, the value of responsibility of directors becomes prominent. In the early stage, the comprehension of interest of the company mainly remains at the level of maintaining the legal interest of shareholders. However, with the popularization of the concept of social responsibility, the connotation of interest of the company is gradually deepening. Besides the legal profits of shareholders, the interests of society like the interest of debtors, the interest of employees, the interest of residents who live in the community which the company is situated in all become important parts of interest of the company.[39] Thus, directors' taking responsibilities to the third party for their violation of duties, acts as an effective way that the company protects the interest of the society, thus should be affirmed. Thirdly, the personality of legal person is prone to be abused and the content of the responsibility of directors needs to break through. The shareholders who own the actual right to control of the company are prone to abuse the independent personality of the company to avoid responsibilities. For example, they may utilize their power to infringe the interest of debtors. Asking directors to take

39 Shi Tiantao & Du Jing, *Social Liability of Company and Redistribution of Power of Company, from a Prospective of the Shock Caused by Capital Diversification to the Management of Company*, 1 Social Science Front 200, 200 (2010).

responsibilities for the third party directly is an important way to pierce the company's veil and protect the interest of the third party.[40]

To be specific, the responsibility of directors should be restricted only to the circumstances that directors violate their duties with intention or gross negligence. The reason is that the work of directors has some specialty. The directors need to bear a relatively high risk in the process of performing duties. Therefore, as for the loss of the third party caused by the directors' violating the duties with general negligence, the company should substitute directors to take responsibilities for the third party, after which, the company and the directors can allocate the responsibilities according to the internal agreements of the company. On the other hand, in nature, the civil compensation responsibility for the third party caused by the directors' violating duties is a kind of statutory responsibility, which lacks the theoretical basis of statutory duty or promissory duty. The existence of this kind of liability is to protect the third party and to fulfill the balance of interests among each party, which should not be too rigorous. Moreover, the way that the directors take responsibility for the third party's loss should adopt the joint liability between the directors and the company, which means the third party can ask the company for compensation at first, and then the company can ask the directors for compensation through an internal mechanism inside of the company, in order to strengthen relief to the third party.

VI. EPILOGUE

In the modern society, it is very common for the listed company to merge and acquire. A successful merger or acquisition will realize a win-win benefitting both the economy and the society. The smooth going of mergers and acquisitions of listed companies is closely related to both parties' directors performing duties actively and taking strict responsibilities. Certainly, in the process of mergers and acquisitions of listed companies, there exist conflicts of interests among the acquiring company, the target company and the directors of the target company, which needs to be taken seriously. Regarding the trend that each party would like to obtain profits for themselves, it is prone for directors to betray their companies and abuse their rights, so it is necessary to restrict the rights of directors. Clarifying the content of duty of directors, affirming the criterion for judging the duty of directors and improving the legal responsibility when directors violate duties

40 Guo Ce, *Discussion on the Rule of Piecing the Corporate Veil*, 5 Journal of Chongqing University of Science and Technology (Social Sciences Edition) 98, 98 (2011).

are connected with each other, which can provide effective guidance to the performance of directors in the mergers and acquisitions and form beneficial supervision. On the basis of categorization research into duty of care and duty of loyalty of directors, as well as under the circumstance where the specific criterion for judgment is being perfected, the directors of the target company and the acquiring company will perform duties diligently and legally, and protect the interest of companies honestly. Furthermore, setting the rule of right to claim to cease, improving the system of the company's exercising disgorgement of directors' wrongful profits and emphasizing the directors' civil compensation liability for the company in the form of joint liability, can not only lower the risk of mergers and acquisitions of listed companies, but also encourage directors to perform duties, which can provide a sound environment for the realization of mergers and acquisitions of listed companies at last.

(Revised by Robert D. Roderick)