

# A Study on the Legal Obligations of Independent Directors in China

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**Abstract:** The independent director system is a policy introduced by China in the light of western corporate governance systems. In 2001, the independent director system in China was gradually standardized. In the past, independent directors only played the role of "vase", and nominally served as independent directors. They often did not play an independent role. In recent years, with the standardization of the system, the legal obligations faced by independent directors have become more complicated, and more and more incidents of independent directors being punished in practice. The study of the legal obligations of independent directors is conducive to the independent directors' standard performance and the improvement of the independent director system.

## 1. Introduction

The independent director system originated in the United Kingdom and the United States, and refers to a system of establishing independent directors on the board of directors to form checks and balances of power and supervision. The China Securities Regulatory Commission issued the "Guiding Opinions on Establishing an Independent Director System in Listed Companies" in 2001. According to this normative document, all listed companies must establish an independent director system. Independent directors in listed companies must be independent before June 2003. Directors must account for at least one-third of the board.

In recent years, independent directors have voluntarily resigned. In addition to the individual's special conditions such as physical reasons, insufficient energy, and policy requirements, the independent directors' resignation is mainly due to the perceived increase in the risk of performance. With the development of the independent director system in China, relevant laws and regulations have increasingly demanded the legal liability of independent directors of listed companies. Although there is currently no complete regulation specifically for the legal responsibility of independent directors in China, such as the "Guidelines for the Performance of Independent Directors of Listed Companies", "Guidelines for the Listing of Articles of Association of Companies", the "Company Law", and the "Securities Law" There are many regulations on legal obligations and legal responsibilities for performing duties, which shows the strengthening of the legal obligations and legal responsibilities of independent directors. In practice, the risks assumed by independent directors are increasing day by day, and the specific obligations of independent directors in the law are not clear, which is not conducive to independent directors performing their duties according to law.

## 2. General obligations of independent directors

Independent directors first need to fulfill their legal obligations as general directors. The general duties of independent directors as directors include three aspects: the obligation to be faithful, the obligation to be diligent, and the responsibility to be responsible for board resolutions. Independent directors are first and foremost directors of the company and bear the legal responsibilities of ordinary directors. Anglo-American law believes that directors have the dual status of agent and trustee for the company. Based on the agency and trust relationship, the director has a "faithful obligation" to the company, which includes the obligation of fidelity and the obligation of care. In

the civil law system, the relationship between directors and the company is attributed to a trust or appointment relationship, and general directors have a duty of good governance and loyalty to the company. The theory of company law in China is inherited from civil law. Therefore, most scholars position the relationship between the company and directors as an appointment relationship, and summarize the directors' obligations as faithful obligations and diligence obligations.

The "Guidelines for the Performance of Independent Directors of Listed Companies" states that "Independent directors of listed companies are responsible for the general requirements of directors under the " Company Law ", " Securities Law ", " Code for Corporate Governance of Listed Companies " and other laws, administrative regulations, departmental regulations and articles of association. Obligations. There are obligations of integrity and diligence to listed companies and all shareholders. Directors violations of their fidelity obligations fall into the following categories: First, unfair self-transactions, that is, the use of positions to make profits through transactions; the second is Abuse of company property; Third, improper benefits due to director status. As far as the obligation of loyalty is concerned, the legal requirements for independent directors are that they must be independent and that they should be maintain the independence during the performance of their duties. Therefore, it is not common for independent directors to have "conflicts of interest", which makes independent directors Violations of the obligation of fidelity are relatively rare.

The diligence obligations of independent directors are the same as those of ordinary directors. According to the Guidelines for the Articles of Association of Listed Companies, directors' due diligence obligations include procedural obligations, informed obligations, and business judgment obligations. Article 69 of the "Guidelines for the Articles of Association of Listed Companies" states that procedural obligations mainly include such obligations as attending the board of directors, attending shareholders' meetings and accepting shareholders' inquiries, and making reports at annual shareholders' meetings. This type of obligation does not involve the professional judgment of independent directors. As long as the independent directors have engaged in corresponding acts, they are considered to have fulfilled their obligations. Generally, independent directors can perform procedural obligations. Even if they cannot attend the board of directors, they can authorize others to participate on their behalf.

Article 98, paragraph 3 of the "Guidelines for the Articles of Association of Listed Companies" stipulates that directors should "know the operating and management status of the company's business in a timely manner", indicating that the directors have the obligation of being informed, that is, the directors must continuously collect and learn information for daily company operations in order to make decisions on major issues and exercise supervisory functions. Independent directors also have the obligation of being informed. At the same time, due to the special nature of the identity, there is a narrow information channel for independent directors to obtain information about listed companies. In a summary, independent directors should pay more attention to the obligation of being informed so as to get rid of inappropriate independent opinions.

Note 1 to Article 55 of the "Guidelines for the Articles of Association of Listed Companies" states that directors have operational judgment obligations. Independent directors need to express their opinions on the relevant proposals of the company's general meeting of shareholders, participate in the voting of major business decisions of the board of directors, and perform the corresponding business judgment obligations. Independent directors, like ordinary directors, are responsible for board resolutions. Independent directors shall carefully and reasonably review the major decisions of listed companies and be responsible for them. Article 113, paragraph 3 of the "Company Law" stipulates that if a resolution of the board of directors violates laws and regulations, or the company's articles of association, or a resolution of a general meeting of shareholders, causing serious losses to a listed company, the directors participating in the resolution shall be liable for compensation to the company.

### **3. Special Duties of Independent Directors**

Independent directors have independence from ordinary directors, and therefore need to bear special obligations. The special obligations of independent directors in Chinese law mainly include

the obligation to maintain independence, the obligation to review major issues, the obligation to disclose information, and the obligation to supervise the company's operations and management.

The independent director's independence obligation is reflected in the independence of the independent director's identity and the performance of his duties. Article 4 of the "Guidelines for the Performance of Independent Directors of Listed Companies" stipulates that independent directors must not have significant economic ties with the company; do not receive additional compensation from the company other than fixed fees; and do not hold management positions in the company. To some extent, the obligation of independence coincides with the obligation of loyalty. The emphasis is on maintaining the independence of independent directors, thereby performing their duties fairly and fairly, and safeguarding the interests of shareholders.

Independent directors have the obligation to review major issues. The Guidelines for the Performance of Independent Directors of Listed Companies stipulate that independent directors have the obligation to review and express opinions on major issues such as connected transactions and external guarantees. Matters such as related party transactions and external guarantees are the hardest hit areas for information disclosure violations. Therefore, independent directors' review of listed companies including major matters such as related party transactions will help ensure that the company's information disclosure complies with regulations and prevent listed companies from infringing shareholders' interests.

Independent directors also need to bear the obligation of information disclosure. Independent directors must bear joint and several risks when information disclosure of listed companies violates laws and regulations. The Securities Law stipulates that independent directors should urge listed companies and other information disclosure obligors to perform their disclosure obligations under laws, regulations, rules and other regulatory documents in a timely manner. To ensure the timeliness and authenticity of information disclosure, there must be no false records, misleading statements, major omissions or other improper disclosures. Article 91 of the "Guidelines for the Governance of Listed Companies" stipulates that independent directors shall not use information disclosure to conduct insider trading, market manipulation or other illegal acts. Independent directors need to supervise listed companies to release relevant information in a timely and accurate manner. The accuracy and timeliness of information is conducive to investors and shareholders to make reasonable judgments. Independent directors' supervision of the accuracy of information disclosure can also prevent the company from concealing information and thereby harming the interests of stakeholders.

Independent directors have the obligation to supervise the management of the company. Article 37 of the "Governance of Listed Companies" stipulates that in the event of a conflict between shareholders or directors of a listed company that affects the management of the company, independent directors shall take the initiative to perform their duties and safeguard the overall interests of the listed company. On the one hand, independent directors need to monitor whether the management is operating reasonably to maximize the shareholders' interests; on the other hand, independent directors need to make reasonable suggestions on the management of listed companies so that the management of the superior company is reasonable and effective. If independent directors can make suggestions on the operation and management of listed companies, this can help listed companies to make better profits. On the one hand, it helps to avoid joint liability of independent directors caused by board decision errors, and on the other hand, it helps to better safeguard shareholders' interests.

#### **4. Conclusion**

In practice, there have been numerous announcements by regulators of penalties for independent directors. In the three years from 2016 to 2018, 28 administrative directors of listed companies were involved in all administrative penalty decisions announced by the China Securities Regulatory Commission, punishing nearly 100 independent directors. The more typical case is the Lu Jiahao incident in 2002. Practice has proven that the risk and difficulty of performance of independent directors are increasing. Although there is no systematic and comprehensive legal requirement for

independent directors, in practice, the requirements of independent directors from regulatory agencies, listed companies, and shareholders have become higher and higher, and the performance risks of independent directors are increasing. Therefore, it is urgent to clarify the legal obligations of independent directors, which is conducive to the independent directors' standard performance. It is also conducive to the improvement of the independent director system. At the same time, this will also help listed companies to clarify the obligations of independent directors and provide assistance for the selection and employment mechanism of independent directors of listed companies.

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