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Assessing the Applicability of the Business Judgment Rule and the “Defensive” Business Judgment Rule in the Chinese Judiciary: A Perspective on Takeover Dispute Adjudication

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Abstract

Since China’s accession to the World Trade Organization (“WTO”) on November 10, 2001, corporate China has been struggling to dismantle the inefficient management systems formed in the era of the planned economy, and it barely survives under the more competitive market economy environment that began to form in 1978. In order to become stronger, both before and after WTO admission, many corporations have been trying to restructure and grow by devouring others. Part I of this Essay provides a basic summary of the business judgment rule and the “defensive” business judgment rule. Part II discusses some of the difficulties that Chinese courts face in adjudicating takeover disputes, focusing on systematic problems within the judiciary: inadequate standards for judicial appointment, lack of judges’ expertise in corporate law, and a lack of independence. Part III analyzes the utility of the business judgment rule for takeover adjudication in China, and argues that the business judgment rule should be transplanted to Chinese courts. Finally, Part III concludes with an examination of how the business judgment rule might be transplanted successfully. It calls for greater specificity within the rule itself to compensate for the lack of established and binding precedent in this area of Chinese law, and for a policy choice to adopt “pro-defender” rules for the adjudication process.

ASSESSING THE APPLICABILITY OF THE
BUSINESS JUDGMENT RULE AND THE
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THE CHINESE JUDICIARY: A PERSPECTIVE ON
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*Charlie Xiao-chuan Weng**

INTRODUCTION

It is hardly news that, with GDP growth continuously in double digits, China has attained significance in the world economy. Since China’s accession to the World Trade Organization (“WTO”) on November 10, 2001, corporate China has been struggling to dismantle the inefficient management systems formed in the era of the planned economy,¹ and it barely survives under the more competitive market economy environment that began to form in 1978.² Some of the corporations formed before the accession, such as Haier Global, survived and have become multinational corporate behemoths, while the rest struggle at the edge of bankruptcy. When there are

* Senior Research Fellow and Assistant Professor, East China University of Political Science and Law, LL.M. & S.J.D. Candidate at the University of Pennsylvania Law School. The author thanks Professor David A. Skeel and Dr. Matthew S. Erie for reading an earlier draft of this Essay. All errors are the author’s.

1. See Arnaldo M. Gonçalves, *China’s Swing from a Planned Soviet-Type Economy to an Ingenious Socialist Market Economy: An Account of 50 Years* 36 (Centro Argentino de Estudios Internacionales, Working Paper No. 19, 2006), available at <http://ssrn.com/abstract=949371> (discussing the details of transforming from a planned economy to a market economy in China). “Planned economy” is an economic system in which the government controls the economy. Its most extensive form is referred to as a “command economy,” “centrally planned economy,” or “command and control economy.” Under such a system, “resource prices are in many cases distorted, failing to reflect the real value, as many types of resources are still priced by the state, operating on the inertia of the old planned economy.” *Id.* at 31. The central government also decides what and how much should be produced. *See id.* at 3.

2. See Randall Peerenboom, *Resistance, Revision and Retrenchment in the Transition to a Competitive Market Economy in China* 1, 2 (La Trobe Univ. Sch. of Law, Legal Studies Working Paper Series, Paper No. 2008/8, 2008), available at <http://ssrn.com/abstract=1265114> (discussing the start of competitive market economy).

valuable assets remaining in a less competitive company, takeover is unavoidable. The “survival of the fittest” is the cliché for present day corporate China.

In order to become stronger, both before and after WTO admission, many corporations have been trying to restructure and grow by devouring others. According to statistics from Thomas Financial, from 1997 to 2001, the number of takeover cases in China increased sixteen percent annually, and related capital increased thirty-eight percent annually.³ Before August 1, 2008, these conglomerates were not reined in by antitrust law.⁴ Even today, antitrust cases are rare due to enforcement problems.⁵ As a result, the incentives to expand intensified. Takeover is the usual way for companies to expand. Especially considering the current financial crisis, Chinese companies have more incentives to merge with other companies, both domestic and offshore, because the different banking business structure⁶

3. Qu Dongmei, *Gongsi Shougou Zhong Mubiao Gongsi Dongshi Xinyi Yiwu Chutan* (公司收购中目标公司董事信义义务初探) [*Initiative Investigation on Directors' Fiduciary Duty of Target Company in Takeover*], 4 J. SHANDONG NORMAL U. 76, 76 (2004).

4. See *Zhonghua Renmin Gongheguo Fanlongduan Fa* (中华人民共和国反垄断法) [Anti-Monopoly Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 30, 2007, effective Aug. 1, 2008), translated in Isinolaw, available at http://www.isinolaw.com/isinolaw/english/detail.jsp?searchword=STATUTES_EN_TITLE%3Danti%5C-monopoly+law+and+catalog%3D0&channelid=76608&record=1&iscatalog=0&statutes_id=10027537&skind=110 (last visited Jan. 24, 2010).

5. See Zheng Na, *Woguo Fanlongduan Zhifa Tizhi Xianzhuang ji qi Pingxi* (我国反垄断执法体制现状及其评析) [*The Situation of Enforcement System of Antitrust Law and Comments of China*], 3 JINKA GONGCHENG [J.K.G.C.] 122, 122 (2009). Pursuant to the Antitrust Law of the People's Republic of China, the central government should establish an antitrust committee to enforce the law. However, the committee was not created until September 2009. See *id.* Additionally, the antitrust law does not articulate the power of the antitrust committee, which obstructs the implementation of the law. See Gui Liyi & Sun Wenyong, *Fanlongduan Zhifa Jigou Wenti Yanjiu* (反垄断执法机构问题研究) [*Study of Antitrust Law Enforcement Authorities*], 3 JINGJIYU FA [J.J.Y.F.] 5, 5 (2009).

6. The Chinese banking structure is both highly regulated and relatively underdeveloped. Savings and loan is the main business of Chinese banks; however, the business has recently begun to expand rapidly as monetary policy becomes integral to China's overall economic policy. As a result, banks are becoming more important to China's economy by increasingly providing more financing to enterprises for investment, seeking deposits from the public to mop up excess liquidity, and lending money to the government. Most important is that most derivatives and means of structured finance, such as securitization, which is the prime culprit of the current worldwide financial crisis, are brand new businesses for Chinese banks, and many structured finance projects are still in the experimental stage. When corporate America

has shielded most of the crucial financial institutions from the brunt of the crisis. Moreover, the depreciation of the US dollar against the *renminbi* (RMB) lowers the cost of taking over foreign companies.⁷ The current situation of corporate China is similar to that of corporate America during the New Deal Era, where the central government tries to employ money supply and regulations to enhance its control over the whole economy.⁸ Given that excessive competition had caused inefficiency and wasted social resources at the beginning of the “Open Door” policy, the government has not only loosened the standard of monopoly in non-utilities industries, but it has also facilitated and encouraged takeovers in order to decrease excessive competition.⁹ As more conglomerates become major players in

is suffering from a funding crisis, Chinese banks have more than enough money absorbed from the public to lend.

7. For instance, the chief of the National Energy Bureau is quoted as saying, “Under the global financial crisis, we should expedite the expansion of energy industry.” Peter Ford, *Zhongguo Jie Quanguo Shuaitui Haiwai Da Shougou* (中国借全球衰退海外大收购) [*China’s Global Takeover under Current Recession*], HNCE, Feb. 26, 2009, <http://news.hnce.com.cn/c/2009-02-26/6867.shtml>. The second biggest domestic energy conglomerate, China Petroleum Chemical Corporation, is taking over a Canadian petroleum company, Tanganyika Oil. The biggest Chinese mining company, China Minmetals Corporation, is trying to buy out an Australian mining company, OZ Minerals. *Id.* The deputy chairman of the China Insurance Regulatory Commission said the biggest Chinese life insurance company, China Life Insurance (Group) Company, is currently negotiating with American International Group (“AIG”) about a potential takeover of an Asian subsidiary of AIG. See *Baojian Huicheng Goushou Zheng Shangtao Shougou AIG Yazhou Zichan* (保监会称国寿正商讨收购 AIG 亚洲资产) [*Insurance Supervision Committee: China Life Insurance Considering Buyout of AIG Asian Assets*], SINA, Feb. 26, 2009, <http://finance.sina.com.cn/stock/hkstock/redchipsnews/20090226/15275905739.shtml>. China’s biggest petroleum refinery company, China National Petroleum Corporation (“CNPC”), reached a takeover agreement with Verenex Energy Inc. See *Zhongguo Shiyou Ni 4 Yi Meiyuan Shougou Verenex* (中国石油拟 4 亿美元收购油气公司 Verenex) [*CNPC Plans USD 400 million Buyout of Oil and Gas Company, Verenex*], FINANCE.IFENG.COM, Feb. 26, 2009, <http://finance.ifeng.com/zq/ssgs/20090227/408327.shtml>.

8. See Gonçalves, *supra* note 1, at 33–34 (“[T]he state continues to have an almost omnipresent role in all aspects of economic life, throughout administrative regulation and direction, macro-coordination of state enterprises and fixing some market price.”); *Objective of the Monetary Supply*, THE PEOPLE’S BANK OF CHINA, <http://www.pbc.gov.cn/english/huobizhengce/objective.asp> (last visited Sept. 11, 2010) (“The objective of the monetary policy is to maintain the stability of the value of the currency and thereby promote economic growth.”).

9. See Bruce M. Owen et al., *China’s Competition Policy Reforms: The Anti-Monopoly Law and Beyond*, 75 ANTITRUST L.J. 231, 247–50 (2008); *China’s New Takeover Rules Spur More Mergers and Acquisitions*, SIEGLE, HU & PARTNERS INT’L, http://www.siegle-hu.com/new/index_01_4.html (last visited Sept. 11, 2010).

the market, their takeovers have attracted greater public attention. With the takeover boom, corporations are bringing more disputes arising from takeovers to the judiciary.

Most takeover cases focus on the breach of the duty of care or loyalty and poor corporate governance, such as executives' excessive risk-taking and cronyism. In the typical situation, the company's stock prices drop significantly after a merger or acquisition. Many stockholders, who plan to turn to the much more profitable and stable real estate market, desperately want their money back. Spurred on by lawyers, just as in the United States, they seek recovery in a court of law. In hearings, judges usually find that the fiduciary rules are vague at best, making it difficult for them to make business decisions in the shoes of directors. The scarcity of fiduciary regulations and of well-trained business judges in China contributes to the current adjudication predicament. Moreover legislative and judicial training issues cannot be solved in a short period of time. Transplanting the modified business judgment rule and the "defensive" business judgment rule is the Alexandrian solution. This will not only circumvent the regulations predicament, but this will also help judges make less disputable decisions.

Part I of this Essay provides a basic summary of the business judgment rule and the "defensive" business judgment rule. Part II discusses some of the difficulties that Chinese courts face in adjudicating takeover disputes, focusing on systemic problems within the judiciary: inadequate standards for judicial appointment, lack of judges' expertise in corporate law, and a lack of independence. Part III analyzes the utility of the business judgment rule for takeover adjudication in China, and argues that the business judgment rule should be transplanted to Chinese courts. Finally, Part III concludes with an examination of how the business judgment rule might be transplanted successfully. It calls for greater specificity within the rule itself to compensate for the lack of established and binding precedent in this area of Chinese law, and for a policy choice to adopt "pro-defender" rules for the adjudication process.

I. *DEFINING THE BUSINESS JUDGMENT RULE AND THE
“DEFENSIVE” BUSINESS JUDGMENT RULE?*

A. *The Business Judgment Rule*

Before discussing the “defensive” business judgment rule, the business judgment rule must first be examined because the former was developed on the theory of the latter. The business judgment rule was introduced as a common law standard of review more than 180 years ago.¹⁰ It has been viewed as the principle that directors can employ to shield their decisions from judicial scrutiny.¹¹

Applied to daily life, the standard of conduct and the standard of review for that conduct may seem similar.¹² For instance, a crane operator should operate the machine carefully. That is the standard of conduct for the operator. Correspondingly, to decide whether the crane operator is liable for a claim, the question is whether he operated the machinery carefully. However, the duty of care for directors of a corporation is different. The standard of conduct applicable to directors and officers of US corporations is set forth in Section 4.01(a) of the American Law Institute’s Principles of Corporate Governance.¹³ It is a fairly demanding standard, but the standard of review applied to the performance of these duties, the business judgment rule, is less stringent.¹⁴ When directors’ and officers’

10. See S. Samuel Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93, 93 (1979).

11. See Joseph Hinsey, IV, *Business Judgment and the American Law Institute’s Corporate Governance Project: The Rule, the Doctrine and the Reality*, 52 GEO. WASH. L. REV. 609, 610 (1985).

12. See MELVIN ARON EISENBERG, CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS 544 (2000). The standard of conduct is how an actor should act under certain circumstances, while the standard of review is the caliber courts should apply to gauge whether to impose liability. See *id.*

13. Section 4.01(a) of American Law Institute Principles of Corporate Governance reads:

A director or officer has a duty to the corporation to perform the director’s or officer’s functions in good faith, in a manner that he or she reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances.

AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01(a) (1994).

14. See EISENBERG, *supra* note 12, at 545.

decisions are called into question, four conditions must be met for the business judgment rule to apply: (1) directors must have made a decision; generally, the rule is inapplicable to an omission; (2) directors may not have an interest, financial or familial, in the subject of the business decision; if the interest will reasonably be expected to affect their judgment, the standard of review will be heightened and the business judgment rule will not apply; (3) directors must have employed a reasonable decision-making process; this is the justification that enables directors to reasonably make appropriate decisions; and (4) decisions should be made in good faith; if the decision breaches the law, the business judgment rule is inapplicable.¹⁵ One of the most salient issues is why the business judgment rule enables directors to shield themselves from more exacting levels of review once the conditions are met. Is it because directors are a preferential group to the legislature? The answer is no.

The most significant contribution of the business judgment rule is that it prevents the judiciary from meddling in managerial decisions. Even if most judges are learned and experienced, they cannot assert that they know the market and business better than the directors and officers. It is much wiser to have courts scrutinize how the board made a decision rather than make a business decision on their own. In most cases, business decisions are “necessarily made on the basis of incomplete information and in the face of obvious risk, so that typically a range of decisions is reasonable.”¹⁶ It is wrong to say directors or officers made a bad decision if they reasonably assessed the risk and made a calculated decision, even if the outcome turned out to be a failure. If judges are allowed to interfere with business judgments, they will inevitably be influenced by hindsight and make a biased decision.¹⁷ For example, suppose a board decides

15. *Id.* at 540, 545.

16. Melvin Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 *FORDHAM L. REV.* 437, 444 (1993).

17. Experimental psychology has shown that in hindsight, people consistently arrive at an outcome that could have been anticipated in foresight. See ROBYN M. DAWES, *RATIONAL CHOICE IN AN UNCERTAIN WORLD* 119–20 (1988); Baruch Fischhoff, *For Those Condemned to Study the Past: Heuristics and Biases in Hindsight*, in *JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES* 335, 341–43 (Daniel Kahneman et al. eds., 1982); Baruch Fischhoff & Ruth Beyth, “*I Knew It Would Happen*”: *Remembered Probabilities of Once-Future Things*, 13 *ORGANIZATIONAL BEHAV. AND HUM. PERFORMANCE* 1, 1–16 (1975).

to acquire a small company that is processing a lucrative patent. After the merger, the patent is barred by a newly enacted law because of an environmental protest. If the board has the chance to remake the decision, it most likely will not choose the buyout. However, the court cannot look to the result to say that it is a bad decision.

Nothing ventured, as the cliché puts it, nothing gained. The business judgment rule is usually described as “a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.”¹⁸ The people the legislature intends to rein in are those who expose the corporation to excessive risk. There is nothing improper with companies taking elaborate and strategic risk.¹⁹ Shareholders pursue risks as well. Establishing the same standard of review as the standard of conduct would be draconian and economically inefficient. It is crucial to keep and curb directors’ enthusiasm of taking risk rather than exterminate it. Keeping the appropriate tension between accountability and authority facilitates better performance of both directors and officers.²⁰ In fact, it is very hard to distinguish between bad decisions and good decisions from the perspective of the courts, as mentioned above. If liabilities are unfairly imposed against directors and officers by applying the reasonableness standard, they might tend to be unduly risk-averse.²¹ The business judgment rule helps to dampen that tendency.

B. *The Heightened Hurdle: The “Defensive” Business Judgment Rule*

In US corporate law, the “defensive” business judgment rule does not exist as an explicit black letter rule; takeover regulation in the United States is an amalgam of state laws and judicial decisions. It is impossible to epitomize the whole galaxy of rules into one short proper term. Therefore, the term the “defensive” business judgment rule is borrowed to depict this amalgam for

18. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

19. See DAVID SKEEL, *ICARUS IN THE BOARDROOM: THE FUNDAMENTAL FLAWS IN CORPORATE AMERICA* 205 (2005).

20. See Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 *VAND. L. REV.* 83, 108 (2004).

21. See Eisenberg, *supra* note 16, at 445.

purposes of this Essay. The reason for employing the term, rather than others, is that it is the business judgment rule that paved the way for the rules for the board of the target company.²² The review of the board's decision is limited and not completely substantive, which can be regarded as the "gene" left by the business judgment rule. After the merger of the different standards, the business judgment rule was heightened and a galaxy of rules was promulgated for the target corporation.

Why did the legislature and judiciary heighten the hurdle and require directors and officers to prove more? The reason is that the core values of these takeover cases are much closer to stockholder ownership rights and values than those tackled by the business judgment rule. Most takeover disputes arise in an injunction proceeding, a posture which is referred to as "transactional justification."²³ In the typical business judgment rule case, almost all the decisions directors or officers make are enterprise or operational issues (such as whether the company needs to buy a new machine or whether it will issue bonds or new shares),²⁴ while in "transactional justification" cases, issues more directly point to stockholder ownership rights and values. The "defensive" business judgment rule protects the decision itself, rather than the decision-makers.²⁵ The legislature and judiciary purport to exhaustively protect the shareholders' rudimentary rights through the heightened hurdle, rather than protecting directors and officers, which is the basic value for the business judgment rule.

One begins an analysis of the "defensive" business judgment rule in Delaware corporate law²⁶ because it is the most influential corporate law in the United States.²⁷ The most significant sources

22. See E. Norman Veasey, *The New Incarnation of the Business Judgment Rule in Takeover Defenses*, 11 DEL. J. CORP. L. 503, 505-12 (1986).

23. See *id.* at 506.

24. See *id.*; see also *Minstar Acquiring Corp. v. AMF, Inc.*, 621 F. Supp. 1252, 1259 (S.D.N.Y. 1985); Bayless Manning, *Reflections and Practical Tips on Life in the Boardroom after Van Gorkom*, 41 BUS. LAW. 1, 4 (1985).

25. See Veasey, *supra* note 22, at 506; see also Hinsey, *supra* note 11, at 609, 611-13.

26. The William Act and other states' statutes are outside the context of this Essay.

27. See Brian E. Rosenzweig, *Private Versus Public Regulation: A Comparative Analysis of British and American Takeover Controls*, 18 DUKE J. COMP. & INT'L L. 213, 229 (2007); see also CHRISTIN M. FORSTINGER, TAKEOVER LAW IN THE EU AND THE USA: A COMPARATIVE ANALYSIS 17 (2002); John Armour & David A. Skeel, Jr., *Who Writes the Rules for Hostile*

of the “defensive” business judgment rule in Delaware are several renowned takeover judiciary decisions. The Delaware Supreme Court in *Unocal Corp. v. Mesa Petroleum Co.* held that the board of directors had wide latitude to take effective measures to protect its firms from being taken over.²⁸ The court upheld the legality of employing a self-tender that discriminated against the bidder.²⁹ Moreover, the court said a board should respond reasonably to any threat posed, but may not take steps which are “draconian” in defending against a takeover.³⁰ In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,³¹ the Delaware Supreme Court held that once the board decides to sell the company, the director’s duty will shift to pursuing “the highest price for the benefit of the stockholders.”³² Furthermore, two cases from the 1990s, *Paramount Communications Inc. v. QVC Network Inc.*³³ and *Unitrin, Inc. v. American General Corp.*,³⁴ changed the “defensive” business judgment rule from a formal instruction to a more substantive standard of review.³⁵ These decisions apply an intermediate standard between the business judgment rule and the intrinsic fairness test. However, they are much closer to judicial deference than strict scrutiny.³⁶ After all, they bourgeoned from the business judgment rule and have the diacritical business judgment rule stamp.

II. ISSUES OF TAKEOVER ADJUDICATION

With the takeover wave ratcheting up in China, problems have begun to emerge. The legislature and judiciary are seeking

Takeovers, and Why?—The Peculiar Divergence of U.S. and U.K. Takeover Regulation, 95 *GEO. L.J.* 1727, 1755 (2007).

28. 493 A.2d 946, 957 (Del. 1985).

29. *Id.* at 958–59.

30. *Id.* at 955.

31. 506 A.2d 173 (Del. 1985).

32. *Id.* at 182.

33. 637 A.2d 34 (Del. 1994).

34. 651 A.2d 1361 (Del. 1995).

35. *Id.* at 1388; *Paramount Communications*, 637 A.2d at 45; see also Ronald J. Gilson & Reinier Kraakman, *Delaware’s Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 *BUS. LAW.* 247, 252 (1989) (discussing the substance of a new defensive standard of review); Jennifer J. Johnson & Mary Siegel, Note, *Corporate Mergers: Redefining the Role of Target Directors*, 136 *U. PA. L. REV.* 315, 332–37 (1987).

36. See William Magnuson, *Takeover Regulation in the United States and Europe: An Institutional Approach*, 21 *PACE INT’L L. REV.* 205, 216 (2009).

a better way to strengthen the ability of the court to properly solve related takeover disputes. Especially given the current political discourse on “Harmonious Society” (*hexie shehui*),³⁷ it is in the best interests of the central government to avoid a situation whereby thousands of stockholders curse at unscrupulous and reckless directors and unfair judicial decisions at the gates of government facilities.

In reforming China’s legal regime to better deal with takeovers, there are three main issues. First, the processes of judicial nomination and the operation of the judiciary affects judicial efficacy in takeover cases as a whole.³⁸ Second, local protectionism jeopardizes the independence of the local judiciary in related influential takeover cases.³⁹ Third, the scarcity of legislation on duty of care is the main cause of long-term pending takeover cases.

A. *The Corporate Court of Takeover Cases*

Although judicial reform in the late 1970s enabled China to learn advanced legal ideas from abroad, system-wide problems in the nomination and functioning of the judiciary continues to cause endemic injustice.⁴⁰ Regarding the judiciary, the three most crucial issues are low standards for judicial nomination, inefficient job rotation, and systemic deprivation of independence. Professionalization and independence are the most crucial issues to the justice of the corporate court.

37. The construction of a “Harmonious Society” (*hexie shehui*) is a socio-economic vision that is said to be the result of Chinese leader Hu Jintao’s signature ideology of the Scientific Development Concept. Recently, Chinese authorities have responded to social unrest by tightening controls and drafting laws to placate society’s ire towards corrupt government and corporations. See Maureen Fan, *China’s Party Leadership Declares New Priority: ‘Harmonious Society’: Doctrine Proposed by President Hu Formally Endorsed*, WASH. POST, Oct. 12, 2006, at A18.

38. This problem is poisoning the whole judiciary rather than just the corporate court. See He Weifang, *Zouxiang Sifa Gongzheng de Ba Yaojian* (走向司法公正的八要件) [*The Eight Essentials Towards Judicial Justice*], 3 DONGBEI ZHI CHUANG [D.Z.C.] 20, 20 (2007), available at <http://lawlover.fyz.cn/art/635974.htm>.

39. See *id.*

40. See Jonas Grimheden, *The Reform Path of the Chinese Judiciary: Progress or Stand-Still?*, 30 FORDHAM INT’L L.J. 1000, 1006 (2007).

The current judicial law's low standards for judicial nomination are wildly criticized in legal academia.⁴¹ The revised judicial law of 2001 stipulates that the starting age for a person eligible to be nominated as a judge is twenty-three, regardless of whether he or she graduated from law school.⁴² The average age of judges in many courts, especially in more developed areas of China, is under thirty-five because all the newly nominated judges finished the two-year probational assistant adjudicator period immediately after graduation from college with a bachelor's degree. Of the 190,000 judges in China, 59,000, representing thirty-one percent, have received formal full-time legal training.⁴³ A significant amount of judges majored in history, literature, or chemistry in college and received little formal legal education. Although revisions to the judicial law in 2001 included passing the uniformed bar exam as an entrance requirement to be designated as a judge,⁴⁴ it seems that the exam has become an alternate way for judges to leave the judiciary and

41. See Hu Bing & Wang Yang, *Lun Gaige he Wanshan Woguo de Faguan Zhidu* (论改革和完善我国的法官制度) [*Reforming and Improving China's Judge System*], 11 PUB. ADMIN. & L. 39, 39 (2009); Yuan Yuan, *Lun Woguo Faguan Linxuan Zhidu zhi Youhua* (论我国法官遴选制度之优化) [*Institutional Analysis on China's Judges Nomination*], 3 FAZHI YU SHEHUI 142, 142 (2008); see also He Weifang, *Zhongguo Fayuan Gaige yu Sifa Duli: Yige Canyuzhe de Guancha yu Fansi* (中国法院改革与司法独立: 一个参与者的观察与反思) [*The Reformation and Independency of China's Judiciary: Observation and Introspection from a Participant*], 2 ZHEJIANG SHE HUI KE XUE 83, 85 (2003).

42. Article 9 of the Judge Law stipulates that a judge shall: (1) be a citizen of the People's Republic of China; (2) have reached the age of twenty-three; (3) endorse the Constitution of the People's Republic of China; (4) have fine political and professional quality and be good in conduct; (5) be in good health; (6) have worked in law for at least two years in the case of a graduate from a four-year law course at an institution of higher education, or a graduate from a four-year course in a non-law specialty of such an institution that possesses the professional knowledge of law, and have worked in law for at least three years in the case of the said graduate to be appointed judge of a Higher People's Court or the Supreme People's Court; and (7) have worked in law for at least one year in the case of a person holding a Master of Law or Doctor of Law degree; or a person holding a master's degree or doctor's degree of a non-law specialty who possesses the professional knowledge of law, and to have worked in law for at least two years in the case of the said person to be appointed judge of a Higher People's Court or the Supreme People's Court. See Judges Law of the People Republic of China (promulgated by the Standing Comm. Nat'l People's Cong., Feb 28, 1995, effective July 1, 1995, revised June 30, 2001), translated in Isinolaw (last visited Jan. 16, 2010).

43. See Kuikui, *Zhongguo Faguan Xueli Kao* (中国法官学历考) [*A Survey of the Educational Background of Chinese Judges*] (July 20, 2009, 10:35 AM), <http://gk1984123.fyfz.cn/blog/gk1984123/index.aspx?blogid=498512>.

44. See ZOU KEYUAN, CHINA'S LEGAL REFORM: TOWARDS THE RULE OF LAW 209-10 (2006).

earn more money as lawyers.⁴⁵ The majority of judges are young people under thirty, to whom income generally matters more than upholding social justice. Additionally, China still has a policy in place that allows for those who served in the military to be assigned to the court as a retirement benefit.⁴⁶ The effect, in the aggregate, is to reduce the proportion of judges with formal legal education.

Inefficient job rotation is the second problem that impairs the professionalization of corporate judges. All courts at every level are divided into specialized divisions, such as civil and criminal, for the convenience of specialized adjudication. No judge, however, can sit in a division more than eight years. After a given term, a judge may sit in another division.⁴⁷ The policy purports to reduce corruption within the judiciary by limiting the influence of fellow judges who have become acquaintances after serving together for a long time. However, this rotation causes a significant waste of professional knowledge.⁴⁸ The rotations create disincentives for judges to perform in-depth research on complex areas of corporate law, knowing that they will soon be rotated out. It is very hard for an experienced criminal judge, for example, to adjudicate a takeover case proficiently because corporate cases, especially takeover cases, involve highly

45. Before the qualification tests were unified, judges and lawyers had separate admissions tests. Although the unified qualification test has widely been recognized as harder than the former judge admission test, it has caused many young judges, now qualified to practice as lawyers, to leave the court for higher pay at law firms. See Suli (苏力), *Faguan Linxuan Zhidu Kaocha* (法官遴选制度考察) [A Probe into the Judge Selection System], 3 FAXUE YUEKAN 3, 4–8 (2004).

46. See He Weifang (贺卫方), *Fuzhuan Junren Jin Fayuan* (复转军人进法院) [Retired Military Officers Going to the Judiciary], NANFANG ZHOUMO, Jan. 2, 1998, available at http://article.china.lawinfo.com/Article_Detail.asp?ArticleId=26402; Taroh Inoue, *Introduction to International Commercial Arbitration in China*, 36 H.K.L.J. 171, 193 (2006).

47. See Renmin Fayuan Wunian Gaige Gangyao (1999–2003) (人民法院五年改革纲要 (1999–2003)) [Five Year Reform Platform (1999–2003)] (promulgated by the Sup. People's Ct., Oct. 20, 1999), <http://www.dffy.com/faguixiazai/xf/200511/20051128111114.htm>; Renmin Fayuan Dierge Wunian Gaige Gangyao (2004–2008) (人民法院第二个五年改革纲要 (2004–2008)) [The Second Five Year Reform Platform (2004–2008)] (promulgated by the Sup. People's Ct., Oct. 26, 2005), <http://www.dffy.com/faguixiazai/xf/200512/20051214221735-2.htm>; Renmin Fayuan Disange Wunian Gaige Gangyao (2009–2013) (人民法院第三个五年改革纲要 (2009–2013)) [The Third Five Year Reform Platform (2009–2013)] (promulgated by the Sup. People's Ct., Mar. 17, 2009), http://news.xinhuanet.com/legal/200903/26/content_11074127_3.htm.

48. See Suli, *supra* note 45, at 16–18.

specialized legal issues. A range of specialized knowledge, such as accounting and finance, is required of the fact-finder. Some jurisdictions in the United States have even established a specialized court for corporate case adjudication, such as the Delaware Court of Chancery.⁴⁹

Independence is a third problem for the Chinese corporate court. There are several factors that affect the independence of the judiciary. The first is the job rotations issue mentioned above. Different positions offer different incomes and career prospects. Some judges may be assigned to hear socially influential cases, whereas others will only handle the administration of petitions, which is regarded as an inferior office in the court. Second, there is no judge position with life tenure. Male judges must retire at age sixty and female judges at age fifty-five.⁵⁰ Older people often have lower living costs, such as housing payments, than young people do. However, just when judges are less likely to ask for pecuniary benefit, they have to leave the court.⁵¹ Third, the court system is generally enveloped in a strong bureaucratic atmosphere. The annual judge performance evaluation still employs the same system used to evaluate government officials.⁵² As a result, when adjudicating cases relating to government interests, judges can hardly remain impartial. A very clear-cut administrative hierarchy makes judges' acts abide by the suggestions of their superiors for a better career development

49. See ABA Ad Hoc Committee on Business Courts, *Business Courts: Towards a More Efficient Judiciary*, 52 *BUS. LAW.* 947, 955–59 (1997).

50. See Guowuyuan guanyu Anzhi Lao, Ruo, Bing, Can Ganbu de Zanxing Banfa (国务院关于安置老、弱、病、残干部的暂行办法) [Interim Measures of the State Counsel on the Placement of Old, Weak, Sick or Disabled Cadres] (promulgated by the Standing Comm. Nat'l People's Cong., June 2, 1978), http://www.gov.cn/jrzq/2009-06/23/content_1348573.htm; Guowuyuan guanyu Gongren Tuixiu, Tuizhi de Zanxing Banfa (国务院关于工人退休、退职的暂行办法) [Interim Measures of the State Counsel on the Retirement and Resignation of Workers] (promulgated by the Standing Comm. Nat'l People's Cong., June 2, 1978), <http://law.cctv.com/program/xyh/topic/C19562/20071017/104947.shtml>.

51. See Suli, *supra* note 38, at 23.

52. Judges will not only be evaluated internally by court officials, but also by the government's human resources department. See Peng Junfeng, *Faguan Kaoping Zhidu Yanjiu* (法官考评制度研究) [Research on the Evaluation System of Judges], 3 *CHUANGYE KEJI YUEKAN* (创业科技月刊) [PIONEERING WITH SCI. & TECH. MONTHLY] 129, 129 (2009).

path.⁵³ Judges waiting for guidance from their superiors before deciding widely influential cases is not a rare occurrence.

B. *The Dilemma of the Judiciary*

The factors affecting the independence of individual judges apply to the judiciary as a whole. The judiciary is not independently funded, nor does it fund itself;⁵⁴ rather, it receives funding and other resources from local governments. It is common for local authorities to try to influence takeover cases relating to government assets or affecting the local unemployment rate. Almost all judicial decisions on such disputes have a significant impact on the local economy. If a judge intends to rule in favor of a non-local company, he will have second thoughts because local revenue is the source of his salary.⁵⁵ Therefore, local influence still undermines the credibility of the judiciary.⁵⁶

Pursuant to the Constitution of the People's Republic of China ("PRC"), it may be legal for political groups to interfere with judicial power.⁵⁷ There are no special regulations to curb

53. See Song Ruiping, *Shilun Woguo Faguan Duli Zhidu zhi Lixiang Jiangou* (试论我国法官独立制度之理想建构) [Discussion on the Optimal Development of China's Independent Judiciary System], 6 ZHONGGONG ZHENGZHOU SHI WEIDANG XIAO XUEBAO 221, 222-23 (2008).

54. See Grimheden, *supra* note 40, at 1011.

55. Although there were rumors about the central government funding local courts from the central revenue in 2009, there has been no official statement on this to date. See Chen Huan, *Jiceng Fayuan Jingfei jiang Naru Zhongyang Yusuan* (基层法院经费将纳入中央预算) [Local Courts to be Funded by the National Treasury], NEWS.163, Dec. 5, 2008, <http://news.163.com/08/1205/05/4SCKC2QD0001124J.html>.

56. See Grimheden, *supra* note 40, at 1011; see also Randall Peerenboom, *Judicial Independence in China* 2, 32-33 (2006) (unpublished manuscript) (on file with author).

57. See XIANFA art. 126 (1986). *Zhonghua Renmin Gongheguo Xianfa* (中华人民共和国宪法) [The Constitution of the People's Republic of China] is the Constitution of the People's Republic of China ("PRC"). Article 126 reads, "The people's courts shall, in accordance with the law, exercise judicial power independently and are not subject to interference by administrative organs, public organizations or individuals." *Id.* Thus, it does not exclude interference from a political group. Therefore, some scholars speculate that this provision is the legal justification for interference. See, e.g., Xie Shiping, *Lun Wo Guo Shen Pan Quan Di Fang Hua Ji Qi Jie Jue: Jian Ping Xianfa Di 126 Tiao* (论我国的审判权地方化及其解决—兼评《宪法》第 126 条) [On the Localism of China's Judicial Power and Its Solution—Along with the Provision 126 in China's Constitution], 2 HENAN ZHI YE SIFA JING GUAN XUEYUAN XUEBAO 82, 84 (2005); see also Zhou Yongkun, *Guan Yu Xiu Gai Xian Fa Di 126 Tiao De Jian Yi* (关于修改宪法第 126 条的建议) [Suggestion on Revising Provision 126 of Constitution], 19 JIANGSU JINGGUAN XUE YUAN XUEBAO 62 (2004).

the Chinese Communist Party (“CCP” or “Party”) from exercising this power (the CCP is the only party in office and can impose political influence on the judiciary). As to local courts, “[p]arty influence at the local level is not always the central party line, but can also be that of the local government or other local interest.”⁵⁸ Based on the constitutional provision, local government or other interests influence the judiciary through the Political & Legal Committee (“PLC”) (*zhenfa weiyuanhui*), which “is the body that plays a decisive role in establishing the finality of a judgment in China.”⁵⁹ If the result of a decision will significantly reduce or increase the local unemployment rate or revenue, the local branch of the Party is inclined to meddle in the judicial decision by calling PLC meetings. Usually, the head of the court is a member of the PLC, who will be persuaded by the committee to consider “social harmony and peace” (*shehui hexie he anding*). Party influence is always irresistible, as evidenced by the powerlessness of the Supreme People’s Court to prevent former members of the military from serving in the judiciary.⁶⁰ Additionally, funding provides extra leverage for the local government and other interests to influence local courts. Given that all of the expenses of local courts are paid from a share of local government revenue, rather than the national revenue,⁶¹ it is impossible for a local court to refuse a request from the local government when it is bargaining for a favorable judgment.

C. *Legislation on the Duty of Care*

In corporate litigation, fiduciary duty is the main vehicle used to rein in irresponsible and reckless behavior of directors and officers. Although law on the duty of care is messy at best, many US scholars have successfully crafted a unified theory of

58. Grimheden, *supra* note 40, at 1011.

59. Nanping Liu, *A Vulnerable Justice: Finality of Civil Judgments in China*, 13 COLUM. J. ASIAN L. 35, 88 (1999).

60. See Weifang, *supra* note 41, at 85.

61. See Yang Yihong, *Lun Faguan Duli Shenpan de Zhiyuexing Yinsu ji qi Xiaojie: Dui Xiugai Woguo Renmin Fayuan Zuzhi Fa Disitiao de Sikao* (论法官独立审判的制约性因素及其消解：对修改我国人民法院组织法第四条的思考) [Discussing the Factors Restricting the Independency of Court Adjudication and Their Solutions: Thoughts on the Modification of Article 4 of China’s Organic Law of the People’s Courts], 3 ZHONGZHOU XUEKAN 113, 115 (2007).

fiduciary duty.⁶² In 2005, the Company Law of the PRC was amended; however, there is only one provision related to the duty of care.⁶³ Given that no decision is binding precedent in the jurisdiction, the meager treatment of the duty of care in legislation is a critical problem in the adjudication of takeover cases.⁶⁴

Pursuant to Article 148 of the amended Company Law:

The directors, supervisors and senior executives of a company shall comply with the laws, administrative regulations and the articles of association of the company, and bear the duties of loyalty and due diligence towards the company. The directors, supervisors and senior executives of a company shall not, by taking advantage of their positions and powers, accept bribes or other unlawful incomes, nor may they misappropriate the property of the company.⁶⁵

Article 148 is the only provision in the newly promulgated company law related to the duty of care. Although there are other regulations, such as the 2008 Law of the People's Republic of China on the State-Owned Assets of Enterprises,⁶⁶ which applies only to the directors, controlling shareholders, and actual controllers⁶⁷ of State Owned Companies ("SOCs"); and the 2008 Measures for the Administration of the Takeover of Listed Companies,⁶⁸ these regulations are not fully enforced because

62. See, e.g., Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399 (2002).

63. Zhonghua Renmin Gongheguo Gongsifa (中华人民共和国公司法) [Company Law] art. 148 (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 29, 1993, revised Oct. 27, 2005), http://www.gov.cn/ziliao/flfg/2005-10/28/content_85478.htm.

64. See Hu Xiaoke, *Lun Woguo "Gongsifa" Xiugai Zhong dui Dongshi Zhuyi Yiwu Guize de Wanshan: Jianxi Yewu Panduan Guize dui Dongshi Zhuyi Yiwu de Pingheng* (论我国《公司法》修改中对董事注意义务规则的完善：兼析业务判断规则对董事注意义务的平衡) [*The Revision of the "Company Law" and the Directors' Duty of Care: Analysis on the Business Judgment Rule*], 4 ZHONGYANG CAIJING DAXUE XUEBAO 76, 79 (2004).

65. Company Law art. 148.

66. See Zhonghua Renmin Gongheguo Guoyou Qiye Zichan Fa (中华人民共和国国有企业资产法) [The Law of the People's Republic of China on the State-Owned Assets of Enterprises] (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 28, 2000, effective May 1, 2009), http://www.gov.cn/flfg/2008-10/28/content_1134207.htm.

67. "Actual controller" shall mean any person who is not a shareholder of a company but can control the company's acts through investment relationships, agreements or other arrangements. Company Law art. 217.

68. Only a few articles, such as Article 8, are related to the duty of care of directors, controlling shareholders, and actual controllers in the target company and the bidding

they lack a systematic logic and integrity, and they are not specific enough for judges to apply. Because of the gaps in the legislation, many problems occur in the takeover process. In many cases, directors and controllers substantially misappropriate a corporation's assets for their own benefit. Sometimes the board of directors of the target company rejects a substantially good tender offer and prefers a less beneficial one because of individual interests or connections. Some directors and actual controllers of SOCs usurp the takeover opportunity to embezzle state assets by acquiring the bidding company's stocks.⁶⁹ In adjudicating these cases, judges tend to do nothing except seek the opinion of the upper level court, because there is no specific rule applicable for those poorly trained judges. In most cases, because of insufficient law on the duty of care, judges are expected to consult across the levels of a court system, and thus a local court judge may receive direct guidance from an intermediate or high court justice while the case is still before the local court:

Where a case has particular significance, or where the district court judge fears reversal, the case may be transferred to the next level prior to reaching any decision. Even after a decision, however, the appeal to the next level does not give deference to the decision, but results in a trial de novo.⁷⁰

The result of the inadequate legislation is inefficiency and corruption of the judiciary.

III. A BETTER WAY TO SLICE THE GORDIAN KNOT

A. *The Applicability of the Standards of Review*

Taken together, the issues discussed above turn takeover litigation into an onerous task for judges and one with an

company. The provisions are vague and elusive. See Shangshi Gongsi Shougou Guanli Banfa (上市公司收购管理办法) [Measures for the Administration of the Takeover of Public Companies] (promulgated by the China Securities Regulation Comm'n, July 31, 2006, effective Sept. 1, 2006) http://www.chinacourt.org/flwk/show1.php?file_id=112131.

69. Wang Junfang, *Dui Guoyou Zhongxiaoxing Qiye Guanliceng Shougou de Sikao* (对国有中小型企业管理层收购的思考) [Thoughts on Management-Buyouts of Small and Middle Sized State Owned Companies], 9 DANGDAI JINGJIREN 86, 86 (2006).

70. See Sam Hanson, *The Chinese Century: An American Judge's Observations of the Chinese Legal System*, 28 WM. MITCHELL L. REV. 243, 250-51 (2001).

uncertain outcome for the parties because of the interference of local government or other interests. Although corporate China and legal academia have made many suggestions to rectify the problems, little system-wide reform has been introduced or effectively implemented.⁷¹ Given that most of the solutions demand tremendous legislative efforts or a series of drastic judicial and political reforms,⁷² they are met with little enthusiasm among government representatives. Because so many changes are needed to improve the adjudication of takeover disputes, people regard these temptations as uneconomical. However, the business judgment rule and the “defensive” business judgment rule prove a better way to slice the Gordian Knot. This does not mean that the importation of these two standards of review into Chinese law will eliminate all the issues analyzed above. However, it will provide the judiciary with a vehicle to circumvent the most persistent problems so as to keep the judiciary from predicaments in the adjudication of takeover cases.

The business judgment rule and the “defensive” business judgment rule are standards of review under which judges must abstain from reviewing the substantive merits of directors’ or officers’ decisions.⁷³ In current Chinese judicial practice, judges actively review the managerial decisions and impose their own value judgments on substantive business decisions. Frequent judicial meddling into the managerial decisions, as previously mentioned, leads to undue risk aversion for the decision-makers.⁷⁴ Application of the standards of review will be helpful to judges deciding takeover cases in three main ways. Currently, judges face the problem of lack of professionalization. Even well-

71. See Grimheden, *supra* note 40, at 1008–09; see also Renmin Fayuan Wunian Gaige Gangyao (人民法院五年改革纲要) [Five Year Reform Platform of People’s Courts], *supra* note 47; Qianfan Zhang, *The People’s Court in Transition: The Prospect of the Chinese Judicial Reform*, 12 J. CONTEMP. CHINA 69, 87 (2003); Zou Keyuan, *Judicial Reform in China: Recent Developments and Future Prospects*, 36 INT’L LAW. 1039, 1045–46 (2002) (discussing selection criteria for judges).

72. See Dong Hao, *Sifa Gaige dui Zhengzhi Tizhi Gaige Jincheng de Po yu Li* (司法改革对政治体制改革进程的破与立) [Judicial Reform in Light of the Abolishment and Establishment of the Political Reform Process], 3 FAZHI LUNCONG 1 (2009) (discussing the strong interrelationship between judicial and political systematic reformations and the tremendous changes necessary for judicial and political systematic reforms in order to achieve a better adjudication environment).

73. See Bainbridge, *supra* note 20, at 90.

74. See Eisenberg, *supra* note 12, at 542–44.

trained US judges should refrain from making substantive business decisions because of asymmetrical business information and knowledge; the case is stronger for Chinese judges with only military or history education backgrounds. Transplantation of the business judgment rule and the “defensive” business judgment rule as standards of review for takeover cases will alleviate the professionalization problem in the Chinese judiciary. Judges should only evaluate whether the decision-making process fits the prerequisites of these standards of review. If they fit, the court must abstain from making the substantive business decision itself, and it may not question the reasonableness, complete or in part, of the decision of the director or officer.

Second, the requirements of the new standards of review will reduce the judicial burden not only for decision-makers, but also for the fact-finding judges. Tremendous social resources will be saved. Business decision-makers in proceedings will not need to gather significant outside professional opinions for litigation and they would be more than happy to consult outside professionals, such as accountants and investment bankers, before making any decision.

Third, the independence of judges will be bolstered because it is harder for outside parties to affect judges’ decisions on the requirements as opposed to substantive business judgments.⁷⁵ The ability to make substantive business judgments awards the non-independent judiciary with excessive discretion, which is easier for local interests to exploit.

The beneficiaries of the importation of the standards of review are not only individuals, but the whole court system as well. From the perspective of resource allocation, when the local government or other local interests try to compel courts to make a favorable judgment, there must inevitably be conflicting interests between local governments. The main reason the central government does not directly intervene to dampen adverse interference by the local government is that the central government can adjust that influence through the hierarchy of

75. An articulate juridical power boundary will help local courts maintain their independence and better enforce judicial power. See Ma Huaide, *Difang Baohuzhuyi de Chengyin he Jiejue zhi Dao* (地方保护主义的成因和解决之道) [*Causes and Solutions of Local Protectionism*], 6 *ZHENGFA LUNTAN* 156, 158–60 (2003).

Party organization, such as the Central Political and Legal Committee (*Zhongyang zhenfa weiyuanhui*), whenever the judicial decisions will jeopardize the interests of the central government. However, such mechanisms are inefficient and onerous. As discussed above, the costs and benefits of enacting a series of laws to abate local influence on the court is uneconomical, especially for takeover cases. In looking back on the history of corporate America, it is easy to find conflicts between state and federal interests as well. Eventually, the state had to obey the superior interests of the nation.⁷⁶ In political terms, application of the two standards of review, which can decrease the excessive discretion of judges on business judgment, will be the red flag to the local governments' local protectionism. That will reduce political pressure on local courts in weighty takeover cases.

New standards of review will also temporarily help alleviate the legislative predicament. China falls within the family of continental law countries, where the main source of law is statutes and where judicial precedents have hardly any binding effect.⁷⁷ Therefore, legislation in those states needs to be articulate and specific. Any legislative default or gap will cause serious application problems. Sometimes, the gap and default will give the judiciary excessive discretion, which can cause corruption.⁷⁸ As analyzed before, Chinese legislation on the duty of care is an outstanding example. However, the application of new standards of review will provide a buffer zone for the predicament of the lack of the duty of care. As with abstention doctrines, the business judgment rule and the "defensive" business judgment rule will significantly cut down on the

76. For instance, in *Time-Warner*, the Delaware court changed its attitude from pro-takeover to anti-takeover. This drastic shift occurred because Delaware "lives in the constant fear that Congress will usurp its authority in corporate law" in order to "throw[] cool water on the takeover market." See Skeel, *supra* note 19, at 138. Fear of the reallocation of legislative right is the main reason.

77. See SHEN ZONGLIN, *BIJIAO FA YANJIU* (比较法研究) [RESEARCH ON COMPARATIVE LAW] 142 (1998).

78. See *supra* notes 70–76 and accompanying text (discussing the problems that occur as a result of gaps in Chinese legislation). Given the low standards for judge nomination, it would be very dangerous to allocate to the judiciary too much discretion on such specialized corporate law. See *supra* notes 43–49 and accompanying text (describing the low standards for nomination). Excessive discretion, under the current situation, will foment more corruption. See *supra* note 75 and accompanying text (explaining the discretion of judges at each level of the Chinese court system).

application of the incomplete duty of care provisions⁷⁹ in takeover cases. More importantly, with specific guidelines for the new standards of review, judges will not need to consult across the levels of the court system and try to solicit guidance from their superiors. The fewer judges that solicit opinions from their superiors, the fewer number of de novo trials there will be.

B. *Crucial Work before Application*

The standards of review are not elixirs for corporate China. However, they are optimal solutions for corporate China to temporarily solve the problems with takeover adjudication. China's political situation and legal system, after all, are different from those of the United States. Whether an imported legal vehicle can be successfully transplanted depends on a detailed examination of the compatibility of the vehicle, its rationale, and proper modification based on that examination. Having studied the business judgment rule, the "defensive" business judgment rule and their rationales at a glance, efforts will be made in the remaining two sections to tailor such rules to the environment of corporate China.

1. Specificity of the Business Judgment Rule

The business judgment rule is a common-law standard of review and is supported by a galaxy of related precedents. Judges only need to look to previous explanations of the conditions, such as the extent to which the decision is believed to be an informed one, in order to apply the business judgment rule. However, in China, precedents are neither binding, nor persuasive. As such, the business judgment rule should be more specific. However, the issue is not whether if the rule needs to be more specific, but how to make the rule more specific.

Australia offers a famous example of transplanting the business judgment rule. In the early 1990s, Australian business interests began campaigning for a statutory business judgment rule.⁸⁰ However, Australians made some substantive modifications, due to their loyalty to English and Australian legal

79. See *supra* Part II.C.

80. Douglas M. Branson & Low Chee Keong, *Balancing the Scales: A Statutory Business Judgment Rule for Hong Kong?*, 34 HONG KONG L.J. 303, 318 (2004).

precedents. This turned the rule into a quasi-substantive standard.⁸¹ A scholar commented that this modification functions as the “[r]eintroduction of a quasi-subjective element, namely motive[,] by enquiring whether the director took the action for a proper purpose, [which] robs the business judgment rule of a measure of its utility.”⁸² Therefore, the tendency to infuse substantive standards into the formal rule should be prevented. What is worse, if the rule is not specific enough for application, judges will have excessive discretion, which would negate one of the original purposes of the transplantation.

Among the four aforementioned prerequisites to the business judgment rule, the “informed” and “good faith” conditions need further clarification in order to make up for the lack of case law. To advance the understanding of “informed decision,” China can borrow the term’s definition from the Model Business Corporation Act, which says that decision-makers should be “informed to the extent the director reasonably believed appropriate under the circumstances.”⁸³ A more detailed definition of “informed condition” will keep the decision-makers from making reckless and unreasonable decisions under specific circumstances and ensure that they make reasonable decisions.

The same rationale applies to the “good faith” condition. China can look to *In re the Walt Disney Co. Derivative Litigation*⁸⁴ from the Delaware Supreme Court for inspiration, which provides a wonderful example of “good faith.” The “good faith” requirement is identified with the subjective intent of the decision-makers to further the best interests of the corporation.⁸⁵ It epitomized what good faith is in the broad picture of business

81. *See id.* at 317. They added language from English and Australian precedents that the business decision must be made “in good faith for a proper purpose.” The expression “for a proper purpose” turns the procedural review into a substantive one.

82. *Id.*

83. *See* MODEL BUS. CORP. ACT § 8.31 (2008).

84. *In re The Walt Disney Co. Derivative Litig. (Disney IV)*, 907 A.2d 693 (Del. Ch. 2005), *aff’d*, 906 A.2d 27 (Del. 2006).

85. *See* Andrew S. Gold, *A Decision Theory Approach to the Business Judgment Rule: Reflections on Disney, Good Faith, and Judicial Uncertainty*, 66 MD. L. REV. 398, 402 (2007); *see also* *In re Walt Disney Co. Derivative Litig. (Disney V)*, 906 A.2d 27, 67 (Del. 2006) (en banc) (discussing good faith requirements in terms of the chancery court’s description of “a true faithfulness and devotion to the interests of the corporation and its shareholders” (quoting *Disney IV*, 907 A.2d at 755 (Del. Ch. 2005))).

decision making and whose interests the directors and officers should pursue. With these specified prerequisites, the business judgment rule will be more explicit and more effective in solving the current judicial problems in takeover cases.

2. Guideline to the “Defensive” Business Judgment Rule

Just as discussed in Section I.B, there is no “defensive” business judgment rule in US corporate law. However, the rules governing the target corporation in a hostile takeover exist in case law. For legislators in the United States, the most common job is to summarize, trim, and codify the rules. Nevertheless, before transplanting the rules, the institutional choice—whether pro-bidder or pro-defender—should be decided. Opinion in the United States in the 1990s was split between pro-bidder or pro-defender.

It is not hard to discover that the attitudes of Delaware courts towards takeover cases changed in the 1990s because of the pressure from the federal government.⁸⁶ After *Paramount Communications, Inc. v. Time Inc.*,⁸⁷ the pro-defender attitude attracted more world-class conglomerates and major US corporations to incorporate in Delaware, which produces a considerable amount of Delaware’s revenue in the form of incorporation and franchise fees.⁸⁸ Obviously, the attraction of the pro-defender policy is the main impetus pushing these behemoths to choose Delaware, because the policy stabilizes the market and makes the corporate future predictable. China is an incorporating jurisdiction in the sense that non-Chinese entities systematically seek incorporation within China’s borders, which has been proven throughout the years by marketing and empirical research. The Chinese government also actively promotes such incorporations. Chinese companies also are actively seeking incorporation within China and may do so increasingly in the future. The latitude to adopt takeover defenses against hostile takeovers is an attractive feature of an incorporating jurisdiction. Therefore, China should adopt a pro-defender policy in order to attract more incorporation. Given

86. See SKEEL, *supra* note 19, at 138.

87. 571 A.2d 1140 (Del. 1989).

88. See DEL. DEP’T OF FIN., DELAWARE FISCAL NOTEBOOK (2009) *passim*, available at http://finance.delaware.gov/publications/fiscal_notebook_09/fiscal_notebook_09.pdf.

that China is a centralist country rather than federalist country, furthering incorporation will help not only the development of the local economy, but also the national economy as a whole.

CONCLUSION

The business judgment rule and the “defensive” business judgment rule have strong applicability to corporate China. The application of these standards of review will help the Chinese judiciary tackle professionalization and independence issues. Additionally, the issue of inadequate legislation on the duty of care will be circumvented temporarily. Under the current political and economic picture, and given that massive legislation and judicial revolution on takeover cases is impossible and cannot be achieved in a short period of time, the transplantation of the new standards of review will create a buffer zone for takeover dispute adjudication so as to provide interim reform of the whole judicial system. Last but not least, the proper specificity of the business judgment rule and the guidelines of the “defensive” business judgment rule should be considered before applying the new standard of review in China.