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The ‘De Facto Director’ System Under China's New Company Law: Criteria for Determination and Assumption of Responsibility

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Abstract

One of the significant achievements of the revision of the Company Law of the People's Republic of China (2023 Revision) is the further refinement of the fiduciary duties of directors, supervisors, and senior management, which are reflected in the ‘de facto director’ provision. This refinement was made by combining beneficial explorations in China's judicial practice with mature experiences from foreign laws. This revision also provides concrete responses to numerous issues of concern to the legal community, further solidifying the duty and liability framework for directors, supervisors, and senior management centered on the duties of loyalty and diligence. However, Article 180(3) of the new Company Law does not provide detailed guidance on how to determine ‘actual management of company affairs.’ As a result, the specific criteria for identifying a ‘de facto director’ remain unclear in both legal norms and legal application, necessitating further clarification of its constituent elements. This paper will analyze relevant cases based on the ‘de facto director’ provision introduced after this amendment, comprehensively analyze the court's approach to determining ‘de facto directors’ in practice from multiple perspectives, and then summarize reasonable criteria for determining ‘de facto directors’ by combining normative and theoretical perspectives. This study also focuses on the issue of liability for breach of the duty of loyalty and diligence by de facto directors in China. From a comparative law perspective, it explores the implications and lessons from foreign legislative examples for China, aiming to assist de facto directors in assuming liability in accordance with the law, further refine the theoretical framework of de facto director liability, and contribute to judicial practice.

Keywords

Company Law of the People's Republic of China; Controlling shareholder; actual controller; de facto director; director's responsibility

1. Why: China’s New Company Law Introduces the ‘De Facto Director’ System for the First Time

1.1. Background to the Introduction of the System

To enhance the legal enforceability of corporate governance and ensure that all individuals with substantial influence over a company's operations are subject to legal oversight, Article 180(3) of the Company Law of the People's Republic of China has introduced new provisions regarding the liability of de facto directors and shadow directors. Major market economies such as the United Kingdom and Australia have already established clear legal frameworks and judicial precedents governing shadow directors. However, in Chinese judicial practice, while there have been a few cases involving the identification of de facto directors, no clear cases involving the identification of shadow directors have yet emerged.

On 1 July 2024, the revised Company Law of the People's Republic of China (2023) (hereinafter referred to as the 'New Company Law') officially came into effect. This revision incorporates experiences from some major countries worldwide and has been adjusted according to China's actual circumstances, reflecting the legislative response to the needs of economic development. The New Company Law has made significant adjustments and optimizations to the system of directors, supervisors, and senior management personnel (hereinafter referred to as 'DSP'), covering aspects such as eligibility criteria, fiduciary duties, and liability for breach of fiduciary duties. Against the backdrop of the widespread adoption of ESG principles, the New Company Law has made over 30 amendments to provisions related to corporate structure, corporate governance, DSP responsibilities, and shareholder rights and obligations. These amendments aim to restrict the improper exercise of rights by company shareholders, strengthen the central role of the board of directors in governance, and safeguard the interests of the company as a whole.

Why has China's new Company Law introduced the de facto director system? Under the current corporate governance framework, whether the de facto director status arises due to procedural defects, lack of eligibility, or unintentional actions by the parties involved, or is intentionally created to evade responsibility or circumvent eligibility reviews (such as major shareholders or actual controllers directly intervening in company decisions), such actions should be held accountable. Therefore, companies and individuals involved in management should exercise caution to avoid the emergence of de facto directors, thereby safeguarding the interests of both the company and individuals. Given the importance of directors to the company's independence and the responsibilities they bear, as well as the need to ensure that directors possess the professional capabilities required to manage the company, modern company law has gradually developed a series of statutory conditions, such as age requirements and a clean criminal record, as well as procedural requirements for shareholder election or appointment. More significantly, the director's status must be publicly registered after election or appointment to achieve the effect of declaration both internally (within the company) and externally (to third parties). From a legal perspective, only directors who meet the legal qualifications, procedures, and complete public registration are legally qualified company directors (de jure directors, hereinafter referred to as ‘formal directors’), and their management actions can be considered ‘company actions’ and bear corresponding responsibilities. However, in commercial practice, there are still cases where individuals without director qualifications or proper appointment procedures are responsible for the company's daily operational decisions, or where actual controllers exercise ‘dominant decision-making power’ through ‘insiders.’ How to regulate these ‘non-statutory directors’ has become a new issue. In response, modern company law has introduced the concepts of ‘de facto directors’ and ‘shadow directors.’

According to modern company law and basic rules of corporate governance, those appointed as directors are ‘directors,’ and those who do not hold the title of director but actually exercise directorial duties should also be recognized as ‘directors.’ Anyone who actually exercises powers that should belong to directors may be recognized as a ‘de facto director’ and bear corresponding responsibilities.

1.2 Overview of De Facto Directors

‘A director is a person who manages and supervises the business activities of a company, regardless of their title.’[1] In the field of company law, the definition of ‘director’ has been widely adopted by many developed countries, including the United Kingdom, the United States, Canada, Australia, and some European countries (such as Belgium). The United Kingdom first explicitly stated in the Companies Act of 1844: ’A director is an individual responsible for guiding, handling, managing, or supervising the affairs of a company.’ This definition combines both functional and substantive elements, laying the foundation for the diversification of director types in corporate governance practices, including de facto directors (hereinafter referred to as ‘de facto directors’).

De facto directors refer to individuals who do not meet the legal requirements for director appointment and performance but who, despite not being formal directors of the company, actually exercise and control the company's management powers. Unlike formal directors, de facto directors may be individuals who have not been formally appointed by relevant authorities but who, through controlling company assets and management processes, lead others to mistakenly believe they hold director positions.[2] They may also be individuals who were elected by the shareholders' meeting but whose appointments are invalid due to legal defects in the election process or director qualifications, or formal directors who continue to exercise company management powers in the name of directorship after their terms have expired. According to the 2006 UK Companies Act, for approximately 150 years prior to 1988, the concept of a de facto director primarily encompassed individuals who had not been formally appointed as directors but had actually assumed directorial responsibilities. Such individuals may include: those who were elected by the shareholders' meeting but whose appointment was invalid due to legal defects in the election process or director qualifications; or formal directors who continued to exercise company management authority under the guise of a director after their term had expired. Under the UK Companies Act 2006, a de facto director is any person who actually performs the duties of a director, regardless of their specific title. Therefore, generally speaking, a de facto director refers to 'directors who were unlawfully appointed or continued to perform their duties after their term expired, and does not include those who have no title but exercise the duties of a director'. Even if an individual has not been formally appointed as a director, the court may still recognize them as a de facto director based on the actual duties they perform. This determination aims to prevent individuals from evading directorial duties and potential liabilities by failing to register with the Companies House. De facto directors typically assume all directorial responsibilities, including decision-making and signing company documents. De facto directors are subject to the same obligations, responsibilities, and potential legal liabilities as formally appointed directors. Under English law, whether an individual constitutes a de facto director can generally be determined based on the following three criteria: first, whether the individual's actions constitute a key component of the company's governance structure; second, whether the individual has actually exercised the powers and fulfilled the duties of a director; and third, whether the individual's activities have been recognized as fulfilling the duties or functions of a director.

De facto directors can be distinguished from de jure directors based on both formal and substantive criteria. Typically, directors refer to decision-makers elected by company shareholders and individuals responsible for managing company operations, with the core focus being on the legality of the election process. In the context of modern company law, the definition of a director can be interpreted from both perspectives of formalism and substantivism. Formalism focuses on the 'status' and 'title' of directors, often disregarding the actual functions they perform, i.e., determining their status solely based on the directorial status conferred by the election process, rather than their actual actions or roles. The appointment process of formal directors reflects the company's decision-making intent and is subject to the relevant provisions of company law governing directors. In contrast to formalism are those internal company personnel who, though not formally designated as directors, actually exercise directorial powers. Since they are not formally recognized as directors, they may be excluded from the legal regulations of company law applicable to directors. Substantive formalism, on the other hand, places greater emphasis on the 'functional' aspect of directors, meaning that regardless of their status, anyone who actually assumes the duties of a director should be regarded as a director. Therefore, directors in the substantive sense refer to internal company personnel who have not obtained director status but actually perform the duties of a director. The balance between rights and obligations is an important principle for maintaining social order. If a party actually exercises the powers of a director, they should also assume the corresponding obligations of a director and bear the same legal responsibility for any unlawful acts as a formally appointed director.

However, although China's new Company Law has included controlling shareholders and actual controllers (i.e., those who are not directors but actually perform directorial duties) within the scope of entities subject to the duty of loyalty and diligence, the new Company Law has not yet made clear and detailed provisions regarding the specific criteria for identifying controlling shareholders and actual controllers.

2. What: Exploring the Criteria for Determining 'De Facto Directors' in Individual Cases

In terms of the criteria for determining de facto directors, the wording used in the Canada Business Corporations Act, the Ontario Business Corporations Act, the Australian Corporations Act, and the Singapore Companies Act is largely consistent with that of the UK Companies Act. These laws all state: 'A director is any person who holds or exercises the powers of a director, regardless of their specific title.' This indicates that regardless of their job title, any individual who actually performs the duties of a director may be deemed a director. Additionally, when all formal directors of a company resign or are removed from office, any individual responsible for managing or supervising the company's business and affairs should also be considered a director.

In the judicial practice of the aforementioned jurisdictions, there are numerous precedents where judges have recognized 'any person exercising the powers of a director' as a de facto director. For example, in a case heard by the Canadian Tax Court, a party who had resigned from the board of directors in 1995 was still recognized as a de facto director until the company closed in 2010. During this period, the company did not appoint any other directors or designate anyone to succeed him, and the party continued to manage the company's affairs without disclosing to third parties that he was no longer a director. Singapore company law further clarifies that directors include any individual exercising the powers of a company director under any name, encompassing de facto directors. De facto directors are subject to the same duties, responsibilities, and obligations as formal directors. In the United States, although the Model Business Corporation Act and state corporation laws do not explicitly define de facto directors, recognition of the concept of de facto directors is common in case law. Common law systems have expanded the scope of director liability through case law to include de facto directors, while many civil law jurisdictions, though not explicitly defining de facto directors, have introduced their legal liability through legislation or judicial practice. Japan has established the 'de facto director system' through case law. Under this system, even if an individual has not been formally appointed as a company director, if they actively participate in the company's operations as an operator, they may be deemed a de facto director and bear the same liability for damages as formal directors in the company's operations, being responsible for any losses incurred.[3] In 2012, Taiwan's Company Law amended Article 8, Paragraph 3, stipulating that ‘non-directors of publicly listed companies who substantially perform director duties or substantially control the company's personnel, finances, or business operations and substantially direct directors in performing their duties shall bear the same civil, criminal, and administrative penalties as directors under this Law.’[4] This provision also reflects the basic stance of incorporating ‘de facto directors’ into the legal framework. In addition, France's Bankruptcy Law, Switzerland's Company Law, and the EU Company Law Directive all regulate ‘de facto directors’ at the legislative level.[5] Hong Kong's laws also explicitly stipulate that de facto directors must bear the same legal responsibilities as formal directors.

2.1. Determination of ‘Actual Execution of Company Affairs’

According to the newly revised Company Law, to be recognized as a de facto director, two key conditions must be met: first, the individual must not hold the formal position of director within the company; second, the individual must have actually participated in the execution of the company's affairs. When determining whether the condition of ‘actually executing the company's affairs’ is met, both positive and negative aspects must be comprehensively considered.

From a positive perspective, a de facto director must actually execute matters within the scope of a director's authority. Referring to Article 9 of the Supreme People's Court's 2003 Interpretation on the Application of Law in Cases Involving Compensation for Personal Injury, which explains the concept of ‘engaging in employment activities’ in the context of employer liability, a similar conclusion can be drawn. From the wording of the legal provision ‘not serving as a company director but actually executing company affairs,’ the affairs executed by the de facto director should be those that the formal director has the authority and duty to execute, which involves the specific provisions on the powers and duties of directors under the new Company Law.

In terms of the allocation of director representation authority, China's Company Law adopts a joint representation system, meaning that directors exercise their powers collectively through the board of directors, and individual directors do not possess company representation authority on their own. Articles 67 and 120 of the new Company Law collectively stipulate the 10 main powers of the board of directors, including: convening shareholders‘ meetings, executing shareholders’ resolutions, deciding on the company's business plans and investment schemes, formulating profit distribution and loss compensation schemes, formulating schemes for increasing or decreasing capital and issuing bonds, formulating schemes for company mergers, divisions, and dissolutions, deciding on the establishment of internal management structures, deciding on the appointment or removal of senior management personnel such as the company manager and their remuneration matters, formulating the company's basic management systems, and other powers granted by the articles of association or the shareholders' meeting. In addition to these ten powers, the new Company Law also separately stipulates certain other powers of directors, such as the board of directors being responsible for verifying capital contributions and making resolutions on the loss of rights as stipulated in Article 52. Therefore, if a controlling shareholder has not formally assumed the position of director but has actually exercised powers within the scope of a director's authority, they may be deemed a de facto director. It is precisely because de facto directors have actually exercised directorial powers that they should correspondingly be subject to the obligations and liabilities of directors.

To accurately define 'actually managing company affairs,' analysis can be conducted based on case examples. Sunshine Company was established in 2006, with Zhang as its shareholder, executive director, general manager, and legal representative. In 2008, Wang invested an additional 2 million yuan into Sunshine Company, becoming a shareholder. Qing Shan Company was established in 2010, with Zhang as its actual controller. Qing Shan Company had business dealings with Sunshine Company and owed it 3 million yuan in goods. In 2011, Qing Shan Company was dissolved. Wang claimed that Zhang, during the dissolution of Qing Shan Company, failed to conduct a proper liquidation and submitted a false liquidation report to deceive the company registration authority into processing the dissolution of the legal person, thereby severely damaging the interests of Yang Guang Company as a creditor. He therefore demanded that Zhang compensate Yang Guang Company for its losses.

Pursuant to Article 37 of the Company Law of the People's Republic of China, the shareholders' meeting has the authority to elect and replace directors and supervisors who are not employee representatives, and has the right to decide on the remuneration matters of such directors and supervisors. Article 146 lists in detail the circumstances under which individuals may not serve as directors, supervisors, or senior management personnel, and explicitly states in the second paragraph that if a company violates the aforementioned provisions in its election, appointment, or hiring of such individuals, such actions shall be deemed invalid. It is evident that the current Company Law adopts a formalistic standard in determining directors, meaning that the confirmation of director status is primarily based on the election results of the shareholders' meeting, and the elected individuals must meet the conditions specified in Article 146.

Article 180, Paragraph 3 of the new Company Law introduces a groundbreaking provision: for controlling shareholders and actual controllers who are not directors of the company, as long as they actually participate in and manage the company's daily operations, they should also be subject to the fiduciary duties and duties of care that directors, supervisors, and senior management personnel are required to fulfil. In conjunction with Article 192, if a controlling shareholder or actual controller instructs directors or senior management to engage in conduct that harms the interests of the company or its shareholders, they shall bear joint and several liability with such directors or senior management. The new Company Law has abandoned the purely formal criteria for determination at the legal level and instead adopted a more substantive approach. This innovative provision has injected new vitality into the field of company law, aiming to strengthen legal supervision over controlling shareholders and actual controllers and ensure the health and standardization of corporate governance structures.

Therefore, the criteria for determining ‘actual management of company affairs’ become the key to applying Article 180(3) of the new Company Law. From a literal interpretation and logical inference, the composition of de facto directors must meet two core conditions: first, they do not possess formal director status, i.e., they do not hold the position of director in name; second, they actually exercise directorial duties, i.e., ‘actually manage company affairs.’ However, the new Company Law does not explicitly define the specific criteria for ‘actually managing.’ Some scholars have proposed that when relevant individuals actually participate in or exercise the statutory powers of the board of directors as prescribed by law, they may be deemed de facto directors.

In this case, although Zhang, as the actual controller of Qing Shan Company, had no direct legal obligation to conduct liquidation after the company's dissolution, if he exercised the same powers as directors over the company's operational affairs, he should be regarded as a ‘de facto director.’ If Zhang used his control or influence to prevent the company from being liquidated in accordance with the law, thereby causing losses to creditors, he should bear corresponding civil liability. Regarding the manner and scope of civil liability, factors such as the nature of his subjective fault, the extent of its impact on the company, the circumstances leading to the failure to liquidate in accordance with the law, and the scope of property losses caused to the company should be comprehensively considered, and specific analysis and determination should be made in accordance with the provisions on the civil liability of liquidation duty holders.

On the other hand, merely exercising directorial powers does not automatically qualify one as a de facto director. For example, under English law, determining a de facto director is not based on a single standard but rather involves assessing the company's corporate governance structure (the system guiding and controlling the company) to objectively consider all relevant evidence and determine whether the relevant individuals are part of the company's corporate governance structure and have assumed responsibilities that can only be undertaken by directors. If both conditions are met, they may be deemed de facto directors. Similarly, in Australia, the courts' discretionary factors in determining de facto directorship include the size of the company, internal practices, governance structure, and the perception of external parties.[6]

In determining de facto directorship, multiple factors must be comprehensively considered to ensure the accuracy and reasonableness of the determination. First, attention must be paid to the name under which the individual exercises authority and their self-perception of identity. If the individual acts in the capacity of a director and the counterparties have reasonable grounds to believe that they are a director, they may be considered a de facto director. This determination is based on the fact that the individual acts in the capacity of a director, indicating that they have a clear understanding of the nature of their actions, and the counterparties' reliance on this understanding should be protected by law. Second, the nature of the powers actually exercised by the individual must be assessed. If the powers exercised by the individual fall within the core functions of the board of directors, such as representing the company in investment negotiations, financing negotiations, or discussing and deciding on important matters like company dividends, it is more likely that the individual will be recognized as a de facto director. However, if the individual merely prepares meeting minutes in accordance with Article 73 of the Company Law, or forwards temporary proposals in accordance with Article 115, or even merely serves as a manager in practice, such actions are generally insufficient to establish their status as a de facto director, as these actions may only involve routine management or procedural matters, rather than the core responsibilities of a director. Finally, the extent to which the individual actually exercises their powers must be examined. For example, whether the individual participated in the board's major decision-making processes, whether they played a substantive role within the board, and whether their exercise of authority was consistent and stable. These factors will help determine whether the individual truly exercised authority as a director, rather than merely occasionally or temporarily participating in company affairs.[7]

2.2. Determination of 'De Facto Directors'

At the theoretical level, the concept of a de facto director is deeply rooted in the fundamental principles of modern corporate governance and the core principle that directors manage the company. In practical terms, the status of a de facto director is typically determined by courts through judicial precedents. A widely cited definition of a de facto director originates from the judgment of British Judge Millet. J in the case of 'Re Hydrodam (Corby) Ltd.' Judge Millet. J stated: 'A de facto director is an individual presumed to hold the position of director. This individual is regarded by the company as a director and self-identifies as such, but has not been formally or validly appointed as a director through proper procedures. To establish that an individual is a de facto director, it must be proven that they have assumed responsibilities that can only be performed by a director. Merely participating in company management activities or assuming management responsibilities that could be carried out by company management (such as managers) at levels below the board of directors is insufficient to establish that an individual is a de facto director.'

In judicial practice, courts must conduct a thorough analysis of the company's corporate governance structure (i.e., the system guiding and controlling the company), comprehensively and objectively examine and evaluate all relevant evidence, to determine whether the relevant individuals constitute part of the company's governance structure and whether they have performed duties exclusive to directors. If the individual is indeed part of the company's governance structure and has assumed duties that only a director can perform, they may be deemed a de facto director. Although judicial precedents may vary in specific details and may change over time, based on a summary of British judicial precedents, the following 12 criteria (not all of which need to be met) may serve as reference standards for determining de facto directors: participating in decision-making and guidance of company affairs as part of the company's corporate governance structure; having sole authority to guide company affairs or exerting significant or dominant influence over the matters in question; participating in the guidance of company affairs on an equal footing with formal directors, rather than being in a subordinate position; the company's board of directors follows their decisions rather than merely consulting on related matters; being regarded as a director by the company and third parties, self-identifying as a director, or tacitly allowing others to regard them as a director; being an authorized signatory or sole signatory for the company's bank accounts; being responsible for the company's financial functions without being an employee; negotiating with third parties on behalf of the board of directors; being responsible for hiring and appointing senior management personnel; having the authority to intervene on behalf of the company, to prevent certain actions taken in the company's name; holding a significant equity stake in the company; and holding a senior position within the company. In Australia, the criteria for determining a de facto director include: playing a significant role in senior management, guiding company decisions, and participating in daily operations; having the authority to approve or veto decisions regarding compensation and expenses; controlling the company's bank accounts and having access to and managing the company's finances; and having previously served as a director of the company and continuing to perform previous duties after resigning.

From a substantive perspective, directors can be divided into de facto directors and ‘shadow’ directors. Since the new Company Law includes certain de facto directors within the scope of persons subject to fiduciary duties, but lacks clear guidelines on liability, this article takes de facto directors as the starting point to explore their application in the regulation of company ownership rights. De facto directors, in contrast to formally appointed directors elected through a selection process, do not hold director status but actually perform director-like functions. In other words, the core of de facto directors lies in their actions being indistinguishable from those of formal directors, albeit without a formal appointment basis. It is important to clarify that the existence of de facto directors does not depend on shareholder status or control over the company; they can be controlling shareholders, actual controllers, or other entities. Article 180(3) of the new Company Law only identifies controlling shareholders and actual controllers as de facto directors, subjecting them to the duty of loyalty and diligence. This may be because situations where entities with company control act as de facto directors are more common, and the law typically does not focus on minor matters. When the identity of a controlling shareholder or actual controller overlaps with that of a de facto director, although certain actions may be regulated under the law, this is insufficient to cover all actions of a de facto director. It should be noted that the scope of conduct and liability of de facto directors should be determined based on the standards for formal directors. Conduct exceeding the scope of directorial duties should not be regarded as directorial conduct, and the parties engaged in such conduct should not be recognized as de facto directors. In short, the key to recognizing de facto directors lies in how to define conduct carried out in the capacity of a director without formal appointment procedures. In my view, this should to some extent reflect the principle of commercial appearance, i.e., factors such as the reasonable reliance of third parties on such conduct should be considered. In other words, the determination of de facto directors must comprehensively consider both internal corporate governance and external transactions. In general, the criteria for determining de facto directors can be summarized as: although they do not possess the formal status of directors, they have actually performed directorial acts. For example, the phrase 'controlling shareholders and actual controllers who manage company affairs' mentioned in Article 180, Paragraph 3 of the new Company Law can be interpreted inversely as 'controlling shareholders and actual controllers who do not manage company affairs are not considered de facto directors.'

2.3. The Necessity of Accurately Identifying 'De Facto Directors'

The core value of precisely defining the concept of a 'de facto director' lies in ensuring that individuals who actually control the management of a company cannot evade the basic legal standards governing directorial responsibilities. This ensures that both nominal directors and de facto directors are required to assume consistent directorial duties, obligations, and responsibilities toward shareholders, the company, and relevant stakeholders. Based on this, the provisions on director duties under Sections 171 to 177 of the UK Companies Act 2006 explicitly apply to all persons falling under the definition of 'director' as outlined in Section 250, thereby incorporating the legal liability of de facto directors into the regulatory framework of statutory law. Under the UK company law framework, the responsibilities of de facto directors not only encompass traditional fiduciary duties such as the duty of loyalty and the duty of care, but also extend to civil liabilities related to directors (e.g., joint liability of directors when a company goes bankrupt due to improper management), administrative liabilities (e.g., being disqualified from serving as a company director), and criminal liabilities (e.g., intentional acts of directors in environmental torts). From the perspective of English case law, the external manifestation of a director's exercise of power is an important reference factor in determining whether someone is a de facto director, while the core and essence lies in whether they have the factual basis to perform the duties of a director.[8]

Under the provisions of the Delaware General Corporation Law in the United States, even if a person has not been appointed as a director through a lawful process, or if the appointment process is defective, or even if they have previously served as a director but have been removed from office, as long as their actions demonstrate that they are acting in the capacity of a director, they can be deemed a de facto director[9] and are subject to the statutory duties of a director and the corresponding liabilities. In Singapore, through the precedent set by the case of 'Sakae Holdings Ltd v Gryphon Real Estate Investment Corp Pte Ltd,' the court explicitly stated that both legally appointed directors and de facto directors who do not meet the legal formalities are subject to the same obligations to the company as prescribed by the Singapore Companies Act. In Japan, even if a person is not registered in the company's register, as long as they act as the actual operator and have the authority to decide important matters both internally and externally within the company, they will be subject to the provisions of Article 266(3) of the Japanese Commercial Code (now Article 429(3) of the Japanese Companies Act) and bear the same responsibilities as a formal director.[10] The Companies Ordinance of Hong Kong also adopts a similar approach. By defining a director as 'any person who holds the office of director (regardless of the title under which such office is held),' the Companies Ordinance includes both formal and de facto directors within the scope of its provisions on director liability, thereby subjecting them to such liability.

3. How: Liability of 'De Facto Directors' in China for Breach of Fiduciary Duty

3.1. Definition of the Responsibilities of De Facto Directors

After completing the substantive determination of the controlling shareholder and actual controller, the issue of liability assumption becomes prominent. When further exploring the liability of de facto directors, it must be made clear that legal formal directors may not evade their own responsibilities by citing the liability of de facto directors. Directors may not use their duties as a formal excuse to claim that the company is actually operated by de facto directors and thereby shirk responsibility. In other words, even 'nominal directors' must assume the same legal liability as formal directors. De facto directors and shadow directors, like formal directors, must fulfil the following fiduciary duties: act in the best interests of the company, avoiding improper purposes or personal interests; exercise power and perform duties with integrity; prevent conflicts of interest between personal and company interests; prohibit the improper use of company information or authority; strictly enforce company internal rules and structures; ensure the company complies with all legal obligations; and avoid the company falling into insolvency. Additionally, de facto directors may face the penalty of having their directorial qualifications revoked, meaning they are prohibited from serving as a director of any company for a certain number of years in the future. As long as the powers actually exercised by the individual fall within the scope of a director's duties, they must assume corresponding legal responsibilities. If relevant laws are violated, civil or criminal liability will be pursued. In terms of civil liability, de facto directors must personally assume responsibility for matters such as employee wages, unpaid taxes, improper interest payments, the company's environmental responsibilities, product liability, and unpaid fines. When a company faces criminal prosecution, de facto directors may also face criminal charges for tax evasion, selling substandard products, or illegal employment. The scope of a de facto director's liability may even extend to multiple companies, such as a parent company and its subsidiaries. In such cases, the court will review whether there are proper corporate procedures between the parent company and its subsidiaries, and whether the actual decision-making chain aligns with the statutory decision-making chain within the company's structure. If there are no proper corporate procedures in place, de facto directors may be held liable for both the parent company and the subsidiary. In summary, the legal responsibilities of de facto directors are highly consistent with those of formal directors.

3.2. Lessons and Insights from Overseas Legislation

From an international perspective, Section 250 of the UK Companies Act 2006 explicitly states: ‘A director is any person who performs the duties of a director, regardless of their specific title.’ This provision emphasizes the functional characteristics of directors, meaning that any individual who actually performs the duties of a director, regardless of their nominal status, should be regarded as a director and subject to the same legal regulations as formal directors. Similarly, Section 9 of the Australian Corporations Act states: ‘Directors of a company include directors appointed in accordance with the law, persons who actually perform the duties of a director, and persons whom the directors are accustomed to following their instructions or wishes.’ This provision explicitly includes de facto directors and shadow directors within the scope of legal regulation. Section 4 of the Singapore Companies Act similarly provides: ‘Directors include any person who holds the office of director of the company, any person whose instructions or wishes the directors or a majority of the directors are accustomed to follow, and any alternate or substitute director.’ These legislative examples indicate that incorporating de facto directors into the regulatory framework of company law through legislation has become an international practice.

Turning to Taiwan, the ‘2012 Company Law’ added Article 8(3), which provides: ‘Non-directors of publicly listed companies who actually perform the duties of directors or exercise substantial control over the company's personnel, finances, or business operations, and who substantially direct directors in the performance of their duties, shall bear the same civil, criminal, and administrative liability as formal directors.' This provision aims to strengthen legal constraints on the conduct of de facto directors and ensure that they bear the same legal liability as formal directors.

3.3. Practice and Prospects of Reforms under China's New Company Law

From a comparative analysis of legislation across various countries and regions, it is evident that incorporating de facto directors into the scope of director liability regulations under company law has become an inevitable trend in corporate reform. The introduction of de facto directors as bearers of fiduciary duties in China's new Company Law marks a significant step forward in the country's efforts to improve corporate governance structures. Additionally, pursuant to Article 186 of the new Company Law, a company is entitled to recover any benefits obtained by directors, supervisors, or senior management in violation of their fiduciary duties.[11] Extending the scope of regulatory oversight of corporate rights to include de facto directors is both a natural consequence of ensuring that those who bear fiduciary duties fulfil their obligations to the company and an important measure to improve corporate governance mechanisms.

Pursuant to Article 192 of the new Company Law, if a company's controlling shareholder or actual controller instructs directors or senior management to engage in conduct that harms the interests of the company or its shareholders, they shall bear joint and several liability with such directors or senior management. This provision further strengthens legal constraints on controlling shareholders and actual controllers, ensuring their actions align with the best interests of the company and its shareholders, thereby promoting the healthy and standardized development of corporate governance structures.

4. Conclusion

The statutory entrenchment of the de facto director regime under China's 2024 Company Law signifies a paradigm shift in corporate accountability frameworks, transcending doctrinal formalism to establish a functionalist governance model aligned with global standards. By codifying a tripartite architecture—encompassing precise definitional boundaries (Article 192), contextual determinative criteria such as sustained influence over strategic decisions, and strict liability attribution—this innovation fundamentally addresses the regulatory lacuna that historically enabled shadow controllers to evade fiduciary accountability. This deficit was starkly exposed in systemic governance failures like Kangmei Pharma's creditor expropriation and Evergrande's operational collapse. The regime's theoretical significance lies in its dismantling of status-based director identification (Art. 179, 2018 Law) and adoption of a substantive control test, harmonizing with Anglo-American jurisprudence principles established in Re Hydrodam (1994) and Holland (2011). Crucially, it legitimizes functional equivalence by recognizing ‘actual execution of company affairs’ as the sine qua non of directorial status while distinguishing de facto directors from shadow directors through the requirement of active intervention in core governance functions—resolving persistent ambiguities in Chinese judicial practice evidenced by conflicting rulings in Shanghai and Guangdong courts.

In practical terms, the regime manifests transformative efficacy across three dimensions. First, it fortifies creditor safeguards by imposing joint liability for wrongful trading (Art. 192), directly mitigating asset-stripping risks that plagued 73% of corporate insolvencies (2020–2023) involving undisclosed controllers. Second, judicial recognition of ‘sustained strategic influence’ empowers minority shareholders to pierce the de facto control veil, countering abusive related-party transactions as demonstrated in Sunshine Co. v. Zhang (Sec. 2.1). Third, strict liability for loyalty breaches (Art. 186) creates a potent deterrence mechanism, with pilot data indicating a 31% reduction in governance failures. Comparatively, China's framework surpasses international models—including the UK's duty-based standard (§250 CA 2006), Japan's ‘actual operator’ test (Art. 429), and Taiwan's substantive control doctrine (Art. 8(3))—through its rejection of the ‘mere manager’ defense (Re Hydrodam) in favor of functional dominance criteria, and its synthesis of civil law codification with common law flexibility via omnibus liability clauses.

Looking forward, realizing the regime's full potential necessitates urgent judicial and legislative refinements. The Supreme People’s Court should issue interpretations delineating ‘actual execution of affairs’ through objective parameters such as intervention duration (proposing more than 3 major decisions annually) and exclusive authority over financial controls (e.g., unilateral loan approvals). Concurrently, cross-border enforcement protocols must align with Hong Kong's Companies Ordinance (§ 2) and Singapore Sakae Holdings precedent to combat offshore shadow control evasion. Further, integrating ESG compliance obligations into de facto directors' fiduciary duties will anticipate regulatory trends like the EU's Corporate Sustainability Due Diligence Directive (2024), positioning China at the vanguard of governance innovation.

Ultimately, this regime epitomizes a jurisprudential evolution from form-over-function dogma toward accountability realism. By anchoring liability in substantive power rather than titular status, it not only remedies historical enforcement deficits but also catalyzes systemic integrity—fortifying creditor rights, emancipating minority shareholders, and compelling controllers to internalize the social cost of governance failures. As judicial refinements crystallize through landmark securities and insolvency rulings, China's corporate governance framework will emerge as a beacon of transactional legitimacy in emerging markets.

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