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# Coordination Path of Fiduciary Duty and Representative Duty of Employee Directors under Dual Identity

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## Abstract

**The employee director system aims to balance employees' rights and interests with corporate interests through employee directors' participation in board decision-making. However, in practice, this system often faces the predicament of functional emptiness and insufficient effectiveness. The reason lies in that under the dual identity of employee directors, their fiduciary duty and representative duty are inevitably in conflict, but there is a lack of corresponding coordination systems, making it difficult for employee directors to perform their duties in accordance with the original intention of the system. Focusing on two major issues-how to choose when fiduciary duty and representative duty conflict, and how to handle situations where the performance of special representative duty leads to a breach of general fiduciary duty-this paper proposes to divide the gradient of duties, construct differentiated liability standards, establish a sound supporting mechanism for the performance of duties, optimize judicial adjudication, and establish rules such as the "Dual Rationality Test", thereby constructing a coordination path for the fiduciary duty and representative duty of employee directors.**

## Keywords

**Employee Director; Fiduciary Duty of Directors; Representative Duty; Corporate Governance; Democratic Management of Enterprises.**

## 1. Introduction

The employee director system is an important part of the democratic management system of enterprises. Its establishment purpose is to protect employees' democratic rights and legitimate interests and improve the corporate governance structure by allowing employee representatives to enter the board of directors and participate in major enterprise decision-making [1]. This system not only reflects the requirements of laws and policies for employees' participation in enterprise management but also serves as an important mechanism for coordinating labor-capital relations and promoting scientific decision-making [2]. Employee directors can directly reflect the demands of front-line employees, safeguard employees' interests on key issues such as compensation, welfare, and safety, and provide first-line practical experience for enterprise decision-making to prevent the management from being divorced from reality. In addition, the employee director system helps enhance employees' sense of belonging, stimulate their enthusiasm, and promote the sustainable development of enterprises.

However, according to the research results of the Social Construction Committee of the National People's Congress, in actual operation, the employee director system is often in a state of "emptiness", and the functions of some employee directors are weakened and cannot be effectively performed. On the surface, there are two main reasons why employee directors

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cannot truly participate in enterprise decision-making. First, the decision-making dilemma caused by dual interests: employee directors, as members of the board of directors, shall perform the duties of loyalty and diligence in accordance with Article 180 of the Company Law; at the same time, as employee representatives, they shall reflect and safeguard the overall interests of employees. In enterprise operation and decision-making, these two types of duties often conflict. For example, when a company plans to lay off employees due to operational pressure, the duty of loyalty may require employee directors to support layoffs to safeguard the company's long-term interests, while the representative duty requires them to do their best to protect employees' employment rights and interests. Such conflicts often put employee directors in a dilemma. Second, the fuzzy boundary of duties leads to more risks in performing duties: the current Company Law only makes general provisions on the general duties of directors, and does not make differentiated provisions on the special duties of employee directors [3]. This institutional gap makes employee directors in the performance of their duties may be accused of "breaching the duty of loyalty" for favoring employees' interests, and also be questioned of "deviating from the representative duty" for supporting the company's decisions. At the same time, the corresponding supporting mechanisms for the performance of duties have not been well constructed, and judicial adjudication lacks uniform standards, which further exacerbates the uncertainty of performance and the inner contradictions of employee directors.

The original intention of the establishment of the employee director system requires distinguishing employee directors from ordinary directors, and the performance duties of employee directors must also be different from the general fiduciary duties of ordinary directors. From a legal perspective, employee directors are democratically elected by the company's employees through the employee representative congress, and at the same time participate in major enterprise decision-making as members of the board of directors, with a dual identity as both employee representatives and board members [4]. As mentioned earlier, under this dual identity, employee directors inevitably face a dilemma in decision-making: to choose between corporate interests and employees' interests? If corporate interests are always prioritized, they are essentially no different from ordinary directors, which violates the original intention of the system design. To transform the dilemma under this dual identity into a real advantage for employee directors to perform their duties and give play to their role in balancing corporate interests and employees' interests, the key is to establish a complete supporting system, reduce the risks of performing their duties, and enhance their confidence in performing duties [5].

Thus, when considering the realistic predicament of the "emptiness" of the employee director system, we inevitably put forward three questions: Is it really necessary to set up employee directors different from ordinary directors to participate in corporate governance? How should employee directors choose when their fiduciary duty conflicts with their representative duty? How should they be liable if the performance of representative duty leads to a breach of general fiduciary duty?

## 2. Theoretical Basis for Employee Directors' Participation in Corporate Governance

The development of the employee director system in China's legislation has experienced a process from exploration to gradual standardization. In 1993, the Company Law of the People's Republic of China (hereinafter referred to as the Company Law) was first promulgated, introducing the concept of "employee directors" and piloting the employee director system in wholly state-owned companies, stipulating that there should be employee representatives in the board of directors. Later amendments to the Company Law have gradually expanded the

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scope of application of employee directors and made more explicit provisions on election procedures, reflecting China's progressive exploration of the democratic management system for employees. The newly revised Company Law in 2023 further expanded the scope of mandatory establishment of employee directors and clarified the election procedures and minimum proportion requirements for employee directors.

It can be seen that on the whole, China holds a positive and prudent attitude towards the employee director system, recognizes and is gradually establishing and improving it, regarding it as an important carrier for the combination of democratic management of employees and the modern enterprise system.

However, in academic circles, there has long been a controversy over whether employees should participate in corporate governance through the form of employee directors due to different theoretical positions. There are roughly the following viewpoints:

## 2.1. Shareholder Primacy Theory

The core logic of the shareholder primacy theory is based on the modern enterprise theory of the "principal-agent relationship", emphasizing that the enterprise management, as the trustee of shareholders' capital, must bear primary responsibility to the capital providers. The core of this theory holds that in a free market economy, an enterprise, as an economic organization owned by shareholders, its fundamental purpose of existence is to maximize shareholders' economic interests through legal operation. As the owners of the enterprise and the ultimate risk bearers, shareholders' rights and interests should take precedence over those of other stakeholders. The social responsibility of the enterprise management is to create maximum wealth for shareholders by improving operational efficiency, expanding market share, increasing profits, etc., on the premise of abiding by laws and basic moral norms. Enterprise resources should not be used for other social goals unrelated to shareholders' interests.

Based on this theoretical position, its supporters usually hold a negative attitude towards the employee director system. They believe that the establishment of the employee director system will blur the boundary between enterprise ownership and control, interfere with the fiduciary responsibility of the management to shareholders, lead to conflicts of interest in the decision-making process, reduce enterprise operational efficiency, and even may cause the problem of "insider control". Under the framework of the shareholder primacy theory, employees are essentially employed laborers rather than enterprise owners, and their rights and interests should be protected through market-oriented human resource management means, including traditional channels such as labor contract agreements, collective bargaining systems, and trade union negotiations, rather than directly intervening in corporate strategic decision-making.

This theoretical system has its own theoretical advantages and practical value. It provides a relatively clear value orientation and performance evaluation standard for enterprise operation, simplifying complex corporate governance issues into quantifiable shareholder return indicators. In addition, emphasizing the responsibility constraints in the "principal-agent" relationship helps reduce the moral hazard of the management. At the same time, the market-oriented solution mechanism it advocates is highly consistent with the principles of the free market economy. For this reason, this theory has a profound influence on modern corporate governance, and has profoundly shaped the modern corporate governance structure, especially in common law countries, forming a shareholder-centric governance model.

However, this theory has also been challenged, and is considered to may lead to short-sighted operation, such as cutting long-term investment, ignoring employee welfare or environmental responsibilities, thereby damaging the sustainable development of enterprises.

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## 2.2. Stakeholder Theory

Compared with the traditional shareholder primacy theory, the stakeholder theory holds that the rights and interests of multiple stakeholders should receive reasonable attention. The success of an enterprise depends not only on shareholders but also on multiple subjects such as employees, customers, suppliers, communities, and the government. All stakeholders are participants in enterprise value creation and bear specific risks. Therefore, the enterprise management should pursue the overall interests of stakeholders, not just the specific interests of certain subjects. From a long-term perspective of corporate development, the interests of all stakeholders are fundamentally consistent. Thus, the enterprise management can optimize the governance structure, balance the demands of all parties, rationally allocate resources, create shared value, and other ways to achieve the optimization of overall benefits on the premise of abiding by laws and moral norms, so that various interests can be balanced in the corporate governance mechanism.

Based on this theoretical position, its supporters usually hold a positive attitude towards the employee director system. They believe that the establishment of the employee director system can effectively coordinate the interest relations within the enterprise, enable the employee perspective to directly enter the decision-making level, effectively make up for the structural defect of the lack of labor voice in traditional corporate governance, strengthen employees' participation in enterprise decision-making, and thus promote long-term cooperation and trust between labor and capital. Under the stakeholder theory, an enterprise is an organic whole composed of multiple stakeholders. Employees are not only employed laborers but also important participants in enterprise value creation and providers of human capital. Their rights and interests should be protected through an institutionalized co-governance mechanism, rather than relying solely on market-oriented employment contracts. The employee director system enables the management to take full account of employees' interests in the decision-making process, avoid excessive bias towards shareholders' short-term returns, and at the same time, enhance organizational stability, establish an institutionalized trust bond between labor and capital, thereby improving the sustainable development capacity and social responsibility of the enterprise.

Although this model may affect decision-making efficiency to a certain extent, the comprehensive benefits it brings, such as enhanced employee sense of belonging, fulfillment of corporate social responsibility, and improved long-term operational stability, precisely reflect the stakeholder theory's profound understanding of the social value of enterprises.

Article 20 of the new Company Law also explicitly introduces the stakeholder theory, and at the same time realizes structural support for this concept through the strengthening of the employee director system. This adjustment has profoundly responded to the realistic needs of modern enterprise development, aiming to promote the transformation of corporate governance concepts from a single pursuit of shareholder wealth maximization to a broader social responsibility. By incorporating the rights and interests of stakeholders into legal considerations, legislators intend to guide corporate decision-making to be more inclusive and sustainable, encourage enterprises to actively balance social impacts while pursuing economic benefits, and prevent damage to the overall social interests due to one-sided profit-seeking. This not only conforms to the international trend of corporate governance emphasizing ESG, but also aligns with China's goals of high-quality development and common prosperity. Through institutional design, it urges enterprises to assume greater social responsibilities, build a more harmonious and stable business ecosystem, and ultimately achieve the coordinated development of long-term corporate value and social public interests.

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## 3. The Dual Duties of Employee Directors

As concluded in the previous section, in practice, the fiduciary duty that employee directors owe to the company as board members often conflicts with the representative duty they bear to the employee group as employee representatives. When exploring the dual duty system of employee directors, clearly distinguishing between their fiduciary duty and representative duty is the foundation for understanding their role positioning, and the differences in the legal basis of these two types of duties are the root cause of the conflict.

Fiduciary duty requires employee directors to prioritize the overall interests of the company, uphold the principles of honesty, trustworthiness, diligence and responsibility, and focus on the long-term development of the enterprise and the protection of shareholders' rights and interests in board decision-making. Representative duty, derived from their special identity as elected by employees, mandates that they must reflect employees' demands, safeguard labor rights and interests, and firmly convey employees' wishes, especially on major matters involving working conditions, remuneration and benefits, and employment stability. This inherent tension not only tests the personal judgment and value trade-offs of employee directors but also exposes the institutional dilemmas to be resolved in the integration of corporate governance structures and democratic management mechanisms. Without legislative clarification of the exercise boundaries of these two types of duties and the design of effective conflict reconciliation mechanisms, employee directors are likely to fall into a dilemma, or even lead to the simultaneous failure of their dual roles-failing to fully participate in corporate decision-making and being unable to truly speak on behalf of employees. The following content will address this issue.

### 3.1. The Priority Issue When Fiduciary Duty and Representative Duty Conflict

In the "Energy Company Merger and Acquisition Case" in the Commentary on Directors' Liability, German courts established a refined balance standard that employee directors must follow when performing management duties in the face of conflicts between the company's overall interests and employees' interests. Its core is to clarify that the primary and non-waivable obligation of employee directors is always the duty of care and loyalty stipulated by company law, which requires serving the overall interests of the company, and their special identity as labor representatives does not constitute an exception to directors' liability. On this premise, the court acknowledges that employee directors can and should legally consider employees' interests in decision-making, but must weigh them strictly within the framework of the company's overall interests: on the one hand, safeguarding long-term employees' interests such as stable labor relations and retention of employees' skills is itself an important part of corporate value, and such consideration is legitimate; on the other hand, when it comes to measures that harm employees' interests in the short term but are crucial to the company's survival or development, employee directors must conduct a prudent assessment using the principle of proportionality, including examining whether the measure is necessary (i.e., the only or optimal path) to achieve the company's goals, whether the harm to employees is reasonable, whether there are milder alternative solutions, and ensuring that the statutory co-determination procedures are followed. At the same time, the court has drawn a clear red line for conduct: employee directors shall not engage in systematic obstruction-unconditionally opposing all necessary decisions, shall not claim priority to represent employees and refuse to perform director duties, shall not disclose confidential board information, nor unreasonably delay urgent decisions leading to significant or irreversible damage to the company. The benchmark for judging the legality of their conduct is the objective business judgment rule. The commentary emphasizes that this set of balance standards provides a "safe harbor" for employee directors, which not only recognizes the particularity of their role and allows them to safeguard employees' interests within the framework but also significantly reduces

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tolerance for obstructive behavior in crisis situations such as the company's survival, thus effectively clarifying the liability boundary, safeguarding the value of employee representatives' participation in management under Germany's co-determination system, and maintaining the unity of board decision-making and the company's overall interests, becoming a classic legal principle for coordinating the co-determination system and directors' liability.

Siemens' global large-scale layoff case from 2024 to 2025 also profoundly demonstrates the labor-capital game under Germany's unique "co-determination system". The background of this layoff is the company's strategic self-renovation in response to economic pressure, but its specific implementation plan is deeply marked by the employee director system. Under German law, half of the members of Siemens' supervisory board are employee representatives, who have the right to approve major restructuring plans proposed by the board of directors. This means that the management cannot implement layoffs unilaterally and must conduct arduous negotiations with employee directors representing employees' interests. The core role of employee directors is not to prevent layoffs, but to act as powerful negotiators, shifting the focus of the game from "whether to lay off employees" to "how to lay off employees". They strived for and passed a social plan centered on minimizing forced dismissals, relying on natural attrition and voluntary departure plans, and providing generous compensation and retraining measures. In the end, this game reached a "social contract": the management gained the flexibility needed to advance its strategy, while employees' rights and interests received institutional protection. Therefore, the operation of employee directors did not cancel the layoffs, but shaped them into a compromise result with greater social responsibility that buffered the severe impact, fully embodying the core value of the co-determination system in balancing capital efficiency and labor rights and interests.

In view of the above comparative legal judgment rules and experiences, this paper argues that to resolve the absolute opposition between the fiduciary duty and representative duty of employee directors, a three-level gradient duty model can be constructed to establish a hierarchical framework for conflict resolution:

The first level is core duty. On matters directly related to the fundamental rights and interests of employees, such as large-scale layoffs or the performance of collective agreements, employee directors should prioritize performing their representative duty, fully reflect employees' demands and opinions, and safeguard the overall interests and legitimate rights and interests of the company's employees. Such decisions are related to the "core representative function" of employee directors, and the choice of position is an inevitable requirement for performing their special representative duties. Therefore, this performance of duty should be exempt from the traditional strict fiduciary duty standards and not regarded as a betrayal of the company's interests. However, this shall not apply if the claim is obviously illegal or related to the company's survival. For example, in a decision involving the company's bankruptcy reorganization, an employee director's support for a layoff plan should not necessarily be deemed a breach of representative duty. This is because "the survival of the company is the fundamental guarantee of employees' interests", which is the fundamental reason why the general fiduciary duty is still prioritized in decisions related to the company's survival.

The second level is intermediate duty. In the field of general operational decision-making, such as mergers and acquisitions, restructuring, major technological investments and other matters that do not directly but significantly affect employees' rights and interests, employee directors need to assume a more stringent balancing obligation. On the one hand, they must actively identify and report to the board of directors the potential impact of decisions on employees, such as job stability and changes in working conditions; on the other hand, if employees' interests conflict seriously with the company's fundamental interests such as survival and development-for example, when a merger is the only way to avoid the company's bankruptcy-the company's overall interests should still be prioritized. The focus of obligation review at this

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level is on the performance procedures, i.e., whether the requirements of diligence and responsibility under the Company Law are followed, especially whether the obligations of information collection, evaluation and reporting are fully performed.

The third level is general duty. In the field of purely technical or commercial decision-making, such as the choice of specific technical routes and the signing of ordinary market contracts that have no substantive connection with labor rights and interests, employee directors must fully apply the fiduciary duty standards of ordinary directors, and shall not deviate from independent judgments made based on professional knowledge and the company's best interests on the grounds of "representing employees".

It is worth noting that the above three-level gradient duties must all be considered strictly within the framework of the company's overall interests. Even for decision-making matters directly related to the fundamental rights and interests of employees, employee directors cannot be exempt from the director's fiduciary duty standards in decisions related to the company's survival, and shall not make decisions that obviously violate the company's overall interests.

The construction of such a gradient duty system can provide clear and predictable legal guidance for the conduct of employee directors in different situations. It can not only draw a clear behavioral boundary for employee directors, effectively alleviate the dilemma of performing duties caused by role conflicts, but also safeguard the substantive effectiveness of employees' participation in corporate governance at the institutional level, preventing employee directors from becoming purely "decorative" roles or being completely assimilated by the capital side, thus truly implementing the legislative original intention of the employee director system.

## 3.2. The Specialization of Employee Directors' Fiduciary Duty Due to the Performance of Representative Duty

The construction of a three-level gradient duty model for employee directors can solve the priority issue of their fiduciary duty and representative duty, resolve the absolute opposition of dual duties, and prevent employee directors from falling into a dilemma where they are unable to make decisions. However, under this model, there are still relative conflicts between the fiduciary duty and representative duty of employee directors, which are specifically manifested in the fact that the exercise of their unique representative duty often breaks through the boundaries of the general fiduciary duty. Therefore, the fiduciary duty of employee directors needs to be subject to limited exemption and moderate expansive interpretation to form differentiated standards different from those of ordinary directors.

1) Limited Exemption of the Duty of Loyalty

In the traditional company law framework, the core of the director's duty of loyalty is to avoid conflicts of interest and strictly safeguard the company's sole interests. However, due to the particularity of their institutional functions, employee directors have an essentially dual attribute in their obligation structure: on the one hand, as directors, they must assume the duty of loyalty to the company; on the other hand, as employee representatives, they also have a representative duty to the employee group. This dual obligation system is not a defect in institutional design, but an inherent requirement and institutional rationality of the employee director's representative function. In matters involving the collective interests of employees-such as voting scenarios for remuneration and welfare plans and the review of collective labor contracts-the act of employee directors exercising their representative power and safeguarding the legitimate rights and interests of employees should not be simply characterized as "seeking improper interests", but as the legitimate performance of statutory duties. Its legitimacy is rooted in the essential "employee representative" identity of employee directors: through the organizational law arrangement in the governance structure, the source coordination and

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institutional checks and balances of labor-capital interests are realized within the board of directors.

In addition, the requirement of prohibiting the disclosure of trade secrets in the duty of loyalty needs to be restrictively interpreted for specific purposes under the dual obligation structure of employee directors. As a "connecting hub" between corporate governance and democratic management of employees, employee directors not only need to report the legitimate resolutions of the employee (representative) congress to the board of directors and objectively convey employees' demands, but also assume the obligation to explain the company's strategic planning, financial status and potential operational risks to the employee group. Under this mechanism, disclosing relevant operational information to employee directors does not weaken the protection of trade secrets, but realizes the necessary restriction of management power through internal information transparency. Therefore, the necessary information disclosure and communication by employee directors to employees in accordance with their authority should not be deemed a breach of the duty of loyalty, but as an institutional act to improve the governance structure.

2) Moderate Expansion of the Duty of Care

The duty of care of employee directors has significant particularities in connotation and degree compared with that of ordinary directors. The duty of care of ordinary directors focuses on the compliance, prudence and rational basis of decision-making procedures, while employee directors, in addition to this, must fulfill the substantive requirement of "representative investigation of employees' interests". The actual scope of their duty of care has been expanded to "while pursuing the company's overall interests, they must fully safeguard the maximum interests of the employee group". This expansion is first reflected in the mandatory procedural rules: in major decisions involving the vital interests of employees-such as layoff arrangements, changes in remuneration systems, and adjustments to working conditions-employee directors must first consult the opinions of the employee representative congress or all employees, and exercise voting rights in accordance with the legitimate resolutions of the employee representative congress when the issue involves the major interests of employees.

Secondly, the expansion of the duty of care also requires employee directors to conduct differentiated assessments of decision-making consequences. They need to comprehensively consider the impact of multiple dimensions such as the age composition of employees, job types, and family burdens, and evaluate the actual effects of corporate decisions on different employee groups; otherwise, they may be deemed negligent due to insufficient investigation or flawed research and judgment. A deeper level of obligation expansion is reflected in the information acquisition mechanism: employee directors need to integrate information sources from formal governance channels and informal employee networks simultaneously. The former includes formal corporate documents such as financial statements, internal audit reports and strategic plans; the latter requires them to establish and maintain a normalized grass-roots communication mechanism, such as regular forums, front-line research, and employee representative liaison systems. For example, the "front-line observer" mechanism implemented by Baoshan Iron and Steel Group, which obtains real demands not filtered by middle management through institutionalized grass-roots contact, is a typical practice of such two-way information integration. This approach is highly consistent with the view advocated by scholar Chen Jiabai that "employee directors should perform their duty of care from the perspective of overall governance and the systematic perspective of labor-capital relations". It is worth noting that Article 12 of the EU's Corporate Sustainability Due Diligence Directive explicitly requires employee directors to establish an effective communication mechanism with grass-roots employees, further confirming the global governance trend of the expansion of employee directors' duty of care to two-way information integration and responsive communication from a comparative law perspective.

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# 4. Construction of the Coordination Path for Fiduciary Duty and Representative Duty

As stated earlier, the conflict between the fiduciary duty and representative duty of employee directors under their dual identity is inevitable and ineliminable. However, this conflict is not irreconcilable; it is essentially the assumption of dual responsibilities preset by the system and, in fact, constitutes the advantage of employee directors in performing their duties. To resolve this conflict and truly exert the role of the employee director system in balancing corporate interests and employees' interests, it is necessary to construct a multi-level and effective coordination path from the aspects of legislation, judicature and supporting mechanisms, so as to solve the dilemma of interest selection when conflicts arise and clarify the liability determination when employee directors breach the general fiduciary duty due to the performance of their unique representative duty.

## 4.1. Legislative Level

China's Company Law only requires enterprises to establish employee directors in principle, without clarifying the special obligation and liability rules that distinguish them from ordinary directors. The stipulated duties of loyalty and diligence for directors also adopt a "one-size-fits-all" standard, failing to consider the dual identity dilemma of employee directors. Therefore, when employees' interests conflict with corporate interests-such as in the voting on large-scale layoff plans-employee directors may be held liable for "breaching the duty of loyalty" for safeguarding employees' rights and interests, and also be held accountable by employees for failing to perform their duties sufficiently. However, the current liability system also does not distinguish between types of decisions, which essentially hinders the effective exertion of their representative functions.

Foreign legislation provides useful references in this regard. Germany's Co-Determination Act explicitly recognizes the "dual duties" of employee directors, requiring them to represent employees' positions while safeguarding corporate interests, and has established the principle of "not being liable for compensation for reasonably safeguarding employees' interests" through judicial precedents. Japan's Special Act on the Companies Act also stipulates: "In decisions involving the vital interests of employees, employee directors shall reflect employees' demands in an appropriate manner; when there is a reasonable conflict between employees' interests and corporate interests, it shall not be deemed a breach of fiduciary duty by default."

Based on this, this paper suggests adding special obligation clauses for employee directors in legislation: First, adaptively adjust the fiduciary duty. Legislation should stipulate: "Employee directors owe fiduciary duties to the company, including the duty of loyalty and the duty of care. When performing the duty of loyalty, they shall specially consider their identity as employee representatives, and may and shall prioritize safeguarding the legitimate rights and interests of employees in major decisions involving the core interests of employees such as labor safety and health, wages and welfare, and the performance of collective contracts, but shall not damage the fundamental interests of the company or engage in malicious acts." Among them, the duty of loyalty shall explicitly allow breaking through the principle of "corporate interests first" in the field of employees' core interests, while setting a bottom line of "not damaging the fundamental interests of the company"; the duty of care shall require them to invest the necessary time to obtain decision-making information, with special emphasis on thoroughly understanding employees' demands and accurately transmitting them to the board of directors, and their performance standards may be flexible in combination with their regular work situations. Second, add mandatory representative obligations. The legislative clause may be expressed as: "Employee directors have the obligation to faithfully represent the interests of all employees, shall timely and accurately reflect employees' demands to the board of directors;

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for major decisions involving the vital interests of employees, they must take the initiative to consult and integrate employees' opinions before voting; and regularly report on the performance of their duties to the employee representative congress or its authorized institution and accept supervision." This obligation needs to emphasize the wholeness of the represented objects and the long-term nature of interests, mandate the performance of two-way communication responsibilities, and establish an accountability mechanism for regular reporting to and accepting inquiries from the employee representative congress. It should be noted that the adjustment of employee directors' fiduciary duty is intended to provide space for the performance of representative duty, and the two are inherently unified; in non-core interest fields, the fiduciary duty should return to traditional standards.

## 4.2. Judicial Level

In practice, employee directors often face the dilemma of being "nominal only". In addition to the conflicts of interest mentioned earlier, more importantly, when their opinions are ignored or rejected, they often lack effective judicial remedies and find it difficult to obtain institutional protection. Therefore, it is crucial to introduce a judicial review mechanism, especially to learn from and adapt foreign review concepts to construct judicial adjudication rules in line with the Chinese context. This paper holds that it is necessary to provide a "safety valve" that emphasizes both procedural and substantive aspects for employee directors to perform their duties at the judicial level, ensuring that they are treated seriously and fairly, thereby truly activating the effectiveness of the system.

At the comparative law level, although the "employee director" arrangement is not common in the common law system, the judicial review standards for director decisions established by the corporate law of Delaware in the United States, especially the dual structure of the "Business Judgment Rule" and the "Entire Fairness Test", still have important reference value. As a basic standard, the Business Judgment Rule presumes that directors make decisions based on sufficient information, in good faith and in the genuine best interests of the company. Objectors must prove the existence of gross negligence, conflicts of interest, abuse of power, etc., and courts generally respect the board's business autonomy and do not conduct substantive review. Once this presumption is broken—such as in the case of serious conflicts of interest-the court will initiate the more stringent "Entire Fairness Test", requiring the defendant board to prove that the relevant transaction is entirely fair to the company and the affected parties both in process and result, including the two dimensions of "fair dealing" and "fair price". At this time, the burden of proof shifts to the defendant, and the intensity of review is significantly increased. This stepped and case-specific review thinking provides an important inspiration for China to handle disputes arising from employee directors' objections: when the legitimate rights and interests of employee directors or the major interests of the employees they represent are affected by board decisions, a transition from general respect to enhanced review can be triggered.

Based on China's existing legal framework such as the Company Law and the Labor Contract Law and actual national conditions, the construction of the China-specific "Dual Rationality Test" rule should focus on the design of applicable situations and review content. This rule is not universally applicable to all board resolutions, but should be limited to matters that directly and seriously affect the core interests of employees, which can clearly include large-scale economic layoffs, employee placement involved in major restructuring or relocation, equity incentive plans that exclude most employees, the formulation and modification of rules and regulations involving the vital interests of employees, and other major resolutions related to employees' interests that are forcibly passed despite explicit objections from employee directors.

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In terms of the review structure, the rule should cover two levels: "procedural rationality" and "substantive rationality". The procedural rationality test requires the board to prove the legitimacy of its decision-making process, including whether it has provided sufficient, accurate and easy-to-understand information to employee directors, whether it has given them a reasonable time to solicit opinions and conduct research, whether it has seriously discussed and responded to objections, and whether directors with conflicts of interest have recused themselves, etc. If procedural rationality is in doubt, the court may revoke the relevant resolution. On this basis, the substantive rationality test is further initiated to review whether the content of the resolution is obviously unfair: including whether it is necessary for the company's survival and development, whether there are alternative solutions that cause less harm to employees, whether the compensation or placement conditions are significantly lower than market or statutory standards, whether it violates the principle of proportionality to excessively damage employees' rights and interests, and whether a basic balance is achieved between corporate and employees' interests. At this stage, the court should still maintain necessary restraint, not replace the board's decision with its own business judgment, but must resolutely reject results that are obviously unreasonable or grossly unfair.

## 4.3. Supporting Mechanisms

1) Liability Insurance for Employee Directors' Performance of Duties

The core value of the employee director system lies in bringing the voices and interests of front-line employees into the company's top decision-making level, but its effective operation faces a key obstacle: due to sensitive interest conflicts and the fact that employee directors are often from front-line positions such as production and technology, their legal and risk awareness may be weaker than that of directors with financial or legal backgrounds, and they may face greater legal risks and compensation pressure personally due to decision-making in the performance of duties. This pressure will make them hesitant to exercise their powers and unable to truly play a check and supervision role. Directors' liability insurance is a key financial tool to resolve this risk and "back them up".

Therefore, this paper holds that efforts should be made from the perspective of insurance product design to develop more adaptable exclusive insurance products, such as encouraging insurance companies to design "special additional clauses for employee directors" or differentiated insurance plans specifically for employee directors. Its core is to expand the scope of protection, explicitly include lawsuits arising from "the performance of employee representative duties" in the scope of coverage, and effectively cover the special liability risks of employee directors. At the same time, considering that employee directors generally have limited personal solvency, the deductible should be appropriately reduced or even waived to truly achieve effective risk transfer. In addition, insurance liability should also cover and prioritize providing legal consulting and risk assessment services before litigation occurs, helping employee directors identify and prevent potential risks at the decision-making stage through pre-litigation legal services, and controlling the probability of litigation from the source.

In the practice of corporate governance, enterprises should clarify their protection responsibilities for employee directors through institutional arrangements and optimize relevant processes. Specifically, enterprises should explicitly write the obligation to purchase sufficient directors' liability insurance for employee directors into the articles of association and director service contracts, and make institutional provisions on the insurance amount, scope of coverage and renewal requirements. To prevent conflicts of interest, the company may establish a special committee with a considerable proportion of independent directors, such as the audit committee, nomination committee or remuneration committee, to be responsible for the procurement and renewal negotiations of directors' liability insurance, ensuring that the

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insurance plan will not weaken the protection for employee directors due to management intervention. In addition, the company is also obligated to fully train and inform employee directors, explaining in detail the coverage content, liability limits, exemption clauses and claims settlement procedures of directors' liability insurance, so that they can timely and effectively seek insurance protection when facing risks in the performance of duties, and maximize the risk management function of directors' liability insurance.

2) Exemption Clauses

In addition to directors' liability insurance, the supporting protection mechanism for employee directors can also be improved through exemption clauses. Compared with directors' liability insurance, which focuses on post-event risk compensation, the exemption clause mechanism focuses more on pre-event behavior guidance and in-event liability clarification. It is an institutional guarantee to reduce the risk of performing duties from the source, and can provide a clear "safe zone" or "haven" for the legitimate, honest and diligent performance of duties by employee directors, especially for decisions that may arouse disputes but are made in the interests of employees and the long-term interests of the company.

The systematic construction of an exemption system for employee directors needs to be promoted in a coordinated manner from multiple levels such as the articles of association, company bylaws, the establishment of special board committees, evaluation mechanisms and corporate culture, forming a complete and organic institutional guarantee system. First, a "special exemption clause for employee directors" can be created in the articles of association, which is the company's "constitution", as the highest level of legal guarantee. This clause should clearly stipulate that: employee directors who make decisions or express opinions in good faith to safeguard the legitimate rights and interests of employees within the scope of their duties shall be exempt from corresponding legal liabilities if they do not violate the mandatory provisions of laws, regulations and the company's articles of association, and there is no gross negligence or intentional misconduct. At the same time, the clause must also clearly define the boundaries of exemption, explicitly excluding fraud, intentional illegal acts, gross negligence and malicious damage to the company's interests from the scope of exemption, thus drawing a red line for conduct while providing protection.

To implement the above principles, the exemption procedures should be further refined in the board meeting rules. For example, it is stipulated that if an employee director has doubts about the legal risks of a certain decision, he has the right to request that his dissenting views, reasons and the information sources on which they are based be detailed in the meeting minutes. This complete record will become key evidence to prove that he has performed his duty of care in the event of a dispute in the future, and constitute an important basis for claiming exemption.

At the governance structure level, efforts should be made to establish a "firewall" for decision support. On the one hand, the role of the nomination committee or governance committee should be established and given full play to. This committee shall regularly evaluate the performance of all directors, including employee directors, and establish an independent special investigation team in the event of litigation or accountability. The investigation conclusion of this team shall serve as the primary basis for deciding whether to initiate the accountability process—if it is determined that the employee director's conduct complies with the standards of good faith and diligence, even if the decision result is unsatisfactory, it shall recommend that the board of directors or general meeting of shareholders grant exemption. On the other hand, it is necessary to guarantee the employee director's right to fully obtain information and the right to seek independent opinions, because the premise of exemption is "making judgments based on sufficient information". The company should clearly stipulate that employee directors have the right to access the information needed for the performance of their duties without obstacles, and when they disagree with the management or have doubts about complex matters, they have the right to hire external independent experts such as lawyers and

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financial consultants on behalf of the board to provide professional opinions, with the expenses borne by the company. Decisions made in accordance with qualified professional opinions will have significantly enhanced exemption eligibility.

In addition, the performance evaluation and accountability mechanism should be improved. Establishing a scientific director performance evaluation system needs to focus on whether the performance process is diligent, honest and in compliance with procedures, rather than being purely result-oriented, such as the company's profit and loss. A sound accountability mechanism should be able to strictly distinguish between bona fide commercial decision-making mistakes protected by the business judgment rule and performance failures caused by laziness, blindness or malicious intent. In addition, the conditions for shareholder derivative lawsuits can be clarified and strictly restricted in the corporate governance guidelines, for example, advocating the setting of a pre-review procedure by independent directors or the board of supervisors, and supporting the lawsuit only when there is preliminary evidence showing that the employee director is indeed "intentional or grossly negligent", so as to prevent shareholders from abusing their litigation rights to initiate "harassment lawsuits" and create an institutional environment for employee directors to dare to make rational decisions and perform their duties with peace of mind.

## 5. Conclusion

As an important link balancing corporate governance and employees' rights and interests, the full exertion of the effectiveness of the employee director system is inseparable from the systematic resolution of the conflict of dual duties. From the perspective of institutional practice, the tension that employee directors are caught in between fiduciary duty and representative duty essentially reflects the in-depth game between capital logic and labor rights and interests in modern corporate governance. To solve this dilemma, it is necessary to build a differentiated liability system based on the gradient duty model, and provide clear behavioral guidance for employee directors to perform their duties with a hierarchical framework of "core duty prioritizes safeguarding employees' rights and interests, intermediate duty focuses on procedural balance, and general duty returns to the corporate standard". The special adjustment of obligations at the legislative level and the "Dual Rationality Test" at the judicial level together constitute the rule basis for the operation of the system: the former reserves legal space for the employee representative function through the limited exemption of fiduciary duty and the mandatory setting of representative duty; the latter provides a fair evaluation criterion for controversial decisions with dual procedural and substantive review standards. The supporting construction of exclusive liability insurance for employee directors and systematic exemption clauses further strengthens the risk protection barrier, eliminates the worries of performing duties, and ultimately promotes the employee director system from "formal participation" to "substantive governance", truly making it an institutional link for establishing a dynamic balance between corporate interests and employees' rights and interests, and injecting the profound connotation of democratic governance and social responsibility into the modern enterprise system.

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