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One of our major roles as a company secretary is to ensure that the company has introduced, and complies with, corporate governance practices that enable our directors to effectively carry out their duties and fulfil their various legal obligations. It is often interesting to discover the nature of liabilities that attach to directors in other legal jurisdictions around the world, and compare them with our own. In doing so, we realise that while director responsibilities may differ, the role of the company secretary remains constant.

This article lists the liabilities of directors, and the additional liabilities imposed upon chairs of foreign investment companies in China. Someone must take on the role of making them aware of their obligations and their liabilities in foreign jurisdictions where their companies do business. If you are not experienced enough in this area to advise your directors, it would be wise to find someone who can advise them appropriately.

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Directors' liabilities in China

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It is imperative that directors in foreign investment companies understand what they and their companies can or can not do in China.

Chinese law has set many duties for directors and also certain penalties arising from breach of these duties. This article analyses directors' liabilities in a foreign investment company under Chinese law. Given that a director might be the chairman of the board and a chairman's liability is different from that of other directors, this article is split into two sections:

1. liabilities of ordinary directors, and
2. liabilities of the chairman.

Liabilities of ordinary directors

Currently in China there is no one specific law regulating the liability of a director in a foreign investment company. The primary legislation is the Company Law of the PRC (Company Law), which is comprehensive and expressly applicable to all foreign investment

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The director of a foreign investment company may be held liable for various illicit activities which may affect the interest of the company.

companies, unless contradictory provisions are contained in relevant foreign investment laws or regulations. The only directly applicable local legislation is the 1996 Tentative Provisions of Shenzhen on Directors' Work in Companies (Shenzhen Director Provisions).

Under the Company Law, a director of a company must take responsibility to not:

- use his position and power in the company to seek personal gain
- accept bribes or other illicit gains or seize the company's property
- embezzle funds or lend the company's funds to others
- deposit the company's funds in accounts in his personal name or in another person's name
- use company assets to provide a guarantee for any personal debts payable by the company's shareholders or other persons
- engage himself or on behalf of other parties in any business of the same type as the company, or engage in any activities which cause damage to the interests of the company

- conclude contracts or conduct business with the company unless it is approved by the board or permitted under the company's articles of association, and
- reveal company secrets unless otherwise approved by the board or in accordance with laws and regulations.

Breach of any of the above could lead to confiscation of any 1 illegal' proceeds, return of property or assets illegally gained and the provision of compensation for the damages to the company. Additionally, if the consequences of the breach are more serious, it may constitute a general crime under the Criminal Law of the PRC (Criminal Law). It should also be noted that if a director commits any of the above illegal acts, the acts so committed will be deemed as his personnel acts, and the criminal liability thus triggered will be imposed on this basis. In other words, the liability that a director may have under the Criminal Law is no different from that of any other employees who have violated the Criminal Law by their personal acts. However, this is not the position for a chairman. A chairman as the 'legal representative' will be criminally liable where the company itself is determined to have committed a crime. This point is further explained below. It is not the practice in China to indemnify directors in China against personal liability for actions taken in the course of serving the company. Such indemnities are considered contrary to the policy of

the law and are likely to be refused enforcement.

Under the Company Law, the board of directors is the highest authority of the company, and directors must act in the best interest of the company. However, directors of a foreign investment company function as nominees of the shareholders, and the board meetings are somewhat comparable to shareholders' meetings. There is obviously a potential conflict between the Company Law duty of a director to the company and the duty a director owes to a shareholder as its nominee. Chinese law does not clarify how this confusion should be dealt with. It should be noted that similar confusion exists under the laws of the UK. However, a director of a foreign investment company surely may act in the interests of his appointing shareholder provided the interests of such shareholder do not conflict with those of the company itself. In the event that a conflict does arise a director may consider whether it would be appropriate to resign his directorate in the company.

A director is required not to engage in a business of the same type as the company where he is a director. As it is quite common for either one party or both parties of a foreign investment company to be engaged in the same business as the foreign investment company, as nominees of shareholders, the directors' continuous working with the shareholder's company would not be seen as a breach.

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In addition to liability under the Company Law, under the Shenzhen Director Provisions, a director bears responsibility for losses to the company's assets and for damages to the company arising from serious investment or other mistakes. Also, directors are liable for the contents of board resolutions passed. In the event that a board resolution is in breach of any laws, regulations or the articles of association of the company, and this results in serious losses to the company, the directors other than those who recorded a vote against the resolution must pay damages to the company. This regulation is only valid in Shenzhen, but the principles underlying the regulation may creep into official interpretations of similar legislation elsewhere.

It should be noted that there is no similar provision in foreign investment laws and regulations. A foreign investment company would refer to the above in determining their directors' liability.

Liability of the chairman

The liabilities set out above are applicable to the chairman of the board in a foreign investment company. Further, liability accrues to the chairman in his capacity of legal representative, unless such responsibility is assigned to another person. Again, there is no law or regulation specifically detailing the liability of the chairman. Liability is to be gleaned in various other legislation. The liability of the chairman can be classified into two categories:

1. ordinary liability, and
2. criminal liability.

The Civil Principles list general requirements for a legal representative of a company which in foreign investment companies is usually the chairman. In addition to the liability set out in the Civil Principles, certain lower level

The chairman may be held criminally responsible in the event that the company has committed a crime.

regulations also set out liabilities which may be attributed to the chairman. Among them there are three basic categories, which will be analysed in the following sections. Other liability to which a chairman must be subject are imposed through regulatory regimes governing the industry within which the company operates. For instance, under a Guangdong regulation, the chairman of a food producing company (Including a foreign investment company) is responsible for reporting to the local food hygiene administrative authority immediately any accident caused by polluted or toxic food. A monetary fine or administrative sanction may be imposed by the authority on the chairman for failing to make such timely report. Related criminal liabilities are set out in the Criminal Law.

Ordinary liability

Under the Civil Principles, the chairman may be fined or administratively sanctioned if the company has conducted the following activities:

- carrying out business activities beyond the scope of business approved and registered by the registration authorities
- concealing the true facts from the registration or tax authorities, or engaging in fraud
- removing funds or concealing assets for the purpose of evading debts
- disposing of property without authorisation following dissolution, annulment or

declaration of bankruptcy

- failing to apply immediately for the registration and public announcement of a change or of termination, causing an interested party to sustain substantial loss, and
- engaging in other activities prohibited by laws and regulations, causing damage to the State or public interests.

The chairman of a company that manufactures (or processes) and sells products is obligated to see to it that products sold are of a quality that conforms to the statutory standards, including State standards, industrial standards and local standards. Under a Guangdong regulation, in the event that a product has harmed user(s) due to quality defects, the chairman may be administratively sanctioned or fined in the amount from RMB5,000 to RMB10,000.

The chairman is the person ultimately responsible for labour safety and hygiene in a company. In the event that the company has broken relevant laws and local rules on labour safety and hygiene, the chairman may be held liable depending on the nature and the seriousness of the illegal activities of the company. For example, a state regulation on preventing serious industrial accidents provides that if the company has not adopted preventive measures against a potential industrial accident which could cause the death of 10 persons or more or result in direct economic losses in an amount of over RMB5,000,000, the chairman of the company may be administratively sanctioned.

Another regulation on reporting and handling labour accidents provides that in the event that an accident occurs which has caused injury to employees, the chairman may also be administratively sanctioned; if death occurs, the chairman may be criminally liable as the 'person directly responsible'. (It

should be noted that there is no statutory definition for 'person directly responsible'. The common understanding of person directly responsible is the person directly responsible for committing the crime together with others or who have committed the crime themselves). The chairman would be liable for failure to report the accident to the relevant labour authority.

The chairman is also the person ultimately responsible for fire prevention and control. If a fire occurs due to negligence in fire prevention, the chairman may be held liable; if the fire has caused severe damage or loss to people's property, the chairman may be criminally liable as the 'directly responsible person'.

Criminal liability

The Criminal Law provides the concept of institutional crimes. This means that enterprises and other

institutions that commit crimes prescribed by the Criminal Law within the territory of China may be criminally punished. Where a foreign investment company is determined criminally liable, the chairman may be punished personally.

The criminal penalties for breaching the Criminal Law include fine, detention from one month to six months, fixed-term sentence from 6 months to 15 years, life sentence and even the death penalty. There are 22 categories of institutional crimes in the Criminal Law, of which the most important are:

- producing and selling fake or shoddy goods
- smuggling
- using false documents or other methods to falsely report registered capital, deceiving the company registration authorities to obtain company registration documents

- breaching financial administrative order
- infringement of intellectual property
- failure of environmental protection
- bribery, and . tax evasion.

Conclusion

In short, the director of a foreign investment company may be held liable for various illicit activities which may affect the interest of the company. A director should also carefully deal with any conflict which might arise between the company and its shareholders.

Certain additional liabilities are imposed on the Chairman under the Civil Principles and other laws and regulations. The chairman may be held criminally responsible in the event that the company has committed a crime.



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