

I am the director of a foreign company with several China operations. With the tort liability law coming into effect next month (July) and recent headlines about corruption, I am concerned about senior personnel liability if any problems arise involving my company. I'm not too certain on PRC laws governing director, supervisor and officer liability.

To what degree could I be held responsible and how do I protect myself?

The domestic perspective

Under the current PRC legal regime, directors and senior management personnel of a China-registered foreign invested company may face two layers of liabilities: one is the civil liabilities under the General Principles of *PRC Civil Law* and the *PRC Company Law*; the other is the criminal liabilities imposed by the *PRC Criminal Law*.

Both the Civil Law and Company Law have general provisions regarding the basic requirements for directors and senior managers, such as fiduciary duty and diligence. The Company Law enumerates certain circumstances where directors and senior managers may bear personal liabilities for damages sustained by the company, which include:

- i) Misappropriating the company's funds;
- ii) Increasing the company's liabilities without the shareholders' consent and beyond their authorities as provided

in the articles of associations of the company;

- iii) Seeking business opportunities for themselves without shareholders' consent; and
- iv) Seeking improper benefits for themselves or other people/entities by taking advantage of their powers.

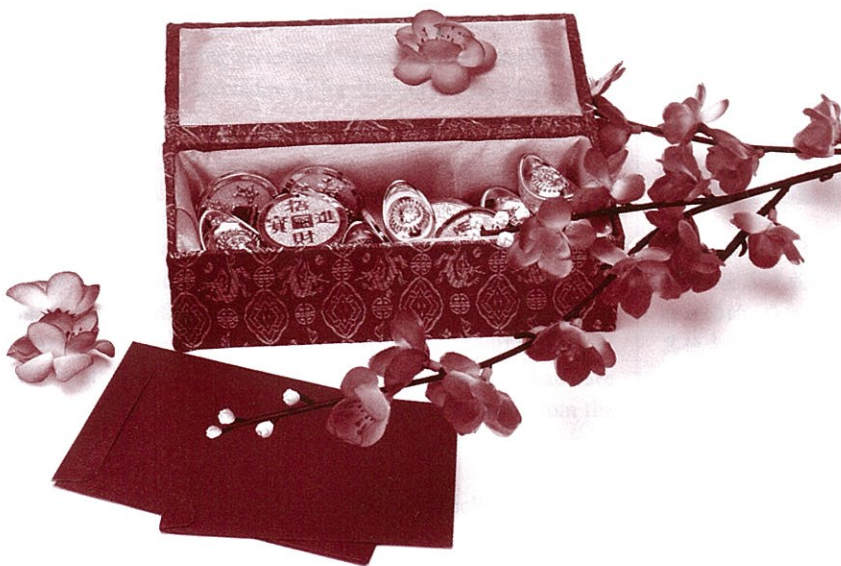
In the event the directors or senior managers violate the foregoing duties, the company, or its shareholders on behalf of the company, may have the right to claim for compensations from the defaulting directors or managers. Although the *PRC Tort Liability Law* which will become effective this July is silent on specific requirements as to directors' liabilities, its future enforcement and judicial interpretations may add another layer of protection to strengthen the company's right to seek indemnifications from the defaulting directors/managers.

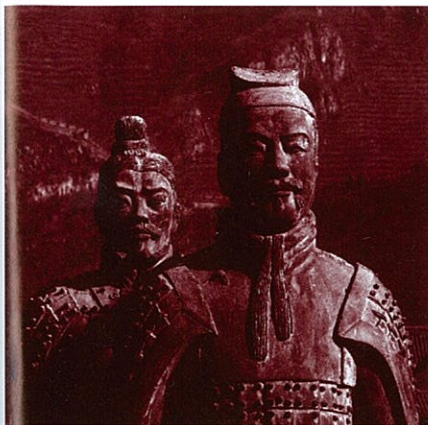
Directors and senior managers may also be held personally liable for violating relevant requirements under the Criminal Law, such as giving or receiving money or valuable gifts for the purpose of seeking or offering improper benefits. The recent enforcement trend indicates that the Chinese government has strengthened the prosecution of bribes not only in

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its traditional government sector, but also in the commercial bribes involving non-state owned entities and foreign-invested companies. This is evidenced by the newly published notice jointly issued by the Supreme People's Procuratorate and the Ministry of Public Security on May 7 2010. This notice provided the thresholds for imposing criminal liabilities on the directors/managers of non-state owned enterprises due to commercial bribes.

In light of China's complex and evolving civil and criminal law system regarding directors/managers liabilities, it would be advisable for any company operating in the PRC to have best practice in place to reduce such exposures. To reduce the potential civil liabilities for directors/managers, it is advisable to include detailed procedure guidance in the articles of association





Should you wish to contribute or comment on **The China question** please contact Candice Mak at:

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of the company in connection with how the directors/managers may exercise their powers. The directors also need to fully disclose to the board of directors and the shareholders meeting any transactions or arrangements that involve his or her personal interests. In the context of criminal liabilities, the offering of monetary gifts to officials is strictly prohibited. In commercial practice, directors/managers need to promptly report to the board or at the shareholders' meeting in the event they receive any payments or treatment involving the return of benefit.

We would also recommend companies keep a close eye on the development of Chinese regulations on this matter and seek further legal counsel, if necessary, on a case-by-case basis.



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The international perspective

We need to look at your question from two angles - first, the liability of the directors of any Chinese subsidiary you might have, and secondly, your own liability as the director of an overseas company that trades with Chinese entities.

The PRC imposes liability on directors by statute only, and in each case requires some degree of wrongdoing by the director to incur such liability. There is no general legal obligation of fiduciary duty, although some of the specific requirements do contain such an obligation.

Liability comes under the following heads:

PRC Enterprise Bankruptcy Law: If a director "violates his obligations of being honest and diligent"

PRC Company Law: Certain types of behaviour are set out in the Company Law as being breaches of fiduciary duties. Any

the income obtained from the enterprise or public institution in the previous year.

Criminal Law: Various types of corporate action can result in criminal liability for "personnel directly in charge and other directly responsible personnel". For example, the sale of food mixed with poisonous or harmful non-food materials is a crime, and the chairman of the Sanlu Corporation has been charged with criminal liability for the sale of contaminated milk powder as a "person directly in charge."

Liability of an offshore director for the activities of its onshore subsidiary can arise as follows if an offshore enterprise or director can be indirectly liable if a malefactor in China is deemed to have been acting as agent of that offshore company. So if a defendant in a bribery case in China were acting as the sales agent for the offshore company during the course of that

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income gained by a director who commits such breaches belongs to the company. These types of behaviour include misappropriating the company's funds, depositing the company's funds into an account under his own name, and disclosing the company's confidential information. If a director violates any law or the articles of association during the course of performing his duties and if any loss is caused to the company, he is liable for compensation to the company.

Environmental liability: The *PRC Law on Prevention and Control of Water Pollution* (revised in 2008) could lead to liability for directors. It provides that if an enterprise causes a serious water pollution accident, the environmental protection bureau may order it to close, and impose upon each of the directly liable persons (which could be directors) a fine of not more than 50% of

defendant's criminal activities, and that offshore company was aware of their activities but failed to object to them, then, the offshore company and its agent could be jointly liable for damages caused to a third party claimant.

There are various ways of reducing the risk to directors, but we would not suggest withdrawing expatriate managers from China, as this generally increases risk rather than reducing it. Protection can be via an indemnity benefitting the director, as well as strong controls and supervision mechanisms.



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