

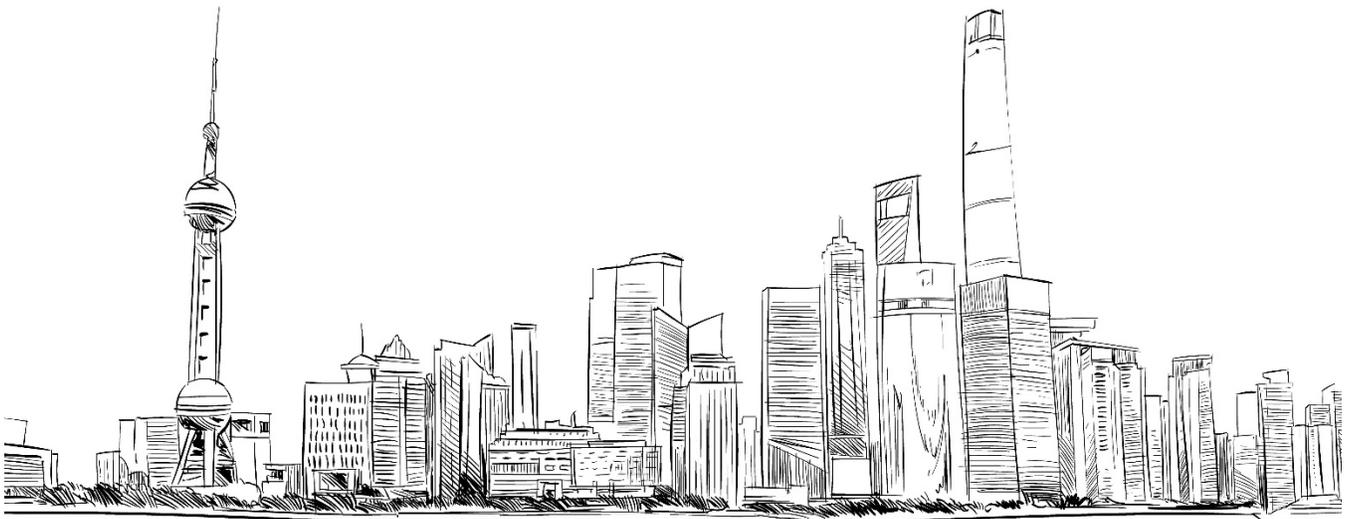


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Choosing the right individuals within your China organization *Part 2 - Allocating the powers*

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Allocating Power in the Company

In any business, one-person delegates power to another to look after his/her interest. But how to ensure the latter doesn't abuse this power for his/her own benefit is a classic dilemma. It is as pressing an issue in China as in any other country, but Chinese laws and practices deal with this problem differently than most. For the foreign investor, this brings along several issues to be aware of, particularly within two positions.

Legal representative / Chief representative

While it is always wise to carefully consider how much power to delegate to different staff members, there are several uniquely Chinese considerations. One of these is the position of legal representative. Along with the person holding the company chop (to be explained later in this article), the legal representative has full power to bind the company. The legal representative must be the chairman of the board, executive director or general manager of the company. The legal representative is appointed when the company is created, and his or her name is registered in the articles of association, with the Administration of Commerce A(IC) and on the company business license.

Changing the legal representative is a tedious and lengthy process, which requires changes of the articles of association and amending the business license. In the meantime, the legal representative could still legally bind the company. A recent court case determined that the company's internal resolution appointing a new legal representative takes precedence over the name registered with the AIC, so any unauthorized acts by the exiting legal representative can be reversed. However, reversing unauthorized acts of the legal representative would likely require intervention by the court system. If you are faced with a legal representative "gone rogue", most of the damage will have already been done by the time the court has pronounced its ruling.

The legal representative is regarded as being fully responsible for the acts of the company, even if he or she did not authorize or approve of them. In theory, they can be held personally liable for the debts of the company. There have been instances where a foreign legal representative has been detained or otherwise prevented from leaving China, because the company was involved in a commercial dispute or was in arrears with a tax payment.

For these reasons, it is advisable not to involve legal representative too much in the daily operations of the company. While technically possible, it is not advisable to have the general manager also be the legal representative. Foreign investors may consider appointing a legal representative that does not reside in China, whose signature is only required two or three times a year, for example the chairman of the board.



General Manager

The general manager oversees day-to-day operations. They can at the same time be a director of the company, but this is not necessary. It is a powerful position in the company, and foreign investors should take care to appoint a trustworthy individual. Sadly, it is not uncommon in China for a general manager to commit fraud, engage in self-dealing or misappropriate company funds. There are several ways foreign investors can protect themselves against misconduct by the general manager.

Don't give the general manager unrestricted access to the company's chops. Set rules for the use of chops, such as requiring major decisions to also bear the chop or signature of the director, supervisor or legal representative. Investors can also hire a third party to act as custodian of the company chops and seals.

Limit the powers of the general manager in the articles of association. This could include capping the amount of money a general manager can deal with. Companies often try to let go of employees by agreement, because dismissing an employee unilaterally can be very difficult and expensive. It is not unheard of that a foreign company wants to dismiss a local general manager for misconduct, only to find itself blackmailed into an astronomical severance payment because the general manager is in control of the company chops and other essential documents.

Company Seals or "Chops"

In China, a company is bound whenever a contract or other document is affixed with the company seal or chop. This is more straightforward in the sense that one can immediately tell whether a company has approved the content of a document or not. What makes it dangerous, however, is that whoever holds the chops can bind the company. On top of that, there is the risk of forged chops. Companies in China have different kinds of chops for different purposes:

- The **company chop** contains the company's full name in Chinese and functions as the official signature of the company. Company chops are used for all basic operations and can cover almost all other chop functions except for that of an invoice or customs chop.
- The **finance chop** is used for basic company operations, as well as opening a bank account, issuing checks, authenticating financial documents (e.g. tax filings, compliance documents, etc.). It is a compulsory chop.
- The **contract chop** is used exclusively for signing and authenticating contracts.



- The **invoice chop** is used for issuing and authenticating official invoices and fapiaos. It is not a compulsory chop and can be replaced by the finance chop.
- The **customs chop** is used for customs declarations on import/export goods (for companies engaged in cross-border trading).

Note: The company, finance and customs chop are mandatory, while the contract chop can be replaced by the company chop, and the invoice chop by the finance chop.

It is not uncommon for individuals to have their own chop as well. For example, the legal representative can have a personal chop to be affixed along with the company chop. Such a personal chop can accompany or replace the person's signature. The company, finance and legal representative chop (if present) need to be recorded with the Public Security Bureau, the Administration of Industry and Commerce (AIC), and with the local bank.

Conclusion

Foreign investors may decide to engage an external party to perform an **internal audit** on the Chinese subsidiary. While delegating power always requires a degree of trust, there are a few simple measures every foreign investor should consider mitigating the risks its Chinese subsidiary is exposed to.

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