
The Company Director Checklist – China

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INTRODUCTION

This Company Director Checklist has been designed as a practical guide to the main duties, obligations and procedures for a director in the board of directors of a limited liability company, a company limited by shares (including a listed public company) under the PRC Company Law, PRC Securities Law, rules issued by China Securities Regulatory Commission, and the listing rules issued by two stock exchanges in Shanghai and Shenzhen, China.

This Checklist is a general guide that is not intended to be a substitute for professional advice. It will, however, highlight to a company director those situations where professional advice may be required. This checklist was updated as at 30 April 2011.

Disclaimer: This Checklist is general and should not be relied on for legal advice. The authors (Jade & Fountain PRC Lawyers) disclaim any liability in respect of anything done in reliance on this publication.

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Before Appointment		
1. Understand: qualifications of directors	<p><u>Qualifications of directors for all types of companies</u> Anyone who is under any of the following circumstances is not permitted to assume the post of director of a company:</p> <ol style="list-style-type: none"> 1) Having no or limited capacity for civil conducts; 2) Having been sentenced to criminal penalty due to corruption, bribery, embezzlement of property, misappropriation of property, or disrupting the order of the socialist market economy, and it has not been five years since the execution of the penalty is completed; or having been deprived of political rights due to any criminal offense, and it has not been five years since the execution of the penalty is completed; 3) Acting as a director, factory manager, or manager of a company or enterprise that is bankrupt and liquidated and is personally liable for the bankruptcy of such a company or enterprise, and it has not been three years since the day when the bankruptcy liquidation of the company or enterprise is completed; 4) Acting as the legal representative of a company or enterprise that is in violation of the law, for which its business license is revoked, accompanied with close down of the company or enterprise under an order, and being personally liable for such penalties, and it has not been three years since the date of revocation of the business license of the company or enterprise; 5) Having a relatively large amount of debts that are due but not paid off. 	<p>Refer to Article 147 of Company Law and Shanghai Stock Exchange's guidelines on appointment and behaviour of directors.</p>

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	<p><u>Qualifications of Directors: special laws and rules for PRC listed companies</u></p> <p>The candidacy of directors shall comply with the general provisions outlined in the preceding row. In addition, a director candidate must meet the following requirements:</p> <ol style="list-style-type: none"> 1) Not having been sentenced to administrative penalty by China Securities Regulatory Commission in last three years; 2) Not having been publicly condemned or criticized more than twice by the relevant stock exchange; 3) Not in the period which has been publicly identified by relevant PRC stock exchange as unfit for being a director of listed company. 	
	Ongoing Duties	
2. What are the powers of directors?	<p>The board of directors of a PRC company is charged with certain major management functions, including:</p> <ol style="list-style-type: none"> 1) Convening the shareholders' meetings and reporting to the meetings of shareholders; 2) Executing the resolutions of the meetings of shareholders; 3) Making decisions on the operation plans and investment plans of the company; 4) Formulating the company's annual financial budgets and final accounts plans; 5) Formulating the company's profit distribution plans and loss recovery plans; 6) Formulating the company's plans on the increase or decrease of registered capital, and on the issuance of corporate bonds; 7) Formulating the company's plans on the merger, division, dissolution, or conversion of the company; 8) Making decisions on the setup of the company's internal 	Refer to Articles 47 and 109 of Company Law.

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	<p>management body;</p> <p>9) Making decisions on the employment or dismissal of the manager of the company and matters related to his/her remuneration, and making decisions, according to the manager's nomination, on the employment or dismissal of the vice manager(s) and the personnel in charge of financial issues and matters related to their remuneration;</p> <p>10) Formulating the company's fundamental management system;</p> <p>11) Other powers specified in the company's articles of association.</p>	
<p>3. What are prohibited activities for directors?</p>	<ul style="list-style-type: none"> ● The director of a company shall not engage into connected transactions which harm the interests of the company. ● No director may, by abusing their powers, take any bribe or other illegal gains, or encroach on the property of the company. ● A directors is prohibited from engaging in a list of certain activities, including: <ul style="list-style-type: none"> 1) Misappropriating funds of the company; 2) Opening an account in his/her own name or any other individual's name and depositing the company's funds therein; 3) Without the consent of the board of shareholders, the general board of shareholders, or the board of directors, lending the funds of the company to others or using the company's property to provide guarantee for others, thereby violating the provisions of the company's articles of association; 4) Concluding contracts or making deals with the company, which is in violation of the company's articles of association or without the consent of the board of shareholders or the general meeting of the 	<p>Refer to articles 21, 148 and 149 of Company Law.</p>

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	<p>shareholders;</p> <p>5) Without the consent of the board of shareholders or the general board of shareholders, seeking, for the benefit of his/her own or others, any business opportunity that is originally for the company by taking advantage of his/her powers, and operating for his/her own or for others any business that is of the same nature with that of the company that he/she serves;</p> <p>6) Accepting, and keeping in his/her possession, commissions for the transactions between others and the company;</p> <p>7) Disclosing the company's secrets without authorization; or</p> <p>8) Committing other acts that violate his/her obligation of being faithful to the company.</p> <p>The income that any director or senior management personnel has gained from any of the foregoing acts shall belong to the company.</p>	
<p>4. What are general duties of directors?</p>	<ul style="list-style-type: none"> ● The directors shall be obligated to be faithful and diligent to the company. ● Where any director is required to attend a meeting of shareholders as a non-voting participant, the director shall do so and accept inquiries from the shareholders. (Article 151 of Company Law) ● The directors shall truthfully provide the relevant information and materials to the board of supervisors or, in the absence thereof in a limited liability company, to the supervisor(s), and shall not hinder the board of supervisor(s) or the supervisors from exercising their powers. 	<p>The faithful and diligent duties of directors of listed company are interpreted in detail in Chapter 3 (faithful duties) and Chapter 4 (diligent duties) of Shanghai stock exchange guidelines on appointment and behaviour of directors.</p> <p>Faithful duties of directors of listed company include:</p> <ul style="list-style-type: none"> ● acting in the best interests of the listed company; ● disclosing names and other related information of close relatives; ● being prudent in the decision-making process for transactions which related to other directors; ● ensuring that the listed company's interests are placed ahead of personal interests; ● without the consent of general meeting of

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		<p>shareholders, a director should not take advantage of his/her position to seek business opportunity for themselves or their close relatives;</p> <ul style="list-style-type: none"> ● keep confidential of information of listed company. <p>Diligent duties of directors of listed company:</p> <ul style="list-style-type: none"> ● exercising duties with the degree of care and diligence that a reasonable person would exercise if he/she was a director in the listed company's circumstances and had the same responsibilities within the company as the director; ● ensuring sufficient amount of time and energy to spend on the activities of the board of directors; ● paying close attention to the decision-making process of the board, especially the proposed procedure, decision-making authorities, voting procedures and withdrawal procedures; ● in principle, the Directors shall attend board meetings and participate board voting decisions; ● keeping alert of the information available and reviewing the information; ● requiring related persons to provide the detailed information. <p>Refer to Articles 148 and 151 of Company Law.</p>
<p>5. What's position on conflicts of interests?</p>	<ul style="list-style-type: none"> ● If a director that is affiliated with any other enterprise is interested in a matter being reviewed by a meeting of the board of directors, this director is not permitted to exercise the voting right for that matter, nor may that director vote on behalf of any other person. ● The director of a listed company shall notify the company of existence of its related party relationship with the company in a timely manner and the company shall then file the situation with the stock exchange for the record. When the 	<p>Refer to Article 125 of Company Law and paragraph 10 of Shanghai Stock Exchange Listing Rules.</p>

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	board of directors of a listed company considers a related party transaction, the related director shall withdraw from voting and shall not exercise any voting rights as a proxy of other directors.	
6. What's the duty of skill?	<ul style="list-style-type: none"> ● The directors of a listed company should have the necessary knowledge and skill to perform their duties and attend the training program to acquire such abilities. ● During the director's tenure, a director shall accept the continuing training program conducted by China Securities Regulatory Commission and obtain relevant certificates. 	<p>The content of training program includes:</p> <ul style="list-style-type: none"> ● Conditions of domestic and international capital markets ● Requirements of information disclosure for a listed company ● Corporate governance principles ● Legal framework for the operation of listed company ● Rights, obligations and liabilities of directors ● Connected transactions, policies of mergers and acquisitions, refinancing of listed companies. <p>Refer to Corporate Governance Guidelines for Listed Companies and Training Guidelines for Senior Management of Listed Companies.</p>
7. What are potential liabilities for directors?	<ul style="list-style-type: none"> ● Directors of the company may not harm the interests of the company by taking advantage of its connection relationship. Anyone who causes any loss to the company due to violating the foregoing provision shall be liable for the compensation. <p>The directors shall bear liability for the resolutions of the board of directors. If a resolution of the board of directors violates any law, administrative regulation, or the company's articles of association, and causes heavy losses to the company, the directors that participate in approving the resolution shall bear the liability for compensation.</p> <ul style="list-style-type: none"> ● Where any director violates the provisions of the laws, administrative regulations, or the company's articles of association when performing his/her duties, he/she shall be 	<p>The PRC Company Law sets out various types of penalties which are triggered by a breach of different duties and prohibitions. These sanctions apply to both directors of limited liability companies and companies limited by shares.</p> <p>Refer to Articles 21, 113 and 150 of PRC Company Law.</p>

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	liable for compensation if any loss is caused to the company.	
8. Are there any statutory defences for directors?	<ul style="list-style-type: none"> ● The directors of a listed company may not waive their liabilities by claiming not understand the related business matters. ● The directors shall bear liability for the resolutions of the board of directors. If a resolution of the board of directors violates any law, administrative regulation, or the company's articles of association, and causes heavy losses to the company, the directors that participate in approving the resolution shall bear the liability for compensation, except where any director is proved to have expressed his/her objection at the voting and such objection is recorded in the minutes, in which case the director may be exempted from liability. 	<p>Article 113 of the PRC Company Law provides a defence to directors of companies limited by shares.</p> <p>Refer to Article 22 of Shanghai Stock Exchange Guidelines on Appointment and Behaviour of Directors and Article 113 of Company Law.</p>
9. Are there any potential criminal liabilities for directors?	<ul style="list-style-type: none"> ● The PRC Criminal Law, as amended, contains an expanded section on "economic crimes" and establishes a "dual punishment" system which subjects both an entity and its management to conviction and punishment for certain economic crimes. ● The PRC Criminal Law provides that, where an entity engages in criminal activity, in addition to the imposition of penalties on the entity, penalties can also be imposed on "the personnel-in-charge" who are directly responsible for such entities. 	<p>The PRC Criminal Law does not define who are considered "personnel-in-charge" and who are directly "responsible for" enterprises. Since these two terms may be interpreted broadly, the chairman of the board as the legal representative and other directors on the board are likely to be considered "personnel-in-charge" and held "responsible for" the relevant enterprise for this purpose.</p> <p>Considering a legal representative may act as the chairman of the board, under Article 49 of the PRC General Principles of Civil Law, a legal representative may be subject to fines or administrative sanctions and may be criminally liable as a result of the activities of the enterprise in the following circumstances:</p> <ol style="list-style-type: none"> a) the enterprise carries out illegal business activities beyond its approved scope of business; b) the enterprise conceals facts from the State Administration of Industry and Commerce or from

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		<p>the tax authorities, or the enterprise engages in fraud;</p> <p>c) the enterprise extracts funds or conceals assets for the purpose of evading debts;</p> <p>d) the enterprise disposes of property without authorisation following dissolution or declaration of insolvency;</p> <p>e) the enterprise fails to register immediately and make a public announcement of a change or of termination, causing an interested party to sustain substantial losses; or the enterprise engages in other activities prohibited by law, causing damage to State interests or the common public interest.</p> <p>Relevant categories of violations of Criminal Law include the following:</p> <ul style="list-style-type: none"> ● Crimes of Disrupting the Administrative Order of Companies and Enterprises (Art. 158-169); ● Crimes of Disrupting the Administrative Order of Financial Markets (Art. 170-191); ● Crimes of Undermining the Taxation System (Art. 201-212); ● Crimes Involving Infringement of Intellectual Property Rights (Art. 213-220); and ● Crimes of Disrupting the Market Order (Art. 221-231).
<p>10. Understanding your disclosure obligations as a director of a listed company</p>	<ul style="list-style-type: none"> ● If the share prospectus, measures for offer of corporate bonds, financial or accounting reports, listing report documents, annual report, interim report or ad hoc report announced by an issuer or securities underwriting company contain or contains any falsehood, misleading statement or major omission, thus causing losses to investors in the course of securities trading, the issuer or the company shall 	<p>Refer to Article 69 of Securities Law and listing rules of the stock exchanges in Shanghai and Shenzhen, China.</p>

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	<p>be liable for the losses and the responsible director(s), supervisor(s) and/or the manger of the issuer or the company shall be jointly and severally liable for such losses.</p> <ul style="list-style-type: none"> ● Directors in a listed company shall guarantee that the listed company disclosed information in a timely and fair manner and that the information disclosed is truthful, accurate and complete and contains no misrepresentations, misleading statements or material omissions. Any company or person unable to guarantee the truthfulness, accuracy and completeness of the information contained in the announcement shall make a statement in the announcement accordingly with an explanation of the reasons therefor. 	
<p>11. Understanding what the company must do to comply with its disclosure obligations</p>	<p>The listed company shall disclose:</p> <ul style="list-style-type: none"> ● financial and accounting reports; ● Interim report within two months following the end of the first half of each fiscal year); ● Annual report within four months following the end of each fiscal year). ● When a major event occurs that may considerably affect the price at which a listed company's shares are traded and that is not yet known to the investors, the listed company shall immediately submit an ad hoc report on the details of such a major event to the securities regulatory authority under the State Council and to the stock exchange and make the same known to the general public. In the report the essence of the event shall be stated clearly. ● Chapter 9 of listing rules provides that a listed company shall make timely disclosure when its transaction reaches several thresholds. ● Chapter 11 of listing rules interpret in detail the major event which a listed company shall report to the securities regulatory authority and to the public, including: major litigations and arbitrations, change of use of proceeds, profit 	<ul style="list-style-type: none"> ● Articles 63-67 of Securities Law provides the disclosure obligations of listed companies. ● Chapters 9 and 11 of Shanghai Stock Exchange Listing Rules provide principles and provisions on information disclosure for listed companies.

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	distribution and transfer of public reserve into share capital, unusual price movement and clarification of rumours, merger by absorption, material matters related to convertible bonds, equity changes and acquisition, bankruptcy, etc.	
12. Is there any limitation on stock selling for directors in a listed company?	<ul style="list-style-type: none"> The directors, supervisors, and senior management personnel of the company shall declare, to the company, the information on their shares held in that company and the changes to the shares. The shares transferred by them each year during their term of office shall not exceed 25% of the total of their shares held in the company. The shares that they held in the company shall not be transferred within one year of the date on which the stocks of the company are listed and traded. Any of the aforesaid persons who has left the company shall not transfer his/her shares held in that company within six months. The company's articles of association may set forth other restrictive provisions on the transfer of the shares held by the directors, supervisors, and senior management personnel of the company. Where any director of a listed company who holds more than 5% of the shares of a listed company, sells the stocks of the company as held within 6 months after purchase, or purchases any stock as sold within 6 months thereafter, the proceeds generated therefrom shall be incorporated into the profits of the relevant company. The board of directors of the company shall withdraw the proceeds. 	<ul style="list-style-type: none"> Article 142 of Company Law and article 47 of Securities Law set out the restrictions on directors' stock selling. The limitation is interpreted in detail in the relevant regulations of China Security Regulatory Commission and guidelines of stock exchange.
13. What are prohibited trading acts of directors in a listed company?	<ul style="list-style-type: none"> A director is deemed to be an insider. Any insider who has access to any insider information of securities trading or who has unlawfully obtained any insider information is prohibited from taking advantage of the insider information as held thereby to engage in any securities trading. 	Refer to Article 73 of Securities Law.
14. What is the position if the	<ul style="list-style-type: none"> The liquidation committee shall be composed of the directors and of the candidates determined by the general 	

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company may be insolvent?	<p>meetings of shareholders.</p> <ul style="list-style-type: none"> The members of a liquidation committee shall devote themselves to their duties and perform their liquidation obligations in accordance with the law. The members of a liquidation committee are not allowed to abuse their powers in order to accept any bribe or other illegal gains, nor shall they encroach on the property of the company. Where a member of a liquidation committee who has caused any losses to the company or the creditors due to his/her intentional acts or gross negligence, he/she shall bear the liability for compensation. 	
Self Defence		
15. Any recommendations for reducing director's exposure?	<ul style="list-style-type: none"> There is little case law or other precedent in the PRC for the application of PRC Company Law in this area. In the interest of reducing potential exposure, however, we would recommend that directors consider taking the basic precautionary measures. We would recommend that if there is any doubt in the mind of directors as to the legality of the subject of a board resolution or the adequacy of legal advice provided to the board with respect to the subject matter, then the directors should vote against the resolution. 	<ul style="list-style-type: none"> the structure and composition of the board should be appropriate according to relevant law and regulations; the functions and roles of the board and its members should be clearly written in the articles of association of the company; the information systems should be adequate for directors, such as monthly reports and minutes; the management supervision, reporting and decision-making structure processes and practices should be appropriate and clearly understood.
16. May the company provide indemnities?	<ul style="list-style-type: none"> As far as we are aware, there is no restriction against a company indemnifying a director against his liabilities arising from any lawful and proper action of the director. 	<ul style="list-style-type: none"> We are not aware of any rule restricting a shareholder indemnifying a director against his liabilities arising out of his lawful and proper actions. The Company Law does not explicitly restrict a company's ability to indemnify directors, although the absolute language used in many of the provisions describing director liabilities implies that indemnification may not be possible in principle.

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17. Is D&O insurance permitted	<ul style="list-style-type: none"> ● With approval of general meeting of shareholders, a listed company may purchase liability insurance for directors. (Article 39 of Guidelines of Corporate Governance for Listing Companies) ● As far as we are aware, there is no prohibition against a company taking out a D&O policy to cover the liability of directors. 	<ul style="list-style-type: none"> ● PRC Company Law focuses on how to strengthen the duties of directors. The limitation of directors' liabilities is not fully understood and defined. The indemnities and insurance of directors are almost blank in company law and relevant regulations. ● There are few precedents of which we are aware concerning the coverage of such policies for PRC civil liability or administrative fines. At least one policy that we have seen contains an exclusion regarding claims made by or on behalf of the government of the PRC. ● Nonetheless, we would recommend that directors consider requesting that companies obtain insurance on behalf of directors.
18. How do I resign?	<ul style="list-style-type: none"> ● Review the requirements in the articles of associations; otherwise deliver your resignation in writing to the company. 	