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China Law Update

Corporate Seal- Something Too Important to Ignore

In China, every company, domestic or foreign invested, has a set of corporate chops, or corporate seals, in particular the common seal or the general corporate seal (*Gong Zhang*, 公章), an instrumentality that is mandatory and indispensable for a legal entity to run and operate here.

However, to many foreign investors, this particular corporate seal may not be a familiar thing. Recent corporate disputes between GigaMedia and its Chinese partner Wang Ji that have ended up with GigaMedia selling its investment for good, have greatly raised the awareness of foreign investors about the legal significance of the general corporate seal/chop.

So, what is a general corporate seal? What is the legal implication associated with the seal?

1. The General Corporate Seal

According to the regulation issued by China State Council back in 1999, the general corporate seal shall take the round shape with a pentastar at the core surrounded by the name of the company, and the diameter of the seal shall not be more than 4.5 cm. A sample:



As per the local rules in Shanghai, upon the issuance of the business license of the company, the company shall apply to local police for an approval for carving the general corporate seal, and then the carving work is conducted by an agency or person designated by the police.

In the case of change of name or other reasons entailing change to the corporate seal, the company shall turn in the old seal and apply for approval to make a new one.

In the case of missing or theft of the seal, the company shall report the situation to the police. In practice, the police will ask the company to announce the loss of the seal in certain newspaper for at least one day, and then the company shall proceed to make a new seal with the police's approval.

2. The Legal Significance of General Corporate Seal

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Though there is no such a law, to the best of my knowledge, explicitly providing that a corporate seal shall have the legal effect of representing and thus binding the company, it is firmly established in practice that affixing of a corporate seal on legal documents has the same legal effect as the signature of a natural person. In some of the most basic laws of China, a corporate seal is so empowered:

- (1) As early as at the time of enactment of the General Principles of China Civil Laws in 1986, Article 65 reads “a written power of attorney in an agency relationship shall specify the name of the agent, matters, scope of authority and period, and *shall be signed OR sealed by the principal*”.
- (2) In PRC Contract Law, Article 32 provides: where the parties enter into a contract by a memorandum of contract, the contract is formed when *it is signed or sealed by the parties*.
- (3) In China Company Law, a corporate seal is required to be affixed on various legal documents such as capital contribution certificate, company stock.

In various other laws and regulations, corporate seals are frequently required when companies need to make filings, recordation, or reports with government departments. For example, every time a company needs to file a change of whatever kind with company registry authority, there will be a standard form to be filled out and sealed by the company.

In summary, the general corporate seal is legally regarded as the “signature” of the company as a legal person. The affixing of the corporate seal on legal documents means that the company agrees on the terms in those documents as if such legal documents were signed by the legal representative of the company. (For understanding of the term of “legal representative” under Chinese laws, please click [here](#).)

3. The Risks Associated with Corporate Seal

Given the aforesaid legal significance of the general corporate seal, poor administration of corporate seals may well breed two aspects of legal risks that shall be cautioned by corporate owners and management.

- (1) *External risks of unauthorized incurrence of legal obligations on company*. As indicated in 2(1) and 2(2) above, when a general corporate seal is affixed onto a contract or agreement, it will generally mean that the company is bound by the terms and conditions of the contract or agreement. Assuming that a company’s employee who harbors hatred against his company may covertly affix the corporate seal onto some business contracts and then probably run off with money or goods, leaving the company to clear up the mess.

This risk is most likely to arise among company’s employees that may frequently have access to the corporate seal when the company does not put in place a prudent and stringent bylaws relating to the access and use of corporate seals.

- (2) *Internal risk of deadlock of the corporate governance and management*. There are a slew of cases that have demonstrated the risk of internal turmoil within the corporate management often involving company’s shareholders and managerial persons such as chairman of board of directors, legal representative or general manager with one of the managerial person hijacking the corporate seal, which often leaves the company’s business operation in deadlock, as in the case of GigaMedia battle against Wang Ji. Such a deadlock can be disastrous for the company.

You may think of remaking a new seal to replace the one that is the hands of a hostile person. It may not work if the hostile person has also controlled the business licenses of the company, because in

order to apply for a new corporate seal, the company shall need to submit the following documents to the local police:

- (a) A piece of newspaper on which the company has announced the loss of its seal;
- (b) The originals of the business licenses of the company;
- (c) A power of attorney granted by the legal representative of the company, unless he attends to the matter in person;
- (d) The ID card copy of the legal representative and the agent authorized under the power of attorney.

As in the case of GigaMedia, Wang Ji took away all of the chops, licenses, effectively hijacking the company leaving GigaMedia helpless except resorting to lengthy litigation proceedings, and in the end, GigaMedia backed out of investment.

Companies that lose control of the corporate seal will also have trouble in respect of participation in the litigation or arbitration proceedings.

4. Legal Advice

It is of no doubt that a corporate seal is a very important thing for the company, something that foreign investors in particular cannot afford to ignore. In practice, it is important that companies maintain detailed rules for the administration of corporate seals/chops. Basically, companies shall consider strengthening the administration of corporate seals/chops in two aspects:

- (1) Add or revise clauses in the articles of association of the company in relation to the control and custody of the seals/chops as part of corporate governance scheme. This is aimed to make clear and allocate the responsibilities of control and custody of the seals/chops. In the absence of clear provisions under laws and regulations, there have been contradictive cases where courts arrive at opposite conclusion as to whether the legal representative shall have the right and power to keep custody and control of corporate seals. *I am of the opinion that the control and custody of corporate seals, as a matter of self-autonomy for the companies, shall be left to the discretion and decision of the companies precluding court intervention.*

With the current confusion, it will be advisable that investors insert clear stipulations in the articles of association of the company when deciding on the corporate governance structure.

- (2) Other than that, companies shall also set forth clear bylaws governing the access and use of corporate seals/chops by employees and other authorized persons. For example, companies shall prepare a standard application forms to be filled out by employees who are going to take the seals out of office for use.

In such bylaws, companies can set out liabilities (not being a liquidated damages clause) for misuse by employees of the corporate seals, as China Labor Contract Law does not bar companies from claiming damages (not preset liquidated damages) against misbehaving employees.

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