

China Law Update

The Concept of Legal Representative in China Laws

When advising foreign investor clients (esp, those from common law jurisdictions) on corporate governance structure of the company they invest, the concept of legal representative often causes great confusion and puzzle. There have been also frequent inquiries from people on what it means to them to be a legal representative of a company in China, as such a concept appears alien to them. This article intends to provide information (not legal opinions) that helps foreign investors to better understand the concept of legal representative in China context.

1. Definition and Understanding of the Term

As a legal terminology, it is important in the first place to define the meaning of the term. Legal representative is widely used in many social organizations in China. For purpose of this article, we focus on the legal representative of companies incorporated in accordance with *China Company Law* (the “**Company Law**”).

The term of legal representative (法定代表人) as used in substantive law made its debut in the *Implementation Rules for Sino-Foreign Equity Joint Venture Law* enacted in 1983 without clear definition. Article 37 thereof reads “The chairman of the board of director shall be the legal representative of the joint venture.” Later in the *General Provisions of the Civil Code of China* (the “**Civil Code**”) enacted in 1986, the term is more clearly used. According to Article 38 of the Civil Code, a legal representative of a legal person is defined to be the person-in-charge who discharges powers and duties on behalf of the legal person in accordance with laws or the constitutional charter of the legal person. The constitutional charter of a company means the articles of association/memorandum of the company.

The current Company Law does not have a definition for the term, but directly provides that “the legal representative of a company shall be served, pursuant to its articles of association, by the chairman, executive director (as in the case of a company without a board of director) OR general manager.

In practice, the legal representative is the only one (1) person of a company that can legally represent the company in all occasions without being challenged in terms of the legality of such representation. In other words, any conducts, decisions, representation made by the legal representative of a company for and on behalf of the said company shall be taken for granted as binding the company.

2. Powers of Legal Representative

As manifested by the term itself, the basic function of a corporate legal representative is to represent the company in various business activities to the outside. We may look at and understand the term from the following three angles.

(1) Representation not decision-making

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A legal representative has the general and all-in powers to represent the company. But representation does not mean decision-making. In other words, a legal representative does not have such general powers in the company to make business decisions, no matter the legal representative is served by the chairman or general manager.

From the perspective of organizational structure, the legal representative is simply a part of the corporate organization which consists of the shareholders meeting, board of directors, and board of supervisors as well that make most corporate business decisions. The legal representative shall act in accordance with decisions made by shareholders meeting or boards.

(2) Scope of representing powers

As mentioned above, the legal representative has the general and all-in powers to represent the company. But only a portion of those representations are statutorily provided solely to be made by the legal representative, including:

- (a) Sign the company's share certificates when the company issues stocks (Article 129 of Company Law);
- (b) Sign the corporate bonds when the company conducts debt financing (Article 156 of Company Law);
- (c) Sign application forms when the company is being incorporated or effects changes to its articles of association, names, registered capital and so on, as required in the *China Regulations on Registration of Companies*.
- (d) Other specific rules requiring signature of the legal representative scattering in different laws and regulations.

Except as provided expressly by laws and regulations, pursuant to the definition in the Civil Code, the articles of association of the company shall also specify and qualify the representations by the legal representative. The articles of association should be well employed by shareholders of the company in order to guard against and forestall abuse of representation by the legal representative.

(3) Legal representative not the sole person being able to represent the company

It is an established practice in China that a company shall only have one (1) legal representative. This differs a lot from some western corporations whose members of the board of directors all have the power to represent the corporation in furtherance of the corporate business.

However it shall be noted that the power of representation is NOT monopolized by this one single person. In case that the legal representative fails or is unable to discharge his powers and duties, the legal representative can authorize someone else to act on his behalf. Further, if the legal representative is in row with the board of directors of the company and refuses to cooperate, the board shall have the right to appoint another person to act, in given occasion, on behalf of the company in lieu of the incumbent legal representative.

When discussing representation of a company, we shall give full attention and regard to another important practice in China, the use of corporate stamp/seal/chop which is widely used in business activities to bind companies. But this will require a separate article to discourse on this important topic which is already on my to-do list, and will be coming soon.

3. Duties and Liabilities of Legal Representative

With the powers mentioned above go the duties and liabilities on the part of legal representative of a company.

As noted above, the legal representative is either chairman of board of directors, executive director or general manager. These people, designated as senior management personnel under Company Law, are all subject to the general duty of loyalty and duty of diligence in performing their functions. Therefore, a legal representative shall comply with such duties in their work.

What concern people appointed as legal representatives most are the legal liabilities that may befall them in such a capacity.

(1) Civil liabilities

Generally speaking, the acts, lawful or unlawful, of legal representative committed in performance of his work shall be taken as the acts of the company and accordingly any civil legal liabilities stemming therefrom shall be assumed by the company instead of the individual legal representative (Article 43 of Civil Code), except for the situation where the counterparty dealing with the company is aware or ought to be aware that the legal representative is acting ultra vires (Article 50 of China Contract Law). In other words, any bona fide third party dealing with the company represented by its legal representative shall only go after the company for remedies or compensations.

A special exception to the aforesaid general rule is provided in *China Bankruptcy Law* in which Article 128 reads “where the debtor (company) commits the acts prescribed in Article 31, 32 and 33 to the detriment of the interests of creditors, the legal representative and other directly responsible persons of the debtor (company) shall be subject to compensatory liabilities”. These detrimental acts refer to sale of assets at unreasonably low prices, concealment or transfer of corporate assets and faking debts etc.

On the other hand, within the corporate organization, the legal representative that commits misconducts to the detriment of the corporate interests may be subject to compensation liability based on the laws (Article 150 of Company Law, for instance) or contracts concluded by the legal representative and the company. Companies shall pay due attention to the contract concluded with the legal representative by inserting penalty clauses to deter the legal representative from wrong-doing.

(2) Administrative liabilities

Relatively speaking, this is a lesser concern for legal representatives.

Article 49 of Civil Code provides that if a company fall within any of the following circumstances, administrative sanctions/penalties or fines may be imposed on the legal representative of the company:

- (a) Be engaged in business activities out of its registered business scope;
- (b) Concealing true information from or providing false information to company registry (i.e. the Industry and Commerce Bureau) or tax authorities;
- (c) Withdraw capital or displace assets to escape debts payable to its creditors;

- (d) Fails to effect registration of changes to those prescribed registered items causing interested parties to suffer substantial loss;
- (e) Be engaged in other prohibited activities causing damages to national or public interests.

In addition, under *China Law on Punishment in Social Security Administration*, Article 18 provides that if a unit (including a company) violates social security, the directly responsible person-in-charge and other directly responsible person shall be punished in accordance with this law. Here, directly responsible person-in-charge often, if not always, refers to the legal representative of the company.

(3) Criminal liabilities

Legal representatives are most concerned with possible criminal liabilities. There are quite a number of provisions in *China Criminal Code* (the “**Criminal Code**”) involving corporate crimes. Article 31 in the “General Provisions” of the Criminal Code provides “A unit (*note*: a company, for instance) responsible for a criminal act shall be fined. The person in charge and other personnel who are directly responsible shall also bear criminal responsibility. Where there are other stipulations in the Special Provisions of this Law or other laws, those stipulations shall apply.” As in the case of administrative liabilities, “the person in charge” often refers to the legal representative of the charged company.

There are many corporate crimes in the Criminal Code. To name a few, crime of manufacturing and selling fake and shoddy products, crime of infringement of intellectual property rights, crime of financial fraud and so on.

(4) Liabilities of nominal legal representative

In reality, there are investors, domestic or foreign, do not want to serve as legal representative for the invested companies for various purpose (in a recent project, the investor retains the original legal representative after takeover because this person has better connection with local government). Instead, they ask their friends to take up the position.

Such arrangement, in the first place, creates risk for the investors themselves. As noted above, a legal representative almost has an absolute power to represent the company. In the event of dispute between the investors and such nominal legal representatives, the legal representatives will have ways to play tricks and cause trouble for the company.

For such nominal legal representatives, they are not risk-proof. Generally speaking, if the nominee is not actually involved in the management of the company, he may be virtually free of administrative and criminal liabilities. As for civil liabilities, he will very much likely run into trouble with the investors as their relationship sours. Moreover, if the company is caught in litigation, Chinese courts may order that the legal representative stay in China till the case is settled. Also as provided in *China Bankruptcy Law*, the legal representative may also be ordered by court to remain in their domiciled place, not being able to travel afar. Foreigner legal representative shall be particularly cautious against such risks.

4. Criteria for being a legal representative

Now, what kind of persons can serve as legal representative for a Chinese company?

First of all, since the legal representative is either the chairman, executive director or general manager,

the criteria set out in Company Law for such senior management personnel shall automatically be applicable to the legal rep. Article 147 provides that: A person who falls within any of the following circumstances may not take up the position of a director, supervisor or senior management personnel of a company:

- (1) an incapacitated person or a person who has restricted capacity only;
- (2) a person who has been convicted of corruption, bribery, embezzlement or misappropriation of property, or disrupting the socialist market economic order where less than five years have elapsed since the date he completed serving the sentence; or a person who having committed a criminal offence has been deprived of his political rights, where less than five years have elapsed since the date on which the deprivation has been enforced;
- (3) a person who was formerly a director, factory manager or manager of a bankrupt company or enterprise, who was personally responsible for the company's insolvency, where less than three years have elapsed since the date of completion of the liquidation of the bankrupt company or enterprise;
- (4) a person who was the legal representative of a company or an enterprise, and who was personally responsible for the revocation of the business license or the order of cessation of operations of such a company or enterprise as a result of violation of the law, where less than three years have elapsed since the date of the revocation of the business license; and
- (5) a person who has relatively large sums of outstanding personal debts.

Shareholders shall be careful in deciding on whom, the chairman or general manager, is to act as the legal representative of the company so as to achieve a balanced and efficient corporate governance structure. Such decision shall be written into the articles of association of the company.

Last but not the least, to legally fill the position of the legal representative, the company shall have the name of the legal representative registered with company registry, and upon change of the person, such change shall be immediately registered also. ***Without immediate and proper registration, the old legal representative though removed by board of director may still legally represent the company which may result in big trouble when the dismissed legal representative is not happy with the company at the time.***

5. Conclusion

The issue of legal representative is an important aspect of China corporate practice. Foreign investors that don't understand the legal system shall be careful when choosing the legal representative for their invested companies. Existing companies may look into and study your articles of association to gauge any problem in relation to the legal representative. We are more than happy to help you to improve and upgrade the corporate governance of your companies.

Please understand, this article is only for informative purpose, and the information contained herein may not be complete. If any of our dear readers needs formal legal opinion on this topic, or needs further clarification or explanation, please contact the author. You can find his contact information on the next page.

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