

Directors' and Officers' liability in the People's Republic of China

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Who are Directors and Officers?

Structure, functions and general obligations of Directors and Officers (D&Os)

Standard structure of board and officer

The board of directors established by a *limited liability company* shall be composed of anywhere from three to 13 members. The board of directors shall have one chairman and may have one or more deputy chairmen. The appointment of the chairman and deputy chairman shall be specified in the articles of association. For the limited liability company with a relatively small number of shareholders or for a relatively small limited liability company, it may have a sole director and no board of directors.

The board of directors of a *joint stock limited company* shall be composed of five to 19 persons. The board shall have one chairman and may have a deputy chairman. The chairman and deputy chairmen shall be elected by more than half of all the directors.

The term of office of the directors shall be provided for by the articles of association, but each term of office shall not exceed three years. The directors may, after the expiry of their term of office, hold a consecutive term upon re-election. If no re-election is timely carried out after the expiry of the term of office of the directors, or if the number of the members of the board of directors is less than the quorum due to the resignation of some directors from the board of directors prior to the expiry of their term of office, the original directors shall, before the newly elected directors assume their posts, perform the powers of the directors in accordance with the laws and administrative regulations, as well as the articles of association.

A company may have a manager, who is deemed as the managing officer of the company. The manager shall be hired or dismissed upon decision of the board of directors and he shall be responsible for the board of directors.

Anyone who is under any of the following circumstances shall not assume the post of a director or officer of a company:

- 1 Being without civil capacity or with only limited civil capacity;
- 2 Having been sentenced to any criminal penalty due to an offence of corruption, bribery, encroachment of property, misappropriation of property or disrupting the economic order of the socialist market and five years have not elapsed since the completion date of the execution of the penalty; or he has ever been deprived of his political rights due to any crime and three years have not elapsed since the completion date of the execution of the penalty;
- 3 He was a former director, factory director or manager of a company or enterprise which was bankrupt and liquidated, whereby he was personally liable for the bankruptcy of such company or enterprise, and three years have not elapsed since the date of completion of the bankruptcy and liquidation of the company or enterprise;
- 4 He was the legal representative of a company or enterprise, but the business license of this company or enterprise was revoked and this company or enterprise was ordered to close due to a violation of the law, whereby he is personally

liable for the revocation, and three years have not elapsed since the date of the revocation of the business license thereof;

- 5 He has a relatively large amount of debt which is due but unclear.

Functions of Directors and Officers

In a company, the board of directors shall be responsible for the shareholders' meeting and exercise the following functions:

- 1 Convening shareholders' meetings and presenting reports thereto;
- 2 Adopting resolutions made at the shareholders' meetings;
- 3 Determining the operational plans and investment plans;
- 4 Working out the company's annual financial budget plans and final account plans;
- 5 Working out the company's profit distribution plans and loss recovery plans;
- 6 Working out the company's plans on the increase or reduction of registered capital, as well as on the issuance of corporate bonds;
- 7 Working out the company's plans on merger, split-up, change of the company form, dissolution, etc.;
- 8 Making decisions on the establishment of the company's internal management departments;





- 9 Making decisions on hiring or dismissing the company's manager and his remuneration, and, according to the nomination of the manager, deciding on the hiring or dismissal of vice manager(s) and the person in charge of finance as well as their remuneration;
- 10 Working out the company's basic management system; and
- 11 Other functions as specified in the articles of association.

The officer, who is called a manager/vice manager in China, shall exercise the following powers:

- 1 Taking charge of the management of production and business operations of the company, organizing the implementation of the resolutions of the board of directors;
- 2 Organizing the execution of the company's annual operational plans and investment plans;
- 3 Drafting plans on the establishment of the company's internal management departments;
- 4 Drafting the company's basic management system;
- 5 Formulating specific rules and regulations for the company;
- 6 Proposing to hire or dismiss the company's vice manager(s) and person in charge of finance;
- 7 Deciding on the hiring or dismissal of the persons-in-charge other than those who shall be decided by the board of directors; and
- 8 Other powers conferred by the board of directors.

Duties and obligations of the Directors and Officers

The Directors and Officer shall comply with the laws, administrative regulations, and articles of association. They shall bear the obligations of fidelity and diligence to the company. No director or officer may take any bribe or other illegal gains by taking advantage of his powers, or encroach on the property of the company. The director is liable/responsible for all board resolutions.

Based on the company laws in China, no director or senior manager may commit any of the following acts:

- 1 Misappropriating the company's funds;
- 2 Depositing the company's funds into an account in his own name or in any other individual's name;
- 3 Without consent of the shareholders' meeting, shareholders' assembly and/or board of directors, loaning the company's funds to others or providing any guaranty to any other person by using the company's property as in violation of the articles of association;
- 4 Signing a contract or dealing with another company which violates the articles of association or is done without consent of the shareholders' meeting or shareholders' assembly;
- 5 Without consent of the shareholders' meeting or shareholders' assembly, seeking business opportunities for himself or any other person by taking advantage of his powers, or operating for himself or for any other person, or any other company in the same line of business as that he works for;

- 6 Taking commissions on the transactions between others and this company into his own pocket;
- 7 Illegally disclosing the company's secrets;
- 8 Other acts inconsistent with the obligation of fidelity to the company. The income of any director or senior manager from any act in violation of the preceding paragraph shall belong to the company.

The Directors and Officers shall be cautious, earnest and diligent to the powers granted by the company, to make sure that:

- 9 The actions and operation of the company follow the laws, regulations, and economic requirements of the country and do not exceed its business scope.
- 10 All shareholders are treated equally.
- 11 All commercial and accounting reports of the company are thoroughly reviewed, in order to control the management condition in time.
- 12 The powers of managements are fulfilled without others' manipulation. Such powers must not be transferred to others without the approval of laws, regulations, or the board resolutions.
- 13 The supervision and recommendations of the board of supervisors are accepted.

Penalties for the Directors and Officers who do not fulfill their duties

Where any director or officer violates any laws, administrative regulations, or the articles of association during the course of performing his duties, if any





loss is caused to the company, he shall be liable for compensation. The directors are liable for any loss of the company made by the board resolution articles of association that breach the laws or regulations, unless he shows his/her dissent to the resolution in the board meeting and this kind of dissent is recorded in the minutes of the board meeting.

A company who commits an act harmful to the society shall bear criminal responsibility if the law holds such an act as a crime committed by a unit. If a company commits a crime, it shall be sentenced to financial penalties. The person-in-charge directly responsible and other persons directly responsible to the company shall be sentenced criminally. This provision is usually applicable to the directors and officers of the company.

Liabilities of Directors and Officers

Securities

- **Specific liabilities**

The information of the directors and senior officers is deemed as one of the most important conditions of a listed company, which shall be disclosed at each stage of operation of the company. The directors and senior managers shall disclose relevant information on the stocks and bonds of the company when this company reaches a listing agreement.

For the directors and senior officers in a listed company whose shares or bonds have been listed for the trading shall, within four months as of the end of each accounting year, disclose their shareholdings

of the company to the securities regulatory authority under the State Council and the stock exchange.

The directors and senior managers of a listed company shall also publish their opinions for recognition in the periodic report of their company in written form.

The directors and senior managers of a listed company shall guarantee the authenticity, accuracy and integrity of the information as disclosed by their listed company. Where the prospectus, measures for financing through issuance of corporate bonds, financial statement, listing report, annual report, midterm report, temporary report or any other information as disclosed that has been announced by an issuer or a listed company has any false record, misleading statement or major omission, and thus results in losses to investors in the process of securities trading, the issuer or the listed company shall be subject to various liabilities.

Any director, senior manager or any other person of the issuer, or the listed company directly responsible, shall be subject to the joint and several liabilities of compensation, except for anyone who is able to prove his exemption of any fault.

Any director and/or senior manager of a listed company who holds more than five percent of the shares of a listed company, shall not sell the stocks of the company as held within six months after purchase, or purchase any stock as sold within six months thereafter, otherwise, the proceeds generated there from shall be incorporated into the profits of the relevant company. The board of directors of the company shall withdraw the proceeds. However, where a securities company holds more than five percent of the shares of a listed company, which are the residing stocks after

sale by proxy as purchased thereby, the sale of the foregoing stocks may not be limited by a term of 6 months. Where a director or senior manager of a listed company violates the above provisions by buying or purchasing any stock of the listed company, he shall be given a warning and be concurrently imposed a fine of RMB 30,000 Yuan up to RMB 100,000 Yuan.

The directors or senior managers of an issuer who have 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.

Penalty

- **The Security Law of PR China**

Where an insider who has access to insider information of securities trading or any person who has obtained any insider information purchases or sells the securities, divulges the relevant information or advises any other person to purchase or sell the securities before the information regarding the issuance or trading of securities or any other information that may have any big impact on the price of the securities is publicized, he shall be ordered to dispose the securities as illegally held thereby according to law. The illegal proceeds shall be confiscated and a fine of 1~5 times of the illegal proceeds shall be imposed. Where there is no illegal proceeds or the illegal proceeds is less than 30, 000 Yuan, a fine of 30, 000 Yuan up to 600, 000 Yuan shall be imposed. Where an entity is involved in any





insider trading, the person-in-charge and any other person directly responsible shall be given a warning and imposed a fine of 30,000 Yuan up to 300, 000 Yuan. Any functionary of the securities regulatory body that conducts any insider trading shall be given a heavier punishment.

- **The Criminal Law of PR China**

A person knowing inside information of securities transaction or a person obtaining illegally inside information of securities transaction who, prior to the information concerning issue of securities, transaction of securities or other information of great impact on the price of other securities is made public, buys or sells the said securities or reveals the information, shall be sentenced to fixed-term imprisonment of not more than five years or criminal detention and concurrently or independently, to a fine of not less than one time and not more than five times of the illegal gains therefrom if the circumstance is serious and; if the circumstance is especially serious, to fixed-term imprisonment of not less than five years and not more than ten years and concurrently to a fine of not less than one time and not more than five times of the illegal gains.

If a unit commits a crime under the preceding paragraph, the unit shall be sentenced to a fine and concurrently, the person-in-charge directly responsible and other persons directly responsible of the unit shall be sentenced to fixed-term imprisonment of not more than five years or criminal detention.

Employment

The Directors and Officers are liable to confidentiality provisions in respect of the company's trade secrets and other confidential matters with regard to intellectual property. The company has rights to contract with the directors and officers to include non-competition provisions in the labor contract or confidentiality agreement, and agree to pay financial compensation to them on a monthly basis during the non-competition period after the termination or revocation of the labor contract. If a director breaches the non-competition provisions, he shall pay liquidated damages to the company in accordance with the stipulated terms. Such provision does not apply to the normal employees who do not have the relationship with the company's trade secrets or other confidential matters.

Insolvency

When a company goes into a bankruptcy proceeding, the directors and senior managers have an obligation to protect the property of the company. Where any director, supervisor or senior manger takes advantage of his/her power to obtain any abnormal income from his/her enterprise or embezzles any enterprise asset, the relevant bankruptcy administrator shall recover it.

Are directors and officers personally liable for civil, criminal, administrative/regulatory and contractual claims made against them in their capacity as a D&O? Is there joint and

several liability? Is there unlimited liability for the director and officer? What do companies in the local country do to handle their issues?

Personal liability

- **The Security Law of PR China**

Where the prospectus, measures for financing through issuance of corporate bonds, financial statement, listing report, annual report, midterm report, temporary report or any information as disclosed that has been announced by an issuer or a listed company has any false record, misleading statement or major omission, and thus incurs losses to investors in the process of securities trading, the issuer or the listed company shall be subject to the liabilities of compensation. Any director, senior manager or any other person of the issuer or the listed company directly responsible shall be subject to the joint and several liabilities of compensation, except for anyone who is able to prove his exemption of any fault. This kind of liability is unlimited. Under certain conditions, the investor subject to the loss has the right to sue either the company or the responsible director or officer for the compensation. In practice, the investor would like to sue the company for the compensation due to its financial advantage. Then the company will require the liable directors and officers to recover the lost of the company.





- **The Company Law of PR China**

Where any director, supervisor or senior manager violates any law, administrative regulation, or the articles of association during the course of performing his duties, if any loss is caused to the company, he shall be liable for compensation.

The directors shall be responsible for the resolutions of the board of directors. Where a resolution of the board of directors is in violation of any law, administrative regulation, articles of association, or resolution of the shareholders' assembly and causes any serious loss to the company, the directors who participate in adopting the resolution shall make compensation. However, if a director is proven to have expressed his objection to the vote on such resolution and his objection was recorded in the minutes, then the director may be exempted from liability.

- **The Criminal Law of PR China**

A company, an enterprise, an institution, or an organization, which commits an act harmful to the society, shall bear criminal responsibility if the law holds such an act as a crime committed by a unit. If a unit commits a crime, the unit shall be sentenced to financial penalties and concurrently, the person-in-charge directly responsible and other persons directly responsible of the unit shall be sentenced criminally.

Joint and several liability

Directors and Officers can be held jointly or severally liable for actions such as false or misleading records, disclosure omissions or others causing loss to the company.

The structure of corporations in the P. R. China

Corporations in China are established based on the Company Law of People's Republic of China. The identification of 'company' in the Law is a limited liability company or a joint stock company limited set up within the territory of the People's Republic of China according to the provisions of the Law. There are mainly two types of companies in China, named the limited liability company and the joint stock company.

The limited company

The limited liability company is the company of which a shareholder shall be liable for the company to the extent of the capital contributions it has paid. The limited liability company is composed by Shareholders' Meeting, which is the highest authority of the company. Also important to the structure of the limited liability company is the Board of Directors and the Board of Supervisors. There are two special types of limited liability companies noted in the Company Law

1 One-person limited liability company.

The one-person limited liability company is a limited liability company with only one natural person shareholder or legal person shareholder. A one-person limited liability company has no board of directors. When the shareholder make a decision on any of the matters that shall be decided by the board of directors in the normal

limited liability company, he shall make it in written form, put his signature to it and preserve it in the company.

2 Solely state-owned company.

The solely state-owned company is a limited liability company established through sole investment by the state, for which the State Council or the local people's government authorizes the state-owned assets supervision and administration institution of the people's government at the same level to perform the functions of the capital contributor. A solely state-owned company has no shareholders' meeting. The state-owned assets supervision and administration institution shall exercise the functions of the shareholders' meeting. The state-owned assets supervision and administration institution may authorize the company's board of directors to exercise some of the functions of the shareholders' meeting and decide on the important matters of the company, excluding those that must be decided by the state-owned assets supervision and administration, such as merger, split-up, dissolution of the company, increase or reduction of registered capital as well as the issuance of corporate bonds. For the merger, split-up, dissolution or application for bankruptcy of an important solely state-owned company, it shall, be subject to the examination of the state-owned assets supervision and administration institution, and then be submitted to the people's government at the same level for approval. The term 'important solely state-owned company' as mentioned above shall be determined according to the provisions of the State Council.





The joint stock limited company

The joint stock limited company is the company of which a shareholder shall be liable for the company to the extent of the shares it has subscribed to. The joint stock limited company is composed by the Shareholder's Assembly, which is the company's organ of power, the Board of Directors and the Board of Supervisors.

The listed company is the joint stock limited companies whose stocks are listed and traded in a stock exchange. A listed company shall have independent directors. A listed company may have a secretary of the board of directors, who shall be responsible for the preparation of the sessions of shareholders' assembly and meetings of the board of directors, preservation of documents, management of the company's stock rights, information disclosure, etc.

Who can sue?

Company

Where any director or officer violates any law, administrative regulation, or the articles of association during the course of performing his duties, if any loss is caused to the company, he shall be liable for compensation. The company has the right to sue the liable director or officer for such kind of compensation.

Supervisor

Where a director or officer is responsible for the loss caused to the company by its violation of law or regulation, the shareholder(s) of the limited liability company or joint stock limited company separately

or aggregately holding one percent or more of the total shares of the company for 180 consecutive days or more may request in writing to the board of supervisors or the supervisor of the limited liability company with no board of supervisors to initiate a lawsuit in the people's court on behalf of the company. The board of supervisors or the supervisor of the limited liability company with no board of supervisors shall fulfill its obligation to the company to be responsible to the lawsuit.

Shareholder

If the board of supervisors, or supervisor of a limited liability company with no board of supervisors refuses to lodge a lawsuit after it (he) receives a written request as mentioned in the preceding Paragraph B, or if it or he fails to initiate a lawsuit within 30 days after it receives the request, or if, in an emergency, the failure to lodge an action immediately will cause unrecoverable damages to the interests of the company, the shareholder(s) as listed in the preceding Paragraph B may, on their own behalf, directly lodge a lawsuit in the people's court, on behalf of the company.

If any director or officer damages the shareholders' interests by violating any law, administrative regulation, or the articles of association, the shareholders may lodge a direct lawsuit in the people's court.

In a listed company, where any director, supervisor and senior manager of a listed company or any shareholder who holds more than five percent of the shares of a listed company, sells the stocks of the company as held within six months after purchase,

or purchases any stock as sold within six months thereafter, the proceeds as generated therefrom shall be incorporated into the profits of the relevant company. The board of directors of the company shall take back the proceeds. If the board of directors fails to implement the above obligation herein, the shareholders concerned have the right to require the board of directors to implement them within 30 days. Where the board of directors of a company fails to implement them within the aforesaid term, the shareholders shall have the right to directly file a lawsuit with the people's court in their own names for the interests of the company.

Scope of liability/indemnification

The company shall have written labor contracts with all its employees, including the directors and officers. The employees are obliged to the contract they agreed with the company.

According to the relevant laws and regulations, in the contract, the company shall truthfully advise the employee of the scope of work, the working conditions, the place of work, occupational hazards, production safety conditions, labor compensation and other matters requested by the employee. The contract shall offer the rights to obtain remunerations for labor, take rests, have holidays and leave, receive labor safety and sanitation protection, get training in professional skills, enjoy social insurance and welfare treatment, and submit applications for settlement of labor disputes, and other labor rights stipulated by law, to the employees on an equal basis. Based on





the contract, the employees shall fulfill their tasks of labor, improve their professional skills, follow rules on labor safety and sanitation, and observe labor discipline and professional ethics.

The directors and officers are liable to confidentiality provisions in respect of the company's trade secrets and other confidential matters with regard to intellectual property. The company has the right to contract with the directors and officers in order to include non-competition provisions in the labor contract or confidentiality agreement, and to agree to pay financial compensation to them on a monthly basis during the non-competition period after the termination or revocation of the labor contract. If the director breaches the non-competition provisions, he shall pay liquidated damages to the contract in accordance with the stipulated terms. Such provision does not apply to the normal employees who do not have the relationship with the company's trade secrets or other confidential matters.

Procedural issues

What are the statute of limitations for claims – civil, criminal, common law, securities, employment, contract and administrative/regulatory?

Civil law

- 1 Except as otherwise stipulated by law, the limitation of action regarding applications to a people's court for protection of civil rights shall be two years.

- 2 The limitation of action shall be one year in cases concerning the following:

- Claims for compensation for bodily injuries;
- Sales of substandard goods without proper notice to that effect;
- Delays in paying rent or refusal to pay rent; or
- Loss of or damage to property left in the care of another person.

- 3 A limitation of action shall begin when the entitled person knows or should have known that his rights have been infringed upon. However, in no event, shall the people's court protect his rights if 20 years have passed since the infringement. Under special circumstances, the people's court may extend the limitation of action.

Criminal law

Crimes shall not be prosecuted if the following periods have elapsed:

- 1 Five years if the maximum prescribed punishment is fixed-term imprisonment of less than five years;
- 2 Ten years if the maximum prescribed punishment is fixed-term imprisonment of more than five years and less than ten years;
- 3 Fifteen years if the maximum prescribed punishment is fixed-term imprisonment of more than ten years; and
- 4 Twenty years if the maximum prescribed punishment is life imprisonment or death. Where,

after twenty years, it is considered that a crime must be prosecuted, the matter must be reported to the Supreme People's Procuratorate for approval.

However, in a case where, after a people's procuratorate, public security organ or state security organ has placed the case on file for investigation or a people's court has accepted the case, a criminal escapes from investigation or trial, no limitation on the period for prosecution shall be applied.

In a case where, within the limitation period for prosecution, a victim puts forward accusation and a people's court, people's procuratorate or public security organ shall place the case on file but fails to do so, no limitation on the period for prosecution shall be applied.

Common law

Chinese Laws belongs to the Continental Law system, which is a different legal system in comparison to Common Law systems.

Securities law

There is no specific stipulation under Securities Law concerning the statute of limitations for claims. Any statute of limitation regarding securities law shall comply with Civil Law, Criminal Law and Contract Law of PR China.

Employment

Where a labor dispute takes place, the parties involved shall go to the labor dispute arbitration committee for arbitration first. The party that requests arbitration shall file a written application to a labor dispute





arbitration committee within 60 days starting from the date of the occurrence of a labor dispute. The arbitration committee may generally make an adjudication within 60 days from the date of receiving the application. Where a party involved in a labor dispute is not satisfied with the adjudication, the party may bring a lawsuit to a people's court within 15 days from the date of receiving the ruling of arbitration.

Contract law

The limitation of actions or arbitration for contracts of international sale of goods and contracts on technology import and export shall be four years, computing from the day on which the party knows or should know its rights are infringed upon. The limitation of actions or arbitration for other contracts shall be governed by the provisions of relevant laws. Generally speaking, the limitation of actions or arbitration for other contracts shall be two years from the day on which the party knows or should know its rights are infringed upon.

Administrative law

Any citizen, legal person or any other organization, who considers that a specific administrative act has infringed upon his or its lawful rights and interests, may file an application for administrative reconsideration within 60 days from the day when he or it knows the specific administrative act, except that the time limit prescribed in laws exceeds 60 days. Anyone who refuses to accept the reconsideration decision may bring a suit before a people's court within 15 days

from the day of the receipt of the reconsideration decision. If the administrative organ conducting the reconsideration fails to make a decision by the expiration of the time limit, the applicant may bring a suit before a people's court within 15 days after the time limit for reconsideration expires, except as otherwise provided for by law.

If a citizen, a legal person or any other organization brings a suit directly before a people's court, he or it shall do so within three months from the day when he or it knows that a specific administrative act has been undertaken, except as otherwise provided for by law.

Are class actions permissible under local law? If so, what are the requirements/limitations?

According to the Civil Procedure Law of PRC, there is a legal term named 'joint lawsuit' which is similar to class actions in common law but not identical.

When one party or both parties consist of two or more persons, the object of action is the same or of the same category and the people's court considers that, subject to the consent of the parties, the lawsuit can be tried together, a joint lawsuit shall be constituted.

If the individuals constituting a party to a joint lawsuit have common rights and obligations with respect to the object of action and the act of litigation of one person is recognized by others of his party, such act shall be effective for all the other members of his party; if the individuals in one party do not have

common rights and obligations with respect to the object of action, then the act of litigation of one person shall have no effect on the others of his party.

A joint lawsuit in which the parties are numerous, may be brought by representatives selected by and from the parties. The act of litigation of such representatives shall be effective for all members of the parties they represent. However, confirmation, modification or waiver of claims of action or confirmation of the claims of the other party or institution of a compromise by the representatives shall be subject to the approval of the party they represent.

With respect to a case in which the object of action is of the same category and one party is numerous and of an uncertain number upon institution of the lawsuit, the people's court may issue a public notice, stating the particulars and claims of the case and informing claimants to file at the people's court within a fixed period of time.

Claimants who have filed with the people's court may select representatives from among themselves to engage in litigation; if such representatives cannot be created through selection, they may be decided by the people's court through negotiation with the claimants who have filed at the court. The act of litigation of such representatives shall be effective for the party they represent.

The judgments of orders rendered by the people's court shall be effective for all the claimants who have





filed at the court. The same judgments or orders shall be proceedings during the limitation of action.

What is the enforceability of a foreign judgment on Directors and Officers?

There are no specific laws and regulations regarding the enforceability of a foreign judgment on directors and officers. However, according to the Civil Procedure Law of PRC, the general principle of enforceability of a foreign judgment shall apply to the one on directors and officers.

Court

If a legally effective judgment or order made by a foreign court requires recognition and enforcement by the people's court of the People's Republic of China:

- 1 The party concerned may directly apply to an intermediate people's court of the People's Republic of China which has jurisdiction over the case for recognition and enforcement or;
- 2 The foreign court may, in accordance with the provisions of the international treaties concluded or acceded to by the People's Republic of China or on the principle of reciprocity, request recognition and enforcement by the people's court.

If a people's court, after its review in accordance with the international treaties concluded or acceded to by the People's Republic of China or under the principle of reciprocity, considers that the legally effective judgment or order of a foreign court which requires recognition and enforcement does not

contradict the basic principles of the law of the People's Republic of China nor violates the State and social, public interest of China, it shall render an order on the recognition of its force. Where an execution is necessary, a writ of execution shall be issued and enforced in accordance with the relevant provisions of this Law. If it contradicts the basic principles of the law of the People's Republic of China or the State and social, public interest of China, the people's court shall refuse its recognition and enforcement.

Arbitration

If an award made by a foreign arbitration agency requires the recognition and enforcement by a people's court of the People's Republic of China, the party concerned shall directly apply to the intermediate people's court in the place where the party subject to execution has its domicile or where its property is located. The people's court shall deal with the matter in accordance with the relevant provisions of the international treaties concluded, or acceded to by the People's Republic of China, or under the principle of reciprocity.

Can the Directors and Officers be liable for punitive damage, exemplary damages, multiple damages or aggravated damages? If so, under what type of law, securities, employment, etc.?

Under the current Chinese legal system, there are no laws and regulations in regards to punitive damages, exemplary damages, multiple damages or

aggravated damages except compensatory damages. Namely, the Directors and Officers are only liable for actual loss caused by their wrongful acts.

Procedural issues

Can the company indemnify its directors and officers and employees? If so, for defence costs; damages, judgments and settlements? If so, for what types of claims, what are the limitations?

There are no specific laws and regulations for such indemnity. Normally, such an indemnity issue may be decided by articles of association, decision of a shareholder meeting, or resolution of the Board.

Is Directors' and Officers' liability insurance permissible or legal under local law? Are there limitations in law to what can and cannot be covered under a D&O insurance policy?

Although PR China has not had any specific laws stipulating director and officer liability insurance, according to China Insurance Regulatory Commission ('CIRC'), such liability insurance is permissible in PR China. Some Chinese insurance companies and foreign-found insurance companies have started such business. And according to the Code of Corporate Governance for Listed Companies in China issued by China Securities Regulatory Commission ('CSRC') and State Economic and Trade Commission, after approval by the shareholders' meeting, a listed company may purchase liability insurance for directors. Such insurance shall not cover the liabilities arising in





connection with directors' violation of laws, regulations or the company's articles of association.

• **Insurance Law of PR China**

Liability insurance refers to insurance that makes the liability to indemnities of the insured to the third party as the object.

• **Administrative Codes of Listed Companies**

Upon approval by the shareholders' general meeting, listed companies are allowed to purchase insurance for their directors save for liabilities resulting from the directors' breach of the laws or regulations or articles of association.

• **The guide for establishing the Independent Director Institution of Listed Company**

Listed companies are allowed to establish a compulsory Independent Directors' Liability Insurance mechanism to reduce the risks associated with the ordinary performance of the duties of independent directors.

An insurance contract shall contain the following:

- Name and domicile of the insurer;
- Names and residences of the insurant and the insured and the name and residence of the beneficiaries of life insurance.
- Objects of insurance;
- Insurance liability and liability exemption;

- Insurance term and the starting time of insurance liabilities;
- Insured value;
- Insured amount;
- Premium and the method of payment;
- The method of payment of insurance indemnity or insurance money;
- Liabilities for breach of contract and the handling of disputes;
- The year, month and date in which the contract is signed.

Can an insurer write D&O insurance on a non-admitted basis? Is a specific license required for the insurer to write D&O insurance?

If insurers want to engage in D&O insurance business:

- 1 The business scope of the Insurer shall include 'property insurance';
- 2 Such business scope shall be approved by the CIRC;
- 3 The terms written in the proposed D&O insurance policy shall also be approved by the CIRC.

According to Insurance Law of PR China, the D&O insurance shall belong to Property Insurance. Therefore, if the insurer would like to conduct the D&O insurance, the Property Insurance, which shall be approved by CRIC, shall be covered in the business scope of the insurance.

And then, the D&O insurance shall be approved by CRIC, and it will take around one month.

Generally, the following documents will be required for the application of the D&O insurance:

- application Letter;
- the forms regarding the effective terms of the property insurance and fees rate;
- legal responsibility letter;
- feasibility study report; and
- other documents to be required by the CRIC.

Are claims made and reported policies permissible under local law, or does the law require occurrence?

In China, D&O insurance is a relatively new business compared to other countries. As a result, there are not specified laws or regulations regarding a claims-made policy or an occurrence policy. However, in practice, claims made and reported policy is permitted by CIRC, which means that regardless of how long ago a wrongful act complained of was committed, the policy will respond provided that the claim is made during the policy period or the extended reporting period, subject to the retroactive date stated in the policy schedule.

Can defence costs be covered inside the limit of liability?

Yes, the defence costs can be covered inside the limit of liability.





What are the laws on rescission of an insurance policy? What are the laws regarding providing severability of the proposal form and conduct exclusions (fraud, criminal acts, intentional acts)?

Rescission of an insurance policy

- 1 The insured may terminate the insurance contract after the contract is signed except otherwise provided for by the Insurance Law of PR China or by the insurance contract.
- 2 The insurer is not allowed to terminate the insurance contract after the contract is signed except otherwise provided for by the Insurance Law of PR China or by the insurance contract.
- 3 If the insured conceals facts deliberately and refuses to perform the obligations of making true representations or fails to perform the obligations of making representations due to negligence that would be enough to affect the insurer from making the decision of whether or not to agree to accept the insurance or raise the insurance premium, the insurer has the right to terminate the insurance contract.
- 4 If the insured or beneficiaries falsify the occurrence of an insured risk, which has not occurred and has made a claim for compensation or insurance payment, the insurer has the right to terminate the insurance contract, with the insurance premiums not to be returned.

- 5 If the insured or beneficiaries deliberately fabricate the occurrence of the insured risks, the insurer has the right to terminate the insurance contract and shall refuse to perform the obligations of compensation or insurance payment.
- 6 If the insured has failed to perform its due obligations concerning the safety of the objects insured, the insurer has the right to demand additional insurance premiums or terminate the contract.
- 7 If within the validity period of the contract, the risks of the objects of insurance have increased, the insured shall notify the insurer in good time according to the contract and the insurer has the right to claim for additional insurance premiums or terminate the contract.
- 8 If part of the objects insured sustain losses, the insured may terminate the contract within 30 days after the insurer pays the indemnities. Except in the case that the contract may not be terminated in accordance with the relevant provisions as contained herein, the insurer may also terminate the contract. In the case in which the insurer terminates the contract, the insurer shall notify the insured 15 days in advance and return the premiums on the part not sustaining losses to the insured after deducting the part receivable from the date when the insured liability starts to the date when the contract is terminated.

Severability of proposal form

No specified Chinese laws or regulations provide for the severability of the proposal form, but in practice, the proposal shall be construed as separate proposal by each of the insured and, with respect to the statements made and particulars provided in the proposal, no such statements or particulars, and no information possessed by the insured, shall be imputed to any other insured to determine whether cover is available for any claim against such other insured.

Conduct exclusion

- 1 If an insurance contract provides for the exemption of liabilities for the insurer, the insurer shall clearly state in before signing the insurance contract. If no clear statement is made about it, the clause shall not be binding.
- 2 If the insured deliberately refuses to perform the obligations of making true representations, the insurer shall not undertake to pay indemnity or insurance money for insured risks that occur before the contract is terminated and shall not return the insurance premium.
- 3 If the insured fails to perform the obligations of making representations due to negligence, thereby seriously affecting the occurrence of insured risks, the insurer shall not undertake to pay indemnity or insurance money for contingency that occurs before the contract terminates but may return the insurance premium.





- 4 If the insured or beneficiaries deliberately fabricate the occurrence of the insured risks, the insurer has the right to terminate the insurance contract and shall refuse to perform the obligations of compensation or insurance payment.
- 5 If, after an insured contingency occurs, the insured or beneficiaries are found to have forged or fabricated related certificates, materials or other evidence to prove the causes of the insured risks or for exaggerating the losses, the insurer shall not compensate or pay for the part falsified.
- 6 If the insured or the beneficiaries deliberately cause the death, injury or sickness of the insured, the insurer shall not undertake to pay the insurance money.
- 7 If the contract takes the death of the insured as the condition of payment, and the insured commits suicide, the insurer shall not undertake to pay the insurance, except in the situation where the insured commits suicide two years after the contract is signed.
- 8 If the insured deliberately commits crimes that lead to its own injury or death, the insurer shall not undertake to pay out on the insurance. If the insurance premium has been paid for more than two full years, the insurer may return the cash value according to the policy.

If a local company is a subsidiary of a foreign parent and such foreign parent has a world wide D&O policy which covers the local subsidiary, is a separate local D&O policy also required to be issued for such subsidiary to comply with local law?

The local D&O policy must be issued for and by companies incorporated in China. However, for companies that provide their D&O cover with a non-admitted insurer, such as through a global D&O program, a local policy can be arranged as a front. Local insurers, such as Ping An Insurance Company and the People's Insurance Company of China are available as 'fronts' for international non-admitted insurers.

What is the local insurance tax for a D&O insurance policy?

According to Provisional Regulations of the People's Republic of China on Business Tax, promulgated by the State Council, the premium is subject to business tax at the rate of five percent (Premium tax = the amount of premium x five percent).

What has been the local claims history for D&O insurance.

Case A

A class action lawsuit was filed on May 10, 2004, on behalf of purchasers of the securities of China Life Insurance Company Limited ('China Life') (NYSE: LFC) between December 17, 2003 and February 3, 2004, seeking to pursue remedies under

the Securities Exchange Act of 1934 (the 'Exchange Act'). The action was filed before the Honorable Colleen McMahon, in the United States District Court for Southern District of New York against defendants China Life, President and Chairman of China Life, Wang Xianzhang, and Directors of China Life, Long Yongtu, Chau Tak Hay, Miao Fuchun and Wu Yan. According to the complaint, defendants violated the Exchange Act by issuing a series of material misrepresentations to the market during the class period. China Life was founded in June 2003 through the restructuring of its state-owned parent company, China Life Insurance (Group) Co. ('CLIC'). On February 3, 2004, the National Audit Office of China ('NAO') reported the results of its audit of CLIC and that it had found the equivalent of about \$652 million worth of irregularities involving CLIC. On February 4, 2004, the price of China Life's American Depository Shares declined in reaction to this news, falling \$2.13 or 7.39% per share from its previous day's closing price, to close at \$26.67. As a result of the defendants' false disclosure during the IPO, the price of China Life's securities was artificially inflated during the class period, causing Plaintiff and other members of the class to suffer injuries.

Case B

On Dec 28, 2004, the Yinguangxia Listed Company (Shenzhen Stock Exchange 000557) was sued before Yinchuan Intermediate People's Court by the investor – Bo Songhua for exaggerating their profits and disclosing false annual reports since Aug 5, 2001. The investor had purchased 5,500 shares of





Yinguangxia from Apr 23, 2001 to Jul 4, 2001. However, the price of the stocks had been extremely decreased due to Yinguangxia's false information. The judge concluded that Yinguangxia shall pay RMB110,000 Yuan to compensate the investor's damages.

Is the local law influenced by another country's law?

Generally speaking, the Chinese legal system has been deeply influenced by civil law systems (Continent law), especially by German, French and Russian Codes. Civil law has its roots in Roman law. Codification is a defining characteristic of a civil law system. The most famous example is perhaps the French Civil Code, although the German Civil Code is also an important and influential period of legal codification. In China, the German Civil Code was introduced in the later years of the Qing Dynasty and formed the basis of the law of the People's Republic of China, which remains in force in Taiwan.

In China, the legal systems are based around one or several codes of law, which set out the main principles that guide the law. Therefore, courts base their judgments on the provisions of codes and statutes, from which solutions in particular cases are to be derived. Courts thus have to reason extensively on the basis of general rules and principles of the code, often drawing analogies from statutory provisions to fill lacunae and to achieve coherence.

In the area of directors' and officers' liability, the Company Law and the Securities Law, effective on Jan 1, 2006, are generally regarded as the legal sources for reinforcing the duties of loyalty and due diligence towards a company on its directors, supervisors and senior executives. In this regard, it mostly absorbed experience from the U.S. and U.K. legal systems to protect the company, its shareholders and any third party from damage by the Directors' and Officers' wrongful acts.

What specific coverage grants are being provided in the local country and market not generally provided (for example certain fines and penalties in Italy, defence costs for BDP exclusion in Belgium)?

No specific coverage grants in this regard.

Are there any special laws or regulations with regard to offering an extended reporting period/discovery in the local law?

Discovery period is the date when the claim or circumstances are made known to the insured. Extended reporting period is the period usually granted (either with additional premium or free, depending on the length or duration provided) to the insured to report the claims to the insurer relating to the wrongful acts committed while the policy period is still in force. Extended reporting period is usually granted when the policy will not be renewed with the existing insurer.

There are no specific laws and regulations with regard to offering an extended reporting period or discovery period in China. However, according to the Insurance Law of PRC, the insurer and the insured are entitled to reach agreements through consultation and negotiation without infringing public interests and compulsory standards.

In practice, when the insurer refuses to renew the policy, the insured may upon payment of a certain amount of premium extend the cover under the policy for a certain period (such as 12 months) which shall run from the date the policy expires, for any claim first made against the insured during the discovery period and notified to the insurer during the discovery period, but only in respect of wrongful acts committed or alleged to have been committed before the date of expiration of the policy period.

What information can you provide on the following for the marketplace?

- Average amount for US SEC retention.
- Average amount for ROW retention.
- Average Limits of Liability purchased for accounts with US SEC exposure and no US SEC exposure.
- Is entity coverage usually purchased.
- Average amount for Coinsurance for US SEC.
- Average price per million for accounts with US SEC exposure and for accounts with no US SEC exposure.





Who are the largest insurers in the local market?

Pursuant to China's WTO accession and commitments, as of today, foreign-funded insurance companies are permitted by CIRC to engage in the insurance business, including property insurance, health insurance, group insurance etc. Except health insurance, there is almost no restriction and prohibition for foreign-fund insurance companies to practice in this field. However, the foreign-found insurance companies account for much lower market share than the Chinese local insurance companies. According to the statistics from CIRC, the foreign-found insurance companies account for a market share of 1.15% in property insurance (AIU ranks first with 0.35%), and 5.79% in health insurance (AIG ranks first with 1.26%).

Ping An Insurance Company (Ping An), the People's Insurance Company of China (PICC), China Pacific Insurance Company (CPIC) and China Life Insurance Company (China Life) are the largest insurers in China.

Market share ranking (statistic from CIRC)

Property Insurance		Health Insurance	
PICC	62.61%	China Life	51.05%
CPIC	11.87%	Ping An	16.93%
Ping An	9.12%	CPIC	10.47%

General comments, recent changes in the law, pending changes in the law

In 1954, the Constitution Law of PRC was promulgated by the People's National Congress, which is regarded as the foundation of the Chinese legal system. Since then, China has been establishing relevant effective legal framework in all legal areas, including constitution law, civil law, criminal law, administrative law, commercial law, corporation law, procedure laws etc

In recent years, pursuant to China's WTO accession and commitments and with rapid economic development, Chinese legislature has promulgated sets of new laws and regulations, such as the Property Rights Law of PRC, the Company Law of PRC, the Securities Law of PRC, the Bankruptcy Law and the Labour Contract Law.

In recent years, D&O insurance has become a core component of corporate insurance. However, D&O Insurance is a relatively new business in China. Until now, there were no specific laws and regulations in this field. It was not until Oct 27, 2005 that China promulgated the new Company Law, which imposes personal liabilities upon directors and officers due to their wrongful acts. We believe, with development and enforcement of the legal system of directors and officers' liability, there is a critical need for directors and officers to protect themselves from increasing lawsuits.

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