

HOW POWERFUL THE CHOP CAN BE IN CHINA?



ASIA

On April 27, 2020, Mr. Li Guoqing, the co-founder of Chinese e-commerce platform Dangdang (China's first US-listed B to C online company), broke into the company offices and snatched their 41 chops to regain control of the company at the expense of the majority shareholder of Dangdang who also happens to be his wife, with whom he has a troubled relationship. According to data from the online search platform Tianyancha, Mr. Li's wife holds 64.2% of Dangdang equity interest, while Mr. Li holds only 27.51%.

Why Li made off with all of the companies' chops? What significant roles are such little red chops playing in China's business world?

■ TYPES OF CHOPS

There are generally 3 types of company chop which are essential for any company in China:

- the company's official chop (公章),
- the chop of its legal representative (法人名章), and
- the finance chop (财务章)。

A company's official chop shows the registered full name of the company and is like the "company's signature". This is the most important chop because it can be used to authorize almost any action taken by the company.

The chop of its legal representative is a personal chop representing the legal representative of the company, which allows the legal representative to sign legal documents or authorize transactions even if he/she is not physically present.

The finance chop is used for basic financial actions of the company, such as opening a bank account, making payment and for most bank related transactions.

Apart from these three essential chops, a variety of other chops are used for specific purposes, such as contract chop, invoice chop, and sometimes also custom chop, human resources department chop, etc.

■ COMPANY CHOPS ROLE IN CHINESE COMPANIES

As you are no doubt aware, China's legal system is quite different from those of the West. In contrast to practices in the Western countries where foreign managers get used to relying on the hand-written signature of an authorized signatory of the company, in China it is affixing the chop of the company which is legally binding. A company's official chop constitutes much more compelling evidence than a manager's hand-written signature.

Every company in China, after it is established, shall make and register its company chop with the Public Security Bureau. The company chop represents a civil act of the company and may be relied upon by a bona fide third party with reason to believe it was affixed by the company. The company chop also represents the company's consent to, and acknowledgement of, the legal instrument in question. The company must assume the legal consequences of sealed documents unless it can prove that the chop was forged or used without due authority, which generally is not an easy task if the use of a chop is not carefully managed.



■ RISKS ARISING FROM THE MISUSE OR LOSS OF CHOP

Anyone who has access to company chops yield immense power. Meanwhile chops are a source of major risk often underestimated by foreign companies unfamiliar with China's legal environment. Therefore, foreign companies in China may be particularly vulnerable to these risks.

Our clients regularly face various risks and difficulties arising from chops being used illegally or without authorization or even getting lost or stolen. While these are extreme examples, they do illustrate what legal issues or problems the chops can cause to the companies.

While the two examples below are admittedly a little extreme, but totally authentic, in concrete terms, they do illustrate potential problems caused by a poor control of the use of chops.

- One of our clients established a wholly foreign-owned company in China, appointing a local general manager and placing all chops in his possession, without any rule or restriction of use. Several years later, the company discovered that the general manager had used the chop to provide guarantee to his wife's company. Moreover, when the employment contract of the general manager was terminated, the shareholder found that the latter had used the company chop to sign an amendment to his original work contract in which he had added single-handedly a number of additional benefits not included in his original contract.
- In another case, our client set up an equity joint venture in China. One accountant of such joint venture stole the company chop and finance chop to blackmail the joint venture in an attempt to coerce the company into providing a generous severance pay.

In this position, a company faces a difficult situation which will engender multiple consequences. The most immediate effect is that operations will be disrupted as it is very difficult to act without the company chop and/or the finance chop: impossible, for example, to withdraw cash from the banks, to enter into a commercial contract with any third party, to sign a labor contract etc.

■ OUR RECOMMENDATION

Given that the unauthorized use or theft of the chops can be extremely detrimental, it is crucial to put in place the following chops management system comprising these aspects.

- *Person Responsible for the Custody of Chops*

Within the company, one or several persons should be designated to be responsible for the custody of each of its chops and the control of their use. These persons must be trustworthy, capable of taking the right decisions and reporting when necessary to the foreign shareholder, or to the legal representative particularly when the shareholder does not live in China or travels frequently.

In addition, we advise to sign a delegation of authority with the persons responsible for the custody of chops, allowing them to affix chops to certain documents within specific limits and to obtain, in some identified cases, prior permission from the general manager, legal representative or even from the shareholder.

In absence of trustworthy persons, another judicious option, commonly used, is to give custody of the chops to a law firm or an external accountant who will only affix those following confirmation from their client.

- *Setting up Regulations for the Custody and Use of Chops*

We also advise to draft regulations for the use of chops which will be communicated to the whole staff of the company and in addition to the specific rules to be followed by the custodians of the chops, should include notably the following arrangements:

a) *Procedure to Follow for the Use of Chop*

The procedure to follow and internal agreements to gain in order to be allowed to affix a chop to a document must be specified in their regulations of use. Overall, each company chop can only be affixed following a request made to the one in charge of its custody, and approved by this person according to the arrangements of the regulations of use, and within the limits of the powers granted to this person.

The person in charge of the custody of the chops may refuse to affix the chop if the procedure to request it has not been followed properly, or still if the intended use is irregular or even illegal.

b) *No Affixation of Chops on Blank Documents*

For obvious reasons, we advise that the company should prohibit affixing chops on blank paper or blank or incomplete documents, and also on blank referral letters or certificates.

c) *Specific Authorisation to Use a Chop Off the Company Premises*

In some cases, it may be necessary to use the company chop off its premises. Therefore, it is important to include in the regulations of use, the procedure to follow for this special type of request. We recommend to include the possibility for the custodian of chops to go with the person who will have to use the chop off the premises of the company in order to ensure its correct use.

d) *Directory of Use of Chops*

It may also be advisable to set up a directory which records precisely each use of chops.

Finally, what should you do if a chop is lost or stolen? An announcement must be published as fast as possible in an official newspaper recognized by the local authorities. Afterwards, the company may apply for the cancellation of the lost or stolen chop and register the new chop with the Public Security Bureau.

It is also possible to lodge a complaint with the police, producing proof that the theft actually occurred. However, the police intervene very rarely in commercial disputes.

In any event, reversing the consequences of the loss or unauthorized use of a chop is not easy. In some cases, it will require the intervention of the authorities or the court. As such, the best course of action is to take preventative action, instead of rectifying a situation when it has gone wrong.



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