China Business Series: Directors and Supervisors

By Woon-Wah Siu and Julian Zou

Every Chinese company, including subsidiaries established in China by foreign companies, is required to have a board of directors and a board of supervisors. Multinationals should understand the responsibilities and liabilities of directors and supervisors of their PRC subsidiaries.

This advisory is one in a series prepared by Pillsbury’s China Practice on questions frequently asked by our clients doing business in China. Here, we summarize current PRC laws relating to the board of directors and the board of supervisors of foreign-invested companies, including the responsibilities and potential liabilities of directors and supervisors. Unless otherwise specified or as otherwise indicated by the context, we will use the word “company” to refer to a foreign-invested company in China, rather than its offshore parent company.

By law, every company in China must have a board of directors and a board of supervisors. A small-scale company may satisfy this requirement by having one executive director and one or two supervisors. What constitute a “small-scale company” is not clear, but in practice a company with no more than two shareholders can be considered a small-scale company. That means a wholly-owned PRC subsidiary will qualify as a small-scale company in China.

Constitution and Qualifications

<table>
<thead>
<tr>
<th></th>
<th>Board of Directors</th>
<th>Board of Supervisors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Members</td>
<td>3-13</td>
<td>At least 3 and at least 1/3 of the members must be employee representatives.</td>
</tr>
<tr>
<td>Qualifications</td>
<td>The following people may not serve as a director or a supervisor:</td>
<td></td>
</tr>
<tr>
<td>1.</td>
<td>An individual with no or limited civil capacity – for example, a minor, a person who is mentally incapacitated, or a person who is legally incompetent;</td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>An individual who has been convicted and sentenced for corruption, bribery, misappropriation of property, embezzlement of property or disruption of economic order, and less than five years have passed since the end of any term of imprisonment or payment of a fine;</td>
<td></td>
</tr>
</tbody>
</table>
Board of Directors | Board of Supervisors
---|---
**Qualifications** | 3. An individual who has served as a director or general manager of a company which has declared bankruptcy or has been adjudged insolvent, and is personally liable for the bankruptcy, and less than three years have passed since the completion of the bankruptcy liquidation;  
4. An individual who has served as the legal representative of a company whose business license was revoked or that has been ordered to close down for violation of law, and less than three years have passed since the revocation or close-down;¹ and  
5. An individual who has a large amount of due and unpaid personal debt.

**Term of Office** | No more than three years, but can serve consecutively if re-elected.

**How the board acts** | The board of directors acts by majority vote.  
The board of supervisors acts by majority vote.

**Collateral Office** | No restrictions  
Directors and officers cannot act as supervisors simultaneously.

**Responsibilities of Directors and Supervisors**

**Board of Directors/Executive Director**

A board of directors, or an executive director of a small-scale company, reports to the shareholders and is responsible for:

1. convening shareholder meetings and presenting operational results to shareholders;  
2. implementing shareholder resolutions;  
3. determining the company’s business and investment plans;  
4. approving the company’s annual budget and final accounts;  
5. formulating the company’s profit distribution plans and loss recovery plans;  
6. approving changes in the company’s registered capital and issuance of corporate bonds;  
7. determining the need for and approving reorganization of the company;  
8. establishing the company’s internal management bodies;  
9. appointing and dismissing the company general manager, deputy manager, chief financial personnel, and determining their compensation;  
10. establishing the company’s general management system; and  
11. other duties specified by the company’s articles of association (AOA).

¹ PRC law is not clear whether this would include a foreigner who was the owner, Chairman or executive officer of an offshore company that had fallen out of good standing. As a practical matter, when applying for the registration of the legal representative of a company, the PRC approving authority and the registration authority would only check domestic public records.
Board of Supervisors/Supervisor
A board of supervisors, or a supervisor of a small-scale company, is responsible for the following:

1. reviewing financial affairs;
2. supervising directors and senior officers in performing their duties, and proposing to the shareholders dismissal of any director or senior officer who violated the law or the company’s AOA;
3. requiring directors or senior officers to rectify their conduct that is in breach of company interest;
4. proposing the call of any special meeting of shareholders to the board of directors, and to call, convene and preside over such shareholder meeting if the board of directors fails to do so;
5. proposing motions to the shareholder’s meeting;
6. initiating legal proceedings against directors and officers pursuant to Article 152 of the Company Law (discussed below); and
7. other functions and powers stipulated in the AOA.

Duties of Directors and Supervisors
Chinese Company Law now embraces the concept of “fiduciary duties” of a director or a supervisor, which, as in western countries, encompass the duty of care and the duty of loyalty. However, the law does not elaborate on what fiduciary duties of directors and supervisors are, but merely lists several activities that are considered a breach of fiduciary duty.

The right to pursue personal liability claims against directors and supervisors rests with the shareholders; however, PRC law does not set forth the procedure by which shareholders can make claims against directors or supervisors. Cases brought by shareholders against directors or supervisors in this area have been rare.

Fiduciary Duty of Directors
Chinese Company Law prohibits a director from any of the following acts:

1. misappropriating the company’s assets or embezzling the Company’s funds;
2. depositing company funds into a personal bank account;
3. use of company property as guarantee for projects not approved by the shareholders or the board;
4. entry into contracts with the company without the approval of the shareholders, or in violation of the AOA;
5. using company resources to pursue private business opportunities for personal benefit or another person’s benefit;
6. misappropriating any commission on any transaction to which the company is a party;
7. disclosing confidential information of the company without proper authorization; and
8. engaging in other conduct in violation of the duty of loyalty to the company.
Fiduciary Duty of Supervisors

The Company Law does not expressly set forth the duties of a supervisor. Basically, a supervisor must:

1. abide by the law and the AOA of the company;
2. not accept bribes or other illegal income; and
3. not misappropriate the company’s assets.

Liabilities of Directors and Supervisors

Breach of Fiduciary Duty

If a director breaches her fiduciary duty to the company, the company may confiscate any illegal income derived from the breach. PRC law does not set forth the procedure for pursuing liability claims against any such breaching director, but based on our informal consultation with the local court in Shanghai, the shareholders of the company may urge the supervisor or the board of supervisors of the company to file a suit against the breaching director to claim the compensation.

Misconduct in the Course of Performing Duty

If a director or a supervisor, in the course of exercising her duty, violates laws, administrative regulations or the AOA of the company, and causes losses to the company, the person should be responsible for any such loss. Again, the shareholders of the company may urge the supervisor or the board of supervisors to file a suit against a breaching director. In a case where a supervisor’s violations of the law or the AOA caused losses, the executive director or the board of directors may file suit against the supervisor.

Board Resolutions Violating Laws, Regulations or AOA

Directors are personally liable for the resolutions of the board of directors. If a board resolution contravenes laws, administrative regulations or the company’s articles of association and causes the company to incur serious losses, directors who voted in favor of such a resolution must compensate the company for the losses incurred.

The personal liability of directors for board resolutions is only stated in the Chinese Company Law chapter relating to companies limited by shares. It is not clear whether it will also apply to directors in limited liability companies. Our informal consultation with the local Administration of Industry of Commerce in Shanghai indicates that this liability can also apply to directors of a limited liability company.

If the company is subject to administrative penalties or criminal punishment, the responsible supervisor may also be held responsible. However, PRC law does not set forth the procedure on how shareholders may make a claim against a supervisor. Our informal consultation with the local court in Shanghai suggests that this will be determined on a case-by-case basis.

If you have questions, please contact the Pillsbury attorney with whom you regularly work, or the authors:

Woon-Wah Siu (bio) Julian Zou (bio)
Shanghai Silicon Valley
+86.21.6137.7924 +1.650.233.4057
woonwah.siu@pillsburylaw.com julian.zou@pillsburylaw.com

This publication is issued periodically to keep Pillsbury Winthrop Shaw Pittman LLP clients and other interested parties informed of current legal developments that may affect or otherwise be of interest to them. The comments contained herein do not constitute legal opinion and should not be regarded as a substitute for legal advice. © 2013 Pillsbury Winthrop Shaw Pittman LLP. All Rights Reserved.