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**
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).
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.

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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.