Appoint a Chinese lawyer as supervisor for your company in China

Description

I am still working on behalf of a European corporate client to clean up the mess of its invested WFOE in Shanghai caused by the WFOE's general manager and legal representative.

The WFOE has a board of directors and a supervisor as well. The management of the WFOE is left to a general manager who also serves as the legal representative of the WFOE. It seemed that the board fully trusted the general manager from the outset and didn't even doubt his credibility until the WFOE was precipitated to the brink of bankruptcy. As the board comprised all foreigners who don't live in China, the client has virtually lost control of the company and has been left in darkness in respect of the business operation and financial conditions of the WFOE. Now the general manager has resigned, and the company is closed by landlord due to failure to pay due rentals, and a few employees have gone to arbitration to request the WFOE company to pay their salaries.

It is a big mess, isn't it?

There is strong suspicion that the general manager has committed wrongs that have led the company to this dire situation.

Unfortunately, this is not the first time I came to know through clients such circumstances where the foreign-invested companies are poorly run by their managements that have betrayed their duty and commitment to the companies they serve. They are often engaged in misconducts that run in conflict with the interests of the companies. Often the lack of a certain level of supervision over the managements is to blame for such business failures.

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However, it is not the case that the foreign invested companies don't have board of supervisor or a one or two supervisors (instead of a board). It is because the supervisors are not functioning.

From the enactment of the revised China Company Law as from January 1, 2006, foreign invested companies are required to install supervision mechanism within their organization. According to China Company Law, a company shall have either a board of three or more supervisors or, in the case of small-scale business, one or two supervisors. Article 51 of China Company Law reads:

> A limited liability company shall establish a supervisory committee with no fewer than three members. If a limited liability company has a relatively fewer number of shareholders or is a relatively small-scale company, it may appoint one or two supervisors and a supervisory committee need not be established.
>
> The supervisory committee shall include representatives of shareholders and an appropriate ratio of representatives of staff and workers of the company, among which the representatives of staff and workers shall be no less than one third of the members of the supervisory committee. The specific ratio shall be specified in the articles of association of

> the company. The representatives of staff and workers on the supervisory committee shall be democratically elected by the staff and workers of the company through the general meeting of the representatives of the staff and workers, the general meetings of the staff and workers or other means.
>
> The supervisory committee shall have one chairman, who shall be elected by more than half of the supervisors. The chairman of the supervisory committee shall convene and preside over the meeting of the supervisory committee. If the chairman of the supervisory committee cannot perform or fails to perform his/her duties, a supervisor recommended by at least half of the supervisors shall convene and preside over the meeting of the supervisory committee.
>
> The directors and the senior management personnel may not concurrently assume the positions of supervisors.

Furthermore, according to Article 53, supervisors can exercise supervising powers:

> The supervisory committee or the supervisors (where the company does not have a supervisory committee) shall exercise the following duties and powers:
> (1) to inspect the financial affairs of the company;
> (2) to supervise the conduct of directors and senior management personnel in performing their duties for the company and, to make proposals to dismiss those directors or senior management personnel who have violated laws and regulations, the company's articles of association or the resolutions of the shareholders' meeting;
> (3) to demand that the directors or senior management personnel rectify when their conduct impairs the interests of the company;
> (4) to propose the convening of interim shareholders' meetings and convene and preside over the shareholders' meetings when the board of directors fails to convene and preside over the shareholders' meetings in accordance with this Law;
> (5) to make proposals to the shareholders' meeting;
> (6) to issue legal proceedings against directors or the senior management personnel in accordance with Article 151 of this Law;
> (7) to exercise other duties and powers specified in the articles of association of the company.

According to second paragraph of Article 150:

> Directors and the senior management personnel shall truthfully provide relevant documents and information to the supervisory committee or the supervisors (where the limited liability company does not have a supervisory committee), and shall not obstruct the supervisory committee or supervisors from exercising their duties and powers.

Given the quoted provisions in China Company Law, if the supervision mechanism functions well, ideally, a company can well prevent or reduce the misconducts by the management (the general managers, and the board of the directors).

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In practice, for small foreign-invested companies, corporate supervision mechanism exists in name only and seldom does the supervisor exercise their functions as expected by laws. For domestic companies, because shareholders are just around, managements will have to somehow restrain themselves from doing the bad things. But for foreign-invested companies, shareholders are far away. If the supervision mechanism does not function well, the management can be very bold and may commit disastrous misconducts.

So for foreign investors, to have an effective supervision mechanism in place is in fact crucial for their business growth and success. Now the question comes to how to establish an effective supervision mechanism.

The possible answer is to appoint the right persons to serve as your supervisors. Who can be the right persons? Chinese lawyers may be your good choices.

The reasons why lawyers can serve as good supervisors are actually obvious: they know what misconducts management may be engaged in, and they also better know how to find out and prevent it. An experienced corporate lawyer can well identify and discern the problems a company may face by looking at transaction documents, financial books. If reasonably paid, lawyers will have the great incentive to deliver expected services and thus results.

What do you think?

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