

# Who the hell has the right to represent a company in China?

## Description

This is a true story. The question here may well boggle minds of fellow professionals in China.

### I. Facts of the Case

A foreign investor has set up a wholly foreign owned enterprise (“**WFOE**”) in Shanghai, a limited liability company. The WFOE has a board of directors with three members, and one supervisor. One of the board member, a foreigner, was appointed as general manager who concurrently served as legal representative of the WFOE. After years of management of this legal representative, the WFOE is in fact insolvency as it has never made any profits. At a point, the WFOE cannot even pay its rental for which reason the landlord took away many of the WFOE’s stuff and properties such as business license, financial books and some machines. The legal representative resigned thereafter but retained some of the WFOE’s important chops (the company general chop, *gongzhang* in Chinese pinyin) and properties.

Now the shareholder shall have to step in to either rescue the WFOE or wind it up. The first thing the shareholder wished to do is to find out and assess the financial conditions of the WFOE. For this purpose, the shareholder contacted the landlord hoping to get the documents and properties of the WFOE from the landlord in particular the financial books and materials.

The shareholder came to agreement with the landlord that the shareholder would pay half of the rental owed by the WFOE and then the landlord would return all the documents and properties in his possession. After the shareholder paid the agreed amount of rental, the landlord insisted that the handover of the documents and properties to the shareholder shall be conducted upon consent by the legal representative of the WFOE on the ground that the documents and properties belonged to the WFOE and only the legal representative of the WFOE shall have the power to decide on whom the stuff shall be turned over to. So the shareholder had make the decision to change the legal representative, but the proposed new legal representative was not registered yet so the landlord refused to follow his instructions. For some reason, the shareholder is reluctant to change the legal representative at the moment.

Here came to the deadlocked situation: the legal representative refused to give consent to the handover of the documents and properties to the shareholder, not to mention giving back the company chop; while the landlord didn’t give the stuff to landlord nor was he willing to give the same to the registered legal representative (for fear that the legal rep won’t pay the remaining rental); without access to the financial books and materials, the shareholder is feeling difficult in making decision as to whether to keep this WFOE or let it die.

### II. Legal Issues and Questions

This corporate plight well reflects the problems inherent in current Chinese corporate governance practice in terms of representation of a company.

The legal representation issue has two facets: internal and external. Respectively, they are embodied in the following two questions in this case:

(1) is the legal representative behaving in compliance with Chinese corporate laws?

(2) is the landlord correct insisting handing over properties only to the legal representative duly registered with company registration authority? Can he hand over the properties to the shareholder of the WFOE or the newly appointed but not yet registered legal representative without legal risk?

### III. Analysis and Answers to the Questions

These are two simple but profound questions and it will take a good theoretical understanding of corporate laws to give a good answer. While theoretically scholars are divided on the nature or essence of a company or body corporate, it is a consensus that a company involves basically issues in two spheres: internal issues within the company, and the external issues between the company and the third party dealing with the company.

A company is a legal person (termed in relation and opposite to natural person) with legal personality separate from the personality of its members. A human person is essentially distinct because of his or her will. Accordingly, a personified company shall also have its artificial will that can be legally recognized.

In judicial practice, like a human being, a company can have or create an idea and then have it presented or expressed to the outside. The creation of an idea is often an intra-company issue, and the presentation or expression of the idea and its effects are an external issue of the company.

*(1) Internal facet: is the legal representative doing right under Chinese laws?*

From a micro perspective, shareholders, directors (or the board of directors), supervisors (or the board of supervisors), legal representative, and other senior officers are often the internal organs of a corporation.

When this legal representative resigned by submitting his resignation letter to board of the directors of the WFOE, upon receipt of the this resignation letter, from that moment, within the company, the resignation shall take effect. Accordingly, the the legal representative shall refrain from acting as legal representative of the WFOE to the outside, even though he is still registered with company registry as the legal representative. In other words, within the company, he or she cannot hold out himself or herself to be the legal representative despite of the registration. He or she shall remind the clients and customers of the company that he has resigned and ceased to be the legal representative.

Is the legal representative right in insisting that he can transfer the properties and chops of the WFOE only to the new legal representative? My answer is No. Again, the transfer of properties and chops in his possession is a matter of intra-corporation matter. When the legal rep is not functioning or acting against the company, the law shall allow the company to appoint an interim representative to deal with the dys-functioning legal representative and with certain external entity like court or arbitration

body.

In the case we are discussing, the legal representative shall transfer the properties and documents to any one that is duly authorized by the board of the directors of the WFOE to act for the transfer.

It may be open to argument as to whether the shareholder or shareholder meeting has the right to appoint the interim representative for the WFOE.

#### *(2) Is the landlord correct?*

The landlord here is of course an external party dealing with the WFOE. Should he insist on transferring the properties and documents to the registered legal representative only?

In many foreign jurisdictions, a company is often represented by not just one member of the board of directors but several. But in China, a company shall only be represented to the outside by its registered legal representative. The legal representative of a company incorporated in China has the indisputable power and authority to represent and bind the company. Legal representative of the legal presentation and expression of corporate ideas to the outside.

To any outsiders, in order to deal properly with a company, it is always safe to deal with its legal representative. The law has not required and cannot require the outsiders to look deep into the corporate organizations for a proper person to deal with. From this point of view, the landlord has actually acted legally. Though from a practical point of view, it is not really wise of this landlord to be stubborn as there is really not much risk for him.

#### **IV. Conclusion**

Representation of a corporation can be very problematic under current Chinese laws. A further example is that in the case of a legal representative acting against the company, the company may use the corporate chop to file the lawsuit which is then immediately withdrew by the defendant legal rep acting in capacity as legal representative of the company. Also, China company law empowers the supervisors to sue directors and senior officers on behalf of the company but in practice courts may be puzzled as to whether the lawsuit should be instituted in the personal name of the supervisor or in the name of the board of the supervisors.

Not easy, aha?



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