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**The Chinese WFOE
and
its most important corporate bodies**

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With the following summary, we would like to provide an introduction to the most important corporate bodies of a *Wholly Foreign-Owned Enterprise* (“**WFOE**”) in the People’s Republic of China (“**PRC**”).

I. Overview

A WFOE is an investment vehicle for foreigners who want to establish a company in China. A WFOE has a separate legal status with the limited liability of the shareholders (limited by the amount of registered capital to be injected into the WFOE). Contrary to a Joint Venture (“**JV**”), the shareholders of a WFOE must be foreign nationals (including legal persons), which includes Hong Kong, Macau and Tai-wan nationals.

Chinese nationals are not permitted to become shareholders of a WFOE. However, if a Chinese national set up a company outside of Mainland China (e.g. Hong Kong, Cayman Islands or the British Virgin Islands), then this entity will be considered a foreign company. Therefore, it may become a shareholder in a WFOE.

II. Legislations of WFOE

The special laws particularly regulating the WFOE can be traced back to 1986. However, to further expand China’s opening up and standardise the administration of foreign investment, these laws have been replaced by the *Foreign Investment Law of the People's Republic of China* (hereinafter called the “**Foreign Investment Law**”) and the *Regulation for Implementing the Foreign Investment Law of the People's Republic of China* (the “**Regulation**”) since 01 January 2020.

The stated **Foreign Investment Law** and the **Regulation** cover the WFOE as well as other entities pursuing foreign investment activities in China. They legislated the investment promotion, investment protection, investment administration, legal liabilities, and related issues of the WFOE. There are also unified administration sections of the WFOE including the State Council and its sub-departments such as the commerce department, investment department, the State Administration for Market Regulation etc.

Nevertheless, the WFOE’s organizational structures were barely affected by the legislature changes. The competent authority requested that the WFOE’s organizational structures be in line with the Company Law since 2006¹ and that rule is well inherited by the new law. The Foreign Investment Law stipulates that the WFOE’s business forms, structures, and rules of activities shall be governed by the Company Law.²

However, in practice, a WFOE’s organizational forms and structures stipulated in the Articles of Association (“**Articles**”) may somehow diverge from the Company Law, such as the highest decision-making body, the method of appointing legal representatives or directors, discussion and voting mechanism, etc. In such a case, a modification registration or filing to the competent

¹ Notice of the State Administration for Industry and Commerce, Ministry of Commerce, General Administration of Customs and the State Administration of Foreign Exchange about Issuing the Executive Opinions on Some Issues Concerning the Application of Law Governing the Examination, Approval and Registration of Foreign-funded Companies (Expired on 01 December 2020) (“国家工商行政管理总局、商务部、海关总署、国家外汇管理局关于印发《关于外商投资的公司审批登记管理法律适用若干问题的执行意见》的通知” Article 3, para. 2).

² Foreign Investment Law, Article 31.

authority within 01 January 2025 shall be requested.³

III. Key Organs in a WFOE

a) Shareholders and Shareholders' Meeting

A minimum of one shareholder is required whose details have to be filed to the State Administration for Market Regulation or its local branch ("SAMR") (previously called "the State Administration for Industry and Commerce").

Corporate shareholders are permitted, however, such shareholders cannot be companies incorporated in Mainland China. The shareholders can be of any nationality except Mainland Chinese and can reside anywhere in the world except for Mainland China. Please note that shareholders registered in countries or regions which have not yet established diplomatic relations with Mainland China shall, in order to be permitted to invest in Mainland China, legalize and notarize the commercial register/passport copy at a Chinese embassy/consulate located in a third country.⁴

When a WFOE has more than 1 shareholder, the **shareholders' meeting** (in Chinese: "股东会") of the WFOE is the highest decision-making body of the company and should be held at least once a year. However, the Articles of the company can decide on the number of annual meetings and on the requirements of a quorum.

When a WFOE has more than 1 shareholder, the **shareholders' meeting** is responsible for the following tasks:

- Contributing the registered capital to the WFOE
- Establishing a Board of Directors or appointing an Executive Director
- Appointing a Chairman of the Board of Directors; the method of appointing the Chairman has to be specified in the WFOE's Articles. The Articles may allow the Directors to elect the Chairman of the Board of Directors.
- Establishing a Board of Supervisors or appointing one or two Supervisor(s).
- Deciding on the long-term strategy of the WFOE.
- Changing and/or amending the Articles of the WFOE.

b) Board of Directors

A WFOE requires at least one Director, whose details must be filed with the SAMR. In the case of a sole Director, this Director shall be the Executive Director or managing Director. Directors can be of any nationality and be residents anywhere. Corporate Directors are not permitted.

The method of appointing Directors shall be prescribed in the WFOE's Articles, which shall also state the Directors' term of office. The maximum length for which Directors can be appointed is three years, after which the Directors can be re-elected.

In case there is more than one Director, the minimum number of Directors is three, and the maximum is 13. In such a case, the WFOE shall set up a board of directors (the "**Board**") including one chairman. The Board shall be responsible for the shareholders' meeting. It shall decide all major issues concerning the company except those issues which shall be decided by the shareholders. It holds the actual leading power within a WFOE. This makes the Board the highest executive body. It is responsible for all operational matters and significant business management decisions, in particular:

³ Notice by the State Administration for Market Regulation of Effectively Completing the Registration of Foreign-Funded Enterprises for the Implementation of the Foreign Investment Law (2020) (市场监管总局关于贯彻落实《外商投资法》做好外商投资企业登记注册工作的通知) para. 10-11.

⁴ ibid para.5.

- Convening shareholders' meetings and reporting on the operation of the company.
- Carrying out the shareholders' resolutions.
- Determining the operation and investment plans.
- Deciding on the establishment of the company's internal management departments.
- Appointing and dismissing the General Manager and other senior staff of the company and determining their salaries.

However, the shareholders are free to assign other tasks to the Board or the shareholders' meetings in the Articles. The Articles shall prescribe the discussion methods and voting procedures of the Board, unless it is otherwise provided for by the relevant Chinese laws and regulations.

c) Chairman

The appointment of the Chairman of the Board shall be specified in the company's Articles and shall then preside over the meetings of the Board. He is responsible to convene and organize the Board meetings in accordance with the company's Articles. The chairman has to ensure proper record keeping of all Board meetings which includes the signature of all attending Directors.

In case the chairman is unable or does not perform his duties, the Board meetings may be convened and presided over by the vice chairman.

Where a limited liability company has a small number of shareholders or is comparatively small in scale, it may have an Executive Director instead of a Board. The Executive Director may concurrently serve as the manager of the company. The power of the Executive Director shall be specified in the Articles.

d) Legal Representative

The shareholders are required to appoint a Legal Representative of the company, who acts as the main person in charge of the company and accordingly holds a special position. He represents the company in all material aspects, for example when concluding contracts. The actions of a Legal Representative are attributed to the Company.

The Legal Representative is also responsible for the implementation of the shareholders' resolutions; the Legal Representative reports to the shareholders.

The Legal Representative must be either the chairman of the Board or the Executive Director of the company. Also, the General Manager can serve as Legal Representative, if provided by the company's Articles.

The Legal Representative signs all relevant documents on behalf of the company and may be held personally liable, even if he/she cannot read nor understand the content of the documents.

e) Supervisor

The shareholders of the WFOE are required to appoint the Supervisor (comparable to the employee's committee in European companies), who does not have to reside in Mainland China. Shareholders of the WFOE may be appointed as the Supervisor.

The supervisor is **not** entrusted with operational duties within the company, but merely reviews the management of the Board and the General Manager on behalf of the shareholders. Therefore, Directors, the manager or personnel in charge of financial affairs of the company may not concurrently serve as supervisors.

Depending on the size of the WFOE, a Board of Supervisors may be established, comprising of a minimum of three persons.

In that case, at least one-third of the Supervisors must be employees of the company.

The term of office of the Supervisor(s) is statutorily three years and is renewable by the shareholders. If stated in the Articles, the Supervisor can have the right to attend Board meetings.

The Supervisor is responsible mainly for following items:

- Inspecting and examining the financial affairs of the WFOE
- Supervising the duty-related acts of the Directors and senior managers, and making proposals for the removal of Directors or senior managers violating the law, any administrative regulation, the Articles or shareholders' decisions
- Making proposals to call interim shareholders' meetings, to call and preside over shareholders' meetings
- Making proposals at shareholders' meeting
- According to Article 151 of the Company Law, filing a lawsuit against the Board members and senior managers of the company, if legally required

f) General Manager

The General Manager of the WFOE is appointed by the Board or the Executive Director and is directly responsible to the Board and exercises its duties under the leadership of the Board.

The General Manager organises the daily management and operation of the company and can be assisted by a deputy General Manager.

While the Board makes the major operational decisions, the General Manager is responsible for executing these decisions in detail, i.e. in day-to-day business.

The chairman of the Board or any other Board member can be appointed as General

Manager; the General Manager can also be appointed as Legal Representative as provided by the company's Articles.

The Articles can assign certain tasks and duties to the General Manager, such as:

- Carrying out the resolutions of the Board or of the shareholders.
- Organising and conducting the daily production, operation, and management of the company.
- Appointing and removing administrative staff under the authorization of the Board.
- Any other powers as authorized by the Board.

IV. Summary

The key organs of a WFOE are:

- Shareholders' meeting;
- Board of Directors;
- Chairman of the Board (or Executive Director);
- Legal Representative;
- Board of Supervisor; and
- General Manager.

The interaction as well as the different duties and responsibilities of these organs can often be confusing from a European or American point of view. A WFOE does not have a single executive body (e.g. a CEO) that is responsible for the operational business and external representation of the company, as it is often the case in Western legal systems. Rather, these tasks are shared among the Board of Directors, the General Manager and the Legal Representative.

There are a number of possibilities to organise the management of a WFOE. One person can hold all three positions or take only two of the roles, such as being a Director and Legal Representative at the same time. A more detailed list of duties and responsibilities of the individual positions can be de-

fined in the Articles of the Company, if desired and permitted by law.

However, it is necessary that the company should be able to remain capable of acting at all times. It is therefore advisable to uphold the dual control principle, especially within the Board of Directors. It is recommended that there are at least three Directors, so that in case of prevention (illness, holidays) the two remaining Directors can take over the business of the company as well as hold important Board meetings.

Before setting up a WFOE, it is necessary that the Articles of the WFOE clearly state which organ has the right to appoint which position.

Furthermore, the Articles need to clarify other points, such as:

- Name and domicile of the WFOE
- Business scope of the WFOE
- Registered capital of the WFOE
- Names of the shareholders
- Form, amount, and schedule of capital contributions by the shareholders

- Organs of the WFOE and the methods of formation, authorities, and rules of procedure thereof
- The Legal Representative of the WFOE
- Term of office of each position
- Procedure for removal from office for each position
- Remuneration for each position (if any) and
- Tasks, responsibilities and duties of each position

Depending on where the WFOE is to be established, the foregoing may be subject to local regulations.

For example, a WFOE that is to be established in Shanghai may be subject to different regulations than one that is to be established in Beijing. Therefore, it is recommendable to appoint a local lawyer prior to the setup to avoid mistakes that may be difficult to correct.

*We hope that the information provided in this newsletter was helpful for you.
If you have any further questions please do not hesitate to contact us.*

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