



September 2018

Michael Lorenz
Managing Partner



Contact

Send [e-mail](#)
Phone: +852 611 396 36
Skype: michaellorenz
[Download Vcard](#)

The WFOE and its most important organs

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

1. 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 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 share-holders 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 sets up a company outside of Mainland China (e.g. Hong Kong, Cayman Islands or British Virgin Islands), then this entity will be considered a foreign company. Therefore, it may become a shareholder in a WFOE.

2. Key Organs in a WFOE

a) Shareholders and Shareholders’ Meeting

A minimum of one shareholder is required whose details have to be filed with the State Administration for Industry and Commerce or its local branch (“SAIC”).

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.

The **shareholders' meeting** of the WFOE is the highest corporate institution of the company and should be held at least once a year. However, the Articles of Association (“**Articles**”) of the company can decide on the amount of annual meetings and on the requirements of a quorum.

The shareholders are 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.
- Appointing a Legal Representative of the company
- 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 SAIC. 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 resident anywhere. Corporate directors are not permitted. In case there is more than one director, the minimum number of directors is three, and the maximum is 13.

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.

The directors shall decide all major issues concerning the company except those issues which shall be decided by the shareholders. They hold the actual leading power within a WFOE. This makes the directors the highest executive body. They are responsible for all operational matters and significant business management decisions, in particular:

- Reporting on the operation of the company
- Carrying out the shareholders' resolutions
- Examining 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 meetings, unless it is otherwise provided for by the relevant Chinese laws and regulations.

c) Chairman

The chairman of the Board is appointed by the shareholders or elected by all the directors 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.

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 or the general manager of the company. The Legal Representative signs all relevant documents on behalf of the company and may be held personally liable.

e) Supervisor

The shareholders of the WFOE are required to appoint a Supervisor (comparable to the employee's committee in European companies), who does not have to reside in Mainland China. The Supervisor must be an independent person and cannot be the chairman, the managing director, the general manager or any other senior staff of the WFOE. Shareholders of the WFOE may be appointed Supervisor.

The supervisor is **not** entrusted with operational duties within the company, but merely reviews the management of the board of directors and the general manager on behalf of the shareholders.

Depending on the size of the WFOE, the authorities may require to establish a Board of Supervisors, comprising 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 for:

- Inspecting and examining the financial affairs of the WFOE
- Supervising the duty-related acts of the directors and senior managers, and bringing forward proposals for the removal of directors or senior management violating the law, any administrative regulation, the Articles or shareholders' decisions
- Making proposals to the shareholders and
- According to Article 151 of the “Company Laws of the P.R.C.” 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 of Directors 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. 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

3. Summary

The key organs of a WFOE are:

- Shareholders' meeting
- Board of Directors
- Chairman of the Board (or Executive Director)
- Legal Representative
- 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 defined in the Articles of Association 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
- 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

The above said can be subject to local regulations depending on where the WFOE is to be set up. For example, a WFOE is to be set up in Shanghai may be subject to different regulations than one to be set up in Beijing. Therefore, it is recommendable to appoint a local lawyer prior to the setup to avoid mistakes that may be difficult to correct.

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*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.*

Lorenz & Partners (Hong Kong) Limited

Unit 2906, 29th Floor, Wing On Centre
111 Connaught Road, Hong Kong, SAR
Tel: +852 252 814 33

E-Mail: hongkong@lorenz-partners.com