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Research on the Qualifications of Employee Directors under the New Companies Law

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Abstract

The new Companies Law, which came into effect in July 2024, adjusted the rules for the establishment of employee directors of limited liability companies and expanded the scope of application of employee directors. On the premise that the new Companies Law provides a framework for employee directors, the legal norms relating to the qualifications of employee directors are ambiguous.The lack of uniform provisions on the prohibition of concurrent employment of employee directors and on candidates for employee directors has led to confusion in practice as to the criteria for companies to apply to the qualifications of employee directors. This is not conducive to the long-term development of the employee directorship system. Therefore uniform provisions should be clearly set out for the persons prohibited from holding concurrent positions as employee directors and the candidates for employee directorship, with further explanations of the eligibility criteria, to give full play to the effectiveness of employee directorships.

Keywords

Employee Directors; Positive Qualifications; Negative Qualifications; Senior Executives.

1. Introduction

The New Companies Law, which came into effect on July 1, 2024, contains amendments to the provisions relating to employee directors, mainly to expand the scope of application of the employee director system. The current revision of the new Companies Law reflects the State's tendency to protect the interests of the majority of employees and to encourage them to actively participate in corporate governance. However, as a systematic and complicated system, expanding the scope of application of the employee directorship system alone is not sufficient to improve the employee directorship system. From a theoretical point of view, although a series of relevant laws, regulations, and documents have made specific requirements and stipulations in respect of the qualifications of employee directors. However, these relevant laws, regulations, and documents have been published for a long time, have a low level of effectiveness, and lack sufficient rigid constraints to meet the needs of reality, and the provisions of the local regulations on the qualifications of employee directors vary from province to province, and in general there is a lack of uniform provisions. From the practical point of view, the criteria for applying the qualifications of employee directors are confusing, and the relevant provisions cannot play a practical role and are marginalized. Therefore, it is of great theoretical significance and practical significance to improve the provisions on the qualifications of employee directors, which can effectively play the role of employee directors, further protect the interests of employees, and actively participate in corporate governance.

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2. The Legislative History of the Employee Director System and its Theoretical Basis

2.1. Legislative History of Employee Directorships

Article 45 of the Companies Law published in 1993 established the legal status of the employee director system for the first time in the form of a law, and Articles 45 and 68 of the revised Companies Law in 2005 also amended the provisions on employee directors. The employee director system was further detailed in the departmental regulation issued by the State-owned Assets Supervision and Administration Commission of the State Council(SASAC) in 2006, "Measures for the Administration of Employee Directors of Pilot Enterprises with Boards of Directors of Wholly State-Owned Companies (for Trial Implementation)" (hereinafter referred to as the "Measures for the Administration of Employee Directors"). When the Board of Directors studies and decides on major issues of the Company, the employee directors shall fully express their opinions, reflect the reasonable demands of the employees, and safeguard the legitimate rights and interests of the employees and the Company. Over some time, the employee director system took shape. The Companies Law (Second Review Draft), published at the end of 2022, amended Article 68. The Companies Law (Third Review Draft), published in September 2023, added a new Article 68, and this addition emphasized the status of employee representation. On December 29, 2023, the Seventh Meeting of the Standing Committee of the Fourteenth National People's Congress voted to adopt the new Companies Law, which has now come into effect and adjusted the rules for the establishment of employee directors in limited liability companies. It can be seen from the several amendments to the Companies Law regarding this provision that the criteria for the application of the employee director system have been changed from the form of company ownership to the size of the company, and the number of employees is used as the criterion for determining whether or not to set up an employee director in a company, thus enlarging the scope of application of the employee director system.

2.2. Theoretical Basis of Employee Director System

First, Article 1 of the new Companies Law adds the requirement that "the Companies Law shall protect the interests of employees", which reinforces the interests of employees and other stakeholders. The core idea of the stakeholder theory is that the interests of all stakeholders should be balanced in a comprehensive manner in a company, rather than just focusing on the accumulation of shareholder wealth.[1] Stakeholders include the company's shareholders, creditors, employees, and other trading partners, but also include government departments, the host community, and other pressure groups, these stakeholders are closely related to the survival and development of the company, some of them share the enterprise's business risks, and some of them supervise and constrain the enterprise. Therefore, enterprises have to be responsible to these stakeholders, and their interests must be taken into account or their constraints must be accepted in the enterprise's business decisions. Among these stakeholders, employees, as the most important stakeholders, should participate in corporate governance, which is also an important way to realize corporate democracy and a concrete embodiment, from which the employee director system came into being. Secondly, the development of enterprises is subject to the constraints not only of shareholders but also of the public interest of society. The employee director system is a concrete manifestation of Corporate Social Responsibility. The theory of Corporate Social Responsibility emphasizes that while pursuing economic interests, enterprises should also assume responsibility for society and the environment. Article 20 of the new Companies Law has added and enriched the specific content of Corporate Social Responsibility, i.e., the company shall give full consideration to the interests

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of stakeholders as well as social public interests such as ecological and environmental protection.

3. Considerations for Employee Director Qualifications

Considerations for the qualifications of employee directors mainly include positive and negative qualifications, which need to be clarified based on the qualifications of directors in conjunction with the functional orientation of employee directors.

3.1. Positive Participation

Positive Qualifications of Employee Directors In addition to fulfilling the positive qualifications of directors, there are additional conditions to be fulfilled based on the special characteristics of employee directors. The positive qualifications mainly include the following.

3.1.1. Status Conditions

Employee directors are democratically elected by the employees and participate in decision-making on behalf of the employees. The fundamental purpose of the employee director system is to represent the interests of employees, so employee directors should be regular employees who have a labor relationship with the company. The correlation between the interests of non-working employees and those of the company's employees is low, and only the company's employees can better understand the company's situation, and then effectively participate in corporate governance. And the dual identity of employee directors as both employees and directors gives them a natural advantage in obtaining human resources information.[2] Therefore, the status of an active employee is a prerequisite for becoming an employee director.

3.1.2. Democratically Elected by the Employees of the Company

Directors are usually elected by the shareholders (general) meeting to represent the interests of shareholders and to manage and supervise the company. Employee representatives on the board of directors are democratically elected by the employees of the company through the employees' congress, employees' meetings, or other forms. The Company shall listen to the opinions of labor unions and employees in the study of important matters. Employee directors are representatives of the employee groups and must be able to reflect the overall interests and demands of the employees. Therefore, to ensure that they can truly represent the interests of the employees and play an active role in the Company's decision-making, they must be democratically elected by the Company's employees.

3.1.3. Ability to Perform

In the Administrative Measures for the Performance of Duties by Employee Directors of Central Enterprises with Pilot Boards of Directors issued by the SASAC in 2009 (now repealed), the SASAC stipulated the special duties of employee directors, which were mainly related to safeguarding the interests of employees. The Opinions of the All-China Federation of Trade Unions(ACFTU) on Strengthening the Construction of the Employee Director System and Employee Supervisory System of Corporate Enterprises (hereinafter referred to as the “Opinions”) issued in 2016 emphasized that employee directors need to be “well-versed in labor laws and regulations”, which put forward high professionalism requirements for the candidates of employee directors. For employee directors, their important duties require them to be familiar with the production and operation of the enterprise and to understand the market economy and enterprise management. The quality of employee directors directly determines the extent of their role in representing employees on the board of directors.[3]

3.2. Negative Qualifications

Article 178 of the new Companies Law stipulates the negative qualifications of directors. In addition to meeting the negative qualifications of directors, employee directors are required to

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have other restrictions based on the special characteristics of employee directors, which mainly stipulate the circumstances under which some persons are not allowed to serve as employee directors, including the following aspects.

3.2.1. Senior Executives are not Allowed to be Employee Directors

The 2012 Provisions on Democratic Management of Enterprises Senior executives are managers of the Company and are likely to put the interests of the Company first. The interests they represent may therefore conflict with those of the employees, making it difficult to protect their interests. Employee directors represent the interests of the majority of employees and need to consider the interests of employees, and shareholders as capital and employee interests in some issues in conflict, the capital wants to maximize the return on investment, which will inevitably produce a reduction in the employee's salary or prolonged working hours and other impact on the employee's rights and obligations of the behavior.[4] Therefore, senior executives may not serve as employee directors.

3.2.2. Employee Supervisors May not Serve as Employee Directors

As the supervisory committee and the board of directors are two different organizations in a company, the main duty of the supervisory committee is to supervise the conduct of directors and senior executives. If employee supervisors also serve as employee directors, this may lead to a weakening or failure of the supervisory function, which is not conducive to the board of directors and the supervisory committee performing their respective functions, thereby affecting the development of the company. Therefore, in order to ensure the independence of the corporate governance structure and the effectiveness of supervision, employee supervisors shall not serve as employee directors.

3.2.3. A Deputy Party Secretary Who is Not Also the President of the Labor Union May not Serve as an Employee Director

Article 6 of the Administrative Measures for Employee Directors stipulates that a deputy secretary of the Party committee who is not also the president of the labor union shall not serve as an employee director of the company. This provision mainly affirms the reasonableness of the president of the labor union as an employee director, who, as the organizer and conductor of the labor union organization playing the roles of representation, maintenance, participation in supervision, and education, shall safeguard the legitimate interests of the masses of employees. The deputy party secretary and the employee director, however, have different duties and may have conflicts of interest in the performance of their duties, which is not conducive to safeguarding the interests of the employees. Therefore, it is not appropriate for a deputy party secretary who is not also the president of the labor union to serve as an employee director.

4. Deficiencies in the Current Legislation on Qualifications of Employee Directors

Departmental regulations and normative documents issued by SASAC and ACFTU provide for the qualifications of employee directors. However, due to certain differences in the provisions of the documents issued by the SASAC and the ACFTU, the application of the criteria for the qualifications of employee directors is confusing in practice.

4.1. Vague and Non-harmonized Legal Provisions

Firstly, with respect to the prohibition of concurrent employment of employee directors, there is a difference between the Measures for the Administration of Employee Directors and the Provisions on the one hand, and the Measures for the Administration of Employee Directors on the prohibition of concurrent employment of employee directors on the other hand adopts an

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enumerative approach to enumerate a series of persons who are not permitted to concurrently hold the position of employee director, whereas the Provisions stipulate generally that “senior executives of the Company” shall not be permitted to concurrently hold the position of employee director. "Senior management personnel of a company shall not concurrently serve as employee directors. On the other hand, the provisions vary from province to province, for example, the Regulations on the Democratic Management of Enterprises of Qinghai Province and the Regulations on the Democratic Management of Enterprises of Hainan Province only stipulate that senior executives of a company shall not concurrently serve as employee directors, while the Measures for the Administration of Employee Directors of Contributing Enterprises of Hubei Province also adopt an enumerated approach, and the list of persons who are not concurrently allowed to serve as employee directors is wider in scope compared with that of the Measures for the Administration of Employee Directors. It is generally stipulated that senior executives of the company are not allowed to serve as employee directors, but nowadays there is no uniform standard for the identification of “senior executives”, and the application in practice is rather abstract, and the phenomenon of senior executives serving as employee directors still exist, and the stipulation of prohibiting senior executives from serving as employee directors is only in the form of formalities. Although the enumerated provisions are more detailed, they are not exhaustive of all the situations in which employee directors are not permitted to serve concurrently, and there are differences in the specific enumeration of persons who are not permitted to serve concurrently as employee directors in each province, which may give rise to divergences.

Secondly, the attitude towards the president of the labor union as a candidate for employee director is not uniform across documents. The Regulations on the Administration of Employee Directors stipulate that the main person in charge of a trade union “may” be a candidate for employee director, indicating that the head of the trade union is not the only option for employee directors. The Provisions consider that the president of the labor union “should” be a candidate for employee director. The Opinions state that the president of the labor union of a company “generally should be” a candidate for employee director. Most of the local regulations of each province also stipulate whether the president of the labor union is a candidate for employee director according to the above three documents, i.e., the words “ may ”, “ should ”, and “ generally should be ” are used to stipulate. The determination is made on the basis of the above three documents. The three words “should”, “generally as” and “may” as stipulated in the above series of documents do not express the same degree of certainty, and the provisions on the qualifications of employee directors are not detailed, resulting in insufficient applicability of the relevant laws and regulations and local documents in practice. The provisions on the qualifications of labor directors are not detailed and local regulations are not uniform, resulting in insufficient applicability of the relevant laws and regulations and local documents in practice, and thus whether the president of the labor union should be a candidate for the position of labor director has yet to be further argued.

4.2. Confusion Over the Eligibility Criteria for Employee Directors in Practice

The Measures for the Administration of Employee Directors stipulate that a deputy secretary of the Party committee who is not also the president of the labor union may not serve as an employee director of the company, a provision that in effect affirms the serving of employee directors in the capacity of the president of the labor union. By organizing the disclosure of the establishment of employee directors and the positions held by employee directors by 98 central enterprises published by SASAC, 47 of the 98 central enterprises have employee directors on their boards of directors. The number of centralized enterprises that could retrieve information on the status of employee directors was 46, of which 9 centralized enterprises had deputy party secretaries serving as employee directors without also serving as the president of the labor

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union, which shows that there are certain problems with the application of the above provisions in practice. On the one hand, from the point of view of the role played by the Party Committee in state-owned enterprises, Article 30(2) of the Constitution of the Communist Party of China (CPC) stipulates that the Party Committee (Party Group) of a state-owned enterprise shall play a leading role in discussing and deciding on major matters of the enterprise in accordance with the regulations. On the other hand, from the point of view of the procedure for the generation of deputy party secretaries, Article 7 of the Regulations on the Work of Grassroots Organizations of the Communist Party of China in State-Owned Enterprises (for Trial Implementation) issued by the Central Committee of the Communist Party of China (CPC) on December 30, 2019, stipulates that the deputy secretaries of the party organizations of State-Owned Enterprises shall be elected by the plenary session of the committee of the respective level. Combining the above two aspects, the deputy secretary is elected by the local party committee and his role is more focused on party construction and organizational management rather than directly representing the interests of the employees, while the employee director is democratically elected by the employees of the company and represents the interests of the employees of the company on the board of directors. Therefore, if a deputy secretary who is not also the president of the labor union serves as an employee director, a conflict of roles may easily arise, which is not conducive to the performance of the employee director's role.

In summary, it can be seen that due to the lack of unified legal provisions on the qualifications of employee directors in China, there are differences and conflicts in the provisions of different norms on the qualifications of employee directors, which leads to confusion about the qualification standards of employee directors in practice. The Provisions indicate that senior executives are not allowed to serve as directors, but the criteria and scope of senior executives are not clearly defined, leading to the possibility that the company may rank the senior executives who are still serving as employee directors, which contradicts the purpose of the establishment of the employee directors, is not conducive to the protection of the interests of the employees, and is also not conducive to the development and improvement of the employee directorship system.

5. Proposals for Legislative Improvement of the Qualifications of Employee Directors

In response to the current legislative deficiencies regarding the qualifications of employee directors, on the one hand, there is a need to standardize the qualifications of employee directors; on the other hand, it is necessary to further explain the criteria for the application of the qualifications of employee directors. Specifically, there are the following two points.

5.1. Uniform Provisions on the Qualifications of Employee Directors in Laws and Regulations

First, concerning the prohibition of concurrent employment of employee directors, it is necessary to establish a judgmental criterion for the scope of senior executives. The scope of senior executives is set out in the new Companies Law. The law can't list all possible senior executives, but in many cases, it is necessary to make a judgment as to whether or not they are senior executives, so when the law cannot exhaust the list, it should adopt a substantive judgment standard. In judicial practice, the determination of senior executives adopts the criterion of substantive determination, which is based on the actual nature and content of the work to determine whether or not they are senior executives of the company. Judging from the aspect of job duties, senior executives shall be those who have the authority to manage and administer the overall affairs of the company, so those who have leadership responsibilities for the company's decision-making, operation, and management, and play a leading role in the operation of the whole company shall be recognized as senior executives. This determination

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standard can avoid some people who are not senior executives under the Companies Law but exercise the authority of senior executives to serve as employee directors, which is more conducive to protecting the interests of the general employees.

Second, the main argument is whether the president of the labor union "should" be a candidate for employee director. The Measures for the Administration of Employee Directors provide that candidates for employee directors may be the principal person in charge of the company's labor union or other representatives of the company's employees, and Article 37 of the Regulations on the Work of Labor Unions in Enterprises issued by the ACFTU at the end of 2006 provides that the president of the labor union of an enterprise "shall, in general, serve as a candidate" for employee director. Article 10 of the 2009 Measures for the Performance of Duties by Employee Directors stipulates that candidates in charge of labor unions should generally be recommended as candidates for employee directors if they have the qualifications and ability to perform the duties of a director, but it does not negate the qualifications of other employees to be elected as an employee director. Article 38 of the 2012 Provisions stipulates that the president of the labor union "should" be a candidate for the election of employee directors. The 2016 Opinions stipulate that the president of the labor union of a company "generally should be a candidate for" employee directors. Article 38 of the 2012 Regulations provides that the president of the labor union "should" be a candidate for employee director, and the 2016 Opinions provide that the president of the labor union of a company "generally should be" a candidate for employee director. From this series of documents, it can be seen that the question of whether the president of the labor union is a candidate for employee director has changed from "can be" to "should be". Although the labor union is the representative and defender of employees' interests, the labor unions in China are not independent in terms of economy and personnel, and the president of the labor union, who lacks independence, may have the dilemma of being subject to the senior executives as well as checking and balancing the power of the senior executives.[5] Therefore, there is a need to standardize whether the president of the labor union "should" be a candidate for employee director. From the perspective of better safeguarding the interests of employees, and taking into account the above discussion, it is more appropriate to stipulate that the president of the labor union "may" be a candidate for employee director, i.e., the president of the labor union is not the "only" option for employee director.

5.2. Further Explanation of the Eligibility Criteria for Employee Directors

First, the legality of deputy secretaries of the party committee who are not also the president of the labor union serving as employee directors. A series of documents stipulate that deputy secretaries of the party committee who are not also the president of the labor union are not allowed to serve as employee directors, but in practice, deputy secretaries of the party committee who are not also the president of the labor union serve as employee directors, which is mainly due to the low level of the effectiveness of the documents and the narrow scope of application. In state-owned enterprises, deputy secretaries of the labor party committee are elected by the plenary of the committee at their level, and employee directors are democratically elected by the employees of the company, so there is a conflict of roles between the two, and it is inappropriate for them to serve as employee directors, and it should be further emphasized that deputy secretaries of the labor party committee who do not also serve as the chairman of the labor union are not permitted to serve as employee directors.

Secondly, in practice, there are senior executives or senior executives who also serve as the president of the labor union as employee directors, so whether the senior executives who serve as the president of the labor union can serve as employee directors is a matter of concern. It is difficult for the president of the labor union who is also a senior executive to truly represent and defend the interests of the employees. For example, the Companies Law stipulates that the

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secretary of the board of directors of a listed company belongs to senior executives, although whether or not to set up a secretary of the board of directors in a non-listed company belongs to the category of company autonomy. However, according to the procedure for the creation of the secretary of the board of directors, his or her powers and duties, the secretary of the board of directors belongs to the senior executives, without distinguishing between the secretary of the board of directors of a listed company or a non-listed company. In central enterprises, there are also employee directors in which the secretary of the board of directors is also the president of the labor union. The interests represented by the senior executives and the president of the labor union are different; the senior executives cannot fully consider the interests of the employees, while the president of the labor union should safeguard the interests of the employees; if the president of the labor union, who is also a senior executive, serves as the employee board of directors, it will lead to a conflict of roles with different interests, which is not conducive to the protection of the interests of the employees. Therefore, it is not appropriate for the president of the labor union, who is also a senior executive, to serve as an employee director.

6. Conclusion

Employee directors, as an important part of corporate governance, mainly express opinions and demands on behalf of employees through direct participation in the board of directors and safeguard the legitimate rights and interests of employees. Therefore, the determination of the qualifications of employee directors is directly related to whether employee directors can better fulfill their duties and safeguard the interests of employees. The qualifications of employee directors are determined on the basis of meeting the qualifications of directors, from the special characteristics of employee directors, and in conjunction with the functional orientation of employee directors. For the improvement of the qualification of employee directors, on the one hand, it is necessary to make uniform provisions for the qualification of employee directors, and on the other hand, it is necessary to make a further explanation for the qualification standard of employee directors, to improve the system of employee directors in China.

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