

# **COMPANY WINDING UP AND LIQUIDATION IN CHINA**

**by Editorial Staff writer**

## **INTRODUCTION**

In the People's Republic of China ("PRC"), winding up is broadly divided into insolvency winding up and winding up by dissolution. Under the winding up by dissolution, there can be voluntary liquidation or compulsory liquidation.

The current legislation on insolvency winding up includes the Enterprise Insolvency Law of the PRC enacted in 2006 ("Insolvency Law of the PRC"), *Provisions (I) & (II) of the Supreme People's Court on Several Issues concerning the Application of the Enterprise Insolvency Law of the PRC* promulgated in 2011 and 2013 ("Insolvency Provisions (I) & (II)").

As to winding up by dissolution in PRC, relevant provisions can be found in Chapter 10 of Company Law 2013 and *Provisions (II) of the Supreme People's Court on Certain Issues Concerning the Application of the Company Law of the PRC 2014* ("Company Provisions (II)"), which was drafted for issues concerning the liquidation of enterprise legal person.

## **INSOLVENCY LIQUIDATION**

According to the Insolvency Law of the PRC, insolvent liquidation has to be instituted in the court by the debtor, the creditor or the person responsible for liquidation. The debts will be subjected to liquidation after the declaration of insolvency by the court.

The grounds for the debtor to make an application to the people's court for insolvency liquidation are provided in art 2(1) of the Insolvency Law of the PRC:

*Where an enterprise legal person cannot pay off its debts due and its assets are not enough for paying off all the debts, or it apparently lacks the ability to pay off its debts, the debts shall be liquidated according to the provisions of this Law.*

The people's court will declare the debtor's inability to settle its debts after satisfaction of the following statutory conditions:

1. Debtor-creditor relationship has been legally established.
2. Time limit for repayment of the debt has expired.

3. Debtor has not fully settled the debt.<sup>1</sup>

As for the meaning of “apparently lacks the ability to pay off its debts”, art 4 of the *Insolvency Provisions (I)* provides:

*Where a corporate debtor falls under any of the following circumstances, the people's court will determine that the debtor apparently lacks the ability to pay off its debts, even though the book value of its assets exceeds that of liabilities.*

*(1) It is unable to repay a debt due to serious lack of funds, realize any assets or any other reason;*

*(2) It is unable to repay a debt because the whereabouts of its legal representative is unknown and there is no other person in charge of asset management;*

*(3) It is unable to repay a debt even after enforcement by the people's court;*

*(4) It is unable to repay a debt because it has suffered losses for a long time and has difficulty in making up losses; or*

*(5) any other circumstance which leads to the debtor's insolvency.*

When the debtor cannot pay off its debts, the creditor is also entitled to make an application to the people's court for the debtor's reorganization or insolvency liquidation. Where an enterprise has been dissolved but has not started or completed liquidation and it does not have enough assets to pay off its debts, the person responsible for liquidation according to law will make an application to the people's court for insolvency liquidation. In such cases, the people's court must accept the application unless the debtor is able to produce evidence that there is no triggering event of insolvency within the statutory time limit for objection.

When the people's court decides to grant an application for insolvency, it will designate an administrator at the same time. However if the creditors' meeting believes that the administrator cannot perform his duties according to law impartially or is incompetent to fulfill his duties, the creditors may apply to the people's court for a replacement.<sup>2</sup> An administrator cannot resign without justifiable reasons and has to be subjected to approval by the people's court.<sup>3</sup>

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<sup>1</sup>*Insolvency Provisions (I), art 2.*

<sup>2</sup> Insolvency Act of the PRC, art 13 and art 22.

<sup>3</sup> Insolvency Act of the PRC, art 29.

The administrator can be a liquidation group comprised of relevant staff in departments and agencies or a law firm, a certified public accountant firm, an insolvency liquidation firm or any other public intermediary agency. If the administrator is an individual, he has to possess necessary professional knowledge and qualifications for the practice. Also, such an individual will not serve as an administrator due to the following:

- (1) He has committed criminal offence.
- (2) His qualification certificate for the relevant practice has been revoked.
- (3) He has an interest in the case.
- (4) The people's court deems it improper to have him as an administrator.<sup>4</sup>

Art 25 of the Insolvency Law of the PRC specifies the following duties of an administrator:

- (1) taking over the property, seals, account books, documents and other data of the debtor;*
- (2) investigating into the financial status of the debtor and preparing a financial statements;*
- (3) deciding the internal management of the debtor;*
- (4) deciding on the daily expenditure and other necessary expenditures of the debtor;*
- (5) deciding, before the first creditors' meeting is held, to continue or suspend the debtor's business;*
- (6) managing and disposing of the debtor's property;*
- (7) participating in arbitral and other legal proceedings on behalf of the debtor;*
- (8) proposing to hold creditors' meetings; and*
- (9) Performing any other functions and duties that the people's court believes it should perform.*

A successful insolvency liquidation application will result in the following consequences :

- (1) Payment of debts made by the debtor to individual creditors will be invalid after the people's court has accepted the application for insolvency liquidation.<sup>5</sup>
- (2) Payment of any debts or delivery of property rights due to the debtor will be made to the administrator. If the administrator intentionally pays off the debts or deliver the property to the debtor, resulting in losses to creditors, his obligation of paying off the debts or delivering the property will not be exempted.<sup>6</sup>

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<sup>4</sup>*ibid*, art 24.

<sup>5</sup>*Ibid*, art 16..

<sup>6</sup>*ibid*, art 17.

- (3) Any arbitration and court proceedings involving the debtor that is in the process of adjudication will be suspended. The action or arbitration can be resumed after an administrator takes over the debtor's property.<sup>7</sup>
- (4) Civil action against the debtor can only be filed with the people's court, which has accepted the application for insolvency winding up.<sup>8</sup>

## **LIQUIDATION BY DISSOLUTION**

The grounds for liquidation by dissolution are provided in art 180 and art 182 of Company Law of the PRC. *Company Provision II* provides more details.

A winding up by dissolution can take place under any of the following circumstances:

- (1) The term of operation specified in the company's articles of association has expired or any other causes of dissolution specified in the company's articles of association has occurred;
- (2) The shareholders' meeting or the general meeting has resolved to dissolve the company;
- (3) The company needs to be dissolved resulting from a merger or division of company;
- (4) The business license of the company is revoked or the company is ordered to close down or is removed in accordance with the law; or
- (5) An action for dissolution of a company is filed by one shareholder that holds or shareholders that collectively hold at least 10% of the voting rights of all the shareholders in the company. The grounds for such shareholder's application include:
  - (a) Failure to hold a shareholders' meeting or a general meeting of shareholders for at least two consecutive years, and it encounters serious difficulty in its business management;
  - (b) Failure to comply with the voting requirement either under statute or articles of association necessary for valid shareholders' resolutions for at least two consecutive years, and it encounters serious difficulty in its business management;

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<sup>7</sup>*Ibid*, art 20.

<sup>8</sup>*Ibid*, art 21.

- (c) Conflict exists among its directors for a long time, which cannot be settled through the shareholders' meetings or the general meetings of shareholders, and it encounters serious difficulty in its business management; or
- (d) It has faced other acute difficulties in its business management, and its continuous existence will substantially the interests of shareholders.<sup>9</sup>

In accordance with art 182 of *Company Law of the PRC 2013*, such circumstances must reach a certain level of severity. In such a case, the company faces serious difficulty in either its operations or management in such a manner that the interests of its shareholders will suffer heavy losses if allows to exist with no timely resolution of the problem

A useful case directive issued by the PRC Supreme Court arises from the case of *Lin Fangqing v. Changshu Kailai Industry Co., Ltd and Dai Xiaoming*<sup>10</sup>. The directive provided useful guidelines on “difficulty in operations and management”:

*It should be judged by comprehensive analysis of its operations. Although it is profitable, the board of shareholders has malfunctioned for a long time, and its internal management is in deadlock with regulatory obstacles and it has fallen into deadlock. Therefore, the people’s court can decide to dissolve it when other conditions required by Company law and relevant judicial interpretations have also been satisfied.*

Under winding up by dissolution, there can be voluntary liquidation or compulsory liquidation.

### ***Voluntary Liquidation***

When the company is to be dissolved due to any of the above mentioned circumstances (1), (2), (4), (5), the company has to form a liquidation group to commence the liquidation within 15 days. In a voluntary liquidation, the liquidation group is formed and instituted by the company itself. The liquidation group of a limited liability company will be composed of the shareholders, while that of a joint stock limited company will be composed of the candidates determined by the

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<sup>9</sup> *Company Provisions (II), art 1*

<sup>10</sup> *Guiding Case No. 8, Gazette of the Supreme People’s Court of the Peoples Republic of China, 12 (2012).*

directors or the general meeting.<sup>11</sup> Failing to form a liquidation group within the specified period, the shareholders or directors may assume relevant liabilities. Art 18 of *Company Provisions (II)* states:

*If the shareholders, in the case of a limited liability company, or the directors and controlling shareholders, in the case of a joint stock company, fail to form a liquidation group to commence liquidation within the statutory time limit, thus resulting in the depreciation, loss, damage, or disappearance of company properties, and the creditors demand that the shareholders or the directors and controlling shareholders shall be liable to the extent of the losses incurred, the relevant people's court shall uphold such demand in accordance with the law.*

*If the shareholders, in the case of a limited liability company, or the directors and controlling shareholders, in the case of a joint stock company, neglect to perform their obligations, thus resulting in the loss of the primary properties, account books, important documents of the company and rendering it impossible to carry out liquidation, the creditors can demand that the shareholders or the directors and controlling shareholders will be jointly and severally liable for repayment of the debts of the company. The relevant people's court shall uphold such demand in accordance with the law.*

*If the aforementioned circumstance is due to reasons attributable to the actual controllers, and the creditors demand that the actual controllers will be accountable to the company, the people's court will grant such a demand.*

### ***Compulsory Liquidation***

Under Chinese law, the compulsory liquidation is a kind of judicial remedy when voluntary liquidation has not been effectively carried out or fulfilled.

In accordance with Company Law of the PRC 2013 and *Company Provisions (II)*, the compulsory liquidation can be triggered through the application of creditors in the following three circumstances.

- (1) A liquidation group has not been formed by the company to carry out the liquidation within the specified time limit;*
- (2) A liquidation group has been formed but the liquidation is deliberately delayed; or*

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<sup>11</sup> Company Law of the PRC 2013, art 183.

*(3) The liquidation violates the law, which is likely to damage the interests of the creditors or shareholders severely.*<sup>12</sup>

In such cases, the creditors may apply to the competent people's court to designate relevant personnel to form a liquidation group. The people's court has to grant an application and expeditiously organize a liquidation group to carry out the liquidation process.

Under English law, the creditor has to satisfy the statutory requirements under the Insolvency Act 1986 before there can be any application to the court. The amount of his debt has to be in excess of £750, and he has to serve a statutory notice on the debtor company.<sup>13</sup> However, there are no such restrictions under Chinese law, which means that any small-amount creditor is entitled to apply to the competent people's court for liquidation without prior notice to the company.

Where the liquidation group has been established but the liquidation process is deliberately delayed, the company's shareholders are entitled to file an application with a people's court to designate another liquidation group to carry out the liquidation. This is provided that the creditors do not make an application.<sup>14</sup> This is compulsory liquidation as the liquidation group is designated by the court.

In compulsory liquidation, the court will select members of a liquidation group from the following personnel or institutions:

- (1) Shareholders, directors, supervisors, senior management personnel of the company;*
- (2) Legally established law firms, accounting firms, insolvency liquidation firms, and other social intermediary agencies; and*
- (3) Personnel from legally established law firms, accounting firms, insolvency liquidation firms, and other social intermediary agencies, who have relevant professional knowledge and practice qualifications.*<sup>15</sup>

If a member of the liquidation group has violated any laws or administrative regulations or harms the interests of company or the creditors, or is professionally incompetent to act, the people's court may replace such individual based on its jurisdiction or upon the application of any creditors or shareholders<sup>16</sup>

If the liquidation group, either voluntarily formed or compulsorily designated, during the process of winding up by dissolution, discovers that the assets of the

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<sup>12</sup>*Company Provisions (II), art 7.*

<sup>13</sup>Insolvency Act 1986, s123 (1).

<sup>14</sup>*ibid.*

<sup>15</sup>*Company Provisions (II), art 8.*

<sup>16</sup>*Company Provisions (II), art 9.*

company are not sufficient for paying off the debts, the liquidation group will file an application to the competent people's court for insolvency winding up. Once the court accepts such application, the liquidation group will hand over all the liquidation matters and the relevant files to the court.<sup>17</sup> The process then converts to that of insolvency winding up.

### **POWERS, DUTIES AND LIABILITIES OF THE LIQUIDATION GROUP**

Under Chinese law, it is the "liquidation group" that is responsible for the liquidation matters. There must be at least two members in a liquidation group. There is only a liquidator or liquidators in English law. Also, a liquidation group is totally different from a liquidation committee under English law.

Art 184 of the *Company Law of the PRC 2013* empowers the liquidation group as follows:

*The liquidation group of a company may exercise the following powers during liquidation:*

- (1) Liquidating the property of the company, and preparing the balance sheet and a list of property;*
- (2) Informing the creditors of the company by notice or public announcement;*
- (3) Handling the outstanding liquidation-related business of the company;*
- (4) Paying off the due and payable taxes and the taxes incurred during the liquidation;*
- (5) Liquidating the claims and the debts of the company;*
- (6) Handling the property remaining after the full repayment of the debts of the company; and*
- (7) Participating in civil litigations on behalf of the company.*

The members of a liquidation group will devote themselves to their duties and perform liquidation obligations in accordance with the law. The members of a liquidation group will not abuse their authority to accept bribes or other illegal gains and misappropriate any of the properties of the company.<sup>18</sup>

In accordance with art 189 of *Company Law of the PRC 2013*, a member of a liquidation group can be accountable when it has caused losses to the company or its creditors intentionally or due to his gross negligence. However, *Company Provisions (II)* extends the scope of the liquidation group's liabilities in art 23. If any member of the liquidation group violates the laws, administrative regulations, or articles of association of the company resulting in losses either to the company or

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<sup>17</sup> Company Law of the PRC, art 187.

<sup>18</sup> Company Law of the PRC, art 189.



creditors, the company or creditors may seek court's redress in making him liable in the form of compensation.

In accordance with art 206 of Company Law of the PRC 2013, where a liquidation group fails to submit a liquidation report to the company registration authority or where any important fact is concealed or there is important omission in its submitted liquidation report, the relevant company registration authority will order the liquidation group to make corrections. Where any member of a liquidation group takes advantage of his authority for personal gains, seek illegal gains or misappropriate any of the company's properties, the relevant company registration authority shall order the member to return such property of the company, confiscate his illegal gains and may impose a fine which is double but not more than five times of the illegal gains.

## **DISSOLUTION**

After the completion of the liquidation of a company, the liquidation group will prepare a liquidation report and submit the report to the shareholders' meeting, the general meeting, the people's court for confirmation, and the relevant company registration authority to deregister the company. The liquidation group will also make a public announcement regarding the termination of the company.<sup>19</sup>

Unlike English law, there is no stipulation on Restoration of Dissolved Company under Chinese Law, which means that company deregistration is irreversible.

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<sup>19</sup> Company Law of the PRC, art 188.