



▶ LIQUIDATION PROCEDURES AND THE ENTERPRISE BANKRUPTCY LAW 2

▶ NEW CHANGES IN THE FIRE SAFETY LAW 3

▶ HURDLES TO WINNING AND ENFORCING JUDICIAL AWARDS 4

CHINA Legal Bulletin

YOUR LEGAL
ADVISORS IN
CHINA

Executive Summary

Liquidation Procedures and the Enterprise Bankruptcy Law

Successfully liquidating an FIE in China involves many complex procedures, as well as also multiple factors to consider including notifying creditors, terminating employee contracts, and the final deregistration of the company which must be done according to the law and within local standards. We provide you with an outline of the basic steps to be taken when liquidating an FIE.

By Seth T. Buckley and Kathleen Cao

New Changes to the Fire Safety Law

On May 1st, 2009 the new Fire Safety Law came into force with strict new regulations regarding business owners' responsibilities in adopting fire prevention measures on their properties. The law also imposes greater personal liability and penalties on violators of the law. Our expert panel gives an overview of what the new Fire Safety Law now includes and in what ways it will affect business owners throughout China.

By Zach Wortham and Liz Heide

Hurdles to Winning and Enforcing Judicial Awards

Resolving legal disputes in China involves strenuous measures for collecting evidence including having documents translated, notarized, and legalized when submitting evidence from foreign jurisdictions. In order to prepare oneself for an upcoming dispute this article provides some insightful observations and advice concerning the requirements of the PRC courts and furthermore how arbitral awards and legal judgments can be enforced through the Chinese legal system.

By Zach Wortham and Nick Valenti

NEWS FLASH

China's product quality authority is publishing a product safety black list

The authority is launching a rating system within three years that will expose companies that have had problems with poor quality products and records of violation of product safety regulations. The blacklist will focus on products used in daily life.

IPO ban has been lifted

The nine month long ban on initial public offerings (IPOs) has been lifted with the approval of a Chinese drug company to commence a stock exchange listing. The suspension of IPOs began in September of last year after Shanghai's Composite Index tumbled 60% over a nine month period.

SAFE implements new overseas lending rules

To encourage Chinese companies to invest overseas, the State Administration of Foreign Exchange (SAFE) will, starting Aug 1, 2009, ease the restrictions on domestic companies loaning funds to finance businesses abroad. The companies will be able to take out a loan of up to 30% of their own equity to fund subsidiaries overseas.

The China Legal Bulletin is produced by Wang Jing & Co. Law Firm

EXECUTIVE EDITOR:
WANG JING

SENIOR EDITOR:
MAARTEN ROOS

EDITOR AND DESIGN:
ZACHARY WORTHAM

Liquidation Procedures and the Enterprise Bankruptcy Law



Navigating a Sinking Ship: Guiding an FIE Through Voluntary Liquidation and the Chinese Enterprise Bankruptcy Law

While China has done relatively well to weather the strong negative trends of the global economic recession, it has certainly not been left unscathed. One consequence which has emerged is a significant increase in the number of foreign invested enterprises pressed with the urgency to liquidate their assets, whether voluntarily or through the bankruptcy system. Under such circumstances, a company must first assess the value of all remaining assets in the company. Based on the value of these assets, the company is able to then determine whether they are valued at a sufficient level to warrant a voluntary liquidation through the establishment of a liquidation committee, or whether it would be best to file for bankruptcy and leave the burden to the court and bankruptcy administrator. A third alternative would be to illegally withdraw from China, which however can be very risky if the investor would like to do business in China again.

Voluntary Liquidation

The most common and preferred method for liquidation by foreign enterprises in China is to voluntarily terminate operations and then de-register the company. Voluntary liquidation may be paramount in circumstances where substantial value still exists in the remaining assets, and the shareholders see an advantage to maintaining control over the liquidation process. Additionally, avoiding the stigma of bankruptcy may be beneficial if the shareholders desire to continue professional relationships with vendors, suppliers, customers, and employees.

The decision to terminate operations is made by the shareholders and/or board of directors, who then appoint a liquidation committee to handle the procedures related to the dissolution. While shareholders attempt to appoint members to this committee who will represent their interests, the members do have fiduciary duties to act in the best interest of the company and its creditors, with penalties for violation of this duty or any laws, regulations, or the Articles of Association. Once the committee has been established, it is imperative to immediately take control of the company stamps, licenses, and bank accounts to prevent any further business activity. With control of the company, the committee can then dissolve the company including arranging for government approvals, terminating employee contracts, collecting or writing off debts, selling off remaining assets, reimbursing creditors, filing liquidation and audit reports, and de-registration procedures.

Obtaining final approval for de-registration from the government and in particular, the tax

authorities, is often the most challenging part of the liquidation process. These departments have the authority to require any outstanding issues to be resolved before endorsing the final de-registration. It is at this stage that the liquidation committee is often caught by surprise with claims and issues related to unpaid taxes, social insurance, foreign exchange, customs duties, and the like.

To prevent any incidents which may cause delay to de-registration, a foreign invested company may wish to adopt a few precautionary business practices. First, companies are advised to retain and organize all relevant documentation, especially financial documents, to ensure ease of accessibility in the event they are required for verification by tax and other authorities. Further, a company may consider reconciling and organizing its financial books; cataloging all tax payment evidence for later use in receiving the tax clearance certificate; and assembling VAT and other invoices together for liquidation sales. Second, it is advantageous for the individual working on behalf of the enterprise to have a good relationship with the authorities, as this will increase the likelihood of a smooth procedure.

Bankruptcy and the Enterprise Bankruptcy Law

At times the financial pressure of a voluntary liquidation becomes too great; other times the value of assets are initially insufficient to expend the time and resources necessary to hire professionals to support the liquidation committee. In such situations, the most viable solution may be to file a petition for bankruptcy, placing the complications of liquidation in the hands of the court and bankruptcy administrator.

Under the Enterprise Bankruptcy Law ("EBL") promulgated in 2006, bankruptcy cases are initiated by an application filed with the People's Court where the debtor company is domiciled. Both the debtor company and its creditors have the right to file an application for bankruptcy, conditioned upon certain requirements. For the debtor, a petition may be filed if it is: (a) cash-flow insolvent; (b) balance-sheet insolvent; or (c) "obviously incapable of clearing off all its debts." This most likely refers to the immanency of insolvency evidenced by the corporate balance sheets. Conversely, a creditor may only file an application if the debtor is cash-flow insolvent.

Pursuant to the EBL, a debtor company may be declared bankrupt, may apply for reorganization, or may apply for conciliation. Reorganization and conciliation will not be discussed in this article. However, it should be noted that these options are not commonly chosen, as the concepts are still relatively new to China and most individuals

do not yet understand the full procedures. If a debtor company is declared bankrupt, the sale of its assets must be conducted by auction, unless the creditor's meeting decides otherwise.

Upon receiving an application, the court then has fifteen days to determine whether to accept the petition. If the application is accepted, the court will appoint a bankruptcy administrator, a position commonly held by law firms, accounting firms, or bankruptcy liquidation firms. The administrator has broad powers to take over the debtor company during bankruptcy proceedings, including the managing of assets, operations, and legal proceedings of the debtor. However, the bankruptcy administrator must report to the court and the creditor's meeting. Also following the acceptance of an application, the court will set a time period during which creditors may declare their rights and claims, usually between 30 and 90 days. Creditors may submit a statement to the bankruptcy administrator declaring its claim, any pledges to that claim, and evidence of the claim. The bankruptcy administrator then notifies all known creditors of the time and location of an official creditors' meeting.

The creditors' meeting has the authority, among others, to oversee management and liquidation of the estate and approve plans regarding the realization and distribution of the debtor's assets. The creditors' meeting may also appoint a creditors' committee, which consists of creditor representatives selected at the creditors' meeting as well as an employee representative or a representative of the work union of the relevant debtor. In practice, the committee adopts a supervisory role, leaving the development of a liquidation plan to the bankruptcy administrator. The administrator then submits the report to the creditors' committee, who will accept the plan insofar as it is regarded as fair to all the parties.

Secured creditors have payment priority out of the proceeds of their collateral, with any shortfall classified as unsecured debt. Following these creditors, the distribution priority is as follows:

1. Bankruptcy expenses and liabilities;
2. Unpaid employee salaries, severance pay, medical insurance, and pension premiums;
3. Unpaid social insurance and taxes
4. Other unsecured creditors/shareholder claims

The EBL brings China's bankruptcy system closer to international standards and, while

Liquidation Procedures and the Enterprise Bankruptcy Law cont.



challenges still remain, improves the transparency and certainty of the China's bankruptcy system.

Illegal Withdrawal of an Enterprise

No doubt compliance with the rules and regulations regarding liquidations, whether voluntarily or through bankruptcy, accrues supplementary costs for the enterprise, both financially and otherwise. Consequently, China has recently witnessed an increase in the trend of foreign enterprises, especially smaller companies, to abandon their operations without observing the statutory liquidation process, thereby leaving behind outstanding bank loans, unpaid debts to creditors and employees, and unpaid taxes. While the financial incentive and ease of exit may be tempting, there are significant potential consequences to consider. First, any favorable reputation that has been

established by the company and shareholder will be quickly and permanently extinguished. Second, the shareholders, actual controllers, legal representative, and other members of the board of directors may be held jointly responsible for the abandoned company's debts and its failure to meet its legal obligations, notwithstanding the limited liability character of the company. Third, the Chinese government has issued a circular declaring the government's right to prosecute foreign offenders through a cross border pursuit. And fourth, an illegal withdrawal may also result in company members being black listed by the local authorities, which can have the affect of preventing investment in China at any time in the future.

Conclusion

A business presence in China can be very profitable and have tremendous advantages for a

foreign enterprise. However, as in any country, it is important to know the full extent of the law, and how the law regulates your business activities and organizational development. China is currently experiencing a substantial transformation within its legal system, and the government is continuously attempting to create a more harmonized business climate for foreign and domestic companies alike. It is therefore essential to remain updated with regard to legal developments and be aware of the financial standing of your company to ensure preparedness in the event an exit strategy becomes necessary.

By Seth T. Buckley and Kathleen Cao

New Changes in the Fire Safety Law

New Changes in the Fire Safety Law

A recent spate of incidents throughout China involving the deaths of many people due to inadequate fire safety systems and procedures, have caused the government to carefully reexamine and revise the current fire safety law. The result is a law which is substantially more extensive in its scope, but also places a significant amount of responsibility on the business owner to ensure adherence to proper protocols.

While the law is still new and more time will be needed to determine how it will be implemented by local governments, it is worth noting that the new law requires that both a fire safety system and an evacuation plan be in place, along with an annual test run of the fire protection facilities to ensure that the systems are effective and in good condition.

Two Categories of Buildings and Personal Liability

The law separates all buildings into two categories: High Occupancy Buildings (HOB), which are directly answerable to the fire department; and all other standard buildings, which are the direct responsibility of the proprietor to ensure fire safety meets the standards set. It is estimated that roughly 20% of all buildings in China fall under the category of HOB and are therefore under the local fire departments' purview for ensuring that they meet the standards in the fire Safety Law, while the remaining 80% of all buildings

will now be under the individual real estate owner's supervision. Before launching an HOB project, the construction's fire facility design must be approved by the fire department. Standard building projects will not need to gain the fire department's approval, but the company appointed director in charge of fire safety will be responsible for ensuring that the construction meets the standards according to the law. Existing buildings will maintain their current fire classification obtained when the last inspection was conducted.

“Standard building projects will not need to gain the fire department's approval, but the director in charge of fire safety will be responsible for ensuring that the construction meets the standards...”

Therefore, upgrading fire protection facilities will not be necessary in most cases unless renovation has taken place and a new classification is imposed.

It is not specified who should perform the annual inspection of the fire

protection facilities, and for that reason it is up to the director in charge of fire safety to ensure that they are followed through. Besides simply filing an annual report with the fire department, it is also a good idea to keep thorough records of all inspections, including pictures. The fire department has the right to conduct random sight inspections and will in those cases request to view all reports certifying that proper testing of the facilities has been completed. Comprehensive documentation could therefore pave the way to successful compliance with the law.

The new law also mandates one key managing

director be responsible for the building's fire safety procedures and plans. This person must be in the top 3 of the management structure of the company and will be held liable should the building fail an inspection for noncompliance, and can even be sued in the case of a severe accident.

Penalties

In contrast to the old national fire protection law, the penalties for violating the new law are more strict and comprehensive. A fine of between RMB 30,000 and 300,000 will be imposed for anyone found to be in violation of the Fire Safety law. Additionally, anyone found to violate the law will be forced to cease all activities until they are in compliance. Fines will also be imposed against any individuals or companies who produce or sell defective fire control products or trade in fire control products declared obsolete by the authorities.

Conclusion

Anyone conducting business in China should take careful note of the new amendments to the fire safety law. The increased scrutiny will be particularly bothersome for those looking to establish a new business presence in China or lease warehouses. As with many things, as China's economy becomes more sophisticated so do its laws, and consequently the burden on business owners increases. Anyone looking to do business in China would do well to take these further measures and their associated costs into consideration when analyzing investment opportunities.

By Zach Wortham and Liz Heide

Hurdles to Winning and Enforcing Judicial Awards



Hurdles to Winning and Enforcing Judicial Awards

When doing business in China, it will quickly become apparent that disputes are common and resolving them can be complicated. In particular there are two common sources of frustration that any businessman in China should understand before deciding against a settlement. 1) The rules regarding the collection and submission of documents into evidence; and 2) The enforcement of legal judgments and arbitral awards.

Procedural Challenges

In China, the burden of proof lies firmly on the plaintiff. As such the deciding factor in many legal disputes is the quality of the evidence submitted by the plaintiff and supported by the courts. When collecting evidence it is important to note that Chinese law requires that all documents produced overseas be original, notarized, and legalized in the country where the document was created. Furthermore, any and all documents not written in Chinese must be translated by an authorized agency. These services are sometimes available at the relevant Chinese Embassy; however, the cost of such document preparation can be significant.

Further China follows a civil law system; therefore the element of discovery in evidence collection is very limited. Thus, Chinese courts are much less likely to compel a defendant to turn over documents which might implicate them in the proceedings. One bright spot is the submission of email as evidence. Email which is obtained from a server, and thus unalterable, is accepted by the court. Email that is taken from a computer through a program such as Microsoft Outlook, where alteration is difficult but not impossible, will often be accepted. In either case, the email must still be notarized by a local notary, which may not be true everywhere. At any rate, foreign companies doing business in China should be aware that most, if not all, of the evidence in a dispute must be provided by the plaintiff itself and will most likely need to be prepared by legal professionals.

Enforcement of Judgments

Another unforeseen difficulty that many foreign companies experience after litigating and winning

disputes is that the opposing company will not voluntarily follow the judgment of the court. This means that the plaintiff must seek enforcement through the judicial system. In cases where the losing party is a large business and has considerable property, payment of court awards will normally face less resistance as it will be harder for the losing party to hide or vacate its assets. However, if the losing party is relatively small with few assets or the judgment constitutes a sizable percentage of the losing party's capital then the winning party will normally need to seek enforcement in a PRC court. Applying for enforcement is a simple procedure but it can be complicated for any of several reasons.

Firstly, in regards to domestic litigation awards, some courts will refuse to enforce civil judgments due to local protectionism, often citing procedural differences from the court of issuance. In our experience the best way to combat protectionism is to consider well the jurisdiction where litigation will be heard when including a dispute resolution clause in a contract. This can be a difficult task when dealing with well connected local agents and a good alternative is often to rely on Chinese arbitration tribunals as they are less likely to be subject to local pressures, and their final rulings more problematic for a court to deny. Another issue when enforcing litigation awards is that most courts will not perform extensive investigations into the location and value of the assets of the losing party. Thus the court can not enforce a judgment if they have no information about what can be seized to satisfy the award. In such cases it is incumbent upon the winning party to assist the court and those that have kept records regarding the account information, real estate, and assets of their business partners will be in a better position.

In regards to foreign arbitration awards, China is a member of the New York Convention, the international agreement on the issue of the recognition and enforcement of foreign arbitral awards. Under this agreement, arbitral awards that are awarded in a foreign country that is also a party to the agreement will be enforced in China. This treaty covers most countries/jurisdictions, as there are currently over 140 state signatories.

Further, under Chinese law, only China's Supreme

Court may review a foreign arbitral award beyond the scope of review called for by the treaty itself. This means that a foreign firm's request for court enforcement of an arbitral award covered under the New York Convention will normally be granted. However, one thing that should be noted is that in a contract dispute when a clause is included which states that foreign arbitrators must be used to settle disagreements, PRC courts do sometimes reject such a clause as invalid in order to maintain jurisdiction over any claim for disputes transacted in their locality. And there is another important reason why we still recommend our clients submit claims to an arbitration commission in China: during the arbitration Chinese courts may agree to freeze the assets of the defendant, and an award from a Chinese based arbitration commission can be more quickly enforced in China. Enforcement of a foreign arbitration award on the other hand is much slower, and since assets cannot be frozen in advance, the losing party will have more opportunity to transfer and/or hide assets.

Finally, in regards to foreign litigation awards it should be assumed that PRC courts will generally not recognize or enforce such awards in the PRC. One of the few exceptions to this rule is the bilateral agreement between the PRC and Hong Kong, under which most civil lawsuits won in Hong Kong can be quickly and easily enforced in China.

Conclusions

While foreign companies can take solace in the fact that China does appear to be moving in the direction of better enforcement of foreign arbitral awards, they should still prepare for the certainty that resolving a dispute through legal channels in China will require specific evidence and sound advice from dispute resolution experts. A well-worded contract, selection of your preferred arbitral or litigation venue, and proper record keeping will go along way towards stopping potential legal entanglements before the lengthy resolution process even gets started.

By Zach Wortham and Nick Valenti

GUANGZHOU

Tel. (+8620) 8760 0082
Fax (+8620) 8778 4482
info@wjnc.com

SHANGHAI

Tel. (+8621) 5887 8000
Fax (+8621) 5882 2460
shanghai@wjnc.com

TIANJIN

Tel. (+86 22) 2532 3818
Fax (+86 22) 2532 3820
tianjin@wjnc.com

QINGDAO

Tel. (+86 532) 8666 5858
Fax (+86 532) 8666 5868
qingdao@wjnc.com

XIAMEN

Tel. (+86 592) 268 1376
Fax (+86 592) 268 1380
xiamen@wjnc.com

SHENZHEN

Tel. (+86 755) 8882 8008
Fax (+86 755) 8284 6611
shenzhen@wjnc.com

HAIKOU

Tel. (+86 898) 6672 2583
Fax (+86 898) 6672 0770
hainan@wjnc.com

FUZHOU

Tel. (+86 591) 8781 2260
Fax (+86 591) 8781 2210
fuzhou@wjnc.com