

How to Handle Company Dissolution Litigation

By Peiming Yang and Kevin Huang

A company is a market entity that involves multiple civil and commercial legal relationships. Dissolution means the closure of this market entity and the termination of all legal relationships, which will affect market stability. In addition, through the judicial procedure and liquidation proceedings, a company's dissolution will not only consume a large amount of judicial resources, but will also bring a devaluation of the company's assets at the liquidation price. This may ultimately damage the legal rights and interests of the shareholders and creditors. Therefore, the court normally exercises caution and will not issue a dissolution judgment without the proper evidence and after following the required process.

A recent case has once again pulled company dissolution litigation into the spotlight. The joint venture shareholder of Guangzhou Wang Lao Ji claimed that there had been irreconcilable contradictions in the operational conditions of the company and asked to dissolve the joint venture, Wang Lao Ji. Should requesting dissolution be the effective relief in case of a company deadlock? How is it applied?

The Company Law's Role in Dissolution

It is stipulated in Article 182 of the *PRC Company Law* that when a company experiences serious difficulties in its business and the shareholders will suffer serious damages if the company continues its operations, a shareholder or a group of shareholders holding 10% or more of the company's shares may, in the absence of any other means, request a mandatory dissolution of the company by the court.

Furthermore, specific grounds to file a suit to dissolve a company are expressly provided in the *Provisions on Several Issues Concerning the Application of the «PRC Company Law» (2) (Revised)*. According to this judicial interpretation, when a shareholder files a lawsuit with the court for dissolution solely on the grounds of harm to his/her right to know and right to ask for profit distribution, deficit or insolvency of the company or failure to carry out liquidation following revocation of the company's business licence, the court shall not accept the application.

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Deciding to Dissolve

As described in the case mentioned above, the shareholders of a joint venture may encounter conflicts during the operations of a company which may further cause deadlock in the company's management. Dissolution of a company may not necessarily be the best option to maximise the company's interests. Nevertheless, there are circumstances where the shareholders fall apart and file a suit to request the dissolution of the company.

As can be seen from the few cases where the court rules for dissolution, the following requirements need to be fulfilled in order to dissolve a company:

- Long term failure of the power organs of a company (board of shareholders, board of directors) where effective resolutions cannot be passed;
- Inability to exercise the right of one shareholder in the long term, which causes a huge loss to the shareholder; and
- The company deadlock is unable to be solved through any other means in the long term.

Moreover, the court will actively organise conciliation among the parties during the trial process. The court will only make a judgment to dissolve a company in the case where this conciliation fails.

Avoiding Litigation

The shareholder of a company, before filing a suit of company dissolution, must collect and prepare the following evidence:

- Evidence showing that the company is experiencing serious difficulties in its business, including the difficulties experienced by the company's authority in running company affairs and external business activities;
- Evidence showing that the interests of the shareholders have suffered huge losses. For instance, the company has a deficit or has lost business opportunities to gain profits;
- Evidence showing the exhaustion of other possible relief, e.g. negotiation among the shareholders, other purchasers have been contacted to purchase the share equities of the dissenting shareholder or settlement plans have been proposed to resolve the company deadlock.

Nevertheless, taking precautions beforehand is always more effective than seeking remedies afterwards. At the establishment of the company or the formulation of the articles of association, the rights of control, management, operation shall be defined clearly, and solutions in the event of a company deadlock also need to be formulated, so they can have a preventive effect in advance. For example, it could be agreed in the articles of association that once the board of shareholders experiences deadlock (i.e. parties with opposing opinions hold 50% of the voting rights respectively), a certain shareholder (e.g. the managing shareholder of the company) has the right to settle disputed matters. The withdrawal mechanism of certain shareholders in special circumstances may also be stipulated. Avoiding a deadlock also avoids company dissolution litigation, which in turn helps to maintain the stability of the company and the shareholders' interests to a greater extent.

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