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Elaboration of Procedures for Compulsory Liquidation by the Supreme People's Court

By David Yu and Eva Chen

According to the *PRC Company Law* ("Company Law"), a company must go into liquidation within 15 days after the occurrence of statutory events of dissolution. Given the impact of the current international financial crisis, in order to prevent a company from illegally escaping or delaying statutory liquidation, which could impair the interest of its creditors or minority shareholders, the Company Law and the *Regulations on Several Issues Regarding Application of the PRC Company Law (II) of the Supreme People's Court* ("Interpretation II") have issued certain procedures and mechanisms for "compulsory liquidation", which can be initiated when a company fails to carry out voluntary liquidation. Recently, the Supreme People's Court has further promulgated a *Summary of Conference on Trial of Compulsory Liquidation Cases* ("Summary") on 4 November 2009, improving such procedures for compulsory liquidation. This article summarizes some key points of the Summary.

Jurisdiction of Compulsory Liquidation Cases

Based on the rules for territorial-jurisdiction prescribed in Interpretation II, the Summary has further set forth the basic principles of grade-jurisdictions for compulsory liquidation. Generally, the jurisdiction of the competent court over compulsory liquidation cases shall be determined according to the level of the company registration authorities. District courts have jurisdiction over companies registered at the county or lower levels, and intermediate courts have jurisdiction over companies registered at the municipal or higher levels.

Examination and Acceptance of Application for Compulsory Liquidation

Further to the procedures for initiating compulsory liquidation as prescribed in Interpretation II, the Summary requires that, in principle, the court not examine or accept any application for compulsory liquidation without hearings. Examination-in-writing is subject to the

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consent of the respondent (i.e., the company which has been dissolved and is required to go into liquidation), and shall only be applicable to cases where the facts and legal relationship are clear and supported by adequate evidence. The Summary has also specified the procedures, participants and scope of hearings.

The Summary has specified the time limit for the court to accept the application for compulsory liquidation, which shall be 10 days starting from the date of hearing, or, in cases where there is no hearing, the expiration of the responding period that the respondent is entitled to. The court shall rule on whether to accept or dismiss, as the case may be, the application for compulsory liquidation within the aforesaid time limit. After accepting the application for compulsory liquidation, the court can also, if it deems such application not in compliance with law, make a ruling to dismiss such an application, and the applicant who considers such a ruling unreasonable shall be entitled to appeal to the court of the higher level.

Withdrawal of Application for Compulsory Liquidation

Under the following circumstances, the application for compulsory liquidation may be withdrawn:

- Before the court accepts the application for compulsory liquidation, the applicant can withdraw the application.

- In the event of a company's voluntary dissolution (e.g., based on the articles of association or shareholders' resolution of such company), if the company decides to continue its business (e.g., by amending the articles of association or making a new shareholders' resolution) after the court accepts the application for compulsory liquidation and before the liquidation committee allocates the remaining properties to the shareholders, the applicant can withdraw the application.

- In the event that a company is forced to be dissolved (e.g., as a result of revocation of its business license or pursuant to a court judgment), if the cause of compulsory liquidation no longer exists (e.g., if the relevant administrative decision is revoked or if the relevant parties have agreed to continue the existence of such company), the applicant can withdraw the application.

Voting Mechanism of the Liquidation Committee

The voting mechanism of the liquidation committee, as adopted in the course of compulsory liquidation, shall be similar to that of the board of directors of companies limited by shares as stipulated in the Company Law. Resolutions of the liquidation committee shall be subject to the confirmative votes of more than half of the committee members. Any committee members having a direct interest in any disputed matters shall not vote on such matters.

Property Preservation in the Course of Compulsory Liquidation

The Summary has also incorporated property preservation procedures for compulsory liquidation. The court shall be entitled to take preservative measures against the company's properties if requested by the liquidation committee or the initiating party of compulsory liquidation.

Failure of Liquidation in Whole or in Part

In practice, some liquidation procedures cannot be completed because the company's personnel or properties, account books, and significant documents may be missing. In order to protect the rights and interests of the initiating party, the Summary has also provided that:

- The court shall not reject the application for compulsory liquidation solely because the liquidation cannot be completed due to substantial properties, account books, important files or personnel of the respondent being missing.

- If liquidation cannot be completed in whole or in part even after explaining to the persons directly responsible or taking punitive measures, (i) in the event that some properties remain and partial payment is feasible based on the existing account books and significant documents, the court should refer to the bankruptcy law for partial payment, then terminate the procedures for compulsory liquidation for failure of complete liquidation; or (ii) in the event that no properties, account books, significant documents or company's personnel remain, the court should terminate the procedures for compulsory liquidation for failure of liquidation.

- After the court makes a ruling to terminate the procedures for compulsory liquidation, the applicant still has the right to claim against the persons directly responsible or the actual controller of the respondent according to the provisions of Interpretation II.

Termination of the Procedures for Compulsory Liquidation

Under the following circumstances, the procedures for compulsory liquidation may be terminated:

- After the liquidation is duly completed and the liquidation report of the liquidation committee is submitted to, and confirmed by the court, the court shall make a ruling to end up the procedures for compulsory liquidation. In this situation, the company will terminate upon de-registration.

- In the event where substantial properties, account books, significant documents or personnel of the respondent are missing, the court shall make a ruling to terminate the procedures for compulsory liquidation for failure of completed liquidation or failure of liquidation. In this event, the applicant still has the right to claim against the persons directly responsible or the actual controller of the respondent.

- In the course of compulsory liquidation, if an application for insolvency is made against the respondent by the creditors, the court shall make a ruling to terminate the procedures for compulsory liquidation after examining the application for insolvency and making a ruling to accept such application.

- In the event of voluntary dissolution, if the company decides to continue its business after the court accepts the application for compulsory liquidation but before the liquidation committee allocates the remaining properties to the shareholders, and if the applicant has not withdrawn the application for compulsory liquidation after the company has paid off all debts, the court can make a ruling to terminate compulsory liquidation at the request of the company. In this situation, the company can continue its business.

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