

liquidate your company properly, no kidding

Description

I am helping a long-term client, a Chinese businessman from Wenzhou, Zhejiang Province with his trouble that befell him totally out of blue recently.

Client set up an entertainment company (the "**Company**") back in 1996 with another two individuals in Wenzhou. In 1998, the Company guaranteed as surety the repayment of a loan taken out from a bank in favor of another company (the "**Debtor**"). The debtor then defaulted on the loan. The lender sued both the Debtor and the Company, and got a winning judgement that was still in the process of enforcement. The bank later spined off the bad debt to an asset management company which in turn sold the debt to the current creditor in 2006. Meanwhile, the Company's business license was revoked by local industry and commerce bureau in 2000 for the reason the Company failed to carry out the annual inspection and three shareholders just closed the Company without going through the liquidation process as prescribed by China Company Law, but the company though revoked, is not deregistered with the local industry and commerce bureau. But just a few days ago, this current creditor applied to the local court for a compulsory liquidation of the Company, ***a prelude to pursuit of unlimited legal liability against the Company's shareholders for outstanding debts owed by the Company.***

Though Client is safe at this moment, he is indeed not far away from being subjected to assume the Company's debt owed to the creditor unless countervailing facts are to be discovered or "created". This raised alarm for investors, both domestic or foreign, who leave their deserted companies behind without carrying out the liquidation to formally wind up and deregister their companies.

In reality, there are hundreds of thousands of enterprises that have ceased operation and are in fact dead, but are not properly liquidated and deregistered. It is often the case that such companies are abandoned with the intention to escape heavy debts that are well greater than the value of company's assets. However, this is actually a very clumsy strategy to shake off debts, leaving shareholders (esp in the case of natural person shareholders) of such companies exposed to greater risk that can be otherwise mitigated or managed.

As a general principle, shareholders of limited liability companies enjoy the protection of the "limited liability doctrine" under which shareholders are accountable to the debts of their companies only to the extent of the value of their contribution to the registered capital of the companies. In case that a company cannot pay off its debts, it may apply to or be brought to court for bankruptcy protection or liquidation. Shareholders won't be called to underwrite obligations of their busted companies.

However, under Chinese corporate laws, shareholders' limited liability are not absolute. In a few circumstances, shareholders are brought up from behind the corporate veil to pay off companies' debts, as in the case of my Client described above. The rationale is actually simple shareholders shall take the responsibilities of not following the laws which are otherwise in their favors.

To pursue the legal liabilities against shareholders of those abandoned companies, judicial practice is

that creditors shall first apply to court for compulsory liquidation of the companies, which proceeding is designed to mandatorily order shareholders to clear up the mess of their companies. If in the end, there is no assets for liquidation (such as in the case of my client, assets and financial books are nowhere indeed) or only partial liquidation can be done, the court would then make a decision to end the liquidation proceeding in which decision court will state that creditor may sue the shareholders of the company for payment of unsatisfied debts.

Creditors who find their debtors in non-operational state may consider further pursuing the company's shareholders' personal liability by initiating the compulsory liquidation proceeding and pushing all the way to getting the shareholders behind the company.

However, it shall be noted that if the company in question has been deregistered without property liquidation proceeding, creditors can directly sue the shareholders for joint and several liability for the unpaid debts, which is actually not bad for creditors. In other words, if your debtor company in China is deregistered without liquidation, you may now directly sue the company's shareholders for repaying your debts. Don't take it for granted that your creditor's right dies with the company.

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