

CHINA LEGAL REPORT*

APRIL 2014



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Debt Collection in China

I Introduction

One of the many problems foreign business operators and investors experience in China are monetary debts that are dishonored by a PRC business partner. Such monetary debts may take many different forms, such as unpaid service fees, license fees and royalties, or compensatory damages etc. Unlike certain European countries, in which administrative authorities are seen to be responsible for handling the collection of dishonored debts, the procedure of debt collection in China, regardless of the various forms of the uncollected debts, will almost always involve the actions of a PRC court.

This issue of the China Legal Report purports to provide the readers with some general information regarding the debt collection procedure against a debtor in China. The different steps in the debt collection procedure to be discussed hereunder are categorized in chronological order into affirmation of the debts and post-affirmation enforcement, for each of which we shall look into more details as follows.

II Affirmation of the debts

Before a court decides on any enforcement measures taken against the debtor, the fact that such debt is due and unpaid has to be cleared of doubts and disputes. Therefore before any unpaid debt can be enforced, there is always a procedure at the court, in only one exception at the notary public, for the purpose of affirming the existence and amount of the debt in question. Such affirmation procedures are (1) the enforcement ruling against collaterals, (2) the repayment order, (3) the enforcement certificate, and most commonly seen, (4) the civil litigation.

2.1 Enforcement ruling against collaterals

If the debtor has pledged collaterals to the creditor, such as a piece of property, any proprietary rights or any movable assets, when the debt is due and unpaid the creditor may apply to the court where such collaterals are located or where such pledge is registered and request the court to enforce the unpaid debt against the collaterals. The enforcement ruling against collaterals mainly involves the following phases:

The creditor first files an application with the competent local court for enforcement against collaterals.

If the court affirms such the application, a ruling on selling the collaterals will be issued, based on which the creditor may apply to the competent court for actual enforcement (post affirmation enforcement).

If the court finds such application unsubstantiated or if it finds any issues in dispute, it shall reject the application and the creditor may choose to start civil litigation.

2.2 Repayment order

A creditor may also apply to the competent court for the issuance of a repayment order against the debtor. In order for the court to accept such application, the following three conditions have to be met:

The creditor's claims are purely for payment of money or marketable securities; there are no other debt disputes between the creditor and the debtor; the repayment order can be served on the debtor.

What we can see from the above conditions is that a repayment order only applies to very simple debt disputes and it does not work when the debtor is in hiding. In practice in some parts of China, the application of a repayment order even requires the presence of both the debtor and the creditor, which in turn makes the repayment order remedy almost non-existent because no debtor would accompany his creditor to a court proceeding for enforcement of his unpaid debt. Only in some limited cases where the debt dispute is between acquaintances, friends or family members could the repayment order come to be effective under such circumstances.

For those limited applications that do get accepted by the court, the repayment order involves the following phases:

The creditor applies for the repayment order. If the facts are clear and valid, the court issues a repayment order to the debtor within 15 days. If the court rejects the application, the creditor may choose to litigate.

Upon receiving the repayment order, the debtor shall honor the debts within 15 days or he shall submit his defense. If the debtor submits a statement of defense and the court affirms his defense, the repayment order expires and the creditor may start litigation. If the debtor does not submit any defense, and does not honor the debt, the creditor may apply directly for actual enforcement (post affirmation enforcement) based on the repayment order.

It must be noted that the above two procedures, i.e. the enforcement ruling against collaterals and the repayment order, do not affect the creditor's right to realize the unpaid debt via an ordinary civil litigation. Instead, such procedures offer some of the debtors a more convenient and less expensive way to obtain the underlying court rulings, upon which an application for actual enforcement could be made directly without obtaining the verdict in a civil litigation.

2.3 Enforcement certificate

Unlike other affirmation procedures discussed, the enforcement certificate is the only measure that relieves the creditor from a court proceeding before applying for the actual enforcement of the debts. With certain documents that have been notarized by a PRC notary public to be legally enforceable, the creditor may directly apply to the notary public for the issuance of an enforcement certificate, based on which the creditor can apply to the competent court directly for actual enforcement.

In other words, the enforcement certificate serves the same purpose as an enforcement ruling and a repayment order. On the other hand, since the underlying documents relating to the unpaid debt have already been notarized, the creditor will bear far less risks of receiving a negative decision from the notary public.

Documents eligible for being notarized to be legally enforceable by a PRC notary public include the following 6 types:

- a) loan contracts and lease contracts without any collaterals;
- b) documents specifying claims against due payment for goods;
- c) various receipts of a loan and certificate of indebtedness;
- d) repayment contracts;
- e) contracts regarding alimony payments, child support payments, tuition payments and compensation payments;

f) other applicable documents.

For contracts in particular, the notarization needs to take place at the time of the signing of the contract in the presence of all parties. A subsequent notarization before enforcement is sought is only possible if the counterparty agrees and is present.

One disadvantage of the enforcement certificate is that the court is entitled to review the content of the enforcement certificate. If and when a court finds any mistakes with the enforcement notice, the court may reject the enforcement application via a court ruling. With the other three procedures, the enforcement court is not entitled to reject enforcement by itself.

2.4 Civil litigation

For creditors not eligible to apply for the above-mentioned debt affirmation procedures, a civil litigation must be initiated and concluded before the creditor may apply for enforcement of the debt based on a favorable verdict.

As a civil litigation is known to be time consuming and there may be a significant deterioration of the debtor's financial status during the course of such litigation, the creditor can apply to the court for property preservation before or during the civil litigation if the following two conditions are met:

If the property is not preserved, it could result in non-enforcement of the verdict or other damages creditor; the applicant has to provide a guarantee.

The procedure can take place *ex parte*, i.e. without an advance notice to the debtor. Upon granting of the property preservation, the assets of the debtor will be detained and frozen to ensure the enforcement of the verdict. One thing worth noting is that when a creditor applies for property preservation before the lawsuit, the property preservation will expire in 30 days if the civil lawsuit is not brought by the creditor accordingly. For the purpose of this issue of the China Legal Report, the ensuing civil litigation procedure will not be discussed in further detail.

III Post-affirmation enforcement

Once the dishonored debt has been affirmed by the court (or the notary public) via any of the four procedures discussed in Section II, i.e. an enforcement ruling on collaterals, a repayment order, an enforcement certificate by the notary public or a favorable verdict in a civil litigation, the creditor may apply to the court for the actual enforcement of the debt based on the affirmation documents, if the debtor still does not honor the debts voluntarily. Based on such application, the competent court will issue an Enforcement Notice to the respective government agencies and institutions for enforcement.

In order to determine the specific and applicable measures for enforcement, the debtor is required to report to the court his financial status at the time as well as during the year previous to the date when the Enforcement Notice is issued. On the other hand, the court may directly investigate with the bank and other like institutions on the savings, bonds, stocks, fund shares or other assets the debtor may own. Based on the results of such report made by the debtor or the investigation initiated by the court, the court will decide on the respective enforcement measures.

For the post-affirmation enforcement, the court generally adopts the following enforcement measures on monetary debts:

3.1 Order to detain, freeze, allocate and appraise the savings and marketable securities of the debtor

For enforcement upon savings, bonds, stocks, fund shares and other marketable securities of the debtor, the court will issue an Enforcement Notice to the institution in possession or in charge of such assets ordering the latter to proceed with the detainment, freezing, allocation or appraisal, whichever applicable. Upon receiving the Enforcement Notice, the respective institutions must comply with the enforcement measures.

3.2 Order to detain or set aside part of the income of the debtor

In case of an enforcement against the income of the debtor, the court will issue an Enforcement Notice to the employer, the bank or other institutions that may be in possession of his income; the recipient agencies must comply with the enforcement measure and set aside part of the income to be received by the debtor.

However, when such measure is taken, the necessary living expenses for the debtor and his family must remain covered.

3.3 Order to attach, seize, freeze, auction and sell other movable and immovable assets of the debtor

For other movable assets or immovable assets of the debtor, enforcement takes place in the following two phases:

An enforcement officer is appointed to handle the attachment, seizure and freezing of the movable or immovable assets. Such officer will notify and order the debtor to be present as the attachment, seizure or freezing takes place, after which the enforcement officer will present a list of attached assets to be signed by all persons present and to be handed over to the debtor. After the attachment, seizure and freezing of the assets, the enforcement officer orders the debtor to honor his debts within a specified period of time.

If the debtor remains inactive, the court will organize for the auctioning and selling of the attached, seized or frozen assets to enforce the payment of the debts.

Assets necessary for the daily life of the debtor and his family must remain intact.

3.4 Supervision of the delivery of certain financial documents and movable assets

In some cases where the enforcement of the debts also involves the delivery of financial documents and movable assets, an appointed officer will order both the debtor and the creditor to be present where the officer shall supervise on the personal delivery of the said documents and assets. Alternatively, the debtor can also deliver such items to the enforcement officer, who then shall forward the items to the creditor.

If upon the enforcement against all enforceable assets of the debtor, the debts are still not completely paid off, the debtor is obliged to continue to repay his debts. As soon as the creditor finds any enforceable assets belonging to the debtor, the creditor can apply to the court for enforcement at any time. The court will make sure that the debtor retains the minimal assets he needs for daily subsistence.*****

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