

# Asset Preservation in China

*Maarten Roos and Tony Lu*

International businesses that purchase from or sell to Chinese counterparts must always ensure that a proper contract is in place. Such a contract serves to summarize the terms and conditions of the deal, and can be the basis for any enforcement actions if the Chinese supplier or customer fails to execute as agreed.

Upon discovering a breach, negotiations usually takes place to see whether a solution can be found to both parties' satisfaction (or at least, acceptance). If no settlement is agreed, the foreign party can file a claim in court or arbitration.

In litigation / arbitration strategies, there is a special place for asset preservation. Chinese law expressly allows a claimant to apply to the competent court to put a restriction on the opponent's assets. The following two objectives are the most common:

- **Cash is king:** If a claimant manages to put a lien on assets of the opponent, this will put the latter under pressure to reach a settlement. The fact that Chinese litigation can take years often creates a problem for the plaintiff, but when relevant assets are frozen, the problem becomes the defendant's.
- **Judgments and arbitration awards** are notoriously difficult to enforce in China. Local protectionism is one problem to cope with, another is that it is relatively easy for asset-light defendants to hide or transfer their assets, making enforcement of an eventual judgment or award much less likely. The freezing of an opponent's assets results in near-certainty that if the case is won, then the claimant will be compensated.

## Assets for Preservation

The kind of assets that are most often the subject of a preservation (or "freezing") order are:

- cash (on a bank account of the target company, meaning that these funds cannot be used)
- real estate / land use right (which then cannot be transferred)
- machinery (which then cannot be transferred, and in some cases used)
- ships (which then cannot leave port)
- stock / fund (which then cannot be sold)
- company shares (which then cannot be transferred)

## Procedures for Asset Preservation

Claimants can apply for the preservation of assets when filing the lawsuit, or after the lawsuit has been filed. Claimants may also apply for assets preservation before filing the lawsuit but subject to very strict legal conditions. More generally, courts will grant plaintiffs the element of surprise by executing the asset preservation before notifying the defendant of the lawsuit, though this should be closely coordinated with the court and its preservation division.

In the case of arbitration, an application for preservation of assets is first submitted to the arbitration tribunal, which then forwards this application to the competent court. The plaintiff can then follow up directly with the court. The procedure is a bit more complex than for litigation, and in practice it is more challenging to ensure asset preservation before the defendant learns of the claim. Again, coordination



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(with both the arbitration tribunal and the competent court) should be a priority.

Chinese courts only accept applications forwarded by an arbitration tribunal in China, which means that the freezing of assets is not an option if the parties have agreed to arbitrate their dispute outside China. This is one (but not the only) good reason why many international companies prefer their contracts to establish that all disputes should be submitted to an internationally-respected, China-based arbitration tribunals such as the SHIAC (in Shanghai, the former CIETAC Shanghai sub-commission) or the CIETAC (in Beijing).

### Requirements for Asset Preservation

When handling an application for freezing assets, the court will generally require payment of a guarantee as security for any damages resulting for illegitimate preservations. In addition, most courts will demand very specific information on the target assets. If both requirements are met and the case has been accepted by a court or arbitration tribunal, the court should normally proceed with the asset preservation.

#### a) Guarantees

The purpose of the guarantee is to cover any potential losses to the target company, if upon hearing the case the court finds against the plaintiff. Courts generally prefer cash, but can also (sometimes) accept bank guarantees, the pledging of assets (incl. real estate), and company guarantees. In some areas, it is even possible to use third parties who ask a percentage of the claim to put up the guarantee amount.

There is no consensus on the amount to be put up as guarantee. Amounts vary between 15% and 100% of the value of assets to be preserved, and this proportion often depends also on the kind of assets. This can make asset preservation very expensive. In other cases, however, very little needs to be done to put the Chinese counterpart in financial difficulties, which makes it a particularly attractive strategy!

#### b) Information on Assets

Courts have the power to investigate assets themselves. But due to their limited resources, they will rarely take the initiative. In practice, most courts will only respond to applications where the applicant provides details evidence on the assets that are the target of the preservation.

To freeze liquid assets – the most effective kind of pressure – the best approach is to find out the target's bank accounts. With sufficient detail, the court may be convinced to proceed to each bank and freeze all the accounts in question, up to the targeted amount.

### Final remarks

Chinese companies are famous for being hard negotiators, and for refusing to compromise when they have a strong hand. International businesses that find themselves in a dispute in China, should be ready to play the same game. Once a dispute arises, the best way to approach the situation is to put the opponent under pressure.

Applying to freeze the opponent's assets, whether his bank accounts, real estate or machinery, can be extremely effective. While some courts have little experience dealing with such applications (especially if the applicant is a foreign company), others are surprisingly flexible and willing to please. Companies should always keep in mind: the successful freezing of assets considerably increases the chances of a favorable settlement or the enforcement of a judgment or award.

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**Maarten Roos &  
Tony Lu**

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