



Enforcement in China Whitepaper

**In-house Research Paper
September 2014**

For Discussions Only

Introduction

Adamas Asset Management (“Adamas”) is an independent alternative asset management firm in Asia currently with firm-wide AUM of approximately US\$ 610 million. Our diversified business consists of both liquid and private investments, which, in our opinion are synergistic and provide investors with an unrivalled informational edge and excellent risk adjusted returns. We have offices in Hong Kong and Shanghai.

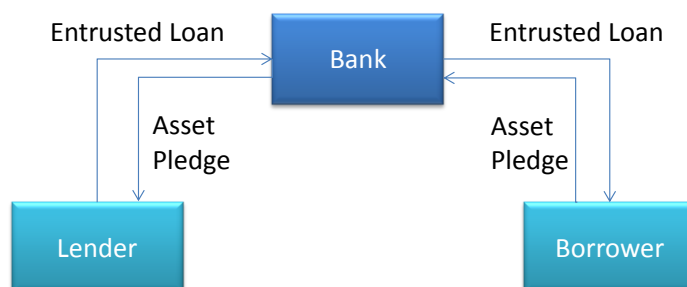
Adamas has been providing private loans to companies since early 2010. Our work has been well recognized by many of our supporters, and we have received several awards, including Asia – Lender of the Year 2014 by ACQ Global Awards; Runner-up to KKR and ahead of Oaktree as Asia Lender of the Year in 2013 by Private Debt Investor; Best Asia Mezzanine Fund of the Year 2013 by Acquisition International Magazine in conjunction with Preqin; and was ranked in the category of “A” by Skyrank in 2013 (our fund was the only Asia fund among 11,000 funds to be ranked in the same category).



Where possible, Adamas provides onshore loans in China via entrusted loans which means we can obtain onshore asset pledge as part of our security package. However, entrusted loans may not be the most easily understood concept by foreign investors as it is rare for oversea lenders to enter into such contracts. In this white paper, we will have a detailed discussion on how entrusted loans are structured, and what the relevant enforcement procedures in relation to defaulted loans in China.

Entrusted Loans

In an entrusted loan, an agent (usually a bank) will act as an agent between the borrower and the lender. The agent is responsible for the collection of principal and interest (if any) and safekeeping of the pledge (or other securities as stated in the loan agreement), for which it charges a small handling fee, but does not undertake any of the loan risk.



Enforcement

Historically, overseas lenders had heavily relied on share pledge with strong focus on operational protection. Nowadays, lenders are able to use means that will enable them to take asset pledge. Due to the foreign exchange control regime in China, a PRC entity may provide security in favour of a foreign creditor, subject to certain restrictions. Under the applicable PRC regulations, the provision of all foreign securities shall be subject to either the prior approval of, or registration with, the State Administration of Foreign Exchange (SAFE), Ministry of Commerce People's Republic of China (MOFCOM), The State Administration of Industry and Commerce (SAIC, or local AIC) or its competent local counterparts, and such process may be difficult and time consuming. There are additional problems associated with other various means and we can devote a separate paper to further discuss. In this paper, we will be only focus on how entrusted loan method works.

Legal proceedings required for the enforcement of entrusted loans

Set forth below is a discussion of the process required for court enforcement of a loan, either through litigation or other options. Diagram I below illustrates the process of exercising the creditors' rights.

1. Litigation

Upon a loan default, the creditor needs to file a complaint with a court of competent jurisdiction together with all the supporting documents. If the complaints meet the Chinese law requirements, the court will accept the case within seven days and serve the claim to the debtor within five days. The debtor, as the defendant, is required to respond within fifteen days of being served and the defense pleading will be forwarded to creditor, the plaintiff, within five days thereafter. After the deadline of the submission of defense, the court usually sets a thirty days deadline for evidence submission. All these will be presented at the hearing (held at a time chosen by the court) and both parties can debate all matters in dispute.

Under the law, the trial against a debtor in default must be completed within six months after the court of first instance accepts the case, extension may be possible upon approval from the court. Appeal is also possible but must be completed within three months.

The terms of the judgment handed down by a court will typically provide a ten to fifteen days grace period. Once the period elapses, the judgment winner can apply to an enforcement court for enforcement action.

In case the loan is collateralized by property, like in the case where Adamas does the entrusted loans, application to freeze this property can also be done at this stage to ensure property preservation, together with freezing of the bank accounts.

2. Non-litigious options

Due to the time-consuming nature of the litigation process, the creditor sometimes looks for more cost and time efficient non-litigation proceedings such as notarization of the loan or payment order.

A) Notarization of the Loan Agreement

If the loan agreement is notarized by a public notary office, and it is made clear in the loan agreement that the debtor agrees to judicial compulsory enforcement if the loan defaults, then the creditor can apply to the notary office for an enforcement certificate when the debtor actually defaults. With an enforcement certificate and the notarized loan agreement, the creditor can directly apply for enforcement without going through the court discussed above. Although the notarization of loan seems to expedite the enforcement process, it also limits creditor's right to seek an enforcement in court directly without first apply notary office for an enforcement certificate.

All of the onshore China entrusted loans which Adamas has done are properly notarized.

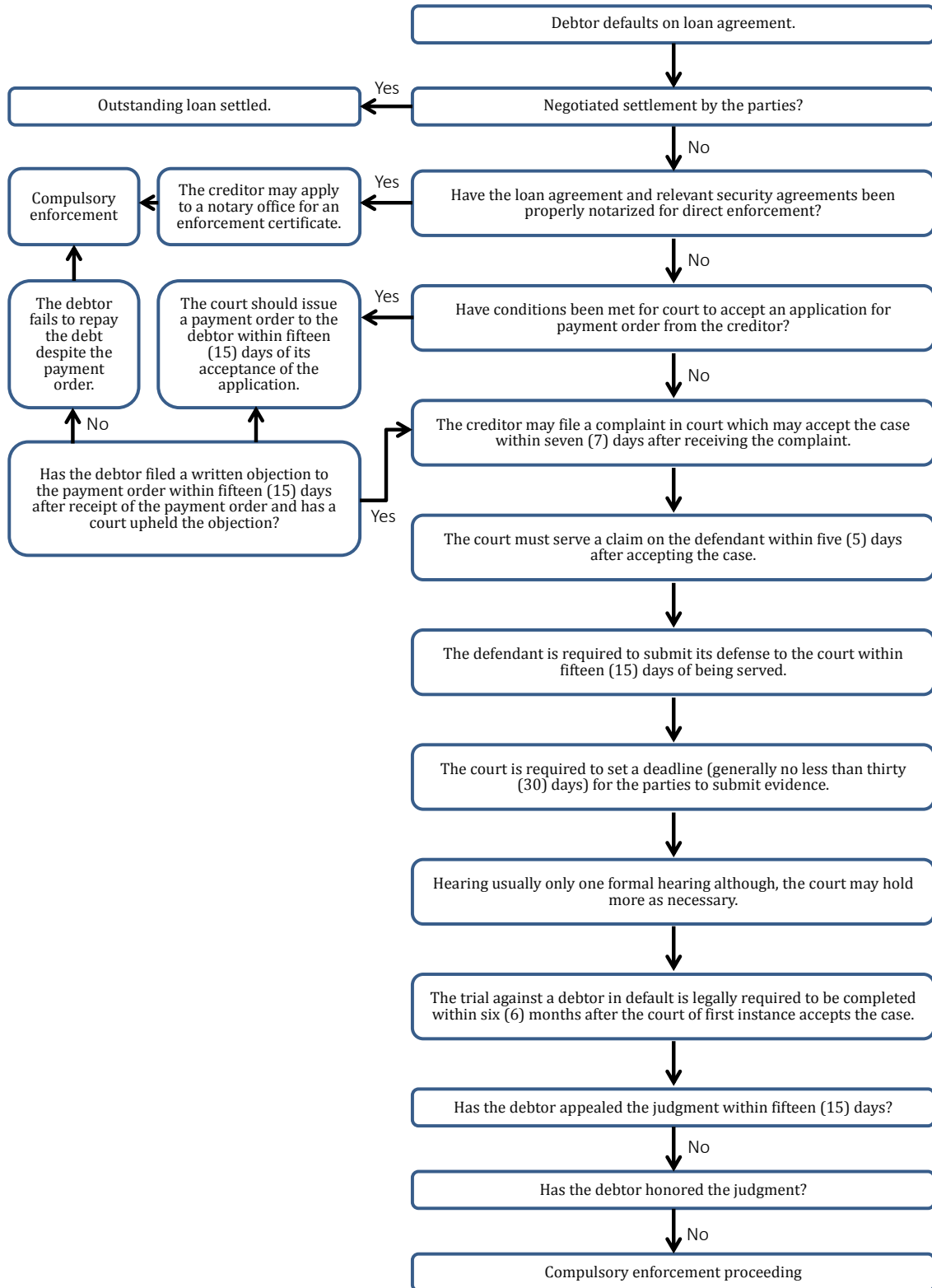
B) Payment order

A "payment order" is a special legal proceeding available for disputes in connection with monetary payment or negotiable securities. Again, compared with a general litigation proceeding, a payment order is more efficient in terms of timing and cost. To obtain such order the creditor will need to apply to the basic-level people's court where the debtor is domiciled and the following conditions must also be met for the court to accept the application:

- a. The dispute must be about payment of money or securities;
- b. The debt must have become due and be for a sum certain with clearly support of evidence;
- c. The creditor must have no outstanding liability to the debtor;
- d. It must be possible to duly serve the payment order on the debtor

The court should issue a payment order to the debtor within fifteen days once it accepts the application from creditor. If the debtor does not file any objection towards the order within fifteen upon receipt of the order nor repay the debt as requested by the payment order, a judicial compulsory enforcement proceeding will be initiated. If the debtor file a written objection within the given period and the court finds the objection being legitimate, the payment order will be invalidated and the dispute should be pursued the normal litigation process.

Diagram I - Process for litigating debt



Enforcement procedures

Set forth below is a discussion of the general procedure and timelines applicable to judicial compulsory enforcement proceedings, together with the application to freeze the property and bank accounts being completed as per the previous section. Please refer to Diagram II for illustration.

1. Appraisal, Court Auction and Sale of Seized Property

A court is generally required to auction the property that has been seized in an enforcement case. According to the corresponding law, the court must engage a commercial auction agency to conduct such auction and pay the agency from the proceeds collection. The floor price of the first auction will be determined according to a qualified asset appraisal agency or the value can be mutually agreed by all parties.

In order to determine the appraisal price, the appraisal agency will perform appropriate due diligence such as review legal documentation and conducting on-site visit. If any for the interest parties doesn't agree on the appraisal value, they shall submit an objection in writing to the court within ten days upon receiving the valuation report. Unless the appraisal agency was found to be unqualified or unlawful, court usually will not conduct second appraisal.

All interested parties including the creditor will be able to participate in the auction. The sale will go to the highest bidder with no preferable treatment to the creditor. If all the bids are lower than the floor price during the first round of auction, the creditor can have two choices, which is to either take the property at the floor price to offset the debt (if appraisal price is higher than the outstanding debt amount, the difference will be paid back to the owner of such property), or proceed with second round of auction within sixty days after the end of the first auction.

The floor price of the second auction should not be less than 80% of the first round floor price. In general, only real property can have up to three rounds of auction and the third round auction floor price should not be less than 80% of second auction floor price. If there is still no higher bid than the floor price in the third round. The court will try to sell the collateral in the public market at the last floor price and the sale will be open for sixty days. If the collateral still cannot be sold in such period, the asset will be returned to the owner. If the collateral is sold successfully at the auction or the court organized sale, the creditor will have the first claim to the proceeds. The remaining proceeds after paying all the legal, auction expense will return back to the owner of the collateral. However, if the proceeds are insufficient to cover the creditor's debt outstanding, the remaining unpaid debt will be treated as unsecured.

While there are no statutory time limits for the auction, in practice it generally takes one to two months to complete an enforcement auction after appraisal has been completed for the

auction property.

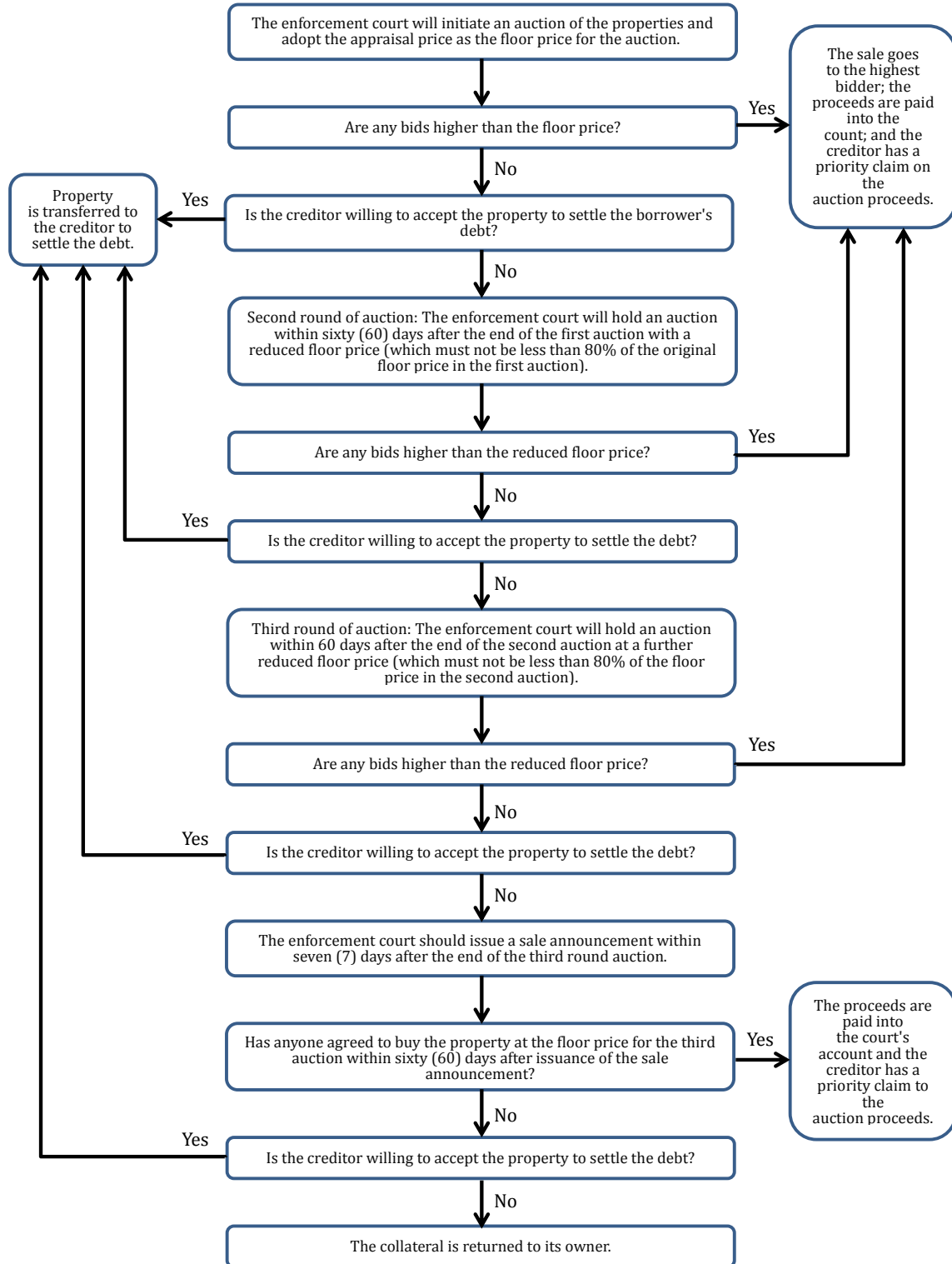
2. Settlement

During the enforcement proceedings, all parties may agree on a settlement in order to shorten the overall process. The court will create a written record to lay out all the arrangement and have both parties affix their signatures or seals onto the record. However, the enforcement may assume if either party fail to fulfill the agreement within the time frame.

Conclusion

As discussed in our Q2 2014 Private Credit Newsletter, a new cross-border lending reform has been introduced by SAFE, and such easing of control can be expected to reduce transaction times and associated costs for offshore investors who also stand to benefit from increased flexibility and strengthened enforcement over security. Our team has done over 40 loans in China with extensive enforcement experience. We believe our experience, together with the continued improvement in China's legal environment, will provide a strong support on our credit investment strategy in China.

Diagram II - Enforcement process



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