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# International Fraud & Asset Tracing 2022

## China: Law & Practice

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## China: Trends & Developments

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## Law and Practice

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## CONTENTS

<b>1. Fraud Claims</b>	<b>p.3</b>	<b>3. Corporate Entities, Ultimate Beneficial Owners and Shareholders</b>	<b>p.13</b>
1.1 General Characteristics of Fraud Claims	p.3	3.1 Imposing Liability for Fraud on to a Corporate Entity	p.13
1.2 Causes of Action after Receipt of a Bribe	p.4	3.2 Claims against Ultimate Beneficial Owners	p.13
1.3 Claims against Parties Who Assist or Facilitate Fraudulent Acts	p.5	3.3 Shareholders' Claims against Fraudulent Directors	p.14
1.4 Limitation Periods	p.5	<b>4. Overseas Parties in Fraud Claims</b>	<b>p.15</b>
1.5 Proprietary Claims against Property	p.6	4.1 Joining Overseas Parties to Fraud Claims	p.15
1.6 Rules of Pre-action Conduct	p.7	<b>5. Enforcement</b>	<b>p.15</b>
1.7 Prevention of Defendants Dissipating or Secreting Assets	p.7	5.1 Methods of Enforcement	p.15
<b>2. Procedures and Trials</b>	<b>p.8</b>	<b>6. Privileges</b>	<b>p.17</b>
2.1 Disclosure of Defendants' Assets	p.8	6.1 Invoking the Privilege against Self-incrimination	p.17
2.2 Preserving Evidence	p.8	6.2 Undermining the Privilege over Communications Exempt from Discovery or Disclosure	p.17
2.3 Obtaining Disclosure of Documents and Evidence from Third Parties	p.9	<b>7. Special Rules and Laws</b>	<b>p.17</b>
2.4 Procedural Orders	p.10	7.1 Rules for Claiming Punitive or Exemplary Damages	p.17
2.5 Criminal Redress	p.10	7.2 Laws to Protect "Banking Secrecy"	p.17
2.6 Judgment without Trial	p.11	7.3 Crypto-assets	p.18
2.7 Rules for Pleading Fraud	p.11		
2.8 Claims against "Unknown" Fraudsters	p.12		
2.9 Compelling Witnesses to Give Evidence	p.12		

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## 1. FRAUD CLAIMS

### 1.1 General Characteristics of Fraud Claims

China, a civil law jurisdiction, does not have standalone laws or administrative regulations to counter fraudulent conduct. Rather, provisions on fraudulent conduct are found within different laws and administrative regulations, which provide legal bases for various fraud claims.

#### Claims to Rescind a Contract or Other Civil Act

Under the Civil Code of the PRC (the Civil Code), one of the elements for a legally effective civil act is the manifestation of true intent. Thus, a victim who is induced by fraud to sign a contract (a civil act) against their true intent can institute a civil action to rescind the contract. In addition to rescission, the victim can also claim against the perpetrator of the fraud for the return of the property fraudulently obtained and/or for compensation for losses so caused. In this instance, the victim may make the same claims against the contract counterparties even if they are not the perpetrator. If a third party fraudulently induces the victim to enter the contract, the victim may still make successful claims against the counterparties if they were or should have been aware of the third party's fraudulent acts.

#### Conspiracy Claims

Under the Civil Code, civil acts committed by a fraud perpetrator and one or more third parties are voidable where they constituted a malicious collusion and harmed the lawful rights and interests of others (Article 154). Thus, a fraud victim can institute a civil action against such parties and claim voidance of the civil acts. Such claims may be useful for the victim to trace and recover assets that are transferred to a third party in a conspiracy.

A third party knowingly assisting or facilitating the fraudulent acts may be held jointly and severally liable to the victim (see **1.3 Claims against Parties Who Assist or Facilitate Fraudulent Acts**).

#### Tort Claims

Chinese law does not generally prescribe deceit as a tortious act. However, as deceit is often merely a means of infringing property or personal rights, the victims can instead find a cause of action to bring a tort claim against the perpetrator based on the infringement of property or personal rights. In addition, provisions of law in certain areas expressly prohibit specified fraudulent acts, for example in the Securities Law of the PRC (the Securities Law), the Law of the PRC Against Unfair Competition (the Anti-unfair Competition Law), and the Company Law of the PRC (the Company Law), where fraudulent acts can give rise to tort liability.

For instance, the Securities Law prescribes securities misrepresentation as a special type of fraud, which is defined as the disclosure of information in connection with the offering of securities that violates relevant provisions on information disclosure and causes false records, misleading statements, or material omissions in the information so disclosed. For more details, see **3.2 Claims against Ultimate Beneficial Owners**.

Generally, the victims have the burden to prove that the perpetrators have engaged in fraudulent acts, the losses suffered, causation and degree of fault. However, considering that it is often too hard for the victim to prove the fraudulent acts and fault, in some areas of law the burden of proof is reversed by requiring the defendant to show there was no fraudulent act or they were not at fault.

### **Duty of Loyalty Claims**

Similar to the concept of fiduciary duty in common law jurisdictions, Chinese law imposes a duty of loyalty on the directors and officers of a company. In addition to other specific prohibited acts for the directors and officers, they have a general duty of loyalty and due diligence to the company they serve. Where a director or officer breaches their duty of loyalty (eg, by receiving corrupt payments or misappropriating assets), the company may institute a civil action against them and claim for damages suffered and/or the profits that the perpetrator has made. Also see **3.3 Shareholders' Claims against Fraudulent Directors**.

### **Criminal Law**

Fraud is a serious criminal offence under the Criminal Law of the PRC (the Criminal Law), which provides for various criminal fraud offences including fraud, contract fraud, illegal taking of deposits from the public, fraudulent fundraising, and financial fraud. The conviction standards under the Criminal Law are quite low for each offence – eg, RMB 3,000 for criminal fraud and RMB 20,000 for criminal contract fraud committed by an individual. The remedies available to the victim are generally limited to a return of the property or compensation for the actual losses in criminal proceedings.

## **1.2 Causes of Action after Receipt of a Bribe**

### **Civil Claims**

Chinese law does not establish a general private right of action for bribery. However, bribery in business activities is expressly prohibited and can trigger civil claims on certain causes of action such as unfair competition or breach of the duty of loyalty.

### **Claims against the Briber**

Under the Anti-unfair Competition Law, business operators and their employees are not allowed

to bribe an agent/employee of a counterparty or someone who can use their authority or influence to influence the transaction with the counterparty to obtain trading opportunities or competitive advantage.

A victim whose legitimate rights and interests are harmed by such conduct may bring a claim against the briber to compensate for damages. The amount of such compensation can be determined on the basis of the actual losses suffered as a result of the infringement. Where the actual losses are difficult to calculate, compensation will be determined on the basis of the benefits obtained by the infringer as a result of the infringement.

### **Claims against Employees, Directors, and Officers**

An employer whose employee receives a bribe may have civil claims against the employee for losses arising from the bribe. The employer may also rely on contributory infringement as a civil cause of action against the employee and the bribe-giver, who can be held jointly and severally liable with the employee.

Directors or officers of a company who accept bribes in connection with their duties violate their duty of loyalty to the company and, according to the Company Law, the income so obtained by the directors and officers belongs to the company. The company, as the victim, may be entitled to claim against directors and executives to compensate for damages and to return the illegally obtained income. For a related discussion on shareholder derivative actions, see **3.3 Shareholders' Claims against Fraudulent Directors**.

### **Administrative Sanctions**

Where business operators violate the provisions of the Anti-unfair Competition Law by bribing others, the victim can also report to the compe-

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tent supervision and inspection authority, which may confiscate the illegal gains and impose a fine of between RMB100,000 and RMB3 million. Where the circumstances are serious, the business licence of the bribing company can be revoked.

## **Criminal Offences**

The Criminal Law provides for various criminal offences for those persons and companies involved in commercial bribery, including the bribe-giver and receiver.

### **1.3 Claims against Parties Who Assist or Facilitate Fraudulent Acts**

Under the Civil Code, a third party who assists a perpetrator in carrying out a fraudulent act may bear joint and several liability with the perpetrator (Article 1169). To establish joint and several liability, the claimant must prove the third party was or should have been aware of the fraudulent act and the possible harmful consequences of providing such assistance. That is to say, the claimant must establish common intent between the third party and the perpetrator.

“Assistance” is defined as facilitating the perpetrator’s commission of a fraudulent act, which does not necessarily cause the perpetrator to commit the act. An act of assistance can be committed after the fraudulent act, such as a third party’s receipt of fraudulently obtained assets, if common intent is established. Conversely, without common intent, the third-party recipient will not be held jointly and severally liable with the perpetrator.

Without common intent, a third party may instead be held liable for losses caused to the claimant to the extent the claimant can establish that the third party’s assistance violated their duties or mandatory provisions of law. In this instance, third-party liability is less certain because there is no direct causation between

the assistance and the losses of the victim. In judicial practice, courts may decide liability at their discretion based on the circumstances – eg, the third party’s degree of fault and their role during the fraud.

A party who assists or facilitates criminal fraud may become a joint defendant to the crime if there is common intent. Standalone criminal penalties may apply where the party knowingly harbours, transfers, acquires, sells on behalf of others, or conceals by other means the proceeds or benefits derived from criminal fraud.

### **1.4 Limitation Periods**

#### **Civil Statute of Limitations**

Under the Civil Code, the right to seek protection of civil rights from the court is subject to a statute of limitations of three years from the date on which the victims knew or should have known that their rights had been infringed and the identity of the perpetrator. The statute of limitations can be suspended or renewed under certain statutory circumstances. However, courts no longer provide remedies when the absolute statute of limitation of 20 years has elapsed from the date the rights were infringed, except that there are special circumstances for which the court grants an extension upon the victims’ application.

In addition to the statute of limitations, there are special types of limitation periods for certain specific remedies. For example, a claim for rescinding a contract or other civil act on the basis of civil fraud must be brought within one year from the date on which the victim is aware or should have been aware of the fraud. Such special limitation period is not allowed to be suspended, renewed, or extended, and expires five years after the civil act is committed, regardless of whether the fraudulent act or the identity of the fraudster was known to the victim.

### **Criminal Prosecution Limitation Periods**

Under the Criminal Law, a 15-year or 20-year limitation period applies for serious offences in relation to fraud whose maximum punishment is fixed-term imprisonment of at least ten years to life, which begins from the date of the commission of the offence. However, no limitation exists where a suspect avoids a criminal investigation after the case has been filed.

### **1.5 Proprietary Claims against Property**

#### **Proprietary Claims and Bona Fide Acquisitions**

Under Chinese law, generally a claimant can make a proprietary claim to seek the recovery of property misappropriated or induced by fraud to transfer. Specific to the claims in litigation, a claimant can plead to the court to affirm its ownership over the defrauded property and order the defendant or the party in possession to return the property. Where the defendant is an insolvent entity, the claimant may obtain the return of the property in the possession of the defendant through the bankruptcy administrator, according to Article 38 of the Enterprise Bankruptcy Law of the PRC (Enterprise Bankruptcy Law).

There is also an exception for proprietary claims, which is called a “bona fide acquisition”. That is, if the perpetrator has transferred the property to a third party who has lawfully acquired the title of such property by showing that certain statutory conditions have been met. Under the Civil Code, a bona fide acquisition must meet the following conditions:

- the transfer of the property was in good faith;
- the transaction price was reasonable; and
- the property has been rightfully registered in accordance with the provisions of the law or is in physical possession of the third party.

### **Recovery of Mixed Funds**

Cash funds are generally regarded as a special type of movable property; hence, the party who possesses the cash funds is presumed to be their owner. Proprietary claims cannot be made over cash funds unless they are separate so as to be specific or otherwise identifiable or distinguishable. Accordingly, if a claimant is defrauded of cash funds or obtains a monetary award, they are generally on par with other unsecured creditors, regardless of whether they have been mixed with the perpetrator’s other funds.

### **Investment Gains from Defrauded Property**

Gains from defrauded property can generally only be recovered together with proprietary claims. If the fraudster invests the proceeds and obtain gains as a result, the victim can only claim an amount equal to their original loss and is not allowed to claim the return of the full amount of profits created as a result of the defrauded property.

### **Proprietary Claims in Criminal Proceedings**

In criminal proceedings, a criminal defendant who illegally possesses or disposes of the victims’ property will be subject to forfeiture of the property (if available) or ordered to compensate the victims for their losses. In the latter case, the defendant’s own lawful property can be subject to forfeiture by the criminal investigation organs and used to compensate the victims.

To the extent the victims are not fully compensated during the criminal investigation procedures, the court will order in the criminal judgment that the defendant’s property be subject to forfeiture and used to further compensate the victims. In this case, the victims’ right to compensation from the defendant will take priority over the defendant’s unsecured creditors.

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## 1.6 Rules of Pre-action Conduct

There are no particular rules of pre-action conduct that apply in relation to fraud claims under Chinese law.

As a practical matter, prospective claimants often apply for pre-action preservation measures, such as to effect property, conduct, or evidence preservation (see **1.7 Prevention of Defendants Dissipating or Secreting Assets** and **2.2 Preserving Evidence**).

## 1.7 Prevention of Defendants Dissipating or Secreting Assets

Fraud claimants, similar to other civil claimants, should observe and make use of preservation measures to increase their chances of a meaningful recovery.

According to the Civil Procedure Law of the PRC (the Civil Procedure Law), where the conduct of the defendant or other reasons may make it difficult to enforce a judgment or cause other harm to the claimant, the court may, upon the application of the claimant, rule to take preservation measures after the filing of the litigation case (ie, litigation preservation). Meanwhile, if there is an urgent situation where the claimant's lawful rights and interest may otherwise sustain irreparable harm, the court may, upon application of the claimant, rule to take preservation measures before the filing of the litigation case (ie, pre-litigation preservation).

Aside from the above, the application requirements are the same for litigation and pre-litigation preservation. For pre-litigation preservation, the victim must file the related civil lawsuit within 30 days; failure to do so will result in the court lifting the preservation measures. In judicial practice, courts have discretion over the review of "urgent situations", and it is usually difficult to obtain approval for pre-litigation preservation.

Under the Civil Procedure Law, the preservation measures include property preservation, conduct preservation and evidence preservation. For the purpose of preventing dissipating or secreting assets, the claimant generally only needs to apply for property preservation, which is in rem. In theory, the claimant is entitled to conduct preservation, which is in personam and similar to a preliminary injunction. However, since the fraudulent act is often instant rather than continuous, generally property preservation is enough to prevent a defendant from dissipating or secreting assets. Thus, courts often reject applications for conduct preservation in fraud cases.

### Property Preservation

Applicants for property preservation should provide the court with relevant clues about the property owned by the intended defendant; the court usually does not take the initiative to inquire about asset information through the court's enforcement and control system or other means. When the applicant applies for property preservation, they are required to pay the property preservation application fee to the court. The application for property preservation is calculated according to the amount of the victim's request for preservation, up to a maximum of RMB5,000 per case.

In addition to the application fee, the court usually requires the applicant to provide a cross-undertaking for the preservation order to reduce the unjustified risk of loss to the intended defendant. The undertaking can take the form of cash deposit, real property mortgage, or a guaranty letter from an insurance company or a qualified guaranty company. For cash deposits, the cash amount should be no less than 30% of the value of the property to be preserved. For real property mortgage or guaranty letter, the appraised value of the real property or the guaranteed amount of

the guaranty letter should be no less than 100% of the value of the property to be preserved.

Property preservation measures remain in effect for a period of one to three years depending on the nature of the preserved property and can be renewed until the completion of the enforcement of final judgement. During this period, if the defendant seeks to evade an asset preservation order by dissipating or fraudulently transferring the assets, the claimant may request the court to impose a fine, detain the defendant, or even pursue criminal liability. If the property preservation proves wrongful or erroneous and causes losses to the defendant, the defendant may file a claim against the applicant and/or guarantor to obtain compensation.

#### **Effect on Third Parties**

When enforcing the ruling for property preservation, the court may seal, distrain, or freeze the property registered under the name or in possession of the defendant, as well as the property registered under the name or in possession of a third party, provided that the third party confirms in writing that the property belongs to the defendant or the claimant submits reasonably sufficient evidence to prove so.

Meanwhile, if a third party believes that they rightfully own the preserved property or otherwise involves their substantive rights, the third party may submit a written objection to the court, and the court will examine and decide within 15 days to cease the enforcement or reject the objection. If the objection is rejected and the third party is not satisfied with the decision, it may file a lawsuit against the claimant and request the court to overturn the property preservation ruling. If the third party ultimately obtains an effective judgment to overturn the preservation ruling, the court will lift the preservation measures accordingly.

## **2. PROCEDURES AND TRIALS**

### **2.1 Disclosure of Defendants' Assets**

A property disclosure order can only be made by the court after the enforcement procedure of judgment is initiated. No procedure exists in civil actions which requires a defendant to give disclosure of their assets pending a judgment.

Before or after the litigation is accepted, the claimant can apply to the court for property preservation (see **1.7 Prevention of Defendants Dissipating or Secreting Assets**), where the claimant needs to investigate on their own or entrust a lawyer to investigate certain public asset information (such as equity interests or shares in a company, intellectual property rights, etc). The claimant usually cannot inquire about real estate under the defendant's name nor access bank accounts in the defendant's name (see **7.2 Laws to Protect "Banking Secrecy"**).

### **2.2 Preserving Evidence**

Under Chinese law, there is no such duty for the parties to preserve evidence. In this regard, claimants may apply to the court for pre-litigation or litigation evidence preservation in accordance with Article 84 of the Civil Procedure Law. In certain circumstances, courts may order evidence preservation at their own initiative.

Evidence preservation orders are imposed where it is believed that important evidence might be destroyed or lost or would be difficult to obtain later. On a pre-litigation basis the claimant must also show there is an "urgent situation" in need of evidence preservation (see **1.7 Prevention of Defendants Dissipating or Secreting Assets**). Claimants may apply for evidence preservation to the court where the evidence is located, the respondent is domiciled, or the court with jurisdiction over the case intended to be filed.

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In China, courts generally do not permit a party to conduct a physical search of documents at the defendant's residence or place of business.

In judicial practice, when examining a claimant's application, the court will usually make its decision based on factors such as the connection between the evidence to be preserved and the facts to be proved, the necessity and feasibility of evidence preservation, and so on. The court is responsible for enforcing evidence preservation, and the court may employ methods such as sealing, distraining, audio-video recording, reproducing, appraising, and inquests to carry out evidence preservation and make a record.

Before ruling to take evidence preservation measures, the court may at its discretion request the applicant to provide a cross-undertaking for losses that the intended defendant or third party may incur due to such preservation. Under normal circumstances, the court will not require the undertaking as evidence preservation is the preserving of specific evidentiary materials for later use, which will not harm property interests. If required, the court will determine the method or amount of undertaking on the basis of factors such as the impact of the preservation measures on the holder of the evidence, the value of the evidence to be preserved, and the amount of the subject matter in dispute.

In addition to evidence preservation carried out by the court, the claimant may on its own preserve evidence through various means – eg, engaging a notary public house to notarise the process of evidence gathering conducted by the claimant or its attorneys.

## **2.3 Obtaining Disclosure of Documents and Evidence from Third Parties**

### **Third-Party Disclosure in Civil Proceedings**

In civil proceedings, a claimant may request any third party to disclose documents and evidence,

but there are no mandatory procedures for the claimant to compel third parties to do so. If there is any important evidence that the parties cannot collect on their own, they may apply to the court to investigate and collect such evidence from third parties, who are required to co-operate with the investigation and provide the requested documents, evidence, or information.

The court has discretion to decide whether to act as requested and may, at its own discretion, question a third party who knows the facts of the case and create an investigation record. The record will then be subject to cross-examination by the claimant and the defendant.

Some provincial level higher courts have issued guidelines for attorney investigation orders. Attorneys to either party to the proceeding may apply for an investigation order, which, if granted, allows the attorney to collect requested evidence from a third party (usually file materials, rights certificates, bank account information, transaction documents, third parties' explanations of the facts related to the case, etc). The guidelines generally provide that the parties must keep confidential any confidential information or commercial secrets obtained through the investigation order and must not disclose the same to anyone else for any other purpose.

Generally, the court will not assist the claimant to obtain evidence from third parties before the commencement of civil proceedings. However, if the claimant is unable to accurately identify the defendant and has difficulty filing a case, the claimant may apply to the court for an investigation order for access to the defendant's identity information from a third party.

### **Third-Party Disclosure in Criminal Proceedings**

In criminal proceedings, public security organs may, in the course of an investigation, obtain

such information from the holder of the information related to the criminal act, and may also question a third party who knows the facts of the criminal offence. The investigation procedures of the public security organs are confidential and the victim is usually not provided with the information obtained during the investigation.

However, the case file materials are handed over to the procuratorate after completion of the investigation procedures, and the victim can apply to the procuratorate to read the case file and obtain a copy of the case file materials.

## 2.4 Procedural Orders

Courts can grant preservation orders over the property, conduct, or evidence of the intended defendant or a third party. These orders may be issued without the need to notify the defendant or hold an ex parte hearing in advance. The intended party should be served with the order after it is issued. In practice, courts generally do not serve the intended party until the ruling has been enforced to ensure the intended party does not obstruct enforcement.

When the court decides to grant the orders, except for the undertaking that the claimant may be required to provide, there will be no additional burden on the claimant, nor does it need to compensate the defendant for not being present.

## 2.5 Criminal Redress

In China, the Supreme People's Procuratorate and its local counterparts are responsible for prosecuting criminal cases. Generally, the victims of fraud cannot themselves commence a criminal proceeding and can only report the suspected fraud to the local counterparts of the Ministry of Public Security, which is responsible for ordinary criminal investigations. In fraud cases, the criminal process is almost always the first choice for victims due to the reasons addressed in the following paragraphs, while the

threshold for instituting a criminal proceeding is much higher than for a civil proceeding, unless there are large scale victims involved.

### Advantages of Criminal Redress

Victims tend to seek redress through the criminal process based on the following three considerations.

- Public security organs have the authority to trace, seal, distrain, and freeze the defrauded assets regardless of whether they are in the name or possession of the fraudster or a third party, and can normally return the assets to the victims during the criminal investigation stage.
- The law stipulates that courts are likely to mitigate punishment if the defendant reaches a settlement with the victims and voluntarily returns the assets. In practice, in order to obtain a more lenient punishment, the defendant will take the initiative to find ways to raise funds to repay the victims.
- Compared to the criminal investigation and assets returning process, civil proceedings are time-consuming and cost-consuming and may even result in no recovery due to a lack of effective means to trace and enforce the defrauded assets that the fraudster usually dissipated and secreted after the fraud is revealed.

### Interplay between Civil and Criminal Redress

Once a criminal proceeding commences, charges against the defendant will not be vacated even if the defendant fully compensates the victims. Accordingly, parallel proceedings may occur if the public security organ has instituted criminal proceedings. Under Chinese law, criminal proceedings take precedent over civil proceedings, provided that the parallel proceedings are based on substantially the same facts. Accordingly, courts will refuse to accept a civil case based on the same legal facts after a criminal proceed-

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ing has been instituted against the defendant. Courts are also expected to dismiss civil cases that have been accepted and transfer the case materials to the relevant criminal investigation organ.

Moreover, after the defendant is criminally charged, it will generally become insolvent, and the assets recovered by the judicial organs must also be distributed proportionally among all victims. This may lead to the victims not being compensated in full. For this reason, victims may prefer to pursue a civil cause of action if they are able to discover and preserve the assets of the defendant or if the defendant is willing to raise funds to compensate the victim for their losses.

## 2.6 Judgment without Trial

In civil proceedings, the court must serve each party a notice for the coming trial and must hold at least one full trial for each case before rendering a judgment. However, where a defendant, after duly served with a notice, fails to appear in court or quits during the trial, the court may at its discretion enter a default judgment. There is no procedure for the claimant to move for a summary or default judgment in any event, even if the defendant fails to appear in court or answer the complaint or makes a wholly unmeritorious defence.

Where the defendant fails to appear in court, the trial shall proceed as normal, and the court has the authority to clarify all the key facts alleged by the claimant to mitigate the risk that a third-party's interest will be harmed by the judgment.

## 2.7 Rules for Pleading Fraud

### Civil Fraud Claims

Chinese courts implement a case registration system for civil litigation, and the court will generally file and accept the pleading as long as the following statutory requirements are met: identity information of the defendant; specific

claims; specific factual basis and reasons; and the court has jurisdiction over the case. Although there are no special rules or professional conduct considerations or heightened standards for pleading fraud in China, the “specific factual basis and reasons” requirement itself grants discretion to the court in examining pleading materials and deciding whether to accept and file the case. Given this, it is possible that the court may require the claimant to provide more cogent evidence than other types of claims with a view to precluding unwarranted allegations of fraud being made.

### Criminal Fraud Claims

If the victim makes a criminal report to the public security organs, it is usually necessary to provide prima facie evidentiary materials on the crime of fraud. There are no particular provisions requiring a victim to provide evidence in the case of fraud. Where, in the course of filing and reviewing a case, public security organs discover that the facts of the case or the criminal clues provided by the victim are unclear, they may employ measures such as questioning, inquiry, inquest, appraisal, and collection of evidentiary materials that do not restrict the personal or property rights of the suspects.

Where, after review, the public security organs find that there are criminal facts and it is necessary to pursue criminal liability, the case may be officially accepted. However, due to lack of detailed guidelines on the criteria for filing a criminal case, the public security organs have broad discretion on whether to accept the case, and the threshold to commence a criminal investigation is usually high.

Notably, the public security organs will explain to the victim the legal consequences of making false accusations. However, as long as the facts are not fabricated or falsified, even if the facts reported by the victim are discrepancies or

even erroneous accusations, the victim will usually not be held legally liable for making accusations against an alleged perpetrator.

## 2.8 Claims against “Unknown” Fraudsters

According to the Civil Procedure Law, one of the requisites for the court to accept a civil case is that the defendant must be specifically identifiable. Therefore, civil fraud claimants must provide the court with the defendant’s identity; otherwise, the court will not accept the case. To remedy this, victims may:

- apply to the court for a pre-litigation investigation order through an attorney and ask the attorney to investigate the identity of the perpetrator from a third party; or
- request to examine the related case file materials prepared by the public security organ and procuratorate to learn the identity of the perpetrator (see **2.3 Obtaining Disclosure of Documents and Evidence from Third Parties**).

By contrast, in the criminal context, public security organs do not require victims of fraud to provide accurate identity information about “unknown” fraudsters when they accept a report of fraud. After accepting the case, the public security organ may independently investigate and ascertain the identity of the perpetrator at the case filing and review stage and prepare a criminal investigation report. A case will be filed if criminality is discovered and it is deemed necessary to pursue criminal charges against the perpetrator.

## 2.9 Compelling Witnesses to Give Evidence

### Civil Proceedings

In civil proceedings, all persons with knowledge of the circumstances of the case are legally obligated to appear in court to testify. However,

in practice, the claimant must usually contact the witness on their own and apply to the court for the witness to testify in court. Only in a few special circumstances will the court subpoena a witness to appear in court and testify, such as if the parties are suspected to have maliciously colluded to harm the legitimate rights and interests of others.

Chinese law does not impose penalties on witnesses who refuse to testify in civil proceedings. However, if a witness falsifies or destroys important evidence, or otherwise obstructs investigation and evidence collection activities, the court may impose a fine, detain the witness, or pursue criminal liability, depending upon the seriousness of the circumstances.

Where a parallel criminal proceeding exists, the victim may apply to the procuratorate during the review and prosecution stage to consult and copy the investigation case file materials and obtain a transcript of the public security organ’s questioning of the witness for submission to the court as evidence to prove the facts claimed by the victim.

### Criminal Proceedings

In the criminal context, all persons with knowledge of the circumstances of the case are legally obligated to co-operate with the investigation. In practice, public security organs may question persons who know the circumstances of the case, require them to truthfully provide evidence and make records of witness testimony. A transcript of a witness’s testimony may serve as evidence in a criminal case.

In a criminal proceeding, the court is entitled to compel witness testimony under special circumstances. For example, if the court deems the witness’s testimony necessary because the procurator, the parties, or the defender objects to the witness’s testimony and the testimony has

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a major impact on the conviction and sentencing of the case. If a witness does not appear in court to testify without a legitimate reason, the court may compel them to appear in court, except where the witness is the defendant's spouse, parent, or child.

Furthermore, if a witness refuses to appear in court without justifiable reasons or refuses to testify after appearing in court, the court may sanction or detain them depending on the seriousness of the offence. Where a witness is dissatisfied with the detention decision, they may apply for reconsideration to the superior-level court for reconsideration, but enforcement is not suspended during the period of reconsideration.

## 3. CORPORATE ENTITIES, ULTIMATE BENEFICIAL OWNERS AND SHAREHOLDERS

### 3.1 Imposing Liability for Fraud on to a Corporate Entity

#### Civil Liability

Under Chinese law, a legal person or non-legal person organisation, including limited liability company or other corporate entity ("employer"), is liable for the actions taken by its employees, including its directors or officers, provided that the actions occur within their responsibility and authority and are carried out in the name of the employer. That is, if an employee commits fraud while performing duties for its employer, the employer may be vicariously liable to the victims of the fraud.

The following factors are generally considered to determine whether an employer can be found vicariously liable:

- whether the time and place where the fraud occurred belonged to the working hours and the place of work;
- whether the subjective intention of the fraudulent act was all or at least partially related to the performance of the employee's duties; and
- whether the employee's acts were for the benefit of the employer.

#### Criminal Liability

The Criminal Law provides for the concept of unit crimes. "Units" under the Criminal Law include not only companies, enterprises, and other types of legal persons with independent legal personality, but also some other organisations such as branches or internal departments of units. To determine whether an employee's acts constitute criminal fraud committed by the unit, the following conditions generally need to be met:

- the employee's fraudulent act can represent the intent of the unit;
- the employee commits the fraudulent act in the name of the unit; and
- the profit from the fraudulent act belongs to the unit.

For crimes committed by units, the unit is generally fined and the directly responsible supervisors and other directly responsible personnel may be subject to criminal punishment.

### 3.2 Claims against Ultimate Beneficial Owners

In some cases, a perpetrator may seek to evade liability for fraud by abusing the independent legal personality of a corporation. Specifically, a perpetrator may be a shareholder of a corporation who uses the corporate form to commit fraud and then takes advantage of the limited liability afforded to them.

To combat such abuse, the Company Law recognises the principle of “piercing the corporate veil”, which allows a court to hold a shareholder jointly liable for the obligations of the corporation.

To invoke this principle, the claimant must show that the shareholder had abused the company’s independent legal person status and the limited liability of the shareholders to evade debts and seriously harm the interests of the company’s creditors. The key fact to be proven is that the shareholder did not treat the corporation as an independent entity. For example, the staff, assets, and business of the company have been commingled with those of the shareholder.

It is difficult in practice to successfully argue a pierce-the-corporate-veil claim, except in the context of a one-person corporation where the sole shareholder, rather than the victim, has the burden to prove that the corporation’s assets are independent of their personal assets.

In addition to “piercing the corporate veil”, as discussed above, there are some other areas where fraud victims can bring claims against those who stand behind companies when the company has been used as the vehicle for fraud. For instance, where a securities issuer violates provisions on information disclosure by making false records, misleading statements, or material omissions in the disclosed information, causing investors to suffer losses in securities transactions, the Securities Law provides that the controlling shareholder and/or actual controller of the issuer will be jointly and severally liable with the issuer for the losses caused to the investors, unless they can prove that they are not at fault.

### **3.3 Shareholders’ Claims against Fraudulent Directors**

Under the Company Law, shareholders have the right to bring derivative actions on behalf of their

company against fraudulent directors. Causes of action against fraudulent directors include where the directors cause harm to the company while undertaking their duties in violation of any law, regulation, or the company’s by-laws. Certain rules exist as to shareholder eligibility, commencing the action, and recovery and costs.

#### **Shareholder Eligibility**

To initiate a derivative action, the shareholders of a company limited by shares (joint stock company) to the action must have held, individually or collectively, at least 1% of the company’s shares for at least 180 consecutive days prior to the action. Shareholders of a limited liability company are not subject to any eligibility requirements for derivative actions.

#### **Commencing the Action**

The shareholders to the action should make a request in writing to the company’s supervisor or board of supervisors. Shareholders themselves can initiate the action on behalf of the company under certain circumstances. This includes exigent circumstances and where the company’s supervisor or board of supervisors refuses to initiate the action or fails to do so within 30 days of receiving the shareholders’ request.

#### **Recovery and Costs**

Recovery obtained in a derivative action belongs to the company. Thus, for example, recovery in the action might involve the fraudulent director disgorging illegal gains and transferring those gains to the company.

The company is required to reimburse the shareholders for litigation costs to the extent they are reasonable. For more information on shareholder derivative actions in China and related matters, see our contribution to *Shareholders’ Rights & Shareholder Activism 2021*.

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## 4. OVERSEAS PARTIES IN FRAUD CLAIMS

### 4.1 Joining Overseas Parties to Fraud Claims

In civil cases, the court must analyse whether it is competent to join as a defendant an overseas party who is not domiciled in China. This analysis considers the nature of the claims and the circumstances over which the court has jurisdiction, including:

- for contract fraud claims against an overseas party, the place where the contract was concluded or performed within China;
- for a tort fraud claims against an overseas party, the tort occurred within China;
- the property in dispute is located in China; and
- the overseas party has assets within China.

To exercise jurisdiction over overseas parties, the court must make sure that they are properly served. Chinese courts may use electronic service (by fax, email, etc) to serve overseas parties not domiciled in China, if the laws of the country or region where they are domiciled allow for electronic service. In addition, Chinese courts may also serve judicial documents through other channels, such as mutual legal assistance agreements, Hague conventions of service, diplomatic channels, and postal service (such as those permitted by the state where the person to be served).

Chinese courts have jurisdiction over overseas parties who commit criminal fraud within China in accordance with the principle of territoriality, according to the Criminal Law. Where an overseas party commits a crime against China or its citizens outside the territory of China, and the minimum sentence under the Criminal Law is fixed-term imprisonment of not less than three years, the Criminal Law applies extraterritorially

to such party except where the party's act does not violate local law in the place where the act was committed.

## 5. ENFORCEMENT

### 5.1 Methods of Enforcement

Under Chinese law, after the judgment takes effect, the successful fraud claimant becomes a judgment creditor, and the defendant becomes a judgment debtor. Where the defendant fails to pay off the debt under the judgment within the time limit designated by the judgment, the claimant can apply to the court to initiate enforcement proceedings against the defendant.

#### Initiating the Enforcement Procedure

A successful fraud claimant who receives a judgment or arbitral award against a defendant may apply to the Chinese court with jurisdiction to initiate the enforcement procedure directly, provided that the judgment or arbitral award is made by a Chinese court or arbitration institution.

Where a judgment or arbitration award is made by a foreign court or arbitration institution, the creditor will first apply to the Chinese court with jurisdiction for recognition of such judgment or award, and the recognition will be handled in accordance with an international treaty concluded or acceded to by China and the country or region where the court or arbitral institution is located (eg, the New York Convention) or in accordance with the principle of reciprocity. After the judgment or award is recognised by the Chinese court, the enforcement procedure can be initiated.

#### Property Disclosure for Enforcement

In the course of enforcement, the applicant should provide clues as to the assets of the judgment debtor. The court will conduct an investigation through the online enforcement

inspection and control system and, where the case requires an investigation, it will conduct an investigation through other means and at the same time employ other investigation methods. Where the judgment debtor does not perform the obligations set forth in effective legal documents, the applicant may also request the court to publish a reward announcement to find assets available for enforcement.

During the enforcement procedures, the court will serve the judgment debtor with an order to disclose their assets and the debtor must truthfully disclose details of their assets to the court. Where the judgment debtor refuses to disclose, falsely discloses, or delays in disclosing without legitimate reasons, the court may sanction the judgment debtor or their legal representative, depending on the seriousness of the offence. Sanctions include adding the judgment debtor's name to a list of "dishonest judgment debtors" and, in serious circumstances, subjecting the judgment debtor to criminal liability.

### **Asset Control and Disposal**

During enforcement, the court has the right to seal, distrain, or freeze the assets of the judgment debtor, including movable property in the possession or real property/specific movable property registered in the name of the judgment debtor, as well as any property in the possession or registered in the name of a third party provided that the third party confirms in writing that the assets belong to the judgment debtor.

Once the judgment debtor's assets have been sealed, distrained, or frozen, the court may dispose of them by auction, public sale, or ruling to pay off a debt in kind, and transfer the money obtained from enforcement to the applicant in satisfaction of the judgment or award.

### **Sanctions for Failure to Satisfy a Judgment**

#### *In general*

Where a judgment debtor does not satisfy their obligations as set forth in a judgment or award, the court may:

- make a record in the credit reporting system, and publicise the debtor's non-performance of their obligations through the media;
- take other statutory punitive measures; and
- name the debtor in the "list of dishonest judgment debtors", which is used to inform others, including credit-reporting agencies, that the judgment debtor has not fully performed their obligations.

#### *Consumption restrictions*

The applicant may request the court to impose consumption restrictions on the judgment debtor once they are named in the "list of dishonest judgment debtors".

Consumption restrictions for natural persons include prohibitions on air and high-speed rail travel, luxury hotel accommodation, leasing of high-end office space, vacation travel, arranging for children to attend expensive private schools, and other luxuries that are not considered necessary for life and work.

Consumption restrictions imposed on legal persons may also be imposed on their legal representative, principal responsible person, persons directly responsible for enabling satisfaction of the debt, and actual controller.

#### *Restrictions on exiting mainland China*

Judgment debtors who fail to satisfy a judgment or award may be prohibited from exiting mainland China. Upon the applicant's request, the court may determine it necessary to impose an exit ban and notify relevant administrative authorities to assist in enforcing the ban.

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## *Detention, fines and criminal liability*

Judgment debtors who refuse to satisfy a judgment, ruling, or obstruct the court's enforcement may be subject to a fine, detention, or even criminal liability, depending on the specific conduct and the corresponding circumstances provided for by law.

## **6. PRIVILEGES**

### **6.1 Invoking the Privilege against Self-incrimination**

In China, no one can be compelled to give testimony that would incriminate themselves in criminal proceedings. In contrast to other jurisdictions, the right to remain silent is not expressly provided for in Chinese law, neither are the judicial authorities obligated to remind suspects of their right to remain silent before taking legal actions against such suspects. However, it is clear that the accused may not be found guilty and sentenced only based on their oral testimony without supporting evidence.

By contrast, in civil proceedings, if one party expressly admits unfavourable facts during court hearings or in written materials such as complaints, the other party does not need to adduce evidence to prove these facts, and the court can usually use this as the factual basis for the judgment.

In accordance with the rules of evidence in the Civil Procedure Law, where a court requests a party to submit relevant evidence and it refuses to do so, submits false evidence, destroys evidence, or commits other acts that make the evidence unusable without a legitimate reason, the court may presume that the other party's relevant factual assertions have been established.

### **6.2 Undermining the Privilege over Communications Exempt from Discovery or Disclosure**

Chinese law does not provide a general privilege over communications that can be exempted from disclosure. Judicial and administrative authorities, particularly public security organs in criminal procedures, are granted broad authority to inquire and collect evidence. Despite this, in criminal proceedings, counsel is required to keep their client's information confidential, except for information related to certain specific criminal offences, including endangering national security, public security and personal safety.

## **7. SPECIAL RULES AND LAWS**

### **7.1 Rules for Claiming Punitive or Exemplary Damages**

Under Chinese law, the remedies for fraud claims are generally limited to the claimant's losses, which may include reasonably expected profits. In general, courts will not award punitive or exemplary damages in cases of fraud, except where the claim may relate to intellectual property infringement.

### **7.2 Laws to Protect "Banking Secrecy"**

There are no special laws in China to protect communications between banks and their clients from disclosure. The general rule under the Law of the PRC on Commercial Banks is that commercial banks must keep strictly confidential their customers' bank account information and have the right to refuse inquiries from third parties regarding bank account details and requests to freeze or withhold funds, unless otherwise provided for by laws and regulations. However, under Chinese law, judicial authorities are granted broad authority to make such inquiries with commercial banks as well as other financial institutions and to collect evidence. Com-

mercial banks will generally comply with a court order on such matters.

Courts may use the online enforcement inspection and control system to search the banking information of the defendant, as mentioned in **5.1 Methods of Enforcement**. However, during fraud-related civil proceedings, it is generally hard for the claimant to obtain the courts' approval to inquire into the bank accounts of the defendant.

### 7.3 Crypto-assets

China has implemented regulations that strictly regulate crypto-assets. As a consequence, Chinese courts often invalidate crypto-asset related trading and investment arrangements.

Chinese law remains silent as to the nature of crypto-assets. To date, no legal provisions have been issued regarding the protection of crypto-assets. This means crypto-assets are not considered statutory property, as Chinese law adopts the *numerus clausus* principle (ie, the categories and content of the real rights are provided by law). Thus, in Chinese judicial practice, "stealing" cryptocurrency has been held as constituting the crime of illegally obtaining data from computer information systems, but not theft.

If an enforcement applicant can provide clear clues as to the location of crypto-assets, it is theoretically possible for a court in China to grant an asset preservation order against such crypto-assets and to enforce the order. Due to China's heavy restrictions on crypto-assets-related activities, however, there is currently no crypto-asset trading platform domiciled within the jurisdiction of Chinese courts. Because of this, it is very difficult for courts to effectively control crypto-assets. Unsurprisingly, no public records exist in which a party has successfully preserved crypto-assets in a civil proceeding.

Regarding fraud involving crypto-assets, since Chinese laws do not recognise crypto-assets as statutory property, fraud related to crypto-assets will not be treated as civil fraud unless it also involves fiat currency or other property. In related criminal proceedings, public security organs also do not invest as much administrative resources in recovering crypto-assets as in recovering other assets.

For a more detailed discussion of crypto-asset regulations and judicial practice in China, see our adjacent article: *International Fraud & Asset Tracing 2022, Trends & Developments, China*.

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**Han Kun Law Offices** is a leading full-service law firm in China with more than 700 professionals located in five offices in Beijing, Shanghai, Shenzhen, Haikou and Hong Kong. The firm's main practice areas include dispute resolution, private equity, mergers and acquisitions, international and domestic capital markets, investment funds, asset management, antitrust/competition, banking and finance, aviation finance, foreign direct investment, compliance, private client/wealth management and intel-

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## Trends and Developments

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### **Introduction**

China has implemented regulations that strictly regulate virtual currencies, which include cryptocurrencies. These regulations are observable in the nation's courts, which tend to take a negative view of cryptocurrencies and related business activities. This has contributed to making cryptocurrency asset tracing in judicial proceedings an exceedingly difficult task.

### **Summary of China's Evolving Regulatory Restrictions on Cryptocurrencies**

On 3 December 2013, multiple central governmental authorities issued the Notice on Prevention of Bitcoin Risks (the 2013 Notice), which stated that Bitcoin should be considered a virtual commodity rather than legitimate currency and should not be circulated in the market as legal tender.

On 4 September 2017, multiple central governmental authorities issued the Announcement on Prevention of Token Fundraising Risks (the 2017 Announcement), which reiterated that virtual currencies are not legitimate currency and further stated that:

- all fundraising activities through token issuances must stop immediately;
- no token trading platforms may engage in exchanges between any fiat currency and tokens or virtual currencies, trade or trade as central counterparties tokens or virtual currencies, or provide pricing, information agency, or other services for tokens or virtual currencies; and
- financial institutions and non-banking payment institutions must not provide products

or services such as account opening, registration, trading, clearing, and settlement for token fundraising or virtual currencies, and must not underwrite insurance associated with tokens or virtual currencies.

On 18 May 2021, multiple central governmental authorities issued the Announcement on Prevention of Risks of Virtual Currency Trading and Speculation (the 2021 Announcement), which reiterated most of the positions of the 2017 Announcement, and (i) further stated that members of an internet platform enterprise must not provide online business premises, commercial display, marketing publicity, paid flow diversion and other services for business activities relating to virtual currencies, and (ii) warned that, in Chinese judicial practice, virtual currency trading contracts are not protected by law and the consequences of and losses arising from such investment transactions will be borne by the parties concerned themselves.

On 15 September 2021, multiple central governmental authorities issued the Notice on Further Preventing and Resolving the Risks of Virtual Currency Trading and Speculation (the 2021 Notice), which reiterated previous positions on cryptocurrencies and further stated that:

- business activities relating to virtual currencies are illegal financial activities;
- the provision of services by offshore virtual currency exchanges to domestic residents via the internet is also considered to be an illegal financial activity; and
- civil acts taken to invest in virtual currencies and related derivatives are null and void when

found to be in breach of public order and good morals, and the losses arising therefrom are borne by the parties concerned themselves.

On 3 September 2021, multiple central governmental authorities issued the Notice on Addressing Virtual Currency “Mining” Activities (the Mining Notice), which explicitly forbids new virtual currency mining projects and subjects existing virtual currency mining projects to severe restrictions, including requiring existing projects to close before a designated time limit. On 27 December 2021, China revised the Catalogue for Guiding Industry Restructuring (2019 Version) and listed virtual currency mining as an industry to be eliminated.

### **Chinese Judicial Views on Cryptocurrencies and Related Business Activities**

#### *Chinese law does not recognise cryptocurrencies as statutory property*

Chinese law remains silent as to the nature of cryptocurrencies. Article 127 of the Civil Code of the PRC provides that “[w]here there are laws particularly providing for the protection of data and online virtual assets, such provisions shall be followed”. However, so far, there are no legal provisions issued regarding the protection of online virtual assets. This omission means denial of property rights to cryptocurrencies for the moment, given that Chinese law adopts the numerus clausus principle. That is to say, cryptocurrencies and other virtual assets are not recognised as “property” under Chinese law. Thus, in Chinese judicial practice, “stealing” cryptocurrency constitutes the crime of illegally obtaining data from computer information systems, but not theft.

#### *Evolution of the regulatory departments’ stringent position on cryptocurrencies has led Chinese courts to render negative judgments on cryptocurrencies and related business activities*

In general, under Chinese law, violating national-level departmental rules (such as the notices and announcements summarised above) does not result in the invalidation of civil acts. However, a legal basis exists for Chinese courts to invalidate civil acts that are determined to be in violation of departmental rules that pertain to financial security, market order, national macro-policies, public order and good morals.

Chinese courts generally agree that departmental rules concerning cryptocurrencies involve the socioeconomic order and national macro-policies, and violation of such rules is contrary to public order and good morals. Thus, as Chinese regulators have taken a more adverse position on cryptocurrencies, so too have Chinese courts become increasingly inclined to rule as void cryptocurrency-related business activities which are found in violation of relevant departmental rules.

#### *Uncertainty exists for claims for the return of cryptocurrency*

Chinese courts generally hold that merely possessing cryptocurrency does not violate Chinese law. In many cases, Chinese courts have supported claims for the return of cryptocurrency based on unlawful infringement of such possession.

Many Chinese courts have supported plaintiffs’ claims for the return of disputed cryptocurrency in cases of robbery, stealing, misappropriation, or wrongful payment of cryptocurrency, and even in instances of cryptocurrency lending or escrow; however, this position is by no means certain. While still uncommon, Chinese courts have become more inclined to deny plaintiffs’

claims for the return of cryptocurrency, particularly as regulatory positions toward cryptocurrency tighten.

For example, last year in a Bitcoin lending dispute case, the Jiangsu Changzhou Intermediate People's Court, citing the 2013 Notice and the 2017 Announcement, held that claims for the return of the disputed Bitcoin were not justifiable; in another Bitcoin lending dispute case, a local court dismissed the plaintiff's claim for return of the disputed Bitcoin based on violation of the 2013 Notice.

While the courts in these cases did not explicitly cite the latest departmental rules, for various reasons, it is likely that the courts' positions in these cases were influenced by the latest changes in the position of Chinese regulatory departments.

### *Contracts for cryptocurrency trading or investment are often found unenforceable*

In cases of trading or investing in cryptocurrencies, Chinese courts diverge on the enforceability of the underlying contracts. For example, the Beijing Higher People's Court held in a recent case that the underlying trading contract for the cryptocurrency Tripio was valid and enforceable because, unlike fundraising activities through token issuances, trading virtual currency as a commodity does not violate mandatory provisions of Chinese law.

However, it is more common for Chinese courts to invalidate cryptocurrency trading or investment contracts which do not directly involve fundraising activities through token issuances. The typical reasoning for these holdings is that the disputed transaction disturbs the socioeconomic order and is therefore contrary to public order and good morals, which is one of the statutory bases for invalidating civil acts.

Notably, after the Mining Notice was promulgated in September 2021, there have been consistent court judgments which found existing mining contracts void (even if reached before September 2021). It is likely that Chinese courts in future cases will continue to invalidate such mining contracts.

### *In general, Chinese courts do not support claims involving conversions between cryptocurrencies and fiat currencies*

In Chinese legal proceedings, a claim for fiat currency is generally more favourable than a claim for cryptocurrency, as the former is easier to enforce. However, Chinese policy expressly prohibits exchange services between fiat currency and cryptocurrency, as mentioned above. Thus, Chinese courts generally do not support the conversion of claims for cryptocurrency into claims for fiat currency.

In a widely discussed arbitration case, the Shenzhen Court of International Arbitration ordered the respondent to pay the applicant a certain amount of money, which was the estimated value of undelivered cryptocurrency as determined by the tribunal based on prices quoted on okcoin.com, an offshore cryptocurrency trading platform. This award, however, was later annulled by the court for the following reasons.

- Chinese policy forbids exchanges between cryptocurrency and fiat currency and forbids cryptocurrency pricing and information agency services.
- The award discretionally ordered payment of the US dollar (USD) equivalent of the disputed cryptocurrency and further ordered conversion of the USD amount into RMB. This was considered a disguised exchange between cryptocurrency and fiat currency that violates Chinese policy and is therefore contrary to social public interests.

Notably, while the ruling to annul the award was entered by a local court, it reflects the position of the Supreme People's Court. This is because, according to Chinese law, local courts must obtain approval from the Supreme People's Court before they may issue such annulment rulings.

A small exception exists as to the above rule: private agreements for conversions between fiat and virtual currencies. If the parties have agreed on a conversion price for exchange between the disputed cryptocurrency and fiat currency, then, if the plaintiff properly so claims, a Chinese court may directly order payment of the relevant amount of fiat currency for undelivered cryptocurrency.

In another widely discussed case, the Shanghai First Intermediate People's Court, based on the agreed conversion price reached by the plaintiffs and the defendants during the trial, ordered the defendants to pay the plaintiffs a specified amount for each unreturned Bitcoin.

#### *Uncertain legal consequences following the invalidation of cryptocurrency contracts*

Normally, after a contract is ruled void, the original owner of the property underlying the contract is entitled to its return or to be compensated based on the property's appraisal value. However, courts in many cryptocurrency trading and investment cases have refused claimant requests for the return of the underlying cryptocurrency or its appraisal value as compensation, holding that the claimants cannot hold protectable rights to cryptocurrency. In other cases, courts have chosen to allocate losses from the dispute between the parties based on each party's degree of fault.

#### **Tracing of Cryptocurrency in Preservation and Enforcement Proceedings**

##### *Tracing of cryptocurrency in property preservation proceedings*

China has shut down all third-party cryptocurrency trading platforms. Currently, no such cryptocurrency trading platforms are domiciled within the jurisdiction of Chinese courts. Because of this, it is very difficult for Chinese courts to trace and control cryptocurrency assets. Tracing methods available to courts in property preservation proceedings are also limited. It is thus unsurprising that no public records can be found in which a party has successfully preserved cryptocurrency assets in a civil proceeding.

##### *Tracing cryptocurrencies in enforcement proceedings*

As discussed above, Chinese courts have almost never preserved cryptocurrency assets in advance of entering a judgment. Relatedly, Chinese courts, even at the enforcement stage, have limited means to trace cryptocurrency assets possessed by judgment debtors. Normally, courts may try to push a judgment debtor to voluntarily surrender their cryptocurrency assets by warning of potential judicial sanctions and/or criminal liabilities, such as the crime of refusing to perform an effective judgment or ruling. However, oftentimes, this approach does not yield favourable results.

Because of the above, most court judgments involving the return of cryptocurrency are ultimately unenforced. In many cases, the court cannot trace the cryptocurrency owned by the judgment debtor and is forced to terminate the enforcement process after it issues a consumption restriction order against the judgment debtor and adds their name to the list of dishonest judgment debtors.

Despite this, upon application and with preliminary leads, a court may decide at its discretion

to take the following actions to trace cryptocurrency assets.

- Tracing carriers of private cryptocurrency asset keys through a search of domiciles, offices, or other premises related to the judgment debtor.
- If private cryptocurrency asset keys are kept by a third-party trading platform, the court may issue a notice of assistance to the third-party platform, requesting the platform to freeze the wallet (and thus the cryptocurrency assets in the wallet) held in the name of the judgment debtor. As discussed, however, all such third-party platforms are operated by offshore entities. There is no guarantee that the offshore platform would follow the Chinese court's request.

## Cryptocurrency Tracing in Criminal Proceedings

In criminal proceedings, obstacles exist as to the attachment of cryptocurrency assets, as listed below.

- According to Article 64 of the Criminal Law of the PRC, "money and property" illegally obtained by a criminal is to be recovered. Some Chinese criminal judicial departments hesitate when deciding to attach cryptocurrency assets because Chinese law does not expressly consider cryptocurrency to be "money and property".
- According to the Criminal Procedure Law of the PRC, the primary means for recovery of "money and property" include sealing, distraining, and freezing. However, cryptocurrency may not be effectively attached by any of these means.
- Cryptocurrency may not be effectively controlled before being transferred to the account (wallet) in the name of the judicial department. However, Chinese policies do not currently allow judicial departments to hold custody of

attached cryptocurrencies in wallets opened with offshore third-party platforms.

Because of the above, criminal judicial departments need to expend more effort than usual in order to trace and effectively control cryptocurrency assets. However, compared to civil proceedings, judicial departments in criminal proceedings generally have more powerful and comprehensive means to trace cryptocurrency assets.

## Difficulties in Disposing of Cryptocurrency Assets

For judgments for the return or delivery of cryptocurrency, courts in enforcement proceedings can directly deliver the controlled cryptocurrency to the applicant (claimant). In other cases, a judgment may order payment in fiat currency but the controlled assets include cryptocurrency. In this case, the court would need to dispose of the cryptocurrency and realise its value in fiat currency and then pay the realised fiat currency to the applicant (claimant).

However, court sales/disposals of cryptocurrency assets face substantial difficulties. Firstly, there is no legitimate trading/pricing market within China for cryptocurrencies. The court's enforcement department would be unable to produce a qualified appraisal value for cryptocurrencies, which is usually a prerequisite for the court to dispose of any assets.

Secondly, there are no explicit rules for disposing of cryptocurrencies, which creates confusion for court enforcement departments. For example, as offshore trading platform services to domestic residents have been deemed as illegal financial activities (2021 Notice), it is uncertain whether an enforcement department can dispose of cryptocurrency assets on these offshore platforms. If not, and given that there is no legitimate trading/pricing market within China, it may

be impossible for the enforcement department to dispose of cryptocurrency assets.

For the above reasons, in many enforcement cases, cryptocurrency assets cannot be disposed of in a proper, timely manner and their market value cannot be fully realised. In some cases, the enforcement department even closes the enforcement proceeding with the attached cryptocurrency assets undisposed.

### **Conclusion and Suggestions**

In general, China's regulatory position on cryptocurrencies and related business activities has become more restrictive in the past few years. As a result, it is now highly risky to conduct cryptocurrency-related business activities in China. Due to a lack of protective legal rules, and in the absence of an integrated Chinese trading platform, tracing and recovering cryptocurrency assets in Chinese legal proceedings have proven to be difficult.

Nevertheless, if one intends to conduct cryptocurrency-related business activities in China at this time, we have the following suggestions.

- Carefully monitor changes in Chinese regulatory policies. In cryptocurrency-related areas, policy changes can be instructive for business activities.
- When possible, consummate the transaction as soon as possible, as regulatory policies may change quickly. Use caution when entering into long-term investment projects involving cryptocurrencies in China at this time.
- Adopt more complete transaction terms. In particular, include terms on exchange between the cryptocurrency and fiat currency and, to the extent possible, stipulate contractual liabilities in fiat currency.
- If applicable, it is also reasonable to consider choosing a governing law other than Chinese law for the transaction.

# CHINA TRENDS AND DEVELOPMENTS

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**Han Kun Law Offices** is a leading full-service law firm in China with more than 700 professionals located in five offices in Beijing, Shanghai, Shenzhen, Haikou and Hong Kong. The firm's main practice areas include dispute resolution, private equity, mergers and acquisitions, international and domestic capital markets, investment funds, asset management, antitrust/competition, banking and finance, aviation finance, foreign direct investment, compliance, private client/wealth management and intel-

lectual property. Han Kun's litigation team has served many top companies in a broad range of fields and industries, both domestically and overseas, providing personalised and effective solutions for their commercial disputes. The litigation team has extensive experience in material, difficult and complex commercial disputes, including in fraud, securities misrepresentation, breach of fiduciary duty, and asset tracing/recovery.

## AUTHORS



**Ronghua (Andy) Liao** is a partner at Han Kun Law Offices. Before joining Han Kun in 2015, Mr Liao was a lawyer and partner with other leading international and PRC law firms

for more than 13 years. He specialises in commercial litigation, cross-border dispute resolution, and asset tracing/recovery. Mr Liao is one of the few internationally recognised asset-tracing and recovery legal experts in China. Over his 20 years of practice, he has successfully represented many well-known companies and individuals in cross-border asset tracing and recovery actions. He is a member of the China Bar and an arbitrator at the Shanghai International Arbitration Centre.



**Chunyao (Alan) Lin** is a counsel at Han Kun Law Offices. He focuses on handling litigation and arbitration cases arising from equity investment and repurchase disputes, private

equity and financial management disputes, M&A disputes, control contests, cross-border investment and trade disputes, and real estate and construction project disputes. He also has a strong interest in alternative dispute resolution (ADR) and endeavours to resolve disputes through ADR measures. Drawing on his transactional experience, he is especially skilled in resolving disputes through renegotiating the original terms and conditions of disputed transactions. He is a member of the China Bar and the New York State Bar.



**John D. Fitzpatrick** focuses on assisting clients to navigate the complexities of doing business in China, particularly with respect to general corporate compliance matters, contract and document reviews, and translations. In addition, he assists Han Kun Law Offices' corporate practice with internal investigative and corruption-related inquiries. He has worked with clients in the consulting, technology, retail and automotive industries, among others. He holds a US Bar licence, is a US-certified public accountant, and also has previous Big Four accounting experience in the USA.

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