

INSTITUTIONAL REASONING

IN DRAFTING NEW BANKRUPTCY LAW OF CHINA

*Wang Weiguo**

Introduction

In line with the legislation plan of the Standing Committee of the 8th NPC, the Fiscal and Economic Committee of the PRC National People's Congress has organized the drafting work for renewing bankruptcy law since March 1994. In the autumn of 1995 the Draft Bankruptcy Law ("the 1995 Draft") containing 10 chapters and 193 articles was proposed to the higher authority. In the next year, the drafting process was actually shelved due to some reasons. After four years past, the drafters were called up and informed of a new working schedule for the drafting work in March 2000. The re-start is fundamentally continuation of the former efforts. A draft named "the Business Bankruptcy and Reorganization Law", formulated on the basis of the 1995 Draft, was discussed at a symposium in July 2000.

During the four-year rest period of the drafting work, there were some significant events that might be influential upon our further efforts, e.g. the deepening of SOE reform, China's entering into WTO, the Asian financial storm, and new achievements of overseas and domestic researches on bankruptcy law. When reviewing the 1995 Draft today, we realize that there are a number of issues that are still disputable or need to be reconsidered under the circumstances of the new experience and achievements.

Bankruptcy law is placed in such a realm that is full of conflicts of interests. Dealing with the conflicts there are different opinions related to legal policies and institutional designs. The task of legislature is not simply to pick up any of them but to find a better solution with good reasoning. This paper intends to make a discussion on the different ideas around some of the major issues.

1. The Scope of Application

The existing 1986 Enterprise Bankruptcy Law and the 1991 Civil Procedure Law limit their application to the scope of enterprise legal persons. Up to now partnerships, sole proprietorships and natural persons are not subject to bankruptcy proceedings.

In early 1994 there was a debate on the scope of application and three propositions were concluded. The first is so-called "large scope" position, suggesting the new law to be applicable to all types of enterprises, legal persons or non-legal-persons, and all natural persons. Second, it is also proposed by "small scope" position that the new law should be applied to merely enterprise legal persons, just as the existing laws stipulated. Thirdly, the "medium scope" position stood inbetween, preferring a scope including enterprise legal persons, partnership enterprises with their partners, sole proprietorships with their investors.

* Professor of law, Dean of the Department of Economic Law, China University of Political Science and Law, Beijing; Member of the Working Group for Drafting Bankruptcy Law, the Fiscal and Economic Committee of the National People's Congress. Email address: wgwang@public.bta.net.cn

The last opinion has been adopted by the 1995 Draft.

There are two focuses in the arguments. The one is whether non-legal-person enterprises should become included in bankruptcy proceedings. The other is concerning the necessity and possibility of involvement of natural persons.

As a matter of fact the voice for "large scope" was not strong enough. Several arguments led to the conclusion that at the present stage China could not push insolvent individuals into bankruptcy unlimitedly. The first argument is that in Chinese history there has long been no bankruptcy system for general individuals. The traditional moral criterion requires people to pay debts faithfully so that all the unpaid debts are supposed to be carried forward from generation to generation. At the second place, in Chinese society the consumers' common attitude is "saving the future" rather than "overdrawing the future" so that the concept of "consumer insolvency" is not important in this country. Thirdly, China is in the transition period and lots of ordinary individuals are unable to pay debts for complicated reasons, social or personal, and cannot be fairly shamed by declaration of bankruptcy. Forth, the capacity of the judicial system and professional service is insufficient to deal with so large number of cases of individual insolvency, that are sometimes more difficult by reason that, among others, insolvent individuals' property is often laborious to be found and captured.

The "small scope" theory was supported by some officials and judges. They stressed on the difficulties in some technical matters, for instance enforcement and exemption of individual debtors' property. The key question here is whether the non-legal-person enterprises should be included in the scope of bankruptcy law. According to the official statistics, at the end of 1994 China had 8.37 million enterprises in total and among them 4.178 million were non-legal-person ones. Under such circumstances the situation that half of the economic entities are kept out of bankruptcy proceedings does not meet the requirements of equal treatment and unified regulation in market economy. Furthermore, it can be seen that the problem of enforceable property also appears in ordinary civil execution but there has never been an argument that individuals are not eligible under the Civil Procedure Law.

The fundamental reason for adopting "medium scope" position in the 1995 Draft is that the new bankruptcy legislation aims mainly at the legal framework for the development of "socialist market economy", in which all the business persons and commercial debts can be regulated uniformly and equally. The "medium scope" scheme may be categorized to the model of traditional "merchant bankruptcy" system that can be seen in French and Italian bankruptcy legislation.

2. Commencement Criterion

The term "bankruptcy cause" is commonly used in China, that refers to one or several factual elements by which a bankruptcy procedure can be applied and a debtor can be declared bankrupt. The existing Enterprise Bankruptcy Law defines such cause with three elements: (1) poor operation and management, (2) serious losses, and (3) inability to repay debts. In the 1995 Draft it is simplified to a single element, i.e. "unable to pay due debts". This element may be presumed on fact of "cessation of payment".¹

¹ Article 3 of the 2000 Draft Business Bankruptcy and Reorganization Law reads: "When a debtor is unable to pay due debts, all its debts shall be liquidated in accordance with the procedures provided in the Law. The cessation of payment by a debtor is presumed as inability of payment."

The Drafting Committee provides two reasons for this single-element definition. First, it is clear and definite so as to be applied easily. Second, it is consistent with the international practice.²

In the drafting process someone argued that the simplification of bankruptcy cause would result in large-scale increase of bankruptcy cases, and therefore suggested to maintain "serious losses" as another element in the definition. This viewpoint is incorrect. Opening up the gate of bankruptcy proceedings does not necessarily mean that more and more enterprises in financial difficulties will be pushed into the abyss of bankruptcy liquidation. Instead, the Draft intends to push them ahead to explore the possibility for rehabilitation by applying timely the proceeding of reorganization or composition that shall be given in the new law. Even in case that an enterprise is not recoverable, earlier commencement of bankruptcy liquidation is more benefit to both creditors and the society in the sense of saving assets and reducing losses as far as possible. On the other hand, just as pointed out by senior judges of the Supreme People's Court when discussing the Draft, the element of "serious losses" is not manipulable because in judicial practice there is no test to identify the seriousness of losses.

In addition to the criterion stated above, that is commonly applicable to all sorts of proceedings in the Draft, there is a special criterion for commencement of reorganization proceeding -- the likelihood of inability to pay due debts owing to difficulties in business and finance. It can be seen that the legislation encourages enterprises in financial difficulties to enter into judicial reorganization before the situation of insolvency has apparently come about. It follows such an idea that when dealing with a sick horse it is better to cure it as early as possible.

3. Administrator

According to the existing Enterprise Bankruptcy Law, during the period between acceptance of bankruptcy case and bankruptcy adjudication the debtor's assets shall be managed by the debtor itself; it is only after the bankruptcy adjudication that the assets shall be taken over by the team of bankruptcy liquidators. Therefore there is a large room for a debtor to conceal, unlawfully distribute or waste its assets.

The 1995 Draft has filled up this gap, providing that the people's court shall appoint an administrator when accepting insolvency case. The administrator shall take over the control of day-to-day management and operations of the debtor's property and be responsible to the people's court. The operations of the administrators shall be subject to the monitoring of the creditors' meeting. Administrator shall attend creditors' meetings, reporting the performance of his mission and answering questions. In reorganization proceeding, furthermore, the administrator shall be in charge of formulation of a draft reorganization plan.

The reason for appointment of administrator is not merely to avoid losses from debtor's unlawful conducts, but to maintain the value, especially the going concern value, of the assets. This is benefit to not only the creditors' interests in liquidation but also the common interests of creditors and the debtor in reorganization, so as to keep consistent with the international trend of shifting the concentration of bankruptcy law from debt liquidation to business

² For example, Section 17 of the Germany Insolvent Statute of 1994 reads: "(1) Illiquidity shall be the reason to open insolvency proceedings. (2) The debtor shall be deemed illiquid if he is unable to meet his mature obligations to pay. Illiquidity shall be presumed as a rule if the debtor has stopped payment."

rehabilitation.

Anyhow, there are still some questions for further consideration.

(1) Administrator or the debtor, who shall be entrusted to manage the assets?

In United States, for instance, most of the insolvent debtors are authorized automatically to control assets and continue business operation as a "debtor in possession" under Chapter 11 of the Bankruptcy Code. The advantage of this arrangement is that the debtor has more skill and incentive to do business well. The disadvantage is the likelihood of the debtor's "moral hazard" that risks the creditors' interests. In present China such kind of hazard is so serious that few people feel at ease if an insolvent company is highly entrusted in managing assets itself in bankruptcy procedure. It seems that rescuing the debtor and protecting the creditors are incompatible objectives. In some countries, for instance UK, Australia, French and Japan, assets and business of an insolvent debtor are usually entrusted to one or several legally-appointed administrators.

Anyhow, compromise solutions are also thinkable. In the Germany Insolvent Statute of 1994, provisions on "Personal Management" in Part Seven allow a debtor to manage and dispose the assets involved in the insolvency proceedings under surveillance by a custodian if the insolvency court orders such personal management while deciding on the opening of the proceedings. The preconditions to this order are (1) the debtor's request, (2) the consent of the creditor who petitioned the opening of the proceedings, and (3) the expectation that the order will not lead to a delay in the proceedings or other disadvantages to the creditors.

In China the 1995 Draft, assets and business are generally authorized to administrator. In the period of reorganization, however, the administrator is entitled to appoint the debtor's management with the mission of carrying out the business operation of the enterprise. Those appointed persons shall ask for the administrator's consent when performing any of the actions specified in the Law. This scheme appears cautious but flexible. It provides the debtor a chance to contribute the business continuation during the bankruptcy proceedings even though it is subject to some restraints.

(2) Administrator or creditors' meeting, who has superior power over the assets?

The 1995 Draft sets out great deal of powers for administrators, for instance taking over the control of all the property, determining the day-to-day expenditure and other necessary spending of the debtor, request for determining whether the debtor continues to operate, management and disposal of property of the debtor, and so on. On the other hand, the Draft also provides the creditors' meeting and its representative, i.e. supervisors, a strong position to monitor administrator's performance. Almost all the dispositions of the debtor's property and related rights performed by administrator must be consented by supervisors or creditors' meeting. For example, assignment of the stock of goods, lending money and pledging property as security, transfer of movables worth more than RMB 1,000 for the purpose of business continuance, are often necessary for administrator's function. If we hope a more efficient administration, why not to give administrator more discretionary powers?³ One of

³ Comparatively, many other countries give administrators much stronger power in control and disposition of insolvency assets. For instance, in England, the Insolvency Act 1986 stipulates in Section 14 that the administrator "may do all such things as may be necessary for the management of the affairs, business and property of the company". In Australia Corporations Law provides in Section 437A that the administrator (a) has control of the company's business, property and affairs; (b) may carry on the business and manage the property and affairs; (c) may terminate or dispose of all or part of the business, and may dispose of any of the property; (d) may perform any function, and exercise any power, that the company or any of its officers could usually perform or exercise.

the reasons lies in the situation that China wants thousands of insolvency practitioners. Before such a profession is developed it could be safe to give priority to adequate protection of creditors. There is no doubt that China has a long way to go for developing and maintaining an ethical and competent profession of bankruptcy practitioners.⁴ Anyway, the new legislation is a good beginning and "a good beginning is half the battle."

4. Encumbered Assets and Secured Creditors

Business rehabilitation has long been one of the objectives of the bankruptcy legislation of China. In the 1986 Enterprise Bankruptcy Law there is a chapter on composition and renovation proceedings. Although these proceedings have proven failed to be utilized for some special reasons,⁵ the demand for business rehabilitation has never ceased and even become stronger along with the deepening of the economic reform.

When viewed internationally, jurisdictions fall into four main groups as regards their attitude to security as a protection against insolvency - (1) those very sympathetic (e.g. English-based countries, Sweden); (2) those fairly sympathetic (e.g. Germany, Netherlands, Japan, Switzerland, United States); (3) those quite hostile (e.g. Belgium, most Latin American countries, Spain) and (4) those very hostile (e.g. Austria, France, Italy).⁶

When designing Chapter 5 proceeding, the drafting team made a favorable consideration to security. On the one hand, they highlighted the necessity of automatic stay for the purpose of corporate rehabilitation. On the other hand, they attempted to maintain the interests of secured creditors. The treatment of encumbered assets and secured creditors may be sketched as the following.

(1) Automatic stay

The 1995 Draft stipulate: "After the acceptance of insolvency case by the people's court and prior to the bankruptcy adjudication, all the rights of mortgage, pledge and lien over the debtor's property or property rights shall stop exercise." This situation shall continue until the reorganisation plan is executed, or the proceeding terminates without fulfillment of reorganisation plan. As a general rule, when the insolvency case goes into the proceeding of composition or bankruptcy liquidation, the secured claims are unfrozen automatically as soon as the proceeding is opened.

(2) Time limit and termination

The Draft takes some measures to avoid unreasonable delay that is harmful to the secured creditors. First, the length of the period of reorganisation observation is limited to "not exceed 12 months", unless a specified extension is proven necessary and permitted by the court. Second, the creditors are entitled to ask the court to terminate the period of reorganisation observation ahead of schedule by one of the reasons specified in the Law.⁷

⁴ For detailed analysis, see Bahrin (Kam) Kamarul, *The Role of Bankruptcy Practitioners and the Draft Bankruptcy Law of the People's Republic of China: An Empirical Perspective*, Australian Journal of Corporate Law, Vol.9, No.3, December 1998, pp.272-283.

⁵ See, Wang Weiguo, *Adopting Corporate Rescue Regimes in China: A Comparative Survey*, Australian Journal of Corporate Law, Vol.9, No.3, December 1998, pp.237-239.

⁶ See, Philip R. Wood, *Principles of International Insolvency*, Sweet & Maxwell, London, 1995, pp.177-178.

⁷ Article 104(1) of the 1995 Draft lists the reasons as the following: (1) The business and financial conditions of the debtor continue to deteriorate, showing little or no hope of rehabilitation; (2) The debtor cheats, or reduces enterprise property in bad faith, or delays unreasonably, or has other acts obviously harmful to the interests of the creditors; (3) The administrator is impossible to perform his missions because of the acts of the debtor's corporate organs and other personnel.

(3) Perishable assets

Perishable assets is a problem concerned with by the drafters. The 1995 Draft provides that in the period of reorganisation observation the mortgagees, pledgees and lienors to the debtor shall not exercise the right of disposal to the security collateral. However, if the movables subject to pledge or lien will possibly be damaged or devalued, the pledgors or lienors may auction off or sell them and have the prices obtained thereby to be lodged.

(4) Disposition of assets

Administrator is not empowered to dispose security unless the secured is protected adequately. The Draft provides that, to continue a debtor's business operation, the administrator may retrieve a movable subject to pledge or lien, with the condition of offering superseded security.

Therefore we share the principle conclusions of the IMF Legal Department:

"In the context of a rehabilitation proceeding, a stay on the ability of secured creditors to exercise their rights against the collateral during the entire period of the proceedings is critical. However, this does not reduce the need to provide such creditors with adequate protection (including relief from the stay when such protection cannot be given) and, in that context, this provides an additional reason for imposing time limits on the duration of the proceedings."⁸

5. Creditors' Meeting

The 1986 Enterprise Bankruptcy Law grants creditors' meeting only three categories of functions and powers: (1) to examine and confirm claims; (2) to vote on a draft composition agreement; (3) to vote on schemes for disposition and distribution of bankruptcy property.

The 1995 Draft expands functions and powers of creditors' meeting to eight categories: (1) to elect and replace supervisors; (2) to investigate filed claims; (3) to determine the continuance or suspension of debtor's business operation; (4) to vote on a composition agreement; (5) to vote on a reorganization plan; (6) to vote on a scheme for management of the debtor's assets; (7) to vote on a scheme for disposition of bankruptcy property; (8) to vote on a scheme for distribution of bankruptcy property. Among them category 1 is related to the design of administrator, categories 3, 5 and 6 are mainly related to the design of reorganization proceeding.

Additionally, the creditors' meeting or individual creditors may exercise the following rights: (1) to request the court to dismiss and replace the administrator or bankruptcy liquidator in case he is incompetent, or neglects his duty, or has other illegal acts; (2) to request the court to declare the debtor bankrupt in case it breaches the terms of satisfaction in the composition agreement; (3) to request the court to make a decision on discontinuing part or entire operations of the debtor, or imposing necessary restrictions on its business activities in the period of reorganization observation; (4) to request the court to make a decision to terminate the reorganization procedure in case one of the specified circumstances takes place after the opening of reorganization proceeding; (5) to request the court to make a decision to terminate the execution of the reorganization plan in case the reorganizing enterprise is unable or refuses to follow the reorganization plan.

⁸ IMF Legal Department, *Orderly & Effective Insolvency Procedures: Key Issues*, published by the International Monetary Fund, 1999, p.70

Briefly speaking, the Draft insist in a fundamental principle when it expands the functions and powers of the creditors' meeting, that is, strengthening the status and function of creditors in bankruptcy proceedings. This principle is significant to the entire system of bankruptcy law, just as the IMF Legal Department states:

"Given that creditors are key beneficiaries of the insolvency process, the law should be designed and implemented in a manner that enables them to play an active role in this process. They should normally be the decision makers in a number of key areas. For example, during liquidation proceedings, it is advisable that creditors be given the authority to dismiss the liquidator (discussed below), approve the temporary continuation of the business by the liquidator, and approve a private sale. In rehabilitation proceedings, they should normally have the authority to dismiss the administrator and propose and approve a rehabilitation plan. In addition, the law should give them a role in requesting or recommending action from the court, including, for example, a recommendation that the rehabilitation proceedings be converted to liquidation. Giving creditors an active role in the process is particularly important when the institutional framework is relatively underdeveloped. Creditors will lose confidence in the process if all of the key decisions are made by individuals that are perceived as having limited expertise or independence."⁹

6. Composition

The 1986 Enterprise Bankruptcy Law lies its original guideline in the purpose of impelling enterprises to improve their management and operation, not expecting to see many enterprises going bankrupt. That is the reason why the Law adopts composition proceeding. What seems unique is that the Law joins a government-handled renovation proceeding with the composition proceeding together. The joint proceedings are stipulated as the following:

-- Commencement of the joint proceedings relies on three conditions: (1) the case is petitioned by creditor(s) rather than the debtor; (2) the government agency authorized to master the debtor enterprise puts forward a request for renovation to the court and the creditors' meeting, referring to a scheme of renovation with the period of no more than two years, within three months after the acceptance of the case; (3) in the meantime the enterprise submits a draft composition to the creditors' meeting.

-- When the draft composition is approved by the meeting and confirmed by the court, it becomes an effective agreement, then the bankruptcy proceeding is suspended.

-- When the composition agreement becomes effective, the enterprise is renovated in the charge of the authorized agency. The scheme of renovation shall be discussed by the workers' congress and the progress of the renovation shall be reported to the workers congress and the creditors' meeting.

-- If the enterprise becomes able to perform the composition agreement after the renovation, the bankruptcy case shall be closed. Otherwise, the enterprise does not perform the composition agreement, the court shall adjudicate it to be bankrupt

Not surprisingly, in the past ten years, the cases applying these joint proceedings were extremely few (near zero), although up to ten thousands of bankruptcy cases were accepted by the people's courts of deferent levels. There are mainly two reasons. First, almost no

⁹ IMF Legal Department, *ibid*, p.74.

authorized agency has the incentive to bear such a costly, troublesome and sometimes risky mission. After all, it has no concern in the interests of the agency or its officers. Secondly, creditors have no basis to trust the authorized agency, for the Law does not grant any means for creditors to control or influence the process of renovation, nor does it impose any responsibility upon the authorized agency for its misfeasance or blamable failure in the process.

The 1995 Draft simplifies the composition procedure to a large extent.

First, the opening of the composition proceeding becomes much easier. On one hand, a debtor when filing petition for acceptance of an insolvency case may, in the meantime or afterwards, apply for composition. On the other, either debtor or any of the creditors is allowed to apply to the court for composition.

Second, if the court deems that the debtor's composition application meets the provisions of the Law, it shall make a decision for opening of composition proceeding and call the creditors' meeting to vote on the draft composition agreement. After the decision the rights of mortgage, pledge and lien to the debtor's property shall be relieved from the stay.

Third, if the composition agreement is approved by the creditors' meeting, it becomes valid by confirmation of the court and at the same time the insolvency case is closed.

Forth, the valid composition agreement is enforceable as a contract, but non-performance of this agreement by the debtor shall lead to an immediate adjudication of bankruptcy.

This simplification is mainly due to the adoption of reorganization proceeding. During the drafting process some foreign and domestic experts suggested to give up composition proceeding, following the examples of France in 1985 and Germany in 1994. The drafting group considered this suggestion carefully. The conclusion was that we would better keep this proceeding because there were some small cases that might be rescued by more flexible and cheaper ways. In our mind, actually, composition proceeding is a traditional and simple tool while reorganization proceeding is a modern and complicated machine. It seems good enough to cultivate a small garden with a hoe rather than a tractor.¹⁰

Additionally, the 1995 Draft provides that after the acceptance of insolvency case by the court, a debtor may request the court to approve a composition agreement reached out-of-court with unanimous agreement from all the creditors. In such circumstances the court shall make a decision to close the insolvency case.

In recent years out-of-court workout has become popular in many countries. The general trend is that successful business rehabilitation should rely more upon compromise between the parties and even involvement of non-party investors. Legal proceedings are always rigidly handled and most of the judges are not familiar with business operation and market transactions practically. Therefore a wise policy is to provide a larger room for parties' discretionary arrangement. On the other hand, thinking about the possible abuse and misuse, we set some requirement such as unanimous agreement for court approval.

7. Reorganization

Reorganization proceeding is very significant in China's new bankruptcy legislation. It had

¹⁰ The same scheme can be seen in UK Insolvency Act 1986 which contains a chapter on composition proceeding named "Company Voluntary Arrangements" and a chapter on reorganization proceeding named "Administration Orders."

yet been considered until the first version of the draft was completed. When the first draft was further discussed, the US Chapter 11 was introduced and looked into. Then based on a consensus that a modern mechanism for business rehabilitation might be adopted, the drafting team worked out a new chapter, namely Chapter 5, on reorganisation proceeding, with some relevant provisions added in other chapters.

The sketch of the reorganisation proceeding may be shown as the following:

-- When application for insolvency case is accepted by court on condition that the debtor meets the requirements stipulated by law, reorganization proceeding may be applied for simultaneously, or later on but before bankruptcy adjudication.

-- When the case is accepted, an administrator is appointed by the court and takes over all the assets and affairs of the company at once.

-- As soon as the case is accepted, all the proceedings or other efforts for claims, either unsecured or secured, are frozen.

-- In a specified period the administrator is authorized to control the property and business operation of the enterprise. Protective provisions for the business continuation are granted.

-- The administrator drafts a reorganisation plan and hands it over to the creditors' meeting. The meeting votes the plan in different groups. When it is passed, or even failed but anyhow meets the requirements provided by law, it is submitted to the court for confirmation.

-- When the plan is confirmed the assets and business are taken over by a reorganisation executor.

-- Upon the execution of reorganisation plan is completed the case is closed or otherwise goes to the exit.

The original inducement for the adoption of modern corporate rescue regime is the fact that China has so many enterprises having been insolvent and the society cannot afford the disaster of enterprises going bankrupt on a large scale. On the other hand, it was realized that a traditional composition is too simple and mild to meet the needs of business rehabilitation. It can be therefore concluded that the objective of the draft reorganisation proceeding is to rescue enterprises in difficulties while fairly clearing their debts.¹¹

Further academic researches have strengthened the legal policy that stresses on, and work for, corporate rescue. Three theories are taken as the supports.

First of all, the theory of going concern value. It is proved that the value of a company, especially a large one, as a going concern is much higher than the obtainable money when it is

¹¹ As stated by the Fiscal and Economic Committee of the NPC in its explanatory report on the draft law:

“Reorganisation as a reconstructive debt-clearing regime purports to prevent enterprises, especially large and medium ones, that are hopeful to be rehabilitate, from bankruptcy liquidation. On the basis of Chinese national conditions, with reference to the experience of foreign legislation on insolvency, the Draft provides for reorganisation in Chapter 5 the scope of application, fundamental procedure, protective measures, formulation and execution of plan, as well as precautions against abuse of the procedure. These provisions may lead those being insolvent or likely to be insolvent to get away from going bankrupt via reorganisation, and may avoid chain bankruptcy of enterprises and huge unemployment thereafter. It is of particular immediate significance and favorable to interest of creditors to keep the business of a reorganizing enterprise continuing, so as to stop the worsening of its financial and business situation, and to keep off the serious losses as a result of bankruptcy liquidation. Such provisions in the Draft are not only necessary but also feasible. As to those on formulation and execution of reorganisation plan, there have been considerable experience from the economic reform. The rules on reorganisation in the Law are fit to the actual situation of the enterprises in our country and not hard to be handled. In the meantime, the Draft sets out rigorous rule on monitoring the formulation, adoption, confirmation and execution of reorganisation plan, so that it is reachable to forestall any abuse of reorganisation proceeding by a debtor intending to escape from liabilities.”

sold out in piecemeal through liquidation. Rescue of an insolvent corporation implies saving the value for creditors, and in a sense for the society as well.

Secondly, the theory of common interests. Both a debtor and its creditors will be sacrificed if the debtor goes bankrupt, or otherwise both are benefited from the rehabilitation of the debtor. So far as the creditors are concerned, to rescue the debtor means to save themselves in the meantime. If they can get more repayment from the survival of the "sick horse" (the enterprise in distress) than the allocated "horse meat" (dividends on a liquidation), it is hardly reasonable to refuse it.

Third, the theory of social interests. Those impaired by corporate bankruptcy are not only the creditors, but also many other groups such as employees, obligees to the debtor's creditors, the community of where the debtor is, the national and local revenues. It seems unjustifiable to give up the effort of corporate rescue by yielding to the preference of some creditors, for instance the charges, and ignoring the detriment suffered by the others.

The following three issues illustrate the efforts under the above guideline.

(1) Commencement of proceeding

In Chapter 5 of the Draft it is provided that the Chapter 5 proceeding applies to enterprise legal persons with the state specified as commencement criterion and however the possibility of rehabilitation. Here two factors, eligible debtors and grounds for petition, need to be noticed.

Eligible debtors. The Chapter 5 proceeding applies to only enterprise legal persons, i.e. corporations or other enterprises registered as legal persons. This is similar to UK proceeding of Administration Order and Australian proceeding of Corporate Voluntary Administration, which are applicable to merely companies. Such a design seems quite careful. In some other countries, legislatures are much bolder. For example, the US Chapter 11 applies to most business enterprises, corporate or unincorporated, and individuals, and the French *redressement judiciaire* applies to individual merchants, craftsmen and farmers, and all legal entities subject to private law. At the very beginning of the draft of Chapter 5, it was considered to have the reorganization proceeding applied to all persons within the general scope of the draft law. Then considering that the proceeding was more likely to be abused at the sacrifice of the creditors in cases of non-legal-person enterprises, that were usually in small-scale and short of normal accounting, we decided to make the limitation and meanwhile provided the composition proceeding as an alternative.

Grounds for application. The Chapter 5 proceeding may be applied when two grounds is settled: (1) the fact or the likelihood of inability of repayment, and (2) possibility of rehabilitation. If a company is obviously hopeless to rehabilitate at the time of filing, it has no grounds for application. For proving the grounds when petition it is required to submit together with relevant evidence. Though the term "relevant evidence" needs to be further defined, the aim of this Article is clear: to prevent the proceeding from abuse.

(2) Business operation

In the Chapter 5 proceeding, administrator becomes more powerful in controlling and operating the company's business. The Draft provides that in the period of reorganisation observation administrator is empowered to determine independently the continuance of the debtor's part or entire business.

To strengthen administrator's power in business operation, the Draft adds a power of

personnel control. He is entitled to appoint the debtor's management or other personnel, or some outsiders, with the mission of carrying out the business operation. The persons so appointed shall ask for the administrator's consent when performing any of the specific actions listed in the Draft.

Besides, there are more provisions to assist the business operation of the reorganizing enterprise. By way of illustration, the Draft provides that, in the period of reorganisation observation, debts arising for the purpose of continuance of the debtor's business operation is deemed as debts of common benefit. Furthermore, the debtor may guarantee the loans borrowed for its business continuance with the property not subject to any security right. This provision is of special importance to business rehabilitation, because the availability of continuing finance is one of the decisive factors to corporate rescue. It can be seen that if the post-commencement contracts of financing have priority over pre-existing unsecured creditors, once the reorganisation fails the unsecured creditors are subordinate and actually bear the costs of the experiment. The policy decision to this problem is hard and even painful. Up to the date many countries do not grant priority to post-commencement creditors even though some pioneer countries e.g. US, UK and France have done.¹² In China it is widely understood that corporate rescue is directly related to the interests of employees, the weakest group in the society, and therefore has stronger moral grounds.

In order to diminish the unsecured creditors' possible losses as a result of excessive expansion of the post-commencement debts, the Draft provides some measures to restrict it. First, the use of the loans shall be specified and subject to control and supervision. Second, the court may, at the request of the interested persons, make a decision on discontinuing part or entire operations of the debtor, or imposing necessary restrictions on its business activities. Third, if the business and financial conditions of the debtor continue to deteriorate, showing little or no hope of rehabilitation, the people's court may, at the request of the interested persons, make a decision to terminate the reorganisation procedure.

(3) Formulation of the plan

Apart from continuation of the debtor's business as stated above, one main focus of Chapter 5 is the institutions for formulation, adoption, confirmation, and execution of reorganisation plan.

As designed by the drafters, formulation of reorganisation plan may be a process of consultation. In Chapter 5 it is provided that the administrator when formulating a draft reorganisation plan should obtain the assistance by the debtor and listen to the creditors, investors and representatives of staff and workers.

In regard to what should be contained in the plan, it is generally provided that a reorganization plan shall stipulate the following particulars: (1) a scheme for operation of the reorganizing enterprise; (2) a scheme for readjustment of the claims; (3) a scheme for satisfaction of the claims; (4) reorganisation executor; (5) the period for execution of reorganisation plan; (6) other schemes beneficial to enterprise reorganisation.

Then there are some further mandatory or permissive provisions given. The schemes for readjustment and satisfaction of the claims must follow the classification of claims, which consists of four sorts: claims secured with property, labor claims, tax claims, and ordinary

¹² See, US Bankruptcy Code, Sections 503(b)(1), 364; UK Insolvency Act 1986, Section 19; French Law No. 85-98, Article 40.

claims. Further, some readjustment methods are stipulated with regard to different categories of claims: (1) reduce the repayment amount of claims on a pro rata basis; (2) extension of payment in lump-sum or installment; (3) changes in other terms or conditions; (4) conversion of a portion or all the creditors' claims into equity. Additionally, to encourage various flexible and practicable schemes, some directive provisions are given. For instance, the plan may provide a scheme of merger or separation for the reorganizing enterprise. It may also provide a scheme on raising fund for the reorganizing enterprise.

Bearing in mind that the situation of enterprises in difficulties stands in endless variety, the Draft does not intend to provide any ready-made solutions on behalf of the parties and practitioners. The legislation limits its mission to the extent that an insolvent enterprise may be protected to keep running as a going concern on one hand, and the relative parties may get together to work out proper schemes in the framework of negotiation and compromise.

On the other hand, by reason that corporate rescue is closely related to social interests, some judicial interference should be necessarily included. In Chapter 5 it is provided that the reorganization plan adopted by the creditors' meeting shall be confirmed by the court. It is also provided that, when a plan fails to be adopted, there is an opportunity to request the court to confirm the plan on condition that the plan meets the specified requirements.¹³ This is comparable to so-called “cram down” rule in US Chapter 11 procedure.¹⁴

8. Liquidation

The 1995 draft esteems order and efficiency as the major objectives for improvement of liquidation proceeding. As commonly recognized, the 1986 Enterprise Bankruptcy Law has been out-of-date. Apart from many other shortcomings, its liquidation procedure is too general to be used to solve the practical matters and thus leaves a large room for debt-escapers. In the past decade, huge amount of bank assets lost in the increasing movement of enterprise bankruptcy. This is partly due to fraudulent and other illegal conducts of the relevant persons (debtors, government officials, assets buyers, etc.), and partly due to the inefficiency of the legal proceeding that wants consummate rules and qualified judges.

The significance of orderly and effective bankruptcy procedure has been well concluded by IMF legal experts as the following:

Recent experience has demonstrated the extent to which the absence of orderly and effective insolvency procedures can exacerbate economic and financial crises. Without effective procedures that are applied in a predictable manner, creditors may be unable to collect on their claims, which will adversely affect the future availability of credit. Without orderly procedures, the rights of debtors (and their employees) may not be adequately protected and different creditors may not be treated equitably. In contrast, the consistent application of orderly and effective

¹³ The requirements prescribed in Chapter 5 of 1995 Draft include: (1) According to the plan, claims secured with property will be fully satisfied, and the losses brought about by the extension will be fairly compensated, and there will be no impairment to their security rights, except the terms otherwise stipulated in the plan has been adopted by the group of claims secured with property; (2) According to the plan, labor claims and tax claims will be fully satisfied, or otherwise the adjusted ratio of payment has been adopted by the relevant voting group; (3) The ratio of payment obtained by unsecured claims according to the plan will not be less than that supposed to be obtained by the same claims via proceeding of bankruptcy liquidation at the time when the plan is submitted for confirmation; (4) The order of claim satisfaction provided in the plan does not violate the provisions in Article 106 of the Law; (5) The scheme for enterprise rehabilitation is feasible, and not inconsistent with the State industrial policy.

¹⁴ See, Section 1129(b) of the US Bankruptcy Code.

insolvency procedures plays a critical role in fostering growth and competitiveness and may also assist in the prevention and resolution of financial crises: such procedures induce greater caution in the incurrence of liabilities by debtors and greater confidence in creditors when extending credit or rescheduling their claims.¹⁵

In drafting the new law, many issues in bankruptcy liquidation were dealt with under the fundamental principles of collectivity, equitableness and transparency. Some of them are described in the following as illustrations.

(1) Ex officio adjudication

According to the existing bankruptcy law of China, the courts are not empowered to ex officio adjudicate an insolvent debtor to be bankrupt.¹⁶ This is helpless to cope with the problem of "race for separate satisfaction", i.e. competition in catching assets from the debtor, following the proverb that the early bird gets the worm. In order to prevent this fashion and meet the need of collective and equitable satisfaction of all creditors over the assets of an insolvent debtor, the 1995 Draft grant the power of ex officio adjudication to any courts with jurisdiction over an insolvency cases, providing that, where the court when hearing a civil case or exercising a civil execution discovers the debtor to be under the circumstances of insolvency as specified in the Law, it may ex officio adjudicate the debtor bankrupt.

(2) Liquidators

In comparison with the existing bankruptcy law, the Draft puts some features on the institution of liquidators. First, liquidators shall not be officials from government agencies any more.¹⁷ They are supposed to be lawyers, accountants and other relevant practitioners. Second, the office of liquidator may be taken by one or several persons, unlike the existing bankruptcy law that always requires a "liquidation team". This change reflects such a fact that in a case of small business insolvency a single liquidator may bring about higher efficiency and lower expenses. Third, the position of liquidator may be assumed by the administrator in the same case. This may keep the continuity of the business operation and administration of the assets. Finally, there are provisions concerning the qualifications, appointment, remuneration and expenses, liability and dismissal of either administrators or liquidators, which are all determined by courts.

Furthermore, considering the needs for maintenance of the assets of estate as a going concern, the Draft grants liquidator the authority to determine the performance or cancellation of the contracts that have not been fully performed by both the debtor and the counterparty.¹⁸

¹⁵ IMF Legal Department, *ibid*, p.1.

¹⁶ The Opinions of the Supreme People's Court on Several Issues in the Implementation of the Enterprise Bankruptcy Law stipulates in section 15: "If, during the process of civil proceedings or civil execution procedures, a people's court finds that a debtor is insolvent, it shall notify the debtor that it may apply to the local people's court for bankruptcy." "If no application is filed for bankruptcy, the people's court have no power to declare that debtor bankrupt, and any original proceeding or execution procedure may be carried out without interruption."

¹⁷ The Enterprise Bankruptcy Law stipulates in Article 24, paragraph 2: "The members of the liquidation team shall be designed by the people's court from among the superior departments in charge, government finance departments, and other relevant departments and professional personnel."

¹⁸ Article 146 of the 1995 Draft stipulates:

As for a bilateral contract unperformed by the bankrupt, bankruptcy liquidators shall be entitled to decide if it will be cancelled or continue to be performed.

The counterpart in an executory contract may specify a deadline to the bankruptcy liquidators, and urge them to make a decision within this period as to whether the contract is to be cancelled or continue to be performed. The liquidators' failure to answer upon the expiration of the period shall be regarded as a cancellation of the contract.

If the liquidators decide to continue the performance of the contract, whereas the counterpart requests

Sometimes an executory contract may be assigned, as a single item or put together with the going concern, to a willing third party for value.

(3) Claims

The general principle of equitable treatment is always restricted by legal policies of some other laws. First, the demand for protection of security rights and other real rights from the civil law leads to the priority of secured claims in bankruptcy liquidation. Second, the demand for administration of bankruptcy procedure from the bankruptcy law itself leads to the preferential position of the administration expenses and debts of common benefit over all other unsecured claims. Third, the demands for protections of labor rights and taxation from the labor law and the tax law lead to the preferential position of labors and taxation over the ordinary claims in ranks of distribution. Therefore, as stated by IMF legal experts, "equitable treatment does not require equal treatment."¹⁹

In the context of China's new bankruptcy law, equitable treatment in liquidation proceeding can be seen in several aspects. First, claims in same situation shall apply the same rules. Second, all claims which have occurred before the commencement of the bankruptcy case, mature or immature, monetary or non-monetary, shall be deemed as, or converted to, the same mature and monetary claims. Third, the resolutions on disposition and distribution of the assets shall be made by creditors collectively through their meeting.

(4) Assets

In the 1995 Draft, "bankruptcy property", a term equivalent to assets of estate, consists of the total property and property rights of all kinds that belong to the bankrupt at the time of bankruptcy adjudication, and the property and property rights of all kinds obtained by the bankrupt after the bankruptcy adjudication but prior to the close of insolvency case. This is consistent with the international trend.²⁰ Just as IMF legal experts state: "As a general rule, the assets of the estate should include the property of the debtor as of the date the insolvency proceedings begin plus the assets acquired by the liquidator after that date."²¹

Unlike the existing bankruptcy law, the 1995 Draft does not exclude the encumbered assets from the scope of bankruptcy property.²² The main reason for that lies in the possibility that the liquidator may retrieve a collateral by paying off the debt or rendering substitute security in order to keep the business going or sell the assets as a whole body. This approach embodies the policy that the collective of ordinary creditors should have more opportunity to get benefit from the assets under the circumstances that the legal status of a secured creditor is not substantially shaken.

them to provide relevant security within an agreed or reasonable period, but the liquidators have not provided security during the period, this shall be regarded as a cancellation of the contract.

Where liquidators cancel a contract, if the counterpart has paid earnest money, the claim for return of the money shall be a bankruptcy claim limited by the amount of the earnest.

When a contract is cancelled under the provisions in the preceding four paragraphs, the counterpart's claims for damages shall be regarded as bankruptcy claims.

¹⁹ IMF Legal Department, *ibid*, p.6.

²⁰ For example, the Germany Insolvency Statute of 1994 stipulates in Section 35: "The insolvency proceedings shall involve all of the assets owned by the debtor on the date when the proceedings were opened and those acquired by him during the proceedings (assets involved in the insolvency proceedings)."

²¹ IMF Legal Department, *ibid*, p.38.

²² Article 28, paragraph 2, of the Enterprise Bankruptcy Law provides: "Property that already constitutes security collateral is not bankruptcy property; the portion of the value of the security collateral exceeding the amount of the debt that it secures is bankruptcy property."

9. Individuals involved

According to the 1995 Draft, an individual may be involved in bankruptcy proceedings as a partner of partnership enterprise or an owner of sole proprietorship. Bearing this in mind, the Draft puts some provisions to deal with the special matters related to the involved individuals.

(1) *Bankruptcy adjudication*

It is stipulated that if a partnership's assets are not sufficient to pay off its due debts, the court shall adjudicate all its partners to be bankrupt in the meantime when adjudicating the partnership enterprise bankrupt. However, if the partners have offered property that is enough to clear off all the partnership's debts, the court shall not adjudicate the partners bankrupt at the time when adjudicating the partnership bankrupt.

This rule implies that partners should have rescued the insolvent partnership by contributing property or taking other measures (e.g. workout) before, or applying composition proceeding after, the acceptance of the insolvency case. If they failed to do so it should be deemed that they did not intend to maintain the partnership. Under such circumstances, the only choice is to rescue themselves from bankruptcy adjudication by paying off all the debts that the partnership owes, or otherwise to bear the shame as bankrupts and meanwhile assume the unpaid debts after the closure of the bankruptcy case. This rule should benefit the creditors to the insolvent partnership.

The same rule shall apply *mutatis mutandis* to bankruptcy of sole proprietorship.

(2) *Exemptions*

If the bankrupt is a natural person, the expenses necessary for the livelihood of the bankrupt and the people he supports and daily necessities do not belong to the bankruptcy property, and the individual bankrupt, with approval of bankruptcy liquidators, is entitled to take them back. This is the rule on individual exemption in the 1995 Draft.

It is noticeable that in many western countries the general trend calls for expanding the scope of the exempted property for insolvent individuals.²³ Comparatively, the scope of exemption is narrow. The reason for this situation is that the proposed new bankruptcy law applies to merely business individuals. According to the existing Civil Procedure Law, the scope of the individual property exempted from civil execution is limited to "necessities for livelihood" of the debtor and his family dependents. If the new bankruptcy law expands the scope for merchants, there will be inequitable standards for different groups of citizens.

(3) *Discharge*

The Draft stipulates that an individual bankrupt shall use all his property gained after the close of insolvency case to repay the residual claims until he is discharged. The rules on discharge provided in the Draft bear the following features.

First, conditional discharge. The residual claims, except liabilities for intentional violation of personal rights, shall be discharged when the specified period of time related to the repayment ratio by the end of the bankruptcy case has expired.²⁴ Additionally, only honest,

²³ For example, the value of the exempted property in Section 522 (d) of the US Bankruptcy Code has increased to a large extent. In 1999 the standard becomes, among others, property for residence up to \$16,150 (\$7500 in 1978), motor vehicle up to \$2,575 (\$1,200 in 1978), jewelry up to \$1,075 (\$500 in 1978).

²⁴ The specified period of time varies as the following:

- (1) In case of not less than 30% of the total bankruptcy claims having been paid off at the time of close of insolvency case, three years have passed since the day of the close of insolvency case; or
- (2) In case of not less than 20% but less than 30% of the total bankruptcy claims having been paid off at the time of close of insolvency case, five years have passed since the day of the close of insolvency case; or

non-fraudulent person can be discharged.²⁵ These provisions are supposed to encourage the honest and diligent people who have conducted as beneficial to their creditors as possible. The longest period specified for discharge is ten years, half the length of the statute of limitations in the civil law,²⁶ aiming at the benefit of the "fresh start" for the individual merchants.

Second, automatic discharge. Whenever the specified period of time is expired and all the relevant conditions are met, the individual shall be discharged automatically; no legal proceeding for discharge is needed. The reason for this provision is to fit the national situation that our country has large territory and huge population and our judicial system has already heavy burdens.

Third, voluntary repayment. If the bankrupt voluntarily pays off a relieved debt after the discharge, the benefit acquired therefrom by a creditor shall be protected by law. This is consistent with the traditional moral norm and the provision in civil law.²⁷

10. Insolvent SOEs

In the process of drafting new bankruptcy law, who to deal with insolvent State-owned enterprises ("SOEs") has been a very difficult problem. The Explanatory Report on the 1995 Draft states: "Due to the historical reasons and the special situation in the period of transition from the old regime to the new one, the bankruptcy of SOEs especially the old ones are very difficult, mainly in respect to, first, the settlement of the staff and workers in the bankrupt enterprise and, second, the ability of the State-owned banks, the major creditors to SOEs, to endure the bankruptcy events." In order to crack these hard nuts, the Draft contains a chapter on "special provisions for bankruptcy of State-owned enterprises", providing some special rules on SOE bankruptcy.

First, if an enterprise applies for acceptance of insolvency case, it shall submit a written approval of the State-authorized department over the enterprise. This rule intends to give the authority a chance to make a pre-commencement scheme to solve the above-mentioned problems.

Second, the income from assignment of the land use right shall be used for settlement of the staff and workers in the bankrupt enterprise; and the surplus after the settlement, if any, shall be included in the bankruptcy property. This is conforming No. 59 document concerning SOE bankruptcy issued by the State Council in 1994, which takes settlement of the unemployed as of overwhelming superiority.

Third, Public welfare utilities such as tenements for employees, schools, hospitals, and kindergartens set up by SOEs shall not be included in bankruptcy property, except those

(3) In case of not less than 10% but less than 20% of the total bankruptcy claims having been paid off at the time of close of insolvency case, seven years have passed since the day of the close of insolvency case; or

(4) In case of less than 10% of the entire bankruptcy claims having been paid off at the time of close of insolvency case, ten year have passed since the day of the close of insolvency case.

²⁵ The Draft stipulates that those who are sentenced criminal punishment because of bankruptcy crimes, or have the illegal acts set forth in the bankruptcy law, shall not be discharged.

²⁶ Article 137 of the General Principles of the Civil Law reads: "A limitation of action shall begin when the entitled person knows or should know that his rights have been infringed upon. However, the people's court shall not protect his rights if 20 years have passed since the infringement. Under special circumstances, the people's court may extend the limitation of action."

²⁷ Article 138 of the General Principles of the Civil Law reads: "If a party chooses to fulfill obligations voluntarily after the limitation of action has expired, he shall not be subject to the limitation."

which are not necessary to continue and can be sold as a whole. These utilities shall be taken over as a whole and managed by the local government in the domicile of the bankrupt enterprise. However, the tenements for employees newly built up after the effective date of the Law shall be included in bankruptcy property.

It can be seen that the 1995 Draft is trying to balance the different demands of labor settlement and bank protection. In 1996 the State Council issued several documents on SOE bankruptcy, providing that bankruptcy property, even security collateral, can be utilized to settle the labors.

In the drafting process some scholars have disagreed such a practice that is detrimental to the order of equity and faith in market transaction and the financial stability. Based on further discussions in 2000, the recent Draft has taken off the special chapter on SOE bankruptcy, leaving the settlement problem solved by local governments and authorizing the State Council to issue regulations on bankruptcy of the SOEs established prior to the date of implementation of the Company Law.

11. Cross-Border Insolvency

Up to the date, the problem of cross-border insolvency is still unsolved. In the 1995 Draft there is a principle article stating that "no procedure of bankruptcy or composition or reorganization that begins outside the domain of the People's Republic of China has force upon a debtor's assets that locate within the territory of the People's Republic of China". Obviously this provision falls into the doctrine of territorialism. The another feature of this provision is the uncompleted wording, not saying a single word about the effect of Chinese procedure upon the assets abroad.

When working with the 1995 Draft the team realized that the international trend was aiming at a universalist model and China should keep pace with it. But at that time the trend was not clear enough and most of the developed countries had not reformed their legislation. The uncompleted provision implies the need for further efforts. We must wait until the conditions become mature.

The first condition is the clearness of the international trend. We feel happy to learn that the UNCITRAL Model Law on Cross-Border Insolvency adopted in 1997 has been worldwide interested. It contributes a good basis for international convergence. However, it needs some time to have the Model Law known and understood in China, especially by the law circle and the law-making related officials.

The second condition is ripeness of China's legislative design. We have to deal with some particular questions. For instance, shall we make a whole chapter with a number of articles on detailed procedural rules or merely a single article on general principle of reciprocity or even universality?²⁸ Should we distinguish the cross-border insolvency between China and foreign

²⁸ In a recent meeting of the drafting team discussing revision of the 2000 Draft held in August 2000, it was suggested to revise the article on cross-border insolvency as the following:

No insolvency proceeding that begins outside the domain of the People's Republic of China has force upon a debtor's assets that locate within the territory of the People's Republic of China, except the one that falls into the situation specified in the second paragraph of this Article.

An insolvency proceeding that begins outside the domain of the People's Republic of China shall be given reciprocal treatment in accordance with Articles 267, 268 of the Civil Procedure Law of the People's Republic of China, if the law of the country where the proceeding begins recognizes the force of the decisions made in accordance with this Law upon the debtor's assets that locate in that country, and also recognizes that the administrator or liquidator appointed in accordance with this law is entitled to take over the assets or file a

countries and that between Mainland China and the special regions such as Hong Kong, Macao and Taiwan? Importantly, it should be borne in mind that the UNCITRAL Model Law does not attempt to substantively unify the national legislation in different countries, and China has to design a model that is adaptable to the national situation on one hand and harmonized with the international practice on the other.

12. Legal Responsibilities

Sanctions against various illegal conducts are necessary for maintenance of the legal order of bankruptcy proceedings. The 1995 Draft places a special chapter, Chapter 9 on "Legal Responsibilities" to bear this mission. Besides, some provisions on avoidance of pre-commencement transactions and transfers are put in another chapter as a consequence of acceptance of insolvency cases.

The illegal conducts dealt with in Chapter 9 may be categorized into two sorts.

The first sort contains the acts of a debtor and its relative persons, including (1) breach of duty to explain,²⁹ (2) breach of duty to submit,³⁰ (3) fraudulent acts of bankruptcy,³¹ (4) partial acts of bankruptcy;³² (5) waste acts of bankruptcy.³³

civil action or civil execution against the assets in that country, so as to bring the assets into the administration and disposition under this Law.

The provision in the above paragraph apply mutatis mutandis to an insolvency proceeding that begins the special administration areas of the People's Republic of China.

²⁹ Article 184 of the 1995 Draft reads:

If a debtor or a debtor's representative who is bound to attend a creditors' meeting still refuses, without justifiable reasons, to appear at the meeting after a summon of the people's court, the court might summon the debtor through arrest warrant and impose a fine of RMB 1000 to 5000.

If a debtor or any other person with obligation of disclosure refuses to make a statement or an answer, or provides a false statement or answer, the people's court might impose him a fine of RMB 1000 to 5000.

If the acts mentioned above constitute crimes, criminal responsibilities shall be investigated in accordance with the law.

³⁰ Article 185 of the 1995 Draft reads:

If a debtor violates the Law and refuses to submit, or submits falsely, property statements, debt information, credit information or the relative financial statements to the people's court, the court might impose a fine of RMB 2000 to 10,000.

If a debtor violates the Law and refuses to transfer the property, and the books, documents, files and seals related to the property, to the administrator or bankruptcy liquidators, the people's court might impose the person or persons directly responsible a fine of RMB 2000 to 10,000.

If the acts mentioned above constitute crimes, criminal responsibilities shall be investigated in accordance with the law.

³¹ Article 186 of the 1995 Draft reads:

If a debtor has any of the acts stipulated in Article 27 of the Law or any of the following within 12 months prior to the acceptance of insolvency case by the people's court, the court might impose the person or persons directly responsible a fine of RMB 10,000 to 100,000; and if the act constitutes a crime, criminal responsibility shall be investigated in accordance with the law:

(1) Selling property at abnormally lower prices;

(2) Paying off undue debt ahead of time;

(3) Giving up obligatory claims;

(4) Fabricate or destroy evidentiary material relevant to property, thus making the property status unclear.

³² Article 187 of the 1995 Draft reads:

If a debtor has any of the following acts, the people's court might impose the person or persons directly responsible a fine of RMB 5000 to 50,000; and if the act constitutes a crime, criminal responsibility shall be investigated in accordance with the law:

(1) Pledging property as security for satisfaction of an unsecured debt, within 12 months prior to the acceptance of insolvency case by the people's court;

(2) Paying off an individual claim or claims even though having been aware of its inability to pay off due debts, within 6 months prior to the acceptance of insolvency case by the people's court.

³³ Article 188 of the 1995 Draft reads:

If a debtor has or should have been aware of its inability to pay off due debts but still unreasonably spends money and property or squanders the property, the people's court might impose the person or persons directly

The second sort related to the acts of institutions and participants, including (1) accepting bribe;³⁴ (2) offering bribe;³⁵ (3) misconduct in office.³⁶

Most of the above are absent in the 1986 Enterprise Bankruptcy Law. However, in that Law there is a provision concerning the personal responsibilities of the management or officials for causing the insolvency of an enterprise.³⁷ Recently the drafting team considered to add a provision of this kind into the draft law.³⁸

According to China's legislative practice, criminal penalties must be stipulated in the Criminal Law. Therefore it is expected that when the new bankruptcy law promulgated, the provisions on penalties against bankruptcy crimes will be issued by the National People's Congress through a separate criminal legislation.

Conclusion

Recently, a group of experts of the World Bank completed a draft report on bankruptcy of State enterprises in China. In its conclusion, the report suggests "rapid introduction of a new bankruptcy regime for non-state enterprises and incorporated SOEs".³⁹ It states:

A new Bankruptcy Law has been drafted in 1995-96. It would apply to state-owned and non-state enterprises. The draft is much improved relative to the older legislation, and largely resembles the bankruptcy laws of market economies. Among other things, it

responsible a fine of RMB 3000 to 30,000; and if the act constitutes a crime, criminal responsibility shall be investigated in accordance with the law.

³⁴ Article 189 of the 1995 Draft reads:

If during a bankruptcy procedure any of the administrators, reorganization executors, bankruptcy liquidators, supervisors, creditors or their proxies asks for or accepts a bribe or other illegitimate interest, by taking advantage of his position, the people's court might impose a fine of RMB 10,000 to 100,000 according to the circumstances; and if the act constitutes a crime, criminal responsibility shall be investigated in accordance with the law.

³⁵ Article 190 of the 1995 Draft reads:

If during bankruptcy procedure, anyone offers a bribe or other illegitimate interest to any of the administrators, reorganization executors, bankruptcy liquidators, supervisors, creditors or their proxies, the people's court might impose the person or persons directly responsible a fine of RMB 2000 to 30,000; and if the act constitutes a crime, criminal responsibility shall be investigated in accordance with the law.

³⁶ Article 192 of the 1995 Draft reads:

If any of the administrators, reorganization executors, bankruptcy liquidators, supervisors causes heavy losses to the creditors, the debtor or a third party, as a result of his misconduct in office or other illegal act, the people's court might impose a fine of RMB 10,000 to 100,000 and a detention; and if the act constitutes a crime, criminal responsibility shall be investigated in accordance with the law.

³⁷ Article 42 of the Enterprise Bankruptcy Law reads:

After an enterprise is declared bankrupt, the government supervisory departments and audit departments shall be on duty to find out the responsibilities for the bankruptcy of the enterprise.

Where the legal representative of the bankrupt enterprise bears the major responsibility for the bankruptcy of the enterprise, administrative sanctions shall be applied.

Where the superior departments in charge of the bankrupt enterprise bear the major responsibility for the bankruptcy of the enterprise, administrative sanctions shall be applied to the leaders of such superior department in charge.

³⁸ The suggested provision is as the following:

After an enterprise legal person is adjudicated bankrupt, the people's procuratorate or the audit organ, supervisory organ of the people's government, if it deems necessary, may investigate the personal responsibilities of the management, financial executives and other relevant personnel for the bankruptcy of the enterprise.

If any of the management, financial executives and other relevant personnel of the enterprise causes bankruptcy of the enterprise by acts of corruption, embezzlement, malpractice or other illegal acts, the people's court shall impose a fine of RMB 10,000 to 100,000 in addition to the liability for damages to the investors and creditors of the enterprise; and if the act constitutes a crime, criminal responsibility shall be investigated in accordance with the law.

³⁹ East Asian and Pacific Region Private Sector Development Unit, the World Bank, *Bankruptcy of State Enterprises in China -- A Case and Agenda for Reforming the Insolvency System*, Washington, DC, Draft May 27, 2000.

envisages a proper trustee function, strengthens the role of creditor committees, provides an elaborate option of court-supervised reorganization that can be initiated by debtors. While the technical content of the law has not been fundamentally challenged since it was drafted, the country's leadership has so far chosen not to submit the law to parliament. The Government and Party seem mainly concerned that the social implications of SOE bankruptcy, if pursuant to a uniform new law, could slip out of their control. In reaction to this concern, an alternative version of the draft includes a special chapter on SOE bankruptcy. However, the legal profession tends to reject the idea of a law that treats state-owned debtor enterprises differently than non-state ones. The result of this gridlock is the absence of a well-functioning bankruptcy regime for the increasingly important non-state economy.

Of course there are still a number of other issues that need to be discussed. People may understand that China is stepping on the path of institutional transition and inevitably confronted with lots of challenges domestically. Bankruptcy law is a typical area in which so many different values and interests are conflicting each other. From 1994 when the drafting team organized, nearly seven years have passed. We are still working, waiting and learning. What I have learned from the long process is that the spirits of pragmatism, compromise and gradual evolution constitute the major characteristics of the legal reform in China.

In the spirit of pragmatism, we always take the practical problems as the start-point, the workable solutions as the aim and the effective results as the test. While looking at and looking into the realities we realize that the theoretic analysis and experiential proof are of equal importance. While researching the cases in the reform and hearing the demands from the society, we keep drawing lessons from the successful examples abroad.

In the spirit of compromise, we always keep a tolerant mind and a moderate attitude in dealing with the different or divergent appeals. We are trying to persuade people to think about the common interests and mutual benefits. We are also using traditional wisdom and modern knowledge to work out some medium schemes to solve the disputes among various extremes.

In spirit of gradual evolution, we push the train ahead from one milestone to another. We have to follow the legislative procedure and waiting patiently for decisions from the authority. We get used to sitting on a cold bench and thinking with a warm heart. We understand the meaning of the proverbs that "a melon falls when it is ripe" and "with water flowing a ditch is completed".

Although we have worked hard and still have a lot of hard work to do, we feel proud of the achievement that we have got. It is proved that the 1995 Draft has been highly appraised and valuably advised in China and abroad. By way of illustration, in April 2000, the China Law Committee of the American Bar Association made a report on the Draft.⁴⁰ The general comment of the report reads:

The Committee acknowledges that the draft law is a product of a tremendous amount of work and study and is a significant improvement over the existing legislation on the subject. It not only clarifies a number of issues that are unclear in the current regime but also has all of elements of a modern insolvency law. If adopted, the law will help

⁴⁰ NBA Section of International Law and Practice, *Report of Recommendations of the American Bar Association's China Law Committee on the Draft Bankruptcy Law of the People's Republic of China*.

increase foreign investors' confidence.

The conclusion of the report put a further comment as the following:

The draft law is already a product of a tremendous amount of study and work. It is a foundation on which a predictable and consistently applied legal framework can be built. The implementation of the Bankruptcy Law, which inevitably affects the banking and financial institutions and social welfare systems, however, will likely pose even bigger challenges. Developing an efficient institutional and regulatory framework, therefore, should be more important than drafting a state-of-the-art law.

I believe that Chinese people will never forget all the efforts made by foreign friends in assisting China in the development of the rule of law.