

Recent Developments in Chinese Cross-Border Insolvencies

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Abstract

One truism of China, which adopted a market economy in the early 1990s,² is that there will be insolvencies. More recently, China's entry into the WTO³ has further created many burning questions; one gaining prominence is how its insolvency infrastructure will perform in cases involving cross-border aspects. The issues produced by cross-border insolvencies are not new to the international legal community although it has been one of the subjects of debates for several years in China. To complicate matters, China's current bankruptcy legislation⁴ is silent on cross-border insolvency. This, together with the lack of cooperation experience among Chinese courts and foreign counterparts, at once constitutes a self-blockade detrimental to the climate of Chinese foreign investment and trade.⁵ Nonetheless, there are some recent notable changes in this area that can be observed from both its judicial practice and pending legislation.

I. Introduction

Universality and Territoriality are often regarded as starting points for discussion

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² In 1993, the decision that China formally established market economy was inserted into the Constitution Law. See Amendments to the Constitution Law of the PRC, adopted by the First Session of the Eighth National People's Congress (NPC) on 29 March 1993. Article 15 of this Law was modified as "the State practises socialist market economy".

³ Fifteen year's extensive and tremendous negotiation efforts over China's entry into the WTO came to an end on 10 November 2001 when the Ministerial Conference approved by consensus the text of the agreement for China's entry. China became legally a member on 10 December 2001, 30 days after the WTO receives notification of the ratification of the agreement by China's NPC.

⁴ The current bankruptcy system of China consists mainly of 1986 Enterprises Bankruptcy Law of the PRC (Trial Implementation, hereinafter "EBL"), Procedure for Bankruptcy and Debt Repayment provided in the 1991 Civil Procedure Law (hereinafter "CPL"), accompanying judiciary opinions and other relevant regulations.

⁵ See eg., Jingxia Shi, 'Chinese Cross-Border insolvencies: Current Issues and Future Developments', *INSOL International Insolvency Review*, No.1, 2001, at pp36-40.

about cross-border insolvency over a long period of time.⁶ Furthermore, as one of the focuses of strenuous debates, recognition of foreign insolvency proceeding and pertinent cooperation matters are of paramount importance in order to achieve satisfactory resolution of cross-border cases.⁷ This article does not try to cover any issue associated with cross-border insolvency; rather it is an attempt at first instance to discern how mutual cooperation should be conducted when cross-border insolvency cases involving Chinese elements arises. In particular, it will discuss two cases in this area, with a focus on recognition of foreign bankruptcy judgments or proceedings.

What is to be addressed in Part II is the first case in which a Chinese court recognized a bankruptcy order made by a foreign court. In this case, the applicant, an Italian company, applied to the Guangdong Foshan Intermediate People's Court (hereinafter "Foshan Court") for recognition of a bankruptcy judgment and an adjudication order made by an Italian court. The Foshan Court granted these applications but no further actions were brought due to some ill-defined reasons.⁸

Part III of this article reviews the Hong Kong High Court's recognition of GITIC bankruptcy proceeding taking place in the Mainland China. From the factors considered by the judge in this case in making his decision, it is not difficult to draw a conclusion that equitable treatment for all creditors in a bankruptcy proceeding

⁶ See e.g., Ian F. Fletcher, *Insolvency in Private International Law* (1999), at p 369; See also Blom-Cooper, *Bankruptcy in Private International Law*, at pp 11-12, 14-17 (1954); John D. Honsberger, 'Conflict of Laws and the Bankruptcy Reform Act of 1978', *30 Case W. Res. L. Rev.*, at pp 633-35 (1980); Timothy E. Powers & Rona R. Mears, 'Protecting a Debtor's Assets in International Bankruptcy: A Survey and Proposal for Reciprocity', *10 N. C. J. Int'l & Com. Reg.*, at pp 305-07(1985); Barbara K. Unger, 'United States Recognition of Foreign Bankruptcies', *19 Int'l Law*, at pp 1154-55(1985); Jay L. Westbrook, 'Choice of Avoidance Law in Global Insolvency', *17 Brook. J. Int'l L.*, at pp 512-19 (1991); Jay L. Westbrook & Emmanuel Gaillard, 'Four Models for International Bankruptcy', *41 Am. J. Comp. L.*, at p 573 (1994).

⁷ See Andre J. Berends, 'The UNCITRAL Model Law on Cross-Border Insolvency: A Comprehensive Overview', (1998) *6 Tul. J. Int'l & Comp. L.*, at p 311.

⁸ As far as this author knows, this case has not been reported publicly in China to date. The knowledge and information about this case bases on the author's collection and telephone conversation with the judge and lawyer who dealt with this case. The relevant materials cited here are on file with the author.

could be a key element in terms of obtaining recognition in foreign jurisdictions.

In Part IV, the provision on cross-border insolvency in the Draft Enterprises Bankruptcy and Reorganization Law of the PRC is examined and commented on. The main contents of the relevant article are firstly reviewed, including its previous and current state. Then the focus shifts to the relevant proposals on its further improvements in order to adapt itself to international trends in this respect.

Finally, Part V concludes that China still needs to meliorate its judicial practice and legislation concerning cross-border insolvency. In particular, mutual judicial assistance between the Mainland and Hong Kong can be the first trial step for China's full-scale participation in international cooperation.

II. The B & T Case: Recognition of Foreign Bankruptcy Judgment by Chinese Court

This case (hereinafter the "B&T case") arose out of the applicant's seeking for recognition of a bankruptcy judgment obtained from Italian courts in a Chinese court. The illegal transfer of corporate shares complicated the issues although the Chinese court granted the applications.

1. The Petitions of the Applicant

In this case, B&T Ceramic Group s.r.l.(B&T), domiciled at Via Calzavecchio n.23, Casalecchio d/R (Bologna), Italy, filed a petition on 18 December 2000, applying for recognition and enforcement of the following judgments and related matters:

- (1) The No.62673 Bankruptcy Judgment which declared E.N.Group s.p.a.(E.N.) bankrupt and was made by the Milan Court (Italy) on 24 October 1997;
- (2) Adjudication Order on the Transfer of Confiscated Assets made by Civil and Penal Court in Milan on 30 September 1999;⁹
- (3) The whole assets of the bankrupt E.N., including its 98% shares in Nanhai Nasseti Pioneer Ceramic Machine Co. Ltd. (Nanhai Nasseti), shall be fully delivered to B&T with the consequence that B&T shall enjoy full right of control over these assets;
- (4) Confirming that B&T holds 98% shares of Nanhai Nasseti, and resuming the legitimate status of B&T in this corporation.¹⁰

The reasons for the above petitions mainly lie in the illegal transfer of corporate shares of Nanhai Nasseti conducted by bankrupt E.N.. On 2 May 1999, E.N. entered into an agreement on shares transfer with Broao Win International Limited (a Hong Kong-based corporation, hereinafter “Broao Win”), transferring 98% of the shares of Nanhai Nasseti to Broao Win at the cost of US\$5.39 million. This transfer of shares was approved by Nanhai Foreign Economic & Trade Bureau (FETB) on 21 July 1999. But given the fact that E.N. had been declared bankrupt when this transfer was made, it evidently infringed upon the applicant’s rights as the only legal holder of shares in overseas corporations of E.N., including 98% shares in Nanhai Nasseti.¹¹

2. The Findings of the Court:

Approved by Nanhai FETB, the Nanhai Pioneer Mould Co. Ltd. was incorporated in

⁹ The main contents of this adjudication order are as follows: The bankrupt E.N. Group s.p.a. was purchased by B&T Ceramic Group s.r.l.. As a result, the bankruptcy administrator shall turn the whole bankruptcy assets of E.N.Group s.p.a. over to the purchaser--B&T Ceramic Group s.r.l..

¹⁰ No.633 Fo zhong fa jing chu zi (2000) Civil Decisions made by Foshan Intermediate People’s Court, Guangdong, at pp 1-2.

¹¹ Written Application for Recognizing and Enforcing Judgments Made by Foreign Courts, filed by B&T Ceramic Group s.r.l. on 18 December 2000, at p 2.

Nanhai City, Guangdong Province in the PRC as a Sino-foreign equity joint venture on 4 March 1993. In this joint venture, the Chinese partner was Nanhai Jili Ceramic Industry Co. Ltd. and the foreign partner was Nasseti Ettore s.p.a., an Italian company. The total amount of investment of Nanhai Pioneer Mould Co. Ltd. was changed into US\$6.1 million in which registered capital amounted to US\$5.5 million on 26 December 1995. The Chinese partner thereinto contributed US\$0.11 million while the contribution of Italian partner reached US\$5.39 million, holding 98% shares of the joint venture. At the same time, the name of Nanhai Pioneer Mould Co. Ltd. was changed into Nanhai Nasseti Pioneer Mould Co. Ltd.¹²

On 9 May 1997, the name of Nasseti Ettore s.p.a. was again changed into E.N. Group and voluntary winding-up of its predecessor commenced at one time. E.N. was shortly declared bankrupt according to No.62673 judgment made by the Milan Court on 24 October 1997.¹³ But E.N. still continued its business in China despite of its bankruptcy.¹⁴ The name of Nanhai Nasseti Pioneer Mould Co. Ltd. was changed into Nanhai Nasseti Pioneer Ceramic Machine Co. Ltd.(Nanhai Nasseti) on 19 November 1997. Moreover, after the above shares transfer took place, the joint venture obtained de novo the Certificate of Joint Venture from Nanhai FETB, which recorded the Chinese partner was still Nanhai Jili Ceramic Industry Co. Ltd. while the foreign partner was changed into Broao Win.¹⁵

On 14 April 1999, the Bankruptcy Division of the Milan Court made an Order on the Sales of Subsidiaries and Branches of E.N. by Way of Wholesale Instead of Auction. Pursuant to this Order, bankrupt E.N., Satiusmac, T.T.C.Gongsi, overseas

¹² *Supra note 9*, at p 2.

¹³ Bankruptcy Declaration made by Bankruptcy Division of the Milan Court (Italy) on 24 October 1997.

¹⁴ The reasons for this are unclear based on available information to this author, possibly due to the untimely information disclosure, conspiracy, etc.

¹⁵ Annexure 2 to Written Application for Recognizing and Enforcing Judgments Made by Foreign Courts, filed by

corporations in which E.N. hold shares, equipments and machines, trademarks, patents and business networks were sold as a whole without exception.¹⁶ B&T bid in this sale and succeeded in winning the bid. On 30 September 1999, the Civil and Penal Court in the Milan Court made an Adjudication Order on the Transfer of Confiscated Assets, ordering the bankruptcy administrator to turn all assets of aforesaid corporations over to the purchaser--B&T for its free control.¹⁷

3. Opinions and Decisions of the Court

The Foshan Court hearing this case took the view that the No. 62673 Bankruptcy Judgment made by the Milan Court on 24 October 1997 and the Adjudication Order on the Transfer of Confiscated Assets made by the Civil and Penal Court in Milan on 30 September 1999 conformed to the conditions on recognition of judgments and decisions made by foreign courts specified in the Treaty on Judicial Assistance in Civil Matters between the People's Republic of China and the Republic of Italy (hereinafter 'The Treaty between China and Italy')¹⁸ and Chinese other relevant laws. The validity of the Bankruptcy Judgment and Adjudication Order shall be recognized accordingly in China.¹⁹

But in terms of the petitions filed by the applicant on turning 98% shares held by bankrupt E.N. in Nanhai Nasseti over to the applicant for its full control and confirming the applicant's holding 98% shares in this corporation, the court can not solve this issue by directly issuing a writ of execution to enforce it, given the said 98% shares has been transferred to the third person—Borao Win. Therefore, this petition will not be dealt with in this decision. The applicant may claim for its rights

B&T Ceramic Group s.r.l. on 18 December 2000, at p 2.

¹⁶ *Supra* note 9, at p 2.

¹⁷ *Ibid*, at p 3.

¹⁸ This treaty was concluded on 20 May 1991 between China and Italy, approved by the Standing Committee of the National People's Congress on 1 July 1992.

according to this decision through other proceedings.²⁰

Based on above opinions, pursuant to article 267,²¹ article 268²² of the Civil Procedure Law (CPL) of the PRC and paragraph 1 of article 20, article 21 and article 26 of the Treaty between China and Italy,²³ the decision was made as follows:

1. Recognize the validity of the No.62673 Bankruptcy Judgment made by The Milan Court (Italy) on 24 October 1997.
2. Recognize the validity of the Adjudication Order on the Transfer of Confiscated Assets made by the Civil and Penal Court in Milan on 30 September 1999.

This decision was final.²⁴

4. Several Remarks

The B&T case is, to this author's knowledge, the first case in which a Chinese court formally and explicitly recognize the validity of bankruptcy judgment made by foreign court. In this sense, it is of significance of landmark despite that the PRC does not for various reasons embrace the Common Law principle of binding precedent. This case to some degree could serve as an indicator on several elements when recognizing foreign bankruptcy by a Chinese courts.

1. Bases for recognition of foreign bankruptcy judgments

As pointed out above, cross-border insolvency is not dealt with in Chinese

¹⁹ *Supra note 9*, at p 3.

²⁰ *Ibid.*

²¹ Article 267 of the CPL stipulates that if a legally effective judgment or written order made by a foreign court requires recognition and enforcement by a people's court of the PRC, the party concerned may directly apply for recognition and enforcement to the intermediate people's court of the PRC which has jurisdiction.

²² Article 268 of the CPL provides that in the case of an application or request for recognition and enforcement of a legally effective judgment or written order of a foreign court, the people's court shall, after examining it in accordance with the international treaties concluded or acceded to by the PRC or with the principle of reciprocity and arriving at the conclusion that it does not contradict the basic principles of the law of the PRC nor violates State sovereignty, security and social and public interests of the country, recognize the validity of the judgment or written order, and, if required, issue a writ of execution to enforce it in accordance with the relevant provisions of this Law.

²³ These articles of the Treaty Between of China and Italy respectively deal with the scope of application (*paragraph 1 of article 20*), the circumstances under which decisions are declined to recognize and enforce (*article 21*) and the effects arising from recognition and enforcement (*article 26*).

legislation now in force. Thus in principle, recognition and enforcement of foreign bankruptcy judgments and written orders shall be conducted in accordance with CPL and other international treaties concluded or acceded to by China. To be more specific, article 267 and 268 of CPL on recognition and enforcement of foreign court's judgments and decisions could be invoked as bases for recognition and enforcement of foreign bankruptcy judgment although there exist some differences between them.²⁵ In addition to CPL, the Treaty between China and Italy more directly forms the foundation for recognition in this case. It should be noted that this Treaty also aims at providing mutual judicial assistance in civil and commercial matters rather than bankruptcy cases. But it can be utilized to settle this case since it does not clearly exclude bankruptcy matters, just as CPL could be invoked here. As a consequence, the following remarks mainly base on the relevant provisions in CPL and the Treaty between China and Italy.

Under Chinese legislation now in force, in the case of an application for recognition and enforcement of foreign bankruptcy judgment in China, the most ideal situation is there is a treaty or there are relationships based on a treaty between China and foreign jurisdiction concerned. The principle of reciprocity then occupies the second consideration.²⁶ Thus it now may be a little difficult for Chinese courts to recognize and enforce a bankruptcy judgment made by foreign courts other than the above two situations.

2. The applicant and Chinese court which has jurisdiction

Pursuant to article 267 of CPL, the applicant in this case may be either B&T or the

²⁴ *Supra* note 9, at pp 3-4.

²⁵ In fact, the very scarce existing international agreement on civil and commercial matters (e.g. the Rome Convention of 14 July 1970 on the *Mutual Recognition and Enforcement of Judgments in Civil and Business Matters*, or the Brussels Convention of 27 September 1968 on *Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters*) exclude insolvency specifically from their scope of application.

²⁶ Article 267, 268 of the CPL. The requirement of reciprocity contradicts to some international trends in this regard. For instance, *The UNCITRAL Model Law on Cross-Border Insolvency*, being given more and more

Milan Court . But the Treaty Between China and Italy confines the eligible applicant only to the party concerned.²⁷ So in this case, only B&T could serve as an applicant. Not every treaty that China concluded or acceded to has the same restrictions.²⁸

In terms of Chinese court enjoying jurisdiction to provide recognition and enforcement, CPL requires that it should be an intermediate people's court. This is in conformity with a newly promulgated judicial interpretation by the Supreme Court of the PRC.²⁹ It is said that this requirement intends to ensure better hearing of civil and commercial cases involving foreign elements. In this case, Nanhai Nasseti registers in Nanhai city subject to the geographic jurisdiction of the Foshan Court.

3. Judicial Review of foreign bankruptcy judgment

For the purpose of recognition and enforcement, a bankruptcy judgment or decision needs to be reviewed and examined by Chinese requested courts.³⁰ The problem here may be come down to how widely the scope of this review is. Shall the Foshan Court in this case review procedural matters or substantive matters on which Italian Court made the judgment? It is argued that substantive review overemphasizes local laws and neglects the differences between domestic laws and foreign laws. Moreover, it gives local laws priority over foreign laws without reference to the authority of foreign judicial practice.³¹ Accordingly, only conducting procedural review on foreign judgments has also been accepted by China as to this issue. What the Foshan Court in this case reviewed and examined mainly are the documents rendered by the applicant

attention, only provides public policy exception for not recognizing a foreign bankruptcy judgment. *See* article 6 of the *Model Law*. It is therefore necessary for China to modify CPL if it enacts the *Model Law* in future.

²⁷ Article 23 of the *Treaty Between China and Italy*, *supra* note 16.

²⁸ For example, *The Treaty on Judicial Assistance between China and Turkey* states that all applications shall be lodged by the court making judgment or decision.

²⁹ Article 3 of the *Judicial Interpretation on Several Issues concerning Jurisdiction on Civil and Commercial Cases Involving Foreign Elements*, Fa shi [2002] N0.5, adopted by the Supreme Court on 25 December 2001 and effective as of 1 March 2002.

³⁰ Article 268 of the CPL.

³¹ *See* Xuhong, *International Judicial Assistance in Civil Matters*, Wuhan University Press (China), 1995, at pp

and relevant procedural matters, which keeps conformity with the Treaty between China and Italy. The Treaty between China and Italy expressly states that the judicial review conducted by the court, which decides matters of recognition shall be limited to the conditions specified by this Treaty.³²

4. The legal effects following recognition

Perhaps this is most controversial issue in this case due to the existence of illegal transfer of shares. As a general knowledge in bankruptcy law, bankruptcy declaration shall lead to the legal effects that the debtor is deprived of power to dispose of all assets and this power is vested in the administrator. But in this case, E.N. still could transfer shares in Nanhai Nasseti in 1999 in spite of its bankruptcy in 1997. It no doubt constitutes an illegal transaction although the relevant background for this transfer is uncharted here, which does make this case complex since the substantive rights of B& T has not been realized although its application was granted by the Foshan Court .

It should also be pointed out that in accordance with CPL and other Chinese laws, recognition and enforcement of foreign judgments are different things. The realization of substantive rights largely depends on enforcement while recognition is only a precondition. The civil decision made by the Foshan Court recognized the validity of Italian bankruptcy judgments and adjudication orders, leaving the enforcement matters to other proceedings to be initiated by the applicant.

But in fact, the applicant B&T finally realized its rights through diplomatic approaches instead of pursuing further judicial proceedings. Nanhai FETB had to approve the shares alteration of Nanhai Nasseti, changing Borao Win into B&T as the

333-34.

³² Paragraph 2 of Article 25 of the *Treaty Between China and Italy*.

holder of 98% shares without reference to rights and interests of Borao Win.³³ It is not clear why B&T did not pursue its rights via other judicial proceedings rather than diplomatic means. If it were the case, we now would have had a full instance to examine the practice of a Chinese court with regard to cross-border insolvency. Anyway, this speculation is less important than some potential issues raised here. For example, there is the possibility of Nanhai FEBT facing an administrative proceedings brought by Borao Win as a bona fide transferee. Of course, it is also imaginable that there existed conspiracy between Borao Win and E.N..

Suppose that B&T brought another proceeding for realizing its rights on the basis of this civil decision, a series of issues need to be settled by the Court, such as the jurisdiction, the nature and effects of share transfer between E.N. and Borao Win, ownership of 98% shares in Nanhai Nasseti, special issues as to enforcement of corporate shares, protection of Chinese partner (despite of minority shareholder) and creditors, keeping normal business operation of the joint venture, etc.

³³ Based on information obtained from the telephone conversation between the author and lawyer and judge who deal with this case.

III. Recognition of Mainland Bankruptcy Proceeding by the Hong Kong Courts

It is worth noting that the bankruptcy of Guangdong International Trust and Investment Corporation (GITIC)³⁴ contributed greatly to the debate on cross-border insolvency in China.³⁵ The case discussed here took place in a Hong Kong High Court between CCIC Finance Limited (CCIC, plaintiff) and GITIC (defendant) and GITIC Hong Kong (Holdings) Limited (GITIC HK, Garnishee).³⁶

1. Factual Background

There were two applications in this case; Firstly, the plaintiff CCIC,³⁷ now judgment creditor, having obtained in the Hong Kong High Court judgment by default against the defendant, now judgment debtor, GITIC and a garnishee order nisi against GITIC HK³⁸ applied to make that garnishee order absolute. Secondly, GITIC applied for a stay of all proceedings including the garnishee application.³⁹

On March 27 1997 CCIC as agent and arranger of a syndicated loan lent GITIC HK US\$35 million. GITIC was not a party to the loan agreement but provided CCIC on 3 April 1997 with a Letter of Support in respect of GITIC HK's obligation to repay the

³⁴ GITIC, as one of a select group of “champions of economic reform”, was established in March 1984 and later became the second largest foreign debenture issuer in China and a fund-raising arm for the Guangdong provincial government as well. In August 1988 it was registered in Hong Kong as an overseas company. GITIC had spectacular rise and fall in the business history of China. *See, e.g.*, ‘The Spectacular Rise and Fall of GITIC’ (May 18, 1999), available at ‘http://www.chinaonline.com/top_stories/breakingnews_b2_99051423.html’.

³⁵ As the first case concerning the bankruptcy of leading state-owned financial institution in China, the GITIC case involves the largest-ever amount of assets and foreign debts in China, drawing international-wide attention in short time. *See eg* T K Chang, ‘The East Is in the Red’, (March 1999) *IFLR*, at p 43; *See also* “Analysis – China Plans Public Fund Injection for ITICs,” *Asia Pulse* (11 January 2000), available at ‘2000 WL 2676073’; Jingxia Shi, ‘Chinese Cross-Border Insolvencies’, *supra note 4*, at pp 40-42.

³⁶ Hong Kong High Court Case No. HCA 15651/1999. Date of Judgment: 31 July 2001.

³⁷ CCIC is a bank incorporated and carrying on business in Hong Kong.

³⁸ GITIC HK was incorporated in Hong Kong as a wholly owned subsidiary of GITIC in 1986.

³⁹ Judgment of 31 July 2001, at para.1.

loan. GITIC HK defaulted in repaying the debt. On 12 October 1998 GITIC HK went into voluntary liquidation in Hong Kong; As at the date of adjudication it was in debt to its parent GITIC.⁴⁰

But GITIC was also declared bankrupt by the People's Higher Court of Guangdong Province (PHC) on 16 January 1999.⁴¹ PHC appointed a liquidation committee to take complete control of GITIC⁴² according to EBL.⁴³ In the course of the conduct of its duties, the liquidation committee filed a proof of debt with the liquidators of GITIC HK for the amount claimed to be due to GITIC, about HK\$819 million with the prospect of a dividend of 54% of proved claims.⁴⁴

On December 1998, CCIC lodged a proof of debt in the GITIC bankruptcy based on the Letter of Support, for the amount owing by GITIC HK.⁴⁵ But the liquidation committee rejected the claim on the ground that Letter of Support was just a non-binding letter of comfort and could not constitute legally binding guarantee recognized by PRC law.⁴⁶ CCIC objected this rejection to the liquidation committee.⁴⁷ Then without waiting for a response, CCIC chose another way to realize its claim. On 2 October 1999, it commenced proceedings in the Hong Kong High Court and obtained default judgment against GITIC, GITIC taking no steps. CCIC sought to attach the debt owed by GITIC HK to GITIC.⁴⁸ On 29 November 1999, the Hong

⁴⁰ *Ibid*, at para. 3-6.

⁴¹ *Public Announcement for Bankruptcy*, (1999) Yue Fa Jing –Po Zi No. 1-7, made by the People's Higher Court of Guangdong Province, 16 January 1999.

⁴² *Directions for the Appointment of the Liquidation Committee*, (1999) Yue Fa Jing – Po Zi No. 1-9, made by the People's Higher Court of Guangdong Province, 16 January 1999.

⁴³ EBL is exclusive to the liquidation, or bankruptcy as it is known in the PRC, of SOEs. It came into force in 1988.

⁴⁴ *Supra note* 38, at para. 9.

⁴⁵ *Ibid*, at para. 10.

⁴⁶ *Notice of Rejection*, Liquidation Committee of GITIC, dated on 11 August 1999.

⁴⁷ *Notice of Objection to Non-Recognition of Claim*, CCIC Finance Limited, dated on 26 August 1999.

⁴⁸ The rationale behind this strategy was that if CCIC attached that debt, then the dividend which would be declared by the liquidator of GITIC HK in favor of GITIC would be subject to the attachment. Accordingly, as GITIC was an extremely large creditor (over HK\$800 million), it would receive a large dividend, which would be

Kong High Court, on CCIC's application, granted a garnishee order nisi attaching 'all debts due or accruing due from [GITIC HK] to [GITIC]' to answer the judgment debt.

⁴⁹ GITIC finally decided to defend the proceedings in Hong Kong.⁵⁰

By letter of 9 June 2000 CCIC supplemented its objection to the liquidation committee, citing the Hong Kong proceedings and the garnishee order it obtained. But the liquidation committee again rejected CCIC's claim, placing no value on the garnishee order on the ground of GITIC's bankruptcy.⁵¹ On November 2000, an interim dividend of 3.38% was struck and paid out to the creditors whose claims had been processed and admitted in the GITIC bankruptcy proceedings. It provided no priority or other distinction between domestic and overseas creditors.⁵²

2. Issues and Orders

The issues raised by Judge Gill in this case include: Firstly, is there a debt due by GITIC HK to GITIC giving the court jurisdiction to make a garnishee order under Order 49 Rule 1 Rules of High Court? Secondly, if so, the exercise of the power being a discretionary one, how should the Court exercise its discretion having regard to the liquidation of GITIC HK, the bankruptcy of GITIC in the PRC, the conduct of CCIC and any other matters? Thirdly, notwithstanding the outcome of the garnishee application, should the proceedings be stayed?⁵³

As to the first issue, Judge Gill thought the answer should be in the affirmative. He formed the view that a debt remains, until satisfied or otherwise provided for, debt. Liquidation cannot change the nature and status of a debt although liquidation bring

subject to the attachment and would be paid to CCIC.

⁴⁹ *Supra note* 38, at para. 13-14.

⁵⁰ *Ibid*, at para. 29.

⁵¹ *Ibid*, at para. 24.

⁵² *Ibid*, at para. 26.

⁵³ *Ibid*, at para. 31.

into existence of an appointed liquidator.⁵⁴

Then, logically the importance of dealing with this case was placed on the resolution of the second issue—how should he exercise the discretion? In the opinion of Judge Gill, the most important consideration in this regard was that a garnishee order will probably not be granted if the effect would be to prefer one creditor of the judgment debtor over others.⁵⁵ It is therefore necessary to examine the nature of the bankruptcy of GITIC in the PRC, particularly whether that proceeding had or purported to have extra-territorial effect or not.⁵⁶

Much of the trial was taken up in the adducing the evidence given by four scholars in PRC bankruptcy law on this topic. All of the experts who held different viewpoints were searchingly cross-examined in the trial.⁵⁷ But Judge Gill considered the approach that is being taken by the liquidation committee as directed by the PHC as being of the most concern for his decision.⁵⁸ According to the factual summaries of GITIC proceeding,⁵⁹ he deduced that GITIC bankruptcy proceeding in the PRC were being pursued, without challenge, on the basis of a universal collection and distribution of assets and that the paramount principle of *pari passu* of distribution was strictly being adhered to. As a consequence, making absolute of the garnishee order would interfere with that process.⁶⁰

In view of above considerations, Judge Gill made his ordered that: the judgment creditor's application that the garnishee pay to the judgment creditor the debt due from the garnishee to the judgment debtor or so much thereof as may be sufficient to

⁵⁴ *Ibid*, at para. 43.

⁵⁵ *Ibid*, at para. 48.

⁵⁶ *Ibid*, at para. 60.

⁵⁷ The difficulties in this regard stem from the legislative blank and the issues arising therefrom. For various opinions of four scholars, *See* summaries by Judge Jill, Judgment of 31 July 2001, at para.62-78.

⁵⁸ *Supra note* 38, at para. 79.

⁵⁹ The relevant factual summary is reflected in the Judgment of 31 July 2001, *Supra note* 38, at para.80

⁶⁰ *Ibid*, at para. 84-85. Among other matters covered by Judge Jill, he gave particular attention to international comity, a key concern regarding exercising judicial discretion. He drew a conclusion that there is even stronger case for leaving the issue of CCIC's claim to be presented to and decided by the PHC, *ibid*, at para. 93-95.

satisfy the judgment recovered by the judgment creditor against the judgment debtor on October 27 1999 is dismissed.⁶¹ The judgment debtor's application that all further proceedings in this action including execution of any judgment therein be stayed is granted.⁶²

3. Relevant Observations

The following observations are based on the judgment made by Judge Gill in the Court of First Instance of Hong Kong High Court and related theoretical backgrounds on cross-border insolvency. This case deserves serious attention in the sense that it brings helpful apocalypses to Chinese judicial practice, although this case is still in the course of appeal and the final outcome is not yet available.

The core issue in this case is a question of the extraterritorial effects of EBL. To be more concrete, there exists a GITIC bankruptcy proceeding in the Mainland. The liquidation committee, in accordance with EBL, will take charge of recovering the assets belonging to GITIC for bankruptcy distribution. Given the fact that the disputed assets in this case (debts due to GITIC by GITIC HK) are situated in Hong Kong, whether the liquidation committee is in a position to recover the assets or not to a large extent depends on the recognition of the GITIC proceedings by the Hong Kong Court.

The orders made by Judge Gill indicate the recognition of the GITIC proceeding opened by PHC. The underlying reason for the orders mainly lies in his understanding that the bankruptcy liquidation of GITIC is pursuing a universal collection and distribution of whole assets of GITIC and all creditors in the same rank, whether Chinese or foreign, obtained first dividend under *pari passu* principle. Furthermore, the rejection by the liquidation committee of CCIC's proof of debt occurred on the

⁶¹ *Ibid*, at para. 104

⁶² *Ibid*, at para. 105.

merits of the claim, and not because it came from outside the territorial boundaries of the Mainland.⁶³ The above deliberations lead to the inescapable conclusion that the making absolute of the garnishee order on CCIC's application would prefer CCIC over other creditors of GITIC and break the paramount principle of equitable treatment to all creditors.

Against the relevant theoretical backdrop, there is a consensus that bankruptcy shall be a collective legal device that operates in each case to protect and adjudicate the interests of many creditors.⁶⁴ The individual enforcement of creditors accordingly ought to be prohibited worldwide for this purpose. Otherwise, "diligent" creditors might be motivated through multiform channels to grab the debtor's assets dispersed in various jurisdictions.⁶⁵ This will hinder the progress of bankruptcy proceeding and even may cause the proceeding to stop. If every court goes its own way and gives little or no regard to foreign proceedings, creditors will be encouraged to engage in forum shopping, which could not protect the interests of creditor as a whole. Notwithstanding the disadvantages of doing so, there still exist protectionism more or less in respect of recognizing and enforcing foreign bankruptcy proceedings.⁶⁶

The fact itself that the Hong Kong High Court which traditionally conforms to common law principle recognizes the bankruptcy proceeding opened in the Mainland (a socialist country with a strong civil law tradition) firstly displays an open attitude of Judge Gill towards cross-border insolvency. He did not pay regard to the difficulties rooted in this respect. Secondly, whether to recognize foreign bankruptcy proceedings or not to a large degree falls into the ambit of exercising discretion. The

⁶³ *Ibid*, at para. 80.

⁶⁴ In this respect, one often cited discussion can be found in Thomas Jackson, *The Logic and Limits of Bankruptcy Law*, 1986.

⁶⁵ See Junichi Matsushita, 'Present and Future of Japanese International Insolvency Law', (1998) 33 *Tex. Int'l L. J.*, at p 75; See also Barbara K. Unger, 'United States' Recognition of Foreign Bankruptcies', (1985) 19 *Int'l Law*, at p 1155; John D. Honsberger, 'Conflict of Laws and the Bankruptcy Reform Act of 1978', (1980) 30 *Case W. Res. L. Rev.*, at pp 634-35.

problem here is which factors shall be stressed so as to exercise discretion properly. In this case, under the circumstance that EBL has no answer and four experts hold diversified opinions as to this issue, the factors that were taken by Judge GJill into consideration shall be attributed to the principle of equitable treatment to creditors. With an eye to the nature and role of bankruptcy proceeding itself, it is fair to say that this stance is on its right way to hear properly cross-border insolvency cases.

It may be interesting to note there are some comments on this case, arguing it does not establish that a Hong Kong Court will recognize any Mainland insolvency proceeding. Rather it should be restricted to its limited facts. Most importantly, the GITIC case is not authority in Hong Kong for the proposition that the EBL has extraterritorial effect.⁶⁷ But in any case, this commentator also agreed that the primary reason for Judge Gill's refusing to make the garnishee order absolute was a finding that the GITIC liquidation was being pursued on the basis of a universal collection and distribution of assets and the creditors worldwide were to be paid *pari passu*.⁶⁸

Further, in judging whether the GITIC proceeding treated all creditors equally, Judge Gill considered such aspects as the transparency of proceeding, *pari passu* distribution, the reasons for recognizing or rejecting a claim and granting objection right to creditors whose claim are rejected. Although there are different considerations in respect of recognizing foreign bankruptcy judgments among various jurisdictions, the equitable treatment of creditors is always put on the top of factors list. But how should we carry out this principle in judicial practice ? As the first case recognizing the bankruptcy proceeding in the Mainland, this case may produce very positive implications on Chinese future judicial practice on cross-border insolvency,

⁶⁶ See Jingxia Shi, *Supra note 4*, at pp 75-77.

⁶⁷ See Prudence Mitchell, 'Recent Cross-border Insolvency Developments in Hong Kong', unpublished paper presented at *Recent Developments in Corporate Insolvency*, Hongkong, 18-19 April 2002, at p 3.

⁶⁸ See Prudence Mitchell, *supra note 66*, at p 4.

particularly requiring Chinese courts to treat all creditors fairly. In this sense, GITIC proceeding as directed by PHC may take on some directing effects.

IV. Draft Enterprise Bankruptcy and Reorganization Law

The reform of bankruptcy laws has been put on the national legislative schedule since 1994 so as to accommodate China's transition from a command economy to a market economy.⁶⁹ In 1995 a comprehensive draft of the uniform bankruptcy law containing 10 chapters and 193 articles was completed and proposed to the higher authority, but was unluckily shelved for a long time due to unripe social and legal conditions.⁷⁰ The drafting process resumed in 1998 and is now in progress. The final event of the drafting work took place in early February 2002 when the latest edition proposed by the drafting group was discussed among academics, government officials and practitioners. But it is still subject to further revisions by the National People's Congress and the enactment has not been penciled into the agenda of the national legislature. As such, it is not clear to what extent this draft will be further revised and when it may be adopted.⁷¹

The scope of proposed new law covers all business entities, including state, private and foreign-funded enterprises and some natural persons.⁷² Many of its articles are

⁶⁹ In order to implement the legislation plan of the Standing Committee of the 8th National People's Congress, the Fiscal and Economic Committee of the NPC has organized the drafting work for renewing bankruptcy law since March 1994.

⁷⁰ See eg Wang Weiguo, "Institutional Reasoning in Drafting New Bankruptcy Law", unpublished paper presented at *Chinese Insolvency Law Symposium: Developing an Insolvency Infrastructure*, Hongkong, 17-18 November 2000, at p 1.

⁷¹ In April 2002, NPC organized two symposiums on the draft insolvency law of the PRC, inviting several foreign experts on insolvency law to discuss the draft. It is expected that further revision to the draft will be done by the drafting group in the future.

⁷² Art 2 of the 2002 Draft Enterprises Bankruptcy and Reorganization Law reads: "This law shall apply to the following civil subjects: (1) Enterprise legal persons; (2) Partnership enterprises; (3) Sole proprietorships; (4) Other profitable economic organizations established in accordance with the laws; (5) Natural persons carrying on operating activities subject to business registration. The Law shall also apply to incidental bankruptcy liquidation of partners or investors on account of the bankruptcy of partnership enterprises or sole proprietorships."

drawn directly from foreign advanced bankruptcy system, with an endeavor to bring China's bankruptcy legislation in line with international standards. But regretfully, cross-border bankruptcy issues are still ill considered even if this proposed new law is much more comprehensive and well thought-out. In the 1995 Draft, there is only one simple article regarding this issue, just providing that no procedure of liquidation, composition or reorganization opened outside the domain of the PRC shall have any effect upon a debtor's assets located within the territory of the PRC. This provision clearly falls into the ambit of so-called territoriality doctrine. In addition, it is uncompleted article since it remains silent on the effect of Chinese insolvency proceedings over the debtor's assets abroad.

The situation has improved in the draft finished in December 2000.⁷³ In the 2002 Draft, the article on cross-border insolvency became a little detailed albeit there is one article on this topic. The article 8 of this draft states thusly:

“The liquidation, reorganization or composition proceedings opened by the People's Court under this law shall have effects on the assets of the debtor located inside and outside of the territory of the PRC.

The application filed by the party concerned for recognition and enforcement of a liquidation, reorganization or composition proceeding opened outside the territory of the PRC shall be subject to the approval by the People's Court.

In the case that the foreign proceeding falls into one of the following circumstances, the People's Court may make a decision of not granting the recognition and enforcement:

- (1) There is no relationships based on the treaty or reciprocity between the PRC and the foreign jurisdiction where the proceeding is opened;*

⁷³ The original edition of this article was proposed by this author but thereafter it has experienced several revisions taking place in 2001 and 2002. The texts contained 2002 draft may be still subject to further revisions.

- (2) *The recognition of the foreign proceeding will violate the social public interests of the PRC;*
- (3) *There exist significant differences in respect of substantive provisions between this Law and the bankruptcy laws of foreign jurisdiction where the proceeding is opened, which is possibly detrimental to the interests of Chinese creditors;*
- (4) *Other considerations deemed necessary by the People's Court."*

At first glance, this article generally adopts the universality principle since it talks of both extra-territorial effect of Chinese proceedings and intra-territorial effect of foreign proceedings. It experienced a long discussion prior to including these provisions in the draft since there are many diversified viewpoints in this regard both nationally and internationally. For instance, there have once been such varying theoretical arguments in China as territoriality, restricted territoriality, mutual recognition, and universality.⁷⁴ Chinese current legislation remains unanswered to this issue but territoriality sometimes seems to be the dominant consideration in judicial practice.⁷⁵ From an international perspective, although territoriality is historically the predominant philosophy endorsed by many States,⁷⁶ modern trends indicate a strong and growing advocate towards universality.⁷⁷ Thus in this sense, this provision may be hailed as a welcome progress, compared to relevant article in the 1995 draft.

But on second thoughts, it may be noted that the conditions on recognition of a foreign bankruptcy proceedings are strictly listed. In effect, it may be not easy for a

⁷⁴ For these discussions, See Zhang Weiping, *Introduction to Bankruptcy Proceedings* (Chinese, China Politics and Law University Press, 1993), at p 189; see also Hu Zeen, 'Bankruptcy Legislation for Foreign-Related Enterprises and Extraterritoriality Effect of Bankruptcy Declaration', (1989) *Legal World* (China), No. 2, at p 23; Tang Weijian, 'On Cross-Border Insolvency', (1995) *Journal of Comparative Law* (China), Vol.2, at p 124; Ke Shanfang, *Introduction to Bankruptcy Law* (Chinese, Higher Education Press, 1988), at p 167.

⁷⁵ See Liwan Case and BCCI case discussed in Jingxia Shi, *supra* note 4, at pp 38-40.

⁷⁶ There is a recent vigorous defense of a cooperative form of territoriality as well. See Lucian Arye Bebchuk & Andrew T. Guzman, 'An Economical Analysis of Transnational Bankruptcies', (1999) *42 J. L. & Econ.*, at p 806. See also Lynn M. LoPucki, 'Cooperation in International Bankruptcy: A Post-Universalist Approach', (1999) *84 Cornell L. Rev.*, at p 696.

⁷⁷ See Jay Lawrence Westbrook, A Global Solution to Multinational Default, *Michigan Law Review*, [Vol. 98:2276 June 2000], at p 2328.

foreign proceeding to obtain recognition in the PRC since one of the circumstances set out in this Article 8 is easily satisfied, particularly on its general clause—other considerations deemed necessary by the people’s court. Therefore, it is by all means a matter of discretion for the people’s court to decide whether to recognize a foreign proceeding or not. As regards the rational explanation behind this provision, it may be risky for China to stride forward too quickly with a view to its national conditions. But at the latest symposium in April 2002,⁷⁸ some foreign experts strongly advocated that this general clause should be deleted due to various reasons.⁷⁹ It may be possible to omit this clause in further revisions.

Another comment here goes to the criticism about limited words on this big topic. It is always this author’s view that one article in any case could not cover the essential aspects on cross-border insolvency. It could be very difficult for this article to function in practice without material and operational supporting provisions. At least, there should be one specific chapter to deal with this topic. Recent classical texts, UNCITRAL Model Law on Cross-Border Insolvency and EU Regulation on Insolvency Proceeding, which draw global attentions, both provide us with a clear illustration on how significant it is to devise a framework under which the courts in different jurisdictions could cooperate well. It is recommended that China should give every consideration to the possibility of incorporating the provisions contained within the Model Law into its future bankruptcy law.⁸⁰ Hopefully, the draft could achieve more improvements with respect to cross-border insolvency in the future.

⁷⁸ *Supra note 70.*

⁷⁹ See Henry Pitny, Charlie D. Booth & others, ‘Report on the Draft Insolvency Law of the PRC’, April 2002, unpublished materials on file with the author.

⁸⁰ Maybe it is not suitable moment for China to enact the Model Law now for two reasons: firstly, more time is needed to have the Model Law known and understood in China, especially by the law circle and the law-making related officials. Secondly, the Chinese legislative design in this regard is not still ripe. *See e.g.*, Wang weiguo, ‘Institutional Reasoning in Drafting New Bankruptcy Law’, unpublished paper presented at *Chinese Insolvency Law Symposium: Developing an Insolvency Infrastructure*, Hongkong, 17-18 November 2000, at pp 17-18. In addition, some members of the drafting group also hold the view that China should not step too fast with respect to the cross-border insolvency.

V. Conclusion

In its efforts to adapt itself to the WTO membership, China needs to speed up reforms with regard to its legal system involving foreign elements. Cross-border insolvency at any rate should be one of the focuses of attention, given its role-playing in inspiring the confidence of foreign investors on this emerging market. It can be happily observed that there are recent improvements associated with Chinese cross-border insolvency reflecting from both judicial practice and pending legislation. But we should not neglect many issues remaining tough and unsolved to date, such as lack of a set of functional framework, unconcerted judicial practice, etc. To improve present status, it would be better to introduce such international initiatives as UNCITRAL Model Law into Chinese legislative consideration.

Another observation is there are more and more economic and legal affiliations between Mainland China and Hong Kong SAR in recent decades, which requires far-reaching cooperation to achieve efficiency and fairness in managing cross-border insolvencies. At present, a hot issue—the Northeast Electrical case, demonstrates this crying need once again.⁸¹ Accordingly, perhaps in the short term it would be helpful for the Mainland to enter into trial schemes of cross-border insolvency cooperation with Hong Kong although it would be best for China to adopt a national solution in

⁸¹ Northeast Electrical Transmission & Machinery Manufacturing Co. Ltd.(NEMM), a Chinese power equipment manufacturer registered in Shenyang Province. It has a stock exchange listing both in Hong Kong (H shares) and in the Mainland (A shares). It was brought a liquidation case by a Hong Kong-based foreign creditor (actually CCIC) due to inability to pay US\$40m. The case was adjourned several times, finally was heard on 10 June 2002 after This case still puts forward some potentially contentious issues although the Hong Kong High Court acceded the request of revoking the winding-up application provided by CCIC given the fact that CCIC approved the NEMM's repayment plan. For instance, whether Chinese courts would accept that Hong Kong court, which follow the common law system, has the power to dissolve a mainland company; how liquidators armed with a bankruptcy order from a Hong Kong court would go about selling off a company's assets that primarily on the Mainland. Suppose the Hong Kong court rules that the company goes into liquidation and appoints a liquidator to sell off assets, the liquidator then faces the hurdle of establishing its credentials on the Mainland. For more information and discussion about this case, visit <http://www.yestock.com>.

this regard.⁸²

⁸² See Xianchu Zhang & Charles D. Booth, 'Beijing's Initiative on Cross-Border Insolvency: Reflection on a Recent Visit of Hong Kong Professionals to Beijing', 31 *HKLJ* 312, at p 322.