

Adopting Corporate Rescue Regimes in China: A Comparative Survey

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1. Introduction

In later 1995, a Draft Bankruptcy Law of PRC was submitted for consideration to the higher level by the Fiscal and Economic Committee of the National People's Congress (NPC), as an outcome of the one and half year drafting work organised by the Committee under the legislation program of the 8th NPC. Purporting to meet the needs of the growing market economy in the country, the draft law bore a number of features that was noticed and highly praised. However, due to some known and unknown reasons, the draft has ridden at anchor for about two years. It is probably a good fortune for us to have enough time to deepen the explore and thus contribute a more praiseworthy legislation for the coming century.

One of the most remarkable features of the draft law is the adoption of a corporate rehabilitation proceeding. This can be seen in Chapter 5, known as "Reorganisation", of the draft law, containing 38 articles, and other relevant provisions in Chapter 1 and 2. This draft proceeding has been highly praised domestically and internationally.

There is no denying that when the draft proceeding was designed and improved some corporate rescue regimes of foreign countries were used for reference, especially those in the US Bankruptcy Code 1978, the French Law No 85-98 on judicial reorganisation in 1985, the UK Insolvency Act 1986 and the new German bankruptcy law enacted in 1994. However, it should be a pity that the Australian "Corporate Voluntary Administration" proceeding in the Corporate Law Reform Act 1992, that became Part 5.3A of the Corporations Law in June 1993, was not involved in, because of the want for relevant documents. Nevertheless we still in the right season to have the opportunity to draw on the experience of Australia, and of course many other countries, to further our engineering for corporate rehabilitation.

This paper is written in Australia. It is of great pleasure for the author to have a chance to read a number of books on Australian as well as international comparative insolvency laws. In this paper the author intends to demonstrate the designed reorganisation proceeding in the draft Bankruptcy Law of PRC, on the basis of his understanding and experience as a script writer of the relevant provisions, stepping along the way of international comparison, especially with Australian Part 5.3A of the Corporations Law that is of great interest to him and, as he believes, to many of the readers.

2. Global Trend of Reformation for Corporate Rescue

Generally, the present-day alternatives purporting to resuscitate debtor companies in distress may be in outline classified into the following groups:

- Out-of-court debt restructuring (work-out);
- Voluntary composition proceedings;

- Traditional composition proceedings;
- Corporate rehabilitation proceedings (reorganisation).

2.1 Out-of-court debt restructuring (workout)

The first alternative may be recognised legally as private contracts by which creditors offer a debtor company some concession or other favourable treatments for debt satisfaction.¹ Sometimes intervention and/or supports by government may be involved in such a process.² This leaves a large room for parties' discretion but sometimes a hard work in negotiation. The incentives for choosing this way are usually considerations on costs, time consuming and information disclosure incurred in formal court proceedings. In an industrialised society, workout is very commonly used. However, it may probably be unworkable where the distress of the debtor is obvious and its future is anxious.

2.2 Voluntary composition proceedings

The second one comes to an in-court proceeding that is composed of court-approved agreement containing a compromise of debts for less than the full amount owing or an arrangement that restructures the debtor company's equity and debt capital.³ This alternative is exemplified by the English-based "scheme of arrangement" adopted in Britain, Australia, Singapore and New Zealand. It is generally concluded that the insolvency proceedings of this kind are virtually ineffective because they do not impose an initial freeze to prevent individual creditors taking unilateral action against the company and, on the other hand, they require unanimous creditor approval.⁴ To some extent, particular reasons for such a situation vary from country to country. In Australia, the scheme of arrangement proceeding provided in s. 411 of the Corporations Law has been criticised to be "inflexible, expensive and time consuming."⁵ The disadvantages of this proceeding are summarised as such: (1) the cost of implementing an arrangement is high, as a consequence of fulfilling the statutory requirements; (2) because of the formality of the arrangement and the rigours of the statute, an arrangement cannot be put into place as a matter of urgency; (3) the arrangement cannot be altered without obtaining the fresh approval of the court, and this means added costs and delay; (4) the court has a discretion whether or not to sanction the arrangement and this introduces an uncertainty factor; (5) a formal arrangement is subject to publicity, that may deleteriously affect the reputation of the company in the marketplace.⁶

¹ In Australia, so-called "informal arrangement" may be placed in this file. Keay, A.R. points out: "In the main, informal arrangements involve private negotiated arrangements which are subject to the general laws of contract. They may be negotiated with one large creditor or a few creditors. Usually such arrangements involve a moratorium on the existing debt." "Informal arrangements are more likely to succeed where there are a small number of creditors, for in such a situation it is easier to negotiate, and the chance of there being a dissenter among the creditors is lessened." (*Insolvency*, 2d Ed., 1994, pp. 236-237)

² The examples of governmental involvement may be seen in China and French.

³ See, Keay, *Insolvency*, 2d Ed., 1994, pp.233-246; Tomasic, R., & Whitford, K., *Australian Insolvency and Bankruptcy Law*, 2d Ed., 1997, pp.112-159.

⁴ See, Wood, P.R., *Principles of International Insolvency*, 1995, pp. 177-178.

⁵ see, Crutchfield, P., *Corporate Voluntary Administration Law*, 2d Ed., 1997, p.3.

⁶ See, Keay, *ibid.*, p.236. In Australia, the report issued by the Law Reform Commission in 1988 (the "Harmer Report"), which led to the 1992 legislation, points out that "(t)he procedure for a scheme of arrangement is cumbersome, slow and costly and is particularly unsuited to the average private company which is in financial difficulties." The main problems is believed to be the considerable court involvement -- at least two applications and several documents, e.g. statement and report, to the court are required, and

2.3 Traditional composition proceedings

The third alternative is widespread in the jurisdictions which following the civil law tradition. Unfortunately, it is usually little used or rarely successful either.⁷ This disappointment is due to, first, that the composition proceeding imposes the debtor a minimum immediate payment to creditor and, as a general result, the debtor is thrown into a hopeless position and thus the threshold payment is unattainable.⁸ Secondly, since the proceeding does not freeze the rights of secured or preferential creditors, nor does it restrain the rights of retrieval, set-off, contract cancellation or lease forfeiture, the debtor loses the assets that are indispensable for its business rehabilitation, even though the procedure stays the execution of unsecured claims and other proceedings automatically. In Germany, for example, the judicial composition procedure (*Vergleich*) drafted from 1935 has high opening requirements, e.g. 35% payment within 1 year, or 40% within 18 months or over 40% if more than 18 months. On court order, execution proceedings are suspended provisionally. High voting majorities are required for the composition. Secured claims and set-off rights are not affected. This procedure has been excluded and replaced by a rehabilitation proceeding in the new German Bankruptcy Law enacted in 1994. Same thing happened in French by legislations in 1984-85.

2.4 Corporate rehabilitation proceedings (reorganisation)

The adoption of the fourth alternative embodies the feature of the globe-wide movement to reform of insolvency law, which started from US in 1978 and then prevailed in the industrialised countries, for example in Italy (1979), French (1985), Britain (1986), Singapore (1987), New Zealand (1989), Australia (1992), Canada (1992) and Germany (1994). All the adopted proceedings, mild or tough, are aimed to resuscitate debtor companies in difficulties. They impose freeze on the proceedings for creditors' claims, secured or unsecured, and therefore enable administrators or even debtors themselves to control the insolvent assets.

The rationale and philosophies of corporate rehabilitation (reorganisation) are being explored. The challenges of reorganising insolvent corporations are also worth to be concerned with.⁹ Up to now, the achievements of the reform have not been highly evaluated. In some countries, reportedly, the new regime has not been adopted yet because of secured creditors' successful resistance.¹⁰ In the meantime, some pioneer countries, for example US and UK, have engaged in review and improvement of their corporate rescue regimes. Some more positive designs are also under consideration. In French, for instance, a 1994 legislation has created a new workout regime, a proceeding of compromise or composition directed by a court-appointed intermediary, which is connected with a pre-information system for corporate finance, following the policy that prevention and curing in early stage is in preference to the treatments at advanced stage.

the restraint to any action or civil proceeding against the company can only be given by court upon application of the company or its member or director. See, also, Crutchfield, *ibid.*, pp. 3-4.

⁷ See, Wood, *ibid.*

⁸ This is the case, for example, in Austria, Brazil, Denmark, Italy, Norway and Sweden. The thresholds vary from 25% to 40% for immediate payment. It far exceeds the normal dividends on a liquidation, which range from zero to 20% in usual cases. See, Wood, *ibid.*

⁹ Some theses on these topics can be seen in Ziegel, J.S., *Current Development in International and Comparative Corporate Insolvency Law*, 1994.

¹⁰ See, Ziegel, *ibid.*, p.xxii.

Indeed, the problem of enterprises in financial difficulties is one of the most persistent ailment in the industrialised modern economy. All the alternatives for corporate rescue are different prescriptions and none of them is a panacea. It is an axiom that a good doctor shall always suit the remedy to the case. So what we need to do with the present alternative is around the questions like how and why the remedy works and to what kind of cases it suits. Moreover, we shall seek answer for the question how to improve the existing remedy and even find out some more effective remedies.

3. China's Attempts for Corporate Rescue

3.1 Failure of the joint proceedings set in 1986

In the decades before the economic reform that emerged and developed in 1980s, China did not worry about the problem of "corporate rescue". Under the regime of planned economy, enterprises were nothing but dependent units of a centralised economic machine. The transactions for fund and material supply between different units were not really regulated on the basis of debtor-creditor relationship but by the execution of state plan. When one of them was unable to pay, the government might decide to delay or even discharge the debts. For the creditors, this did not mean a misfortune; they could just report the delay or bad debts and manage to reduce the amount that must be turned over to the state. It seems that such a regime is a paradise for enterprises as well as their employees. In a sense it may be. From a long-term point of view, however, it is untrue. Under such a regime the enterprises slept too well to stir up themselves in vigorous operation, and the economic efficiency was too low to improve people's living standards.

Since China turned to the policy of economic reform and opening to the outside world, it has been long a common notion that enterprises must become independent business entities, or in legal terms, "juristic persons". That means all the profits and losses belong to the enterprises themselves. They are not on duty to turn over profits to the state except taxation. They cannot shift their losses and business risks to the state either. Therefore they must take their debts and obligatory rights seriously. In such circumstances it is not strange that law suits and other sorts of effort for debt collection have always been numerous since 1980s.

China promulgated its first insolvency legislation, Enterprise Bankruptcy Law, in 1986. As its original guideline, the Law mainly purports to impel enterprises to improve their management and operation, not expecting to see many enterprises going bankrupt. That is the reason the Law adopts a composition proceeding. What seems unique is that the Law joins a government-handled renovation proceeding with the composition proceeding. The joint proceedings are stipulated as the following:

- Commencement of the joint proceedings relies on three conditions: (1) the case is one petitioned by creditor(s) rather than the debtor; (2) the government agency authorised to master the debtor enterprise ("the authorised agency") 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 authorised 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.

-- If the enterprise does not perform the composition agreement, or its financial situation has worsened, or it commits fraudulent conduct, during the renovation period, or it is unable to perform the composition agreement at the expiration of the renovation period, 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 authorised 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 authorised 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 authorised agency for its misfeasance or blamable failure in the process.

One more reason worthy to be mentioned is that the number of the creditor-petitioned cases is very low and the joint proceedings are not available to the majority, the voluntary cases. Why? According the Law, a debtor enterprise cannot petition bankruptcy case unless it is approved by the authorised agency. It can be assumed that an authorised agency is not willing to rescue its subordinate under the circumstances of having decided to let it petition for bankruptcy.

It is quite understandable that the joint proceedings reflected the common notion at the ear of "planned economy", that is, the economic regulation should not be workable without the dominant role of the government. We could put the failure of the joint proceedings on the historical limitation. At the time when the Law was drafted, China was in the early stage of the transition, which was characterised by the strong influence of the government upon the economic regulation. As the economic reform going further, however, the old notion and the old regulation model became out-of-dated. It seems decreed by fate that the too much government oriented regime such as what we reviewed above would go sink into a decline at last.

3.2 New efforts in legislation since 1995

The reorganisation proceeding had not been considered until the first version of the Draft Bankruptcy law of PRC was completed. In this version there is just a single traditional composition proceeding, to which no government-involving renovation adjoined.

In March 1995, when the first draft is discussed in a symposium held in Chengdu, the US Chapter 11 was introduced by a member of the drafting team and looked into by the participants. It was the consensus by the majority that adoption of a modern mechanism for enterprise rescue might be considerable.

After a couple of months, the drafting team worked out a new chapter for on reorganisation proceeding, adding some relevant provisions (mainly concerning automatic stay) in the other chapters. The new draft was discussed on many occasions. The comments and suggestions contributed by numerous jurists, judges and government officials, as well as some foreign experts, were integrated in the third version of the Draft Bankruptcy Law. In this version, as may be seen, there is an improved proceeding of reorganisation, a simplified proceeding of composition, and a proceeding of bankruptcy liquidation that is far more detailed than the existing legislation.

- The sketch of the reorganisation proceeding may be described as the following:
- Application for insolvency case may be accepted by court if the debtor company meets the requirements stipulated by law. Reorganisation proceeding could be applied for simultaneously, or later on but before bankruptcy adjudication issued.
 - When the case is accepted an administrator is appointed by the court, who 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, unsecured or secured, are frozen, except filing them at the court.
 - In a specified period administrator is authorised to control the property and business operation of the company. Some protective provisions for the business keeping are granted by law.
 - Administrator drafts a reorganisation plan and hands it over to the creditors' meeting. The meeting votes the plan in different groups. When the plan is passed, or even failed but anyhow meets the requirements provided by law, it is submitted to the court for confirmation.
 - When court confirms the plan the assets and affairs are shifted to reorganisation executor. If not confirmed, the case takes its exit, transferring to bankruptcy liquidation or coming to closure.
 - Upon the execution of reorganisation plan is completed the case is closed, or otherwise it 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, we realise that a traditional composition proceeding is too simple and too mild to meet needs of corporate rehabilitation.

Further academic researches have strengthened our resolution to adopt 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 is accepted by both jurists and economists. 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 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 is also considerable. Both a debtor and its creditors will be sacrificed if the debtor goes bankrupt, or otherwise both be benefited from the rehabilitation of the debtor. So far as the creditors are concerned, to rescue the debtor is in the meantime to save themselves. If they can get more repayment from corporate rescue of the debtor than the dividends on a liquidation, do they have any reason to refuse it?

In the third place, theory of social interests is convincing too, especially to Chinese people. Those being impaired by corporate bankruptcy include not only the creditors, but also many other groups, e.g. employees, obligees to the debtor's creditors, the community of where the debtor is, the national and local revenues. Is it justifiable to give up the effort of corporate rescue by yielding to the preference of some creditors, for instance the chargees, and ignoring the detriment suffered by the other people and the society?

The object of the draft reorganisation proceeding is to rescue enterprises in difficulties while fairly clearing their debts, 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 favourable to interest of creditors to keep the business of a reorganising 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.”

3.3 Steps under governmental manipulation since 1996

Since later 1995, while the Draft waiting for the higher decision, practice of rescuing enterprises in difficulties under governmental manipulation has been keeping in ascendant. The state-owned enterprises (SOEs) are owned by central or local governments; they could not wait so patiently as the Draft did. In 1996, “the year of merger”, as code-named by an official at the State Committee of Economy and Trade (SCET), a number of mergers in state industry were recorded as achievements of the manipulators. The scheme of these out-of-court arrangements is no more than having a profit-making SOE to merger one or several insolvent SOEs. It is however that the profit-makers are few and their appetite is limited, and thus, reportedly, many of the swallows felt indigestive. As a result, more and more distressing SOEs could not be merged though the authorities wanted so. The tide of merger did not last longer than the same year. In the meantime, bankruptcy liquidation was involved in the process of merger, that is to say, having the merged go bankrupt first and then be taken over in the lowest price with their debts wholly discharged. This practice was angrily condemned as “false bankruptcy, real debt-escape” by banks, the largest creditors to SOEs.¹¹

In 1987, “the year of reconstruction”, as described by the above-mentioned SCET official, the government turned to adopt another practice. It is supposed to be some kind of workout under the governmental interference, sometimes using the means of merger. However, since the banks are reluctant to yield to their debtors by reason that they cannot afford so much bad debts, the successful cases of government-manipulated reconstruction have been still rare so far.

Legally speaking, government cannot compel creditors to give up their claims, nor is it able to require court to deny or cease the proceedings for creditors’ claims. In practice, however, such things have been often done by interfering with the courts’ judicial independence. It is really abnormal and undermining the goal of rule-of-law

¹¹ The condemnations may be seen in the “*Quan-guo Jin-rong Zhai-quan Guan-li Hang-zhang Lian-xi Hui-yi Ji-yao* [Summary of the National Joint Meeting of Chief Banking Managers Dealing with Financial Claims]” (18 November 1996), issued by the People’s Bank as official document No. 413 [1996].

society. People have reason for the expectation that the policy of corporate rescue should turn to more rely on legislation and legal professions in the future.

4. Rules and Policies in Reorganisation Proceedings

4.1 Commencement of proceeding

4.1.1 Ease of entry

In Chapter 5 of the Draft Bankruptcy Law (DBL) of China, Article 88 provides:

The Chapter applies to enterprise legal persons with the state described in Article 4 of the Law and however the possibility of rehabilitation.

In Part 5.3A of the Australian Corporations Law (ACL), Section 435A reads:

The object of this Part is to provide for the business, property and affairs of an insolvent company to be administered in a way that:

(a) maximises the chances of the company, or as much as possible of its business, continuing in existence; or

(b) if it is possible for the company or its business to continue in existence - results in a better return for the company's creditors and members than would result from an immediate winding up of the company.

Here two factors, eligible debtors and grounds for petition, need to be considered.

Eligible debtors. The Chinese reorganisation proceeding applies to only enterprise legal persons,¹² i.e. corporations or other enterprises registered as legal persons. This is similar to the Australian proceeding of corporate voluntary administration which applies to merely companies.

These designs seem quite careful. In some other countries, legislatures are much bolder. For example, the US Chapter 11 applies to most business enterprises, corporate or unincorporate, and individuals, and the French *redressement judiciaire* applies to individual merchants, craftsmen and farmers, and all legal entities subject to private law.

Grounds for application. Chapter 5 procedure is applicable when two grounds is settled: first, the state that the enterprise is unable or likely to be unable to pay due debts,¹³ and second, it has possibility of rehabilitation.

Comparatively, Part 5.3A procedure simply indicates that the company is “insolvent”, i.e. “it is unable to pay its debts as they due from its own resources.”¹⁴ However, it does not mean that the door is merely open to those who have already become insolvent. “It should be noted that the administration procedure is open to companies which are not insolvent at the time the resolution is passed. The directors merely have to be satisfied that there is a likelihood that the company will become insolvent at some future time.

¹² Art.88 of DBL. According to art.3 of DBL, the Law applies to (1) enterprise legal persons; (2) partnership enterprises, with their partners involved; (3) sole proprietorships, with their investors involved; (4) other economic organisations established in accordance with the law. It can be seen that the reorganisation proceeding has a much narrower scope of application than those of composition and bankruptcy liquidation.

¹³ Art.4 of DBL 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 procedure of reorganisation provided in the Law is applicable to enterprise legal persons that are going to be unable to pay due debts owing to difficulties in business and finance.

¹⁴ Donovan, J.O., *Corporate Insolvency: Policies, Perspectives and Reform*, 3 Corporate and Business Law Journal 1, (1990), p.14.

This should be a case, for example, where the company faces the prospect of a large damages award if legal action taken against the company is successful.”¹⁵

Possibility of rehabilitation is a question regarded but not taken as a requirement by Australian legislature. It is explained in the Explanatory Memorandum to the 1992 Corporate Law Reform Act (para. 450) that “... section 435A will also recognise that, no matter how efficiently the new administration procedure operates, there will be cases where it is not possible to save a company or its business. In this situation, the object of the new provisions will be to provide for a fair and efficient winding up, and in particular one that results in a better return for the company’s creditors and members than would result from an immediate winding up of the company.” This may be a better choice, because the possibility of rehabilitation is usually unclear when people stand at the entrance. This is a fact that shall be determined after the commencement. It seems a good idea to leave the door wider and keep an exit for those that proves impossible to be saved after they come in.

If a company is obviously hopeless to rehabilitate at the time of commencement, does it have the grounds for application? The answer is negative in China,¹⁶ but positive in Australia. There is an Australian case in which the judicial decision supports the view that it is not an abuse of Part 5.3A to put a company into administration when it is clear that the company cannot be saved from liquidation.¹⁷

Is it required to prove the grounds when applying the proceeding? In China, Article 90 of DBL provides: “Reorganisation petition shall be submitted together with relevant evidence when reorganisation is applied.” Although the term “relevant evidence” needs to be further defined, the aim of this Article is clear - to prevent the proceeding from being abused. In Part 5.3A, there is no such provisions. In January 1997, the Companies and Securities Advisory Committee proposes in its Voluntary Discussion Paper of (“CASAC Paper”) that the directors should provide to creditors a statement of how they seek to achieve the objective of Part 5.3A through the appointment of an administration. This proposal makes some sense, though not every sense, to cope with the problem of Part 5.3A being “abused”.¹⁸

4.1.2 Starting gate for commencement

It is a common case in majority of the countries that the starting gate of reorganisation proceeding is controlled by court - its commencement embodies a procedure of petition and acceptance. Of course the parties who are allowed to file a petition are different from country to country. In China, according to Article 89 of DBL, (1) a debtor, or (2) a creditor or a group of creditors, or (3) an investor or a group of investors holding not less than one-third of the total sum of the debtor's registered capital, may apply to courts for reorganisation, initially or during the period after the insolvency case is accepted and prior to the bankruptcy adjudication. In France, however, investors (shareholders) are not supposed to petition reorganisation proceeding.

¹⁵ See, Crutchfield, P., *Corporate Voluntary Administration Law*, 2d Ed., 1997, p. 5.

¹⁶ Art.91 of DBL provides: “If the people's court, after review, deems that an application for reorganisation meets the provisions of the Law, it shall make a decision for opening of reorganisation proceeding.” Here the term “provisions” shall include the requirement of “possibility of rehabilitation” stipulated in Art.88.

¹⁷ *Dallinger v. Halcha Holdings* (1996) 14 ACLC 263. In this case, it was held that Section 435A does not require Part 5.3A to be so limited. Sundberg J said: “The machinery provided by the Part should be available in a case where, although it is not possible for the company to continue in existence, an administration is likely to result in a better return for creditors than would be the case with an immediate winding-up.”

¹⁸ For some doubts on this proposal, see, Crutchfield, *ibid.*, pp.62-63.

In Australia, things are quite different. There is no starting gate handled in the hands of court. The procedure of voluntary administration begins when one of the circumstances happens: (1) administrator is appointed by board of creditors of the company, or (2) administrator is appointed by liquidator or provisional liquidator, or (3) administrator is appointed by chargee who is entitled to enforce a charge on the whole, or substantially the whole, of the company's property.¹⁹ What is required here is just the appointment in writing; no court approval is necessary. In practice, as reported, the vast of the administrations (98 per cent) are initiated by the directors.²⁰

4.1.3 Debtor incentives to commence proceedings

In Britain the personal liability for wrongful trading cannot be invoked if they file for an administration, so that this is an incentive to directors to file.²¹ In Napoleonic countries, the incentive is from the other side. For example, in French the debtor is obliged to file within 15 days of the cessation of payment.²² Such provisions do not appear in both Chinese and Australian procedures, nor in those of US and Canada. According to Australian experience, if the internal incentives of directors are sufficient to push them ahead, externally imposed incentives may be unnecessary.

4.2 Automatic stay

4.2.1 Length of the period of freeze

The period of freeze is a matter of time legally specified to prevent creditors from taking actions or proceedings against the company or its property during the administration. In China, it is called "period of reorganisation observation," as stipulated in Article 92 of DBL:

A period of reorganisation observation refers to that from the opening of reorganisation proceeding decided by the people's court and the end with confirmation of reorganisation plan or the close of reorganisation procedure by the court.

The period of reorganisation observation shall not exceed 12 months. If the period needs to be extended, the administrator may apply to the people's court for extension, with a statement on the supposed length of extended period and the reason. The people's court may, after review, make a decision to approve the extension application along with a time schedule for the proceeding.

In Australia, such a period is called "moratorium." Its length is up to 60 days - very short comparatively.

The advantage of a shorter period is the less cost. The disadvantage is the less opportunity for rehabilitation. It seems more favourable for creditors. In China, the policy turns to saving enterprises as far as possible. However, the period of freeze in DBL is certain and limited, unlike US Chapter 11 which has no time limit, and the extension is subject to some statutory conditions and court's discretion, unlike French 1985 Law in which a one-year extension is available whenever requested.

4.2.2 Stay on legal proceedings

In DBL, the automatic stay of civil proceedings is stipulated in the following articles.

¹⁹ s. 436A, 436B and 436C of ACL.

²⁰ See, Coad, S., *The Australian Society of CPA's Survey of the First Year of Voluntary Administration*, pp.49-72; Tomasic & Whitford, p.168.

²¹ Insolvency Act 1986, ss 214 and 215.

²² French Law No. 85-98, art.3(2).

First, in Article 19, it is provided that after the acceptance of insolvency case, all other civil execution procedures related to the debtor's property shall be suspended. In the meantime, all other protective measures than provided by the Law over the debtor's property shall be stopped.

Second, according to Article 21, after the acceptance of insolvency case, any civil action on the debtor's property and property rights that has begun but not ended shall be suspended; the pending action is supposed to continue after administrator have taken over the control of the debtor's assets.

In Australia, Section 440D(1) of ACL seems to the almost the same effects, as provided that during the administration of a company, a proceeding in a court against the company or in relation to any of its property cannot be begun or proceeded with, except (a) with the administrator's written consent, or (b) with the leave of the Court and in accordance with such terms (if any) as the court imposes.

As explained, “[t]he purpose of the moratorium which commences when an administrator is appointed will be to protect the corporation from all civil actions, so that the administrator can formulate a rational plan for future action.”²³ Same idea is shared by China and many other countries.

4.2.3 *Impact on security*

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).²⁴

When designing Chapter5 proceeding, the draft team made a favourable 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.

In Article 20 it reads: “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 fulfilment of reorganisation plan.²⁵

The problem of perishable assets is concerned with by the drafters. In Article 95 (1) it reads: “In the period of reorganisation observation, 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 pledges or lienors may auction off or sell them and have the prices obtained thereby to be lodged.”

Administrator is not empowered to dispose security unless the secured is protected adequately. Article 95(2) provides: “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.”

It may be properly alleged that we can classify the Chinese design into the second group as above-mentioned.

²³ The *Explanatory Memorandum to the 1992 Corporate Law Reform Act*, para. 521.

²⁴ See, Wood, *ibid.*, p.189.

²⁵ If the insolvency case goes into the proceeding of composition or bankruptcy liquidation, the secured claims are unfrozen automatically as soon as the proceeding is commenced.

In Australia, Part 5.3A of ACL provides the basic rule of automatic stay in Section 440B: “During the administration of a company, a person cannot enforce a charge on property of the company, except: (a) with the administrator’s written consent; or (b) with the leave of the Court.”

It is noticeable that a ledge or lien is not subsumed within the scope of “charge” as defined in Section 9 of ACL,²⁶ and therefor not stayed by Part 5.3A procedure. This is different from the provisions adopted in China, and from some other countries (e.g. US, UK and France), by which pledgees and lien holders do not have any better position than chargees.²⁷

Another unique provision in ACL is that the proceeding does not stay the universal floating charge. It is stipulated in Section 441A that creditors who hold a charge or charges on “the whole, or substantially the whole, of the property of a company” are not bound by moratorium if the charge or charges are enforced in respect of all of the secured property, either before the commencement of the administration, or alternatively, within 10 business days of being notified of the administrator’s appointment (so-called “decision period”).

Favourable treatments can also be seen in Sections 441B and 441C. According to the former, the general freeze will not be apply to charge holders who have already sought to enforce their charge before the administration commenced. The forms of such enforcement include (a) entering into possession, or assumed control, the property, (b) entering into an agreement to sell the property, (c) making arrangements for the property to be offered for sale by public auction, (d) publicly inviting tenders for the purchase of the property, or (e) exercising any other power in relation to the property.²⁸ In China, secured creditors do not have such preferential exception; all the property under the title of the debtor should be taken over by administrator when the case is accepted by the court, that is to say, all the incompleated enforcement, either by court or not by court, shall be stopped.

According to the latter, Section 441C, a charge holder holding a charge over perishable property is not affected by the general freeze and may take possession, or otherwise recovering, such property at any time during the administration. These powers are however subject to the restraint by court’s order, *ex officio* or on the request of the administrator, as provided in Section 441D.

Administrator must not dispose of property of the company that is subject to a charge except: (a) in the ordinary course of the company’s business; or (b) with the written consent of the chargee; or (c) with the leave of the Court, if it is satisfied that arrangements have been made to protect adequately the interests of the chargee, as stipulated in Section 442C.

4.2.4 Impact on title finance

In a developed economy, title finance covers various forms of vendor, or lessor finance, such as sale and repurchase, retention of title, financial leasing, sale and lease-back and

²⁶ s. 9 of ACL: “ ‘charge’ means a charge created in any way and includes a mortgage and an agreement to give or execute a charge or mortgage, whether on demand or otherwise.”

²⁷ Crutchfield alleges: “The holder of a pledge or lien should not be entitled to enforce the pledge or a lien without the consent of the administrator or the leave of the court.” (*Ibid.*, p.107) The CASAC Paper proposed that the legislation be amended to bring pledges and liens within the moratorium.

²⁸ However, it is pointed out by Townley, A. & Pratt, D., *A Practical Guide to Insolvency*, 1995, p164, that “[a]lthough a charge holder may have taken certain steps to enforce its charge prior to the administration, this does not guarantee the charge holder will be able to take advantage of this exception. An administrator may apply to the court to have the secured creditor’s rights restricted by seeking an order that the chargeholder not continue the enforcement process: s 441D(2).”

hire purchase. It also covers ordinary land leases and true equipment lease.²⁹ In China, the forms of title finance are developing, although not as many as in developed countries at present. The Draft seeks to keep a balance between encouraging title finance and encouraging corporate rescue. In Article 98 it provides: “As to the property possessed by the debtor with lawful basis, a request of the obligee to retrieve it in the period of reorganisation observation in violation of the agreed terms may be refused by the administrator.” This rule just freezes the requests for retrieve property ahead of schedule. That means all the effects of the commencement of the proceeding affecting the execution of the original contract may not be deemed to justify the alleged breach of contract and the demand of retrieval. On the other hand, the contracts should be normally fulfilled; nobody can breach the agreed terms by virtue of utilising reorganisation procedure. It seems the position of title finance is better than that of security.

In Part 5.3A of ACL, title finance has almost the same position as security. In Section 440C it reads: “During the administration of a company, the owner or lessor of property that is used or occupied by, or is in the possession of, the company cannot take possession of the property or otherwise recover it, except: (a) with the administrator’s written consent; or (b) with the leave of the Court.”

Where the property is “perishable”, the owner or lessor is free to recover that property at any time notwithstanding the moratorium, subject to the administrator’s right to make application to the court to prevent recovery under Section 441H.

The restraint on administrator’s disposal and the exceptions set in Section 442C are applicable not only to a charge, but also to property of which someone else is the owner or lessor. In practice, the exception (a), “in the ordinary course of the company’s business”, is often utilised by administrator in order to raise fund for the corporate rehabilitation. The wording in the exception has been disputed and the judicial opinions appear divergent.³⁰

4.2.5 *Impact on insolvency set-off*

In most developed countries, insolvency set-off is allowed but in an important group of countries it is not. The object of preventing set-off on a rehabilitation is to preserve the cash available to the business. On the contrary, there are some reasons for allowance of set-off: first, the denial of set-off leads to the result that the debtor takes but does not pay, and second, the availability of set-off as “security” against insolvency should be predictable.

In China, the DBL adopts a medium scheme - it allows ordinary set-off rather than insolvency set-off. The latter is adopted in the liquidation proceeding, as Article 148 provides: “If a creditor is indebted to the bankrupt before bankruptcy adjudication, whether or not the obligations are same in nature, it may assert a set-off to liquidators before the promulgation of distribution scheme.”

In Chapter 5, however, Article 99 restricts the set-off as the following:

In the period of reorganisation observation, the debts that are allowed to be set off between creditors in reorganisation and the debtor shall be limited to those that are same in nature and have become due at the time when the insolvency case is accepted by the people’s court.

A reorganisation claim obtained by an obligor to the debtor through assignment shall not be used in set-off.

²⁹ See, Wood, *ibid.*, p.198.

³⁰ See, e.g., Tomasic and Whitford, *ibid.*, pp.183-184.

No provision on set-off is found in Part 5.3A of the ACL. It is not mentioned in the Australian books discussing the Part 5.3A proceeding.

4.2.6 *Impact on executory contracts*

In order to assist the continuance of the debtor's business, the Chapter 5 of DBL sets up an importance article on executory contracts, for example contracts for supplies of essential raw materials, licences to intellectual property, charters and equipment leases, or undertaking contracted projects. Here the wording "executory" means not only "waiting for performance in whole", but also "having be performed but not completed". The provisions are contained in Article 100 as the following:

In the period of reorganisation observation, an administrator has the right to decide revocation or continuance of performance of a bilateral contract established prior to the opening of reorganisation proceeding but then still executory, and inform the other party in writing. If the administrator fails to inform the other party within 3 months, or fails to respond within 1 month after he receives the urge of the other party, it will be regarded as cancellation of the contract. Claims for damages arising from the cancellation may be filed as obligatory claims.

As for a bilateral contract that has been established and begun to be executed at the time of opening the reorganisation proceeding, the other party shall not refuse to perform the contract, or terminate it ahead of schedule, by reason of the debtor's default prior to the opening of reorganisation proceeding, if the administrator decides to continue to perform it.

According to Chinese mode of understanding, any clause on contrary to the law provisions as the above-mentioned is null and void. Same effects can be seen in US Chapter 11, the French *redressement*, the Canadian commercial reorganisation, subject to various exceptions.

In Australia, although the right of preserving contracts is not specially granted to as administrator, contracts with a company under administration are not automatically terminated; they should be valid and enforceable as usual. Also, unlike a liquidator, an administrator does not have any statutory right to disclaim contracts. If an administrator chooses to repudiate a contract, the other party will be left with a claim which is an unsecured claim against the company for damages.³¹

4.3 Administrator

4.3.1 *Appointment*

In China, as the rule of DBL, administrator shall be appointed at the very beginning of the insolvency case is accepted by court, no matter whether reorganisation proceeding is commenced simultaneously. The provisions are shown in Article 30 as the following:

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, and report on their works to, the people's court.

The administrator shall be one person. When the debtor has different business operating places or property locations, the people's court may appoint several administrators to carry out affairs separately and independently. The operations of the administrators shall be subject to the monitoring by the creditors' meeting.

³¹ See, Keay, *ibid.*, p.208.

Administrator shall attend creditors' meetings, reporting the performance of his mission to the meeting and answering its questions.

In Australia, Part 5.3A of ACL provides three alternative ways for appointment of administrator.

First, under Section 436A, company may appoint administration if the board of directors thinks it is or will become insolvent, except the company is already being wound up.

Second, under Section 436B, liquidator of a company may appoint administration. It is annotated that such an appointment “would assist a liquidator in implementing a plan to dispose of the company’s business as a going concern.”³²

Third, under Section 436C, holder of a charge on the whole, or substantially the whole, of a company’s property may appoint administrator.

In any of the above circumstances, the written consent of the person to be appointed administrator must be obtained before the appointment is made, as stipulated in Section 448A.

4.3.2 *Qualification*

Provisions on qualification and disqualification of administration are set out in Chapter 2 of DBL. Their counterparts can be found in Division 14, Part 5.3A of ACL.

Article 31(1) of DBL stipulates that “[a]n administrator shall be the people with professional knowledge needed.” In practice such sort of people are supposed to be, generally, registered lawyers and chartered accountants. Similarly, according to Section 448B of ACL, a person must not to be an administrator unless he or she is a registered liquidator.

In addition to the general requirement stated above, both DBL and ACL provide some circumstances in which a person is unqualified to be an administrator. Article 31(2) of DBL reads:

Anyone who falls in the following categories shall not serve as an administrator:

- (1) Those once given criminal punishment, during the five year period since the day of the completion of the punishment;
- (2) The notaries during the five year period since the revoke of notary certifications because of law violation;
- (3) Registered accountants during the five year period since the revoke of registered accountants licenses because of professional ethics violations;
- (4) Lawyers during the five year period since the revoke of lawyer's licenses because of violations of professional ethics;
- (5) Anyone who has interests with the case;
- (6) Other people whom the people's court may consider not qualified for administrator.

The negative tests in Section 448C(1) of ACL are the following:

- (a) the person, or a body corporate in which the person is a substantial shareholder for the purpose of Part 6.7, is indebted in an amount exceeding \$5,000 to the company or to a body corporate related to the company; or
- (b) the person is, otherwise than in a capacity as administrator or liquidator of, or as administrator of a deed of company arrangement executed by, the company or a related body corporate, a creditor of the company or of a related corporate in an amount exceeding \$5,000; or

³² Crutchfield, *ibid.*, p.69.

- (c) the person is an officer of the company (other than because of being an administrator or liquidator of, of an administrator of a deed of company arrangement executed by, a body corporate related to the company; or
 - (d) the person is an officer of a body corporate that is a mortgagee of property of the company; or
 - (e) the person is an auditor of the company; or
 - (f) the person is a partner or employee of an auditor of the company; or
 - (g) the person is a partner, employer or employee of an officer of the company;
- or
- (h) the person is a partner or employee of an employee of an officer of the company.

The above 8 items in ACL provide a good example for China to detail the item (5) of Article 31(2), “anyone who has interests with the case”, in the future.

4.3.3 Functions and powers

The DBL sets out in Article 32 a great deal of functions and powers that administrator shall assume from the day of his appointment: (1) taking over the control of all the property, books, documents, files, seals and stamps and other objects of the debtor; (2) investigating the property conditions and civil activities of the debtor, with the information concerning wages and salaries owed to the labours, unpaid social insurance premiums and default taxes included; (3) making out a report on debtor's property situation; (4) determination of the day-to-day expenditure and other necessary spending of the debtor; (5) requisition for determining whether the debtor continues to operate; (6) management and disposal of property of the debtor; (7) accepting payment or delivery of property to the debtor by a third party; (8) determination of the internal management affairs of the debtor; (9) employment of management, professionals and other personnel as needed; (10) request for summoning creditors' meetings; (11) taking part on behalf of the debtor in proceedings or arbitration with regard to its property-related disputes; (12) other functions which the court deems necessary for the administrator to carry out.

In Part 5.3A of ACL administrator's functions and powers are generally provided in Section 437A, where it states that an 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 status of administrator is both the agent (s. 437B) and the officer (ss. 9 and 82A) of the company. Therefore he or she must be mindful that his or her actions or decisions should (a) maximise the chance of the company continuing its existence; or (b) if the company cannot continue, maximise the return to creditors and members as compared to an immediate winding up of the company.³³

Some more tasks or rights related to the above-mentioned functions are specially provided in separate sections. Three of them should be noticed here.

First, administrator has a duty, and meanwhile a power, to investigate the company's business, property, affairs and financial circumstances, as provided in Section 438A. The investigation is aimed to make clear (a) whether the company should enter a deed of arrangement; (b) whether the administration should be end; or (c) whether the company should be wound up.

³³ See, Townley, *ibid.*, p.157.

Second, administrator has rights to company's books, which are specially provided in Section 438C, including (a) retaining possession of company books; (b) to claim or enforce a lien on such books. Administrator may issue a notice demanding delivery of the books, and compliance with such a demand is compulsory.

Third, administrator has duty and power to convene and preside meeting of the company's creditors in accordance with the stipulated time limit and procedural rules, as Section 439A provides. It seems that the status of Australian administrator at creditors' meeting is much stronger than that of the Chinese counterpart.

4.3.4 Business operation

According provisions in DBL, administrator should become more powerful in controlling and operating the company's business and property when the insolvency case steps into reorganisation proceeding. It is provided in Article 93(1) that "[i]n the period of reorganisation observation, the administrator shall assume the functions provided in Article 32 of the Law. Administrator may however determine independently the continuance of the debtor's part or entire business." In the meantime, the limitations binding administrator's conduct set out in Article 64 are all removed in accordance with Article 19(2).³⁴

To strengthen administrator's power in business operation, DBL adds a power of personnel control in Article 94(1) and (2): "In the period of reorganisation observation, the administrator is entitled to appoint the debtor's existing management or other personnel, or some outsiders, with the mission of carrying out the business operation of the enterprise." "The persons appointed in accordance with the preceding paragraph shall ask for the administrator's consent when performing any of the actions listed in Article 64 of the Law."

Besides, three more articles are provided to assist the business operation of the reorganising enterprise.³⁵

³⁴ Art.64 of DBL reads:

Supervisors' consent is required for the following actions performed by administrator:

- (1) Transfer of the ownership of real property;
- (2) Transfer of the such property as mining right, right to use land, patent right, copyright and right to exclusive use of trademark;
- (3) Assignment of the stock of goods or the business;
- (4) Lending money;
- (5) Pledging property as security;
- (6) Transfer of movables worth more than 1,000 RMB yuan for the purpose of continuance of the debtor's business operation;
- (7) Transfer of claims and securities portfolios;
- (8) Request for performance of executory bilateral contracts;
- (9) Engaging in composition, arbitration, litigation or other legal proceedings related to the debtor's property;
- (10) Waiver of rights;
- (11) Letting a person with right of recovery retrieve his property;
- (12) Satisfying a creditor with right to separate satisfaction.

If the meeting has not appointed supervisors, the performance of the actions provided in the preceding paragraph shall solicit the approval of the creditors' meeting.

³⁵ The status of "debts of common benefit" mentioned in art.96(1) is shown in Art.50 of DBL as the following:

Administration expenses and debts of common benefit shall be paid off at any time by the debtor's assets.

If the debtor's assets are insufficient to pay off all administration expenses and debts of common benefit, administration expenses shall be paid off first.

If the debtor's assets are insufficient to pay off administration expenses or debts of common benefit, they shall be repaid on a pro rata basis.

Article 96 Debts arising for the purpose of continuance of the debtor's business operation in the period of reorganisation observation is regarded as debts of common benefit.

In the period of reorganisation observation, the debtor may guarantee the loans borrowed for its continuance of business operation with the property not subject to any security right.

The use of the loans mentioned in the preceding paragraph shall be specified and be subject to some necessary control and supervision.

Article 97 In order to help reorganising enterprise to be rehabilitated, the State Council and the local people's governments at provincial level may grant these enterprises' business activities tax reduction, tax exemption or interest discount in accordance with the provisions of relevant laws and statutes.

Article 101 For the continuance of business operation in the period of reorganisation observation, an administrator has the right to decide employment and unemployment of the available staff and workers in the reorganising enterprise during the period, and also to decide employment of personnel with some specialty from outside of the reorganising enterprise.

The provision in Article 96 is of special importance to business rehabilitation, because the availability of continuing finance is one of the decisive factors to corporate rescue. It is known that if the post-commencement contracts and financing have priority over pre-existing unsecured creditors, and 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. Therefore we understand that Australia and many other countries have not grant priority to post-commencement creditors even though some pioneer countries, e.g. US, UK and French have done so.³⁶

In order to diminish the unsecured creditors' possible losses as a result of excessive expansion of the post-commencement debts, China's DBL provides some measures to restrict it. First, the use of the loans shall be specified and subject to control and supervision (art. 96(3)). 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 (art. 103). 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 (art. 104(1)).

In Australia, anyhow, some efforts are made in Part 5.3A to give strength to administrator's role in business operation.

In Section 437D it is made clear particularly that "only administrator can deal with company's property", and therefore any transaction is void unless (a) the administrator entered into it on the company's behalf; or (b) the administrator consented to it in writing before it was entered into; or (c) it was entered into under an order of the court.

Additional powers of administrator are provided in Section 442A, including: (a) remove from office a director of the company; (b) appoint a person as such a director, whether to fill a vacancy or not; (c) execute a document, bring or defend proceedings, or do anything else, in the company's name and on its behalf; (d) whatever else is

If the debtor's assets are insufficient to pay off administration expenses or debts of common benefit, the administrator or bankruptcy liquidators shall submit a request to the people's court for a decision to close the insolvency case. The people's court shall make a decision on close of the insolvency case within 10 days after it has received the request for such a decision by the administrator or bankruptcy liquidators.

³⁶ See, US Bankruptcy Code, ss 503(b)(1), 364; UK Insolvency Act 1986, s. 19; French Law No. 85-98, art.40.

necessary for the purpose of this Part. The last item implies that the administrator is allowed a wide discretion in the exercise of these powers.

Section 442B provides that administrator may deal with any of the property subject to a floating charge that has crystallised. Further, as mentioned, administrator is allowed to dispose of encumbered property “in the ordinary course of the company’s business”, as Section 442C(2)(a) provides.

Besides, Section 442F entitles a person dealing with an administrator to assume that the administrator is acting within his or her function and powers as administrator and, in particular, is complying with the law. This should be conducive to the business continuance of a company under administration.

4.3.5 Liability and Indemnification for administration debts

The question arises as to whether administrators are subject to the normal rule applicable to corporate managers or agents, or otherwise have some dispensation.

In China, DBL adopts some comfort to administrator, considering that the risk of business failure in an insolvent company is much higher than ordinary enterprises. In Article 34(3), it is provided that “[a]n administrator is liable for the losses resulted in by his or her intention or gross negligence in performance of his or her functions; if there are several administrators, they shall bear joint liability.” This comes to the effect that an administrator shall not be liable for failure to pay extraordinary diligence in carrying out administrative affairs, or otherwise many professionals will shrink back from insolvency administration at the sight of the heavy burden and high risks. On the other hand it is expectable that some professional standards of conduct and skill for insolvency practitioners will be laid down in the future. In Australia, administrator has general fiduciary duties as a corporate officer, and therefore, the relative liabilities commensurate with those of a director.

There is something special in Australia. Sections 443A, 443B and 443BA of ACL set out that an administrator is personally liable for debts incurred when acting on behalf of the company. This rule is intended to encourage third parties to deal with the company during the administration, while the company’s affairs are reviewed.³⁷ On the other hand, according Section 443D, the administrator is entitled to be indemnified out of the company’s property in relation to such debts. This right of indemnity has priority over other debts, including unsecured debts and those secured by a floating charge on property of the company (s. 443E) and a lien on the company’s property (s. 443F). It seems this is not of enough encouragement to administrator, especially in case the assets of the company appear quite limited.³⁸

4.3.6 Removal, replacement and remuneration

It is no doubt that provisions on removal and replacement of administration is necessary for urging him or her to work diligently and safeguarding interests of the company and its creditors. In China, Article 35(2) of DBL reads: “The people’s court may dismiss and replace an administrator, either on request of interested persons or ex officio, in case he is not competent, or neglects his duty, or has other illegal acts.”

³⁷ For annotation of Section 443A, see Crutchfield, *ibid*, p.149.

³⁸ As O’Donovan notes, if the company is insolvent a registered liquidator might be reluctant to accept an appointment because of the liability which may fall on him or her. (Voluntary Corporation and Deed of Company Arrangement Under Part 5.3A of the corporations Law (1994), 12 Company & Securities Law Journal 75, 92.)

In Australia, court and the meeting of creditors have the power to remove and replace administrator (s. 449B), although they are not empowered to appoint administrator.³⁹ The one who has appointed an administrator cannot revoke the appointment.⁴⁰ The purpose of such a rule is to safeguard the independence of the administrator. In judicial practice, the reasons for removal and replacement are suggested to be, first, “that the administration would be better conducted if the administrator were replaced by another person”, or second, “that the administrator lacked impartiality.”⁴¹

As to remuneration of the administrator, it is stipulated in Article 34(1) and (2) that the amount of remuneration for an administrator shall be determined by the people's court, and paid from the debtor's assets. There is some difference in Australia. The administrator's remuneration may be fixed by the company's creditors at the first meeting or the meeting to consider the administrator's proposal for the company's future. If no remuneration is fixed by the creditors, the administrator may apply to the court for determination.

4.4 Creditors

4.4.1 Status in general

Unlike bankruptcy liquidation, which decides the fate of the company and therefore, viewed from the creditors' side, the distribution of the assets among them, reorganisation proceeding is focused on the rehabilitation of the company as a live going concern. When establishing this proceeding, people do not take the insolvent company as merely a group of assets subject to creditors' claims, and therefore do not regard them as the dominator over the insolvent company.

As designed in both Chinese Chapter 5 and Australian Part 5.3A, an insolvent company is controlled and operated by an independent and neutral administrator, and execution of any of the claims is stayed. The main right of the creditors is to discuss and vote the reorganisation plan. Besides, individual creditors are welcome to contribute suggestions to the formulation of reorganisation plan. If we view the reorganisation proceeding as a process of negotiation, the collective of creditors is one of the parties. Besides, as generally recognised, creditors have right to monitor administrator's conduct, on the line of avoiding abuse or misuse of the administrative powers.

4.4.2 Representative of creditors

In principle, creditors shall exercise their rights collectively, “as one man” and there should be some form of representative for them. For example, in US Chapter 11 there is a committee of creditors, that is in parallel with a committee of shareholders. In French *redressement* there is just several individual representatives of creditors, no committee nor meeting of them.

In China, Chapter 5 of DBL sets out a meeting of creditors with the function of discussing and voting the plan, and a supervisor empowered to monitor the execution of plan on behalf of the creditors.⁴²

In Australia, Part 5.3A of ACL requires to convene meeting of creditors twice. The first meeting is to determine whether or not to appoint a committee of creditors, and if so, who are to be the members (s. 436E). The second meeting is to be held to decide the company's future, namely, that the company execute a deed of company arrangement,

³⁹ ss 449B, 436E(4) of ACL.

⁴⁰ As provided in s. 449A of ACL.

⁴¹ See, Tomasic & Whitford, *ibid.*, p.198.

⁴² Art.113-115 (meeting) and art.63 (supervisor)

or that the administration should end, or that the company be wound up (s. 439C). This meeting may be adjourned from time to time, up to 60 days after the first day on which the meeting was held (s. 439B).

The functions of a committee of creditors, if it is appointed, (a) to consult with the administrator about matters relating to the administration, and (b) to receive and consider reports by the administrator. It cannot give directions to the administrator. (s. 436F).

4.4.3 Voting rights

In China, according to Chapter 5 of DBL, the creditors' meeting shall vote in separate voting groups, namely (1) Claims secured with property, (2) Labor claims, (3) Tax claims, and (4) Ordinary claims, for the passage of a draft reorganisation plan.

In Australia, the voting formula, stipulated elsewhere but applicable to Part 5.3A proceeding, is comparatively flexible. A resolution of the meeting may be carried on the voices. When a poll is demanded, the resolution is passed if a simple majority of the voting creditors vote in favour of the resolution and the value of the debts owed to those voting in favour is more than half the total debts owed to all the voting creditors. If no result is reached, the administrator may exercise a casting vote.⁴³

4.5 Internal parties

4.5.1 Shareholders, directors and management

With the same reason as stated in 4.4.1 hereinabove, the rights and powers of shareholders, directors and management of a reorganising company should be overridden by those of administrator in the context of controlling and operating property, business and affairs of the company. As Professor Key points out: "Obviously this is necessary if the legislature is going to clothe an administrator with power to control the company--otherwise his or her decisions could be undermined by the officers."⁴⁴

On the other hand, the role of the internal members in the corporate rehabilitation should not be ignored. Normally, their incentive in corporate rescue is much higher than that of creditors. It should be noticed that the financial capacity of the shareholders and the contribution of skill and cooperation in business continuance by the directors and management are all valuable factors.

The provisions related to shareholders, directors and management in the circumstances of reorganisation may be found in DBL as the following.⁴⁵

(1) Petition by shareholders. In case a company has become, or is likely to be, insolvent, one or several shareholders holding not less than one-third of the total sum of the company's registered capital may apply to the court for reorganisation.

(2) Participation in business operation. In the period of reorganisation, the management or other personnel of the company may be appointed by administrator to carry out the business operation.

(3) Participation in formation of plan. When drafting reorganisation plan, the administrator shall listen to the creditors, shareholders and representatives of staff and workers. Shareholders may attend the creditors' meeting and discuss the draft reorganisation plan.

⁴³ Corporations Regulations, s. 5.6.11(2), 5.6.12 - 5.6.36A, ss 600A and 600E of ACL.

⁴⁴ Keay, *ibid.*, p.208.

⁴⁵ The corresponding articles in DBL for those items are: (1) art.98; (2) art.94; (3) art.105, 114; (4) art.123; (5) art.102; (6) art.102; (7) art.29.

(4) Participation in execution of plan. Directors and management may make some resolutions in execution of the plan, subject to the reorganisation executor's veto power and supervision.

(5) Claims frozen. When reorganisation proceeding commenced, shareholders shall not come up with any claims to the company on the basis of the rights of investors.

(6) Share transfer frozen. In the same period, directors, managers or other high-ranking personnel of the company shall not transfer their individual shares to third parties.

(7) Unpaid capital. After the acceptance of insolvency case by court, a shareholder who has not honoured the obligation to inject capital shall pay up the subscribed capital on request of administrator, regardless of the original deadline for the payment.

The provisions on shareholders, directors and other officers in the circumstances of Part 5.3A administration are mainly the following.

(a) Appointment of administration. The board of directors of a company is entitled to appoint administrator, as mentioned in 4.3.1 hereinabove.

(b) Position and actions frozen. As the Explanatory Memorandum issued by the Parliament indicated, Section 437A(1) "will ensure that the position of shareholders is frozen during the administration, in the same way as actions by creditors are to be prevented during that period".⁴⁶ Same idea is shared by China and many other countries, but except US, which adopt the concept of "debtor in possession" allowing officers of debt company to control the assets and affairs.

(c) Share transfer frozen. "A transfer of shares in a company, or an alteration in the status of members of a company, that is made during the administration of the company is void except so far as the Court otherwise orders."⁴⁷ The reason of this provision is, as annotated, to freeze the position of shareholders, even though sometimes a transfer of shares is necessary or desirable during the administration.⁴⁸ Differently, China's DBL does not impose such freeze on ordinary shareholders, but only upon high-ranking persons, purporting to link up their interests with the corporate rescue closely and prevent them from decamp.

(d) Duty of help administrator. According Section 438B, first, at the time that the administration begins, each director of the company must deliver to the administrator all books in his or her possession that related to the company, and a statement about the company's business, property, affairs and financial situations. Second, during the period of administration, a director of the company must attend on the administration and give the administrator information about the company's business, property, affairs and financial situations as the administrator requires.

4.5.2 Labours

Labour is often an influential factor in the reorganisation proceedings. Generally, corporate rescue consists with the interests of labours as a whole, but sometimes is inconsistent with the interests of certain part of the labours, especially in case that some labours are dismissed for the needs to reduce the expenses or/and shrink the production size.

⁴⁶ Explanatory Memorandum to the 1992 Corporate Law Reform Act, para.494. See also Tomasic & Whitford, *ibid.*, p.178. Furthermore, Section 437C(1) of ACL provides: "While a company is under administration, a person (other than administrator) cannot perform or exercise, and must not purport to perform or exercise, a function or power as an officer of a company, except with administrator's written approval."

⁴⁷ s. 437F of ACL.

⁴⁸ See, Crutchfield, *ibid.*, p.89.

In China, Article 101 of DBL provides that, for the continuance of business operation in the period of reorganisation observation, administrator has right to decide unemployment of the staff and workers in the reorganising enterprise.

Such a power is also granted in US Chapter 11 and French *redressement*, being subject to confirmation of the court.⁴⁹

In Australian, no such a power appears Part 5.3A of ACL, but it does exist on the legal basis provided elsewhere.

4.6 Role of court

In China, DBL empowers people's court to, as far as reorganisation proceeding is concerned, (1) decide to accept, or not to accept, an insolvency case; (2) appoint administrator; (3) make a decision on opening of reorganisation proceeding; (4) approve the application for extension of the period of reorganisation observation; (5) make decision on discontinuation of part or entire business operation by request of interested persons; (6) summon creditors' meeting for vote on plan; (7) make decision on confirmation of plan which has been, or has not been, adopted by creditors' meeting; (8) decide to terminate the reorganisation proceeding ahead of schedule; (9) make a decision to close the insolvency case.⁵⁰ All these matters, except item (5), cannot be determined by anyone else. This conflicts the common sense of lawyers in some of the civil law jurisdictions that bankruptcy and other insolvency proceedings should be characterised by litigation procedures.⁵¹ Therefore, reorganisation proceeding is, like other civil proceedings, supposed to be handled by court at every step.

In Australia, Division 13 of Part 5.3A provides "Powers of Court" as the following:

- Make such order as it thinks appropriate about how this Part is to operate in relation to a particular company, for example, if the court is satisfied that the administration should end because the company is solvent, or the provisions of the Part are being abused, or for some other reason, it may order that the administration is to end. Such order may be end made subject to conditions, and may be made on the application of an interested person.⁵² This provision gives the court its general supervisory jurisdiction.⁵³
- Make such order as it thinks necessary to protect creditors as a whole on the application of the Australian Securities Commission (ASC), or to protect an individual creditor on his or her application, when the company is under administration.⁵⁴
- Make an order declaring whether an appointment of administrator was valid on the ground specified in the application of a person, the company or its creditors or on some other ground.⁵⁵
- Give directions to administrator about a matter arising in connection with the performance of the administrator's function or powers, or with the operation of the deed, if the administrator applies.⁵⁶
- Make such order as it thinks just where the court is satisfied that the administrator (a) has managed or is managing the company's affairs in a manner which is prejudicial to

⁴⁹ See, US 1978 Bankruptcy Code, s.1113; French Law No.85-98, art.45.

⁵⁰ The corresponding articles in DBL are: (1) art.13; (2) art.30; (3) art. 91; (4) art. 92; (5) art.103; (6) art.113; (7) art.116, 118, 119; (8) art.104, 124; (9) art.120, 125.

⁵¹ For instance, in Japan, insolvency proceedings are commonly deemed as civil procedures, and the major scholars dealing with these proceedings are those making a speciality of civil procedure law rather than commercial law or corporate law. In China, some scholars have the same allegation.

⁵² s. 447A of ACL.

⁵³ See, Crutchfield, *ibid*, p.207.

⁵⁴ s. 447B of ACL.

⁵⁵ s. 447C of ACL.

⁵⁶ s. 447D of ACL.

the interests of some or all the company's creditors or members, or (b) has done an act or made an omission or proposes to do an act or make an omission which is or would be so prejudicial.⁵⁷

It appears that the main powers of Australian court in Part 5.3A proceeding are basically of the character of supervision. Really, the court is not supposed to grasp the progress of the procedure firmly, though there are some procedural matters that may be determined by court on the application of ASC or interested parties.⁵⁸

4.7 Reorganisation plan

4.7.1 Formulation

According to China's Chapter 5 of DBL, the main function of administrator is, apart from control and operate the debtor's assets and business, to formulate a draft reorganisation plan. It is statutory function, not subject to the decision about the company's future by creditors' meeting. As far as the proceeding has not been terminated by court's decision, the administrator must do it. In Australia, as above-mentioned, administrator must investigate the affairs of the company and form an opinion whether one of the three options - (1) a deed of company arrangement, (2) termination of the administration, or (3) winding up of the company - is in the best interests of the creditors, which should be decided by creditors' meeting. If creditors resolve to adopt the first option, administrator shall prepare an instrument setting out the terms of deed. As indicated by the legislature, "[o]ne of the most common results of the administration process will be that the company and its creditors will inter into a 'deed of company arrangement'".⁵⁹

As designed by Chinese drafter, the formulation of reorganisation plan may be a process of consultation. In Article 105(1), 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, Article 105(2) generally provides that a reorganisation plan shall stipulate the following particulars: (1) a scheme for operation of the reorganising 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, as stated in the following.

Category of claims. The schemes for readjustment and satisfaction of the claims must follow the classification of claims stipulated in Article 106, that consists of (1) claims secured with property; (2) labour claims; (3) tax claims; (4) ordinary claims.

Readjustment methods. According to Article 107, a plan may contain the following readjustment methods 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 instalment; (3) changes in other terms or conditions; (4) conversion of a portion or all the creditors' claims into equity. As a rule seen in Article 108, claims in the same

⁵⁷ s. 447E of ACL.

⁵⁸ These procedural matters include, for example, removal of administrator (s. 449B), cancellation of variation of deed (s. 445A); termination of a deed (s. 445D); declaring a deed, or a provision of it, to be void or valid (s. 445G); excusing administrator from liability (s. 443B(8)); extending the convening period (s. 439A(6)); filling vacancy in the office of administrator (ss.449C, 449D).

⁵⁹ Explanatory Memorandum to the 1992 Corporate Law Reform Act, para.577.

category in a plan shall be repaid under the same terms, except that individual creditors accept voluntarily some unfavourable repayment terms

Optional schemes. Additionally, to encourage various flexible and practicable schemes to be adopted, some directive provisions are given. First, Article 109 points out that a plan may provide a scheme of merger or separation for the reorganising enterprise. Second, Article 110 prompts that a plan may provide a scheme on raising fund for the reorganising enterprise.

Executor of plan. As to the post of reorganisation executor, Article 111 provides that it may be assumed by the administrator.

The attitude of the Australian legislature to the matter of reorganisation plan, or in Australian terms, deed of company arrangement, seems not different from that of Chinese. It stated in the Memorandum: “The contents of this deed will vary according to the needs of the particular company and its creditors, though it might often be expected to provide for some for of compromise of debts, such as repayment of debts by delaying instalments. In exchange, the activities of company management might be subject to supervision by the creditors. The new Part 5.3A will not seek to limit in any way the scope for the company and its creditors to reach an arrangement suitable to all parties, In recognition, however, of the importance of such an arrangement, proposed Division 10 will specify certain minimum requirements, together with rules for the protection of the rights of dissenting parties.”⁶⁰

In Section 444A(4), the Law prescribes that the following matters must be specified in the instrument of a deed: (a) the administrator of the deed; (b) the property that is to be available to pay creditors’ claims; (c) the nature and duration of a moratorium period for which the deed provides; (d) the extent to which the company is to be released from its debts; (e) the conditions (if any) for the deed to come into operation; (f) the conditions (if any) for the deed to continue in operation; (g) the circumstances in which the deed terminates; (h) the order in which proceeds of realising the property are to be distributed among creditors bound by the deed; (I) the day (not later than the day when the administration began) on or before which claims must have arisen if they are to be admissible under the deed. “The legislation places little restriction on the form that such an arrangement may take. It may involve continued trading, sale of part of the assets, a rescheduling of debts, a composition of debts, conversion of debt to equity, a continued moratorium on creditor’s rights, or whatever the creditors decide.”⁶¹ It may be fairly to say that such practicable experience is worth to be introduced in our country.

An administrator of a deed must be appointed, who is usually, though does not have to be, the administrator of the administration because he or she is conversant with the affairs of the company. If the creditors refrain from passing a resolution to appoint someone else to be the administrator of the deed, the administrator will become the administrator of deed. (s. 444A).

4.7.2 Adoption and confirmation

With some characteristics of a “civil procedure”, DBL of China sets out a suit of procedural rules for voting and confirmation of the reorganisation plan.

-- Administrator shall submit to court a draft plan and a statement of feasibility study on reorganisation within the time specified by the court (art. 112). If the court deems that a draft plan meets the provisions of the Law, it shall summon a creditors' meeting and put the plan into voting (art. 113(1)).

⁶⁰ *Ibid.*

⁶¹ Wood, *ibid.*, p.214.

-- Administrator shall explain the draft reorganisation plan to the meeting and answer questions (art. 113(2)). Shareholders or other kind of investors may attend the meeting and discuss the draft plan (art. 114).

-- The meeting shall vote in separate voting groups in accordance with the classification provided in Article 106 for the passage of the draft plan. The plan is passed in one voting group when it is adopted by more than one half of the creditors presenting at the meeting in the same group, whose amount of claims must account for not less than two-third of the total amount of confirmed claims in the group. When all the voting groups have passed the draft, the reorganisation plan is adopted. (art. 115)

-- If the reorganisation plan fails to be adopted, some remedial measures are provided (art. 116):

First, the administrator may negotiate with the voting group that has not passed the plan. The group may vote on the plan once again after negotiation.

Then, if the voting group fails to pass the plan again in the second voting, the administrator, or the local government of the municipality or county where the debtor locates, or the administrative department of the industry that the debtor belongs under, may apply to the court for confirmation of the plan. If the reorganisation plan meets the prescribed requirements, the court shall confirm the plan.⁶² This is so-called rule of “cram down” known as in the US Chapter 11.⁶³

-- After the adoption of the plan, the administrator shall apply to the court for confirmation of the plan. If the court deems the application is in keeping with the provisions of the Law, it shall make a decision to confirm the plan. (art. 118)

-- The court shall open a court session to hear the statements by administrator, supervisors, parties concerned, and the opinions of the proper authorities and experts, before it makes the above decisions provided in Articles 116 and 118. (art. 119)

-- If the court deems that a submitted plan does not meet the provisions of the Law, it shall overrule the application on confirmation of the plan (art. 120(1)).

In Australia, the proceeding is much more simple and flexible. The administrator is not required to submit a completed deed of company arrangement to the creditors’ meeting for voting, nor is it supposed to be confirmed by court.⁶⁴ In practice, usually, the material submitted to the second meeting should contain a sufficient account of the deed to enable the creditors to make a judgement about what the deed will contain as a matter of substance. After that, the administrator is likely to continue to keep the creditors’ committee informed of progress and involved in the process. Furthermore, if for any reason the creditors are not happy with the finished product, they could require

⁶² The requirements prescribed in this article are the following:

(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, labour 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.

⁶³ See, US Bankruptcy Code, s.1129(b).

⁶⁴ Same in UK. See Insolvency Act 1986, s.23.

the administrator to convene a meeting of creditors to consider a proposed variation of the deed in accordance with Section 445F (discussed below).⁶⁵

4.7.3 *Effect and execution*

The rules in DBL, and those in ACL and other countries, on the effect and execution of a plan can be summarised as the following.

Binding effect. In China, a reorganisation plan confirmed by court shall have a binding force on all the claims established prior to the acceptance of the insolvency case by the court. The claims not having been filed up to this time shall not be enforced until the plan has been executed; they may be satisfied according to the repayment terms of the plan after the execution of the plan is fulfilled. (art. 122)

By comparison, it is almost the same in Australia that all creditors are bound by the deed to the extent that their claims arose prior to the time specified for that purpose in the deed irrespective of whether they voted in favour of the deed.⁶⁶ No substantial difference from this is found in the laws of US and France.⁶⁷

ACL also provides that a secured creditor is not prevented from realising or otherwise dealing with the security, except (a) the deed so provides in relation to a secured creditor who voted in favour of the resolution of creditors, or (b) the court so orders on condition that the creditor's interests will be adequately protected. (ss. 444D, 444F). Same rules are applied to owners and lessors. Such a court order may only be made on application of the administrator.

Executive power. In China, a reorganisation executor is in charge of execution of a reorganisation plan. Any resolution made by the authorities of the reorganising enterprise that violates the plan is subject to the executor's veto power. The appointment of management made by the authorities shall be approved and supervised by the executor (art. 123).

In Australia, ACL provides that the deed of company arrangement must be executed by both the company and the administrator, and the board of the company may, by resolution, authorise the instrument to be executed by or on behalf of the company (s. 444B).

Supervision. The execution of the plan is monitored by the supervisors on behalf of the creditors (art. 63(1)).

In Australia, an administration of a deed of company arrangement is subject to the court's supervision in a same way to the administrator of a company under administration (s. 447E).

Completion. Upon the completion of the execution of the plan, the executor shall end his performance of missions and timely submit a general execution report to the court. The court shall make a decision to close the insolvency case. Starting from the day when the court makes decision to close the insolvency case, the reorganised enterprise shall be relieved of its responsibility of paying off the portion of claims that are reduced under the plan. (art. 125)

There is no specific provision in Part 5.3A dealing with the consequences of the completion of deed execution.

4.7.4 *Variation, termination and avoidance*

Variation. In Chapter 5 of DBL there is no provision in regard to variation of a confirmed reorganisation plan. The attempts to vary a plan that has been closely

⁶⁵ See, Crutchfield, *ibid.*, pp.165-166.

⁶⁶ s. 444D of ACL.

⁶⁷ See, US 1978 Bankruptcy Code, s.1141(a); French Law No.85-98, art.64.

reviewed and carefully approved through a complex procedure should be costly and time-wasting. Anyway, this does not mean that any variation of the plan is prohibited. If any variation on the scheme for business operation is of the creditors' interests, the administrator may make a decision, subject to the consent of the supervisor on behalf of the creditors and the approval of the court. However, variation of the scheme for readjustment and satisfaction of the claims is generally not permissible.

In Australia, it is stipulated that a deed of company arrangement may be varies by a resolution passed at a meeting of the creditors in accordance with some procedural provisions given in Part 5.3A (ss. 445A, 445F). Since the creditors are not empowered to approve the deed when it is completed by administrator, this stipulation is justifiable. Possibly such a projection is more economical.

Termination. As provided in Chapter 5, where the reorganising enterprise is unable or refuses to follow the plan, the court may, at the request from the interested persons, make a decision to terminate the execution of the plan. In such circumstances, the concessions made by the creditors in the plan shall become no longer effective. However, a guarantee offered by a third party for the execution of the reorganisation plan shall continue to be enforceable within the pale of the secured amount provided in the plan. (art. 124)

In Part 5.3A, it is prescribed in Section 445C that a deed will terminate when (a) the court so orders under Section 445D; or (b) the creditors so determine; or (c) the circumstances in the deed providing for termination have been fulfilled. Section 445D enumerates seven grounds on which a court may terminate a deed. They are:

- Information about the company's affairs was given to the administrator or creditors and was false or misleading and can reasonably be expected to have been material to creditors in their decision concerning the deed;
- False or misleading information was contained in the statement that was delivered to the creditors' meeting for determining the company's future;
- There was an omission from the statement of the company's affairs and it would have been material to the creditors in their decision;
- There was a material contravention of the deed by someone bound by it;
- The deed cannot be given without injustice or undue delay;
- The deed or a provision of it would be oppressive or unfairly prejudicial or unfairly discriminatory against one or more creditors or contrary to the interests of the creditors of the company as a whole; or
- The deed should be terminated for some other reason.

Avoidance. According to Section 445G of ACL, court has the power to declare the deed, or a provision of it, to be void or not to be void if there is doubt on its validity and an interested party, for instance a creditor, applies to the court for an order to this effect. It is explained that this section will deal with the consequences of a deed of company arrangement being entered into in circumstances which involve a contravention of Part 5.3A.⁶⁸ In China, Chapter 5 of DBL do not has a specific provision like this, because it requires court to review and hear from the interested parties before confirming a reorganisation plan.

4.8 Exit from the proceeding

4.8.1 Transition to bankruptcy liquidation

Although bankruptcy liquidation is not an object of Chapter 5 of DBL, the possibility of transition to bankruptcy liquidation is always taken into account by the drafter. The

⁶⁸ Explanatory Memorandum to the 1992 Corporate Law Reform Act, para.610.

provisions dealing with such transitions in different stages of the proceeding may be described as the following.

First, in the stage after the opening of reorganisation proceeding and prior to the confirmation of the plan, where any of the situations prescribed in Article 104(1) takes place, the court may, at the application of the interested persons, make a decision to terminate the reorganisation procedure. These situations are: (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 act 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. In the same stage, where there is no reorganisation plan to be confirmed one month prior to the expiration of the period of reorganisation observation, the people's court may make a decision *ex officio* to terminate the reorganisation proceeding.

In the circumstances stated above, if the debtor has become insolvent, the court shall adjudicate the debtor to be bankrupt immediately, except the debtor or creditors apply to liquidate the debts by way of composition beforehand.

Second, in the process of adoption and confirmation of reorganisation plan, where the creditors' meeting has not adopted the draft plan, and the plan has not been adopted through negotiation or submitted to the court for confirmation in accordance with Article 116, or where the court overrules the application on confirmation of the plan on the ground that the plan does not meet the provisions of the Law, the court shall make a decision to terminate the reorganisation proceeding and, in the meantime, if the debtor has become insolvent, adjudicate the debtor to be bankrupt. (art. 117, 120)

Thirdly, in the stage of execution of the plan, where the reorganising enterprise is unable or refuses to follow the reorganisation plan, the court may make a decision to terminate the execution of the plan on the application of the interested persons, and in the meantime adjudicate the debtor to be bankrupt if it has become insolvent,. (art. 124)

Division 12 of Part 5.3A, ACL, deals with the matters of "transition to creditors' voluntary winding up". According to Section 446A, a company under administration is deemed to have entered a creditors' voluntary winding up in the three situations: (a) where the creditors have resolved that the company should be wound up; (2) where the company has failed to execute the deed of company arrangement within 21 days after the end of the meeting of creditors; and (3) where the creditors terminate the deed and resolve that the company should be wound up. In such circumstances the administrator is deemed to have been appointed as the liquidator of the company.

It is reported in a survey of insolvency practitioners that 56 per cent of respondents saw voluntary administration as suitable means of placing a company into liquidation as this was seen to be quicker and easier to use than a creditors' voluntary winding up.⁶⁹ Thus, it has been reported that only 10 per cent of those administrations which convert in to deeds of company arrangement actually seem to avoid winding up.⁷⁰

4.8.2 Closure of the insolvency case

In China, Chapter 5 prepares a triumphal arch for victors, as declared in Article 125:

Upon the completion of the execution of a reorganisation plan, the reorganisation executor shall end his performance of missions and timely submit a general execution report to the people's court. The people's court shall, after review and acknowledgment, make a decision to close the insolvency case.

⁶⁹ See, Tomasic and Whitford, *ibid.*, p.200.

⁷⁰ *Ibid.* The situation of France Law No. 85-98 cases is similar: 10 - 15 per cent avoid liquidation.

Starting from the day when the people's court makes decision to close the insolvency case, the reorganised enterprise shall be relieved of its responsibility of paying off the portion of reorganisation claims that are reduced under the reorganisation plan.

In Australia, rehabilitated companies do not have such a ritual.

5. Conclusions

Now let us have a summary on the comparison between the proceeding of corporate rehabilitation designed in China and that of Australia, that may be a start of some more comprehensive researches in the future.

-- Entrance and exit. In China, anyone coming into the proceeding must pass a guarded check point. Only qualified person with proper application is allowed to get in, and allowed to step out only when some requirement is met. The purpose is clear: to minimise the abuse of this proceeding and avoid the waste of money and time, and, moreover, to keep the proceeding a good fame and thereby to have it be well utilised. In Australia, the entrance is quite open; people may feel free to come in, and feel free to step out, although the specified purposes shall be satisfied and some judicial orders are available for restricting abuse or misuse.

-- Automatic stay and creditors' autonomy. The restraint to secured creditors and property owners by the provisions of automatic stay is much stronger in China. This difference is due to the divergence in policy preference. Australia, like England, is a traditionally creditor, especially secured creditor, oriented jurisdiction. In China, the policy on corporate rescue and rehabilitation is underpinned by more vigorous social appeals. Anyhow, protection of the interests of creditors, particularly secured creditors, is always taken seriously in the process of the reform of Chinese insolvency law. Accordingly, Australian legislation provides more chances for creditors to resolve the matters related to corporate rescue, and meanwhile fewer chances for shareholders, directors and labour, than Chinese legislation.

-- Court and administrator. In Chinese, reorganisation is one of the proceedings in bankruptcy law, which is traditionally characterised as a civil procedure and therefore firmly controlled by court. Under such circumstances the functions and powers of administrator are not as much as those in Australia. As well known, Australia has a long history of liquidation practitioners. They are well trained and well organised. This is the basis of the less court-involving regime. Anyhow, we should notice that the efficiency of such a system is remarkably higher than that in the more court-involving regimes of, for example, US and France. It seems possible for us to make some efforts to have administrators become more active in the process of corporate rehabilitation.

-- Plan/deed. The substance of reorganisation plan in China and that of deed of company arrangement in Australia is very similar, although there are some procedural differences in respects to formulation, adoption, execution and variation of plan/deed.

On the basis of on the description and analysis in this paper, I would like to remind of two points of view that should not be forgotten.

First, viewed from the global setting, we can easily find out that the existing corporate regimes are different from country to country, and none of them can be esteemed as a universal model. The question about what may be a suitable legal policy and workable technological schemes is up to a country's state situation, including the economic structure, legal framework and even cultural tradition.

Fundamentally, corporate distress is just a symptom of the complex sickness of an economic society, rather than a corporation itself. Since the "pathogenic mechanism"

varies from case to case, every treatment must be worked out and evaluated specifically. However, there exist some common causes, and a treatment used in a specific case should be used for reference in another case. We need to explore more and more cases and advance the theoretical basis, through comparison and integration, for the on-going reformation of insolvency law in all-over the world.

Second, China's experiment of adopting corporate rescue regimes is just in the very beginning. In a country transiting peacefully from planned economy to market economy, such a problem is much more complicated than that in an industrialised country. What we have to do in present time is to dissolve the bitter results left by the old regime in the framework of modernising commercial law. There is no example of such an engineering in the world. On the other hand, "Chinese characteristics" should not become a hindrance against the tendency of globalisation in at least the realm of commercial law. Nowadays the former factor, the need to dissolve the historical heritage, seems overwhelming and the appeal for the latter object looks weak. Anyway, people should realise that physical training is a much better medicine; a patient is more likely to recover when the positive factors develop in his body.