The New Chinese Bankruptcy Law: Text and Limited Comparative Analysis

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I. Introduction

The new Enterprise Bankruptcy Law (EBL) of the People’s Republic of China (PRC) went into effect on June 1, 2007. The law permits a bankruptcy filing by “a debtor with legal person status,” (i.e., a corporation). In addition a partnership is eligible for liquidation, but not reorganization. At present, there is still no PRC statute for a bankruptcy case with respect to an individual (a physical person). However, it is noteworthy that the law includes both financial institutions and insurance companies, which are excluded from the coverage of the U.S. bankruptcy law.

For the most part, since the establishment of the PRC in 1949, businesses have not been allowed to fail. In consequence, there has been no perceived need for a bankruptcy law to provide for the orderly liquidation of failed companies. There has been no social security system in place, because there were no worker layoffs resulting from business failures. In 1986, the PRC enacted a law providing for the liquidation of certain state-owned enterprises with government approval. In addition, in 1991 the PRC adopted a one-page chapter (eight sections) in its Civil Procedure Law to provide, in very skeletal fashion, for the bankruptcy of privately owned corporations. As part of its move toward a capitalist economy, the PRC has now adopted a full-fledged bankruptcy law providing generally for the liquidation of insolvent partnerships and corporations, both publicly and privately owned, and for the reorganization of those corporations (but not partnerships) that can be restructured and salvaged.

The EBL is a unified law in two respects. First, a single law provides for both reorganization and liquidation procedures. In contrast, for example, Japan has three different laws, one for liquidation, one for reorganizing large businesses, and one for reorganizing small businesses.

Second, the EBL is unified in that there is a single bankruptcy road at the outset, which later forks into a reorganization route and a liquidation route. Like the German law, the EBL presumes that a bankruptcy case will result in liquidation, and requires a separate court order for the case to take the reorganization road. French law, in contrast, presumes that every insolvency case is a reorganization case, and directs a case onto the liquidation route only where reorganization is not feasible. In the United States, in contrast to all of these countries, the filer of the bankruptcy petition chooses whether the case begins on the reorganization or the liquidation road.

This commentary highlights certain major provisions of the EBL and provides a comparative analysis between it and the laws of certain industrial countries, principally the United States. Part II examines the principal features of the reorganization provisions in the EBL, including the procedures for commencing a reorganization case, the extent to which the EBL provides for a debtor in possession (DIP) in such a case, the financing of a reorganization, the drafting of a plan of reorganization, and the requirements for the confirmation of a reorganization plan (including provisions for nonconsensual plan confirmation). Part III analyzes the treatment of other selected topics, including the procedure for commencing a bankruptcy case; the insolvency tests that must be satisfied for initiating such a case; the scope of the automatic stay (moratorium) arising upon an order opening a case and the grounds for relief therefrom; the role and powers of a committee of creditors; the relative priorities of claims of secured creditors in comparison with those of employees; and the provisions relating to cross-border insolvencies.
To clarify ambiguities and provide further detail, the Supreme People’s Court has issued three sets of judicial interpretations of the EBL, covering the appointment and compensation of administrators and certain transitional issues. In addition, the Court has established a working committee to prepare a comprehensive judicial interpretation of the new law.

The statutory text of the new bankruptcy law, in a new translation that I have prepared together with my staff, follows this commentary. In interpreting the law, it is useful to know that Chinese law generally follows the civil law tradition, not the common law tradition.

II. Reorganization

Chapter 8 of the EBL provides a detailed regulatory scheme for reorganizing a corporation in financial difficulty, which is discussed in this Part. A case filed under the new law is presumptively a liquidation. However, the debtor or a creditor may apply to the court for the reorganization of the debtor.

Many of the features of the reorganization provisions are similar to provisions in Chapter 11 of the U.S. Bankruptcy Code, and are obviously drawn from U.S. law. This Part mainly highlights the important differences between the two laws. While committees of creditors are provided under the EBL, they are described in Part III because such committees may be appointed in liquidation cases as well as reorganization cases.

The EBL also has a separate set of provisions in Chapter 9 for prepackaged and simplified reorganization plans. These provisions will likely be useful principally for a small business that has arranged its deal with its creditors before it comes to court. This article does not examine these provisions in detail.

A. Commencing a Reorganization Case

Either the debtor or a creditor may file a petition with the court to initiate a reorganization of the debtor under the EBL. In addition, shareholders holding more than ten percent of its registered shares may file a petition to have the business reorganized. Alternatively, if a creditor files a petition for liquidation and an opening order is granted, the debtor may apply to have the case proceed as a reorganization. The application must be made before the court issues a declaration of bankruptcy.

This procedure can make it very difficult for a debtor to intercept a petition for liquidation filed by a creditor. The window of opportunity for the debtor to request a reorganization opens with the order opening the case, and closes with the issuance of the order for bankruptcy. The statute does not require any time period between the opening order and the bankruptcy order. In consequence, it may be extremely brief.

It is important to give the debtor sufficient time to collect information and to hire and consult with counsel about the advisability of trying to reorganize before this window closes. Otherwise, reorganizable businesses will be liquidated because the debtor has failed to make the application to reorganize during a possibly very brief window of opportunity. It would be better to permit the debtor to make this application at any time after the petition is filed, or to specify a period of time after the opening order for making the application (whether or not an order for liquidation is issued).

B. Insolvency

In place of showing insolvency under both the balance sheet and the liquidity tests required for a voluntary liquidation case, the EBL permits the opening of a voluntary reorganization case if the debtor “obviously lacks the possibility” to pay its debts. This provision is designed to encourage debtors to address their financial problems at an early stage, before they reach actual insolvency. A broader variety of circumstances, apart from insolvency as such, can make this condition “obvious.”
However, the statute gives no guidance in making this determination of obviousness. Ultimately, obviousness is in the eye of the judge deciding whether to open the case, and is harder to predict than the application of the insolvency tests themselves. Thus, this test may be too strict and variable.

This test is similar to the French bankruptcy law’s condition for eligibility for the sauvegarde procedure (which is based on the U.S. Chapter 11 procedure), that requires a showing that the debtor is “in difficulties that it is not able to overcome, whose nature is to bring it to cessation of payments.” The entire title of the French bankruptcy law is quite new: It took effect at the beginning of 2006. Thus, its application in French cases remains to be illuminated. However, the French formulation provides better guidance to a court than the simple requirement of obviousness.

It is not at all clear that an insolvency test is a good idea as a gatekeeper for entry into reorganization under the bankruptcy law. In a voluntary reorganization case, U.S. law imposes no insolvency requirement: It only requires that the debtor make the filing in good faith, which can be tested only afterwards pursuant to a motion to dismiss filed by a party in interest. The U.S. procedure makes the commencement of a voluntary reorganization case far simpler because time, effort and funds are not spent at the outset to determine whether the debtor meets an insolvency test. This is important, because there are many other very important tasks to be performed in the opening days of a reorganization case. Indeed, the debtor may easily wither and die while the parties are arguing about its solvency.

C. Debtor in Possession (DIP)

The EBL provides that, “[d]uring the period of reorganization... the debtor may, under the supervision of the administrator, manage its assets and business operations by itself.” Typically, it appears that such a DIP order will be issued only after an administrator has been appointed in the case. In these circumstances, the administrator who has taken over the assets of the business is required to turn them over to the debtor. Thereafter, the debtor is obligated to perform the obligations that the statute imposes on an administrator.

Alternatively, the court may leave the administrator in charge of the reorganization. If the administrator remains in charge of the reorganization, the administrator is authorized to hire officers of the debtor to manage the debtor’s business operations.

The DIP concept in the EBL has some similarity to the concept of a DIP provided under the U.S. Bankruptcy Code. However, the PRC statutory provision contemplates that the DIP will operate under the general supervision of an administrator. In this respect, the EBL more resembles the sauvegarde procedure under the French bankruptcy law, which likewise provides for the appointment of an administrator in a reorganization case, but for the debtor to remain in possession and to operate the business.

There is a parallel in U.S. law to the supervisory function of the administrator under the EBL in a reorganization case. Where the debtor is in possession in a Chapter 11 case, the U.S. Trustee (an official in the Department of Justice) exercises certain uncodified supervisory functions. However, the supervision of the U.S. Trustee is usually exercised with a lighter touch than that contemplated under either the EBL or the French law. It thus appears that the U.S. DIP has more autonomy and control over the business operations throughout the reorganization as compared to the powers of the DIP under the EBL.

D. Financing a Reorganization

The EBL authorizes a debtor to obtain a loan to finance the reorganization process. Such a loan may be on a secured basis, which presumably permits the lender to take a security interest in some or all of the assets of the corporation. Even if the loan is unsecured, it presumably qualifies as a “bankruptcy expense” that is entitled to priority in payment.

Unlike U.S. bankruptcy law, there is nothing in the EBL to authorize financing that primes existing secured creditors. This is an important omission because it is very difficult to find DIP financing unless the lender can obtain priority over existing secured creditors.
E. Plan of Reorganization

Either the debtor or the administrator must draft and submit a reorganization plan to the court. If the debtor is a DIP, it must prepare and submit the draft reorganization plan. If the debtor is not a DIP, it is the administrator who must draft and submit the plan. Notably, neither an individual creditor nor the committee of creditors (nor the government) has the right to submit a reorganization plan.

The reorganization plan must be submitted to the court within six months after the issuance of the order for reorganization. Upon the request of the debtor or the administrator, the court may grant a single three-month extension of this deadline. If a plan is not submitted to the court within the required time frame, the case must be converted to a liquidation case.

The EBL mandates four classes of claims, each of which votes separately: (1) secured creditor claims, (2) employee-related claims (including wrongful death), (3) taxes, and (4) general unsecured claims. If the plan makes changes in the rights of shareholders, they are entitled to their own class. In addition, the plan may establish a subclass for small claims in the general unsecured claims class (and to vote on the reorganization plan). Certain social claims must be paid in full, and holders of those claims may not vote on the plan.

F. Voting and Plan Confirmation

The provisions in U.S. law and the EBL on creditor voting and plan confirmation are surprisingly similar. With minor exceptions, the EBL follows the U.S. provisions and rejects the alternatives found in the statutes of other industrial countries.

1. Consensual Plans

The U.S. and PRC statutory provisions are in accord with respect to the voting requirements for the approval of a consensual reorganization plan. Both laws require that each class satisfy a two-part requirement with respect to votes in favor of the plan. Consensual approval of a plan requires that a majority of each creditor class vote in favor of the plan, and that those voting in favor in each class hold claims exceeding two-thirds of the claims in that class.

If all classes vote in favor of the plan, it can be approved by the court. The U.S. law provides for court approval if 14 other requirements are met. The EBL provides for court approval if the plan receives the requisite number of votes and it “complies with the statute.”

The voting procedure, however, is different in the two countries. EBL provides for the creditors to vote in a meeting of creditors. In the United States, in contrast, there is no meeting of creditors to vote on a reorganization plan; instead, all voting on a reorganization plan is conducted by mail.

In both the PRC and the United States, the calculation of the number and value of votes is based only on the creditors who vote, and the creditors who fail to vote are ignored. For example, if a particular class has 10 creditors owed a total of 1,000,000 yuan, but only five, holding claims totaling 300,000 yuan, attend the meeting of creditors to vote on a reorganization plan, the class votes sufficiently in favor of the plan if three of the claimants vote in favor and their claims exceed 200,000 yuan.

If one or more classes does not have sufficient favorable votes for the approval of a consensual plan, the EBL authorizes the debtor or the administrator to negotiate with a dissenting class and to have it vote again on the plan. If, in the second vote, each previously dissenting class meets the voting requirements for approval, the plan can be confirmed by the court.
revision is not permitted to impair further the interests of the other voting classes.82

While there is no similar U.S. statute, a similar procedure is utilized in practice. However, instead of having the entire class vote again, typically a U.S. plan sponsor negotiates with individual class members to induce them to change their votes so that each class receives sufficient favorable votes.

2. Nonconsensual Plans

Very few countries that provide for creditors to vote on a reorganization plan permit “cram down” plan confirmation where the requisite majorities are not satisfied. United States law and the EBL are in accord that, in the appropriate circumstances, such a procedure can be used for confirmation.

The EBL imposes three general conditions for the approval of a nonconsensual plan. First, the plan must provide “fair” treatment to every member in the same class.83 Second, the distributions under the plan must not violate the statutory priorities for distribution to creditors in a liquidation.84 Third, the plan must be feasible.85

In addition, the EBL imposes requirements for particular classes of creditors in a nonconsensual plan. If a dissenting class is a priority class (secured creditors, employees, or taxing agencies), that class must be paid in full.86 If the dissenting class is the secured creditor class, the EBL imposes the additional requirements that its members must be fairly compensated for any delay in payment, and the secured interests must not be injured substantially.87 If the dissenting class is the class of general unsecured creditors, these creditors must receive at least as much as they would in a liquidation of the debtor.88 If the dissenting class is the equity class, the adjustment of its rights must be “fair and equitable.”89

For approval of a nonconsensual plan under U.S. law, the statute addresses only the dissenting classes. Generally, such a plan may only be confirmed if it does not “discriminate unfairly” and it is “fair and equitable” as to each dissenting class.90 Discrimination is not unfair if it has a reasonable basis and is necessary for the reorganization.91 For a secured creditor class, “fair and equitable” treatment requires that these creditors retain their liens and that they receive a market rate of interest to compensate for the delay in payment, or otherwise receive the “indubitable equivalent” of their claims.92 For an unsecured creditor class,93 “fair and equitable” treatment invokes the “absolute priority” rule: no junior class may receive any distribution under the plan unless this class is paid in full (without interest).94 The U.S. statute imposes no “fair and equitable” requirement for equity holders, except to protect the status of preferred shareholders.95

If the draft plan is not approved or confirmed, the EBL requires the conversion of the case to a liquidation.96 U.S. law does not adopt this “one bite at the apple” approach: it requires conversion to liquidation or dismissal on a showing of “cause,” which may include a variety of factors, but not simply the failure to confirm a plan of reorganization.97

III. General Statutory Provisions

In this Part, this article comments on the procedures for commencing a bankruptcy case under the EBL, the applicable insolvency test for opening a case, the scope of the automatic stay (moratorium), committees of creditors, priorities between secured creditors and employees, and cross-border provisions.

A. Commencement Procedure

The commencement of a bankruptcy case under the EBL requires that the debtor meet two important tests, one procedural and one substantive. Procedurally, the bankruptcy case commences, for most relevant purposes, only when the people’s court issues an order opening the case.98
A short period of time elapses under the EBL between the filing of the bankruptcy petition and the opening order. If the debtor files the bankruptcy petition, the people’s court is required to decide within 15 days whether to open the case. This may be a too short period of time for the insolvency findings required to authorize the opening of a case. In comparison, the European civil law jurisdictions which also require an order opening a bankruptcy case typically take substantially more time. For example, it usually takes about three weeks for a French court to decide to open a voluntary bankruptcy case, and it may take two or three months for a German court to act on a voluntary bankruptcy petition.

It is important that a decision whether to open a bankruptcy case be made as soon as possible after the filing of the petition. Any delay in opening a case can cause substantial prejudice between the filing and to opening to lenders and suppliers, who may not be paid if the case is opened, and to customers who are not informed of an impending bankruptcy case. For these reasons, under U.S. law, the filing of a voluntary bankruptcy petition commences the case immediately with no further formalities.

There is apparently no statutory authority for the people’s court to take any action or to grant any relief to the debtor or to the creditors pending the decision to open a case. In contrast, Japanese law authorizes the court to grant a broad range of interim relief while a decision to open a reorganization case is pending. Because opening is automatic upon the filing of a U.S. bankruptcy petition, this issue does not arise.

It appears that, in most cases, a PRC bankruptcy case will be filed by creditors, and not by the debtor. In contrast, business incentives and creditor financial pressure in the United States normally operate effectively to force a business debtor to file a voluntary Chapter 11 case. Indeed, an involuntary Chapter 11 case in the United States is quite uncommon.

B. Insolvency Test for Commencing a Case

Substantively, whether a bankruptcy petition is filed under the EBL by the debtor or by creditors, the debtor must satisfy an insolvency test to qualify for the opening of a bankruptcy case. If the petition is filed by creditors, they must show that “the debtor is not able to repay its debts that are due.” This version of the liquidity test differs from the traditional test by limiting the inquiry to the debts that are presently due. In contrast, the traditional liquidity test (which plays a different role in the EBL) defines insolvency more broadly, and applies if the debtor is unable to pay its debts as they become due. Thus, debts not yet due play no role in the insolvency test for an involuntary case, even if the debtor demonstrably will not have the ability to pay when the debts ripen.

The insolvency test under the new EBL is somewhat broader for a voluntary case. The case may be opened in two situations: (a) the debtor “is unable to repay its debts when they come due, and its assets are insufficient to pay all debts,” or (b) the debtor “obviously lacks the possibility to pay its debts.”

To bring a voluntary liquidation case, the debtor must satisfy two separate insolvency tests. First, it must meet the traditional liquidity test (inability to pay its debts as they come due), which is usually easier to satisfy than the modified test (unable to pay its debts that are due) for creditors in an involuntary case under the EBL. Second, the debtor must also satisfy the balance sheet test, by showing that its liabilities exceed its assets, in order to commence a voluntary bankruptcy case.

It is not clear whether the test of “assets... insufficient to pay all debts” reflects a traditional balance sheet test or a modified balance sheet test. Under the traditional balance sheet test, a debtor is insolvent if its liabilities exceed the value of its assets, as shown on the balance sheet. However, the balance sheet rarely reflects accurately the financial status of a business because, under international accounting standards, the balance sheet only reflects the historic cost of assets. For most assets, the balance sheet does not reflect their present market value. Thus, the balance sheet test is usually not an accurate indication of whether a business is in financial distress.

For certain purposes apart from qualifying under bankruptcy, the U.S. Bankruptcy Code uses a modified balance sheet definition of insolvency. Under this test, a debtor is insolvent if, “it is in a financial condition such that the sum of [its] debts
is greater than [the value of] all of [its] property, at a fair valuation.” This formulation derives from the Uniform Fraudulent Transfer Act. The “fair valuation” requirement may require the valuation of many of the debtor’s assets, which could be impossible to accomplish within the 15-day deadline for the court to determine whether to open a bankruptcy case. This version of the balance sheet test is a much better measure of financial distress. It appears that the EBL balance sheet test for commencing a voluntary bankruptcy case is open to this interpretation.

For an involuntary case, it makes sense to require that the creditors show that the debtor is insolvent in some relevant respect. U.S. law is similar to the EBL in this respect: in an involuntary case, the petitioning creditors must show either that the debtor is generally not paying its debts as they come due or that, within 120 days before the filing of the petition, a custodian was appointed or took possession of substantially all of the debtor’s property. As with a voluntary reorganization case, U.S. law imposes no insolvency requirement for a voluntary liquidation case: it only requires that the debtor make the filing in good faith, which can be tested only afterwards pursuant to a motion to dismiss filed by a party in interest.

C. Scope of Moratorium (Automatic Stay) and Relief Therefrom

The EBL imposes a moratorium (automatic stay) with respect to creditor collection activities. The moratorium commences with the court order opening a bankruptcy case, and it is automatic with the issuance of such an order. The moratorium prohibits the commencement of any civil lawsuit related to the debtor except in the court where the bankruptcy case is filed. The moratorium also prohibits any execution against the debtor’s property. Furthermore, the moratorium applies to any pending litigation or arbitration related to the debtor.

However, the EBL stay for litigation and arbitration is very brief. As soon as an administrator takes possession of the debtor’s property, this stay expires. Thus the administrator must step in for the debtor and defend any litigation or arbitration pending against the debtor. Once a judgment is final, however, the execution stay prohibits the enforcement of a judgment against the debtor.

There is a broader stay in an EBL reorganization case. During the period of reorganization (which lasts six months and may be extended for an additional three months), secured creditors are stayed from foreclosing on their collateral. In such a case, the EBL provides for a secured creditor to obtain relief upon order of the court “if it is possible that the collateral will be damaged or its value will obviously decrease to the extent that such damage or reduction in value is sufficient to affect the secured creditor’s interest.”

The stay against litigation and arbitration may also apply during the reorganization period, if the debtor obtains an order to pursue a reorganization and to be a DIP at the same time as the court orders the opening of the case. In such a case, it is possible that an administrator will not be appointed at the outset of the case, and thus the brief litigation and arbitration stay will not end when the court orders the opening of the case.

This is fairly similar to the U.S. provision for the application of the moratorium to a secured creditor in a reorganization case. Under U.S. law, a secured creditor in a Chapter 11 case may obtain relief from the moratorium if an effective reorganization is not reasonably in prospect, the property is not necessary for an effective reorganization, the secured creditor does not receive “adequate protection” for its security interest, or other “cause.”

The EBL does not provide for relief from the moratorium in a liquidation case. While U.S. law does provide for such relief, this difference is unimportant for secured creditors because the EBL moratorium does not apply to them in liquidation cases. For unsecured creditors, relief from the moratorium under U.S. law is quite uncommon. Thus, U.S. and Chinese law provide similar results in these circumstances.

D. Committees of Creditors
The EBL authorizes the meeting of creditors to establish a committee of creditors in any liquidation or reorganization case. This article has not addressed the creditors’ committee issue in the context of reorganizations because such committees can also exist in liquidation cases under the EBL.

A creditors’ committee, under the EBL, may not have more than nine members, and it must include a representative from either the debtor’s employees or the workers’ unions. Such a committee has the right to oversee management and liquidation of the estate, to oversee the distribution of assets to creditors, to propose a meeting of creditors, and to exercise any other rights delegated by the meeting of creditors. The committee also may request the administrator or relevant personnel of the debtor to explain or provide documents relevant to the scope of their employment with the debtor. Moreover, the administrator must report major activities to the committee, including major transfers of assets, financial transactions, and transfers of licenses.

The powers granted to a committee of creditors under the EBL are similar to those granted to a committee of creditors under U.S. law, which can only be appointed in a reorganization case. For example, under U.S. law, a committee has the power to investigate the conduct of the administrator regarding the operation of the business and participate in formulation of the reorganization plan.

There are several important differences between a U.S. creditors’ committee and an EBL committee. The first is that it appears that an EBL committee may include secured creditors, while U.S. law only permits unsecured creditors to serve on a standard creditors’ committee. A second important difference is that a committee in an EBL case is appointed by the meeting of creditors, and presumably is responsible to it. In contrast, a committee in a U.S. case is appointed by the U.S. Trustee and has no responsibilities to a meeting of creditors. A U.S. committee of creditors has a fiduciary duty to creditors of the class that it represents, and has an obligation to provide access to information to individual creditor members of that class. A third difference is that a committee appointed under U.S. law has a number of specified statutory powers that have no counterparts in the EBL. However, some or all of these powers apparently may be conferred on an EBL creditors’ committee by the meeting of creditors.

U.S. law makes it clear that a committee has the authority to employ attorneys, accountants, and other professionals and agents to represent the committee or to perform services for it. Under this law, a U.S. committee almost always hires legal counsel, and may appoint accountants, investment advisors, and other professionals to assist it in its work. These professionals are paid from the estate for their services to the committee.

There is no provision in the EBL authorizing a committee to hire any such professional. However, if a committee may employ such professionals, their compensation may qualify as “bankruptcy expenses” that are entitled to priority in payment from the assets of the debtor.

E. Priorities between Secured Creditors and Employees

One of the major revisions of the EBL is that secured creditors are now entitled to priority in payment from their collateral ahead of any employee claims. Under the former PRC bankruptcy law, employees’ claims took priority over payment to secured creditors from their collateral. Because wage laws have not traditionally been strictly enforced in the PRC, the employee claims in a bankruptcy case have frequently been very substantial, even to the point of preventing a secured creditor from receiving any payment from its collateral. In contrast, wage claims in U.S. bankruptcy cases are comparatively small, because wage laws are strictly enforced.

F. Cross-Border Provisions
With the PRC’s greatly enlarged participation in world markets and its entry as a member into the World Trade Organization, the cross-border provisions in its bankruptcy law have taken on much larger importance. Many PRC businesses now engage in international commerce and can become participants in cross-border insolvency cases.

The EBL does not adopt the UNCITRAL Model Law on Cross-Border Insolvency (Model Law). However, it does have one article relevant to cross-border insolvency cases with two important provisions. First, the EBL adopts a modified universalist view of the extent of the bankruptcy estate: it includes property located outside of PRC as well as within its borders.

Second, the EBL provides for an application in the PRC people’s court for recognition of a foreign bankruptcy order or judgment involving the debtor’s property located in the PRC in accordance with the principle of reciprocity or pursuant to an international treaty to which the PRC is a party. This provision authorizes the recognition of a court order involving PRC property belonging to a foreign debtor in any country (including the United States, the United Kingdom, Japan, Canada, and Mexico) that has adopted the Model Law because these statutes provide for the recognition of a bankruptcy order issued by a PRC court. This provision also applies to those countries that have adopted reciprocity provisions in their versions of the Model Law (Union of South Africa, Romania, and Mexico), because reciprocity provisions are reciprocal.

The EBL provides two exceptions to the recognition of a foreign bankruptcy order or judgment that are not generally found in other countries adopting the Model Law. First, in addition to providing a commonly recognized exception for public policy, the EBL denies recognition to a foreign bankruptcy judgment or order if its enforcement would harm PRC sovereignty, national security, or the public interest. These exceptions need further clarification, because they might impose substantial barriers to cross-border cooperation with respect to PRC assets.

Second, the EBL makes exception for any foreign order or judgment that “harm[s] the legitimate rights and interests of creditors in PRC.” The application of this provision may also be problematic, because it may be interpreted to give its domestic creditors priority over foreign creditors. This violates the international norm that foreign creditors (except for subordinated claims and claims held by foreign sovereigns) should not rank lower than domestic general unsecured creditors in the distribution of assets of a bankruptcy estate.

In addition, it appears that the EBL authorizes the recognition of a foreign bankruptcy judgment or order only as to a debtor’s property located in the PRC. In contrast, the Model law gives far broader authority to an authorized foreign representative; it gives such a representative a general right to participate in a domestic bankruptcy. Furthermore, unlike the EBL, the Model Law specifically permits a foreign representative to apply for the commencement of a domestic bankruptcy case.

G. Other Statutory Provisions

Two other issues merit brief comment. First, unlike U.S. law, the EBL does not give the courts the power to rule on the legitimacy or proper amount of fees for professionals employed by an administrator or debtor in possession. Second, while the EBL does not establish a separate bankruptcy court, the PRC follows the procedure in many countries of assigning bankruptcy cases to the civil and commercial law panels of its courts.

IV. Conclusion

The EBL adopts a structure for the reorganization of corporations and partnerships in both the public and the private sector, including financial and insurance companies, that is modeled after the U.S. Chapter 11. The law should be adequate to permit the restructuring of such corporations if they have viable businesses. The principal limitation in the reorganization provisions is the gate-keeping requirement that the debtor be insolvent, or nearly so: this may prevent businesses from entering the
system until their financial conditions are beyond salvage. In addition, there remains no insolvency regime for individual debtors, and partnerships only qualify for liquidation.

The EBL also contains updated provisions that are typical of modern bankruptcy laws, including the prompt opening of a bankruptcy case, the imposition of a moratorium or automatic stay on all creditors, the appointment of a committee of creditors, and the protection of collateral rights of secured creditors. The law has only rudimentary provisions for cross-border insolvencies, and fails to adopt the UNCITRAL Model Cross-Border Insolvency Law.

Bankruptcy law in the PRC remains a work in progress. The new law is a giant step forward in this legislative expert. At the same time, much legislative work remains to be done to complete the task of bankruptcy reform in the PRC. At the same time, there is also much work to be done to educate the judiciary, the bar, and the public on the EBL. Especially, there is a need for education to develop a “rescue culture” with experience and expertise in applying the reorganization provisions of the new law.135

Footnotes


2. See EBL art. 2.

3. See EBL art. 135 (providing that the EBL governs the bankruptcy liquidation of any entity that is not a legal person).

4. See EBL art. 134.

5. See 11 U.S.C.A. § 109(b)(2) (eligibility to be a debtor in a Chapter 7 case); 11 U.S.C.A. § 109(d) (eligibility to be a debtor in a Chapter 11 case).


7. See Shi, supra note 6, at 650.


9. See EBL art. 2.


German law is somewhat different: it is the creditors, at their second meeting, who have the power to direct a bankruptcy case onto the reorganization road. See InsO, v. 5.10.1994 (BGBI I S.2866) § 157 (Ger.).

See C. com. art. L. 631-1 (Fr.).

See 11 U.S.C.A. § 301(a): Official Form 1 (providing a box to check for choosing a reorganization case (under Chapter 11) or a liquidation case (under Chapter 7). Official Form 1 also offers several other alternatives not relevant to this paper.

See Shi, supra note 6, at 679. The Supreme People’s Court also issued a series of judicial interpretations for the 1986 law. See Shi, supra note 6, at 651. At first blush, this procedure may seem anomalous to a common law audience. However, the U.S. Supreme Court has done something substantially similar in issuing the Federal Rules of Bankruptcy Procedure.

Only a corporate entity can be reorganized under the law. See notes 2-3, supra.

See EBL art. 73.

See text at notes 105-20 infra.

See EBL arts. 95-106.

See EBL art. 70.

See EBL art. 70.

See EBL art. 70.

See EBL art. 70.

See text at notes 87-89, infra.

See Shi, supra note 6, at 669.

C. com. art. L. 620-1 (Fr.).

An administrator is appointed at the same time as the court issues an order opening the bankruptcy case. See EBL art. 13.

See EBL art. 73.

See EBL art. 651.

See EBL art. 73.

See EBL art. 73.

See EBL art. 74.


See EBL art. 75.

See EBL art. 75.

See EBL art. 74.

See EBL art. 41.

See EBL art. 43.


See EBL art. 79.

See EBL art. 80.

See EBL art. 80.

See EBL art. 80.

See EBL art. 80.

U.S. law provides for the appointment of an administrator (trustee) in a Chapter 11 case for “cause,” or if such a trustee is in the best interests of the creditors, equity holders and other interested parties. See 11 U.S.C.A. § 1104(a). In fact, a trustee is appointed only rarely in a U.S. Chapter 11 case. Furthermore, such an appointment is frequently a prelude to the conversion of the case to a liquidation under Chapter 7.
See EBL art. 80.

See EBL art. 80.

See EBL art. 82.

See EBL art. 85.

See EBL art. 85.

See EBL art. 81.

See EBL art. 83.

See, e.g., InsO, v. 5.10.1994 (BGBI I S.2866) § 244 (Ger.) (requiring an affirmative vote of a majority of creditors, holding more than half the sum of the claims); Kaisha Kseih [Corporate Reorganization Act], Law No. 154 of 2002, amended by Law No. 76 of 2004 (amending Law No. 172 of 1952), art. 196.5.2 (Japan) (requiring approval by unsecured creditors holding more than half of the sum of the claims, and by secured creditors holding at least two-thirds of the sum of the secured claims (and even higher majorities of secured creditors in certain circumstances)).

See EBL art. 84; 11 U.S.C.A. § 1126(c).


See EBL art. 86.

See EBL art. 84.


See EBL art. 84.

See EBL art. 87.

See EBL art. 87.

See EBL art. 87.

See EBL art. 87(5).
See EBL art. 87(5). U.S. law does not include such a provision in its requirements for nonconsensual plan confirmation.

See EBL art. 87(6).

See EBL art. 87(6).

See EBL art. 87(1).

See EBL art. 87(3).

See EBL art. 87(4). The EBL gives no definition for “fair and equitable” in this context.


U.S. law permits multiple unsecured creditor classes. See 11 U.S.C.A. § 1123. The EBL permits only one general unsecured creditor class, except that it permits a subclass for small claims. See EBL art. 82.


See EBL art. 88.


See EBL arts. 10-12.

See EBL art. 10. Upon a showing of “special circumstances,” the deadline for a decision to open a bankruptcy case can be extended for an additional 15 days with the approval of the appellate court. See EBL art. 10.

See text at notes 85-91 infra.
See 11 U.S.C.A. § 301(a) (“A voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter”).


See EBL art. 7 (italics added).

See, e.g., 11 U.S.C.A. § 303(h)(1) (authorizing the opening of an involuntary bankruptcy case if “the debtor is generally not paying such debtor’s debts as such debts become due”).

See EBL art. 2.

For non-real estate assets, the balance sheet also contains a reserve for depreciation or amortization. However, the reserve is based on a formula (e.g., straight line depreciation) which frequently has little relation to actual market value.


See EBL arts. 19-21. In these respects, the commencement of the moratorium under the EBL is typical of continental European systems. See, e.g., C. com. art. L. 622-21 (Fr.); InsO, v. 5.10.1994 (BGBI I S.2866) § 87-91 (Ger.).

See EBL art. 21.

See EBL art. 19.

See EBL art. 20.
See EBL art. 20.

See EBL art. 79.

See EBL art. 75.

See EBL art. 75.


“Adequate protection” is defined as payments (or an additional replacement lien, or other relief) to cover any decrease in the creditor’s interest in the collateral. See 11 U.S.C.A. § 361.


See EBL art. 67.

See EBL art. 67.

See EBL art. 68.

See EBL art. 68.

See EBL art. 69.

See 11 U.S.C.A. § 1102-03. A committee may exist in a liquidation case under Chapter 7 of the U.S. law only if the case has been pending under Chapter 11 and a committee has been appointed, and the case is then converted to a case under Chapter 7.

See 11 U.S.C.A. § 1102. This provision also authorizes the appointment of an equity committee, which would consist in shareholders of the debtor. The statute also authorizes the appointment of additional committees of creditors or equity security holders, which apparently could include a committee of secured creditors. Such committee appointments are rare in U.S. practice.


116 See EBL art. 41.

117 See EBL art. 43.

118 See EBL art. 109 (a secured creditor has priority in payment from its collateral). The new law reverses the higher priority given to wage claims under the prior law (as interpreted by the courts). See EBL art. 132.

119 The statutory requirements in the EBL and in the prior PRC bankruptcy laws on the relative priorities of secured creditors and employees are essentially identical. It was special legislation adopted subsequently that gave employees priority over secured claimants. See Shi, supra note 6, at 670-675 (discussing history of priority given to employee claims, the compromise in the new law, and the continuing tensions that it creates).

120 See Shi, supra note 6, at 670-672.


122 See EBL art. 5.


124 See EBL art. 5. See also Shi, supra note 6, at 675-679 (discussing article 5 and its history).

125 See EBL art. 5. At present, there is no relevant PRC treaty, not even between China and Hong Kong, on bankruptcy issues. See Shi, supra note 6, at 678. However, general treaties on judicial cooperation (of which there are 30), may have provisions applicable to bankruptcy cases. See Shi, supra note 6, at 678-679.

126 See EBL art. 5 (adopting the public policy exception contained in Model Law art. 6).

127 See EBL art. 5.
See Shi, supra note 6, at 677.

See, e.g., Model Law art. 13(1).

See EBL art. 5.

See EBL art. 5.

For the definition of “foreign representative,” see Model Law art. 2(d).

See EBL. art. 12.

See EBL art. 11.

See EBL art. 11.


See Shi, supra note 6, at 666-667.


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