The Reorganization Process Under China’s Corporate Bankruptcy System

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Abstract

The number of enterprises plunging into bankruptcy starting in 2008, during which time China was affected by the global financial crisis, tested the efficacy of the Enterprise Bankruptcy Law (EBL), which established a statutory-based reorganization process to be followed and which was seemingly designed for the resurrection of corporate entities caught in financial malaises. During the global financial crisis, the EBL served its intended purpose—the prevention of a greater number of small- and medium-sized enterprises in temporary financial difficulties from premature corporate bankruptcy; but the implementation of the EBL and, by extension, China’s corporate bankruptcy system was less than ideal. One of the main tenets of the EBL is the requirement for any reorganization plan to be approved dually—i.e., sanctioned by both the creditors and the court; but the EBL fails to prescribe clearly the circumstances under which the court’s discretionary power in granting its approval should be exercised and, if so done, to what extent those powers should be kept in check.

The deficiencies of the EBL might impact adversely China’s securities markets because there is a strong linkage between an effective corporate bankruptcy reorganization system and increased securities trading. A listed company facing bankruptcy but whose shares remain tradable in China’s securities market would normally be labeled as an “ST corporation” first, before being delisted eventually. While reorganization can theoretically, if not practically, provide reprieve for a bankrupt company by saving it from premature corporate bankruptcy, recent research has indicated that the number of successful reorganization cases are few and far between. The paucity of successful bankruptcy reorganization cases in China suggests the EBL, as it was implemented, may have inadvertently put restraints in its own application, in contrast to the more efficacious corporate bankruptcy laws in jurisdictions such as Australia, the United Kingdom, and the United States.

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2. ST means ‘special treatment.’ Special treatment connotes a distinctive ‘warning system’ that was formulated by the securities exchanges in China to warn investors of listed companies suffering severe losses and that are at risk of being delisted from the stock exchange(s). For more details, please refer to infra Part IV concerning the issue of “ST” prefixed corporations. See id. at 307.

939
each of which provided a model for reorganization legislation. There are both internal and external factors attributive to such lackluster results following the EBL's implementation. The internal factors consist of some judges' preference in applying the old law (which contains no reorganization provisions whatsoever) over the newer EBL, as the new law is less familiar to them. The external factors comprise local protectionism of preferred enterprises and a lack of qualified bankruptcy professionals in China. This article aims to examine the implementation and practice of China's corporate reorganization process, formed and shaped by Chapter 8 of the EBL, immediately before and throughout the global financial crisis. Relevant issues in regards to the administrator system and the expenses associated with the reorganization process will also be addressed. It is hoped that this article, if construed properly, may inform of future amendments to China's EBL.

I. Introduction

China's corporate bankruptcy\(^3\) system is comprised mainly of two parts: (1) the Enterprise Bankruptcy Law of 2006 (the EBL or new law), passed into law by the National People's Congress and (2) judicial interpretations,\(^4\) made by the Supreme People's Court of the People's Republic of China (the SPC), the highest court of law in China. The EBL, consisting of twelve chapters with 136 articles, was promulgated on August 27, 2006 and came into effect on June 1, 2007. The five judicial interpretations to date have been issued at various times in order to facilitate the implementation of the EBL.

At the heart of China's corporate reorganization process is the independent administrator system. The EBL distinguishes itself from its predecessor law, the 1986 Enterprise Bankruptcy Law Trial Implementation (the 1986 Law or old law), with some distinctive features. First, the EBL has broader application as it applies to all enterprise legal persons, inclusive of SOEs, non-SOEs, private enterprises, and foreign-invested enterprises (not just state-owned enterprises (SOEs) as in the old law\(^5\)). Second, the EBL replaced the liquidation group system with the independent administrator system. Inspired by both the U.S. and the U.K. models, the EBL also provides for a reorganization system by drawing upon Chapter 11 of the U.S. Bankruptcy Code\(^6\) (U.S. Chapter 11) and introduces an independent administrator system by borrowing from the concept of administrator in the U.K.'s Insolvency Act 1986.\(^7\)

'Reorganization' (i.e., 'corporate bankruptcy reorganization,' also known as 'corporate rescue' in some jurisdictions) encapsulates a legal procedure that aids the revival of a com-

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3. The words 'insolvency' and 'bankruptcy' are used interchangeably throughout this article, and refer to bankruptcy of a corporate nature and not a personal one.

4. With a view to facilitating the implementation the EBL, the Supreme People's Court has in 2007-2008 issued five judicial interpretations, namely: (1) Supreme People's Court Regulation on Law Application of Cases Still Pending upon the Enterprise Bankruptcy Law of People's Republic of China Coming into Effect (Fashi (2007) 10, Apr. 23, 2004); (2) Supreme People's Court Regulation on the Appointment of Administrators (Fashi (2007) 8, Apr. 4, 2007); (3) Supreme People's Court Regulation on the Compensations of Administrators (Fashi (2007) 9, Apr. 4, 2007); (4) Supreme People's Court Regulation on Bankruptcy Cases in which the Whereabouts of the Debtor or Its Assets are Unclear (Fashi (2008) 10, Aug. 4, 2008); and (5) Supreme People's Court Regulation on Time Limits for Hearing Civil Cases (Fashi (2008) 11, Aug. 11, 2008. See Li & Wang, supra note 1, at 303.

5. Compared to the EBL, the 1986 Law has a narrower scope of application as it concerned merely, and thus applied only to, the bankruptcy of SOEs.


VOL. 45, NO. 4
pany in current and temporary financial difficulty but with viable business prospects and whose business operations may be operated continually as a going concern during the reorganization process. Reorganization gives the financially distressed company a short respite or 'breathing space,' generally referred to as a 'moratorium' (or an 'automatic stay' of corporate bankruptcy proceedings) with which the debtor company (i.e., the financially distressed company) will be free temporarily from its creditors' debt collection or debt enforcement actions. Reorganization cannot be executed effectively without the statutory protection of a moratorium against the company's creditors, whose rights of claims will be suspended temporarily while the company seeks ways to restructure itself and its debts. For each creditor, if he agrees to the company's reorganization initiative, his right of claims under relevant corporate bankruptcy law will be barred temporarily from being exercised or brought to a halt in the course of a bankruptcy proceeding. A moratorium thus works as a major intervention, with the overriding purpose of preserving the debtor company's employees' jobs and averting the unnecessary winding-up of the company. Technically, a reorganization application in China may be commenced by a debtor company itself, a creditor, or an investor whose capital contribution comprises one-tenth (1/10th) or more of the debtor company's registered capital. Initially, a debtor or creditor may apply directly to the People's Court for the reorganization of the debtor company, but in circumstances where there is a liquidation application by a creditor, the debtor company or investor may still apply to the People's Court for reorganization, provided that the said court, after accepting the previous bankruptcy application by the creditor, has not yet declared the debtor company to be bankrupt. Reorganization appears to be a welcome solution for companies listed in stock exchanges in China. Recent study shows that over a period of eight years (from March 2000 to March 2008), there were merely eighteen listed companies that filed for bankruptcy; among which, all but one company had undergone the reorganization process. Each of those seventeen listed companies had been reorganized successfully by reaching a settlement plan with its creditors, while the remaining one company's bankruptcy application was rejected eventually by the court.

The EBL is built on the three pillars of (1) liquidation; (2) reorganization; and (3) settlement, whereof the law offers comprehensive options for a bankrupt company to choose from in order to practically and effectively eliminate its debts and associated liabilities. Reorganization may potentially predominate over liquidation or settlement as viable options, at least when and only if financial difficulty arises at an early enough stage that it is still possible to attempt corporate rescue. Reorganization can also prevent the bankrupt company from premature or unnecessary liquidation and, as a result, the employees' jobs can be saved. Reorganization is oftentimes a precondition for settlement, as reorganization would inevitably involve the preparation of a settlement agreement. Thus one can view that reorganization, if successful, is consummated by reaching a settlement between

9. Id. at art. 70, ¶ 2.
11. Id. at 139.
the debtor company and all its creditors. It would seem to follow that the pinnacle of the
EBL is reorganization, to be carried out by a court-appointed independent administrator
whose main task is to carry on the debtor company’s business operation as a going concern
over a statutorily prescribed period called a moratorium. Only when that fails will the
debtor company be wound up and liquidated.

China is a country more accepting of legal transplantation. A case in point is that
China’s corporate rescue system is a hybrid of the systems used in the United States (the
U.S.) and the United Kingdom (the U.K.)—the former refers to ‘debtor-in-possession’
(DIP) and the latter, ‘administrator replacement.’ Under the U.S. system, the debtor
company’s management is permitted to stay and continue to run the business as a going
concern; under the U.K. system, the management would be replaced by an independent
administrator who would run the business during the reorganization process. Under the
Chinese system, the administrators must be appointed by the People’s Court from the
roster system, kept and operated by the said court. The administrators should be dili-
gent and faithful in the performance of their duties and such positions should be held by
professional service firms, such as law firms, accounting firms, liquidation firms, and/or
persons qualified professionally to manage bankruptcy procedures. During the pre-
scribed period of moratorium, it is the administrator’s responsibility to deliver a reorgani-
zation plan, essentially a settlement or concession proposal subject to ‘dual approval,’—
first by creditors of all four voting classes and then by the court. Alternatively, the
existing management (represented by directors of the company) may produce a reorgani-
zation proposal under the DIP model (like the U.S. system). Once approved at ‘meet-
ings of the creditors’ by creditors and sanctioned by the court, the reorganization proposal
will have a binding effect on the debtor company and all its creditors.

Reorganization is arguably the most innovative feature of the EBL, applicable to all
time and be expensive. First, reorganization requires the submission of numerous plans: (1)
the business plan of the debtor company; (2) the classification of debt claims; (3) the plan
for claims adjustment; (4) the plan for claims repayment; (5) the time limit for implement-
ing the reorganization plan; (6) the time limit for supervision over the implementation of
the reorganization plan; and (7) other plans favorable to the debtor company’s reorganiza-
tion.

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12. The EBL, art. 13.
13. 最高人民法院關於法院指定的管理員在審理企業破產案件的規定 [Provisions of the Su-
preme People’s Court on the Designation of Administrators during the Trial of Enterprise Bankruptcy
Cases], (promulgated by Standing Comm., Nat’l People’s Cong., Apr. 12, 2007, effective June 1, 2007), art. 1
(China) [hereinafter Designation of Administrators].
14. The EBL, art. 27.
15. Id. art. 24.
16. Id. art. 84, ¶ 2.
17. Id. art. 86, ¶ 2.
18. HAIZHENG ZHANG, Corporate Rescue, in CHINA’S NEW ENTERPRISE BANKRUPTCY LAW–CONTEXT,
INTERPRETATION AND APPLICATION 207, 207 (Rebecca Parry, Yongqian Xu, and Haizheng Zhang eds.,
2010).
19. Id.
20. The EBL, art. 81.
In connection to that, the People's Court would have to convene the creditors' meeting within thirty days from the date of receipt of the draft reorganization plan to entitle the creditors to vote on the draft reorganization plan. By this time, the procedure would have taken up a maximum of ten months already (6+3+1=10 months). Because it also requires the court's approval, the reorganization plan, once approved, requires a public announcement to be made within thirty days from the date of the court's receipt of the application. This means that it will take a minimum of eleven months (6+3+1+1=11 months) for a reorganization plan to be carried out successfully.

Needless to say, due to the 'dual approval' requirement, where the reorganization plan fails to obtain approval either by the creditors or the court, the undergoing of an entire procedure will most likely exceed one year. It may drag even longer because the EBL does not set a time limit for the court to approve a reorganization plan that has survived initially in the creditors' meeting. There also seems no prescribed time limit for the court to exercise discretion to 'cram-down' an unsuccessful reorganization plan that the dissenting creditors failed to approve.

That said, one should be mindful about the strict time limits set by the EBL for the court to handle expeditiously corporate bankruptcy applications. For example, in a creditor's bankruptcy petition, the court has five days from the date of receipt of the application to notify the debtor, who is given seven days from the date of receipt of the notification from the court to object to the creditor's application. The court shall also make an order whether or not to accept the bankruptcy application within ten days from the date of expiration of the time limit for the debtor to file with the court objections against the creditor's application. Conversely, in a debtor's bankruptcy petition, the court normally would have fifteen days in which to decide whether or not to accept a bankruptcy application, although in special circumstances, it might be necessary for the court to extend the time period, usually for a further fifteen days upon approval by the court at the next higher level. Once an application has been accepted by the court, it has twenty-five days from the date on which it makes an order to accept a bankruptcy application to notify known creditors and to make a public announcement of its decision. In addition to Articles 10-14 of the EBL as aforementioned, the timeliness requirement can also be found in other parts of the EBL, such as in Article 111 of the EBL that involves the timely realization and distribution of the debtor company's assets.

The role, appointment, and remuneration of administrators have been set and provided with some detail as a result of the SPC's issuance and adoption of (1) the “Provisions of the Supreme People's Court on the Designation of Administrators During the Trial of Enterprise Bankruptcy Cases” and (2) the “Provisions of the Supreme People's Court on Determination of the Administrator's Remunerations” (collectively, the SPC Provi-
sions)—both were issued on April 12, 2007 in supplement to the EBL. A report by The World Bank suggested that in the past fifteen years, some countries have moved towards devising a particular set of rules for regulating administrators, reflecting not only the need for protecting both individual and public economic interests, but also an increased awareness of the complexity involving corporate bankruptcy issues and hence its potentially far-reaching impact. Whether bankruptcy reorganization can be carried out successfully depends a lot on the ability, qualification, and professionalism exhibited by the administrators; hence it has been suggested that the study of administrator systems is conducive to the successful development of a reorganization process within a corporate bankruptcy system.

To this end, the commentator referred to the INSOL International 2005 Global Marketplace Survey, suggesting that bankruptcy services, implied to include bankruptcy reorganization, are executed principally by professional (bankruptcy) administrators, of whose professional qualification can be divided into two categories: licensed and unlicensed. In England, Canada, and Australia, a strict licensing system is adopted for qualifying administrators; whereas, in the United States, where a 'private trustee' system is adopted, it does not require strict licensing but is nonetheless guided by a de facto licensing system due to the stringent performance standards required of trustees in the United States. In China, the administrators must be appointed by the court, and such position should be held by either 'individual administrators' (e.g., lawyers or accountants) or by 'institutional administrators' (i.e., 'social intermediary institutions,' which are law firms, accounting firms, and/or liquidation firms). It is suggested that pursuant to the SPC Provisions, jurisdictions in China are authorized and thus have been busy creating 'Administrators Lists;' and those that have been placed on the list will be the first to enter into the market of bankruptcy practice following the recent bankruptcy reform.

In preparing the 'Administrators List,' the High Court of Chongqing City developed the “Chongqing Model” to limit the court’s unchecked, wide discretionary power and to restrain corruption because most of the information used in the five categories (details will be expounded further below) is both verifiable and available for public scrutiny. As such, it is easier for failed applicants to challenge the court’s selection process if they feel they were unfairly treated. The Chongqing Model is commendable and has been followed by jurisdictions in Beijing and Tianjin, with only small variations. By juxtaposing the Chongqing Model and the SPC Provisions, it is clear that the model was not far from the existing regulations.

29. Id.
30. The EBL, art. 24.
32. Id. at 540-41.
33. Designation of Administrators, arts. 6-7.
The court’s discretion needs to be guided properly or restrained, or it will likely be subject to abuse or misconstruction. First, the EBL simply uses the ‘negative conditions’ to disqualify those who wish to be qualified as administrators.\textsuperscript{34} Second, the SPC Provisions were designed to keep the door wide open for lawyers/accountants and their associated social intermediaries to apply to be included in the ‘Administrators List,’ as long as they have ‘professional knowledge and adequate practicing qualifications.’\textsuperscript{35} The selection decisions thus will be left with a court with higher level jurisdiction than the People’s Court (or the intermediary People’s Court within its jurisdiction), “according to the number of law firms, accounting firms, bankruptcy liquidation firms and other social intermediary agencies, number of full-time practitioners, and number of enterprise bankruptcy cases within its jurisdiction,” all defined loosely. Therefore, none of these terms should be treated as objective criteria whereby the court can apply easily such vague terms to decide who may be named to the ‘Administrators List.’

To address this problem, the Chongqing Model adopts a one hundred point scoring system for evaluating law firms, using five categories:\textsuperscript{36} (1) achievement in practice (up to thirty-five points);\textsuperscript{37} (2) firm size (up to twenty-five points);\textsuperscript{38} (3) experience in handling bankruptcy cases (up to twenty points);\textsuperscript{39} (4) competency (up to ten points); and (5) level of specialty (up to ten points).\textsuperscript{40} The fourteen law firms with the top overall scores will be named to the Preliminary Administrators List,\textsuperscript{41} which must be published on the Court’s website to solicit public comment or objection.\textsuperscript{42} The list is finalized within ten days if there are no objections.\textsuperscript{43}

For evaluating accounting and liquidation firms, the criteria are similar to those for law firms—the above-mentioned five categories are still applicable, but with a higher qualification threshold for annual income, hired employees, number of cases handled, etc. The accounting firms with the top five scores are named to the Preliminary Administrators List for public comment and objection in the same fashion as law firms. In the evaluation of liquidation firms, because they account for a small number of the total number of institutional administrators, their assessment criteria have not attracted much attention.\textsuperscript{44}

\textsuperscript{34} For example, pursuant to Article 24 of the EBL, “individuals or organizations that have been convicted of intentional crimes, whose license has been revoked, are an interested party in the case, or otherwise deemed unfit by the court are disqualified from serving as an administrator.” The EBL, art. 24.
\textsuperscript{35} Designation of Administrators, arts. 2-4.
\textsuperscript{36} Yang, supra note 31, at 535-40.
\textsuperscript{37} Id. at 536 (the first criterion concerns the firm’s annual gross income or the award or praise it received from the tax or other relevant government departments).
\textsuperscript{38} Id. (the second criterion looks at the firm’s number of employees and its leased office space).
\textsuperscript{39} Id. (the third criterion refers to the number of full-time lawyers hired to handle for each bankruptcy case).
\textsuperscript{40} Id. at 536-37 (the fifth criterion helps prove for the law firm’s specialty, based on the number of journal articles that have been published on civil cases).
\textsuperscript{41} Id. at 537.
\textsuperscript{42} This is according to Article 5 of The Provisions of the Supreme People’s Court on the Designation of Administrators during the Trial of Enterprise Bankruptcy Cases, which prescribes that “the people’s court shall, through the most influential media within its jurisdiction, make an announcement about the matters relevant to the preparation of roster of administrators . . . .” Designation of Administrators, art. 5.
\textsuperscript{43} Yang, supra note 31, at 537.
\textsuperscript{44} Id. at 538.
In addition to law firms, accounting firms, and liquidation firms (that can be named to the Administrators List as 'institutional administrators'), individuals who work for them can be qualified as 'individual administrators,' and are kept on a separate Administrators List. It needs to be emphasized that individual administrators will have to be selected from among lawyers and accountants whose firms have been named to the Administrators List.46 For such individuals, their time in practice, achievements, level of specialty, and experience in handling bankruptcy cases will score points47 for them;48 the ten lawyers and ten accountants with the most accumulated points may be named to the first Preliminary Administrators List, which also needs to be published on the court's website for a period of ten days so the public may provide its comments and objections.49

Because corruption and guanxi (the latter refers to the favoritism extended to those associated with the network of influence)50 have played a notorious role in China's historic and modern politics for government intervention, the objective criteria suggested by the Chongqing Model should limit the broad (and thus potentially flawed) discretionary power accredited to the court in appointing administrators. Despite the improvement, the EBL and SPC Provisions are silent about when, if there is a timeframe at all, the new names can be added to the Administrators List.51 It is also unclear why an individual administrator must be selected from the institutional administrators that are already on the Administrators List.52 It is particularly intriguing given the EBL already requires practitioners to have effective malpractice insurance to administer a case as an individual administrator.53

As a matter of practice, the administrators are established by the EBL to replace the liquidation group in almost all types of bankruptcy enterprises (所有破產企業, in Chinese), especially special private and non-publicly owned enterprises (特別民营企业, in Chinese). But the liquidation group is not out of the picture entirely yet, as its main function is to supervise the reorganization of all SOEs or State-owned Holding Companies (國有或國有控股企業, in Chinese) and Collective Enterprises (集體企業, in Chinese).54 The remuneration of an administrator is likely to be much higher than what the members of the liquidation committee (or liquidation group) can be remunerated. The high level of administrator's fees explains why, in actual practice, reorganization is adopted mainly by large enterprises, and reconciliation by small-and-medium sized enterprises (SMEs), as is so indicated by the Superior Provincial Court in An Hui Province (安徽省高级人民法院, in Chinese).55 Theoretically, however, reorganiza-

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46. Designation of Administrators, art. 3.
47. The numbers of points required may vary, as there are different grades (Grade 1-4) of lawyers. Additional points may be gained for those holding a position as a professional committee member of Chongqing Registered Accountants Association.
49. Id. at 539.
50. Id. at 541.
51. Id. at 536.
52. Id. at 539.
53. The EBL, art. 24, ¶ 4.
55. Id. at 341-42.
tion can be applied to all types of 'enterprise legal persons,' \(^5\) regardless of the size and scale of the individual enterprise.

II. Bankruptcy Statistics

Bankruptcy statistics are essential, especially those concerning the numbers of bankruptcy (including reorganization) applications made every quarter or year because they help identify the means by which such debt claims are ultimately resolved, whether it be through liquidation, reorganization, or settlement. Stakeholders, most importantly lawmakers but also including debtors and creditors, will inevitably need to draw upon bankruptcy statistics to make data-informed discussions before attempting any resolution options. As far as legislative proposals or reforms are concerned, statistical data can attest to or, conversely, cast doubts on the efficacy of China's statutory bankruptcy system. For creditors, quantitative and evaluative data may help assuage their concerns, if questions arise as to whether the number of administrators in a local jurisdiction is desirable \(^5\) or whether the court-appointed administrators in China are qualified sufficiently in accordance with internationally accepted guidelines (i.e., the UNCITRAL Legislative Guide on Insolvency Law). \(^5\)6 While the U.S. courts took pains to publish on a regular basis the bankruptcy statistics, \(^5\)9 information of a similar nature is not easily accessible in China. The PRC courts have unofficially attributed the scanty information to the need for protecting the interested parties' privacy. There is presumably no subterfuge implied in the courts' (in)action unless it is taken to conceal the EBL's implementation problem under the existing political and legal culture in China. Worse still, recent research has suggested that some government officials have interfered actively with the SOEs' bankruptcy proceedings in an attempt to boost local gross domestic product (GDP) by allowing only a small number of enterprises to declare bankruptcy. \(^6\)0 By analyzing twenty-five corporate reorganization cases in China, the underlying research led to the conclusion that the current bankruptcy reorganization system, embodied in Chapter 8 of the EBL, has not oper-

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\(^{56}\) The EBL, arts. 2, 7. The term 'enterprise legal persons' refers to both state-owned enterprises (SOEs) and enterprises that are not state-owned. Enterprise legal persons include (1) limited liability companies; (2) companies limited by shares; (3) private enterprises; and (4) foreign-invested enterprises, but exclude partnerships and individual-owned businesses. The reason is because partnerships and individual-owned businesses have unlimited liabilities. See WeiGuo Wang, THE SUM AND SUBSTANCE OF BANKRUPTCY LAW (Peking: Law Press China) (2007), at 4 (Chinese book with English title).

\(^{57}\) See Designating the Administrator, art. 2, where it stipulates that "a higher people's court shall, according to the number of law firms, accounting firms, bankruptcy liquidation firms and other social intermediary agencies, number of full-time practitioners, and number of enterprise bankruptcy cases within its jurisdiction, decide to prepare a roster of administrator by itself or by the intermediary people's court within its jurisdiction."

\(^{58}\) In § 39 of the UNCITRAL Legislative Guide, it is stated expressly that the administrator should be qualified appropriately, with knowledge of insolvency, commercial, finance, and business laws, as well as with adequate experience in commercial, financial, and accounting matters. U.N. COMMISSION ON INTERNATIONAL TRADE LAW (UNCITRAL), LEGISLATIVE GUIDE ON INSOLVENCY LAW, Sales No. E.05.V.1 (2004), available at http://www.uncitral.org/uncitralen/uncitral_texts/insolvency/2004Guide.html [hereinafter The UNCITRAL LEGISLATIVE GUIDE].


\(^{60}\) Li & Wang, supra note 1, at 308-10.
ated fully to the legislative design of preserving the bankrupt company’s going concern value.\(^{61}\)

**Chart 1 Number of Bankruptcy Cases Accepted to be Heard by the PRC Courts from 1989-2008**

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Source: The Supreme People’s Court and the Bankruptcy Law & Restructuring Research Center, The China University of Political Science and Law

*Not available*

**Chart 2 Number of Bankruptcy Cases Accepted to be Heard by the U.S. Courts from 1999-2006**

<table>
<thead>
<tr>
<th>Year</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
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<th>2004</th>
<th>2005</th>
<th>2006</th>
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<tr>
<td>Cases</td>
<td>1,002,098</td>
<td>895,394</td>
<td>982,931</td>
<td>1,064,631</td>
<td>1,176,595</td>
<td>1,164,233</td>
<td>1,352,838</td>
<td>839,150</td>
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</table>

Source: U.S. Courts series of annual reports\(^{62}\)

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\(^{61}\) Id. at 309.

\(^{62}\) By the categorization of original U.S. Courts of annual reports, bankruptcy cases in the United States fall into either one of the two sub-categories: liquidation or reorganization, from which either one of the two means bankruptcy cases will be resolved. Hence the total number of bankruptcy cases in the United States
To better balance the rights of debtors and creditors, the EBL was designed for the administrator to take over the role and function discharged previously by the liquidation group under the old 1986 Law. The liquidation group mainly consisted of government agencies or governmental institutions, among which were the Administration for Industry and Commerce, Public Security Agency, Land Administration Agency, and the management team of the SOE facing bankruptcy. Because so many government departments and agencies were members of the liquidation group, the government therefore orchestrated the direction and decisions. Government intervention was not uncommon, especially for earmarked SOEs whose bankruptcy applications could not be filed with the court without having first obtained the approval from their supervising government department(s). This may explain why the number of bankruptcy cases in China is dwarfed immensely by those in the United States for the same period from 1999-2006, as seen in Charts 1 and 2 above.

Chart 1 shows that the number of bankruptcy cases in China has increased dramatically since 1996 and reached their peaks in 2001 and 2002, nearly fourteen years after the old law was issued in 1986. Since the peak years, the number has since then been reduced significantly—by 2008, only two years after the old law was replaced by the EBL, the number dropped to 3,139, much lower than a year ago at 3,810 when the EBL first came into effect. It is observed that the number of bankruptcy cases recorded was higher in 2006 (at 4,300) than in 2007-2008. The reason is believed to be that a larger number of bankrupt enterprises preferred to file for bankruptcy in 2006 while the old law was still applicable because they were more familiar with that law than the EBL.

Professor Shuguang Li, of The China University of Political Science and Law in his joint article examining the EBL three years after its implementation, suggested that there are gaps between legislation expectancy and actual practice. Since the EBL came into effect on June 1, 2007, immediate revision of the law is suggested to be rather doubtful. Speaking at the annual meeting of China INSOL in 2009, Professor Li, as a member of the drafting group for the EBL, attributed the problem to a couple of what he labeled as “abnormities.” First, the number of bankruptcy cases heard by the People’s Court has dropped significantly since the enactment of the EBL. Second, over the past two years, hundreds of thousands of enterprises stepped out of the market, not by way of proper bankruptcy procedure but by having their licenses deregistered (zhuxiao, 註銷 in Chinese)

over the period from 1999-2006 (as shown in Chart 2) have actually combined both numbers for liquidation and reorganization. See also Liu, supra note 28, at 6.


64. Professor Shuguang Li is the Director of Bankruptcy Law and Restructuring Research Center, housed at The China University of Political Science and Law located in Beijing. He was also a member of the drafting group for the EBL.

65. Li & Wang, supra note 1, at 303.

or cancelled (diaoxiao, 吊銷 in Chinese). In Li’s article, he highlighted the lack of use of the EBL after it was implemented:

There were 3,139 enterprise bankruptcy cases in 2008 while there were 780 thousand [780,000] enterprises stepped out of the market in the same year. Among the 780 thousand [780,000] enterprises 380 thousand [380,000] exited the market through the path of deregistration (zhuxiao) and 400 thousand [400,000] through the path of license cancellation (diaoxiao).69

The statistics above mean that in 2008 alone, the rate for bankruptcy applications (by making use of the EBL) accounted for only 4.02% of all business closures, quite an insignificant ratio compared to deregistration (48.71%) and license cancellation (51.28%). If numbers can talk, the EBL may have been viewed by many corporate debtors as too cumbersome70 to be acted on; hence they resorted to administrative procedures for a quick fix. This could potentially leave their creditors with little or even no assets for recourse. Worse still, the weak position of the administrators, compared to the strong position enjoyed by the liquidation group in disposing SOEs under the old law, leaves them with few bankruptcy fees.71

To top it off, unless the creditor, administrator, capital contributor of the debtor company, or any other interested party is willing to make advanced payments,72 when and where the bankruptcy fees fall short, the bankruptcy procedure will be terminated early, leaving the EBL with no way to be applied and creditors stuck in limbo.

Last but not least, bankruptcy reorganization is reportedly used more frequently by non-listed companies than listed companies. A more recent book publication, of which Professor Li was a co-author, indicated that over a period of three years (since June 1, 2007, when the EBL came into effect, and up until May 31, 2010), there were in total 142 enterprises that entered into reorganization processes, of which 116 were non-listed companies and the remaining twenty-six were listed companies; of these twenty-six listed companies, fifteen of them have been reorganized successfully.73 In terms of the registered capital or residual company assets before reorganization, it ranges from CNY218 million to CNY2.291 billion (equivalent to approximately US$33.7 million to US$354.1 million) for listed companies and from US$40 million to US$431 million dollars for non-listed companies.74 This suggests that for reorganization to be successful, either the listed companies or non-listed companies must have maintained a certain level of assets, which shall attest to its viability as a company. Compared to the U.S. bankruptcy statistics, relatively

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69. Li & Wang, supra note 67, at 2.
70. For example, due to the 'dual approval' requirement, as manifested in Article 86 of the EBL, the reorganization plan submitted by the debtor company must be approved by creditors of all four voting classes and by the court. This arguably may render the approval more difficult to obtain.
71. See MEMBER OF CHINA INT’L INSOLVENCY ASS’N ANNUAL MEETING, supra note 68.
72. 最高人民法院關於審理企業破產案件確定管理人報酬的規定 [Provisions of the Supreme People's Court on Determination of the Administrator's Remunerations], (promulgated by Sup. People's Ct., Apr. 12, 2007, effective June 1, 2007) art. 12 (China).
74. Id.
large companies, indicated by having generated an annual revenue of over US$100 million, maintain a reorganization rate of sixty-nine percent (by undergoing successfully U.S. Chapter 11 bankruptcy procedures), compared to smaller companies with only US$25 million in revenue, whose success rate in coming out of bankruptcy proceedings as a viable company has decreased to only thirty percent.75

III. The EBL’s Outstanding Issues

Listed below are some outstanding issues that merit a further assessment for considerations of future amendments to the EBL. The list is meant for practical discussions only and cannot be deemed as exhaustive.

A. DOMICILE

The reluctance of judges to accept bankruptcy or reorganization applications also poses a threat to the evocation of the EBL—“some judges may not be willing to accept applications until they can find out whose local toes will get trodden on.”76 The problem lies in Article 3 of the EBL, which stipulates that the jurisdiction of a bankruptcy case shall be reserved exclusively for the People’s Court of the place where the debtor company is domiciled.77 Article 3 appears to be overly restrictive, considering that China is a vast country. The creditors and the assets of the debtor may be located throughout the country and the creditors may not be aware where the debtor’s principle place of business is, thus the ‘domicile’ issue can but should not bar the court from accepting bankruptcy petitions. A suggestion might be for the domicile requirement to be tempered so that it will enhance the likelihood for best preservation of the debtor’s going concern value. In light of this, Article 3 perhaps should be included in the future amendment of the EBL. Inspiration can possibly be drawn from the domicile regulation in the U.S. Chapter 11, which upholds a multiple-list of possible domiciles from which the creditors and courts can choose in order to determine the debtor company’s domicile.

Article 3 excludes the jurisdiction of a bankruptcy case to the People’s Court of the place where the debtor is domiciled. Supplementary to that provision, the SPC interpreted that the debtor’s domicile refers to its principle place of business.78 Article 3 apparently supplies little or no choice about where to file a bankruptcy case.79 In contrast, the law in the United States is very different as “it permits a considerable amount of choice about where an enterprise may file its U.S. Chapter 11 case... the case could be filed where the debtor has its principal place of business, where its assets have been located.

75. Id.
77. The EBL applies only to ‘enterprise legal persons’ and not natural persons; therefore, where ‘the debtor’ is used in the EBL or mentioned in this article, it refers to ‘the debtor company.’

WINTER 2011
for the 180 days prior to the filing, or where it is domiciled.\textsuperscript{780} Concerning domicile, the U.S. cases have upheld that domicile includes, among other options, the place where the corporation is incorporated.\textsuperscript{81} Using various attributes to link jurisdiction, the U.S. law enables the debtors and creditors to choose in which venue and over which asset that bankruptcy proceeding can be filed. Such flexibility is desirable for a vast country like China, especially in circumstances where the creditors and the debtor's assets may be located throughout the country, so that bankruptcy proceedings may commence sufficiently early and thereby preserving the debtor company's remaining value. One should also be aware of the problem inherent in making the domicile as the only linkage to the jurisdiction of a bankruptcy case, which can be a serious problem in China where 'local protectionism' runs rampant (at least that is still the case in some areas) and thus makes bankruptcy filings against the preferred enterprises difficult to be accepted by the local courts under pressure of the local governments.

On the ground of domicile, some judges might refuse to get the bankruptcy proceedings commenced early for a lack of jurisdiction power. The U.S. law may again provide some inspiration for future amendment of the EBL. It may, however, be likely to create another problem known as 'venue shopping.'

In the business bankruptcy area, venue shopping in the United States has become a focus of heated debate. In the United States' largely voluntary business bankruptcy system, it is clear from the empirical data that those who control the corporate debtor are choosing where to file for strategic reasons. The debate concerns why they are doing so and whether this is a good thing.\textsuperscript{82}

For now though it is safe to say that venue shopping is possible in the United States in a way that is not in China.\textsuperscript{83} A public hearing to instigate the debate of venue shopping is advisable, before the legislators in China decide whether China should follow suit of the United States to expand the jurisdiction of a bankruptcy case beyond the point of the debtor's domicile.

B. Non-obliging Attitude by Court Judges and Its Impact on Securities Regulations

Relevant to the last point, as indicated by a judge working in the People's Court in An Hui Province, some courts have decided to hold off accepting bankruptcy applications on the grounds that relevant SPC interpretations are still pending. This led to a slip of bankruptcy cases in An Hui Province from 175 to 169 cases, over the one-year period after the EBL was promulgated.\textsuperscript{84} The numbers were supposed to have gone up instead in the midst of financial crisis in 2007-2008. Also to be inferred from the judge's report published in 2009, some judges simply preferred to apply the old law (i.e., the 1986 Law) over the new law (i.e., the EBL), for the sake of their own convenience, even though the new law had already come into effect on June 1, 2007 and thus should be implemented. This

\textsuperscript{780} Id. at 149; see also 28 U.S.C. § 1408.
\textsuperscript{81} Woodward, supra note 79, at 149.
\textsuperscript{82} Id.
\textsuperscript{83} Id.
\textsuperscript{84} MING HUA WANG, supra note 54, at 336.
anomaly in practice may be linked to the paucity of bankruptcy reorganization cases as the old law contains no reorganization provisions whatsoever; in contrast, the new law dedi-
cates an entire chapter (Chapter 8) to that effect. Judges' negation to apply the EBL deprives the creditors or other stakeholders (such as employees of the debtor company) of the benefits and protection of rights, as intended by the new, and thus the more recent or current, law. It also implicates that there may not be enough competent judges capable of handling complex bankruptcy cases that generally require adequate expertise in commercial, financial, and accounting matters. A longer trial period and even delay in bankruptcy proceedings may also arise due to a lack of professional training among concerned judges who either are not familiar with the EBL where time is of great essence or do not possess sufficient knowledge in commercial, financial, and accounting to handle bankruptcy cases. In light of this, the courts should streamline their human resources in order to handle the growing number of bankruptcy liquidation or reorganization cases as can be foreseen reasonably. This is especially true given that the EBL has expanded its scope of application to all 'enterprise legal persons,' compared to the 1986 Law that applied only to SOEs. Moreover, the EBL has also removed previous restrictions for bankruptcy filing—SOEs no longer need to obtain permission/approval from their supervisory government bodies to file for bankruptcy.

Presumably the non-obliging attitudes by some judges who refuse to apply the EBL also make foreign investors in China query "how the bankruptcy process will actually work for them—many are likely to decide to avoid using the [EBL] altogether, as it may not meet their needs." The aversion to the EBL allegedly led more companies to adopt the 'consensual methods,' in lieu of the legislatively-prescribed reorganization procedure, in dealing with their financial problems, so as to avoid a "formal and public process." Consensual methods are often seen by foreign investors as more desirable, even though the legislators' aim was to provide unified legislation (i.e., the EBL) to facilitate the reorganization of both Chinese and foreign enterprises based in China. Needless to say, the EBL's supplementary legislations will not be put to use if the EBL is not invoked. "There is more prospect of foreign companies taking the view [that] the value will come out in consensual discussions, rather than through reorganization proceedings under the EBL or relying on the EBL as an absentee stakeholder." Wherever the EBL fails to be invoked, it would inevitably put relevant securities regulations under pressure for non-compliance, which include:

(1) "Supplementary Provisions on Pricing Shares Issued in Significant Assets Reor-

85. New Bankruptcy Law Faces Severe Test, supra note 76, at 1.
86. Id.
87. Id.
88. 關於破產重整上市公司重大資產重組股份發行定價的補充規定 [Supplementary Provision on Pricing Shares Issued in Significant Assets Reorganization of Bankrupt Listed Companies for Restructuring], (promulgated by the China Sec. Regulatory Comm’n, Nov. 11, 2008, effective Nov. 12, 2008) (China).
The resolution shall be subject to adoption by two-thirds or more of the voting rights of shareholders that are present at the meeting, and shall be subject to adoption by two-thirds or more of the voting rights of public shareholders that are present at the meeting.

(2) "No. 2 Rules on Contents and Format of Information Disclosure by Companies for Publicly Issuing of Securities—Content and Format of Annual Reports" (公開發行證券的公司信息披露內容與格式準則第2號—年度報告的內容與格式，in Chinese), which mandates that companies shall disclose such relevant issues as bankruptcy and reorganization that occurred within the reporting period, including application to courts for reorganization, reconciliation, bankruptcy, or liquidation, any courts' rulings concerning said reorganization, reconciliation, bankruptcy, or liquidation, and that being handed down during the reorganization of companies, and other material issues. Companies that have implemented reorganization shall state the specific content and implementation of such reorganization plans.

By the name of it, it may be needless to say that the above-mentioned regulations (that are supplementary to the EBL) are applicable only to and thus have a particular focus on listed companies.

The reason for the declining number of bankruptcy cases is not the result only of judges' shirking their duties to apply the EBL. Another major reason is the cost-prohibitiveness of the EBL. The large amount of expenses associated with undertaking a reorganization process has forced SMEs to reconsider reorganization. Reorganization costs include, among others, (1) general expenses; (2) evaluation costs; (3) administration costs; (4) other professional fees; and (5) administrative costs. All of these costs will be expounded further below. Understandably, these costs all together will likely be too high for the average SMEs to absorb, considering they had come into financial difficulty in the first place.

C. REORGANIZATION COSTS

Reorganization costs can be immense, within one or several of the following categories.

1. General Expenses

The EBL requires that the administrator or debtor company submit a draft reorganization plan within six months (which is extendable for another three months) of the date on which the People's Court makes an order for the reorganization of the debtor company. To facilitate that requirement, the administrator must call for the holding of the creditors
meeting, which entails not only a thorough investigation and confirmation of debts but also a variety of other expenses for the purposes of producing creditors' lists and printing and mailing said lists to (or calling) the creditors to inform them of the said meeting. Moreover, Article 81 of the EBL provides that the proposed reorganization plan shall contain the following contents, among others:

(i) the business plan of the debtor company; (ii) the classification of the claims; (iii) the adjustment mechanism of the claims; and (iv) the repayment schedule of the claims; (v) the time limit for implementation of the reorganization plan and (vi) the time limit for supervision (by the administrator) over implementation of the reorganization plan.

All of the content requirements are highly technical and, in the making of a reorganization plan, will require a great deal of secretarial assistance in making and tabling the reorganization plan.

2. Professional Services Costs

Professional services in commercial/financial trading will also likely be sought, in order to transform illiquid assets into liquid cash to be distributed fairly to creditors of different classes. Remunerations for these professionals who are service providers will add more charges to the overall expenses towards reorganization.

3. Evaluation (or Financial Advisory) Costs

Evaluation costs stem from analyses for both the debtor company's business and assets. The purpose for evaluating the business is for creditors to determine the debtor company's viability to operate as a going concern, while the purpose for evaluating the asset is to "estimate the discount rate implicit in creditors' reorganization plan decisions."95 Value for the discount rate is essentially an assumption in evaluating the 'best-interests test.' The best-interests test is embodied in paragraph (3) of Article 87 of the EBL, borrowing from § 1129(a)(7)(A) of the U.S. Bankruptcy Code, which states that a U.S. Chapter 11 plan cannot be confirmed unless creditors receive as much under the plan as under liquidation,96 or put another way, unless the reorganization plan is calculated to benefit the general body of the creditors.97 In China, the EBL requires that a reorganization plan be approved not only by the creditors, but also the court—this is known as 'double approval.' Influenced by the U.S. practice, whereof court-supervised reorganization procedures typically require judges to apply the best-interests test, the EBL shall require the bankruptcy judges to undertake the same test. A successful reorganization plan entails a discount rate acceptable to the creditors for agreeing to a 'haircut.'98 Creditors can also agree to ex-
change debt for equity in the reorganized entity; thereby reorganization entails a change in the debtor company's capital structure. Proper value analysis is material in assessing the feasibility of the debt-credit swap.

4. **Administration Costs**

Administration costs are the fees payable to an independent administrator appointed by the People's Court. The EBL adopts partially from the U.K. model for administrator replacement, which was not seen in its predecessor law (the 1986 EBL) as the latter did not establish an administrator system, but rather provided that the (bankruptcy) liquidation group be responsible and report to the court. 

Administrators in China must be designated by the People's Court, and once appointed, the EBL allows the administrators to engage in a wide range of activities and responsibilities. The administrator's job consists mainly of checking, investigating, and confirming bankruptcy claims, for which remuneration must be paid. The administrator's remunerations are to be paid out of the debtor company's assets. In this respect, an administrator would "nearly always be an add-on expense, or at least until the ranks of management were trimmed," said one commentator who proposes "[substituting the DIP for the administrator] saves money for the estate [of the debtor company]." This is, strictly speaking, not the practice in China, considering the EBL is essentially a hybrid of both the U.K. and U.S. systems—the role of an administrator in the U.K. system is introduced to the EBL, but instead of assuming 'management replacement' as in the U.K. model, the EBL adopts DIP as in the U.S. model. Last but not the least, the remuneration of administrators in China will be borne from the debtor's unsecured assets, pursuant to the respective percentage charges as


100. The EBL, art. 13.

101. Id. art. 25.


103. Woodward, supra note 79, at 147.

104. The debtor-in-possession (DIP) principle is central to the U.S. system, where the incumbent management of the debtor company remains in place to continue to operate its business and manage its assets during the reorganization process.

105. Woodward, supra note 79, at 147.
stipulated in the “Provisions of the Supreme People’s Court on Determination of the Administrator’s Remunerations.”

5. Other Professional Services Fees

According to Article Two of the “Provisions of the Supreme People’s Court on Designating the Administrator during the Trial of Enterprise Bankruptcy Cases,” the position of administrator should be held by professional services firms (e.g., law firms, accounting firms, or bankruptcy liquidation firms) or individuals (including lawyers or certified public accountants). Each of them understandably possesses a distinctive set of skills and, as such, it is not uncommon that an administrator would need to engage other professionals to carry out a complex reorganization plan. For example, a lawyer appointed as an administrator would have knowledge in law, but not likely in accounting or finance; thus he would likely have to engage financial services firms for value analysis of the debtor company, especially if such efforts involve the bankruptcy restructuring of a listed company with a major asset reorganization plan. In that case, on top of the administration costs payable to the lawyer, other professional fees will also be incurred for the financial services firms in consideration of their provision of services, inclusive of setting the price for those shares to be issued by the debtor company, which would then form a newly-acquired fund for the debtor company to purchase assets.

Professional fees are likely to be charged to the debtor on either a percentage basis or a time-cost basis; the former refers to the estimation of fees being based on a certain percentage (usually agreed upon beforehand, between parties) of the debtor’s estate and the latter, on the actual time spent multiplied by the professional’s hourly rate in rendering the services described above. Professional fees could be high, especially for those financial services that are highly technical and strategically complex.

6. Administrative Costs

Under the EBL’s framework, there is a high degree of court involvement (hence the legal fees payable to the court) throughout the reorganization procedure. For example:

(i) the debtor company or its creditor shall apply to the People’s Court for entering into bankruptcy proceedings;

(ii) the administrator shall report his work to the People’s Court, during the reorganization procedure;

(iii) the administrator or debtor company shall submit a draft reorganization plan to the People’s Court;

106. [Provisions of the Supreme People’s Court on Determination of the Administrator’s Remunerations], (promulgated by Sup. People’s Ct., Apr. 12, 2007, effective June 1, 2007) art. 2 (China).
107. Designation of Administrators, art. 2.
108. The EBL, arts. 2, 7.
109. Id. art. 23.
110. Id. art. 79.
(iv) the People’s Court shall convene the creditor’s meeting for the creditors (of four voting classes) to vote on the reorganization plan;\textsuperscript{111}

(v) the administrator or debtor company shall submit an application to the People’s Court for approval of the reorganization plan;\textsuperscript{112}

(vi) the administrator or debtor company may apply to the People’s Court to cram down the objection of the dissenting group(s) of creditors and, in so doing, approve the reorganization plan.\textsuperscript{113}

Reorganization cannot commence without petitioning to the People’s Court in the location where the debtor is domiciled.\textsuperscript{114} Once the bankruptcy petition is approved and filed,\textsuperscript{115} the administrator must call for the holding of the creditors’ meetings, participate in any lawsuit, arbitration, or other legal proceedings on behalf of the debtor, and report his work to the People’s Court.\textsuperscript{116} Within six months of the commencement of the reorganization period, the administrator or the debtor company is to prepare a draft reorganization plan.\textsuperscript{117} The EBL requires the reorganization plan to be approved by the creditors as well as by the court.\textsuperscript{118} To that end, where the reorganization plan is not passed at the creditor’s meeting, the administrator or the debtor company may negotiate with the dissenting groups and a second vote may be convened after negotiation.\textsuperscript{119} Where the draft plan is still not adopted by the second vote after negotiation, the administrator or the debtor company may apply to the court for approval of the reorganization plan over the objection of the dissident group(s).\textsuperscript{120} For any stage of work required under the EBL, a potentially substantial amount of fees will be borne due to this complicated reorganization procedure.\textsuperscript{121}

While the legal fees are most likely to be paid only to the People’s Court, if the debtor company is involved with a third party (which is also bankrupt and to which the debtor company is a creditor), then in order to receive the collectable debts, the legal fees will also include those that are payable to a foreign court.\textsuperscript{122} More specifically, in instances of cross-border corporate bankruptcy, it is possible that the administrator (of the debtor company in China) will have to file a petition in a foreign court for accessing the assets located outside China that belong to the third party.\textsuperscript{123} The administrator has the duty to collect any receivable debts to be included in the debtor company’s estate, from which the reorganization expenses will be paid out.

\begin{enumerate}
\item \textsuperscript{111} Id. arts. 82, 84.
\item \textsuperscript{112} Id. art. 86.
\item \textsuperscript{113} Id. art. 87.
\item \textsuperscript{114} Id. art. 3.
\item \textsuperscript{115} The filing can be made either by the debtor, the creditor, or the investor with capital contribution of one-tenth or more of the debtor company’s registered capital. See id. art. 70.
\item \textsuperscript{116} Id. art. 25.
\item \textsuperscript{117} Id. art. 79.
\item \textsuperscript{118} Id. art 86.
\item \textsuperscript{119} Id. art 87.
\item \textsuperscript{120} Id.
\item \textsuperscript{122} Id.
\item \textsuperscript{123} Id. at 23.
\end{enumerate}
IV. The EBL’s Deficiencies & Remaining Issues

A. Reorganization Used Rarely in China

1. Low Number of Reorganization Cases

The low number of reorganization cases has been described in an earlier section titled “Bankruptcy Statistics” above. Despite the EBL’s modest success, certain bankruptcy experts in China seem rather optimistic about its achievements so far. In a joint article published by Professor Li and Zhofa Wang in 2009, as noted above, it was indicated that:

[T]he newly introduced reorganization system seems to be working well. There appear to have some reorganization cases since the enactment of the new law [EBL], especially that of some large listed corporations. There have been 16 reorganization cases adopted by the courts of listed corporations [until] June 2009. There are also some reorganization cases of close corporations.124

It is necessary to note that the number of cases (sixteen) herein is slightly less than the number of cases (twenty-three) reported at the meeting of China INSOL mentioned above—where Professor Li spoke in his capacity as the Director of Bankruptcy Law and Restructuring Research Centre of China University of Political Science and Law. The discrepancy in the two figures was a result of Professor Li’s article being written before the said meeting that took place on November 29, 2009.125 As mentioned before, a more recent book publication co-authored by Professor Li further indicated that there are twenty-six listed companies that have begun the reorganization process.126

Despite these slight discrepancies, reorganization is not used widely in China compared to other jurisdictions. The number of Chinese reorganization cases over a period of three to four years (since the EBL’s promulgation in August 2006) is significantly less than those recorded in Australia and the United Kingdom, following the respective promulgation of their reorganization laws,127 namely the Insolvency Act of 1986 (in the U.K.) and the Corporations Act of 2001 (in Australia).128 Contrary to China’s slow acceptance of its new statutory corporate reorganization system, reorganization under the Australian shelter regime (voluntary administration) was used widely from its genesis. In Australia in 2003, “40.3 per cent of all companies entering formal corporate bankruptcy went into voluntary administration.”129 Although the actual number of companies having been reorganized was not available, the ratio stood at a relatively high level, considering it was then only two years following Australia’s Corporations Act of 2001.130 In the United Kingdom in 1987, one year after the U.K.’s Insolvency Act of 1986, there were 131 companies undergoing

124. Li & Wang, supra note 67, at 3.
125. See Member of China Int’l Insolvency Ass’n Annual Meeting, supra note 68.
126. Li & Zhen, supra note 73, at 73.
127. Reorganization in the United States is conducted under Chapter 11 of the U.S. Bankruptcy Code. Correspondingly, the Insolvency Act 1986 is the central piece of U.K. legislation while the central piece of Australian legislation is the Corporations Act 2001.
130. Id.
administration procedures. Note that reorganization, as the shelter regime, has been introduced in the United Kingdom as simply “administration” and in Australia as “voluntary administration.” China adopted the U.K. system, with the administrator replacing the management of the debtor company in (bankruptcy) reorganization. In terms of actual acceptance and adoption of the reorganization system, the ratio or number in Australia and the United Kingdom, respectively, far exceeded the numbers recorded in China.

In the United States, a recent study by Professor Elizabeth Warren of Harvard University suggested that reorganization is very well received in the United States, as evidenced by nearly all troubled companies having chosen U.S. Chapter 11 restructuring over U.S. Chapter 7 liquidation; among those, seventy percent resulted in confirmed plans of reorganization. Professor Warren’s research was premised on data collected from large samples of U.S. Chapter 11 cases filed in 1994 and 2002, against which she identified that “almost half the unsuccessful cases were jettisoned within six months and almost eighty percent were gone within a year.”

To this end, Professor Warren concluded that the reorganization system under U.S. Chapter 11 serves as a critical screening function to eliminate hopeless cases relatively quickly. As such, she challenged the conventional wisdom that U.S. Chapter 11 is characterized by a relatively low success rate and endless delay. Unfortunately, the same conclusion does not apply in China just yet. It has been known that reorganization can take much longer in China, well over one year or beyond. Although a sufficient period of adjustment may be required before the new reorganization legislation becomes widely accepted, Australia’s “immediately engaging” experience proved that it does not always have to be the case. It thus merits further assessment to determine whether China’s low number of reorganization cases is any indication of its administration process being less efficient and too costly. While it is an important issue, it is beyond the scope of this article.

On the other hand, in terms of the cost of corporate bankruptcy, a World Bank report conducted in 2010 indicated that undergoing a bankruptcy process in China is estimated to cost about twenty-two percent of the estate value in each year of the period from 2006-2009, which is about sixty-two percent more than the OECD average. To minimize the cost, commentary in favor of DIP argues that substituting the DIP for the ad-

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131. Id. at 108 (Table 5.1 Administrative Procedures).
133. Id.
134. Id.
135. Id.
137. For more details, see id. at 155-59.
139. OECD stands for the Organization for Economic Cooperation and Development.
ministrator saves money for the debtor company’s estate.140 In connection to this, Professor Li suggested that even though the DIP mode is embedded in China’s EBL, “[a]mong the 16 reorganized listed corporations [as mentioned above], there are only 3 DIP cases.”141

The deficiencies of the EBL impel one to probe into the many hurdles to this law. In addition to the relatively small number of reorganization cases approved in China,142 a meeting at China INSOL mentioned above also noted that reorganization is undertaken increasingly by more “Special Treatment” (*ST) companies than regular companies wanting to restructure themselves.143 Special treatment connotes a distinctive “warning system” that was formulated by the securities exchanges in China to warn investors of listed companies suffering severe losses and that are at risk of being delisted from the stock exchange(s). If a listed company accumulates losses for some consecutive years, varied slightly from each and every stock exchange in China, that company’s shares will be suspended from trading; and during the period of suspension, if the company’s finance fails to improve, then its business license will be revoked and the company’s shares will be delisted from the stock exchange(s). For example,

[A]ccording to the rules of the Shenzhen and Shanghai stock exchange[s], listed corporations suffering losses for two continuous years shall be [branded with the prefix] *ST . . . [e.g., a fictitious company known as “ABC Company Limited” prior to the branding thus becomes, after the branding, “**ST ABC Company Limited”] to warn investors of the potential risk that the corporation may be de-listed if the losses continue. If the *ST corporation continues to lose money for two years, it will [then be further branded with the prefix] “S*ST” in the third year. If the company is still unable to recover by the end of the third year, its shares will be de-listed.144

It is worthwhile to note that “[s]ince the [listing cost] in China’s securities market is quite high, the *ST corporations still possess considerable ‘shell value.’ *ST corporations become attractive targets of acquisition for outside financial or strategic investors.”145 In 2009 alone, there were reportedly at least ten *ST companies that began the reorganization process, including among others *ST Xia Xin (*ST夏新, in Chinese), *ST Dan Hua (*ST丹化, in Chinese), and S*ST Guang Ming (S*ST光明, in Chinese).146 Among them, unofficial statistics suggested that following the EBL’s coming into effect on June 1, 2007, almost all *ST companies applying for bankruptcy reorganization have been successfully restructured, after which their share prices have soared.147 This makes restructuring of *ST companies a highly profitable investment in China, considering that reorganization will generally only take about seventeen months to complete.148 For *ST companies, normally on the twentieth trading day after the People’s Court accepted their applications for

140. Details will be further explained in the section titled “Reorganization Cost.”
141. Li & Wang, supra note 67, at 4.
142. See Member of China Int’l Insolvency Ass’n Annual Meeting, supra note 68.
143. Id.
144. Li & Wang, supra note 67, at 4.
145. Id. at 4.
147. Li & Wang, supra note 67, at 4-8.
148. Lee & Ho, supra note 63, at 146.

WINTER 2011
entering into a bankruptcy reorganization procedure, the *ST company will be suspended from trading for a period of six months; then, it will take a further ten months for formulating a reorganization plan, which will then need to be approved by the *ST company’s creditors and the court before its ultimate implementation. Once reorganization becomes successful, the *ST companies’ shares, as the historical track records of such events show, quickly soar and become highly profitable for speculators trading in the stock market.

Restructuring of *ST companies is arguably the most peculiar side of reorganization business in China. In common cases, the *ST company has minimal or no value (other than shell value), and even so, reorganization application can surprisingly be accepted by the court. Had the same type of cases been applied in other countries, bankruptcy liquidation would likely be the one and only option to resolve the debtor company’s debts, as it lacked a viable business prospect at the time of bankruptcy application, a prerequisite to applying for reorganization in most jurisdictions. An extreme example for this is *ST Guangxia (*ST银广夏, in Chinese), which was bankrupt with no assets, no operating capital, and even no fixed business premise, and yet with its remaining shell value, CITIC Bank entered into a debt transfer agreement with one of the debtor company’s creditors, “Beijing Jiu Zhi Hang” (北京九知行, in Chinese), from which CITIC Bank reportedly took on debt of more than CNY100 million. It was reported that Beijing Jiu Zhi Hang was preparing to file a bankruptcy reorganization application in court, on the basis that the debtor company’s debts exceeded its assets. Beijing Jiu Zhi Hang sought to maximize its gains from the debt buy-out by getting priority claims against other creditors. Had the *ST Guangxia ended in bankruptcy liquidation (instead of bankruptcy reorganization as the case was proceeding toward), the creditors’ financial loss (including that of Beijing Jiu Zhi Hang) would have been enormous. While reorganization is the preferred option for Beijing Jiu Zhi Hang, it remains to be seen whether it can be carried out successfully due to the conflict of interests between the *ST company’s (*ST Guangxia) original shareholders and creditors. As such, the case has been reported widely as highly skeptical and controversial.

2. Application of the EBL by the Provincial Court

As with a majority of PRC legislation, the EBL’s effectiveness will depend on how it is implemented and enforced at the provincial level. Despite the difficulty facing the People’s Courts in adjusting to the EBL, they have demonstrated good intentions in making the transition from the old system to the new one. As evidence of the courts making
the transition to the new system, one may witness the recent acts of the Superior Provin-
cial Court in An Hui Province (安徽省高级人民法院, in Chinese). That court maintains
and operates a roster of administrators comprised of fifty law firms, twenty-six account-
ing firms, and two bankruptcy liquidation firms.\textsuperscript{161} The administrator is appointed by the
People’s Court through a transparent process of random methods such as rotation, draw-
ing lots, or machine-controlled lottery (roster system).\textsuperscript{162} Alternatively, the court may
even hold a competitive bidding process in its selection of an administrator who is to
handle a complex case (such as the bankruptcy of a commercial bank, securities company,
insurance company, or any other financial institution).\textsuperscript{163} By way of legislative design, the
‘administrator’ under the EBL is to replace the ‘liquidation group’ under the old law, so as
to provide fairness and transparency to the creditors. In that connection, the court’s role
has become less dominant, shifting from “administrating” the bankruptcy procedure (as in
the old law) to mainly “facilitating and supervising” it (as in the EBL). But to facilitate the
matter, the People’s Court shall first convene the creditors’ meeting\textsuperscript{164} (so as to take a
vote on the draft reorganization plan) and then approve the reorganization plan, if a ma-
jority of creditors has passed it.\textsuperscript{165} From a legislative viewpoint, the administrator is de-
signed by the EBL to lead the reorganization plan, and with the benefit of the
administrator’s professional expertise and training, this is a move in the right direction.\textsuperscript{166}

As more evidence of the courts making the transition to the new system, one may wit-
ness the recent acts of the Supreme People’s Court in An Hui Province whereby the court
has convened three training sessions for 380 civil and commercial law judges and seventy-
eight (bankruptcy) administrators to apply and implement the EBL.\textsuperscript{167} Such efforts are
also evidenced in its presiding of various symposiums for the discussion of key issues aris-
ing from the EBL.\textsuperscript{168} This is yet another move in the right direction.

B. THE EBL’s COMPATIBILITY ISSUES

While implementing the EBL, some judges expressed the challenges they felt in dealing
with ‘jurisdiction’ and ‘responsibility of proof,’ highlighting the issue of the EBL’s com-
patibility with pre-existing laws that are still in effect. For example, Article 3 of the EBL
sets out that the jurisdiction of a bankruptcy reorganization case lies in the People’s Court
of the place where the debtor company is domiciled. The very same provision can poten-
tially create a conflict with the civil procedural law wherein certain types of cases (bank-
ruptcy being one of them) may be reserved for jurisdiction by a specific level of court
(級別管轄, in Chinese) or special court (專屬管轄, in Chinese).\textsuperscript{169} ‘Reserved jurisdiction’
is arguably a familiar practice for many courts in China, at least before the EBL came into

\begin{itemize}
\item \textsuperscript{161} MING HUA WANG, supra note 54, at 336.
\item \textsuperscript{162} See Designation of Administrators, art. 20.
\item \textsuperscript{163} Id. art 21.
\item \textsuperscript{164} The EBL, art. 84.
\item \textsuperscript{165} Id. art. 86.
\item \textsuperscript{166} DERYCK PALMER, RECENT DEVELOPMENTS IN BANKRUPTCY LAW IN CHINA, 2010 WL 3650157, at *1 (2010).
\item \textsuperscript{167} MING HUA WANG, supra note 54, at 336.
\item \textsuperscript{168} Id.
\item \textsuperscript{169} Id.
\end{itemize}
being, to sort out and further delegate to the specific division of the courts the cases filed with them based on their internal management rules.\textsuperscript{170}

Another compatibility issue involves Article 7 of the EBL, which allows the creditors to file for the bankruptcy of the debtor company as long as the latter is generally unable to pay its debt as and when they fall due.\textsuperscript{171} To prove the debtor's inability to pay, the court relies on information provided by and accessible usually only to the debtor company and not the creditor; thus, it creates a limitation on ascertaining the true state of the debtor company's financial affairs.\textsuperscript{172} Problems may arise where the debtor company does not cooperate or fails to provide true accounts of its financial situation.\textsuperscript{173} This problem is further exacerbated as the EBL does not specify whether the onus of responsibility to prove insolvency rests on the debtor company, creditors, or elsewhere.\textsuperscript{174} This legal lacuna will need to be filled for better creditors' rights protection.\textsuperscript{175} It is applicable equally for instances where the creditors files for reorganization of or bankruptcy against the debtor company.

C. DIP Proceedings

Under the EBL, a debtor, creditor, or substantial investor is eligible to apply to the court for reorganization of the debtor company.\textsuperscript{176} Generally speaking, once the reorganization application is accepted by the court, an administrator will be appointed by the court to take over and manage the debtor's business and assets.\textsuperscript{177} Accordingly, once the reorganization application is accepted by the court, the managing power of the existing board will be suspended,\textsuperscript{178} unless and until the debtor applies to the court for the administrator proceedings to be converted into DIP proceedings under the supervision of the previously appointed administrator during the reorganization period.\textsuperscript{179} From this angle, the EBL offers a hybrid of the U.S. and the U.K. systems, the former being the DIP and the latter being management replacement.\textsuperscript{180} What remains unclear by the EBL is that it does not provide instructions as to “who is entitled to make such an application—whether it is the general meeting of shareholders or the board of directors.”\textsuperscript{181} This legislative lacuna could “impede the implementation and effectiveness of the Chinese-modified DIP” concept, as suggested by one commentator who viewed that given the limited management power of the board of directors accorded to them under Chinese company law, the board of directors, without the authority of the shareholders' meeting, should not be allowed to petition the court for applying to convert the administrator proceedings to DIP

\textsuperscript{170} Id.

\textsuperscript{171} The EBL, art. 3.

\textsuperscript{172} \textsc{The UNCITRAL Legislative Guide, supra note 58, at 46, ¶ 25.}

\textsuperscript{173} Id. at 46; The EBL, art. 8.

\textsuperscript{174} See generally \textsc{The EBL}.


\textsuperscript{176} The EBL, art. 70.

\textsuperscript{177} Id. art. 13.

\textsuperscript{178} \textsc{Zhang, supra note 18, at 215.}

\textsuperscript{179} See id.; \textsc{The EBL, art. 73(1).}

\textsuperscript{180} \textsc{Zhang, supra note 18, at 214-15.}

\textsuperscript{181} Id. at 215.
proceedings. In relation to this, the EBL also failed to account for what considerations the court ought to make before granting a DIP application, which again as suggested by the commentator creates yet another legislative lacuna. Some suggested that the court should investigate the root problem for causing the corporate distress and, if poor management and decision making is responsible for the company's bankruptcy, the court should accordingly dismiss the DIP application. Likewise, the "judges need to assess whether or not the existing directors" are competent "to manage the ailing company" and to continue "trading during the reorganization process." To this end, the judges would be expected to "evaluate the directors' experience and ability to deal with the balance of risk and return, to negotiate and produce a reasonable and practicable rescue proposal during the reorganization." By doing so, it is suggested that the debtor company should submit to the court "the management records and board minutes along with the DIP application for the consideration of the court;" on the other hand, the court should also consult the opinions of the creditors and the representatives of the labor union(s) who are familiar with the management's competence, governance style, and decision-making. While all attempts for eliminating the legislative lacuna are commendable, the questions remain as to whether the judges would be given too much discretionary power in making relevant decisions and whether all the necessary investigations to be carried out by the judges who decide on such matters could be completed within the prescribed reorganization period of six months. If that time period is exceeded the unpaid employees and creditors would suffer from the prolonged reorganization procedure and, which, if unsuccessful, could lead eventually to and end with the corporate bankruptcy procedure for the failing/failed company. Given that the EBL is silent on the amount of time before which judges are required to make DIP decisions, it raises another layer of concern for the law's effectiveness and application. It should be noted that, once the DIP application is accepted by the court, the administrator who has taken over the business affairs and assets of the debtor company shall hand over those back to the debtor company's management, and the administrator's functions and powers provided for in the EBL should be exercised by the debtor company's management.

D. Requirements for Reorganization Application—Two-Limb or One-Limb Test?

The persons eligible for applying for reorganization are set out in Article 70 of the EBL, being the debtor company itself, a creditor, or investors whose capital contribution comprises one-tenth (1/10th) or more of the debtor company's registered capital. Then, the next task is to identify the requirements for commencing a reorganization process.

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182. Id.
183. Id.
184. Id. at 215-16
185. Id. at 216.
186. Id.
187. Id.
188. The EBL, art. 79.
189. ZHANG, supra note 18, at 216.
190. The EBL, art. 73.
191. Id. art. 71.
The EBL appears to provide the same requirements for the debtor company to resolve its debt, either through bankruptcy liquidation or reorganization process.\textsuperscript{192}

Article 2 of the EBL states that:

“Where an enterprise is unable to pay off a debt that is due and its assets are insufficient to pay off all of its debtors . . . it shall clear off its debts in accordance with the provision of this Law.”\textsuperscript{193}

Article 7 of the EBL further states that:

“A debtor who comes under the circumstances described in Article 2 of this Law may submit an application to the people’s court for reorganization . . . or bankruptcy liquidation.”\textsuperscript{194}

Considering these two articles together, it can be reasonably construed that, for a debtor company to apply for either liquidation or reorganization, it must satisfy both the ‘liquidity test’ and the ‘balance sheet test’ (i.e., the two-limb test).\textsuperscript{195} The ‘liquidity test’ (also known as the ‘cash flow test’) assesses the debtor’s ability to pay off a debt that is due, while the ‘balance sheet test’ gauges the debtor’s total assets and total liabilities.\textsuperscript{196} In contrast, a creditor can apply for the debtor’s liquidation or reorganization by meeting only the liquidity test.\textsuperscript{197}

For a debtor to apply for reorganization, the stricter two-limb test shall apply, but it remains unclear whether a lower threshold test can come into play. That is because Article 2 of the EBL also provides that:

“Where an enterprise with the status of legal entity comes under the circumstances described in the preceding paragraph, or [emphasis added] is facing the possibility [emphasis added] to lose the ability to pay off a debt apparently [emphasis added], the enterprise may be reorganized . . . ”\textsuperscript{198}

Whether the legislators had ever intended for it to mitigate the strictness of the two-limb test is unknown. Moreover, the debtor’s burden of proof for the application of reorganization is also unclear. At the risk of mincing words, the very word ‘possibility’ points to a lower standard, but the [paring] word ‘apparently’ points the other way. The issue for consideration is whether the provision, “[the debtor is] facing the possibility to lose the ability to pay off a debt apparently,” constitutes as a separate test, apart from the “two-limb” test.\textsuperscript{199} On the one hand, this particular provision may be construed as evidence that the EBL encourages reorganization by toning down the stricter two-limb test—as long as there is “possibility” that the debtor would lose the ability to pay off to debt, the
debtors can apply reorganization to the People's Court. On the other hand, as one commentator suggested, this provision is not a separate test but rather an element inherent in the meaning of the general cessation of payment. The commentator goes on to say that this provision is not meant to mitigate the strictness of the two-limb test. The commentator's view is justifiable so as to eliminate potential uncertainties in the application of law. Otherwise, due to the absence of objective standards, in defining the degree of which the "possibility" (of the debtor's inability to pay off a debt) would become so 'apparent' that it would amount to the debtor's inability to pay, the debtor could effectively be disqualified to apply for reorganization under the EBL than it would otherwise be allowed to do so.

To assist effectively debtors with financial difficulties at an early stage, the commencement standard for reorganization must be one that is less onerous than that for liquidation. By extension, the reorganization requirement must not require the debtor to wait until it is actually unable to meet its debt before making an application.

The liquidity test is seen as a preferred measure, as suggested by both the United Nations Commission on International Trade (UNCITRAL) and the World Bank. The UNCITRAL Legislative Guide, adopted by the UNCITRAL in 2004, suggests that the liquidity test serves to discover early in the period of the debtor company's financial distress, hence minimizing dissipation of assets and avoiding the 'asset-grab' that would cause the dismemberment of the debtor company to the collective disadvantage of all creditors. Although the UNCITRAL Legislative Guide suggests that the balance sheet test suffers from a number of disadvantages and thus should not be used as the single test, it does not object to a standard that contains both the liquidity and balance sheet tests. It states only that if a single test for assessing corporate bankruptcy is adopted, it should be the liquidity test, as in the case of the cessation of payments test, which provides an effective trigger for access to corporate bankruptcy proceedings. Second, the World Bank's "Principles and Guidelines for Effective Insolvency and Creditor Rights Systems" in 2001 also suggests that "the preferred test for insolvency should be the debtor's inability to pay debts as they come due—known as the liquidity test. A balance sheet test may be used as an alternative secondary test, but should not replace the liquidity test."

E. Dual Approval for Reorganization Plan

Relevant provisions governing the reorganization system under the EBL are contained in Chapter 8. The EBL dedicates an entire chapter for the initiation of reorganization period and the approval of a reorganization plan. Essentially, reorganization in China is a court-supervised three-stage procedure, namely (1) application to the court; (2) com-

201. THE UNCITRAL LEGISLATIVE GUIDE, supra note 58, at 46, ¶ 23.
202. Id. The balance sheet test is seen as problematic because it relies on information provided by and accessible usually only to the debtor, not the creditor; this creates a practical limitation on ascertaining the true state of the debtor's financial affairs. In addition, the balance sheet test subjects insolvency determination to accounting principles and standards, whose adoption and interpretation vary across countries or even different subparts of the same country.
203. Id. at 48, ¶ 29.
mencement of reorganization period; and (3) ‘double approval.’ Double approval alludes to the fact that the reorganization plan has to be approved not only by creditors of the debtor but also by the court.205 Where the double approval procedure is concerned, the first approval must be obtained from creditors, who will be divided into separate voting classes (such as secured creditors, unsecured creditors, and employment-related creditors) for purposes of approving a reorganization plan.206 It is important to note that approval from each voting class is necessary for the reorganization plan to be adopted.207 The second approval must be obtained from the court whereby the debtor or administrator shall, within ten days from the date of first approval, submit an application to the People’s Court for approving the reorganization plan.208

To examine whether the dual approval requirement would pose any difficulty to the implementation of the corporate reorganization system in China, it is helpful to see what the international benchmark is. The UNCITRAL Legislative Guide states that, throughout the world, most corporate bankruptcy systems require only the creditors’ approval of the reorganization plan and not the court’s approval; those foreign courts often approve subsequently the plan that has already been approved by the creditors.209 Where the reorganization system requires only ‘single approval’ by the creditors for adopting the plan, even though there is no court supervision of the plan, the corporate bankruptcy laws usually provide for the plan to be challenged in the court.210 Common grounds for the court’s challenge include reorganization approval implicated by:

(1) fraud;
(2) “irregularity in the voting procedure;”
(3) “irregularity in the organization or conduct of the meeting at which the vote was taken;”
(4) inadequate opportunity for voting classes to participate in relevant proceedings;
(5) no access or lack of access to information necessary for voting classes to make an informed decision to reject or accept the proposed reorganization plan; and
(6) unfair prejudice against the interest of dissenting classes of creditors.211

In contrast, where the corporate bankruptcy law requires the court to confirm a plan, the UNCITRAL Legislative Guide suggests that the court’s duty is to “ensure that the approval of the plan was properly obtained” and the stipulated conditions were satisfied.212 In relation to ‘stipulated conditions,’ the UNCITRAL Legislative Guide suggests that such conditions shall include: (1) dissenting creditors of the plan would share the economic benefits of the said plan; (2) dissenting creditors would receive “as much under the plan as they would have received in liquidation;” (3) “no creditor would receive more than the full value of its claim;” (4) normal ranking of claims under the corporate bankruptcy law is observed by the plan; (5) “similarly ranked creditors are treated equally;” (6) the

205. The EBL, arts. 84, 86.
206. Id. arts. 82, 84, 86.
207. THE UNCITRAL LEGISLATIVE GUIDE, supra note 58, at 226.
208. The EBL, art. 86, ¶ 2.
209. THE UNCITRAL LEGISLATIVE GUIDE, supra note 58, at 226.
210. Id. at 227.
211. Id.
212. Id. at 228, ¶ 60.
plan can be considered to be fair in respect of those classes of creditors “whose interests are modified or affected by the plan but which nevertheless have voted to approve the plan,” and (7) the plan is feasible from a practical point of view. Such stipulated provisions, on the surface, are similar to the ‘cram-down’ provisions in the EBL except that the EBL does not provide any guidelines for the court’s scrutiny. From one’s viewpoint, where the court’s approval (i.e., second approval of the reorganization plan) is required, the provisions should not be open to the court’s wide discretion so as to prevent undue judicial influence. Essentially, the court’s approval should be constrained only to legal formality. Likewise, the court cannot investigate into the merits of the reorganization plan as it is not up to the court to make commercial decisions. The court should not be expected to examine the economic and commercial basis of the decision of the creditors either.

F. FORMS OF REORGANIZATION

The EBL focuses mainly on procedural matters and is silent on the substantial matters such as the forms of transactions that qualify for restructuring. In this regard, lessons may be drawn from the “Circular on Several Issues on Corporate Income Tax Treatment of Corporate Restructuring Transactions,” which is the tax implementation rules for corporate restructuring. Under the rules, the forms of transactions that qualify for restructuring are:

1. Changes in legal form (such as registered name, address or entity type);
2. Debt restructuring;
3. Equity acquisition;
4. Asset acquisition;
5. Merger; and
6. Spin-off (or splitting and transferring an enterprise’s partial or entire assets to other existing or new enterprises whereby shareholders of the spun-off enterprise receive equity or non-equity payment of the spin-off enterprise in return).

One needs to be aware of the distinction between the ordinary ‘corporate restructuring’ and ‘bankruptcy reorganization.’ In the former case, the company most likely has not yet entered into the bankruptcy process, but for various business reasons the company has

213. Id. ¶ 61.
214. Id. ¶ 62.
215. Generally, a reorganization plan will be approved only if (1) an affirmative vote of two-thirds (2/3rd) of the total amount of claims in each class and a majority of the same group present at the creditor’s meeting and (2) approval is obtained from all voting classes and the court. The EBL, art. 84. But, a court can “cram down” a dissenting class and approve the reorganization plan once these four tests are met: (i) fair and equitable test; (ii) best-interest test; (iii) no unfair discrimination and absolute priority; and (iv) feasibility test. See id. art. 87.
216. Id.
217. The words “reorganization” and “restructuring” are used almost interchangeably in most bankruptcy literature to refer to the rescue of a company approaching insolvency.
218. Circular of the Ministry of Finance and the State Administration of Taxation on Several Issues on Corporate Income Tax Treatment of Corporate Restructuring Transactions, n. 59 (Cai Shui 2009).
sought to augment its revenue; whereas, in the latter case (which the article is focused on),
because the bankruptcy proceeding has already commenced, the mainstay of the reorganiza-
tion will rest on debt-repayment. The UNCITRAL Legislative Guide conveys that 
reorganization can take a number of different forms, including (i) a ‘composition,’ refer-
ing to a simple agreement concerning debts, where the creditor agrees to take a ‘hair-
cut;’219 or (ii) a complex reorganization, where debts are restructured; or (iii) a conversion 
of debt to equity, together with a reduction or even cancellation of existing equity.220 The 
UNCITRAL Legislative Guide sets the international benchmark for corporate bank-
ruptcy law, which is accepted by many countries including China, as the EBL conforms 
largely to the recommendations of the UNCITRAL Legislative Guide and is therefore on 
par with international standards of corporate bankruptcy law.221 Deduced from the differ-
ent context that provides for China’s tax implementation rules for corporate restructuring, 
such rules should not be understood to supplement the EBL without proper adjustment. 
Where the implementation of the rules will impinge on the creditors’ rights, especially 
those expressly protected under the EBL, they shall cease to apply.

G. Disclosure

For the draft reorganization to be acceptable, Article 84 of the EBL states that the 
People’s Court shall convene the creditors’ meeting within thirty days from the date of 
receipt of the draft reorganization plan so as to allow for the creditors to vote on the draft 
reorganization plan.222 Then, the draft reorganization plan will have to be adopted by 
each voting group (or class) of creditors before it can be submitted to the People’s Court 
for its approval.223 Because the creditors’ approval is fundamental and prerequisite to the 
court’s final approval, one might suggest that, for future amendment of the EBL, provi-
sions should be made to give creditors reasonable access to information pertaining to the 
debtor company’s business operations, financial state of affairs, and assets. Information of 
truth and reliability is absolutely crucial and indispensable for an ultimately successful 
implementation of the reorganization plan; without these elements, the creditors would 
not be able to vote with confidence and may instead decide later to bring individual law-
suits against the company through the corporate bankruptcy system, once the reorganiza-
tion plan fails to be adopted. In light of this lack of disclosure, the creditors would be 
deprived of the chance to make an informed decision and may debilitate the voting mech-
anism provided in Article 84 of the EBL, rendering it a mere formality with little or no 
substance.

H. Research Limitations

Reorganization has priority over bankruptcy liquidation, as emphasized by Professor Li: 
“The new law [EBL] encourages insolvent businesses to choose restructuring methods as 
first choice. Only when there is no business viability should the bankruptcy liquidation

219. The UNCITRAL Legislative Guide, supra note 58, at 28, ¶ 27. See also Lee & Ho, supra note 63. 
220. The methods for debt restructuring are exemplified in The UNCITRAL Legislative Guide, supra 
note 58, at 28, ¶ 27. See also Lee & Ho, supra note 63. 
221. Lee & Ho, supra note 63, at 149. 
222. The EBL, art. 84. 
223. Id. art. 86.
While Professor Li's efforts are commendable in reviewing the EBL in 2009, he seemed to have left unanswered a lot of intriguing questions that could help in assessing the practical application of the EBL, such as:

1. What was the scale and size of these sixteen listed corporations (as mentioned by him);
2. What was the jurisdiction of these sixteen reorganization cases;
3. What was the reorganization cost;
4. Whether those petitions were filed by the debtor companies themselves, their creditors, or their investors whose capital contribution comprise one-tenth (1/10th) or more of the debtor company's registered capital; and
5. Whether the courts that accepted the bankruptcy petitions have exercised, at their discretion, the cram-down discretionary power to approve the reorganization plan, pursuant to the cram-down provisions embedded in Article 87 of the EBL.

One should consider these questions crucial as they would help in assessing whether reorganization is expensive in China and thus accessible only to sizeable listed corporations. Instinctively, there is a correlation between the reorganization cost and the size and scale of the debtor company, given that reorganization cost will be paid off from the debtor company's assets.

The jurisdiction of the reorganization cases might well be linked to the types of enterprises that are being rescued. In the midst of the global financial crisis of 2008-2009, there were many reports of the successful reorganizations of private enterprises; it is worth noting that there were very few reorganization cases reported for SOEs in China during that same period. This is somewhat perplexing as a review in 2007 suggested that there were 2,100 financially distressed SOEs exempted from the EBL's application until the end of 2008, not to mention that it is a well-known fact that many SOEs have suffered economic loss for a long time and therefore were in need of being liquidated or restructured. Why would there be so little reporting on SOEs' reorganizations? There are several possible reasons to consider. First, recent economic reforms in China have led to a large number of SOEs being converted to corporatized enterprises, stemming from China's transition from a planned economic system to a market economic system. Second, amid the financial crisis in 2008-2009, there were tremendous losses suffered by many SOEs such as Air China, China Eastern Airlines, and China Southern Airlines, "resulting from their entering into (often complicated) financial derivatives transactions;" but because they were experiencing only temporary business downturns, there required no bankruptcy liquidations or bankruptcy reorganizations. Third, for those SOEs earmarked for 'administrative bankruptcy,' whose insolvencies are to proceed according to the 'policy bankruptcy' framework administered by the government and under State Council regula-
tions, the EBL (hence the bankruptcy reorganization) were rendered inapplicable. All such reasons catered to the reduced opportunities for us to examine the reorganization of SOEs. Suffice it to say that if SOEs have any chance of survival, the Chinese government or State Assets Management System (SAMS) is likely to resuscitate them, by either providing them with financial support or entering them into corporate restructuring before the underlying SOEs go into bankruptcy.

Although this article aims to examine the practical application of the EBL from a broader perspective, focusing especially on the reorganizations of all legal enterprises under the EBL, the research result is inevitably restrained by the limited bankruptcy information available for public consumption in China. The article draws its conclusions confined by visible research limits, but ideally the research should be examined on a larger scale and on a more quantitative basis. One can only hope that the research horizon will be significantly broadened so that the assessment may explore the issues in greater depth, if and when more case law is accumulated over time and the bankruptcy statistical data—kept by the People’s Court (at the various levels) as well as by only a handful of bankruptcy research centers in China—can be released for public information in general or for creditor’s protection in particular.

V. Conclusion

Bankruptcy reorganization is arguably the most cost-effective scheme in restoring a financially distressed company back to a state of financial viability. Because the company was in financial difficulty in the first place, for restructuring purposes it relies not only on rearranging (or adjusting) debts but also, and perhaps more effectively, on acquiring new quality assets in backing up a reorganization plan. Debt rearrangement (債務重組, in Chinese) can be flexible, and includes options such as (1) taking a “haircut” by the creditors; (2) extending the period for repayment; (3) deferring payment of interest by the debtor; (4) changing the identity of the lenders (meaning another lender steps into the shoe of the original lender); and (5) swapping debt for equity. Once the reorganization process begins, the restructuring will rely greatly on the sale of assets to obtain the necessary cash to repay creditors. As such, a true and reliable assets valuation is essential in controlling reorganization cost, which needs to be kept in check at all times. There are other benefits arising from the bankruptcy reorganization. First, all debts of the debtor company can be resolved fully once and for all, as the court will be supervising and presiding over the reorganization case. The EBL requires the creditors who enjoy claims against the debtor company to declare their claims within a period set forth by the court for doing so, which shall not be less than thirty days at least and not more than three months at most, calculated from the date on which the People’s Court makes a public

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231. The EBL, art. 133.
232. In China, a state assets management system (SAMS) was established in 2003 to manage the SOEs being converted to corporatized enterprises. The SAMS, reflecting the state supervision system (on state assets), has resulted in a new regulatory process set out in the PRC Law on State-owned Assets of Enterprises (the SOAE law), which was promulgated by the Standing Committee of the National People’s Congress on Oct. 28, 2008 and became effective on May 1, 2009. The State-owned Assets Law is an Imperfect Guardian, supra note 229.
233. THE UNCITRAL LEGISLATIVE GUIDE, supra note 58, at 28, ¶ 27.
announcement on the acceptance of the bankruptcy application.\textsuperscript{234} It can be inferred that most creditors would oblige to declare their claims within that period, as deliberate non-compliance would likely render their claims unrecoverable. As provided, where a creditor fails to declare its claims in accordance with the provisions of the EBL, it shall not exercise its right in the implementation of the reorganization plan.\textsuperscript{235} Second, shall the administrator work at his best in raising the recovery rate, it is often conducive to the creditors' approval of the reorganization plan. And an acceptable plan (by the creditors) is also a workable reorganization plan, likely to be implemented successfully. Third, debts that fail to be recovered will be treated as being foregone by the creditors. This reorganization and especially the restructuring of debt will benefit greatly the debtor company. More often than not, as soon as reorganization is completed, the company's share price in the stock market starts to soar, as a result of having restored investors' confidence in the company. This provides one good reason why many financially distressed companies chose bankruptcy reorganization over bankruptcy liquidation.

Despite the EBL's deliberate design to encourage and facilitate reorganization for companies facing bankruptcy, the number of successful reorganization cases is quite slim. Attributive to this are a number of factors such as local protectionism, lack of qualified bankruptcy professionals in China, and certain judges' inclination to apply the more familiar old bankruptcy law over the EBL. Inadequate knowledge possessed by judges in relevant areas can bring down sufficiently any reorganization attempts or efforts. This is a radical problem in China where judges are sometimes Communist Party members and appointed by the government; hence they often lack the qualifications, professional training, or legal knowledge as well as the required expertise in economic, financial, or accounting matters. Considering that there is only one specialized bankruptcy court in China, established by the Shenzhen Intermediate People's Court (深圳中级人民法院, in Chinese) in December 1993, its undertaking of bankruptcy cases can be rather overwhelming; reportedly, there are only eight to ten specialized bankruptcy judges in this court in recent years.\textsuperscript{236} Shenzhen is a pioneer city in China, being one of the first five economic zones in Southern China; until the end of 2000, its bankruptcy court had accepted 486 cases and closed 373 of them, or averaged sixty-nine accepted cases and fifty-three closed cases per year.\textsuperscript{237} Professor Weiguo Wang of The China University of Political Science and Law suggests that about 5,000 bankruptcy cases were filed in economic trial courts, accounting for only 0.3% of the total of 1.5 million economic cases per year.\textsuperscript{238} In addition to the few number of bankruptcy judges, there is also a lack of experienced bankruptcy professionals in China to implement the EBL in a consistent manner. Various levels of People's Courts in China are aware of this problem and it is commendable that the educational responsibility is carried out not only by the courts but also profes-

\textsuperscript{234} The EBL, art. 45.  
\textsuperscript{235} Id. art. 92.  
\textsuperscript{236} Weiguo Wang, Forum for Asian Insolvency Reform—An Assessment of the Recent Developments and the Role of Judiciary, Strengthening Judicial Expertise in Bankruptcy Proceedings in China 3 (Feb. 7-8, 2001), available at http://www.oecd.org/dataoecd/8/24/1874188.pdf. According to an anonymous judge in the Shenzhen Intermediate People's Court, the number of insolvency judges working in this court remains the same today.  
\textsuperscript{237} Id. at 3-4.  
\textsuperscript{238} Id. at 1.
SIONAL BODIES (E.G., CHINA INSOL) AND DISCUSSION FORUMS (E.G., POCHANFA LUNTAN, 破產法論壇, IN CHINESE).

SOEs ARE ANOTHER INHERENT PROBLEM IN CHINA’S REORGANIZATION SYSTEM. IN THESE CASES, GOVERNMENT INTERFERENCE IS LIKELY TO COMPLICATE THE REORGANIZATION PLAN OR PROCESS. FOR EXAMPLE, THE DEBTOR COMPANY MAY BE AN SOE THAT MAY NOT HAVE OBJECTIVELY HEALTHY FINANCIAL PROSPECTS OR SIGNIFICANT CONTINUING OPERATIONAL PURPOSES, AND YET THE DEBTOR COMPANY, ESSENTIALLY THE STATE BECAUSE IT IS BOTH THE MAIN STAKEHOLDER AND MANAGING AUTHORITY, MIGHT SUBJECTIVELY DECIDE TO COMMENCE A REORGANIZATION APPLICATION. THIS PROBLEM CAN BE EXACERBATED UNDER THE EBL (IN ARTICLE 87), WHERE THE SOE, AS DIP, CAN CONTINUE TO MANAGE THE SOE AS A GOING CONCERN.²³³ IN LIGHT OF THIS, THE STATE WILL LIKELY TO HAVE EXTENSIVE CONTROL OF REORGANIZATION, NOTWITHSTANDING THE SUPERVISION BY A COURT-APPOINTED ADMINISTRATOR. NOT TO MENTION THAT AT THIS JUNCTURE, THE APPOINTMENT, QUALIFICATION, COMPENSATION, AND AVAILABILITY OF THE COURT-APPOINTED ADMINISTRATOR MIGHT APPEAR DUBIOUS.²⁴⁰ ON THE CONTRARY, FOR THOSE SOES THAT ARE KNOWN TO BE SUBJECT TO THE PRESSURE OF THE COMMAND ECONOMY, THEY MIGHT OTHERWISE FIND THE JUDICIARY PREDISPOSED AGAINST ACCEPTING THEIR REORGANIZATION APPLICATION. FROM A THIRD-PARTY PERSPECTIVE, THREATENED BY LOCAL PROTECTIONISM, POLITICAL INTERFERENCE, AND RAMPANT CORRUPTION, IT REMAINS UNCERTAIN WHETHER THE COURTS WOULD ACCEPT REORGANIZATION APPLICATION FROM CREDITORS OR INVESTORS AGAINST THOSE ENTERPRISES (ESPECIALLY SOES) THAT ARE IMPORTANT LOCALLY OR POLITICALLY WELL CONNECTED.²⁴¹

IT HAS BEEN SUGGESTED THAT THE SUPREME PEOPLE’S COURT IS DRAFTING “A COMPREHENSIVE JUDICIAL INTERPRETATION ON THE [EBL] BASED ON THE PROBLEMS ACCUMULATED AND EXPERIENCE GAINED DURING THE RECENT FOUR YEAR IMPLEMENTATION OF THE EBL. THE EXISTING DRAFT OF THIS JUDICIAL INTERPRETATION CONTAINS ABOUT 300 ARTICLES, WHICH IS FAR MORE THAN THE 136 ARTICLES CONTAINED IN THE [EBL]. IT IS EXPECTED TO BE PUBLISHED WITHIN THREE YEARS. A SMALLER-SIZED JUDICIAL INTERPRETATION DIRECTING THE INSOLVENCY OF LISTED COMPANIES IS EXPECTED TO BE ISSUED BEFORE THIS COMPREHENSIVE ONE.”²⁴² IN LIGHT OF THIS, IT IS HOPEFUL THAT ALL THE OUTSTANDING ISSUES AS DISCUSSED IN THIS ARTICLE CAN BE CLARIFIED BY UPCOMING SUPREME PEOPLE’S COURT’S JUDICIAL INTERPRETATIONS.

²³⁹. THE EBL, art. 87.
²⁴¹. EU JIN CHAU, supra note 121, at 1.
²⁴². LI & WANG, supra note 1, at 303.