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by

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ABSTRACT

Following the adoption of the Enterprise Bankruptcy Law in the People's Republic of China (PRC), effective June 1, 2007, rather few bankruptcy cases have been commenced in that country, in part because of judicial uncertainty in how to apply the law in particular cases. In the last four years, the Supreme People's Court of the People's Republic of China ("the PRC Supreme Court") has issued two interpretive rulings to assist the courts in applying the law in specific cases. After a summary of the PRC bankruptcy law, this article publishes translations of these two interpretive rulings and provides a commentary explaining how they fit in the context of the Enterprise Bankruptcy Law. Additionally, the article describes the further interpretations needed from the PRC Supreme Court for applying the provisions of the law that have not yet been addressed.

I. INTRODUCTION

With the growth of the economy of the People's Republic of China ("PRC") into the world's second largest economy,[1] more pressure has come on the PRC to limit its subsidies to insolvent enterprises, and to restructure them into viable business entities or to liquidate them and remove them from the economy. This is likely to push an increasing number of PRC business enterprises into bankruptcy, either voluntarily or involuntarily.

In 2006, the PRC adopted its Enterprise Bankruptcy Law [EBL][2] pro-

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[1]*See* http://www.worldbank.org/en/country/china/overview (last visited October 14, 2016) (stating that China is the world's second largest economy).

[2]*See* Zhonghua Renmin Gongheguo Qiye Pochan Fa (中华人民共和国企业破产法) [Enterprise Bankruptcy Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., August 26, 2006, effective June 1, 2007), 2006 Standing Comm. Nat'l People's Cong. Gaz. 561 (China) [hereinafter EBL]. For an English translation of this law, *see* Hon. Samuel L. Bufford, *The New*

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viding for the bankruptcies of business enterprises,[3] which became effective on June 1, 2007. However, notwithstanding the size of its economy and that the PRC's population includes some 20% of the world's population, the PRC has a surprisingly small number of bankruptcy cases.[4] This relative inactivity with respect to bankruptcy cases has numerous causes, the full exploration of which lies beyond the scope of this article.[5] However, recent interpretations issued by the PRC Supreme Court should make bankruptcy more accessible to legal entities with financial difficulties.[6]

A. Need to Know

U.S. lawyers will find it essential to know the PRC insolvency law in a number of circumstances. The most likely imminent need to know this law will arise when a chapter 15 case is commenced under U.S. law for a PRC entity that is in an insolvency case there (or in a third country). If there are U.S. assets or disputes, an administrator for the PRC insolvency case will contact a Chinese-speaking U.S. lawyer (probably lacking substantial U.S. bankruptcy expertise), who will associate local bankruptcy counsel to file a U.S. chapter 15 case to administer U.S. assets or to defend claims on behalf of

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Chinese Bankruptcy Law: Text and Limited Comparative Analysis, 16 Norton J. Bankr. L. & Practice 5, art. 3 (2007). All references herein to the EBL are to this translation. For a detailed description and analysis of the EBL, *see* Jingxia Shi, *Twelve Years to Sharpen One Sword: The 2006 Enterprise Bankruptcy Law and China's Transition to a Market Economy*, 16 Norton J. Bankr. L. & Prac. 645 (2008). For a general discussion of reorganization in China by Chinese scholars after the passage of the new bankruptcy law, *see* Qi Ming (齐明), *Lun Pochan Chongzheng Zhong de Gongsi Zhili* (论破产重整中的公司治理) [*Corporate Governance in Insolvency Reorganization*], 23 Dangdaifaxue (代法学) [Contemp. L. Rev.] 133 (2009); Wang Xinxin (王欣新), *Chongzheng Zhidu Lilunyu Shiwu Xinlun* (重整制度理论与实务新论) [*Contemporary Analysis of the Reorganization Theory and Practice*], 11 Falüshiyong (法律适用) [J.L. Application] 10 (2012); Zhang Yanli (张艳丽), *Chongzheng Jihua Bijiao Fenxi* (重整计划比较分析) [*Comparative Analysis about Reorganization Plan*], 4 FaxueZazhi (法学杂志) [L. Sci. Mag.] 80 (2009); Zhao Hongren (赵泓任), *Qiye Pochan Chongzheng Jihua Kexingxing de Falü Fenxi* (企业破产重整计划可行性的法律分析) [*Legal Analysis About the Feasibility for the Reorganization Plan of Corporate Bankruptcy*], 6 Faxuezazhi (法学杂志) [L. Sci. Mag.] 137 (2010).

[3]The EBL initially specifies that an entity taking advantage of the bankruptcy law must be an entity with legal status. *See* EBL, *supra* note 2, art. 2. However, a supplemental provision extends the law to cover any other kind of entity. *See id.* art. 135.

[4]In 2015, for example, a total of some 3000 bankruptcy cases were opened in China. *See, e.g.*, Zheng Zhibin & Zhang Ting, China - Law & Practice, chambersandpartners.com, last visited October 15, 2016. *See generally* Yujia Jiang, *The Curious Case of Inactive Bankruptcy Practice in China: A Comparative Study of U.S. and Chinese Bankruptcy Law*, 34 Nw. J. Int'l L. & Bus. 559 (2014). *See also* Chuin-Wei Yap, China Shifts Stance, Letting Firms Go Bust, Wall St.J., March 4, 2017, at A1. In the same year, there were 24,735 business cases filed in the United States (where opening is automatic except for the rare case of an involuntary petition). *See* U.S. Bankruptcy Courts—Business and Nonbusiness Cases Commenced, by Chapter of the Bankruptcy Code, During the 12-Month Period Ending December 31, 2015 Table F-2.

[5]This issue has been explored recently by Yujia Jiang. *See* Jiang, *supra* note 4.

[6]The applicability of the EBL to state-owned enterprises ("SOE"s) in China has been an ongoing political issue. While the EBL is drafted to cover these enterprises, art. 133 provides that the timing of its application to EBLs is governed by supplementary State Council regulations. This is an on-going issue.

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the PRC debtor, or to deal with pending U.S. litigation with the PRC entity (which may be either a plaintiff or a defendant in the U.S. litigation).[7] Other U.S. lawyers will become involved to represent the other parties in interest, which will likely be largely U.S. entities. All of those U.S. lawyers will need to educate themselves on the PRC insolvency law, both the text and the interpretive rulings from the PRC Supreme Court. Because this scenario could happen any day (including today), it is important for U.S. lawyers to know something about PRC insolvency law, or at least to be able to find out enough to educate themselves sufficiently to handle such a case competently when such an occasion arises.

A second scenario, also rather likely to occur, is that the debtor may be based in the United States, but have assets in the PRC (e.g., a factory or a business entity) that should be administered as part of a U.S. insolvency case.[8]

It is important for U.S. lawyers who practice international insolvency or financial services law to be familiar with the insolvency law of the PRC because many Chinese businesses have become insolvent and the number of insolvency cases with a PRC connection is likely to increase (perhaps dramatically). This increases the likelihood that a PRC enterprise with which their clients are doing business may enter an insolvency case, or that their clients should commence an involuntary insolvency case against the PRC enterprise.

The PRC enacted the EBL because it wanted insolvent entities (at least the smaller ones) to enter bankruptcy to restructure or liquidate their businesses. This may surprise those who assume that the PRC government will bail out troubled entities. That, however, is old wisdom—the PRC government increasingly is not willing to bail out troubled businesses. This was the point of enacting its bankruptcy law ten years ago.

B. The Interpretive Rulings

In the last five years, the PRC Supreme Court has issued two interpretative rulings[9] that provide substantial guidance to Chinese judges and adminis-

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[7]This is very close to the fact pattern involved in the *Artimm* case, where an Italian entity in bankruptcy in Rome had litigation pending against it in Los Angeles, and hired an Italian-speaking lawyer to associate local bankruptcy counsel in Los Angeles to defend the local litigation. *See In re* Artimm, 335 B.R. 149 (Bankr. C.D. Cal. 2005). As it turned out, Artimm also had substantial U.S. assets, not initially known to the debtor in Rome, which resulted in a settlement of some $150,000 for the Artimm estate.

[8]The EBL provides that the People's Court (at the appropriate level) may evaluate and enforce a valid foreign bankruptcy order or judgment, either on the basis of an international treaty to which China is a party or on the basis of reciprocity. *See* EBL, *supra* note 2, art. 5.

[9]*See* Guanyu Shiyong, Qiye Pochan Fa, & Ruogan Wenti De Guiding (Yi) (最高人民法院关于适用《中华人民共和国企业破产法》若干问题的规定(一))) [Provisions (I) of Sup. People's Ct. on Several Issues concerning the Application of the Enterprise Bankruptcy Law of the People's Republic of China] (promulgated by Sup. People's Ct., Sep. 9, 2011, effective Sep. 26, 2011) [Judicial Interpretation No. 1]; Guanyu Shiyong, Qiye Pochan Fa, & Ruogan Wenti De Guiding (Er)

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trators on how to administer their bankruptcy cases.[10] Better clarity on these issues may provide a substantial stimulus to increase the utilization of the bankruptcy law in China for businesses with financial problems. These interpretations fill in a number of details and deal with a number of the ambiguities in interpretation of the EBL. However, the provision of judicial interpretations is incomplete, and substantial further interpretative work is needed.

The function of the interpretive rules is much similar to that of the U.S. rules of bankruptcy procedure: they tell the courts and the parties how to handle a variety of procedural problems in respect to the application of the law in particular cases. Like the U.S. bankruptcy law without the rules, there is a substantial lack of clarity in determining exactly how the parties and the court should proceed in a particular insolvency case. Like the U.S. rules, there are still interpretive problems in applying the law in light of the interpretations, but (for the subjects covered by the interpretations) the interpretive problems are much smaller than they would be without the interpretations.

Generally, the topics covered by the interpretations fall into five areas. Interpretation No. 1 addresses the filing and opening[11] of a bankruptcy case.[12] Interpretation No. 2 addresses case administration, commercial transactions of the debtor, avoidance actions, and corporate law issues (and a number of other areas of bankruptcy procedure). This article discusses these two judicial interpretations in light of the statutory provisions of the 2007 law,

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(最高人民法院关于适用《中华人民共和国企业破产法》若干问题的规定(二)) [Provisions (II) of Sup. People's Ct. on Several Issues concerning the Application of the Enterprise Bankruptcy Law of the People's Republic of China] (promulgated by Sup. People's Ct., Sep. 5, 2013, effective Sep. 16, 2013) [Judicial Interpretation No. 2].

[10]These judicial interpretations are not the first that the PRC Supreme Court has issued with respect to the EBL. With a view to facilitating the implementation the EBL, the Court issued four judicial interpretations in 2007-2008: (1) Regulation of the Supreme People's Court of the People's Republic of China on the Appointment of Administrators (Fashi (2007) 8, Apr. 4, 2007); (2) Regulation of the Supreme People's Court of the People's Republic of China on the Compensations of Administrators (Fashi (2007) 9, Apr. 4, 2007); (3) Regulation of the Supreme People's Court of the People's Republic of China on Bankruptcy Cases in which the Whereabouts of the Debtor or Its Assets are Unclear (Fashi (2008) 10, Aug. 4, 2008); and (4) Regulation of the Supreme People's Court of the People's Republic of China on Time Limits for Hearing Civil Cases (Fashi (2008) 11, Aug. 11, 2008). There is no known English translation of these interpretations.

[11]This article uses the international term "opening" to refer to the court order at the commencement of a bankruptcy case that determines that the case should proceed as a bankruptcy case. The PRC law, including the EBL and the Interpretations, more specifically refers to this event as the "acceptance" of a bankruptcy case. This paper follows the international terminology rather than the Chinese terminology, and calls it the "opening" of the case.

[12]Unlike under U.S. law, a bankruptcy case in the PRC does not automatically proceed upon the filing of the case. Following the civil law model (in contrast to the common law model), the PRC law requires a court order to commence or "open" the bankruptcy case.

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and makes comparisons with the laws of other countries (chiefly the United States).

However, this article does not undertake a general comparison of the EBL statue with U.S. law. There is a substantial (although incomplete) body of scholarship on this issue,[13] while there is virtually nothing on the interpretive rules, mainly because no translation (into English or any other language) is available.

In addition, there are a number of subjects covered in the EBL that have not been addressed in the PRC Supreme Court interpretations. These subjects include: the types of entities that qualify to be debtors in bankruptcy cases,[14] the qualification and compensation of bankruptcy administrators, the meeting of creditors and committees of creditors, the processing of creditor claims, the reorganization of businesses under the law (including the option of the debtor's management remaining in control of the business during the reorganization process), the settlement of a bankruptcy case[15] between the opening of the case and the entry of an order of bankruptcy, and the liquidation and distribution process in liquidation cases. It is anticipated that the PRC Supreme Court will issue additional interpretive rulings in the future to cover these topics.

II. THE PRC BANKRUPTCY LAW

This section gives a brief introduction to the PRC bankruptcy law, to provide a background for a more detailed discussion of the interpretive rulings.[16]

China's first bankruptcy law was enacted in 1906, and was abolished

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[13]*See, e.g.*, REBECCA PARRY ET AL., CHINA'S NEW ENTERPRISE BANKRUPTCY LAW (2010); DERYCK A. PALMER & JOHN J. RAPISARDI THE PRC ENTERPRISE BANKRUPTCY LAW: THE PEOPLE'S WORK IN PROGRESS (2009); Anna Ansari, *The 2006 Enterprise Bankruptcy Law of the People's Republic of China: A Further Step Toward the Creation of a Modern Insolvency Framework*, 20 J. BANKR. L. & PRAC. 5, art. 2 (Nov. 2011); Emily Lee, *The Reorganization Process Under China's Corporate Bankruptcy System*, 45 INT'L L. 939 (2011). For a summary of the provisions in the EBL, *see also* Steven Arsenault, *Westernization of Chinese Bankruptcy: An Examination of China's New Corporate Bankruptcy Law through the Lens of the UNCITRAL Legislative Guide to Insolvency Law*, 27 PENN ST. INT'L L. REV. 45, 45-63 (2008).

[14]*See* EBL, *supra* note 2, art. 2. Many countries have special insolvency regimes for certain kinds of entities, usually apart from their bankruptcy laws. Such entities may include banking institutions, insurance companies, stockbrokers and commodity brokers, railroads and utilities. The bankruptcy law may or may not specify that such entities, for which special insolvency regimes are provided, are not eligible for relief under the bankruptcy law.

[15]The composition or settlement process provided under the EBL is different in many respects from the business reorganization process, and is much simpler and more direct. *See* Xin Ge, *Composition*, *in* PARRY ET AL., *supra* note 13, at 231. Notably, the two processes of reorganization and settlement or composition are mutually exclusive under the EBL: once the debtor has started down one road, it cannot change to the other. *See id.* at 235.

[16]For a more detailed discussion of the PRC bankruptcy law, *see* Shi, *supra* note 2.

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after two years in 1908.[17] Thereafter, several regional bankruptcy laws were enacted from time to time beginning in 1915, but all were abolished when the PRC was formed in 1949. For the first several decades thereafter, businesses were by and large not permitted to fail. In consequence, there was no perceived need for a bankruptcy law to provide for the restructuring of businesses with financial difficulties or the orderly liquidation of failed companies.[18] In 1986, the PRC enacted a law[19] providing for the liquidation of certain state-owned enterprises with government approval.[20] In addition, in 1991 China adopted a one-page chapter (eight sections) in its Civil Procedure Law[21] to provide, in very skeletal fashion, for the bankruptcy of privately owned corporations.

As part of its move toward a market economy, in 2006 China adopted a full-fledged bankruptcy law, effective on June 1, 2007, providing generally for the liquidation of insolvent partnerships and corporations, both publicly[22] and privately owned, and for the reorganization of those legal entities that can be restructured and salvaged.

The EBL is a unified law in two respects. First, a single law provides for both reorganization and liquidation procedures. In contrast, for example, Japan has three different laws, one for liquidation, one for reorganizing large businesses and one for reorganizing small businesses.[23]

Second, the EBL is unified in that there is a single bankruptcy road at the outset, which later forks into a reorganization route and a liquidation route. Like the German bankruptcy law, the EBL presumes that a bankruptcy case will result in liquidation, and requires a separate court order[24] for the case to

[17]*See* Rebecca Parry & Haizheng Zhang, *Introduction*, in PARRY ET AL, *supra* note 13, at 5.

[18]There has been no social security system put in place because there have been no worker layoffs resulting from business failures. *See id.* at 9.

[19]*See* Qiye Pochan Fa (Shixing) (企业破产法(试行)) [Enterprise Bankruptcy Law (Interim)] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 2, 1986, effective Oct. 1, 1988, repealed 2006).

[20]*See* Zhonghua Renmin Gongheguo Minshi Susong Fa (中华人民共和国民事诉讼法) [Civil Procedure Law of the People's Republic of China] (promulgated by the Nat'l People's Cong., April 9, 1991, effective April 9, 1991), art. 7, http://www.npc.gov.cn/wxzl/gongbao/2012-11/12/content_1745518.htm (China).

[21]*See id.* arts. 199-206.

[22]For publicly owned entities, art. 133 authorized the government to adopt regulations, prior to the effective date of the law, to govern bankruptcy cases for state-owned enterprises "in certain categories and for certain time periods." *See* EBL, *supra* note 2, art. 133. Pursuant to this authority, the application of the EBL to certain state-owned enterprises was delayed for a period of time.

[23]*See* Kaisha Koseiho [Corporate Reorganization Act], Law No. 154 of 2002, *amended by* Law No. 76 of 2004 (amending Law No. 172 of 1952), arts. 24-39 (large companies); Minji Saiseiho [Civil Rehabilitation Act], Law No. 255 of 1999, *amended by* 80 & 129 of 2001, Laws No 45, 98 & 100 of 2002, and Law No. 76 of 2004), art. 26-31 (small companies); Hasanho [Bankruptcy Act], Law No. 75 of 2004 (liquidation).

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

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take the reorganization road. French law, in contrast, presumes that every insolvency case is a reorganization case, and directs a case onto the liquidation route only where reorganization is not feasible.[25] In the United States, in contrast to all of these countries, the filer of the bankruptcy petition chooses whether the case begins on the reorganization or the liquidation road.[26]

A. Reorganization

Chapter 8 of the EBL provides a detailed regulatory scheme for reorganizing a corporation[27] in financial difficulty. A case filed under the new law is presumptively a liquidation. However, the debtor or a creditor may apply to the court for the reorganization of the debtor.[28] If a creditor files the case as a liquidation case, the debtor may request a reorganization case, but only before the court issues an order finding the debtor insolvent[29]—thereafter the case must proceed as a liquidation.

Many features of the reorganization provisions are similar to provisions in chapter 11 of the U.S. Bankruptcy Code, and are obviously drawn from U.S. law. The EBL also has a separate set of provisions in its chapter 9 for prepackaged and simplified reorganization plans.[30] These provisions will likely be useful principally for a small business that has arranged its deal with its creditors before it comes to court.

1. *Insolvency*

The insolvency requirement for a corporate debtor's commencing a reorganization under the EBL has two parts.[31] First, a debtor is eligible to commence either a reorganization or a liquidation proceeding if it is presently unable to pay its debts as they come due, and (a) its assets exceed its liabilities, or (b) it otherwise lacks the ability to pay its debts.

Second, in addition to the first test, a debtor is also eligible for reorganization, but not liquidation, if it is approaching the zone of insolvency (as stated in the first test). As articulated by the EBL, this second alternative is available if it is obvious that, in the future, the debtor will become insolvent (in the first sense). This provision is designed to encourage debtors to address their

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[25] *See* Code de Commerce [C. COM.] [Commercial Code] art. L. 631-1 (Fr.).

[26] *See* Official Form 201 (providing a box to check to choose a reorganization case (under chapter 11) or a liquidation case (under chapter 7). Official Form 1 also offers several other alternatives not relevant to this paper.

[27] Only a corporate entity can be reorganized under the EBL. *See* EBL, *supra* note 2, art. 1.

[28] *See* EBL, *supra* note 2, art. 70.

[29] *See id.* In addition, a shareholder holding more than ten percent of the total registered shares of the debtor is authorized to request a reorganization of the debtor. *See id.*

[30] *See id.* arts. 95-106.

[31] *See id.* art. 2.

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financial problems at an earlier stage, before they reach actual insolvency.[32] A broader variety of circumstances, apart from insolvency as such, can make this condition "obvious."

The statute gives no guidance in making this determination of obviousness. The first regulation fills in this gap by specifying what conditions permit a case to be opened and to proceed.[33]

2. *Debtor in Possession*

The EBL provides that, "[d]uring the period of reorganization . . . the debtor may, under the supervision of the administrator, manage its assets and business operations by itself."[34] Typically, it appears that such a "debtor in possession" ("DIP") order will be issued only after an administrator has been appointed in the case.[35] Upon the issuance of such an order, the administrator who has taken over the assets of the business is required to turn them over to the debtor.[36] Thereafter, the debtor is obligated to perform the obligations that the statute imposes on an administrator.[37]

Alternatively, the court may leave the administrator in charge of the reorganization. If the administrator remains in charge of the reorganization, the administrator is authorized to hire officers of the debtor to manage the debtor's business operations.[38]

The DIP concept in the EBL is substantially different from the concept of a DIP provided under the U.S. Bankruptcy Code.[39] The EBL contemplates that the DIP will operate under the general supervision of an administrator.[40] In this respect, the EBL more resembles the *sauvegarde* procedure under the French bankruptcy law, which likewise provides for the appointment of an administrator in a reorganization case, but for the debtor to remain in possession and to operate the business.[41] However, in practice the administrator plays a central role in the restructuring of a business, notwithstanding the appearance that a restructuring may be similar to a U.S. debtor in possession regime.[42]

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[32]*See* Shi, *supra* note 2, at 33.

[33]*See* text *infra* at notes 101-110.

[34]*See* EBL, *supra* note 2, art. 73. For a discussion of difficulties in applying the DIP procedure in the PRC under the EBL, *see* Lee, *supra* note 13, at 964-65.

[35]An administrator is appointed at the same time as the court issues an order opening the bankruptcy case. *See id.*, art. 13.

[36]*See id.* art. 73.

[37]*See id.*

[38]*See id.* art. 74.

[39]*See* 11 U.S.C.A. § 1107 (West 2012).

[40]*See* EBL, *supra* note 2, art. 13.

[41]*See* Code de Commerce [C. COM.] [Commercial Code] art. L. 622-1 (Fr.).

[42]*See, e.g.*, Jiang, *supra* note 4, and sources cited therein.

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3. *Scope of Moratorium (Automatic Stay) and Relief Therefrom*

The EBL imposes a moratorium (automatic stay) with respect to creditor collection activities. The moratorium commences with the court order opening a bankruptcy case, and it is automatic with the issuance of such an order.[43] The moratorium prohibits the commencement of any civil lawsuit related to the debtor except in the court where the bankruptcy case is filed.[44] The moratorium also prohibits any execution against the debtor's property.[45] Furthermore, the moratorium applies to any pending litigation or arbitration related to the debtor.[46]

For the purposes of the moratorium, the EBL distinguishes between (1) debts that are the subject of litigation or arbitration that is pending at the time of the opening of an insolvency case and (2) debts for which no litigation or arbitration proceeding has commenced. If there is litigation or arbitration pending when the insolvency case is opened, the EBL stay is brief: it expires as soon as an administrator takes possession of the debtor's property.[47] Thus the administrator must step in for the debtor and defend any litigation or arbitration pending against the debtor. Once a judgment is final, however, a stay against execution of the judgment prohibits its enforcement against the debtor. In contrast, if there is no such litigation or arbitration pending on the date of the opening of the insolvency case, such a claim may only be made to the court where the insolvency case is pending.

For litigation that has not yet been commenced, on the other hand, the EBL automatic stay remains effective throughout the case.[48] While a creditor may commence a lawsuit against the debtor after the case has been opened, the court with the bankruptcy case has control over timing and processing of the litigation. Thus the EBL places a premium on the actual commencement of litigation against the debtor before the opening of an insolvency case. The making of a claim or negotiating a dispute before the opening of the case is not sufficient to avoid the automatic stay.[49]

There is a broader stay as to secured creditors in an EBL reorganization

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[43]*See* EBL, *supra* note 3, arts. 19-21. In these respects, the commencement of the moratorium under the EBL is typical of continental European systems. *See, e.g.*, Code de Commerce [C. COM.] [Commercial Code] art. L. 622-21 (Fr.); Insolvenzordnung [InsO] [Insolvency Law] v. 5.10.1994 (BGBI I S.2866) § 87-91 (Ger.) [hereinafter InsO].

[44]*See* EBL, *supra* note 2, art. 21.

[45]*See id.* art. 19.

[46]*See id.* art. 20.

[47]*See id.*

[48]*See id.* art. 21.

[49]While a creditor may commence litigation against the debtor during the period after the filing of the bankruptcy case but before its opening, the filing of the insolvency application itself is not typically an event that is publicized—notice to creditors is not given until the opening of the case, at which time the stay goes into effect. *See id.* art. 14 (requiring notice to creditors of the opening of a bankruptcy case within 25 days after the opening order).

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case. During the period of negotiating a reorganization and obtaining its approval (which lasts six months and may be extended for an additional three months),[50] secured creditors are stayed from foreclosing on their collateral.[51] The EBL permits a secured creditor to obtain relief upon order of the court "if it is possible that the collateral will be damaged or its value will obviously decrease to the extent that such damage or reduction in value is sufficient to affect the secured creditor's interest"[52]

4. *Committees of Creditors*

The EBL authorizes the meeting of creditors to establish a committee of creditors in both liquidation and reorganization cases.[53] Such a committee has the right to oversee management and liquidation of the estate, to oversee the distribution of assets to creditors, to propose a further meeting of creditors, and to exercise any other rights delegated to it by the meeting of creditors.[54] The committee also may request the administrator or relevant personnel of the debtor to explain or provide documents relevant to the scope of their employment with the debtor.[55] Moreover, the administrator must report major activities to the committee, including major transfers of assets, financial transactions and transfers of licenses.[56]

5. *Financing a Reorganization Case*

The EBL authorizes a debtor to obtain a loan to finance the reorganization process.[57] Such a loan may be on a secured basis,[58] which presumably permits the lender to take a security interest in some or all of the assets of the corporation. If the loan is unsecured, it presumably qualifies as a "bankruptcy expense"[59] that is entitled to priority in payment under the EBL.[60] Unlike U.S. bankruptcy law,[61] nothing in the EBL authorizes financing that primes existing secured creditors.

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[50] *See* EBL, *supra* note 2, art. 79.

[51] *See id.* art. 75.

[52] *See id.*

[53] *See id.* art. 67.

[54] *See id.* art. 68.

[55] *See id.*

[56] *See id.* art. 69.

[57] *See id.* art. 75.

[58] *See id.*

[59] *See id.* art. 41. This section authorizes the payment as a "bankruptcy expense" of funds paid "for managing, appraising and distributing assets of the debtor." This language is not exactly clear in treating unsecured credit that is obtained for the restructuring of the debtor, after the opening of the case, as a "bankruptcy" expense (which is a priority expense that may be paid from the debtor's assets at any time, *see id.* art. 43).

[60] *See id.* art. 43.

[61] *See* 11 U.S.C.A. § 364(c) (West 2012).

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6. *Plan of Reorganization*

Either the debtor or the administrator must draft and submit a reorganization plan to the court.[62] If the debtor is a DIP, it must prepare and submit the draft plan.[63] If the debtor is not a DIP, the administrator must prepare and submit the plan.[64] Notably, neither an individual creditor nor the committee of creditors (nor the government) has the right to submit a reorganization plan.

The reorganization plan must be submitted to the court within six months after the issuance of the order for reorganization.[65] Upon the request of the debtor or the administrator, the court may grant a single three-month extension of this deadline.[66] If a plan is not submitted to the court within the required time frame, the case must be converted to a liquidation case.[67]

The EBL mandates four classes of claims, each of which votes separately: (1) secured creditor claims, (2) employment-related claims (including wrongful death), (3) taxes, and (4) general unsecured claims.[68] If the plan makes changes in the rights of shareholders, they are entitled to their own class.[69] If necessary, the plan may establish a subclass for small claims in the general unsecured claims class (who presumably vote separately on the plan).[70] Certain social security premium claims must be paid in full, and insurance companies holding such claims may not vote on the plan.[71]

7. *Voting and Plan Confirmation*

The provisions in U.S. law and the EBL on creditor voting and plan confirmation are surprisingly similar. With minor exceptions, the EBL follows the U.S. provisions rather than the alternatives found in the statutes of many other developed countries.[72]

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[62] *See* EBL, *supra* note 2, art. 79.

[63] *See id.* art. 80.

[64] *See id.*

[65] *See id.*

[66] *See id.*

[67] *See id.* In fact, under the time frames set by the EBL, it likely takes a minimum of 11 months to bring a reorganization plan to judicial approval, and likely will take more than a year. *See* Lee, *supra* note 13, at 942-43.

[68] *See* EBL, *supra* note 2, art. 82.

[69] *See id.* art. 85.

[70] *See id.*

[71] *See id.* art. 83.

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

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a. Consensual Plans

The U.S. and the PRC statutory provisions are essentially the same with respect to the voting requirements for the approval of a consensual reorganization plan. Both laws require that each class satisfy a two-part requirement with respect to votes in favor of the plan: a majority of each creditor class must vote in favor of the plan, and those voting in favor in each class must hold claims exceeding two-thirds of the value of the claims in that class.[73]

If all classes vote in favor of the plan, it can be approved by the court. The EBL provides for court approval if the plan receives the requisite number of votes and it "complies with the statute."[74]

The voting procedure, however, is different in the two countries. The EBL provides for the creditors to vote in a meeting of creditors.[75] In the United States, in contrast, all voting on a reorganization plan is typically conducted by mail, and is never done in a meeting of creditors.[76]

In both the PRC and the United States, the calculation of the number and value of votes is based only on the creditors who vote, and the creditors who fail to vote are ignored.[77] For example, if a particular class has ten creditors, and is owed a total of 1,000,000 yuan, but only five creditors holding claims totaling 300,000 yuan, attend the meeting of creditors to vote on a reorganization plan, the class votes sufficiently in favor of the plan if three of the claimants vote in favor and their claims exceed 200,000 yuan.

If one or more classes does not have sufficient favorable votes for the approval of a consensual plan, the EBL authorizes the debtor or the administrator to negotiate a revision of the plan with a dissenting class and to have the class vote again on the plan.[78] If, in the second vote, each previously dissenting class meets the voting requirements for approval, the plan can be confirmed by the court.[79] The revision is not permitted to impair further the interests of the other voting classes.[80]

b. Non-Consensual Plans

Both the EBL and U.S. law authorize a court to approve a restructuring plan even where the requisite majority is not achieved for voting up a consensual plan. Very few other countries permit the confirmation of a "cram down" plan where the requisite majorities are not satisfied.

The EBL imposes three general conditions for the approval of a non-con-

[73]*See* EBL, *supra* note 2, art. 84; 11 U.S.C.A. § 1126(c) (West 2012).
[74]*See id.* art. 86.
[75]*See id.* art. 84.
[76]*See* Fed. R. Bankr. P. 3017(d).
[77]*See* EBL, *supra* note 2, art. 84.
[78]*See id.* art. 87.
[79]*See id.*
[80]*See id.*

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sensual plan. First, the plan must provide "fair" treatment to every member in the same class.[81] Second, the distributions under the plan must not violate the statutory priorities for distribution to creditors in a liquidation.[82] Third, the plan must be feasible.[83]

In addition, the EBL imposes requirements for particular classes of creditors in a non-consensual plan. If a dissenting class is a priority class (secured creditors, employees or taxing agencies), that class must be paid in full.[84] If the dissenting class is the secured creditor class, the EBL imposes two additional requirements: the members of the class must be fairly compensated for any delay in payment, and the secured interests may not be injured substantially.[85] If the dissenting class is the class of general unsecured creditors, these creditors must receive at least as much as they would in a liquidation of the debtor.[86] If the dissenting class is the equity class, the adjustment of its rights must be "fair and equitable."[87]

If the draft plan is not approved or confirmed, the EBL adopts a "one bite at the apple" approach: it requires the conversion of the case to a liquidation.[88]

B. State Owned Enterprises

Notably, the EBL contemplates that state owned enterprises will qualify for restructuring or liquidation under the law.[89] However, article 133 in the supplemental provisions of the EBL authorized the Central People's Government to adopt regulations with respect to such enterprises in certain categories and in certain time periods.[90] Pursuant thereto, the government delayed the effective date for the application of the EBL to such entities for a period of time. In consequence, there were only a few state owned enterprises that were the subject of bankruptcy cases before 2013, after which several SOEs have initiated bankruptcy cases.[91]

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[81] *See id.* art 87(5).

[82] *See id.* U.S. law does not include such a provision in its requirements for non-consensual plan confirmation.

[83] *See id.* art 87(6).

[84] *See id.*

[85] *See id.* art 87(1).

[86] *See id.* art 87(3).

[87] *See id.* art 87(4). The EBL gives no definition for "fair and equitable" in this context.

[88] *See id.* art. 88.

[89] *Accord*, Yujia Jiang, *supra* note 4, at 563-64.

[90] *See id.*

[91] See, e.g., Zhang Yu, Huang Caixi & Chen Na, *Guanxi Nonferrous Metals Gets Court OK to Liquidate*, CAIXIN ONLINE, Sept. 20, 2016 (noting that several SOEs have commenced bankruptcy cases). The Guanxi Nonferrous Metals Group Companies case was opened in December, 2015, pursuant to which the Nanning Intermediate People's Court gave the debtor six months to set up a committee and to put together a proposal for its restructuring. When this failed, the court ordered the liquidation of the company. *See id.*

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III. THE JUDICIAL INTERPRETATIONS

Upon the adoption of the EBL in 2007, it was expected that the PRC Supreme Court would issue a comprehensive commentary on the law. However, this did not happen, for reasons that have not been made public.

In place of such a comprehensive commentary, the PRC Supreme Court has issued two interpretive rulings, in 2011 and 2013 (and here published for the first time in English). These rulings cover a variety of topics relating to cases under the EBL. In many regards, the interpretations are detailed and technical. They are designed for professional lawyers and judges who must interpret and apply the EBL: they are not crafted for the general reader. This section of this article takes up each of these interpretations.

A. Filing and Opening of a Bankruptcy Case

Judicial Interpretation No. 1[92] addresses five different kinds of issues relating to the filing and opening of a bankruptcy case in China: the definition of insolvency (a requirement to qualify for a case under the EBL); the procedure upon the filing of a creditor's involuntary case against a debtor; the procedure for court review of an involuntary filing to determine whether to open the case; the payment of the administrative costs for the case; and the procedure in case the first-instance court fails to take action on a request to open a bankruptcy case.

1. *Definition of Insolvency*

The EBL requires that a debtor be insolvent to be a debtor in a bankruptcy case.[93] Article 2 states the insolvency requirements, which apply for both voluntary and involuntary bankruptcy cases. However, these requirements are somewhat confusing and difficult to understand. The first set of Judicial Interpretations takes up the definition of insolvency.

Insolvency can be defined a variety of ways for various purposes. There are two classical forms of insolvency: a balance sheet test (where the value of the assets, at a fair valuation, is less than the amount of the liabilities), and the liquidity test (inability to pay debts as they come due).[94] A third alternative, used in some countries, is the "cessation of payments,"[95] where the

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[92]*See* Judicial Interpretation No. 1, *supra* note 9.

[93]See EBL, *supra* note 2, art. 2.

[94]*See, e.g.*, 11 U.S.C. § 303(h)(1) (2012) (requiring that petitioning creditors, in an involuntary case under the U.S. bankruptcy law, show that the debtor is unable to pay its undisputed debts as they come due (or that a custodian was appointed for some of the debtor's property)); InsO § 17 (2) (stating the liquidity test as one of the grounds for opening an involuntary insolvency case) (Ger.). Notably, for a voluntary bankruptcy case filed by the debtor, U.S. law has no insolvency requirement at all. *See, e.g., In re* Mt. Carbon Metro. Dist., 242 B.R. 18, 32 (Bankr. Colo. 1999); *In re* Marshalek, 158 B.R. 704, 708 (Bankr. N.D. Ohio 1993). The only exception is for municipality bankruptcy cases under chapter 9. *See* 11 U.S.C. § 109(c)(3); *In re* Detroit, 504 B.R. 168-71 (Bankr. E.D. Mich. 2013).

[95]Although France is generally considered the origin of the concept of cessation of payments as a

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debtor has stopped making payments to creditors.

Very few countries use the balance sheet test for commencing insolvency cases.[96] This test is difficult to use because most balance sheets do not show a fair current valuation of the assets. On the asset side of the balance sheet, the standard accounting practice is to list assets at historical acquisition cost (sometimes showing an adjustment for depreciation), and not at current fair market value, which may be higher or lower (sometimes much higher or much lower). On the liability side, judgment is required to determine when to recognize a contingent liability that may or may not have to be paid and as to which the maturity date is uncertain.

The liquidity test, which is much more common[97] and much easier to apply, simply looks at the current assets that are cash or cash equivalents, and compares them with the liabilities that are currently due and payable. However, this test also may not give a realistic appraisal of whether a business is viable or not because it does not consider assets that will soon be realized or liabilities not yet due but which may become due soon. A variation on this test, which gives a more realistic appraisal of a debtor's short-term viability, is to look at the current assets that are likely to be turned into cash (or its equivalent) in the next twelve months and to compare then with the liabilities that will become due in that period of time.[98]

The Chinese bankruptcy law applies a combination of the balance sheet test and the liquidity test. The EBL states that a debtor may apply to dispose of its debts under the EBL if "it is unable to repay its debts when they

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condition for qualification for a bankruptcy case, in fact the French bankruptcy law has defined "cessation of payments" as the lack of available assets to pay debts that have come due. *See* COMM. C. § 631-1. Other countries, however, continue to use the concept to mean that the debtor has ceased making payments to creditors. *See, e.g.*, Loi fédérale sur la poursuite pour dettes et la faillite [Federal Law on Debt Collection and Bankruptcy] du 11 avril 1889 (as of January 1, 2014), RECUEIL SYSTEMATIQUE DU DROIT FÉDÉRAL [RS] [Collection of Federal Law] art. 190, ¶1 (as amended), *available at* http://www.admin.ch/opc/fr/classified (Switz.); Loi sur les faillites [Bankruptcy Law] of Aug. 8, 1997, art. 2, MONITEUR BELGE [M.B.] [Official Gazette of Belgium], Oct. 28, 1997, 28562, ("Every business that has stopped making payments ("cessé ses paiements") in a continuing manner and whose credit is impaired is in a state of bankruptcy"). Under Belgian law, such a business is required, within a month after becoming bankrupt (i.e., arriving at this state), to commence a bankruptcy case in the commercial court. *See id.*, art. 9.

[96] It appears that no country now uses the balance sheet test as the sole insolvency test for qualifying to commence an insolvency case with respect to a debtor. However, in several countries it is a sufficient qualification for an insolvency case. *See, e.g.*, Law on Economic Insolvency and Bankruptcy of 30 May 1991, art. 8 (Belr.); Insolvency Law, DIFC Law No.7 of 2004, art. 51(2) (Dubai); Law of Georgia on Proceedings in Bankruptcy, July 4, 2002, as amended, art. 2 (Geor.). The U.S. bankruptcy law also uses this definition for limited purposes (not including whether a debtor is eligible for bankruptcy). *See* 11 U.S.C. § 101(32) (2012) (defining a corporation as "insolvent" when "its financial condition is such that the sum of [its] debts is greater than all such entity's property, at a fair valuation . . .").

[97] *See, e.g.*, InsO § 19(2) (Ger.) (stating the lack of liquidity as additional grounds for opening an involuntary insolvency case).

[98] This insolvency test is not used much in national insolvency laws. For an example of its use, *see, e.g.*, 9 C.F.R. 203.10 (insolvency test for packers and stockyards under U.S. law).

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come due, and its assets are insufficient to pay all debts or it obviously lacks the ability to pay its debts."[99] The entity is also eligible for a voluntary reorganization if it is in the zone of insolvency.[100]

Judicial Interpretation No. 1 clarifies this language. To be eligible to commence a bankruptcy case, a debtor must meet two conditions: first, it must be unable to pay its debts as they come due. Second, either its assets must be insufficient to pay its debts, or it must otherwise obviously lack the ability to pay its debts.[101] This judicial interpretation further states that the test of failing to pay debts as they come due is satisfied if, (1) the debts are legally enforceable, (2) they are due, and (3) the debtor has failed to pay such debts in full.[102] The Judicial Interpretation adds that, if the debtor is jointly obligated with a solvent third party on an obligation, such an obligation may not be counted in the determination of whether the debtor is insolvent.[103]

Judicial Interpretation No. 1 recognizes that several kinds of financial reports may show that a debtor has insufficient assets to pay all of its debts, including a balance sheet, an audited financial statement or an asset appraisal report.[104] If such a report shows that the debtor has insufficient assets to pay its debts, the court is directed to conclude that the debtor lacks the capacity to pay its debts.[105] However, other evidence may show that the debtor has the capacity to pay its debts, in which case the court should not permit the bankruptcy case to be opened.[106] While ordinarily it would be the debtor that would provide this evidence, the Judicial Interpretation recognizes that another party in interest may provide evidence that the debtor has the capacity to pay off its debts, notwithstanding its apparent shortage of assets.

Furthermore, article 4 of Judicial Interpretation No. 1 provides that, if the debtor's book value exceeds its debts, the court should find nonetheless that the debtor is apparently insolvent if any of the following circumstances exists: (1) the debtor has a severe cash flow deficit or is unable to market its assets (i.e., convert them into cash); (2) the debtor's legal representative has disappeared and nobody is managing its assets; (3) the debtor has not paid its debts despite judicial enforcement proceedings; (4) the debtor has failed to pay its debts and has been losing money for a long period of time, and it is difficult for it to return to profitability; or (5) other circumstances make it

[99] *See* EBL, *supra* note 2, art. 2.
[100] *See* text *supra*, at note 32.
[101] *See* Judicial Interpretation No. 1, *supra* note 9, art. 1.
[102] *See id.* art. 2.
[103] *See id.*
[104] *See id.* art. 3.
[105] *See id.*
[106] *See id.*

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insolvent.[107]

This discussion makes it apparent that Judicial Interpretation No. 1 gives the court substantial flexibility in determining whether a debtor is insolvent for the purposes of the bankruptcy law. In essence, this flexibility requires the judge to make a judgment whether the debtor should be subject to bankruptcy proceedings. In making such a determination, the judge needs to draw on his or her experience and background and understanding of the conditions of the economy in the circumstances existing at the time.[108]

Judicial Interpretation No. 1 also provides that a court must accept jurisdiction of a bankruptcy case for a corporation if it has been dissolved informally without liquidation at all, or without completing its liquidation within a reasonable time.[109] Such mandatory jurisdiction applies only if a creditor applies for bankruptcy liquidation.[110] The debtor may rebut such jurisdiction if it files a timely response to the bankruptcy application and presents evidence in response showing a lack of grounds for bankruptcy.

2. *Procedure for Opening an Involuntary Bankruptcy Case*

Article 6 of Judicial Interpretation No. 1 provides the procedure for opening a bankruptcy case on the application of a creditor. First, the creditor is required to present evidence on the debtor's failure to pay its debts as they come due.[111] The Interpretation requires the court to commence the bankruptcy case if the debtor fails to submit a timely response, or where the response is rejected.[112] The Interpretation does not specify the grounds on which a timely response may be rejected - presumably such a rejection should be based on the weight of the evidence as evaluated by the judge.[113]

Upon the acceptance of an application for bankruptcy and the opening of a bankruptcy case, the court is directed to require the debtor to submit a list of its assets, a list of its debts, a list of its creditors, and its relevant financial statements.[114] If the debtor fails to provide the required information, the court may impose sanctions on the debtor, including a fine or other coercive measures.[115]

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[107]*See id.* art. 4.

[108]Thus, experienced and wise judges are needed to handle insolvency cases.

[109]*See* Judicial Interpretation No. 1, *supra* note 9, art. 5.

[110]*See id.*

[111]*See id.* art. 6.

[112]*See id.*

[113]Jiang states that this provision gives broad discretion to a court in China in deciding whether to open a case. *See* Jiang, *supra* note 4, at 568.

[114]*See id.*; *cf.* 11 U.S.C. § 521 (2012) (imposing similar obligations on debtors in U.S. bankruptcy cases).

[115]*See* Judicial Interpretation No. 1, *supra* note 9, art. 6.

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3. *Court Review and Determination to Open a Case*

Upon receiving the bankruptcy application, the court is required to review the legal status of the applicant and the debtor and the bankruptcy grounds, as well as other related materials. Based on this review, the court must decide whether to accept the application and to open the bankruptcy case.

Article 10 of the bankruptcy law and article 7 of Judicial Interpretation No. 1 establish the procedure for determining whether to open the bankruptcy case by imposing time limitations on the sequence of events leading to the acceptance and opening of a bankruptcy case or its rejection. If a creditor submits the application, the court must notify the debtor within five days after receiving the petition.[116] If the debtor objects to the application, the debtor must file its response within seven days thereafter.[117] The People's Court must decide whether to open the case within 10 days after the expiration of the time to respond.[118] If the debtor files the application, the court has 15 days to decide whether to open the case.[119] Within five days after the decision to open a bankruptcy case, the court must deliver notice to the applicant that the case has been opened.[120]

4. *Bankruptcy Application - Court's Failure to Act*

Finally, Judicial Interpretation No. 1 provides a remedy to an applicant (whether a creditor or the debtor) for the opening of a bankruptcy case if the court fails to act on the application. This is particularly important because Chinese courts have been reluctant to act on bankruptcy applications, in part because of a lack of rules for applying the bankruptcy law in particular cases. The failure of the court to take action on a bankruptcy petition has been a problem in the PRC: many petitions have just sat at the courts where they have been filed with no action by the court. This leaves the filing party in a quandary: there is no court order to take to a higher court for review.

The remedy provided for a court's failure to act on a bankruptcy application is that the applicant (whether the debtor or a creditor) may file its bankruptcy application with the People's Court at the next higher level.[121] Upon receipt of the application, the next higher court may order the lower court to

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[116] *See* EBL, *supra* note 2, art. 10.

[117] *See id.*

[118] *See id.*

[119] *See id.* Upon approval of the appellate court, the period for the court to decide on the application may be extended for an additional 15 days.

[120] *See* EBL, *supra* note 2, art. 11. In contrast, the notice to creditors of the opening of a bankruptcy case is required within 25 days of the issuance of the opening order. *See supra* note 50 and sources cited therein.

[121] The level of the court where a bankruptcy case is filed in China varies depending on the size of the case and perhaps other factors. Thus the Interpretation specifies that it is the next higher court, not a specific court, where the application is filed if the original court does not take action.

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process the application in accordance with the law. If the lower court still fails to act on the application, the next higher court may review the application itself.[122] If the higher-level court approves the application, it may order the lower court to proceed with the case at that point.

B. Case Administration

Judicial Interpretation No. 2[123] addresses four subjects of bankruptcy case administration, each of which is important to a well-run bankruptcy system. The topics regulated are the administrator, the debtor's assets (that are subject to administration in the case), the automatic stay (or moratorium), and the suspension of prescription (similar to a statute of limitations).

1. *The Administrator*

The court makes the appointment of the administrator,[124] whose responsibilities are mostly specified by the EBL.[125] It provides that the administrator's responsibilities include (a) taking possession of all of the debtor's property, (b) investigating the debtor's assets and making an asset report, (c) taking over the debtor's management decisions, (d) determining the debtor's operating expenses and other necessary expenses, (e) deciding whether to continue the debtor's operations until the first meeting of creditors,[126] (f) managing and disposing of the debtor's property, (g) representing the debtor in any court proceedings, arbitration or other legal proceedings, (h) calling the meeting of creditors, and (i) performing any other obligations as directed by the People's Court.[127]

If the court authorizes the reorganization of the debtor in a voluntary case, it may also authorize the debtor's management, at the debtor's request, to restructure its business as a debtor in possession.[128] In such a case, the administrator is required to return the assets and business operations to the debtor (if the administrator has taken control of them).[129] Alternatively, the court may authorize the administrator to hire officers of the debtor to manage the debtor's business operations.[130] If the debtor is authorized to manage the

[122]*See* Judicial Interpretation No. 1, *supra* note 9, art. 9.

[123]*See* Judicial Interpretation No. 2, *supra* note 9.

[124]*See* EBL, *supra* note 2, art. 22. Chen Bao; *Comparative Studies of China's Enterprise Bankruptcy Law and the U.S. Bankruptcy Law*, 19 J. BANKR. L. & PRAC. 5 Art. 5 599 (2010). On issues regarding the appointment of an administrator (or trustee) under the EBL, *see id.* at § III(B)(1).

[125]*See* EBL, *supra* note 2, chapter 3 (arts. 22-29); *see also* Jianhua Xiao, *Bankruptcy Administrator: Status, Powers and Duties*, *in* PARRY ET AL., *supra* note 13, at 89.

[126]The meeting of creditors decides whether the business operations of the debtor are to continue after the meeting. *See* EBL, *supra* note 2, art. 61(5).

[127]*See* EBL, *supra* note 2, art. 25.

[128]*See id.* art. 73. On the reorganization of a debtor under the EBL, *see generally* Haizheng Zhang, *Corporate Rescue*, *in* PARRY ET AL., *supra* note 13, at 207.

[129]*See* EBL art. 73.

[130]*See id.*

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reorganization of the business, the administrator is responsible for supervising the reorganization and the administration of the debtor by its management.[131]

As between the management of a business in reorganization under Chinese law and U.S. law, the standard procedures are opposite. Under Chinese law, an administrator manages a business in reorganization, but the court may authorize the debtor to operate under its own management (which corresponds to the U.S. concept of "debtor in possession"). In the United States, the standard procedure is for the pre-filing management of a business in a chapter 11 case to continue to manage the business after the bankruptcy filing, but the court may appoint a trustee to displace prepetition management at any time before the confirmation of a reorganization plan, on the request of a party in interest or the U.S. trustee, (1) upon a showing of "cause" ("including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case") or (2) if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate.[132]

The People's Court may remove the administrator on any of three (overlapping) grounds. First, such removal may be sought if the meeting of creditors believes that the administrator cannot fulfill the administrator's obligations impartially and in accordance with the law.[133] Second, removal may be sought if, during the meeting of creditors or the committee of creditors, the administrator unjustifiably rejects a request by a creditor to recover any assets owing to the debtor or owing from a shareholder.[134] Third, such removal may be sought if there are other grounds for disqualifying the administrator.[135] Such a removal must be initiated by the meeting of creditors.[136] Notably, neither the EBL nor Judicial Interpretation No. 2 provides any information about what "other grounds" may merit the removal of the administrator. The court is granted complete discretion on this issue (presumably subject to appellate review).

2. *"Property of the Debtor"*

The Chinese bankruptcy law utilizes the concept of "property of the debtor"[137] to designate that property that is subject to administration in the bankruptcy case. "Property of the debtor" in the EBL corresponds to the U.S. concept of "property of the estate."[138]

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[131] *See id.*
[132] *See* 11 U.S.C. § 1104(a) (2012).
[133] *See* EBL, *supra* note 2, art. 22.
[134] *See* Judicial Interpretation No. 2, *supra* note 9, art. 23.
[135] *See* EBL, *supra* note 2, art. 22.
[136] *See id.*
[137] *See id.* chapter 4 (arts. 30-40) entitled "Property of the Debtor."
[138] *See* U.S. Bankruptcy Code § 541 (2012) (providing that the filing of a bankruptcy case (except

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EBL article 30 specifies that the property of the debtor that is subject to bankruptcy administration includes, "all property belonging to the debtor at the time the court opens the bankruptcy case, and all property that the debtor obtains after the opening but before the conclusion of the case."[139] EBL article 5 specifies that property of the debtor includes property wherever located, including property located outside of China.[140]

The concept of "property of the debtor" is further elaborated in the first four articles in Judicial Interpretation No. 2. Article 1 provides that "property of the debtor" includes, in addition to the debtor's money and other property, obligations owing to the debtor by third parties, shares of stock in other entities, intellectual property rights, rights of use, possession and profit, and any other property rights.[141] These rights are property of the debtor under the EBL if they can be valued in monetary form: if they cannot be so valued, they are not subject to such administration.[142]

In contrast, article 2 provides four categories of assets that do not become "property of the debtor" and subject to administration. First, property of the debtor does not include assets that belong to third parties that are in the possession of the debtor or used by the debtor on the basis of warehousing contracts, storage contracts, contracts for work, agency sales contracts, lending contracts, deposit contracts, leases or other legal relationships.

Second, assets in the possession of the debtor that are subject to retention of title[143] are not subject to bankruptcy administration.[144] In contrast, if the assets are subject to a security interest, and not retention of title, they are assets of the debtor subject to bankruptcy administration.[145] If the security interest or pledge has been paid off or otherwise terminated, the surplus is available to pay bankruptcy expenses, mutual benefit claims[146] and other

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under chapter 15) creates an "estate" and specifying what property of the debtor becomes property of the estate and subject to administration in the bankruptcy case).

[139] *See* EBL, *supra* note 2, art. 30. Articles 30-40 provide greater detail on what constitutes "property of the debtor."

[140] *See id.* art. 5. U.S. law likewise includes in the debtor's estate all property, "wherever located and by whomever held." *See* 11 U.S.C. § 541(a) (2012).

[141] *See* Judicial Interpretation No. 2, *supra* note 9, art. 1.

[142] *See id.*

[143] The retention of title as a device for providing a security interest to the seller is common in a number of countries, including most civil law countries.

[144] U.S. law has no such provision. In a typical seller-financing transaction in China, the seller retains the title to the property until the financing is paid. Under U.S. law, the seller retains a security interest, and these assets are administered in the bankruptcy case subject to the security interest of the seller. Under Chinese law, these assets are not administered in the bankruptcy case unless the court restricts the transfer of these assets under article 6 of Judicial Interpretation No. 2, *supra* note 9.

[145] *See* EBL, *supra* note 2, art. 3.

[146] "Mutual benefit" claims, in international insolvency law terminology, are payments the generally benefit all creditors and may be paid from the bankruptcy estate at any time. This concept is rather similar to the U.S. concept of an administrative expense. *See, e.g.*, EBL *supra* note 2, arts. 42-43.

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bankruptcy claims.[147]

This provision imposes a striking difference between goods that the debtor has purchased but not yet paid for: if the seller has retained title to the assets as security for the payment of the price of the sale, they do not become property of the debtor, while goods purchased without such a contractual provision become property of the estate.[148]

A sale of goods with the retention of title is a trap for the unwary lawyer. Under U.S. law, the retention of title by a seller is of no consequence.[149] Such a retention of title clause could easily be overlooked in the sales transaction, because it would likely be contained in fine print buried in the sales contract, and typically it would have no other application.

Third, assets that belong to the government, ownership of which cannot be transferred to a non-state party, are not subject to bankruptcy administration.[150] Fourth, assets in the possession of the debtor but not belonging to the debtor under other laws are also not subject to bankruptcy administration.[151]

Property jointly owned by the debtor and by a third party becomes property of the debtor, whether or not the debtor's interest has been divided from the other interests in the property, and regardless of whether the debtor's interests are divisible or not.[152] In a liquidation case, the property must be partitioned. If the court approves a reorganization or a settlement as to jointly-owned property, the partition must be performed under article 99 of the Property Rights Law.[153] If the partition causes damage to another joint owner, that party is entitled to payment of damages as a mutual benefit claim.[154]

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[147]It appears that this provision is designed for application where the bankruptcy administrator pays off an encumbrance during the bankruptcy case, thus making the assets available for other bankruptcy administration purposes. *See id.*

[148]*See id.* art. 2.

[149]See Uniform Comm. Code § 9-109(a)(1) (Article 9 applies to any "transaction, regardless of its form, that creates a security interest in personal property.") (2010).

[150]*See* Judicial Interpretation No. 2, *supra* note 9, art. 2.

[151]*See id.*

[152]*See id.* art. 4.

[153]Article 99 of the Property Rights Law provides that partition is available on the consent of the joint owners and in certain other circumstances. If the owners are joint tenants, partition may be requested at any time. In contrast, for a tenancy in common, partition is not available until the tenancy in common terminates except where a tenant in common has important reasons for partition. If other joint owners are harmed as a result of the partition, they are entitled to damages. *See* Zhonghua Remin Gongheguo Wuquan Fa (中华人民共和国物权法) [Property Rights Law of the People's Republic of China] (promulgated by the Nat'l People's Cong., March 16, 2007, effective October 1, 2007), art. 99, 2007 STANDING COMM. NAT'L PEOPLE'S CONG. GAZ. 291 (China) [hereinafter, "China Property Rights Law."].

[154]*See* Judicial Interpretation No. 2, *supra* note 9, art. 4.

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3. *Automatic Stay (Moratorium)*

Upon the opening of a bankruptcy case, the EBL imposes a general moratorium (stay) on all litigation against the debtor.[155] The moratorium is equally applicable to any arbitral tribunal where a claim against the debtor is pending at the time of the opening of the bankruptcy case, or that may be commenced thereafter.

The general moratorium has three parts. First, any execution on a previous judgment against the debtor is stayed.[156] Second, any lawsuit against the debtor brought after the opening of the bankruptcy case must be brought as a claim in the court where the bankruptcy case is pending.[157] Third, Judicial Interpretation No. 2 requires a people's court to dismiss any litigation pending against the debtor unless the litigation is converted into a claim and is filed in the bankruptcy case pursuant to the claims process.[158] Thus, any litigation against the debtor, or any attempt to enforce a judgment against the debtor, may only proceed in the bankruptcy case.

The general moratorium against creditor collection activity against a debtor in a case in China has world-wide application pursuant to article 5, which provides: "Any bankruptcy case commenced in accordance with this Law shall extend to the debtor's property locate outside the People's Republic of China."[159] While this provision is in accord with the stay provisions under most bankruptcy laws today, it is probably important for the EBL to say this, because there remain a few countries that continue to adhere to the old view that a stay cannot apply outside the country where the case is commenced.

Judicial Interpretation No. 2 gives further power to the court with respect to property of the debtor after the opening of the case. It authorizes

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[155]*See* EBL, *supra* note 2, art. 20; *cf.* 11 U.S.C. § 362 (2012) (providing a stay, in a U.S. bankruptcy case, of virtually all creditor collection activity).

[156]*See* EBL, *supra* note 2, art. 19. In contrast, the U.S. Bankruptcy Code does not require that the trustee (or debtor in possession) obtain a court order for the sale of property of the debtor unless the sale is not in the ordinary course of the debtor's business. *See* 11 U.S.C. § 363(b) (2012).

[157]*See* Judicial Interpretation No. 2, *supra* note 9, art. 21.

[158]*See id.* This provision appears to be a substantial gloss on EBL article 20, which states that civil litigation against the debtor may proceed after the administrator has taken possession of the debtor's property. Under article 19 of the interpretation, the civil litigation may proceed, but only as a claim in the bankruptcy case. Apparently, any other people's court is required to dismiss any such litigation and require that the claim be pursued in the bankruptcy case.

[159]EBL, *supra* note 2, art. 5. The United States automatic stay also applies worldwide (although its enforcement outside the United States is sometimes problematic). *See, e.g.*, Hong Kong & Shanghai Banking Corp., Ltd. v. Simon (*In re* Simon), 153 F.3d 991, 996 (9th Cir. 1998) (holding that the discharge injunction under 11 U.S.C. § 524, which replaces the § 362 automatic stay upon the entry of a discharge in favor of the debtor in a bankruptcy case, has worldwide application because the automatic stay has worldwide application). While the worldwide extent of the Chinese moratorium is consistent with the law of many other countries, it is subject to the classical practical problem that its enforcement depends to a substantial extent on the voluntary compliance of foreign courts and foreign parties.

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the court, on the application of the bankruptcy administrator or *sua sponte*, to issue an order restricting the transfer of some or all of the debtor's assets.[160] Furthermore, upon notice of the opening of the bankruptcy case, any prior non-bankruptcy judicial or administrative restriction on any of the debtor's assets must be promptly released pursuant to EBL article 19.[161]

Civil litigation against the debtor may proceed with the permission of the court in which the bankruptcy case is commenced. If the bankruptcy case is pending in a first instance court, that court may request that civil litigation involving the debtor be tried in a higher level court or a different first instance court.[162] In addition, if the litigation against the debtor involves a maritime dispute, a patent dispute or securities litigation based on misrepresentation, a higher level court must determine whether it should be tried in a higher level court or in a different first-instance court pursuant to article 37 of the Civil Procedure Law.[163]

4. *Prescription*

For debts owing to the debtor, Judicial Interpretation No. 2 provides that prescription[164] is suspended on the date that the bankruptcy case is

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[160] *See* Judicial Interpretation No. 2, *supra* note 9, art. 6.

[161] *See id.* art. 7. If the People's Court rescinds the opening of a bankruptcy case or dismisses it before opening on the grounds that (a) the debtor has paid all debts that are due, or (b) a third party has paid all of the debts owing by the debtor or given a sufficient guarantee thereof, the People's Court is required to hold up the release of a restriction on the debtor's assets until any non-bankruptcy restriction has been re-imposed. *See id.* art. 8 (incorporating EBL art. 108 by reference).

[162] Article 37 of the Civil Procedure Law provides:

> If a People's Court cannot exercise jurisdiction over a case that is within its jurisdiction due to special reasons, a higher level People's Court may appoint another People's Court to exercise jurisdiction over the case. If there is a dispute as to jurisdiction between People's Courts, the dispute shall be settled by negotiation among the People's Courts at issue. If the negotiation fails, a higher court with jurisdiction over all the People's Courts at issue may appoint a People's Court to exercise jurisdiction.

Civil Procedure Law, art. 37. Zhonghua Renmin Gongheguo Minshi Susong Fa (中华人民共和国民事诉讼法) [Civil Procedure Law of the People's Republic of China] (promulgated by the Nat'l People's Cong., April 9, 1991, effective April 9, 1991), art. 37, http://www.npc.gov.cn/wxzl/gongbao/2012-11/12/content_1745518.htm (China).

[163] *See* Judicial Interpretation No. 2, *supra* note 9, art. 47.

[164] "Prescription" is a civil law concept that is similar to the common law concept of "statute of limitations." It differs mainly in the effect of the expiration of the time to sue to enforce an obligation. When a prescription period has run, the claim disappears altogether and it can have no legal effect thereafter. A statute of limitations, in contrast, is a procedural right, which prohibits a party from commencing litigation against the debtor party after the limitations has run. However, the obligation usually still persists (depending on state law in the United States), and may be revived in certain circumstances and used for other purposes such as setoff. Indeed, with respect to U.S. bankruptcy cases, there is a vigorous market for stale claims for which the statute of limitations has run. *See, e.g., Paper Boys*, THE NEW YORK TIMES MAGAZINE, Aug. 14, 2014; Dana Dratch, *6 Ways to Not Reset the Clock on Old Debt*, BANKRATE, http://www.bankrate.com/finance/debt/6-ways-not-to-reset-old-debt-1.aspx (last visited September 19, 2015) (explaining how to avoid reviving a debt as to which the statute of limitations has run). Such claims are

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opened.[165] In addition, if prescription for a debt has run within one year before the opening of the bankruptcy case and the debtor has failed to collect the debt without good cause, the opening of the bankruptcy case revives the claim and a totally new prescription begins to run on the date of opening of the bankruptcy case.[166]

This second alternative, which applies after prescription has run, is a very substantial and unusual change in the law of prescription.[167] While it is not unusual for a bankruptcy law to provide that the opening of a bankruptcy case suspends the running of prescription (or of a statute of limitations),[168] the revival of a claim that is barred by prescription before the commencement of the bankruptcy case is unknown in the bankruptcy laws of other countries.

C. Commercial Transactions Involving the Debtor

The EBL gives the administrator several powers with respect to commercial transactions undertaken by the debtor.

1. *Property Belonging to a Third Party*

As noted above, in a variety of circumstances, the debtor may be in possession of property belonging to a third party. For example, the debtor may be providing delivery services for the property, or holding the property for safekeeping, or may be in possession of the property pursuant to a lease or other commercial transaction.

Judicial Interpretation No. 2 provides guidance in three circumstances relating to such property. These include return of the property to the owner, damage or loss to the property caused by the administrator, and the handling of insurance proceeds resulting from a loss.

a. Owner Recovery of Property

After the opening of the bankruptcy case, the owner of the property may recover the property from the administrator, unless otherwise provided by law.[169] Typically, if the debtor has possession of the property pursuant to a

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frequently filed in bankruptcy cases, especially in consumer cases, and often are paid notwithstanding the running of the statute of limitations, because no objection to the claim is made.

[165] *See* Judicial Interpretation No. 2, *supra* note 9, art. 19; *cf.* 11 U.S.C. § 546(a) (2012) (providing that any statute of limitations in the United States with respect to avoiding powers is extended by the filing of a bankruptcy case to the later of (1) two years after the date of the entry of an order for relief (generally, the filing of a bankruptcy case), (2) one year after the appointment or election of a trustee (if within the 2-year period after the date of entry of an order for relief), or (3) the date that the case is closed or dismissed). This issue is not addressed in the EBL.

[166] *See* Judicial Interpetation No. 2, *supra* note 4.

[167] There are no known provisions of this sort in the bankruptcy law of any other country.

[168] *See, e.g.*, 11 U.S.C. § 108(a) (2012) (extending statute of limitations for all debts in a U.S. bankruptcy case to the longer of (a) two years after the filing of the bankruptcy case or (b) when it would expire absent bankruptcy).

[169] *See* EBL, *supra* note 2, art. 38.

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lease or rental agreement, the debtor may continue in possession of the property because this is "otherwise provided by law." However, if the debtor no longer needs the property (for example, if the case is a liquidation case), the administrator should return the property to the owner.[170]

If the debtor is entitled to payment by the property owner for the costs of manufacturing, storage, commission or sales commission, the administrator may refuse to deliver the property to the owner until such charges are paid.[171] If such assets in the possession of the debtor are perishable and the administrator has sold the assets, the People's Court may order the prompt turnover of the payment proceeds to the owner.[172]

If the owner of such property intends to take possession of the property, the owner must exercise its right to possession prior to the submission to the meeting of creditors of a liquidation plan, a settlement agreement or a reorganization plan.[173] If the owner takes possession of the property at a later date, the owner is liable for any extra expense incurred.[174] If the administrator refuses to grant possession of such property to the owner, the People's Court may award damages to the property owner.[175]

If the property owner makes a claim for the property at issue on the basis of a court order or an arbitral award, and the administrator denies the claim on the grounds that the court order or arbitral award is in error, the People's Court must reject such a defense.[176] The proper venue for making such a claim is the court or arbitral panel that issued the order or award, respectively. Judicial Interpretation No. 2 provides that it is not proper to make a collateral attack on such a judicial order or arbitral award in the bankruptcy case.

b. Damage or Loss Caused by Administrator Conduct

If the administrator (or a responsible person)[177] causes assets belonging to a third party to be damaged or destroyed as a result of intentional or grossly negligent misconduct,[178] the resulting loss gives rise to a mutual benefit claim

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[170] If the property is in the possession of the debtor pursuant to an unexpired lease, the return of the property to the owner may give the owner a claim for the unexpired portion of the lease. *See id.* art. 53.

[171] *See* Judicial Interpretation No. 2, *supra* note 9, art. 28.

[172] *See id.* art. 29.

[173] *See id.* art. 26.

[174] *See id.*

[175] *See id.* art. 27.

[176] *See id.*

[177] Chinese law provides that a "responsible person," in connection with a legal entity, is one who acts on behalf of the entity in exercising its functions and powers and is its legal representative. *See* General Principles of the Civil Law of the People's Republic of China, art. 38. In the case of a corporation, such a person may be a director or officer, or someone else designated to act on behalf of the corporation.

[178] If the loss is caused by intentional or grossly negligent misconduct, insurance coverage may not be available to cover the loss.

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to be paid from the debtor's assets.[179] The administrator or responsible person may have personal liability for such a claim if the debtor's assets are insufficient to cover such a mutual benefit claim and the owner claims that the administrator or responsible person has joint liability with the debtor.[180]

c. Insurance Proceeds

If assets belonging to a third party have been destroyed or damaged while in the possession of the debtor and an insurance claim is pending, the court is required to order that the insurance proceeds be delivered to the owner.[181] The same rule applies if the debtor has already received the insurance proceeds and obtained replacement assets that are distinguishable from the debtor's other assets: the owner is entitled to the new assets.[182]

However, if the debtor has used the proceeds to obtain replacement assets that cannot be distinguished from other assets of the debtor, the treatment of the owner's claim depends on when the loss occurred. If it occurred before the opening of the bankruptcy case, the owner's claim is a general bankruptcy claim. However, if the loss was caused by the negligence of the administrator or another responsible person after the opening of the bankruptcy case, the owner's claim is a mutual benefit claim.[183]

If the debtor in such circumstances receives no insurance payment or the payment is insufficient to cover the loss, the claim receives the same status as where the replacement assets cannot be distinguished from other assets of the debtor.[184]

2. *Goods in Transit*

Article 39 of Judicial Interpretation No. 2 governs the rights of the parties when the debtor has purchased goods that are in transit when the bankruptcy case is opened. If the seller makes no demand for the return of the goods before the goods are delivered to the debtor, the administrator may not allow a claim for the return of the goods.[185] If the goods have not yet been delivered when the seller demands the return of the goods, the administrator is required to approve the return of the goods to the seller.[186]

If the goods have been returned to the seller, the administrator may de-

[179] *See* Judicial Interpretation No. 2, *supra* note 9, art. 33.
[180] *See id.*
[181] *See id.* art. 32.
[182] *See id.*
[183] *See id.* For an explanation of the status of a mutual benefit claim, see *supra* note 146.
[184] *See id.* art. 38.
[185] *See id.* This rule applies even where the seller has notified the carrier to suspend the shipment, to return the goods to the seller, to change the destination of shipment, or to deliver the goods to another address. This rule assumes that the debtor has paid for the goods that have been delivered.
[186] *See id.*

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mand a return of any amount that the debtor has paid for the goods.[187]

3. *Recovery of Pledged Collateral*

Certain assets of the debtor may be in the possession of a creditor as security for a debt owing to that creditor (i.e., a pledge).[188] After the opening of a bankruptcy case, the EBL authorizes the administrator to recover any such property for the debtor.[189] The administrator may recover the property by providing protection to the creditor in two ways: the administrator may pay the debt, or the administrator may provide a guarantee of payment that is acceptable to the creditor.[190]

If the debt is undersecured (i.e., the value of the collateral is less than the amount owing on the debt), the payment must be limited to the value of the collateral.[191] As to the remainder of the debt, the creditor becomes an unsecured creditor in the bankruptcy case.

4. *Sale of Goods to Debtor Under Reservation of Title*

A sale of goods with a reservation of title is a traditional way to create a security interest in goods in civil law countries, including China. Judicial Interpretation No. 2 has a number of provisions dealing with the sale of goods to a debtor under reservation of title where the debtor has gone into bankruptcy.

a. General Rule for Executory Contracts

The EBL gives the administrator the right to assume or to reject any executory contract, including a contract for the purchase or sale of goods, which is pending when a bankruptcy case is opened.[192] The EBL gives the administrator two months to assume or reject an executory contract after the date of the opening of the bankruptcy case.[193] The default alternative is that, if the administrator fails to notify the counterparty of an assumption of a contract within two months after the opening of the case, the executory contract is deemed rejected.[194] Alternatively, the counterparty to the contract may send an inquiry to the administrator about the contract. If the administrator does not respond to the inquiry within thirty days, the contract is also deemed rejected.[195]

If the administrator assumes a contract, the EBL provides that the

[187]*See id.*
[188]Such a transaction is designated as a "pledge."
[189]*See* EBL, *supra* note 2, art. 37.
[190]*See id.*
[191]*See id.*
[192]*See id.*, art. 18.
[193]*See id.*
[194]*See id.*
[195]*See id.*

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counterparty is required to perform thereunder.[196] However, the counterparty may demand a guarantee from the administrator: if the administrator fails to provide such a guarantee upon demand, the contract is rejected.[197]

b. Application of General Rule to Contracts with Reservation of Title

The general rule on executory contracts applies to contracts for the sale of goods with a reservation of title to the seller. For such a contract, if one of the parties (either the buyer or the seller) becomes bankrupt after the making of the contract, the administrator may either assume or reject the contract, if title to the goods has not been transferred to the buyer.[198]

i. *Debtor is Seller of the Goods*

If the debtor is the seller of the goods and has retained title pending payment by the buyer, and the administrator decides to assume the contract and to continue performing it, the buyer must pay the contract price and perform any other obligations under the contract.[199] If the buyer fails to pay the contract price (or to perform its other duties under the contract) and thereby causes damage to the debtor-seller, the administrator may repossess the goods unless (a) the buyer has paid at least 75% of the price, or (b) a third party has acquired the goods in good faith.[200] These remedies are also available to the administrator, subject to the same conditions, if the buyer sells, pledges or inappropriately disposes of the goods and thereby causes damage to the seller-debtor.[201]

If the seller has failed to repossess the goods after the buyer's non-payment (prior to the opening of the bankruptcy case), the administrator may require the buyer to continue to pay the contract price, perform any other duties under the contract, and be responsible for any loss.[202] Thus, the administrator would have a claim against the buyer for the unpaid portion of the price for the goods, plus any damages.

ii. *Debtor is Buyer of the Goods*

If the debtor is the buyer of the goods pursuant to a contract where the seller has reserved title to the goods, Interpretation No. 2 has two provisions that could be applicable. First, article 38 of Interpretation No. 2 provides

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[196] *See id.*

[197] *See id.*

[198] *See* Judicial Interpretation No. 2, *supra* note 9, art. 34.

[199] *See id.* art. 35.

[200] *See id.* For a discussion of the circumstances where a third party may acquire the goods from the buyer free of the reservation of title, *see infra*, text accompanying notes 133-39.

[201] *See* Judicial Interpretation No. 2, *supra* note 9, art. 35.

[202] *See id.*

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that the administrator may reject the contract, in which case the seller is entitled to the return of the goods upon the seller's request.[203] If the seller takes back the goods, the administrator is entitled to a refund of the price paid.[204] If there has been a substantial reduction in the value of the goods[205] before their return to the seller, the seller may deduct this loss from the funds to be repaid.[206] If the payment to the seller is insufficient to cover the loss in value of the goods, the seller is entitled to a mutual benefit claim[207] in the bankruptcy case for the difference.[208]

The second possibly relevant provision is article 2(2), which provides that assets as to which title has not yet been transferred are not considered assets of the debtor for bankruptcy law purposes.[209] If this provision is applied to sales to the debtor under a retention of title, there would be no impediment to the seller repossessing the goods without waiting for the administrator to assume or reject the contract. In addition, the automatic stay would not apply, the property would not be subject to administration by the administrator, and the administrator could not keep the property upon paying the contract price to the seller.

The better interpretation is that article 2(2) does not apply to sales subject to the retention of title, but only to other circumstances where the title has not been transferred to the debtor. This avoids the problem of the inconsistency with the provision authorizing the administrator to assume the contract and to pay the debt to the seller.

c. *Debtor's Sale to a Subsequent Purchaser of Property Held Subject to a Reservation of Title*

Judicial Interpretation No. 2, article 30 governs the rights of the parties if the debtor has purchased goods under a reservation of title by the seller, and resells them to a subsequent purchaser. If the subsequent purchaser has acquired the property in good faith[210] as provided by article 106 of the Property Rights law, so that the owner cannot obtain a return of the property

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[203] *See id.* art. 38; EBL, *supra* note 2, art. 38.

[204] *See* Judicial Interpretation No. 2, *supra* note 9, art. 38.

[205] There are a variety of circumstances where the value of the goods may diminish with the passage of time. If the goods are perishable, for example, they may be worth much less at the time of their return. If they are traded in a market, such as steel or grain, the market may have gone down for goods of that type. If the goods are automobiles and the model year has changed before they are returned to the seller, they may be worth substantially less because they are year-old models.

[206] *See* Judicial Interpretation No. 2, *supra* note 9, art. 38.

[207] For a discussion of the status of a mutual benefit claim, *see supra* note 146.

[208] *See id.*

[209] *See id.* art. 2(2).

[210] Often the seller of the goods under reservation of right is a manufacturer or jobber, and the purchaser of the goods is a retailer who in turn sells the goods to customers, who obtain unrestricted ownership of the property. Article 30 provides the rights of the seller in this kind of circumstance. *Cf.* Uniform Comm Code § 9-320 (2010).

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from the subsequent purchaser,[211] the claim by the initial seller with a reservation of title may take one of two forms in the bankruptcy case. If the sale to the subsequent purchaser occurs before the opening of the bankruptcy case, the original seller's claim is a general claim in the bankruptcy case.[212] On the other hand, if the transfer occurs after the opening of the bankruptcy case and the original seller's loss is caused by the negligence of the administrator or other responsible person,[213] the original seller is entitled to a mutual benefit claim.[214]

If the original seller has taken possession of the property involved in such a transaction after the purchaser has paid for it because the purchaser has not obtained title to the property,[215] the subsequent purchaser's claim has the same status: if the transfer occurs before the opening of the bankruptcy case, the purchaser's claim is a general claim; however, if the transfer occurs after the opening of the bankruptcy case the subsequent purchaser's claim has the status of a mutual benefit claim.[216]

5. *Setoff*

Article 40 of the EBL provides for the setoff of mutual debts in determining whether the creditor owes money to the administrator or the administrator owes money to the creditor.[217] The administrator may not initiate a setoff between the creditor and the debtor unless the setoff benefits the debtor.[218]

In general, a creditor may request the administrator to set off a mutual debt owed by a creditor prior to the opening of the bankruptcy case against a claim by the creditor against the debtor.[219] However, a setoff is not permit-

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[211]Property Rights Law art. 106 provides in relevant part:

> Unless otherwise provided by law, the transferee [of real or movable property] shall obtain the ownership respecting such real or movable property in any of the following events:
> (i) The transferee accepts the transfer as bona fide;
> (ii) The property is transferred at a reasonable price;
> (iii) The transferred property has been registered in accordance with the laws requiring such registration or, if registration is not required, has been delivered to the transferee.

See China Property Rights Law, *supra* note 153, art 106. In these circumstances, art. 106 gives the transferee a right to damages against the transferor. This provision is similar to the rights under U.S. law for a "holder in due" course of a promissory note. *See* Uniform Comm. Code § 3-302 (2002).

[212]*See* Judicial Interpretation No. 2, *supra* note 9, art. 30.

[213]For a definition of "responsible person," *see supra* note 177.

[214]For an explanation of a mutual benefit claim, *see supra* note 146.

[215]*See* Property Rights Law, art. 106.

[216]*See* Judicial Interpretation No. 2, *supra* note 9, art. 31.

[217]*See* EBL, *supra* note 2, art. 40; *cf.* 11 U.S.C. § 553 (2012) (providing for setoff in U.S. bankruptcy cases).

[218]*See EBL*, *supra* note 2, art. 40.

[219]*See id.*

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ted under any circumstances if the creditor obtained the debt owed by the debtor after the opening of the bankruptcy case.[220]

EBL article 40 prohibits such a setoff in two additional circumstances: where the creditor granted credit when it had actual knowledge either that the debtor was insolvent (i.e., it was not able to pay its debts as they came due), or that it had filed a bankruptcy application.[221] However, notwithstanding the creditor's knowledge of the debtor's financial status, a setoff is permitted if the debt at issue resulted from the application of a law or regulation; or if the debt resulted from an event occurring more than a year before the bankruptcy opening.[222] If the debtor made a setoff within six months before the opening of the bankruptcy case, the administrator may commence litigation to invalidate the setoff.[223]

An administrator's objection to a setoff by a shareholder must be sustained if the debtor's claim against the shareholder results from (a) a contribution of capital owing to the debtor or capital withdrawn from the debtor, or (b) shareholder misconduct constituting an abuse of the shareholder's rights or use of influence which caused damage to the company.[224]

If a creditor whose setoff is prohibited by article 40 is owed a priority debt in the bankruptcy case and also owes money to the debtor (which could support a setoff if not prohibited), the People's Court must authorize the setoff if the value of the priority debt owing to the creditor exceeds the value of the debt owed to the debtor.[225]

If the creditor decides to take advantage of its setoff rights under article 40, the creditor is required to notify the administrator.[226] The effective date of a creditor's setoff, as a general rule, is the date that the administrator receives notification of the setoff.[227] Presumably, the purpose of this rule is to establish a date when interest ceases to accrue on the creditor's claim.[228]

If the administrator has an objection to a setoff, the administrator is required to initiate litigation to invalidate the setoff in the People's Court within three months of receiving notice of the setoff or within the time specified by applicable court procedural rules.[229] The People's Court is required

[220] *Cf.* 11 U.S.C. § 553(a) (2012) (same under U.S. law).

[221] *See* EBL, *supra* note 2, art. 40.

[222] *See id.*

[223] *See* Judicial Interpretation No. 2, *supra* note 9, art. 44. Notably, there is no parallel provision for disallowing a setoff by a creditor within the six-month period before the opening of the bankruptcy case.

[224] *See id.* art. 46.

[225] *See id.* art. 45.

[226] *See id.* art. 42.

[227] *See id.*

[228] Under U.S. law, this problem does not arise because the U.S. Bankruptcy Code provides that an unsecured claim may not include any interest accruing after the date of the filing of the bankruptcy petition. Thus no post-petition interest is payable on such debts. *See* 11 U.S.C. § 502(b)(2) (2012).

[229] *See* Judicial Interpretation No. 2, *supra* note 9, art. 42.

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to overrule the objection if the administrator has not provided good cause for the rejection within the objection period.[230] If the objection is overruled, the setoff takes effect as of the date that the administrator received notice of the setoff.[231]

The following grounds for objection to a setoff are not permitted: that the debt owing the creditor was not yet due (either at the time that the bankruptcy application was made or at the time that the bankruptcy case was opened), or that the debts do not involve the same subject matter.[232]

d. Avoidance Actions

The Chinese bankruptcy law has a rather sophisticated set of rules on the avoidance of pre-bankruptcy transactions.

1. *Avoidable Transactions*

The Chinese bankruptcy law provides generally that the administrator may avoid five types of transactions occurring within one year prior to the opening of the bankruptcy case: (a) a gratuitous transfer (i.e., a gift); (b) a transfer for an obviously unreasonable price (an undervalued transaction); (c) a grant of a security interest for a previously unsecured debt; (d) a payment of a debt before it is due; and (e) a waiver of any debt owing to the debtor.[233] Furthermore, any action concealing or transferring property for the purpose of avoiding the payment of a debt is void.[234] Similarly, any action creating a fictitious debt or acknowledging such a debt is void,[235] and any payment on such a debt may be recovered.[236]

The administrator may recover property of the debtor that is avoided under any of these kinds of transactions.[237] If the court revokes a transfer of assets pursuant to EBL article 31 or 32, Judicial Interpretation No. 2 requires the People's Court to order the restitution of these assets to the debtor.[238]

2. *Protected Transactions*

Bankruptcy law normally protects a number of kinds of transactions from avoidance by the administrator (or a creditor).[239] These laws vary substan-

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[230] *See id.*

[231] *See id.*

[232] *See* EBL, *supra* note 2, art. 43.

[233] *See id.* art. 31; *cf.* 11 U.S.C. § 548 (2012) (providing for the avoidance of similar transactions by the trustee in a U.S. bankruptcy case).

[234] *See* EBL, *supra* note 2, art. 33(1).

[235] *See id.* art. 33(2).

[236] *See* Judicial Interpretation No. 2, *supra* note 9, art. 17.

[237] *See* EBL, *supra* note 2, art. 34; *cf.* 11 U.S.C. § 550 (2012) (providing for a U.S. trustee to recover assets that are the subject of an avoided transaction, or their value).

[238] *See* Judicial Interpretation No. 2, *supra* note 9, art. 9.

[239] *See, e.g.*, 11 U.S.C. § 547(c) (2012) (exempting several categories of transactions from U.S. preference avoidance law, including contemporaneous transactions, transactions in the ordinary course of business, and the creation of a security interest in exchange for new value).

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tially from country to country. Chinese bankruptcy law likewise protects a number of kinds of transactions from a preference challenge.

The administrator may not avoid a pre-bankruptcy payment made by the debtor as a result of litigation, arbitration or a judicial debt enforcement action, unless the payment was made in bad faith.[240] In effect, this rule reflects a public policy decision to protect the finality of payments resulting from debt enforcement procedures.

In addition, the administrator may not avoid a debtor's payment on a secured debt under Chinese law unless the value of the collateral is less than the amount due (i.e., the debt is undersecured).[241] The effect of a payment on an undersecured debt is to reduce the unsecured portion of the debt, which in effect makes it a payment on an unsecured debt (and thus avoidable).

Certain other transactions are also protected from avoidance under Chinese law. First, any payment of a debt that benefits the debtor's assets may not be set aside.[242] This likely would include payments for goods or services (including wages) where the price is not obviously unreasonable. It would also include debt service on longer term secured debts except where the debt is undersecured.

In addition, payments of water bills or electric bills, where these services are necessary for maintaining production, and payments for labor or compensation for personal injury[243] may not be set aside.

3. *Prepayment of a Debt*

Judicial Interpretation No. 2 refines the provision on the prepayment of a debt. It provides that, if a debt was prepaid within the one-year window for the avoidance of such a payment, but at least six months before the opening of the bankruptcy case, it may not be avoided.[244] Thus, this provision effectively limits the suspect period for the prepayment of a debt to six months before the opening of the bankruptcy case.

Furthermore, Judicial Interpretation No. 2 specifies that such a debt prepayment may not be avoided unless, at the time of the prepayment, the debtor was insolvent as defined in paragraph one of article 2:[245] the debtor was unable to pay its debts as they came due, its assets were insufficient to pay all of its debts, or it obviously lacked the ability to pay its debts.[246]

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[240]*See* Judicial Interpretation No. 2, *supra* note 9, art. 15.

[241]*See id.* art. 14.

[242]*See id.*

[243]*See id. art.* 16.

[244]*See id.* art. 12.

[245]*See id.*

[246]*See* EBL, *supra* note 2, art. 2. The EBL's definition of insolvency (a prerequisite to eligibility for a case under the bankruptcy law) has further refinements beyond those stated in art. 2, paragraph 1. *See supra*, text accompanying notes 31-33.

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4. *Avoidance Action by a Creditor*

A creditor may invoke many of the avoidance powers under the EBL if the bankruptcy administrator does not challenge a particular pre-bankruptcy transaction. Such litigation may be brought by a creditor to avoid a transaction that occurred within one year before the opening of the bankruptcy case that constitutes a gratuitous transfer, an undervalued transaction, or the waiver of a debt owing to the debtor.[247] However, even though the administrator has failed to take action, a creditor may not invoke two types of avoidance powers: a creditor may not bring an action to avoid a prepayment of a debt, or the granting of security for a previously unsecured debt.

Judicial Interpretation No. 2 makes it clear that any avoidance action brought by a creditor is brought on behalf of the bankruptcy case, and not for the benefit of the individual creditor initiating the action. Thus, the transferee of such a transfer may not defend on the grounds that the creditor is owed less than the amount sought for recovery.[248]

D. Corporate Law Issues

Judicial Interpretation No. 2 has several provisions that generally fall under the heading of corporate law. These relate to director and officer liability in the bankruptcy case, unpaid capital contributions by shareholders, and abnormal or unusual transactions with an insider.

1. *Director and Officer Liability*

If the debtor's managing director, or any other responsible person (including a director or officer), has engaged in intentional or grossly negligent conduct resulting in losses of the debtor's assets, the bankruptcy administrator is authorized to bring litigation to hold such a person directly liable for these losses.[249]

2. *Capital Contributions*

The law in China does not require all of the stated capital to be paid in order to start a corporation. Furthermore, capital may be withdrawn from a corporation in certain circumstances. The EBL has no provision authorizing the bankruptcy administrator to pursue any remedy for a violation of the Corporation Law of China in this regard.

However, Judicial Interpretation No. 2 gives the administrator strong

[247] *See* Judicial Interpretation No. 2, *supra* note 9, art. 13.

[248] *See id.*

[249] *See id.* art. 18. For the most part, U.S. law on the subject of director liability and is not unified: each state in the United States has its own law. While these laws are generally similar, they may vary in important details from one state to another. In a bankruptcy case, the trustee may assert a claim against a corporate director or officer under state law pursuant to 11 U.S.C. § 544 (2012), but only if the state law permits such a claim by a creditor (and not by a shareholder).

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tools in such circumstances. The administrator may bring litigation on behalf of the debtor against any capital contributor for the failure to pay into the corporation any unpaid capital or to recover any capital that has been withdrawn from the corporation.[250] Such an action may be brought even where the payment of the capital has not yet come due pursuant to the corporation's articles of association.[251] Additionally, the administrator may bring such an action even though the contribution is sufficiently past due that prescription has run against the claim.[252]

Furthermore, the bankruptcy administrator may bring litigation on behalf of the debtor for damages against a promoter, director or senior manager of the corporation for failure to collect any capital contribution.[253] In addition, the administrator may bring litigation against a shareholder, director, senior manager or person in control of the corporation who has the duty to collect such contributions or who has assisted in the withdrawal of capital.[254]

3. *Abnormal or Unusual Transactions with an Insider*

EBL article 36 requires the bankruptcy administrator to recover any abnormal or unusual income or converted property of the debtor received by a director, a member of the supervising committee, or a senior officer of the debtor (an insider) in that person's official capacity.[255] Judicial Interpretation No. 2 specifies that the payment of a performance bonus, back wages or other unusual payment constitutes abnormal income under EBL art. 36[256] if the debtor is insolvent at the time of the transaction.[257]

If the administrator's recovery under this provision arises from the payment of back wages, the funds are divided into two parts: to the extent that the amount recovered constitutes a normal wage for the insider, it is payable back to the insider as a priority wage claim under EBL article 113(1).[258] The remainder of the funds recovered from an insider who has received back wages, and the recoveries of any other abnormal income, go into the fund for paying general claims in the bankruptcy case.[259]

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[250]*See* Judicial Interpretation No. 2, *supra* note 9, art. 20; *cf. Sawyer v. Hoag*, 84 U.S. 610 (1873) (suit against investor for failure to pay portion of corporate subscription).

[251]*See* Judicial Interpretation No. 2, *supra* note 9, art. 20.

[252]*See id.*

[253]*See id.*

[254]*See id.*

[255]*See* EBL, *supra* note 2, art. 36. Notably, "abnormal income" is not defined for the purposes of this statutory provision.

[256]*See* Judicial Interpretation No. 2, *supra* note 9, art. 24.

[257]For a discussion of what constitutes "insolvency" for the purposes of the EBL, see *supra*, text accompanying notes 31-33.

[258]Wage claims have a priority status under the EBL and are next in priority after the payment of bankruptcy expenses and debts. *See* EBL, *supra* note 2, art. 113.

[259]*See* Judicial Interpretation No. 2, *supra* note 9, art. 24.

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IV. UNFINISHED PRC SUPREME COURT WORK

The Judicial Interpretations leave unfinished work for the PRC Supreme Court. More judicial interpretations will likely be issued by the court in the future.

Perhaps the most important subject on which Judicial Interpretations are needed is the business restructuring and reorganization process.[260] In particular, interpretations are needed for the procedure for approving a reorganization plan where one or more classes of creditors has not voted in favor of the plan (the "cramdown" provision): this provision largely tracks that in the U.S. chapter 11 process, but without any of the history of "cramdown" in U.S. jurisprudence that puts meat on the bones of the U.S. statute.[261]

Judicial interpretations remain to be issued also with respect to the statutory provisions on the bankruptcy settlement or composition process,[262] the process of liquidation and distribution of assets of the debtor,[263] and the legal responsibilities of directors, officers and other responsible parties (apart from those duties specified in EBL article 125).[264]

V. CONCLUSIONS

In conclusion, the PRC Supreme Court's Judicial Interpretations No. 1 and 2 add substantially to the Enterprise Bankruptcy Law and help to make it workable in many ways. Some of the provisions fill in details in the existing law. Others add to it in ways that make the law easier to use.

Generally, the subjects addressed by the law include the filing and opening of a bankruptcy case, case administration, commercial transactions of the debtor, avoidance actions, and corporate law issues. The interpretations are technical and detailed, and designed for the professional, not the casual reader. These interpretations are likely to make it a more attractive law to use for enterprises in financial difficulty in China.

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[260] *See* EBL, *supra* note 2, arts. 70-94; *see also* Zhang, *supra* note 128, at 207. On the "settlement" process under the Chinese bankruptcy law, *see* note 16 *supra* and accompanying text.

[261] *See, e.g.*, COLLIER ON BANKRUPTCY, § 1129.03 (Alan N. Resnick & Henry J. Sommer eds., 16th ed., 2015).

[262] *See id.* arts. 95-106.

[263] *See id.* arts. 111-124.

[264] *See id.* arts. 125-131. Director and officer liability, pursuant to art. 125, is addressed in Judicial Interpretation No. 2, *supra* note 9, art. 18. *See also* text *supra* at note 250.

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