eiger

BANKRUPTCY LAW IN CHINA

Dr. Konstantin HOPPE

Referent: Nathan KAISER

August 2009

Inhaltsverzeichnis

Abkürzungsverzeichnis

1986 Bankruptcy Law	Enterprise Bankruptcy Law (for trial implementation) of the People's Republic of China, promulgated December 2, 1986
1994 Notice	Notice on Issues Relevant to Tentative Implementation of Bankruptcy of State-Owned Enterprises in some cities from October 25, 1994
2006 Bankruptcy Law	Enterprise Bankruptcy Law of the People's Republic of China from August 27, 2006
CCP	German Code of Civil Procedure
e. g.	For example
EIR	European Insolvency Regulation
et seq.	And the following
GDP	Gross domestic product
i. e.	That is
NPC	National People's Congress
NPL	Non-Performing Loan
PRC	People's Republic of China
SOE	State-Owned Enterprise
U.S.	United States of America
USD	U.S. Dollars
WTO	World Trade Organization

Literaturverzeichnis

Berube, Cardine; Pu, Patrick, Bankruptcy and Insolvency in the PRC: A Myth?, IPBA Journal 3/2009, Seite 22

Chua, Eu Jin, Chinas New Bankruptcy Law: A Legislative Innovation, China Law & Practice, October 2006, Seite 17/zitiert: Chua, China's New Bankruptcy Law

Economist, The, Bankruptcy in China: Silent Busts, ed. October 9, 2008

Fehl, Elske, Das neue Konkursgesetz der Volksrepublik China, ZInsO 2008, Seite 69

Fung, Will, Policy-oriented vs. market-oriented Bankruptcy: A tour on the PRC New Enterprise Bankruptcy Law, in Best Practices for Bankruptcy Law in China, 1. Aufl. 2008, Seite 219/zitiert: Fung, Policy-oriented vs. market-oriented Bankruptcy

Fung, Will; Li, Zhou, Responding to the Enterprise Bankruptcy Law, in Best Practices for Bankruptcy Law in China, 1. Aufl. 2008, Seite 137

Geimer, Reinhold (Hrsg.), Internationales Zivilprozessrecht, 5. Aufl., Köln 2005/zitiert: Geimer, Internationales Zivilprozessrecht

Gottwald, Peter (Hrsg.), Insolvenzrechts-Handbuch, 3. Aufl., München 2006/zitiert: Gottwald, Insolvenzrechts-Handbuch

Guo, Kevin, An Introduction to Bankruptcy in China, in Best Practices for Bankruptcy Law in China, 1. Aufl. 2008, Seite 83/zitiert: Guo, Introduction to Bankruptcy in China

Hua, Xiaojun, The Evolution of Bankruptcy Law in China, in Best Practices for Bankruptcy Law in China, 1. Aufl. 2008, Seite 7/zitiert: Hua, Evolution of Bankruptcy Law in China

Jiang, Qing-Yun, Court Delay and Law Enforcement in China: Civil Process and Economic Perspective, 1. Aufl., Hamburg 2006/zitiert: Jiang, Court Delay and Law Enforcement in China

Klumb, Jan P., Kollisionsrecht der Insolvenzanfechtung, 1. Aufl., Köln 2005

Koppitz, Ralph, The Response to China's New Bankruptcy Law: Changing Strategies, in Best Practices for Bankruptcy Law in China, 1. Aufl. 2008, Seite 121/zitiert: Koppitz, Response to China's New Bankruptcy Law

Kranemann, Karl R., Insolvenzanfechtung im Deutschen Internationalen Insolvenzrecht und nach der Europäischen Insolvenzrechtsverordnung, 1. Aufl., Frankfurt 2002

Kübler, Bruno M./Prütting, Hanns/Bork, Reinhard (Hrsg.), InsO, Kommentar zur Insolvenzverordnung, Stand Mai 2009/zitiert: Kübler/Prütting-Bearbeiter, Insolvenzordnung

Mong, Leonie Y.L., Changing Trends and Regulations in PRC Bankruptcy Law, in Best Practices for Bankruptcy Law in China, 1. Aufl. 2008, Seite 95

Münchener Kommentar, Insolvenzverordnung, 2. Aufl., München 2008/zitiert: MüKo-Bearbeiter, InsO

Münchener Kommentar, Zivilprozessordnung, 3. Aufl., München 2008/zitiert: MüKo-Bearbeiter, ZPO

Münzel, Frank, Einige Anmerkungen zum neuen Konkursgesetz der Volksrepublik China, ZChinR 2007, Seite 47

Neelmeier, Axel, Verbürgung der Gegenseitigkeit zwischen Deutschland und China?, ZChinR 2007, Seite 287

Peters, Stefan, Das neue Insolvenzgesetz der Volksrepublik China - Rechtsstaat Made in Germany?, RIW 2008, Seite 112/zitiert: Peters, Das neue Insolvenzgesetz der Volksrepublik China

Piekenbrock, Andreas, Das neue chinesische Insolvenzrecht in rechtsvergleichender Perspektive, in Yuanshi Bu (Hrsg.), Chinesisches Zivil- und Wirtschaftsrecht aus deutscher Sicht, 1.Aufl. Tübigen 2008, Seite 79/zitiert: Piekenbrock, Das neue chinesische Insolvenzrecht

Schack, Haimo, Internationales Zivilverfahrensrecht, 4. Aufl., München 2006

Seidl-Hohenveldern, Ignatz, Völkerrechtswidrigkeit der Konfiskation eines Gemäldes aus der Sammlung des Fürsten von Liechtenstein als angeblich 'deutsches' Eigentum, IPRax 1996, Seite 410

Stucken, Bernd-Uwe, Investing in Distressed Assets and Debts in China, in Best Practices for Bankruptcy Law in China, 1. Aufl. 2008, Seite 39/zitiert: Stucken, Investing in Distressed Assets

Uhlenbruck, Wilhelm, Kommentar zur Insolvenzordnung, 12. Aufl., München 2002/zitiert: Uhlenbruck, Insolvenzordnung

Wang, Fuxiang, From a Death to a Rebirth, The Changing Face of Bankruptcy Law in China, in Best Practices for Bankruptcy Law in China, 1. Aufl. 2008, Seite 59/zitiert: Wang, From a Death to a Rebirth

Wimmer, Klaus (Hrsg.), Frankfurter Kommentar zur Insolvenzordnung, 5. Aufl., Köln 2009/zitiert: FK-Bearbeiter, Insolvenzordnung

Zöller, Richard (Begr.), Zivilprozessordnung, 27. Aufl., Köln 2009/zitiert: Zöller-Bearbeiter, ZPO

Introduction

The current financial crisis and its negative impact on world trade is a major challenge for the Chinese economy. For many years being one of the fastest growing major economies in the world with the nominal GDP top-ranked in the world, a slow-down in growth raises major concerns as to the consequences not only within China but also for foreign investors.

China, member of the WTO since 2001, has adopted, effective as of June 1, 2007, a new bankruptcy law. The new bankruptcy law is a milestone for the Chinese economy towards a market-oriented economy, given that creditor-oriented insolvency proceedings with bad debt losses are basically in contrast to a more socialist economy. The new bankruptcy law now constitutes a comprehensive legal framework on key issues facing insolvent companies.

In particular international investors, but also trade creditors of Chinese debtors around the world need to be familiar with the key elements of bankruptcy proceedings in China in an international perspective. Therefore, background and key elements of bankruptcy proceedings in the PRC under the new law will be described in more detail. In this context, cross-border insolvency issues need to be discussed under the framework of the new bankruptcy law and significant similarities as well as differences to established bankruptcy laws be shown.

I. Development Lines of Bankruptcy Law in the PRC until 2006

A. Key Insolvency-Related Rules prior to 1986

With respect to the new bankruptcy law, a main difference between China and other socialist countries that introduced market-oriented laws (like e.g. Poland), the PRC could not go back to laws from the pre-socialist era[1]. The republican bankruptcy law from June 17, 1935 had been abolished in the revolution and has stayed (subject to subsequent changes) only in force in Taiwan[2]. However, it should be noted that the Chinese lawmakers could take into

[1] See Piekenbrock, Das neue chinesische Insolvenzrecht, page 80
[2] See Piekenbrock, Das neue chinesische Insolvenzrecht, page 80

consideration regulations that the highest court and the Ministry of Justice after 1949 had rendered for the remaining private companies upon request of lower authorities[3]. Taking into consideration such regulations, a draft for a new bankruptcy law from 1984 and local insolvency laws, the standing committee of the National People's Congress enacted the 1986 Bankruptcy Law on December 2, 1986.

B. The 1986 Bankruptcy Law

It was intended to be a tentative bankruptcy law only and shows express references to the increasing development of a market-oriented economy, as can be seen in the wording of Article 1 of the 1986 Bankruptcy Law:

"This Law is formulated in order to suit the development of the planned socialist commodity economy and the needs of the reform of the economic structure; to promote the autonomous operation of enterprise owned by the peoples; to strengthen the economic responsibility system and democratic management, to improve the state of operations, to increase economic efficiency and to protect the lawful rights and interests of creditors and debtors."[4]

It should be noted that such bankruptcy law was applicable only to those enterprises which were state-owned (enterprises owned by the whole people), i.e. "SOEs", pursuant to Article 2 of 1986 Bankruptcy Law[5]. Moreover, the 1986 Bankruptcy Law moreover does not address reorganization issues[6].

In other words, no such bankruptcy law existed for private entities. Only the laws of civil procedure from 1991 had some basic stipulations how to deal with the inability of a legal enterprise to pay its debts[7]. Also the PRC Company Law from 1993 had some short stipulations on the liquidation of insolvent stock corporations and limited liability companies[8].

---

3 See Piekenbrock, Das neue chinesische Insolvenzrecht, page 80

4 Cited after Best Practices For Bankruptcy Law in China, First edition 2008 Appendix B

5 See Koppitz, Response to China's New Bankruptcy Law, page 122

6 See Wang, From a Death to a Rebirth, page 60

7 Pursuant to Sections 199 to 206 of such laws, see also Piekenbrock, Das neue chinesische

However, for enterprises that were not organized as a legal person, no special insolvency law existed until the effectiveness of the new PRC bankruptcy law in 2007.

Section 19 of the laws of civil procedure from 1991 addressed a bankruptcy system for companies being organized as legal persons, encompassing collective enterprises, jointly operated enterprises, private enterprises, organized as legal entities and also certain sino-foreign joint ventures and wholly-foreign-owned enterprises[9]. The PRC Company Law from 1993 more particularly provided for certain bankruptcy proceedings when in case of liquidation the company's assets were not sufficient to settle all debts (Article 196), thus addressing both liquidation and bankruptcy issues[10]. Moreover, in case of bankruptcy (to be declared by the People's Court), the PRC Company Law from 1993 in its Article 189 provided for a liquidation group to be composed of shareholders, certain authorities and others in order to take care of the "bankruptcy liquidation"[11]. It should further be noted that under the laws of civil procedure from 1991, certain provisions of the (tentative) 1986 Bankruptcy Law were declared applicable by analogy[12].

C. "Political Bankruptcy" under the 1994 Notice

Based on the State Council's Notice on Issues Relevant to Tentative Implementation of Bankruptcy of State-owned Enterprises in some Cities (1994 Notice), the concept of "political bankruptcy" was introduced in China. The purpose of such notice was to safeguard the survival of the fittest enterprises and to give orientation for a standardized bankruptcy frame for state-owned enterprises in 18 Chinese cities. As a deviation from the normal ranking of creditors, it was provided that employees had a senior ranking, even with respect to assets that were subject to a security or a mortgage, thus overriding such collateral[13].

---

9 See Koppitz, Response to China's New Bankruptcy Law, page 122 et seq.

10 See Koppitz, Response to China's New Bankruptcy Law, page 123

11 See Koppitz, Response to China's New Bankruptcy Law, page 123

12 See Koppitz, Response to China's New Bankruptcy Law, page 123 (with reference to Article 250 of the opinions regarding its application)

13 See Koppitz, Response to China's New Bankruptcy Law, page 123

In addition to the 1994 Notice, a "Supplementary Notice on Issues Relevant to Tentative Implementation of the Merger and Bankruptcy of State-Owned Enterprises in Some Cities and the Reemployment of Workers" was issued on March 2, 1997 in order to address issues such as disposition of liquidated assets, pre-bankruptcy plan issues and the extension of the geographical scope of "political bankruptcy" to 111 Chinese cities[14].

D. Interpretations and guidelines by the PRC's courts

Another milestone on the way to a modern bankruptcy law was the PRC's Supreme People's Court's interpretation on how to deal with insolvencies, as set out in the "Provisions on Some Issues Concerning the Trial of Enterprise Bankruptcy Cases" dated July 18, 2002[15]. The purpose and background of such interpretations by the courts was the attempt to overcome the obvious lack of a comprehensive bankruptcy law on one hand and practical needs on the other hand. It should be noted that also some higher level courts in regions such as Shanghai or Beijing issued additional local instructive opinions for the lower courts when confronted with bankruptcy cases[16].

E. Interim Notes

Following the above sequence of events prior to enacting the new 2006 Bankruptcy Law, the following can be emphasized:

- For certain issues, which normally form part of a comprehensive bankruptcy act, certain regulations and laws existed already before the new 2006 Bankruptcy Law.

- However, no comprehensive bankruptcy law was in force in the PRC prior to the new 2006 Bankruptcy Law. The regulations/laws applicable prior thereto, addressing certain bankruptcy/liquidation issues, could be found in various acts/regulations, not necessarily exclusively dealing with bankruptcy/liquidation.

---

14 See Koppitz, Response to China's New Bankruptcy Law, page 124

15 See Wang, From a Death to a Rebirth, page 60, Koppitz, Response to China's New Bankruptcy Law, page 124

16 See Koppitz, Response to China's New Bankruptcy Law, page 124

- The PRC, when addressing bankruptcy issues prior to the new bankruptcy law, did so on a rather tentative basis, e.g. limiting the scope to certain types of enterprises only or to certain regions or for testing purposes.
- Prior to the new bankruptcy law, there was a massive lack of uniform insolvency rules to which legal entities in the PRC in case of insolvency events were subject to, in contrast to comprehensive bankruptcy laws such as existing in leading G10 states (e.g. the U.S. Bankruptcy Code/Title 11 of the United States Code or the German Insolvency Code).
- An over-all concept for such diverse and incomprehensive bankruptcy issues actually did not exist.
- The lack of uniform insolvency laws stood in an increasingly obvious contrast to the market-oriented development of the PRC.
- The deficiencies in comprehensive standards to deal with insolvency and the "patchwork" of regulations led to "auxiliary" interim solutions on various levels, in particular by extending the scope of applicable regulations and increasing the scope or opinions and guidelines from higher courts.

II. The New 2006 Bankruptcy Law – Background

A. Legislative History

1. Key Data

In 1994, lawmakers in China recognized the need for a new comprehensive bankruptcy code. It took more than a decade until the new bankruptcy law regime for enterprises was enacted on August 27, 2006. A first draft of the new bankruptcy law was presented by a special drafting committee formed by the NPC already in 1995 to the Standing Committee of the NPC. In the following years, a series of drafts was discussed but none of them was enacted.

Background of the remarkably long time until the new bankruptcy code became law was an opposition on various levels[17]:

- Banks
- Labor unions
- Certain social affair related authorities

The opposition of banks was in particular driven by a strong "bad debt" portfolio of Chinese banks who had granted extensive loans to state-owned enterprises under governmental influence. Moreover, the concern of the banks was that access to state-of-the-art insolvency proceedings might cause unbearable risks and losses to them. It was the clear aim of the banks to get a sufficient priority in the insolvency for secured lenders.[18] This, in turn, led to a natural opposition by labor unions that had the strong aim to protect the interests of the working force. With respect to the "bad debt" portfolio of the banks, it should be noted that from 1994 on, a large number of smaller state-owned enterprises has been liquidated or privatized. These "political bankruptcies" were to a large extent finalized by the time when the new law entered was enacted in 2006[19]. In numbers, this development can be seen as follows:

- In the period between 1994 and 2004, a total number of 3,484 SOEs became insolvent. State-controlled banks had to write-off USD 28.5 billion in outstanding loans[20]. In 2005, 1,828 SOEs were still seeking approval for the declaration of insolvency, with outstanding loans equal to a loss-risk for the lenders of about half of the aforementioned amount, i.e. USD 14.7 billion[21].

17 Hua, Evolution of Bankruptcy Law in China, page 9
18 Hua, Evolution of Bankruptcy Law in China, page 9
19 Münzel, ZChinR 2007, page 47
20 Fung, Policy-oriented vs. market-oriented Bankruptcy, page 222
21 Fung, Policy-oriented vs. market-oriented Bankruptcy, page 222

- In 1994, 395 of 1,624 insolvent companies were SOEs, whereas in 1997, more than 3,060 of the 5,396 bankrupt entities were state-owned[22].

This shows that the long duration of preparational legislative work on the new bankruptcy law was not only due to "academic" discussions but also consequence of political endeavors implemented at the same time to deal with a large number of practically insolvent, in particular smaller SOEs, which became subject to "political bankruptcies".

The latter point leads directly to the issue of "social stability" which was one of the key opposing arguments with respect to the new bankruptcy law[23]:

An essential function of SOEs was taking responsible care for social security for its work force (including pensions). Whereas it can be seen that increasingly such tasks were taken away from SOEs, public social security at the same time was not sufficiently developed. Thus, there was the major concern that a sharp and quick increase of the number of insolvencies might inevitably lead to soaring unemployment and, as a consequence thereof, a considerable threat to the social stability and the national economy as a whole[24].

Given the aforementioned conflict of interests, certain transitory rules became part of the 2006 Bankruptcy Law: According to its Article 133, the possibility of a political bankruptcy for SOEs was upheld[25]. It was intended that such political bankruptcies should, according to the administrative plans, come to an end by the end of the year 2008[26]. Also, with respect to already defaulted wages and public security premiums owed, Section 132 of the 2006 Bankruptcy Law provides for a priority of such "old" social security debts over other (secured) creditors. As a consequence, financial institutions rank junior to such "old" social security debts[27].

---

22 Fung, Policy-oriented vs. market-oriented Bankruptcy, page 222

23 Hua, Evolution of Bankruptcy Law in China, page 9

24 Hua, Evolution of Bankruptcy Law in China, page 9

25 Hua, Evolution of Bankruptcy Law in China, page 9

26 Chua, China's New Bankruptcy Law, page 17

27 See also Münzel, ZChinR 2007, page 47

The new 2006 Bankruptcy Law eventually was adopted on August 27, 2006 by the Standing Committee of the NPC. The extraordinarily long legislative discussion led to a comprehensive bankruptcy code for both state-owned enterprises and private enterprises (being qualifiable as legal person), irrespective whether sino-owned or partly or fully foreign-invested. The new law became effective on June 1, 2007

2. Driving factors for the implementation of the new 2006 Bankruptcy Law

As can be seen from the above, the long duration in preparing the new bankruptcy law is a consequence of strong domestic particularities of the PRC:
On the one hand, it is true that the progress and the economic changes throughout China towards a more market-oriented economy made it, from an objective point of view, necessary to implement a state-of-the-art insolvency law (also in order to strengthen the confidence of international investors in investments in Chinese enterprises). In addition, the membership of China to the WTO effected in the year 2001 supported a more pro-active approach of the Chinese government to deal with insolvency issues.

On the other hand, however, strong domestic particularities were a key factor in the conflicts to be dealt with in the legislative process leading to the new bankruptcy law. This is exemplified with the above mentioned Articles 132 (with respect to the priority of existing social security debts) and Article 133 (with respect to the ongoing special regime for certain state-owned enterprises) of the 2006 Bankruptcy Law. Notably, the conflict lines between secured creditors such as banks and the employees/workforce as well as the issue of protection of their rights was a trigger for remarkable lobby-work. In addition, the fact that "political bankruptcies" of thousands of SOEs needed to be channeled in a moderate way without too sudden hardship potentially threatening social stability (a value not to be underestimated in Chinese culture) contributes to the explanation why it took twelve years from the point in time when the first draft of a new bankruptcy law was presented until its enactment in 2006, respectively its effectiveness as of June 1, 2007.

As it has been put into words by local commentators to the development of bankruptcy law in China: It is not a Chinese way "to change its bankruptcy laws for the sake of

pleasing the world" and as a mere result of global pressures[28]. Therefore, it is not only the requirement of a globalized world but rather the agenda of the Chinese government which is very much driven by economic considerations within China, following the aims of safeguarding economic stability and, thus, also national security[29].

3. Summary: Key considerations driving the legislative process

In the light of the above discussion, certain overriding key considerations underlying the new 2006 Bankruptcy Law can be summarized as follows:

a) Insufficiency of the existing bankruptcy regime

The rise of the Chinese economy in the years during which the new bankruptcy law was discussed made an adaptation of the insufficient existing bankruptcy rules towards the needs of a modern market economy practically inevitable[30]. In particular, the lack of consistent bankruptcy rules applicable not only to few types of enterprises but with much broader scope became evident. Moreover, it should be noted that the various layers of laws, rules and regulations on different levels, including loopholes due to the inconsistency of the different rules and the lack of uniform bankruptcy law, led to unwanted strategies for debt evasion[31].

b) Safeguarding the stability of the finance sector

State-owned enterprises were often financed to a large extent by bank loans[32]. Traditionally, the non-performing loan (NPL)-ratio of Chinese banks was higher than compared to its western peers. For 2007, a number of 6.2% was set out, however, that number must be seen as already being the result after spinning-off trillions of non-performing debts to special asset management companies[33]. The NPL-ratio set out for the top 100 international banks in average was 2.5% only[34].

---

28 Fung/Li, Responding to the Enterprise Bankruptcy Law, pace 154
29 Fung/Li, Responding to the Enterprise Bankruptcy Law, pace 154
30 See also Hua, Evolution of Bankruptcy Law in China, page 12
31 See also Hua, Evolution of Bankruptcy Law in China, page 13
32 See also Hua, Evolution of Bankruptcy Law in China, page 13
33 See also Hua, Evolution of Bankruptcy Law in China, page 13
34 See also Hua, Evolution of Bankruptcy Law in China, page 14

The fact of an extensive financing of state-owned enterprises through Chinese banks led to the vital interest of the financial sector in China not to be put into a disadvantageous position in comparison to their international competitors.

Given these aspects, it cannot surprise that against the background of the consolidated and comprehensive new 2006 Bankruptcy Law, investment banks, hedge funds and other types of investment vehicles are more and more interested in possible investment opportunities, in particular with respect to distressed assets and distressed debt in China[35]. It has been noted that in the recent years, the region has seen the creation of distressed-debt-related teams, namely in Hong Kong, in order to take advantage and to profit from the changing legal environment in China and current economic trends in China[36]. However, given the necessary understanding and familiarity with the Chinese market, its legal system, business attitudes and overall mentality will require more patience from investors in comparison to jurisdictions with a more "proven" environment[37].

c) Particularities of state-owned enterprises

It has already been noted in detail that the fate of state-owned enterprises was a key driver for the legislative reforms. In particular, the particularities of "political bankruptcies" with respect to hundreds, if not thousands, of state-owned enterprises may not be ignored when dealing with the new bankruptcy rules implemented under the new 2006 Bankruptcy Law. It has been critically noted by authors that at least the older, 1986 Bankruptcy Law "did very little to ensure the preservation of enterprises with viable future prospects"[38]. So it cannot surprise that before the implementation of the

35 See Stucken, Investing in Distressed Assets, page 40
36 See Stucken, Investing in Distressed Assets, page 40
37 See Stucken, Investing in Distressed Assets, page 41
38 See Hua, Evolution of Bankruptcy Law in China, page 13

new bankruptcy rules in 2006, bankruptcy, in particular with respect to state-owned enterprises, was a notably political challenge - less a process primarily driven by consistent and comprehensive bankruptcy rules. The latter in fact did not exist when taking into consideration the standard achieved by highly developed countries on an international level such as the U.S.A. and most European jurisdictions.

d) Further Observations

It is surprising that in particular Chinese authors, when dealing with the new bankruptcy rules and commenting thereon, very rarely prominently highlight the international requirements affecting China as being member of the international legal community such as a WTO member. Again, it is not to be ignored that domestic particularities are of high relevance in order to understand where the Chinese bankruptcy regime came from and why it led to the results enacted as the 2006 Bankruptcy Law.

B. Overview: Major Differences of the New 2006 Bankruptcy Law compared to pre-existing Bankruptcy Rules

1. Broader application on more diverse types of enterprises

In contrast to the 1986 Bankruptcy Law, which applied only to SOEs, the new bankruptcy law covers also other types of enterprises that have been conferred the status of a legal person (see Article 2 of the new 2006 Bankruptcy Law). Thus, the new Bankruptcy Law not only covers state-owned enterprises but also listed companies or private limited liability companies. Thus, foreign investment enterprises would normally fall under the scope of the new Bankruptcy Law, whereas neither individuals nor partnerships are addressed. This is a remarkable progress in comparison to the situation before, as such extension of the scope of application potentially creates a "level playing field" for various types of enterprises. This being said, however, it should be noted that with respect to financial institutions, a special regime might apply, as provided for in Article 134 of the new 2006 Bankruptcy Law (see above). Pursuant to such article, where financial institutions are insolvent, the State Council may, in accordance with applicable laws,

formulate the relevant measures. The fact that financial institutions are partly outside the scope of general insolvency rules, however, is not a particularity of Chinese law. As the world's financial crisis has shown, practically every major economy is reluctant to let financial institutions go bankrupt. On the international level, there is an apparent consensus not to let financial institutions which are relevant for the economic system as such go bankrupt. It is in particular due to the potential impact on the stability of the economy that the relevant Chinese regulatory and/or supervisory bodies play a major role in potential bankruptcy proceedings initiated over the assets of such institutions. More specific rules on "tailor-made" proceedings for the insolvency of financial institutions, however, still were to be developed by the State Council[39].

2. Bankruptcy administrator to replace the government-appointed liquidation committee

Whereas under the 1986 Bankruptcy Law, it was provided for a liquidation committee having broad competences and being appointed by the government, the new 2006 Bankruptcy Law provides for the implementation of a bankruptcy administrator who, as e.g. known in the German insolvency code, takes control of the debtor's estate and to a large extent administers the estate throughout the bankruptcy proceedings. It is up to the People's Court - not the government as under the 1986 Bankruptcy Law - to appoint the insolvency administrator (see Article 22 of the new 2006 Bankruptcy Law).
As not uncommon in comparison with the insolvency laws of the major economies, e.g. the German insolvency code, creditors have, subject to certain conditions to be met, the right to request the People's Court for the appointment of a new insolvency administrator, in particular when it is decided at the creditors' meeting that the previous bankruptcy administrator fails to perform or to fulfill its duties and functions in a lawful and impartial manner.

3. Right to file a bankruptcy application

Another new element provided in the new bankruptcy law is that the debtor and each creditor are entitled to file an application for the opening of bankruptcy proceedings (see

---

39 Hua, Evolution of Bankruptcy Law in China, page 10

Article 10 of the 2006 Bankruptcy Law)[40], subject to certain conditions to be discussed in more detail below.

4. Reorganization proceedings

Bankruptcy under the new bankruptcy law does not necessarily lead to a liquidation of the debtor. The new bankruptcy law notably provides for a potential reorganization in case the distressed debtor has certain prospects to survive following a restructuring. Thus, it opens an alternative that is not uncommon in an international perspective, where reorganization proceedings are quite common[41].

5. Creditors' protection

Commentators to the new bankruptcy law note that the new bankruptcy law "offers creditors more protection than they ever had under the old regime"[42]. Indeed, there is no general rule under the new bankruptcy law pursuant to which claims of employees against the debtor are principally senior to such of secured creditors. Therefore, employees have no access under the new rules to secured assets in order to settle their outstanding claims. This notably strengthens the position with respect to affected financial institutions. Moreover, no general provision exists pursuant to which the omission to file claims by creditors is legally deemed to be a waiver of claims. Under the new law, certain opportunities exist to file (at a later stage) claims as long as a final distribution has not yet occurred (see Article 56 of the new 2006 Bankruptcy Law).[43]

C. The influence of foreign laws

1. Introduction

As to the new bankruptcy law, remarkable advice and influence can be noted from an international perspective. For example, the German "Gesellschaft für technische

---

40 See also Fung/Li, Responding to the Enterprise Bankruptcy Law

41 Hua, Evolution of Bankruptcy Law in China, page 11

42 Hua, Evolution of Bankruptcy Law in China, page 12

43 Hua, Evolution of Bankruptcy Law in China, page 12

Zusammenarbeit" (GTZ) was supporting the Chinese endeavors to implement a new bankruptcy law[44]. International law firms were on many occasions consulted by the NPC and provided comments to the various drafts of the new bankruptcy law[45]. Not surprisingly, as will be seen in more detail below, most of the concepts which have been implemented in the new bankruptcy law are nothing unique but can be found at least in parts or in a comparable way in other insolvency laws of developed jurisdictions (in particular on the G10-level).

2. Historical perspective

In a historical perspective, it needs to be mentioned that other than for instance with respect to Japan, the influence of "western law concepts" in China was traditionally characterized by a strong imperial approach, in particular from the 19th century onwards, when China became subject to unreasonable privileges of western "expats" widely beyond the scope of the extraterritorial "insulas" in China. A series of "unequal treaties" put China in a strong disadvantage. To give an example: With respect to enforcement issues and related bankruptcy issues, foreigners were not subject to Chinese authorities but to foreign authorities[46]. The clear violation of Chinese sovereignty is characteristic for the imperial period of western powers in the 19th and 20th century. The reception of western law concepts by China against that background is widely understood as a traditional means in the attempt to regain a higher degree of sovereignty[47]. Not surprisingly, the first Chinese bankruptcy code dated April 25, 1906 - exactly 100 years before the enactment of the new bankruptcy law - shows in certain of its characteristics a clear impact of foreign law concepts[48]. The scope of application, e.g. of the Chinese bankruptcy law from 1906 was limited to businessmen/traders and trade enterprises. As new historical research shows, such limitation of the scope of applicability of the bankruptcy laws at that time cannot be derived from English law (which at that time did not know a separation between traders and non-traders for bankruptcy purposes), but rather from French bankruptcy laws[49].

---

44 Piekenbrock, Das neue chinesische Insolvenzrecht, page 82

45 Chua, China's New Bankruptcy Law, page 17

46 See Piekenbrock, Das neue chinesische Insolvenzrecht, page 83, in particular with reference to the treaty between the United Kingdom and China from June 26, 1858

47 See Piekenbrock, Das neue chinesische Insolvenzrecht, page 83, in particular with reference to Japan

48 See Piekenbrock, Das neue chinesische Insolvenzrecht, pages 84 et seq.

49 See Piekenbrock, Das neue chinesische Insolvenzrecht, pages 84 et seq.

Such concept had been brought by a German professor to Japan in the first place and via Japanese influence on China ultimately to China.[50] Although the limitation of the scope also had certain inner-Chinese reasons, foreign influence can clearly be seen. This holds true not only for the first bankruptcy law which was in force only a few years, but also with respect to the Chinese bankruptcy law from 1935, where considerable German influence - as is the case for the whole republican legal framework - must be noted[51].

To sum up, the reception of foreign laws in Chinese legal enactments has to a considerable extent a strong tradition that goes back more than 100 years. Against that background, it does not surprise that also with respect to the new 2006 Bankruptcy Law, China was eager to receive comments and opinions from foreign experts on how to structure and elaborate a state-of-the-art bankruptcy code (despite the fact that certain homework regarding domestic particularities - e.g. insolvent state-owned enterprises - which had to be done, led to an extraordinarily long legislative process).

3. Current influence

With respect to the new bankruptcy law, the influence of the US-American bankruptcy concepts as set out under Chapter 11 of the U.S. Bankruptcy Code should not be over-estimated. In an overall-assessment, it is rather to be noted that the new bankruptcy law contains considerably more concepts specific to European insolvency rules (e.g. under the German Insolvency Code) than under Chapter 11. The fact that a number of authors tend to compare the new bankruptcy law with Chapter 11 is more a result of a strong presence of US-American law firms in China and Hong Kong, than due to an actual identity of the inherent insolvency concepts. An example: On the one hand, it is true that both in China and in the U.S., the insolvency rules know the "debtor-in-possession"-concept pursuant to which the management of the debtor stays in control of the business administration (see Article 73 of the 2006 Bankruptcy Law). On the other hand, however, European concepts - e.g. in Germany – also know the concept of self-administration (*Eigenverwaltung*)[52], even if not much relevant in practice.

---

50 See Piekenbrock, Das neue chinesische Insolvenzrecht, pages 84, 85 with reference to the Rostock professor Hermann Roesler

51 See Piekenbrock, Das neue chinesische Insolvenzrecht, pages 86 et seq.

52 See with respect to the similarities and differences with respect to Chapter 11: Peters, Das neue Insolvenzgesetz der Volksrepublik China, RIW 2008, page 112

The strongest arguments, however, to deny a close analogy between the US Chapter 11 concept and the new Chinese bankruptcy law is the position of the insolvency administrator. In China as well as in European jurisdictions, such as under the German Insolvency Code, it is common practice in insolvency proceedings that an insolvency administrator is appointed by the court in order to take control of the bankrupt enterprise, rather than an administration by the "debtor-in-possession".

D. Traditional cultural aspects of bankruptcy in China

Bankruptcy in China is described culturally as a "last resort"[53]. Consequently, not only authorities on various levels are reluctant vis-à-vis the concept of bankruptcy, but also creditors and shareholders doubt that they can expect insolvency proceedings as fair and subject to the rule of law as known from other developed countries. In this context, it has been described by legal authors that the old bankruptcy regime facilitated an "abuse of the system", leading to "a myriad of fraudulent bankruptcy cases"[54]. Here again, the special situation of SOEs is an important factor, as for a long time the approach was to avoid bankruptcy, with sometimes disastrous results for creditors. Consequently, confidence in the new bankruptcy law and the options thereunder still needs to be developed. Certain authors, however, obviously still under the impression of the insufficiencies in the bankruptcy praxis prior to the new bankruptcy law, stress that it still will not be very attractive for creditors to wait to get one day a share of the insolvent enterprise's "bankruptcy left overs"[55]. On the contrary, it still might be wise to seek - to the extent possible - to settle or restructure the entity in order to create a more profitable outlook. The fact that China has now implemented a more modern bankruptcy law in which proven concepts of insolvency rules of leading developed countries can be

53 See Guo, Introduction to Bankruptcy in China, page 86
54 See Guo, Introduction to Bankruptcy in China, page 85
55 See Guo, Introduction to Bankruptcy in China, page 86

identified does not necessarily mean that a change in the attitude vis-à-vis bankruptcy will be triggered in China. As can be seen in other fields of law, where at first glance modern rules have been implemented, e.g. in the field of intellectual property protection, the practice and reality often lacks behind the theoretical legal comfort. The fact that under the old bankruptcy rules, employees in state-owned enterprises were clearly privileged even vis-à-vis secured creditors does not support more favorable prospects. Also with respect to the very technical and rather sophisticated field of insolvency law, the outlook is quite uncertain whether enough qualified personnel will be available to implement and "live" the new bankruptcy laws[56]. In this context, it should again not be underestimated that social stability continues to be an overwhelmingly strong factor in Chinese day-to-day politics and it still needs to be proven whether in a case of conflict, e.g. with junior ranking employees, secured creditors will be able to enforce their senior ranking claims in insolvency proceedings.

III. The 2006 Bankruptcy Law - Selected Topics

1. Introduction

Key elements of bankruptcy proceedings in the PRC under the 2006 Bankruptcy Law that are of particular interest not only for domestic creditors but also for international investors/creditors include:

- scope of application and relevant debtors/entities;
- financial requirements;
- appointment and powers of the bankruptcy administrator;
- legal effects of the opening of bankruptcy proceedings;
- filing of proofs of claims by creditors;
- creditors' meetings and creditors' representatives;

[56] See Peters, Das neue Insolvenzgesetz der Volksrepublik China, RIW 2008, 112

- rights of secured creditors;
- asset distribution;
- potential alternatives, such as reorganization, conciliation and liquidation proceedings.

All of these notions are, from an international perspective, common concepts. Therefore, it is of particular interest to see what "Chinese" particularities need to be taken into consideration.
Certain elements have already been briefly presented when discussing major achievements and particularities in comparison to the 1986 Bankruptcy Law and shall be discussed in more detail below.

2. Scope of applicability - potential debtors

It has already been set out that a major achievement of the 2006 Bankruptcy Law is that it applies to a wide scope of entities. Whereas - see Article 2 of the 2006 Bankruptcy Law - the insolvency of "enterprise legal persons" is addressed, the resulting limitations thereof should be not overseen. Neither does the new law apply to individuals, nor to non-legal persons, i.e. not to partnerships, representative offices or branch offices. Also with respect to state-owned enterprises (SOEs), a quite vague stipulation (Article 133 of the 2006 Bankruptcy Law) contains a limitation with respect to bankruptcies, in particular before the effectiveness of the 2006 Bankruptcy Law. Legal commentators have expressed the view that the wording of such clause opens the possibility of different interpretations, even to the effect that to SOEs, the old provisions will in principle continue to apply[57].

3. Grounds for insolvency

Pursuant to Article 2 of the 2006 Bankruptcy Law, when a debtor ("enterprise legal person"), *"fails to settle its debt as they fall due",* and if, moreover,

- the assets of such debtor are insufficient to pay-off all debts, or

[57] MüKo - Neelmeier, InsO, Anhang Länderberichte, China, margin 6

- the debtor is obviously not able to settle its debts,

the provisions of the new 2006 Bankruptcy Law apply.

Certain restrictions exist with respect to entities being part of the financial sector (see Article 134 of the new 2006 Bankruptcy Law).

With respect to the insolvency grounds, it is a significant hurdle with respect to the application requirements that the inability of settling debts and over-indebtedness must *both* be given, which is, from an external creditor's perspective, a potentially quite difficult task to set out[58]. In practice, that would mean that the insolvency analysis must not only meet the "cash-flow" test but also the "balance-sheet" test. Critical commentators with respect to the new insolvency law hold it for "questionable" for a creditor or debtor applying for insolvency to have to prove a combination of "cash-flow" and "balance-sheet" insolvency[59]. In particular, creditors with only limited insight in the internal financial and balance sheet situation of the debtor might face difficulties. Moreover, with respect to the alternative requirement of an obvious lack of ability of the debtor to settle its debts, the language is not quite clear and commentators in this respect expect that this might trigger litigation and give debtors the opportunity to delay insolvency proceedings[60].

In contrast thereto, e.g. the German rules in Sections 17 through 19 German Insolvency Code contain a more precise set of insolvency grounds (illiquidity which shall be presumed if the debtor has stopped payments; imminent illiquidity if insolvency is applied for by the debtor; alternatively over-indebtedness in case of corporations).

However, in a historical perspective, it must be seen that key elements of a sophisticated insolvency code such as in Germany can also in parts be found in the Chinese new 2006 Bankruptcy Law. It remains to be seen how certain ambiguities will hinder the effectiveness of insolvency proceedings in the PRC. A practical solution for the issues

---

58 MüKo - Neelmeier, InsO, Antrag Länderberichte, margin 10

59 Chua, China's New Bankruptcy Law, page 18

60 Chua; China's New Bankruptcy Law, page 18

mentioned above might potentially be guidance through interpretative opinions of the Supreme People's Court[61].

4. The Insolvency Administrator

A major achievement of the 2006 Bankruptcy Law is the appointment of a bankruptcy administrator by the competent court. By implementing the well-known concept of a bankruptcy administrator like in many western jurisdictions (such as Germany), the PRC obviously does not follow the "debtor-in-possession" concept common under the U.S. Chapter 11 proceedings.

With respect to the person to be eligible as insolvency administrator, it should be noted that, other than e.g. in Germany, not only natural persons are eligible as bankruptcy administrators. Also legal persons/liquidation groups or law firms and accounting firms may be appointed as insolvency administrators (pursuant to Article 24 of the 2006 Bankruptcy Law).

Powers of the bankruptcy administrator encompass in particular:

- taking over the assets (and seals) and administrative documents such as accountancy books;
- investigating the financial status of the debtor;
- deciding before the first creditors' meeting whether to continue or to shut down the debtor's business;
- management and disposition of the debtor's assets and certain other rights and duties as set out in Article 25 of the 2006 Bankruptcy Code.

The bankruptcy administrator is appointed by the People's Court, Article 22 of the 2006 Bankruptcy Law.

[61] Chua, China's New Bankruptcy Law, page 18; Piekenbrock, Das neue Chinesische Insolvenzrecht, page 91

5. The Role of the People's Court

Besides the appointment of the bankruptcy administrator pursuant to Article 22 of the 2006 Bankruptcy Law, the filing for insolvency has to be submitted to the People's Court and it is up to the People's Court to decide whether to order insolvency proceedings be opened or not (see Articles 10 *et seq.* of the 2006 Bankruptcy Law). Other than in the 1986 Bankruptcy Law, there is no prior formal approval from the relevant government authority required for the bankruptcy proceedings to take place.

Competent under the new 2006 Bankruptcy Law is the People's Court, i.e. not a dedicated, separate bankruptcy court. Competent is the People's Court at the place where the "relevant debtor is domiciled" (see Article 3 of the 2006 Bankruptcy Law).
The bankruptcy administrator has to report to the People's Court on the status and progress regarding the insolvency proceedings, see Article 23 of the 2006 Bankruptcy Law.

These authorities of the People's Court are quite similar to those that can be found in the German Insolvency Code (see Section 2 of the German Insolvency Code). However, a significant deviation to the German proceedings is the acceptance of the principle "*vis attractiva concursus*" laid out in Article 21 of the 2006 Bankruptcy Law: Pursuant to such provision, after the People's Court has accepted an application for bankruptcy, all relevant

"debtor's civil action shall be requested with the said People's Court that is handling the bankruptcy proceedings".[62]

Thus, other as under German insolvency law, the competent People's Court at the principal place of business of the debtor has broad competence for all insolvency-related lawsuits, e.g. also, other than in Germany, with respect to a contestation (*Anfechtung*) by the bankruptcy administrator of certain debtor's pre-insolvency transactions. In Germany, by contrast, it is normally the competent court at the place of business of the defendant with general jurisdiction to decide on a legal contestation/challenge by a bankruptcy administrator. In an international perspective, the deviation in the 2006

[62] See also Piekenbrock, Das neue chinesische Insolvenzrecht, page 92

Bankruptcy Law is of major importance, e.g. in case the bankruptcy administrator of a Chinese debtor in China successfully challenges transactions having taken place outside China and, as a consequence thereof, seeks a recognition and enforcement of such ruling of the People's Court abroad.

It should be noted that bankruptcies are typically dealt with in the official language of the PRC (Putonghua)[63].

6. Creditors' Meetings and the Creditors' Committee

a) Creditors' Meetings

Every creditor that has filed its claims in the bankruptcy of the debtor is entitled to attend as a member creditors' meetings, see Article 59 of the 2006 Bankruptcy Law. In case the creditor's claim has not been finally reviewed, the People's Court may grant temporary rights to vote in the creditors' meeting. Employees also have the right to attend creditors' meetings, the same holds truth for representatives of the work unions who are entitled to present their views on the relevant issues, see Article 59 para 5 of the 2006 Bankruptcy Law. No special voting rights, however, are granted to them.
The rights and duties of the creditors' meeting cover in particular the following items:

- examination of the filed creditors' claims;
- application with the People's Court for a replacement of the appointed bankruptcy administrator;
- supervising the bankruptcy administrator;
- decision on a continuation of the debtor's business operations
- establishment of a creditors' committee;
- decision on a potential reorganization plan, a compromise, a management/conversion/distribution plan;

[63] Mong, Changing Trends and Regulations in PRC Bankruptcy Law, page 115

- other functions that may be granted to the creditors' meeting by the People's Court.

The above duties are expressly provided for in Article 61 of the 2006 Bankruptcy Law.

The first creditors' meeting must be held within 15 days of the deadline for the declaration of creditors' claims, see Article 62 of the 2006 Bankruptcy Law. Decisions of the creditors' meeting require a *quorum* of a minimum of 50% of the creditors to attend the meeting and have the right to vote, representing at least 50% of the aggregate amount of unsecured creditors' claims, Article 64 of the 2006 Bankruptcy Law.

b) The Creditors' Committee

The new Chinese Bankruptcy Law knows as an optional body the creditors' committee, see Article 67 of the 2006 Bankruptcy Law. The creditors' committee may be appointed by the creditors' meeting and consists of a maximum of nine persons. It should be noted that the creditors' committee, if established, not only comprises representatives of the creditor as selected at the creditors' meeting but also an "employee representative" of the debtor or a representative of the trade union. The elected members of the creditors' committee must be confirmed by the People's Court.

The creditors' meeting has the following rights and duties:

- supervising the management and disposal of the debtor's assets;
- supervising the distribution of proceeds to the creditors;
- requesting to hold the creditors' meetings;
- certain other functions as conferred to it by the creditors' meeting.

Details are set out in Article 68 of the 2006 Bankruptcy Law.

7. Procedural Milestones in a Chinese Insolvency

From a procedural point of view, bankruptcy proceedings under the new 2006 Bankruptcy Law follow the basic order set out as follows:

a) Application

The bankruptcy application may be filed not only by the insolvent company itself but also by a creditor, details are set out in Articles 7 *et seq.* and 10 of the 2006 Bankruptcy Law. In case the bankruptcy application has been filed by a creditor, the debtor will be informed by the People's Court in order to give him the opportunity to comment thereon within a timeframe of a few days, see Article 10 of the 2006 Bankruptcy Law. A special regime applies for financial institutions, where it is up to the financial supervision organ under the State Council to file an insolvency application with the People's Court, see Article 134 of the new Bankruptcy Law.

From an international perspective, such elements are quite common and nothing unusual or particular to the new Chinese Bankruptcy Law.

In regular insolvency proceedings, the People's Court will decide whether or not to accept an application for bankruptcy within 15 days from the day when the application is received (extension possible), see Article 10 of the new Bankruptcy Law.
It should be noted that, in contrast to insolvency laws of other jurisdictions, the new Chinese Bankruptcy Law does not know the opportunity of the insolvency court to take interim measures in order to avoid any detriment to the financial status of the debtor for the creditors until the insolvency court has decided on the request[64]. Consequently, it neither knows a "temporary insolvency administrator" to be in charge until the final decision on the opening of the insolvency proceedings (see, e.g., Sections 20, 21 of the German Insolvency Code).

b) Acceptance of the Application

In case the People's Court accepts the application, it will notify the relevant creditors within 25 days and pronounce its decision on the acceptance of the bankruptcy application, see Article 14 of the 2006 Bankruptcy Law. As to the insolvency grounds to be considered by the People's Court, it has already been discussed that the combination of "cash-flow" test and "balance-sheet" test is a concept rather special to the Chinese bankruptcy regime and, due to the wording in the respective statute (Article 2 of the

[64] MüKo - Neelmeier, InsO, Anhang Länderberichte, China, margin 16

2006 Bankruptcy Law), a matter of ambiguity and uncertainty.

It should be noted that the new Chinese Bankruptcy Law does not know an *obligation* of the debtor to file for bankruptcy[65].

Commentators to the new Chinese Bankruptcy Law emphasize that the People's Court obviously has a discretion whether or not to accept an application[66]. However, Article 2 of the 2006 Bankruptcy Law grants the right to the applicant to file an appeal against the People's Court's decision with the respective higher court.

Critical comments to the new Bankruptcy Law point out that it is conceivable that the People's Court does "not reply or remain silent" on the bankruptcy matter, in particular if it has major concerns regarding unemployment and social instability[67].

The established practice with respect to courts that are located outside China's main industrial/business centers shows that such critics are not unfounded[68].

c) Steps following the Acceptance of the Bankruptcy Application

Following the acceptance of the bankruptcy application by the court, such acceptance will be announced (respectively creditors be notified, Article 14 of the 2006 Bankruptcy Law) and the bankruptcy administrator be appointed by the People's Court, see Article 22 *et seq.* of the 2006 Bankruptcy Law.

The People's court will also set a deadline of up to three months (however, not less than 30 days) for the creditors to grant them the opportunity to file their claims, as provided for in Articles 45 and 48 of the 2006 Bankruptcy Law. In case a creditor fails to exercise this right, such creditor is entitled to make up its filing until the final distribution of the insolvent assets; however, any filing in already granted distributions is excluded (see

65 See Fehl, Das neue Konkursgesetz der Volksrepublik China, ZInsO 2008, page 69, 71
66 Chua, China's New Bankruptcy Law, page 17
67 Chua, China's New Bankruptcy Law, pace 17
68 Chua, China's New Bankruptcy Law, pace 17

Article 56 of the 2006 Bankruptcy Law).

After expiry of the claim submission period, the first creditors' meeting will be held, i.e. no later than 15 days after expiration of the term for the declaration of the creditors' rights, see Article 62 of the 2006 Bankruptcy Law.

The general order of payment with respect to the distribution of the proceeds to be generated from the remaining debtor's estate after the debtor is formally declared bankrupt is the following:

- bankruptcy costs and administrative/estate liabilities;
- unpaid wages and related claims;
- social insurance premiums and unpaid taxes;
- "normal" bankruptcy claims, i.e. general unsecured claims.

Details are provided for in Article 113 of the 2006 Bankruptcy Law.

After the final distribution, liquidation procedures are normally concluded and the bankruptcy administrator will, upon formal conclusion, be released of its duties. As a final act, the insolvent entity will be deregistrated (under certain circumstances, however, an additional distribution is conceivable), see Article 120 *et seq.*

8. Legal effects of the acceptance of the bankruptcy application

a) Contractual Obligations

One of the most relevant effects of the People's Court's acceptance of the application for bankruptcy is the option of the bankruptcy administrator under Article 18 of the 2006 Bankruptcy Law to decide whether to terminate or continue to perform a contract that has been established before acceptance and has not yet been fully performed by both parties concerned. Should the bankruptcy administrator decide to continue a contract, the non-insolvent counter-party has the right to request the administrator to provide some kind of collateral (should the insolvency administrator fail to do so, the contract is

deemed to be terminated), see Article 18, para 2 of the 2006 Bankruptcy Law.

From an international insolvency law perspective, such concept is well-known. Section 103 of the German Insolvency Code, for instance, grants a similar option to be exercised by the insolvency administrator either to request performance of a contract or to refuse to do so (in case of refusal, the consequence is that the counter-party is entitled to claim damages for non-performance, however, only as a general unsecured claim).

Furthermore, pursuant to Article 39 of the 2006 Bankruptcy Law, if a seller of goods has sent such goods to the debtor and the latter has not yet received the goods and paid the purchase price, the seller may take back the good which is on delivery, unless the bankruptcy administrator pays the purchase price and requests the seller to deliver.

A privileged position of a seller of goods in the critical days preceding the insolvency is quite common from an international perspective as well. For example, Section 503 (b)(9) of the U.S. Bankruptcy Code provides that a creditor shall have privileged administrative claims equalizing "the value of any goods received by the debtor within 20 days before the date of commencement of a case under this title in which the goods have been sold to the debtor in the ordinary course of such debtor's business".

b) Claw-back provisions

Pursuant to Articles 31 to 34 of the 2006 Bankruptcy Law, the insolvency administrator has the right to claw back assets of the debtor being given away under questionable circumstances and thus had diminished the insolvency estate. Such provisions are quite similar to the contestation rights known in other insolvency laws, e.g. under Sections 129 *et. seq.* German Insolvency Code (*Insolvenzanfechtung*).

Pursuant to Article 31 of the 2006 Bankruptcy Law, certain transactions having taken place within one year before the acceptance of the bankruptcy application are voidable if they have not been made for a reasonable consideration. In particular, Article 31 grants the right to the bankruptcy administrator to "revoke" any legal act (within the above deadline) which either included the

- transfer of assets free of charges; or
- trade at an obviously unreasonable price; or
- paying off undue debts in advance.

Avoidable are as well transactions having taken place within six months before the acceptance of the bankruptcy application if the debtor has made a preferential payment to creditors despite already being in crisis.

Furthermore, the bankruptcy administrator may challenge transactions aiming at concealing or transferring assets to avoid liabilities or the acknowledgement of debts which have no merits, Article 33 of the 2006 Bankruptcy Law.

Quite relevant for international investors is the right granted to the bankruptcy administrator under Article 35, pursuant to which the bankruptcy administrator may claim full contribution of the capital to the estate in cases where any capital contributor of the debtor had failed to fulfill its obligation of capital contribution.

c) Set-off

Similarly to well-known international insolvency concepts (see e.g. Section 94 of the German Insolvency Code), the 2006 Bankruptcy Law restricts post-bankruptcy set-offs: Whereas a pre-bankruptcy set-off right is not affected, a set-off is in particular prohibited in the following scenarios:

- where the creditor's right was acquired from another creditor after acceptance of the bankruptcy application;
- where the creditor had knowledge of the existing insolvency ground or the imminent bankruptcy filing, unless the creditor had acquired its claim more than one year before the bankruptcy filing (for more details see Article 40 of the 2006 Bankruptcy Law).

d) Secured creditors' and employment-related claims

As a major achievement of the new 2006 Bankruptcy Law, secured creditors rank senior with respect to the secured assets or, in other words, they "enjoy the priority right to be repaid by means of the particular assets", see Article 109 of the 2006 Bankruptcy Law. If, after realization of the secured asset, a shortfall remains, such remaining claim ranks as general unsecured claim, see Article 110 of the 2006 Bankruptcy Law.

In addition to this achievement, which should strengthen the confidence of financial institutions in their position in potential bankruptcy proceedings with respect to security rights they had acquired, a further achievement is that employment-related claims do not have a general priority over secured creditors. This is a major improvement in comparison to the 1986 Bankruptcy Law.

However, two favorable provisions in the new law regarding labor-related claims need to be emphasized:

- Employment-related claims rank as preferential claims senior to other general unsecured claims in the distribution of the bankruptcy assets, as provided in more detail for in Section 113 of the 2006 Bankruptcy Law.
- Certain labor-related claims that have arisen prior to the effectiveness of the 2006 Bankruptcy Law rank even senior to secured creditors, see Article 132 of the 2006 Bankruptcy Law.

9. Reorganization and compromise

As an alternative to the normal bankruptcy liquidation, the new 2006 Bankruptcy Law also holds the option for reorganization proceedings and a compromise. Only in case such alternatives are not implemented, the People's Court pronounces the debtor formally bankrupt and the debtor is liquidated (Article 107 of the 2006 Bankruptcy Law).

a) Reorganization

ignificantThe debtor or any creditor may apply directly for a reorganization of the debtor, Article 70 of the 2006 Bankruptcy Law. Reorganization is a quite s new

instrument under the new 2006 Bankruptcy Law[69] and is intended to facilitate the survival of enterprises in crisis, however, still having some prospects for survival. Important for creditors is that during the reorganization period, secured rights as to particular assets of the debtor are suspended, Article 75 of the 2006 Bankruptcy Law. If approved by the People's Court, a debtor or bankruptcy administrator may submit a reorganization plan. The reorganization plan needs to be accepted by the creditors' meeting and the People's Court. If approved, it is binding upon all creditors, including those having voted against the plan, Article 92 of the 2006 Bankruptcy Law.

The concept of insolvency reorganization is known in other jurisdictions as well, certain similarities exist, for instance, with the insolvency plan under the German Insolvency Code (see Sections 217 *et seq.* German Insolvency Code).

b) Compromise

Pursuant to Sections 95 *et seq.* of the 2006 Bankruptcy Law, a compromise with the creditors is another option, facilitating as well a continuation of the business operations of the enterprise in crisis. However, the procedural hurdles for a compromise are relatively high: As provided for in Article 97 of the 2006 Bankruptcy Law, a compromise requires in particular the approval of the unsecured creditors representing 2/3 of the outstanding claims at a minimum. It is up to the People's Court to decide whether to confirm the compromise agreement (if confirmed, such compromise has a binding effect upon all creditors, Article 100 of the 2006 Bankruptcy Law). In case the compromise is not approved and confirmed, "normal" bankruptcy proceedings are being pursued (see Article 99 of the 2006 Bankruptcy Law).

10. Costs and Effectiveness

Creditors of the insolvent entity must bear in mind that under the general order of payment (under Article 113 of the 2006 Bankruptcy Law), bankruptcy costs and administrative/estate liabilities are settled with priority, i.e. have a first rank. With respect to the remuneration of the bankruptcy administrator, remuneration provisions

[69] Peters, Das neue Insolvenzgesetz der Volksrepublik China, RIW 2008, page 115

have been published by the Supreme Court of the PRC in April 2007[70]. Traditionally, China is well known for high expenses in bankruptcy cases, i.e. not only with respect to their long duration but also to the transaction costs involved[71]. Traditionally, reports as to legal costs, in particular regarding insolvencies, say that "after deducting various fees, the remaining value is even insufficient to cover the costs incurred by the court, the law firm, audit firm, assessment firm and the auction firm."[72]. Indications of the perception of the 2006 Bankruptcy Law as to the effectiveness do not give the impression that a material change of that picture has taken place. The majority of enterprises still seems to have "just closed their doors with their related debts and liabilities remaining"[73]. Therefore, creditors should not only have a look at the laws that contain many similarities to well known bankruptcy law concepts in other developed countries, but also to the realities that still seem to be characterized by many insolvent companies leaving as only trace the "rusting locks on their old front gates"[74].

IV. International Law Aspects

1. Cross-border issues addressed in the new 2006 Bankruptcy Law

a) Article 5 of the 2006 Bankruptcy Law

For the first time and in contrast to the 1986 Bankruptcy Law, the new bankruptcy law in its Article 5 expressly addresses cross-border issues. Such cross-border issues are dealt with in two perspectives:

- the scope of PRC proceedings with respect to foreign jurisdictions; and
- the recognition of foreign decisions with respect to the debtors' assets in the PRC.

---

70 See Peters, Das neue Insolvenzgesetz der Volksrepublik China, RIW 2008, page 118

71 Jiang, Court Delay and Law Enforcement in China, page 183

72 Jiang, Court Delay and Law Enforcement in China, page 183

73 See Berube/Pu, Bankruptcy and Insolvency in the PRC: A Myth?, page 23; also The Economist, Bankruptcy in China: Silent Busts, October 9, 2008

74 See The Economist, Bankruptcy in China: Silent Busts, October 9, 2008

As concerns the international scope, Article 5 para. 1 expressly states that insolvency proceedings which have been initiated in accordance with the new bankruptcy law shall have binding effect also over the assets of the debtor which are situated outside the territory of the PRC.

That the effects of a domestic insolvency proceeding normally also covers the assets of the debtor abroad is nothing uncommon and e.g. known under the relevant rules contained in the German Insolvency Code (see Sections 35, 335 German Insolvency Code).

As concerns recognition, the new bankruptcy law for the first time expressly deals with the effects of foreign insolvency proceedings within China. Other than e.g. provided for in the UNCITRAL Model Law on Cross-Border Insolvency, the PRC has implemented with respect to the recognition of foreign insolvency proceedings certain requirements potentially limiting the effectiveness in China, e.g. with respect to reciprocity. Article 5 para. 2 of the new bankruptcy law in quite vague words provides that a recognition of foreign insolvency-related judgments with respect to debtors' assets situated within the PRC is subject to

- an international treaty reflecting the principle of reciprocity; and
- the insolvency proceedings not violating the sovereignty, safety of social public interests of China and furthermore do not have a detrimental effect on the legitimate rights and interests of Chinese creditors.

Whereas the principle of reciprocity had been a quite common concept with respect to international recognition of foreign court decisions in general, its influence has diminished in insolvency-related matters in recent years in developed countries. In particular, the consideration of the interests and rights of Chinese creditors as vague as it has been worded leads to an extraordinary degree of uncertainty with respect to the recognition of foreign insolvency proceedings as to assets located in the PRC.

Based on such rather undetermined conditions for a recognition of foreign insolvency related decisions within the PRC, it is still too early to predict how this rule will be applied in concrete cases by the People's Court.

b) No territorial insolvency proceedings in international insolvencies

The new bankruptcy law does not provide for secondary or non-main insolvency proceedings related to domestic (Chinese) assets, e.g. as provided for in the German Insolvency Code[75]. Pursuant to Section 354 German Insolvency Code, if a German court does not have jurisdiction to open insolvency proceedings relating to all assets of the debtor, but the debtor, however, has a branch office or other assets in the domestic territory, separate insolvency proceedings are permissible with regard to such domestic assets of the debtor ("*territorial insolvency proceedings*").

c) Assessment

On one hand, when assessing in particular Section 5 para. 2 of the new bankruptcy law, the vague criteria set out above (reciprocity, ordre public, interests of Chinese creditors) give every right to criticize such provision, in particular given that a recognition of insolvency proceedings within Europe between most European jurisdictions is guaranteed under Article 16 para. 1 of the European Insolvency Regulation. On the other hand, the following should be taken into consideration: The new provisions, although not tested sufficiently in practice, are a major step towards a more international perspective of inner-Chinese insolvency rules. As already mentioned, the 1986 Bankruptcy Law did not contain any comparable provision. Thus, the new provision reflects the internationalization of the Chinese economy and Chinese law step by step, trying to reflect adequately the reality of international commerce. Furthermore, it should be noted that in particular the requirement of reciprocity is a notion which was only a few years ago also well known in European insolvency laws (although considerable changes have occurred in the last years, see e.g. Article 16 para.1 of the European Insolvency Regulation)[76].

---

75 "*Partikularverfahren" über das Inlandsvermögen*, see Section 354 German Insolvency Code

76 Piekenbrock, Das neue chinesische Insolvenzrecht, see Section 354 German Insolvency Code, page 113

2. Recognition of a People's Court's judgment under German law

a) Introduction

With respect to assets of the insolvency estate located outside China and, in particular, with respect to business dealings of an insolvent Chinese entity abroad, it is of major importance to understand if and to what extent an insolvency-related decision of the competent Chinese People's Court will be recognized and, thus, be enforceable in foreign jurisdictions. Whereas on the European level, the European Insolvency Regulation (EIR) safeguards to a large extent the recognition and enforceability of decisions of the competent insolvency court in other member states, see Articles 3, 16, 25 EIR, the situation might be quite different with respect to China.

To show the legal challenges that the recognition and enforcement of a decision of a Chinese People's Court abroad might have, it will be discussed in the following whether the decision of a Chinese People's Court confirming the challenge by the bankruptcy administrator of a transaction/act from the pre-insolvency time, is recognizable and enforceable in Germany.

b) Applicable law

(1) Since there is no multilateral or bilateral agreement or convention applying to the relationship between China and Germany with respect to the recognition and enforcement of the other state's judgments, the question as to whether the judgment of a Chinese People's Court will be recognized is governed by German international law.

(2) According to the prevailing view in legal literature, Section 328 German Code of Civil Procedure (CCP) is applicable to the recognition of a judgment issued by a foreign court regarding the legal challenge of a certain transaction under foreign insolvency law (*Anfechtungsurteil*). Section 343 German Insolvency Act governs the recognition of the opening of bankruptcy proceedings and of certain measures that directly relate to the bankruptcy proceedings such as protection measures. According to the prevailing opinion as expressed in German legal literature, the foreign judgment deciding on the legal challenge of a transaction brought by the insolvency administrator is deemed as

not to fall within the scope of Section 343 German Insolvency Act although being connected to the insolvency proceedings, but to be governed by Section 328 CCP[77]. Under the EIR, however, which favors the recognition in other Member States, the situation is different[78].

(3) Under German law, the recognition of a foreign judgment pursuant to Sec. 328 CCP does not allow for a thorough review of its content with respect to procedural and material law (prohibition of the so-called "révision au fond"). Rather, the foreign judgment will not be recognized by German courts if one of following conditions is met:

- The foreign court did not have international jurisdiction to decide on the matter under German international procedural law (under lit. c); or

- The judgment constitutes a violation of the German ordre public (under lit. d.); or

- It is not guaranteed that a Chinese court would recognize a corresponding judgment of the German court, i.e. lacking mutual recognition (under lit. e).

(4) Should a German court – contrary to the prevailing opinion in German legal literature - decide to apply Sec. 343 German Insolvency Act instead of Sec. 328 CCP with respect to the legal challenge of a transaction/legal act by a foreign insolvency administrator, the first two requirements (given international jurisdiction and no violation of the German ordre public) are required by Sec. 343 German Insolvency Act as well, whereas the third requirement (mutual recognition) does not apply within the scope of application of Sec. 343 German Insolvency Act.

(5) A general distinction under German law has to be drawn between the recognition and the enforcement of the foreign judgment. The recognition does not require any court proceedings but happens automatically if the legal requirements as described are given.

---

77 FK-Wenner/Schuster, Insolvenzordnung, Section 343, margin 42; Klumb, Kollisionsrecht der Insolvenzanfechtung, page 199 et seq.

78 See ECJ, February 12, 2009, Case C-339/07, margin 30 with reference to Article 3(1) EIR

Different from that, the enforcement of the foreign judgment requires that an enforcement procedure is brought in front of the competent German court pursuant to Sec. 353 German Insolvency Act in connection with Sec. 722, 723 CCP. However, Sec. 722 CCP however stipulates that the foreign judgment will only be enforced if it is recognized. In common practice, the consequence of this concept is that the question as to whether the foreign judgment is recognized will only emerge in the course of the enforcement procedure. In addition to the requirement of recognition, any enforcement is only possible if the foreign judgment disposes of an enforceable content.

c) No lack of jurisdiction of the Chinese People's Court

(1) First, recognition of a foreign judgment requires that the foreign court that has rendered the ruling has had international jurisdiction to decide on the matter. Under German procedural law, the court at the place of business of the defendant has general international jurisdiction to decide on the legal challenge (Sec. 17 para 1 CCP). Furthermore, German procedural law generally allows several additional venues.[79] For example, the insolvency administrator may bring the claim against the defendant in front of the court in whose district the defendant has substantial assets, provided that the defendant does not have its seat in Germany (Sec. 23 CCP).[80]

(2) Under Chinese law, however, jurisdiction over such a claim is granted to the People's Court based on the principle of *vis attractiva concursus*[81](see Articles 3, 21 of the 2006 Bankruptcy Law). Accordingly, there may be a discrepancy between German and Chinese law with respect to international jurisdiction.

---

79 The following rules do not apply to claims challenging the validity of a transaction brought by the insolvency administrator: Sec. 19 a CCP (only applies to claims brought against the insolvency administrator, BGH, ZIP 2003, page 1419), Sec. 29 CCP (venue at the place of the performance of a contract) and Sec. 32 CCP (tort claim).

80 However, details are highly disputed with respect to the application of Sec. 23 CCP in the event of an enforcement procedure, see Zöller – Vollkommer, ZPO, Sec. 23, margin no. 1, 7a.

81 According to the principle of vis attractiva concursus the insolvency court is competent to decide all disputes arising in connection with the insolvency proceedings.

(3) Despite such discrepancy, German legal literature does not automatically assume that the foreign court whose jurisdiction is based on *vis attractiva concursus* is internationally incompetent to decide on legal challenges of transactions brought by the insolvency administrator. Rather, it is referred to Sec. 3 German Insolvency Act providing for the following:

> Sec. 3 German Insolvency Act:
>
> (1) The insolvency court in whose district the debtor has his usual venue shall have exclusive local jurisdiction. If the centre of the debtor's self-employed business activity is located elsewhere, the insolvency court in which district such place is located shall have exclusive jurisdiction.
>
> (2) If several courts have jurisdiction, the court first requested to open insolvency proceedings shall exclude any other jurisdiction.

Although actually referring to local jurisdiction, Sec. 3 German Insolvency Act is considered as also governing the international jurisdiction according to a general principle under German procedural law. Based on this rule, individual German legal authors take the view that pursuant to Sec. 3 German Insolvency Act, the foreign court in which district the centre of the business activities of the debtor is located has international jurisdiction with respect to the opening of the insolvency proceedings. The extent of this reference to foreign law is considered to be comprehensive and to cover the material and procedural impacts of the insolvency proceedings, such as the legal power of disposition of the insolvency administrator and, also, the competence of the foreign law to decide whether the principle of *vis attractiva concursus* shall apply, e.g. to stipulate that the insolvency court has also jurisdiction over the legal challenge brought by the insolvency administrator[82]. A further argument that can be made in this regard is that the effects of the opening of insolvency proceedings are generally governed by the *lex fori concursus,* e.g. the law of the country where the insolvency proceedings have been opened (Section 335 German Insolvency Act, so called *principle of universality*). Legal literature also indicates that the concentration of competences at the insolvency court based on *vis attractiva concursus* as such is not inappropriate[83].

---

[82] Uhlenbruck, Insolvenzordnung, Art. 102, margin 158

[83] Kranemann, Insolvenzanfechtung, page 169 et seq.

(4) Based on this concept of German International Insolvency Law and on the quoted authorities[84] the conclusion is that a German court may likely find that international jurisdiction is given in the discussed case.

d) No violation of German ordre public

(1) Restrictive application of principle

The recognition of a Chinese People's Court decision regarding the challenge under Chinese insolvency law could be rejected by German courts in case of a violation of the German *ordre public*.[85] The assumption of a violation of the German *ordre public* in the context of recognition of a foreign court decision, however is only *ultima ratio*. The German Court of Federal Justice has repeatedly confirmed that regarding the effects of foreign insolvency proceedings in Germany, recognition can only be refused if the recognition of the judgment would lead to a result manifestly in contrast to material principles of German law, in particular if the recognition would be in contrast to the fundamental rights, as expressly set out in the relevant statutory provisions[86]. The German court in this context will not review whether the foreign judge has applied foreign law correctly.

(2) Domestic element

The more remote the case at hand is from a German perspective or if there are only a few domestic elements of the case (e.g. no extensive assets in Germany affected by the decision or no parties seated in Germany involved), the more likely a deviation from German law standards of the foreign decision is to be accepted under the criterion of *ordre public* than in a case having strong domestic German elements.

---

84 Uhlenbruck, Insolvenzordnung, Art. 102, margin 158

85 The compliance of a recognition of such foreign court decision with the German ordre public is binding German statutory law, irrespective of the question, whether such recognition follows German international insolvency law (Sec. 343 para 1 no. 2 German Insolvency Code) or the German Law of Civil Procedure (see. Sec. 328 para 1 no. 4 CCP).

86 Sec. 328 para 1 no. 4 CCP; Sec. 343 para 1 no. 2 German Insolvency Code; *see* BGH, decision dated May 27, 1993, ZIP 1993, page 1094, 1097; also BGH, judgment dated November 14, 1996, ZIP 1997, page 39, 44.

(3) Violation of procedural *ordre public* or violation of ordre public based on substantive law

A violation of *ordre public* could be the consequence of a violation of basic procedural principles as well as a violation of substantive law.

(a) Violation of basic procedural principles

The German *ordre public* could be violated if, e.g., there has been a violation of due process of law. In this context, violation of due process of law concerning the insolvency proceedings could be implicitly contemplated. Alternatively, a violation of due process of law regarding the claim launched by the insolvency administrator against the defendant in China could be alleged. If the underlying insolvency proceedings could be deemed to be a manifest violation of due process of law, an *ordre public* violation could be contemplated. However, any such violation of the principle of due process would require an analysis of the proceedings as conducted in the case at hand; no such violation can be derived from the Chinese insolvency laws as such. This question therefore would be primarily a matter of facts.

(b) Violation of substantive law

As to a material violation of substantive law, in particular an assessment of the effects with respect to the German fundamental rights, has to be taken into consideration[1]. In this context, a recognition could be rejected, if e.g. the insolvent company was arbitrarily made insolvent by public authorities by measures that effectively could be deemed to be a hidden expropriation, e.g. by charging excessive duties[1]. This question, however, is also a matter of fact and it has to be taken into consideration that there are no comparable precedents under which, in the context of insolvency proceedings, a violation of the German *ordre public* based

---

87 See Kübler/Prütting-Kemper, Insolvenzordnung, Sec. 343, margin 17

88 Gottwald, Insolvenzrechts-Handbuch, Section 132 margin 28. In the context, the "act of state doctrine" might become relevant, pursuant to which every sovereign state is bound to respect the independence of every other sovereign state and the courts of one country will not sit in judgment on the acts of the government of another, done within its own territory. This concept in the context of an expropriation without any indemnification as such is not recognized in Germany. Under German constitutional law, the basic principles of public international law prevail; such principles do not generally recognize foreign expropriations having occurred without due compensation, such expropriations therefore might violate German *ordre public (see Seidl-Hohenveldern*, IPRax 1996 page 410 et seq.).

on the legal protection of property (Art. 14 of the German Constitution) has been acknowledged[89]. The raising of unsubstantiated general allegations in the sense that insolvency related proceedings in China do not meet basic legal standards would not be sufficient.

(4) No *révision au fond*

Within the context of the restrictive applicability of the *ordre public* reservation, the German court, as set out above, will in principle not review whether the foreign judge has applied foreign law correctly (unless such assessment is necessary for reviewing whether the foreign decision is void or not). The German judge will, however, review whether the result of the application of foreign law in the case at hand is an evident violation of basic German law principles.

In this context, there are two levels under which a violation of *ordre public* in a concrete case of a People's Court decision to be recognized in Germany are conceivable:

On the more obvious level, the question is whether certain rights of the parties subject to court proceedings in China are violated in the court proceedings in China or whether such proceedings are based on material allegations which are an apparent violation of German fundamental legal principles.

A relevant violation of the German *ordre public* could be conceived under the underlying question whether e.g. the Chinese insolvency administrator assumed rights which violated basic legal principles. This could then lead to an incident legal review in the course of the legal proceedings where recognition becomes relevant. In this context, only extreme circumstances e.g. an expropriation by means of provoked insolvency proceedings might become relevant. German law widely accepts the powers of foreign insolvency administrators under foreign insolvency law. Thus, only an evident violation of substantive law principles acknowledged in Germany would be relevant in this context. This could be the case if the insolvency administrator assumed powers with respect to independent foreign companies

89 See Geimer, Internationales Zivilprozeßrecht, margin 3516

This of course would be a matter of fact again. Moreover, German law in principle acknowledges the determination of the scope of the insolvency estate under foreign law (*lex fori concursus*)[90].

Thus, only under very exceptional circumstances, a violation of the German *ordre public* is conceivable.

(5) As a result, the concept of the German *ordre public* does not necessarily exclude the recognition of the judgment of the Chinese People's Court. There are certain scenarios conceivable under which a violation of the *ordre public* could be considered.

e) Guaranteed mutual recognition

Pursuant to Sec. 328 para 1 no. 5 CCP, a recognition of a Chinese judgment requires that so called "mutuality" (*Gegenseitigkeit*) with regard to recognition is guaranteed. This means that recognition might occur only if, in case a German judgment was to be recognized in China, Chinese law would provide for a recognition under the same or at least comparable conditions.

Such concept of mutuality may be given by way of a bilateral or multilateral international treaty between the respective countries. Germany and China, however, have not entered into any international treaty regarding the mutual recognition of judgments.

If, as the case is here, no treaty on mutual recognition exists, the conditions of mutuality have, pursuant to German legal principles, to be regarded on the basis of the actual current practice of recognition of German judgments in the respective country[91]. Only in a second step, the national rules on recognition of judgments are to be taken into consideration. To answer the question whether the required mutuality for recognition of foreign judgments is given with regard to China, it would be necessary to take a look a the current practice in China with regard to recognition of German judgments. As such practice is not documented to a sufficient extent, it is still unclear whether a sufficient practice exists.

---

90 Geimer, Internationales Zivilprozeßrecht, margin 3519

91 MüKo - Gottwald, ZPO, Section 328, margin 117; Zöller - Geimer, ZPO, Section 328, margin

However, the new prevailing view in German legal literature is that mutual recognition is guaranteed with regard to China.[92]

The Higher Regional Court of Berlin (*Kammergericht*), in a widely discussed decision from May 18, 2006, confirmed that a final and binding decision of a Chinese People's Court can be recognized pursuant to Section 328 CCP[93]. In this context, the *Kammergericht* expressly noted that there are no grounds to reject the assumption of a mutual recognition. The court, however, conceded that there is no extensive experience as to the recognition of German judgments in China. However, the *Kammergericht* expressed the positive expectation that Chinese authorities would recognize German court decisions. Such positive prognosis, according to the judgment, is sufficient, provided that no concrete examples showing that China, contrary to that expectation, does not respect German court decisions exist.

As a result, it can be noted that according to the new prevailing view in German legal literature, mutual recognition is guaranteed between China and Germany. Thus, there are good chances that a German court would assume mutual recognition to be guaranteed and, thereby, the prerequisites of Sec. 328 para. 1 no. 5 CCP be fulfilled.
To conclude, it is not unlikely that the judgment of a Chinese People's Court on an insolvency challenge within the *vis attractiva concursus* will be recognized in Germany.

f) Resulting options for Chinese insolvency administrator

In light of the above, the Chinese insolvency administrator in the above example has the following opportunities:

- First, he may claim for a declaratory judgment stating that the judgment of the Chinese People's Court will be recognized in Germany[94].

---

92 Zöller - Geimer, ZPO, Anh. V; MüKo - Gottwald, ZPO, Section. 328, margin 122, dissenting opinion: Neelmeier, Verbürgung der Gegenseitigkeit zwischen Deutschland und China?, ZChinR 2007, page 287 et seq.

93 See KG Berlin, decision dated May 18, 2006, NJW-RR 2007, page 1438

94 See Schack, Internationales Zivilverfahrensrecht, margin 885; Geimer, Internationales Zivilprozeßrecht, margin 2996

- Secondly, the insolvency administrator may, in general, apply for the enforcement of the foreign judgment according to Sec. 722, 723 CCP.

- Once the enforcement is awarded, the defendant could in addition (with uncertain prospects though) file a claim raising objections against the enforcement act (*Vollstreckungsgegenklage*) but would be precluded with respect to all objections that could have been raised already in the proceedings according to Sec. 722, 723 CCP.

V. Summary

The new 2006 Bankruptcy Law is a remarkable step forward in the PRC legal system compared to the benchmarks set by developed countries with respect to insolvency laws. Many concepts that can be found in the new 2006 Bankruptcy Law are well known in other jurisdictions and should be able to strengthen the confidence of the international community in the Chinese legal system.

With respect to the historical development of the new 2006 Bankruptcy Law, driving factors for the implementation were, in particular, the insufficiency of the previous bankruptcy regime, safeguarding the stability of the finance sector and also certain particularities of state-owned enterprises.

It is remarkable that the new 2006 Bankruptcy Law applies to more diverse types of enterprises although there is no insolvency provided for individuals. New and comparable to certain "western" concepts (e.g. Germany) is the strong position of the bankruptcy administrator.

From an international perspective with respect to the recognition of decisions of the local People's Court, the concept of *vis attractiva concursus* that can be found in the 2006 Bankruptcy Law will likely incur certain discussions with respect to a potential recognition in other jurisdictions. Court decisions rendered, for example, in Germany but also Article 5 of the 2006 Bankruptcy Law indicate that a mutual recognition and enforceability, at least for the time being, can be supported with good legal arguments.
Whether or not the rather reluctant cultural attitude in China vis-à-vis bankruptcy proceedings will change still is an open issue. First indications concerning the development of number of insolvencies and reports on "silent, informal liquidations", however, do not justify too much confidence that in the short term, a considerable change of such attitude is to be expected.

VI. Lebenslauf

Dr. Konstantin Hoppe

Dr. Konstantin Hoppe wurde am 19. Juni 1970 in Berlin geboren. Er studierte Rechtswissenschaft an den Universitäten Heidelberg, Genf und der Hochschule für Verwaltungswissenschaften in Speyer. Dr. Konstantin Hoppe schloss seine juristische Ausbildung mit dem 1. und 2. Staatsexamen des Landes Baden-Württemberg ab. Im Jahre 2003 wurde ihm von der Universität Jena der Titel des Dr. jur. verliehen.

Dr. Konstantin Hoppe ist Rechtsanwalt im Münchner Büro der U.S. Anwaltssozietät Weil, Gotshal & Manges LLP. Er ist spezialisiert auf Prozessführung, Immobilientransaktionen sowie Intellectual Property auf nationalem und internationalem Level. Dr. Konstantin Hoppe berät zu einem maßgeblichen Anteil Mandanten im asiatischen Bereich (Japan, Korea).

Er ist Teilnehmer des Nachdiplomstudiums Executive Master of European and International Business Law M.B.L. - HSG an der Universität St. Gallen (2008/2009).

From an international perspective with respect to the recognition of decisions of the local People's Court, the concept of *vis attractiva concursus* that can be found in the 2006 Bankruptcy Law will likely incur certain discussions with respect to a potential recognition in other jurisdictions. Court decisions rendered, for example, in Germany but also Article 5 of the 2006 Bankruptcy Law indicate that a mutual recognition and enforceability, at least for the time being, can be supported with good legal arguments.

Whether or not the rather reluctant cultural attitude in China vis-à-vis bankruptcy proceedings will change still is an open issue. First indications concerning the development of number of insolvencies and reports on "silent, informal liquidations", however, do not justify too much confidence that in the short term, a considerable change of such attitude is to be expected.

VII. Erklärung

Ich erkläre hiermit, dass ich die vorliegende Arbeit ohne fremde Hilfe und ohne Benützung anderer als der angegebenen Hilfsmittel verfasst habe.

Ort, Datum: München, 28. August 2009

Unterschrift: .....

* * * * *

* * *

*