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Contents

	<u>Forward</u>	1
1.	<u>Introduction</u>	2
2.	<u>Background</u>	3
3.	<u>Social Stability – Role of Government</u>	5
4.	<u>Judicial Interpretation 2011</u>	7
5.	<u>The Judiciary</u>	9
6.	<u>Over view of “Acceptance” of a Case under the EBL</u>	10
7.	<u>Liquidation</u>	10
8.	<u>Reorganisation</u>	11
9.	<u>Case Study – the EBL in a Cross Border Context</u>	13
10.	<u>Conclusion</u>	19
11.	<u>Bibliography</u>	20

Forward

This paper attempts to identify and illustrate, by practical example, the major impediments to the acceptance and use of China's Enterprise Bankruptcy Law.

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1. Introduction

- 1.1. The People's Republic of China ('PRC') introduced the Enterprise Bankruptcy Law ('EBL') in 2007ⁱ which was the first comprehensive bankruptcy law introduced in PRC, replacing the 1986 Bankruptcy Law ("the 1986 Law") which related only to the bankruptcy of State Owned Enterprises ("SOEs").
- 1.2. The EBL includes three types of proceedings; Liquidation, Reorganisation and Conciliation.
- 1.3. This paper highlights some of the practical issues identified in the implementation of the EBL, with particular emphasis on those considerations relating to offshore insolvency practitioners representing foreign creditors.
- 1.4. Whilst modelled largely on the United States Bankruptcy Code (and many similarities occur as a result) there are also a number of profound differences which are the result of; inter alia, lack of clarity in the EBLⁱⁱ, the lack of detailed guidelines to assist in the implementation and operation of the EBL, the history of bankruptcy in China, the small number of cases under the EBL to date, and the relatively short period in which the EBL has been in operation.

2. Background

- 2.1. The Introduction of the EBL replaced the 1986 Law which was drafted exclusively for the liquidation of State Owned Enterprises ('SOEs') under what became known as "Policy Bankruptcy"ⁱⁱⁱ. The 1986 Law did not apply to other types of legal entities leaving no mechanism for the liquidation of private companies. Policy Bankruptcy sought to address the insolvency of thousands of SOEs which survived by virtue of Government funding support, usually through State owned banks (which subsequently often forgave loans)^{iv} primarily to provide workers "with the prospect of lifetime employment in SOEs.....The fact that SOEs guaranteed the social stability of the country was one of the main arguments against its (the EBL's) implementation"^v.
- 2.2. The issue of social stability in China is probably the greatest factor influencing the implementation of the EBL. The mere word of the law has not traditionally been predictable since the Communist Party came to power in 1948. As Neelen observed "...the written law was effectively futile because the Party cadres interpreted the law in favour of the Communist Party"^{vi}
- 2.3. It is not unusual where high profile private companies with substantial work forces encounter financial difficulties for the State's interests to play a greater role in influencing the outcome, even in cases before the Courts under the EBL. An understanding of the historical and cultural background is essential in developing successful strategies in dealing with cases under the EBL.
- 2.4. Governments were often key players in dealing with SOEs under the 1986 Law (often balancing a number of interests putting them in positions of conflict) and it may be argued that role has continued under the EBL since its introduction largely due to concerns for social stability in high profile cases.
- 2.5. China's Courts also have a financial dependence on local government^{vii} and a tendency to rule in favour of the social ideology of the Party instead of adhering to the written laws.^{viii} Even though the EBL has been widely applauded and is essential to the development of China's economy in future, there remains (inherently and structurally) a lack of judicial independence and local protectionism. Chinese Courts lack transparency and have a tradition of secrecy, with judicial proceedings unavailable to the public (including bankruptcy petitions, financial information of the debtor etc. which remain confidential), no searchable system of reporting of judicial decisions and a lack of judicial precedent to develop the law^{ix}.
- 2.6. One of the key factors in the future success of the EBL is for the training and development of bankruptcy judges in China. Bankruptcy is a unique area of law and given the recent economic and political history of PRC it is not surprising that their professionals and regulators do not have the experience or background at present and will benefit from the overseas training and development programs that are being put into place. It is important these continue.

- 2.7. Despite the rapid rise, continued growth and success of PRC's market economy, China remains culturally diverse with unique socio economic factors. Government officials and agencies play a key role in social and economic policy and are interested in the outcome of companies in financial difficulty because of the impact on employment and accompanying social implications, particularly in large cases which may underpin the local economy particularly in regional areas.
- 2.8. From a practical perspective it is also necessary to understand the concept of a Legal Representative ("Legal Representative") under PRC law^x, who has total control to bind or represent a company and how this impacts EBL particularly in the cross-border context. Liquidators of foreign owned companies focused on Chinese businesses or investments often have 100% owned subsidiaries in PRC as their major assets. One mechanism to gain control of the subsidiaries is to replace the incumbent directors with the foreign liquidator (or his nominees) and to replace the Legal Representative. Without the Legal Representative's consent and delivery of the company chop and records the Legal Representative cannot be changed. Lengthy and costly delay will result as an application to Court will be necessary to change the Legal Representative. The outcome of these applications may not always be consistent.
- 2.9. Notwithstanding the issues outlined above, the EBL has been well received as a step in the right direction, although most commentators point to further development and refinement being required. This is not unusual as all law is developed and refined over time. Practitioners, lawyers and other market participants eagerly awaited the release of guidelines and judicial interpretation of EBL by the Supreme Peoples Court to aid in the implementation of the law^{xi}, which were introduced in the last quarter of 2011. However these have fallen short of expectations and further interpretation and guidelines are anticipated.

3. Social Stability – Role of Government

- 3.1. It has been suggested by all of the experts I interviewed that the most important factor to consider in the experience to date of the adoption of the EBL is the impact on social stability when a company is declared bankrupt and how this impacts on the various players in the implementation of the law. These issues are not new, and while this paper is not intended to provide social or cultural commentary, it is important in any jurisdiction to understand how these factors influence decisions and actions taken by lawmakers and the judiciary, and it is particularly important for representatives of foreign based creditors to orient themselves with a general understanding of these issues in PRC.
- 3.2. In a paper presented by the Congressional Research Service, the Library of Congress on 8 May 2006, the impact of social unrest in the new economy of China suggested that the closure, privatisation or restructure of SOEs since the early 1990's had led to millions of layoffs. At the same time, economic reforms since the 90's had led to rapid growth in the middle class, then estimated at 100 million people^{xii}.
- 3.3. The middle class is urban, better educated and have a greater sense of entitlement than rural based people leading to fears by the Communist Party of a democratic movement emerging, similar to Poland's "Solidarity". As a result the Government moved to suppress efforts to form independent labour organisations. Add to that equation approximately 150 million migrant rural workers who are paid less than established urban residents which fuels anger about discrimination and ill treatment.^{xiii}
- 3.4. Against this backdrop almost six years ago, the slowdown in China's economy in recent months is said to be a direct cause of the ongoing fallout of the GFC and Europe's debt woes in the last twelve months^{xiv} leading to reduced demand for goods manufactured in PRC. Large scale strikes have occurred in many regions, including a strike by 7,000 footwear industry workers in Guangdong province in November 2011 protesting large scale layoffs and wage cuts^{xv}.
- 3.5. A public rally of workers from a bankrupt bamboo and wood furniture factory in December 2011 was quelled by police^{xvi}.

In regions where bankruptcies are likely to result in mass layoffs of workers, regional and local government authorities become involved in trying to influence the outcome to limit potential social unrest.

- 3.6. Local or regional Governments will often take control of an ailing company, inject new funds to maintain operations and provide workers with wages to assist in maintaining order.
- 3.7. The Government will then seek an investor to take over the business, to recover the outlay they have made and restore the company in a form of restructure. The success or prevalence of these unofficial “rescues” is unclear. What complicates the process is where other creditors commence actions under the EBL to liquidate or restructure the company or take other legal action seeking attachments over assets to secure debts. In such cases the Government may seek to influence the direction of proceedings initiated under the EBL.
- 3.8. Judicial independence has often been cited as one of the impediments to the wide acceptance and successful implementation of EBL^{xvii}. It is perhaps not surprising in this environment that Bankruptcy Judges will defer to local Government in such cases or the Government will place pressure on the Courts for particular outcomes^{xviii}.
- 3.9. “The Judges believe that, with Government support, they are more likely to make decisions which will be followed through and enforced. Without that support decisions are harder to implement. With support it is more likely the company will survive and less likely employees campaign to make trouble^{xix}”.
- 3.10. Mr Han suggests the Governments first priorities are employees and social stability. Local creditors, their workers and suppliers are also in a position to impact stability through the failure of a major business and may have strong connections with Government or its’ officials and be in a position to exert influence on the process. Foreign creditors are of secondary importance to the Governments strategies in dealing with bankruptcy cases.

4. Judicial Interpretation 2011

- 4.1. Interpretation (2011) No. 22, dated 9 September 2011 of the Supreme People's Court ("the Interpretation") seeks to provide some additional clarification and guidance for the Courts in the implementation of the EBL.
- 4.2. The primary focus of the Interpretation is to provide more guidance as to the meaning of "insolvency" as it applies to Article 2 of the EBL. That article provides three principle tests which must be met in an application for liquidation by the debtor;
 - Cash flow test: the company is unable to pay its debts as they fall due;
 - Balance Sheet test: the assets are insufficient for the company to pay its debts; and
 - The company is "obviously lacking the capability to pay its debts".
- 4.3. Article 2 of the Interpretation requires the People's Court to consider a debtor as unable to repay a due debt where;
 - The creditor-debtor relationship was established in accordance with the law;
 - The time limit for repaying the debt has already expired and
 - The debtor has not completely repaid its debts.
- 4.4. Article 3 of the Interpretation extends the concept of balance sheet insolvency contained in Article 2 of the EBL to provide that where a statement of financial position, auditors report, asset valuation report etc. demonstrates that the assets are insufficient to repay all debts, it is sufficient to prove the debtor is unable to repay its debts (in the absence of evidence to the contrary).
- 4.5. Article 4 of the Interpretation provides additional considerations the court may take into account where theoretical balance sheet solvency may exist, where for example;
 - (1) The assets cannot be liquidated and there is no way to repay the debt;
 - (2) The location of the legal representative is unclear and there are no other persons responsible for the management of the property, so there is no way to repay the debt.
 - (3) Even if enforcement action is taken there is no way to repay the debt
 - (4) It is difficult to recover from long term deficits through continuing operations, so there is no way to repay the debt

- 4.6. One of the most common criticisms since the implementation of the EBL has been the time the Courts have taken to make decisions on Bankruptcy (or Reorganisation) applications. Article 7 of the Interpretation seeks to address this by requiring the Court to “conduct a timely examination of the eligibility of the applicant and the debtor to initiate bankruptcy procedures and the debtor’s cause of bankruptcy.....”
- 4.7. Article 9 of the Interpretation provides that where the Court has not made such a “timely examination”, the applicant has the right to make an application to the next higher level Court for a determination.
- 4.8. The experience of practitioners to date would suggest that even when an application to a higher Court has been made it has not provided any speedier resolution to outstanding applications, nor has it resulted in consistency of interpretation. It is difficult to expect, given the factors described more fully below, that Articles 7 or 9 of the Interpretation will have any greater impact.
- 4.9. Whilst the Interpretation has been welcomed by many observers, it is unlikely to have any impact on the level or timeliness of acceptance of a case or increased use of the EBL. Whilst theoretically a case may be moved to a higher Court under Articles 7 and 9, the higher Court will have many similar issues to defer a decision as the lower Court^{xx}.

5. The Judiciary

- 5.1. Article 3 of the EBL provides the basis for judicial oversight and control of insolvency proceedings under the EBL. However there is no specific bankruptcy court to handle insolvency proceedings, which may be brought in any one of the four levels of Court in the PRC.
- 5.2. Much has been written of the current limitations of the Courts in overseeing bankruptcy cases under the EBL, particularly the lack of experience and knowledge of the Judiciary overseeing cases. As insolvency cases are often complex involving multiple stakeholders, often with competing interests, a lack of experience coupled with a new law and the prospect of pressure from Government are all factors influencing the Court's handling of bankruptcy cases. Whilst international training and educational programs are being used to improve the Judges ability to handle cases, there are also other practical issues which have an impact on the number of cases progressing through the courts.
- 5.3. Mr Han suggests that “acceptance” of cases, as provided by Article 10 of the EBL may also be influenced by other factors, such as;
 - A Judges performance is based on the number of cases concluded each year. As bankruptcy cases are complex and take time to resolve or conclude, Judges may be reluctant to accept new cases. Judges don't have time to get involved in bankruptcy cases and that without a dedicated Bankruptcy Court; the EBL is more difficult to be accepted and unlikely to be more widely used. In some areas, such as Taiyun Court in Shanxi Province a distinct bankruptcy court has been established to handle these cases, however this is an exception;
 - Judges are likely to look to Government to provide direction in many cases, particularly in high profile cases. Many Judges believe their decisions are more likely to be followed through and enforced where the Government has played a role in the case;
 - Judges may be reluctant to be involved where employees are disgruntled and take an antagonistic stance (or worse) in the proceedings in relation to outstanding entitlements.

6. Over view of “Acceptance” of a Case under the EBL

7. Liquidation

- 7.1. For the Court to accept the application for a debtor initiated liquidation, the company must demonstrate insolvency. There are three tests for insolvency under the EBL which must be met in an application for liquidation by the debtor^{xxi} which have been further developed by the introduction of the Interpretation as noted in Section 3.
- 7.2. The threshold in the EBL for a creditor initiated application is lower than other jurisdictions, requiring only that the creditor show that the company is unable to pay its debts. This reflects the difficulty a creditor has in obtaining any detailed information of the debtor’s affairs in China.
- 7.3. One of the requirements in any petition filed by a debtor under the EBL is that a proposal for the settlement of employees and the payment status of employees’ wages and social insurance premiums must be included.^{xxii} This was one of the major areas of debate in the drafting of the EBL and the one factor which was ultimately responsible for its delay in implementation.
- 7.4. The Peoples Court is required to make an order appointing an Administrator^{xxiii} if it “accepts” the application^{xxiv}. Article 10 also allows a debtor an opportunity to object to an application filed by a creditor, providing one example where the Court may apply its discretion and not accept an application.

8. Reorganisation

- 8.1. Similar to an application for liquidation the debtor must demonstrate to the Court that it is insolvent under the three tests provided by Article 2. Where an application for reorganisation is made by a creditor the threshold of insolvency is limited to the cash flow test (unable to pay its debts as they fall due) pursuant to Article 7.
- 8.2. Where a creditor has made application for bankruptcy liquidation under the EBL, the debtor, or shareholders representing more than 10% of the issued capital of the company may apply to the Court for Reorganisation after the Court has accepted the bankruptcy application, but before it has declared the debtor bankrupt^{xxv}.
- 8.3. A reorganisation only commences on acceptance of the application by the Court. The EBL does not provide a time frame for acceptance^{xxvi} and the Interpretation merely refers to an application being made to a higher Court where a timely examination of the application has not been made. What “timely” means in this context remains open to further debate, but the interpretation is unlikely to resolve the issue.
- 8.4. It remains possible creditors may take action to exercise their rights (e.g. by attaching assets) where the debtor’s financial position is deteriorating or that assets are dissipated prior to the Court accepting the reorganisation. Given the delays of the Courts in accepting cases, it is most likely the financial position will deteriorate further during this period and the business may be incapable of reorganisation by the time a decision is made.
- 8.5. Article 42(4) provides for priority of wages and social security payments^{xxvii} advanced during a reorganisation but any other form of reorganisation finance is not given similar priority. This illustrates the social concerns of priority for wages being afforded a priority, but practically the lack of availability of financing during a restructure being given priority may hinder some cases. There are provisions to secure existing assets, but these will generally be limited in the event of a company in severe financial distress.
- 8.6. Furthermore, there is no priority afforded the Administrator in the EBL for debts incurred in the course of implementing a reorganisation plan, nor for the fees and costs of the Administrator in carrying out his duties. Whilst some see this as an oversight^{xxviii} which may be clarified by further judicial interpretation it limits the effectiveness of the Reorganisation provisions and may be a contributing factor to the underutilization of reorganisation under the EBL to date.
- 8.7. The EBL provides for a six month period in which a reorganisation plan must be presented which may be extended by not more than three months^{xxix}.
- 8.8. There is no mechanism under the EBL for a modification of a Reorganisation Plan if it is unsuccessful. Upon the failure to implement the plan, the company is declared bankrupt and an Administrator is appointed in a bankrupt liquidation. In many cases flexibility is

required to successfully implement a reorganisation and without that flexibility being covered under the EBL it may deter some from undertaking a reorganisation.

8.9. Conclusion

8.9.1. Since introduction of the EBL, the Liquidation and Reorganisation procedures have been used sparingly, with the main reasons being;^{xxx}

- The concept of reorganisation is not well known;
- Lack of experienced professionals able to undertake the work;
- Lack of clarity over a number of aspects of the law;
- Local protectionism by Government is a fundamental obstacle to implementation; and
- Absence of Judicial autonomy.

8.9.2. Small to medium sized enterprises are unlikely to use the EBL to address financial problems or failure. Mr Han suggests that in these cases any remaining assets are usually sold or transferred out by the major shareholder or Legal Representative who often “disappears” leaving the creditors empty handed. Without the Legal Representative being available there is little chance of proceedings being commenced and insufficient impact on the economy for the Government or the Courts to consider becoming involved. There is a trend in recent years that these companies just die quietly without bankruptcy procedures^{xxxi}

8.9.3.

9. Case Study – the EBL in a Cross Border Context

- 9.1. China Taizi Foods Company Ltd ('TZN') is a Cayman Islands registered company to which official liquidators were appointed on 12 April 2010^{xxxii}. The case has drawn significant attention as one of the first cross-border cases to utilize the EBL^{xxxiii}.
- 9.2. TZN controls, via intermediary offshore entities, seven PRC subsidiaries (together 'the TZN Group') with substantial operations in four Provinces in China. At one time the TZN Group controlled 31% of the market for yoghurt drinks in PRC. The company employed thousands of people and was a major contributor to the local economies in its most active locations and a major tax payer. Worsening liquidity due to a combination of mismanagement and alleged fraud committed by the Chairman resulted in social unrest and disturbances caused by employees and creditors when the PRC subsidiaries were unable to meet their obligations.
- 9.3. Prior to the appointment of the liquidators, the local government in Hunan province attempted to informally reorganise the PRC companies by negotiating with the TZN Group to enter into a lease of all of its' assets and operations with a SOE ('Gaoke') which was provided with government funding to continue operations and consider restructure alternatives.
- 9.4. Offshore creditors lent the company almost US\$100 million and purchased 30% of the equity for a further \$79 million. The liquidators sought to gain control of the PRC Subsidiaries by changing the directors of the intermediary subsidiaries and the directors and Legal Representative of each of the PRC subsidiaries. The existing Legal Representative who is also the Chairman and major shareholder of the TZN Group resisted all attempts by the liquidators to co-operate and refused to hand over the company chops and financial records, nor allowed them access to the premises. Gaoke also refused to provide any information to the liquidators.
- 9.5. The Liquidators made an application to the local government authorities ('AIC') responsible for commercial registers to change the Legal Representative but encountered barriers such as;
 - One AIC sought approval from a higher authority which has not responded;
 - One AIC approved the application of the change to the Legal Representative, but a local Court has since prohibited any change to the records; and
 - In another province the local police have stopped any change of Legal Representative being recorded whilst they investigate criminal charges against the TZN Chairman.
- 9.6. Despite the difficulties in changing the Legal Representative, the Liquidators applied under the EBL for Reorganisation in several Provinces. The case demonstrates the inconsistent approach made by the Courts in different regions. The Courts rejected the applications made by the liquidators as they were unable to provide the company chops

or financial statements and had been unable to register the change in Legal Representative. One of the major creditors subsequently applied for Reorganisation with differing results in each province. In all cases there have been substantial time delays in decisions from the Courts.

9.7. Overview of Proceedings

- | | |
|-------------------|---|
| Zhuzhou Province: | <ul style="list-style-type: none"> • Applications in respect of three of the group companies were eventually accepted and an Administrator (“the Administrator”) was appointed pursuant to Article 71; • The Court considered seeking direction from a higher Court as the assets of all three companies had been comingled, and the Court was considering an order to treat the companies as one despite no provision in the EBL allowing for the consolidation of Group entities in a reorganisation case; • Whilst the Administrator took control of the three companies, the Liquidators maintained close collaboration with the Administrator and undertook substantial work to assist the Administrator facilitate a reorganisation; • The Administrator did not submit a Reorganisation Plan to the Court within the 6 month time requirement but secured an extension of three months pursuant to Article 79 of the EBL; • The Liquidators identified several potential investors interested in purchasing the businesses and rejuvenating the operations. The Liquidators facilitated meetings with the Administrator and the Government to gain access to information, arrange for visits to operational sites by potential investors and hold negotiations; • The Administrator received two offers to facilitate the reorganisation of the three companies from Chinese investment consortiums. The Administrator sought the views of Government prior to formally accepting one of those offers; • The Liquidators and the major creditors supported the reorganisation plan proposed by the successful bidder on the basis that it represented a better return to creditors than the liquidation of the companies; • Formal meetings of creditors were held pursuant to the EBL at which the Reorganisation Plan was approved by the required majority; • Gaoke did not submit an offer to the Administrator, as had previously been suggested, but remained in control of the operations and affairs of the business until the Reorganisation Plan was implemented. |
| Beijing: | <ul style="list-style-type: none"> • Shortly after their appointment (in April 2010) the Liquidators and a major creditor both applied to the Beijing Intermediate Court for the judicial reorganisation of Beijing TZN; • The Court requested a Reorganisation Proposal be submitted including the identity of any investor and amount to be invested before even considering the application for reorganisation, despite the EBL requiring the Court to accept an application if the applicant can demonstrate insolvency; • The EBL requires that an Administrator submit a Reorganisation plan within six months from his appointment. It is unclear why the Court insisted on this |

information prior to accepting the case, when the law contemplates either the debtor or an Administrator having six months in which to file a reorganisation plan, which would include such information;

- The Administrator appointed in the Zhuzhou case (above) also unsuccessfully lobbied the Court to accept the application for Reorganisation. The Court continued to maintain there would be no decision until the information requested was provided;
- In the meantime another Court, the MiyunBeijing Court, on application by various local creditors, ordered the auction of the subsidiaries assets, dismissing the objections of the offshore creditors and the Liquidators. The police (who are investigating the TZN Group Chairman on criminal charges of fraud and absorption of public funds) attended the auction in an attempt to stop it proceeding, however the auction continued when the Judge also attended;
- The Court has still not accepted the application for reorganisation or made any determination on the case. It has, however confirmed that the Court holds the balance of funds realised from the sale of assets;
- The Liquidators subsequently filed a complaint to the Chief Judge of the Court.
- The Liquidators made an application for the formal liquidation of this company under the EBL. The only asset of the Company known to the Liquidators was a parcel of land that had been pledged in favour of foreign creditors, but was also the subject of six separate Court Orders sought by local creditors.
- Almost twelve months later, the Court requested financial information in respect of the Company from the Liquidators. As all the company records were in the hands of the police this could not be provided.
- In August and September 2011 the Liquidators filed a formal complaint with the Court regarding the delays in acceptance of the case and were advised by the Court that it does not have the necessary resources to handle the formal liquidation of the Company.

Kunshan
Province:

Huanggang
Province:

- Applications were made by the liquidators and a major creditor for the appointment of an Administrator to enable a Reorganisation;
- The Court has advised that it is seeking direction from the local Government prior to making any decision; and
- The local Government has requested the identity of a purchaser and the amount to be invested before giving any directions to the Court.

9.8. This case demonstrates the different application of the EBL being applied across regions and the role the Government has played.

9.9. In Beijing the Courts demand for the identity of an investor and the amount of any investment to be made is inconsistent with Article 71. Whilst a pre-packaged plan is theoretically possible under the EBL, in the circumstances where the Legal Representative (i.e. debtor) is not participating, the foreign liquidators have not been able to exercise control of the debtor and there is no understanding of the company's

financial position, it would be extremely difficult for an investor, even if one had been identified, to state the amount of any transaction that it may contemplate. This demonstrates a lack of understanding and experience in bankruptcy procedure by the Court.

- 9.10. The decision by the Beijing Miyun Court demonstrates the potential impact on a debtor when a stay of proceedings does not apply from the date of filing of the reorganisation application. The auction of the assets proceeded and the Liquidators subsequently applied to a higher Court for the re-examination of the Beijing Miyun Courts decision to dismiss the objections raised by creditors to the auction of assets. A decision is still pending.
- 9.11. The Huanggang Court in seeking direction from the local government demonstrates that the historical influence of government will take time to change. Whilst technically the Court does not need input from the government, the situation demonstrates the concern of many regarding judicial independence and how the EBL will work practically. The Government's demand for information of an investor when the procedures specified under the EBL have not yet commenced demonstrates a lack of understanding of the law and the independence of the Court.
- 9.12. The takeover of TZNs business by Gaoke lacked transparency to other significant stakeholders. Gaoke initially incorporated by the Zhuzhou Government, but two private investors subsequently invested in it. Gaoke was reluctant to provide any information to the Liquidators.
- 9.13. After the Administrator was appointed to the Zhuzhou companies, he entered into a new asset lease agreement with Gaoke, the details of which were not disclosed to the Liquidators. The Administrator also had difficulty in obtaining financial information from Gaoke in relation to the operations and assets of the companies and made repeated requests for information before any substantial details were provided.
- 9.14. The Administrators efforts to undertake a marketing campaign to offer the business/assets for sale or restructure were delayed as a result. Once this information was made available, the Liquidators were able to work with the Administrator to market the business in a transparent and competitive manner, to ensure the best result for creditors;
- 9.15. There is no way of knowing how the TZN Group issues would have been resolved without the foreign creditors having sought the appointment of Liquidators to the Cayman Islands parent company. The main advantage of that appointment was that the Liquidators were able to maintain a level of pressure and scrutiny on the process, using the EBL to have the Administrator appointed, which ultimately (in the case of the Zhuzhou companies in particular) led to more transparency, an open market sale process and a better return to creditors.
- 9.16. The elements of this case highlight some of the more common issues encountered by a foreign liquidator or other representative of foreign creditors in PRC. These include;

- Social disturbances by creditors and employees led to initial intervention by Government and the lease of operations to Gaoke.
- Government driven restructurings of this type are performed “in secret” and EBL is not utilised;
- Ongoing operations or the sale of businesses or assets not transparent, leading to concerns as to whether the best result is being achieved for creditors;
- Government action in these circumstances is tightly controlled allowing little independent scrutiny;
- The financial information necessary to conduct a proper investigation into the affairs of PRC subsidiaries is often not available and when it is, substantial further work is required to understand the true picture;
- Different elements of Government, or those from other regions may have their own agenda’s leading to a lack of coordination in the interests of the Group as a whole;
- The slow or non-response of higher Courts to intervene when decisions are delayed, or not made at all.

9.17. Strategies to Engage

- 9.18. Despite the difficulties outlined above, there are a range of strategies available to a foreign liquidator pursuing assets or investments in China. The foreign liquidator will require a level of patience and persistence in pursuing claims and the particular strategies adopted will depend on the circumstances of the case.
- 9.19. A foreign liquidator will attempt to take control of the Chinese assets by replacing the directors and Legal Representative as outlined above. Whilst changing the Legal Representative may be difficult without consent of the incumbent, there are options available in the Courts to assist, although these may be time consuming and results inconsistent.
- 9.20. Engage PRC legal counsel with experience with the EBL and the Courts and select a firm respected by the Courts.
- 9.21. Regular communication with Government Authorities handling the case is essential. This may lead to access to financial information regarding the company and an increased opportunity to seek greater transparency.
- 9.22. Communication will commence with formal letters to the relevant Government Authorities (which may be numerous) in an effort to engage and lead to formal meetings with the decision makers in the case.

- 9.23. Pursue applications under the EBL for either Liquidation or Reorganisation in the PRC Courts. It will often be necessary to monitor and follow up such applications to the Court.
- 9.24. Given the lack of experience in insolvency and restructuring in China generally, foreign IPs have a role to play in working with Chinese counterparts to bring knowledge and perspective to the table. Through developing relationships with key players in Government it is possible to influence proceedings by measured exertion of pressure and collaboration leading to greater transparency and a more level playing field.

10. Conclusion

- 10.1. Whilst the introduction of the EBL was largely applauded there remain significant obstacles to the successful implementation and consistent application of the law across PRC. The TZN case demonstrates that Courts in different regions will interpret the law inconsistently, or in a manner which appears contrary to the statute. The success of the EBL in future will depend on the de-politicisation of the process and the ability of the Courts to act independently. However in cases where social issues are of concern to Government, such de politicisation is unlikely to occur in the foreseeable future. In the meantime it will be incumbent on insolvency practitioners to be aware of the role played by government authorities and canvas broad support for proposals, particularly in relation to Reorganisations.
- 10.2. Any successful application of the EBL, whether it be a reorganisation or a winding up will require close cooperation and liaison with the local governments and agencies in order that they understand and support the objectives. That doesn't mean they would control or dominate the process but engaging with them and keeping them up to date is crucial, especially where there is a large representation of foreign investors or creditors. Devising a reorganisation plan that maximizes employment opportunities will also be critical in garnering support for the process.
- 10.3. There are many factors which impact China's social stability concerns which are not relevant for the purposes of this paper. What is clear from the perspective of a foreign observer is that there are numerous policies, cultural and economic factors to be addressed and that real progress is unlikely to occur in the short to medium term. As a result, Insolvency Practitioners acting for foreign creditors in PRC will need to find practical ways to deal with the limitations outlined herein.

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12. Endnotes

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