



Journal of Social and Political Sciences

Hunter, Richard J. (Jr), Shannon, John H., and Lozada, Hector R. (2019), China Embraces Capitalism and the Prospect of Bankruptcy of State-Owned and Private Companies: Can Provisions for Individual Bankruptcy Be Far Behind? In: *Journal of Social and Political Sciences*, Vol.2, No.4, 937-959.

ISSN 2615-3718

DOI: 10.31014/aior.1991.02.04.132

The online version of this article can be found at:
<https://www.asianinstituteofresearch.org/>

Published by:
The Asian Institute of Research

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China Embraces Capitalism and the Prospect of Bankruptcy of State-Owned and Private Companies: Can Provisions for Individual Bankruptcy Be Far Behind?

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Abstract

As part of its economic transformation, China has adopted several of the core elements of capitalism, and in the process, has recognized the possibility of bankruptcy for both state-owned-enterprises and private companies. Part I of this paper outlines the main characteristics of the Chinese economy, especially focusing on export and import activities. Part II of the paper outlines in detail the procedures identified as part of the Chinese bankruptcy regulatory environment in order to understand the role that bankruptcy plays in the capitalist model in assuring that decision-making will be conducted on the basis of financial data and will not be based on political considerations. At the same time, however, the paper underscores that the prospect of bankruptcy must also be viewed from the prism of internal Chinese politics and traditions relating to socialism. The Chinese government must take into account the prospect of social unrest that the possible bankruptcy of an enterprise would have on Chinese workers, perhaps further weakening the role of the Communist Party in Chinese society. Information is provided regarding bankruptcies that have taken place under the new law. Finally, the paper discusses the possibility of creating a system of bankruptcy for individuals in China which was not a part of the original legislative scheme.

Keywords: Bankruptcy, Reorganization, Liquidation, Exports, Imports, State-owned-enterprises, Belt and Road Initiative

1. Introduction

Since the 1980s, China has occupied a unique position in international finance. In pursuit of its policy of creating a "socialist market economy" or "socialism with Chinese characteristics" (Lim, 2013), China has taken significant steps modernize and enhance its economic performance. As a part of evolving a strategy to achieve economic growth, China has opened its economy to the world, engaging in substantial import and export

activities and has adopted several of the core elements of capitalism, including accepting the possibility of bankruptcy for both state-owned-enterprises and private companies.

This paper will first outline the main characteristics of the Chinese economy, especially focusing on export and import activities because many of the companies inclined to take part in a bankruptcy proceeding—either *reorganization* or *liquidation*—are involved in the export and import sectors. The paper then outlines the procedures of the Chinese bankruptcy regulatory environment in order to understand the key role that the prospect of bankruptcy plays in the capitalist model, assuring that decision-making will be conducted on the basis of sound financial data and not based on political considerations. At the same time, the paper underscores the fact that the prospect of bankruptcy must be viewed from the prism of internal Chinese politics and traditions relating to socialism, where the Chinese government must take into account the social disruption that the bankruptcy of an enterprise would have on Chinese citizens, perhaps further weakening the role of the Chinese Communist Party in Chinese society (see Kelly-Meyrick, 2017).

PART I

2. The Chinese Economy (data adapted from Amadeo, 2019)

China's economy produced \$25.3 trillion in 2018, based on purchasing power parity (e.g., Zhang & He, 2019), which takes into account the effect of exchange rates. China today is the largest economy in world, the European Union (EU) is in second position, at \$22 trillion, and the United States is now third, producing \$20.5 trillion (World Bank, 2019). In terms of its standard of living, China is still a relatively poor country occupying 73rd place in the world economy. China produces \$18,120 in per capita income. In comparison, the U.S. gross domestic product per capita is \$62,518.

Reflecting China's comparative advantage relative to labor (see Coxhead, 2007), China's standard of living permits companies to pay workers far less than American workers. Products made in China attract many overseas manufacturers to outsource jobs to China (Bartash, 2018; Osadchiy & Seshadri, 2019). These companies often ship the finished goods to the United States or to other markets around the world.

A key indicator of a country's economic performance is its unemployment rate. According to Trading Economics (2019), China's unemployment rate was 3.61% as of June 2019, down from 3.9% in January 2018. Statista.com (2019b) reports that there are 139.52 million Chinese workers employed in private enterprises; 57.4 million in state-owned units; and 3.47 million employed in collective-owned units. Chinese workers have become accustomed to full employment, slowly growing wages, and a rising standard of living.

2.1 Components of China's Economy

China built its economic growth, which until 2013, surpassed 10% on an annual basis, on low-cost exports of machinery and equipment. The Chinese government invested heavily in state-owned-enterprises (SOEs) (generally, Jia, Huang, & Zhang, 2019) to fuel its export economy. Many of these state-owned-enterprises proved less profitable than private firms, returning only 4.9% on assets compared to 13.2% for private companies. Harrison, Meyer, Wang, Zhao, and Zhao (2019) note that "Moreover, both SOEs and privatized SOEs significantly underperform in profitability compared to private firms." SOEs still dominate their sectors, including the "big three" energy companies: PetroChina, Sinopec, and China National Offshore Oil Corporation.

In addition, because of limited available housing (Chen, Yang, & Wang, 2014), plans called for developing cities around factories in order to attract workers. Yeung and Howes (2006, p. 343) noted:

“Along with economic achievement, housing problems in major cities in China have remained largely unsolved. Under the traditional planned economy since 1949, all housing production

was the responsibility of the State. Due to the lack of finance, new housing production has not been able to keep up with the increasing urban population. Urban housing reform introduced in 1988 proposed a strategy of developing affordable housing for the ordinary households through the private housing market. However the implementation of such a strategy has encountered a number of obstacles including the lack of a second hand housing market, an undeveloped real estate profession, unclear land and property legislation and an absence of proper property management support.”

Man (2011, p. 20) commented:

“The rapidly rising housing prices and lack of affordable housing for low- and middle income urban households in China, particularly in big cities, have posed risks and challenges for a stable and harmonious society as sought by the Chinese central government. The current issues and challenges in the affordable housing system warrant attention and support from the Chinese government and the entire country to search for cost-effective and equitable public policies to deal with affordable housing needs to ensure sustainable development and a harmonious society in the future. The government needs to redouble efforts....”

Apparently, the crisis has not been completely alleviated (McCormack, 2018). As a result, *one-fourth* of China's economy is involved in real estate and real estate-related activities (see Li, Ji, Guo, & Chen, 2018). The government has also funded construction of railways, highways, roadways, and other infrastructure to support planned growth, amounting to approximately 9% of China's GDP (Wang, 2016). In order to meet these objectives, China imported massive amounts of building-related commodities, like aluminum and copper. Commodity.com (2019) reported that imports for mineral fuels, including oil, were \$116.2 billion; iron ore, \$57.1 billion; and copper and copper ore, \$53.2 billion.

2.2 The “One Belt, One Road Initiative”: The Centerpiece of the Chinese Economy and Influence

2013 also saw China's launch its "One Belt, One Road Initiative" with two developing countries, Kazakhstan and Indonesia (Johnston, 2018)—the largest global infrastructure project in history. According to Zhou (2018, p. 163), Chinese international expansion can be characterized into three aspects:

- “First, in terms of trade, China started exports (see Wang, Qiu, & Choi, 2018) mainly since its adoption of the open-door policy in the late 1970s (Bertinelli, 2018), and became the largest trading nation in 2012”;
- “Second, is construction; China has become a major player in the global construction community”;
- “Third, is investment; China has become the second largest nation of outbound direct investment in 2016” (see also Caesar, HaiBo, Udimal, & Osei-Agyemang, 2018). [In fact, China recorded \$139 billion of foreign direct investment (FDI) in 2018. Since 1982, China has attracted approximately \$3,362,941,779 in foreign investment (World Bank, 2019). According to the 2019 UNCTAD World Investment Report (2019), China was ranked as the world's second largest FDI recipient after the United States and before Hong Kong. According to Nordea Trade.com (2019), China's economy “was ranked the second most attractive to multinational companies for 2017-2019, only behind the U.S.].

China has committed itself to spending \$150 billion annually to link 68 countries along the old *Silk Road* with Europe. Horn, Reinhart, and Trebesch (2019) report, there were “a total of 1,974 Chinese loans and 2,947 Chinese grants to 152 countries from 1949 to 2017.” China will construct ports, railways, pipelines, and even hotels (Liu & Lin, 2018). China intends to extend its influence throughout Eurasia (Cheng, Chen, Degtarev, & Zhao, 2019) and even into Latin America through “technology-intensive exports” (Narins, 2018), rivaling the American-dominated transatlantic trading area. The withdrawal of the United States from the Trans Pacific Partnership, from which China had been excluded, has facilitated China's expansion plans (Neppalli & Hunter, 2018).

The "One Belt, One Road Initiative" was designed to accomplish four core objectives:

1. *Provide investments for China's extensive foreign exchange reserves* (generally, Horn, Reinhart, & Trebesch, 2019). At present, most of China's reserves are invested in U.S. Treasury Bills (see Fang & Liu, 2018; Chavez-Dreyfuss, 2019; Mayeda, 2019). Yet, as Cox (2019) notes, China had "reduced its holdings of U.S. debt in March 2019 by about \$20.5 billion, bringing its overall ownership to \$1.12 trillion. The holdings are at their lowest level in two years and come amid escalating trade tensions. There's worry that China might use its status as the world's No. 1 U.S. debt holder as leverage in trade negotiations."
2. *Provide new markets for China's high-speed rail firms, and for cement, steel, and metal exports.*
3. *Stabilize countries on China's western border* (Huang, Nie, Zhu, & Du, 2019).
4. *Increase China's claims in the South China Sea* (SCMP Reporter, 2019; Bodeen, 2019). Dutton (2011, p. 2) outlined the basis of the disputes in these three categories resulting "in recurring flashes of tension and conflict for approximately forty years. Notable incidents over sovereignty include the Chinese attack on the forces of the Republic of Vietnam in the Paracel Islands in 1974, China's attack on Vietnamese forces near Fiery Cross Reef in 1988, and China's military ouster of Philippines forces from Mischief Reef in 1995." Dutton (2011, pp. 43-44) continued:

"A flare-up in tensions in the South China Sea began when China pressured Vietnam and several oil companies in connection with oil exploration and drilling off the Vietnamese coasts.... Disputes over sovereignty center on questions of which coastal states have the right to exercise the full measure of state authority over the physical territory of the islands in the South China Sea. They involve Vietnam, Malaysia, the Philippines, and perhaps Brunei, as well as China and Taiwan."

3. China's Exports

World Integrated Trade Solutions (WITS) (2019) reported that China's exports in *goods* amounted to \$2.263 trillion in 2017. The European Union (EU) briefly assumed the first position in 2016. It now is second, exporting \$1.9 trillion. The United States is third, exporting \$1.6 trillion. Workman (2019b) noted that in 2018, "China's most valuable exported products were phone system devices including smartphones, computers including optical readers, integrated circuits or micro-assemblies, computer parts or accessories, processed petroleum oils, automobile parts or accessories, TV receivers, monitors and projectors, lamps and lighting including illuminated signs, solar power diodes or semi-conductors then miscellaneous furniture."

Statista.com (2019a) reported that in 2018, China shipped US\$2.494 trillion worth of *goods* around the globe, representing a 6.5% gain since 2014 and a 10.2% increase from 2017 to 2018.

3.1 China's Top 10 Exports

Workman (2019b) provides the following export product groups which categorize the highest dollar value in Chinese global shipments during 2018. [Also shown is the percentage share each export category represents in terms of overall exports from China.]

1. Electrical machinery, equipment: US\$664.4 billion (26.6% of total exports)
2. Machinery including computers: \$430 billion (17.2%)
3. Furniture, bedding, lighting, signs, prefab buildings: \$96.4 billion (3.9%)
4. Plastics, plastic articles: \$80.1 billion (3.2%)
5. Vehicles: \$75.1 billion (3%)
6. Knit or crochet clothing, accessories: \$73.5 billion (2.9%)
7. Clothing, accessories (not knit or crochet): \$71.4 billion (2.9%) (Baiadi & Bianchi, 2019)
8. Optical, technical, medical apparatus: \$71.4 billion (2.9%)
9. Articles of iron or steel: \$65.6 billion (2.6%)
10. Organic chemicals: \$59.8 billion (2.4%)

Workman (2019a) notes that China's top 10 exports accounted for approximately two-thirds (67.7%) of the overall value of its exports. Organic chemicals represented the fastest-growing sector among China's top 10 export categories from 2017 to 2018, thanks to a 20.2% gain. In second place for improving export sales was the 15.6% increase for the articles made from iron or steel category.

Country-specific data shows that 62.3% of products exported from China were bought by importers from:

- United States (19.2%)
- Hong Kong (12.1%)
- Japan (5.9%)
- South Korea (4.4%)
- Vietnam (3.4%)
- Germany (3.1%)
- India (3.1%)
- Netherlands (2.9%)
- United Kingdom (2.3%)
- Singapore (2%)
- Taiwan (2%)
- Russia (1.9%).

3.2 China's Export Services by Category (Workman, 2019a)

Workman (2019) noted that "China provided US\$228.1 billion worth of export *services* to clients around the globe during 2017. That dollar amount is 4.3% of the global total for services, and represents about one-tenth (10.1%) of the \$2.263 trillion in exported products China shipped over the same timeframe." China's exported services increased in value by 10.8% since 2013 and appreciated 8.9% from 2016 to 2017.

The following are services exported by China in 2017. Eleven of these categories are considered *commercial services* and are worth 99.3% of all exported services from China. Government goods and services account for the remainder. [Also shown is the percentage share each export category represents in terms of overall exports of services from China.]

1. Miscellaneous business services: US\$61.5 billion (27% of China's total)
2. Travel: \$38.8 billion (17%)
3. Transport: \$37.1 billion (16.3%)
4. Telecom/computer/information services: \$27.8 billion (12.2%)
5. Construction: \$23.9 billion (10.5%)
6. Manufacturing services on other's inputs: \$18.1 billion (7.9%)
7. Maintenance/repair services: \$5.9 billion (2.6%)
8. Intellectual property use: \$4.8 billion (2.1%)
9. Insurance/pension services: \$4 billion (1.8%)
10. Financial services: \$3.7 billion (1.6%)
11. Government goods, services: \$1.7 billion (0.7%)
12. Personal, cultural, recreational services: \$759.3 million (0.3%)

In 2018, China furnished an estimated \$266.8 billion worth of international services, encompassing about \$42.3 billion from transport-related and \$39.5 billion for travel-related services.

3.3 China's Imports

On the import side, China is the world's second largest importer. WITS (2019) reported that in 2017, it imported \$1.843 trillion. By way of comparison, the United States, the world's largest, imported \$2.3 trillion. China mainly imports raw commodities from Latin America and Africa. These include oil and other fuels, metal ores, plastics, and organic chemicals. China is the world's largest importer of aluminum and copper. In 2018, China imported US\$2.135 trillion worth of goods from around the globe in 2018, reflecting a 9% increase since 2014 and a 15.8% increase from 2017 to 2018.

Workman (2019b) writes that "55.9% of China's total imports in 2018 were purchased from Asian countries. European trade partners accounted for 17.7% of imported goods bought by China. Smaller percentage of overall Chinese imports came from suppliers in North America (9.3%), Latin America (6.7%) (excluding Mexico but including the Caribbean region), Australia and other Oceanian sources (5.7%) and Africa (4.6%)."

The following product groups represent China's imports during 2018 by both dollar value and percentage share in terms of overall imports into China (Workman, 2019b):

1. Electrical machinery, equipment: US\$521.5 billion (24.4% of total imports)
2. Mineral fuels including oil: \$347.8 billion (16.3%)
3. Machinery including computers: \$202.3 billion (9.5%)
4. Ores, slag, ash: \$135.9 billion (6.4%)
5. Optical, technical, medical apparatus: \$102.5 billion (4.8%)
6. Vehicles: \$81.5 billion (3.8%)
7. Plastics, plastic articles: \$74.9 billion (3.5%)
8. Organic chemicals: \$67.4 billion (3.2%)
9. Gems, precious metals: \$62 billion (2.9%)
10. Copper: \$47.6 billion (2.2%)

Workman (2019b) notes that China's top 10 imports account for over three-quarters (77%) of the overall value of its product purchases from other countries. Imported mineral fuels, including oil, had the fastest-growing increase in value among the top 10 import categories, up 39.3% from 2017 to 2018. In second place was the organic chemicals category, showing a 20.7% increase, trailed by Chinese imports of machinery, including computers, which showed a 19.3% gain, and a 15.4% boost in copper imports. The sole decline shown among China's top import categories was gems and precious metals, with a 5.1% year-over-year decline. That decline was mostly caused by smaller imports of gold on international markets (Workman, 2019b).

PART II – BANKRUPTCY IN CHINA

4. The Chinese Economy and Bankruptcy

The twin facets of rapid industrial expansion, with its heavy emphasis on export related activities, and China's success in exporting services as indicated in Part I of this study, coupled with heavy borrowing, have not changed the economic reality that China's economy is slowing (Wei, 2019). As China's economy has continued to recede (Birmingham & Wang, 2019) and debt has piled up, the Chinese government made a decision to continue to pursue, perhaps now more seriously, one of the more controversial aspects of the capitalist systems: the real prospect of further enterprise bankruptcy.

Bendapudi (2008, pp. 206-207) provides a fitting context to the discussion of the evolution of bankruptcy in China:

“Generous subsidies from the state, coupled with lack of competition from the private sector, meant that Chinese SOEs could never go bankrupt. As a result, China's business law framework was virtually non-existent until the late 1970s. Bankruptcy as a concept and the laws to govern the system were also non-existent in communist China. The 1986 Chinese

Enterprise Bankruptcy Law In the late 1970s under the leadership of late Premier Deng Xiaoping, China began to abandon the Soviet/Communist economic model and started to introduce market reforms. In response, the National People's Congress introduced the first Chinese Enterprise Bankruptcy Law in 1986. However, the 1986 bankruptcy law did not adequately address the complexities of insolvency in the transitioning Chinese economy, and it was also weakened by major discrepancies in enforcement."

The possibility of bankruptcy for many companies has confused many creditors and has required the Chinese judicial system to embrace one of the basic tenets of capitalism that had not been a part of the Chinese system before the onset of "socialism with Chinese characteristics," as China makes its transition from a system of state central planning to a market-based economy (see Hunter & Ryan, 1998, pp. 86-87). In this sense, notes Booth (2004, p. 94), "an effective bankruptcy law is an integral part of the institutional framework necessary for this transition." Wei (2019), however, notes that this possibility has left creditors concerned, "debtors fighting to save their businesses and judges on a mission to promote the benefits of bankruptcy."

The numbers relating to China's debt appear staggering. Wei & Ng (2010) report in the *Wall Street Journal* that at present, there are more than \$17 trillion in outstanding bank loans in China. Chinese regulators have insisted that banks should recognize any loans more than *90 days past due as nonperforming*. Official data has found nonperforming loan ratios at 1.81%, ominously reflecting a total unpaid principal balance of about \$319 billion. However, many analysts report that "the low ratio is widely thought to severely understate the level of bad debt on banks' balance sheets." On a macro level, as of October 2018, the national debt of China stood at approximately \$5.2 trillion, equivalent to about 46.6% of Chinese GDP. In addition, Standard and Poor's Global Ratings (2019) indicated that Chinese local governments had amassed an additional \$5.8 trillion in "off balance sheet debt."

Parry and Long (2019) noted that "The slow transformation of China, which is indeed ongoing, inevitably impacted upon efforts to introduce a modern bankruptcy law" which was accomplished in 1986. They continue: "Over time, pressures to enact a new bankruptcy law grew, including external pressures. Upon joining the WTO in December 2001 China was expected to transition to a more market-based economy."

The situation is complicated because of the dominance of state-owned-industries and companies heavily subsidized by the Chinese "mono banking" system. Turner, Tan, & Sadeghian (2012, p. 53) point out that the five largest banks in China are, in order of decreasing size, Industrial and Commercial Bank of China (ICBC), China Construction Bank (CCB), Bank of China (BOC), Agricultural Bank of China (ABC) and the Bank of Communications (BCOM). "Together these banks account for around one half of Chinese banking system assets and deposits. These banks are majority-owned by the Chinese state, but have private sector shareholders through their listings on the Hong Kong stock exchange."

In this circumstance, it had been commonplace for the government simply to continue to offer financial support to "favored industries or enterprises" in order to keep the economy functioning at the targeted range of an 8-10 percent increase in GDP. Decisions were often taken in favor of one group or another as a result of their political connections with the Chinese Communist Party, which "assisted distressed firms in gaining increments to debt financing and contributed to a higher likelihood of recovery" (He, XU, & McIver, 2019, p. 2770)—but at an economic cost. Parry and Long (2019) commented that:

"At the time when the law was going through the reform process the state was rightly concerned about the potential impact of an unrestrained application of a new bankruptcy law to liquidate large numbers of uneconomic state-owned enterprises. This was a society of vastly differing levels of economic advancement in different regions and which lacked a developed social security infrastructure, with SOEs providing equivalent lifelong benefits to employees. If SOEs were simply liquidated there would be no social safety net. Significant numbers of market-driven bankruptcies could therefore have been disastrous in terms of social costs and there were fears of unrest."

5. An Introduction to the Law of the People's Republic of China on Enterprise Bankruptcy

The *Enterprise Bankruptcy Law of the People's Republic of China* (PRC) was first enacted in 1986 (see Zheng, 1986; Chang, 1987; Harmer, 1996). Tomasic (2009, p. 211) writes that “The 1986 law had limited application and there was widespread recognition in China of the need for a more broadly based insolvency statute which served to facilitate both the reorganization and the winding up of companies and other business entities.” On June 1, 2007, the new *Enterprise Bankruptcy Law of the PRC*, which had been enacted in August of 2006, came into force (see Jiang, 2014).

To a large extent, China modeled its efforts to U.S. bankruptcy provisions found in U.S. Chapter 11 bankruptcy provisions (Jiang, 2013/2014) relating to reorganization, which are designed to allow Chinese companies to *restructure their debts* under court protection in order to keep businesses in operation, pay creditors over time, and to assuage the fears of Chinese workers who otherwise might lose their jobs when a debtor company collapsed. In effect, China transformed its bankruptcy from “inactive” to “active” status (Jiang, 2013/2014). Parry and Long (2019, p.) noted: “Reorganization, along the lines of the US Chapter 11 approach, can potentially preserve value by enabling jobs to be saved, while also bringing potential benefits of ongoing business relationships and higher returns to creditors through the negotiation and approval of a plan of reorganization.”

However, there are major differences. China's system does not completely track the US system in that Chinese bankruptcy courts are inclined to protect the interests of shareholders over debtholders (Wei, 2019)—perhaps with the clear aim of averting social unrest and any potential challenge to the closed political system dominated by the Chinese Communist Party. Cheung (2019) of the law firm of Baker McKenzie also notes that “A significant feature of the legislation relates to the protection of workers' right. The regime ranks employees ahead of other unsecured creditors but behind secured creditors, who retain their priority over secured creditors.” One other feature of Chinese bankruptcy law is that *it did not contain any provisions for personal bankruptcy protection*.

The 2006/2007 law contains 136 articles. Parry and Long (2019) provide an overview of the Chinese law:

“The new law adopted a greatly reformed system of governance, reflecting a reduced role for the state. In insolvency systems, governance structures tend to involve a blend of controls by insolvency practitioners; the courts; the debtor, under supervision; and creditors. The Chinese law fits in with this pattern but it is notable that its blend is changing in accordance with the transition to a market-based system. State direction was ostensibly stripped away and a new role of administrator was created to oversee cases upon being appointed by the court. The use of a liquidation group remained possible in some instances, however, in particular to resolve labour related issues and to handle the bankruptcies of SOEs. Indeed the use of liquidation groups has tended to be common in reorganization cases, with only 12% of reorganization cases being managed by a wholly private administrator.”

The following is a summary of the provisions of the 2006/2007 law:

- Chapter 1 General Provisions
- Chapter 2 Application and Acceptance
 - Section 1 Application
 - Section 2 Acceptance
- Chapter 3 Administrator
- Chapter 4 Debtor's Property
- Chapter 5 Expenses for Bankruptcy Proceedings and Debts of Common Benefits
- Chapter 6 Declaration of Credits
- Chapter 7 Creditors' Meeting
 - Section 1 General Provisions

	Section 2 Creditors' Committee
Chapter 8 Reorganization	
	Section 1 Application for and Period of Reorganization
	Section 2 Preparation and Approval of Reorganization Plan
	Section 3 Execution of Reorganization Plan
Chapter 9 Composition	
Chapter 10 Bankruptcy Liquidation	
	Section 1 Declaration of Bankruptcy
	Section 2 Appraisal and Distribution
	Section 3 Termination of Bankruptcy Proceedings
Chapter 11 Legal Liability	
Chapter 12 Supplementary Provisions	

[An outline of bankruptcy law in the United States is provided in Appendix I for comparison purposes.]

Sun (2019) describes the current bankruptcy law:

“China completely amended its bankruptcy law in 2007, which introduced the option of reorganization, as opposed to only liquidation. The new law was adopted with the support of foreign bankruptcy specialists and generally modeled after Western legal principles. Since its promulgation in 2007, bankruptcy cases steadily increased. SOE bankruptcy filings have focused on heavy industries, such as steel and coal production, as opposed to high-tech firms or firms in pillar industry sectors.”

“In addition to the development of the law, by the end of 2017, 97 courts throughout China had established liquidation and bankruptcy divisions to facilitate the trial and settlement of bankruptcy cases. In early 2015, only five courts in China had such tribunals.”

“The current available data released by the SPC in 2018 indicates an increase in bankruptcy court filings of 68.4% compared with the previous year.” [See Appendix II.]

5.1. A Detailed Summary of the 2006/2007 Enterprise Bankruptcy Law

The following is a summary of the *Enterprise Bankruptcy Law*, adapted from and found on the website of *Baker McKenzie* (Cheung, 2019; see also generally Hoppe, 2009; Bufford, 2017):

PURPOSES: “This Law is formulated for purposes of regulating the procedures for enterprise bankruptcy, fairly resolving the settlement of debts and credits, safeguarding the legitimate rights and interests of creditors and debtors, and maintaining the market order of the socialist economy.” [Article 1]

FOUNDATIONS FOR BANKRUPTCY: As a threshold, a Chinese enterprise will qualify for bankruptcy, restructuring, or settlement (liquidation) (Yu & He, 2018) if the enterprise “is not able to meet its financial obligations to repay its debts and its assets are less than its liabilities or it is obviously incapable of paying off its debts.” [Article 2]

APPLICATION TO COURT: Bankruptcy proceedings are commenced in the People’s Court where the enterprise is domiciled by filing an *application*. [Article 3] Bankruptcy proceedings can be initiated by either the debtor or its creditors. However, if the debtor is a financial institution, the application shall be filed by the relevant Chinese regulatory or supervisory authorities.

The following matters shall be stipulated in the Application for Bankruptcy:

- (1) Basic introduction to the applicant and respondent;
- (2) Purpose of application;
- (3) Facts and grounds of the application; and
- (4) Any other matter that the people's court deems necessary to be stipulated. [Article 8]

APPOINTMENT OF AN ADMINISTRATOR: Upon acceptance of the bankruptcy application, the court will appoint a bankruptcy administrator [Article 13] who may be a member of recognized legal, accounting, or specialist bankruptcy firm, or an individual who possesses relevant professional expertise and qualifications. [Article 24] The mode of selecting an administrator and his remuneration is determined by the Supreme People's Court. [Article 22; Article 28]

“The administrator reports to the People's Court and is supervised by the creditors' meeting and the creditors' committee. The creditors' meeting has the ability to replace the administrator or to seek his removal should he fail in performing his duties in a lawful and impartial manner, or if the creditors' meeting deems there are circumstances that prevent him from performing his duties competently” (Cheung, 2019).

“The administrator's powers and duties include: taking control of the debtor's property, company seals, accounting records, documents and other such materials; investigating and reporting on the debtor's financial status; making decisions in relation to the debtor's internal management and daily expenditures; deciding whether to continue or suspend the debtor's business operations prior to the first creditors' meeting; managing and disposing of the debtor's property; representing the debtor in litigation, arbitration or other proceedings; proposing the holding of creditors' meetings; and performing other functions that may be required by the court” [Article 24] (Cheung, 2019; see also Yang, 2008, pp. 545-546).

An administrator who fails to act with *due diligence* and *reasonable care* in faithfully performing his or duties [Article 27] is subject to a fine or the imposition of personal liability if the administrator is found to have caused a loss to a creditor, the debtor or a third party in breach of that fiduciary duty (see also Patel, 2009, pp. 118-119).

Parry and Long (2019) underscore the vital role the administrator plays in Chinese bankruptcy (see also Yu & He, 2018).

“The role of administrator was a new one requiring the development of new skills and competencies for law and accountancy firms and it offered the prospect of management of insolvency proceedings in an independent manner in the interests of creditors and free from state control. Other new governance institutions were the creditors' meeting and creditors' committee. The institutions that might be expected under a market-based bankruptcy framework are therefore present but progress is to be made in the development of these institutions in place of state influence.”

BANKRUPTCY CLAIMS: Creditors are required to file their claims within a time period stipulated by the People's Court. Such period commences from the date of publication by the People's Court of the announcement of its acceptance of the bankruptcy petition and runs for a minimum of *30 days and a maximum of three months*.

Eligible claims include: debts that exist at the time of the court's acceptance of the application for bankruptcy; certain un-matured debts; conditional debts or debts subject to time limits; claims pending litigation or arbitration; debts owed to joint creditors; indemnity obligations owed to a guarantor of the debtor or to another joint debtor who has discharged a debt on the behalf of the debtor; and damages under a contract terminated by the administrator or the debtor under the provisions of the Bankruptcy Law.

CREDITORS' MEETINGS: The meeting of creditors is a critical part of the bankruptcy proceedings. An individual creditor may participate in the bankruptcy process through creditors' meetings and by participating in a creditors' committee. A creditor who has submitted a claim is entitled to attend and vote at the creditors' meeting. However, a *secured creditor* with priority rights over specific property cannot vote on the adoption of a settlement plan or distribution plan of the debtor's assets unless they have waived their right to their priority position. A creditor whose claim has not been determined to be valid may not exercise voting rights, except that the People's Court can provisionally determine the amount of his or her claim for the purpose of allowing him or her to vote. Generally, a *resolution* of the creditors' meeting is passed by a simple majority of the creditors with

voting rights present at the meeting and a majority representing 50% or more of the value of the debtor's unsecured debt (see also Arsenault, 2008. [Article 59]

“The creditors’ meeting may: verify creditors’ claims; apply with the court to replace or remove the administrator; supervise the administrator; select members of the creditors’ committee; determine whether to continue or suspend the debtor’s business operations; approve restructuring plans and settlement agreements; approve plans to manage, realize and distribute the debtor’s property; or perform other functions that the court requires” (Cheung, 2019). [Article 68]

CREDITORS’ COMMITTEE: [Article 67] The creditors’ meeting may establish a creditors’ committee that comprises creditor representatives elected at the creditors’ meeting. “The composition of the creditors’ committee, which totals not more than nine people and must include a representative of the debtor’s *employees* or a representative of its *trade union*, is subject to the approval of the People’s Court in writing” (Cheung, 2019). The creditors’ committee is responsible for “supervising the management, disposal and distribution of the debtor’s property, proposing the convening of creditors’ meetings and such other duties as may be delegated by the creditors’ meeting” (Cheung, 2019). The inclusion of employees and trade union representatives may be seen as a concession to the traditional roles played by workers in Chinese society.

CREDITORS’ RIGHT TO SET-OFF OF CLAIMS: A creditor who incurred debts to the debtor *prior* to the court’s acceptance of the bankruptcy application may request the administrator to “set off” their debts against their claims. “However, set-off is not permitted if the creditor incurred the debt with knowledge of the debtor’s inability to repay its debts unless the debt was incurred more than one year prior to the application for bankruptcy or is due by operation of law” (Cheung, 2019). The burden is on the creditor to prove any lack of knowledge of the debtor’s inability to repay its debts.

COUNTERPARTIES (THIRD PARTIES) TO CONTRACTS: Any contracts entered into *before* the acceptance of the bankruptcy application, but which have not yet been fully performed, can be *terminated or continued* (essentially ratified) by the administrator. [Article 18] The administrator is required to notify the counterparty of his or her decision within two months of the acceptance of the bankruptcy application or 30 days after receiving a reminder from the counterparty. *Failure to do so deems the contract to be terminated*. If the administrator decides to continue, ratify, or honor a contract, the counterparty is entitled to request the administrator to provide a *guarantee*. A failure to provide the guarantee by the administrator also deems the contract to be terminated or rescinded.

PRIORITY AND RANKING OF DEBTS: The Bankruptcy Law sets out a hierarchy or priority position of debts to determine priority of payment, which must be made in the following order:

- Bankruptcy expenses (see LawyersChina.net, 2018); [Article 41]
- Common interest debts (i.e. certain debts incurred after the court accepts the bankruptcy petition);
- Employee claims, including unpaid salaries, medical and disability subsidies, basic old-age and medical insurance premiums, and compensation in accordance with PRC law (Weiguo, 2006);
- Social insurance premiums and outstanding tax; and
- Common (*unsecured*) claims in bankruptcy.

If the property subject to bankruptcy is insufficient to satisfy the discharge requirements of a certain categories or ranks of debts, the distribution to such category or rank shall be paid on a *pro rata* basis. Secured creditors generally have priority to the extent of the value of their secured interests, while any shortfall is to be treated as an unsecured claim.

RESTRUCTURING AND SETTLEMENT: Perhaps the most important feature of the bankruptcy system is the ability of a company to *restructure or rehabilitate* a viable business. Although the court may have accepted a bankruptcy application, the Bankruptcy Law allows a debtor or its creditors the opportunity—prior to an

enterprise being declared bankrupt—to *apply with the court for restructuring or reorganization of its business*. The law describes this as a “Plan of Rectification.” [Article 79] The legislation also allows a debtor to apply for a “compromise or settlement” of its debts with its creditors.

RESTRUCTURING PROCEDURE: The debtor or bankruptcy administrator must submit a draft restructuring plan to the court and the creditors’ meeting *within six months* (with an extension of three months if approved by the court) of the court’s approval of restructuring. “During the restructuring period, *the debtor can apply for court approval to continue to manage its properties and business under the administrator’s supervision*” (Cheung, 2019).

A draft of rectification plan shall include the following contents:

- (1) A business plan of a debtor;
- (2) Classification of the creditor’s rights;
- (3) An adjustment plan of the creditor’s rights;
- (4) A repayment plan of the creditor’s rights;
- (5) Term for implementing the rectification plan;
- (6) Term for supervising the performance of the rectification plan; and
- (7) Any other plan conducive to the debtor’s rectification [Article 81] (see also Zu, 2008)

CREDITOR GROUPS: Similar to priority and ranking of debts, creditors are classified into the following voting groups:

- Creditors with *secured claims* over specific properties of the debtor;
- *Certain employees* with claims on salaries, medical and disability subsidies, basic old-age and medical insurance premiums, and compensation payable into the individual accounts of employees in accordance with PRC law;
- Claims for outstanding *taxes*; and
- *Common* (unsecured) claims.

Upon receipt of the draft restructuring plan, the court will convene a creditors’ meeting within 30 days in order to vote on the draft plan. [Article 84] “The draft plan must be approved by a majority of the number of creditors in each voting group, and the amount of claims they represent must account for at least two-thirds of the total amount of claims in that group. If the draft restructuring plan is not approved by all of the voting groups, the debtor or the administrator can still apply with the court for approval if certain conditions are satisfied. If the restructuring plan is not approved, the court terminates the restructuring and declares the debtor bankrupt” (Cheung, 2019). The debtor is responsible for the implementation of the restructuring plan. An appropriate supervision period is imposed by the court, during which time the administrator is required to supervise the implementation process. If the debtor is unable or fails to implement the restructuring plan, the court will terminate the restructuring plan and will declare the debtor bankrupt upon petition from the administrator or a “materially interested party.”

The survival of a debtor is not guaranteed. During the restructuring period, the court has additional powers to terminate the restructuring plan and declare the debtor bankrupt if:

- The debtor’s business operation or financial status continues to deteriorate and cannot be salvaged;
- The debtor has acted fraudulently, diminishes its assets in bad faith, or has acted in a way adverse to the interests of creditors; or
- The administrator is unable to perform his or her duties and functions as a result of actions undertaken by the debtor.

“Secured creditors’ rights over pledged assets are suspended during the restructuring period. If there is a risk of damage to the secured asset or of significant diminution in its value such that the secured creditors’ rights are

prejudiced, the secured creditor may apply with the People's Court to enforce its rights. *Once the restructuring plan is approved by the court, it is binding on the debtor and all of the creditors*" (Cheung, 2019).

SETTLEMENT PROCEDURES: A *settlement* of claims allows the debtor to compromise (settle) its debts directly with its creditors after the bankruptcy proceedings have commenced. The settlement process requires an application by the debtor to the court accompanied by a draft settlement agreement. Cheung (201) writes:

"If the court approves the settlement application, it will make an announcement and convene a creditors' meeting. Secured creditors may exercise their security rights from the date the court approves the settlement. Once the settlement plan is approved by the creditors' meeting and the court, the administrator is obliged to transfer the business and assets to the debtor. For the plan to become effective, it must be approved by more than half of the creditors with voting rights present at the meeting. The claims represented by such creditors must account for at least two-thirds of the total amount of unsecured claims. If the settlement plan is rejected at the creditors' meeting or by the court, the court will declare the debtor bankrupt. A settlement agreement that has been approved is binding upon the debtor and the creditors covered by the settlement, i.e. the creditors who held an unsecured claim against the debtor at the time the court accepted the bankruptcy petition. If the debtor is unable or fails to implement the settlement agreement, the court, upon the request of a creditor covered by the settlement, terminates the implementation of the settlement agreement and declares the debtor bankrupt."

ASSET RECOVERY MORATORIUM (AUTOMATIC STAY): A *moratorium* or a *stay* is imposed on actions brought against the debtor's assets upon acceptance of the bankruptcy application by the court (see Bufford, 2017, pp. 23-24). "Upon acceptance of the bankruptcy application, all preservation measures against the debtor's property are lifted and all enforcement actions suspended." Any civil actions or arbitration procedures that had been commenced against the debtor, but which were not yet completed, are "stayed" (Cheung, 2019). Any repayment of debts to an individual creditor during this period is deemed invalid and would be considered as an impermissible preference.

COLLECTION AND REALIZATION OF ASSETS: The chief duty of the administrator is to gather ("marshal") together all of the assets of a debtor in a process termed *asset realization*. "The debtor is obliged to deliver up its property to the administrator after the court accepts the bankruptcy application" (Cheung, 2019). The administrator has a duty to gather all of the property of the debtor and to prepare a list of such property and to create a distribution plan that will be submitted at the creditors' meeting for approval. "Unless resolved otherwise at the creditors' meeting, the administrator is obliged to dispose of the debtor's property in the bankruptcy by way of auction" (Cheung, 2019). Other property that cannot be auctioned or whose transfer may be restricted by regulations imposed by the state will be disposed of under the terms of any state regulations.

VOIDABLE TRANSACTIONS: The administrator has the power to investigate and then "claw back" any questionable or improper transactions. The administrator is able to petition the People's Court to revoke transactions entered into within *one year preceding the court's acceptance of the bankruptcy application*. The following are examples of possible "claw back" actions that may be undertaken by the administrator:

- Transfers of property for no consideration;
- Transactions carried out at clearly unreasonable prices;
- Provision of security for unsecured debts;
- Premature settlement of debts not yet due; and
- Renouncement of creditors' claims. [Article 31]

Likewise, the administrator can recover any debts that have been *repaid* to an individual creditor within *six months* prior to the acceptance of the bankruptcy petition as an impermissible preference, except where the debtor can demonstrate that it benefitted from such a repayment.

RECOVERY FROM DIRECTORS AND OFFICERS: [Article 125] The administrator is able to recover any "irregular income" or assets misappropriated from the debtor by its directors, supervisors, or senior management.

A director or an officer may also face civil liability if a breach of their fiduciary duty of “honesty and due diligence” has occurred which resulted in the debtor’s bankruptcy. If after bankruptcy proceedings are completed, a director or officer is found to be liable, they will be disqualified from being an officer of any enterprise for three years.

OUT-OF-COURT PROCEDURES FOR DEBT SETTLEMENT OR COMPROMISE: [Article 95] It is still possible for entities to adopt “informal measures” for resolving debt issues outside of formal bankruptcy proceedings under the jurisdiction of the courts. “Informal work-outs or similar options may be an alternative to those parties seeking greater control of the restructuring process and not wishing to be restricted by the requirements under the legislation” (Cheung, 2019). One other possibility might be a “debt-to-equity” swap as a strategy employed by Chinese bank creditors for “corporate rescues” (Wei & Chen, 2018).

The 2007 legislation makes it possible to engage in “cross-border insolvency proceedings” commenced in the PRC pursuant to the bankruptcy law which “cover not only the debtor’s assets in the PRC but also extend to its overseas assets” (Cheung, 2019; see also Guo, 2019a; Wang, 2018). The legislation also recognizes the validity of foreign bankruptcy proceedings involving assets in the PRC so as to allow execution of any legitimate foreign judgment in the PRC provided “there are *reciprocal treaties* between the PRC and the foreign country; the foreign bankruptcy proceedings do not contravene the laws, sovereignty, security, social and public interests of the PRC; and if the legal interests of creditors in the PRC are not prejudiced” (Cheung, 2019).

6. Some Notable Chinese Bankruptcies: Is the System Working?

Sun (2019) provides ten examples of notable bankruptcies that have occurred in China and the commentaries provided by the Supreme People’s Court (SPC). We cite them as broad examples of bankruptcy actions relating to both private companies and state-owned-enterprises:

- **“Bankruptcy Liquidation Filed by Zhejiang Nanfang Petrochemical Industry Co., Ltd., et al. (Private Firm)**
“The SPC (Supreme People’s Court) comments that this case is a good example of how the bankruptcy court, in a liquidation proceeding, can help the debtor enterprise maintain its productivity, save employees’ jobs, achieve regional industrial integration and upgrade with supportive industrial policies from the local government.”
- **Transfer of Enforcement Action for Bankruptcy Review filed by Songhui Industry (Shenzhen) Co., Ltd. (Private Firm)**
“The SPC comments that this case is typical as it provides guidance on handling competing employee claims against the employer in civil enforcement actions. In particular, the court had a hard time balancing the employees’ interests in the enforcement actions filed by the 459 unpaid employees; thus, transferring the enforcement actions for bankruptcy review was an efficient way to ensure the employees were fairly paid and to further avoid employee protest.”
- **Bankruptcy Reorganization Filed by Chongqing Iron and Steel Co., Ltd. (SOE)**
“The SPC comments that this case has significant value in that it is the first restructuring case in the country related to a dual-listed SOE (both A Stock-listed and H Stock-listed) in the steel and iron industry. The local court used the bankruptcy reorganization mechanism to spin off bad assets of the company and introduced industrial structure adjustment funds through the capital market channel.”
- **Bankruptcy Reorganization Filed by Jiangsu Textile Industry (Group) Import and Export Co., Ltd., et al. (SOE)**
“The SPC comments that this case shows the local court’s exploration of joint review of bankruptcy reorganization cases filed by six affiliated SOEs. Specifically, the local court consolidated six bankruptcy reorganization proceedings into one, given that the debtors share similar assets and debts as well as resources, to ensure a successful reorganization. This case highlights the bankruptcy court’s function in providing social value and offering helpful assistance to the ongoing SOE reform.”

- **Bankruptcy Reorganization Filed by Yunnan Coal Chemical Industry Group Co., Ltd., et al. (SOE)**
“The SPC comments that in the context of cutting excessive industrial capacity and making structural adjustments, this is a typical case where the local court, through the bankruptcy reorganization proceeding, shut down 18 unprofitable coal mines within the debtor’s group, reduced excessive coal capacity in the amount of 3.57 million tons per year and settled employment claims with 14,552 laid-off workers.”
- **Bankruptcy Reorganization Filed by Beijing Technology Zhongxing Science and Technology Co., Ltd. (SOE)**
“The SPC comments that this is the first bankruptcy reorganization case filed by a non-listed public company on the National Equities Exchange and Quotations. The local court, through the bankruptcy reorganization proceeding, helped the debtor introduce investments and financings. The local court creatively took the pre-reorganization method through holding hearings to discuss reorganization plans among creditors and investors.”
- **Bankruptcy Reorganization Filed by Zhuangji Group Co., Ltd. (Private Firm)**
“The SPC comments that this case shows how the local court can exercise its mandatory right of approval on a draft reorganization plan when the creditor’s group cannot reach a consensus. Even though the court proceeding ended after the local court issued its order of approval, the local court took further steps to help the debtor restore its credit to enjoy tax benefits. After the successful bankruptcy reorganization, the debtor became the top tax payer in the local city.”
- **Bankruptcy Reorganization Filed by Fujian Anxi Tieganyin Group Co., Ltd. and Affiliates (SOE)**
“The SPC comments that this is a typical case showing how the bankruptcy reorganization proceeding promoted a traditional agricultural enterprise to upgrade its production. In particular, the Chinese traditional tea brand “Anxi Tieganyin” survived and the investors brought in an internet-based business model.”
- **Bankruptcy Reorganization Filed by Zhongshun Automobile Holding Co., Ltd. (Private Firm)**
“The SPC comments that the significance of this case is that it shows how the local court can make sound business judgments in carefully selecting competent investors suiting the debtor’s business model in the automobile industry. The local court worked efficiently to assist relevant government agencies in issuing licenses for the debtor and helped achieve the goal of revitalizing an old industrial base in northeast China.”
- **Bankruptcy Reorganization Filed by Guilin Guangwei Wenhua Tourism Culture Industry Co., Ltd. (Private Firm)**
“The SPC comments that this is the first bankruptcy reorganization case accepted by the higher people’s court. Given the significance of the debtor running the world’s largest natural theater, “Impression Sanjie Liu,” the Guangxi Higher People’s Court allowed the debtor to independently run the theater without interference by the court proceedings and was able to help the debtor turn losses into profits and boost the local tourism industry.”

7. Issues Relating to Personal Bankruptcy

“On 9 October 2019, a court in Wenzhou, Zhejiang province, delivered the first judgment regarding personal bankruptcy in China. In this case, a debtor with over 2 million RMB (approximately 250,000 euros) in debts reached a settlement with four creditors. This resulted in a first-time repayment of around 32,000 RMB (approximately 4,000 euros) within 18 months, and, within six years upon the completion of the first repayment plan, the debtor will have to pay 50% of his household income exceeding 120,000 RMB (approximately 15,000 euros)” (Guo, 2019b).

The significance of this case cannot be overstated. Shujun (2019) notes that “The case is the pilot exploration of a personal banking system and it will play a demonstration role in the establishment of China’s natural person

bankruptcy

system.”

However, there was one problem: There is no personal bankruptcy law in China (Gehlen-Dabbs, 2019). The 2006 Enterprise Bankruptcy Law, discussed above, only applied to enterprises, including legal persons and unincorporated organizations, but excluded natural persons. As noted by Guo (2019, p. 1) “Such legislation would rather go against the long-held Chinese tradition that a debt must be repaid; particularly, the debt of a father must be repaid by his son.”

Zhang (2019) provides a proper context to the discussion, writing: “In fact, personal bankruptcy should be the footstone of group bankruptcy (e.g. enterprise liability) which can be used as an effective tool in state regulation, especially when the country is in the process of reform and recovery.” Yang (2019) supports the creation of a personal bankruptcy system and writes: “Establishing a personal bankruptcy system, where an individual may be declared bankrupt, can encourage entrepreneurial innovation, and help people who took debt in good faith to start over again.”

Wei and Menglu (2019) cite the following potential benefits in support of creation of a personal bankruptcy system which would:

- Result in a simplification of social claim-debt relationships, which are conducive to maintaining a good economic order;
- Be conducive to the efficient use of judicial resources and stability of social order;
- Be more conducive to realizing the principles of fairness and equality, and the recovery of debt claims;
- Give the debtor a chance at a new beginning, and manifests the values of humanism; and
- Keep with the trends of internationalization and uniformity in legislation.

What was the legal basis for extending bankruptcy to individuals? In June 2019, the Chinese Supreme Court issued *The Guidelines for People’s Courts on Enforcement Work (2019-2023)* confirming the move to establish a personal bankruptcy system. In July 2019, the National Development and Reform Committee under the State Council, together with 13 other government departments, jointly issued *The Reform Plan for Accelerating the Improvement of Market Entity Exit System*, which related to the establishment of a personal bankruptcy system. Wenzhou became the first Chinese city to deal with the possibility of personal bankruptcy. The Intermediate Court in Wenzhou published *The Implementing Opinions on the Centralized Clean-up of Personal Debt* which only have legal effect within the municipality of Wenzhou, but may be an indication of creating rules for resolving other cases involving individual debtors in the future.

According to the *Implementing Opinions*, personal bankruptcy proceedings can only be initiated when the debtor cannot fulfill a monetary obligation imposed by a valid judgment, and he or she does not have enough assets to repay the debt in full, or where a debtor “clearly lacks the ability for repayment.”

One of the following circumstances must also occur: (i) an enterprise has entered into insolvency proceedings or has been declared bankrupt, and the debtor is associated with a *joint guarantee responsibility*; (ii) the debtor is responsible for the debt of a company because of *piercing the corporate veil*; (iii) the debtor is responsible for the debt of unincorporated organizations; (iv) the debtor cannot repay the debt because of “life difficulties”; or (v) the debtor has voluntarily proposed a repayment plan and obtained the consent of all the creditors.

According to the Wenzhou Intermediate People’s Court and the Pinyang County People’s Court, an administrator will be appointed to administer any personal bankruptcy case, or the debtor and creditors can jointly agree on a representative creditor selected by the creditors’ meeting to act as an administrator. The administrator will be required to inform all the creditors in writing within 20 days from the moment the court accepts a petition to open proceedings and make public announcements. The announcement period should be within the range of 30 days to 3 months.

The court can refuse to approve a repayment plan offered by or on behalf of an individual when one of the following conditions occurs: (i) the plan violates statutory rules, prohibition rules or “public order” and cannot be amended; (ii) the plan is reached through unjust methods; (iii) there is no possibility to implement the plan; (iv) the debtor privately satisfies the interest of one or more creditors and severely infringes the interest of other creditors; (v) other circumstances decided by the court.

Since one of the core purposes of establishing a personal bankruptcy regime includes the restoration of a debtor’s credit position, a debtor will be barred from engaging in the following activities before his or her credit is restored:

- i. conducting high consumption activities and spending unnecessary expenses other than for life and work, except for economy class flights or second class for the high speed train;
- ii. taking on positions as a legal representative or being a shareholder in profitable companies;
- iii. taking on positions as a legal representative or director or supervisor of state-owned enterprises;
- iv. other circumstances decided by the court.

Interestingly, in return for permitting the debtor to avail him or herself of personal bankruptcy protection, the debtor will be required to meet all the following conditions: (i) there are no other cases involving monetary payment outside Wenzhou, unless a creditor outside Wenzhou agrees to participate in the proceedings voluntarily; (ii) the debtor and his or her spouse will be required to both declare their assets fully and faithfully; (iii) the spouse should agree to accept investigation by a court, including an investigation on his or her bank account; other family members should also agree to an asset investigation if necessary; (iv) the debtor must agree not to conduct “high consumption activities” nor to spend unnecessary expenses other than for life and work. In addition, “going abroad” for work reasons should be approved by the court, in advance.

In the case of the “*Wenzhou debtor*”, the court appointed an accountant as the custodian of his property in order to avoid any concealment of assets; the court issued a “behavior restraining order,” which restrained his “high end consumption” and prohibited the debtor from holding a management post at any enterprise; and the court set a 6-year bankruptcy transitional period” during which a significant portion of the debtor’s household income is to be used for the benefit of creditor. The court also ruled that his “personal credit” could be “recovered” three years after the plan is fulfilled (Shujun, 2019).

8. Conclusions and Observations

In February of 2019, Nagumo (2019), reporting on information provided by trade insurer Euler Hermes, which suggested that insolvencies would rise 20% in 2019, “far exceeding the global rate of 6%.” This increase would follow the 60% jump in bankruptcies in China in 2018. Data indicated that “some 30% of China’s roughly 3,600 listed companies suffered a fall in net earnings during 2018. About 400 are expected to book a net loss.” Coupled with the high levels of personal debt in China (Mandra, 2019), these data underscore the importance of a functioning and “perceived as fair” bankruptcy system in attempting to modernize and regularize the Chinese economy.

The authors of this study concur with Parry and Long (2019) that “There is no doubt the PRC Enterprise Bankruptcy Law 2006 remains a remarkable achievement but the enactment of formal rules with features of a market-based system was never going to be sufficient in itself to bring about a transformation to a market-based system in practice.” Wei & Ng (2019) note that “The country now has more than 90 U.S.-style specialized bankruptcy courts to help sort through a morass of corporate debt that, until recently, would have been swallowed by state banks and other creditors.” Li & Ponticelli (2019, p. 1) add: “Specialized courts are run by more experienced and better trained judges that are less likely to be under the influence of local politicians.”

Kam, Citron, and Muradoglu (2008, P. 567), however, cautioned that “government ownership has an adverse impact on the distress-resolution process as it distorts resource allocation, management incentives and investment decisions in a liberalized and competitive environment”—a position that must be considered in light of the number of state-owned-enterprises in China (see Garnaut, Song, & Yao, 2006) which still number over 150,000—50,000 of which are owned by the central government and the rest by local governments (Export.gov, 2019). Fortune (2015) pointed out that the number of Chinese companies on the *Fortune Global 500* list, 98 were located in China—the top 12 companies were all state-owned, including “massive banks and oil companies that the central government controls through the State-Owned assets Supervision and Administration Commission of the ruling State Council, which appoints CEO’s and makes decisions on large investments.” Of the 98 Chinese companies on the list, only 22 were private. [See Appendix III for a listing of the top 12 Chinese companies that appeared on the Forbes Global 500 list.]

Tomasic (2009, p. 211) added that “... the key to an effective insolvency administration will be the creation of an effective legal and administrative infrastructure which will ensure that insolvency administrations are undertaken economically, expeditiously, and fairly.”

Much depends on the path China will take in decades to come.

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APPENDIX I

United States Code: Title 11 - Bankruptcy:

- Chapter 1—General Provisions (§§ 101–112)
- Chapter 3—Case Administration (§§ 301–366)
- Chapter 5—Creditors, the Debtor, and the Estate (§§ 501–562)
- Chapter 7—Liquidation (§§ 701–784)
- Chapter 9—Adjustment of Debts of a Municipality (§§ 901–946)
- Chapter 11—Reorganization (§§ 1101–1174)
- Chapter 12—Adjustment of Debts of a Family Farmer or Fisherman With Regular Annual Income (§§ 1201–1231)
- Chapter 13—Adjustment of Debts of an Individual With Regular Income (§§ 1301–1330)
- Chapter 15—Ancillary and Other Cross-Border Cases (§§ 1501–1532)

APPENDIX II

According to the Supreme Court of China, in March 2018, the number of bankruptcy filings accepted was 1,521 in 2012; 1,919 in 2013; 2,031 in 2014; 3,568 in 2015; 5,665 in 2016; and 9,542 in 2017, with an average growth rate of 47%. The number of cases closed also experienced an increasing trend: 1,521 in 2012; 1,919 in 2013; 2,031 in 2014; 3,568 in 2015; 5,665 in 2016; and 6,257 in 2017, at an average growth rate of 28% (Sun, J., 2019).

APPENDIX III

Leading Chinese Companies – All of which rank in the world’s largest companies by revenue and all of which are state-owned

1. Sinopec Group – oil refining (Global 500 Ranking # 2)
2. China National Petroleum – oil producing (Global 500 Ranking # 4)
3. State Grid – utility (Global 500 Ranking # 7)
4. Industrial & Commercial Bank of China - banking [The world’s largest bank] (Global 500 Ranking # 18)
5. China Construction Bank – banking (Global 500 Ranking # 29)
6. Agricultural Bank of China – banking (Global 500 Ranking # 36)
7. China State Construction Engineering – construction and real estate conglomerate (Global 500 Ranking # 37)
8. Bank of China – banking (Global 500 Ranking # 45)
9. China Mobile Communications – wireless phone provider [Largest wireless provider in the world] (Global 500 Ranking # 55)
10. SAIC Motor – auto manufacturing (Global 500 Ranking # 60)
11. China Railway Engineering – railway infrastructure projects (Global 500 Ranking # 71)
12. Chinese National Offshore Oil – oil production (Global 500 Ranking # 72)