

**BANKRUPTCY LAW  
IN A  
COMPARATIVE PERSPECTIVE**

**Austria – Mainland China**

**Part I**

By Mag. iur. Klaus Peichl

# CURRICULUM VITAE

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**Berufsziel** Internationale Tätigkeit im asiatischen Kulturkreis

## PREFACE - 序言

About three years ago I have started studying the law at the Johannes Kepler University Linz in Austria. My enormous interest and enthusiasm for international trade and experience with different cultures have brought me to London (OMV Trading Services Ltd.) and Singapore (legal research) so far and gave me the motivation to connect my interest in the People's Republic of China with my legal tasks. Furthermore, it was my ambitious intention to write a legal work which will be of worth for Austrian companies doing business in Mainland China as well as for Chinese business units investing in Austria. International trusts, especially banks and investment firms, have to deal with enterprises on the brink of insolvency in their daily business transactions and regularly encounter the danger of losing due claims, in consequence high amounts of money. Comprehensive and detailed knowledge of bankruptcy law and restructuring can help to reduce this risk.

As specialized literature dealing comprehensively with the Chinese bankruptcy law is hardly obtainable in Austria and even the Austrian bankruptcy law has not yet been officially translated into the English language, I intended to fill this market-gap with this comparative work about the bankruptcy law and restructuring process in Austria and Mainland China (with a focus on the Special Economic Zone of Shenzhen).

Finally, I would like to thank Dkfm., Univ.-Prof. Dr. Hans Dolinar for his useful advice and assistance in this comparative study. Furthermore, I thank the Austrian Trade Organizations in Beijing, Shanghai and Hongkong for their useful and materials.

My special thanks go to Associate Professor Say Goo at Faculty of Law, University of Hong Kong for the legal materials he had given me on this topic which only then put me into the position to write this legal comparison.

Linz, 23. April 2002

Klaus Peichl

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## LIST OF ABBREVIATIONS - 缩写列表

ABGB	Allgemeines Bürgerliches Gesetzbuch (Civil Code of Austria; 1811)
AnfO	Anfechtungsordnung (Code for Annulment of Legal Acts; 1914)
AO	Ausgleichsordnung (Restructuring Act; 1914)
BL	Bankruptcy Law
B-VG	The Austrian Federal Constitution (1920/1929)
CL	Company Law of the People's Republic of China (1994)
CPL	Civil Procedure Law of the People's Republic of China (1991)
CSOP	Capital Structure Optimization Program
EBL	Law of the People's Republic of China on Enterprise Bankruptcy (1986)
EO	Exekutionsordnung (Act on Executive Proceedings; 1896)
FIE	Foreign Invested Enterprises
GITIC	Guangdong International Trust & Investment Corporation
IESG	Insolvenz-Engelsticherungsgesetz (Bankruptcy Employee Protection Act; 1977)
KEG	Kommanditerwerbsgesellschaft
KG	Kommanditgesellschaft (Limited Partnership)
KO	Konkursordnung (Bankruptcy Act; 1914)
No.	Notice
Nr.	Number
OEG	Offene Erwerbsgesellschaft
OHG	Offene Handelsgesellschaft (General Partnership)
PBOC	People's Bank of China
PRC	People's Republic of China

RGBI	Reichsgesetzblatt
RMB	Renminbi
SOE	State-owned enterprise
SR	Rules of Shenzhen Special Economic Zone on Enterprise Bankruptcy (1993)
URG	Unternehmensreorganisationsgesetz (Law of Business Reorganization; 1997)
WTO	World Trade Organization

\* \* \* \* \*

## HISTORY OF BANKRUPTCY LEGISLATION

### 破产法的历史

#### People's Republic of China

##### 1. Bankruptcy Proceedings in the Late Qing Dynasty

Despite the long historical tradition of the Chinese legal system and its impact on much of East Asia, the concept of "bankruptcy" was not formally recognized in Chinese law until 1906. The first bankruptcy law of China was passed on the 25.04.1906<sup>1</sup> during the Qing Dynasty. It regulated the bankruptcy proceedings of businessmen and private persons in nine chapters and only 69 articles. The Qing government followed the civil law system, especially the law of China's neighbour, Japan, by the enactment of this law.<sup>2</sup> In 1908 it was annulled by Emperor Guang Xu due to difficulties in its implementation. The main reason for the short life-time of this first bankruptcy law was that governmental tax claims and those of other creditors had an equal position. The law was not even applied once during its validity which leads Hieker<sup>3</sup> to doubts about the government's intention to apply bankruptcy law. Furthermore, the implementation was hard due to several irregularities in the legal text. Article 2 demanded the presentation of accounts and Article 45 the registration of private family property, although law did not prescribe it. Before the enactment of this first bankruptcy legislation in China the gap was filled by legal and ethical tradition such as "The son pays for the debts of his father."<sup>4</sup> In the ancient China, all property theoretically was part of the emperor's assets. Therefore, it was hardly imaginable that an individual person could go bankrupt with her private property. 2000 years ago the term "po de chan" or "po chan"<sup>5</sup> was used in the context of criminal offences and bankruptcies. The legal codes of the Tang- and Song Dynasty and the fourth book of Finance laws of Qing Dynasty punished "po de chan" with corporal punishment.

The Chinese mentality always preferred out-of-court-settlements<sup>6</sup> between the creditors and the insolvent debtor. The creditors usually confiscated independently the debtor's assets, made a statement

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<sup>1</sup>Hieker, Konkursgesetzgebung in der Volksrepublik China 19.

<sup>2</sup>Zhenmin Wang, Civil Law, [http://www.enstar.co.uk/china/law/vm\\_articles/items/item6.htm](http://www.enstar.co.uk/china/law/vm_articles/items/item6.htm), Date: 04.12.2001.

<sup>3</sup>Hieker, Konkursgesetzgebung in der Volksrepublik China 20.

<sup>4</sup>Li Shuguang, BL in PRC, <http://www.fas.harvard.edu/~asiactr/haq/200101/0101a006.htm>, Date: 15.11.2001.

<sup>5</sup>Bankruptcy, [http://www.isinolaw.com/jsp/bankruptcy/BKRUPT\\_sys.jsp?LangID=0](http://www.isinolaw.com/jsp/bankruptcy/BKRUPT_sys.jsp?LangID=0), Date: 15.11.2001.

<sup>6</sup>Hieker, Konkursgesetzgebung in der Volksrepublik China 18.

of his assets, sold the assets and settled their claims. In case the debtor refused to pay due debts, two "legal" instruments helped to break his will: corporal punishment and imprisonment. Nowadays the legal term "daobi" is only used for simple bankruptcies, whereas "pochan" mainly refers to qualified (fraudulent) bankruptcies. At the same time "pochan" acts as the general term for both - simple and qualified - bankruptcies.

## 2. The Developments of the Bankruptcy Law until 1949

After emperor Guang Xu had annulled the bankruptcy regulations of the Qing Dynasty in 1908, the Supreme People's Court pronounced that (a) Express Provisions of Law, or in the absence thereof, (b) Customs, or in the absence thereof, (c) Legal Principles should be used.<sup>1</sup> In the following years the Supreme People's Court declared that parties can use methods for dealing with bankruptcies that may be recognized as consistent with general principles of bankruptcy law and later that the principles of the bankruptcy law of 1906 should be applied. In 1915, during the era of the Republic of China, the so called Northern Warlords Government drafted a new bankruptcy law. The Nationalist Government published and implemented a bankruptcy law in 1935. It is still valid in force - apart from some amendments<sup>2</sup> - in Taiwan today.<sup>3</sup>

## 3. The Founding of the People's Republic of China and its Impact

After the foundation of the People's Republic of China on the 1st of October 1949<sup>4</sup>, the new government abolished all the laws the Nationalist Government had enacted. As a consequence, China did not have a bankruptcy law under the command economy for more than 30 years, as production was determined on need and not on any financial basis. Several "jieda, pifa, fahan" and "tongzhi"<sup>5</sup> - a kind of statements - regulated the discharge of debts and bankruptcy proceedings for unexpropriated private enterprises.

Mao Zedong said once:

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<sup>1</sup>Hieker, Konkursgesetzgebung in der Volksrepublik China 20.

<sup>2</sup>Russin & Vecchi, Taipei, [http://www.adb.org/Documents/reports/restructuring\\_asia/Taipei.pdf](http://www.adb.org/Documents/reports/restructuring_asia/Taipei.pdf), Date: 15.12.2001.

<sup>3</sup>Li Shuguang, BL in PRC, <http://www.fas.harvard.edu/~asiactr/haq/200101/0101a006.htm>, Date: 15.11.2001.

<sup>4</sup>Ferrier Hodgson & Marfan, PRC-insolvency, [http://www.fh.com.hk/topic3\\_pdf.pdf](http://www.fh.com.hk/topic3_pdf.pdf), Date: 25.11.2001.

<sup>5</sup>Hieker, Konkursgesetzgebung in der Volksrepublik China 21.

*"We believe that revolution can change everything, and that before long there will arise a new China with a big population and a great wealth of products, where life will be abundant and culture will flourish. All pessimistic views are utterly groundless."<sup>1</sup>*

In order to achieve these objectives, he fundamentally restructured the Republic of China in accordance with his ideology. It did not take the new government a very long time to dispose of private enterprises and establish only State-owned and collectively owned enterprises in the People's Republic of China. Their profits were turned over to the State and all losses were assumed by the State. Enterprises with chronic and serious deficits either were "closed, suspended, consolidated or [had their] production changed<sup>2</sup>" by administrative orders, or went automatically bankrupt without running through any legal proceedings. The government was busy to keep the facts of bankruptcies secret, in order to uphold social stability and to prevent social turmoil.

From about 1950 onwards the Chinese government practiced a uniform policy of centralized assumption of profits and losses of State-owned enterprises under the planned economic system. The system was characterized by centralized financial revenue and expenditures, planned coordination of supply and demand in commercial distribution, and government-controlled labor supply and placement. Bankruptcy was regarded as a capitalistic economic element which could not exist and tolerated in a socialist society. The socialist ideology did not provide any place for bankruptcy because State-owned enterprises could not go bankrupt. More important, China was proud of the fact that there were no bankruptcy cases<sup>3</sup> during the first three decades after the People's Republic was founded and thought that that was one of the crucial reasons for the superiority of socialism over capitalism. Chinese ideology<sup>4</sup> acknowledged bankruptcy in capitalistic economic systems. In these systems private property was common and as a matter of fact could be declared bankrupt. But this could never happen to State-owned enterprises which were part of the State's assets.

#### 4. The 1980s in an Economic and Legal Perspective

##### a) Reform measures

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<sup>1</sup>Mao Tse-tung, History, [http://www.maoism.org/msw/vol4/mswv4\\_70.htm](http://www.maoism.org/msw/vol4/mswv4_70.htm), 20.12.2001.

<sup>2</sup>Li Shuguang, BL in PRC, <http://www.fas.harvard.edu/~asiactr/haq/200101/0101a006.htm>, Date: 15.11.2001.

<sup>3</sup>Bankruptcy, [http://www.isinolaw.com/jsp/bankruptcy/BKRUPPT\\_sys.jsp?LangID=0](http://www.isinolaw.com/jsp/bankruptcy/BKRUPPT_sys.jsp?LangID=0), Date: 15.11.2001.

<sup>4</sup>Hieker, Konkursgesetzgebung in der Volksrepublik China 31.

The People's Republic of China did not enact a new bankruptcy law before the reform and opening to the outside world in 1978<sup>1</sup>. The necessity of great reforms was recognized by Deng Xiaoping. "If we do not start reform, " Deng said, " then our goal to modernize socialism will be buried."<sup>2</sup> That's why in December 1978 the Communist Party of China decided to reform the enterprise sector fundamentally. State-owned enterprises should be offered the opportunity to act more flexible, autonomous, competitive and profit-oriented in a State-driven country. Hence, various significant reforms<sup>3</sup> such as the following were implemented by the Communist Party over the next few years:

- The agricultural sector was opened to private enterprises
- The Chinese economic was opened to foreigners
- Interest-free economic assistance of the State was changed into interest-bearing bank-loans
- The introduction of the socialist planned commodity economy
- The iron-rise-bowl-principle<sup>4</sup> was broken

Despite these countless economic measures in the enterprise-sector, many of the reforms did not lead to the desired results. The success remained modest. On the one hand, the State-owned enterprises were not completely independent from administrative authorities, on the other local authorities put too much pressure on bank institutions to offer cheap loans to highly-indebted Chinese businesses. This widespread practice of revitalization led to a reduction of the "national deficit" but simultaneously generated bad bank loans.

## b) Necessity of Bankruptcy Legislation

In the early 1980s Chinese economists, legal experts and governmental officials began to realize the drawbacks of the way the planned economic system dealt with insolvent enterprises and advocated the promulgation of a business bankruptcy law.<sup>5</sup> The enormous losses of the State-owned enterprises could not be neglected any longer and forced the Chinese government to act instead of passively accepting the losses scratching on the fragile Chinese financial system.

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<sup>1</sup>Qi Duo-jun, Mainland China, <http://www.ieem.org.mo/projects/ecli/Reports/bkruptcy.html>, Date: 19.09.2001.

<sup>2</sup>Lawrence, Made in China, 39.

<sup>3</sup>Hieker, Konkursgesetzgebung in der Volksrepublik China 23-24.

<sup>4</sup>Explanatory Note: The iron-rise-bowl principle - lifetime employment - is discussed in details on page 52.

<sup>5</sup>Li Shuguang, BL in PRC, <http://www.fas.harvard.edu/~asiactr/haq/200101/0101a006.htm>, Date: 15.11.2001.

Cao Siyuan<sup>1</sup> is one of China's leading scientists who soon realized the hopelessness of the economic situation. He was the first to promote the legal institution of bankruptcy and urged thorough reform-measures. He stated in details:

*"Only when an enterprise has to be responsible for its own survival, is there a need and can it be possible to make appropriate use of the autonomy of business management. If an enterprise has to shoulder the economic consequence of the loss, where can it find money for bonuses? If there is a threat of bankruptcy, who dares to issue and receive such a "bonus" to break the rice bowl? ... The essential remedy is to allow enterprises to bear responsibility for all the consequences of their business operations."*<sup>2</sup>

A committee of the State's Council was charged with the preparation of a draft for a bankruptcy law. According to the legal department of the Standing Committee of the National People's Congress the main goals of this new law were to rise the competitiveness of State-owned enterprises, to improve the enterprises' autonomy through higher responsibility, to separate strictly ownership from management and to gain confidence of foreign investors. The objectives of the new law were generally clear and easy to identify but the process of putting this draft into reality was accompanied by fierce debates between experts and scholars in the beginning and finally by ideological controversies in the Standing Committee of the National People's Congress.<sup>3</sup> The bankruptcy-opponents were hard to convince. They were afraid of the complete removal of the administrative control over State-owned enterprises. Hence they preferred and advocated other reform-measures. One of the arguments<sup>4</sup> of the bankruptcy-supporters was that competition and bankruptcy were phenomena of a commodity-economy. Furthermore, they argued that not all capitalistic elements should be eo ipso regarded as bad.

### c) The Bankruptcy Law of 1986

The bankruptcy-supporters succeeded in convincing the Standing Committee of the economic and legal necessity for the introduction of a comprehensive bankruptcy law. In 1984 the formal legislation process of the new bankruptcy law started with the presentation of a proposal which was worked out by a group of 30 members of the 6th National Peoples' Congress and then handed over to a committee of the State Council under the charge of Cao Siyuan. Hieker states that before the enactment of the new law it was considered to be necessary to gain some practical experience of essential bankruptcy. Hence,

<sup>1</sup>CIPE, Bankruptcy Law, [http://www.cipe.org/ert/e32/e32\\_01.php3](http://www.cipe.org/ert/e32/e32_01.php3), Date: 17.12.2001.

<sup>2</sup>Hieker, Konkursgesetzgebung in der Volksrepublik China 28.

<sup>3</sup>Li Shuguang, BL in PRC, <http://www.fas.harvard.edu/~asiactr/haq/200101/0101a006.htm>, Date: 15.11.2001.

<sup>4</sup>Hieker, Konkursgesetzgebung in der Volksrepublik China 32.

provisional measures were passed in Shenyang in the Province of Liaoning on the 9th of February of 1985<sup>1</sup>. These rules only applied to municipal collectively owned industrial enterprises. Other towns in which bankruptcy was strictly tested were: Wuhan, Taiyuan, Chongqing and the Special Economic Zone of Shenzhen.

The 2nd of December 1986 marks the beginning of the establishment of a business bankruptcy system in Mainland China.<sup>2</sup> At this time the Standing Committee of the National's People's Congress adopted the Law of the People's Republic of China on Enterprise Bankruptcy (for trial implementation). Nevertheless almost two more years should pass until the new law came into effect in 1988 and it was not implemented until 1992. The moderate reformers intended to avoid a premature implementation of the law.<sup>3</sup> Besides, the number of changes required to be made to this legislation resulted in major defects in its practical implementation.<sup>4</sup>

The above-mentioned law is the sole comprehensive bankruptcy law in Mainland China and, it only applies to enterprises owned by the whole people. (Article 2 EBL 1986) The legislation simply reflects the economy at this time (1986) which entirely comprised of State-owned enterprises.

It was the idea of the Chinese legislator that the business bankruptcy law should be implemented on a trial basis three full months after the "Law on Industrial Enterprises with Ownership by the Whole People" came into effect. Article 43 of EBL 1986 also provided that the State Council should make specific plans taking steps for trial implementation. These rules were never passed.

Hieker also points out in her book "Konkursgesetzgebung in der Volksrepublik China"<sup>5</sup> that the legislator's intention might not have been to apply the EBL of 1986 in each bankruptcy case of a State-owned business because "for trial implementation" was added in brackets to the enterprise bankruptcy title. The more urgent objective seemed to be the deterrence of State-owned enterprises by exemplary application of the law to raise their efficiency. The government chose certain State-owned enterprises, started the bankruptcy proceedings and accepted the bankruptcy of some selected companies. The manager in charge were called to account for the bad management of State-owned property and punished in case of criminal behaviour. In a simple bankruptcy case, State-owned enterprises were reorganized. Hieker and colleagues come to the conclusion: "Enterprises are selected to go bankrupt, and it seems that whether they in fact do so is still a matter of political choice." The prevention of

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<sup>1</sup>Hieker, *Konkursgesetzgebung in der Volksrepublik China* 36.

<sup>2</sup>Qi Duo-jun, Mainland China, <http://www.ieem.org.mo/projects/ecli/Reports/bkruptcy.html>, Date: 19.09.2001.

<sup>3</sup>Hieker, *Konkursgesetzgebung in der Volksrepublik China* 49.

<sup>4</sup>Ferrier Hodgson & Marfan, PRC-insolvency, [http://www.fh.com.hk/topic3\\_pdf.pdf](http://www.fh.com.hk/topic3_pdf.pdf), Date: 15.11.2001.

<sup>5</sup>Hieker, *Konkursgesetzgebung in der Volksrepublik China* 49-50.

unemployment and social stability were still considered to be far more important. Bankruptcies should be avoided if possible.

The fact, that the law had been rarely applied, changed in 1994 by the starting of the Capital Structure Optimization Program (CSOP)<sup>1</sup> for industrial SOEs in a few pilot cities. This program addressed social constraints by earmarking land use rights of the bankrupt debtor to pay for the "rehabilitation" of its workers, and ensuring that the firm's main social facilities are taken over by the municipality. The firms granted to participate in this program have been selected quite administratively and the process, although involving courts, has largely been handled by local government representatives. As the number of bankruptcies increased steadily and even involved larger State-owned enterprises, new problems began to arise.

#### d) Regional Bankruptcy Regulations

In order to attract more foreign enterprises to invest in China, bankruptcy regulations were passed in some towns but only on a local level. In the Province of Guangdong "Regulations of Foreign-Related Cooperations of the Special Economic Zone in Guangdong Province"<sup>2</sup> were passed on the 28th of September 1986 and enacted on the 1st of January of 1987<sup>3</sup> in Shenzhen, Zhuhai and Shantou. Only a few months later Shenzhen passed its own "Bankruptcy Regulations of Shenzhen Special Economic Zone on Companies with Foreign Investment". These rules should provide a minimum of legal security for foreign investors and caused hardly any troubles. In general, foreigners were used to bankruptcy and did not have any ideological reservations.

### 5. The Economic and Legal Situation in the 1990s

#### a) Reform of the Economy

Due to political and economic reasons, reforms had to be stopped on the whole in the years of 1989 and 1990. The Tiananmen-incidents led to a temporary standstill of bankruptcy experimentations. In the early 90s the government restarted to change economic restructuring with important measures.

The term "Planned Socialist Commodity Economy" was removed and replaced by "Socialist Market Economy" on the 3rd Plenum of the 14th Central Committee of China's Communist Party in 1992.<sup>4</sup>

<sup>1</sup>World Bank Office, Beijing, Insolvency, <http://www.worldbank.org.cn/English/Content/485a6232469.shtml>, 20.12.2001.

<sup>2</sup>Hieker, Konkursgesetzgebung in der Volksrepublik China 42.

<sup>3</sup>Bankruptcy Regulations of Shenzhen Special Economic Zone on Companies with foreign investment 1987.

<sup>4</sup>Hieker, Konkursgesetzgebung in der Volksrepublik China 52.

Additionally, some more reorganization measures for State-owned enterprises were introduced. For example: the transformation of State-owned enterprises into limited liability companies, the founding of corporations and joint-ventures between State-owned enterprises and non-State-owned enterprises. However, the complete ownership of State-owned enterprises remained the same. So privatization on a large scale was avoided.

The task to maintain big State-owned enterprises was part of the Central Government's responsibility whereas the local governments were in charge of smaller State-owned enterprises. Those were permitted to be leased, sold by auction or simply sold. The restructuring measures were brought down in the "Company Law of the People's Republic of China"<sup>1</sup> (1994).

#### b) Mergers

The legal instrument of bankruptcy was not the only possibility to liquidate highly indebted business units. Mergers were preferred<sup>2</sup> by Prime Minister Li Peng because of the unavoidable side-effects of bankruptcies, closure and layoff of workers which could lead to social unrest. Jiang Zeming also stressed in 1996 that more emphasis should be put on merger rather than the bankruptcy of State-owned enterprises.<sup>3</sup> So did Zhu Rongji who emphasized that the central government encourages mergers as bankruptcy usually incurs more losses for the State. Nevertheless solvent enterprises normally refused to overtake insolvent enterprises. For this reason, the government supported such mergers with special credits, low bank interests or debt-release.

#### c) Legal Reforms

The restricted scope of application of the EBL of 1986 and the non-existence of a bankruptcy law for non-State-owned enterprises forced the government to pass other regulations to establish a properly-working bankruptcy system.

The Civil Procedure Law of the People's Republic of China, revised and promulgated in 1991, provides procedures in respect of the bankruptcy of non-State-owned enterprises with the status of a legal person.<sup>4</sup> The positive and the detailed negative scope of application is mentioned in a particular chapter below.

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<sup>1</sup>Company Law of the People's Republic of China 1994.

<sup>2</sup>Hieker, Konkursgesetzgebung in der Volksrepublik China 57.

<sup>3</sup>CFA Update, Drafting, <http://www.china.finance.org/update/volume1/v1n29.html>, Date: 11.12.2001.

<sup>4</sup>Bankruptcy, [http://www.isinolaw.com/jsp/bankruptcy/BKRUPPT\\_sys.jsp?LangID=0](http://www.isinolaw.com/jsp/bankruptcy/BKRUPPT_sys.jsp?LangID=0), Date: 15.11.2001.

In a very early stadium of the implementation of the EBL of 1986 it turned out that the short and unprecise rules were insufficient. Hence, the Supreme People's Court issued its "Opinion on Several Issues in the Implementation of the Law of the People's Republic of Bankruptcy" on the 7th of November<sup>1</sup> in order to correctly implement the above-said law.<sup>2</sup> Essential matters of jurisdiction, bankruptcy petition, creditor's conferences and many more were explained to avoid legal uncertainty.

There are also scattered and simple provisions concerning bankruptcy in some legislation, such as Article 17 in the Regulations on Rural Enterprises with Collective Ownership adopted 1991, Article 71 of the Law on Commercial Bank and in the Company Law. The last-mentioned was adopted on the fifth session of the Standing Committee of the eighth National People's Congress<sup>3</sup> on the 29th of December 1993<sup>4</sup>. Chapter Eight deals with bankruptcy, dissolution and liquidation of companies. There are only two articles referring to bankrupt businesses. (Articles: 189 and 196)

In the early 1990s new regional bankruptcy regulations were passed such as the "Bankruptcy of Companies" in the Province of Guangdong. It replaced the "Bankruptcy Regulations of Shenzhen Special Economic Zone on Companies with foreign investment of 1987" and was promulgated on the 14th of May 1993.<sup>5</sup> An increased number of articles thoroughly regulated in 9 Chapters and 88 articles the bankruptcies of limited liability companies, joint-stock companies and companies with foreign investment such as Sino-foreign equity and contractual joint-ventures, and wholly foreign-owned enterprises and Sino-foreign joint-stock-limited companies. These provisions clearly improved the implementation of the bankruptcy rules. Even more detailed were the "Regulations on Company Bankruptcy in the Shenzhen Special Economic Zone" which were issued by the Shenzhen Municipal People's Congress in November 1993<sup>6</sup>. Article 79 for instance introduced provisions for petty bankruptcy, thus accelerated certain bankruptcy proceedings significantly.

## 6. New Bankruptcy Legislation

The implementation of bankruptcy rules had always been difficult. State enterprises have been generally involved in the mire of debt chains which disordered national economy and made State assets

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<sup>1</sup>Li Shuguang, BL in PRC, <http://www.fas.harvard.edu/~asiactr/haq/200101/0101a006.htm>, Date: 15.11.2001.

<sup>2</sup>Opinions of the Supreme People's Court 1991, [http://www.fh.com.hk/e02%20Fa%20\(jing\)%20%5B1001%5D%20No%2035.PDF](http://www.fh.com.hk/e02%20Fa%20(jing)%20%5B1001%5D%20No%2035.PDF), Date: 12.12.2001.

<sup>3</sup>Explanatory note: The National People's Congress is China's supreme organ of state power.

<sup>4</sup>Company Law of the People's Republic of China 1994.

<sup>5</sup>Hieker, *Konkursgesetzgebung in der Volksrepublik China* 60.

<sup>6</sup>Li Shuguang, BL in PRC, <http://www.fas.harvard.edu/~asiactr/haq/200101/0101a006.htm>, Date: 15.11.2001.

move inefficiently.<sup>1</sup> Debt chains means that one enterprise owes another enterprise a debt which in turn owes a third one and so on. Despite bankruptcy regulations, the inefficiency of State-owned enterprises made clear that major reform was unavoidable. The new law is intended to meet the needs of a market economy and apply uniformly to all enterprises.<sup>2</sup> The existing laws contain countless defects (mentioned below) and led to confusion.

The bankruptcy laws were enacted during the time of the "socialist planned commodity economy". For instance the EBL of 1986 was destined to enterprises owned by the whole people and therefore does not fit anymore to the new economic system. The changing to a "socialist market economy" led to an increase of private enterprises. In the meantime the dominance of State-owned enterprises was broken by the higher number of private enterprises which logically led to an increased number of private business bankruptcies.

The old laws do not adequately address the complex economic realities of China. The high number of various legal provisions - for instance - distinguishes between a geographical scope of application and another one which refers to the kind of enterprise. Besides, the cause of bankruptcy is defined differently in the bankruptcy regulations which causes problems especially for judges but also for the people who are involved in the bankruptcy proceedings. As bankruptcy is a new legal institution for China, there are only a few specialists who really understand the legal implications.

One should not forget that the restructuring or closure of State-owned enterprises also has extensive political and social consequences. The difficulty of implementing any type of bankruptcy or restructuring in the People's Republic of China stems from its impact which this type of system has on the social and labour structure of the PRC. China's social security system was characterised by a secure job, labor insurance, and free medical care and welfare housing under the planned economy system. While this system is shifting to market economy, the old social security system is being broken, and the new one has not yet been completely established.<sup>3</sup> So each enterprise within the PRC is financially responsible not only to its current labor force but also for large numbers of retired workers.<sup>4</sup> Therefore, the Chinese government is concerned about mass-dismissals which would raise unemployment triggering social instability. Behind this economic and legal background the uncertainty whether this legislation will be implemented in the near future is quite understandable. New reform measures are inevitable to adapt to the modified political and economic relations, especially with regard to China's WTO accession. Decades of negotiation were necessary until this historical step. The negotiation period had been so long because China's socialist market economy is still emerging from decades of

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<sup>1</sup>Xingming Fang, Economic Reform, <http://www.cipe.org/wp/prc.html>, Date: 17.12.2001.

<sup>2</sup>TCFA Update, Debate, <http://www.china.finance.org/update/volume1/v2n05.html>, Date: 11.12.2001.

<sup>3</sup>Qi Duo-jun, Mainland China, <http://www.ieem.org.mo/projects/ecli/Reports/bkruptcy.html>, Date: 19.09.2001.

<sup>4</sup>Ferrier Hodgson & Marfan, PRC-insolvency, [http://www.fh.com.hk/topic3\\_pdf.pdf](http://www.fh.com.hk/topic3_pdf.pdf), Date: 25.11.2001.

centralized planning. Many domestic enterprises still suffer from under-capitalization, the remnants of State planning and controls, and the relative inexperience of management personnel as compared to their multinational counterparts. Furthermore, the primary focus of the Chinese government was and still is to maintain social stability.<sup>1</sup> Hence, all bankruptcies are still carefully selected by the central government.

Due to these countless defects resulting from changes in the global economic and legal surrounding, Li Shuguang, an associate professor at China University of Politics and Law, came to the conclusion:

*"Drawing on the experience of developed countries and incorporating global trends in bankruptcy law, the draft of the new bankruptcy legislation is intended to adapt to the new market economy in China. It contains detailed provisions that broaden the scope of application, set up simple and streamlined bankruptcy procedures, improve the court's standing in bankruptcy case hearings, better protect the creditors' interests, establish a trustee system, re-created a reorganization mechanism, and establish a special procedure for SOE [=State owned enterprises] bankruptcies.*

*After twelve years, a new stage in bankruptcy practice has arrived. It will have far-reaching impact on the deepening of China's economic reforms, in particular SOE reform, and on the establishment of an improved market economy. There is every reason to believe that the future of the enforcement of a bankruptcy law is bright, despite the challenges that lie ahead."*<sup>2</sup>

The last draft of the Chinese bankruptcy law largely resembles the bankruptcy laws of market economies. The drafting work for the new bankruptcy law of PRC started in 1994.<sup>3</sup> One reason - besides the above-mentioned - was that a modern bankruptcy law was an inevitably component of every legal system which is orienting itself on market economy. The aim of priority was to create a well-working competitive system which leads to survival of the fittest.<sup>4</sup> In the beginning of 1995 the first draft of a possible new bankruptcy law was presented, the opinions of administrative authorities and governmental departments were heard and led to a revised draft presented in July 1995. While new legislation has been drafted, it still awaits approval by the National People's Congress. The approval is long overdue because of the lack of a properly working social security system much needed in China's current climate of economic growth. However, by now, the notion and importance of

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<sup>1</sup>Linklaters & Alliance, WTO, <http://www.linklaters.com/english/publications/pdf/643.pdf>, Date: 20.12.2001.

<sup>2</sup>Li Shuguang, BL in PRC, <http://www.fas.harvard.edu/~asiactr/haq/200101/0101a006.htm>, Date: 15.11.2001.

<sup>3</sup>Wang Weiguo, Judicial Expertise in Bankruptcy Proceedings,

<http://www1.oecd.org/daf/corporate-affairs/insolvency/in-asia/fair-1/weiguo.pdf>, Date: 17.12.2001.

<sup>4</sup>Hieker, Konkursgesetzgebung in der Volksrepublik China 71.

bankruptcy are widely accepted among China's leadership and in the public. Considerable experience has already been gained and capacity built over the last few years. On this base State enterprise bankruptcies, once filed, proceed quickly in the courts. Most importantly, social and financial stability have been maintained so far. This provides a foundation on which to build an improved bankruptcy system.

An unknown judge of the Economic Division of the Supreme People's Court has a somewhat pessimistic view but expresses the PRC's intention and efforts to reformation:

*"We have only built a basic knowledge and experience of bankruptcy law and practice. We are in the stage of improving our law and practice, to bring them to a higher level. We have studied many foreign bankruptcy laws and practices, for instance the U.S. law and the Hong Kong law. We will extend the Law to non-legal persons or non-State enterprises. We have looked at the purpose of giving enterprises a "new start". We will amend the Law in many ways to bring our law into line with international practice."*<sup>1</sup>

In general, one can follow the Worldbank's view that the current bankruptcy system does need reform<sup>2</sup>. The People's Republic of China entered the World Trade Organization and moves towards market economy. Therefore, it can no longer postpone the required restructuring of the inefficient components - in particular the State-owned enterprises - of its economy.<sup>3</sup>

## **HISTORY OF BANKRUPTCY LEGISLATION**

### **Republic of Austria**

The current Austrian bankruptcy law goes back to 1914. It was enacted by an imperial order dealing with bankruptcy (KO), restructuring (AO) and rescission (AnfO).

The old bankruptcy law only provided for compulsory composition in the bankruptcy of registered businessmen, whereas the imperial order of 1914 separated the restructuring proceedings from the bankruptcy proceedings and gave debtors the way to petition judicial restructuring instead of

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<sup>1</sup>Kamarul/Tomasic, Draft Bankruptcy Law, [http://management.canberra.edu.au/china\\_economic\\_law/conferencepapers.html](http://management.canberra.edu.au/china_economic_law/conferencepapers.html), Date: 15.12.2001.

<sup>2</sup>World Bank Office, Beijing, Insolvency, <http://www.worldbank.org.cn/English/Content/485a6232469.shtml>, 20.12.2001.

<sup>3</sup>Woo, Restructuring and Stability, <http://www.sccie.ucsc.edu/papers/epapers/woomitchina.pdf>, 20.12.2001.

bankruptcy.<sup>1</sup> Furthermore, the KO of 1914 (RGBl 337) did not make any difference between businesses and private persons. The 90-year-long practice of the law proved that normally only businesses were able to enjoy the advantages of general execution - or: bankruptcy - if they were unable to pay their debts, while individuals were confined under the Act on Executive Proceedings (EO).

Due to economic crisis after the World War I, the KO had to be amended in the years of 1925 and 1934. In the World War II Article 7 of the regulation of the 1st of September 1939 determined that only the debtor was allowed to file for bankruptcy. This special provision was annulled on the 30th of November 1939 again. In 1974 the possibility to appoint judges of a district-court as trustee or receiver was cancelled.<sup>2</sup> Although there were several amendments of the KO and the AO since its enactment, the cornerstones of the bankruptcy law of 1914 are still valid today.

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<sup>1</sup>Chalupsky/Ennöckl/Holzapfel, Handbuch des österreichischen Insolvenzrechts, 1.

<sup>2</sup>Sabaditsch, Die Konkurs-, Ausgleichs- und Anfechtungsordnung - Geschichtlicher Rückblick, XXX-XXXI.

## Part II

### INTRODUCTION

### 导论

#### 1. Legal Framework<sup>1</sup>

##### People's Republic of China

There exists a great variety of Chinese bankruptcy legislation which often applies only for different forms of business units. Even special geographic regions have partly different bankruptcy rules and technical terms. Furthermore, law has sovereignty only in theory in China, but in practice, the operations of the state, government and policy are above law. Policies can be viewed as by-laws. Some of them have a long tradition and are subconsciously followed by the people. Wang Weiguo indicates that for this reason they have *de facto* priority over the Law.<sup>2</sup> Since these policies of government are effective by-laws in China, one has to look at central government policies and exceptions at the local government level. Most local governments have their own rules.<sup>3</sup> Therefore, the bankruptcy law is not administered uniformly in China.

The deficiencies of this sketchy system are well illustrated in the bankruptcy of Guangdong International Trust & Investment Corp. (GITIC) in 1999 and other cases involving large debtors or foreign creditors.<sup>4</sup> GITIC was the first State-owned company with 4\$ billion<sup>5</sup> in debts and with a significant amount of foreign debts. The foreign banks involved were irritated because their loans registered with the State Administration of Foreign Exchanges were not guaranteed by the Chinese Government and had no priority over other creditors.<sup>6</sup> Prior to GITIC, the bankruptcy law had been used for small State-owned enterprises only. Also prior to GITIC, financial institutions were simply closed by the relevant authorities, such as the People's Bank of China (PBOC) under central banking regulations promulgated by the PBOC in 1994.<sup>7</sup>

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<sup>1</sup>Explanatory note: This work deals with the legal framework of the PRC until November 2001.

<sup>2</sup>Wang Weiguo, Judicial Expertise in Bankruptcy Proceedings, <http://www1.oecd.org/daf/corporate-affairs/insolvency/in-asia/fair-1/weiguo.pdf>, Date: 17.12.2001.

<sup>3</sup>Kamarul/Tomasic, Draft Bankruptcy Law, [http://management.canberra.edu.au/china\\_economic\\_law/conferencepapers.html](http://management.canberra.edu.au/china_economic_law/conferencepapers.html), Date: 15.12.2001.

<sup>4</sup>World Bank Office, Beijing, Insolvency, <http://www.worldbank.org.cn/English/Content/485a6232469.shtml>, 20.12.2001.

<sup>5</sup>CIPE, Bankruptcy Law, [http://www.cipe.org/ert/e32/e32\\_01.php3](http://www.cipe.org/ert/e32/e32_01.php3), Date: 17.12.2001.

<sup>6</sup>Zhang/Claflin, Comments on China, <http://www.tangmeifunds.com/chinawatch299.html>, 20.12.2001

<sup>7</sup>CMS Cameron Mc Kenna, PRC, [http://www.adb.org/Documents/reports/restructuring\\_asia/China.pdf](http://www.adb.org/Documents/reports/restructuring_asia/China.pdf), Date: 15.12.2001.

The bankruptcy system has grown complex through these different laws, regulations, by-laws and a high amount of Supreme People's Court-statements. The whole formal legal setting is quite comprehensive but often does not meet the expectations of foreign investors who have hardly any knowledge of the Chinese legal system, the appropriate method and way to deal with the debtor and the courts.

In general, investors, creditors and borrowers must also remember that the courts have only limited experience in civil and commercial matters. Actions are often exposed to long delays as all documents must be translated into Chinese for presentation to the court.<sup>1</sup> In reference to bankruptcy an unknown judge of the Economic Division of the Supreme People's Court said:

*"The courts do not have enough experience. I believe our practitioners and judges are in the period of learning and experiencing. Only since 1989 have we started to have more bankruptcy cases."*<sup>2</sup>

There is also a tendency of courts to be biased in favor of local parties, and to be reluctant to enforce foreign judgements. Finally, the PRC has a relatively undeveloped body of legislation with little or no court interpretation of conflicts within each law.<sup>3</sup> The Chinese Professor Wang Weiguo mentioned in this context:

*" ... the rule of law is a long goal that has not been achieved [yet] ... "*<sup>4</sup>

Today there are several parallel bankruptcy regimes - for SOEs under a pilot program, other SOEs, non-State corporations, and some special economic zones such as Shenzhen which are described in detail in this work. First, one has to differentiate between the national legislation and the regional legislation. The latter applies to so-called Special Economic Zones in which the bulk of foreign investment is concentrated. These Special Economic Zones have their own local congresses and the ability to enact their own regulations.<sup>5</sup> However, these rules only apply within the geographical area of the special zone. Ferrier Hodgson Limited, a company in Hong Kong which has specialized in corporate, recovery and reconstruction, indicates that it is important to know the exact status of the entity, as different rules may apply due to variations in treatment of different types of entities even

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<sup>1</sup>Ferrier Hodgson & Marfan, PRC-insolvency , [http://www.fh.com.hk/topic3\\_pdf.pdf](http://www.fh.com.hk/topic3_pdf.pdf), Date: 25.11.2001.

<sup>2</sup>Kamarul/Tomasic, Draft Bankruptcy Law, [http://management.canberra.edu.au/china\\_economic\\_law/conferencepapers.html](http://management.canberra.edu.au/china_economic_law/conferencepapers.html), Date: 15.12.2001.

<sup>3</sup>Ferrier Hodgson & Marfan, PRC-insolvency , [http://www.fh.com.hk/topic3\\_pdf.pdf](http://www.fh.com.hk/topic3_pdf.pdf), Date: 25.11.2001.

<sup>4</sup>Wang Weiguo, Judicial Expertise in Bankruptcy Proceedings, <http://www1.oecd.org/daf/corporate-affairs/insolvency/in-asia/fair-1/weiguo.pdf>, Date: 17.12.2001.

<sup>5</sup>Shenzhen, Legislation, <http://www.shenzhenwindow.net/law/legislation.htm>, Date: 11.12.2001.

within the same region.<sup>1</sup> Furthermore, foreign investors should not neglect the security law which was adopted on the 30th of June 1995 by the National People's Congress of the PRC. It regulated the broad types of securities recognized in the PRC, such as guarantees, mortgages, pledges, liens and deposits. These securities' regulations can play a major role in bankruptcy proceedings as well as in special liquidation-procedures for foreign invested enterprises (FIEs) in some regions. Due to the complex and confusing legal situation in the People's Republic of China it is useful to list some important current valid Chinese laws that refer to bankruptcy, reorganization, dissolution:

### **National Legislation**

- Bankruptcy Law for State-owned Enterprises (November 1988)
- Chapter 19 Code of Civil Procedure (April 1991)
- Chapter 8 Company Law (July 1994)

### **Regional Legislation and Special Economic Zones**

#### *Shenzhen*

- Rules of Shenzhen Special Economic Zone on Enterprise Bankruptcy (March 1994)
- Bankruptcy of Foreign Related Companies (July 1994)
- Liquidation and Dissolution of Enterprises (October 1995)
- Shenzhen Special Economic Zone Foreign Company Insolvency Regulations (November 1996)

#### *Shanghai*

- Shanghai Municipality Liquidation of Foreign Investment Enterprises Regulations (Aug. 1991)
- Liquidation Procedures for Foreign Investment Enterprises (October 1991)

#### *Beijing*

- Liquidation Measures for Foreign Investment Enterprises (June 1992)
- Beijing Municipality Liquidation of Foreign Investment Enterprises Procedures (Sept. 1992)
- Dissolution of Foreign Investment Enterprises (July 1995)

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<sup>1</sup>Ferrier Hodgson & Marfan, PRC-insolvency , [http://www.fh.com.hk/topic3\\_pdf.pdf](http://www.fh.com.hk/topic3_pdf.pdf), Date: 25.11.2001.

## *Others*

- Guangdong: Bankruptcy of Companies (August 1993)
- Hong Kong: Bankruptcy Ordinance

## **Republic of Austria**

The Austrian Federal Constitution provides for the appointment of all powers between the State and the Provinces in Article 10 - 15 B-VG . Bankruptcy belongs to the legislative federal power of the State. Hence, the legal position is far more transparent in Austria due to rule of law.

There is a single law for bankruptcy called the Bankruptcy Act (*Konkursordnung, KO*). It covers all important provisions concerning the bankruptcy proceedings and the substantive bankruptcy rules for enterprises with the status of a legal person as well as for others and even the special regulations for the bankruptcy of individuals. The Restructuring Act (*Ausgleichsordnung, AO*), which is a separate Act, contains the formal and substantive rules in case the debtor applies for reconstruction of the debtor's estate. In 1997 the Law of Business Reorganization (*Unternehmensreorganisationsgesetz, URG*) had been enacted. Its objective is to improve the assets, the financial and the operating situation of businesses which are on the verge of bankruptcy. It should provide the base for the endangered business to continue its operations. Article 1 URG determines that a business that needs reorganization may file a petition to initiate reorganization proceedings. The most important by-law is the Bankruptcy Employee Protection Act (*Insolvenz-Entgeltsicherungsgesetz, IESG*). Its objective is to secure the employees' claims in case of the employer's insolvency.<sup>1</sup>

### Overview:

- Bankruptcy Act (*Konkursordnung, KO*)
- Restructuring Act (*Ausgleichsordnung, AO*)
- Law of Business Reorganization (*Unternehmensreorganisationsgesetz, URG*)
- Bankruptcy Employee Protection Act (*Insolvenz-Entgeltsicherungsgesetz, IESG*)

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<sup>1</sup>Explanatory note: Further details are mentioned under the chapter "Bankruptcy Claims".

## 2. Prerequisite for Bankruptcy

### People's Republic of China

#### National Legislation

##### Enterprise Bankruptcy Act of 1986

The EBL addresses in Article 2 enterprises owned by the whole people, so called State-owned enterprises (SOEs), such as the international trust and investment corporations, known as "*itics*". Guangdong itic or GITIC is the most famous and has already been mentioned above.<sup>1</sup> The EBL limits application to enterprise legal persons.<sup>2</sup> Another relevant rule for State-owned enterprises are derived from policies of the State Council<sup>3</sup> in some pilot cities.<sup>4</sup> Two of them are very important: Document Guofa No. 59 (1994) and Document No. 10 (1997).

The Chinese bankruptcy system does not only differentiate between SOEs and non-SOEs. Within SOEs there is a difference between those which belong to the pilot cities and those which do not. As a consequence, many statements issued by the State Council or the Supreme People's Court contain a special scope of application for specific pilot cities. In Guofa 1997 the State Council issued that the policy defined for bankruptcy in document No. 59 Guofa 1994 only applies to State-owned industrial enterprises within the limits of enterprises with "optimal capital structure" in pilot cities affirmed by the State Council.<sup>5</sup> A similar determination was issued one year before by the Supreme People's Court<sup>6</sup> and also in 1997. The latter one even lists several "Notices" which should not be applied to enterprise bankruptcy cases in non-pilot cities and bankruptcy cases involving non-State-owned enterprises in pilot cities.<sup>7</sup>

The disadvantage of SOEs that do not belong to the experimental cities, is substantial. They do not enjoy certain preferential policies upon bankruptcy such as the possibility to use bank's money to make arrangements for laid-off workers.<sup>8</sup> Non-pilot cities are only covered by EBL-provisions.<sup>9</sup> Though the

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<sup>1</sup>CMS Cameron McKenna, PRC, [http://www.adb.org/Documents/reports/restructuring\\_asia/China.pdf](http://www.adb.org/Documents/reports/restructuring_asia/China.pdf), Date: 15.12.2001.

<sup>2</sup>Wang Weiguo, Drafting, <http://www.law.hku.hk/aiifl/events/symposium/papers/wang%20weiguo.doc>, Date: 10.1.2002.

<sup>3</sup>Explanatory note: The State Council is the executive organ of the supreme organ of State power and the State's supreme administrative organ, i.e. the Central People's Government.

<sup>4</sup>Li Shuguang, Law & Restructuring, [http://www.fh.com.hk/Lecture\\_6.pdf](http://www.fh.com.hk/Lecture_6.pdf), Date: 18.12.2001.

<sup>5</sup>Guofa 1997, Problems Pertaining to the Trial Implementation of State-owned Enterprises.

<sup>6</sup>Fa Min Chuan 1996, Urgent Notice in Enterprise Bankruptcy Cases, No. 431.

<sup>7</sup>Notice No. 2 (Fafa 1997), <http://www.fh.com.hk/e13%20Fafa%20%5B1997%5D%20No%202.PDF>, Date: 20.12.2001.

<sup>8</sup>TCFA Update, Bankruptcies Down in 1997, <http://www.china.finance.org/update/volume1/v4n20.html>, Date: 11.12.2001.

<sup>9</sup>Guofa 1994/1997, <http://www.mpipriv-hh.mpg.de/mitarbeiter/chinas-recht/konkurs2.htm>, Date: 10.10.2001.

EBL was designed for State-owned enterprises due to the deep-rooted central control economic system, the common belief that bankruptcies in China are limited to SOEs is wrong.<sup>1</sup> There are various scattered provisions for non-SOEs, which were also implemented in some cases resulting in business bankruptcy.

#### Civil Procedure Law

Due to the steady increase of non-State-owned enterprises as well as its bankruptcies, the government was forced to provide new regulations which were laid down in the Civil Procedure Law.<sup>2</sup> Article 206 CPL explicitly states that the bankruptcy repayment process for State-owned enterprises is governed by the EBL, whereas Chapter XIX CPL contains bankruptcy and debt repayment procedures for non-State-owned legal enterprise persons (non-SOEs) such as Chinese-foreign equity joint ventures, Chinese foreign-contractual joint ventures, foreign enterprises or collectively owned enterprises<sup>3</sup>. There exists a substantial negative scope of application of the CPL which says that the CPL-provisions are not applicable to any enterprise that is not a legal entity, nor to self-employed workers, rural households working under contract and private partnerships. Therefore, non-SOE bankruptcies mainly apply only to firms with collective, private, and mixed ownership. Such cases fall under some elementary provisions in the CPL and Company Law, and Opinions of the Supreme Court, and sometimes additional provisions of Special Economic Zones.<sup>4</sup>

#### Company Law

The Company Law<sup>5</sup> of the People's Republic of China came into effect in 1994. The term "company" refers to a limited liability company or a joint stock company limited set up within the territory of the People's Republic of China according to the provisions of the law. (Article 2 CL) Both kinds of companies are granted the status of legal persons (Article 3 CL). The CL covers some special rules for the organization of the liquidation group, its functions and powers and the bankruptcy proceedings, especially in Article 189 and 196 CL and other rules for the winding-up of companies with foreign interests. The special bankruptcy provisions apply to the bankruptcy of both domestic and foreign

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<sup>1</sup>Li Shuguang, BL in PRC, <http://www.fas.harvard.edu/~asiactr/haq/200101/0101a006.htm>, Date: 15.11.2001.

<sup>2</sup>Explanatory note: CPL = Civil Procedure Law.

<sup>3</sup>Bankruptcy, [http://www.isinolaw.com/jsp/bankruptcy/BKRUPPT\\_sys.jsp?LangID=0](http://www.isinolaw.com/jsp/bankruptcy/BKRUPPT_sys.jsp?LangID=0), Date: 15.11.2001.

<sup>4</sup>World Bank Office, Beijing, Insolvency, <http://www.worldbank.org.cn/English/Content/485a6232469.shtml>, Date: 20.12.2001.

<sup>5</sup>Explanatory note: CL = Company Law.

investment enterprises.<sup>1</sup> Up to now partnerships, sole proprietorships and natural persons are not yet subject to bankruptcy regime.<sup>2</sup>

### **Local Legislation**

The "Rules of the Shenzhen Special Economic Zone on Enterprise Bankruptcy" were adopted on the 10th of November 1993, promulgated on the 18th of December 1993 and enacted on the 1st of March 1994 (Article 93). Whenever this work mentions "Shenzhen Rules"<sup>3</sup> it refers to the above mentioned rules. Furthermore, businesses located in the Shenzhen area usually fall within the scope of application of certain decisions of the Supreme People's Court and the State Council such as the Guo Fa Document No. 10 (1997). The Shenzhen rules contain detailed rules of application in Article 2. It is restricted to businesses with the status of a legal person, unless it is otherwise stipulated by laws and statutory regulations. Following types of firms including foreign investment enterprises in Shenzhen are covered by these rules:

- (1) business units with legal person status registered in the Special Zone; and
- (2) business units with legal person status registered in regions outside the Special Zone but which have an address within the Special Zone.

### **Republic of Austria**

Compared with the PRC's understanding Austria's position is different. In Austria, every physical person and business unit (corporations and limited companies), which can bear responsibilities, is subject to bankruptcy laws. Even children may go bankrupt.<sup>4</sup> There are no major distinctions between the bankruptcy of business units with the status of a legal person and those which are not regarded as legal persons. In other words: Natural and legal persons, the estate of deceased and commercial partnerships can go bankrupt (such as: *OHG*<sup>5</sup>, *KG*<sup>6</sup>, *OEG*, *KEG*, *EWIV*). The bankruptcy of individuals who do not run a business unit is also covered in the Bankruptcy Act but contains special provisions concerning the subject-matter jurisdiction and an extraordinary kind of compulsory restructuring, the so called payment-schedule (*Zahlungsplan*).

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<sup>1</sup>Lehmann, Lee & Xu, Bankruptcy, <http://www.lehmanlaw.com/lib/articles/bankruptcy.htm>, Date: 14.10.2001

<sup>2</sup>Wang Weiguo, Drafting, <http://www.law.hku.hk/aiifl/events/symposium/papers/wang%20weiguo.doc>, Date: 10.1.2002.

<sup>3</sup>Explanatory note: SR = Shenzhen Rules.

<sup>4</sup>Holzhammer/Roth, Konkursrecht, 4.

<sup>5</sup>OHG = general partnership.

<sup>6</sup>KG = limited partnership.

### **3. Structure of the Bankruptcy Laws**

#### **People's Republic of China**

##### **National Legislation**

###### The Enterprise Bankruptcy Act of 1986 & Others

The EBL of 1986 comprises of 6 chapters: the general provisions, the submission and acceptance of bankruptcy applications, the creditor's meetings, the settlement and reorganization, the bankruptcy decree and bankruptcy liquidations and the supplementary provisions. It contains a total of 43 Articles, 5400 characters.<sup>1</sup> Despite the low number of articles regulations for settlement and reorganization are also included in the Act. The Enterprise Bankruptcy Act is not the sole basis for the bankruptcy practice in China. After the Act was promulgated, the National People's Congress issued the amended 19th Chapter of the Code of Civil Procedure on the 9th of April, 1991.<sup>2</sup> This Chapter comprises only 8 articles (Article 199-206) starting with the cause of bankruptcy followed by bankruptcy petition, bankruptcy decree, creditor's conference, liquidation reorganization, conciliatory agreement, mortgages, bankruptcy fees, jurisdiction and provisions concerning the negative scope of application.

Two other important bankruptcy provisions are contained in Chapter Eight of the Company Law: Article 189 and 196.<sup>3</sup>

##### **Local Legislation**

The "Rules of the Shenzhen Special Economic Zone on Enterprise Bankruptcy" (enacted in 1994) are more detailed than the EBL provisions. All in all, they comprise 93 articles in 8 chapters: general principles, submission and hearing of petition for bankruptcy, creditor's meetings, conciliation, bankruptcy decree and bankruptcy liquidation, petty bankruptcy, penalties and supplementary principles. It is obvious that the structure of the Shenzhen Rules is similar to the EBL. However, they are more in line with modern bankruptcy laws. As an unknown member of the Bankruptcy Law Draft Committee of the Shenzhen Municipal's People's Congress said:

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<sup>1</sup>Ferrier Hodgson & Marfan, Restructuring , [http://www.fh.com.hk/Lecture\\_1.pdf](http://www.fh.com.hk/Lecture_1.pdf), Date: 18.12.2001.

<sup>2</sup>Li Shuguang, BL in PRC, <http://www.fas.harvard.edu/~asiactr/haq/200101/0101a006.htm>, Date: 15.11.2001.

<sup>3</sup>Qi Duo-jun, Mainland China, <http://www.ieem.org.mo/projects/ecli/Reports/bkruptcy.html>, Date: 19.09.2001.

*"If you talk of law itself, it is very advanced. Japanese bankruptcy scholars found Shenzhen more advanced than theirs. But it is very difficult to enforce law in practice - there is a gap when you come to large SOE's. The first SOE's were not set up under the Corporation Law because there was a lot of contradiction. Maybe older enterprises should follow the old rules and new enterprises should follow the new rules. There is a mixture of rule of law and rule by person."<sup>1</sup>*

The Shenzhen Rules do not contain settlement and reorganization as does the EBL rather contain a very detailed chapter for restructuring and petty bankruptcy to accelerate bankruptcy proceedings.

The broad coverage of the Shenzhen Rules explains why their relevance far exceeds their apparent geographic limitation. Shenzhen has the largest number of foreign investment enterprises in the PRC. Moreover, Shenzhen has traditionally been the testing ground for the PRC's foreign investment legal regime. There are even scholars who would be in favor of the analog application of the SR to the remaining foreign investment enterprises nationwide. It is certain that they provide an insight into the development and ultimate form of bankruptcy law for foreign investment enterprises on the national level.<sup>2</sup>

### **Republic of Austria**

The structure of the Chinese bankruptcy laws can not be compared with the Austrian law. The Austrian Bankruptcy Act (*Konkursordnung, KO*) comprises of three main-parts:

- Articles 1 through 62 KO regulate the substantive bankruptcy law such as the requirements and effects of the opening of the bankruptcy and the termination of the bankruptcy, the legal rights and duties of the parties involved in the bankruptcy proceedings and the invalidation of transactions.
  
- The Articles 63 through 180 KO cover the bankruptcy proceedings.
  
- Even the Articles 181-218 KO contain special substantive and procedural bankruptcy regulations for individuals.

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<sup>1</sup>Kamarul/Tomasic, Draft Bankruptcy Law, [http://management.canberra.edu.au/china\\_economic\\_law/conferencepapers.html](http://management.canberra.edu.au/china_economic_law/conferencepapers.html), Date: 15.12.2001.

<sup>2</sup>Toronto, Shenzhen, <http://www.columbia.edu/cu/asiaweb/v4n2toro.htm>, Date: 01.12.2001.

The EBL of 1986 and the Shenzhen Rules are not strictly separated into a substantive and a procedural part. The law's structure always orientates itself on the practical order of bankruptcy proceedings. Compared with the PRC's bankruptcy laws, the Austrian KO contains more detailed articles. Hence, it provides more legal security for creditors and debtors. With reference to the long-expected bankruptcy reform in the PRC, Qi Duo-jun points to this lack of detailed articles and finds fault with the poor amount of regulations:

*"Many stipulations are not specific so that it is difficult to enforce them. And various important problems are not stipulated. Many stipulations conform to neither international practices nor the situations of China, especially the needs of current developing circumstances of the reform up to the outside world."*<sup>1</sup>

The Shenzhen Rules point into the right direction. The enormous foreign investment by companies had been leading to proper notifications in the Shenzhen Rules of 1987. They now provide more detailed rules that meet the expectations of the investors' interests. However, the structure of the SR has hardly changed.

#### **4. The Legislators' Intentions**

##### **People's Republic of China**

The primary goal of Chinese bankruptcy laws is to get rid of financially-troubled State-owned enterprises, whereas the KO regards bankruptcy as one way to settle all the debtor's liabilities in the bankruptcy proceedings in order to achieve equal treatment of the involved creditors. In the meantime, Shenzhen seems to follow the same aim to satisfy all creditors in proportion of their claims.

##### **National Legislation**

The Enterprise Bankruptcy Act of 1986

Article 1 EBL is formulated in order to suit the development of the planned socialist commodity economy and the needs to reform the economic structure, to promote the autonomous operation of

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<sup>1</sup>Qi Duo-jun, Mainland China, <http://www.ieem.org.mo/projects/ecli/Reports/bkruptcy.html>, Date: 19.09.2001.

business units owned by the people, to strengthen the economic responsibility system and democratic management, to improve the state of operations, to increase economic efficiency and to protect the lawful rights and interests of creditors and debtors. The first article of the EBL deals with the "planned socialist commodity economy", although the change of thinking about the modern concept of market economy was introduced by Deng Xiaoping in 1978. He cautiously launched market reform soon after Mao Zedong's death in 1976. Yan Mingfu, a former senior leader, remembers: " I had heard the word *market* before, but it was always considered something negative. Deng Xiaoping was the first person to say that the market economy could exist under socialism."<sup>1</sup> Despite Deng's new attitude towards market economy which was not shared by all officials, the term *market* was not used because it was still regarded as a suspect term.<sup>2</sup> This might explain why the EBL which was promulgated in 1986 refers to a "planned socialist commodity economy" which was established by the government in the middle of the 1980s as part of some major economic reform-measures and which does not use the term *market* yet.

### **Local Legislation**

The Shenzhen Rules of 1994 were destined to standardize the conduct of business bankruptcy, to protect the rights and interests of creditors and debtors and to safeguard the order of the socialist market economy of the Shenzhen Special Economic Zone (Article 1 SR). These objectives seem to have been achieved according to an unknown judge of the Shenzhen Bankruptcy Court:

*"In some parts of China, bankruptcy law practice is more developed than in other areas. For example, in Shenzhen the system is more developed than in the rest of China ... the law has matured."*<sup>3</sup>

Even foreign investors seem to have confidence in the Shenzhen Rules because the Special Economic Zone of Shenzhen shows the largest number of foreign investment enterprises in the PRC. The weekly magazine "*Der Spiegel*" wrote recently that the former fishing-village Shenzhen belongs to the most rapidly expanding industrial areas of the world. Shenzhen could break the dominant role of Hong Kong as the most important finance-center in the PRC. The reason for this change might be found in the cheap labor.<sup>4</sup>

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<sup>1</sup>Lawrence, Made in China, 39.

<sup>2</sup>Lawrence, Made in China, 48.

<sup>3</sup>Kamarul/Tomasic, Draft Bankruptcy Law,

[http://management.canberra.edu.au/china\\_economic\\_law/conferencepapers.html](http://management.canberra.edu.au/china_economic_law/conferencepapers.html), Date: 15.12.2001.

<sup>4</sup>Der Spiegel, China - Traum von der Perlenstadt, 123-125.

## Republic of Austria

In contrast to the Chinese bankruptcy laws, the KO itself does not have any preamble or any provision which mentions the objectives of the legislator. However, the KO aims of the rapid liquidation of the debtor's property and the distribution of the proceeds among the creditors. Bankruptcy proceedings lead to elimination of the debtor from future business and to the extinction of further business operations. The advantage of bankruptcy proceedings as compared to individual enforcement of judgement-debts lies in the equal treatment of all creditors in a single bankruptcy proceeding. Hence, Holzhammer/Roth emphasize the general comprehensive enforcement of debts with the equal creditor treatment proportional to their claims (*Gesamtvollstreckung mit paritätischer Gläubigerbefriedigung*).<sup>1</sup>

The new Chinese bankruptcy legislation, refers to the "Socialist Market Economy" in Article 1<sup>2</sup>. The change to this new system goes back to Deng Xiaoping's momentous visit to Southern China in 1992, when he revived reform, and embarked on reform's third stage - the restructuring of the large State-owned enterprises. Deng pointed out that socialist ideology and market economy were not necessarily incompatible.<sup>3</sup>

Since this point in time, the Chinese government finally began to use the term "market economy". The system was then called "Socialist Market Economy" - the adjective *socialist* was attached for historical continuity and political legitimacy.<sup>4</sup> Furthermore, this term can be regarded as a compromise between the reformers and the more conservative powers in the PRC. It helps China, a socialist country, which is still led by a Communist Party, to save its face. If one is more in favor of capitalism, he could read "market economy", otherwise one could read "socialist".

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<sup>1</sup>Holzhammer/Roth, Konkursrecht, 1.

<sup>2</sup>Hieker, Konkursgesetzgebung in der Volksrepublik China 108, 150.

<sup>3</sup>WTO, <http://www.china-laws-online.com/china-WTO/WTO-chinese-legal-system.htm>, Date: 11.12.2001.

<sup>4</sup>Lawrence, Made in China, 48.

Part III

**SUBSTANTIVE BANKRUPTCY LAW**

**主要破产法**

**1. Bankruptcy Estate**

**People's Republic of China**

**National Legislation**

The Enterprise Bankruptcy Act of 1986

According to Article 28 bankruptcy estate comprises

- (1) all property items that the bankrupt business unit administers and manages at the time when it is declared bankrupt;
- (2) property obtained by the bankrupt business unit during the period from the bankruptcy declaration to the conclusion of the bankruptcy proceedings; and
- (3) other property rights that the bankrupt business unit should be entitled to.

The special purpose property of the State such as public utilities, land owned by the State, the land use right and the property which is managed or used by the bankrupt enterprise but not belonging to the business unit etc, do not count as bankruptcy estate.<sup>1</sup> Because rules were interpreted differently in some provinces, additional and more detailed provisions referring to bankruptcy estate were published, in order to standardize enterprise bankruptcy proceedings. They can be found in the "Provisional Regulations on the Financial Problems in the Trail Bankruptcy of State-owned Enterprises".<sup>2</sup>

**Local Legislation**

Article 51 of the Shenzhen Rules determines that bankruptcy estate includes the following:

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<sup>1</sup>Provisional Regulations on the Financial Problems, <http://www.fh.com.hk/e11%20PR%20on%20Financial%20Problems%20in%20Trail%20Bankruptcy%20of%20SOEs.PDF>, Date: 15.11.2001; else: Bankruptcy, <http://www.isinolaw.com/jsp/bankruptcy>, Date: 15.11.2001.

<sup>2</sup><http://www.fh.com.hk/e11%20PR%20on%20Financial%20Problems%20in%20Trail%20Bankruptcy%20of%20SOEs.PDF>, Date: 15.11.2001.

- (1) all property operated and managed by a State-owned enterprise at the time of a declaration of its bankruptcy or all of the property owned by another bankrupt enterprise;
- (2) property obtained by a bankrupt business unit between the time of a declaration of bankruptcy and the conclusion of bankruptcy proceedings; and
- (3) other property rights over which the bankrupt enterprise exercises authority.

These rules can be compared with the EBL. However, Article 51/1 SR explicitly refers to State-owned enterprises as well as to other bankrupt enterprises whereas the other two sections are equivalent to the EBL.

### **Republic of Austria**

The KO determines all property which is subject to the enforcement at the time of the opening of the bankruptcy and which is purchased during the bankruptcy proceedings represents the bankruptcy estate. It shall be used for the satisfaction of the creditor's claims according to Article 1/2 KO. The Austrian legal restrictions of enforcement will also apply in bankruptcy proceedings. Hence, exempt assets (Articles 250, 251 EO)<sup>1</sup> do not belong to the bankruptcy estate. The same applies to unattachable claims (Articles 290 ff EO).

Although the term of bankruptcy estate is different in the Austrian bankruptcy law as opposed to the EBL of 1986 (respectively the Shenzhen Rules), the fundamental rules are the same. In both legal codes the current assets, the non-current assets, the outside investment, the intangible assets and the whole property acquired by the bankrupt enterprise from the opening of the bankruptcy proceedings until the bankruptcy terminates, represents the bankruptcy estate. The KO determines in several scattered articles that the certain debtor's property shall not be subject to enforcement (Article 1/1 KO) or that property which is granted to the debtor as alimony (Article 5/2 KO) is exempt of bankruptcy.

The EBL and the SR hardly ever mention property exempt from bankruptcy. There is one example reflecting the ideological differences in the structure of the Austrian and Chinese bankruptcy law. The KO does not include a ruling as the EBL saying that staff and workers' apartments, schools, kindergartens, hospitals and other welfare facilities shall not be included in bankruptcy estate.

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<sup>1</sup>Explanatory note: Act on Executive Proceedings = EO.

## 2. Opening of the Bankruptcy

### People's Republic of China - Republic of Austria

The opening proceedings in **Austria** consist of **two** steps:

1. The petition of the debtor or the creditor to declare bankruptcy  
(Article 69, 70 KO)
2. The decree of the bankruptcy court (*Konkurseröffnungsbeschluss*)

Once the decision is taken by the bankruptcy court, the bankruptcy is "opened". All legal consequences of bankruptcy take effect from the decree opening the bankruptcy. The trustee in bankruptcy, too, obtains his authority from the opening decision of the court.

The opening of bankruptcy proceedings in the **People's Republic of China** consist of **three** steps:

1. The petition of the debtor or the creditor to declare bankruptcy  
(Article 7,8 EBL)
2. The acceptance of bankruptcy (Article 9 EBL)
3. The bankruptcy declaration (Article 23 EBL)

Once the bankruptcy court has *accepted* - the second step - the bankruptcy case, debtors and creditors have to deal with the bankruptcy effects as described in the chapter below. The EBL offers the superior departments in charge of the enterprise the possibility to file an application for "settlement and reorganization" of the business unit, after the People's Court has accepted the case.

The People's Court will declare bankruptcy only in the following cases (Article 23 EBL):

- if the persons in charge do not file for reorganization in case his business unit is unable to pay debts which have fallen due (Article 3 EBL)
- if after the expiration of the period of reorganization his business unit is unable to repay debts in accordance with the settlement agreement

After the bankruptcy has been declared, the liquidation team is established. The Shenzhen Rules have the same characteristic structure.

It is interesting to compare these basic proceedings with the Austrian KO. The legal issue is whether the Chinese "acceptance" or the later "declaration" can be regarded as counterpart to the Austrian "Opening of Bankruptcy Proceedings". This identification is necessary because the regulations (concerning the legal consequences of the bankruptcy opening) which Austrians expect to find in the Chapter "Legal Consequences of the Opening of the Bankruptcy Proceedings" in the KO, are contained in the EBL partly in the chapter "Submission and Acceptance" and partly in the Chapter "Bankruptcy Declaration and Liquidation", so in an earlier or later stage of bankruptcy proceedings.

This can be illustrated by two examples:

Offsetting of claims is regulated in Article 33 EBL. Creditors which owe debts to the bankrupt business unit may offset them before the liquidation of the bankrupt business commences.<sup>1</sup> Wang Jianping added that offset is only possible if claim and obligation came into existence before bankruptcy declaration.<sup>2</sup> The creditor in question has the burden of proof. This Article 33 EBL is contained in the Chapter V "Bankruptcy Declarations and bankruptcy Liquidations" and not in Chapter II which deals with the "Acceptance of Bankruptcy". In Austria, the possibility to offset is provided for Article 19 f. KO and belongs to the first main part of the KO which concerns the legal effects of the opening of the bankruptcy.

The trustee is appointed in the decree of the bankruptcy-opening according to the KO. The EBL stipulates that the liquidation team - which has similar functions and powers as the trustee - is established after declaration of bankruptcy and not the acceptance.

The Austrian position: One could say that the decree in favor of the application for bankruptcy by the Austrian bankruptcy court comprises of the - what the EBL calls - "Acceptance" **AND** "Bankruptcy Declaration" because with this one and only decree the bankruptcy is opened and the requirements for the further proceedings such as the liquidation are created.

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<sup>1</sup>Explanatory note: Bankruptcy liquidation is the procedural step which follows bankruptcy declaration.

<sup>2</sup>Unternehmenskonkursgesetz, <http://www.mpipriv-hh.mpg.de/mitarbeiter/chinas-recht/konkurs.htm>, Date: 18.11.2001.

### **3. Legal Consequences of Bankruptcy** (*respectively Acceptance & Declaration*)

#### **People's Republic of China - Republic of Austria**

##### **National Legislation**

###### The Enterprise Bankruptcy Act of 1986

After the People's Court has accepted the bankruptcy case, it shall notify the debtor within ten days and make a public announcement (Article 9 EBL). As none of the articles of the EBL *explicitly* - in contrast to the Austrian KO - says anything about the way how to announce the acceptance of the bankruptcy and the point of time when the legal consequences commence, the Supreme People's Court was forced to provide additional measures. In order to guarantee the correct implementation of the EBL it issued its "Opinions" in 1991. In reference to the public announcement<sup>1</sup>, it explained that after the acceptance of bankruptcy cases, the People's Court shall make a public announcement within ten days. Such announcements, additionally posted on the public announcement boards of People's Courts accepting bankruptcy cases, shall also be published on local or national newspapers with reference to the specific circumstances of the cases (such as the areas in which the creditors are located or the areas in which the bankrupt properties are located)." The Supreme People's Court mentions in reference to the point of time of the legal consequences<sup>2</sup> that the debtors have to cease paying off their debts as of *the date of receiving the notice*. Any repayment which the debtors have to make in order to maintain normal production and management shall, prior to the establishment of the liquidation committee, be examined and approved by the People's Court. If the debtor persists in paying off the debts to some of their creditors or if they commit any of the acts listed in Article 35 EBL after receiving the People's Courts' notice concerning the termination of debt clearance, the People's Court shall rule that all such repayment or acts are void, recover such properties and impose punishment upon the legal representative of the enterprise, the responsible persons of the competent departments at higher level as well as other personnel held directly responsible pursuant to the provisions of Article 102 and 104 of the Civil Procedure Law of China.

The People's Court also has to advise the bank of deposit to terminate the settlement business of debt clearance for the debtor, otherwise it can be punished in the above-mentioned way. Finally, even the

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<sup>1</sup>Opinions of the Supreme People's Court 1991, III. Acceptance of Bankruptcy Cases, Nr. 10, [http://www.fh.com.hk/e02%20Fa%20\(jing\)%20%5B1001%5D%20No%2035.PDF](http://www.fh.com.hk/e02%20Fa%20(jing)%20%5B1001%5D%20No%2035.PDF), Date: 12.12.2001.

<sup>2</sup>Opinions of the Supreme People's Court 1991, III. Acceptance of Bankruptcy Cases, Nr. 19, [http://www.fh.com.hk/e02%20Fa%20\(jing\)%20%5B1001%5D%20No%2035.PDF](http://www.fh.com.hk/e02%20Fa%20(jing)%20%5B1001%5D%20No%2035.PDF), Date: 12.12.2001.

staff and workers of the bankrupt business unit have to be notified of the acceptance of the bankruptcy case. The People's Court shall request that they protect the enterprise's property and refrain from illegally disposing of the accounts, documents and so on.<sup>1</sup> After the People's Court has accepted a bankruptcy case, payment by the debtor to only some of the creditors shall be null and void, with the exception of payments required for the normal production and operations of the debtor (Article 12 EBL). As a consequence, the estate still formally belongs to the debtor but his possibility of legally effective disposal is temporarily restricted. Once the business unit is declared bankrupt, Article 24 EBL defines that a liquidation team has to take over the bankrupt business and takes responsibility for the keeping, putting into order, appraisal, disposition and distribution of the bankruptcy property after declaration of bankruptcy. Then debtors may only repay debts to this team.

Apart from the debtor's restricted possibility of disposal, Article 11 EBL determines as second important legal consequence that other individual enforcement proceedings against the property of the debtor must be suspended after the People's Court has accepted a bankruptcy case.<sup>2</sup> The situation seems to be comparable with Austrian bankruptcy laws where individual enforcement proceedings are not enforced anymore.

In contrast to the KO, the EBL itself does not provide any legal solution how to handle legal disputes. Therefore the Supreme People's Court has clarified the legal situation with his published "Opinions" in details. After a business bankruptcy case has been accepted by the People's Court, other civil disputes in which it is involved as a debtor, shall be handled with respect to the following different conditions:<sup>3</sup>

- (1) if the trial has been terminated by a judgement but the ruling has not yet been carried out, such ruling shall be suspended. However, the creditors may, on the basis of binding legal documents submit their claims to the People's Courts,
- (2) if the trial is not yet terminated and there are no persons of joint liability, such proceedings shall be terminated. However, the creditors may report their claims to the People's Court accepting the bankruptcy cases, or
- (3) if the trial is not yet terminated and there are persons of joint liability, such proceedings shall be terminated. However, the creditors may submit their claims to the People's Court hearing the relevant bankruptcy cases. The trial may be resumed after the termination of the bankruptcy proceedings.

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<sup>1</sup>Opinions of the Supreme People's Court 1991, III. Acceptance of Bankruptcy Cases, Nr. 21, [http://www.fh.com.hk/e02%20Fa%20\(jing\)%20%5B1001%5D%20No%2035.PDF](http://www.fh.com.hk/e02%20Fa%20(jing)%20%5B1001%5D%20No%2035.PDF), Date: 12.12.2001.

<sup>2</sup>Law of the People's Republic of China on Enterprise Bankruptcy (for trial implementation) 1986.

<sup>3</sup>Opinions of the Supreme People's Court 1991, III. Acceptance of Bankruptcy Cases, Nr. 12, [http://www.fh.com.hk/e02%20Fa%20\(jing\)%20%5B1001%5D%20No%2035.PDF](http://www.fh.com.hk/e02%20Fa%20(jing)%20%5B1001%5D%20No%2035.PDF), Date: 12.12.2001.

If other lawsuits with the bankrupt business as the creditors are not settled by the People's Court accepting the proceedings within three months, such cases shall be transferred to the People's Court hearing the bankruptcy cases pursuant to the provisions of Articles 45 and 46 of these Opinions.<sup>1</sup> Even if the People's Court learns after the acceptance of a bankruptcy case that the bankrupt business has other financial cases in which it is a creditor being handled by another People's Court and such cases are unable to be concluded within three months, it shall notify such other People's Court to transfer the cases.<sup>2</sup>

The following provisions are ruled in Chapter V "Bankruptcy Declaration and Liquidation" of the EBL:

a) Claims that are not due when bankruptcy is declared shall be deemed to be claims that have already become due, provided, however, that the interest that is not yet due shall be deducted (Article 31 EBL). Similar to the EBL, the KO deems claims due after the bankruptcy opening (Article 14/2 KO). However, the EBL rules that claims for individual performance are transformed into money-claims (Article 14/1 KO).

b) According to Article 26 EBL the liquidation team may decide to terminate or to continue to perform contracts that have not yet been performed by the bankrupt business. Furthermore, the Supreme People's Court mentions in its "Opinion" that if a liquidation team decides to terminate a contract, and the other party to the contract suffers damages as a result of the termination of the contract, the dispute therefrom over the compensation for the damages shall be settled by decision of the People's Court. The amount of compensation determined by the written decision shall be deemed as bankrupt claim.<sup>3</sup> The KO contains similar rules in Article 21/2 KO which states that the party who suffers damage from breach of contract may request compensation. There are special rules in the chapter dealing with labor contracts. According to Article 25/2 KO the employee's claim to request compensation for the caused damage is a bankruptcy claim.

### **Local Legislation**

Under the Shenzhen Rules the People's Court has to decide within 10 days of the receipt of a petition whether or not to hear the case (Article 12 SR). The debtor shall be notified within 10 days of the

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<sup>1</sup>Opinions of the Supreme People's Court 1991, III. Acceptance of Bankruptcy Cases, Nr. 13, [http://www.fh.com.hk/e02%20Fa%20\(jing\)%20%5B1001%5D%20No%2035.PDF](http://www.fh.com.hk/e02%20Fa%20(jing)%20%5B1001%5D%20No%2035.PDF), Date: 12.12.2001.

<sup>2</sup>Opinions of the Supreme People's Court 1991, III. Acceptance of Bankruptcy Cases, Nr. 14, [http://www.fh.com.hk/e02%20Fa%20\(jing\)%20%5B1001%5D%20No%2035.PDF](http://www.fh.com.hk/e02%20Fa%20(jing)%20%5B1001%5D%20No%2035.PDF), Date: 12.12.2001.

<sup>3</sup>Opinions of the Supreme People's Court 1991, III. Acceptance of Bankruptcy Cases, Nr. 57, [http://www.fh.com.hk/e02%20Fa%20\(jing\)%20%5B1001%5D%20No%2035.PDF](http://www.fh.com.hk/e02%20Fa%20(jing)%20%5B1001%5D%20No%2035.PDF), Date: 12.12.2001.

hearing of a bankruptcy case in the People's Court and a public announcement shall be made (Article 13 SR). The contents of the public announcement are the same as the Supreme People's Court has set forth for the EBL. In contrast to the KO the Shenzhen Rules do not contain any explicit determination of the day when the legal consequences shall take effect. After the acceptance of a bankruptcy case by the People's Court, the payment of creditors' claims by the debtor shall be invalid unless repayment is part of the debtor's necessary and normal production operations (Article 17 SR). After a business is declared bankrupt, the liquidation committee is responsible for keeping, inventory, valuation, disposal and distribution of bankruptcy estate (Article 47 SR). The statements which were mentioned for the EBL also apply for the Shenzhen Rules.

The SR also provide two legal consequences depending on acceptance. However, there seems to be no provision for dealing with individual enforcement of judgement-claims in the SR. Article 16 generally relates to the suspension of civil law suits after acceptance, whereas the EBL provides for the suspension of enforcement proceedings. This discrepancy leads to ambiguity in the interpretation of the law but maybe the result of improper translation of the legal code.

The Shenzhen Rules do not provide as comprehensive provisions for dealing with legal disputes as the KO. Article 16 SR only rules that after the acceptance of a bankruptcy case by the People's Court, other civil law suits concerning the debtor's property are suspended. This rule seems to be similar to the one in the KO where legal disputes ,which have already been brought to court, are interrupted ipso iure by the opening of the bankruptcy. However, the KO emphasizes the interruption of law-suits and not their suspension. Furthermore, it is up to the trustee to initiate law suits for the bankrupt debtor. Law suits against the debtor stay interrupted until the termination of the general hearing to examine claims.

Following items are covered in Chapter V "Declaration of Bankruptcy and Bankruptcy Liquidation" of the Shenzhen Rules:

a) Unmature bankruptcy claims at the time of a declaration of bankruptcy shall be regarded as matured claims, but the unmatured interest component shall be deducted therefrom. (Article 59 SR) Although the language of Article 59 SR is different to the EBL and to the KO, both of them are based on the main-idea that all claims shall become due during bankruptcy proceedings.

b) The SR also contain detailed provisions for offset. Article 67 SR provides that a creditor may offset its claims against any debts which it owes to a bankrupt business before the commencement of a bankruptcy liquidation. However, claims shall not be offset in any of the following circumstances:

- (1) where a creditor owes any debts to a bankrupt company which were incurred after the business was declared bankrupt;
- (2) where a debtor of a bankrupt business acquires claims after the business was declared bankrupt;
- (3) where a debtor of a bankrupt business acquires claims with the knowledge that the business had been ceasing to pay its debts or which were incurred after the filing of a bankruptcy petition.

The KO also addresses the issue of offset. The three SR provisions mentioned above are covered in Article 20 /1 KO. There seems to be no difference, except the fundamental one that the PRC's bankruptcy systems always differentiate between acceptance and declaration, while in Austria all legal consequences commence with the bankruptcy opening.

Article 48 SR determines that after a declaration has been made, and where the bankrupt business has yet to fulfil a contract, the liquidation committee may decide whether to terminate or fulfill the contract. The creditor's rights are secured in Article 61 SR. If a liquidation committee decides to dissolve a contract which has not yet been implemented by the bankrupt firm, and the other party concerned incurs losses due to the breach of the contract, the amount paid for compensation of such losses is deemed to be a bankruptcy claim. The arguments that apply for the EBL are of relevance for the SR too.

### **Republic of Austria**

In contrast to the Chinese bankruptcy systems the KO explicitly determines the day when the legal consequences of bankruptcy shall take effect. It is the beginning of the day which follows the public announcement of the bankruptcy edict (Article 2/1 KO). According to Article 173a KO the public announcement is effected through registry of the bankruptcy edict into the "*Insolvenzdatei*" which is the free accessible internet-databank<sup>1</sup> administered by the Austrian Ministry of Justice. After the opening of the bankruptcy, the bankruptcy estate is confiscated in favor of the creditors. The technical term for this process is called *Konkursbeschlag*.<sup>2</sup> It has two legal consequences:

- (1) The property still formally belongs to the debtor but his possibility of disposal is temporarily terminated.<sup>3</sup> Payment by the debtor to only some of the creditors shall

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<sup>1</sup><http://www.edikte.justiz.gv.at>, Date: 22.01.2002.

<sup>2</sup>Holzhammer/Roth, Konkursrecht, 7.

<sup>3</sup>Holzhammer/Roth, Konkursrecht, 7.

be null and void (Article 3/1 KO). The only person who can effectively dispose of the bankruptcy estate is the trustee in bankruptcy, a single person, in contrast to the EBL, where a liquidation group is formed.

- (2) The claim in bankruptcy is deemed the claim of the creditors against the State to participate in the bankruptcy proceedings. Through the *Konkursbeschlag*, this claim deepens into a right to take part in the bankruptcy. The creditors have the right to request liquidation and the settlement of claims.<sup>1</sup>

The Austrian handling of individual enforcement seems to be similar as the way in China. The only difference is that in the PRC the effects start with the "Acceptance" of the bankruptcy case, whereas in Austria civil enforcement proceedings against the property of the debtor which were approved before the bankruptcy's opening must not be pursued anymore. Furthermore, the KO rules that no lien, no right of satisfaction and no right to retain can be obtained on bankruptcy estate (Article 10/1 KO). It is particularly difficult to compare bankruptcy proceedings of the KO and the Chinese system. The issue of pending lawsuits is a point in case. The KO deals with lawsuits that do not concern the bankruptcy estate and which concern the bankruptcy estate.

- (1) Those which **do not** concern the bankruptcy property can be instituted or continued even during the bankruptcy proceedings against the debtor (Article 6/3 KO). For example: claims to personal performance.

- (2) Legal disputes which **concern** the bankruptcy property are interrupted ipso iure according to Article 7/1 KO.

- Lawsuits against the debtor are interrupted until the conclusion of the general hearing to examine claims. The plaintiff has to register the claim in an official registry.<sup>2</sup>
- Lawsuits which the debtor intends to file, can be taken by the trustee in bankruptcy.

New actions can not be filed after the opening of the bankruptcy. The bankruptcy claims of these creditors have to be filed and registered (Article 104 KO) as all other registered bankruptcy claims. Article 14/2 KO regulates that all unmatured claims against the debtor become due after the opening of the bankruptcy. The same rule is set forth in Article 31 EBL and Article 59 SR). However, the EBL

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<sup>1</sup>Holzhammer/Roth, Konkursrecht, 8.

<sup>2</sup>Holzhammer/Roth, Konkursrecht, 1.

and the SR do not contain rules which prescribe that claims for individual performance<sup>1</sup> against the debtor are converted into money claims. (Article 14/1 KO) Those are fixed according to their estimated value.

The EBL provides only one short article about offset, while the KO contains far more detailed rules about it. Even the Shenzhen Rules cover comprehensive provisions. However, both legal systems address the issue of offset. In Austria, offsetable<sup>2</sup> claims need not to be asserted in bankruptcy (Article 19/1 KO). The arguments advanced in the SR under which offset shall not be possible are the same as listed in Article 20/1 KO. Comparing the EBL with the KO, it is interesting to see that the Austrian bankruptcy law provides a great variety of rules concerning contracts in the Articles 21-25 KO. Furthermore, Article 25a KO provides that the parties can not deviate from the above-mentioned rules. Such a ruling is neither included in the EBL nor in the SR.

The KO contains regulations about the general treatment of contracts and special provisions for: *Fixgeschäfte* (=contracts, in which one party is obligated to fulfill to a certain point of time or within a determined period of time)<sup>3</sup>, rental contracts, labor contracts and orders and offers. If the debtor has fulfilled all his duties before the bankruptcy opening, the other party is obliged to pay to the bankruptcy estate. In the reverse case - which means if the creditor has fulfilled all his duties but not the debtor whose business was declared bankrupt - the creditor can only file his claim as bankruptcy claim which will lead to appropriate satisfaction.<sup>4</sup>

Article 21 KO contains an exception for a contract that has already been made but has not yet been performed by any of the parties. In such a case the trustee in bankruptcy has the right to choose between performance or cancellation of the contract. (Article 21/1 KO) The EBL grants this duty to the liquidation group.

According to Article 9/2 KO a claim which has been filed in bankruptcy suspends the statutory limitation period. Furthermore, it retroactively changes into an interruption of the period under various circumstances. Such a suspension of the statutory limitation period of a claim is neither mentioned in the EBL itself, the SR nor in the Opinions of the Supreme People's Court of 1991.<sup>5</sup>

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<sup>1</sup>Holzhammer/Roth, Konkursrecht, 14.

<sup>2</sup>Reference: In general, offsetable are claims which are valid, due and of similar type. Article 19/2 KO provides some more extended rules for the offsetability during bankruptcy proceedings.

<sup>3</sup>Holzhammer/Roth, Konkursrecht, 18.

<sup>4</sup>Holzhammer/Roth, Konkursrecht, 17.

<sup>5</sup>Opinions of the Supreme People's Court 1991,

[http://www.fh.com.hk/e02%20Fa%20\(jing\)%20%5B1001%5D%20No%2035.PDF](http://www.fh.com.hk/e02%20Fa%20(jing)%20%5B1001%5D%20No%2035.PDF), Date: 12.12.2001.

Rules referring to the debtor's subsistence can not be found in the Chinese laws. The KO determines the bankruptcy-exempt property to serve as alimony for the debtor. The debtor can be granted pecuniary aid out of the proceeds of a sale which is subject to enforcement under special circumstances.<sup>1</sup>

#### **4. Preferential Claims**

##### **People's Republic of China**

##### **National Legislation**

The Enterprise Bankruptcy Act of 1986

The main-characteristic of preferential claims is their privileged position over bankruptcy claims.<sup>2</sup> They differ from each other because of their character and their rank. There exist in both the EBL and the KO various types of claims which apply in the bankruptcy liquidation proceedings.

- (1) The claim to offset (Article 33 EBL) which was mentioned in the previous chapter.
- (2) Property of the bankrupt firm that belongs to other persons shall be recovered by the persons with the right to such property against the liquidation team (Article 29 EBL).
- (3) Creditors with secured claims that are established before bankruptcy is declared enjoy the right to receive repayment with priority (Article 32 EBL). With respect to secured claims whose amount exceeds the value of the collateral, the part that is not repaid constitutes a bankruptcy claim, and will be repaid in accordance with the bankruptcy proceedings.
- (4) Priority shall also be given to the following bankruptcy expenses (Article 34 EBL):
  - expenses needed for the management, sale and distribution of the bankruptcy property, including the expenses of hiring work personnel;
  - the expenses of the bankruptcy proceedings; and
  - other expenses paid in the course of bankruptcy proceedings for the common interest of the creditors.

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<sup>1</sup>Holzhammer/Roth, Konkursrecht, 9.

<sup>2</sup>Holzhammer/Roth, Konkursrecht, 21.

The CPL also determines that assets for bankruptcy debt repayment shall be used in paying bankruptcy fees first (Article 204 CPL).

### **Local Legislation**

Under the Shenzhen Rules following claims can be regarded as preferential claims:

- (1) Offset claims (Article 67 SR)
- (2) Creditors with claims secured before bankruptcy declaration enjoy preferential repayment rights from that security (Article 65 SR)
- (3) Property not owned by a bankrupt firm shall be recovered by the owner of the property through the liquidation committee (Article 66 SR)
- (4) The following bankruptcy expenses shall take precedence (Article 68 SR):
  - expenses incurred in the management, sale and distribution of bankruptcy property, including expenses for the hiring of working personnel
  - legal expenses incurred during the bankruptcy proceedings
  - remunerations to members of the liquidation committee and
  - other expenses paid during the bankruptcy proceedings for the common benefit of creditors.

The SR also contain four kinds of preferential claims which enjoy preferential treatment in Austria too. The bankruptcy expenses appear to be similar to the Austrian term *Masseforderung*. However, there is a difference between the EBL and the SR because the more modern SR directly mention that remuneration of the liquidation committee is covered by the term bankruptcy expenses. Such a clear provision can not be found in the EBL. The Supreme People's Court clarified this misunderstanding and interprets these expenditures under the first item of the first paragraph of Article 34 EBL.

### **Republic of Austria**

The Austrian technical term *Massebeteiligte* covers four privileged claims which do not differ from the EBL in principal although the KO-regulations are far more detailed as usual:

- (1) the *claim to offset* (Article 19 KO, *Aufrechnungsanspruch*) which seems to be equivalent to Article 33 EBL and Article 67 SR.

- (2) the *Aussonderungsanspruch* (Article 44 KO) which is equivalent to Article 29 EBL and Article 66 SR.
- (3) the *Absonderungsanspruch* (Article 48 KO) can be compared with Article 32 EBL and Article 65 SR.
- (4) the *Masseanspruch* (Article 46 KO) is equivalent to the regulations of Article 34 EBL and Article 68 SR.

In the EBL there are privileged claims with similar characteristics as in the KO but it does not provide any useful legal terms which would permit easy comparison of foreign bankruptcy systems with the Chinese regime. The claims seem to be the same as in the KO with some modifications, particularly in the case of offsets. This has already been described in the previous chapter.

If any items or claims part of the bankruptcy estate that partly or completely do not belong to it, the entitled person may request sorting out. (*Aussonderungsanspruch*, Article 44 KO) The entitled person need not be the owner. The critical element are the economic affiliations (*wirtschaftliche Zugehörigkeit*).<sup>1</sup> For example: lenders have the right to request recovery of the lent item. The Chinese bankruptcy laws provide similar legal tools in order to return foreign items to the real owner.

This Act helps creditors who are entitled to request separate satisfaction of their secured claims out of the proceeds realized by selling collateral. (*Absonderungsanspruch*, Article 48 KO) The collateral object is turned into money and the proceeds are used to satisfy creditors. The concept of this type of preferential settlement of claims is similar to Article 65 SR. Creditors who have secured rights shall receive priority repayment from that security. The ranking of several *Absonderungsansprüchen* follows the principal rules of the EO<sup>2</sup>. (Article 49/2 KO) The court (otherwise the trustee in bankruptcy) distributes the proceeds, once the object was sold.<sup>3</sup> Reasons can be various collateral securities such as liens of the creditors, the right to retain and secured property.<sup>4</sup>

Under the KO particular creditors may have a privileged right to be fully satisfied before other (casual) creditors with bankruptcy claims. They are called: creditors of the estate (*Massegläubiger*).<sup>5</sup> *The bankruptcy expenses (Masseforderungen)* arise after the bankruptcy's opening and are listed in Article 46/1 KO: litigation expenses, expenses needed for the management of the bankruptcy property or the trustee's claims. They can be compared to the bankruptcy expenses listed in Article 34 EBL, respectively Article 68 SR.

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<sup>1</sup>Holzhammer/Roth, Konkursrecht, 22.

<sup>2</sup>Explanation: Act on Executive Proceedings = EO.

<sup>3</sup>Holzhammer/Roth, Konkursrecht, 25.

<sup>4</sup>Holzhammer/Roth, Konkursrecht, 26.

<sup>5</sup>Holzhammer/Roth, Konkursrecht, 28.

The ranking of the *Masseforderungen* is regulated in Article 47 KO. It is important if the bankruptcy estate is not sufficient to cover all bankruptcy expenditures. In contrast to the KO, both the EBL and the SR do not provide a special order for the settlement of bankruptcy expenses, in case the bankruptcy estate does not suffice.

## **5. Bankruptcy Claims**

### **People's Republic of China**

#### **National Legislation**

The Enterprise Bankruptcy Act of 1986

Bankruptcy claims are defined as following in the EBL: Unsecured claims and secured claims for which the priority right to receive repayment has been abandoned and which are established before bankruptcy is declared are bankruptcy claims. (Article 30 EBL) A more detailed description of bankruptcy claims is given in the "Provisional Regulations on the Financial Problems in the Trail Bankruptcy of State-owned Enterprises".<sup>1</sup> Bankruptcy claims have the lowest ranking in the arrangement of the creditors. Before their settlement, the bankruptcy expenses are deducted from the bankruptcy estate; repayment is carried out in the following order (Article 37 EBL):

- (1) the wages of staff and workers and labor insurance expenses that are owed by the bankrupt business unit;
- (2) taxes that are owed by the bankrupt business unit; and
- (3) bankruptcy claims.

Where the bankruptcy estate is insufficient to repay all claims within a single order of priority, it shall be distributed on a pro-rata-basis. The bankruptcy process is unfriendly to creditors and hardly an effective incentive to motivate business performance. Creditors have little influence in the process. They are treated inconsistently and suffer interference of their secured claims for the sake of settling affected workers. Creditor banks commonly recover only 3-10% of their claims<sup>2</sup> but they are at least

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<sup>1</sup><http://www.fh.com.hk/e11%20PR%20on%20Financial%20Problems%20in%20Trail%20Bankruptcy%20of%20SOEs.PDF>, Date: 15.11.2001.

<sup>2</sup>World Bank Office, Beijing, Insolvency, <http://www.worldbank.org.cn/English/Content/485a6232469.shtml>, 20.12.2001.

still in a better position than non-bank creditors. As there is often little money left after employee settlement, State-owned banks, which are the main creditors of SOEs, are often hit hard by SOE bankruptcies and try to oppose SOEs efforts to file for bankruptcy.<sup>1</sup>

In contrast to the KO Chinese bankruptcy law gives preferential standing to employees in the distribution process. Employees are reluctant to accept bankruptcy because bankruptcy means that they lose their identity as state-employees. This identity is important because of the Chinese tradition that a state-employee is guaranteed an "iron rice bowl", or lifetime employment.<sup>2</sup> This catching phrase refers to an entire lifetime employment that was guaranteed under the socialist system. People not only had stable jobs but also stable living. A bowl made of iron will never break, unlike one made of glass or ceramic. The iron was iron in more ways than one. College graduates, high school graduates or graduates of a professional school were subsequently assigned jobs by the government, regardless of whether they enjoyed the job or not. One had to stay in it for a very long time, usually a lifetime. Since the 1980s, China has been reforming the labour market. Workers have to look for their own jobs now. They can be hired and fired. Jobs are not longer as secure as in the past. Often, prospective employees must sign employment contracts.<sup>3</sup> However, although there have already been some interferences into the iron-rice-bowl principle, nobody dares to destroy it definitely because laid off employees would become a serious potential source of social instability.

The employee's priority rule can also be found in the "Proposal for Carrying out State-Enterprise Bankruptcy Act in Some Cities (Document 59)" which indicates that where this directive applies the first priority is to re-settle employees.

Even Article 4 EBL provides that the State shall arrange for appropriate re-employment of staff and workers of bankrupt businesses and shall guarantee the basic living needs prior to re-employment. Other specific measures are separately stipulated by the State Council in Document 59. In summary, they involve the resettlement of the employees, in order to maintain order and stability in the society.

The government of the province or region even has to take appropriate measures to re-train employees, assign employees to other business units or export the employees' skills with a view to resettling the employees and insuring them of basic living before they find a new job.<sup>4</sup>

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<sup>1</sup>Li Shuguang, BL in PRC, <http://www.fas.harvard.edu/~asiactr/haq/200101/0101a006.htm>, Date: 15.11.2001.

<sup>2</sup>Li Shuguang, BL in PRC, <http://www.fas.harvard.edu/~asiactr/haq/200101/0101a006.htm>, Date: 15.11.2001.

<sup>3</sup>Lawrence, Made in China, 77.

<sup>4</sup>State Council Notice, No. 59 (1994),

<http://www.fh.com.hk/e10%20-%20Proposal%20for%20Carry%20out%20SOEs%20Bankruptcy%20Law.PDF>,  
Date 20.12.2001.

The KO contains important provisions for the settlement of employees' claims in the Austrian Bankruptcy Employee Protection Act (*IESG*). It shifts the employee's risk of the employer's bankruptcy to a special fund which is established at the governmental department of labor and social matters. This fund is filled with employer's premiums and has legal personality. It then pays a special amount of money for non-settled claims for wages to employees. This alternative wage is only paid in the case of bankruptcy opening or opening of composition proceedings (Article 1/1 IESG).

In addition to bankruptcy claims, it should be mentioned that the expenses of creditors for participating in the bankruptcy proceedings do not constitute bankruptcy claims.

### **Local Legislation**

The Shenzhen Rules contain a comprehensive definition of bankruptcy claims. One can distinguish between a "positive and negative definition" of bankruptcy claims. The latter one lists which claims can not be recognized as bankruptcy claims. According to Article 59 SR claims which are not secured by property rights before the declaration of bankruptcy are referred to as bankruptcy claims. Even secured property claims for which preferential payment have been renounced are referred to as bankruptcy claims. (Article 60 SR) But where the amount of a claim secured by property is in excess of the value of that security, the portion yet to be discharged shall become a bankruptcy claim. The negative list of items which can not be recognized as bankruptcy claims are following:

- (1) interest accrued on debtors' claims after the declaration of bankruptcy
- (2) expenses paid by a creditor as a result of their participation in bankruptcy proceedings
- (3) creditor's claims which failed to be declared within the stipulated time limit
- (4) creditor's claims which exceed the limitation of actions
- (5) late payment fines, fines, penalties and property to be confiscated which have not been carried out.

After bankruptcy expenses are deducted from bankruptcy estate, the discharge of liabilities shall be conducted in the order set forth in Article 69 SR. Where the bankruptcy estate is insufficient to fully discharge liabilities in the above prescribed order, it shall be distributed proportionally.

In contrast to the KO, the high priority of the employees' claims is laid down in the Shenzhen Rules, as it is in the EBL. The wages owed to employees by the bankrupt enterprise and social insurance premiums come in the first ranking. In contrast to the SR, the Austrian bankruptcy law does not give such a preferential treatment of employees in the distribution process. The importance of content employees is also reflected by Article 8 SR which states that social insurance for employees shall be handled pursuant to the relevant regulations of the Special Zone. The content of this provision may be compared to the provisions of the Austrian Bankruptcy Employee Protection Act (*IESG*) because both provisions try to secure the social needs of employees. However, the SR deals with the social insurance of employees, while the IESG intends to pay the employee's claims in case of bankruptcy. For this reason, the way to favor employees is different. In addition, the IESG is only indirectly linked to the KO because the fund is used to settle employees' claims regardless of the bankruptcy estate.

### **Republic of Austria**

Bankruptcy claims are claims of creditors against the debtor at the time of the bankruptcy opening. (Article 51 KO) Bankruptcy claims have a lower status than above-mentioned privileged claims. Therefore the property which is not used for *Massebeteiligte*, is used for the settlement of bankruptcy claims. Casual creditors get a certain per centage of their claims which is called bankruptcy dividend.<sup>1</sup>

The expenses of creditors for participating in the bankruptcy proceedings do not count as bankruptcy claims according to Article 58 Nr. 1 KO. There is the same provision in the EBL and in the Shenzhen Rules. In addition, the KO states that fines for criminal behaviour can not be regarded as bankruptcy claims. Such a provision can not be found in the EBL itself but is in place in the more modern Shenzhen Rules. In this respect, Article 58 KO is almost identical with Article 64 SR. Latter one is even more detailed than Article 58 KO.

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<sup>1</sup>Holzhammer/Roth, Konkursrecht, 22.

## **6. Fraudulent Conveyance**

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### **The Right to Annul Legal Acts**

#### **People's Republic of China**

##### **National Legislation**

The Enterprise Bankruptcy Act of 1986

In order to provide legal security for creditors, every bankruptcy law has to prohibit fraudulent acts. The possibility to annul legal acts is only one way. Hence, the claim to annul (Article 27 ff KO) also appears in the EBL but - compared with Austria - in a different way: With regard to bankrupt firms which have committed acts listed in Article 35, the liquidation team has the right to petition the People's Court to recover property, which shall be added to the bankruptcy estate. During the period from six months before the People's Court accepts the bankruptcy case until the date that bankruptcy is declared, the following actions of a bankrupt firm are null and void (Article 35 EBL):

- (1) concealment, secret distributions or transfers of property without compensation;
- (2) sale of property at abnormally depressed prices;
- (3) securing with property of claims that originally were not secured by property;
- (4) early repayment of claims that are not yet due; and
- (5) abandonment of the enterprise's own claims.

The term "null and void" might be confusing for Austrian legal scholars because Article 35 EBL seems to determine that the legal acts are *ipso iure* invalid. It is the task of the liquidation team to request the People's Court to recover the property. In Austria, those legal acts are not *ipso iure* invalid but have to be annulled by the court upon an action filed by the trustee. After successful invalidation, the property belongs to the bankruptcy property.

##### **Local Legislation**

The Shenzhen Rules of Article 18 in connection with Article 52 SR are comparable to the EBL provisions. The facts under which the liquidation committee shall be entitled to petition the People's

Court to recover property and to add it to the bankruptcy estate are the same. The annulment of various legal acts listed in Article 18 is possible within a period of 6 months. No distinction is made among all various types of claims as the Austrian KO. Recovered property shall become bankruptcy property.

### **Republic of Austria**

The requirement for the annulment of legal acts is that general facts (Article 27 KO) and additionally one of the various special facts (Article 28 - 31 KO) are fulfilled. **The general rule** to annul legal acts is Article 27 KO. It says that the trustee can request annulment of legal acts of the debtor with which the debtor transferred property in order to settle the claims of individual creditors in case the legal act was taken before the opening of the bankruptcy (Article 27 KO). **Specific regulations** are contained in Article 28 through 31 KO.

Under Article 28 Nr. 1,2,3 KO legal acts of the debtor which are deemed to be a fraud to other creditors, can be annulled. The time period for annulment depends on whether the creditor knew or should have known the debtor's intention to commit a fraud. Furthermore, there are special rules - particularly concerning the burden of proof - which apply to close relatives. There does not exist a proper counterpart to the annulment based on fraud (*Absichtsanfechtung*) in the EBL and the SR.

Article 28 Nr. 4 KO deals with cases in which property was sold at extremely low prices or transferred without any compensation. This kind of annulment can be compared to Article 35 Nr. 2 EBL and Article 18 Nr. 2 SR. The KO-rule only applies to certain types of contracts which have been made one year before the opening of the bankruptcy. It generally deals with sales-contracts, barter-contracts and supply-contracts.

Its Chinese counterpart seems to be in Article 35 Nr. 1 EBL (Article 18 Nr. 1 SR) which mentions that transfers of property without compensation can be declared to be null and void by the People's Court. As well as in all other cases, the period within the responsible organ (according to the KO: the trustee) is entitled to have the transfer annulled, is much longer than in the EBL and SR. It is two years compared to only six months in the EBL respectively the SR.

Article 30 KO regulates the annulment in situations in which a creditor was treated in a preferential way after bankruptcy. Article 30 KO contains similar elements as Article 35 Nr. 3 and 4 EBL. The same applies for the SR. The KO allows the annulment of all securities and repayment of debts not yet

due under defined circumstances one year before the opening of the bankruptcy. The Chinese laws do not provide such a long period for annulment.

Article 31 Nr.1 and 2 KO determines the same period of time for the annulment of legal acts as the EBL provides in general: 6 months before the opening of the bankruptcy. Nevertheless, Article 31 KO determines that only those legal acts can be annulled which were taken despite knowledge of the debtor's inability to pay.

Major differences between the Austrian Bankruptcy Act and the Chinese rules are: **(1)** Article 35 EBL only applies to the annulment during the period of six months before the People's Court declares the bankruptcy opened. The time-period for claims is the same: six months. The KO takes the opening of the bankruptcy as starting point for the beginning of the time limit. The time-limit itself depends on the type of the special annulment claim. **(2)** Under the EBL a liquidation group has to apply to the People's Court to recover the property in case of an invalid action, whereas the responsible organ of the KO is the trustee who is entitled to rescind the action. **(3)** The EBL does not provide special rules which shift the burden of proof for close relatives in certain cases as the KO does. **(4)** Furthermore, the EBL does not contain the formal term of annulment. The rules are less-detailed and the time-limits are very short and do not differentiate between annulment. **(5)** Outside bankruptcy proceedings, legal acts of a debtor are voidable by any creditor under similar circumstances as in the KO provided that an unsuccessful enforcement against the debtor has been attempted (Article 8/1 AnfO).

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**To be continued ...**

With following chapters (about 55 pages):

- Subjects of the Bankruptcy Proceedings
- Bankruptcy Proceedings
- Composition Proceedings

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