

# **Bankruptcy Law in a Comparative Perspective**

## **Austria – Mainland China**

### **Part II**

By Mag. iur. Klaus Peichl

# CURRICULUM VITAE

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- 2) Singapur, 2001, Quellenstudium für die Diplomarbeit mit dem Titel „ Bankruptcy Law in a Comparative Perspective – Austria and Mainland China“

**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.

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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-Engeltsicherungsgesetz (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

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## **SUBJECTS OF THE BANKRUPTCY PROCEEDINGS**

### **破产诉讼的程序**

#### **General Introduction**

The Chinese government plays a special role in business bankruptcies in China. The government's role is both dominant and multi-faceted in SOE bankruptcies. It initiates these bankruptcies, at the same time is the policymaker, the leader and the direct operator in them. The government not only controls their number, scale and speed but also decides what industries and trades are covered under the bankruptcy law. It also covers the costs of SOE bankruptcies.<sup>1</sup> The Austrian legal situation cannot be compared to the Chinese one. The KO does not vest the government with powers and functions in the bankruptcy proceedings. The organ which is in charge of the proceedings is the bankruptcy court. All courts are completely independent in Austria (Article 87 B-VG) and must not be linked with administrative organs such as the government (Article 94 B-VG).

Today's differences in politics, economy and law between Austria and China are the result of special historical developments. Austria provides space for almost any political parties, while China is still ruled by a single Communist party. Furthermore, Austria chose to establish democracy and market economy, while China relied on Communism and the central-planned-economy. The Chinese government's role was important and decisive, especially in economic matters. There existed only State-owned enterprises which have to face deep financial trouble nowadays.

As a consequence, the primary objective of the Austrian and Chinese bankruptcy law could not be more different. In Austria the KO has the function to settle the claims of creditors in a legally effective and legally secure way. The People's Republic of China regards bankruptcy as a legal tool to reform the economy. Government-controlled bankruptcy shall support the changing, respectively the elimination of insolvent State-owned enterprises to prohibit the collapse of the fragile Chinese financial system.

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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.

## 1. Bankruptcy Court

### People's Republic of China

There are four types of general jurisdiction: the Supreme Court, the High Courts, Intermediate Courts and Local Courts. There are no provisions in China specifying which bankruptcy courts should have exclusive jurisdiction over bankruptcy cases. Most of these cases are conducted by the Economic Trial Branch of Local Courts and Intermediate Courts.

#### National Legislation

The Enterprise Bankruptcy Act of 1986

Article 5 EBL determines that bankruptcy cases shall be under the jurisdiction of the People's Court of the debtor's place of business. This short article did not effectively implement the EBL, because it defines only unprecisely and quite vaguely the venue of the court but does not clearly fix which type of bankruptcy court shall have subject matter jurisdiction. For this reason, the Supreme People's Court was forced again to lay down its important "Opinions of 1991" referring to the correct implementation of the EBL. It divided the jurisdiction into a) venue and b) subject matter jurisdiction.

Ad a) As for venue the Supreme People's Court explicitly determines that business bankruptcy cases shall be under the jurisdiction of the *debtor's local People's Court*. The debtor's place of business shall be the location of the firms headquarters.<sup>1</sup>

Ad b) As for subject matter jurisdiction, the People's Court of the same level as that with which the debtor firm is *registered for business* has jurisdiction to deal with the bankruptcy of the debtor's firm.<sup>2</sup> The "Opinions of 1991" distinguish between the registration by the Administration of Industry and Commerce at the county, county city or district level<sup>3</sup>; and above the prefecture and prefecture city level. If a debtor firm is registered with the county Administration of Industry and Commerce, the People's Court at the county level has jurisdiction to deal with the bankruptcy petition of the firm.<sup>4</sup> The

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<sup>1</sup>Opinions of the Supreme People's Court 1991, I. Jurisdiction, Nr. 1

[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>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>3</sup>Opinions of the Supreme People's Court 1991, I. Jurisdiction, Nr. 2

[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>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.

intermediate People's Court shall generally take business bankruptcy cases examined, verified and registered by the Administrative Authorities of Industry and Commerce above the primary level.

According to the plain-meaning of the EBL provisions the People's Court accepts bankruptcy cases, declares and terminates bankruptcy. It is in charge of the bankruptcy proceedings, it establishes the liquidation team, monitors this team, takes the essential measures to secure bankruptcy estate and orders the implementation of the distribution plan. Apart from differences resulting from the Austrian and Chinese bankruptcy proceedings, the tasks of the People's Court are the same in theory. What sounds simple, as the listing of the People's Court's tasks mentioned above, caused severe problems in practice. Chinese courts did not know the system of bankruptcy for a very long time. The judges in large cities have accumulated considerable bankruptcy experience over the last few years, small-city courts still have not. This resulted in differing implementations of the Chinese bankruptcy laws and forced the Supreme People's Court to create legal clarity through many statements.<sup>1</sup>

Besides, China's judiciary is not entirely free of executive control. The government for example appoints judges and allocates budgets for courts.<sup>2</sup> An unknown lawyer from Guangzhou Law Office of Commerce and Finance said of adjudication in bankruptcy matters that:

*"Bankruptcy cases are not decided by the courts - they are really decided by the government. Bankruptcy cases in the PRC have to be approved by the government. The government directs the courts not to accept bankruptcy petitions. The courts often feel helpless when it comes to bankruptcy cases as they do not have the capacity to solve the problem themselves, for example, the power to determine what is to be done with the retired dependents of a particular enterprise, and have to rely on the enterprise and the department in charge to solve the problem. ...*

*It is much easier for the courts when the enterprise involved is a private enterprise because there is none of the problems associated with SOE's and the "iron rice bowl" mentality associated with them."<sup>3</sup>*

Jurisdictional provisions are as short and simple as in the EBL: Debt repayment by bankrupt legal entities are under the jurisdiction of the People's Court in the locality of the legal entity.

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

## **Local Legislation**

The Shenzhen Rules contain an interesting distinction between domestic enterprises and foreign investment enterprises.

A bankruptcy-case involving a foreign investment enterprise shall come under the jurisdiction of the Shenzhen Municipal Intermediate People's Court, whereas a domestic case involving a debtor shall fall under the jurisdiction of the People's Court in the place where the debtor business is located. The Austrian KO does not make any difference in court jurisdiction for foreign enterprises. This does not seem to be necessary because of the powerful tool of rule of law and the different attitude towards proceedings which treat domestic and foreign enterprises equally.

## **Republic of Austria**

The Austrian Civil Court System comprises of three instances: District Courts and Regional Courts, Courts of Appeals and the Supreme Court. The second part of the KO deals with bankruptcy proceedings starting with the jurisdiction in Article 63 KO. Jurisdiction can hardly be compared with the Chinese EBL and the SR because of their differing organization. However, the division in a) subject matter jurisdiction and b) venue seems to be similar.

Ad a) Subject matter jurisdiction lies within the Regional Courts where a single judge controls the proceedings.<sup>1</sup>

Ad b) The venue lies with the court of the district where the debtor has his place of business. In the absence of such place, the venue is determined by the debtor's domicile, residence or the location of assets.

The bankruptcy court is in charge of the opening of the bankruptcy and its termination. It provides bankruptcy proceedings, appoints the trustee, controls his actions, takes the essential measures to secure bankruptcy estate, takes part in the determination of assets and liabilities and orders the implementation of the distribution plan. So far the duties of the Austrian bankruptcy court are comparable with the Chinese People's Court. Nevertheless there are strong differences in practice.

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<sup>1</sup>Holzhammer/Roth, Konkursrecht, 36.

## **2. Trustee in Bankruptcy**

*(respectively: Liquidation Team)*

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

#### **National Legislation**

The Enterprise Bankruptcy Act of 1986

The EBL does not provide a trustee system for dealing with bankruptcies but has a similar institution called: liquidation team. It shall be established in order to take over the bankrupt enterprise within 15 days after the enterprise has been declared bankrupt (Article 24 EBL).

The Supreme People's Court has laid down in its "Opinions of 1991" that prior to the establishment of a liquidation team, the People's Court shall, through consultation with the People's governments at the same level, appoint members of the liquidation team from among the personnel of the superior departments in charge of the business units and governmental departments such as finance, administration of industry and commerce, planning, audit, taxation, price, and labor, as well as other professional personnel. These persons shall be appointed in the form of official orders communicated to them.<sup>1</sup> Since government officials usually have little or no experience in liquidations, an experienced liquidator for a well-known international accounting firm works behind the scenes and assists the liquidation committee in performing their duties in - for example - the case of GITIC.<sup>2</sup> The chair of the liquidation team shall be appointed by the People's Court.<sup>3</sup> The liquidation team is also allowed to hire necessary work staff such as accountants from a certified accounting firm<sup>4</sup> (Article 24 EBL).

The liquidation team is in charge of the keeping, putting into order, appraisal, disposition and distribution of the bankruptcy estate. It shall also carry out the necessary civil actions and can recommend the court to invalidate any of the acts listed in Article 35 EBL conducted by the bankrupt enterprise which took place within 6 months before the court accepted the case<sup>5</sup> (Article 24 EBL). More detailed information about the duties, in particular the appraisal and disposal of the assets are

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<sup>1</sup>Opinions of the Supreme People's Court 1991, VII. Bankruptcy Liquidation, Nr. 52

[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>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>3</sup>Notice No. 2 (Fafa 1997), <http://www.fh.com.hk/e13%20Fafa%20%5B1997%5D%20No%202.PDF>, Date: 20.12.2001.

<sup>4</sup>Opinions of the Supreme People's Court 1991, VII. Bankruptcy Liquidation, Nr. 53

[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>5</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.

mentioned in the Notice of the Supreme People's Court.<sup>1</sup> These functions could be compared with the trustee's duties in the KO. This leads to the conclusion that the liquidation team can be regarded as the Chinese counterpart. The liquidation team is responsible to and shall report on its work to the People's Court (Article 24 EBL). The People's Court is moreover supervising the team. In contrast the KO provides that the trustee is responsible to all involved parties for monetary damages which are caused by his unconscientious behaviour according to Article 80/3 KO.

"Chapter VII Bankruptcy Liquidation Nr. 54 of the Supreme People's Courts Opinions of 1991" states that any acts conducted by the liquidation team which damage the creditors' interests or which are illegal, force the People's Court to intervene, and dismiss the unqualified members of the liquidation team. Besides, it can also appoint new members to the team. In the KO there are similar rules providing for example for the dismissal of the trustee by the bankruptcy court. Moreover the creditor's rights are preserved by following provision: If a decision made by the liquidation team is contrary to the interests of creditors, the adversely affected creditors may apply to the People's Court for annulment of such decision.<sup>2</sup>

The necessary expenditures of the liquidation team fall under the term "expenses" of Article 34 Nr. 1. This has the advantage that those expenses are privileged claims which enjoy highest ranking and are fully paid.<sup>3</sup>

The provisions of Article 201 Civil Procedure Law concerning the liquidation team are similar to the EBL but very short. It will be the task of the Supreme People's Court to clarify the gaps in detailed statements. Article 189 contains special provisions for the organization of the liquidation group applying to companies. Article 189 states that in case of a company declared bankrupt the People's Court shall organize a liquidation group composed of shareholders, relevant departments and specialized personnel and conduct liquidation of the company.

The liquidation group shall exercise the following powers during the period of liquidation:

- (1) Determination of the assets of the company and compiling the balance sheet and list of assets
- (2) Notifying creditors or making public announcement about liquidation
- (3) Monitoring the remaining businesses of the company

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<sup>1</sup>Notice No. 2 (Fafa 1997), <http://www.fh.com.hk/e13%20Fafa%20%5B1997%5D%20No%202.PDF>, Date: 20.12.2001.

<sup>2</sup>Opinions of the Supreme People's Court 1991, VII. Bankruptcy Liquidation, Nr. 55  
[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, VII. Bankruptcy Liquidation, Nr. 68  
[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.

- (4) Paying taxes
- (5) Clearing credits and debts
- (6) Disposal of the remaining assets after all the debts have been paid off
- (7) Participation in civil proceedings on behalf of the company

## **Local Legislation**

The Shenzhen Rules do not provide a trustee system either but have an organ called "liquidation committee" which has similar functions. The People's Court shall appoint a liquidation committee after a firm was declared bankrupt in order to take control of the bankrupt firm. The members shall be chosen and appointed by the People's Court from among persons within relevant government departments and such professional personnel as certified accountants and lawyers. The last two examples of qualified personnel improve the application of the SR. The EBL only refers to professional personnel without giving any clear examples. It would be the Supreme People's Court task to interpret the term "professional personnel". The KO provides detailed rules in Article 80/2 KO by stating that only persons who have the necessary knowledge in business management and law, can be appointed as trustee in bankruptcy.

After the declaration of bankruptcy, the bankrupt business unit has forfeited the right to manage and dispose of bankruptcy estate (Article 44 SR). The liquidation committees shall be responsible for keeping, stock-taking, valuation, disposal and distribution of bankruptcy estate. Furthermore, it may conduct necessary civil actions in accordance with the Act. The duties are the same as the one of the liquidation team in the EBL and also comparable with the Austrian trustee's tasks. A detailed comparison is given below.

The liquidation committee is responsible to and shall report on its work to the People's Court (Article 46 SR). This provision is the same as in the EBL but not comparable with the KO, where the trustee is explicitly responsible to all involved persons according to Article 80/3 KO. When it is deemed necessary, the People's Court may replace members of the liquidation committee (Article 46 SR). Under KO provisions, it is also possible to dismiss the trustee for important reasons. However, there is a gap in the KO because it does not specify the term "important reasons".

The KO defines that the trustee's claims are regarded as *Masseforderungen*. In comparison with the KO, the term "bankruptcy expenses" as it is mentioned in Article 68 SR refers to the expenditures of the liquidation committee. These expenses have the highest ranking in the distribution process and

therefore belong to those claims which enjoy preferential treatment. The remuneration of the liquidation team is subject to similar rules as the compensation of the trustee under the Austrian Bankruptcy Act.

### **Republic of Austria**

The bankruptcy court officially appoints the trustee in the decree which opens the bankruptcy. The appointment is announced to the public (Article 80/1 KO). In contrast to the EBL, the administrative subjects such as the governments of various levels are not involved in the appointment of the trustee. The courts and therefore judges are completely independent. Article 94 of the Austrian Federal Constitution strictly prohibits connections between administrative and judicial subjects. Furthermore, the liquidation team does not seem to be independent from the governmental agencies, as the trustee of the KO. The Austrian bankruptcy law appears to be stricter because it does not even allow the appointment of a trustee who is a close relative of the debtor or close to one of the creditors (Article 80/3 KO).

In contrast to the EBL, the KO also puts some features on the institution of the trustee. Only persons who have the necessary knowledge of business management and law may be appointed as trustee (Article 80/2 KO). In particular: lawyers and business consultants. Trustees are allowed to hire necessary work personnel with special knowledge in for example: accounting.<sup>1</sup> Article 86/1 KO provides rules for the appointment of additional administrators who shall assist the trustee if required by the extent of the business.

The trustee's duties are as follows:

- (1) Representation of the bankruptcy estate
- (2) Investigation of the debtor's economic situation
- (3) Continuation of the debtor enterprise
- (4) Investigation of the assets and liabilities
- (5) The selling of the assets
- (6) Distribution of the proceeds

The trustee is responsible for damages in property to all concerned persons. Furthermore, he is supervised by the bankruptcy court and the committee of creditors. The bankruptcy court is allowed to

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<sup>1</sup>Holzhammer/Roth, Konkursrecht, 37.

give oral and written instructions<sup>1</sup> and can even dismiss the trustee for important causes (Article 87/1 KO).

### **3. Creditors' Meeting**

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

##### **National Legislation**

The Enterprise Bankruptcy Act of 1986

A creditor's meeting is a temporary organization whose members are all the creditors of the enterprise subject to bankruptcy proceedings. (Article 13 EBL) The chairman of the creditors meeting is designated by the People's Court from among creditors. He also has the right to vote. The first creditors' meeting is called by the People's Court, and shall be convened within 15 days after the expiration of the period for reporting claims (Article 14 EBL), whereas in Austria, it shall take place 14 days after the bankruptcy-opening. Under the EBL, it is chaired by the People's Court whereas subsequent creditor's meetings are presided over by the chairman of the creditor's meeting.<sup>2</sup> In the KO all creditors' meetings are chaired by the bankruptcy court. Members of the creditors' meeting have the right to vote, provided, however, that creditors with secured claims which have not abandoned their priority right to be repaid are excepted.

Decisions of the creditors' meeting may be adopted by a simple majority of the creditors who have the right to vote and are present at the meeting provided the amount of their claims represents more than half of the total amount of unsecured claims. (Article 16 EBL) This double majority requirement is destined to ensure that all the creditors will have an opportunity to express their views and to exercise their rights at the creditors' meeting. With respect to decisions adopting a draft settlement agreement, the majority of the creditors present at the meeting in favor of such decisions must represent no less than two-thirds of the total amount of the unsecured claims. Decisions of the creditors' meeting are binding on all creditors. Creditors who consider decisions of the creditors' meeting to be in violation of law may, within seven days after the creditors' meeting has made such decisions, apply to the People's Court for judgement.

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<sup>1</sup>Holzhammer/Roth, Konkursrecht, 39.

<sup>2</sup>Opinions of the Supreme People's Court 1991, IV. Creditor's Conference, Nr. 23  
[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.

The creditors' meeting does not play such an important role as in the KO because it has less powers than in Austria. According to Article 15 EBL the creditors' meeting has the function and power

- (1) to examine materials of proof relating to the claims, and to confirm the amount of such claims and whether or not the claims are secured with property;
- (2) to discuss and adopt a draft settlement agreement; and
- (3) to discuss and adopt a plan for the disposition and distribution of bankruptcy estate.

These few powers of the creditors' meeting and the fact that they are engaged only late in the process are the reasons why only a few creditors other than the main State-owned commercial banks show up in the meeting.<sup>1</sup> Article 200 CPL also offers the creditors the possibility to establish a creditors' meeting to discuss and approve the disposal of the bankrupt estate, the distribution plans and the agreement of settlement. The term "creditors' meeting" of the Civil Procedure Law<sup>2</sup> was changed to "creditor's conference".

### **Local Legislation**

A creditors' meeting is composed of all creditors. The chairperson of the creditor's meeting shall be appointed by the People's Court from among those creditors with voting rights (Article 19 SR). The first creditor's meeting shall be convened by the People's Court within 15 days of the expiry of the claim declaration period (Article 21 SR). There are special rules for later creditors' meetings. As well as in the EBL, they may be convened when considered necessary by

- the People's Court or the chairperson,
- at the request of the liquidation committee, or
- by creditors whose claims are equal to one quarter of the total non-property guaranteed claims.

The KO also offers the possibility of extraordinary meetings. They shall be called by the trustee, the creditors' committee or by at least two creditors but only under various circumstances. Members of a creditor's meeting have the right to vote with exception of creditors with security who have to renounce their preferential repayment rights. In order to become a member of the creditors' meeting with all powers, the guarantor has to discharge liabilities on the debtor's behalf (Article 19 SR). Decisions on

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

Date: 20.12.2001.

<sup>2</sup><http://www.moftec.gov.cn>, Date: 14.10.2001.

the adoption of a draft conciliation agreement require the approval of a majority of creditors with voting rights to be present at the meeting in order to be valid. Moreover, the combined amount of claims represented by those members must be equal to two-thirds or more of the non-property guaranteed claims. In contrast to this provision, the KO contains specific rules for the adoption of compulsory composition. Other decisions do not require this qualified consent. They are adopted if they are approved by a majority of creditors with voting rights who are present at the meeting. Moreover, the combined amount of claims represented by those members is equal to one-half or more of the total amount of unsecured claims (Article 23 SR). Decisions are binding on all creditors. In case a creditor disagrees with a decision of the creditors' meeting, he can request a ruling of the People's Court within 7 days after the decision has been passed. The ruling is not subject to an appeal. The tasks of the committee are similar to the rules of the EBL. However, Article 22/2 SR contains a major difference. It is a function of the creditors' meeting to discuss and adopt a draft settlement agreement. Settlement provisions play a major role in the Shenzhen Rules. The creditors' meeting may elect a representative from among the creditors to monitor the progress of the liquidation committee. He shall also supervise the conduct of bankruptcy proceedings.

### **Republic of Austria**

Just as in the provisions of the EBL and the SR, all creditors are member of the creditor's meeting according to the Austrian bankruptcy law.<sup>1</sup> The creditors' meetings are called by the bankruptcy court which also acts as chairman. In contrast to Article 91/1 KO, in the EBL (SR) a special designated chairman is in charge of the creditor's meeting. The KO states that the first creditor's meeting (Article 74/3 KO) is generally called within 14 days after the opening of the bankruptcy, another one (Article 91a KO) within 90 days after the bankruptcy opening, in order to decide about the continuation or closure of the firm. The last-mentioned meeting is called hearing for discussion on the trustee's reports. Only creditors who are present at the meeting have a right to vote (Article 92/1 KO); provided that their claims were determined by the Regional Court (Article 93/1 KO). Decisions and motions under Article 87/2 KO, 88/1 and 3 KO require absolute majority which is calculated according to the amount of claims.<sup>2</sup>

In Austria, the creditor's meeting may have a real impact on the bankruptcy proceedings. The situation is different in China where the meeting has only a few functions and powers. The KO vests the creditors' meeting with following functions:

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<sup>1</sup>Holzhammer/Roth, Konkursrecht, 40.

<sup>2</sup>Holzhammer/Roth, Konkursrecht, 41.

- (1) the dismissal of the trustee in bankruptcy (Article 87/2 KO)
- (2) the establishment of the creditors committee (Article 88/1 KO)
- (3) the dismissal of single members of the creditors' committee (Article 88/3 KO)
- (4) special functions in the hearing on reports (Article 91a KO)
- (5) the acceptance or rejection of the proposal of compulsory composition

The decisions of the creditor's meeting are supervised by the bankruptcy court which has even the power to prohibit decisions which are contrary to the common interest of the creditors (Article 95/3 KO).

#### **4. Legal Representative**

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

##### **National Legislation**

The Enterprise Bankruptcy Act of 1986

The legal representative is mentioned in various scattered parts in the EBL: Chapter III "Creditor's Meeting" and Chapter V "Bankruptcy Declarations and Liquidations". The KO does not show separate rules for a subject similar to the legal representative. The registered legal representative can be either the chairman of the board of directors in a limited liability company or the general manager of a State-owned enterprise. His primary duty is to preserve the property before a liquidation committee takes over.<sup>1</sup> However, the legal representative has three important functions:

- (1) He is forced to attend the creditor's meetings where he has to answer the questions raised by the creditors (Article 13 EBL). If the debtors refuse such conferences, the People's Court can issue warrants for them pursuant to the provisions of Article 100 of the Civil Procedure Law.<sup>2</sup>
- (2) He is responsible for keeping property, account books, documents, materials, seals, etc. of the debtor enterprise before its transfer to the liquidation team (Article 27 EBL).

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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>Opinions of the Supreme People's Court 1991, IV. Creditor's Conference, Nr.32

[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.

- (3) In case the People's Court or the liquidation team demand to carry out work until the conclusion of the bankruptcy proceedings, he is not allowed to leave his position without authorization (Article 27 EBL).

Other regulations for the legal representative are laid down in the Articles 41 and 42 which refer to the punishment.

### **Local Legislation**

The Shenzhen Rules determine that the legal representative and the relevant personnel is not allowed to leave their posts without authorization after bankruptcy declaration. They have to work according to the requirements of the People's Courts (Article 50 SR). The legal representative and the relevant personnel, who are responsible for the bankrupt enterprise, have the duty to hand over to the liquidation committee all books and all property under its management. They have to answer questions from the liquidation committee concerning property and business operations (Article 53 SR). In order to answer questions, the legal representative and the relevant personnel shall also attend the creditors' meetings. However, they do not have the right to vote.

### **Republic of Austria**

There is no exact counterpart to the legal representative in the Austrian bankruptcy system. According to Article 1 of the "Provisions for registration of legal representatives in business units" the ruling shall standardize the registration of legal representatives of legal persons. The concerned person is not permitted to become legal representative if she has committed certain listed criminal acts or she has already been legal representative, member of the board, etc of a firm that has run bankrupt due to bad management and has been liquidated and is personally responsible for the bankruptcy (Article 4).

The Austrian legal environment only seems to know partly provisions such as the appointment of managers for commercial matters (*handelsrechtlicher Geschäftsführer*) and managers for conducting business (*gewerberechtlicher Geschäftsführer*). Managers of commercial enterprises with the status of a legal person are registered in the registry of companies (*Firmenbuch*). This has the function to determine subjects entitled to represent the firm. An argument for the non-existence of a full counterpart to the legal representative in the Austrian bankruptcy system is that after the trustee has been appointed with the decree opening bankruptcy, all powers and functions of the firm are automatically transferred to him. So there is no gap between acceptance and adjudication of bankruptcy

during which a subject as the legal representative shall be responsible for instance for the keeping of assets and documents.

## **5. Committee of Creditors**

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

In contrast to the Chinese bankruptcy rules which are not familiar with the committee of creditors, the bankruptcy court has to establish a creditors committee if the special kind or particular extent of the debtor firm makes such step necessary (Article 88/1 KO). Its main-function is to supervise and to support the trustee. In certain cases (listed in Article 116, Article 117 KO) the trustee even needs the authorization of the creditors committee. Above all, the trustee is obligated to ask this committee in all important cases.

In a bankruptcy case where it is not necessary to establish a committee of creditors, the bankruptcy court shall exercise its functions. Where the consent of the committee of creditors is stipulated, the court needs a decision of the creditor's meeting (Article 90 KO).

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## **BANKRUPTCY PROCEEDINGS**

### **破产诉讼**

#### **1. Cause of Bankruptcy**

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

The cause of bankruptcy is a collection of specific factual elements to open bankruptcy proceedings. Together with the capacity to have standing in bankruptcy proceedings, it constitutes the main condition for bankruptcy proceedings to start.

#### **National Legislation**

The Enterprise Bankruptcy Act of 1986

Firms which are unable to repay debts that are due because of poor operations and management resulting in serious losses shall be declared bankrupt in accordance with the provisions of this Act (Article 3 EBL).

The EBL premises the cause of bankruptcy on three elements:

- (1) poor operation and management
- (2) serious losses
- (3) inability to repay debts

The basic element to open bankruptcy proceedings is the firm's inability to pay debts. This criterion is an objective standard and has nothing to do with the debtor's willingness to pay the due debts. In practice, the condition should not be considered as a straightforward balance sheet criterion. In other words, in determining whether a firm in question is unable to repay the debt or not, judges should take into consideration the overall condition of the enterprise such as its assets, credit situation, technology

involved, labor force employed and the size of the debt outstanding.<sup>1</sup> The definition of Article 3 EBL is too vague and opens several ways to interpretation. "Losses"<sup>2</sup> mean a negative difference between sales revenues and the sum of the costs, taxes and other expenses of an firm. The greater such a difference is, the heavier the losses will be. However, the term "serious losses" is too vague and leads to uncertainty in practice.<sup>3</sup> "Bad management", which is the direct reason for great losses, excludes losses caused by central planning and policies, prices control and bad decision by the government.<sup>4</sup> The Supreme People's Court attempted to clarify inability to pay debts in its detailed "Opinions of 1991". It provides that bankruptcy is indicated by:<sup>5</sup>

- (1) delay in the repayment of debts that have matured
- (2) creditors have demanded payment and
- (3) clear evidence that a debtor is unable to pay its debts

A debtor may be judged insolvent if he terminates the payment of due debts and if such situation continues over a period of time without any evidence to the contrary. The determination of whether a debtor is able to repay due debts is a key element in a decision of the People's Court of whether a firm meets the criteria for declaration of bankruptcy. Mere insolvency does not necessarily lead to the declaration of bankruptcy.

Firms for which creditors file for bankruptcy shall not be declared bankrupt under any of the following circumstances:

- (1) public utility businesses and business units which are important to the national economy and the people's standard of living, for example those providing water, gas and electricity to the public, public transportation and communication firms, banks and insurance companies<sup>6</sup> for which the relevant government departments grant subsidies or adopt other measures to assist the payment of debts;
- (2) firms that have obtained guarantees for the payment of debts within six months from the date of the petition for bankruptcy.

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<sup>1</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>2</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>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, Restructuring, [http://www.fh.com.hk/Lecture\\_1.pdf](http://www.fh.com.hk/Lecture_1.pdf), Date: 18.12.2001.

<sup>5</sup>Opinions of the Supreme People's Court 1991, III. Acceptance of Bankruptcy Cases, Nr. 8

[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>6</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.

The Austrian KO does not protect businesses which are important to national economy or the people's standard of living. There are no special provisions for these key firms. All the business units are treated equally in bankruptcy proceedings.

Chapter XIX of the Chinese Civil Procedure Law has a separate definition for the cause of bankruptcy. Article 199 CPL states: " Where a legal person enterprise lacks the ability to repay the debt due for repayment because of serious losses, ... may apply to the People's Court to declare ... bankrupt for debt repayment ..." Compared with the definition laid down in the EBL, "bad management" is deleted, but "serious losses" is preserved in the Law of Civil Procedure.

The Corporation Law developed different rules about the cause of bankruptcy than the EBL and the CPL. Bankruptcy is mentioned in Article 189 and 196 CL. Both articles clearly determine "unable to pay off its due debts"-requirement as the key for declaring the debtor bankrupt; no matter whether or not the company suffers losses and how great the losses are.<sup>1</sup>

### **Local Legislation**

The cause of bankruptcy is defined in Article 3 Shenzhen Rules: "When a business firm is unable to discharge debts which have fallen due it may apply for conciliation or declaration of bankruptcy. A business that ceases to pay debts which have fallen due shall be regarded as unable to discharge debt which has fallen due." The last provision is similar to the Article 66/2 KO. This clear and simple language improves proceedings. The EBL itself - for example - does not contain such a rule. For this reason, it was the Supreme People's Court that clarified the legal situation. Since this published "interpretation", the mentioned provision also applies for the EBL.

### **Republic of Austria**

The Austrian bankruptcy law distinguishes between legal persons and non-legal persons. In the case of legal persons the KO speaks of "overindebtedness" in contrast to the Chinese bankruptcy laws. The key words of the EBL, the CPL, CL and the Shenzhen Rules are "... unable to pay due debts". The term "overindebtedness" is not mentioned; at least not in the CL, CPL and Shenzhen Rules which only apply for enterprises with legal person status. Article 66 KO sets forth as key cause for the opening of the bankruptcy proceedings the inability of the debtor to pay debts which have become due. This

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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.

requirement is deemed to be met if the debtor ceases to pay his outstanding debts (Article 66/2 KO). Such a situation must continue over a period of time. The relevant case law takes into account all circumstances and sometimes tolerates delays of payments over a period of three months.<sup>1</sup> The mere risk of bankruptcy is insufficient neither in Austria nor in the Chinese bankruptcy laws.

Indebtedness is defined as financial situation where liabilities exceed assets. It is regarded as an additional cause for the opening of bankruptcy proceedings in following cases:

- the business assets of legal persons (Article 67/1 KO)
- the estate of deceased persons (Article 67/1 KO)
- etc.

\* \* \* \* \*

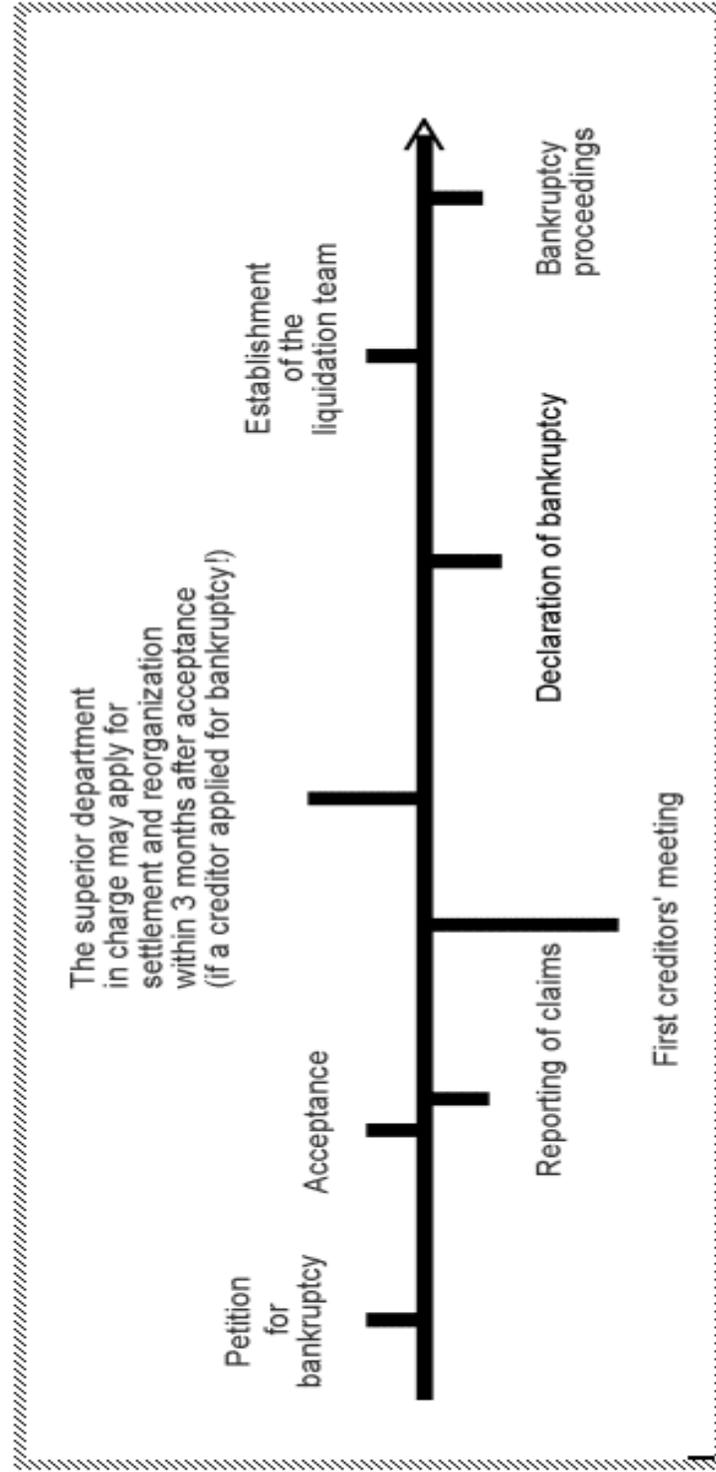
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<sup>1</sup>Holzhammer/Roth, Konkursrecht, 52.

## 2. Visualized and Simplified Plan of the Bankruptcy Proceedings

People's Republic of China

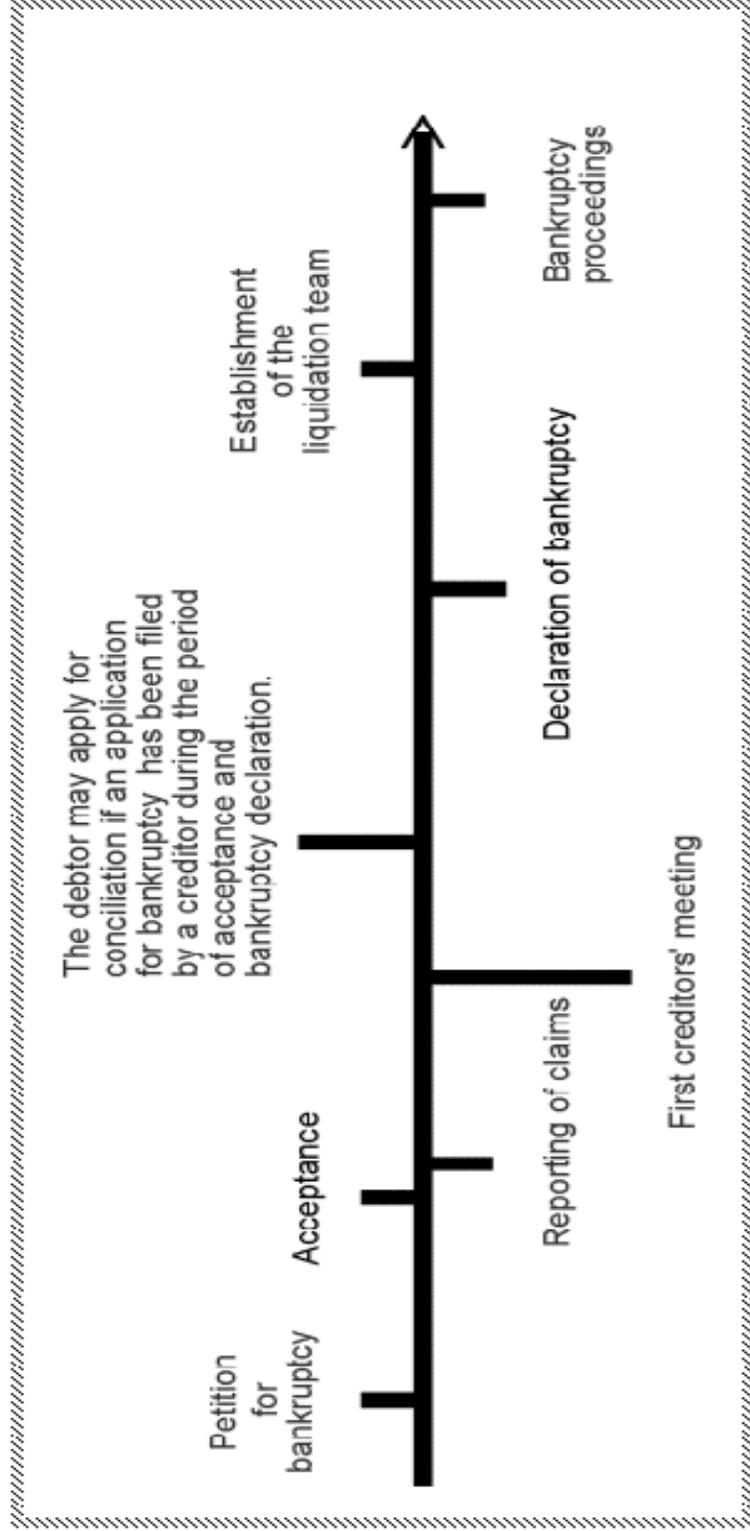
Enterprise Bankruptcy Act of 1986



## 2. Visualized and Simplified Plan of the Bankruptcy Proceedings

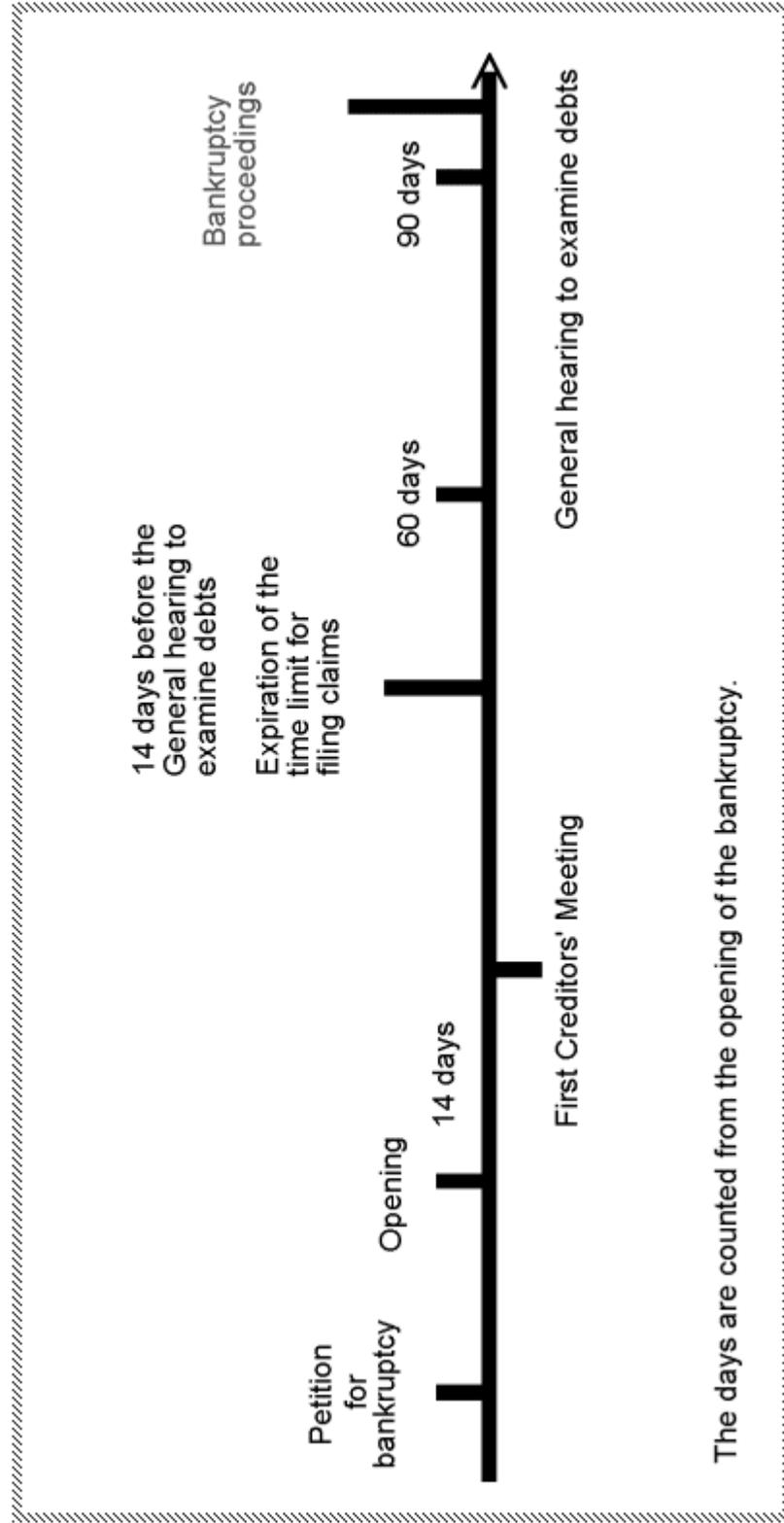
People's Republic of China

Rules of Shenzhen Economic Zone on Enterprise Bankruptcy



## 2. Visualized and Simplified Plan of the Bankruptcy Proceedings

Republic of Austria



### **3. Bankruptcy Opening**

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

##### **National Legislation**

The Enterprise Bankruptcy Act of 1986

A petition for bankruptcy may be made by one of the creditors (Article 7 EBL). The debtor may also petition for bankruptcy but he requires the consent of the superior government department (Article 8 EBL).

Article 8 EBL has no counterpart in the Austria bankruptcy law. The EBL only applies to State-owned businesses which are enterprises owned by the whole people. The government tries to control bankruptcy by forcing the debtor to reach the approval of the superior government department. The Shenzhen Rules and the Civil Procedure Law have eliminated governmental interference and orientate themselves on modern bankruptcy laws where only the debtor and the creditors can file for bankruptcy. In contrast to the Austrian bankruptcy law the EBL, the CPL and even the Shenzhen Rules do not force the debtor to file for bankruptcy within a special period of time if he is unable to pay due debts.

The People's Court has to decide within seven days<sup>1</sup> upon receiving a bankruptcy petition whether or not to accept the case. If the court decides to accept the bankruptcy case, it must notify the debtor firm and make a public announcement of the bankruptcy proceedings within ten days (Article 9 EBL). The debtor firm has to file account statements and a list of its debts and claims to the court within fifteen days of notification. After receiving this information, the court should, within ten days, notify the identified creditors. The public announcement and the notice should contain details of the first creditor's meeting to be held. Where the creditor has made the bankruptcy petition, the debtor has to file all above-mentioned relevant materials to the People's Court within fifteen days (Article 10 EBL).

In practice, due to China's economic structure and tradition, it is still difficult for business firms to go bankrupt. Creditor's rights are, in theory, enforced through a court system that is still not considered mature or independent and is marred by local protectionism.<sup>2</sup> The following case summary illustrates this point:

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<sup>1</sup>Opinions of the Supreme People's Court 1991, II. The Submission and Acceptance of Bankruptcy Applications, Nr. 6, [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>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.

*"On 11 May 1991, the Higher People's Court of Hainan Province made a public announcement that the court, in accordance with Articles 2, 3, 5 and 8 of the Bankruptcy Law, accepted a bankruptcy application made by Hainan Foreign Capital and Material Supply Co (the "Company") and its subsidiaries on 18 March 1991. Creditors of the Company and its subsidiaries were advised to report their claims to the court within 3 months, starting from 15 May 1991, and to provide the court with evidence of their claims. The creditors were also advised that the first creditors' meeting would be held at 9am on 25 August 1991.*

*The Company was established in 1984 as a State-owned enterprise, which later on established 12 subsidiaries including 2 subsidiaries with foreign investment. According to available information, the president of the Company, Mr Zhang Chang Biao seriously neglected his duties and engaged in illegal business activities which consequently resulted in heavy economic losses to the Company. By the time Zhang was arrested, the Company had a total debt of Rmb 110.94 million, with a total of Rmb 74.14 million in assets and a net deficit of Rmb 44.8 million. Three banks started a lawsuit and had the Company's property frozen. On 24 April 1990, the Company applied to its superior department, the Planning Commission of Hainan Province for bankruptcy, which refused to accept the case. On 5 August 1990 the governor of Hainan accepted the application. On 11 October and 12 November 1990, the Company submitted a bankruptcy application twice to the Higher People's Court of Hainan Province. Eventually, after investigation by Chinese bankruptcy experts and under the pressure of the public, the People's Court accepted the case and made a public announcement accordingly."<sup>1</sup>*

The Civil Procedure Law states that either the creditor or the debtor can initiate bankruptcy. In contrast to the EBL, the need of the approval of a superior department was omitted. This is because the CPL addresses non-State-owned enterprises. The official text of Article 199 CPL speaks of "may apply" which stands in sharp contrast to the KO where at least the debtor is obligated by law to file for bankruptcy within 60 days after he turned unable to pay due debts (Article 69/2 KO).

Article 196 Company Law contains a significant breakthrough. Under the EBL and the Law of Civil Procedure only creditors and debtors can apply for bankruptcy. The situation is different in the CL, where Article 196 CL determines that the liquidation group shall immediately apply for declaration of bankruptcy of the company with the People's Court if after the clearance of the assets and compilation

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<sup>1</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.

of the balance sheet and list of assets of a company to be liquidated due to dissolution or liquidation, the assets of the company are found to be insufficient for debt payments.

### **Local Legislation**

According to Article 9 Shenzhen Rules the debtor or the creditor, who is unable to discharge debts which have fallen due, may petition for a declaration of bankruptcy. There are different rules for State-owned enterprises. When a SOE is unable to discharge debts which have become due and neither the creditor nor the debtor have filed a bankruptcy petition, the department in charge of the SOE's property rights may file for a declaration of bankruptcy. None of the rules forces the creditor, the debtor or the department in charge of the SOE to apply for bankruptcy declaration. The principle that only the debtor, creditor and department in charge of the SOE's property rights are allowed to apply for bankruptcy suffers exceptions:

- Article 10 SR vesting the right in the liquidation committee under special circumstances and
- Article 43 SR transfers the right to declare the debtor bankrupt to the People's Court if it is discovered during civil litigation or enforcement proceedings that the debtor is unable to discharge his debts which have fallen due or does not meet settlement requirements.

There is no similar provision in the EBL. A judicial statement of the Supreme People's Court has stated quite the opposite by explicitly forbidding the People's Court to declare the debtor bankrupt, if it discovers the insolvency of the debtor during the civil proceedings or civil execution procedures.<sup>1</sup>

The People's Court has to decide within 10 days of the receipt of a petition whether or not to hear the case. If a petitioner disagrees with a decision taken by the People's Court, he may file an appeal (Article 12 SR). The debtor shall be notified within 10 days of the hearing of a bankruptcy case in the People's Court and a public announcement shall be made. Creditors who are already known to the People's Court shall be notified by the People's Court. In case the bankruptcy petition has been filed by a creditor, the debtor shall, within 15 days of receiving notification from the People's Court, submit to the People's Court a property situation statement and a detailed list of the liabilities submitted by the debtor (Article 13 SR).

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<sup>1</sup>Opinions of the Supreme People's Court 1991, III. Acceptance of Bankruptcy Cases, Nr. 15, [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.

## Republic of Austria

If the **debtor** files for bankruptcy the court has to open proceedings immediately (Article 69/1 KO). The debtor is obligated to do so, within sixty days after he becomes unable to pay due debts, but only if the necessary prerequisites (Article 66 and Article 67 KO) for the opening of the bankruptcy are met (Article 69/2 KO): the inability to pay due debts or in certain cases indebtedness. The duty to file for bankruptcy concerns physical persons, personally liable partners and liquidators of a commercial company and agents of legal entities (Article 69/3 KO).

The **creditor** may also file for bankruptcy. The court has to open bankruptcy without undue delay if the creditor shows that he has a bankruptcy claim and that the debtor is unable to pay due debts. The bankruptcy claim need not be due (Article 70/1 KO). The prerequisites for the opening of bankruptcy in China are comparable with the Austrian Bankruptcy Act:

- (1) Cost-recovery
- (2) Bankruptcy claim of the creditor
- (3) Inability to pay due debts or overindebtedness

Cost recovery means that the amount of debtor's property must suffice to cover the costs of the bankruptcy proceedings. It is the courts' responsibility to determine that point (Article 166 KO). Several scattered but more detailed provisions are contained in the Articles 71, 71a, 71b, 72, 72a KO. Chinese counterparts exist in Article 76 of the Shenzhen Rules and in Article 34 EBL. Both arrange the termination of the proceedings. Both creditors and debtors may file for bankruptcy to start the bankruptcy-opening. The bankruptcy courts usually do not have the function to initiate it.<sup>1</sup> In some exceptional cases they have to start bankruptcy proceedings on their own initiative. For example: the *Anschlusskonkurs*.

The Chinese EBL adheres to the "doctrine of application" but does not provide any circumstance under which the court could declare a debtor bankrupt.<sup>2</sup> The Supreme People's Court states explicitly: "If, during the process of civil proceedings or civil execution procedures, a People's Court finds that a debtor is insolvent, it shall notify the debtor that it may apply to the local People's Court for bankruptcy. ... If no applications are submitted for bankruptcy, the People's Courts have no power to declare the debtors bankrupt and any original proceedings or execution procedures may be carried out without interruption."<sup>3</sup>

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<sup>1</sup>Holzhammer/Röth, Konkursrecht, 48.

<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>Opinions of the Supreme People's Court 1991, Acceptance for Bankruptcy Cases, Nr. 15, [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.

The bankruptcy court issues a decision on the bankruptcy petition. In case where petitioners are not satisfied with a decision of the court, rejecting a petition for bankruptcy, they may apply to the court of the appellate level. In addition, the measures of preservation and notices are taken simultaneously with the opening of the bankruptcy.<sup>1</sup>

According to Article 78/1 KO the bankruptcy court has to take all measures which are necessary to secure the estate and which ease the continuation of the enterprise. Furthermore, the court has to inform (for example) post offices, airports and railroad stations in the district where the debtor has his domicile (Article 78/2 KO) as well as all banks where the debtor has deposits. The notification shall also be entered in the land registry (*Grundbuch*) and in the registry of corporations (*Firmenbuch*) (Article 77 and 77a KO).

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<sup>1</sup>Holzhammer/Roth, Konkursrecht, 55.

**4. Reporting of Claims  
and  
General Hearing to Examine Claims**

**People's Republic of China**

**National Legislation**

The Enterprise Bankruptcy Act of 1986

The provisions referring to the reporting of claims are written in Article 9 EBL and are linked to the acceptance of bankruptcy. The period of time the creditors have to file their claims depends on their information or their non-information of bankruptcy petition. Creditors who have been informed of the bankruptcy petition through notice must report the amount of their claims, whether or not they are secured and submit the relevant proof to the court within *one month* after receiving the notice. Unidentified creditors are allowed to report their claims to the court within *three months* after the public announcement.

If a creditor fails to report his claims within the prescribed time it shall be deemed to have abandoned his claims.<sup>1</sup> In contrast, the KO does not include such claims in the bankruptcy proceedings but they shall not be deemed to be relinquished either (Article 107/1 KO). In the Code of Civil Procedure the periods for reporting claims (Article 200 CPL) and the treatment of creditors who have failed to declare their rights within the prescribed time are similar to the EBL.

**Local Legislation**

Under the Shenzhen Rules the reporting of claims follows a process which is similar to the EBL. Creditors shall apply to the People's Court for a declaration of their creditors' rights within 30 days of receiving notification, or within 90 days of the public announcement if they have not received notification. Failure to file a claim within the stipulated time limit shall be regarded as automatic abandonment of that claim. However, this restriction shall not apply if failure to file a claim within the stipulated time limit is not the fault of a creditor and if a claim has been filed before distribution of bankrupt estate. The EBL and the CPL do not have such a rule favoring creditors.

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<sup>1</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.

## Republic of Austria

According to Article 74/3 KO the general hearing to examine claims takes place between 60 and 90 days after the opening of the bankruptcy. Claims must usually be reported 14 days before the general hearing to examine claims. Claims which have not been filed in time, shall not be taken into consideration (Article 107/1 KO). This proceeding is similar to Article 9 EBL which says that creditors who do not report their claims in time shall be deemed to have automatically relinquished their claims. The difference lies in the details. The KO excludes these creditors of bankruptcy but does not block their way to file an action, get a judgement and then have it enforced against the debtor's (bankruptcy-exempt) property or his new purchases. It is also contrary to the KO that all claims have to be reported to the People's Court. In Austria, it is the trustee's duty to register all reported claims in a special list called the filing list (*Anmeldungsverzeichnis*, Article 104/6 KO) and to pass it over to the bankruptcy court. Such a rule would not be possible under the Chinese bankruptcy law because the reporting of claims is controlled by the chapter of "acceptance". The trustee's counterpart - the liquidation group - is not established until the declaration of bankruptcy. This explains why the registration of claims falls within the responsibility of the People's Court under the EBL.

Under Austrian bankruptcy law, all claims must be examined in a general hearing. There are no similar provisions in the Chinese bankruptcy law. A claim is established if its recognized by the trustee and not disputed by bankruptcy creditors (Article 109/1 KO). To determine a claim, the court has to call each claim and give the involved persons the possibility to state their position. The bankruptcy court has to register the results of the hearing (Article 108 KO).

If a claim has been denied by either the trustee or one of the creditors, it can not participate in the bankruptcy. In order to take part in the settlement during the bankruptcy proceedings, the creditor may initiate a lawsuit before the bankruptcy court (Article 110 KO).

The general hearing to examine claims has two important effects:

(1) The determination of the claims spares the creditor to start a lawsuit. It secures settlement of his claim in the bankruptcy proceedings.<sup>1</sup>(2) If a claim has been determined without the debtor's denial, the registration (to be more specific: an extract of the official claims register<sup>2</sup> has the effect of a judgement (Article 1 Nr. 7 EO) which allows the creditor to have it enforced against the debtor's (bankruptcy-exempt) property and after termination of bankruptcy even against his new assets (Article 61 KO).

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<sup>1</sup>Holzhammer/Roth, Konkursrecht, 60.

<sup>2</sup>Holzhammer/Roth, Konkursrecht, 60.

## **5. Hearing on Claims**

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

#### **National Legislation**

Neither the liquidation group nor any other Chinese organ has to examine whether the business unit can be continued or reopened in exactly the same way as the trustee has to do in accordance with the KO. In order to continue the business, the EBL offers the superior departments in charge the possibility to apply for reorganization of the enterprise under special circumstances (Article 17 EBL). The regulations are similar to the compulsory settlement of the KO but only in some basic respects.

#### **Local Legislation**

Under the Shenzhen Rules the situation is similar to the EBL where no proper analogy to the hearing on claims can be found.

### **Republic of Austria**

The trustee has to examine until the hearing on claims whether a temporary continuation or a present undetermined continuation is possible and if a compulsory settlement would meet the creditor's interests and if this is probably possible (Article 81a/3 KO, Article 91a KO). The results are reported in the hearing which can either be connected with the general hearing to examine claims or even meet the purpose of the first creditor's meeting (Article 91a KO). It is the trustee's duty to continue the management of the enterprise until the hearing on reports but it shall be closed if the continuation would increase the creditor's losses (Article 114a KO).

A Chinese counterpart to the hearing of reports, as we know it in Austria, can neither be found in the EBL nor in the Shenzhen Rules. The only ways to avoid bankruptcy and continue the enterprise are to carry out restructuring (EBL) or to apply for conciliation (Shenzhen Rules).

## **6. Declaration of Bankruptcy**

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

#### **National Legislation**

In contrast to the KO, the EBL has three steps of declaring the debtor bankrupt: submission, acceptance and declaration. A firm shall be declared bankrupt if it, in accordance with the provisions of Article 3 EBL should be declared bankrupt; or if, reorganization has been terminated in accordance with the provisions of Article 21 of this Law; and if the business unit, upon the expiration of the period of reorganization, is unable to repay debts in accordance with the settlement agreement. The declaration by the People's Court shall be made public and the creditors and debtors shall be informed to appear at the court. The declaration of the business bankruptcy takes effect from the date of declaration. The bankrupt firm shall stop production and operation as of this date, except for production and operation which the People's Court or the liquidation team deems necessary to maintain.<sup>1</sup>

The provisions of Article 200 Civil Procedure Law are similar to the EBL. After rendering a ruling declaring the commencement of bankruptcy and debt repayment procedure, the People's Court has to notify the debtor and known creditors and issue a public notice.

#### **Local Legislation**

The Shenzhen Rules also provide three steps in declaring the debtor enterprise bankrupt. However, the SR provide a full range of declaration-requirements for the People's Court:

- (1) where conciliation has not been applied for by the debtor after a creditor's bankruptcy application has been accepted for hearing by the People's Court
- (2) where a ruling which is not in favor of the application for settlement has been made in accordance with the provisions of Article 29 of these Rules
- (3) where the draft conciliation agreement is overruled by a creditors' meeting in accordance with the provisions of Article 35 of these Rules

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<sup>1</sup>Opinions of the Supreme People's Court 1991, VI. Declaration of Bankruptcy, Nr.41-43, [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.

- (4) where a ruling which is not in favor of the conciliation agreement has been made in accordance with the provisions of Article 37 of these Rules
- (5) where the conciliation process is terminated in accordance with the provisions of Article 40 of these Rules
- (6) if at the end of the term of conciliation, the debtor is unable to discharge liabilities pursuant to the conciliation agreement.

The difference of acceptance and declaration compared to the KO is once more demonstrated in following situation. After bankruptcy has been *declared*, the bankrupt firm's debtors and property holders may only discharge liabilities or hand over property to the liquidation committee (Article 49 SR). This situation seems to be comparable with Article 3/2 KO. Yet after the *acceptance* of a bankruptcy case by the People's Court, the debtor can not validly discharge of creditor's claims unless repayment is part of the debtor's necessary and normal production. Article 17 SR can be compared with Article 3/1 KO.

In Austria Article 3 KO regulates the effects of the bankruptcy opening. From this point of time, it is the trustee's duty to manage the debtor's assets. Under the EBL, the debtor's assets shall be managed by the debtor himself during the period between acceptance of bankruptcy case and bankruptcy adjudication. It is only after the bankruptcy adjudication that the assets shall be taken over by the team of bankruptcy liquidators. Therefore, there is a large room for the debtor to conceal, unlawfully distribute or waste its assets.<sup>1</sup>

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<sup>1</sup>Wang Weigu, Drafting, <http://www.law.hku.hk/aiifl/events/symposium/papers/wang%20weigu.doc>, Date: 10.1.2002.

## **7. Sale of the Bankruptcy Estate**

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

#### **National Legislation**

After a business unit is declared bankrupt under one of the three circumstances listed in Article 23 EBL, the People's Court has to establish a liquidation team which is responsible for the keeping, putting into order, appraisal, disposition and distribution of the property. Under Article 36 EBL complete sets of equipment in the bankruptcy estate shall be sold as a whole. Only those which can not be sold as a whole may be sold in parts.

#### **Local Legislation**

After the declaration of bankruptcy a liquidation committee has to be established by the People's Court with the power of disposal of bankruptcy estate. Article 54 SR prohibits the liquidation committee to sell bankruptcy estate before the completion of the investigation of claims. But where losses are incurred if bankruptcy estate is not sold quickly, the liquidation committee may, subject to approval of the People's Court, sell the bankruptcy estate. This is not the only case where the approval of the People's Court is required. Seven other cases are listed in Article 55 SR such as the assignment of fixed assets, loans, abandonment of rights.

### **Republic of Austria**

The function of the liquidation team is similar to the ones' of the trustee but more detailed in the KO. Article 114/1 KO forces him to administer and sell the property. In addition, he has to obtain statements and agreements of the committee of creditors (Article 114 KO). Money which is not required to pay bankruptcy expenditures has to be disposed. All assets belonging to the bankruptcy estate shall be sold by court on the request of the trustee (Article 119/1 KO). There exist only a few exceptions in the KO. Finally, the trustee has to report about the sales to the court (Article 121 KO).

## **8. Distribution of the Proceeds**

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

#### **National Legislation**

The liquidation team has to propose a distribution plan for the bankruptcy estate. It must be adopted by the creditors meeting and submitted to the People's Court for judgment before implementation (Article 37 EBL). In Austria, it is the trustee's duty to prepare such a plan which then must be approved by the committee of creditors. Once the plan had been passed on to the People's Court, it must be examined by the court.

#### **Local Legislation**

Under the Shenzhen Rules, the liquidation committee has to prepare a distribution plan. It shall be implemented after its discussion and adoption by a creditors' meeting and submission to the People's Court for ruling (Article 70 SR). In contrast to the EBL, the SR also provide a solution in case no bankruptcy estate distribution plan has been passed by two successive creditors' meetings. Furthermore, the liquidation team has to prepare a distribution schedule within 30 days from the date on which a bankruptcy estate distribution plan has been confirmed by the People's Court. It must be approved by the People's Court which then has to make a public announcement. According to Article 74, the liquidation committee shall request the People's Court to conclude bankruptcy proceedings and to make a public announcement when the distribution of the bankruptcy estate is completed.

### **Republic of Austria**

In contrast to the EBL, it is the trustee who usually has to work out a distribution plan which needs the consent of the committee of creditors. After these steps he has to pass the plan on to the bankruptcy court (Article 129/2 KO) which provides for its public announcement and notifies the debtor and creditors after the plan's examination (Article 130/1 KO). The distribution of the property to the bankruptcy creditors is continued as long as there is enough property (Article 128/2 KO). The distribution is carried out by the trustee after the agreement with the committee of creditors and the consent of the bankruptcy court (Article 128/3 KO).

The final distribution is carried out in accordance with a formal distribution plan (Article 136/2 KO).<sup>1</sup> Article 136/1 KO regulates that the all the property has to be sold, all claims have to be settled all claims of the trustee have to be determined and the final settlement must be approved.

New assets which appear after the termination of the bankruptcy are redistributed. The EBL contains such a provision too.

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<sup>1</sup>Holzhammer/Roth, Konkursrecht, 67.

## **9. Termination of Bankruptcy Proceedings**

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

#### **National Legislation**

The Enterprise Bankruptcy Act of 1986 states that the liquidation team shall apply to the People's Court for the conclusion of bankruptcy proceedings and the distribution of the bankruptcy estate. In Austria, the bankruptcy court officially has to terminate proceedings if one of the several requirements laid down in the KO are met. Claims that have not been paid shall no longer be repaid after the termination of bankruptcy proceedings. The EBL contains a few exceptions which are not mentioned in details. After the conclusion of the bankruptcy proceedings, the liquidation team shall pursue the procedures for the cancellation of registration with registration authorities of the bankrupt firm (Article 39 EBL). After bankrupt debtors are declared bankrupt, their personal freedoms will be restrained by bankruptcy proceedings. This restraint gets lifted at the termination of bankruptcy proceedings.<sup>1</sup>

#### **Local Legislation**

Under the Shenzhen Rules, creditor's claims which have not been settled during the course of bankruptcy proceedings shall not be discharged after the termination of the proceedings. In addition, the liquidation committee shall apply to the original registration authority to register cancellation of the bankrupt firm (Article 77,78 SR).

### **Republic of Austria**

The conclusion of the bankruptcy formally ends the proceedings. In contrast to the EBL and Shenzhen, the bankruptcy court has to terminate the proceedings if the facts of one of the several bankruptcy termination requirements apply. The court has to terminate the proceedings ex officio. Requirements for conclusion are for example: the final distribution of assets (Article 139/1 KO), the complete settlement of all creditors (Article 167/2 KO). After the conclusion, the debtor regains his right to dispose of his property. However, all legal acts, which were carried out by the trustee during the bankruptcy proceedings, are legally binding for the debtor too.

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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.

## **10. Small Bankruptcy**

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

#### **National Legislation**

The EBL does not provide any regulations for small bankruptcy. All bankruptcies are carried out according to the rules of the EBL.

#### **Local Legislation**

Chapter VI of the Shenzhen Rules covers detailed provisions for "Small Bankruptcy". The SR speak of petty bankruptcy if the amounts of bankruptcy property or debts for which the clear relationship of claims and debts and factual particulars confirmed by the People's Court after hearing the case, are less than RMB 500,000 yuan.

Small bankruptcy is characterized by shorter time limits for the declaration of creditors' claims. Furthermore, there are special rules for the creditors' meetings or the liquidation committee which may not be established. Then it could be the People's Court responsibility to exercise the liquidation committee's function. All these provisions have one point in common: They accelerate the bankruptcy proceedings significantly.

### **Republic of Austria**

The KO covers small bankruptcy-regulations in Article 169 KO and states: "If all assets belonging to the bankruptcy property will probably do not exceed the amount of 50.000 Euro<sup>1</sup>, the bankruptcy will be deemed to be small." It is one of the bankruptcy court's responsibilities to decide whether bankruptcy will be considered to be small or not. The advantage of small bankruptcies are faster proceedings regulated by special rules which can but need not be used by the court (Article 170 KO).

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<sup>1</sup>BGBL 2001/98, 1. Euro-Umstellungsgesetz-Bund (issued on the 7th of August 2001).

## **11. Bankruptcy of Physical Persons**

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

The Chinese bankruptcy law has not developed any rules for the bankruptcy of individuals.<sup>1</sup> Even the new draft of bankruptcy law of the PRC does not provide any provisions. Almost all of the current bankruptcy laws apply to business firms (with the status of a legal person).

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<sup>1</sup>Hieker, Konkursgesetzgebung in der Volksrepublik China 88.

## Part VI

### COMPOSITION PROCEEDINGS

#### 和解协议

##### General Introduction

The system of conciliation is a regime in which debtors enter into an agreement with creditors for the payment of debts when they are insolvent and want to avoid bankruptcy. The court has to confirm the agreement (settlement) which the debtor will have to perform. Conciliation gives debtors the chance to avoid bankruptcy and allows them to recover their position in business. The main prerequisite is a compromise between the debtors and creditors. The debtors' and creditors' interests must be preserved. A special type of composition is covered by the KO itself. Many debtors run into bankruptcy for many reasons which often have been developing over a long time. The system of conciliation does not lead to the desired results. Another system becomes necessary: bankruptcy reorganization.

The EBL prescribes a system of conciliation combined with reorganization which has no counterpart in the Austrian bankruptcy law. Reorganization presupposes that conciliation occurred effectively. On the other hand, after conciliation has taken effect, reorganization must be carried out. This way of preventing bankruptcy is opposed by Qi Duo-jun.<sup>1</sup> He objects that the right to apply for conciliation and reorganization belongs to the department in charge of bankrupt firms which has to supervise reorganization.

Qi Duo-jun comes to the conclusion that this stipulation ignores the autonomous right of firms and suggests to regulate the conciliation proceedings in a special chapter. The Chinese combination of settlement and reorganization was closely linked to planning system, when the enterprise bankruptcy law was promulgated.<sup>2</sup> The Civil Procedure Law of the PRC and the Shenzhen Rules provide separated conciliation provisions.

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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>Li Shuguang, Restructuring of insolvent SOEs, [http://www.fh.com.hk/Lecture\\_4.pdf](http://www.fh.com.hk/Lecture_4.pdf), Date: 18.12.2001.

## 1. Settlement<sup>1</sup> and Reorganization

### People's Republic of China

#### National Legislation

Although CMS Cameron McKenna points to a kind of informal corporate rescue process which makes it possible to use Hong Kong China rules in the restructuring process, this chapter only deals with the formal corporate rescue process of the EBL.<sup>2</sup>

The Enterprise Bankruptcy Act of 1986

Reorganization can also be called restructuring. There is no law giving a specific definition. In the EBL restructuring means active proceedings implemented in insolvent firms or the business units on the verge of bankruptcy that have the potential to recover.<sup>3</sup> Its objective is to pay off debts by the debtor firm in the long view.<sup>4</sup> The EBL gives the superior departments in charge the right to apply for reorganization within three months after the People's Court has accepted the bankruptcy case but only if creditors file a petition for bankruptcy (Article 17 EBL). Two plans have to be prepared to carry out reorganization: the settlement agreement and the reorganization plan.

Reorganization can only be carried out after the firm and the creditor's meeting have reached a settlement agreement which has been confirmed by the People's Court (Article 19). The People's Court has to make a public announcement and to suspend the bankruptcy proceedings. The original version of the EBL does not contain any detailed rules about such a settlement agreement. The Supreme People's Court states in its "Opinions of 1991". The agreement shall include the following<sup>5</sup>: property sources for clearing debts, methods for clearing debts and the limited term for debt clearance. If the firm which has applied for reorganization requests a reduction in its debt, the firm shall clearly write down the amount by which its debt should be reduced in such draft settlement agreement. Apart from this settlement agreement, the superior department in charge of the bankrupt firm has to work out a reorganization plan. The EBL does not contain any explicit provisions about such a plan. It is again the

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<sup>1</sup>Explanation: Settlement = Conciliation.

<sup>2</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>3</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>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.

<sup>5</sup>Opinions of the Supreme People's Court 1991, IV. Settlement and Reorganization, Nr. 34, [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.

Supreme People's Court which offers detailed solutions for its content<sup>1</sup>: an analysis of the reasons that the enterprise is at the brink of bankruptcy; a plan for the adjustment or establishment of the enterprise's new leadership, measures for the improvement of operation and management as well as a feasibility report regarding the measures for changing production and methods for turning losses into profits.

Furthermore, the period of reorganization cannot exceed two years<sup>2</sup> (Article 17 EBL) and is supervised by its superior departments in charge (Article 20 EBL).

If a firm has undergone reorganization and is able to repay debts in accordance with the settlement agreement, the People's Court has to terminate the bankruptcy proceedings and make a public announcement thereof. If reorganization is not successful which means that the debtor is not able to repay the debts in accordance with the settlement agreement (Article 22 EBL) or if one of the requirements of Article 21 EBL is met, the People's Court has to declare the firm bankrupt.

Although there exists court-supervised reorganization under the EBL, it is rare since the creditors have no right to initiate. Moreover, no authorized agency has the incentive to bear such a costly, troublesome mission. Creditors have no basis to trust the authorized agency. The Act does not give creditors any means to control or influence the process of restructuring, nor does it impose any responsibility upon the authorized agency for its misconduct or failures in the process.<sup>3</sup> The debtor would rather initiate merger or takeover instead.<sup>4</sup>

In the past there were cases where solvent State-owned firms were required, by administrative order, to merge with insolvent ones which were on the verge of bankruptcy to protect State-owned assets and prevent unemployment and possible unrest.<sup>5</sup> The case of Shanxi Textile Dyeing Plant, a government-owned enterprise, serves as a good example.

*"The government initially tempted to force a merger by auctioning off the plant. But no buyer was willing to pay the RMB 550 million price set by the government. Eventually, the government set up a textile company for the sole purpose of taking over the plant. The new government-owned company bought the plant for RMB 486 million."*<sup>6</sup>

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<sup>1</sup>Opinions of the Supreme People's Court 1991, IV. Settlement and Reorganization, Nr. 33, [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>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>3</sup>Wang Weiguo, Drafting, <http://www.law.hku.hk/aiifl/events/symposium/papers/wang%20weiguo.doc>, Date: 10.1.2002.

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

<sup>5</sup>Ferrier Hodgson & Marfan, Reform, [http://www.fh.com.hk/topic4\\_pdf.pdf](http://www.fh.com.hk/topic4_pdf.pdf), Date: 25.11.2001.

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

Such cases motivated the bankruptcy-expert Li Shuguang even more to advocate bankruptcy as the preferred solution for insolvent SOEs because other approaches amounted to a mere shifting of problems from one firm to another. With the State-owned business reform of the People's Republic of China, State-owned business have started to sever their links with governmental authorities and have become more autonomous in making commercial decisions. Indeed, the practice of merger as a result of governmental order is less and less used.<sup>1</sup>

### **Local Legislation**

The Shenzhen Rules also apply the system of conciliation. Article 7 SR contains special provisions for State-owned enterprises. When a creditor files a petition for bankruptcy against a SOE and the department in charge of the State-owned enterprise's property rights applies for reorganization of the business unit, the provisions of the State concerning SOE bankruptcy apply.

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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.

## **2. Compulsory Composition**

### **Republic of Austria**

Compulsory composition is judicial composition which is concluded between the debtor and his creditors in the bankruptcy proceedings. It shall help the debtor to keep his property and business and the creditors to achieve higher quotas by granted prolongation of debt repayment and partly discharge of the debts.<sup>1</sup>

The debtor is entitled to apply for compulsory composition during the bankruptcy proceedings (Article 140/1 KO). He has to explain his methods to settle creditors' claims or how to secure them. Moreover, the trustee has to inform the creditors, the debtor and the bankruptcy court in the hearing on reports, if compulsory composition would meet the interests of all creditors and might be probably carried out (Article 81a/3 KO). The debtor has to offer creditors the payment of at least 20% of their claims payable within 2 years after acceptance (Article 141 Nr. 3 KO).

Compulsory composition will only be granted if agreed to by the majority of the creditors present at the hearing and 75% of the total value of claims of the creditors present at the hearing.

If compulsory composition is effectively carried out, the debtor will be discharged from all liabilities. This can not be achieved in the ordinary bankruptcy proceedings. (except in private bankruptcy proceedings) In case the debtor defaults on the compulsory composition, the advantages which were granted by the creditors shall become invalid (Article 156/4 KO). Claims, which have partly been settled, revive with a special quota; those, which have completely been settled, do not revive anymore (Article 156/5 KO).

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<sup>1</sup>Holzhammer/Roth, Konkursrecht, 69.

### **3. Judicial Composition**

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

##### **National Legislation**

There are no composition provisions in the EBL. The CPL offers legal entities the possibility to reach a simple conciliatory agreement with its creditors. The People's Court has to approve the agreement and then may issue a public notice terminating the bankruptcy debt repayment process. The conciliatory agreement shall come into effect on the day public notice is issued (Article 202 CPL). Nothing more is said about formal restructuring.

##### **Local Legislation**

Under the Shenzhen Rules conciliation proceedings start with the petition for conciliation filed by the debtor. The People's Court has to decide within 7 days of the receipt of the conciliation application in favor or against the conciliation. Within seven days of a decision in favor of a conciliation application, the People's Court has to make a public announcement which shall include the following: (1) reasons for ruling in favor of the conciliation application; (2) names and addresses of the members of the conciliation supervisory group; and (3) time and place at which the draft conciliation agreement is to be discussed at a creditor's meeting.

After that the People's Court has to issue a decree in favor of the draft conciliation agreement within ten days from the discussion and adoption of the draft conciliation agreement in a creditor's meeting. In case the People's Court issues the decree in favor of the conciliation agreement, it shall make a public announcement within 5 days. The conciliation agreement is legally effective from the date of such public announcement.

The debtor is entitled to apply for conciliation if an application for bankruptcy is filed by a creditor during the period after the acceptance of a bankruptcy case by the People's Court but before declaration of bankruptcy has been made (Article 25 SR). This rule stands in sharp contrast to the KO where the debtor is entitled to apply for judicial composition proceedings if he is insolvent. There is no restriction such as the filing for bankruptcy of a creditor as it is known in the SR. The debtor has to provide following documents:

- (1) an application for conciliation
- (2) a property situation statement
- (3) a detailed list of claims and debts and
- (4) a draft conciliation agreement

The draft conciliation agreement shall include (Article 27 SR):

- (1) titles of full names of the conciliation applicant and creditor(s) and the amount(s) of their claim(s)
- (2) details of the extension of the period for the discharge of liabilities or the amount by which the debtor shall be exempt from the discharge of its liabilities or the amount by which its liabilities are to be reduced
- (3) details of the state of production and operations and reasons for the incurring losses and
- (4) measures taken for the recovery of capacity to discharge liabilities

However, the Act itself does not force the debtor to settle a certain amount of claims as the Austrian Composition Act does in Article 3 AO.

Where a ruling in favor of a conciliation application is made by the People's Court, it has to appoint members of the conciliation supervisory group from among such personnel as accountants, lawyers and other professionals (Article 30 SR). This group has the function and power to supervise operations and management activities conducted by the conciliation applicant and it may inspect the account books and documents of the conciliation applicant (Article 32 SR). Furthermore, production and business operations conducted by the conciliation applicant are subject to supervision by the conciliation supervisory group (Article 33 SR). The conciliation supervisory group seems to be the comparable subject to the bankruptcy receiver. Both shall get at least an overview of the situation of the enterprise and the reasons for losses. This legal institution is responsible to the People's Court and has to report on its work to the People's Court (Article 30 SR). In Austria, the composition court supervises the acts of the bankruptcy receiver and is even entitled to give him orders (Article 34/1 AO).

The People's Court shall issue a decision in favor of the draft conciliation agreement within ten days of the discussion and adoption of a draft conciliation agreement by a creditor's meeting. If a decision on a conciliation agreement taken at the shareholders' meeting is in violation of laws and statutory regulations or where the agreement contains fraudulent items, the People's Court shall issue a decision which is not in favor of the conciliation agreement (Articles 36,37 SR). Once the People's Court has

ruled in favor of a conciliation agreement, it shall become legally effective from the date of its public announcement (Article 38 SR).

If at the end of the term of conciliation the debtor is able to discharge its liabilities in accordance with the conciliation agreement, the People's Court has to issue a decision to terminate the bankruptcy proceedings against the debtor and a public announcement shall be made. In Austria, the fulfillment of the legally binding and approved composition results in the discharge of all liabilities of the debtor. If the debtor is unable to discharge of its liabilities under the SR, the People's Court has to declare the debtor bankrupt. Moreover, claims have to be re-registered.

### **Republic of Austria**

Instead of bankruptcy proceedings the insolvent debtor may apply for judicial composition proceedings (Article 1 AO<sup>1</sup>) in which he must offer to pay at least 40% of the creditor's claims within two years (Article 3 AO). He is also allowed to apply for composition if inability to pay due debts is threatening (Article 1 AO). It is interesting to note that the Chinese bankruptcy system does not give any direction about a minimum per centage of debts to be settled.

In case a creditor filed for bankruptcy, the debtor can apply for the opening of composition as long as the bankruptcy court has not taken a decision about the opening of the bankruptcy (Article 1/2 AO).

Composition will only be granted if agreed to by the majority of the creditors present at the hearing and by 75% of the total value of claims of the creditors present at the hearing. After the court has confirmed, the composition becomes valid and binding for all creditors (Article 42/1 AO). The SR states that the draft conciliation agreement requires the approval of a majority of creditors with voting rights to be present at the meeting in order to be valid and the combined amount of claims represented by those members must be equal to two thirds or more of the non-property guaranteed claims (Article 23 SR). All in all, the SR also determine qualified consent.

During the proceedings the management is supervised by a bankruptcy receiver - similar to the conciliation supervisory group of the SR - who has to get precise knowledge of following (Article 30 AO):

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<sup>1</sup>Explanatory Note: Restructuring Act = AO.

- investigation of the present economic situation of the enterprise and the previous management
- reasons for the losses
- effects on the job market
- assets and total and equity liabilities
- adequacy of the offered composition
- liabilities of third persons
- reliability of accounting
- and the enterprise's capacity of survival.

If the legally binding and approved composition was fulfilled properly, the debtor will be discharged from all liabilities.<sup>1</sup> This effect seems to be similar to the SR but only if the draft conciliation agreement includes the exemption of liabilities.

In case the debtor defaults on the composition the advantages, which were granted by the affected creditors, shall become invalid (Article 53/4 AO). The rulings are similar to the one stipulated in the KO. Claims, which have partly been settled, revive with a special quota; those, which have completely been settled, do not revive anymore (Article 53/5 AO).

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<sup>1</sup>Buchegger/Holzhammer/Roth, Ausgleichsrecht, 34.

## **4. Non-judicial Composition**

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

Though there are various forms of in-court conciliation in the People's Republic China, the concept of non-judicial agreements - a simple contract between the debtor and all creditors - is also known (Article 128 Contracts Law). It is an easy way to discharge liabilities but the negotiation process can be tiresome because the debtor needs full consensus with all creditors. Besides, creditors run the risk of being treated inequally.

In Austria non-judicial composition is a private-law composition following the rules of Article 1380 ff ABGB. Such a successful agreement exempts the debtor who is on the verge of insolvency from a part of his debts or at least prolongs debt repayment. In order to become legally effective, the consent of all creditors must be reached. It is even possible that one creditor is offered special favour. Such disadvantages might be avoided by judicial composition.<sup>1</sup>

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<sup>1</sup>Buchegger/Holzhammer/Roth, Ausgleichsrecht, 2.

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