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An Analysis of Cross-Border Insolvency in China's New Bankruptcy Law: A Big Step Forward

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I. Introduction

The new China was founded in October 1949 and then a highly centralised planned economy was formulated by referring to the previous Soviet Union.¹ The assets of private firms were nationalised through a significant movement called 'socialist transformation' from 1952 and 1956. Enterprises were owned by the state and business transactions between them were carried out under government instruction rather than commercial rules. There was no need for insolvency legislation because creditors did not have incentives to enforce their claims against their debtor. In addition, each state-owned enterprise ('SOE') carried the serious financial burden of making social security payments for their employees. In light of this burden, struggling SOEs could not be wound up simply because their liquidation may cause unpredictable social unrest. The turning point of the Chinese economy was the establishment of the Reform and Opening up Policy which was launched at the end of 1978 and put China onto the track from a planned economy to a market economy. The legal reforms borrowed from foreign advanced legal institutions and formulated into a series of laws serving the economic transition, with the Enterprise Bankruptcy Law promulgated in 1986 on a trial basis being one of them.² In the two decades which followed, the development of economic and social security reforms of SOEs and the banking community promoted the reestablishment of a

new bankruptcy law replacing the outdated 1986 Law. Domestic need and external pressure from the US and EU, who were lobbying for a new bankruptcy law, led to a need for reforms in accordance with both the Chinese peculiar situations and international standards. Under this background, the high profile Enterprise Bankruptcy Law was eventually promulgated in August 2006 and came into force in June 2007.³ Compared with the 1986 Law, there are many notable features in the new bankruptcy legislation, such as special provisions for the bankruptcy of financial institutions, the establishment of the office of bankruptcy administrator, a focus on reorganisation procedures and the provision of cross-border insolvency measures.⁴ This article will fully describe the cross-border insolvency related issues, exploring potential problems and coming up with some suggestions.

II. Legislative background

The 1986 Law did not contemplate extraterritorial effects when it was first drafted.⁵ It placed too much emphasis on territorial factors, a focus which could have led to duplication of proceedings both in China and foreign countries. These duplicated proceedings would enlarge bankruptcy expenses and reduce the amount of payments for creditors involved.⁶ However, in consideration of the background at the time, this

Notes

- 1 H. Zhang, *The Establishment and Effectiveness of the Chinese Corporate Rescue Laws: From a Comparative Analysis among the UK, the US and China* (World Affairs Press, Beijing, 2010) (forthcoming); L. Wong, 'Market Reform, Globalization and Social Justice in China' (2004) 13 *Journal of Contemporary China* 153.
- 2 Ta-Kuang Chang, 'The Making of the Chinese Bankruptcy Law: A Study in the Chinese Legislative Process' (1987) 28 *Harvard International Law Journal* 333.
- 3 R. Parry, Y. Xu and H. Zhang (eds), *China's New Enterprise Bankruptcy Law: Context, Interpretation and Application* (Ashgate Publishing, Farnham, 2010); J. Shi, 'Twelve Years to Sharpen One Sword: The 2006 Enterprise Bankruptcy Law and China's Transition to a Market Economy' (2007) 16 *Norton Journal of Bankruptcy Law and Practice* 645; H. Bufford, 'The New Chinese Bankruptcy Law: Text and Limited Comparative Analysis' (2007) 16 *Norton Journal of Bankruptcy Law and Practice* 697.
- 4 H. Zhang, 'A Notable Feature of China's New Bankruptcy Law: "Administrator"' (2009) 6 *International Corporate Rescue* 98; R. Parry and H. Zhang, 'China's New Corporate Rescue Laws: Perspectives and Principles' (2008) 8 *Journal of Corporate Law Studies* 113; J. Shi, 'Recent Developments in Chinese Cross-Border Insolvency' (2002) 15 *Australian Journal of Corporate Law* 12.
- 5 J. Shi, 'Chinese Cross-Border Insolvencies: Current Issues and Future Developments' (2001) 10 *International Insolvency Review* 33, 36.
- 6 J. Shi, 'Cross-border Insolvency', R. Parry, Y. Xu and H. Zhang (eds), *China's New Enterprise Bankruptcy Law: Context, Interpretation and Application* (Ashgate Publishing, Farnham, 2010), p. 323.

was understandable because China was in the process of economic transition and emphasised the protection of state sovereignty and the interests of Chinese creditors. Moreover, before the Enterprise Bankruptcy Law 2006 was enacted, there were not many cross-border insolvency cases.⁷

Since there was a legislative lacuna in the old bankruptcy law, the international creditors had to seek the recognition of judgments by a Chinese court by referring to the existing Civil Procedure Law 1991 (amended in 2007). Cross-border insolvency related issues would arise in those enterprises with foreign investment. When an international company solely funded or jointly funded an enterprise with a Chinese investor, the bankruptcy of the international company outside China might involve the property of the Chinese foreign funded enterprise.⁸ When the foreign liquidator claimed the debtor's assets located in China, the method of share transfer⁹ was preferred by the Chinese court. There are different requirements regarding share transfers, subject to the form taken by a foreign investment enterprise. The procedure for a share transfer of a sino-foreign joint venture company requires the approval of the Chinese partners. There was no such requirement if the company was solely funded by a foreign investor.

As reform and opening up policy has been implemented on a deeper level in China, and economic exchange increases under the condition of globalisation, there are not only more and more foreign-funded enterprises being declared bankrupt in foreign countries, but also the number of bankruptcies of Chinese enterprises who invest in foreign countries has also increased a lot. Bankruptcy in the global context will bring about an internationalisation of debt, which will further raise the issue of cross-border insolvency. Also, increasing international investment would make a bankruptcy judgment of one country have a greater influence on creditors or debtors in another country.¹⁰ Under this situation, a legally recognised extraterritorial effect is

in urgent need. Otherwise, problems such as unclear effects on assets in China posed by foreign bankruptcy procedures and fraudulent acts like transferring assets to foreign countries would arise. Considering the limitations of the territoriality¹¹ approach and the urgent need in China, a revised universality principle is adopted by the new Law.¹²

Article 5 of the Enterprise Bankruptcy Law 2006 provides that:

'Procedures for bankruptcy commenced in accordance with this law have binding effect on the debtor's property located outside the territory of the People's Republic of China (hereinafter referred to as "the PRC").

Where the verdict or ruling made by a foreign court involving the debtor's property within China's territory requires the acceptance and execution by a Chinese Court, the Chinese Court shall, based upon a relevant application or request, check the foreign verdict or ruling and adjudicate acceptance and execution in accordance with the international treaties to which the PRC is a party, or based on a mutual reciprocity principle after ascertaining that there is no violation to the basic principles of the laws of the PRC, no detriment to state sovereignty, security and social public interests and no harm to the legitimate rights and interests of creditors in the PRC'¹³

This is the only article in the new bankruptcy law which concerns cross-border insolvency and stipulates the effects of outbound proceedings and inbound proceedings respectively. Initially, the legal reformers produced a separate chapter to deal with cross-border insolvency-related issues during the legislative stage, but eventually, the legislature only adopted one article on the basis of the initial draft.

Firstly, any bankruptcy procedure initiated in China has binding effects on the assets of the involved debtor beyond the territory of China.¹⁴ That means that the bankruptcy estate includes not only the debtor's assets

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- 7 For the details of some cases before the new law, like The LMK Nam Sang Dyeing Case, Liwan District Construction Company Case and BCCI (Shenzhen Branch), see J. Shi, 'Chinese Cross-Border Insolvencies: Current Issues and Future Developments' (2001) 10 *International Insolvency Review* 33, 36-40; J. Shi, 'Recent Developments in Chinese Cross-Border Insolvencies' (2002) 15 *Australian Journal of Corporate Law* 122; Donald J. Lewis and Charles D. Booth, 'Case comment, Liwan District Construction Company v Euro-America China Property Limited' (1990) 6 *China L. & Prac.* 27.
- 8 Although there was legislation regarding bankruptcy issues called 'Foreign-Related Enterprises Liquidation Regulation' promulgated in July 1997, it was silent on cross-border insolvency.
- 9 Share transfer is where an existing shareholder transfers issued shares to another person who is then registered as holder of those shares.
- 10 F. Luo, 'Cross-border Insolvency: There Are Laws To Go By' (2007) 1 *Foreign Business* 60, 61.
- 11 Territoriality proposes that bankruptcy assets only limit to assets within a particular country. J. Shi, 'Twelve Years to Sharpen One Sword: The 2006 Enterprise Bankruptcy Law and China's Transition to a Market Economy' (2007) 16 *Norton Journal of Bankruptcy Law and Practice* 645, 675.
- 12 Revised universality means bankruptcy proceedings have effect on foreign assets, but only limit to movable properties. Ian Fletcher, *Insolvency in Private International Law* (Oxford University Press, Oxford, 1999), p. 369.
- 13 Bankruptcy Law 2006, Article 5.
- 14 J. Shi, 'Twelve Years to Sharpen One Sword: The 2006 Enterprise Bankruptcy Law and China's Transition to a Market Economy' (2007) 16 *Norton Journal of Bankruptcy Law and Practice* 645, 676.

within the territory of China, but also extraterritorial assets. Both of them should be dealt with and put into the pool of assets available for distribution to creditors according to the provisions of the new law. In judicial practice, realisation of the legal effect usually relies on the corresponding laws and regulations of the other countries involved or recognition from those jurisdictions. Paragraph one also implies that (1) debtors of the debtor or holders of the debtor's assets, including those outside China, should repay their debts or hand over the assets to the bankruptcy administrator; (2) properties of the debtor should be released from the extraterritorial property preservation and the execution of properties should be discontinued after the Chinese court accepts the application; (3) civil actions or arbitrations related to the relevant debtor that have not been concluded overseas should be discontinued until the administrator takes over the properties; and (4) after the Chinese court has accepted the application, the repayment of debts made by the debtor using the extraterritorial assets to individual creditors shall be invalidated.

Secondly, China shall recognise and enforce a foreign bankruptcy judgment after an examination conducted by the PRC courts. The initiation of the examination procedure is based on international treaties between China and the relevant foreign jurisdiction or the principle of 'mutual reciprocity'. On the condition that there is no international treaty or the mutual reciprocity principle has not been implemented, the PRC court can adjudge that no recognition or enforcement of the foreign bankruptcy judgment shall be given without further examination. If international treaties between China and the relevant foreign country do exist or the principle of mutual reciprocity has been implemented, the PRC court should further make sure, through examination, that the foreign bankruptcy judgment does not violate the basic principles of the laws of China, that it does not damage the sovereignty, safety or social public interests of the state and that it does not damage the legitimate rights and interests of the creditors within the territory of China. If there is none of the above, the court would recognise and enforce the foreign bankruptcy judgment; otherwise, no recognition or enforcement is granted.¹⁵

Article 5 is a gap-filling law in Chinese bankruptcy law enabling a big step forward. It is beneficial to both Chinese and foreign investors because it provides a legal basis for cross-border insolvencies which can help to encourage capital flow into China and the Chinese investors to inject their capital to other countries without the worry of inequality of distribution. This article

is capable of boosting the Chinese market economy and can raise the level of cooperation between China and foreign countries.

III. Recognition and enforcement of the foreign bankruptcy judgments

i. B&T Case

As the only case in which a Chinese court recognised a foreign bankruptcy judgment in China, the B & T Case deserves a detailed examination. In this case, Nanhai Pioneer Mould Co. Ltd. was incorporated as a sino-foreign equity joint venture in 1993. The Chinese partner of the joint venture was Nanhai Jili Ceramic Industry Co. Ltd and the foreign partner was an Italian company called Nasseti Ettore s.p.a. ('NE'). The registered capital amounted to USD 5.5 million in which USD 0.11 million was owned by the Chinese partner while USD 5.39 million was owned by the Italian partner. Therefore, 2% of shares of the joint venture were held by the Chinese partner and 98% was held by the Italian party. On 9 May 1997, the name of NE was changed into E.N. Group s.p.a. and a voluntary winding-up of its predecessor was initiated at the same time. On 24 October 1997, E.N. was declared bankrupt according to No. 62673 judgment made by the Milan Court. On 19 November 1997, the name of Nanhai Nasseti Pioneer Mould Co. Ltd. was changed into Nanhai Nasseti Pioneer Ceramic Machine Co. Ltd. ('Nanhai Nasseti'). On 14 April 1999, the Bankruptcy Division of Milan Court made an Order on the Sales of Subsidiaries and Branches of E.N. by Way of Wholesale Instead of Auction that all its property, rights and shares were sold as a whole package without exception. On 30 September 1999, the Civil and Penal Court in Milan Court made an Adjudication Order on the Transfer of Confiscated Assets, ordering the bankruptcy administrator to turn all assets of aforesaid corporations over to the purchaser – B&T for its free control.¹⁶

On 2 May 1999, NE and Broao Win International Limited, a Hong Kong company, made an agreement on share transfer. NE transferred 98% of the shares of Nanhai Nasseti to Broao Win at the cost of USD 5.39 million. On 21 July 1999, Nanhai Foreign Economic and Trade Bureau ('FETB') approved the share transfer and Broao Win became the foreign partner of Nanhai Nasseti. However, B&T held that E.N. had been declared bankrupt when this transfer was made, it undoubtedly infringed upon the applicant's rights as the only legitimate holder of shares in overseas corporations of

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¹⁵ X. Wang, *Bankruptcy Law* (Renmin University Press, Beijing, 2007), pp. 31-41.

¹⁶ J. Shi, 'Cross-border Insolvency', R. Parry, Y. Xu and H. Zhang (eds), *China's New Enterprise Bankruptcy Law: Context, Interpretation and Application* (Ashgate Publishing, Farnham, 2010), p. 329; J. Yu, *Legal Matters of Multinational* (Law Press-China, Beijing, 2008), pp. 295-297.

E.N., including its 98% shares in Nanhai Nasseti.¹⁷ On 18 December 2000, B&T filed a petition in Guangdong Foshan Intermediate People's Court ('Foshan Court') applying for recognition and enforcement of the following judgments and related matters:

- (1) the No. 62673 Bankruptcy Judgment which declared E.N. Group s.p.a.(E.N.) bankrupt and was made by Milan Court (Italy) on 24 October 1997;
- (2) an adjudication Order on the Transfer of Confiscated Assets made by Civil and Penal Court in Milan 30 September 1999;
- (3) that the whole assets of the bankrupt E.N., including its 98% shares in Nanhai Nasseti Pioneer Ceramic Machine Co. Ltd. (Nanhai Nasseti), shall be fully delivered to B&T with the consequence that B&T shall enjoy full right of control over these assets; and
- (4) confirmation that B&T holds 98% shares of Nanhai Nasseti, and reinstating the legitimate status of B&T in this corporation.¹⁸

Foshan Court heard this case and held that: the No. 62673 Bankruptcy Judgment made by the Milan Court on 24 October 1997 and the Adjudication Order on the Transfer of Confiscated Assets made by the Civil and Penal Court in Milan on 30 September 1999 had come into effect and did not have any conditions excluding recognition and enforcement stipulated by Article 21 in the Treaty on Judicial Assistance in Civil Matters between China and Italy (The Sino-Italy Treaty). Neither did they violate the basic principle of the Law of China, nor damage the sovereignty, safety and social public interests of the state. Therefore the court ruled that, the No. 62673 Bankruptcy Judgment made by the Milan Court on 24 October 1997 and the Adjudication Order on the Transfer of Confiscated Assets made by the Civil and Penal Court in Milan on 30 September 1999 conformed to The Sino-Italy Treaty and relevant Chinese laws and regulations so that the validity of

the Bankruptcy Judgment and the Adjudication Order shall be honoured in China.

As for the petitions filed by the applicant on turning 98% shares held by bankrupt E.N. in Nanhai Nasseti over to the applicant for its full control, and confirming the applicant's holding of 98% shares in this corporation, the court could not enforce these two petitions directly by issuing a writ of execution since the 98% shares had been transferred to the third party Borao Win. The applicant could file another application with this judgment as a legal basis to claim its rights.

After examination and approval by the Guangdong Provincial High Court, and according to Article 267,¹⁹ Article 268²⁰ of the Civil Procedure Law ('CPL') of the PRC and paragraph 1 of Article 20, Article 21, and Article 26 of the Sino-Italy Treaty,²¹ the Foshan Court made a final decision as follows:

- (1) To recognise the validity of the No. 62673 Bankruptcy Judgment made by Milan Court (Italy) on 24 October 1997;
- (2) To recognise the validity of the Adjudication Order on the Transfer of Confiscated Assets made by the Civil and Penal Court in Milan on 30 September 1999.

The B&T case happened before the new bankruptcy law was promulgated. Recognition of the Italian judgment by the Chinese court was based on the Civil Procedure Law. Article 5 of the new bankruptcy law is consistent with the relevant articles of the Civil Procedure Law. Considering there has not been a more typical cross-border insolvency case that has happened in China since the new bankruptcy law was implemented, a close study of the B&T case would be helpful to understand how the article might work in practice. The case indicates that if there is a treaty between China and relevant countries, the treaty lays a foundation for recognition and enforcement of the foreign bankruptcy judgment. In this case, the key to the successful recognition and enforcement of the foreign judgment

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- 17 Written Application for Recognizing and Enforcing Judgments Made by Foreign Courts, filed by B&T Ceramic Group s.r.l. on December 18, 2000, at 2. J. Shi, 'Cross-border Insolvency', R. Parry, Y. Xu and H. Zhang (eds), *China's New Enterprise Bankruptcy Law: Context, Interpretation and Application* (Ashgate Publishing, Farnham, 2010).
- 18 No.633 Fo zhong fa jing chu zi (2000) Civil Decisions made by Foshan Intermediate People's Court, Guangdong, at 1-2. J. Shi, 'Cross-border Insolvency', R. Parry, Y. Xu and H. Zhang (eds), *China's New Enterprise Bankruptcy Law: Context, Interpretation and Application* (Ashgate Publishing, Farnham, 2010), p. 330.
- 19 Article 267 of the CPL provides that if a legally effective judgment or written order made by a foreign court requires recognition and enforcement by a PRC court, the party concerned may directly apply for recognition and enforcement to the intermediate court of the PRC which has jurisdiction.
- 20 Article 268 of the CPL provides that in the case of an application or request for recognition and enforcement of a legally effective judgment or written order of a foreign court, the people's court shall, after examining it in accordance with the international treaties, conclude or accede to it by the PRC or with the principle of reciprocity arrive at the conclusion that it does not contradict the basic principles of the law of the PRC nor violates State sovereignty, security and social and public interests of the country, recognise the validity of the judgment or written order, and, if required, issue a writ of execution to enforce it in accordance with the relevant provisions of this Law.
- 21 The relevant articles of the Treaty between China and Italy respectively mainly include Articles 20, 21 and 26. Article 20 deals with the scope of application. Article 21 involves the circumstances under which decisions may be denied recognition and enforcement, and Article 26 concerns the effects arising from the recognition and enforcement.

was the existence of the Sino-Italy Treaty. The Sino-Italy Treaty was concluded on 20 May 1991 and came into effect on 1 January 1995. According to the Treaty, the foreign bankruptcy judgment shall be recognised and enforced except for 6 conditions (including where the fact in petition does not exist; the petition violates the basic principle of the law where the debtor is domiciled or damages the sovereignty, safety or social public interests of the state; the judging court has no jurisdictional power; the judgment has not come into effect and so on). The Foshan Court made its decision based on the treaty and properly solved the complicated issue.

Now, even after the Bankruptcy Law 2006 has been enacted in China and Article 5 provides a legal basis for the recognition of a foreign bankruptcy judgment, due to its lack of specifics and interpretation, a treaty between China and the relevant foreign countries still counts for a lot. However, there are not many treaties like the Sino-Italy Treaty that China has signed with other countries. This poses a difficulty if China is to recognise and enforce a foreign bankruptcy judgment. The following sections will analyse important elements included in Article 5 and provide specific ways of implementation of each element.

ii. Analysis of elements of Article 5

Given the lack of specifics and interpretation in Article 5, each element of it deserves a close analysis and specified ways of implementation.

a. Priority and examination standard of acknowledgment of a foreign bankruptcy judgment

In practice, multiple bankruptcy procedures in respect of a multinational debtor are initiated in many different countries at the same time or successively, and they may entail a request to a Chinese court for recognition of a foreign bankruptcy judgment. According to the new law, a bankruptcy case shall be governed by the court where the relevant debtor is domiciled.²² Following the same logic, a Chinese court should recognise the bankruptcy judgment of the debtor's domicile as a priority. If the applicant who is seeking the acknowledgment of a bankruptcy judgment is not within the debtor's domicile and if the Chinese court recognises their judgment, no greater remedy than that given to the judgment within the debtor's domicile should be given to those who are not in the debtor's domicile, unless unfairness of the limitation has been proved.

If the bankruptcy law of the debtor's domicile does not recognise the extraterritorial effect of their bankruptcy procedure, or the bankruptcy procedure has not been initiated in that country, the Chinese court may acknowledge the extraterritorial effect of the bankruptcy procedures of the non-debtor's domicile country. However if the application from the country of the debtor's domicile recognises the extraterritorial effect of their bankruptcy procedure and the Chinese court also recognises their judgment, the remedy given to applicants from outside the debtor's country of domicile should be changed to no more than that given to those who come from the country of the debtor's domicile, unless unfairness of this limitation has been proved.²³

b. The way of acknowledging foreign bankruptcy procedures and its retrospective effect

Unlike many other countries who directly acknowledge foreign bankruptcy judgments without initiating a court procedure, in China, according to Bankruptcy Law 2006, an acknowledgment procedure conducted by court should be initiated. But the Law does not mention whether or not this acknowledgment has retrospective effect, namely whether or not it has an effect on the disposal of property by a debtor within the Chinese border and repayment of debts to individual creditors between the time when the bankruptcy procedure has been initiated in a foreign country and the time when the Chinese court recognises the judgment.

Generally, acknowledging a foreign judgment is acknowledging the legal relationship confirmed by it. If a foreign judgment is acknowledged, its effect naturally traces back to the day when the legal relationship was formed. However, if the retrospective effect of a foreign bankruptcy judgment is acknowledged, it might be unfair to creditors who have acted in good faith²⁴ within the boundary of China in receiving payment from the debtor after the foreign bankruptcy procedure has started, since their interests are damaged because of the invalid or voidable repayment. On the other hand, if the retrospective effect is not acknowledged – the repayment of debts made by the debtor to individual creditors or other disposals of properties are not to be interfered with. Therefore fraudulent actions of bankruptcy or partial repayment are inevitable. This is due to the time gap between the beginning of the foreign bankruptcy procedure and the acknowledgment of the foreign bankruptcy judgment made by the Chinese court. Therefore, a conflict between the protection of

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22 Bankruptcy Law 2006, Article 3.

23 X. Wang and J. Wang, 'Analysis about China's Acknowledging Extraterritorial Effect System of Foreign Bankruptcy Procedure and its Improvement' (2008) 6 *Journal of Legal Studies* 11.

24 Creditors in good faith means the creditors who do not know bankruptcy proceedings have been initiated in a foreign country.

home creditors' legitimate interests and reinforcement of international cooperation to tackle fraudulent actions by the debtor has emerged. The conflict has not been resolved even in countries with high levels of international cooperation.

Based on the analysis above and the lack of a uniformed solution or precedents internationally, there are two possible solutions for a Chinese court. One is to refuse to acknowledge the retrospective effect of a foreign bankruptcy judgment. Provisional relief²⁵ in respect of a foreign bankruptcy judgment has not been established in China. In order to guarantee fairness, the decision of recognising a foreign bankruptcy judgment should be made as soon as possible. This suggestion is preferable considering the protection of home creditors and is consistent with the implied rules in the UNCITRAL Model Law on Cross-Border Insolvency.²⁶

The other is to acknowledge the retrospective effect of a foreign bankruptcy judgment, and enable payments made to creditors in good faith to be exempt from the retrospective effect. The burden of proof (of good faith of a creditor) lies on the foreign applicants.²⁷ It is submitted that this is the more preferable solution because it can not only resolve the conflict, but can also comply with the general legal theory. While in the first solution, although it is said that the decision of recognising a foreign bankruptcy judgment should be made as soon as possible, there must be a gap that lies between the two time points. What consists of 'as soon as possible' remains a question.

c. Examination conducted according to the relevant international treaties that China has concluded or acceded to or according to the principles of reciprocity

According to the new Chinese bankruptcy law, an examination of the foreign bankruptcy judgment is conducted according to the relevant international treaties that China has concluded or acceded to or according to the principles of reciprocity.²⁸ However, China has not concluded or acceded to any relevant specialised

international treaties until now. What the Chinese court may rely upon are bilateral treaties on judicial assistance in civil and business matters. By 14 August 2006, China had signed 29 bilateral treaties on judicial assistance in civil and business matters with countries such as France and Poland, and a treaty signed with Singapore which does not include acknowledgment of judgments. Chinese courts should examine a foreign bankruptcy judgment issued in one of these countries according to such treaties. Items of examination are often procedural matters rather than substantive ones, including: 1) right jurisdiction, 2) conclusiveness and enforcement of the decision, 3) fairness of judicial proceedings, 4) no conflicting judgment or litigation in China and 5) reserve clause of public power.²⁹ In the B & T Case, the Foshan Court reviewed and examined the documents submitted by the applicant and relevant procedural matters, without touching upon substantive matters. This conforms to general practice and the provisions contained in the Sino-Italy Treaty.³⁰ The following will expand upon three of the above-listed aspects.

Jurisdiction for acknowledging a foreign bankruptcy judgment is not stipulated in the Bankruptcy Law 2006. Among different scholars' opinions, it is submitted that the universal way is workable in China. The UNCITRAL Model Law on Cross-Border Insolvency, defines a 'foreign main proceeding' and a 'foreign non-main proceeding' as follows: 'a foreign main proceeding means a foreign proceeding taking place in the State where the debtor has the centre of its main interests' and 'a foreign non-main proceeding means a foreign proceeding, other than a foreign main proceeding, taking place in a State where the debtor has an establishment'.³¹ It should be noted that 'in the absence of proof to the contrary, the debtor's registered office, or habitual residence in the case of an individual, is presumed to be the centre of the debtor's main interests.'³² From these articles we can see that a foreign main proceeding empowers jurisdiction to the court in the place where the centre of main interests lie while a foreign non-main proceeding empowers jurisdiction

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- 25 Provisional relief means to order the debtor not to dispose of bankruptcy estate by compulsory means within a certain term in order to avoid decrease of the property. <www.chinacourt.org>.
- 26 UNCITRAL Model Law on Cross-border Insolvency is one of the efforts on a universal bankruptcy law between countries made by UN under the situation of globalisation. China's new bankruptcy law was drafted under the influence of international efforts, but China has not adopted it in detail.
- 27 X. Wang and J. Wang, 'Analysis about China's Acknowledging Extraterritorial Effect System of Foreign Bankruptcy Procedure and its Improvement' (2008) 6 *Journal of Legal Studies* 11.
- 28 Bankruptcy Law 2006, Article 5.
- 29 Reserve clause of public power refers to where there is no violation to the basic principles of the laws of PRC, no detriment to state sovereignty, security and social public interests of the PRC. It would be discussed in detail in the following section.
- 30 J. Shi, 'Cross-border Insolvency', R. Parry, Y. Xu and H. Zhang (eds), *China's New Enterprise Bankruptcy Law: Context, Interpretation and Application* (Ashgate Publishing, Farnham, 2010, p. 329).
- 31 UNCITRAL Model Law on Cross-Border Insolvency, Article 2 (b) (c).
- 32 UNCITRAL Model Law on Cross-Border Insolvency, Article 16.3.

to the court in the place where the debtor has its main business interests.³³ Therefore, the Chinese court can recognise the extraterritorial effect of bankruptcy proceedings initiated in the debtor's domicile, which conforms to international practices as well as Article 3 of the Bankruptcy Law 2006 which states that 'a bankruptcy case shall be governed by the court where the relevant debtor is domiciled.'³⁴ But if the bankruptcy law of the domicile country does not recognise the extraterritorial effect of its bankruptcy proceedings, a Chinese court can acknowledge the extraterritorial effect of its foreign non-main proceedings.³⁵

The second item for examination is the conclusiveness and enforcement of the decision, namely that the decision has come into legal effect. Here, the time when 'the decision has come into effect' should be understood as the time when the bankruptcy proceedings have been initiated rather than after the bankruptcy declaration has been made. This is because both the initiation of the proceedings and the bankruptcy declaration would lead to the debtor's properties being under the control of the administrator, so that the debtor is not allowed to dispose of his properties or pay the individual creditors. If the Chinese court does not recognise the legal effect of initiation of the proceedings, fraudulent trading and repayment of individual creditors between the two time points cannot be avoided, which would lead to an ineffectiveness of international cooperation in cross-border insolvency.³⁶

As for countries that China has not yet signed bilateral treaties on judicial assistance in civil and business matters with, it is stated in the Bankruptcy Law 2006 that an examination should be conducted based on the principle of reciprocity. The principle of reciprocity in international relations and treaties states that favours, benefits or penalties that are granted by one state to the citizens or legal entities of another, should be returned in kind. In international practices, the reciprocity principle in recognising foreign bankruptcy proceedings usually means that the foreign country should recognise the bankruptcy proceedings of that country in turn. Thus, the reciprocity principle in China is satisfied when the laws of recognition of extraterritorial effect in a foreign country are similar to or more flexible than

those of China.³⁷ It is submitted that any countries that apply the UNCITRAL Model Law in Cross-Border Insolvency or who have made similar laws of recognition and enforcement of a foreign judgment with China should pass the examination of the reciprocity principle considering a relatively strict examination of other elements.³⁸

d. Reserve clause of public order

In the Bankruptcy Law 2006, it is stated that a foreign bankruptcy judgment shall be recognised and enforced 'when believing that it does not violate the basic principles of the laws of the People's Republic of China, does not damage the sovereignty, safety or social public interests of the state'.³⁹ This rule of law is called the 'reserve clause of public order' in China or 'public policy clause' in some other countries. There are few interpretations of the reserve clause of public order in China, leaving a strong discretionary power to judges. Therefore, the clause would be easily abused and the introduction of mature experience from foreign countries is needed in China.⁴⁰

It should be noted that recognition of a foreign bankruptcy is different from recognition of other civil and business matters. If any civil or business judgment is denied recognition by a Chinese court, applicants can still bring a lawsuit in other courts with jurisdiction. However, exclusive jurisdiction is applied in bankruptcy proceedings, since Article 3 of the Bankruptcy Law 2006 provides that a bankruptcy case shall be governed by the court where the relevant debtor is domiciled,⁴¹ which means if a foreign bankruptcy judgment is denied for the reason of violating the reserve clause of public order, applicants can hardly get a judicial remedy in any other way.

Although some discretion should be left to judges considering different specific circumstances, the application of the reserve clause of public order should be based on the outcome of a foreign bankruptcy judgment. Only if the outcome (rather than application of laws or relevant procedures) violates the basic principles of the laws of the PRC or damages the sovereignty, safety or social public interests of the state can

Notes

33 H. Sun, 'The application of jurisdiction in cross-border insolvency' (2007) 12 *Legal System and the Society* 380.

34 Bankruptcy Law 2006, Article 3.

35 X. Wang and J. Wang, 'Analysis about China's Acknowledging Extraterritorial Effect System of Foreign Bankruptcy Procedure and its Improvement' (2008) 6 *Journal of Legal Studies* 11.

36 *Ibid.*

37 X. Wang and H. Wang, 'Legal basis of Chinese recognition and enforcement of foreign bankruptcy judgment' (2008) 6 *PKU International and Comparative Law Review* 1.

38 *Ibid.* at 12.

39 Bankruptcy Law 2006, Article 5; J. Shi, 'Twelve Years to Sharpen One Sword: The 2006 Enterprise Bankruptcy Law and China's Transition to a Market Economy' (2007) 16 *Norton Journal of Bankruptcy Law and Practice* 645, 678.

40 T. Zhou, 'The application of reserve of public order in international civil and business matters' (2010) 82 *Economic Research Guide* 160.

41 Bankruptcy Law 2006, Article 3.

a Chinese court refuse to recognise for the reason of violation of the reserve clause of public order. In order to protect foreign bankruptcy representatives from losing opportunities of getting judicial remedies in China, the Chinese court cannot abuse the reserve clause of public order to exclude the effect of foreign bankruptcy proceedings on properties within the boundary of China. For example, a Chinese court cannot refuse to recognise a foreign bankruptcy judgment using the reserve clause of public order only because the relevant bankruptcy laws of that country are different from those of China.⁴²

e. Legitimate rights and interests of the creditors

China's new Bankruptcy Law also states that a foreign bankruptcy judgment should 'not damage the legitimate rights and interests of the creditors within the territory of the PRC'⁴³. But what are 'legitimate rights and interests' and what are their legal basis? The law does not make it clear. There is a way of making sure what rights and interests can be enjoyed by creditors in China by distinguishing where the debtor's domicile is located. If the debtor's domicile is within the territory of China, then the Chinese court have jurisdiction to the bankruptcy proceedings, so that the creditors' legitimate rights and interests refer to all rights and interests derived from all the relevant laws including the Bankruptcy Law 2006. Anything that does not accord with China's Bankruptcy Law 2006 in a foreign bankruptcy judgment may possibly damage the legitimate rights and interests of creditors within the territory of China. But if the debtor's domicile is not in China, China's Bankruptcy Law 2006 is not applicable because a Chinese court does not have jurisdiction over the bankruptcy proceedings. The legitimate rights and interests of creditors in China are derived from other Chinese civil laws and foreign bankruptcy laws based on where the bankruptcy judgment is made. Under these circumstances, the damage to legitimate rights and interests of creditors in China by foreign bankruptcy proceedings means that Chinese creditors cannot be treated fairly to enjoy the same rights and interests as creditors from the country in which the bankruptcy proceeding is initiated.⁴⁴

iii. Improvement of the system of recognising the extraterritorial effect of a foreign bankruptcy proceeding

Compared to countries with higher levels of international cooperation in cross-border insolvency, China can use international practice and relevant laws for reference and establish a system for distinguishing foreign main proceedings and foreign non-main proceedings.⁴⁵ It has been mentioned that foreign main proceedings take place in the State where the debtor has the centre of its main interests. If only the country where main proceedings are taking place recognises the extraterritorial effect of its bankruptcy judgment, it would also be recognised by most countries. Foreign non-main proceedings take place in the State where the debtor has properties or places of business. It only has effects on properties within the boundary of that country. The distinction between foreign main proceedings and foreign non-main proceedings is stipulated in Council Regulation (EC) on Insolvency Proceedings and the UNCITRAL Model Law on Cross-Border Insolvency. The first paragraph of Article 3 of Council Regulation (EC) on Insolvency Proceedings provides that 'the courts of the Member State within the territory of which the centre of a debtor's main interests are situated shall have jurisdiction to open insolvency proceedings. In the case of a company or legal person, the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary'⁴⁶. There is a similar definition in the UNCITRAL Model Law on Cross-Border Insolvency.

Foreign non-main proceedings are necessary in two aspects. On the one hand, it is more convenient for Chinese creditors since they can get their payment at home. Also the legitimate rights and interests of Chinese creditors would not be influenced because of different priority of creditors in different foreign bankruptcy laws. On the other hand, it is easier to enforce a foreign bankruptcy judgment in China after a Chinese court has recognised the effect of a foreign bankruptcy judgment if a foreign non-main bankruptcy proceeding is initiated in China. Thus, the distinction of foreign main proceedings and foreign non-main proceedings is a better way of protection for parties.

In addition, a foreign non-main proceeding can solve the problem of the different priority of creditors in different countries (as we have discussed above in respect

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42 X. Wang and J. Wang, 'Analysis about China's Acknowledging Extraterritorial Effect System of Foreign Bankruptcy Procedure and its Improvement' (2008) 6 *Journal of Legal Studies* 12.

43 Bankruptcy Law 2006, Article 5.

44 X. Wang and J. Wang, 'Analysis about China's Acknowledging Extraterritorial Effect System of Foreign Bankruptcy Procedure and its Improvement' (2008) 6 *Journal of Legal Studies* 12.

45 H. Sun, 'The Application of Jurisdiction in Cross-border Insolvency' (2007) 12 *Legal System and the Society* 380, 381.

46 Council Regulation (EC) on Insolvency Proceedings, Article 3 (1).

of Article 132 of the Bankruptcy Law 2006). However, there are still two questions that remain to be solved. Firstly, Article 3 of the Bankruptcy Law 2006 states that 'the People's Court where the relevant debtor is domiciled has the exclusive jurisdiction to open bankruptcy proceedings.' From the textual meaning of Article 3, a Chinese court does not have jurisdiction if the debtor's domicile is not in China, so that a foreign non-main proceeding cannot be initiated in China. An amplified interpretation is needed here. Secondly, the first paragraph of Article 5 of the Bankruptcy Law 2006 states that 'the procedures for bankruptcy which have been initiated according to the present Law shall have binding force over the assets of the relevant debtor beyond the territory of China.' However the effect of a foreign non-main proceeding should not have binding force over the properties beyond the territory of China.⁴⁷

Although there are still many questions that remain to be solved, the foreign non-main proceeding is a relatively proper way of establishing a functional system of cross-border insolvency. The Chinese legislator can refer to the UNCITRAL Model Law on Cross-Border Insolvency to make up the gap between Chinese Bankruptcy Law and international practices. Adopting the foreign non-main proceeding stipulated in the UNCITRAL Model Law on Cross-Border Insolvency can also show China's sincere will of international cooperation and establish a positive image of an active participant in international cooperation on cross-border insolvency. This is beneficial to Chinese administrators when they are claiming the extraterritorial effect of a Chinese bankruptcy judgment in a foreign country.

IV. Conclusion

Although Article 5 of the Bankruptcy Law 2006 is far from enough in itself to be practical and specific in cross-border insolvency, it is still a big step forward in terms of legislation in cross-border insolvency because it can strengthen the confidence of Chinese and foreign investors and encourage capital flow between China and foreign countries. The B&T case is a typical cross-border insolvency case where a Chinese court recognised a foreign bankruptcy judgment based on a bilateral treaty and it can set an example for similar cases thereafter. Besides international treaties, the principle of reciprocity, the issues of public order and the legitimate rights and interests of creditors should also be examined by Chinese courts. To improve the system of recognising foreign bankruptcy proceedings, borrowing from international practice which distinguishes between foreign main and non-main proceedings is suggested. It is submitted that as China is getting more and more involved in globalisation, there will be more cases of cross-border insolvency in China, which requires more intensive cooperation between China and foreign countries. The urgent need will facilitate specific regulation on cross-border insolvency.

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47 X. Wang and J. Wang, 'Analysis about China's Acknowledging Extraterritorial Effect System of Foreign Bankruptcy Procedure and its Improvement' (2008) 6 *Journal of Legal Studies* 13.

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