

CHINA LAW UPDATE

MINUTES OF THE NATIONAL COURT WORK CONFERENCE
ON BANKRUPTCY TRIALS ISSUED BY THE SUPREME
PEOPLE'S COURT

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I. INTRODUCTION	160
II. IMPROVEMENT OF THE ADMINISTRATOR SYSTEM	160
A. Improving the Structure of the Administrator Team	161
B. Implementing a Rating and Evaluation System of the Administrators.....	161
C. Establishing a Working Mechanism for Competitive Appointment of Administrators	162
III. BANKRUPTCY OF THE RELATED ENTERPRISES	163
A. Establishing the Conditions for Adopting the Substantive Consolidation Process	163
B. Establishing the Jurisdiction Principle of the Substantive Consolidation Process	164
IV. ADVANCING EFFICIENT CONNECTIONS BETWEEN THE ENFORCEMENT PROCEDURE AND THE BANKRUPTCY PROCEDURE	164
A. Improving Information Sharing Between the Bankruptcy and the Enforcement Procedure	165
B. Emphasizing the Parties' Consent to the Transfer Process	165

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I. INTRODUCTION

On December 25, 2017, the Supreme People's Court of the People's Republic of China ("PRC") convened the National Court Work Conference on Bankruptcy Trials in Shenzhen, Guangdong Province. Representatives from higher people's courts of all provinces, autonomous regions and municipalities attended the conference and reached a consensus on major issues concerning bankruptcy trials. Minutes of the conference were issued by the Supreme People's Court on March 4, 2018, which have become authoritative guidelines for bankruptcy judicial practice in China.

The economic reform in China demands the improvement of bankruptcy law. Under the pressure of economic downturn, China launched economic reform to reduce the excess capacity and shut down "zombie enterprises", which persistently incurred financial losses but continued to operate in the market.¹ The crackdown of zombie firms consequently increased the amount and complexity of bankruptcy cases in Chinese courts. The Enterprise Bankruptcy Law, which was promulgated a decade ago, could no longer meet the demands of judicial practice. Therefore, the Supreme Court held a national conference and addressed prominent problems in bankruptcy trials. An analysis of several key provisions detailed within the minutes of the conference is provided below.

II. IMPROVEMENT OF THE ADMINISTRATOR SYSTEM

Administrators are the major promoters of bankruptcy procedure and the specific executors of bankruptcy matters. In the bankruptcy process, the administrators are responsible for managing assets, designing restructuring plans and organizing the creditors' meetings.

¹ Guowuyuan Guanyu Huajie Channeng Yanzhong Guosheng Maodun de Zhidao Yijian (国务院关于化解产能严重过剩矛盾的指导意见) [The State Council's Guiding Opinion on Eliminating Severe Excess Capacity] (promulgated by the St. Council, Oct. 15, 2013, effective Oct. 15, 2013) (Chinalawinfo).

Due to the significant role administrators play in bankruptcy proceedings, the minutes have taken several measures to enhance their professional capacity.

A. Improving the Structure of the Administrator Team

The minutes endeavor to diversify the structure of the administrator team by opening access to experts in business management. According to the Enterprise Bankruptcy Law, the administrators should be selected from law firms, accounting firms or bankruptcy liquidation firms.² The status quo was such that administration teams consist solely of certified accountants and lawyers. However, the newly-launched minutes seeks to broaden access to roles in the administrator team to candidates with a wide range of professional skills. Experts in business management are encouraged to become administrators and play an active role in corporate rescue cases.³ The key reason for the diversification approach is that the designing of the restructuring plan, which is the most important duty of the administrator, requires deep knowledge of the financial strategy of a corporation. Professional managers with their expertise in corporate finance may be more qualified to design a restructuring plan that can satisfy the needs of the creditors and enhance the profit-making ability of the enterprises that enter into bankruptcy proceedings, as compared to accountants and lawyers.

B. Implementing a Rating and Evaluation System of the Administrators

Before the promulgation of the minutes, there was no rating and evaluation system in the bankruptcy cases, and consequently, there was no division of work between higher-level and lower-level administrators. The minutes implements the first rating and evaluation system of the bankruptcy administrators in China. Specifically, the administrators will be divided into several levels depending on their professional level, experiences, practicing integrity, performance and diligence. The highest-level

² Qiye Pochan Fa (企业破产法) [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2017) art. 24 (Chinalawinfo).

³ Quanguo Fayuan Pochan Shenpan Gongzuo Huiyi Jiyao (全国法院破产审判工作会议纪要) [Minutes of the National Court Work Conference on Bankruptcy Trials] (promulgated by Sup. People's Ct., Mar. 4, 2018, effective Mar. 4, 2018) sec. III, art. 4 (Chinalawinfo). The minutes is considered to be of judicial interpretation nature and is binding in the judicial system.

administrators will be assigned to the most complicated bankruptcy cases while the lower-level administrators are only allowed to handle simpler bankruptcy cases with fewer properties and less complex debtor-creditor relationships.⁴ In addition, a strict evaluation system will be set up to review the performance of administrators annually and to adjust the classification result on a regular basis.⁵

The new administrator assignment mechanism optimizes the allocation of legal resources as the higher-level administrators are able to devote their time to more complex cases while the lower-level administrators can provide widespread assistance to the public. Moreover, the evaluation system will encourage the administrators to further improve their professional skills and provide legal services of high quality in order to retain their reputation and status.

C. Establishing a Working Mechanism for Competitive Appointment of Administrators

For more complex bankruptcy cases, the minutes establishes a system of competitive appointment of the administrators to improve the quality of legal services. Based on the minutes, for bankruptcy cases involving listed companies and cases with significant local impact or complicated debtor-creditor relationships, the administrators should generally be selected and appointed through a competitive process.⁶ Potential candidates are required to enter into a competitive process and demonstrate their professional abilities by drafting a preliminary assets management plan and designing a debt reconstruction plan. The people's court will make the final decision about the appointment of the administrator.⁷ This new measure is regarded as an important step to ensure complex cases are dealt with by competent administrators, thus boosting the overall efficiency of judicial practice in bankruptcy cases. Furthermore, the high-quality

⁴ *Id.* sec. III, art. 6.

⁵ Du Jun (杜军), Guanli Ren Zhidu Wanshan de Lujing Yu Sikao, Quanguo Fayuan Pochan Shenpan Gongzuo Huiyi Jiyao (管理人制度完善的路径与思考——《全国法院破产审判工作会议纪要》的解读(一)) [*The Methods and Thoughts in Relation to Improving the System of the Administrator - An Interpretation of the Minutes of the National Court Work Conference on Bankruptcy Trials*], RENMIN FAYUAN BAO (人民法院报) [PEOPLE'S COURT DAILY], Mar. 21, 2018, at 7.

⁶ Quanguo Fayuan Pochan Shenpan Gongzuo Huiyi Jiyao (全国法院破产审判工作会议纪要) [Minutes of the National Court Work Conference on Bankruptcy Trials] (promulgated by Sup. People's Ct., Mar. 4, 2018, effective Mar. 4, 2018) sec. III, art. 7 (Chinalawinfo).

⁷ Qiye Pochan Fa (企业破产法) [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2017) art. 22 (Chinalawinfo).

service of the administrators will better satisfy the expectations of the creditors and hopefully contribute to the revival of the enterprise facing bankruptcy.

III. BANKRUPTCY OF THE RELATED ENTERPRISES

The minutes further endeavor to establish the fundamental adjudication principles of bankruptcy cases involving related enterprises. On one hand, to protect the interests of the creditors, the related enterprises with highly confusing legal personalities should be subjected to substantive consolidation, which means the consolidation of assets and liabilities of related debtors into a single big pool to pay creditors. On the other hand, to avoid the infringement of the lawful rights of related enterprises, the substantive consolidation process should be adopted with prudence and caution. Therefore, the minutes attempts to balance the interests of the creditors and the related enterprises by establishing a series of detailed regulations on the substantive consolidation process.

A. Establishing the Conditions for Adopting the Substantive Consolidation Process

Before the promulgation of the minutes, the judicial practice of the substantive consolidation process was highly disordered. The minutes announces that as a basic principle the court shall respect the independence of the legal personalities of enterprises. Only when there are highly confusing legal personalities among related enterprises and it costs too much to distinguish the individual property of each related enterprises, shall the courts adopt the substantive consolidation process. The consolidation process shall be implemented with serious prudence by the court, and the interests of the creditors for compensation shall be respected.⁸ In brief, the minutes clarifies that the independence of legal personalities should be respected as a general principle, and thus the substantive consolidation process should only be used in exceptional instances. In this way, the minutes seeks to fairly protect the interests of the

⁸ Quanguo Fayuan Pochan Shenpan Gongzuo Huiyi Jiyao (全国法院破产审判工作会议纪要) [Minutes of the National Court Work Conference on Bankruptcy Trials] (promulgated by Sup. People's Ct., Mar. 4, 2018, effective Mar. 4, 2018) art. 35 (Chinalawinfo).

relevant enterprises, preventing well-operated companies from being embroiled in the bankruptcy of a related enterprise.

B. Establishing the Jurisdiction Principle of the Substantive Consolidation Process

The minutes establishes the first jurisdiction principle of the substantive consolidation process. The minutes clarifies that if a case involving related enterprises is tried through the substantive consolidation process, the people's court in the place where the essential controlling enterprise is located shall have the jurisdiction.⁹ The reason for this is that, with the main assets and the management located, the people's court should be able to carry out the bankruptcy procedure more effectively and thus reduce costs incurred in the judicial process. Moreover, if the essential controlling enterprise is difficult to be identified, the people's court in the place where the major property of the related enterprises is located shall have the jurisdiction. If several courts are in dispute over which has jurisdiction, their common superior people's court shall be requested to designate the jurisdiction.¹⁰ In this way, the minutes provides a solid basis for the designation of jurisdiction in case when the substantive consolidation process is relied upon, to improve the judicial efficiency and minimise unnecessary disputes.

IV. ADVANCING EFFICIENT CONNECTIONS BETWEEN THE ENFORCEMENT PROCEDURE AND THE BANKRUPTCY PROCEDURE

Finally, the minutes attempts to connect enforcement with the bankruptcy procedure to enhance judicial efficiency. "Difficulties in enforcement" have constantly been a serious problem in China's judicial practices. Due to the financial hardship of the enterprises undergoing bankruptcy proceedings, it is difficult for creditors to receive full repayment, and as such, their financial interests are harmed. Efficient connections between enforcement and the bankruptcy procedure would be a powerful tool in solving this problem. Therefore, the minutes requires that the people's courts at all levels to fasten the transfer process from the enforcement to bankruptcy procedure when the enterprise conforms to the

⁹ *Id.* art. 35.

¹⁰ *Id.*

bankruptcy standards. The minutes not only encourages the information sharing between the bankruptcy and enforcement procedures, but also emphasizes the importance of the Party's consent to the transfer process. These measures would be an efficient way to help creditors ensure repayment and would speed up the clearing out of "zombie companies" that fail to operate sustainably and damage the national economy.

A. Improving Information Sharing Between the Bankruptcy and the Enforcement Procedure

Information sharing will greatly improve the efficiency of the administrators because it helps the administrators to conduct assets management and verify the creditors' rights. The information shared from during enforcement procedures will assist the administrators in conducting thorough due diligence. The information provided in existing lawsuits will help the administrators to determine the number of creditors, the amount of debts of the company and the location of valuable assets. In this way, the administrators will be able to draft the form of the creditor's rights more quickly and the creditors will receive their repayment sooner. The minutes therefore strongly encourages cooperation between the enforcement courts and bankruptcy courts,¹¹ which will significantly improve the efficiency of the bankruptcy process. In practice, Liuzhou Intermediate People's Court promoted the co-operation between different divisions of the court and successfully finished the trial of a bankruptcy in six months, much shorter than the state average length of bankruptcy trials, which amounts to nearly two to three years.¹²

B. Emphasizing the Parties' Consent to the Transfer Process

By emphasizing the need for consent to the transfer process from the enforcement to bankruptcy procedure, the minutes helps to protect the lawful rights of the parties in the lawsuits. Specifically, if the enforcement court discovers that an enterprise meets the

¹¹ *Id.* art. 43.

¹² Qin Liusu & Wei Feiyu (覃流苏 & 韦飞宇), Guangxi Liuzhou: Datong "Zhizhuanpo" Zuihou YI Gongli, Liangnian Jiejue "Jiangshi Qiye Zhixing An Jin Sanshi Yiyuan (广西柳州：打通"执转破"最后一公里 两年解决"僵尸企业"执行案近30亿元) [Liuzhou, Guangxi Province: Fastened the Transition from Execution to Bankruptcy, Eliminated Zombie Enterprises in Two Years, Resolving Enforcement Cases in the Amount of Nearly Three Billion], JSZX COURT (June 19, 2018), <http://jszx-court.gov.cn/main/ExecuteExperience/25859.jhtml>.

conditions of bankruptcy, it shall inquire promptly whether the parties involved consent to transfer the case to bankruptcy procedure.¹³ The consent of the parties involved is emphasized here because the liquidation sequences are different in enforcement and bankruptcy procedures. In the enforcement procedure, creditors who file applications for seizure first shall get paid off first. However, in the bankruptcy procedure, creditors are paid off simultaneously; debts derived from the employment and taxation enjoy top priority. Other creditors then get payment in proportion to their creditors' rights. The minutes therefore provides that during the transfer, consent of the relevant parties, especially the creditors, shall deserve close attention. It is expected that this measure will better protect creditors' lawful rights and improves the fairness of bankruptcy procedure.

¹³ Quanguo Fayuan Pochan Shenpan Gongzuo Huiyi Jiyao (全国法院破产审判工作会议纪要) [Minutes of the National Court Work Conference on Bankruptcy Trials] (promulgated by Sup. People's Ct., Mar. 4, 2018, effective Mar. 4, 2018) art. 44 (Chinalawinfo).