

Chapter 1

Introduction

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This book presents an analysis of the new Enterprise Bankruptcy Law 2006 of the People's Republic of China, presenting a detailed discussion of key features of the law and its context. This context is important, since the concept of bankruptcy is by no means a straightforward one in China, ideologically, socially and politically. The enactment of this law was a complex and difficult task which took many years of efforts. The new law therefore represents a significant milestone but the economic, social and political context of the law is likely to continue to impact upon its operation for many years to come.

This introductory chapter will provide a background to the concept of bankruptcy in China, highlighting the role of legal culture, the early history of bankruptcy laws in China, the social and economic impact of the Mao era, the previous bankruptcy law and the passage of the 2006 Law. The new law will then be briefly introduced before an overview of the book and its structure will be provided.

Impact of Traditional Legal Culture

Chinese traditional legal culture has had a significant historical impact, both on the understanding of the concept of bankruptcy, and on the bankruptcy legislation itself. This legal culture can clearly be divided into three stages. In the ancient Chinese empire, it was built upon the Confucian theory which was involved in every aspect of people's lives including politics, the economy, law, culture and morality. When the Chinese Communist Party (CCP) took control over the new China in 1949, people were living under the strong influence of Maoism which was formulated through the combination of Marxist theory and unique Chinese perspectives. In contemporary China, the legal culture and ideology have been developing towards a rule of law since the government carried out the economic reform and opening up policy in 1978.¹ This chapter will consider each of these phases and their impact on the development of bankruptcy laws at the time.

1 See in particular Lubman (1999) and Peerenboom (2002).

Confucianism

Confucianism emphasized the natural harmony of the society that motivated the approach of collectivism and opposed individual rights which were deemed to be contrary to the natural order.² There was no autonomy for individuals who only assumed obligations to the community. Under Confucian theory, the ancient legal system was comprised by propriety (*li*) and law (*fa*). It was noteworthy that propriety was preferred as a means of conflict resolution, rather than law.³ Confucius advocated that 'If people are guided by *fa*, and order among them is enforced by means of punishment, they will try to evade the punishment, but have no sense of shame, but if they are guided by virtue, and order among them is enforced by *li*, they will have the sense of shame and also be reformed'.⁴ In this conception, law played a less important role than morality in dispute resolution between individuals. In addition, the disputants might have felt shamed and embarrassed at having to resolve their conflict through judicial process. Out-of-court means of reconciliation were preferably adopted.⁵ Viewed through Western eyes, the Chinese ancient legal culture was not individualist. The most significant point was that Confucianism had been adopted by the ruling class since the Han Dynasty as the principal guideline which strongly influenced the ruling strategy of each emperor, the enforcement of laws and people's patterns of thought in the feudal society.⁶ A conception that a 'son should repay the debts of his father' was deduced from Confucian theory which had a negative impact on the legislation of bankruptcy law.⁷ Since the debts could pass from one generation to another, it is submitted that there was no need for the enactment of bankruptcy laws for insolvent individuals because the creditors could enforce their debts by claiming against the debtor's children who had the ability to repay. It can be perceived that the Confucian theory had a far-reaching influence on the ideology and legal construction. Just as Friedrich Hirth said 'for even at the present day, after the lapse of more than two thousand years, the moral, social and political life about one-third of mankind continues to be under the full influence of his (Confucius's) mind'.⁸

Early Bankruptcy Laws, 1906-49

Influenced by Confucian ideologies, bankruptcy laws were absent from China for much of its history. Such laws only appeared in the last few years of Imperial

2 Hoecke and Warrington (1998), p. 506.

3 Lee and Lai (1978), p. 1308.

4 Confucian Analects, bk. II, ch. III. as quoted in Lee and Lai (1978), p. 1310.

5 Hoecke and Warrington (1998), p. 506.

6 Zhang (2007), pp. 72-3.

7 Tang (2005), para. 1.07.

8 Ibid. at para. 1.02.

China and accordingly there were no bankruptcy laws for several decades following the emergence of modern business enterprises in Imperial China in the 1840s.⁹ Besides the ideological factors, noted above, a possible further factor that may have lain behind this comparatively late development may have been the nature of business at this time. It has been noted that ‘family businesses’ were at this time prevalent¹⁰ and so the nature of business may not have given rise to a need for such laws. This is, however, a point of some debate, as the scale of such businesses may have been rather more significant than their family nature suggests. A strong contention is that the ‘kinship’ which marked the family business out was in effect a smokescreen, ‘a finely wrought legal fiction that legitimated the existence of private enterprises by profit-seeking individuals in a state in which Confucianism was the official orthodoxy’.¹¹ These ‘family businesses’ were in fact ‘clan corporations’¹² or ‘patricorporations’¹³ which in fact performed similar functions to modern corporations.¹⁴ It seems clear however that the development of modern commercial *law* in China only took place towards the end of the Qing dynasty.¹⁵

The first company law, *Da Qing Gong Si Lu*, was enacted in 1904 and the first bankruptcy law, *Pochan Lu*, followed soon after, in 1906. However, this first bankruptcy law was only short lived, due to protests by merchants and implementation difficulties, and it was abolished by Emperor Guan Xu in 1908.¹⁶ The Qing dynasty fell in 1912 and during the era of the Republic of China, which lasted until 1949, a time of legal instability followed, in particular during the period from 1912 to 1928, when the Republic was ruled by warlord factions. Several versions of bankruptcy laws were enacted during the period from 1915, when a new bankruptcy law was enacted by the Northern Warlords Government by referring to the bankruptcy laws of Germany and Japan.¹⁷ This bankruptcy law included substantive rights, procedures and responsibilities and contained as many as 337 articles. However, owing to a lack of legal skills and legislative lacunae, this law did not come into force.¹⁸ Subsequently, in the ‘Nanjing Decade’ established by the Kuomintang from 1928, significant efforts were made towards the modernization of the legal system, and a new bankruptcy law was enacted in 1935 on the basis

9 It is contended that this emergence began when China was forced to enter the world of globalized trade following the Opium Wars of the 1840s: Gu Minkang (2006), p. 5.

10 Weber (1978), p. 727.

11 Ruskola (2000), pp. 1617-18.

12 Ruskola (2000).

13 Gates (1996).

14 See Gates (1996), pp. 31-3 and sources cited therein.

15 See for example Rowe (1984), p. 145 noting that tea guild merchants in nineteenth century Hankou preferred to ‘rely upon private compulsion to guarantee prompt and fair payment’.

16 Li (2001).

17 Gu (2006), p. 278.

18 Wang (2007), p. 28.

of the 'Provisional Regulation on the Disposal of the Debts of Merchants' which was issued in 1933. This bankruptcy law included corporate liquidation and composition procedures which drew upon the advanced experiences of Western jurisdictions.¹⁹ However, like all laws enacted by the Kuomintang, these laws were abolished following the founding of the People's Republic of China in 1949.²⁰

Establishment of the People's Republic of China

When the new China was founded in 1949, the people became the 'real masters' of the state under the leadership of the Chinese Communist Party, 'CCP', which developed the traditional Marxist theory on the basis of the peculiar characteristics of China. In terms of legal culture in the Maoist era, law was treated as a tool of the ruling class and all the legal rules were politicized, whether criminal or civil law.²¹ In the West, private law in particular is utilized to facilitate the exchange of private property rights and transactions, while in the Maoist China, private law, which mainly referred to civil law, was 'far from the autonomous and semiautonomous institutions that bear similar labels in the west'.²² The legal system under Mao emphasized the functions of extra-judicial mediation as a fundamental means of dispute resolution. One major distinction between mediation under Mao and reconciliation under Confucius was that the former was strongly marked by its political colour. In that era, the ideological debate was intense and sensitive, and it was important that a line was drawn between capitalism and socialism. It can be generalized that the Maoist legal framework focused on the collectivist approach and neglected the protection of individual rights. Fundamentally, this system led to a serious problem, equalitarianism, which may be metaphorically termed as 'eating from the big pot' (giving an equal claim to state and enterprise largesse).²³ It largely influenced people's attitudes and incentives to produce and innovate, and impeded the enhancement of productivity.

In the 1950s the Chinese Communist Party swiftly and successfully accomplished the 'socialist transformation' in which all the private enterprises and factories were transferred to public ownership. Replacing capitalism was

19 Ibid.

20 See further Li (2001). The 1935 law survives as the framework of the bankruptcy law of Taiwan.

21 Lubman (1999), pp. 88-9.

22 Ibid. at 91.

23 'Eating from the big pot' was a vivid description of equalitarianism. Literally, it meant that people who worked in a state-owned enterprise or a rural collective shared food from the same pot. In essence, it criticized people's backward thought in pursuit of equality of living standards. Under this thought, people who worked or did not work and people who worked well or worked badly enjoyed the same treatment and social distribution. It eroded people's attitudes and creativity. From Western people's eyes, the Chinese equalitarianism in the Maoist era was unbelievable. Wong (2004), p. 156.

the tenet of this political and economic campaign, the result of which was that all the private property in enterprises and businesses was owned by the state.²⁴ The completely public ownership and state-owned property structure paved the way for the construction of a highly centralized planned economic system and a socialist institutional framework which formulated the almighty and unshakable leadership of the Communist Party on the nationalized economy and the operation of enterprises. The deployment of resources and the transactions between enterprises was arranged in accordance with the order of the central or local government, rather than the market forces of supply and demand.²⁵ It has therefore been observed that ‘politically, conceptually and ideologically, it was impossible at the time to bankrupt any ailing or failing business enterprise. Any and all failing enterprises would have the support and back up of the State’.²⁶

In the first decade since ‘liberation’ in 1949, Communist China experienced the increasing development of the economy and the full construction of socialism. Then a large-scale economic campaign, which was launched by the central government in 1958 named the ‘Great Leap Forward’, caused a significant setback in the economy.²⁷ The partial pursuit of incredibly high goals and a ‘catch up strategy’ (*ganchao zhanlue*) in heavy industry and the production of steel caused an imbalance in the industrial structure and chaos for the economic order.²⁸ The subsequent Cultural Revolution, which invoked political campaigns, mass mobilization and class struggle at the national level from 1966 to 1976, resulted in a deterioration of the national economy. Many state-owned enterprises fell into financial difficulties or reached the brink of bankruptcy during these events. Because the state-owned enterprises could not be wound up at that time, the state adopted a compulsory administrative approach to deal with the distressed enterprises, which was called a programme of ‘closures, stoppages, mergers and transfers’ (*guan ting bing zhuan*). Administrative orders of closure or provisional stoppage could be imposed on ailing enterprises or factories which consumed excessive natural resources, caused extremely high costs or produced products that were inferior in quality. Where a weak enterprise severely lacked equipment or technologies, the government could bring about through a merger an amalgamation with a strong enterprise doing the same business. Where an enterprise which operated under a wrong productive strategy, or where the product of the enterprise could not be readily sold, the enterprise could be ordered to change its strategy or to transfer to another area. Workers who were made redundant under the ‘closures, stoppages, mergers and transfers’ programme were reallocated to the rural commune to contribute to the rural economy.²⁹ It should be noted that even

24 Article 10, Chinese Constitution 1954.

25 Wong (2004), p. 153.

26 Tang (2005), para. 3.04.

27 Yang (2006), pp. 45-7.

28 Vogel (2005), pp. 753-5.

29 Xie (2005), pp. 30-31.

though this centralized programme was only a temporary administrative process to handle ailing enterprises, it did play a significant role in closing completely failing enterprises and rehabilitating financially distressed enterprises which could still be rescued. As a result, the programme played a role of enhancing the efficiency of the operation of enterprises in the era of the planned command economy where there was no bankruptcy legislation.³⁰

Development of a Socialist Market Economy

China has been in the process of establishing a socialist market economy since the CCP initiated the economic reform and opening up policy in 1978. The development of the economy required an efficient and well-functioning legal system to facilitate commercial transactions and protect the order of the market. In a bold step the government bravely introduced market-oriented mechanisms and borrowed Western legal institutions to promote the legal reforms and to change people's traditional views and attitudes towards legal rules. The CCP was determined to transfer the focus from the class struggle to the national economy.

Impact of Marxism

One problem that seemingly stood in the way of economic development was that traditional Marxism viewed the market mechanism and legal concepts such as private property, companies and bankruptcies as unique characteristics of capitalist society. A key contribution to the resolution of this problem was made by a former party veteran, Chen Yun, who came up with a notable metaphor, known as 'bird in a cage' theory.³¹

In this metaphor, the market is the bird and the plan is the cage. The cage can be enlarged to give greater freedom to the bird, but without the cage, the bird will fly away – which is analogous to disorder in the market.³²

This theory ingeniously resolved the ideological argument and influenced people's attitudes towards the Western advanced legal institutions. It may however be observed that the concepts of 'planning' by the state and the 'competitive market' are not fundamental distinctions between capitalism and socialism but merely economic tools. A capitalist economy cannot operate well without macroeconomic regulation in fiscal policy, and, accordingly, capitalist governments still play some significant roles in order to avoid economic recession, inflation, high unemployment and to safeguard the order of the market economy. Equally, a socialist economy

30 Tang (2005), para. 3.04.

31 Vogel (2005), p. 759.

32 Bell, Khor and Kochhar (1993), p. 2.

is unlikely to be prosperous without a market base.³³ This viewpoint effectively harmonized the ‘planning’ and ‘market’ in the Chinese economy and motivated the reforms of marketization, legal construction and individuals’ patterns of thought which paved the way for the acceptance and establishment of a bankruptcy legal framework.

Enactment of the EBL 1986

Historically, the legal concept of bankruptcy was among those categorized into the domain of capitalism which was ideologically resisted by the Chinese people in the Maoist era. Since all the enterprises and their property were completely owned by the State, the bankrupting of enterprises would indirectly mean the insolvency of the State, which was unlikely to be understood and accepted by the people whose families were working in the SOEs from one generation to another. The ideological mindset that Western bankruptcy law theory and Communism could not co-exist dominated in the era of the traditional planned economy.

The launching by the central government of its opening up policy in 1978 was a striking and bold achievement and since then China has been placed on a track of economic structural transition. The economic reform led to a relaxation of the government’s control over the SOEs, which to some degree were conferred operational and managerial autonomy. As the door gradually opened to the outside world, China bravely introduced market-orientated competitive mechanisms and closely related legal concepts which encouraged the swift and continuous growth of its economy, even though they were traditionally identified as capitalist characteristics. With the deepening of the reform, the Chinese leadership became released from the previous constraint of ideological debate and came to view the market and related legal institutions such as bankruptcy as economic tools to resolve economic problems in the Communist context. Economic development therefore overrode ideology. In the words of the former party leader Deng Xiaoping, ‘it did not matter if the cat was black or white; it was a good cat if it caught the mouse’.³⁴

The importation of market-orientated rules intensified competition among enterprises, and was one of a number of measures that urged poorly operated enterprises to improve their management and reduce costs, and to redeploy their limited resources. In this sense, the winding up of any insolvent enterprise that had no hope of a turnaround was a necessary part of the reform of marketization, since competitive market forces would enable uneconomic and inefficient enterprises to be exposed.³⁵ The planned economy had not been conducive to the economic efficiency and profitability of state-owned enterprises. Although the exact scale of the problem at the time was not known with precision, official statistics indicated

33 Guo (2003), p. 553.

34 Vogel (2005), p. 756.

35 Xiao (1989), p. 58.

that around 20 to 25 per cent of SOEs sustained losses each year and there were many such enterprises that made losses year upon year.³⁶

The role that might be played by bankruptcy laws in the economic transformation of China, was not merely as a means to remove failing enterprises from the market but also as a spur to improved levels of performance. This idea was enthusiastically promoted by Cao Siyuan,³⁷ an economist and lobbyist who at one time held a position at the State Council's Technology and Economic Research Centre. He had become enthusiastic about promoting the need for a bankruptcy law while a graduate student and in 1979, soon after graduation, he produced a paper, 'On Reforming the State-Ownership System', that was subsequently expanded and which set out the case for reform. The contention was that the potential for bankruptcy might shock failing enterprises into a 'sense of crisis'³⁸ and as a result this might raise their productivity. This was, however, only one of a number of necessary measures and, to the same end, SOEs would be exposed to competition; the level of state interference in the market would be scaled down; and enterprises would be responsible for their own profits and losses. Managers would be held accountable for mismanagement and corruption and the threat of unemployment would encourage higher standards among employees.³⁹

Bankruptcy therefore came to be considered in principle to be an effective approach to deal with the problems of financially ailing and loss-making enterprises by the government in the early stages of the economic reform, even though the government was reluctant to bankrupt distressed enterprises due to the concerns of large-scale unemployment and the threat to the nature of Communism.⁴⁰ On 27 February 1984, an article named 'A Discussion on the Bankruptcy of Long-term Loss-making Enterprises' was published in an official journal, and for the first time at the national level discussed the legal concept of bankruptcy, of which most citizens had never heard before.⁴¹ Cao Siyuan's lobbying led in late 1984 to the establishment of a Bankruptcy Law Committee by the State Council and he was appointed to head up a Bankruptcy Law Drafting team. The process of drafting began in early 1985 and a working group was given the task of drafting, investigation and research.⁴²

By late 1984 it had therefore become clear that the introduction of bankruptcy laws was needed. However in view of the scale of such an undertaking, the central government firstly selected three significant industrial cities, respectively Shenyang,

36 Zheng (1986), p. 685.

37 For an introduction to whom see Keyser (1998), pp. 4-7. A detailed account of the efforts taken to influence the enactment of a bankruptcy law are detailed in Cao (1998).

38 Cao (1998), p. 25.

39 Cao (1998).

40 Tang (2005), para. 5.01.

41 Chang (1987), p. 336.

42 Zheng (1986), p. 694.

Wuhan and Chongqing,⁴³ to formulate a bankruptcy system on a trial basis at the beginning of 1985. The local governments of the three cities were delegated to produce local bankruptcy regulatory rules. Shenyang issued its local bankruptcy regulation known as 'Bankruptcy of Urban Collective Industrial Enterprises' on 9 February 1985, which only applied to the collective enterprises owned by the Shenyang city.⁴⁴ It is noteworthy that the government's efforts gradually changed the people's patterns of thoughts and attitudes of hostility to bankruptcy.

As part of the process of changing the mindsets of the people, steps were taken from mid-1984 to provide empirical evidence of the potential for bankruptcy laws to act as a stimulus to improved performance by companies.⁴⁵ Eight failing companies in the test cities were issued with warning notices and were ordered to go through reorganization.⁴⁶ The first of these was the No. 3 Radio Factory in Wuhan, which had been losing money on a significant scale for three years. This firm was warned by the Mayor of Wuhan that unless it became profitable in 12 months it would be closed. In response to this warning the company was shocked into reviewing its business. It conducted market research, as a result of which it adjusted its factory production structure, discontinued some lines and opened others. The warning acted as a remarkable trigger for improved productivity and the firm soon became profitable.⁴⁷ Similar experiments were carried out in Shenyang.⁴⁸ Although the experiment in that city involved the issuing of warning notices to only three companies, one of which failed,⁴⁹ it was considered to have had effects more widely in improving working practices and productivity in the city.⁵⁰ This experiment provided valuable evidence that bankruptcy laws could be employed beneficially to shock companies into improving their efficiency and profitability in a manner that did not have devastating consequences for the economy or for society.⁵¹ In the third participating city, Chongqing, the experiment

43 The trial also extended to the northern industrial city of Taiyuan, although to a more limited extent: Zheng (1986), p. 688.

44 Xiao (1989), p. 59. For detailed discussion of typical bankruptcy cases which happened in the three cities at the initial stage, see Tang (2005), para. 5.02; *People's Daily*, 10 November 1986.

45 Cao (1998), p. 19 notes the failure of a similar ultimatum at a loss-making machinery factory prior to the introduction of bankruptcy laws.

46 Zheng (1986), p. 688, reporting that seven of the eight companies returned to productivity as a result of the warning having been issued.

47 For further details see Cao (1998), pp. 33-7.

48 See Cao (1998), pp. 38-44.

49 Shenyang Explosion-Prevention Devices Factory, which had been loss making for ten years, failed to gain the capacity to repay its debts, in spite of some improvements. It therefore became the first company to become bankrupt in China since the commencement of the reform process. See further Cao (1998), p. 43.

50 Cao (1998).

51 Zheng (1986), p. 683 provides an overview of debates that appeared in newspaper articles during 1985 and 1986.

was initially less ambitious, since it was carried out in relation to rural enterprises, although it was subsequently extended, with effective results, to a medium sized SOE.⁵²

Building upon the momentum of these experiments, Cao wrote newspaper and journal articles and conducted public opinion polls in support of the proposed law. Eventually, after much lobbying, progress was made with the enactment of the Chinese General Principles of Civil Law 1986 which for the first time mentioned the term 'bankruptcy' in a national law,⁵³ and introduced the concept of a 'legal person' and the notion of corporate property rights which paved the way for the promulgation of a bankruptcy law. By early 1986, following further lobbying and propaganda but also significant opposition, a draft bankruptcy law was taking shape. The idea of introducing a bankruptcy law was widely supported by Chinese economists and lawyers at a conference held in Shenyang in June 1986. Eventually the draft law was put before the Standing Committee of the National People's Congress. After much debate and investigation as to the feasibility of such laws,⁵⁴ the law, consisting of only 42 articles, gained approval in November 1986. The approval of this law, after two years of efforts by the State Council, was a notable achievement.⁵⁵ However, since it was considered that insufficient experience of the operation of bankruptcy laws had yet been gained, the law was enacted with the qualification that it was for 'trial implementation'. In addition the application of the law was restricted to state-owned enterprises.⁵⁶

Enactment of Additional Bankruptcy Laws to Supplement the 1986 Law

The restriction of the scope of the 1986 Law to state-owned enterprises meant that there was no unified bankruptcy law dealing with the insolvencies of all types of enterprises prior to the promulgation and implementation of the new Enterprise Bankruptcy Law 2006. With the deepening of the economic reforms and the emerging establishment of a market economy, the 1986 Law was followed by a series of additional measures, which caused the legal framework to become very complicated and cumbersome.⁵⁷ First of all, Chapter XIX of the Civil Procedure

52 See Cao (1998), pp. 46-7.

53 Article 45, General Principles of Civil Law 1986; Harmer (1996), p. 2569.

54 See generally Zheng (1986), pp. 695-6.

55 For further discussion of the 1986 law, see: Chen (2000), p. 49; Chang (1987), p. 333. The English version of the 1986 bankruptcy law is available at <<http://www.chinacourt.org>>, and Boshkoff and Song (1987), p. 359.

56 It had earlier been contemplated that the law might extend also to foreign investment enterprises. See Zheng (1986), pp. 697-9 regarding the approach that was ultimately taken to such enterprises.

57 Metaphorically, China's old bankruptcy legal system was described as 'an onion' with different layers of laws and regulatory rules which applied to different types of enterprises and in specific situations. It was inevitable that ambiguities and conflicts of laws would arise. See Tomasic (2006), p. 95.

Law 1991 regulated the reconciliation and liquidation of non-SOEs with legal person status. In addition, disparate insolvency provisions were enacted in relevant national laws and regulations to specifically deal with the bankruptcies of various types of foreign investment enterprises.⁵⁸ Further measures of importance were two judicial interpretations that had been promulgated by the Supreme People's Court, respectively in 1991 and 2002, both of which were of far-reaching influence on the hearing of bankruptcy cases.⁵⁹ The 1991 Interpretation aimed to overcome the loopholes and imprecision of the EBL 1986, and the 2002 Interpretation clarified the ambiguities of insolvency provisions in various national laws and attempted to avoid the potential conflicts of bankruptcy procedures.⁶⁰ Furthermore, some national laws also involved bankruptcy provisions. For example, the Company Law stipulates the dissolution and liquidation of companies including limited liability companies and joint stock companies, both of which have separate corporate personality,⁶¹ and the Commercial Bank Law also articulated particular rules regulating the winding up of commercial banks and the distribution of bankruptcy estates.⁶² Finally, it is notable that bankruptcy regulatory rules were enacted by the local legislatures of 'special economic zones'.⁶³ For example, the Shenzhen Enterprise Bankruptcy Regulations, were enacted by the local congress on 10 November 1993 under the delegated power of the Standing Committee of NPC and may be regarded as a typical example. These local bankruptcy regulations comprised an important component of the Chinese bankruptcy legal framework, and they applied in local areas as long as they did not conflict with the principles of the national laws.⁶⁴ The effect of accumulation of all these laws was that the

58 For more details, see Tomasic (2006), p. 97.

59 Although in China's legal structure, judicial interpretations issued by the SPC are placed at a lower level than national laws enacted by the NPC, in practice, judicial interpretations almost have the same legal effect as the national laws.

60 'The Opinion of the Supreme People's Court on Several Issues in the Implementation of PRC Enterprise Bankruptcy Law (Trial Implementation)', (the 1991 Opinion); 'The Regulation on Several Issues Concerning Hearing Enterprise Bankruptcy Cases', (Regulation 2002); Tang (2005), paras 5.26, 5.27 and 5.29; Lam and Wong (2003), p. 82.

61 Articles 188 and 191, PRC Company Law 2005.

62 Article 71, PRC Commercial Bank Law 2003.

63 These special areas include Shenzhen, Zhuhai, Shantou, Xiamen and Hainan which were the earliest cities to engage in market-oriented economic practices, ahead of other areas of mainland China. These areas were deemed as the 'windows' of the reform and opening up policy. In these areas, foreign investors can enjoy special economic and tax policies and the local governments to some degree have autonomy.

64 Harmer (1996), p. 2571; Zhang and Booth (2001), p. 1. According to Article 136 of EBL 2006, the new law replaces the 1986 law, but it does not stipulate that the new law replaces the previous judicial interpretations and other regulations. As long as those regulations do not conflict with the rules, principles and spirits of the new, they should still be applicable.

bankruptcy legal structure as a whole was scrappy in nature, embracing a wide range of measures for different types of enterprises and geographical regions.

Weaknesses of the pre-2006 Bankruptcy Legal Framework

From the perspective of judicial practice, the old bankruptcy legislations were not effectively used for a number of reasons. The most significant problems related to debt-laden SOEs, which could not be simply liquidated since they were the main social welfare providers of the employees. It was feared that the insolvent winding up of SOEs would cause social instability because the social security system was not adequate to provide a social safety net for redundant employees. In addition, it was anticipated that the bankruptcy of SOEs would give rise to an accumulation of non-performing loans of state banks which had been required to advance policy loans to SOEs under government instruction. The above two factors led the government to be highly active in bankruptcy-related matters respecting SOEs, practices that continue even today. Rather than using the bankruptcy legislations to deal with struggling SOEs, the preference was to apply government policies under the planned bankruptcy programme. The problems of uneconomic SOEs and the administrative response to them are considered in detail in Chapter 15.

Enactment of the EBL 2006

With the development of the market reform, China was in need of an effective bankruptcy law which accorded with its socialist market economy. The process of bankruptcy law reform commenced in 1994 and lasted for 12 years. The way towards the passage of the legislation was paved by the economic transition, the reform of SOEs, development of the social security system and progress of the Chinese judicial reform. However, it was notable that the reform process was prolonged by lingering fears over uneconomic SOEs. There were a number of factors that led to these fears eventually being overcome.

One factor that contributed to the eventual passage of the new bankruptcy law was external pressure from the international economic environment. Although China has made great achievements on its economic transition to becoming a market economy, China's full market economy status is still not recognized by the US and EU, both of which are the two largest trade partners of China.⁶⁵ The inefficiency and ineffectiveness of China's old bankruptcy law constituted one of the reasons upon which the EU refused to recognize China as having a full market economy.⁶⁶ Undoubtedly, this non-recognition may have a bad impact on

⁶⁵ See EU-China News (2004).

⁶⁶ At the 9th Annual EU-China Business Summit held in September 2006 in Helsinki, the EU Commission once again rejected the China's petition for full market economy status, giving four reasons, one of which was the ineffectiveness and inconsistency of China's bankruptcy law.

China's export interests, put China in a disadvantageous position in trade disputes and will have eroded its international image and reputation.⁶⁷ To some degree, the non-recognition urged the Chinese legislature to push forward the bankruptcy law reform and accelerated the legislative process, particularly after the EU first refused China's petition for full market economy status in 2003.

Although China was left relatively unscathed by the Asian Financial Crisis that began in 1997, since the controls that were exerted in China over the flow of capital meant that the crisis did not have the devastating effect on China that it had on other jurisdictions, the crisis drew attention to the dangers of having undeveloped insolvency laws and acted as a spur to bankruptcy reform. Such laws can both prevent financial difficulties and also reduce the duration of a crisis. Furthermore, a modernized bankruptcy law which is in line with international standards and principles may assist China to build an appealing investment environment, which could eliminate the concerns of investors and ensure an increase in the flow of foreign capital into the Chinese market.⁶⁸

In spite of the attractions of the new law, the reform process was long and difficult. During the legislative process, the draft of the new bankruptcy law was revised many times and, as discussed further in Chapter 2, the Chinese reformers travelled extensively to gain experience of insolvency systems elsewhere in the world and consulted widely with foreign insolvency law experts in order to devise a suitable set of laws for China and to follow international standards. The final draft eventually passed the deliberation of the Standing Committee of the National People's Congress on 27 August 2006, and the Enterprise Bankruptcy Law 2006 came into force on 1 June 2007.

Overview of the EBL 2006

The features of the EBL 2006 will be discussed in detail in subsequent chapters in this volume and so only a brief overview of the main achievements of the law will be noted here. The new law is a law which contains identifiable influences of German, Australian and United States laws in particular but which has been carefully drafted to take account of the particular circumstances in China. It represents a breakthrough and a modernization of Chinese bankruptcy law in several aspects, including the following:

- The law is significantly expanded, running to 136 Articles, which although short in comparison to the laws of some jurisdictions, is very much more detailed than the 43 provisions of the EBL 1986.

67 Shi (2007), p. 653.

68 See European Bank for Restructuring and Development (2000), p. 43; La Porta et al. (1997) regarding the link between effective bankruptcy laws and the attraction of foreign direct investment. See also Tabb and Curtis Campbell (2006); and vom Eigen (2006) regarding the position in China.

- The conditions for opening insolvency proceedings are less stringent than under the EBL 1986: see further pp. 74-8.
- The EBL 2006 applies to both SOEs and non-SOEs with legal person status.
- Government intervention is significantly scaled down, with only a limited remaining scope for the liquidation group to administer proceedings, although it is likely that the state will continue to exert influence behind the scenes via the courts.
- A new office of 'administrator' has been established to oversee bankruptcy proceedings, a significant development in the transition from state control: see further Chapters 5 and 6.
- The new law emphasizes the reorganization of insolvent companies and, although the default position is that such proceedings will be managed by an administrator, it contains provision for the proceedings to be converted to debtor in possession proceedings: see further pp. 215-16.
- Creditors' committees appear in the legislation for the first time: see further Chapter 10.
- A more extensive list of transaction avoidance powers is included: see further Chapter 8.
- The new law contains the first provision as to the bankruptcy of financial institutions in insolvency law: see Chapter 16.
- It includes the first provision as to cross border insolvencies: see Chapter 17.
- A more detailed overview of the new law, in light of international standards, is provided by Professor Roman Tomasic in Chapter 2 of this volume.

Overview of this Book

The aim of the book is to provide a comprehensive overview of this important new piece of legislation by systematically and comprehensively introducing the Chinese bankruptcy legal framework, including theoretical, substantive and procedural issues, drawing upon comparisons with the laws in other jurisdictions where appropriate. In addition, this book will analyse typical cases which have been, or are being, heard since the new bankruptcy law was implemented. The book will draw a clear picture of the newly reformed Chinese bankruptcy legal structure.

The authors in the contribution team include authors with legislative and judicial experience, practising lawyers and accountants with experience of handling insolvency cases and also academic authors with specialist interests in Chinese bankruptcy law. Each chapter is devoted to a particular aspect of the new law and, given the multi-authored nature of the text, some small points of overlap may be found between chapters from time to time. We have tried to minimize these areas of overlap during the editing process and those that remain are considered important to the development of arguments and ideas in the chapters concerned.

The authors will analyse Chinese bankruptcy-related issues in the following four parts. Part I, with three chapters, will identify the historical development of China's bankruptcy legal framework, the background to the enactment of the law, the corporate governance structure and the general principles of the new bankruptcy law. Part II, from Chapter 4 to Chapter 14, will discuss the detailed contents of the new law, including substantive issues such as the powers and duties of the administrator, and the key procedures of liquidation, reorganization and reconciliation. Part III will examine the bankruptcies of SOEs and financial institutions, and these issues will be explored in two separate chapters. Part IV will focus on cross-border insolvencies which is a notable feature in China's new bankruptcy law.

The law is stated according to sources available to the authors on 1 February 2009. Throughout the text the abbreviation 'EBL 2006' will be used to refer to the Enterprise Bankruptcy Law 2006 and 'EBL 1986' will be used to refer to the previous law, the Enterprise Bankruptcy Law (for Trial Implementation) 1986.

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