

## **The New PRC Insolvency Law**

**by Dr. Christian Gloyer**

After a preparatory period of more than 10 years, the new Chinese insolvency law has been promulgated by the national Peoples' Congress on August 27, 2006 and shall come into force on June 1, 2007.

Chinese insolvency laws have been severely criticized, especially under the impression of spectacular company collapses, such as, but not limited to, the Guangzhou Trust and Investment Corporation (GITIC). In the past, such criticism focussed on the wide gaps of the existing legislation, its contradictions and the unpredictable administrative practice. The new law shall do away with all that; it is applicable to all Chinese corporate entities, to public and private ones alike, including Foreign Invested Enterprises ( FIEs). The only exception from the applicability of the new insolvency law is consumer insolvencies, which are to be dealt with separately.

### **Reasons for insolvency**

The new law establishes – similar to German Law – two reasons for insolvency, the first being excessive indebtedness, the second one being illiquidity. An excessive indebtedness is given, if the existing debts of a company exceed its assets. Illiquidity means the inability of enterprise to fulfil its current payment obligations. It is now possible for any creditor to initiate insolvency proceedings, once the illiquidity of the respective enterprise appears to be obvious.

The competent insolvency court opens the insolvency proceedings and appoints an insolvency liquidator. It furthermore informs all creditors known to the court. Creditors have to file their claims with the court within the deadline set by the court. The new law makes it possible to file a claim even after the expiry of such time limit just unto the distribution of the bankrupt company assets, which shall in particular please foreign creditors, who are very often the last ones 'in the queue'.

### **Legal introduction of insolvency liquidators into Chinese bankruptcy system**

Independent insolvency liquidators, this being the core innovation of the law, shall help reduce administrative interference and make bankruptcy proceedings more effective and market-oriented. Apart from governmental institutions, also lawyers and public accountants may be eligible as insolvency liquidators. A liquidator is appointed by court, but may be

dismissed by the creditors' assembly. He has to propose a plan for the liquidation and distribution of the company's assets, such plan then has to be accepted by the creditors' assembly.

As an alternative to a liquidation/termination of a bankrupt company, the new law opens the possibility of such company's restructuring, thus aiming at a restoration of the company's profitability and, of course, a preservation of the company's jobs. Restructuring may be initiated by the company itself, any one of its creditors, or even a shareholder of the company who owns at least 10 percent of the bankrupt company's shares.

In Chinese legal circles, there has been a long debate, whether certain creditors shall be given priority rights over others with regard to their claims. Local Courts and government officials more often than not ignored a creditor's reservation of property rights and other means of security. Instead, Chinese administrative departments very often acted in favour of the employees of a bankrupt company who claimed their wages due. The Chinese legislators now found a compromise: Such insolvency creditors who have obtained security for their claims, may separate such secured assets from the company's property; this new rule however only applies to such claims who have been established after the implementation of the new law. Older security rights remain burdened with the priority of wage claims in case of an insolvency.

## **Conclusion**

The new law as such means a significant improvement compared to the complicated and often contradictory legal environment of the past. With regard to the new law's content, in particular German companies shall warm up to it, as the Chinese legislation follows in its outline the legal concepts of the German Insolvency Code. It has to be feared, however, that also after the new law has come into force, Chinese legal practice has to compromise a lot with the difficult social realities of the country.

Remarks:

Opinions expressed in this contribution are those of the author.

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