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**The Significance Brought by the Drafting of the New Bankruptcy Law to China's Credit Culture and Credit Institution: A perspective of Bankruptcy Law**

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**The Significance Brought by the Drafting of the New Bankruptcy Law to China's Credit Culture and Credit Institution From A perspective of Bankruptcy Law**

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Sound credit culture and institution are in symbiosis with a viable market economy. A market economy based on sound credit tradition and foundation is inevitably cost-effective and highly efficient. China is currently undergoing economic transformation, the goal and orientation of which is a market economy. During this stage, the old-fashioned credit institution, credit culture and credit security system are shaken by a new economic structure and institutional structure, while the credit institution and credit culture required by market economy is still in its gradual formation and development stage. In this development stage, Laws and institutions are playing and will play a vital role.

Legal structure that a market economy needs is mainly composed of three parts: laws on market access; laws on market operation and laws on market exit. Laws on market access ensure that players involved in the market competition have the basic credit by means of administering their identity qualification; laws on market operation define the rules of conduct in market competition; laws on market exit refers to bankruptcy law which is concerned with how to provide a viable channel for market players to exit the market or survive with the least economic side-effects when players encounter failure. The three-layered legal structure sets up a credit platform for the market economy. As far as china's current situations are concerned, the insolvency legal system is a fragile link among the three integral parts, which leads to a lot of credit problems.

## 1. Credit Absence Caused by the Current Insolvency Legal System in China

Legal system and institution constitute the basic structure necessitated by market operations, while at the same time they ultimately constitute the basic and core bedrock for the credit institution and credit culture of a market economy. Insolvency in essence refers to the fact that debtors default on debts due owing to one or more than one creditors (under common circumstances the latter). It is abnormal situation opposite to normal market credit. The insolvency legal institutions are to bring the impaired credit system under normal conditions and maintain effective operation of the economy. Aspiring after this goal, the unity and improvement of the current insolvency system is a prerequisite.

### 1) The disunity of the current insolvency legal structure and credit absence

The current insolvency legal system in China is characterized by its multi-layered structure which is composed of five institutional structures.

The first institution is the "Law of the People's Republic of China on Enterprise Insolvency (trial implementation)" which was adopted on 2 February 1986 and came into force on 1 Nov 1988. According to Article 2 of this law, it only applies to state-owned enterprises[1] and is still under its trial implementation. It is the only law in China under trial implementation.

The second institution is the "Procedure of Repayment for Insolvency of Enterprises As Legal Entity", Chapter 19 of the "Law of Civil Procedure" amended on 9 April 1991. The law extends the application scope of the insolvency repayment procedure to non state-owned enterprises from Articles 199 to 206.

The third institution is the judicial interpretation released by the supreme court on 7 November 1991. By summing up its trials of insolvency cases the supreme court, in accordance with the Insolvency Law, enacted the "Opinions On A Number of Issues Concerning the Execution of the 'Law of the People's

[1] Article 2 of "Law of the People's Republic of China On Enterprise Insolvency" stipulates that "this law applies to enterprises owned by all people".

Republic of China On Enterprise Insolvency (trial implementation)'" to provide for additional regulations for a number of issues concerning the current Insolvency Law. On 18 July 2002, the supreme court released the "Regulations On A Number of Issues Concerning Hearing of Enterprise Insolvency Cases" where the supreme court made many rectifications to the judicial interpretation released in 1991 and gave interpretation on substantive issues concerning such as protection of creditors and fraudulent insolvency currently appearing in the implementation of the insolvency law. This interpretation replaced the judicial interpretation released in 1991 and came into force on 1 September 2002[2].

The fourth institution refers to a series of policy documents for state-owned enterprise insolvency released by the state council since 1994 with a view to give impetus to the course of state-owned enterprise insolvency. The principal part of these policies are the three documents, i.e. "Notice on Related Issues on A Try Out of Insolvency on State-owned Enterprises in A Certain Number of Cities" promulgated on 25 October 1994, "Notice on Certain Issues on Trial Implementation of Mergers and Insolvency on State-Owned Enterprises" jointly released by the former State Economic and Trade Commission and the People's Bank of China on 25 July 1996, and "Supplementary Notice on Related Issues on A Try Out of Mergers, Insolvency and Reemployment of staff and workers on State-owned Enterprises in A Certain Number of Cities" promulgated on 2 March 1997. Policy documents on insolvency first applied only to 18 pilot cities, extended later to 56 big to medium cities and 111 various cities and ultimately to all cities in China. The "Bankruptcy fever" in China in the last ten years is mainly ignited by the insolvency policies.

The fifth institution is constituted by the local rules, regulations and policies on insolvency enacted by many provinces, prefectures and some cities. For instance, the standing committee of the people's congress of Guangdong Province drafted in August 1993 the "Regulation of Insolvency on Companies in Guangdong Province"; the standing committee of Shenzhen people's congress adopted on 10 November 1993 the "Regulation of Insolvency on Enterprises in Shenzhen Special Economic Zone[3]. Many cities had even drawn up their own policies on insolvency implementation and implementative measures[4].

The five coexisted insolvency institutions at least have problems in 3 substantive aspects. First, the multi-layered insolvency institutional structure categorizes enterprises into different types with the inclusion of state-owned enterprises participating in the insolvency experiment, other state-owned enterprises, non state-owned enterprises and enterprises in special economic zones. Accordingly different types of enterprises are applied by different rules. Second, despite the complexed institutional structure, these institutions, regulations, rules and policies are fairly simple, and there is no institutions apply to insolvency of natural persons and their enterprises. And third, in the current Chinese insolvency legal system, legal institutions at various levels are often in conflict with one another.

The inconsistent institutional structure renders it impossible for creditors and debtors to have expectation on stable rules and credit in their early days of economic contact, thus fundamentally undermines the credit basis of the market economy.

**2) The faulty insolvency legal system undermine the credit basis**

Notwithstanding the multi-leveled insolvency legal institutions mentioned above, the provisions of these legal institutions are often too principle to be utilized in real life. Even state-owned enterprises that have an insolvency law to be applied to are incapable to undergo bankruptcy due to various issues regarding such as employee settlement. Thereupon, the state council promulgated a large number of policy documents to regulate insolvency of the state-owned enterprises. Correspondingly insolvency of state-owned enterprises are declared in accordance with these policies, thus it is regarded as "insolvency

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[2] Li guoguang, on "*Comprehension and Application of the Judicial Interpretations on the Insolvency Law made by the supreme court"*, people's court publication.
[3] Xu dongliang, on *trying procedure of the bankruptcy case,* people's court publication
[4] world bank report, on *bankruptcy research of china's state-owned enterprises---the necessity and avenues to reform the bankruptcy law and institutions,* china finance and economy press

by policy". These "insolvencies by policy" have led to assets of the insolvent state-owned enterprises to be used in priority in settling unemployed and laid-off staff and workers, instead of paying off debts owed to banks. Insolvency by policy aims at settling the extreme urgent and near problems in reality, thus it is in certain conflict with the enterprise insolvency law.

As for insolvency of non state-owned enterprises, applicable legal provisions are even seriously insufficient. Provisions directly regulating insolvency of non state-owned enterprises embodied in the "repayment procedure for insolvent enterprises of legal person", Chapter19 of the Civil Procedure Law. However there are only 8 articles in the chapter. The judicial interpretation delivered by the Supreme Court concerning chapter 19 contains 14 articles. The insufficiency of laws and regulations on non-SOES make it necessary to regulate the bankruptcy of non-SOES in reference to bankruptcy procedure applied to SOES. This reference is legally accepted.[5]

The status quo of china's bankruptcy law and institutions has a negative effect on china's social credit in the following four aspects:

a. The current bankruptcy procedure prejudices secured creditors' interests. "the protection of the secured rights and interests is crucial to the stability of the financial system as a whole. The significance brought by secured financing lies in the fact that banks may expand loaning scope to small and medium-sized borrowers and raise funds for trade in cost-effective way. When bankruptcy is looming it is vitally crucial to confirm the secured rights and interests, especially it making it possible that creditors are willing to reorganize bankrupt enterprises falling into predicament ".[6] <the bankruptcy law of enterprises > recognize the priority of secured rights and interests as evidence by stating that "secured debts rank higher than other claims in repayment order". However secured rights and interest fail to get effective protection in bankruptcy practices. Firstly, policy-oriented bankruptcy denies the priority of secured rights and interests. According to document numbered 492 released by the state economic and trade commission in 1996 and another document numbered 10 released by the state council in 1997, though land use rights held by a state-owned enterprises has been mortgaged ,it still shall be used to pay for laid-off worker's settlement fees. Secondly, even legally-established secured rights fail to get proper protection in real life due to regional protectionism, near-mandatory registration system on secured rights and the deficiency in executing the secured debts. Up till now, a lot of secured creditors are banks. The fact that secured rights held by banks fail to be protected directly leads to the reluctance on the banks part to lend, thus making it rather difficult for small and medium-sized enterprises to obtain loan.

b. Common creditors' rights and interests don't gain protection under the current bankruptcy procedure. In strict terms, the current bankruptcy law is not established on the ground that the relationship between creditors and debtors shall be properly adjusted and achieve the social economic well-being by virtue of this adjustment. The disregard to the protection of creditors traced back to goals crystallized in <the bankruptcy law of enterprises>. <The bankruptcy law of enterprises > in 1986 purposed to enhance the vitality and energy of state-owned enterprises, prompt them to improve management and the adjustment of creditor-debtor relationship and credit was out of its horizon. This guiding purpose resulted in the disregard to creditor whose rights and interests rank second to laid-off workers settlement. The liquidation percentage of common debt inclusive of the outstanding tax payable to the state is rather low. Take banks for instance, the recovered debt owed to banks and collected from state-owned enterprises rarely exceeds 20% of their loan book value. The commonly liquidating rate varies from 3% to 10%. The relationship between creditors and debtors is the basic relation model in market economy, therefore the credit basis of the market economy is on the verge of collapse when rights and interests of creditors don't get protection under law.

[5] the supreme court: article 253 of *opinions on several issues concerning the application of the civil litigation law,states that: the people's court shall apply, inclusive of chapter 19 of civil litigation law, and refer to relevant provisions stipulated in <the bankruptcy law of enterprises (trial implementation)> when it trying the bankruptcy case.*

[6] world bank report, on *bankruptcy research of china's state-owned enterprises---the necessity and avenues to reform the bankruptcy law and institutions,* china finance and economy press

c. Regional protectionism and fraudulent bankruptcy practices run rampantly. Courts being susceptible to influences exerted by local governments tend to treat native and out of town creditors differently. It is a common occurrence that enterprises took advantage of the bankruptcy procedure to escape debts. The commonly-utilized methods include business re-operation with a new shell, enterprises division, property transferring and claim-abandonment, etc.

d. Certain institutional instrument is absent from current bankruptcy law and regulations. There is no reorganization procedure embodied in current bankruptcy law and regulations, which incapacitate the bankruptcy law to tide near-bankrupt enterprises through predicament. Although reconciliation and reorganization are stipulated in <the bankruptcy law of enterprises>, these two procedures are dominated by relevant competent government agencies while creditors play a quite minor in these procedures. The deficiency of reorganization institution makes it impossible for some newly-emerging mixed-ownership enterprises to be rejuvenated and leads to the gradual sinking of asset especially the intangible asset by waiting and seeing. Another side of the coin is that the operation of reorganization constantly resorts to administrative powers when reviving the enterprises is necessary. Logically, disadvantaged groups are vulnerable to be neglected and exploited. That shareholders were prejudiced in Zhengbaiwen case is very illustrative. Lack of professional personnel engaging in bankruptcy is another striking evidence of the insufficiency of the bankruptcy law and regulations. Most of members on liquidation team come from governmental agencies with lower professional expertise.

To summarize, the faulty and inconsistent bankruptcy law and institutions deprive the major market players ----both investors and creditors, of the basic credit guarantee, to a certain extent act as catalyst to the formation of unfaithful credit culture on the debtors part and seriously undermine the credit basis of china's market economy.

## 2. Cases: Issues Need to be Solved and Policy Guide Line for the New Insolvency legislation

### 1) The bankruptcy of Zhongjiang silk company in Sichuan

*Zhongjiang silk company was a state-owned commercial and trade enterprise located in Zhongjiang County and was incorporated in 1982. This company mainly engaged in selling and purchasing pod enjoyed the exclusive right to purchase raw silk and pod and was a very important enterprise in Zhongjiang county. From 1995 to 1999 Zhongjiang company operated profitably well. From 1995 to 2000, regional tax and agriculture tax it turned over exceeded 13.344 million RMB compared with the tax it should turn over. It came no surprise that in 1998 and 1999 bank of china' Sichuan branch categorized it as AA credit enterprises, at the corresponding period its major creditor--- agriculture bank of china' Sichuan branch topped it as superfine and first-class credit enterprise. The book value of its asset prior to the declaration of bankruptcy amounted to 119 .64 million RMB with the amount of debt and net asset totaling 86.7657 million RMB and 38.8758 million RMB respectively. The rate of debt on asset averaged 72.52%. The Zhongjjiang Company didn't have default on loans and interests prior to its bankruptcy. The only debt due was 100 million Yuan owned to Jianghzong county financial bureau. Besides that, the monetary balance of book currency totaled 792 thousand Yuan in saving account coupled with stock in trade worth 12.155 million Yuan mainly in pod form.*

*However, under the direct intervention and manipulation from Zhongjiang county commission and government, the company whose earnings amounted to 106.71 million Yuan in former 11 months of 2000 was required by its creditor----financial bureau to undergo bankruptcy procedure. Court at county level accepted the case, made a ruling and public announcement in the same day, and a bankruptcy liquidation team were set up simultaneously. Under the government's arrangement, new century silk industry limited liability company which was co-foundered financially by private Tianyou company and Zhongjiang County acquired the bankrupt Zhongjiang Company by auction. In this case, rights and interests of major creditor----Zhongjiang agriculture bank branch, were seriously prejudiced; at least 40 million Yuan debt owned to it was escaped.*

*To obtain the purpose of making the Zhongjiang company bankrupt, Zhongjiang county commission and government arranged for 10 county-owned or town & village-owned silk enterprises which were related to Zhongjiang silk company to be bankrupt and led to the complete disappearance of claims held by Zhongjiang silk company. Besides the above-mentioned arrangements, Zhongjiang county commission and government drafted a plan that most of the debt owned to Zhongjiang financial bureau, 16 million Yuan, should be recovered as quickly as possible, while repayment for the remaining portion debt in 1 million Yuan should be suspended. And then, Zhongjiang financial bureau submitted bankruptcy application against Zhongjiang silk company to court for consideration. Prior to the filing of bankruptcy application, Zhongjiang county commission and government instigated the company to withdraw its capital and fabricate balance sheet and accounts so as to be assumed as being insolvent. In the predetermined plan a vice secretary of Zhongjiang county commission would head the liquidation team, cooperation from enterprises, court and other relevant competent government agencies was secured.*

*On 31 July 2001, china central television spotlighted the case. From 12 to 17 in August, in-depth investigation was carried out into this case by the investigative team jointly form by relevant competent departments of the state council, major creditor---banks and the supreme court. Later persons who directly manipulated and were responsible for the case got administrative punishment and legal penalty.*[7]

This a very typical fraudulent bankruptcy case under government direct manipulation.

Various legal procedures embodied in the bankruptcy law fell victim to the manipulation and intervention exerted by the Zhongjiang county commission and government. In this case, based on fact that the county court failed to examine the application for bankruptcy and relevant materials in strict accordance with law as evidence by its unscrupulous acts that it not only accepted the case and delivered the ruling to declare the silk company bankruptcy in the same day but failed to notified creditors of declaring and confirming their claims, suffice it to say that the county court was not an independent and impartial judicial agency. Unfair practices also were adopted in the bankruptcy asset-auctioning process. The bankruptcy asset of the silk company was auctioned to the vendee who had been designated by the government in advance. All above-mentioned man-made insolvency aiming at escaping debts owned to debt infringes upon the capital contributors and creditors' rights and interests, leads to the massive drain on state-owned asset and seriously undermines the credit and legal environment.

In Zhongjiang silk company case, a series of delicately-designed plans aimed at escaping the debts owned to state-owned commercial banks. This case indicated that local governments had their own pursuits during the transformation from planned economy to market economy and played the game with central government using administrative and legal instruments. The emergence of the case and occurrence of the fraudulent bankruptcy make it an imperative task to have a new and unifying bankruptcy law with specific regulations to combat the fraudulent bankruptcy.

### 2) ST Ningjiao bankruptcy case

*ST Ningjiao was a stock-joint company which was solely sponsored by Ningcheng conglomerate located in Inner Mongolia and was incorporated by means of share offer with its major business being manufacturing liquids and beverages. As of the end of 2001, Ningcheng county state asset bureau and its controlling Ningcheng conglomerate appropriated 505.95 million Yuan from ST Ningjiao compared with 434.8 million Yuan ST Ningjiao raised 6 years commencing on the date of its listing. Nijiao was capped as ST in 2003 due to its worsening business operation as well as failure to disclose its annual report duly and situation that cash was appropriated by its controlling-shareholder. Hereafter, Beijing Pengtai Company reorganizing efforts on ST Ningjiao turned to be futile. Up to 30 June 2004, ST Ningjiao's asset totaled 450 million Yuan with net asset totaling 54.05 million Yuan coupled with its net asset per share valued at 0.187 Yuan and total debt amounting to 388 million Yuan.*

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[7] case origins: *why profitable enterprises went bankrupt all of a sudden---the investigation into and in-depth reflection on the bankruptcy of Zhongjiang county silk company in Sichuan province, people daily, published in 31st oct,2001*

*On 17 June 2004 Chifeng intermediary court accepted the bankruptcy application filed by Taifeng glasswork limited liability Company in conformity with law. According to the public notice made by Chifeng intermediary court, the first creditors' meeting should be convened on 15 October 2004. Court, provided that the company failed to enter into reconciliation agreement with the creditors' meeting or emergence of other circumstances initiating bankruptcy in accordance with law, would declare the company bankrupt.*

*On 15 October 2004 at the first creditors' meeting convened by Chifeng intermediary court ST Ningjiao and its creditors entered into reconciliation agreement in which the majority of debts would be repaid by a mysterious third party-- Haotian green industrial investment limited liability company. Small shareholders narrowly escaped heavy losses which were expected to fall on them without this desirable result.*

The bankruptcy of listed companies is invariably a hard nut to crack notwithstanding that law never forbids listed companies to go through bankruptcy procedure. up till now there is no bankruptcy case of a listed company yet.

The difference between a listed company and a common enterprise lies in the fact that the bankruptcy of a listed company not only affects shareholders' interests but has a negative effect on the securities market. It is the wide range of affected stake-holders that make the bankruptcy of a listed company very thorny. Like Ningjiao, a lot of listed companies failed to pay debts due and ultimately escaped the bankruptcy-declaring fate prior to the Ningjiao case. It is justified in claiming that this phenomenon is abnormal.

The institutional instrument insufficiency of the current bankruptcy law makes it impossible for a listed company to go bankrupt. Listed companies, with the absence of reorganization system, under predicament have no alternative but resort to new ways to survive. However during the alternative process seeking survival, rights and interests of small and medium-sized shareholders are constantly impaired.

**3) The Delong case**

*The crisis of Delong Group has been a very hot topic in the market in recent years. Delong Group is a typical enterprise among private-run enterprises which is characterized by two noticeable features. The first feature is merger and acquisition levered by Delong. In a short time period commencing the acquisition of Xingjian Tunhe legal person shares, Delong emerged hundreds of manufacturing-oriented enterprises ranging from ketchup, power facilities, cement, alloy materials, auto fittings manufacturing industries to mining and agricultural industry. On financial industry side, Delong was widely engaged in financial leasing, trust, security and banking sectors. Finally Delong became a sophisticated enterprises system involving in different industries. The second striking feature distinguishing Delong from its counterparts is its aggressive involvement in the banking industry. Delong quietly entered the banking industry by subscripting for shares issued by banks during china's financial reform process. Banks which were controlled by or whose shares were subscribed for by Delong are widely geographically scattered inclusive of banks located in Yunnan, Hunan, Sichuan and Jiangxi provinces, most of which are commercial banks.*

*On 4 April 2004 the price of shares issued by three companies in securities market controlled by Delong company, named Xianghuoju, Xinjiang Tunhe and alloy investment respectively, plummeted suddenly. However, from 2001 to 2003, the price of these three companies' shares remained relatively high against the continuously bearish secondary market background. Up till 21 April 2004 the range of price drop of these three companies' shares amounted to 40%. This means that negotiable market value worth more than 6.1 billion varnished suddenly in less than 10 days. The whole Delong chain ruptured. Creditors one after another file the bankruptcy lawsuit against Delong with the court, which set Delong chain into crisis.*

*August 2004, relevant supervisory departments at top levels intervened into solving the Delong-related crisis and made a decision that china Huarong asset management company shall be primarily responsible for asset reorganization of Delong chain in a market-oriented way. As of the date by delivering this article, Delong international strategic investment limited liability company has assigned its all property, inclusive of shares issued by listed industry company, such financial institutions as securities firms and other asset at its disposable, to china Huarong asset management company under its custody.*

The still pending Delong case is another typical case in market economy peculiar to china. What make it typical or distinct not only lies in its private attribute but in its integrating industry with finance. Against the status qua chaotic credit system this kind of integration is disposed to trigger the systematic crisis. The tardy reforms carried out in financial sectors and the chaotic financial investment contribute to the scenario that he who is bold is capable to set its foot in financial sectors at discretion. Where conglomerate integrating the finance with industry deeply involves in financial area but loses control, as a result, crisis is to be brought to the spotlight. Delong is a case that has been exposed.

To make the matter worse, as an institutional instrument to control and cut the throat of crisis, the current bankruptcy law plays no role in solving or alleviating this crisis with the result that the breakdown of Delong conglomerate is likely to have a rippling effect on the market as a whole. Therefore this is another imperative task the bankruptcy law has to face.

### 3. The Formulation of the New Insolvency Law and its Effect on Reshaping the Credit Culture and Credit System

Two incentives, interior and exterior, stimulate the formation of the new bankruptcy law. The establishment of socialist market economy becomes the goal and orientation for china's economy and social institutional development since 15th Plenary Meeting of the Central Committee of the Communist Party. From the legal system structure, the establishment of market economy requires a unifying and perfect bankruptcy law to guarantee the smooth functioning of the market economy. At the same time, various kinds of inconsistencies and problems arising from the old-fashioned bankruptcy legislation and practices work as the interior factor in prompting the improvement on and amendment to the current bankruptcy law. Compared with the interior requirement, china's accession to the WTO in 2001 accelerates its growing wide-ranging international economic intercourse with the outside world, which necessitates a brand-new bankruptcy law in conformity with international practice.

As far as a country whose economic transformation is under way is concerned, the bankruptcy law is the basic institution for economic reforms, for avoiding the economic crisis and social turbulence. It bears resemblance with highly sensitive nerves in affecting social stability, economic well-being and culture in a multi-faceted way. It has been 10 years since the 8th national people's congress resolved to draw up a new bankruptcy law. June 2004, the 10th national people's congress considered the draft of the new bankruptcy law. It is the first time that the draft of new bankruptcy law has been submitted to national people's congress for consideration. October 2004, the standing committee of the national people's congress considered the draft for the second time, which means that the drafting of the new bankruptcy law entered a crucial stage. The draft submitted by finance and economy commission to the standing committee is composed of 11 chapters, 164 articles covering general provisions, application for and acceptance of bankruptcy cases, the administrator, debtor's property, declaration of claims, creditors' meeting, reorganization, reconciliation, liquidation, legal obligations and liabilities and the supplementary provisions. The institutional frame of the new bankruptcy law will deeply affect the credit system, credit culture and even the social and economic tenor.

#### 1) A consistent bankruptcy law based on market economy

Compared with the current bankruptcy law, the most impressive feature of the new bankruptcy law is that it brings the logically chaotic old-fashioned bankruptcy rules and regulations into consistency. Article 2 of the draft stipulates that the application scope of the bankruptcy law covers the enterprises as legal persons, partnership enterprises and its partners, sole proprietorship enterprises and its capital

contributors, other profit-making organizations established in accordance with law[8]. Thus, the staging of the new bankruptcy law will end the scenario that different treatment is administered to different types of enterprises. After the new bankruptcy law comes into force, chapter19 of the civil litigation law will be abrogated. The bankruptcy of –SOES will be covered by the new bankruptcy law with the result that the days of policy-oriented bankruptcy are numbered. According to the new bankruptcy institutional law the identity of being the SOE or non-SOE, being foreign or domestic will not be the criterion by which different treatment is given, that is to say debts owned by all enterprises shall be recovered in accordance with the new market-based bankruptcy law. The implementation of the new bankruptcy law virtually will be conducive to the formation, development and maturity of a fair play and well-functioning market.

The new bankruptcy law is, in addition to being a consistent law, a market-based bankruptcy law which aims at alleviating or/and solving crisis occurring during the operation of market economy.

The guidelines to the new bankruptcy law may be summed up as follows: 1) basing upon the country-specific situation and practices, to accommodate to the requirements and challenges brought by establishment of socialist market economic institution and china's access to WTO at the same time committed to solving practical issues; 2) bringing all enterprises ,whether it be newly-established, old-fashioned, SOE, or foreign ones, under a unifying bankruptcy law; 3) establishing the survival of the fittest system and reorganization institution targeted at enterprises under predicament. With regards to enterprises with no hope of being revived greater losses shall be avoided; medium-sized and large-scale enterprises with hope of being dragged from predicament shall be revitalized through reorganization and reconciliation procedures; 4) rendering fair protection to all interested parties to the bankruptcy case, preventing fraudulent bankruptcy, regulating the bankruptcy in a comprehensive way; E, fully protecting the legitimate rights and interests of staff and workers. There are bankruptcy cases where the staff and workers' legitimate rights and interests are seriously prejudiced, social stability is gravely undermined. Solving these above-mentioned social problem and fully protecting worker's legitimate rights and interests top the drafting agenda; 5) maintaining the unity and consistency of the bankruptcy law and institutions as a whole. Besides the new bankruptcy law, there are other laws, rules and regulations inclusive of civil litigation law, company law; law for commercial banks, insurance law etc. which stipulates in particularity the bankruptcy of relevant enterprises. Special attention must be given to the coherence and consistence between this special bankruptcy provisions and general provisions stated in the new bankruptcy law[9].

Two value inclinations determine the guidelines to the new bankruptcy law and its specific content. Specifically speaking, the first value inclination refers to the disposition that the new bankruptcy law shall meet the requirements raised by the market economy development and provides a fair and market-oriented basis on which the bankruptcy case may be properly handled. With a transparent, clear -cut bankruptcy law, both the existing and the prospective debtors and creditors are able to make a definite commercial decision, which is instrumental to avoiding risks and reducing transaction costs. Where insolvent and faithful debtors go bankrupt, bankruptcy assets shall be liquidated and distributed to creditors in transparent, fair, well-ordered way. The second directing value inclination is that the new bankruptcy law shall stand up to the special problems, without limitations, arising from the planned economy to market economy transformation, properly and clearly defining the rights enjoyed by and obligations bore by debtors, creditors, government, employees and other stake-holders, appropriately dealing with the relationship between government and enterprises, adequately guaranteeing the source of social insurance, cost-effectively solving the non-performing loans.

**2) The institutional frame of the social credit elevated by the draft of the new bankruptcy law**

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[8] *during the drafting process, some advocated that the bankruptcy of 23 million individual industrial and commercial households, personal consumptive acts shall be under the applicable scope of the bankruptcy law. the drafting group held that the time was not ripe to bring the above-mentioned objects under bankruptcy law's regulation, or that a new law on bankruptcy of individuals.*

[9] finance and economic commission under national people's congress: *explanation on the draft of the new bankruptcy law, released 21st Jul 2004.*

a. the administrator

The administrator is a new institution introduced by the draft of the new bankruptcy law. This draft put the administrator institution in a prominent and important position. Chapter 3 of the draft submitted to the standing committee of national people's congress stipulates the qualification, legal status, powers and functions, supervision, remuneration, punishment and the like, which is a breakthrough made upon the old-fashioned liquidation team provided for in the current bankruptcy law and a favorable disposition to be in line with international practices.

The administrator system is expected to enhance the credit at least from three aspects:

Firstly, the implication of the administrator system resides in making the bankruptcy procedure more convincing, more transparent by creating an independent third-party. Under the current bankruptcy law members on the liquidation team are designated and appointed by relevant government departments. Few, if any, professionals involve in the liquidation process, which make it hard for the bankruptcy procedure to operate in market-oriented way. More unfortunately, the liquidation team is almost absent for the liquidation process of the bankruptcy of non-SOE. To solve this problem, the draft of the new bankruptcy law emphasizes the professionalism of the administrator. According to the draft, the administrator shall be liquidation team either designated by court or established in accordance with law with the inclusion of such intermediary institutions as law firms, accounting firms, and bankruptcy & liquidation firms etc established in accordance with law. Likewise, persons who have relevant professional knowledge and obtain practice qualifications are capable of being appointed as the administrator.

Secondly, besides the improvement on the neutrality of the administrator, the draft confirms the essential role creditors shall play in the administrator-appointing process, thus guarantees creditors' rights and interests. Pursuant to Article 19, the administrator should be appointed by the court. Per Article 56 of the draft, creditors' meeting is entitled to apply for replacing the administrator and review remuneration of the administrator.

Thirdly, the draft prescribes the diligent and loyal obligation of the administrator to ensure it performs its powers and functions prudently and diligently. Article 21 of the draft provides that, apart from the liquidation team, law firms, accounting firms and liquidation firms, persons with relevant professional knowledge and who have obtained practice qualification may be appointed as the administrator. Following article 21, article 22 stipulates that one of the following circumstances disqualifies persons from being the administrator: 1) having been criminally punished or having social records; 2) certified accountants, lawyers' practicing license being revoked; 3) being interested to the bankruptcy case; 4) persons court considering as inappropriate to be the administrator.

b. the reorganization

The reorganization system is another freshly-introduced procedure in the draft in order to revitalize enterprises with hope of being dragged from the predicament. The application scope, basic procedure, protective measures, reorganizing plan are specifically stipulated in a particular chapter of the draft. The reorganization system typifies the mainstream of development of the modern international bankruptcy and become the important section of the draft. It became a consensus that the reorganization system should be specifically provided for in a separate chapter in the draft at the outset. This directing consensus aims at revitalizing enterprises without necessitating the initiation of the liquidation procedure.

To increase the possibility of being reorganized, the draft widens reasons for reorganization by stating that enterprises may, with the likelihood of being able to pay debts due, directly apply for reorganization. Based on the fact that the management knows the real business condition of enterprises better than anyone else does, the draft encourages the debtor to resolve its inner problems through legal procedure as soon as possible by specifying that the debtor may, when applying for the reorganization, apply for managing property and business in itself.

I hold that the reorganization system is the real game of the market economy. That is to say, the normal scenario is enterprises constantly confronting complicated financial and business difficulties. This is especially true with respect to large-scale enterprises. For them, the creditor-debtor relationship and financial structure is so sophisticated, and factors affecting their business operation are so numerous that using the value of enterprises to appraise whether they are insolvent or not is virtually unjustifiable. However, the reorganization of enterprises not only maintains and enlarges their operating value by creating a revival opportunity for them but avoids the social turbulence by retaining human resources of enterprises.

c. preferential protection to secured claim

Based on the theory that the protection of the secured rights and interests is crucial to the stability of the financial system as a whole, the draft of the new bankruptcy law points clearly stipulates that if a claim is secured by mortgaged property, pledged property or lien property, it shall be realized to the extent that relevant debt is covered by secured property. This means that the secured asset will not form part of the bankruptcy assets of a debtor. However, a secured debt is not inevitably or always safe. This point deserves further comments since it tends to give people a wrong impression that secured claims are secured against any legal risk. However, there may be one more than 1 mortgage over the same secured asset. In this instance, the priority of the secured rights will rank according to the respective date they came into effect, which should either be the date of registration of the secured right or from the date of execution. So if the secured asset is registerable but all the mortgages over it have not been registered, the priority of payment will be determined in order of their respective execution dates. If some of the mortgages have been registered while others not, the registered mortgages shall have priority over non-registered ones. It is therefore not always the case that a mortgage will have the first priority. Besides that, if the debt is secured by a guarantee, creditors shall be careful with the termination dates of guarantees under security law. Even they took actions to demand payment, they will have to do the same again every two years to ensure that their secured claims will not be barred due to lapse of time.

d. combating the fraudulent bankruptcy

Fraudulent bankruptcy is a persistent problem plaguing the unsound social credit. The occurrence of the fraudulent bankruptcy acts makes the drawing-up of the bankruptcy law run counter to its own original intention. Therefore, the draft of the new bankruptcy law takes it as its primary task to combat the fraudulent bankruptcy acts by invalidating such credit-undermining practices. Article 33 of the draft provides that: the following activities concerning a debtor's property and property rights taken by the debtor within one year before the People’s Court accepts a bankruptcy case, the Administrator is entitled to request the People’s Court to rescind such activities: 1) transferring property or property rights free of charge; 2) transferring property or property rights at abnormally depressed value; 3) providing property security for debts that originally have no property security; 4) paying off in advance undue debts; 5) giving up creditor’s rights. Besides this, the draft further states that: where a debtor having known of his inability to pay off debts due but still paid off debts to specific creditors during the six months before the People’s Court accepts a bankruptcy case, which impairs the interests of other creditors, the Administrator is entitled to request the People’s Court to rescind such repayments unless specific repayments that benefit the bankrupt property. Compared with the current bankruptcy law, the draft metes out more severe punishment to fraudulent bankruptcy acts and null bankruptcy acts, by which sets up a stronger defense belt against the unfaith and credit-undermining bankruptcy acts.

In addition to null and void acts, the new bankruptcy law prescribes civil, administrative, even the criminal liabilities to the extent that acts committed constitutes a crime. The criminal liability includes: 1) directors, managers and other personnel of the bankrupt enterprise, owing to gross negligence or intentional offense, bearing major responsibility for the bankruptcy of the bankrupt enterprise; 2) Debtors or debtor's representatives who are obliged to be present at the creditors' meeting yet absent from the meeting without justifiable reasons in spite of the summon from the People’s Court; 3) the debtor, in violation of the Provisions of this Law, refusing to submit the specification on his financial status, the detailed list of debts, the detailed list of credits and related financial report to the People’s Court, or submitting unreal documents; 4) the debtor, in violation of the Provisions of this Law, refusing to transfer the property or the accounting books, documents, material, data, seals related to the property

to the Administrator or the bankrupt liquidator, or the debtor counterfeiting, destroying evidence related to the property resulting in the ambiguity of the property status; 5) Where the debtor has known or should have known his inability to pay off his due debts, but still making irrational or extravagant expenses; 6) the Administrator, members on the creditors committee, demanding, accepting bribes to obtain inappropriate interests by taking advantage of their duties or position; 7) Administrator, members on the creditors committee causing economic losses to the creditors, the debtor or a third party due to negligence of duty or other unlawful activities.

e. implications for risk management brought by the draft of the new bankruptcy law

The draft of the new bankruptcy law awakens both the enterprises as legal persons and individuals either as capital contributors of sole proprietary ship enterprises or as partners of partnership enterprises to the insolvent crisis which will wield a negative effect on their future business operation materialized in the increased difficulty of obtaining loans etc, thus market players under the draft's applicability shall enhance their awareness of insolvency crisis. Another newly-introduced risk management instrument, deserving special attention, stipulated in this draft is the reorganization system by which large-scaled enterprises internalize firm-specific, whether it be financial or operational, dislocation and avoid wide-ranging social turbulence. But how about the bankruptcy of the financial institutions with the inclusion of banks and insurance companies, is it omitted intentionally from the draft. Article 163 of the draft stipulates that: the bankruptcy of the commercial banks and insurance companies shall be dealt with pursuant to the implementation measures that will be formulated by the State Council in conformity with this law and other relevant laws and regulations. This provision is based upon the typical structure peculiar to financial institutions which distinguishes them from non-financial enterprises. Besides reserve fund requirement and sound capital adequacy ratio requirement, in the foreseeable future, the financial institutions are expected to face challenging requirements raised by implementation measures of the new bankruptcy law. what are the specific requirements which are likely to impose on the financial institutions, we will wait and see.

Generally speaking, the draft of the new bankruptcy law not only draws on the advanced and mature practices of the bankruptcy law of modern developed countries but caters to china's country-specific situations. Considering the wide-ranging participation from enterprises, legal section, rank and file in the drafting process, I would expect the possibility of that the new law might be finally passed at the end of 2004 by the standing committee of the National People's Congress. It will, by then, definitely propel china's economic reforms, market economy development and reshape the social credit constructively.