

**THE COURTS' ROLE IN THE PROCEEDINGS OF ENTERPRISE
BANKRUPTCY AND RESTRUCTURING AND THE PROBLEMS THAT
NEED TO BE SOLVED**

Mr. SONG Xiaoming

Chief Judge of No. 2 Civil Court

the Supreme People's Court

Ladies and Gentlemen:

Good Morning !

It is a great pleasure to join the Forum for Asian Insolvency Reform 2006 jointly held by the Enterprise Economic Research Institute of Development Research Center of The State Council of PRC and OECD's Corporate Affairs Division, and to give my personal opinions on the role of the courts in the proceedings of enterprise bankruptcy and restructuring and the problems that need to be solved.

Bankruptcy is a final stage where a market subject exists the market due to its business failure. From a court's point of view, a bankruptcy law is actually the procedural law and substantive law applied by the court while liquidating debtors. Courts pay much attention to the legislation and reform of the bankruptcy law, and while participating actively in the formulation of the Enterprise Bankruptcy Law, the Supreme People's Court of the PRC unceasingly summarizes its practical judicial experience as well and perfects the current bankruptcy law system of China by adopting the methods of judicial interpretation and case guidance.

Modern bankruptcy laws pay more attention to designing the function of bankruptcy proceedings in regenerating an enterprise whose business fails or who may lose its repayment ability. The proceedings of conciliation and reorganization under the current bankruptcy law system of China are similar to the restructuring system. As for the provisions on systems of conciliation and reorganization under the current bankruptcy law of China, see the *Bankruptcy Law of the People's Republic of China (For Trial Implementation)* (hereinafter referred to as the "*Bankruptcy Law (for Trial Implementation)*"), the "Procedure for Bankruptcy and Debt Repayment of Legal Person Enterprises" under the *Civil Procedure Law of the People's Republic of China*, and the *Opinions of the Supreme People's Court on Several Issues Concerning the Implementation of the Law of the People's Republic of China on Enterprise Bankruptcy (For Trial Implementation)* (hereinafter referred to as the "*Opinions of the Supreme People's Court concerning the Application of the Bankruptcy Law*"), the *Opinions of the Supreme People's Court on Several Issues Concerning the Application of the Civil Procedure Law of the People's Republic of China*, and the *Provisions by the Supreme People's Court on Some Issues concerning the Trial of Enterprise Bankruptcy Cases* (hereinafter referred to as the "*Provisions*"). Through comprehensive analysis of the provisions of the above-mentioned laws and judicial interpretations, the systems of conciliation and reorganization within the framework of the current bankruptcy law of China have the following features: 1. conciliation and reorganization shall be applied for by a debtor or the authority in charge of the debtor after the creditors file a bankruptcy petition; 2.

conciliation and reorganization are closely linked and are actually the same procedure; 3. the superior authority in charge of the enterprise or the person appointed at the shareholders' meeting of the enterprise shall be responsible for the reorganization; 4. the conciliator agreement is enforceable under some conditions; 5. Conciliation and reorganization are only applicable to the debtors' liabilities, not including the capital reorganizations of the debtors. The systems of conciliation and reorganization play an important role in a bankruptcy law. However, only six articles in *the Bankruptcy Law of China (for Trial Implementation)* provide them. Although, thereafter, eight articles in the *Opinions of the Supreme People's Court concerning the Application of the Bankruptcy Law* and six articles in the *Provisions of 2002* make supplementary provisions, many important problems, such as the lack of rules concerning supervision over reorganization, the lack of rules concerning the application for withdrawal of bankruptcy declaration, and the lack of more delicate formation of voting groups, are still unsolved. Besides, the provisions concerning the withdrawal of proceedings of conciliation and restructuring are not perfect enough; some other provisions, such as those concerning the administratization of reorganization procedures, are not rational enough.

Because the provisions concerning conciliation and reorganization in the bankruptcy law of China are too principled and have poor operability. For example, prior to the successful conciliation of Ningcheng Laojiao Company Limited, no other listed companies were successfully reorganized through conciliation. It was the Case of ST zhengBaiWen Capital Reorganization that prompted the systems of conciliation and reorganizations to be applied to listed companies. The biggest problem in ZhengBaiWen case was the problem concerning the distribution of equities among new investors and original shareholders. Because a large number of shareholders were involved in ZhengBaiWen case and the reorganization agreement was out of bankruptcy proceedings, opinions of all shareholders were sought by the adoption of an alternative that "objection shall be lodged explicitly and approval may be made tacitly", through which consent was obtained from a majority of shareholders, and as for minority shareholders dissenting, stocks of dissenting shareholders were repurchased at a fair price by using international experience as reference. Reorganization was finally completed, and Zhengzhou Municipal Intermediate People's Court made a judgment to confirm this result. Although the judgment by Zhengzhou Municipal Intermediate People's Court substantively conformed to the regulations generally recognized by the restructuring legislations of countries and procedurally complied with the international trend that the public authorities represented by courts intervene in restructuring proceedings, there are still legislative blanks, so that disputes arose in the jurisprudential circle. The case also caused people to think about the effects of restructuring proceedings on avoiding the shock brought by the delisting and bankruptcy of listed companies to the market.

The Supreme People's Court of the PRC also paid attention to causing the restructuring of listed companies by means of the conciliation mechanism, and explicitly indicated that, for the purpose of reorganization through conciliation, the bankruptcy petitions filed by listed companies may be accepted where conditions become mature, and successively, three listed companies, that is, Ningcheng Laojiao, Jinan Qingqi, and Jilin Paper Manufacturing, were successfully reorganized through conciliation mechanism, and the reorganization of listed companies such as Shengfang Technik and SHENZHEN CHINA is brewing. Prolonged weakness in the securities market has caused liquidity risks to quite many securities companies, and the regulatory

department has become interested in the reorganization of securities companies by making use of the system of reorganization through conciliation. However, because law resources are not enough to provide basis for the restructuring of these public companies, so that the restructuring process is beset with difficulties. However, such beneficial attempts ensured that the medium and small shareholders of a listed company did not completely lose their original capital due to the delisting of the listed company, helped financial institutions avoid the systematic risks and effects on social stability brought by the insolvency thereof, and provided reference cases for the formulation of restructuring proceedings under the new Bankruptcy Law.

The Bankruptcy Law of China under review provides for the classified voting system completely for secured and unsecured creditors and some special claims during the bankruptcy restructuring of an enterprise, but fails to make provisions concerning voting groups of shareholders. In combination with the current restructuring status of listed companies in China, if no provisions concerning the acceptance or rejection of shareholders' equity in the restructuring proceedings are made in the Bankruptcy Law, the problems similar to the reorganization of ZhengBaiWen are still unable to be solved. As a result, a remedy when the voting groups of shareholders do not approve the restructuring scheme needs to be specified to prevent the failure of restructuring caused due to the shareholders' refusal to cooperate.

A way of doing that may be used for reference is to increase the voting groups of investors in the classification of voting groups for restructuring plan, that is, "while the matters concerning the adjustment of equities of investors are involved in the draft restructuring plan, the people's courts shall make a decision to establish groups of investors for voting." When a court approves a restructuring plan, although the voting group of shareholders fails to approve the restructuring plan, "the distribution proportions enjoyed by shareholders according to the draft restructuring plan shall be no lower than the distribution proportions that can be enjoyed according to bankruptcy proceedings when the draft restructuring plan is submitted for approval", and the people's court may approve the restructuring plan. Such provisions play a positive role in the restructuring of public companies, such as financial institutions, including commercial banks and securities companies, and listed companies, and are of help to attracting third party investors and prompting the regeneration of enterprises. It needs to be noticed that attention should be paid to the protection of equities of medium and small investors during the adjustment of stock equities at the time of compulsory approval of restructuring plans of listed companies, and even if such shareholders gain nothing according to bankruptcy proceedings, a certain proportion of stock equities should be reserved for medium and small investors in the restructuring plan, so that while protecting the best interests of creditors, the restructuring proceedings can perform the function to maintain social stability to do good to the prolonged development of the securities market.

China is still feeling around in enterprise restructuring in judicial practice, and the most important thing is to perfect the legislation for enterprise restructuring and to create conditions for restructuring proceedings to play bigger roles. I sincerely hope that all experts who join this forum can fully carry out researches and discussions on the bankruptcy and restructuring of enterprises and provide experience and references for the trial of enterprise bankruptcy cases by the courts of China and the promotion of the restructuring and regeneration of enterprises.

Thanks !