



## **THE COURT'S ROLE IN ENTERPRISE BANKRUPTCY PROCEEDINGS AND RESTRUCTURING IN CHINA**

*by Song Xiaoming*

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Bankruptcy is a final stage where a market subject exits the market due to its business failure. From a court's point of view, a bankruptcy law is actually the procedural and substantive law applied by the court while liquidating debtors. Courts pay great attention to the legislation and reform of bankruptcy laws. The Supreme People's Court of China participated actively in the formulation of the Enterprise Bankruptcy Law and uses its practical experience to perfect the current bankruptcy system by adopting methods of judicial interpretation and case guidance.

Modern bankruptcy laws focus on reviving enterprises that fail or that may lose their ability to service their obligations. The conciliation and reorganisation proceedings under the current bankruptcy system of China are similar to a restructuring system. Provisions for conciliation and reorganisation under the current bankruptcy law are found in the Bankruptcy Law of China (For Trial Implementation) (hereinafter, the Trial Bankruptcy Law), the Procedure for Bankruptcy and Debt Repayment of Legal Person Enterprises under the Civil Procedure Law of China, and the Opinions of the Supreme People's Court on Several Issues Concerning the Implementation of the Law of China on Enterprise Bankruptcy (For Trial Implementation), (hereinafter, Opinions), the Opinions of the Supreme People's Court on Several Issues Concerning the Application of the Civil Procedure Law of China, and the Provisions by the Supreme People's Court on Some Issues Concerning the Trial of Enterprise Bankruptcy Cases (hereinafter, Provisions).

A comprehensive analysis of the provisions of the above-mentioned laws and judicial interpretations, and the systems of conciliation and

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reorganisation within the framework of the current bankruptcy law shows the following:

1. Conciliation and reorganisation 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 reorganisation are closely linked, and are actually the same procedure;
3. The supreme authority in charge of the enterprise or the person appointed at the shareholders' meeting of the enterprise shall be responsible for the reorganisation;
4. The conciliation agreement is enforceable under some conditions; and
5. Conciliation and reorganisation are only applicable to the debtors' liabilities, not including the capital reorganisations of the debtors.

Systems of conciliation and reorganisation play an important role in a bankruptcy law. However, only six articles in the Trial Bankruptcy Law provide them. Although eight articles in the Opinions and six articles in the Provisions of 2002 make supplementary provisions, many important problems (such as the lack of rules concerning the supervision of reorganisation, the application for withdrawal of bankruptcy declarations, and on the formation of voting groups), remain unsolved. Furthermore, the provisions concerning the withdrawal of proceedings of conciliation and restructuring have not been perfected, and other provisions, such as those concerning the administration of reorganisation procedures, are insufficiently rational.

The provisions concerning conciliation and reorganisation in the bankruptcy law of China are too theoretical and insufficiently operational. For example, prior to the successful conciliation of Ningcheng Laojiao Company Limited, no other listed company had been successfully reorganised through conciliation.

It was the case of ST ZhengBaiWen Capital that prompted the systems of conciliation and reorganisation to be applied to listed companies. The biggest problem in the ZhengBaiWen case concerned the distribution of equity among new investors and the original shareholders. Because a large number of shareholders were involved, and the reorganisation agreement was outside of the bankruptcy proceedings, the opinions of all shareholders were sought through the application of the principle that "objection shall be lodged explicitly and approval may be made tacitly". The result was the consent of a majority of the shareholders. As for the dissenting minority

shareholders, their shares were repurchased at a fair price calculated by making reference to international practices. The reorganisation was finally completed, and the Zhengzhou Municipal Intermediate People's Court made a judgment to confirm the result.

Although the judgment by the Zhengzhou court conformed substantively to the regulations generally recognised by the restructuring legislation of other countries, and complied procedurally with the international trend for public authorities, represented by courts, to intervene in restructuring proceedings, there are still legislative lacunae that have caused disputes to arise in jurisprudential circle. The case has also caused people to think about the impact that restructuring proceedings, delisting and bankruptcy can have on the equity markets.

The Supreme People's Court of the People's Republic of China also paid attention to the restructuring of listed companies by means of the conciliation mechanism, and explicitly indicated that, for the purpose of reorganisation through conciliation, the bankruptcy petitions filed by listed companies may be accepted where conditions are appropriate. Three listed companies (Ningcheng Laojiao, Jinan Qingqi, and Jilin Paper Manufacturing), were successfully reorganised through the conciliation mechanism. The reorganisation of listed companies such as Shengfang Technik and Shenzhen China are currently being considered.

Prolonged weakness in the securities market has heightened liquidity risk in quite a number of stock companies. As a consequence, regulators have become interested in their reorganisation through conciliation. However, the restructuring process is beset with difficulties because legal resources are insufficient. Nevertheless, attempts to ensure that small and medium-sized shareholders of listed companies do not completely lose their original capital due to delisting, have helped financial institutions avoid systemic risks, have attenuated the effects on social stability, and have provided cases for reference in the formulation of restructuring proceedings under the new Bankruptcy Law.

The Bankruptcy Law of China, which is currently under review, provides for a classified voting system 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. If no provisions concerning the acceptance or rejection of shareholders' equity in the restructuring proceedings are made in the Bankruptcy Law, problems similar to those encountered in the reorganisation of ZhengBaiWen will remain unsolved. As a result, a remedy needs to be specified for when groups of reference shareholders do not

approve the restructuring scheme in order to prevent the failure of restructuring due to shareholders' refusal to co-operate.

A way of doing this may be to increase the groups of voting investors in the classification of voting groups for the 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, even though the group of voting 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, and are of help in attracting third party investors and prompting the revival of enterprises. Attention also needs to be devoted to the protection of the shareholdings of small and medium-sized investors during the adjustment of stock equities that results from the compulsory approval of the restructuring plans of listed companies. Even if such shareholders gain nothing from the bankruptcy proceedings, a certain proportion of stock should be reserved for them in the restructuring plan so that (while protecting the best interests of creditors), the restructuring proceedings can perform the function of maintaining social stability, and benefit the long-term development of the securities market.

China is finding its way forward in the judicial practice of enterprise restructuring. The most important goal at present is to perfect the legislation for enterprise restructuring, and to create the conditions for restructuring proceedings to play a more significant role.