



The New Enterprise Bankruptcy Law in China

On 27 August 2006 the Standing Committee of the National People's Congress finally adopted the long awaited new enterprise bankruptcy law (the "new law"). The new law will come into effect on 1 June 2007 replacing the current enterprise bankruptcy law which was enacted back in 1986.

Comprised of 12 chapters and containing 136 articles, the new law establishes a unified statutory framework for bankruptcy for all types of enterprises in China, whether state or privately owned, and provides much clearer procedures for insolvent enterprises to restructure or exit the market by means of restructuring, conciliation or bankruptcy.

The Bankruptcy Procedures

A bankruptcy administration starts with a bankruptcy application to the People's Court. Under the new law, both the debtor and its creditors have the right to make such an application if the debtor is unable to pay its debts as they fall due and has insufficient assets to pay off all debts or clearly lacks the ability to do so. For financial institutions like commercial banks, securities houses and insurance companies, the application can be made by financial supervisory bodies established by the State Council.

Within 15 days from the receipt of an application, the People's Court will be required to make a ruling whether to accept the application. If an application is accepted, the People's Court will notify the debtor, the applicant (if the applicant is not the debtor itself) and all known creditors of the ruling and at the same time appoint an administrator who shall take over control of the bankruptcy enterprise's affairs and oversee the administration.

After acceptance of the bankruptcy case, the People's Court will also make a public announcement of its ruling, which, among other things, will specify the period of time in which creditors can submit their claims. Creditors other than employees will need to submit their claims to the administrator before the prescribed deadline in order to be entitled to attend and vote at the first creditors' meeting. As stipulated by the new law, the period allowed for filing of claims should not be less than 30 days or more than 3 months from the date following the public announcement of the acceptance of the bankruptcy case.

Within 15 days of the deadline for submission of claims, the People's Court will convene the first creditors' meeting in which the creditors, the debtor and the administrator will review and discuss the claims. The agreed list of claims will then be submitted to the People's Court for its confirmation. This list will form the basis for subsequent bankruptcy distributions.

Some Salient Features of the New Law

The new law has taken a great leap forward in bringing the bankruptcy regime in China in line with international practice. It introduces the concept of an independent administrator, i.e. a professional organisation or individual charged with managing the subject enterprise's affairs and overseeing the administration. The duties of the administrator includes taking over, managing and disposing of the assets of the subject insolvent enterprise, managing its daily affairs, reviewing and adjudicating claims, investigating affairs of the enterprise and making distributions. Having a professional, independent organization such as an accounting firm as an administrator in bankruptcy proceedings is very different from current practice in China where the bankruptcy process is under the control of a liquidation committee comprising mainly government officials and related parties.

It is generally believed that the new law will be well received by creditors as it broadens significantly their role and power in a bankruptcy. Other than the rights to apply to the People's Court to change the initially appointed administrator and appoint a creditors' committee to supervise the work of the administrator in the first creditors' meeting, the new law stipulates that a number of important matters, e.g. the plans as to how the debtor's properties will be realised and distributed, will need to be discussed with and approved by creditors at creditors' meetings.

The new law also upholds the rights of secured creditors over assets pledged to them in priority to that of other creditors, including employees. Article 109 of the new law clearly provides that secured creditors shall have priority over the assets pledged to them by the bankrupt enterprise. The only exception to this rule is provided in Article 132 which states that after the implementation of the new law, any entitlements of employees (e.g. salaries, pension funds, medical expenses) accrued before the promulgation of this law that remain outstanding shall be settled out of the secured assets referred to in Article 109 in priority to the entitlements of secured creditors.

Another important feature of the new law is that it provides alternatives to bankruptcy, namely options of restructuring and conciliation. After the People's Court makes a ruling to accept the bankruptcy but before the debtor is declared bankrupt, the debtor and/or creditors can apply for restructuring (where the debtor will have the opportunity to submit a plan for rehabilitation of its business) or conciliation (where the debtor can propose a compromise and settlement of its debts with its creditors).

Conclusion

The new law is clearly one of the cornerstones of China's efforts to expand its use of market forces to bring efficiency to its economy. It has clear reference to international best practices while at the same time accommodating China's economic and social realities. It is creditor friendly and should provide a clear endgame for stakeholders in troubled commercial enterprises in China. That said, the success of the new law can ultimately only be measured after it is implemented 9 months from now.

If you require any further information or have any questions on the new law, please seek advice from one of our Business Recovery Services contacts.

In the context of this China Tax / Business News Flash, China refers to the People's Republic of China but excludes Hong Kong Special Administrative Region, Macao Special Administrative Region and Taiwan Region.

The information contained in this publication is for general guidance on matters of interest only and is not meant to be comprehensive. The application and impact of laws can vary widely based on the specific facts involved. Before taking any action, please ensure that you obtain advice specific to your circumstances from your usual PricewaterhouseCoopers client service team.

Beijing

Tel: (86) (10) 6533 2866
Fax: (86) (10) 6533 8800
Edward Shum
edward.shum@cn.pwc.com

Chongqing

Tel: (86) (23) 6374 0008
Fax: (86) (23) 6374 0990
Tony Kwan
tony.kwan@cn.pwc.com

Dalian

Tel: (86) (411) 8370 6668
Fax: (86) (411) 8370 6665
Edward Shum
edward.shum@cn.pwc.com

Guangzhou

Tel: (86) (20) 3819 2128
Fax: (86) (20) 3819 2100
Charles Leung
charles.leung@hk.pwc.com

Hong Kong

Tel: (852) 2289 3669
Fax: (852) 2810 9888
Petrina Tam
petrina.tam@hk.pwc.com

Qingdao

Tel: (86) (532) 8089 1888
Fax: (86) (532) 8089 1800
Steven Wong
steven.wong@cn.pwc.com

Shanghai

Tel: (86) (21) 6123 2515
Fax: (86) (21) 6123 8800
Tony Kwan
tony.kwan@cn.pwc.com

Shenzhen

Tel: (86) (755) 8261 8899
Fax: (86) (755) 8261 8800
Charles Lee
charles.lee@cn.pwc.com

Suzhou

Tel: (86) (512) 6288 6860
Fax: (86) (512) 6288 6870
Billy Hsieh
billy.hsieh@cn.pwc.com

Tianjin

Tel: (86) (22) 2330 6789
Fax: (86) (22) 2339 3662
Alan Wu
alan.wu@cn.pwc.com

Xian

Tel: (86) (29) 8720 3336
Fax: (86) (29) 8720 3335
Elton Huang
elton.huang@cn.pwc.com

To make enquiries about our China tax and business advisory services, please feel free to contact the following lead specialist partners:

Human Resources Services

Tel: (86) (21) 6123 2517
Fax: (86) (21) 6123 8800
Nora Wu
nora.wu@cn.pwc.com

International Assignment Services

Tel: (86) (10) 6533 2698
Fax: (86) (10) 6533 8800
May Huang
may.huang@cn.pwc.com

Worldtrade Management Services

Tel: (86) (21) 6123 3599
Fax: (86) (21) 6123 8800
John Robinson
john.p.robinson@cn.pwc.com

Indirect Tax

Tel: (86) (10) 6533 2889
Fax: (86) (10) 6533 8800
Alan Wu
alan.wu@cn.pwc.com

Mergers & Acquisitions

Tel: (852) 2289 3097
Fax: (852) 2810 9888
Danny Po
danny.po@hk.pwc.com

Transfer Pricing

Tel: (86) (21) 6123 2580
Fax: (86) (21) 6123 8800
Spencer Chong
spencer.chong@cn.pwc.com

Tel: (86) (21) 6123 3028
Fax: (86) (21) 6123 8800
Glenn Desouza
glenn.desouza@cn.pwc.com

Registration & Corporate Compliance Services

Tel: (86) (21) 6123 3052
Fax: (86) (21) 6123 8800
Matthew Wong
matthew.mf.wong@cn.pwc.com

Business Recovery Services

Tel: (86) (10) 6533 2228
Fax: (86) (10) 6533 8800
Brian Cheung
brian.cheung@hk.pwc.com

Tel: (852) 2289 2412
Fax: (852) 2810 9888

Rainier Lam
rainier.lam@hk.pwc.com

Tel: (86) (21) 6123 3650
Fax: (86) (21) 6123 8800
Victor Jong
victor.yk.jong@cn.pwc.com

Additionally, we welcome you to visit our PricewaterhouseCoopers China website at <http://www.pwccn.com> or <http://www.pwchk.com> for practical insights and professional solutions to current and emerging business issues.