

China Legal Report*

April 2019



* CHINA LEGAL Report is a monthly review of Chinese law related topics gathered from various media and news services, edited by WENFEI ATTORNEYS-AT-LAW LTD. distributed to its clients and CHINA LEGAL Report subscribers.

WENFEI ATTORNEYS-AT-LAW LTD. does not accept responsibility for accuracy of quotes or truthfulness of content. CHINA LEGAL Report is not intended to provide advice.

Subject [Provisions of the Supreme People's Court on Several Issues Relating to Application of the Enterprise Bankruptcy Law](#)

I Introduction

II Content

III Conclusion

Provisions of the Supreme People's Court on Several Issues Relating to Application of the Enterprise Bankruptcy Law

I. Introduction

On March 27, 2019 the Supreme People's Court of the People's Republic of China published Provisions III on Several Issues Relating to Application of the Enterprise Bankruptcy Law ("Provisions III").

Compared to Provisions I on Several Issues Relating to Application of the Enterprise Bankruptcy Law published in September 2011, which focused on the issues of acceptance of bankruptcy cases, and Provisions II on Several Issues Relating to Application of the Enterprise Bankruptcy Law published in September 2013, which focused on the determination of the debtor's property, Provisions III puts emphasize on issues relating to the exercise of creditors' rights in the trial of enterprise bankruptcy cases. The promulgation of Provisions III offers clear rules on the scope of bankruptcy debts, creditors' rights, voting mechanism of creditors' meeting, and procedures of disposing of the debtor's material assets, etc. which will have a major impact on the allocation of property in bankruptcy cases.

II. Contents

1. Scope of Bankruptcy Debts

(1) Expansion of the Scope of Bankruptcy Expenses

According to Enterprise Bankruptcy Law, bankruptcy expenses are expenses that incur after the acceptance of a bankruptcy application by People's Court. Thus, previously incurred expenses were not included, which lead the result that these expenses would be paid off only after settlement of bankruptcy expenses and collective debts – if at that time, there was still money left to pay for such expenses.

However, the Provisions III stipulate, a company's compulsory liquidation expenses which are yet to be paid by the debtor, as well as the enforcement of expenses such as valuation expenses, safekeeping expenses and so on, arising from pending enforcement proceedings, may be paid out of the debtor's assets according to the order stipulated by the law. The order of debtor settlement is as

follows: bankruptcy expense and collective debts, before employees' wages and social insurance, before other insurance and tax, before bankruptcy creditor rights.

(2) Expansion of the Scope of Collective Debts

Furthermore, the scope of collective debts is expanded. Article 2 of the Provisions III stipulates that upon acceptance of a bankruptcy application, if the creditors' meeting has adopted a resolution, or approval of a People's Court is obtained prior to convening of the first creditors' meeting, the manager of a bankrupt enterprise ("manager") or debtor may borrow funds for continued operation of the enterprise. The creditor who provides the loan can assert that such loan has priority over unsecured creditors' rights in bankruptcy with reference to item (d) of Article 42 of the Enterprise Bankruptcy Law. Namely the debts have the same priority as the labor remuneration and social premiums incurred during after the acceptance of the bankruptcy, and should be paid out of the debtor's assets any time.

From the above information, one can conclude that the People's Court encourages enterprises to continue to operate by borrowing money even after entering into the procedure of bankruptcy rather than go bankrupt directly. Once the debtor enters the bankruptcy proceedings, the pressing issue to continue operation is the lack of funds. This provision stipulates that the financing provided to the debtor will be preferentially compensated with reference to normal debt, which will certainly attract more capital to pay attention to the bankruptcy market, so that those bankrupt enterprises which still have salvage value can hopefully obtain sufficient financial support.

(3) Exclusion of Interest and Late Payment

According to the Provisions III, claims out of late payment fines are not considered as bankruptcy debt, also not included are double deferred interests resulting from the debtor's failure to fulfil a legal effective instrument, and late payments of fine for social security premiums.

2. Creditors' Rights

To protect creditors' right, the Provisions III grant creditors the right to inspect the debts and other financial information. According to article 6 of the Provisions III, the bankrupt manager has the obligation to examine the nature, amount and secured assets of creditor's rights. He then has to formulate a statement of creditor's rights and submit it to the creditors meeting for verification. The debtor, the debtor's employees and other stakeholders have the right to inspect these materials.

Besides the protection of creditors' rights, article 10 of the Provisions III sets up a protection mechanism for single creditors, which gives each creditor the right to inspect the debtor's financial and business information and materials required for participation in the bankruptcy proceedings, including the debtor's assets status report, resolutions of creditors meetings, resolutions of the creditors committee, the manager's supervision report etc. If the manager refuses to provide such materials without a legal reason, the creditor may file a lawsuit.

The creditor's right to access the debtor's financial and operational information is not clearly defined in previous laws and regulations. The Provisions III clearly states that a single creditor has right to access the financial and operational information of the debtor. In addition, for the information involved in trade secrets, the creditors are not prohibited from accessing, but are subject to confidentiality obligations.

3. Voting Mechanism of Creditors Meeting

(1) Voting Methods

In order to save the expense, most enterprise managers will hold creditors meetings through off-site methods such as WeChat, written or online voting. The Provisions III clearly define the matters for off-site voting. According to article 11 of Provisions III, in addition to onsite voting, the resolutions of creditors' meetings may be voted via off-site methods such as correspondence, online voting and so forth, after the manager notifies the creditors beforehand by announcing the items of the agenda. If voting via off-site methods, the manager should notify creditors who have participated of results within three days from convening of the creditors meeting.

(2) Voting Member

According to Enterprise Bankruptcy Law, the creditors' meeting consists of creditors who declare credits according to law. Regarding group voting on draft restructuring plan pursuant to the provisions of Article 82 of the Enterprise Bankruptcy Law, Provisions III creditors or shareholders whose interests are adjusted or affected by the draft restructuring plan have the right to participate in voting.

This provision excludes creditors who are not affected by the reorganization plan from voting in order to promote the efficiency of enterprise restructure. However, there is no clear definition of whether "interests are adjusted or affected" and the interest of creditors might be easily damaged.

(3) Resolution Rules

The resolutions of a creditors committee adopt a simple majority of all committee members and must be recorded in minutes.

4. Dispose of the Debtors' Material Assets

The procedure of disposing the debtor's material assets is as follows:

(1) Plan and Vote

Article 15 stipulates, if disposing of the debtor's major property as stipulated in Article 69 of the Enterprise Bankruptcy Law, i.e. transferring land use rights, intellectual rights, houses, business and so forth. The manager has to formulate an asset management or price variation plan beforehand and submit it to the creditors meeting for voting; if the creditors meeting fails to accept, the dispose will be prohibited.

(2) Report to the Creditor Committee

Prior to asset disposal, the manager must submit a written report to the creditors' committee or a People's Court 10 days in advance. The creditors' committee has the right to require explanation for the disposal or relevant documents and evidence.

The purpose of setting out special regulations on disposing major property is to protect the creditors' rights. According to article 69 of Enterprise Bankruptcy Law, the manager is required to just report to creditors committee when disposing major property. While the Provisions III clearly state the right to dispose major property will be transferred to creditors' meeting.

III. Conclusion

The Provisions III directly and clearly respond to some problems existing in the application of the Enterprise Bankruptcy Law, which is helpful for the protection of the interests of creditors, and to the supervision of the loyalty of the manager to perform duties.

However, the new provisions on the reorganization procedure and the remedies for creditors are still imperfect. In particular regarding the bankruptcy issues of enterprise merger, the interference between the civil litigation enforcement procedures and bankruptcy procedures, the Provisions III are lacking specific provisions.

© Wenfei, Beijing, April 2019

Check the China Legal Briefing archives on: <http://www.wenfei.com/publications.html>

Obtain your personal subscription from: china@wenfei.com