

Restructuring and insolvency increase in China

Restructuring is becoming more common in China. **Jiuguang Zhao, Weiwei Gu, Yunjian Hou**, and **Jieyi Chen** of **Global Law Office** provide a guide to the key legal provisions

In recent years, the number of cases regarding restructuring and insolvency in China has increased. This is due to the policies to improve the business environment and deepen supply-side structural reform, as well as the impact of the Covid-19 pandemic.

More than 13,000 restructuring and insolvency cases were concluded in 2021, according to a work report of the Supreme Court. The number of creditors' rights involved in restructuring and insolvency cases is also dramatically increasing.

Recent cases in which we have participated include the reorganisation of Hainan Air Group in 2021. This is the largest reorganisation case so far, involving creditors' rights of over RMB 1,600 billion (\$240 billion), nearly six times of that in Tewood Group, the previous largest reorganisation case. Just two to three years before, a reorganisation case worth tens of billions was notable.

A series of laws and regulations have recently been published to respond to the growing demand for reorganisations. For example, many of the articles in the Civil Code of the People's Republic of China (PRC) and the relevant judicial interpretations, which came into effect in 2021, concerned restructuring and insolvency.

In August 2020, the first regulation relating to individual bankruptcy was issued in Shenzhen. Subsequently, a series of regulations have been issued in other provinces, such as Zhejiang, Jiangsu, and Shandong. Moreover, a number of other relevant regulations have been issued nationwide, covering a wide range of issues, including the promotion of efficiency, and preliminary reorganisation:

Framework

According to the Enterprise Bankruptcy Law of the PRC, when an enterprise legal person (debtor) cannot pay off its debts due and its assets are not enough to pay off the debts,



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Jiuguang Zhao is one of the first generation of lawyers to focus on the business of restructuring and bankruptcy in China.

Jiuguang has participated in a number of significant bankruptcy projects as administrator, investors' legal counsel, creditors' legal counsel. He has dealt with many litigation and arbitration cases that derived from or related to bankruptcy cases, many of which have been closely followed by the national or worldwide market.

For many years, Jiuguang has been recommended by a series of institutions, such as Legal 500, Asialaw Profiles, and Asia Law Business, in the fields of insolvency and dispute resolution.



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Weiwei has rich experience in connection with the area of insolvency and bankruptcy. He provides professional legal services such as consulting, training, and onsite supporting.

Weiwei has dealt with hundreds of cases in the area of commercial dispute resolution. He assists both multinational enterprises and well-known domestic enterprises, including IFC, Deutsche Bank, Standard Chartered, BNP, UBSS, CDB Capital, Lane Crawford, Tyco, Siemens, Samsung, Navistar, Boehringer-Ingelheim, Coach, Burberry, Bayer, Novartis, Petronas, Pentair, United Airline, Parker, and Sanofi-Aventis.

or it apparently lacks the ability to pay off its debts, it may, through judicial proceedings, undertake processes of bankruptcy liquidation, reorganisation, or compromise, to pay off its debts.

Bankruptcy liquidation

The debtor, its creditors, and (if an enterprise has been dissolved but has not started or completed liquidation) the person who has the responsibility for liquidation according to the law may make an application to the people's court for bankruptcy liquidation.

Bankruptcy liquidation is a procedure to dispose of and distribute the assets of the debtor. It will ultimately lead to the debtor's deregistration and loss of legal person status.

Reorganisation

The debtor or its creditors may apply to the people's court for reorganisation. A capital contributor whose capital contribution makes up one-tenth or more of the debtor's registered capital may also apply for reorganisation before the court declares the debtor bankrupt, on the condition that a creditor applied for bankruptcy liquidation.

The purpose of a reorganisation is to make certain arrangements in the form of a reorganisation plan, to help the debtor to get out of its business predicament and recover its operating ability.

Compromise

The debtor may apply to the people's court for compromise. If the debtor applies for

compromise, it shall submit a draft settlement agreement.

Compromise is a mechanism for the concession of creditors, with the aim of creating conditions for the debtor's recovery.

Preliminary reorganisation

In recent years, to reduce the cost and improve the success rate of reorganisation, in practice in many regions preliminary reorganisations have frequently been carried out.

There has been no statutory provision on the legislative level. However, in regions such as Beijing, Zhejiang, and Shenzhen, some regulations and instructions related to preliminary reorganisation have been published.

A preliminary reorganisation is a process to investigate the enterprise and to make preliminary reorganisation arrangements. These can be adopted in the later formal reorganisation, with the creditors and the relevant parties, by appointing a preliminary reorganisation administrator before the court's formal acceptance of a reorganisation.

Restructuring

In addition to the bankruptcy (and related) proceedings, some enterprises choose to resolve troubles out of court.

In these cases, the forms of restructuring are more flexible. All means allowed by law and agreed by the parties can be adopted, but without the protecting mechanism of bankruptcy. In some circumstances the difficulty is much greater than that in bankruptcy proceedings.

Processes and procedures

At the time of acceptance of the bankruptcy application:

1. Creditors' claims that are not due shall be deemed to be due;
2. Claims with interest accruing shall cease to accrue interest;
3. Repayment by the debtor to individual creditors shall be null and void;
4. The administrator is entitled to terminate or continue the performance of contracts that were not concluded by both the debtor and the other party;
5. Any preservation measure relating to the debtor's property shall be terminated;
6. Enforcement procedures against the debtor shall be suspended; and
7. Any civil litigation or arbitration relating to the debtor that has been commenced

but not yet concluded shall be suspended; such litigation or arbitration shall proceed after the administrator takes over the debtor's property.

During the period from the date when the people's court's decision to accept an application for bankruptcy is served on the debtor until the date when the procedure for bankruptcy is concluded, the legal representative of an enterprise, or (upon decision by the court) the financial managers and other business managers shall execute the following obligations:

1. Properly preserving the property, seals, account books, documents, etc. that are in their possession and under their management;
2. Proceeding with the work according to the requirements of the people's court and the administrator, and truthfully answering their inquiries;
3. Attending the creditors' meetings as non-voting participants and truthfully answering the creditors' inquiries;
4. Remaining at their domiciles, unless otherwise permitted by the people's court; and
5. Not taking up any post as director, supervisor, or senior manager in any other enterprise.

Reorganisation

In reorganisation cases, the creditors shall vote on the draft reorganisation plan in groups. The draft reorganisation plan is adopted when all the voting groups agree to adopt it.

Where there are still some voting groups that do not agree to adopt the draft reorganisation plan after two votes, the debtor or the administrator may apply to the people's court to approve the draft reorganisation plan if it complies with the following conditions:

1. According to the draft reorganisation plan, the secured claims have been paid in full with the particular property, it has been fairly compensated for the delay and its security right has not been materially impaired, or the corresponding voting group has agreed to adopt the draft reorganisation plan;
2. According to the draft reorganisation plan, employee-related claims and taxes have been paid in full, or the corresponding voting group has agreed to adopt the draft reorganisation plan;
3. According to the draft reorganisation plan, the repayment ratio of the common claims is not lower than the repayment ratio that



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Yunjian Hou focuses on the business of restructuring and bankruptcy in China. He has extensive practical experience in handling complex bankruptcy cases.

Yunjian has acted in a series of bankruptcy liquidation and reorganisation cases as principal of the administrator, and has represented creditors and investors. He has participated in many famous reorganisation cases, such as the reorganisations of HNA Group, Tewoo Group, Bohai Steel Group, and Yunnan Coal Chemical Industry Group.

For many years, Yunjian has been recommended by a series of institutions, such as Legal 500, Asialaw Profiles, and IFLR in the fields of insolvency and dispute resolution.

obtained according to bankruptcy liquidation when the draft reorganisation plan was reported for approval, or the corresponding voting group has agreed to adopt the draft reorganisation plan;

4. The draft reorganisation plan makes fair and impartial adjustments to the rights and interests of capital contributors, or the corresponding voting group has agreed to adopt the draft reorganisation plan;
5. The draft reorganisation plan fairly treats the members of the same voting group, and the prescribed order of repayment shall comply with the provisions of the law; and
6. The business plan is feasible.

Bankruptcy litigation

In bankruptcy liquidation cases, if a plan for management of the debtor's property or a plan for selling off the bankruptcy property into money is not adopted at the creditors'



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Jieyi Chen has extensive practical experience in handling complex restructuring and bankruptcy cases.

Jieyi has participated in many famous restructuring projects such as those of HNA Group, Wuyang Group, Huaxun Group, and Tengbang Group as investors' legal counsel and creditor's legal counsel. He has also represented a large number of litigation and arbitration cases derived from or related to bankruptcy cases that were closely followed by the market and resulted in successful judgments.

Jieyi has been recommended by a series of institutions such as IFLR in the field of debt restructuring.

meeting by a vote, the people's court shall make a ruling on the matter.

If a plan for the distribution of the bankruptcy property is not adopted after a second vote of the creditors' meeting, the people's court shall make a ruling.

If a creditor objects to the ruling rendered by the people's court, they may apply to the same people's court for reconsideration. Execution of the ruling shall not be suspended during the period of reconsideration.

From six months before the people's court accepts the application for bankruptcy, if a debtor cannot pay off their debts due and their assets are not enough to pay off all the debts, or they apparently lack the ability to pay off their debts, but choose to make repayment to specific creditors, the administrator has the right to request the people's court to nullify the application, except where such specific repayment is beneficial to the debtor's property.

“More bankruptcy courts will be established and practitioners will become more and more specialised.”

An administrator shall have the right to request the court to nullify any of the following actions taken within one year before the people’s court accepts the application for bankruptcy in respect of the debtor’s property:

1. Transferring the property free of charge;
2. Trading at an obviously unreasonable price;
3. Providing property guarantee to unsecured debts;
4. Paying off undue debts; or
5. Waiving credits.

The following actions taken in respect of the debtor’s property shall be deemed as invalid:

1. Concealing or transferring the property in order to avoid repayment of debts; and
2. Fabricating debts or acknowledging unreal debts.

According to the laws and regulations, after an application for bankruptcy is accepted:

1. Litigation costs involved in the bankruptcy case, expenses for management, realisation, and distribution of the debtor’s property, and expenses involved in the administrator’s performance of its duties and paid for its remuneration and expenses for the employees it recruited, are expenses for bankruptcy proceedings; and

2. Debts incurred from the following are common good debts: continuing to fulfil a contract, or spontaneous agency on the debtor’s property, or the debtor’s unjust enrichment, or remunerations for work and social insurance premiums payable to sustain the debtor’s business operations, or damages caused by the administrator’s or an employee’s performance of their duties, or damages caused by the debtor’s property.

Expenses for bankruptcy proceedings and common good debts shall be paid off with the debtor’s property at any time. The contractor’s claims on the prices of the construction project shall enjoy priority in being repaid with proceeds from project liquidation or auction.

Secured claims shall enjoy the priority in being repaid with the secured property. Claims shall then be paid off in the following order:

1. Employee-related claims;
2. Other social insurance premiums and taxes;
3. Common claims;
4. Subordinated claims.

Cross-border cases

To recognise and enforce judgments and decisions in insolvency cases rendered by foreign courts, the following conditions must be satisfied:

1. The judgment or ruling has become legally effective;

2. It involves the debtor’s property within the territory of the PRC;
3. Examination has been conducted in accordance with international treaties concluded or acceded to by the PRC or the principle of reciprocity;
4. It does not violate the basic principles of the laws of the PRC, and is without prejudice to national sovereignty, security, and public interests; and
5. It does not harm the legitimate rights and interests of creditors within the territory of the PRC.

Looking ahead

As the number of cases regarding restructuring and insolvency continues to increase, more bankruptcy courts will be established to handle bankruptcy cases centrally all over the country. Practitioners engaged in restructuring and insolvency in China will become more and more specialised.

With this continuing development, clients’ needs will become increasingly diversified and their demand for professionalism will become greater.

Finally, the legal system and supporting measures related to restructuring and insolvency will be improved continuously to promote the market-oriented, law-based, specialised, and information-based development of restructuring and insolvency work.