A comparative study of the corporate bankruptcy reorganization law of the U.S. and China
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6 Overall Comparison of US and Chinese bankruptcy reorganization law and practice, Conclusion

6.1 Overview of the US and Chinese bankruptcy reorganization Law

From the perspective of the reorganization decision-making mechanism, Chapter 2, 3 and 4 of this book analyze and compare the efficiency of the three major components of US and Chinese bankruptcy reorganization law, these being the plan-drafting system, plan-passing system and the reorganization-fostering system. The similarities and differences between US and Chinese bankruptcy reorganization law may be summarized as below.

In respect of the plan-drafting system, the two laws share the same feature in that they allow the qualified debtor to be a DIP and provide the DIP with an exclusivity period for proposing a plan. The DIP system combined with the exclusivity period reflects that both laws intend to establish a debtor-controlled decision-making mechanism in the plan-drafting process. Both laws have adopted measures for strengthening the non-debtor parties’ participation in the decision-making process and for restraining the DIP, such as the committee device, the judicial supervision over the length of the exclusivity period and the trustee device. The plan-drafting system of US and Chinese bankruptcy reorganization law differ in relation to the following aspects: a US debtor becomes a DIP by default, while a Chinese debtor must file an application to the court and get the court’s permission before becoming a DIP; under US law, a trustee is appointed to replace the debtor’s management only when the debtor’s management is too incompetent to be the controller and should be removed from possession, while under Chinese law, an administrator is always appointed for every case and the DIP’s business management is under the supervision of the administrator; under US law, the trustee is just a bankruptcy professional who replaces the incompetent debtor’s management,\(^6\) while under Chinese law, besides bankruptcy professionals, liquidation panels may be the administrator and government officials can influence or control the decision-making of specific reorganization cases through being members of the liquidation panel; US law allows

\(^6\) Brian A. Blum (2006), Bankruptcy and Debtor/Creditor: Examples and Explanations, Aspen Publishers, 4th Ed. , p. 110 (noting that the qualifications of a trustee include “honesty, impartiality, professional qualifications (such as a law degree or a CPA), and requirements of general competence and experience” according to the relative US laws).
plan-competition in cases where the debtor is replaced by a trustee, or where the DIP fails to propose a plan, or the plan proposed by the DIP fails to gain consensual acceptance within the exclusivity period, while under Chinese law, the non-debtor interested parties can never get the chance of proposing a plan and it is the business controller (DIP or the administrator) that has the right to propose a plan.\footnote{617}

The US and Chinese plan-passing systems are similar in that both systems require a draft plan to go through two steps, i.e. classified voting and judicial confirmation, before becoming effective. Both systems adopt the supermajority rule for class voting and both systems provide that the court may cram down a non-consensual plan if the plan meets with the cram-down requirements. The differences between the US and Chinese plan-passing system are quite prominent.

The US law provides the plan proponent the right to mold classification. The US law, on the one hand, requires that the claims being put into one class should be substantially similar, on the other hand, it does not mandate that claims that are substantially similar should be put into one class. The Chinese law adopts a rigid classification method by putting all the claims into five classes, these being secured claims, employee claims, tax claims, general unsecured claims and shareholders’ claims. Under US law, all classes have the right to vote while unimpaired classes are deemed to accept the plan and classes receiving nothing are deemed to reject the plan. Under Chinese law, creditors always have the voting right and shareholders can vote only when the plan involves an adjustment of the shareholders’ interest. Compared with the US plan-confirmation requirements, the Chinese plan-confirmation requirements are too general and loose. With respect to a consensual plan, Chinese law just requires the court to check whether it is in conformity with the law and does not state any detailed tests. By contrast, US law contains detailed general confirmation standards, such as the best-interest test and the feasibility test etc. for the confirmation of both consensual and non-consensual plans. With respect to the cram down of non-consensual plans, the EBL contains certain requirements that are too loose compared with the US cram down requirements. The most prominent defect of the Chinese cram-down requirements is the lack of complete provision on the absolute priority rule. On the whole, compared with the US plan-passing system, the

\footnote{617 Please refer to Chapter 3 for a detailed comparison and analysis.}
Chinese plan-passing system is problematic in the respect of classification, shareholders’ voting right, the general confirmation requirements and the cram-down requirements, which may cause inefficient elements.\(^{618}\)

In order to foster the collective reorganization efforts, both US and Chinese bankruptcy reorganization law contain reorganization-fostering systems, the most prominent being provisions on the automatic stay and post-petition financing. While the protection of creditors’ interest under the US automatic stay system is recognized as being inadequate, the protection of creditors’ interest under the Chinese automatic stay system is even weaker. Under Chapter 11, although time-value compensation to secured creditors as a general principal is rejected, over-secured creditors may receive post-petition interest for the delay under the automatic stay and the total amount of the compensation is limited to the value of the collateral in excess of the secured claim. The EBL fails to provide time-value compensation to secured creditors for the delay caused by the automatic stay. With respect to the protection of secured creditors’ interest, the EBL only contains one provision, which says that a secured creditor may apply for a relief from the stay if there is a risk of a decline in the collateral’s value that is big enough to affect the secured creditors’ interest. However, it is unclear what risk constitutes the eligible risk for a relief. For instance, if the value of the collateral exceeds the amount of the secured claim, i.e. there is an equity cushion in the collateral, then does the risk of a decline in the value of the cushion but not in the part of the collateral’s value equal to the principal amount of the secured claim constitute a valid basis for relief from the stay? Compared with US law, the EBL fails to provide that a secured creditor may apply for relief from the automatic stay where the collateral is not necessary for an effective rehabilitation and the debtor has no equity in the collateral. While US law offers the debtor the opportunity of providing “adequate protection” in exchange for keeping the collateral under the automatic stay, Chinese law does not contain such a rehabilitation-fostering element.

The US post-petition financing system helps the debtor in attracting post-petition financing by providing special priority to the post-petition lenders. By contrast, the Chinese post-petition financing system does not offer the debtor so much special help in acquiring new finance.

\(^{618}\) Please refer to Chapter 4 for a detailed comparison and analysis.
since it does not provide the post-petition lenders with special priority. Compared with US law, Chinese law is less powerful in helping the debtor to attract new finance. However, Chinese law keeps the pre-bankruptcy creditors’ interest from being materially influenced by post-petition financing and limits inefficient post-petition financing.619

6.2 Overview of the US and Chinese Bankruptcy Reorganization Practice

6.2.1 The Control Model in US and Chinese Bankruptcy Reorganization Practice

6.2.1.1 The Control Model in US Bankruptcy Reorganization Practice

US bankruptcy reorganization practice is generally divided into two phases: the debtor-controlled phase and the DIP-lender-controlled phase. In the 1980s and early 1990s the debtor quickly seized upon the super protection offered by Chapter 11. The number of reorganization cases increased dramatically.620 During the reorganization case, the debtor could stiff-arm creditors, drag out the cases for inordinate periods of time until they forced out settlement from creditors. The practice of Chapter 11 in the early stage of its application is commonly summarized being a long, costly procedure.621 From late the 1990s, the practice of Chapter 11 has changed dramatically and Chapter 11 has entered into a new era of secured creditors’ control, to be more exact, DIP lenders’ control.622 DIP lenders’ control stems from the special US DIP financing system, which provides the post-petition financiers with super protection and induces an active DIP financing market.623

The development process of the DIP lenders’ control may be summarized as below. During the bitter period of being oppressed by the debtor at the early stage of Chapter 11’s application, secured creditors quickly “found the holes and handles in chapter 11 and have

619 Please refer to Chapter 5 for a detailed comparison and analysis.
used them to their advantage.” The most prominent handles have been found in DIP financing and § 363 sale. Since Chapter 11 has made the debtor’s managers the controller of the decision-making, Secured creditors created their own way of control—achieving control of the reorganization decision-making by controlling the debtor’s managers. A debtor in financial distress is often in dire need of new capital. DIP lenders, while providing new finance to the debtor, restrain the decision-making actions of the debtor’s management by the oppressive provisions of DIP financing contracts. The DIP lenders’ control over the reorganization often results in using the Chapter 11 as a procedure for selling all or virtually all of the debtor’s business before the confirmation of a plan under § 363 of Chapter 11.

In contrast to the universal critics of Chapter 11 in the era of debtor control, in the era of DIP lender control, Chapter 11 has been praised. It is commented that because of the DIP lenders’ control, Chapter 11 reorganization is no longer the long, expensive process that depletes the debtor’s value, but is a swift, market-driven process that quickly moves the assets of troubled firms into more capable hands. Some scholars worried that the DIP lenders, while pursuing their self-interest, may influence the debtor to deviate away from the direction of maximizing its overall value.

To summarize, the US law established a debtor-controlled decision-making model. In the

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625 See Section 5.2.1.3 for the discussion of the control of DIP lenders.
early stage of the practice of Chapter 11, the debtor did control the decision-making. However, from the late 1990s, creditors have learned to achieve control through becoming the DIP lenders and controlling the DIP by oppressive DIP financial contractual terms. The US practice reveals that although bankruptcy law may provide controlling leverage to a certain party, the market parties’ natural bargaining leverage, such as their possession of the cash that is necessary to the debtor’s rescue, plays a significant role in the decision-making of bankruptcy reorganization. Bankruptcy reorganization law may respond to the practice and provide restraining measures that prevents the capable market parties, such as the DIP lenders, from using its bargaining leverage in a way that is not in line with the maximization of the debtor’s overall value.

6.2.1.2 The Control Model in the Chinese Bankruptcy Reorganization Practice

While the current US bankruptcy reorganization law has been operating for more than thirty years and has shown two different stages in its practice, Chinese bankruptcy reorganization based on a market economy is still at an early stage since the current Chinese bankruptcy law has been operating for less than four years. With respect to the control model of bankruptcy reorganization, Chinese bankruptcy reorganization law adopts the debtor-controlled model as the main model. Although the legislators intended to adopt a debtor-controlled model, in practice, the government’s control is quite significant in the reorganization of listed corporations. Recall that the SPCS provides that in some cases, the court may appoint a liquidation panel, which is mainly constituted by government officials. By allowing the court to appoint a liquidation panel as the bankruptcy administrator for a reorganization case, Chinese law provides a legal way for the government to exert control in special bankruptcy cases.

While it is understandable that certain qualified bankruptcy professionals, such as lawyers and accountants, maybe be legally allowed to serve as bankruptcy trustee, it is very special that Chinese law allows the liquidation panel to be the bankruptcy trustee. The discussions at a

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630 The EBL had been operating for less than four years by the time the author wrote this Chapter (February, 2011), since it came into effect on June 1, 2007
631 See Section 3.2.2.1.
632 Article 18 of the SPCS. See part (2) of Section 3.2.1.1 for a detailed discussion of the appointment of the liquidation panel as the administrator.
seminar, which was held by the Supreme People’s Court, and the Listed Corporation Supervision Department and Law Department of the China Securities Regulatory Commission in October 2007, provides a valuable indication of the reason why the liquidation panel was provided as a special kind of administrator. At the seminar, the dominant opinion was that keeping the liquidation panel as a kind of administrator was a pragmatic solution based on the practical situation of China. There were three main reasons for allowing the government to participate as the administrator.

First, since most of the listed corporations in China are SOEs with the state as the controlling shareholder, the bankruptcy reorganization of SOEs involves special problems, such as how to deal with the state-owned assets, how to solve the problems accompanying a great amount of jobless workers etc., which can not be solved without the participation of the government.

Second, bankruptcy reorganization often involves a reduction of creditors’ claims. The cancellation of the state-owned bank’s credit should be approved by the risk management department of the bank’s headquarter. Only certain government agencies or officials may have the capacity and influencing power to negotiate with the risk management departments of the state-owned banks. Without the government’s participation, it is difficult to reach a compromise with the state-owned bank concerning the reduction of the debt.

Third, bankruptcy reorganization often needs new finance. In order to attract a new financier, the local governments often provide some preferential treatments in relation to tax or land-use rights etc. The preferential treatment needs government’s approval and thus justifies the government’s participation.

When one takes the rule of law as a given, the reasons mentioned above, such as the treatment of the state-owned shareholders’ interest, the settlement of workers, the reduction of 633

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state-owned bank creditors’ claims, preferential treatment of the new investors, may all be solved according to the relevant legal rules instead of by the government’s special help. However, China is still in a transitional period, during which China needs to transfer its old political management system to the rule of law and change its planned economy to the market economy. The rule of law and a developed market based on the rule of law has not yet been established in China. In this transitional period, the market parties involved in bankruptcy reorganization can not solve some problems without the government’s help and thus there arises the need for the government’s participation. The opinion the Supreme People’s Court—the legislator of the SPCS, reveals the legislative rationale of the provisions on the liquidation panel: Chinese bankruptcy reorganization law has to allow the government to participate or even take control in some special bankruptcy reorganization cases if in these cases many important problems can not be solved simply according to the law and can only be solved by negotiation between different governments or with the approval of a specific government agency.

In addition to the legal provisions on the liquidation panel, the lack of judicial independence contributes to the government’s control. China is still its way towards the complete establishment of the rule of law. In China, the judicial power is not completely independent of the administrative power. Against this background, although item (iv) of

635 In March 1999, Article 5 of the Constitution of the People’s Republic of China was amended to include the principle of “governing the country according to law and establishing a socialist, rule of law country”. However, it takes time to achieve the rule of law and China is still on the march to the rule of law. See e.g., Randall O. Peerenboom, China’s Long March Toward Rule of Law (2002); Yingyi Qian & Jinglian Wu, China’s Transition to a Market Economy: How Far across the River?, available at http://cenet6.nsd.edu.cn/userfiles/2009-9-16/20090916234149833.pdf, accessed on October 1, 2010.

636 “The market is not fully developed in the transition period. The less developed market provides justification for government interference. The implementation of the [bankruptcy] Law lacks an open and transparent market. The backward market provides very narrow room for the market intermediaries and professional practitioners to participate in bankruptcy cases. Since many problems to be solved in bankruptcy cases are not simply market issues, to transfer the control of the cases to those market intermediaries and professionals might instead aggravate the difficulty and costs of the case.” Shuguang Li and Zuofa Wang (2010), China’s Bankruptcy Law after Three Years: The Gaps Between Legislation Expectancy and Practice and the Future Road (Part Two), 7 Intl’l Corp Rescue 371, p. 379.

Article 18 of the SPCS provides that the court may designate the liquidation panel as the administration where the court deems proper. One may suspect that whether it is proper to involve the government in the reorganization of a specific corporation is not independently judged by the court. The fact that a liquidation panel is designated by the court as the administrator serves as an indication that the government wants to control the decision-making in a particular case.

To conclude, the legal provisions that allow a liquidation panel to be the administrator, combined with the government’s influence over the judicial power, provides a government-controlled model that is used in cases where the government wants to ensure a certain result.

In practice, the liquidation panel has been commonly designated as the administrator in the reorganization of listed corporations. The author found that 18 listed corporations entered into the bankruptcy reorganization procedure and came out with a confirmed plan during the twenty four months after the effective date of the EBL. In 17 cases, the administrator was a liquidation panel. Moreover, it is worth noting that in cases where a liquidation panel was appointed as the administrator, it was the administrator, i.e. the liquidation panel, rather than the DIP that controls both the business management and plan formulation. As discussed above, the appointment of a liquidation panel as the administrator may be taken as a sign that the government wants to control the process to ensure a certain result in a reorganization case. Some bankruptcy experts commented that the government has been dominant in the reorganization of listed corporations.

Since the court does not publish the details of tried cases, authentic documents revealing the role of the liquidation panel and the government can not be found. The stories reflected by the public media and some scholar’s articles about the reorganization of Jiufa Edible Fungi Co.,

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638 Since China does not have legal provisions that require mandatory public disclosure of the tried cases, the author collected information concerning the reorganization cases of listed corporations from the public notice on the website of the Shanghai Stock Exchange and the Shenzhen Stock Exchange in order to get a clear view of the practice of the EBL. The author cannot guarantee that the list is exhaustive.

639 See Appendix A.

640 See Appendix A.

Ltd. ("Jiufa") and East Star Airline Co. Ltd. ("ESA") shed some light on the government’s controlling role in a bankruptcy reorganization. Newspaper and internet articles reveal that the local government regarded Jiufa as an important listed corporation. The local government contacted potential new financers, and sent the court a paper named “Letter on the Feasibility of Bankruptcy Reorganization of Jiufa Corp. Ltd.” ("the feasibility letter"), which stated: because no listed corporations located in Shandong province had been delisted, the bankruptcy and delisting of Jiufa would damage the financial image and overall image of the province and the local government and the government was determined to rehabilitate Jiufa. According to the story in the public media, government had chosen the reorganizer of Jiufa before the reorganization case was initiated and the public auction of the shares of the controlling shareholder was organized in such a way that the government ensured that certain investors would win the auction and become the new controlling shareholder and reorganizers of the debtor. While the story of Jiufa tells how the government could foster the rehabilitation of a specific corporation, the story of East Star Airline Limited Corporation ("ESA") indicates how the government could obstruct the rehabilitation of a corporation. ESA, a privately owned airline, was once highly profitable but became financially distressed in 2008. After ESA entered the liquidation procedure upon the application of one creditor, Wuhan Intermediary People’s...

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642 The author wants to emphasize that the information in the story of Jiufa and ESA discussed in the following three paragraphs, as shown in the footnote, is mainly from newspapers and websites, which is not as authentic as the material officially published by the authentic institutes, such as the court, the Securities Exchange, or the relevant government department. The author has endeavored to collect information from the comparatively influential and large newspapers and websites in China. In China the law dictates that the public media, i.e. newspapers and websites, and the authors of the articles published by the public media must provide true information; they have to take legal responsibility for any false reports, which helps to ensure the reliability of the information revealed by these public media.

643 This is supported by newspaper articles. There are no further details available. In general practice, the bid deposit is 10% to 20% of the expected market price of the object under auction. In Jiufa, the bid deposit was RMB 100 million (information from the website article). The final price in the auction was about RMB 15,918,980.50 (revealed in the public notice No.2008-072 of Jiufa at the website of Shanghai Securities Exchange), which means that the bid deposit was higher than 6 times of the auction price. This is supported by newspaper articles. There are no further details available. In general practice, the bid deposit is 10% to 20% of the expected market price of the object under auction. In Jiufa, the bid deposit was RMB 100 million (information from the website article). The final price in the auction was about RMB 15,918,980.50 (revealed in the public notice No.2008-072 of Jiufa at the website of Shanghai Securities Exchange), which means that the bid deposit was higher than 6 times of the auction price.
Court accepted the bankruptcy case and designated a liquidation panel as the administrator. The ESA’s controlling shareholder and some of the ESA’s creditors, one after another, applied the case to be converted from a liquidation procedure into a reorganization procedure. The applicants presented several draft reorganization plans to the court in order to support their reorganization petition and to prove the viability of ESA. The trial court denied all the reorganization petitions on the basis that the debtor lacked viability and the draft plans were not feasible. The newspaper articles reflected that at the court hearing on whether to convert the case to a reorganization procedure, the administrator insisted that the debtor lacked viability and the draft plans were not feasible and that the government’s favor of the big state-owned enterprise, i.e. Air China Ltd., was one of the factors that led to the death of the ESA.

A Chinese scholar commented that the court did not apply the law properly since the EBL requires procedural instead of substantive examination for the initiation of a reorganization procedure. In the author’s opinion, the court in the case of the ESA acted contrary to Chinese bankruptcy law in requiring the shareholders and creditors to provide a feasible reorganization plan at the time of the reorganization petition as described by the public media, since feasibility is provided in Article 87 of the EBL as a standard against which the court...

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645 索佩敏（Peimin Suo），《破产管理人铁心清算东星 中航油坚持重整》（Bankruptcy Administrator Determined to Liquidate the East Star, CNAF Insisting on Reorganization），上海证券报（Shanghai Securities News），2009年7月13日（July 13, 2009），available at [http://paper.cnstock.com/html/2009-06/25/content_71017852.htm](http://paper.cnstock.com/html/2009-06/25/content_71017852.htm), accessed on September 6, 2010. CNAF is the abbreviated name of China National Aviation Fuel Group Corp. Ltd. and was said to be the biggest creditor of the ESA.
646 叶晓红(Xiaohong Ye), 《重整申请的困惑——屡败屡战的东星航空重整申请之路》(“Confusions concerning the Bankruptcy Reorganization Application—the East Star Airline’s repeated fight for Rehabilitation Opportunity after repeated defeat”), 公司法评论(Company Law Review)，第10卷(Vol. 10), 418-9.
647 Id, at 418-25.
648 索佩敏（Peimin Suo），《破产管理人铁心清算东星 中航油坚持重整》（Bankruptcy Administrator Determined to Liquidate the East Star, CNAF Insisting on Reorganization），上海证券报（Shanghai Securities News），2009年7月13日（July 13, 2009），available at [http://paper.cnstock.com/html/2009-06/25/content_71017852.htm](http://paper.cnstock.com/html/2009-06/25/content_71017852.htm), accessed on September 6, 2010. CNAF is the abbreviated name of China National Aviation Fuel Group Corp. Ltd. and was said to be the biggest creditor of the ESA.
649 毕舸（Bi Ke），从东星航空破产看“国进民退”（Discerning the Advance of the State and the Retreat of the Private from the Liquidation of the ESA），上海证券报（Shanghai Securities News），2009年8月28日第6版（August 28 of 2009, Page 6）.
650 叶晓红(Xiaohong Ye), 《重整申请的困惑——屡败屡战的东星航空重整申请之路》(“Confusions concerning the Bankruptcy Reorganization Application—the East Star Airline’s repeated fight for Rehabilitation Opportunity after repeated defeat”), 公司法评论(Company Law Review)，第10卷(Vol. 10), 418-425.

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should examine the plans to be crammed down.\textsuperscript{651}

It should be noted that the government is not the controlling party of every bankruptcy reorganization case. In cases where the government has no interest in controlling the decision-making process, the administrators were not liquidation panels, but professionals, such as accounting firms and/or law firms. Nevertheless, even if the administrator is not a liquidation panel, the government might still provide support for the rehabilitation. For instance, in the reorganization of five solely foreign-owned enterprises in the city of Changshu, all subsidiaries of one foreign corporation, the administrator was Jiangsu Zhuhui Law Firm and was the controller since the administrator controls both the business management and plan-drafting.\textsuperscript{652}

To summarize, the EBL provides a debtor-controlled model. In addition, the SPCS, by allowing the liquidation panel to be the bankruptcy administrator, opens the way for government control. In practice, based on the fact that the judicial power is still not separated from the administrative power, the government may become the controller in cases where the government intends to achieve a certain result, especially in the reorganization case of big listed corporations. In the author’s opinion, the adoption of a liquidation panel as a kind of bankruptcy administrator in Chinese bankruptcy legislation and the government’s control of

\textsuperscript{651}The EBL contains three articles concerning the initiation of a reorganization procedure. Article 3 provides that the debtor may apply to the court for reorganization when there is obvious probability of losing payment ability. Article 70 provides that where the creditors apply for the liquidation of the debtor, shareholders holding more than 10% of the registered capital of the debtor may file an application for reorganization after the court accepts the case and prior to the court’s declaration of the insolvency. Article 71 provides that the court, if after examination, deems that the application is in conformity with the law, shall rule to reorganize the debtor. To summarize, the EBL does not provide any substantial conditions that a case shall satisfy for the purpose of entering into reorganization. In the author’s opinion, the examination made by the court should be mainly a procedural one, as it is almost impossible for the judge, who is not well equipped with business knowledge and expertise, to do the essential business judgment on the viability of the debtor in a short time. This should be further clarified by supplementing legislations in order to make sure that the court does not abuse its discretionary power in permitting the initiation of a reorganization procedure.

\textsuperscript{652}The five enterprises were Chanshu Kehong Material Tech Corp. Ltd., Chanshu Xingyu Xinxing Construction Material Corp. Ltd., Chanshu Xingdao Xinxing Construction Material Tech Corp. Ltd., Chanshu Xinghai Xinxing Construction Material Tech Corp. Ltd., Chanshu Changgang Bancai Corp. Ltd., generally called as the “科宏系(Kehong Series)”. 丁国锋（Guofeng Ding）, 《国内最大一起企业破产重整案前幕后》（The Front and the Back of the Big Reorganization Case），法制日报（Legal Daily），2009年9月16日第004版（September 16 of 2009, page 004）。In the reorganization of the foreign-invested enterprise, Jiatong Sci-Tech (Suzhou) Corp. Ltd., the administrator was Jiangsu Wuzhou Law Firm and Anyong Huaming Accounting Firm. 张帅（Shuai Zhang）, 《从400亿中“重生”》 (“Rehabilitation” from the Big Deficit of 400 Million），苏州日报（Suzhou Daily），2009年12月20日第A03版（December 20 of 2009, Page A03）。
some bankruptcy cases in Chinese bankruptcy practice is a phenomenon in the transitional period from the planned economy to the market economy and should phase out with the development of the market economy and the perfection of the rule of law.653

6.2.2 The Time Length to a Confirmed Plan, Confirmation Rate, Consummation Rate in US and Chinese Reorganization Practice

6.2.2.1 The Time Length to a Confirmed Plan, Confirmation Rate, Consummation Rate in US and Chinese Reorganization Practice

When it first came into effect Chapter 11 was criticized for the length of its procedures. Now procedures under Chapter 11 are considered to be swift procedures compared with the early practice.654 With respect to Chapter 11’s early practice, Lopucki’s study showed that debtors who got a confirmed plan in the Madison Division of the Western District of Wisconsin in 1987 and 1988 were in Chapter 11 for a median time of 17.5 months;655 Jesen-Conklin studied all Chapter 11 cases filed in the year from 1980 to 1989 in the U.S. Bankruptcy Court for the Southern District of New York located at Poughkeepsie (“Poughkeepsie Study”) and found that the average time for plan confirmation was about 22.04 months.656 Warren and Westbrook made a study on the late practice of Chapter 11. They studied the cases filed in 1994 and 2002 and found that the median time used for confirmation of a plan was about 9 months.657 How long does it take for a Chinese debtor to reach a confirmed plan? Empirical study of the 18 cases showed that on average, the time period used by a Chinese listed corporation to reach a confirmed plan was 105 days.658 Therefore, compared with the US cases, reorganization procedures under Chinese law are very short.

With respect to the confirmation rate, the US empirical studies showed a low confirmation in

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653 See Shuguang Li and Zuofa Wang (), See Section 3.2.6.4 for the reform suggestion concerning the liquidation panel and government’s participation in bankruptcy.
658 See Appendix D: Time length of the in the bankruptcy reorganization of 18 listed corporations.
the reorganization of all kinds of corporations and a high rate for large, publicly held corporations. According to the FICS (Fee Information and Collection System) database, 26% of the cases filed between 1989 and 1995 ended up with a confirmed plan.\footnote{Two percent of the cases remained open as of December 1, 1997.} Jesen-Conklin found in the Poughkeepsie Study that the confirmation rate was about 17.3%;\footnote{Susan Jensen-Conklin (1992), Do Confirmed Chapter 11 Plans Consummate? The Results of a Study and Analysis of the Law, 97 Com. L. J. 297, pp. 316-25.} Warren and Westbrook studied the cases filed in 1994 and 2002 and found the respective confirmation rate was 30.3% and 33.4%.\footnote{Elizabeth Warren and Jay Lawrence Westbrook (2009), The Success of Chapter 11: A Challenge to Critics, 107 Mich. L. Rev. 603, p. 611-5.} LoPucki and Whitford studied the reorganization cases filed after the effective date of the Current US bankruptcy Code (Oct. 1, 1979) and before March 15, 1988 by publicly held companies reporting at least $100 million in assets at filing and found that the confirmation rate was about 96%.\footnote{Lynn M. LoPucki and William C. Whitford (1993), Patterns in the Bankruptcy Reorganization of Large, Publicly Held Companies, 78 Cornell L. Rev. 597, p. 600.} With respect to the consummation rate, Jesen-Conklin’s Poughkeepsie Study showed that about 58% of the confirmed plans were consummated.\footnote{Susan Jensen-Conklin (1992), Do Confirmed Chapter 11 Plans Consummate? The Results of a Study and Analysis of the Law, 97 Com. L. J. 297, pp. 316-325.} What is the confirmation rate and consummate rate in China? The empirical study of the reorganization of 18 listed corporations showed that the confirmation rate was 100%. In China, the debtor is in charge of the implementation of the confirmed plan and the administrator supervises the implementation of the confirmed plan.\footnote{The EBL, Art. 89; 90.} The administrator should file a report to the court on the supervision of the implementation of the confirmed plan when the supervisory period expires.\footnote{The EBL, Art. 91.} If a debtor fails to carry out the plan, the court should make a ruling terminating the implementation and convert the case to liquidation procedure.\footnote{According to Article 93 of the EBL, if the debtor fails to or does not implement the plan, the court shall, upon the application of the administrator or the interested parties, rule to terminate the implementation and declare the bankruptcy of the debtor. On the study date, i.e. February 15, 2011, 16 plans had been consummated. Baoshuo failed to carry out its plan within the time period stipulated in the plan and its controlling shareholder was taking efforts for achieving a successful implementation of the plan. Pianzhuan was still in the process of implementation.} In practice, when the debtor fulfills the debt-payment obligation contained in the confirmed plan, the administrator files a report to the court to this effect and the court makes a ruling which confirms that the debtor has fulfilled its debt-payment obligations in the
confirmed plan, that the debtor has no legal obligation to pay the debt reduced by the plan and that the administrator’s supervisory duty is terminated.\textsuperscript{667} Based on the information concerning the court’s ruling on the debtor’s fulfillment of the debt-payment obligations disclosed by the listed corporations, the consummation rate was 100%.\textsuperscript{668} Therefore, the comparison showed that the confirmation rate and consummation rate in China is high. In addition, the author found that the average time used for plan consummation is 238 days.\textsuperscript{669} It is unfortunate that the author failed to find any empirical study result concerning the time used for consummation of confirmed Chapter 11 plans.

6.2.2.2 Exploring the factors contributing to the prominent features of Chinese reorganization practice

What factors have contributed to the short time period used for reaching a confirmed plan, the high plan-confirmation rate and high plan-consummation rate in Chinese bankruptcy reorganization practice? The author suspects that the possible reasons are EBL’s loose plan confirmation requirements as compared to the US plan confirmation requirements, the most prominent being the loose feasibility test, the lack of the best-interest test and the lack of absolute priority rule. A detailed analysis is below.

(1) Exploring the factors contributing to the short time period used for reaching a confirmed plan and the high plan-confirmation rate in Chinese reorganization practice

As discussed in Chapter 4, the EBL does not require a consensual plan to be checked against the standards of the feasibility test and the Chinese courts have adopted very loose standards when applying the feasibility test in the cram down stage. Thus, in a Chinese reorganization case, a plan, whose operation scheme fails to meet with the US feasibility test, can be confirmed by the Chinese court. The empirical study of the 18 cases showed that none of the 18 confirmed plans contained an operation scheme that met with the US feasibility test.\textsuperscript{670} Moreover, the EBL’s loose confirmation requirements lead to the result that a Chinese plan may be confirmed without some valuations that are a necessary in relation to a US confirmed

\textsuperscript{667} See the public notices disclosing the court’s ruling of the termination of the implementation of the confirmed plan in Appendix D.
\textsuperscript{668} See Appendix D.
\textsuperscript{669} See Appendix D.
\textsuperscript{670} See Section 4.2.2.3 and Appendix C.
plan. The EBL differs from Chapter 11 in that it does not adopt the best-interest-test as a general confirmation requirement, nor does it contain the absolute priority rule as a cram-down requirement. These differences lead to the result that a Chinese plan can be confirmed without providing a convincing valuation of the debtor’s liquidation value, reorganization value, the distribution to the objecting claimholder of an assenting class, and the distribution to an objecting class and some relevant classes, which a US confirmed plan in a similar case must provide.\(^{671}\) In the US, even if a plan has gained consensual acceptance of the voting classes, if it is objected to by any claimholder of an assenting class, the plan needs to include a calculation of the debtor’s liquidation value, reorganization value and the value of the distribution to the objecting claimholder under liquidation and reorganization in order to prove that it passes the best-interest-test.\(^{672}\) However, under the EBL, a consensual plan does not need to prove the objecting members of a consenting class receive no less than what they would receive under a hypothetical liquidation since there is no best-interest-test for the confirmation of a consensual plan.\(^{673}\) In the US, a non-consensual plan must calculate the debtor’s reorganization value and the value of the distribution to the objecting classes and the other relevant classes in order to prove that it passes the fair-and-equitable-test, which contains the absolute priority rule.\(^{674}\) By contrast, in China, a non-consensual plan does not always need to provide the exact amount of the present value of the reorganized debtor and the distribution to the objecting classes because of the lack of a complete provision on the absolute priority rule. In a Chinese case, if the plan proponent of a non-consensual plan can prove that the dissenting classes of secured claims, and/or tax claims and/or employee claims receive full payment and the dissenting class of general unsecured creditors receive more than what they would receive under liquidation without a calculation of the debtor’s reorganization value, the plan may still be crammed down.\(^{675}\) For instance, if the payment to the dissenting class of general unsecured creditors under liquidation is expected to be 5%, a plan which provides the dissenting class of unsecured claims with 5% cash payment and shares of the

\(^{671}\) See Section 4.1.2.2 for the valuations required by the best-interest-test; See Section 4.1.2.4 for the valuations involved in cram down.

\(^{672}\) See Section 4.1.2.2 for the valuations required by the best-interest-test in a Chapter 11 case.

\(^{673}\) See Section 4.2.2.3.

\(^{674}\) See Section 4.1.2.4 for the valuations involved in Chapter 11 cram down procedure.

\(^{675}\) See Section 4.2.2.3.
reorganized debtor meets with the cram-down requirement and there is no need to calculate the value of the shares or the debtor’s reorganization value.

The study of the 18 cases shows that although there is no mandatory valuation requirements on a consensual plan, influenced by the cram-down requirements, most plans (13/18) provided a comparison of the payment to the class of general unsecured creditors under the hypothetical liquidation and the plan. However, most plans (12/18) avoided valuation of the reorganized debtor and still achieved the goal of proving that general unsecured creditors receive more than what they would receive under hypothetical liquidation.

It should be noted that even when a Chinese plan touched upon the valuation of the reorganized debtor, the valuation is rough and simple in comparison to the US practice.

Among the 18 plans, 6 plans, i.e. the plans of Jiufa, Huayuan, Qinling, Xiaxin, Shentai and Beisheng, used the debtor’s shares to pay general unsecured creditors and touched upon the pricing of the share of the reorganized debtor in an attempt to estimate the value of the shares distributed to unsecured creditors. For the purpose of calculating the value of the shares of the reorganized debtor, the plan of Jiufa, Huayuan and Qinling used the closing price of the debtor’s share on the day before the trade suspension of the debtor’s shares. The plan of Xiaxin and Shentai used the average of the price of the shares within a certain period that was near the date of the plan-confirmation as the price of the shares of the reorganized debtor.

To summarize, 5 of the 6 plans, i.e. the plan of Jiufa, Huayuan, Qinling, Xiaxin, and Shentai, adopted the debtor’s pre-reorganization share price as the price of the reorganized debtor without stating the reason for such a method. It is noticeable that by adopting the price of the debtor’s shares just before the debtor’s reorganization as the price of the reorganized debtor, these five plans neglected the difference between the debtor’s value before and after reorganization. In contrast, the plan of Beisheng, showed a special notice to this difference. However, it simply stated that “taking into consideration of factors such as the asset

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676 See the column of “Hypothetical Liquidation Payment Ratio to General Unsecured Creditors” in Appendix B.
677 E.g., the plan of Huayuan and the plan of Qinling used this standard. See Jiufa’s Public Notice NO. 2008-068 and 2009-079; Huayuan’s Public Notice 2008-12-07 and Qinling’s Public Notice No. 2009-053.
678 E.g. the plan of Xiaxin and the plan of Shentai used the average of the prices of the debtor’s share in the 20 days before the trade suspension of debtor’s share. See Xianxin’s Public Notice No. 2009-044 and Shentai’s Public Notice issued on May, 8, 2010.
investment in the future and the increase of the shares, the price of each share is determined as RMB 3.0\textsuperscript{t}.\textsuperscript{679} Thus the plan of Beisheng failed to discuss in detail how the debtor’s reorganization valuation is calculated and why the valuation is reasonable for the case. In contrast, in US bankruptcy practice, valuation takes place in a more meticulous way. In a US case, at the stage of plan confirmation, the propriety of the valuation is the center of debate since valuation provides the foundation for judging whether the plan passes the best-interest test and complies with the absolute priority rule.\textsuperscript{680} A plan proponent in a US case should at least provide valuation based on one proper method and sometimes provides competing valuations based on several applicable methods in order to provide a convincing valuation.\textsuperscript{681} Thus, compared with a Chinese plan proponent, a US plan proponent needs more time to prepare a proper and convincing valuation. The comparison shows that the interested parties and professionals and judges involved in a Chinese reorganization have not paid proper attention to the importance and science of valuation in the context of bankruptcy reorganization.

To conclude, compared with Chapter 11, the EBL’s confirmation requirements are quite relaxed. This leads to the result that a Chinese plan proponent only needs to prepare a plan containing simple content. It takes much less time to formulate a plan that states a sincere reorganization attempt and provides a simple and rough valuation than to propose a plan which contains a feasible operation scheme, proper valuation of the debtor’s liquidation value, reorganization value and the distribution to the dissenting classes and/or claimholders based on the feasible operation scheme. Moreover, it is more difficult for a plan-proponent to get its plan confirmed when the confirmation requirements are stricter. Therefore, the EBL’s loose confirmation requirements fundamentally lead to the short time period between reorganization initiation and high plan confirmation rate.

(2) Exploring the factors contributing to the high plan-consummation rate in Chinese reorganization practice

\textsuperscript{679} See Beisheng’s Public Notice No. 2009-004.


\textsuperscript{681} Id. See also, Stuart C. Gilson, Edith S. Hotchkiss, and Ruback Richard S. (200), Valuation of Bankrupt Firms, 13 Rev. Fin. Stud. 43, p. 45.
Judged against the background of the EBL’s loose confirmation requirements, the content of the Chinese confirmed plans were mainly a rehabilitation wish and a debt-restructuring scheme.\textsuperscript{682} In the shadow of the EBL’s cram-down requirements, the debt-restructuring model of the Chinese confirmed plans may be summarized as such: full payment to the class of secured claims, tax claims, employment claims; partial payment to the class of unsecured claims; paying a substantial percentage of the shares of the reorganized debtor to old shareholders. The empirical study of the 18 cases showed that the confirmed reorganization plans in China are just plans concerning the payment of reduced debt. In all the 18 cases, why a certain amount of debt (for instance, why 80% instead of 60% of the general unsecured debt should be reduced in a case) should be reduced is never discussed. What is discussed is that creditors will receive something that is higher than what they would receive under a hypothetical liquidation.\textsuperscript{683} In sharp contrast to this, in a US case, it is mandatory for the confirmed plan to contain a feasible operation scheme and for the plan’s debt-restructuring scheme, based on the debtor’s reorganization value calculated on the basis of the future income from operations, to be a feasible scheme. As discussed in Section 4.2.2.3, because of the lack of a complete provision on the absolute priority rule, unsecured creditors are much more passive in the bargaining procedure and may be forced to accept a low percentage of payment only if it is higher than what they would receive under the hypothetical liquidation. Taking all these factors into account, a possible reason for the high consummation rate of the Chinese plans is that the plan proponent has made the central content of the plan, i.e. the debt-restructuring scheme easier for the debtor to carry out. The loose feasibility test, the lack of a complete provision on the absolute priority rule, the negligence of proper valuation and justification for the reduced amount of the debt combined makes it possible for the confirmed Chinese plans to simply provide a debt-restructuring scheme that the debtor can fulfill and that the debtor can force the creditors to accept or in respect of which the debtor can apply to the court for cram-down.

In addition, it is worthwhile noting that the loose feasibility test, the negligence of accurate valuation of the debtor’s reorganization value, the lack of the best-interest-test and the lack of

\textsuperscript{682} See Section 4.2.2.3 and Appendix B and C.

\textsuperscript{683} See Section 4.2.2.3 and Appendix B.
the absolute priority rule are consistent with each other. When there is not a feasible operation scheme in the plan, it is not possible to make an accurate calculation of the debtor’s reorganization value. The lack of the best-interest-test for consensual plans and the lack of a complete provision on the absolute priority rule provide the legal foundation for the negligence of an accurate calculation of the debtor’s reorganization value. These three factors combined reflect the underlying policy of Chinese reorganization law, which is that the confirmation of a plan is justified if the plan can make the debtor’s shell or business continue and pay creditors what they would receive under a hypothetical liquidation. Chinese law puts the creditors’ interest in a vulnerable position and may induce abuse of the reorganization procedure. Chinese practice corresponds to the law very well and has shown that creditors are really under the control of the debtor. In Chinese practice, the reorganization plans are just a debt-payment arrangement since the confirmed plans do not contain a feasible operation scheme and an accurate valuation of the debtor’s reorganization value and the reorganization procedure is just a device with which to legally get rid of a substantial percentage of the unsecured debts with the old shareholders retaining a substantial percentage of the shares of the reorganization debtor. In contrast, the US law emphasizes whether the debtor’s value is enhanced under a feasible operation scheme and whether there is fair and equitable distribution of the enhanced value. When a Chapter 11 plan is cram-drown over the objecting general unsecured creditors, the justification for the confirmation is that the cram-drown plan contains the most efficient operation scheme which could help the debtor to maximize its value and that the debtor’s reorganization value should be distributed to the claimholders in a fair and equitable way, i.e. be distributed according to the pre-bankruptcy priority order. Based on this logic, in the cram-down stage, the US law adopts plan competition (allows all the interested parties to propose a plan) and the absolute priority

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684 See Section 4.2.2.3.
685 See Section 4.2.2.3 and Appendix C.
686 See Section 6.4.2.
687 See Section 4.2.2.3 and Appendix B.
689 11 U.S.C. 1121(c). Although the limited use of plan-competition in US law is considered insufficient for promoting efficient decision making, it is better than Chinese law which completely excludes plan competition. A detailed discussion of the exclusivity period and plan competition is in Section 3.1.2.2.
rule\textsuperscript{690} to check how much the debtor’s reorganization value is based on the feasible operation of the scheme contained in the competing plan, whether the crammed-down plan can realize the highest reorganization value and whether a plan makes a fair and equitable distribution of the reorganization value or distributes the reorganization value in accordance with the absolute priority rule.\textsuperscript{691} The comprehensive comparison of the Chinese and US reorganization law and practice shows that the legal regulation over bankruptcy reorganization in China is superficial and immature.

6.3 Conclusion

The US and Chinese bankruptcy reorganization laws are quite similar in relation to the main structures. The Chinese bankruptcy reorganization law is basically a product of transplanting the US law. In the transplantation, the Chinese legislators made certain modifications, such as adding the administrator’s supervision over the DIP, allowing the liquidation panels whose main members are government officials to be administrators and refusing to provide special priority to post-petition lenders. In addition, some valuable parts of the US law are not properly incorporated into the Chinese law. This leads to the problematic elements of the EBL, the most prominent being the inadequate protection of the creditors’ interest under the automatic stay, the unreasonable classification, improper design of the shareholders’ voting right and the loose confirmation requirements. On the whole, the comparison has showed that Chinese law and practice are much less developed than the US counterparts. The prominent manifestation of the immature nature of Chinese reorganization law and practice is the lack of the best-interest test and feasibility test for consensual plans, the lack of a complete provision on the absolute priority rule, the loose feasibility standards, and the negligence of the proper valuation of the debtor’s reorganization value. The study finds that Chinese reorganization law needs to be improved in many aspects and that at the early stage of the reorganization practice, the reorganization procedure is simply a device with which to legally getting rid of

\textsuperscript{690} 11 U.S.C. 1129(b)(2)(B); (C).

\textsuperscript{691} See e.g., In re Coram Healthcare Corp., 271 B.R. 228 (The Chapter 11 trustee and equity holders’ committee sought to confirm their competing Chapter 11 plans. The court compared the valuations in the competing plans and made a judicial decision over the debtor’s reorganization value and then decided which plan is preferable and should be confirmed.)
unsecured debts. With more and more reorganization cases emerging and ending, the positive and negative sides of bankruptcy reorganization law and practice will be observed and studied. As the Chinese legislators, judges and the bankruptcy professionals accumulate their knowledge and experience, they will further develop Chinese bankruptcy reorganization law into a mature legal system that helps and encourages the interested parties to achieve the maximization of the debtor’s overall value and a fair and equitable distribution of the overall value.