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China's New Bankruptcy Law: A Translation and Brief Introduction

by

Douglass G. Boshkoff and Yongxin Song***

A bankruptcy law for China was adopted by the Sixth National People's Congress on December 2, 1986. The text of the new legislation is not yet widely available in an English translation.¹ It appears here with a brief introduction to some of the statute's most interesting and important features.

Readers familiar with American bankruptcy legislation will have no difficulty understanding the basic structure of the Chinese law. The statute is divided into six chapters entitled: General Provisions; The Bankruptcy Petition and Its Approval; The Creditors' Committee; Conciliation and Reorganization; Bankruptcy Declaration and Bankruptcy Liquidation; and Supplementary Provisions. These titles are generally accurate. However, in a few instances, a chapter contains material more appropriate for another chapter or material relevant to a matter appears at more than one place in the statute. For example, both Articles 21 and 23 must be consulted to determine when a declaration of bankruptcy is appropriate. One would expect both to appear in Chapter Five (Bankruptcy Declaration and Bankruptcy Liquidation) but Article 21 is part of Chapter Four (Conciliation and Reorganization). This somewhat confusing format would be very troubling in a lengthy statute. Fortunately, China's new bankruptcy law is quite brief.

The sequence of events in a bankruptcy proceeding is also easily understood. Both voluntary and involuntary cases are permitted.² Court approval is required in both instances.³ Creditors must file their claims within a fairly short period of time.⁴ Liquidation then follows under the control of a liquidation panel authorized by Article 24, the Chinese version of a chapter 7 trustee with rights and responsibilities similar to those of its American counterpart.

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¹There is one recently published translation. See Zheng, *The Enterprise Bankruptcy Law of the People's Republic of China (for Trial Use): A Translation*, 19 VAND. J. OF TRANSNATIONAL LAW 683 (1986). Our text generally agrees with this translation. Differences are noted in the footnotes to this translation.

²See *infra* Articles 7 and 8.

³See *infra* Article 9.

⁴*Id.*

Once the liquidation panel has completed its work, the proceeding is closed and unpaid claims are discharged.⁵

Chinese law does not provide for alternative proceedings with varying objectives, e.g., liquidation or reorganization. Instead, all cases begin as liquidations. The statute, however, requires suspension of an involuntary bankruptcy⁶ whenever there is a request for a reorganization and the debtor is able to conclude a conciliation (reorganization) agreement with its creditors.⁷ Thus, some bankruptcies will not move immediately to liquidation but will be delayed for a period, possibly more than two years,⁸ during which the debtor attempts to obtain and implement a reorganization plan.

China's enactment of a bankruptcy law, as Article 1 makes clear, is related to economic reforms taking place in that country. The past decade has been marked by a notable shift from reliance on central planning to a market economy model.⁹ Business failures can be anticipated in this new economic environment and orderly liquidation procedures have been established for state enterprises.¹⁰ However, and here Chinese law diverges sharply from American bankruptcy law, the establishment of an orderly liquidation procedure is not the sole objective. Assessment of responsibility for business failure is a major feature of this statute. For example, Article 3 qualifies the right of creditors to force involuntary proceedings by requiring proof that the businesses' losses are due to poor operation and management. Businesses whose losses could not be anticipated and prevented are outside the bankruptcy net,¹¹ even though deeply in debt. For qualifying (mismanaged) debtors, Article 42 requires an inquiry into the causes of bankruptcy and, when appropriate, the application of civil and criminal sanctions against management.

⁵See *infra* Article 38.

⁶See *infra* Article 3. It is not clear why suspension is permitted only in involuntary cases. See *infra* note 24.

⁷See *infra* Article 3.

⁸The application for a reorganization must occur within three months of approval of the petition and the reorganization may not last more than two years (Article 17). Since Article 18 does not prescribe a time within which the conciliation agreement must be negotiated, it is possible that the delay will exceed two years and three months.

⁹This shift involves greater reliance on private ownership of economic resources and the use of market forces to determine prices, as well as decentralized decision-making. See generally Chow, *Development of a More Market-Oriented Economy in China*, 235 SCIENCE 295 (Jan. 1987); Zheng, *Bankruptcy Law of the People's Republic of China: Principle, Procedure and Practice*, 19 VAND. J. OF TRANSNATIONAL L. 683, 685-689 (1986); WHITE, *CHANGING RELATIONS BETWEEN STATE AND ENTERPRISE IN CONTEMPORARY CHINA: EXPANDING ENTERPRISE AUTONOMY, IN CHINA'S CHANGED ROAD TO DEVELOPMENT* (N. Maxwell and B. McFarlane ed., 1984).

¹⁰See *infra* Article 2.

¹¹See *infra* note 32. Cf. 11 U.S.C. 303(a) (1983) (farmer not eligible for involuntary bankruptcy). "The exceptions contained in current law that prohibit involuntary petitions against farmers . . . are continued. Farmers . . . are excepted because of the cyclical nature of their business. One drought year or one year of low prices, as a result of which a farmer is temporarily unable to pay his creditors, should not subject

It should also be noted that the Chinese government, directly or indirectly, retains control over access to the bankruptcy process. Voluntary proceedings are not possible without consent from the department in charge of the debtor.¹² The State may also block involuntary proceedings by either providing for direct subsidies to the debtor or arranging for a guarantee of obligations by another enterprise.¹³ Thus, any impact of bankruptcy, including possible sanctions for mismanagement, will only be felt by those businesses which the Government permits to enter the bankruptcy system. Bankruptcy in China is an instrument for implementing government economic policy as well as a mechanism to insure that an orderly and equitable liquidation takes place.

Many of the terms used in this translation are similar to terms appearing in United States' bankruptcy legislation. However, it should be pointed out that there is a difference between approval of the bankruptcy petition by the People's Court (Article 9) and the declaration of bankruptcy (Article 23). The former is issued at the beginning of a bankruptcy proceeding.¹⁴ The declaration of bankruptcy has no close American counterpart. It occurs when liquidation becomes inevitable either because there is no reorganization proposal or when the reorganization fails. In the latter instance, it is similar to an order for conversion to chapter 7.¹⁵

Both procedurally and substantively, the Chinese bankruptcy statute often resembles American bankruptcy legislation. These similarities, nonetheless, should not be overemphasized. China, despite recent changes, remains a nation with a centrally planned economy, most of whose businesses are still state-owned. Their productive activities continue to be subject to the provisions of a central plan. Bankruptcy law in this different political and economic environment will emphasize goals other than an equitable and efficient distribution of assets, the objective of primary concern in American commercial bankruptcies.

Chinese law features the application of administrative and criminal sanctions to poorly managed enterprises and those persons responsible for business failure. Bankruptcy is a device for encouraging, and requiring, more efficient management of state-owned enterprises. The new statute is only one of a number of measures which the current government is proposing in an attempt to achieve significant economic reform. If this effort is successful, one can anticipate enactment of another bankruptcy statute, one which is closer in spirit to the current United States' Bankruptcy Code.

him to involuntary bankruptcy." H.R. REP. No. 595, 95th Cong., 1st Sess. 321 (1977); 1978 U.S. CODE CONG. & ADMIN. NEWS 5787. It has been observed that "[The exclusion] is justifiable only upon the assumption that bankruptcy is a harsh proceeding from which the favorites of the law should be sheltered." J.A. MACLACHLAN, BANKRUPTCY 28 (1956). Article 3's protection of well-run, albeit unfortunate, businesses is very similar to America's protection of farmers.

¹²See *infra* Article 8.

¹³See *infra* Article 3. Zheng, *supra* note 1 at 701.

¹⁴11 U.S.C. §§ 301, 303 (h) (1983).

¹⁵11 U.S.C. § 1112(b) (1983).

The Law of Bankruptcy for Enterprises
of the People's Republic of China (Trial Implementation)¹⁶
Adopted by the 18th Session of the Sixth National
People's Congress on December 2, 1986

Chapter One: General Provisions

Article 1. This Law is devised to meet the need for development of the socialist planned commodity economy¹⁷ and economic system reform, to promote the operation of all-people-owned enterprises,¹⁸ to strengthen the economic responsibility system¹⁹ and democratic administration of all-people-owned enterprises, to improve management, to enhance economic efficiency, and to protect the legal rights and interests of creditors and debtors.

Article 2. This law applies to all-people-owned enterprises.²⁰

Article 3. Enterprises which, due to poor operation and management, have incurred severe losses and cannot repay their debts as they become due shall be declared bankrupt in accordance with the provisions of this law.²¹

In creditor-initiated cases, bankruptcy proceedings cannot be commenced against enterprises in the following categories:

(1) Public utilities and enterprises of major concern to the national economy and the general welfare of all the people whose debts are to be repaid by governmental subsidies or through other arrangements with appropriate governmental departments.

¹⁶See also Article 43. The references to trial implementation indicate that the Chinese Government is unsure of how a bankruptcy law should function and may wish to amend the law in the near future. However, it will have full legal force when it enters into effect until it is revised.

¹⁷This term was first introduced in 1984. It refers to a new economic system, basically a limited market-economy system, as contrasted with the former economic system which relied exclusively on central planning.

¹⁸A term used to indicate that the enterprise is owned by the state on behalf of all the people of the country. In present China, there are two other types of ownership: collective ownership and private ownership.

¹⁹The economic responsibility system was introduced in 1979. Its first application was in rural areas as a contractual system for operating the farming industry. Farmers were only responsible for production of crops specified in a contract and the State was not directly involved in farming operations. It was successful and well received by the farmers. The same system, with appropriate changes, is now being applied to industrial production.

²⁰Many state-owned enterprises are not operated efficiently. At present, approximately 25 percent operate at a deficit and require a subsidy from the central government. While there are some private enterprises, this bankruptcy law only applies to state-owned entities.

²¹Both Articles 2 and 3 define the scope of this law. Article 2 makes it clear that private and collectively owned enterprises are not eligible for bankruptcy. Article 3, read in conjunction with Articles 7 and 8, indicates when it is appropriate to institute bankruptcy proceedings involving a public enterprise.

(2) Enterprises which obtain a guaranty²² and are able to repay their debts within six months from the day when the bankruptcy petition is filed.

A creditor-initiated bankruptcy²³ is to be suspended²⁴ if the department in charge²⁵ of the debtor has applied for a reorganization and the debtor has entered into a conciliation agreement²⁶ with the creditors' committee.²⁷

Article 4. The State will make appropriate arrangements through various channels for reemployment of the debtor's workers and to satisfy their basic daily needs until such workers are reemployed. The State Council²⁸ is authorized to make the necessary specific arrangements.

Article 5. The People's Court²⁹ for the district where the debtor is located shall have jurisdiction of the bankruptcy case.

Article 6. Unless inconsistent with this statute, the law of civil procedure is applicable in bankruptcy proceedings.

Chapter Two: The Bankruptcy Petition and Its Approval

Article 7. Creditors³⁰ may file a bankruptcy petition if the debtor cannot repay its debts as they become due.

The creditor, when filing a bankruptcy petition, shall provide evidence of the amount of its claim, of whether the claim is secured or unsecured, and of the failure of the debtor to repay its matured debts.³¹

²²Every enterprise has its own accounting system so, theoretically, one enterprise may decide to guarantee payment of another enterprise's debts.

²³See Article 7.

²⁴Apparently, suspension of the liquidation process in favor of a reorganization proposal is only possible in an involuntary bankruptcy. See also Article 17 and Zheng, *supra* note 9 at 707. This distinction between voluntary and involuntary proceedings is probably a drafting error.

²⁵All state-owned enterprises are subject to administrative control by one or more governmental agencies.

²⁶See Articles 17-22. The conciliation agreement is similar to a chapter 11 plan.

²⁷See Articles 13-16.

²⁸The executive branch of the central government.

²⁹The basic court of general jurisdiction.

³⁰The term "creditors" is not qualified in any way. It is, therefore, not clear whether fully secured creditors, if they choose, may initiate bankruptcy proceedings. Cf. 11 U.S.C. § 303(b)(1) (1983). The denial of other privileges by Article 14 (authority to demand a creditor's meeting), Article 16 (voting), Article 30 (definition of bankruptcy claims), and Article 32 (payment of unsecured claim) suggests that secured creditors are not eligible to file a bankruptcy petition.

³¹Cf. Article 3 which refers to an inability to repay debts caused by "poor operation and management." Must creditors prove this cause of failure even though there is no reference to it in Article 7? We conclude that the creditors are required to prove "poor operation and management" because Article 23 refers to Article 3, not Article 7, when establishing the requirements for a declaration of bankruptcy. Cf. Zheng, *supra* note 9 at 702.

Article 8. The debtor, with the consent of the department in charge of the debtor,³² may file a bankruptcy petition.

The debtor, when filing a bankruptcy petition, shall submit a statement explaining the losses it has incurred and shall submit relevant accounting records and a list of all debts and claims.

Article 9. The People's Court shall, within 10 days of approval³³ of the bankruptcy petition,³⁴ notify the debtor of its approval and issue public notice thereof. The People's Court shall, within 10 days of the receipt of the debtor's list of debts and claims, provide notice thereof to all known creditors. The notice to creditors and the public notice shall stipulate the date of the first session of the creditors' committee.

Within one month of receipt of actual notice of the bankruptcy, creditors shall file their claims with the People's Court, indicating the amount of their claims and whether they are secured or unsecured, and submit proper evidence thereof. All other creditors shall file their claims and provide the same information within 3 months of the date of the public notice.³⁵ A claim filed beyond these time limits is deemed to have been abandoned.³⁶

The People's Court shall separately register secured and unsecured claims.

Article 10. In creditor-initiated bankruptcy proceedings, the debtor shall, within 15 days of receipt of the notification from the People's Court, submit to the People's Court the materials listed in section 2 of Article 8 of this law.

If the debtor is a guarantor³⁷ for other entities, the debtor shall, within 5 days of its receipt of the notice from the People's Court, inform all the parties concerned of that notice.

³²It is arguable that this decision should be within the sole discretion of the entity in financial difficulty. The economic reforms now taking place in China are an attempt to move toward a market-economy system. See *supra* note 9. Retention by another entity of control over the decision to file a bankruptcy petition is inconsistent with the decentralization inherent in a shift to a market-economy system.

³³It is not clear whether the People's Court has discretion to withhold approval of the petition even if the petition complies with the statutory requirements.

³⁴Note that approval of the petition is not the equivalent of a declaration of bankruptcy. The latter is governed by Article 23. See *infra* note 51.

³⁵The first two sentences of this paragraph appear as a single sentence in the original text. This sentence has been divided in this translation for purposes of clarity.

³⁶Cf. 11 U.S.C. § 726(a)(2)(C), (3).

³⁷See *supra* note 22.

Article 11. The People's Court shall suspend other ³⁸ civil execution against the debtor upon its approval of the bankruptcy petition.

Article 12. Any payment to part of the creditors after the approval of the bankruptcy petition by the People's Court is invalid,³⁹ except to the extent that it is essential to ordinary business operations.⁴⁰

Chapter Three: The Creditors' Committee

Article 13. All creditors are eligible to be members of the creditors' committee.⁴¹ All creditors enjoy the right to vote, except secured creditors who have not relinquished their security.⁴² A guarantor⁴³ of the debtor may become a creditor and enjoy the right to vote when it has repaid the guaranteed debts.

The chairman of the creditors' committee is to be appointed by the People's Court from among the creditors who are entitled to vote.

The legal representative of the debtor⁴⁴ must attend creditors' meetings and answer inquiries of creditors.

Article 14. The first session of the creditors' committee shall be convened by the People's Court within 15 days after the last day upon which creditors may file their respective claims with the People's Court. Subsequent sessions may be convened when the People's Court or the chairman of the creditors' committee considers it necessary, or when the liquidation

³⁸Bankruptcy is assumed to be a collection device. This explains the reference to "other execution." The stay authorized by Article 11 is much narrower than the one provided by 11 U.S.C. § 362(a) (1983). It also does not come into effect until the petition has been approved.

³⁹Article 12 only prohibits post-approval transfers which are preferential. Cf. 11 U.S.C. § 549 (1983). There is no provision in the statute which provides for the recovery of every type of prebankruptcy preferential transfers. Note, however, Article 35 which prohibits two types of preferences: the payment of unmatured claims and the grant of security to a previously unsecured creditor. Article 35 applies to transfers which take place both before and after the petition is approved. There is, therefore, some overlap between these two sections.

⁴⁰Cf. 11 U.S.C. § 363(c)(1) (1983).

⁴¹Cf. 11 U.S.C. § 1102(b)(1) (1983).

⁴²It appears that secured creditors are powerless if a reorganization is proposed. Collection activity is stayed by Article 11 which contains no provision for adequate protection or relief from stay. At the same time, the secured creditor has no right under Article 16 to vote on the draft conciliation agreement and possibly affect the course of the reorganization. Thus, the position of the secured creditor will be seriously compromised in many bankruptcies.

⁴³See *supra* note 22.

⁴⁴The director of the enterprise will usually be its legal representative. However, he may appoint an associate director or someone else from among the personnel of the enterprise to serve in his place.

panel⁴⁵ or creditors whose claims represent more than one fourth of the total amount of the unsecured claims so request.

Article 15. The creditors' committee is authorized:

- 1) to examine evidence concerning claims, to determine whether the claims are secured or unsecured and their respective amounts;
- 2) to discuss and approve the draft conciliation agreement;⁴⁶
- 3) to discuss and approve the plan by which the debtor's assets are to be administered and distributed.

Article 16. Resolutions of the creditors' committee must be approved by a majority of creditors present at the meeting who are entitled to vote and whose claims represent a majority of the total amount of unsecured claims. But, a resolution concerning a draft conciliation agreement must be approved by more than two thirds of the total amount of the unsecured claims.⁴⁷

Resolutions approved by the creditors' committee shall bind all creditors.

If any creditor considers a resolution approved by the creditors' committee to be contrary to the provisions of any law, he may appeal to the People's Court within seven days of the day on which the resolution is approved.

Chapter Four: Conciliation and Reorganization

Article 17. If creditors file a bankruptcy petition, the department in charge of the debtor may, within three months after the approval of the petition by the People's Court, apply for reorganization of the debtor.⁴⁸ The period of time for reorganization may not exceed two years.

Article 18. Following the filing of the reorganization application, the debtor shall submit a draft conciliation agreement to the creditors' committee.

The conciliation agreement shall stipulate the term within which the debts of the enterprise are to be repaid.

Article 19. When the debtor and the creditors' committee enter into a conciliation agreement, the People's Court, fol-

⁴⁵See Article 24.

⁴⁶See Articles 17-22.

⁴⁷Cf. 11 U.S.C. § 1126(c) (1983).

⁴⁸See *supra* note 24.

lowing its confirmation of the agreement,⁴⁹ shall issue a public notice of the agreement and suspend the bankruptcy proceedings. The conciliation agreement is effective from the the day of the public notice.

Article 20. The reorganization shall be administered by the department in charge of the debtor.

The plan for reorganization of the debtor shall be discussed by the representative assembly of the debtor's workers and staff. The representative assembly⁵⁰ shall be kept informed of the status of the reorganization and its opinion concerning the reorganization should be respected.⁵¹

The status of the reorganization shall be periodically reported to the creditors' committee.

Article 21. The reorganization shall be terminated, and a declaration of bankruptcy shall be issued if the People's Court finds that any one of the following events has occurred:

- 1) failure to implement the conciliation agreement; or
- 2) further deterioration of the financial status of the debtor, provided that there is an application from the creditors' committee for termination of the reorganization; or
- 3) the occurrence of one of the acts listed in Article 35 of this law, provided that it seriously impairs creditors' interests.

Article 22. If through the reorganization the debtor is able to repay its debts in accordance with the terms of the conciliation agreement, the People's Court shall then terminate the reorganization and issue a public notice thereof.

If the debtor, upon the expiration of the period of time for the reorganization, cannot repay its debts in accordance with the conciliation agreement, the People's Court shall declare the debtor bankrupt and re-enter the claims in accordance with the provisions of Article 9 of this law.

⁴⁹It is not clear whether the People's Court has any discretion to withhold confirmation of the conciliation agreement. This is the same point which was noted in connection with approval of the bankruptcy petition. See Article 9 and *supra* note 33.

⁵⁰A body composed of representatives elected by the workers and staff of an enterprise. This assembly is supposed to represent the interests of workers and staff and supervise the management of the enterprise.

⁵¹This discussion will take place after the People's Court has confirmed the draft conciliation agreement. The power of the representative assembly is unclear. It clearly does not have the right to veto the reorganization plan but its opinion cannot be disregarded. Cf. Article 20, Zheng Translation, *supra* note 1.

Chapter Five: Bankruptcy Declaration and
Bankruptcy Liquidation

Article 23. The People's Court shall issue a declaration of bankruptcy if it finds that:

- 1) bankruptcy should be declared in accordance with Article 3 of this law;⁵² or
- 2) the reorganization should be terminated in accordance with Article 21 of this law; or
- 3) upon the expiration of the period established for a reorganization, the debts cannot be repaid in accordance with the terms of the conciliation agreement.⁵³

Article 24. The People's Court shall, within 15 days of the bankruptcy declaration, establish a liquidation panel⁵⁴ to assume control of the debtor. The liquidation panel is responsible for preservation, valuation, administration and distribution of the debtor's assets. The liquidation panel may engage in all necessary civil activities in accordance with law.

Members of the liquidation panel are to be appointed by the People's Court from among the personnel of the department in charge of the debtor, the personnel of governmental finance departments, and other professionals. The liquidation panel may employ any necessary staff.

The liquidation panel is responsible to and reports its work to the People's Court.

Article 25. No entity shall illegally dispose of the property, account books, documents, materials and seals, etc., belonging to the debtor.

Persons owing debts to, or holding property of, the debtor can only repay their debts or turnover property to the liquidation panel.⁵⁵

⁵²It is arguable that Article 23(1) applies when the debtor and its creditors are unable to agree on the terms of a conciliation agreement. Cf. Zheng, *supra* note 9 at 707. "The National Act does not provide a remedy where the debtor and creditors fail to reach a conciliation agreement. Whether the court will go ahead to declare bankruptcy or impose a conciliation agreement that the court considers reasonable is unclear."

⁵³The declaration of bankruptcy authorized by Article 23 is not the exact equivalent of an order for relief pursuant to 11 U.S.C. §§ 301 and 303(h). Approval of the petition [see Article 9] marks the beginning of a proceeding which may lead to either a reorganization or liquidation. A bankruptcy declaration will occur only when liquidation becomes inevitable, either because there has been no reorganization proposal or because the reorganization has failed.

⁵⁴The liquidation panel has a function similar to that of a chapter 7 trustee.

⁵⁵Cf. 11 U.S.C. § 542 (1983).

Article 26. The liquidation panel may decide to reject or assume executory contracts of the debtor.⁵⁶

If the liquidation panel decides to reject a contract, the resulting damage to the other party to the contract is deemed to be a bankruptcy claim.⁵⁷

Article 27. The legal representative of the debtor is responsible for preservation of the debtor's property, account books, documents, materials and seals, etc. until the process of transferring them to the liquidation panel has been completed.

The legal representative of the debtor shall work as the People's Court or the liquidation panel directs and shall not leave his post without permission until the conclusion of the bankruptcy proceeding.

Article 28. Assets of the bankruptcy estate consist of:

1) all property operated and administered by the debtor at the time the bankruptcy is declared;⁵⁸

2) all property acquired by the debtor between the bankruptcy declaration and the termination of the bankruptcy proceedings;

3) other property rights belonging to the debtor.

Property subject to a security interest is not an asset of the bankruptcy estate. If the value of the collateral exceeds the secured debt, the excess is included in the bankruptcy estate.

Article 29. Assets administered by the debtor but belonging to others shall be recovered by their owners through the liquidation panel.⁵⁹

Article 30. Bankruptcy claims consist of unsecured claims established prior to the bankruptcy declaration and also secured claims whose preferential right to repayment have been relinquished, but do not include expenses incurred by creditors while participating in the bankruptcy proceeding.

Article 31. Claims which are unmatured at the time of the bankruptcy declaration shall be regarded as matured claims after interest for the unmatured period has been deducted.

⁵⁶Cf. 11 U.S.C. § 365(a) (1983).

⁵⁷Cf. 11 U.S.C. § 502(g) (1983).

⁵⁸Assets of the bankruptcy estate can include property belonging to others. Article 29, accordingly, establishes a procedure for recovery of these assets by their owners.

⁵⁹See Zheng, *supra* note 9 at 730, which suggests that creditors can obtain greater protection by use of financing leases than by retaining purchase money security interests. Even if the financing lease is not regarded as a security interest [Cf. Uniform Commercial Code §§ 1-201(37), 9-102(1)(a)], it will be subject to assumption in accordance with Article 26.

Article 32. A secured creditor whose claim arose prior to the bankruptcy declaration is entitled to preferential payment from its collateral.

If a claim exceeds the value of the collateral for such claim, the balance thereof is to be deemed an unsecured claim⁶⁰ and is to be repaid in accordance with the provisions of this law.

Article 33. Any creditor's claims against the debtor may be offset against his debts owed to the debtor prior to the bankruptcy liquidation.⁶¹

Article 34. The following bankruptcy expenses have priority in payment from the estate:⁶²

- 1) expenses incurred in the administration, sale and distribution of assets of the bankruptcy estate, including wages paid to the staff of the liquidation panel;
- 2) legal fees of the bankruptcy proceeding;
- 3) other expenses incurred in the common interest of creditors during the bankruptcy proceeding.

If the assets of the bankruptcy estate are insufficient to cover these expenses, the People's Court shall terminate the bankruptcy proceeding and announce this termination to the public.

Article 35. The following acts of the debtor are invalid if they occur in a period beginning six months before approval of the bankruptcy petition by the People's Court and ending on the date of the bankruptcy declaration:

- 1) the concealment, secret distribution⁶³ or gratuitous transfer of assets;
- 2) the sale of assets at an unusually low price;⁶⁴
- 3) the grant of security to previously unsecured creditors;
- 4) the repayment of unmatured debts;⁶⁵
- 5) the relinquishment of claims held by the debtor.

⁶⁰Cf. 11 U.S.C. § 506(a) (1983).

⁶¹Cf. 11 U.S.C. § 553(a) (1983).

⁶²All these claims are entitled to the same priority. The statute does not create three separate priority classes.

⁶³The term "secret distribution" refers to the possibility that the enterprise's employees will distribute its assets (which are state property) among themselves.

⁶⁴Cf. Article 35 (2) Zheng Translation, *supra* note 1.

⁶⁵Article 35 does not prohibit the payment of matured obligations.

If the debtor has committed any of these acts, the liquidation panel is entitled to request the People's Court to recover the property transferred. The recovered property is included in the bankruptcy estate.

Article 36. Complete sets of equipment included in the bankruptcy estate shall be sold as a unit. If they cannot be sold as a unit, they may be sold separately.⁶⁶

Article 37. A plan for distribution of assets of the bankruptcy estate prepared by the liquidation panel, following discussion and approval by the creditors' committee, shall be submitted to the People's Court for confirmation and shall then be executed.

The assets of the bankruptcy estate, after payment of all priority bankruptcy expenses,⁶⁷ are to be distributed in the following order:⁶⁸

- 1) salaries and labor insurance benefits⁶⁹ owed by the debtor to its workers and staff;
- 2) taxes owed by the debtor;
- 3) unsecured claims.

If the assets are insufficient to satisfy claims in the same class, they are to be distributed *pro rata* among creditors in that class.

Article 38. When all the assets have been distributed, the liquidation panel shall request the People's Court to close the bankruptcy proceeding. Any claims remaining unpaid at the conclusion of the proceeding are discharged.

Article 39. Following the conclusion of the bankruptcy proceeding, the liquidation panel shall request the original registration office⁷⁰ to cancel the debtor's registration.

Article 40. If any of the acts listed in Article 35 is discovered within one year of the day on which the bankruptcy proceeding is concluded, the property shall be recovered by the People's Court⁷¹ and distributed in accordance with the provisions of Article 37 of this statute.

⁶⁶Sale of equipment as a unit will often produce a better price. Article 36, however, requires sale as a unit even if a more advantageous price could be achieved by a piecemeal liquidation.

⁶⁷See Article 34.

⁶⁸Cf. 11 U.S.C. § 726(a) (1983).

⁶⁹These are various fringe benefits to which the workers are entitled.

⁷⁰Any enterprise, prior to commencing business operations, must register with a government office in its district. This office is referred to as the original registration office.

⁷¹The statute does not require appointment of a new liquidation panel.

Article 41. If the debtor has committed any of the acts listed in Article 35, its legal representative and the person directly responsible for such act shall be subject to administrative disciplinary sanctions. If such an act amounts to a crime, they shall be subject to criminal liability in accordance with law.

Article 42. Subsequent to the bankruptcy declaration, the supervision and auditing departments of the government shall inquire into responsibility for the bankruptcy.

If the legal representative of the debtor is primarily responsible for the bankruptcy, such representative shall be subject to administrative disciplinary sanctions.

If the department in charge of the debtor is primarily responsible for the bankruptcy, the leaders of such department shall be subject to administrative disciplinary sanctions.

The legal representative of the debtor and the leaders of the department in charge of the debtor shall be subject to criminal liability under the provisions of Article 187 of "The Criminal Law of the People's Republic of China," if the bankruptcy is the consequence of their neglect of duty and has caused great loss to state property.

Chapter Six: Supplementary Provisions

Article 43. This law shall become effective for trial implementation⁷² three months after the law for all-people-owned industrial enterprises becomes effective. Specific plans and procedures for trial implementation will be separately established by the State Council.

Appendix:

Article 187 of the Criminal Law of the People's Republic of China.

State personnel who, because of neglect of duty, cause public property or the interests of the State and the People to suffer great losses shall be sentenced to no more than five years of fixed term imprisonment or criminal detention.

⁷²See *supra* note 16.