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Bankruptcy behind the Great Wall: Should U.S. Businesses Seeking to Invest in the Emerging Chinese Market be Wary?

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Bankruptcy Behind the Great Wall: Should U.S. Businesses Seeking to Invest in the Emerging Chinese Market Be Wary?

TABLE OF CONTENTS

I. INTRODUCTION 351

II. WHY HAVE BANKRUPTCY LAWS TAKEN SO LONG TO DEVELOP? 354

III. ELEMENTS OF BANKRUPTCY LAW 358

 A. *State-Owned Enterprises* 359

 B. *Enterprises with Foreign Investment in the Shenzhen SEZ* 364

 1. *About the Zone* 364

 2. *Bankruptcy of Foreign Entities in the Shenzhen SEZ* 365

IV. RECENT DEVELOPMENTS IN CHINESE BANKRUPTCY LAW 368

V. SUGGESTED STRATEGIES 371

VI. CONCLUSION 373

I. INTRODUCTION

China is, by some accounts, the largest emerging market in the world.¹ As such, it has attracted investors from many developed countries.² In the United States, the government encourages businesses to seek out opportunities in China in an effort to help the U.S. economy and to promote foreign policy interests in

1. See Joe Palca, *China Appears to be a Burgeoning Consumer Market* (National Public Radio, All Things Considered radio broadcast, Feb. 18, 1995) (recognizing the lucrative consumer market in China as determined by a scientific poll); see also U.S. Dep't of Commerce Office of Pub. Affairs, *Secretary Brown Leads Presidential Business Development Mission of CEOs to China and Hong Kong, August 27-September 3, 1994—First Cabinet-Level Visit Since Administration MFN Decision Initiates New U.S.-China Commercial Era*, U.S. DEP'T OF COMMERCE NEWS, Aug. 17, 1994 (emphasizing the importance of the world's fastest growing economy, namely China, to the growth of the U.S. economy).

2. See Gary J. Dornelle, Note, *Direct Foreign Investment and Contractual Relations in the People's Republic of China*, 6 DEPAUL BUS. L.J. 331, 331-32 (1994) (outlining the explosion in direct foreign investment in China since 1979). Until 1978, direct foreign investment in the PRC was not permitted. *Id.* However, from 1979-1986, 7500 contracts with foreign investors were signed totaling approximately US\$19.1 billion. *Id.* See also Marcus W. Brauchli, *China's Economic Role in Asia is Burgeoning*, WALL ST. J., July 24, 1995 (noting that in 1994, investments pouring into China totaled nearly US\$34 billion).

China.³ As a result of an August 1994 trip to China by U.S. Commerce Secretary Brown and several CEOs of U.S. corporations,⁴ some U.S. firms and their Chinese counterparts signed several contracts to provide goods and services and also entered into several joint ventures.⁵ Undoubtedly, before seeking opportunities in China, other U.S. companies will measure the success of those who have already invested in China and analyze all foreseeable commercial and political risks associated with their investments.⁶ In making investment decisions, these companies will consider the degree of protection afforded to debtors and creditors under China's bankruptcy system.⁷ Moreover, firms currently doing business in Hong Kong may find information concerning the bankruptcy laws in China useful, given the upcoming reversion of Hong Kong to China in 1997.⁸ U.S. firms providing goods or services to existing state-owned enterprises or

3. U.S. DEP'T OF COMMERCE NEWS, Aug. 17, 1994, *supra* note 1. See Mike Shuster, *Clinton Aims at International Economic Policy - Part I* (National Public Radio, Morning Edition radio broadcast, Feb. 20, 1995); Mike Shuster, *Clinton Aims at International Economic Policy - Part II* (National Public Radio, Morning Edition radio broadcast, Feb. 21, 1995) (describing the Clinton administration's desire to pursue large emerging markets).

4. U.S. DEP'T OF COMMERCE NEWS, Aug. 17, 1994, *supra* note 1.

5. See, e.g., U.S. Dep't of Commerce Office of Pub. Affairs, *Member of U.S. Presidential Business Development Mission Announces Major Agreement with Ministry of Post and Telecommunications to Modernize China's Postal System*, U.S. DEP'T OF COMMERCE NEWS, Aug. 29, 1994; U.S. Dep't of Commerce Office of Pub. Affairs, *Westinghouse Announces Major Contract for Chinese Power Plant During Presidential Business Development Mission*, U.S. DEP'T OF COMMERCE NEWS, Aug. 29, 1994; U.S. Dep't of Commerce Office of Pub. Affairs, *Major Agreements Reached During Brown Trade Mission Advance U.S. Commercial Interests in China*, U.S. DEP'T OF COMMERCE NEWS, Sept. 2, 1994. See also *infra* notes 9-10 (describing the type of agreements reached and the joint ventures entered into between U.S. and Chinese companies).

6. See Robert B. Shanks, *Protecting Investments in China*, in LEGAL ASPECTS OF DOING BUSINESS WITH CHINA 1986, 389 (1986) (describing elements of political and commercial risks of investing in China). An investor minimizes these risks using mechanisms such as: (1) commercial or financial devices; (2) negotiation and skillful drafting of contracts and other legal documents, including choice of law and dispute resolution provisions; and (3) insurance or guaranties. *Id.* Because of the pervasive role of the Chinese government in commercial enterprises, commercial and political risk are highly interrelated. *Id.*; Dernelle, *supra* note 2, at 340 (stating that foreign investment in China remains risky for investors unfamiliar with China's evolving legal system and economic past). See generally Pat K. Chew, *Political Risk and U.S. Investments in China: Chimera of Protection and Predictability?*, 34 VA. J. INT'L L. 615 (1994).

7. See Shanks, *supra* note 6, at 389 (determining that an effective and well defined bankruptcy system exemplifies a commercial practice which helps minimize political risk); Foo Choy Peng, *Bankruptcy Law to Speed Reform*, S. CHINA MORNING POST, Dec. 30, 1994, at 5 (emphasizing that enforcement of bankruptcy law enhances an enterprise's awareness of risk and that China's bankruptcy law should incorporate overseas experience and international practice). Thus, a U.S. business should determine how any claim regarding its investment is likely to fare under the Chinese legal regime. Richard C. Breedon, *The Globalization of Law and Business in the 1990's*, 28 WAKE FOREST L. REV. 509, 515 (1993).

8. It is beyond the scope of this comment to forecast what exactly will be the effect of China's absorption of Hong Kong on insolvency procedures currently practiced. Because the Shenzhen Special Economic Zone adjoins Hong Kong and was created especially with Hong Kong in mind, it is instructive to study bankruptcy law in Shenzhen. See *infra* notes 128-153 and accompanying text (analyzing provisions under the Shenzhen Rules).

private businesses in China may become creditors.⁹ U.S. corporations creating or becoming part of a wholly-owned enterprise or entering into a joint venture, may become debtors if the business fails.¹⁰ Whether as a debtor or creditor, it is important that U.S. businesses become aware of the intricacies of Chinese bankruptcy law.¹¹

Bankruptcy law has been slow to develop in China.¹² In August 1986, the Shenyang Explosion-Proof Equipment Factory in Shenyang became bankrupt.¹³ This was the first declared bankruptcy since the 1949 Communist takeover.¹⁴ The first failure of a foreign-owned enterprise took place in Shenzhen in October 1983 when the LMK Nam Sang Dyeing Factory collapsed.¹⁵ It was the first wholly-owned foreign enterprise established in the People's Republic of China (PRC) and the insolvency was not handled as a formalized bankruptcy.¹⁶ Prior to these

9. See, e.g., U.S. DEP'T OF COMMERCE NEWS, Sept. 2, 1994, *supra* note 5 (announcing agreements to provide goods and services between U.S. and Chinese companies). For example, Pitney Bowes will sell postal processing equipment; TRW agreed to provide cable TV descramblers; Westinghouse will manufacture steam turbine generators and related power plant equipment; and AT&T will provide telecommunications equipment. *Id.* If any of these companies perform according to the agreement and do not receive payment because the other party has become insolvent, the U.S. firm would become a creditor having a claim in bankruptcy.

10. See, e.g., *id.* (announcing joint venture agreements between U.S. and Chinese companies). IBM and Ji Tong Communication Co. will jointly develop data and consumer credit card networks and General Electric will install and operate turbine generators in a power plant jointly with Shanghai Municipal Electric Power Corp. *Id.* These joint ventures, and derivatively the U.S. firm as a part owner, could become debtors if the enterprise's liabilities overcome its assets.

11. See Breeden, *supra* note 7, at 515 (noting that investment managers analyze the legal systems of national economies and that bankruptcy law is a variable which helps determine the attractiveness of an investment, thus influencing investment patterns).

12. The Qing dynasty enacted China's first bankruptcy law (*pochan lu*) in 1906. Peng Xiaohua, *Characteristics of China's First Bankruptcy Law*, 28 HARV. INT'L. L.J. 373, 373 n.1 (1987). Later, the Kuomintang (Republican, "Nationalist" Chinese) government passed a bankruptcy law in 1935. *Id.* The Standing Committee of the National People's Congress of the People's Republic of China enact all civil laws in China. *Id.* The current bankruptcy laws were initiated in the 1980s and are still being implemented. *Id.* The Chinese legal system is purely statutory, with no officially reported cases and, hence, no case law. Dernelle, *supra* note 2, at 331 n.1. The Finance and Economics Committee under the National People's Congress is responsible for bankruptcy legislation. Foo Choy Peng, *supra* note 7, at 5. Although many Chinese laws touch some of the peripheral aspects of bankruptcy (e.g., laws on Chinese-Foreign Joint Ventures, on Wholly Foreign-Owned Enterprises, the Civil Procedure Law, the Company Law of the People's Republic of China), this comment focuses on the Enterprise Bankruptcy Law and the Shenzhen Rules. See Flaxer, *infra* note 60 (mentioning the impact of the other laws on bankruptcy). See also *infra* notes 64-113 (discussing the Enterprise Bankruptcy Law) and notes 128-153 (discussing the Shenzhen Rules) and accompanying text.

13. Michael Minor & Karen J. Stevens-Minor, *China's Emerging Bankruptcy Law*, 22 INT'L. LAW. 1217, 1218 (1988).

14. *Id.*

15. Steven L. Toronto, *Bankruptcy of Foreign Enterprises in the PRC: An Interpretation of the "Rules Concerning Bankruptcy of Foreign Related Companies in the Shenzhen Special Economic Zone,"* 4 J. CHINESE L. 277, 277 (1990).

16. *Id.* The factory was a subsidiary operated by a Hong Kong holding company already in receivership. *Id.* The authorities in Shenzhen negotiated with Peat Marwick, the receiver appointed by the Hong Kong court. *Id.* Peat Marwick ultimately gained possession of the factory and liquidated its assets. *Id.* At the time, bankruptcy laws had not been passed. *Id.* Thus, it was simply a matter of negotiation. *Id.*

events, the Chinese economy was unprepared for business failure because of the inadequate development of bankruptcy laws.

This comment assesses the current state of bankruptcy law in China. Part II examines the reluctance by the Chinese Government and other actors to initiate bankruptcy proceedings and, hence, to enforce established bankruptcy laws.¹⁷ Part III explores the basic provisions of existing bankruptcy law in China.¹⁸ Part IV relates recent developments in Chinese bankruptcy,¹⁹ while Part V discusses possible strategies for U.S. businesses suggested by the structure and enforcement of the bankruptcy laws.²⁰

II. WHY HAVE BANKRUPTCY LAWS TAKEN SO LONG TO DEVELOP?

The concept of establishing and applying bankruptcy laws has been vexing for the PRC. The basic Communist model of a command economy with state-owned enterprises rejects the notion of business failure because, at least theoretically, business failure only happens in a capitalist economy.²¹ Insolvency of a state-owned business is also unpalatable for the government, as this implies improper management by the state, not the managers of the enterprise.²² But as the PRC moves to the political principle of Deng Xiaoping, "one country, two systems,"²³ a tenet which allows private as well as state-owned enterprises to operate in China, the necessity for a method to deal with business insolvency grows.

17. See *infra* notes 21-51 and accompanying text.

18. See *infra* notes 52-153 and accompanying text.

19. See *infra* notes 154-174 and accompanying text.

20. See *infra* notes 175-191 and accompanying text.

21. Minor, *supra* note 13, at 1217. See Richard J. Goossen, *China's Bankruptcy Law: Taking Legal Reform to the Next Level*, E. ASIAN EXECUTIVE REP., July 15, 1987 (noting that the government in the Maoist era suppressed individual economic responsibility as a trademark of a capitalistic society).

22. Minor, *supra* note 13, at 1217.

23. ROBERT KLEINBERG, CHINA'S "OPENING" TO THE OUTSIDE WORLD: THE EXPERIMENT WITH FOREIGN CAPITALISM 48 (1990). The principal "one country, two systems" is Deng's non-Marxist political ideal of command and market economies coexisting in China. *Id.* Chinese leaders in 1978 announced an "open door" policy for foreign investment to implement China's "Four Modernizations." See Dermelle, *supra* note 2, at 332. While the original idea was to accelerate the socialist regime by attracting capital and advanced technology, the leadership now views foreign trade as necessary for a strong economy and modernized infrastructure. *Id.*

Even with the development and implementation of bankruptcy legislation,²⁴ many factors conspire against utilizing the lawfully enacted procedures. These factors include: inaccurate analysis of a company's efficiency; the potential for unemployment; the effect on banks and other state-run firms; and the interconnection between the judiciary and the administrative arms of the government.²⁵

First, because the government still controls prices, the efficiency of an enterprise cannot necessarily be measured by its profitability.²⁶ Consequently, an enterprise's profitability does not necessarily reflect its viability, and shutting down a business because of losses is illogical and inequitable.²⁷ Treated similarly, both well managed and poorly run companies with artificially depressed price constraints do not become insolvent and thereby escape bankruptcy.²⁸ Presumably, as the market economy in China grows larger and begins to dominate, prices will fluctuate more with the supply and demand of goods and it will be easier to distinguish between inefficient companies and those which are well-run.

As another factor, the potential for dislocation of workers should a firm be liquidated hinders the proper application of the bankruptcy laws.²⁹ As with any government, the PRC is reluctant to initiate massive unemployment by declaring a large number of enterprises bankrupt.³⁰ Since the right to work is guaranteed under the Communist model, the underpinnings of the entire Chinese economy may be questioned by dislocated workers.³¹ Because the workplace administers much of the welfare system,³² resettlement, retraining, old age pensions, unem-

24. Zhonghua Renmin Gongheguo Qiye Pochanfa [Law of the People's Republic of China on Enterprise Bankruptcy] (Nov. 1, 1988) [hereinafter Enterprise Bankruptcy Law], reprinted in 2 CHINA LAWS FOR FOREIGN BUSINESS: BUSINESS REGULATIONS ¶13-522 (CCH Austl. 1991); Shenzhen Jingji Tequ Shewai Gonsi Pochan Tiaoli [Rules Concerning Bankruptcy of Foreign Related Companies in the Shenzhen Special Economic Zone] (July 1, 1987), [hereinafter Shenzhen Rules], reprinted in 1 CHINA LAWS FOR FOREIGN BUSINESS: SPECIAL ZONES & CITIES ¶ 73-540 (CCH Austl. 1991). The Enterprise Bankruptcy Law was promulgated on December 2, 1986 and became effective November 1, 1988. Toronto, *supra* note 15, at 277 n.3. The Shenzhen Rules were promulgated on November 29, 1986 and became effective July 1, 1987. *Id.* at 277 n.5.

25. See *infra* notes 26-51 and accompanying text (elaborating on these factors).

26. Donald C. Clarke, *What's Law Got To Do With It? Legal Institutions and Economic Reform in China*, 10 UCLA PAC. BASIN L.J. 1, 51 (1991).

27. *Id.* For example, if a government artificially deflates or maintains prices, it reduces the earning potential of businesses, perhaps preventing them from earning a profit. *Id.* Likewise, a poorly run company appears profitable if prices are set artificially high. *Id.*

28. *Id.*

29. See Sheila Tefft, *Beijing Tries to Limit Slew of Bankruptcies*, CHRISTIAN SCI. MONITOR, Aug. 11, 1994, at 9.

30. *Id.*

31. See, e.g., Geoffrey Murray, *China Plans to Give Teeth to Bankruptcy Law*, JAPAN ECON. NEWSWIRE, Mar. 5, 1995, available in LEXIS, News Library, Jen File (explaining that the Chinese government has rarely used the existing bankruptcy laws because of fear of "social chaos and political instability").

32. Clarke, *supra* note 26, at 51. "The urban population receives various welfare benefits through the work unit such as cheap housing, special wage subsidies, ration coupons, theater tickets, vacations, health care, child care and old age pensions." *Id.* In other words, the workplace currently distributes social welfare benefits and not a separate governmental agency.

ployment insurance and medical insurance programs are currently inadequate to handle large numbers of layoffs or retirements.³³ If the government applies a more national approach to the welfare system, the disruption due to bankruptcy and consequential joblessness is lessened.³⁴

Another important reason for the hesitation in liquidating insolvent businesses stems from China's banking sector.³⁵ Most state-owned businesses have expanded by receiving loans from government banks.³⁶ Companies on the verge of insolvency are likely to be heavily indebted³⁷ and large-scale bankruptcy would simply shift the insolvency burden to the banks.³⁸ Banks in most developed countries maintain adequate reserves for bad debts.³⁹ Chinese banks, however, have maintained a very low ratio of bad debt reserves to total debt⁴⁰ because the government always ensured continued operation, and thus continued repayment of debt.⁴¹ As a result, Chinese banks are ill equipped for a large number of bankruptcies with derivative loan default. If the banks fail as a consequence of such action, the Chinese economy would be in turmoil.⁴² In order to prepare for a surge of bankruptcies, the government has set up a reserve fund of seven billion yuan⁴³ as a guard against bad debts due to anticipated bankruptcies.⁴⁴

33. *Prospects for China's Bankruptcy System Viewed*, INT'L INTELLIGENCE REP., July 11, 1994.

34. See Mark O'Neill, *China Says It Will Implement Bankruptcy Laws*, REUTERS, Aug. 16, 1994, available in LEXIS, News Library, Reuwl File (discussing reasons for not implementing the current bankruptcy laws). If welfare benefits are distributed through the workplace and the enterprise fails, the benefit is extinguished and the government must find new work for an employee. *Id.* Therefore, a national unemployment insurance or pension system would secure those benefits for a worker regardless of the health of an enterprise. *Id.*

35. INT'L INTELLIGENCE REP., *supra* note 33; see Tony Walker, *China Prepares Its Banks for the 21st Century*, FIN. TIMES, July 4, 1995 (noting that China's banking sector remains rooted in the past and while it needs to become more responsive to the needs of a modern economy, some 20-30% of loan portfolios are "non-performing" due to state-run enterprises).

36. INT'L INTELLIGENCE REP., *supra* note 33.

37. *Id.*

38. *Bankruptcy Law Implementation Faces "Mountains of Difficulties,"* BBC SUMMARY OF WORLD BROADCASTS, May 12, 1994 [hereinafter BBC SUMMARY].

39. INT'L INTELLIGENCE REP., *supra* note 33. Commonly, banks in developed countries keep this ratio at 1% or more of loan assets. *Id.*

40. *Id.* In China, the ratio of bad debts to loan assets has typically been 0.1%, or 1/10 that of developed countries. *Id.*

41. See Walker, *supra* note 35 (explaining that China's "big four" specialized banks which dominate the banking sector—Industrial and Commercial Bank, Bank of China, Agricultural Bank and People's Construction Bank—act like fiscal agents of government policy rather than commercial financial institutions). *But see id.* (discussing a new commercial banking law, effective June 30, 1995, which gives banks legal authority to resist interference from state officials in their lending decisions).

42. BBC SUMMARY, *supra* note 38. Because the money loaned comes mainly from ordinary depositors, "if a bank also goes bankrupt, society would experience major turmoil." *Id.* Rather than see their debtors go bankrupt, banks prefer to see the enterprises "indefinitely in arrears." *Id.*

43. As of September 1, 1995, 8.32 Chinese yuan exchanged for US\$1, or one yuan equaled US\$0.12. *Foreign Money*, S.F. CHRON., Sept. 2, 1995, at D6. Thus, seven billion yuan represents a bad debt reserve of approximately US\$840 million.

44. INT'L INTELLIGENCE REP., *supra* note 33.

A similar phenomenon could extend to businesses other than banks. If one enterprise becomes insolvent, other firms with business ties will likewise suffer serious losses.⁴⁵ Bankruptcy on a large scale may precipitate a chain reaction of business failure because of the interrelation of so many state-run firms.⁴⁶

An overriding consideration in applying bankruptcy laws is the interconnection of the administrative and judicial functions of the government.⁴⁷ In bankruptcy proceedings, Chinese judges consider the relationship between the central and local administrative authorities and the judiciary itself.⁴⁸ Judges share many of the concerns of the workers and bankers.⁴⁹ Accordingly, the judiciary works very closely with the central administrative agency overseeing failing enterprises and the local authority regulating the state-controlled bank.⁵⁰ Judges hesitate to apply the bankruptcy laws because the courts are not entirely independent from other sectors of the government.⁵¹

45. BBC SUMMARY, *supra* note 38. For example, because some enterprises dominate the processing of local resources, their bankruptcy jeopardizes the development of local resources and impacts an entire local economy. *Id.*

46. *Id.* "[T]he bankruptcy of a large number of enterprises will inevitably bring about a chain reaction because debt chains exist among all enterprises. If one enterprise goes bankrupt, other enterprises with business relations will suffer serious losses." *Id.*

47. See *Jurists on China's Bankruptcy Law*, XINHUA NEWS AGENCY, Jan. 11, 1995, available in LEXIS, News Library, Xinhua File [hereinafter *Jurists*] (describing the relationship between the judiciary and the administrative arms of the government, which has the responsibility of overseeing the operations of state-owned firms). While technically a separate branch of the government, under the Communists, until recently, the courts existed as an arm of the central leadership (particularly when it concerns political dissidents). MARCUS W. BRAUCHLI, *Beijing Eases Up: China's New Economy Spurs Legal Reforms, Hopes for Democracy*, WALL ST. J., June 20, 1995, at A1. The Communist Party's Central Political-Legal Committee guides the judiciary, and every court includes a committee of senior judges, often party members, with reversal power. *Id.*

48. *Jurists*, *supra* note 47. Hu Yulin, Chief Judge of the Economic Court of Tianjin's Higher People's Court, recognized "that it is quite different for a state-owned enterprise in China to go bankrupt than for a firm in the western world to go bankrupt." *Id.*

49. *Id.* Judge Hu noted that "[d]ue to historical reasons, the bankruptcy of a state-owned enterprise has a great bearing on the interests of its workers, creditors and the state in China, especially when the relation between the government and enterprises has not yet been streamlined and the government still has a final say over the enterprises." *Id.*

50. *Id.* Judge Hu added, "[I]n the course of a bankruptcy and auction, the judicial departments have to consult with those of the administrative in resettling workers, evaluating fixed assets and land-use transfer. . . . For this reason, a unity of law, economy and social development must be achieved." *Id.* This close working relationship and the fact that Chinese laws grant considerable judicial leeway often result in regional protectionism. Brauchli, *supra* note 47, at A1.

51. *Jurists*, *supra* note 47. In essence, judges in China regard their function in bankruptcy as a coordinator of interests, rather than a final arbiter of disputes as they are in the United States. *Id.* Cf. 11 U.S.C. § 105 (1994) (granting the bankruptcy court broad authority to carry out, to any necessary extent, the provisions of the Bankruptcy Code). But see Brauchli, *supra* note 47 (noting the slow emergence of an independent Chinese judiciary).

III. ELEMENTS OF BANKRUPTCY LAW⁵²

Unlike the United States⁵³ and other developed countries, China does not uniformly apply its Bankruptcy Laws.⁵⁴ Two main variables affect what law is used: how an enterprise is organized and where it is located.⁵⁵

As originally enacted, the Enterprise Bankruptcy Law applies only to state-owned businesses.⁵⁶ While this covers the vast majority of Chinese companies, the law excludes local collective, township and cooperative enterprises, privately owned firms, and, of more importance to Western investors, Sino-foreign joint ventures and wholly foreign-owned enterprises.⁵⁷ Bankruptcy rules formulated especially for foreign enterprises in the Shenzhen Special Economic Zone (SEZ) govern joint ventures and foreign-owned enterprises.⁵⁸ Accordingly, if the busi-

52. In this Part, the term "insolvency" refers to the condition whereby a debtor is unable to pay its debts to its creditors, or, more specifically, a debtor's assets, if immediately available, do not satisfy its liabilities. BLACK'S LAW DICTIONARY 547 (6th ed. 1990). "Bankruptcy" is the ensuing judicial process which either distributes the assets among creditors, thereby discharging the debtor from liability, or restructures the debt. *Id.* at 100. Simply put, a "liquidation" occurs when the assets of an enterprise are sold and the proceeds are distributed among its creditors according to a set formula. *Id.* at 642. In the United States, this is covered in Chapter 7 of the Bankruptcy Code. 11 U.S.C. § 701 *et. seq.* (1994). Entities and individuals may also liquidate substantially all their assets in a Chapter 11 bankruptcy. 11 U.S.C. §1123(b)(4) (1994). In a "reorganization," the debtor proposes to keep all its assets in exchange for a promise to pay its debts over a longer period of time. BLACK'S LAW DICTIONARY 900 (6th ed. 1990). Chapter 11 of the U.S. Bankruptcy Code addresses this area. 11 U.S.C. §§ 1101 *et. seq.* (1994). Sole proprietors in the United States may reorganize under a Chapter 13 Bankruptcy. 11 U.S.C. §§ 1301 *et. seq.* In reorganization, the debtor and its creditors devise a "conciliation" plan for paying out the owed debt. U.S. reorganization cases may convert to Chapter 7 liquidations at the request of the debtor or by the court if in the best interest of creditors. 11 U.S.C. § 1112 (1994).

53. In the United States, all bankruptcy proceedings for individuals and businesses, regardless of geographic location, fall under the jurisdiction of a Federal District Court. 28 U.S.C. § 1334 (1994). The bankruptcy court constitutes a unit of the district court. 28 U.S.C. § 151 (1994). The district court refers all bankruptcy cases to the bankruptcy judges within this unit. 28 U.S.C. § 157(a) (1994). While there are inevitable minor variations from district to district, the bankruptcy courts all follow the procedures set forth by the Bankruptcy Code and Bankruptcy Rules. This uniformity is not so in China; *see infra* notes 56-59 and accompanying text (expanding on the differences in the application of bankruptcy law within China).

54. *See supra* note 12 (discussing the history of bankruptcy law in China) and note 24 (giving the names and effective dates of the Enterprise Bankruptcy Law and the Shenzhen Rules).

55. *See infra* notes 56-59 and accompanying text (reviewing the applicability of bankruptcy laws to business entities in China).

56. Enterprise Bankruptcy Law, *supra* note 24, art. 2; *see* Xiaohua, *supra* note 12, at 375-77 (stating that most of the large industrial and commercial enterprises are state-owned). The law only applies to state-run businesses because: (1) close government supervision and responsibility for poor performance makes the enterprises inefficient, and therefore, bankruptcy provides incentive to operate more efficiently; (2) state-run firms dominate the economy, so the law's greatest impact will be on the largest part of the economy; and (3) since only state-owned enterprises can transfer debts to the government, a bankruptcy system will impact the government's budget more than other forms of ownership. *Id.* at 376-77. *But see* Murray, *supra* note 31 (stating that a new law will apply to all enterprises).

57. Xiaohua, *supra* note 12, at 376.

58. Shenzhen Rules, *supra* note 24. Article 2 describes which enterprises may utilize the law. *Id.*, art. 2. *See* Toronto, *supra* note 15, at 277. For insight into the special economic zones, *see* KLEINBERG, *supra* note 23, at 48-52; *infra* notes 115-127 and accompanying text.

ness is not owned by the state or located in the Shenzhen SEZ, it is not specifically covered under the bankruptcy laws of China.⁵⁹

Chinese laws, including those covering bankruptcy, serve as guidelines for the People's Courts in dispute resolution rather than as rigid binding statutes. Consequently, they are more concise than laws in the United States.⁶⁰ So while the Enterprise Bankruptcy Law and the Shenzhen Rules are technically only applicable to a narrow set of circumstances, the general principles they espouse apply, by analogy, to all businesses.⁶¹ This Part examines the basic provisions of the Enterprise Bankruptcy Law⁶² and how businesses with some component of foreign ownership fare under the Shenzhen Rules.⁶³

A. State-Owned Enterprises

Under the Enterprise Bankruptcy Law, the bankruptcy process begins upon the filing of a petition with the People's Court.⁶⁴ While either debtors or creditors may file bankruptcy petitions, a debtor's petition requires the consent of its supervising governmental department.⁶⁵ Voluntary bankruptcy filings by a debtor are not considered for reorganization, unlike U.S. law which permits the debtor to choose between reorganization and liquidation.⁶⁶ Debtors are unlikely to file a voluntary petition to liquidate because of the resultant unemployment and, if they

59. A court might apply the Shenzhen Rules by analogy outside of the SEZ. Toronto, *supra* note 15, at 277. But facially the Rules only apply to foreign enterprises within the SEZ. Shenzhen Rules, *supra* note 24, art. 2.

60. Jonathan L. Flaxer, *Bankruptcy in China*, AM. BANKR. INST. J., June 13, 1994, at 24.

61. Toronto, *supra* note 15, at 277. Recall that there is no case law in the Chinese civil system and, therefore, each new case is an interpretation of the statute. Dernelle, *supra* note 2, at 331 n.1; cf. Brauchli, *supra* note 47 (indicating that in some disputes, judges follow international practices rather than just Chinese laws because, as one judge explained, "[s]ometimes there are inadequate laws.").

62. Enterprise Bankruptcy Law, *supra* note 24; see *infra* notes 64-113 and accompanying text (detailing the provisions of the law).

63. Shenzhen Rules, *supra* note 24; see *infra* notes 128-153 and accompanying text (describing the provisions of the Rules).

64. Enterprise Bankruptcy Law, *supra* note 24, arts. 5, 7, 8; Flaxer, *supra* note 60, at 24.

65. The law refers to the "higher level department in charge." Enterprise Bankruptcy Law, *supra* note 24, art. 8; Flaxer, *supra* note 60, at 24. For state-owned businesses, government agencies control each economic sector. See, e.g., Joseph Kahn, *Chinese Corporations Bulk Up to Take on the World*, WALL ST. J., July 5, 1995, at A6 (recognizing that Sinochem, China's largest company was "[o]riginally structured as a fief, with oil and trade officials acting as its overlords. . .").

66. Article 17 indicates that a creditor-initiated bankruptcy may result in a reorganization. Enterprise Bankruptcy Law, *supra* note 24, art. 17. Debtor-initiated reorganizations are not mentioned. Minor, *supra* note 13, at 1220. Under the U.S. Bankruptcy Code, a debtor or creditor may file a plan for a Chapter 11 reorganization. 11 U.S.C. § 1121 (1994). For a sole proprietor or individual under Chapter 13, only the debtor files the plan. 11 U.S.C. § 1321 (1994).

are found to be primarily responsible for the insolvency, concomitant sanctions to both managers and employees of the overseeing government department.⁶⁷

After considering the debtor's capacity to repay debts and its payment history to its creditors, the court will either accept or reject the case within seven days.⁶⁸ Should the court refuse to accept the case, the petitioner has ten days to appeal.⁶⁹ If the court accepts a creditor's petition, the debtor is given fifteen days to respond.⁷⁰ The debtor must provide the same type of information it would give if it were filing a petition.⁷¹ Once accepted, the court grants the rough equivalent to an automatic stay.⁷² However, unlike U.S. law, there is no relief from the stay provision, nor is it effective before the court agrees to accept the petition.⁷³

The court gives written notice of the case by mail to known creditors within ten days of acceptance, and by publication to all others.⁷⁴ Creditors receiving notification must file their claims within one month, while others have three months from the public announcement.⁷⁵ A creditor voluntarily renounces its

67. See Enterprise Bankruptcy Law, *supra* note 24, art. 42 (describing the process whereby government inspectors and auditors ascertain who is at fault for leading the enterprise into bankruptcy). Article 42 states that the legal representative or the leaders of the higher level department in charge will incur "disciplinary sanctions" should they bear responsibility for the bankruptcy. *Id.*; Minor, *supra* note 13, at 1224. If, through neglect of duty, the party responsible causes "great loss to state property," criminal liability may be imposed according to Article 187 of the Criminal Code of the People's Republic of China. Enterprise Bankruptcy Law, *supra* note 24, art. 42. Article 187 in the Criminal Code specifies a prison sentence or forced labor up to a period of five years. *Id.* at App.

68. Flaxer, *supra* note 60, at 24.

69. *Id.*

70. Enterprise Bankruptcy Law, *supra* note 24, art. 10; Flaxer, *supra* note 60, at 24.

71. See Enterprise Bankruptcy Law, *supra* note 24, art. 8 (outlining briefly what a debtor needs to submit in its response to the creditor's petition for bankruptcy). It is quite similar to the information required in a U.S. bankruptcy petition. Flaxer, *supra* note 60, at 24. Basically, in the United States, a petition requires a list with the names and addresses of known creditors, a list of the equity security holders and a schedule of assets and liabilities. See Bankruptcy Rule 1007 (setting forth lists, schedules and statements required).

72. Enterprise Bankruptcy Law, *supra* note 24, art. 11; see Minor, *supra* note 13, at 1223 (analogizing the Enterprise Bankruptcy Law and the U.S. Bankruptcy Code with respect to an automatic stay). An automatic stay enjoins creditors from pursuing their claims, thus protecting the debtor from other collection attempts. See 11 U.S.C. § 362 (1994) (discussing the provisions for an automatic stay in the U.S. Bankruptcy Code).

73. Enterprise Bankruptcy Law, *supra* note 24, art. 11; Minor, *supra* note 13, at 1223. The Enterprise Bankruptcy Law is therefore less accommodating to both debtors and creditors. *But see* 11 U.S.C. § 362(d) (1994) (giving rationale for lifting or relieving the automatic stay under the U.S. Bankruptcy Code).

74. Enterprise Bankruptcy Law, *supra* note 24, art. 9; Minor, *supra* note 13, at 1223. Article 9 states that a "public announcement shall be issued," but fails to indicate the medium by which notice is published. Enterprise Bankruptcy Law, *supra* note 24, art. 9.

75. Enterprise Bankruptcy Law, *supra* note 24, art. 9. Under U.S. bankruptcy procedures, claimants in Chapter 7 liquidation proceedings generally must file within 90 days from the first date set for the meeting of creditors, with six narrowly drawn exceptions. See Bankruptcy Rule 3002(c) (listing requirements for filing claims in the U.S. bankruptcy system). For a Chapter 11 reorganization, the U.S. Bankruptcy Court fixes the claims bar date. See Bankruptcy Rule 3003(c)(3) (giving requirements for filing timely claims in Chapter 11 cases).

claim if not lodged within the time limit.⁷⁶ Interestingly, secured and unsecured claims are filed separately,⁷⁷ even though it is difficult to obtain and perfect a security interest in China.⁷⁸ Property pledged to secured creditors is excluded from the bankruptcy estate.⁷⁹ If the underlying asset is insufficient to satisfy the debt, the remainder may be asserted as an unsecured claim.⁸⁰

The Enterprise Bankruptcy Law also permits creditors to initiate bankruptcy proceedings.⁸¹ If this type of filing occurs, the supervising governmental department may intervene within three months and request a reorganization.⁸² This initiates a process similar to the development of a Chapter 11 plan in U.S. bankruptcy law.⁸³ Once sought, the creditor must complete a reorganization within two years.⁸⁴ All unsecured creditors form a creditors' committee and the court appoints a chairperson.⁸⁵ As in the United States, the debtor must propose a conciliation plan to a meeting of the creditors.⁸⁶ The conciliation agreement must include the reasons for the insolvency, proposed improvements to management and productivity, a repayment plan and a proposal to discharge any remaining debts.⁸⁷ The term of reorganization may not exceed two years.⁸⁸ The creditors may approve or reject the plan.⁸⁹ If the committee agrees upon a plan, the court suspends bankruptcy proceedings.⁹⁰ The governmental department in charge of the debtor administers the plan.⁹¹ If the plan succeeds, the reorgani-

76. Enterprise Bankruptcy Law, *supra* note 24, art. 9. The U.S. Bankruptcy Code generally bars untimely claims, but may permit them if lodged before distribution. *See* 11 U.S.C. § 726(a)(1) (1994) (providing for the distribution of bankruptcy estate property).

77. Enterprise Bankruptcy Law, *supra* note 24, art. 9; Flaxer, *supra* note 60, at 24.

78. *See* Toronto, *supra* note 15, at 277 (discussing the lack of a registration system to publicize security interests in China and, hence, the problems of establishing priority among secured creditors); *see also* Shanks, *supra* note 6, at 389 (examining the undeveloped concept of security for financing in China). Because the process of obtaining and documenting security is unclear, gaining a security interest that is enforceable is highly problematic. *Id.*

79. Enterprise Bankruptcy Law, *supra* note 24, art. 28.

80. *Id.* art. 28; Flaxer, *supra* note 60, at 24.

81. Enterprise Bankruptcy Law, *supra* note 24, arts. 3, 7.

82. Enterprise Bankruptcy Law, *supra* note 24, art. 17; Minor, *supra* note 13, at 1221.

83. Minor, *supra* note 13, at 1221; *see* 11 U.S.C. §§ 1101-46 (1994) (covering the administration, formation and implementation of a reorganization under Chapter 11 in the U.S. Bankruptcy Code).

84. Enterprise Bankruptcy Law, *supra* note 24, art. 17; Flaxer, *supra* note 60, at 24.

85. Enterprise Bankruptcy Law, *supra* note 24, arts. 13, 18; Flaxer, *supra* note 60, at 24.

86. Enterprise Bankruptcy Law, *supra* note 24, art. 18; *see* 11 U.S.C. § 1121 (indicating that, generally, a debtor files a reorganization plan).

87. Flaxer, *supra* note 60, at 24.

88. Enterprise Bankruptcy Law, *supra* note 24, art. 17.

89. *Id.* art. 19; *see* 11 U.S.C. § 1126 (discussing the acceptance of a reorganization plan under Chapter 11 of the U.S. Bankruptcy Code).

90. Enterprise Bankruptcy Law, *supra* note 24, art. 19; Minor, *supra* note 13, at 1221. The court suspends proceedings to allow execution of the plan. *Id.*

91. Enterprise Bankruptcy Law, *supra* note 24, art. 20.

zation terminates the case entirely and the People's Court issues a public announcement to that effect.⁹²

The voting system within the creditors' committee resembles U.S. procedures: one-half of the claimants and two-thirds of the total debt represented must approve the plan.⁹³ A positive vote binds all members of the committee to the agreement.⁹⁴ If the committee is unable to agree on a plan, or the debtor subsequently abrogates the agreement, the parties may convert the reorganization plan to a liquidation.⁹⁵ Conversion may also occur if the business continues to deteriorate financially, conceals or sells off assets at prices less than fair market value, or commits other fraudulent acts.⁹⁶ If the supervising governmental agency declines to support a reorganization effort in the first place, or if the debtor initiates the proceeding, the court declares a liquidating bankruptcy.⁹⁷

Under liquidation, the court establishes a liquidating committee consisting of representatives of the supervising authority, government finance departments and other professionals.⁹⁸ Notably absent is representation from workers.⁹⁹ This is surprising given the prominence of the worker in Communist ideology and the fact that wages are given the highest priority under claims by unsecured creditors.¹⁰⁰ The liquidation committee acts as trustee and has the power to terminate contracts;¹⁰¹ recover property transferred within six months of bank-

92. *Id.* art. 22; Minor, *supra* note 13, at 1221.

93. Enterprise Bankruptcy Law, *supra* note 24, art. 16. Under the Enterprise Bankruptcy Law, the creditors' committee consists of all creditors. *Id.*, art. 13. Usually the seven largest unsecured creditors comprise the creditors' committee under U.S. bankruptcy law. 11 U.S.C. § 1102 (1994). The voting required for approval in the United States is also one-half of the number of claimants and two-thirds of the total debt, but these fractions apply to the entire class of creditors, not the creditors' committee. *Id.* § 1126(c).

94. Enterprise Bankruptcy Law, *supra* note 24, art. 16; Flaxer, *supra* note 60, at 24.

95. Enterprise Bankruptcy Law, *supra* note 24, art. 21; Flaxer, *supra* note 60, at 24.

96. Enterprise Bankruptcy Law, *supra* note 24, arts. 21, 35; Flaxer, *supra* note 60, at 24.

97. Flaxer, *supra* note 60, at 24; *see* Enterprise Bankruptcy Law, *supra* note 24, arts. 7, 8, 23 (describing situations in which the People's Court will declare bankruptcy).

98. Enterprise Bankruptcy Law, *supra* note 24, art. 24; Minor, *supra* note 13, at 1222.

99. Minor, *supra* note 13, at 1222. Workers are involved to an extent in reorganization in that their representative assembly is kept informed regarding the status of the plan and its opinion is "respected." *Id.* at 1222 n.35; *see* Enterprise Bankruptcy Law, *supra* note 24, art. 20 (detailing workers involvement in the bankruptcy process). In the United States, worker representation is neither required nor precluded, although a creditors' committee under the U.S. Bankruptcy Code ordinarily consists of the seven largest unsecured creditors. 11 U.S.C. § 1102(b)(1). In China, the government has always protected workers' interests with its "iron rice bowl" policy. Murray, *supra* note 31. The Bankruptcy law reflects this by authorizing the government to re-employ the workers and to guarantee their basic living requirements. Enterprise Bankruptcy Law, *supra* note 24, art. 4. Despite this provision, it may be that workers are excluded because they would reject any plan that closes down the enterprise and causes unemployment. For a discussion on the effects of bankruptcy on the dislocation of workers, *see supra* notes 29-34 and accompanying text.

100. Enterprise Bankruptcy Law, *supra* note 24, art. 37; Minor, *supra* note 13, at 1224. Workers wages rank fairly high in the U.S. priority scheme, as well. *See* 11 U.S.C. § 507 (1994) (arranging claim priority under the U.S. Bankruptcy Code).

101. Enterprise Bankruptcy Law, *supra* note 24, art. 26.

ruptcy under certain conditions;¹⁰² commence civil actions on behalf of the bankruptcy estate; appraise and dispose of property; and employ appropriate personnel to perform these functions.¹⁰³ After the liquidation panel formulates and the creditors' committee approves a plan for liquidation, the finalized plan is filed with the court for confirmation.¹⁰⁴ If accepted, the liquidation committee executes the plan.¹⁰⁵

Claim priority resembles that in the U.S. Bankruptcy Code.¹⁰⁶ Because the estate does not include assets pledged as security for debt, secured creditors are paid first to the extent that the assets satisfies their claim.¹⁰⁷ The administrative expenses of the liquidation, including legal, management, and cost of selling, obtain the highest priority for repayment from the remaining assets.¹⁰⁸ Finally, unpaid salaries and labor insurance premiums for the employees; taxes owed; and unsecured creditor claims, including the unsecured portion of a partially secured debt, on a pro rata basis all follow in order.¹⁰⁹

Upon successful completion of the plan, the court closes the bankruptcy case.¹¹⁰ If the court discovers within a year of concluding the proceeding that the debtor improperly transferred property,¹¹¹ it may reopen the case, recover the property and distribute the proceeds among creditors.¹¹² These wrongful actions may also result in disciplinary sanctions and criminal liability for the legal representative of the enterprise and other responsible parties.¹¹³

102. Minor, *supra* note 13, at 1222; Enterprise Bankruptcy Law, *supra* note 24, art. 35. The conditions are: (1) concealment of assets; (2) asset distribution without any or adequate consideration; and (3) securitizing a previously unsecured debt or pre-paying an unmatured debt. *Id.* Some of these conditions are similar to the concept of "fraudulent conveyances" under U.S. law. See generally UNIF. FRAUDULENT TRANSFER ACT § 1 *et. seq.*, 7A U.L.A. 639 (1984); UNIF. FRAUDULENT CONVEYANCE ACT § 1 *et. seq.* 7A U.L.A. 427 (1918). However, the Enterprise Bankruptcy Law does not provide for recovery of pre-petition payments of unsecured debts. Minor *supra* note 13, at 1222. Under U.S. law, the bankruptcy trustee may void these preferential payments. 11 U.S.C. § 547 (1994).

103. Enterprise Bankruptcy Law, *supra* note 24, art. 24; Flaxer, *supra* note 60, at 24.

104. Enterprise Bankruptcy Law, *supra* note 24, arts. 37-38; Minor, *supra* note 13, at 1223.

105. Enterprise Bankruptcy Law, *supra* note 24, art. 37; Minor, *supra* note 13, at 1223.

106. See Enterprise Bankruptcy Law, *supra* note 24, arts. 34, 37 (listing the priority of unsecured claims); Cf. 11 U.S.C. § 507 (stating priorities of unsecured claims under the U.S. Bankruptcy Code); 11 U.S.C. § 506 (determining secured claim status).

107. Enterprise Bankruptcy Law, *supra* note 24, art. 9; Flaxer, *supra* note 60, at 24. See *supra* notes 77-80 and accompanying text (examining secured claims).

108. Enterprise Bankruptcy Law, *supra* note 24, art. 34; Minor, *supra* note 13, at 1223. Accord 11 U.S.C. § 507(a)(1).

109. Enterprise Bankruptcy Law, *supra* note 24, art. 37; Minor, *supra* note 13, at 1224.

110. Minor, *supra* note 13, at 1223; Enterprise Bankruptcy Law, *supra* note 24, art. 38. While the liquidation committee performs the distribution of assets, the court retains jurisdiction until all assets are gone. *Id.* The liquidation group then petitions the court to conclude the bankruptcy proceedings. *Id.*

111. See *supra* note 102 and accompanying text (listing instances of improperly transferred property).

112. Enterprise Bankruptcy Law, *supra* note 24, art. 40.

113. *Id.*, art. 41. Article 41 states that "criminal liability will be investigated in accordance with the law," yet does not indicate what punishments might ensue. *Id.* But recall that negligence which results in serious losses can be punished by prison or forced labor for up to five years. See *supra* note 67 and accompanying text

B. Enterprises with Foreign Investment in the Shenzhen SEZ

The history and development of the Shenzhen SEZ help explain why the bankruptcy laws differ from those in other areas of China. This section briefly explores the evolution of Shenzhen and then describes its bankruptcy laws.

1. About the Zone¹¹⁴

In the 1970s, China began to address its declining economy as contrasted with the successes of foreign investment in other East Asian States.¹¹⁵ In 1979, the government created four Special Economic Zones where outsiders could invest and become owners in Chinese enterprises.¹¹⁶ Incentives to foreigners included tax concessions,¹¹⁷ reduced land fees¹¹⁸ and more flexible labor regulations.¹¹⁹ The state intended for the zones to attract advanced technology and capitalist expertise which could be used elsewhere in the country.¹²⁰ China would also accumulate needed foreign currency.¹²¹ The location of zones was thought to advance political ties with other centers for foreign investment: Shenzhen, next to Hong Kong; Zhuhai, adjacent to nearby Macao; and Xiamen, directly across from Taiwan.¹²² Shantou had close trading ties to Southeast Asia because Chinese nationals there speak a similar dialect.¹²³ Because of its proximity to Hong Kong and, more importantly, the reversion of Hong Kong to China in 1997, Shenzhen is the largest and most developed of the four zones.¹²⁴ China hopes to minimize

(discussing negligence of enterprise officials).

114. See generally KLEINBERG, *supra* note 23, at 47-66.

115. *Id.* at 47-49. Specifically, China decided that direct foreign investment was desirable. *Id.*

116. *Id.* at 47-48.

117. *Id.* at 54. The government taxes enterprise income at a flat 15% rate, less than in other parts of China. *Id.* If the business introduces advanced technology or is valued above US\$5 million, the tax may be reduced by 20% to 50%. *Id.*

118. KLEINBERG, *supra* note 23, at 54. The authorities may grant exemptions or reduce fees by 50%, depending on factors such as the introduction of advanced technology. *Id.*

119. *Id.* at 54-55. Differences with the rest of China include: contracts with individual employees rather than with workers' trade unions; wage levels not set in concert with state-run firms, including wage incentives for performance; flexibility in probation, wage reduction, and redundancy dismissals; and the right of workers to resign. *Id.*

120. *Id.* at 47. Shenzhen instead became an entry point which allowed foreigners access to China's internal markets, building low-technology assembly plants and creating a large service sector. *Id.* at 48.

121. *Id.* By greatly subsidizing the growth in infrastructure to support the anticipated industrial development, the Chinese Government drained hard currency from other sectors, including agriculture. *Id.* This overshadowed any gain in foreign currency. *Id.*

122. KLEINBERG, *supra* note 23, at 51. The government particularly wished to assure Hong Kong about its capitalist future after 1997 and, assuming success, induce negotiations with Taiwan. *Id.*

123. *Id.*

124. *Id.* at 48-52. In geographic size, Shenzhen originally comprised 97% of all the SEZs and even with expansion of the others is still 62%. *Id.* at 52. By 1984, Shenzhen accounted for US\$580 million of the total foreign investment in China of US\$840 million. *Id.* Its proximity to Hong Kong gives Shenzhen access to one

the gap in social and economic development between China and Hong Kong by 1997, and limit the flow of refugees to Hong Kong as well.¹²⁵ Not coincidentally, Shenzhen has the largest number of foreign investors in China.¹²⁶ As a natural result of the existence and growth of the zone, Shenzhen developed a bankruptcy law for foreign related companies.¹²⁷

2. Bankruptcy of Foreign Entities in the Shenzhen SEZ

Development of the Shenzhen Rules¹²⁸ coincided with proposals for the Enterprise Bankruptcy Law.¹²⁹ The efforts in Shenzhen ebbed when the national law was proposed.¹³⁰ But since the Enterprise Bankruptcy Law excluded all but state-owned businesses, Shenzhen forged ahead and developed its own rules for foreign related enterprises.¹³¹ The Guangdong Provincial People's Congress promulgated the Shenzhen rules in November 1986.¹³²

For the Rules to apply, an enterprise must have some component of foreign investment and be considered a legal person under Chinese Law.¹³³ While pro-

of the largest consumer markets in the world. *Id.*

125. *Id.* at 51. Roughly 480,000 people emigrated—most illegally—from China to Hong Kong between 1976 to 1981. *Id.* at 49.

126. Toronto, *supra* note 15, at 277; *see supra* note 124 (discussing foreign investment activity in Shenzhen).

127. Toronto, *supra* note 15, at 277. The legal structure in Shenzhen was developed to reassure foreign investors. KLEINBERG, *supra* note 23, at 53. To supplement this framework, a special governmental unit was created to reduce delays in approving foreign investment projects due to bureaucratic inefficiency. *Id.* at 56. Much of China's foreign investment legal practices originated in Shenzhen and their slow adoption in the rest of the country continues. Toronto, *supra* note 15, at 277 n.7. Because the Enterprise Bankruptcy Law only covers state-owned businesses, the authorities in Shenzhen developed bankruptcy provisions for the foreign enterprises within the SEZ. *Id.* at 277.

128. Shenzhen Rules, *supra* note 24.

129. Enterprise Bankruptcy Law, *supra* note 24.

130. Toronto, *supra* note 15, at 227. Because of the drive to construct a legal framework conducive to foreign investors, the Rules were most likely drafted by the Shenzhen authorities before the National People's Congress drafted the Enterprise Bankruptcy law. *Id.* But since the Enterprise Bankruptcy Law initially covered foreign investment enterprises, efforts to formulate the Shenzhen Rules waned because they would be duplicative. *Id.*

131. *Id.* at 227. Once it became clear that the Enterprise Bankruptcy Law only applied to state-owned businesses, impetus for the Shenzhen Rules began anew. *Id.* For the Rules to apply, the enterprise must have some element of foreign ownership. *See infra* note 133 (elaborating on the foreign ownership requirement).

132. Shenzhen Rules, *supra* note 24; Toronto, *supra* note 15, at 277.

133. Toronto, *supra* note 15, at 277. The Rules apply to "Sino-foreign joint equity companies, Sino-foreign co-operative companies, companies with sole foreign investment and Sino-foreign limited stock companies established in the Special Zone." Shenzhen Rules, *supra* note 24, art. 2. For a description of what constitutes a "legal person" in China, see Henry T. Zheng, *Business Organization and Securities Laws of the People's Republic of China*, 43 BUS. LAW. 549, 553-57 (1988). A legal person must be lawfully established, possess the necessary property or funds, have its own name, organizational structure and residence, and be capable of assuming civil liability independently. *Id.* This is analogous to the concept in the United States of a corporation as a separate legal entity. *See* 11 U.S.C. § 101(41) (1994) (defining "person" as an individual, partnership or corporation for purposes of the U.S. Bankruptcy Code).

cedurally similar to the Enterprise Bankruptcy Law, the Shenzhen Rules differ in some key areas on a substantive level.

Under the Shenzhen Rules, creditors and debtors may both initiate actions; however, creditors may petition only for a liquidation bankruptcy, not a reorganization or conciliation.¹³⁴ Under the Enterprise Bankruptcy Law, reorganization is only available if a creditor petition is filed, and only if requested by a supervising government agency.¹³⁵ Further, debtors under the Shenzhen Rules may petition for conciliation, rather than the mandatory liquidation under the Enterprise Law.¹³⁶ Under the Shenzhen Rules, foreign debtors and creditors may pursue remedies in the Shenzhen Municipal Intermediate People's Court.¹³⁷

For an involuntary bankruptcy, a creditor must submit to the court evidence of its claim against the debtor along with proof that the debtor is unable to satisfy the claim.¹³⁸ If the court accepts the case for review at a formal hearing, it sets up a liquidation committee even before a formal hearing may take place.¹³⁹ It seems premature that the liquidation committee takes control of the enterprise prior to a judicial declaration of bankruptcy; nevertheless, the Shenzhen Rules do not clarify or explain this procedural inconsistency.¹⁴⁰

At the formal hearing, the court decides whether the firm should be declared bankrupt.¹⁴¹ Upon that event, one would normally expect a stay from other judicial proceedings against the insolvent business.¹⁴² But unlike the U.S. Bankruptcy Code and the Enterprise Bankruptcy Law, there is no such provision in the

134. Shenzhen Rules, *supra* note 24, art. 7; Toronto, *supra* note 15, at 277.

135. Enterprise Bankruptcy Law, *supra* note 24, art. 17; *see supra* note 82 and accompanying text (discussing the required permission of a supervising government agency for reorganization under the Enterprise Bankruptcy Law).

136. The Rules state that a debtor may apply for either a reorganization/conciliation or a declaration of bankruptcy. Shenzhen Rules, *supra* note 24, art. 7; *cf.* Enterprise Bankruptcy Law, *supra* note 24, arts. 7, 8, 23; *supra* note 66 and accompanying text (describing the lack of a conciliation process for a debtor petition under the Enterprise Bankruptcy Law).

137. Shenzhen Rules, *supra* note 24, art. 6. Recall that the Enterprise Bankruptcy Law concerns only state-owned debtors. Enterprise Bankruptcy Law, *supra* note 24, art. 2; *see supra* notes 56-57 and accompanying text (detailing why only state run enterprises are covered under the Enterprise Bankruptcy Law).

138. Shenzhen Rules, *supra* note 24, art. 8; Toronto, *supra* note 15, at 277.

139. Shenzhen Rules, *supra* note 24, art. 12; Toronto, *supra* note 15, at 277.

140. Toronto, *supra* note 15, at 277; *see* Shenzhen Rules, *supra* note 24, art. 15 (establishing the duties of a liquidation committee, including taking operational control of the enterprise). For involuntary cases in the United States, the Bankruptcy Court appoints a trustee—the equivalent of a liquidation committee—only after notice, hearing and an order for relief has been issued. 11 U.S.C. § 303 (1994).

141. Shenzhen Rules, *supra* note 24, art. 27.

142. In the United States, the filing of a voluntary or involuntary petition operates as a stay to further collection avenues. 11 U.S.C. § 362 (1994). Perhaps the main reason U.S. debtors file for bankruptcy is to gain the benefit of the automatic stay. ROBERT L. JORDAN & WILLIAM D. WARREN, *BANKRUPTCY* 26 (4th ed. 1995).

Shenzhen Rules.¹⁴³ Without this needed protection, the debtor is vulnerable to claims from other creditors.¹⁴⁴

Once a debtor is declared bankrupt, the procedures greatly resemble those in the Enterprise Bankruptcy Law. The liquidation committee meets with a creditors' committee to evaluate their claims.¹⁴⁵ Secured creditors take their assets out of the pool available for the bankruptcy estate.¹⁴⁶ The distribution of assets continues, with the following priority scheme: bankruptcy administrative expenses; employee wage and insurance claims; taxes; and unsecured debt.¹⁴⁷

As with state-owned enterprises, a debtor under the Shenzhen Rules may elect to file for conciliation or reorganization.¹⁴⁸ Supplying the same information to the court as in a bankruptcy petition, the debtor is permitted to continue operating if the court approves the application.¹⁴⁹ The court selects a liquidation committee to oversee operations and develop a conciliation plan with the assistance of a creditors' committee.¹⁵⁰ Both the court and the creditors' committee must approve the plan before implementation.¹⁵¹ Once approved, the creditors and court may police the execution of the plan.¹⁵² If not followed satisfactorily, the court can revoke approval and bankruptcy proceedings may begin anew.¹⁵³

143. Toronto, *supra* note 15, at 277. The U.S. Bankruptcy Code provides for an automatic stay. 11 U.S.C. § 362 (1994). The Enterprise Bankruptcy Law also provides for an automatic stay. Enterprise Bankruptcy Law, *supra* note 24, art. 11; *see supra* note 72 and accompanying text (describing the automatic stay provisions in the Enterprise Bankruptcy Law).

144. Toronto, *supra* note 15, at 277. Without the stay, creditors are presumably free to pursue remedies such as repossession, foreclosure and judicial sale. *Id.* Because these actions are difficult to pursue, the effect of not having a stay does not disadvantage debtors as much as it could. *Id.*

145. Shenzhen Rules, *supra* note 24, arts. 14-15. *Accord* Enterprise Bankruptcy Law, *supra* note 24, art. 15.

146. Shenzhen Rules, *supra* note 24, art. 39. If the security is insufficient, the unsatisfied portion of the debt stands as an unsecured claim. *Id.* *Accord* Enterprise Bankruptcy Law, *supra* note 24, art. 32.

147. Shenzhen Rules, *supra* note 24, arts. 48-49; Toronto, *supra* note 15, at 277. *Accord* Enterprise Bankruptcy Law, *supra* note 24, arts. 34, 37.

148. Shenzhen Rules, *supra* note 24, art. 7. A resolution from the shareholders or Board of Directors must accompany the application, including a list of liabilities. *Id.* art. 8.

149. *Id.* art. 23; *cf.* Enterprise Bankruptcy Law, *supra* note 24, art. 20 (stating the state-run enterprise's "higher level department in charge" manages the enterprise during reorganization).

150. Shenzhen Rules, *supra* note 24, arts. 14, 20-21; *cf.* Enterprise Bankruptcy Law, *supra* note 24, arts. 17-18 (authorizing the enterprise to submit a draft conciliation plan in consultation with its supervising governmental agency).

151. Shenzhen Rules, *supra* note 24, arts. 18, 25; Toronto, *supra* note 15, at 277. Unsecured creditors with at least one-half of the total debt must approve the plan. Shenzhen Rules art. 18. This voting requirement differs from both the U.S. law and that elsewhere in China. *See supra* notes 93-94 and accompanying text (describing voting on a reorganization plan in a creditors' committee under the Enterprise Bankruptcy Law and the U.S. Bankruptcy Code).

152. Shenzhen Rules, *supra* note 24, art. 26. Unsecured creditors with at least one-half of the debt may vote to cancel the plan. *Id.*

153. *Id.* art. 26; Toronto, *supra* note 15, at 277. If the creditors' committee votes to cancel the reorganization, or a creditor or the court discover some fraud committed by the enterprise in connection with the conciliation process, the court may withdraw approval of the plan and declare the enterprise bankrupt. Shenzhen Rules, *supra* note 24, art. 26.

IV. RECENT DEVELOPMENTS IN CHINESE BANKRUPTCY LAW

Despite the fact that the Enterprise Bankruptcy Law and the Shenzhen Rules became effective in the mid-1980s,¹⁵⁴ the laws have been implemented at a very slow pace. The factors noted in Part II,¹⁵⁵ creating a hesitancy on the part of the government to declare businesses bankrupt, remain a barrier to full implementation of the bankruptcy system. Although some companies have filed for bankruptcy, they are but a fraction of the enterprises which are actually failing.¹⁵⁶ Workers, banks and local governments, wary of large-scale unemployment, have opposed the application of the bankruptcy law to insolvent businesses.¹⁵⁷ Some members of the central leadership do not wish to declare many state-run firms bankrupt.¹⁵⁸ Ironically, this opposition and, consequently, the scant application of bankruptcy laws has resulted in economic disruption.¹⁵⁹

Notwithstanding the pressures slowing the implementation of bankruptcy laws, there are signs China is ready to begin applying the law to declare a number

154. The Enterprise Bankruptcy Law was promulgated on December 2, 1986 and became effective November 1, 1988. Toronto, *supra* note 15, at 277 n.3. The Shenzhen Rules were promulgated on November 29, 1986 and became effective July 1, 1987. *Id.*

155. See *supra* notes 21-51 and accompanying text.

156. Since December 1986, slightly more than 2000 Chinese firms have filed for bankruptcy. Foo Choy Peng, *supra* note 7, at 5. Official estimates, however, indicate that about half of the country's 200,000 major state-run enterprises are operating at a loss. *Id.* Also, the State Economic and Trade Commission released figures showing that 41% of 72,000 state-owned businesses in the industrial sector are losing money. *Id.* In 1994, 46 state-run businesses were declared bankrupt and closed. *China to Announce Bankruptcy Law in 1996*, REUTERS, Aug. 21, 1995, available in LEXIS, News Library, Reuwlid File [hereinafter *China to Announce*].

157. See O'Neill, *supra* note 34 (stating that because almost 20% of the loans held by China's four largest banks are non-performing, the banking sector is an especially strong opponent of implementing the law, since they currently do not have the reserves to cover potential losses); 'Liaowang' on Problems of Bankruptcy in Medium and Large State Enterprises, BBC SUMMARY OF WORLD BROADCASTS, May 27, 1994 (observing that taking care of employees and finding new work for them is the most difficult problem facing state firms after bankruptcy and that practice demonstrates that the government cannot fully resolve the dislocation of workers).

158. O'Neill, *supra* note 34. Some leaders may be ideologically opposed to private enterprises and the resultant market economy, while others, jealously guarding their state-owned firms, consider them the core of the Chinese economy and hope to avoid accelerating the shrinking of their share of the economy. *Id.* See Murray, *supra* note 31 (reporting that the existing bankruptcy law is subject to excessive administrative interference and that bureaucrats regulating sectors have no desire to diminish their empires by cutting out the under-achievers). In truth, however, development of the market economy may add to the structural unemployment, with those out of work from state-run businesses unqualified to perform tasks in the more competitive and technologically advanced market sector. O'Neill, *supra* note 34.

159. O'Neill, *supra* note 34. Chinese economists note that, because wages have not been paid, there have been a number of strikes and slow downs at state-owned businesses this year. *Id.* As a result, millions of workers from facilities where production has ceased are staying home and living on subsistence wages. *Id.* The effect of this is a high urban inflation rate of over 20%. *Id.* See Kathy Chen, *Withering of China's State Industries Creates Hordes of New Street Vendors*, WALL ST. J., June 13, 1995 (reporting that small-scale labor protests have become common in Shenyang and other major cities). Several hundred workers marched through the Shenyang chanting "we want to eat." *Id.* In Chongqing, employees demonstrated after a laid-off factory worker and his family committed suicide because they had no funds to buy food. *Id.*

of state enterprises insolvent.¹⁶⁰ One reason the government has reversed direction is that bad debt reserves at banks have improved to afford stability in the face of a large number of bankruptcies.¹⁶¹ Also, a new commercial banking law provides the banks with greater independence from the government.¹⁶² To further ease the pressure on Chinese banks, the government now permits foreign banks to establish branches in China.¹⁶³

As another improvement, the increased availability of unemployment and health insurance diminish the disastrous effect of worker dislocation due to bankruptcy.¹⁶⁴ However, many believe that the implementation of bankruptcy must proceed slowly to avoid instability due to joblessness.¹⁶⁵

In conjunction with these developments, many expect the Chinese Government to amend the Enterprise Bankruptcy Law in the near future.¹⁶⁶ Some of the

160. See O'Neill, *supra* note 34 (noting that The Economic Information Daily reported that Shanghai, Tianjin, Chongqing and Harbin, along with 14 other cities have been chosen to implement a program of bankruptcy closures); Murray, *supra* note 31 (reporting that senior officials issued warnings to struggling state-run businesses to become more efficient or face closure).

161. See Josephine Ma, *Bankruptcy Law Set for Changes*, S. CHINA MORNING POST, Oct. 7, 1994, at 9. According to government advisor Cao Siyuan, the bad debt reserve has been increased from 0.1% of a bank's outstanding loans to 0.6% since January 1994. *Id.* The Chinese Government also intends to increase the ratio to 1% in the next few years. *Id.* Thus, the government has effectively set aside an additional seven billion yuan (US\$841 million) for bad debts in 1994. *Id.*

162. See Walker, *supra* note 35 (noting that among the provisions in the new law is the legal authority of banks to resist pressure from government officials to grant improvident loans); *China Sets Change in Motion*, THE BANKER, June 1995 (reporting that the new law makes the banks separate legal entities, operating independently from the government).

163. Tony Walker et al., *Way is Cleared for Five Banks to Open in Beijing*, FIN. TIMES, June 7, 1995. As of March 31, 1995, foreign bank branches totaled 101, with assets of US\$14 billion, an increase of 40% over the previous year. *Foreign Banking in China Grows*, WALL ST. J., June 20, 1995. Loans to Chinese businesses grew 78% to US\$8.8 billion. *Id.*

164. See O'Neill, *supra* note 34 (stating that 470,000 state-owned companies employing 74 million workers now provide unemployment insurance, while 80% of all businesses are developing health coverage). The rapidly growing number of companies not run by the state (private, collective and foreign) are starting their own retirement programs because their workers are not eligible for government benefits. *Id.*; see also *Developments in Selected Non-OECD Countries*, OECD ECON. OUTLOOK, June 1994 (noting that explicit bankruptcy laws in other countries changing from centrally planned to market economies—Poland, Hungary, and the Czech and Slovak Republics—have not resulted in large increases in unemployment).

165. *Reform Moratorium on Bankruptcy Experiment*, XINHUA NEWS AGENCY, July 7, 1995, available in LEXIS, News Library, Xinhua File [hereinafter *Reform Moratorium*].

166. See Ma, *supra* note 161 (quoting bankruptcy expert and government advisor Cao Siyuan, who was instrumental in drafting the original Enterprise Bankruptcy Law, as saying that he expected the amended draft to be approved at the next meeting of the Standing Committee of the National People's Congress); *Drafting for New Bankruptcy Law Nears Completion*, XINHUA NEWS AGENCY, Aug. 21, 1995, available in LEXIS, News Library, Xinhua File [hereinafter *Drafting*] (noting that the Financial and Economic Committee of the National People's Congress expects to complete a draft of the new bankruptcy law by early 1996). The new law constitutes part of a wave of legal reforms sweeping China. See Brauchli, *supra* note 47 (noting that a primary rationale for the legal changes is to reassure investors about their interests with a strong commercial code); but see *Reform Moratorium*, *supra* note 165 (quoting the State Commission for Restructuring the Economy as stating that bankruptcy reform would be postponed because of China's underdeveloped social welfare system).

main revisions include: extending the reach of the Enterprise Bankruptcy Law to all enterprises, notwithstanding the type of ownership; allowing non-governmental entities to effectuate post-bankruptcy assessment functions; shortening the timetable for bankruptcy procedures; and clearly defining bankruptcy terms and penalties for violating procedures.¹⁶⁷ Perhaps the most important new provision will sever the judicial function in bankruptcies from the government administrative agencies.¹⁶⁸ These amendments, along with a renewed effort to apply bankruptcy law, should improve competitiveness in enterprises which are currently suffering losses.¹⁶⁹ Also, while fear of massive unemployment remains high, the Chinese Government expects that only a small portion of state-owned enterprises will actually fail as a result of applying the law because most of the firms currently operating at a loss are strong enough to survive.¹⁷⁰

As an encouraging step in the effort to implement bankruptcy laws, the government, utilizing the Enterprise Bankruptcy Law, recently auctioned a major state-owned brewery in Tianjin, the largest port city in North China.¹⁷¹ While creditors only recovered approximately ten percent of their stake, they were apparently satisfied with the legal procedures.¹⁷² The Chinese Government, viewing success of this auction may allow other state-run firms to go bankrupt.¹⁷³

167. See *China to Issue New Enterprise Bankruptcy Law*, XINHUA NEWS AGENCY, Dec. 29, 1994, available in LEXIS, News Library, Xinhua File; Ma, *supra* note 161 (describing the changes to the bankruptcy law).

168. The new law explicitly defines the relationship between government, the enterprise and the courts. *Drafting*, *supra* note 166. The law stipulates that the government may not interfere in bankruptcy proceedings. *Id.*; *China to Announce*, *supra* note 156; see *China to Pass New Bankruptcy Law Next Year*, AGENCE FRANCE PRESSE, Aug. 21, 1995, available in LEXIS, News Library, Asper File [hereinafter *China to Pass*] (noting that the new law prohibits official departments from intervening in bankruptcy procedures). The bankruptcy reform is just part of a drive towards an increasingly independent judiciary. See Brauchli, *supra* note 47 (observing that reversals by senior judges with significant ties to the Communist party are becoming rare, and that many Chinese leaders, who were victims of extrajudicial prosecution during the 1966-1976 Cultural Revolution, favor the establishment of an independent court system).

169. Ma, *supra* note 161; see Murray, *supra* note 31 (reporting that senior government officials have warned state-run businesses that they will face closure under the new bankruptcy law and that they should take immediate steps to become more efficient).

170. Ma, *supra* note 161. Advisor Cao estimates 10% of state enterprises operating at a loss would be dissolved in bankruptcy. *Id.* He predicts that only 700,000 workers would lose their jobs, dismissing fears of widespread unemployment. *Id.*

171. Jurists, *supra* note 47. On January 10, 1995, the brewery with more than 600 workers, fixed assets of 89 million yuan (US\$10.7 million), but reportedly in debt 183 million yuan (US\$22 million), was sold to a Sino-foreign joint venture for 54 million yuan (US\$6.5 million). *Id.* See Foreign Money, *supra* note 43, at D6 for exchange rate. The sale of the brewery was Tianjin's third bankruptcy case and the largest, in terms of fixed assets, in China to date. Jurists, *supra* note 47.

172. Jurists, *supra* note 47. It is significant that the Enterprise Bankruptcy Law was utilized in this instance and that the creditors agreed to abide by the procedure rather than expect a supervising government agency to intervene and pay off the debts. *Id.*

173. See, e.g., Toronto, *supra* note 15, at 277, n.94 (reporting the declaration of bankruptcy of the Nanchang Motorcycle Factory in Jiangxi Province on December 7, 1989); Chen, *supra* note 159 (noting that government authorities are now more inclined to allow state-owned enterprises to go bankrupt).

However, it remains to be seen if this rejuvenated effort to implement bankruptcy law in China will overcome the resistance of workers, the banking sector, and elements of the government itself.¹⁷⁴

V. SUGGESTED STRATEGIES

The structure and enforcement of the bankruptcy laws suggest several strategies. These include: maintaining a good relationship with a state-owned business' supervising governmental department; securing debt when possible; working around stay provisions; arguing that the court apply international bankruptcy practices if the Chinese law is too vague; and acquiring businesses at bargain prices.¹⁷⁵

If a U.S. business is a creditor to a state-owned enterprise,¹⁷⁶ it is imperative to maintain a positive working relationship with the debtor's supervising governmental agency.¹⁷⁷ Because conciliation is usually preferable to liquidation¹⁷⁸ and since the government department must decide whether to support a reorganization petition submitted by the debtor, the government's support in a decision to reorganize or liquidate is crucial.¹⁷⁹ To avoid the disruption caused by the loss of jobs, the government agency may more readily support conciliation.¹⁸⁰

While true in almost any bankruptcy regime, securitizing any debt gives an advantage to a U.S. business in the position of creditor. This is true in China because under either the Enterprise Bankruptcy Law or Shenzhen Rules, secured creditors sit in a preferential situation.¹⁸¹ However, it is difficult to register a

174. Note the conflicting reports that the bankruptcy reform efforts continue. Compare *Reform Moratorium*, *supra* note 165 (stating that "bankruptcy will be postponed in this year's reform of state-owned enterprises") with *China to Announce*, *supra* note 156 (relating that the new law is expected to be promulgated in 1996).

175. See *infra* notes 176-191 and accompanying text (elaborating on the strategies).

176. See, e.g., *supra* note 9 and accompanying text (explaining how some U.S. businesses could become creditors).

177. Recall that the higher level department in charge must intervene to request a reorganization. Enterprise Bankruptcy Law, *supra* note 24, art. 17.

178. A creditor or owner of an enterprise favors the course of action—liquidation or reorganization—which promises the highest return. J. FRED WESTON & EUGENE F. BRIGHAM, *MANAGERIAL FINANCE* 900 (6th ed. 1978). Frequently, a firm is more valuable as a going concern compared to the sum of its liquidated component assets. *Id.*

179. Also, from the government's point of view, recall that in a liquidation, the government is responsible for finding new employment for the workers. Enterprise Bankruptcy Law, *supra* note 24, art. 4.

180. A policy decision to encourage conciliation rather than liquidation surrounded passage of the Enterprise Bankruptcy Law. Toronto, *supra* note 15, at 277. Fear of losing jobs and worker opposition remains one of the reasons bankruptcy laws have not been fully implemented. See, e.g., O'Neill, *supra* note 34 (stating reasons for lack of implementation).

181. Recall that the bankruptcy estate does not include debt secured by assets. See *supra* notes 77-80, 107, 146 and accompanying text (assessing secured debt under Chinese bankruptcy laws).

security interest, so a U.S. business should balance the costs in obtaining the interest with the lower risk associated with an improved priority position.¹⁸²

The existence or lack of stay provisions in the two sets of laws suggest different paths, depending on whether one is a debtor or creditor.¹⁸³ If dealing with a state-run business under the Enterprise Law, which has a stay provision, negotiation with the firm before petitioning as a creditor for an involuntary bankruptcy would seem appropriate.¹⁸⁴ As a creditor under the Shenzhen Rules, one can pursue legal remedies even after a declaration of bankruptcy because of the lack of an automatic stay.¹⁸⁵ This could be problematic, however, if one were to enter into a joint venture or own outright a concern in Shenzhen and be in the position of debtor, as declaring bankruptcy would not provide protection from creditors.¹⁸⁶ This issue becomes superfluous if the new bankruptcy law takes effect, because the Enterprise Bankruptcy Law would then apply to all enterprises, state run, private or foreign owned.¹⁸⁷

If a U.S. business should find the applicable bankruptcy law inadequate, it might argue before a people's court to apply international standards of practice.¹⁸⁸ Judges may be more receptive to this proposal because of the increasing independence of the judiciary from other arms of the government.¹⁸⁹

Even the continuing reluctance of the Chinese Government to close down insolvent businesses could present business opportunities to investors from outside China.¹⁹⁰ Already, investor groups from within China and from abroad have acquired businesses and land at bargain prices.¹⁹¹

182. *See supra* note 78 and accompanying text (describing the problems associated with perfecting a security interest in China).

183. The automatic stay benefits a debtor and disadvantages a creditor by halting all collection proceedings by creditors against debtors. *See supra* note 72 (describing the automatic stay in the Enterprise Bankruptcy Law and the U.S. Bankruptcy Code).

184. Enterprise Bankruptcy Law, *supra* note 24, art. 11.

185. *See supra* notes 142-144 (examining the lack of an automatic stay under the Shenzhen Rules).

186. *See supra* note 144 (detailing the extra-judicial actions a creditor may pursue against a debtor).

187. *See, e.g., China to Pass, supra* note 168 (listing the changes in the new bankruptcy law, including its application to all kinds of enterprises).

188. *See Brauchli, supra* note 47 (noting that judges in futures trading disputes have followed international practices because the Chinese laws were too vague).

189. *See supra* note 168 and accompanying text (noting the emergence of a judiciary independent from the administrative arm of the government, especially in bankruptcy procedures).

190. *See Murray, supra* note 31 (observing that many current merger and acquisition regulations assist foreign investors in acquiring small scale state-owned enterprises). The methods used range from establishing joint ventures to a complete stock buy out of the loss-making firms. *Id.*

191. For example, an ailing beverage factory in Xinle tried in vain for over a year to be taken over by the Haomen Group from Yutian. Tefft, *supra* note 29, at 9. When plans for a new airport near Xinle were announced, the thirty acres of real estate proved too tempting for Haomen. *Id.* Also, in Sichuan, the provincial government announced in April 1994, that, after two unsuccessful attempts, it would negotiate a deal with foreign investors for 33 firms specializing in electronics, metallurgy, machinery and pharmaceuticals. *Id.* These companies were worth more than US\$400 million in assets and had 77,000 workers. *Id.*

VI. CONCLUSION

The bankruptcy laws in China continue to evolve. As U.S. businesses consider whether or not to invest in the potentially lucrative Chinese market, they need to keep abreast of the changing legal climate in the PRC.¹⁹² Other considerations include the effect of proposed modifications to existing bankruptcy law¹⁹³ and the government's success in actually applying bankruptcy over the ever-present reluctance of workers,¹⁹⁴ bankers¹⁹⁵ and entrenched government officials.¹⁹⁶

The U.S. Government will, most certainly, continue to encourage U.S. businesses to invest in emerging markets.¹⁹⁷ China, one of the world's largest markets, seems especially lucrative given its growth in demand for consumer goods.¹⁹⁸ Opportunities to participate in and profit from China's growing economy grow more competitive, particularly with investors already located in Asia.¹⁹⁹

For investment managers analyzing markets, a country's legal system determines the attractiveness of an investment, along with peculiarities of its national economy.²⁰⁰ One such consideration entails the protections offered to debtors and creditors under bankruptcy law.²⁰¹ The Chinese bankruptcy laws in their current state are vague and underutilized, and it remains to be seen whether proposed changes will provide incentives for attracting more foreign investment.

Steven L. Seebach

192. See Brauchli, *supra* note 47 (reporting the numerous legal reforms sweeping China). As a result of the new laws, commercial litigation has grown rapidly, resulting in a recruitment drive for new attorneys. *Id.* 41 foreign law firms have opened offices in China. *Id.*

193. See *supra* notes 166-168 and accompanying text (describing proposed changes to China's bankruptcy laws).

194. See *supra* notes 30-35 and accompanying text (assessing the negative effects of bankruptcy on workers). *But see supra* note 164 and accompanying text (describing improvements in the social welfare system which may blunt some of the criticism by workers).

195. See *supra* notes 36-45 and accompanying text (explaining the reluctance of banks to allow widespread bankruptcy); *but see supra* notes 161-163 (listing reasons for banks current improved position, which makes them better able to survive of bankruptcies wave).

196. See *supra* note 158 and accompanying text (describing the opposition of government officials to the application of bankruptcy proceedings).

197. See *supra* notes 2-3 and accompanying text (noting the recent growth of foreign investment in China and affirming the Clinton Administration's goals in directing foreign investment).

198. See *supra* note 1 and accompanying text (emphasizing the potential for U.S. investors in China).

199. See Brauchli, *supra* note 2 (describing the growth in foreign investment in China, especially from its neighbors in Asia and the importance of the Chinese market to the United States).

200. Breeden, *supra* note 7.

201. *Id.*

