

DRAFTING BANKRUPTCY LAWS IN SOCIALIST MARKET ECONOMIES: RECENT DEVELOPMENTS IN CHINA AND VIETNAM*

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I. INTRODUCTION

Both the People's Republic of China (the "PRC" or "China") and the Socialist Republic of Vietnam ("Vietnam") are making the transition from a centrally planned economy to a market-based economy. An effective bankruptcy law is an integral part of the institutional framework necessary for this transition. China enacted the Law of the People's Republic of China on Enterprise Bankruptcy (Trial Implementation) on December 2, 1986, and it came into operation on October 1, 1988 (the "1986 Chinese Bankruptcy Law").¹ This law is applicable to State-Owned Enterprises ("SOEs"). On April 9, 1991, the PRC Civil Procedure Law was approved,² with Chapter XIX applying to the bankruptcy of non-SOE enterprises with legal person status.³ The drafting of a bankruptcy law in Vietnam followed from Article 15 of the 1992 Constitution of the Socialist Republic of Vietnam, which institutionalized the policy to "promote the development of the multi-sector market-oriented economy with...State management towards socialism."⁴ The new bankruptcy law

¹ 中华人民共和国企业破产法 (试行) [Laws of the People's Republic of China on Enterprise Bankruptcy (Trial Implementation)] (Dec. 2, 1986) [hereinafter the 1986 Chinese Bankruptcy Law], translated in Legislative Affairs Commission of the Standing Commission of the National People's Congress (compilation), LAWS OF THE PEOPLE'S REPUBLIC OF CHINA (CIVIL AND COMMERCIAL LAWS 289-297) (1983-1986).

² 中华人民共和国民事诉讼法 [PRC Civil Procedure Law] (promulgated by Order No. 44 of the President of the PRC on Apr. 9, 1991 and effective as of that date).

³ Another bankruptcy provision included in national legislation is art. 189 in Chapter VIII of the 中华人民共和国公司法 [PRC Company Law of 1993] (adopted on Dec. 29, 1993 and revised on Dec. 25, 1999 and Aug. 28, 2004) [hereinafter the PRC Company Law] (for companies formed under Chinese law). Also applicable to the bankruptcy of both SOE and non-SOE legal person enterprises are various judicial interpretations, rules, and administrative decrees, such as the 最高人民法院 (关于审理企业破产案件若干问题的规定) [Provisions of the Supreme People's Court on Issues Concerning the Trial of Enterprise Bankruptcy Cases] (promulgated on July 30, 2002 and effective on September 1, 2002) [hereinafter the 2002 PRC Supreme People's Court Provisions]. Local insolvency procedures have also developed in many parts of China, e.g., in Shenzhen: see Xianchu Zhang & Charles D. Booth, *Chinese Bankruptcy Law in an Emerging Market Economy: The Shenzhen Experience*, 15 COLUM. J. ASIAN L. 1 (2001) [hereinafter Zhang & Booth, *Chinese Bankruptcy Law in an Emerging Market Economy*].

⁴ See RESEARCH TEAM (Chaired by Dr. Duong Dang Hue), RESEARCH REPORT, ASSESSMENT, ANALYSIS, RESEARCH OF CURRENT STATUS TO RECOMMEND ON COMPLETION OF BANKRUPTCY LAW AND RELATED LEGAL PROVISIONS, Vietnamese Ministry of Justice, at Introduction

was one of the laws that the Vietnamese began drafting later that year with the goal of creating a “uniform, complete legal system.”⁵ The drafting process moved quickly, and the Vietnamese Law on Enterprise Bankruptcy (the “1993 Vietnamese Bankruptcy Law”) was enacted on December 30, 1993, and took effect on July 1, 1994.⁶ This law rejected the bifurcated Chinese approach of separate laws for SOEs and non-SOE legal person enterprises in favor of a single law that applied to both SOEs and non-SOE enterprises.⁷ It was also more expansive than the Chinese approach in that it applied to both legal person and non-legal person enterprises.⁸

These laws did not live up to early expectations. By 1994, the Chinese government had already decided to begin drafting a new national bankruptcy law. From 1989 until 1994, the courts had accepted few bankruptcy cases: 98 in 1989, 32 in 1990, 117 in 1991, 428 in 1992, and 478 in 1993.⁹ In Vietnam, from July 1994 to September 2001, the number of cases was even lower: the number of bankruptcy applications per year never exceeded 30, and only 58 enterprises were adjudicated bankrupt by the courts.¹⁰ Of these bankruptcies in China and Vietnam, the number of cases that led to successful reorganizations was very low.¹¹

(Vietnamese Ministry of Justice 2002) [hereinafter VIETNAMESE BANKRUPTCY LAW RESEARCH REPORT].

⁵ *Id.*

⁶ Vietnamese Law on Enterprise Bankruptcy (Dec. 30, 1993) [hereinafter the 1993 Vietnamese Bankruptcy Law], available at

http://www.vietnamese-law-consultancy.com/sources/s_bankruptcy/bankruptcy_05_98.htm. In Vietnam, the bankruptcy law has also been supplemented by various judicial interpretations and administrative decrees. See also VIETNAMESE BANKRUPTCY LAW RESEARCH REPORT, *supra* note 4, at Part One, III (“Actual status of enterprise bankruptcy law in Vietnam”).

⁷ This followed on from the policy that all enterprises should be treated equally. VIETNAMESE BANKRUPTCY LAW RESEARCH REPORT, *supra* note 4, at Introduction.

⁸ *Id.* at Part Three, II, 1 (“On applicable scale of the Bankruptcy Law”).

⁹ According to the Statistics of the PRC Supreme People’s Court in March 2001, cited in WANG WEIGUO & CHARLES D. BOOTH, STUDY ON ALTERNATIVE APPROACHES FOR DEBT RESTRUCTURING OF ENTERPRISES IN CHINA 12 (World Bank Report for the State Economy and Trade Commission of China, 2002). The statistics of the PRC Supreme People’s Court are not uniformly accepted. According to the statistics of the 北京思源兼并与破产咨询事务所 [Beijing Siyuan Merger and Bankruptcy Consultancy], as reported by 曹思源 [Cao Siyuan] in the *Implementation and Revision of the Bankruptcy System in China*, a paper presented at INSOL China 2002, held in Beijing, China, (Oct. 9-11, 2002) [hereinafter Statistics of the Beijing Siyuan Merger and Bankruptcy Consultancy], there were 710 cases in 1993.

¹⁰ Statistics of the Vietnamese Supreme People’s Court, cited in VIETNAMESE BANKRUPTCY LAW RESEARCH REPORT, *supra* note 4, at Part Two, I, 1.1 (“Practice of Acceptance and Settlement of Application for Declaration of Bankruptcy”) and Introduction. However, the REPORT notes that the statistical data provided by the Vietnamese Supreme People’s Court was “incomplete.” *Id.* Most of the cases were from the larger provinces and cities (such as Ho Chi Minh City, Hanoi, and Hai Phong); some provinces reported no bankruptcies at all. *Id.* at Part Two, I, 2.2.

¹¹ Regarding China, see 王卫国, 破产法 [WANG WEIGUO, BANKRUPTCY LAW] 220 (in Chinese, 1999) (the number of cases invoking the reorganization provisions in the law was close to zero); regarding Vietnam, see VIETNAMESE BANKRUPTCY LAW RESEARCH REPORT, *supra* note 4, at Part Two, II, 1.1.1.

For many years, both China and Vietnam have focused on how best to improve these older laws and enact more modern insolvency regimes. The Chinese government initiated a review of the Chinese bankruptcy law in 1994, and a first draft was completed in 1995. After a hiatus that was caused in part by a concern about the high level of unemployment likely to be caused by allowing many SOEs to go into bankruptcy,¹² the drafting process resumed in 1998. Further drafts of the law were released for comment, including drafts in 2000, 2001, 2002, and more recently, in June 2004 (respectively the “2000,” “2001,” “2002,” or “June 2004 Draft Chinese Bankruptcy Law”). Roughly two-thirds of the 2002 draft was incorporated into the June 2004 draft. The June 2004 draft was submitted to the Standing Committee of the National People’s Congress on June 21, 2004; since then an even more recent draft has emerged (the “October 2004 Draft Chinese Bankruptcy Law”). In effect, the current version is a work in process. There remains a general hope that a draft will be finalized by the middle of 2005 and come into operation in 2006, but this is dependent on agreement being reached on several issues that have proved to be intractable and which are discussed below.

By June 2002, Vietnam had completed a draft bankruptcy law (the “2002 Draft Vietnamese Bankruptcy Law”). When comparing the 2002 Vietnamese and Chinese drafts shortly after they were issued, it appeared that the Vietnamese reform process was at an earlier stage; but much progress was made in Vietnam over the next two years and a new Vietnamese bankruptcy law, the Vietnamese Law on Bankruptcy, was enacted on June 15, 2004 and came into operation on October 15, 2004 (the “2004 Vietnamese Bankruptcy Law”).¹³ The fact that Vietnam enacted its new bankruptcy law before China did is significant because during the drafting process the Vietnamese were interested in how the Chinese government was dealing with similar issues of insolvency law reform and the movement towards a market-oriented economy in the Chinese draft law.¹⁴ However, the Vietnamese were able to reach a consensus more quickly than the Chinese have.

An earlier article I co-authored compared the 2002 draft Chinese and Vietnamese laws and highlighted seven areas of the proposals.¹⁵ The present article provides an update on the insolvency reform processes in

¹² Charles D. Booth, *Chinese Insolvency Law: Developing an Insolvency Infrastructure*, IPBA J. 13, 13 (Mar. 2001) (noting comments of 朱少平 [Zhu Shao Ping], Chair of the Working Group for Drafting the New Chinese Bankruptcy Law, Fiscal and Economic committee under the Standing of the PRC National People’s Congress).

¹³ Vietnamese Law on Bankruptcy, Law No. 21/2004/QH11 [hereinafter the 2004 Vietnamese Bankruptcy Law].

¹⁴ I learned this first-hand when I conducted four days of workshops organized by the Vietnamese Ministry of Justice, including two days with the Vietnamese bankruptcy law drafting committee, on the 2002 Draft Vietnamese Bankruptcy Law, in Hanoi, Vietnam, in June 2002.

¹⁵ See Booth & Chiu in the note referenced to the title of this article.

China and Vietnam since mid-2002. Part I sets out the overall insolvency framework in China and Vietnam, and Parts II to VI consider five of the areas discussed in the earlier piece – namely, the scope of the bankruptcy laws; bankruptcy administration; corporate rehabilitation; priorities in distribution and the protection of employees' interests; and cross-border insolvency.¹⁶ This article identifies weaknesses in the current bankruptcy law regime in China and in the former regime in Vietnam that the law reform processes in both countries have addressed. It notes where the October 2004 Draft Chinese Bankruptcy Law differs from the 2002 Chinese draft and highlights the areas that still need to be finalized. It also identifies those areas in which the new 2004 Vietnamese Bankruptcy Law differs from the 2002 Vietnamese draft and suggests where further improvements could be made. Throughout the article, I will be drawing comparisons between the Vietnamese and Chinese approaches.

II. INSOLVENCY FRAMEWORK

Legal reforms in and of themselves are not sufficient to solve insolvency problems. This is even truer in countries such as China and Vietnam with economies in transition and systemic insolvency in some state-owned sectors. For example, when trying to address the problems with SOEs and state-owned banks, government officials must decide (1) whether to enact laws such as formal court-centered liquidation and corporate rescue laws to allow the market to sort out the problems; or (2) to implement administrative reforms, such as the creation of Asset Management Companies ("AMCs") to fulfill central or local government policy directives, or a combination of the two. Viewing the bankruptcy laws in China and Vietnam as but one part, albeit a very important part, of this overall framework proves helpful in deciding what the proper scope of these laws should be.

China

China's current insolvency framework is a patchwork of overlapping structures including the following:¹⁷

(1) *National bankruptcy laws and other legal provisions and procedures.* The two national bankruptcy laws are the 1986 Chinese Bankruptcy Law for SOEs¹⁸ and Chapter XIX of the PRC Civil Procedure Law entitled Procedure for Bankruptcy and Debt Payment of Legal Person Enterprises for non-SOE enterprises with legal person status.¹⁹ Article 206 of the PRC Civil Procedure Law excludes from the coverage of Chapter XIX "non-legal person enterprises, individual businesses,

¹⁶ *Id.*

lease-holding farm households and partnerships formed by private individuals.”²⁰

China also has solvent liquidation procedures in Chapter VIII of the PRC Company Law entitled Bankruptcy, Dissolution and Liquidation of Companies for companies (limited liability companies and companies limited by shares) formed under the PRC Company Law²¹ and in the PRC Liquidation Procedures of Foreign Investment Enterprises (“PRC Liquidation Procedures of FIEs”).²² Both the PRC Company Law and the PRC Liquidation Procedures of FIEs include provisions for commencing a bankruptcy case where in the course of the liquidation of the enterprise it becomes apparent that the assets are insufficient to cover the debts: Article 196 of the PRC Company Law and Article 27 of the PRC Liquidation Procedures of FIEs each require the liquidation committee to apply to the People’s Court for a declaration of the bankruptcy of the enterprise. Article 196 provides that after the People’s Court has ruled to declare the company bankrupt, the liquidation committee shall turn the liquidation matters over to the court. Article 27, in a similar vein, provides that if the enterprise is declared bankrupt in accordance with the law, matters shall be handled in accordance with the laws and administrative regulations concerning bankrupt liquidation. In other words, Articles 196 and 27 take insolvent liquidations out of the company law and FIE procedures and “feed” them into the bankruptcy provisions under the PRC Civil Procedure Law. For FIEs, once the bankruptcy declaration is made, the PRC Liquidation Procedures for FIEs are no longer applicable. However, that is not the result for companies under the PRC Company Law, because Article 189 of the PRC Company Law provides:

Where a company is declared bankrupt according to law because it is unable to pay off its due debts, a People’s Court shall, in accordance with relevant laws, organize the

¹⁷ For further discussion of this patchwork, see Ronald Winston Harmer, *Insolvency Law and Reform in the People’s Republic of China*, 64 FORDHAM L. REV. 2563 (1996); Gordon C. Chang, *Bankruptcy Law in China: too much or too little?* 13(5) CHINA L. & PRAC. 22 (June/July 1999); GUANGHUA YU & MINKANG GU, *Enterprise Bankruptcy Law* (Chapter 15) in LAWS AFFECTING BUSINESS TRANSACTIONS IN THE PRC (2001); Li Shuguang, *The Significance Brought by the Drafting of the New Bankruptcy Law to China’s Credit Culture and Credit Institutions*, paper presented at the Forum on Asian Insolvency Reform 2004: Insolvency Systems and Risk Management in Asia, held in New Delhi, India, Nov. 3-5, 2004, sponsored by the World Bank, the Asian Development Bank, and the OECD.

¹⁸ See 1986 Chinese Bankruptcy Law.

¹⁹ See PRC Civil Procedure Law (1991).

²⁰ See also 2002 PRC Supreme People’s Court Provisions, art. 4.

²¹ PRC Company Law of 1993, Chapter VIII (adopted on Dec. 29, 1993 and revised on Dec. 25, 1999 and Aug. 28, 2004) [hereinafter the PRC Company Law].

²² 外商投资企业清算管理办法 [Liquidation Procedures of Foreign Investment Enterprises adopted by the Ministry of Foreign Trade and Economic Cooperation] (July 9, 1996) [hereinafter the PRC Liquidation Procedures of FIEs].

shareholders, the relevant departments and relevant professional to form a liquidation committee which shall conduct the bankruptcy liquidation of the company.

This provision is applicable *after* the declaration of bankruptcy has been made. It applies in bankruptcies commenced by company liquidation committees under Article 196 of the PRC Company Law and in bankruptcies commenced by debtors or creditors under Article 199 of the PRC Civil Procedure Law. Thus, Article 189 of the PRC Company Law supplements the provisions of the PRC Civil Procedure Law in bankruptcies involving PRC companies.

Also relevant in the legal framework is Article 71 of the PRC Commercial Bank Law,²³ which provides that if a commercial bank is unable to pay its debts as they fall due, a People's Court shall, after obtaining consent of the China Banking Regulatory Commission, declare it bankrupt. A similar provision is included in the PRC Insurance Law for insurance companies, which requires approval from the China Insurance Regulatory Commission instead.²⁴

With so many applicable laws, it might at first glance appear that the law is comprehensive. In fact, the reality is just the opposite because these laws are so short and incomplete - comprising merely the 43 articles in 1986 Chinese Bankruptcy Law, the eight articles in Chapter XIX of the PRC Civil Procedure Law, and a handful of other provisions (as noted above). Moreover, as one commentator has noted, the changing nature of the ownership interests of SOEs (e.g. through government distribution of ownership interests and the selling small stakes of SOEs) has even made it difficult at times to determine the proper scope of demarcation between the 1986 Chinese Bankruptcy Law and the PRC Civil Procedure Law.²⁵

(2) *Judicial interpretations.* With so few provisions related to insolvency in the existing legislation, it should not be surprising that there are many inconsistencies as well as gaps and omissions. The PRC Supreme People's Court has attempted to address these problems by issuing judicial interpretations. The PRC Supreme People's Court issued its Opinion on Questions Concerning the PRC Enterprise Insolvency Law (Trial Implementation) on November 7, 1991 (the 1991 "PRC Supreme People's Court Opinion").²⁶ This opinion interprets the 1986 Chinese

²³ 中华人民共和国商业银行法 [PRC Commercial Bank Law] (Promulgated by the President of the PRC on May 10, 1995, and effective as of July 1, 1995).

²⁴ 中华人民共和国保险法 [PRC Insurance Law] (Promulgated by the President of the PRC on June 30, 1995, and effective as of October 1, 1995).

²⁵ Chang, *supra* note 17, at 22-23.

²⁶ 最高人民法院关于贯彻执行《中华人民共和国企业破产法（试行）》若干问题的意见 [Ref No. 2500/91.0.07]. Printed in the Research Office of the Supreme People's Court (compilation), 中华人民共和国最高人民法院司法解释全集 (活页) [THE ASSEMBLAGE OF JUDICIAL

Bankruptcy Law and with 76 articles is almost twice as long as the law itself. In 1992, it promulgated the Application of the PRC Civil Litigation Law Several Issues Opinion for non-SOE enterprise legal persons (with 14 articles).²⁷ Most recently, on July 30, 2002, the Supreme People's Court promulgated its most comprehensive insolvency interpretation to date with "106 Articles: Several Issues Concerning the Trial of Enterprise Bankruptcy Cases" (the "2002 PRC Supreme People's Court Provisions").²⁸ This interpretation applies to both the 1986 Chinese Bankruptcy Law and the PRC Civil Procedure Law and supercedes the court's earlier interpretations where they are inconsistent. The 2002 PRC Supreme People's Court Provisions "appear to be an attempt by the Supreme People's Court to promulgate one set of regulations that will govern both SOE and non-SOE bankruptcies" and "should go some way towards obviating speculation as to whether certain provisions of the [1986 Chinese Bankruptcy Law] have been applicable in non-SOE bankruptcies."²⁹

(3) *Important policy decrees issued by the government for certain SOEs.* These decrees may form the most important structure in China for setting insolvency policy. The series of decrees are intended to facilitate debt restructuring on a large scale through merger and acquisition and bankruptcy under the Capital Structure Optimization Program ("CSOP").³⁰ On October 25, 1994, the State Council issued the notice entitled Proposal for Implementing State-Owned Enterprise Bankruptcy Law in Some Cities (the "1994 PRC Notice"),³¹ which addressed problems involving the resettlement of workers of state-owned industrial enterprises ("SIEs") made bankrupt in eighteen pilot cities, including Shanghai. This notice provided special treatment for the resettlement of workers – the land use rights obtained by a SIE were to be sold by auction or tender with the first priority to the proceeds to be used for the resettlement of the employees. The 1994 PRC Notice was followed by the Notice on Certain Issues on Trial Implementation of Mergers and Insolvency on State-Owned Enterprises, which was issued by the former State Economy and Trade Commission ("SETC") and the People's Bank of China on July 25, 1996.³² This increased the number of trial cities to

INTERPRETATIONS OF THE SUPREME PEOPLE'S COURT OF THE PRC] [hereinafter the 1991 PRC Supreme People's Court Opinion].

²⁷ 最高人民法院关于适用《中华人民共和国民事诉讼法》若干问题的意见 [APPLICATION OF THE PRC CIVIL LITIGATION LAW SEVERAL ISSUES OPINION] (Nov. 7, 1991) available at http://www.lawbook.com.cn/law/law_view.asp?id=8106.

²⁸ See 2002 PRC Supreme People's Court Provisions.

²⁹ Chua Eu Jin, *The Reform of the PRC Corporate Bankruptcy Law: Slowly but Surely*, 16(8) CHINA L. & PRAC. 19, 19 (Oct. 2002).

³⁰ See WANG & BOOTH, *supra* note 9, at 8-16 (Wang).

³¹ 国务院关于在若干城市试行国有破产有关问题的通知 (国发) [Document No. 59] [hereinafter the 1994 PRC Notice].

³² 国家经济贸易委员会、中国人民银行关于试行国有破产有关问题的通知 [Document No. 492], 1996.

56.³³ On March 2, 1997, the State Council issued a further Supplementary Notice concerning the Problems Pertaining to the Trial Implementation of State-Owned Enterprise Merger & Bankruptcy and Re-employment in Certain Cities (the "1997 PRC Notice"), which increased the number of trial cities to 111.³⁴ Section 2 of the 1997 PRC Notice provided for the formulation of a Mergers and Bankruptcies of Enterprises Program to be established under the coordination of the former SETC, whereby in various trial cities, a list of enterprises would be drawn up for merger, bankruptcy, and rescue. The largest creditors of the SOEs – the State-owned banks – were to play an active role in the process and help identify bad debts to be cancelled.

These policy documents currently apply to all the cities in China.³⁵ They apply to SOEs whether or not the 1986 Chinese Bankruptcy Law applies, and the "special treatment" for workers resettlement rights would have priority over secured creditors and thus be inconsistent with the procedures for distributing assets in the 1986 law.³⁶ These policy documents are crucial to understanding China's current approach to bankruptcy and SOEs, and are an integral part of China's "insolvency by policy" approach.³⁷ They are certainly responsible for part of the dramatic increase in the number of insolvency cases in China over the last decade.³⁸ However, it is interesting to note that with the increase in the number of pilot cities from 18 to 56 in mid-1996 and then to 117 in early 1997, although the number of SOE bankruptcies increased from 1,232 in 1995 to 3,651 in 1996, they then decreased to 3,060 in 1997 and remained roughly at that level through 2000 (3,056 in 1998; 2,886 in 1999; and 3,296 in 2000³⁹). This leveling off, in fact, may be attributed in part to the government policy of "controlled 'planned bankruptcy,'" according to the statistics of the former SETC, from 1996 to 2000 less than 30 per cent of SOE bankruptcies were bankrupted in accordance with initiatives of the CSOP.⁴⁰

(4) *Additional administrative out-of-court restructuring efforts.* Of the variety of government-led restructuring efforts, several others

³³ *Id.*

³⁴ 国务院关于在若干城市试行国有企业兼并破产和职工再就业有关问题的补充通知(国发)[Document No. 10], 1997 [hereinafter the 1997 PRC Notice].

³⁵ Li, *supra* note 17, at 3.

³⁶ See Chang, *supra* note 17, at 23.

³⁷ Li, *supra* note 17, at 3-4.

³⁸ According to the Statistics of the PRC Supreme People's Court in March 2001, there were 1,625 cases in 1994; 2,583 in 1995; 5,875 in 1996; 5,396 in 1997; 5,673 in 1998; 5,622 in 1999; and 7,219 in 2000: WANG & BOOTH, *supra* note 9, at 12 (Wang). The Statistics of the Beijing Siyuan Merger and Bankruptcy Consultancy, *supra* note 9, for that same period are 1,625 cases in 1994; 2,344 in 1995; 6,233 in 1996; 4,515 in 1997; 6,148 in 1998; 4,591 in 1999; and 7,528 in 2000. It also reports that there were 8,939 cases in 2001. See *supra* note 9 for the statistics for 1989 to 1993.

³⁹ According to the Statistics of the PRC Supreme People's Court in March 2001, cited in WANG & BOOTH, *supra* note 9, at 12 (Wang).

⁴⁰ WANG & BOOTH, *supra* note 9, at 12 (Wang).

deserve mention. In September 1999 at the 4th Session of the 15th Party Congress, the Decision on Several Significant Issues on the Reform and Development of State-Owned Enterprises was made, which included measures for the banks to increase their bad-debt write-off of funds to support the merger and bankruptcy of the large and medium-sized SOEs.⁴¹ Other measures included converting the debt of SOEs into equity, thereby converting the major creditors of the SOEs (the state-owned commercial banks) into shareholders.⁴² Also in 1999, four AMC's were established to deal with the high level of non-performing loans ("NPLs") of the four main state-owned commercial banks,⁴³ (estimated at about US\$125 billion⁴⁴) and others have been established since then.⁴⁵ A further effort to improve the situation of SOEs and the state-owned banks was the restructuring procedure devised by the former SETC, which has come to be known as the "Changchun Approach."⁴⁶

(5) *Local rules and regulations.* Many local governments, including provinces and prefectures and some cities, have enacted their own local regulations, procedures and rules to meet their local needs. An example can be found in the Shenzhen Special Economic Zone (the "Shenzhen SEZ Enterprise Bankruptcy Regulations," enacted by the Standing Committee of the Shenzhen People's Congress on November 10, 1993).⁴⁷

These five structures in China combine to form a complicated framework for bankruptcy: there are national efforts and local initiatives, government central-planning policies and more market-oriented initiatives, and different national bankruptcy laws for different types of debtors.

⁴¹ *Id.* at 11 (Wang).

⁴² YU & GU, *supra* note 17, at 550-551.

⁴³ China Xinda Asset Management Company (Cinda) for the Construction Bank of China (the first to be established, in Apr. 1999), China Huarong Asset Management Corporation for the Industrial and Commercial Bank of China, Dongfang Asset Management Company (Oriental) for the Bank of China, and the China Great Wall Asset Management Company for the Agricultural Bank of China available at http://www.gii.co.jp/english/ae7393_asset_manage_china.html.

⁴⁴ *Id.*

⁴⁵ See, e.g., the 广东广业 [Guangdong Guangye Asset Management Company] at http://www.chinaonline.com/estore/financial/AA030-75_PR.htm.

⁴⁶ See WANG & BOOTH, *supra* note 9.

⁴⁷ These regulations replaced the Shenzhen Bankruptcy Provisions on Foreign Related Companies that were enacted in 1986 before the 1986 Chinese Bankruptcy Law was promulgated. For a discussion of Shenzhen practice, see Zhang & Booth, *supra* note 3. In Beijing there are provisions applicable to the solvent liquidation of FIEs called the Liquidation Provisions of Foreign Investment Enterprises, which were adopted by the Standing Committee of the Beijing People's Congress on August 14, 1993. For a discussion of the Beijing practice, see Xianchu Zhang & Charles D. Booth, *Beijing's Initiative on Cross-Border Insolvency: Reflections on a Recent Visit of Hong Kong Professionals to Beijing*, 10 AM. BANKR. INST. L. REV. 29 (2002). [hereinafter Zhang & Booth, *Beijing's Initiative on Cross-Border Insolvency*].

Vietnam

The pre-2004 insolvency law reform landscape in Vietnam involved the following:

(1) *National bankruptcy law and other legal provisions and procedures.* The 1993 Vietnamese Bankruptcy Law, with 51 sections, was the only national bankruptcy law and applied to both SOEs and non-SOE enterprises. It was broader than the Chinese law in that it also applied to enterprises without legal person status.

Vietnam, like China, has other legislation pertaining to the solvent liquidation of enterprises outside the scope of the bankruptcy law, notably the Vietnamese Foreign Investment Law⁴⁸ ("Vietnamese FIL") and the Vietnamese Enterprise Law 2000.⁴⁹ There are legislative provisions in these laws that direct insolvent liquidations to follow the 1993 bankruptcy laws. Article 53 of the Vietnamese FIL provides that if in the course of the liquidation of an FIE it is discovered that the FIE is on the verge of bankruptcy, the FIE's bankruptcy should be carried out in accordance with the provisions of the laws concerning enterprise bankruptcy.⁵⁰ In contrast to Article 27 of the PRC Liquidation Procedures of FIEs, Article 53 of the Vietnamese law does not provide how the bankruptcy should be commenced. In addition, unlike the Chinese national FIE law, the Vietnamese provision applies in some cases involving the value of land use rights after a bankruptcy case has been commenced.⁵¹ Lastly, the 1993 Vietnamese Bankruptcy Law overlapped with other legislation regarding the treatment of land use rights and this was the source of many conflicts.⁵²

⁴⁸ Vietnamese Foreign Investment Law (1996) arts. 52, 53. This replaced an earlier foreign investment law dating from 1987. This law was amended on June 9, 2000, under Law No. 18/2000/QH10 available at <http://www.dpi.hochiminhcity.gov.vn/invest/html/law2.html> [hereinafter the Vietnamese FIL]. The reorganization (division, demerger, merger, or consolidation) of an FIE pursuant to Articles 31 and 32 of Vietnamese Decree No. 24 providing detailed regulations on the implementation of the law on foreign investment in Vietnam would also be outside the scope of the 1993 Vietnamese Bankruptcy Law. See Joelle Daumas, *Socialist Republic of Viet Nam*, in THE ASIA-PACIFIC RESTRUCTURING & INSOLVENCY GUIDE 2003/04 at 173-77 (2003).

⁴⁹ Daumas, *supra* note 48. The same is true of a reorganization of a solvent enterprise under the Vietnamese Enterprise Law 2000.

⁵⁰ See JOHNSON, STOKES & MASTER, VIETNAM, A GUIDE TO DOING BUSINESS 22 (2002).

⁵¹ Article 53.4 of the Vietnamese FIL, *supra* note 48, provides that where the Vietnamese Party participating in a joint venture enterprise who has contributed capital in the form of the value of land use rights is dissolved or bankrupt, the remaining value of the land use rights contributed as capital shall be included in the enterprise's assets that are subject to the liquidation.

⁵² VIETNAMESE BANKRUPTCY LAW RESEARCH REPORT, *supra* note 4, at Part Two, II, 5 ("Problems on dealing with the land use rights of enterprise declared bankrupt"). One such conflict involved a contest between the 1993 Vietnamese Bankruptcy Law and Article 26 of the Vietnamese Land Law (enacted on July 14, 1993 and came into operation on October 15, 1993), which also applied to bankruptcies. *Id.* at Part Two, II, 5.1(2) ("Land recollecting by the state"). Available at <http://coombs.anu.edu.au/~vern/luat/english/Law-land-law.txt>, as amended in Nov. 1998 and June 2001. See also JOHNSON, STOKES & MASTER, *supra* note 50, at 24.

(2) *Judicial interpretations and regulations.* These included the following: Decision No. 528/QDBT, dated June 13, 1995, of the Vietnamese Minister of Justice, issuing Operation Regulation of the Trustee Committee and the Property Realization Committee; Decision No. 426/QD of the Vietnamese People's Supreme Court, dated July 1, 1994, issuing Operation Regulation of the Collective of Judges Responsible for Handling Applications for Bankruptcy; and Official Letter No. 457/HKXX, dated July 21, 1994, of the Vietnamese People's Supreme Court, on the application of some provisions of the 1993 Vietnamese Bankruptcy Law.⁵³

(3) *Government decrees and regulations.* Decree No.189/CP of the Vietnamese government, dated December 23, 1994, guided the implementation of the 1993 Vietnamese Bankruptcy Law ("Vietnamese Decree No. 189").⁵⁴ Article 1 provided greater detail concerning the scope of the enterprises subject to the 1993 Vietnamese Bankruptcy Law, as including "state-owned enterprises, enterprises of socio-political organizations, private enterprises, limited liability companies, stock companies, wholly or partly foreign owned enterprises ("FIEs"), and cooperative groups."⁵⁵ However, Article 2 provided that the bankruptcy of an FIE must comply with both the 1993 Vietnamese Bankruptcy Law and the Vietnamese FIL, thereby causing some difficulties.⁵⁶ The promulgation of other decrees led to some overlap with the 1993 Vietnamese Bankruptcy Law. For example, Decree No. 92/CP of the government, dated December 19, 1995, pertained to the settlement of employees' interests in bankrupt enterprises and included some provisions that set out a special priority for workers who were injured in a labor accident or suffered from a disease in their course of work, which was inconsistent in some respects with the 1993 bankruptcy law.⁵⁷

(4) *Administrative out-of-court restructuring efforts.* In 1998, Vietnam established the National Enterprise Reform Committee (the "NERC") to reactivate an equitization process for SOEs.⁵⁸ Decree 44/1998/ND-CP, dated June 29, 1998, regulates the equitization of SOEs.⁵⁹ The NERC has equitized more than 700 SOEs since 1999. It has

⁵³ VIETNAMESE BANKRUPTCY LAW RESEARCH REPORT, *supra* note 4, at Part One, III ("Actual status of enterprise bankruptcy law in Vietnam").

⁵⁴ VIETNAMESE DECREE NO. 189 (1994), available at http://www.vietnamese-law-consultancy.com/sources/s_bankruptcy/bankruptcy_12_94.htm.

⁵⁵ VIETNAMESE BANKRUPTCY LAW RESEARCH REPORT, *supra* note 4, at Part Two, I, 2.5 ("The Enterprises whose bankruptcy has been declared were mainly belonging to non-state sectors").

⁵⁶ JOHNSON, STOKES & MASTER, *supra* note 50, at 23.

⁵⁷ VIETNAMESE BANKRUPTCY LAW RESEARCH REPORT, *supra* note 4, at Part Two, II, 4 ("With respect to protection of the interests of employees of the bankrupt enterprises").

⁵⁸ AUSTRALIAN ECONOMIC ANALYTICAL UNIT, DEPARTMENT OF FOREIGN AFFAIRS AND TRADE, CHANGING CORPORATE ASIA: WHAT BUSINESS NEEDS TO KNOW 171 (March 2002), available at http://www.monash.edu.au/casestudies/css/416_ca.htm [hereinafter AUSTRALIAN ECONOMIC ANALYTICAL UNIT, CHANGING CORPORATE ASIA].

⁵⁹ JOHNSON, STOKES & MASTER, *supra* note 50, at 28.

also pushed for the liquidation of non-viable SOEs.⁶⁰ Other government initiatives have helped finance severance payments for workers who have been made redundant, have devolved control of the equitization of provincial SOEs to provincial governments, have restructured large SOEs, and have privatized small SOEs.⁶¹ Vietnam has taken steps to improve the banking system and, like China, has established AMCs connected to the commercial banks to dispose of NPLs.⁶² Vietnam has also established a national Debts and Assets Trading Company managed by the Ministry of Finance.⁶³

(5) *Local provisions.* There are also some local laws with provisions regarding bankruptcy, such as the 1972 Commercial Code of Saigon, which pre-dated the 1993 Vietnamese Bankruptcy Law.

There was a concern in Vietnam that some of the provisions in the 1993 Vietnamese Bankruptcy Law and the guiding implementation documents lacked uniformity, conflicted with other related documents, and therefore caused some problems for the competent bodies in the settlement of bankruptcy applications.⁶⁴ The bankruptcy drafting committee was also aware that the low rate of bankruptcy did not reflect the reality – that given the number of enterprises in Vietnam and the regulatory effect of the bankruptcy law, it was clear that, in effect, the official bankruptcy rates were “fictitious.”⁶⁵

It can be seen that the framework for insolvency in Vietnam shares many similarities with the Chinese framework. However, one key difference is that from the outset the Vietnamese promulgated one national bankruptcy law that applied to SOEs, legal person enterprises, and non-legal person enterprises. This broader jurisdiction, however, did not lead to an increase in cases. Although the formal law was simpler, it was almost never utilized.

III. SCOPE OF THE BANKRUPTCY LAWS

Throughout the insolvency reform process, Vietnam debated, and China is still debating, what the proper scope of the new laws should be. Among the issues that have been debated are the following: Should the new laws apply to all SOEs? Should the new laws apply to banks,

⁶⁰ AUSTRALIAN ECONOMIC ANALYTICAL UNIT, *CHANGING CORPORATE ASIA*, *supra* note 58, at 171.

⁶¹ *Id.*

⁶² See Hoang Tien Loi, *Trends and Developments in Insolvency Systems and Risk Management – The Experience of Vietnam*, paper presented at the Forum on Asian Insolvency Reform 2004: Insolvency Systems and Risk Management in Asia, held in New Delhi, India, Nov. 3-5, 2004, sponsored by the World Bank, the Asian Development Bank, and the OECD.

⁶³ *Id.*

⁶⁴ VIETNAMESE BANKRUPTCY RESEARCH REPORT, *supra* note 4, at Introduction.

⁶⁵ *Id.* at Part Two, I, 2.1. See also AUSTRALIAN ECONOMIC ANALYTICAL UNIT, *CHANGING CORPORATE ASIA*, *supra* note 58, at 183 (citing YOUTH, Nov. 2, 2001, which reported that 300 companies in 2001 alone “disappeared” without going through the bankruptcy process).

insurance companies, and securities companies? Should the new laws apply to non-legal persons, including partnerships and sole proprietorships? Moreover, should the new laws extend beyond business-related enterprises and apply to consumers?

A. Should the law apply to SOEs?

SOEs often provide important public goods and services. In addition, they provide a broad array of guaranteed benefits to their workers including housing, education, and health care. This can prove to be an especially expensive proposition if the SOE has far too many workers. Thus, when an SOE files for liquidation or reorganization, in addition to addressing the business issues, it will also have to satisfy the guaranteed minimum social benefits, which will likely involve the "resettlement" and retraining of many of its workers.

China

The Chinese have been grappling with the issues involving the insolvency of SOEs since the beginning of the bankruptcy law drafting process. The reform process was started, in great part, to improve the dire straits of SOEs. There is no doubt that many, if not the majority, of state-controlled enterprises in China would benefit from the enactment of a comprehensive insolvency regime. However, a dramatic increase in the number of SOEs filing for bankruptcy would likely lead to two other sets of problems: (1) high unemployment that could result in social unrest, and (2) a knock-on effect leading to the bankruptcy of many state-owned banks.⁶⁶ Because of these problems, and concurrently with the drafting process, China took other major steps to address the problems of the SOEs and the related problems of the high level of the NPLs owed by SOEs to the state-owned banks. Included in the steps are those discussed above in Part I: instituting the CSOP and promulgating the 1994 and 1997 PRC Notices, establishing AMCs, and experimenting with the Changchun Approach.

Given the magnitude of the problems with the SOEs and the high level of government control over the SOE reform process, it is not surprising that the Chinese have hotly debated whether to subject SOEs to the new bankruptcy regime. One of the main reasons for commencing the bankruptcy reform process was to correct the inadequacies of the 1986 Chinese Bankruptcy Law in dealing with SOEs. Nevertheless, by 2000, it was clear that a split was emerging within the bankruptcy law drafting committee. At a conference organized by the Asian Institute of International Financial Law at the University of Hong Kong in November

⁶⁶ See Zhang & Booth, *supra* note 3, at 3.

2000, there was a heated discussion among drafting committee members as to whether the new law should apply to all SOEs or whether there should be a carve-out for some of the older SOEs.⁶⁷ This latter view was incorporated into the 2001 and 2002 Draft Chinese Bankruptcy Laws. Article 3 of the 2002 draft law provided that the State Council was authorized to stipulate regulations concerning the special issues of bankruptcies conducted by SOEs that were established before 1994, when the PRC Company Law took effect.⁶⁸ It thus appeared from the 2002 draft that only SOEs established after that date would be subject to the new law and that the older, larger, and more inefficient SOEs would be exempt from its application.⁶⁹

This exemption for the older SOEs does not appear in the October 2004 Draft Chinese Bankruptcy Law, but the effect appears to be the same. Article 148 of the October 2004 Draft provides that before the new bankruptcy is enacted, the special matter of the insolvency of SOEs within a certain scope and within certain deadlines previously set by the State Council shall be addressed by regulations prescribed by the State Council. Further details have emerged: the current proposal is to allow certain SOEs to go bankrupt under relevant regulations issued by the State Council within the next two to three years. After that, the new law will handle all SOE bankruptcies.⁷⁰ This exemption will apply to the largest of the SOEs. The State-Owned Assets Supervision and Administration Commission ("SASAC") of the State Council estimates that roughly 2,000 SOEs may take advantage of this "administrative closure."⁷¹ The irony of the situation is that over a decade has passed since the Chinese began reforming their bankruptcy law, and although the new Chinese bankruptcy law was intended to deal with serious SOE problems, by the time the new law comes into operation the majority of SOEs in need of assistance will already have been dealt with through bankruptcy, reorganization, merger, or other mechanisms discussed above. Early ambitions have given way to a pragmatic administrative

⁶⁷ Symposium, *Chinese Insolvency Law: The Need to Develop An Effective Insolvency Infrastructure*, organized by the Asian Institute of International Financial Law at the University of Hong Kong (Nov. 17-18, 2000). See also Booth, *supra* note 12, at 15.

⁶⁸ Earlier language to this effect appeared in Article 168 of the 2001 Draft Chinese Bankruptcy Law.

⁶⁹ Although it remained unclear whether the older SOEs would be subject to new regulations or remain subject to the 1986 Chinese Bankruptcy Law. Article 162 of the 2002 Draft Chinese Bankruptcy Law provided for the abolition of the 1986 law upon the enactment of the new law, but at a workshop in which I participated that was organized by the Finance and Economic Committee of the National People's Congress of the People's Republic of China and held in Beijing, China, in Apr. 2002, members of the bankruptcy law drafting committee noted that perhaps the old law would continue to apply to these old SOEs until new regulations were drafted.

⁷⁰ Lan Xinhen, *Outdated Bankruptcy Law Upgraded* (2004) available at [http://www.bjreview.com.cn/200430/Business-200430\(B\).htm](http://www.bjreview.com.cn/200430/Business-200430(B).htm). But see PricewaterhouseCoopers, *China's new bankruptcy law: The start of something big?* (2004) available at http://www.pwchk.com/home/printeng/cn_bankruptcy_law_oct2004.html, which notes that this period of exemption may extend for three to five years.

⁷¹ See Lan Xinhen *supra* note 70, at 1.

solution. However, after the period for administrative closure has expired, one of the main advantages of the new law over current practice will be the unification of the law and treating the bankruptcy of SOEs and non-SOE legal persons under the same legal framework.

The new law will also include a significant policy change from current law. Under the 1986 Chinese Bankruptcy Law, an SOE may not file for bankruptcy without first getting permission to proceed from the government authority in charge.⁷² This requirement for first obtaining the permission of the government authority has been removed from the draft bankruptcy laws.⁷³ Deletion of this requirement will arguably weaken the power that local government authorities exercise over SOEs subject to their control. Similar changes will also apply in cases against SOEs commenced by creditors' petitions. At present, under Article 3 of the 1986 PRC Chinese Bankruptcy Law, the People's Court will not enter a bankruptcy declaration against "public enterprises and enterprises which have an important relationship to the national economy and to the people's livelihood" (a public interest exception) unless the relevant government authority in charge has not provided financial assistance or adopted other measures to assist the enterprise in repaying its debts. In other words, if a creditor petitions for bankruptcy against such an SOE and the relevant government authority decides to provide financial assistance, the bankruptcy declaration can be avoided. If the government authority decides not to provide financial assistance, the declaration may be made. Furthermore, in a case commenced by a creditor's petition against an SOE, the government authority may delay the making of a bankruptcy declaration by filing a reorganization plan.⁷⁴ The October 2004 Draft Chinese Bankruptcy Law no longer includes these exceptions, which will further erode the control of the local government authorities.

Vietnam

Although Vietnam, like China, adopted a multi-pronged approach to deal with the problems caused by the financial weaknesses of SOEs, the issue of whether the new bankruptcy law should apply to SOEs does

⁷² 1986 Chinese Bankruptcy Law art. 8; 2002 Supreme People's Court Provisions art. 5. The law appears to require only government approval for a debtor's petition, but the reality is that the approval of the relevant state authorities is always required. *See also* Zhang & Booth, *supra* note 3, in notes 25-27 and accompanying text. In fact, the local authorities are reluctant to grant their approval, because they are responsible for resettling the employees after the bankruptcy of the SOE. *See also* Lan, *supra* note 70, at 1.

⁷³ *See, e.g.*, the 2002 and June and October 2004 Draft Chinese Bankruptcy Laws.

⁷⁴ *See* Chang, *supra* note 17. *See* art. 17 of the 1986 Chinese Bankruptcy Law and art. 28 of the 2002 PRC Supreme People's Court Provisions: Article 17 of the 1986 law provides that the application for reorganization must be filed by the government authority within three months of the date the People's Court accepts the bankruptcy case and that the reorganization must be completed within two years. Article 28 of the 2002 provisions further provides that the application must be filed before the People's Court enters the bankruptcy declaration.

not appear to have been a controversial one in Vietnam. Under the 1993 Vietnamese Bankruptcy Law, very few SOEs actually resorted to the procedure – at the end of 1999, only ten SOEs and two state-owned cooperative groups had been declared bankrupt.⁷⁵ Reasons for this low rate included the following factors:

- (1) SOEs are entitled to various forms of preferential treatment and state provided assistance in running their business;
- (2) The courts would only consider issuing bankruptcy applications against SOEs after the relevant state authority had issued a decision not to adopt measures necessary to assist the repayment of debts;
- (3) Some state authorities and agencies were not sufficiently aware of the importance of the 1993 Vietnamese Bankruptcy Law;
- (4) State authorities often failed to decide (or when they decided, failed to do so clearly and definitely) whether to apply for a declaration of insolvency or to seek dissolution of the enterprise, with the result that SOEs were often allowed by the superior agencies to be dissolved instead of being declared bankrupt under the 1993 Vietnamese Bankruptcy Law.⁷⁶

It is clear that in Vietnam, as in China, the relevant government authorities played an integral role in determining whether an SOE should file for bankruptcy. However, the articles regarding the petition make no mention of the need to secure the approval of the relevant government authority.⁷⁷

One of the primary goals of the Vietnamese reform process was to enact a new law that would be utilized by more SOEs. The extent to which this goal is achieved will be dependent in great part on whether SOEs are confident that the new law offers enough substantive improvements over the old law and whether the necessary supporting infrastructure is in place to ensure the efficient operation of the new law.

Both the 2002 draft and the 2004 Vietnamese Bankruptcy Law retain the unified approach in which the same rules apply to SOE and non-SOE enterprises. Both the draft law and the current law also retain a limited exemption from Section 1 of the 1993 Vietnamese Bankruptcy

⁷⁵ VIETNAMESE BANKRUPTCY LAW RESEARCH REPORT, *supra* note 4, at Part Two, I, 2.5.

⁷⁶ *Id.*

⁷⁷ 1993 Vietnamese Bankruptcy Law arts. 7 (creditor's petition), 8 (worker's petition), 9 (debtor's petition). Compare with 1986 Chinese Bankruptcy Law art. 8 (requiring approval in the case of a debtor's petition).

Law for some SOEs engaged in providing public services, national defense, and/or security.⁷⁸ Revised Article 2.2 provides that:

The Government shall make detailed provisions on the list of enterprises and the application of this Law to special enterprises that directly serve the national defense and security, enterprises and cooperatives that operate in the fields of finance, and banking and insurance and other fields that provide essential products and public service on a regular and direct basis.⁷⁹

The new 2004 Vietnamese Bankruptcy Law thus applies to all SOEs, with the exception that Article 2.2 provides that the government shall promulgate “detailed provisions” on the application of the new bankruptcy law to the narrow category of “special enterprises.” As is discussed below, the category of exempt enterprises in China is narrower and only applies to enterprises operating in the areas of banking, finance, and insurance.

B. Should the law apply to banks, insurance companies, and securities companies?

There is no international consensus about whether the bankruptcy of banks, insurance companies, securities companies, and other financial institutions should be handled under bankruptcy laws or under separate laws. For example, the United States generally excludes these entities from the U. S. Bankruptcy Code.⁸⁰ On the other hand, Hong Kong relies on an old English company law approach in which the company law includes both insolvency-related commencement criteria as well as non-insolvency regulatory grounds for winding-up companies in regulated industries such as banking and insurance.⁸¹

⁷⁸ Under the 1993 Vietnamese Bankruptcy Law, a bankruptcy case against SOEs operating in these areas could not proceed unless the Court received a letter of authorization from the Prime Minister or the head of the government agency that established the business. JOHNSON, STOKES & MASTER, *supra* note 50, at 22.

⁷⁹ 2004 Vietnamese Bankruptcy Law art. 2(2).

⁸⁰ More particularly, in the United States, banks and insurance companies are excluded from both the liquidation and reorganization provisions in the U.S. Bankruptcy Code (11 U.S.C. § 109(b)(2), (b)(3), & (d) (2005)) and stockbrokers and commodity brokers are excluded from the reorganization provisions (*Id.* § 109(d)).

⁸¹ For example, petitions based on these non-insolvency related grounds, called “public interest” petitions, are handled under the usual insolvency provisions in the H. K. Companies Ordinance (cap. 32) as supplemented or amended by relevant provisions in the legislation that directly applies to the regulated industry. See Charles D. Booth, *When Government Intervenes: Winding Up Fraudulent Companies in Hong Kong*, 29 HONG KONG L.J. 368 (1999).

China

Article 71 of the PRC Commercial Bank Law provides that a commercial bank not paying its debts may, with the consent of the China Banking Regulatory Commission, be declared bankrupt by a People's Court. A similar provision is included in Article 86 of the PRC Insurance Law, subject to the approval of the China Insurance Regulatory Commission. Both of these provisions provide for the appointment of a liquidation team and the banking provision. Section 71 also includes a paragraph setting out that the "payment of the principal of savings deposits of individuals and interest thereon shall be given a priority after the liquidation expenses, the wages owed to the employees and labor insurance premiums have been paid." That is the full extent of the discussion of bankruptcy in these two laws. It is noteworthy, and unfortunate, that neither of these provisions refers to the 1986 Bankruptcy Law, the PRC Civil Procedure Law, nor the PRC Company Law.⁸²

The 2002 Draft Chinese Bankruptcy Law explicitly excluded commercial banks from the scope of coverage.⁸³ There was a view among some that the new bankruptcy law should apply to commercial banks and insurance companies, but that securities companies and trust companies would not be mentioned explicitly for fear that they would seek special treatment.⁸⁴ This view, however, did not carry the day and the exclusion was carried over into the June and October 2004 drafts. Article 149 of the October 2004 Draft Chinese Bankruptcy Law provides that the insolvency of banks, insurance companies, and other financial organizations shall be governed by implementation regulations based on the new bankruptcy law and related laws to be issued by the State Council. The matter has not been finalized, however. This is one issue still being debated by the drafting committee and the ultimate treatment still remains uncertain.

Vietnam

The 1993 Vietnamese Bankruptcy Law did not extend to banking, financial, or insurance entities.⁸⁵ The 2002 Draft Vietnamese Bankruptcy Law expressly took financial, monetary, and insurance business outside the scope of the new law through the interaction of Sections 1.2 and 6.5. This exclusion was carried over into Article 2.2 of the 2004 Vietnamese

⁸² See Harmer, *supra* note 17, at 2573 (discussing the bank provision).

⁸³ 2002 Draft Chinese Bankruptcy Law art. 160.

⁸⁴ The securities firms in China are arguably in a more precarious situation than the Chinese banks. See REPORT ON THE 2004 SYMPOSIUM ON BUILDING THE FINANCIAL SYSTEM OF THE 21ST CENTURY: AN AGENDA FOR CHINA AND THE UNITED STATES, held in Beijing, China (June 11-13, 2004), at 21.

⁸⁵ See VIETNAMESE BANKRUPTCY LAW RESEARCH REPORT, *supra* note 4, at Part One, III, 3.5.

Bankruptcy Law in the same form as the treatment for excluded SOEs. The government is to make "detailed provisions" on the application of the new bankruptcy law to "enterprises and cooperatives which operate in the fields of finance, banking and insurance." This is similar to the approach adopted by China for these institutions, except that the Vietnamese provision refers solely to the bankruptcy law and not to bankruptcy and "related laws."

C. Should the law apply only to legal persons or should it also apply to partnerships and sole proprietors?

As noted above, the PRC Civil Procedure Law applies only to non-SOE legal person enterprises, and Article 206 explicitly excludes individual businesses (e.g., sole proprietorships) and partnerships formed by private individuals. The 2002 Draft Chinese Bankruptcy Law rejected this approach. Article 3 expressly included partnership enterprises and their partners, individual proprietorship enterprises, and other profit-making organizations that are established in accordance with the law. The enactment of this article would have dramatically expanded the scope of the new bankruptcy law to that of a far-ranging business bankruptcy law. However, the October 2004 draft returned to the position in the current PRC Civil Procedure Law. Article 2 of the October 2004 draft expressly applies to debtors that are legal person enterprises and the revised Article 147 provides that the bankruptcy of partnerships and sole proprietorships shall be dealt with under other related laws. The Chinese bankruptcy reform process on this issue has thus come full circle. However, the issue has not yet been conclusively resolved, as it is understood that there is still some support for including partnerships and sole proprietors in the new law.

Vietnam

The situation in Vietnam was quite different. Unlike the Chinese law, the 1993 Vietnamese Bankruptcy Law applied to a broad range of both legal person and non-legal person enterprises. Section 1 of this law applied this law "to all forms of business ownership" and Vietnamese Decree 189 provided further details as to the scope of application as including private enterprises.⁸⁶ Partnerships were also covered.⁸⁷ An

⁸⁶ See *supra* note 54 and accompanying text.

⁸⁷ Partnerships were included pursuant to the general language in Article 1 of the 1993 Vietnamese Bankruptcy Law. VIETNAMESE BANKRUPTCY LAW RESEARCH REPORT, *supra* note 4, at Part One, III, 1.1 ("Limits on the subjects to apply bankruptcy procedures"). In Vietnam, a partnership is defined as an enterprise, which must have at least two partners (who are personally liable for the firm's obligations), in addition to equity contribution members (whose liability is limited by the level of their capital contributions). JOHNSON, STOKES & MASTER, *supra* note 50, at 27. ("Unlike

impetus in the early drafting was to expand further the scope of the law to include some non-private enterprises such as household businesses. It was noted that although both private businesses and household businesses had unlimited liability and although neither was a legal person, under the old law private enterprises were allowed to file for bankruptcy to release their obligations, but household businesses were not permitted to do so.⁸⁸

The drafting of the 2002 Draft Vietnamese Bankruptcy Law was influenced by these arguments in favor of expanding the scope of application, as well as by arguments that the defined category for the new law should be a “merchant,” which under Article 35.1 of the Vietnamese Commercial Law extended to organizations, individuals, legal persons, households, or cooperatives.⁸⁹ Thus, Section 1.1 of the 2002 Draft Vietnamese Bankruptcy Law stated that the new law would be applicable to merchants who had fallen into a bankrupt situation. Section 6.4, in turn, defined merchant quite expansively as including the following:

Individuals, collective groups, households, collectives, limited liability companies, holding companies, partnerships, private enterprises, enterprises with partly foreign invested capital, enterprises with 100% foreign invested capital, enterprises belonging to political or social organizations, state enterprises, and those that have a business registration certificate and operate independently and continuously.

The 2002 Vietnamese draft, however, did carve out an exception for small-scale sole proprietorships, namely hawkers and nosh vendors with low business capital, turnover, and income.⁹⁰

Interestingly, the Vietnamese, like the Chinese, retreated from their expansive draft and returned to notions in their existing law. Thus, Article 2 provides that the new law applies to all enterprises, cooperatives and cooperative unions. The expansive definition in Section 6.4 of the 2002 Draft Vietnamese Bankruptcy Law was deleted and no new definition inserted. Instead, a series of provisions from Article 15 through Article 18 provide for who may file the petitions on behalf of the debtors that are able to use the new law – enterprises and cooperatives (Article 15), SOEs (Article 16), joint stock companies (Article 17), and partnerships (Article 18). Sole proprietor private enterprises are included (Article 15), but household businesses are not. Although partnerships and sole proprietorship private enterprises are included in the scope of the

limited liability and shareholding companies the concept of partnerships is new in Vietnam and their status, therefore, is less clear.”)

⁸⁸ VIETNAMESE BANKRUPTCY LAW RESEARCH REPORT, *supra* note 4, at Part Three, II, 1 (“On applicable scale of the Bankruptcy Law”).

⁸⁹ *Id.*

⁹⁰ 2002 Draft Vietnamese Bankruptcy Law § 1.3.

new law, there are no provisions that address the possibility of a discharge or an entitlement to retain exempt property.

Summary

It is unfortunate that Vietnam, like China, retreated from its more expansive jurisdiction, although the position to which the Vietnamese law has returned is broader than the existing (and proposed) Chinese position. Business entities that are not covered by the new laws still need to raise capital and have creditors. By excluding these debtors from the new law, the government policy discriminates against these other forms of business.⁹¹

D. Should the law apply to consumers?

When China enacted its bankruptcy law in 1986 and Vietnam in 1993, the debate in each country focused on which business enterprises should be permitted to utilize the new procedure. It was too early to raise even the possibility of consumer bankruptcy legislation and consumers were left outside the scope of the new laws. In contrast, in the United States consumer petitions comprise the great majority of bankruptcy petitions⁹² (more than 1,000,000 individuals file for bankruptcy every year).⁹³ The number of people who file for bankruptcy annually is greater than the number of people who have a heart attack, are diagnosed with cancer, graduate from college, or file for divorce.⁹⁴ Thus, it may be difficult for Americans to envision a country where consumers are not permitted to file for bankruptcy. However, given that even early English and U.S. bankruptcy laws were applicable only to merchants or to others engaged in commerce,⁹⁵ it should not be surprising that China and Vietnam, which have only enacted bankruptcy laws over the last two decades, have excluded consumers from the application of the law.

At the time that bankruptcy laws were being introduced in China and Vietnam, each country was in only the initial stage of making the transition from a planned economy to a market-based economy; therefore, there were few opportunities for consumer finance. However, a strong argument can be made that the China and the Vietnam of today, with their

⁹¹ VIETNAMESE BANKRUPTCY LAW RESEARCH REPORT, *supra* note 4, at Part Three, II, 1.

⁹² Between 97%-98% for each year from 2000 to 2004. *News Release of the Administrative Office of the U.S. Courts* (Dec. 3, 2004) available at http://www.uscourts.gov/Press_Releases/fy04bk.pdf.

⁹³ From 2000 to 2004, the number of non-business filings ranged from a low of 1,226,037 (2000) to a high of 1,625,813 (2003). *Id.*

⁹⁴ ELIZABETH WARREN & AMELIA WARREN TYAGI, *THE TWO-INCOME TRAP: WHY MIDDLE CLASS PARENTS ARE GOING BROKE* 6 (2003).

⁹⁵ *See, e.g.*, 13 Eliz. ch. 7 (1571) in England and the Bankruptcy Act of 1800 in the United States. DOUGLAS G. BAIRD & THOMAS H. JACKSON, *CASES, PROBLEMS, AND MATERIALS ON BANKRUPTCY* 27-31 (2nd ed., 1990).

emerging middle classes and increased consumer financing and spending,⁹⁶ should now expand the coverage of the laws beyond their business-oriented origins. Although during the drafting process there was some limited support in both China and Vietnam for enacting a comprehensive bankruptcy law that also applied to consumers, this was clearly the minority view, and neither the new Vietnamese bankruptcy law nor the October 2004 Chinese draft has moved in this direction. Of course, as the purchasing power of consumers increases and a larger percentage of such purchases are made on credit, it is only a matter of time before both countries will have to reconsider this issue.⁹⁷

The Chinese and the Vietnamese have been approaching the issue of sole proprietorship and partnership bankruptcies from the perspective of business bankruptcies. However, including these categories in the bankruptcy law also has benefits from a consumer bankruptcy perspective. Applying a bankruptcy law to individual business owners and partnerships enables courts to gain experience grappling with the types of issues that arise with individual bankruptcies, such as the automatic discharge and exempt property, and provides the courts with a head start for the day when consumer bankruptcy laws will have to be enacted.

IV. BANKRUPTCY ADMINISTRATION

There are a variety of ways to structure the administration of bankruptcy cases and many questions to be debated by law reformers: Should an outside trustee be appointed? What role are creditors allowed to play? How active should the court and the government be in the process? Are there proper checks and balances? The Chinese and Vietnamese have addressed these issues and both the October 2004 Draft Chinese Bankruptcy Law and the 2004 Vietnamese Bankruptcy Law improve upon the organizational structures for the administration of bankruptcies contained in the 2002 drafts and in the older laws.

China

A major innovation that has emerged from the drafting process in China is the introduction of a new functionary in the bankruptcy

⁹⁶ For example, during the SARS scare in Beijing in 2005, car sales boomed; in April 2003, 50% of the sales were on installment. See *Auto Market to Maintain Fast Growth*, XINHUA NEWS AGENCY, May 30, 2003 available at <http://www.china.org.cn/english/2003/May/65827.htm>.

⁹⁷ For a comprehensive analysis of the relationship between consumer credit and personal bankruptcy law reform in China, see Xian-Chu Zhang, *Development of Consumer Credit in China and Concerns about the Underlying Legal Infrastructure* (Chapter 5) in JOHANNA NIEMI-KIESILAINEN, IAIN RAMSAY & WILLIAM C. WHITFORD (eds.), *CONSUMER BANKRUPTCY IN GLOBAL PERSPECTIVE* (2003).

procedure called an “administrator” to take control of the debtor’s assets and exercise a broad range of administrative responsibilities. This innovation appears as a new Chapter III in the October 2004 Draft Chinese Bankruptcy Law⁹⁸ (it was a chapter section in the 2002 draft).⁹⁹ The post of administrator does not exist under the current bankruptcy regime. In bankruptcies under current Chinese law, a trustee or administrator is not appointed. Rather, the court establishes a liquidation committee. Article 47 of the 2002 Supreme People’s Court Provisions provides that in cases under the 1986 Chinese Bankruptcy Law, within 15 days of declaring the enterprise bankrupt, the court shall establish a liquidation committee. Article 48 provides that the committee may consist of members chosen from the superior department in charge of the SOE (if the case involves an SOE); liquidation-related intermediary organizations; relevant government departments (including financial departments, administrations for industry and commerce, planning commissions, etc.); and professionals, including lawyers and accountants.¹⁰⁰ In practice, professionals are rarely appointed to the committee, and, in the bankruptcy of non-SOEs, the liquidation committee usually plays a minor role.¹⁰¹

A further problem under current law flows from the fact that the liquidation committee is not appointed when the court accepts the case, but rather within 15 days of the date that the court makes the adjudication order. Thus, during the gap period, which can be lengthy, there is no one in charge to prevent existing management from misappropriating the debtor’s assets.¹⁰²

The introduction of the office of the administrator should address many of the infirmities in the current law. First, the administrator (or administrators, as it appears that in effect a team of administrators may be appointed) shall be appointed from the day the case is accepted.¹⁰³ Second, an administrator will be a professional – either an individual or a relevant social intermediary – with the necessary expertise and background to perform the responsibilities. An individual may be a

⁹⁸ See 2004 Draft Chinese Bankruptcy Law arts. 19-27.

⁹⁹ See 2002 Draft Chinese Bankruptcy Law arts. 27-32.

¹⁰⁰ See also 1986 Chinese Bankruptcy Law art. 23 (for SOEs); PRC Civil Procedure Law art. 201 (for non-SOEs); PRC Company Law art. 189 (for companies). The relevant government departments often designate members of the committee. See Li, *supra* note 17, at 13.

¹⁰¹ Li, *supra* note 17, at 13.

¹⁰² Wang Weiguo, *Administrator in New Bankruptcy Law of China*, paper presented at the Forum on Asian Insolvency Reform 2004: Insolvency Systems and Risk Management in Asia, held in New Delhi, India, Nov. 3-5, 2004, sponsored by the World Bank, the Asian Development Bank, and the OECD. Article 18 of the 2002 Supreme People’s Court Provisions addresses in part this “gap period” problem by providing the court upon accepting a bankruptcy case with the power to appoint “an enterprise management committee.”

¹⁰³ October 2004 Draft Chinese Bankruptcy Law art. 19; 2002 Draft Chinese Bankruptcy Law art. 16. The day the case is accepted is also when the automatic stay on unsecured creditors comes into operation. October 2004 Draft Chinese Bankruptcy Law art. 30; 2002 Draft Chinese Bankruptcy Law art. 19.

lawyer or certified public accountant, and relevant social intermediaries¹⁰⁴ may be drawn from law firms, accounting firms, and bankruptcy and liquidation firms.¹⁰⁵ Administrators should have professional expertise and qualifications, and individuals should carry liability insurance.¹⁰⁶ The Supreme People's Court shall establish further details regarding the qualifications of, and appointment methods for, the administrator.¹⁰⁷ Eventually, there will be a special license required of insolvency administrators and a unified examination will be established.¹⁰⁸

Article 22 of the October 2004 Draft Chinese Bankruptcy Law, (Article 27 in the 2002 draft) sets out criteria that disqualify an individual or institution from appointment, including a prior criminal record, revocation of a professional license, being an interested party in the case, or being thought of by the People's Court to be otherwise inappropriate for appointment. Other provisions provide for situations in which the administrator is negligent, incompetent, or commits unlawful or wrongful acts. The institution of the administrator will play a major role in the new bankruptcy procedure.¹⁰⁹ The administrator will be able to hire staff.¹¹⁰ Unlike the current liquidation team, the administrator (or administration team) will be a disinterested and neutral party.

Article 29 of the October 2004 Draft Chinese Bankruptcy Law authorizes the administrator to take over all of the debtor's property from the date of appointment by the People's Court.¹¹¹ Article 23 sets out a broad list of administrative functions that the administrator shall perform after his designation:¹¹²

- (1) taking over all of the debtor's property, accounting books, documents, data, seals, and other articles;
- (2) investigating into the debtor's property, status, and civil activities, including salaries owed to laborers, owed costs for social security and tax owed by the debtor;
- (3) making a report on the investigation into the financial status;
- (4) determining the internal management affairs of the debtor;

¹⁰⁴ October 2004 Draft Chinese Bankruptcy Law art. 21; 2002 Draft Chinese Bankruptcy Law art. 27.

¹⁰⁵ See Li, *supra* note 17, at 13.

¹⁰⁶ October 2004 Draft Chinese Bankruptcy Law art. 22.

¹⁰⁷ *Id.*; compare with 2002 Draft Chinese Bankruptcy Law art. 27 (specifying that the State Council would be responsible for this).

¹⁰⁸ Wang, *supra* note 102, at 3.

¹⁰⁹ October 2004 Draft Chinese Bankruptcy Law art. 27; 2002 Draft Chinese Bankruptcy Law arts. 26, 27.

¹¹⁰ October 2004 Draft Chinese Bankruptcy Law art. 26.

¹¹¹ 2002 Draft Chinese Insolvency Law art. 25.

¹¹² It deletes one function from Article 29 of the 2002 Draft Chinese Bankruptcy Law and changes the order of priority.

- (5) employing necessary managing personnel, professional technicians and other staff;
- (6) determining whether or not the debtor shall continue to operate the business before the convention of the first creditors' meeting;
- (7) managing and handling the debtor's property;
- (8) accepting the property delivery by a third party to the debtor;
- (9) participating in a lawsuit or an arbitration concerning the disputes over the debtor's property and distribution of the bankrupt property;
- (10) calling for the convening of the creditors' meeting; and
- (11) other rights that the court thinks shall be exercised by the administrator.

In addition to these functions set out in Chapter III, there are many other functions to be exercised by the administrator that are set out in other chapters of the draft law. These range from seeking application of the avoidance powers to raising objections to creditors' claims to playing an integral role in the reorganization.¹¹³ If a reorganization is attempted, the administrator is intended to play the leading role, unless the debtor chooses to retain control of the business – under a modified debtor-in-possession approach – in which case the administrator will supervise the debtor.¹¹⁴

The most contentious issue regarding the administrator is who should have the power of appointment. Article 16 of the 2002 draft provided that the People's Court would designate an administrator when accepting an application for bankruptcy, but Article 56(2) of the 2002 draft provided that when the case was underway, the creditors' meeting had the power to select, appoint, and replace the administrator. This procedure has been modified in the October 2004 draft. Article 19 of the October 2004 Draft Chinese Bankruptcy Law now provides that the administrator shall be appointed by the court. Where the creditors' meeting thinks that the administrator cannot perform his duty fairly or is not competent, it may apply to the court to dismiss the administrator and appoint another one.¹¹⁵ Some groups are unhappy at this demotion of the role of the creditors in the current draft. Some members of the drafting committee argued in favor of the doctrine in which the administrator would be a "representative of the creditors," but ultimately the majority of the committee opted for the administrator serving as a "legal organ"

¹¹³ For a comprehensive list of these functions, see Wang, *supra* note 102, at 3.

¹¹⁴ See discussion *infra* Part IV.

¹¹⁵ October 2004 Draft Chinese Bankruptcy Law art. 19.

independent of the creditors.¹¹⁶ The power of appointment is one of the other issues that has not yet been fully resolved.

Another issue that has proved controversial is the process for the supervision of the administrator. The 2002 Draft Chinese Bankruptcy Law established an office called the "supervisor."¹¹⁷ Article 62 of the 2002 draft provided that the creditors' meeting could select up to three supervisors. One of the weaknesses of the 2002 draft was that it was unclear what the lines of demarcation were among the supervisors, the People's Court, and the creditors' meeting in supervising the administrator.¹¹⁸ The October 2004 draft makes important improvements in this area. The office of the supervisor has been abolished. In its place, a creditors' committee has been established. Article 62 of the October 2004 Draft Bankruptcy Law provides that the creditors' meeting may select up to nine members, who then need to be affirmed by the court.¹¹⁹ Members may include creditors or their representatives, and must include at least one worker or workers' representative. The creditors' committee is intended to play much more than a merely symbolic role in the process.¹²⁰ Article 63 provides that the creditors' committee shall supervise the management and handling of the debtor's property and is entitled to request the administrator to make explanations or to supply relevant documents. The committee may seek rulings by the People's Court where an administrator violates the bankruptcy law and refuses to accept supervision. In addition, Article 64 of the October 2004 draft requires the administrator to report in a timely fashion on twelve major activities to the creditors' committee. These activities include, *inter alia*, transferring the ownership of real property, transferring property rights, transferring all of the company's stock or business operations, and requesting the performance of a bilateral contract. If the administrator wants to undertake an activity specified in Article 64 before the convening of the first creditors' meeting, and thus before the creditors' committee has been formed, then the administrator is required to obtain permission from the People's Court.¹²¹ Article 20 of the October 2004 draft also provides that the administrator must appear before the creditors to report on his activities and answer any enquiries.

The creation of the administrator post will have a significant effect on the bankruptcy process in China. This movement away from government control (through the membership of the liquidation committees at present) is to be welcomed. Independent experienced

¹¹⁶ Wang, *supra* note 102, at 2.

¹¹⁷ 2002 Draft Chinese Bankruptcy Law, Chapter V, § 2.

¹¹⁸ See Booth & Chiu in the note referenced in the title of this article.

¹¹⁹ A creditor chairs the creditors' meeting. October 2004 Draft Chinese Bankruptcy Law art. 55. The same was true under Article 55 of the 2002 Draft Chinese Bankruptcy Law.

¹²⁰ Wang, *supra* note 102, at 3.

¹²¹ October 2004 Draft Chinese Bankruptcy Law art. 24.

insolvency professionals will be more likely to gain the confidence of creditors. The proposed law also strikes the proper balance among the administrator, the court, and the creditors. The creation of a creditors' committee should make the process more transparent and keep creditors well informed. Active committees will help ensure that administrators perform efficiently and comply with the new procedures. It will be interesting to see to what extent foreign creditors (especially foreign banks) choose to participate in the process and seek appointment to the committee.

It has been noted that after implementation of the new bankruptcy law, "bankruptcy administration will emerge as a new profession in China."¹²² In the short term, a key goal will be to find qualified individuals and institutions willing to serve in this capacity. Foreign accounting and law firms with expertise in these matters in other jurisdictions will likely seek to be appointed. However, in the long term it is crucial that China develop expertise domestically. China needs to establish a training and education program for potential administrators as soon as possible after the enactment of the new laws.¹²³ Another way to address this problem would be for the government to take a leading role and create a new administrative agency within China with the responsibility for administering bankruptcies, akin to the Official Receiver's Office that exists in many jurisdictions. The responsibilities of this office could include assisting with regulatory matters, such as licensing administrators and monitoring administrators in bankruptcies. In the first few years, the office could also actually provide staff to serve as administrators in bankruptcy cases, or at least in cases with insufficient assets to attract members of the professions.¹²⁴

Vietnam

Under the 1993 Vietnamese Bankruptcy Law, once the court decided to proceed with the bankruptcy case (under Section 15 of the 1993 Vietnamese Bankruptcy Law), the debtor continued to manage the enterprise subject to the supervision of the court and a trustee committee¹²⁵ (which was also called a "property management team" or an "asset management team"). After making the decision to proceed with the bankruptcy case, the court would initiate a mandated conciliation and reorganization process. If the conciliation and reorganization stage did not succeed, the court would declare the business bankrupt pursuant to Section 36 of the 1993 Vietnamese Bankruptcy Law. Pursuant to Section 42, upon the making of the declaration of bankruptcy, a property

¹²² Wang, *supra* note 102, at 4.

¹²³ See Booth, Lees, Pitney & Tabb in the note referenced in the title of this article, at 7.

¹²⁴ *Id.*

¹²⁵ See 1993 Vietnamese Bankruptcy Law §§ 17 (trustee committee), 18 (court).

settlement team (also called an asset liquidation team or property realization team) would be created and would be permitted to include members of the property management team. In theory, the first stage appears to include a modified debtor-in-possession reorganization procedure, but the reality under the 1993 Vietnamese Bankruptcy Law was that "the opening of bankruptcy proceedings [was] for the purpose of liquidation rather than rehabilitation of the insolvent enterprises."¹²⁶ Thus, one of the unique aspects of the 1993 Vietnamese Bankruptcy Law was the adaptation of a modified debtor-in-possession approach to bankruptcy.

Article 17 of Vietnamese Decree 189 provided that the trustee committee was to consist of an officer of the Economic Court nominated by the Chief Justice of the provincial People's Court as the Chairman, an enforcement officer of the Judgment Execution Office nominated by the head of the Judgment Execution Office,¹²⁷ the creditor holding the largest debt, a representative of the debtor, a trade union representative, a representative of the Department of Finance, a representative of the provincial state bank, and, as necessary, experts from other specialist branches.¹²⁸ The 1993 law did not intend for the trustee committee to participate in and interfere with the running of the enterprise, which was still the responsibility of the enterprise's management.¹²⁹ Other functions (e.g., to enforce the bankruptcy judgment over the enterprise) were carried out later (after the making of the bankruptcy declaration) by the property realization team, which was also comprised of government officials and creditor and debtor representatives, who could also have served on the property management team.¹³⁰ These teams with their hybrid composition exercised functions that in other jurisdictions are normally exercised by trustees (or administrators), and, in a few instances, by creditors' committees.

The administrative structure from the 1993 Vietnamese Bankruptcy Law carried over into the 2002 Draft Vietnamese Bankruptcy Law. Section 59 of the 2002 draft modified old Section 18.1 of the 1993 law and provided that as of the date the court issues the decision to handle the petition for settlement in bankruptcy, the power to manage the indebted merchant's assets would vest in the asset management team. Section 16 of the 2002 draft modified old Section 17. The basic structure of the asset management committee was quite similar, although the

¹²⁶ See VIETNAMESE BANKRUPTCY LAW RESEARCH REPORT, *supra* note 4, at Part Two, II, 1.1.1 and discussion in *infra* Part IV.

¹²⁷ This office is based in the executive branch, not the judicial branch. VIETNAMESE BANKRUPTCY LAW RESEARCH REPORT, *supra* note 4, at Part One, III, 1.7 ("Execution of the enterprise bankruptcy decision is the job of the executive branch").

¹²⁸ *Id.* at Part One, III, 1.6 ("Asset management of debt burden enterprise is carried out by a collective or committee consisting of members representing different interests").

¹²⁹ *Id.*; see also 1993 Vietnamese Bankruptcy Law § 18.

¹³⁰ 1993 Vietnamese Bankruptcy Law §§ 42, 44.

composition changed somewhat from that set out in Article 17 of Vietnamese Decree 189. The asset management team was to consist of the following: court staff; the bailiff of the Judgment Execution Office or Judgment Execution Group; up to three creditors' representatives¹³¹ (although it appears from Section 75.1.c of the 2002 Draft Vietnamese Bankruptcy Law that both the court and the creditors each were to choose three representatives and that in the case of a conflict the court was empowered to override the creditors' choice and appoint its own representatives); a labor union representative or an employee's representative if there was no labor union; and officials of financial, banking and other professional offices. The head of the asset management team was to be a member of the court's staff.¹³² Section 16 empowered the asset management team to do the following:

- a) make the list of all of the assets of the indebted merchant;
- b) supervise and examine the management of assets by the merchant (including when necessary, the power to request the judge to issue provisional measures to preserve the remaining estate of the merchant);
- c) compile the list of creditors and debts that should be paid to each creditor; and
- d) enforce the judge's decisions during bankrupt settlement.

The modified debtor-in-possession approach from old Section 18.1 of the 1993 Vietnamese Bankruptcy Law was retained in Section 59 of the 2002 Draft Vietnamese Bankruptcy Law. Section 59 provided that the indebted merchant would ordinarily conduct its business activities subject to the supervision and monitoring by the judge and the asset management team. In a change from the 1993 law, it also provided that the indebted merchant's assets would vest in the asset management team.

Section 17.3 of the 2002 draft provided that the asset liquidation team was to consist of bailiffs and officials of the judgment execution office or judgment execution group; representatives of financial and banking offices at the corresponding level; a creditor's representative;¹³³ a labor union representative or employees' representative where a labor union does not exist; and a representative of the indebted merchant. Pursuant to Section 17.1 of the 2002 Draft Vietnamese Bankruptcy Law, the enforcement of the liquidation decision over the indebted merchant was under the power of the Judgment Enforcement Office or Judgment Enforcement Group where the main merchant's address as prescribed in the merchant's business certificate was located. The asset liquidation

¹³¹ This is specified in 2002 Draft Vietnamese Bankruptcy Law § 75.1.c.

¹³² *Id.* § 16.1.

¹³³ However, in contrast to the creditors' representative on the asset management team, it is not specified how the representative is appointed and whether there can be more than one.

team was given the following powers and duties pursuant to Section 19 of the 2002 Vietnamese Draft Bankruptcy Law (a revised version of old Section 44 of the 1993 Vietnamese Bankruptcy Law):

- 1) to receive assets and the relevant documents transferred to it by the asset management team;
- 2) to recover and manage all of the assets, documents, accounting books and seal of the merchant who was declared bankrupt;
- 3) to discover the indebted merchant's assets and request the head of the asset management team to recover them or the value of the assets or the difference in the value of the assets that were sold or transferred illegally in accordance with Section 20 (pursuant to the exercise of avoidance powers). The asset liquidation team shall recover the assets, the value of the assets, or the difference under the decision of the head of the asset liquidation team;
- 4) Based on the decision of the head of the asset liquidation team, to organize an auction of the indebted merchant's assets;
- 5) To deposit all money received of the merchant who is declared bankrupt into newly opened bank accounts; and
- 6) To implement the liquidation in accordance with the decision of the judge.

The 2004 Vietnamese Bankruptcy Law, pursuant to Article 9, merged the asset management and liquidation teams into one committee called the "trustee committee." The judge is to establish this committee at the time he makes the decision to commence bankruptcy proceedings. The members of the trustee committee are to include an officer of the court, an enforcement officer of the Judgment Execution Office of the same level (who is to act as Chairman of the Committee); a representative of the creditor (not necessarily the largest);¹³⁴ a representative of the debtor; and, as necessary, a representative of the trade union; a labor representative; and representatives of the relevant professional agencies. The basic structure is the same but there have been some important changes. First, an officer of the court no longer chairs the committee. Rather, that function is exercised by an officer from the judgment enforcement body, which is part of the executive branch. Second, the mandatory membership of the committee has been decreased and representatives from various governmental departments no longer automatically serve on the committee.

¹³⁴ Pursuant to Article 64 of the 2004 Vietnamese Bankruptcy Law, it appears that there is only one creditor's representative on the committee and that the creditors are able to vote on the replacement.

The duties and powers of this unified committee combine the duties and powers of the two previous teams under the 2002 Draft Vietnamese Bankruptcy Law, with only two main changes: (1) the implementation of a plan of asset distribution as may be directed by the judge has been added to the list, and (2) and in some of the duties and powers, the reference to the head of the asset management team or the asset liquidation team has been changed to the judge. Lastly, under the 2004 Vietnamese Bankruptcy Law, as under the 2002 Draft Vietnamese Bankruptcy Law, the judge in charge of the bankruptcy proceedings chairs the meeting of creditors.¹³⁵

Pursuant to Article 30 of the 2004 Vietnamese Bankruptcy Law, the modified debtor-in-possession approach continues subject to the supervision and inspection by the judge and the trustee committee, although the vesting language from the 2002 draft has been deleted. However, an important innovation of the 2004 law is that Article 30.2 provides that where it is considered that the manager of the enterprise of cooperative is incapable of operating the business, or his operation does not benefit the preservation of the assets of the enterprise or cooperative, the judge, upon request from the creditors, shall make a decision to appoint a person to manage and operate the business activities or the enterprise or cooperative. This "manager" would be subject to the supervision and inspection by the judge and the trustee committee.

It is a positive development that the head of the trustee committee is no longer a member of the court's staff and that government departments are no longer automatically on the committee, but this committee lacks the professional expertise and independence that the administrator will bring to the Chinese proceedings. The Vietnamese acknowledge that one of the reasons for adopting a modified debtor-in-possession approach is that the trustee committee does not have the necessary knowledge to manage the assets and run the enterprise at the same time.¹³⁶ It will be interesting to see if the manager position proves attractive to creditors and if the manager "exception" in Article 30.2 becomes the norm and eventually replaces the modified debtor-in-possession approach. If the manager position were utilized in practice, it would be helpful for the Vietnamese courts to follow the Chinese example and appoint independent insolvency professionals. Well-qualified, experienced managers would be able to compensate for many of the weaknesses of the trustee committee.

¹³⁵ See 2004 Vietnamese Bankruptcy Law art. 61.4; 2002 Draft Vietnamese Bankruptcy Law art. 72. In contrast, it is proposed under both the 2002 and October 2004 Draft Chinese Bankruptcy Laws that a creditor will chair the meetings. See October 2004 Draft Chinese Bankruptcy Law art. 22.

¹³⁶ VIETNAMESE BANKRUPTCY LAW RESEARCH REPORT, *supra* note 4, at Part One, III, 1.6 ("Asset management of debt burden enterprise is carried out by a collective or committee consisting of members representing different interests").

Creditors are involved in the process through representation on the trustee committee and participation in the creditors' meetings, but this involvement will not provide as much oversight and supervision as the creditors' committee is intended to do in China. Vietnam would be well advised to separate the functions and membership of the trustee committee and create a distinct creditors' committee.

The judge in Vietnam has historically played the "central and decisive" role¹³⁷ in bankruptcy proceedings – from appointing the members of the trustee committee to chairing the creditors' meeting. It has been argued that this has been "suited to the social-economic and cultural situation" of Vietnam.¹³⁸ However, at this stage in the development of the Vietnamese bankruptcy law, it would be better for the judge to play a less central role, or, at a minimum, to relinquish some of the administrative functions such as chairing the creditors' meeting. It is a positive change that court staff no longer chairs the trustee committee, but it would be even better if an officer of the court did not even serve on the committee. In contrast to the checks and balances that have been built into the proposed Chinese law, the Vietnamese procedure still lacks independent functionaries and an adequate supervisory structure.

V. CORPORATE REHABILITATION

Corporate reorganization is possible under both the 1986 Chinese Bankruptcy Law and the PRC Civil Procedure Law, but the number of cases is very low.¹³⁹ The situation was similar under the 1993 Vietnamese Bankruptcy Law.¹⁴⁰ A major impetus for the enactment of new insolvency laws in both China and Vietnam was to put in place more user-friendly corporate rescue procedures.

China

Existing Chinese bankruptcy law provides for corporate rescue, but there are very few provisions. Part 4 of the 2002 Supreme People's Court Provisions (Articles 25-30) and Part IV of the 1986 Chinese Bankruptcy Law (Articles 17-22) include provisions regarding conciliation (also called reconciliation, mediation, settlement, composition, or compromise) and reorganization. The PRC Civil Procedure Law also includes one provision on conciliation (Article 202). The laws also include separate provisions on approval by the creditors. In

¹³⁷ *Id.* at Part One, III, 1.5 ("The Court – the central subject, playing a decisive role in the bankruptcy proceeding in Vietnam").

¹³⁸ *Id.*

¹³⁹ See Wang, *supra* note 11, at 220 (the number of cases invoking the reorganization provisions in the law was close to zero).

¹⁴⁰ *Id.*

cases involving both SOEs and non-SOEs, after the court accepts the case and before the case is concluded, the debtor may apply to the court for conciliation. Alternatively, the People's Court itself, in the course of trying the bankruptcy case, may propose a settlement to the parties.¹⁴¹ The creditors may not commence the conciliation process. If the debtor and creditors reach a settlement agreement (e.g., to reduce the amount to be paid to the creditors) and the People's Court approves the agreement before a declaration of bankruptcy has been made, the bankruptcy procedure is stayed.¹⁴² If agreement among the debtor and creditors and the approval of the People's Court occurs after the declaration of bankruptcy, the People's Court shall stay the enforcement of the bankruptcy declaration ruling and stay the bankruptcy procedure.¹⁴³ If the debtor later fails to discharge all of its debts in accordance with the settlement agreement, the creditors may apply to the People's Court for enforcement.¹⁴⁴ If the debtor fails or is unable to perform the settlement, the creditors may apply to the People's Court to resume the bankruptcy procedure. In addition, in cases where the settlement was reached prior to the declaration of bankruptcy, the People's Court shall simultaneously rule to declare the debtor bankrupt when ruling to resume the bankruptcy procedure.¹⁴⁵

Reorganization is a more formal process that may only be used for SOEs and only in cases in which a creditor filed the bankruptcy petition. Where the SOE has a superior department in charge, only the government department may apply for reorganization and must file the application within three months of the date the People's Court accepts the bankruptcy case and before the People's Court makes the bankruptcy declaration.¹⁴⁶ Where the SOE does not have a superior department in charge, the SOE's shareholders' meeting may pass a resolution and apply for reorganization and persons designated by the shareholders' meeting shall undertake the reorganization.¹⁴⁷ Pursuant to Article 18 of the 1986 PRC Bankruptcy Law, the reorganization of an SOE always involves conciliation; after the application for reorganization is made, the SOE is required to submit a conciliation agreement to the creditors' meeting.

¹⁴¹ 2002 Supreme People's Court Provisions art. 25. Through use of the words *qi ye* (企业) [enterprise], Article 25 of the 2002 Supreme People's Court Provisions would appear to apply to both SOEs and non-SOEs. This would extend the use of conciliation to SOEs in cases not involving reorganization. Articles 17 and 18 of the 1986 Chinese Bankruptcy Law only discuss conciliation in the context of the reorganization of SOEs – Article 18 states that the enterprise must submit a draft conciliation agreement to the creditors' meeting after an application for reorganization has been presented. See *infra* notes 146-157 and accompanying text. The 1986 law is silent on the issue of whether conciliation can apply to an SOE in a case not involving a reorganization.

¹⁴² 2002 Supreme People's Court Provisions art. 25.

¹⁴³ *Id.*

¹⁴⁴ *Id.* art. 26.

¹⁴⁵ *Id.* art. 27.

¹⁴⁶ 1986 Chinese Bankruptcy Law art. 17; 2002 Supreme People's Court Provisions art. 28. The period for reorganization may not exceed two years. 1986 Chinese Bankruptcy Law art. 17.

¹⁴⁷ 2002 Supreme People's Court Provisions art. 28.

During the reorganization, the superior department in charge or the designated persons, as the case may be, shall periodically report on the reorganization and the implementation of the settlement agreement to the creditors' meeting and the People's Court.¹⁴⁸ During the reorganization, any enforcement against the debtors' property continues to be stayed pursuant to Article 11 of the 1986 Chinese Bankruptcy Law. Pursuant to Article 13 of the 1986 Chinese Bankruptcy Law, secured creditors do not vote at the creditors' meeting and thus act outside the reorganization process.

Articles 33 and 34 of the 1991 Supreme People's Court Opinion help clarify the differences between conciliation and reorganization. Article 34 provides that where an application for reorganization is made, the draft conciliation agreement submitted to the creditors must set out sources of capital for debt repayment, a method of debt repayment, and the term of the debt repayment. In contrast, pursuant to Article 33, the reorganization plan must include the following: analysis of the reasons for the enterprise having reached the edge of insolvency; a plan for the adjustment or establishment of a new management group for the enterprise; feasibility-concerning measures and reforms to be taken for the improvement of business management and measures to be taken for changes in production; methods of reducing losses and increasing profits; and the term and objectives of the reorganization (not to exceed two years). Article 34 also provides that where an enterprise being reorganized requires a reduction of debt, the application shall clearly state the amount of the reduction required. From these articles, it can be seen that "[t]he conciliation will focus only on the relationship between a debtor and [its] creditors regarding [the] payment scheme while the reorganization will focus on how to improve the economic situation of the debtor in the future."¹⁴⁹

The insolvency reform process in China has emphasized the importance of corporate rescue. Chapter VI of the 2002 draft applied to reorganization and Chapter VII to conciliation. To highlight their importance, they appeared before the liquidation chapter, Chapter VIII. In the October 2004 draft, these chapters have been renumbered as follows: Reorganization, Chapter VII; Conciliation, Chapter VIII; and Bankruptcy Liquidations, Chapter IX.

Debtors will be able to choose whether to file for reorganization or conciliation.¹⁵⁰ Under the 2002 Draft Chinese Bankruptcy Law, conciliation was available to all entities subject to the new law, but reorganization was limited to legal person enterprises. There was a general view that conciliation would be more useful for partnerships and

¹⁴⁸ *Id.* art. 29. See also 1986 Chinese Bankruptcy Law arts. 17-18.

¹⁴⁹ See YU & GU, *supra* note 17.

¹⁵⁰ October 2004 Draft Chinese Bankruptcy Law art. 9.

sole proprietors. However, with the October 2004 Draft Bankruptcy Law now limited to legal person enterprises, this distinction is no longer relevant. The simpler conciliation procedure might appeal to smaller enterprises or to less complicated cases in which the debtor is confident that an agreement can be reached quickly.

Under the October 2004 draft, the commencement of a reorganization will no longer also trigger a formal conciliation procedure. However, as will be seen in the discussion below, the reorganization plan incorporates the factors that are included in the conciliation agreement under the 1986 Chinese Bankruptcy Law.

Chapter VII dramatically broadens the scope of debtors that may use reorganization, as well as the range of parties that may petition for the procedure. No longer will reorganization be a procedure limited to SOEs to be used at the discretion of the government (or the shareholders in the absence of a superior department in charge). All legal person enterprises, both SOEs and non-SOES, will be able to utilize the procedure.¹⁵¹ The October 2004 draft does not require the petitioner to specify the relief sought at the time of petitioning, and, where relief is not requested, certain parties are permitted to make a request after the court accepts the case, but before the declaration of bankruptcy. Article 9 of the October 2004 Draft Chinese Bankruptcy Law¹⁵² provides that either the debtor or the creditors may file a petition. A debtor may file an application for bankruptcy with the People's Court if (1) the debtor is unable to pay its debts when due, and (2) the debtor's assets cannot pay all of its liabilities or obviously lack the ability to pay them.¹⁵³ The balance sheet test in the second prong of this clause unfortunately inserts some uncertainty into the process. In contrast, a creditor may file a petition relying on the debtor's inability to pay its debts when due.¹⁵⁴ Article 65 of the October 2004 draft¹⁵⁵ provides that either the debtor or the creditors may apply for reorganization at the time of petitioning or after the court accepts the case, but before the court declares the debtor bankrupt. Although shareholders are not permitted under the draft Chinese law to file a petition, Article 65 permits them to apply for reorganization after the court accepts the case, but prior to the declaration of bankruptcy, so long as more than one-tenth (one-third in Article 66 of the 2002 draft) of the shareholders support the application. The conciliation commencement procedures are more limited: Article 93 of the October 2004 draft¹⁵⁶ provides that only the debtor may apply for conciliation either at the time

¹⁵¹ *Id.* art. 2; 2002 Draft Chinese Bankruptcy Law arts. 65, 66.

¹⁵² 2002 Draft Chinese Bankruptcy Law art. 11.

¹⁵³ October 2004 Draft Chinese Bankruptcy Law arts. 2, 9. The balance sheet test did not appear in the 2002 Draft Chinese Bankruptcy Law. See 2002 Draft Chinese Bankruptcy Law art. 4 (cash flow test for both a debtor's and creditors' petitions).

¹⁵⁴ October 2004 Draft Chinese Bankruptcy Law art. 9.

¹⁵⁵ *Id.* art. 66.

¹⁵⁶ *Id.* art. 95.

of petitioning or after acceptance, but prior to the declaration of the bankruptcy case. Creditors may not apply for conciliation.

The period from when the People's Court decides to reorganize the debtor to the date that the court approves the reorganization plan or terminates the reorganization procedure is called the protective period of reorganization.¹⁵⁷ As a general rule, during the protective period of reorganization, the administrator shall perform the duties and powers prescribed in Article 23 of the October 2004 Draft Chinese Bankruptcy Law¹⁵⁸ and may employ staff to manage the business operations of the enterprise or ask the debtor to take on management responsibilities.¹⁵⁹ However, a major change included in the new Article 69 of the October 2004 draft provides that in a case in which the debtor files a petition, at the time of the filing the debtor is allowed to request permission to manage the assets and continue the running of the business. Subject to the approval of the People's Court, the debtor may thus be allowed to carry on under what is basically a modified debtor-in-possession approach. Where the debtor opts to retain control, if an administrator has already been appointed the administrator, she must return possession to the debtor. In such cases, the administrator's role becomes one of supervising the debtor.¹⁶⁰

The initial period of protection may not exceed six months, but upon request of the administrator (or the debtor, as the case may be) and with the agreement of the creditors, the People's Court may approve the extension of the protective period for up to another three months.¹⁶¹ During the protective period, secured creditors are stayed from seeking repossession of their collateral, but they are allowed to seek exemption from the stay in cases in which their collateral may be damaged or its value decreased dramatically.¹⁶²

During the protective period, to assist the debtor in continuing its business operation, the debtor is permitted to borrow money; moreover, subject to restricted use and necessary controls, the debtor is even permitted to grant lenders during the protective period security interests in property not yet collateralized.¹⁶³ In other words, during this period, the debtor is able to seek what is often called "post-petition" financing on

¹⁵⁷ October 2004 Draft Chinese Bankruptcy Law art. 68; 2002 Draft Chinese Bankruptcy Law art. 68.

¹⁵⁸ 2002 Draft Chinese Bankruptcy Law art. 29.

¹⁵⁹ October 2004 Draft Chinese Bankruptcy Law arts. 26, 70; *compare with* 2002 Draft Chinese Bankruptcy Law (including a provision on hiring staff [art. 70] but no provision on asking debtor to take on management responsibilities).

¹⁶⁰ *Id.* art. 69.

¹⁶¹ *Id.* art. 77; *compare with* 2002 Draft Chinese Bankruptcy Law art. 68 (six months).

¹⁶² October 2004 Draft Chinese Bankruptcy Law art. 71; 2002 Draft Chinese Bankruptcy Law art. 71. Secured creditors are not bound by the stay in bankruptcy or conciliation. *See* October 2004 Draft Chinese Bankruptcy Law art. 71; 2002 Draft Chinese Bankruptcy Law arts. 119-121.

¹⁶³ October 2004 Draft Chinese Bankruptcy Law art. 72; 2002 Draft Chinese Bankruptcy Law art. 72.

terms that allows the lender to leapfrog over existing unsecured creditors. There is a variety of other provisions applicable during the protective period regarding other matters including allowing owners to reclaim property in the possession of the debtor¹⁶⁴ and providing for the rejection or acceptance of executory contracts.¹⁶⁵ Article 77 of the 2004 draft provides that if the reorganization procedure is terminated for cause during the protective period, the People's Court is required to make a ruling declaring the debtor bankrupt.¹⁶⁶

Section 3 of Chapter VII pertains to the reorganization plan. The administrator (or debtor) is responsible for drafting the plan of reorganization.¹⁶⁷ Article 79 of the October 2004¹⁶⁸ draft provides that the plan must contain the following:

- (1) the management scheme of the reorganized enterprise;
- (2) the classification of the debts;
- (3) the adjustment scheme of the debts;
- (4) the repayment scheme of the debts;
- (5) the executing time limits of the reorganization plan; and
- (6) the supervising time limits of the reorganization plan; and
- (7) other schemes that are conducive to the reorganization of the enterprise.

Debts in the plan are classified in one of four categories: secured debts; workers' wages; tax debts; or ordinary unsecured debts.¹⁶⁹ The administrator (or debtor) is required to submit the plan of reorganization to the People's Court creditors' meeting within six months, but may seek an extension for up to three months.¹⁷⁰ After the People's Court receives the draft plan of reorganization, if after an examination the plan is deemed to meet the requirements of the new bankruptcy law, the court shall convene the creditors' meeting to vote on the plan, and at the meeting the administrator (or debtor) shall make explanations about the draft plan to the creditors' meeting and answer questions.¹⁷¹

¹⁶⁴ October 2004 Draft Chinese Bankruptcy Law art. 73; 2002 Draft Chinese Bankruptcy Law art. 73.

¹⁶⁵ October 2004 Draft Chinese Bankruptcy Law art. 74; 2002 Draft Chinese Bankruptcy Law art. 75.

¹⁶⁶ See also 2002 Draft Chinese Bankruptcy Law art. 77.

¹⁶⁷ October 2004 Draft Chinese Bankruptcy Law art. 78; 2002 Draft Chinese Bankruptcy Law art. 78.

¹⁶⁸ Compare with 2002 Draft Chinese Bankruptcy Law art. 79 (2004 draft adds additional factor (6) and deletes a factor referring to the executor of the reorganization).

¹⁶⁹ October 2004 Draft Chinese Bankruptcy Law art. 80; 2002 Draft Chinese Bankruptcy Law art. 80.

¹⁷⁰ October 2004 Draft Chinese Bankruptcy Law art. 77; compare with 2002 Draft Chinese Bankruptcy Law art. 81 (plan must be submitted to court within period set by People's Court).

¹⁷¹ October 2004 Draft Chinese Bankruptcy Law art. 81; 2002 Draft Chinese Bankruptcy Law art. 82.

The creditors shall vote on the plan in the four groups noted above. Approval requires a majority in number of the creditors in each group present at the meeting and more than two-thirds of the settled amount of the debts of the group.¹⁷² The debtors' shareholders are also allowed to attend the creditors' meeting, but only as non-voting delegates.¹⁷³ The plan is deemed to be adopted where all of the groups pass the plan.¹⁷⁴

Article 85 of the October 2004 Draft Chinese Bankruptcy Law¹⁷⁵ applies in those situations where any of the groups do not approve the plan. At first instance, the administrator (or the debtor) is empowered to negotiate with each group that has rejected the plan and allow the group to vote again after concluding negotiation. If the plan is still not accepted after the second vote, the administrator (or the debtor) may then apply to the court for approval of the plan over the objection of the group(s) that voted against the plan based on the application of further criteria (including a limited "cramdown" power). Where the creditors have not approved the plan on the second vote after the negotiation with the administrator (or the debtor as the case may be) the People's Court shall declare the debtor bankrupt.¹⁷⁶

Where the four groups have adopted the reorganization plan, the administrator has ten days in which to apply to the People's Court for its approval of the plan.¹⁷⁷ Upon receipt of the application, the People's Court must decide whether to approve the plan within 30 days after examining it and determining if it satisfies the procedures prescribed in the new bankruptcy law.¹⁷⁸

When the plan is approved by the court, it is binding over all debts that were established before the People's Court accepted the bankruptcy case.¹⁷⁹ The debtor is responsible for the performance of the reorganization plan, subject to supervision by the administrator.¹⁸⁰ Where

¹⁷² October 2004 Draft Chinese Bankruptcy Law art. 83; 2002 Draft Chinese Bankruptcy Law art. 84.

¹⁷³ October 2004 Draft Chinese Bankruptcy Law art. 82; 2002 Draft Chinese Bankruptcy Law art. 83.

¹⁷⁴ October 2004 Draft Chinese Bankruptcy Law art. 84; 2002 Draft Chinese Bankruptcy Law art. 84.

¹⁷⁵ See also 2002 Draft Chinese Bankruptcy Law art. 85.

¹⁷⁶ October 2004 Draft Chinese Bankruptcy Law art. 86 (where the plan is not approved); compare with 2002 Draft Chinese Bankruptcy Law art. 86 (also includes where the plan has not been submitted).

¹⁷⁷ October 2004 Draft Chinese Bankruptcy Law art. 84; 2002 Draft Chinese Bankruptcy Law art. 87.

¹⁷⁸ October 2004 Draft Chinese Bankruptcy Law art. 84; 2002 Draft Chinese Bankruptcy Law art. 87.

¹⁷⁹ October 2004 Draft Chinese Bankruptcy Law art. 90; 2002 Draft Chinese Bankruptcy Law art. 91.

¹⁸⁰ October 2004 Draft Chinese Bankruptcy Law arts. 87, 89. In the 2002 Draft Chinese Bankruptcy Law, a plan executor was to be appointed to carry out this function and the administrator was permitted to become the plan executor. 2002 Draft Chinese Bankruptcy Law art. 90.

the reorganized enterprise is unable or fails to carry out the reorganization plan, the People's Court shall terminate the execution of the reorganization and declare the debtor bankrupt.¹⁸¹ When this occurs, the creditors may claim in the debtor's bankruptcy for the total of any unpaid amounts under the plan.¹⁸²

This new reorganization procedure is a major improvement over current law. It includes the broad variety of provisions that are found in other modern corporate rescue laws such as U.S. Chapter 11, although in many places the proposed provisions would benefit from greater detail. Providing the debtor with the choice between having an administrator or retaining control might well prove to be one of the proposed law's strengths, although more thought should be given to situations in which the creditors would prefer to have an administrator appointed. Even where the debtor retains control, the administrator will continue in a supervisory role and, with the administration's insolvency experience, will contribute greatly to the corporate rescue process. However, it is curious that the Chinese have decided to include a balance sheet test for debtors' petitions, as such a requirement will create unnecessary obstacles to commencing the corporate rescue process.

Vietnam

The rehabilitation process under the 1993 Vietnamese Bankruptcy Law was very different from the current Chinese procedures. The 1993 Vietnamese law mandated the use of corporate rescue procedures before an enterprise could be declared bankrupt. Although these corporate rescue efforts were required both before and after a bankruptcy petition was filed,¹⁸³ the reality was that petitions were normally commenced for the purpose of liquidation rather than rescue.¹⁸⁴ How was it that these mandated procedures proved so ineffective? The problem under the old regime revolved around Section 2 of the 1993 law:

A bankrupt enterprise means an enterprise that still faces financial difficulties or still suffers losses in its operations after it has applied all necessary financial measures and as a result, loses its ability to repay debts when they fall due.

Article 3 the Vietnamese Decree No. 189 added the following detail:

¹⁸¹ October 2004 Draft Chinese Bankruptcy Law art. 91.

¹⁸² *Id.* art. 92.

¹⁸³ In addition, voluntary conciliation was permitted in the period after the petition was filed and before the court decided whether to make a bankruptcy order. 1993 Vietnamese Bankruptcy Law § 6.

¹⁸⁴ VIETNAMESE BANKRUPTCY LAW RESEARCH REPORT, *supra* note 4, at Part Two, II, 1.1.1.

1. A business is deemed to have shown signs of falling into a bankrupt situation defined at Section 2 of the [1993 Vietnamese Bankruptcy Law] when it has taken losses for two consecutive years to the point that it is no longer capable of repaying the due debts and of giving full pay to its laborers under the labor agreement for three consecutive months.
2. When signs of a bankrupt situation appear as defined in Item 1 of this Article, the business shall have to take financial measures to overcome insolvency. These include:
 - a) To adopt a program to reorganize production and business, exert tight controls of expenditures, and find outlets for its products;
 - b) To take measures to handle commodities, products, and materials in stock;
 - c) To recover misappropriated loans and properties;
 - d) To negotiate with creditors to delay payment of debts, to assure loan transfers or guarantees, and to reduce or write off debts; and
 - e) To seek sources of funding and loans to pay the due debts and to invest in technological renewal.
3. After having taken the necessary financial measures mentioned in Item 2 of the Article, if the business is still not out of difficulties and cannot overcome insolvency then it has fallen into a bankrupt situation and must be dealt with as prescribed by the [1993 Vietnamese Bankruptcy Law] and this Decree.

Thus, before an enterprise could even be eligible for bankruptcy relief, it already had to have exhausted "all financial measures" including out-of-court rescue and negotiation strategies to address financial losses over a consecutive two-year period. This policy was open to manipulation by enterprises that wished to avoid bankruptcy: they would conceal the fact that they were bankrupt and delay the filing of the petition.¹⁸⁵ It also created a two-year moratorium on the ability of creditors to push recalcitrant enterprises into bankruptcy. The delays were even longer in many cases, leading to situations where there were few remaining assets when the bankruptcy was eventually declared.¹⁸⁶ At

¹⁸⁵ *Id.* at Part Two, II, 1.2.1.

¹⁸⁶ *See, e.g.*, the discussion of the case of the SOE Quang Nam Da Nang Meat Export Company in *id.* at Part Two, II, 3.1.1 ("Dealing with insolvent enterprises by bankruptcy proceedings").

times, there was not even enough to cover the costs of the bankruptcy fees.¹⁸⁷

The situation was exacerbated by the courts' application of the relevant provisions in the 1993 Vietnamese Bankruptcy Law once a petition was filed. After a bankruptcy petition was filed, the court, pursuant to Sections 13 and 15 of the 1993 Vietnamese Bankruptcy Law, was required to determine whether the case should be dismissed or the court should proceed with the petition. This decision required an application of Section 2. It was not uncommon for enterprises to be given the opportunity to implement necessary financial measures.¹⁸⁸ In many other cases, petitions were rejected "merely due to the failure by the applicant to comply with the required formalities, such as insufficient accounting books, records and documents necessary for determining losses or financial difficulties, or lack of accounting certification."¹⁸⁹ Yet other applications were dismissed because the enterprise's losses resulted from illegal or fraudulent activity and therefore the enterprise was not eligible to use the bankruptcy procedures.¹⁹⁰

Section 6 of the 1993 Vietnamese Bankruptcy Law provided that "voluntary conciliation" could be attempted between the creditors and the debtors after the filing of the petition and before the judge decided whether to proceed with the petition. Moreover, pursuant to Section 20 of the 1993 Vietnamese Bankruptcy Law, after the court issued the decision to proceed with the bankruptcy case, the court then initiated the mandatory corporate rescue process.¹⁹¹ This has been identified as a "unique" feature of the old Vietnamese bankruptcy law.¹⁹² The court would request the owner or legal representative of the enterprise to prepare a conciliation proposal and restructuring solutions for restructuring the operations of the enterprise. The time limit for completing the restructuring would be set by the creditors' meetings, but in any case could not exceed two years from the date the creditors agreed on the conciliation proposal. The conciliation measures and restructuring solutions had to include detailed terms and a plan of implementation for the measures to reorganize the business and to reduce and repay debt.¹⁹³ The parties had only 60 days from the date of the judge's request to forward the judge the conciliation proposal and restructuring solutions. Where this deadline was not complied with, the judge would enter a bankruptcy declaration. Where a proposal was forwarded to the judge,

¹⁸⁷ *Id.* at Part Two, II, 1.1.1. There were no cases in which debt recovery exceeded 30% of the debts. *Id.* at Part Two, II, 3.1.1.

¹⁸⁸ *Id.* at Part Two, II, 3.1.1.

¹⁸⁹ *Id.* at Part Two, I, 2.3.

¹⁹⁰ *Id.* at Part One, III, 2.1

¹⁹¹ For a detailed discussion of the process under Section 20 of the 1993 Vietnamese Bankruptcy Law, see *id.* at Part One, III, 2.4.e.

¹⁹² *Id.* at Part One, II, 5.2.3; Part Two, II, 1.1.1.

¹⁹³ Vietnamese Government Decree No. 189 art. 13.

the judge was required to convene a meeting of creditors, which he would chair.¹⁹⁴ At the meeting, the creditors would decide whether to approve the conciliation proposal and restructuring solutions. Approval required a majority in number and at least two-thirds of the total amount of the unsecured debts present at the meeting.¹⁹⁵ The judge would then temporarily suspend the bankruptcy proceedings and the owner or the legal representative of the enterprise would be responsible for implementing the plan.¹⁹⁶ Only if the process failed at any of the various stages could a declaration of bankruptcy be made and a liquidation of the enterprises' assets commence.¹⁹⁷ Liquidation was the norm.

A comparison of the corporate rescue provisions in Chapter VI, Section 1 of the 2004 Vietnamese Bankruptcy Law (and Part II, Chapter VI of the 2002 Draft Vietnamese Bankruptcy Law) with the 1993 Vietnamese Bankruptcy Law yields one major change – old Section 2 of the 1993 Vietnamese Bankruptcy Law has been omitted and replaced with a simple cash flow test for determining whether the enterprise is in a bankrupt situation.¹⁹⁸ This one change should have a significant effect on corporate rescue because, as can be seen from the discussion above, the application of old Section 2 made it almost impossible to rehabilitate an enterprise under Vietnamese bankruptcy law.

There are also some very important similarities between the 2004 law (and the 2002 draft) with the 1993 law -- most importantly, the retention of the modified debtor-in-possession approach in which the trustee committee (asset management team in the 2002 draft) and the judge supervise the debtor.¹⁹⁹ The 2002 draft modified aspects of the procedure in the 1993 law, only to be amended in the 2004 Vietnamese Bankruptcy Law to a form, in some respects, closer to the original 1993 law. Of course, with the deletion of old Section 2, the new procedure in the 2004 law will operate quite differently.

The 2002 Draft Vietnamese Bankruptcy Law required the petitioner to “clearly state whether it require[d] the commencement of the rehabilitation procedure or the liquidation procedure.”²⁰⁰ Section 13 of the 2002 draft provided that where it was found that the merchant was in a bankrupt situation, the judge had the power to decide whether to proceed with bankruptcy or rehabilitation. Chapter V of Part II (Sections 78-84)

¹⁹⁴ 1993 Vietnamese Bankruptcy Law art. 28.

¹⁹⁵ *Id.* art. 29.

¹⁹⁶ *Id.* arts. 29, 30.

¹⁹⁷ *Id.* art. 30 (the section provides for six circumstances in which the court could make the declaration of bankruptcy).

¹⁹⁸ 2004 Vietnamese Bankruptcy Law art. 3. For merchants under the 2002 Draft Vietnamese Bankruptcy Law, see §§ 6.9, 52.2.

¹⁹⁹ 2004 Vietnamese Bankruptcy Law art. 30; 2002 Draft Vietnamese Bankruptcy Law art. 59. Article 30 of the 2004 law provided for the appointment of a manager in certain circumstances. See discussion in Part III of the Article.

²⁰⁰ 2002 Draft Vietnamese Bankruptcy Law art. 48.1.

required the judge to hold a trial to determine the matter. At the meeting, the head of the asset management team would make a report on the indebted merchant's financial situation, the merchant and creditors would have the right to present their opinions, and the merchant would have the opportunity to suggest a solution to deal with the debts and business and produce a reorganization plan. The judge would then decide which procedure to pursue. Where the court opted for rehabilitation, the rehabilitation provisions in Chapter VI of Part II (Sections 85 to 96) would apply and the merchant and creditors would have 15 days in which to negotiate and reach agreement on a merchant rehabilitation plan. Approval of the plan would require a majority of the secured creditors holding two-thirds of the total value of the secured debts of the creditors attending the meeting (unlike the 1993 law) and a majority of the unsecured creditors holding a majority of the value of the unsecured debts of the creditors attending the meeting. The agreed plan would then be confirmed by the court.

In contrast, the 2004 Vietnamese Bankruptcy Law returns to the procedure in the 1993 law in which the petitioner is not allowed to choose between liquidation and rehabilitation, but rather files a bankruptcy petition.²⁰¹ This change in the filing requirements leads to the second change, relating to the meeting of creditors. Since the petitioner is not able to choose between liquidation and rehabilitation, Article 64.1 provides the creditors with that choice. At the first meeting of creditors, the following must occur: (1) the chairman of the trustee committee must report on a variety of matters including the financial status of the enterprise (or cooperative) at risk of bankruptcy, and the results of the asset inventory; (2) the owner or legal representative of the enterprise (or cooperative) must comment on the report made by the chairman of the trustee committee and propose solutions and plans to restructure the enterprise's business operations and the possibility and term of debt repayment.²⁰² After the reports, the creditors must vote on a resolution to restructure the enterprise or cooperative.²⁰³ For a resolution to pass it must get a majority of the unsecured creditors present at the meeting, so long as the attendees as a group represent at least two-thirds of the value of the unsecured debts.²⁰⁴ At the first meeting, the judge is also requested to appoint a person to manage the operation of the business activities of the enterprise or cooperative, thus ending the modified debtor-in-possession process.²⁰⁵

²⁰¹ See 2004 Vietnamese Bankruptcy Law arts. 13-18.

²⁰² *Id.* art. 64.1.b. This information was put forth at the judicial trial under the 2002 Draft Vietnamese Bankruptcy Law.

²⁰³ *Id.* art. 64.1.d.

²⁰⁴ *Id.*

²⁰⁵ *Id.* art. 64.1.e. Under the 2002 Draft Vietnamese Bankruptcy Law § 87, the debtor-in-possession stage continued until a plan was approved. When the creditors voted in favor of the rehabilitation

Once the creditors pass such a resolution, the judge has the obligation to apply the procedures for the rehabilitation of the business.²⁰⁶ It is at this stage that the business rehabilitation procedures under Chapter VI commence. Within 30 days of the creditor resolution in favor of business rehabilitation, the enterprise or cooperative is required to submit its business rehabilitation plan.²⁰⁷ If more time is needed, it may request the court to grant one extension for up to an additional 30 days.²⁰⁸ The right to submit the plan is not exclusive, and any creditor or person responsible for the business rehabilitation of the enterprise or cooperative is entitled to submit a draft plan.²⁰⁹ Within 15 days of receiving the business rehabilitation plan, the court must either introduce the plan to the meeting of creditors for its consideration and decision, or make suggestions to amend and supplement the plan if it fails to comply with the plan requirements in Article 69.²¹⁰ Article 69 provides that the plan must specify “necessary measures” to assist with the recovery of the enterprise’s business operations, and set out the conditions, term, and schedules for the repayment of debts. The necessary measures may include proposals:

- a. to mobilize new capital sources;
- b. to change production and business goods of an enterprise;
- c. to renew production technology;
- d. to restructure the enterprise’s or the cooperative’s management apparatus and to merge or demerge production divisions to enhance productivity and production quality;
- e. to re-sell new shares to creditors;
- f. to sell or lease unnecessary assets; and
- g. other measures not contrary to the law.²¹¹

The court must convene the creditors’ meeting within ten days of deciding to refer the plan to the creditors.²¹² At this stage, a further difference from the 2002 draft law arises. At the meeting of creditors, a plan is adopted where a majority of unsecured creditors holding at least two-thirds of the total unsecured debts vote in favor of the plan.²¹³ Unlike

plan, the asset management team would be dissolved and the supervision of the merchant would be taken up by the creditors’ representatives.

²⁰⁶ 2004 Vietnamese Bankruptcy Law art. 68.1.

²⁰⁷ *Id.* art. 68.2.

²⁰⁸ *Id.*

²⁰⁹ *Id.*

²¹⁰ *Id.* art. 70.

²¹¹ *Id.* art. 69.2.

²¹² *Id.* art. 71.1.

²¹³ *Id.* art. 71.2.

the proposed 2002 draft, the 2004 law does not provide the secured creditors with the opportunity to vote on the plan.

After creditors approve the plan, the judge shall adopt the resolution. As under the 2002 proposals, it is at this stage that the trustee committee (asset management team under the 2002 draft) is dissolved and creditors become responsible for supervising the implementation of the plan.²¹⁴

The Vietnamese reorganization procedure will benefit immensely from the deletion of the old Section 2 requirement. Rescues will now be possible. However, unlike the Chinese model, the new Vietnamese law lacks a “driver” for the process. The professional administrator in China, whether running the enterprise day-to-day or supervising management, will almost certainly prove more effective than the trustee committee in Vietnam.

Another party missing from the reorganization process is the secured creditor. Where a secured creditor has a lien or mortgage over assets necessary for carrying on the business of the enterprise of the cooperative, problems are very likely to arise since a secured creditor is entitled to have its debts settled by its mortgaged assets (pursuant to Article 37 of the 2004 Vietnamese Bankruptcy Law). In practice, before attending the first meeting of creditors, the chairperson of the trustee’s committee should meet with the secured creditor to get the creditor’s consent to release the asset for use in the reorganization. Where the trustee is unable to secure the consent/participation of the secured creditor(s), the secured creditor(s) in essence will have veto power over the process.

VI. PRIORITIES IN DISTRIBUTION AND THE PROTECTION OF EMPLOYEES’ INTERESTS

Asset distribution to creditors in bankruptcies in China and Vietnam historically has been complicated by the need to protect the workers of insolvent SOEs. This special protection has been necessary in the absence of well-developed social security systems.

China

Pursuant to Article 32 of the 1986 Chinese Insolvency Law, secured creditors enjoy a right of priority over unsecured creditors to the extent of the level of their security. Article 37 of the 1986 Bankruptcy Law provides that after paying the expenses of the winding up, the order of priority among unsecured creditors is as follows:

²¹⁴ *Id.* arts. 72, 73. See *supra* note 205.

- (1) employees' wages and labor insurance expenses owed by the insolvent enterprise;
- (2) taxes owed by the insolvent enterprise; and
- (3) insolvency claims (claims of the unsecured creditors).

Where there are insufficient assets to satisfy all of the claims within the same ranking, Article 37 provides for the assets to be distributed *pro rata* within that ranking. Articles 56 to 58 of the 2002 PRC Supreme People's Court Provisions provide that the first priority for worker's claims in Article 37(1) above includes severance pay owed to workers whose labor contracts are terminated due to the bankruptcy of the enterprise, labor compensation owed by the debtor to regular non-staff and workers (including temporary workers), and the pooled funds of the enterprise's staff and workers owed by the debtor, but not high interest thereon.

From the legislation, it appears that the priority scheme in the 1986 Chinese Bankruptcy Law adopts the traditional model. However, in reality the practice is quite different for SOE insolvencies subject to the policy decrees that have provided workers' resettlement rights with a first claim on the land use rights of SOEs in priority to the preexisting rights of secured creditors.²¹⁵ In thousands of cases, these policy decrees have cut back on the traditional priority scheme in the 1986 Chinese Bankruptcy Law. In other words, there appear to be two competing priority schemes in China.

The 2002 draft retained the priority scheme of the 1986 law, with secured creditors getting paid first up to the level of their security, followed by the (1) costs and expenses relating to the bankruptcy case (and public debts or debts of common benefit),²¹⁶ (2) wages of employees, social insurance and other relevant debts as provided under labor law, (3) tax liabilities, and (4) general unsecured bankruptcy claims.²¹⁷ It also retained the rule for *pro rata* distributions where the assets are insufficient to pay all of the claims within a single ranking in full. Supplementing this general priority scheme in the 2002 Draft Chinese Bankruptcy Law was Article 10:

The People's Court shall safeguard the lawful rights and interests of the employees of the bankrupt enterprises in accordance with the law when trying bankruptcy cases.

The People's Government of the place where the bankrupt enterprise is located shall properly arrange the settlement and

²¹⁵ See, e.g., the PRC 1994 and 1997 Decrees.

²¹⁶ 2002 Draft Chinese Bankruptcy Law art. 40 (providing that debts of common benefit are certain debts generated after the People's Court accepts a bankruptcy case, e.g., a debt generated as a result of the administrator's request to perform a bilateral contract).

²¹⁷ *Id.* art. 135.

lifetime guarantee of the rights of employees of the bankrupt enterprise.

The second paragraph of Article 10 tried to mediate the conflict between the two competing priority schemes in China, by putting the burden of providing for the settlement and lifetime guarantee of the rights of workers on the local governments.

The October 2004 Draft Chinese Bankruptcy Law adopted a different approach to workers' rights. On the one hand, Article 8 appears to cut back on the protection of workers' rights – although it retains the first paragraph of Article 10 of the 2002 draft, it omits the second paragraph that provided that local governments have the responsibility to arrange for resettlement and guaranteed benefits. On the other hand, there is the new priority scheme in Articles 113 and 127 that substantially expands worker protection under the bankruptcy law. These articles provide that where there are sufficient funds to pay workers' claims in full (including unpaid wages, unpaid basic society insurance, and other payments pursuant to administrative regulations and the law), the traditional priority ranking will apply. However, where workers' claims cannot be paid in full, the workers get first priority over the prior rights of secured creditors from the assets securing the secured creditors' claims.

This amendment has taken many people by surprise, especially in the light of the proposal accompanying the October 2004 draft that provides that over the next few years certain SOEs will be subject to "administrative closure" procedures pursuant to regulations to be prescribed by the State Council.²¹⁸ These "administrative procedures" are intended to address the special problems faced by SOEs, including resettlement and the guarantee of lifetime benefits. When this period expires and all SOEs are subject to the new law, there should be few SOEs that will need special treatment for their workers. It is thus even less understandable why the October 2004 draft proposes to give workers a special priority right that even exceeds in many respects the treatment that workers get under the government policy decrees. This proposal goes beyond the decrees in three ways: (1) *all* workers are covered, not just employees of SOEs; (2) the claims apply to a broad range of claims and not to a specific type of claim (i.e., resettlement rights); and (3) the priority extends to all of the property of the enterprise and not just the land use rights. Where the workers cannot get paid in full, the burden will fall on the secured creditors. If these provisions are enacted into law, they could have an adverse consequence for bank lending in China and lead to higher borrowing costs. Further details are needed as to the scope of the claims that are protected by this new priority scheme. It is hoped that this change in the priority rules is not symptomatic of a more

²¹⁸ See text accompanying *supra* notes 64-66.

significant policy shift in the October 2004 draft in favor of protecting workers. It would be unfortunate if the People's Courts were to interpret Article 8 as broadly supporting a judicial discretion not to accept a bankruptcy case where it appeared that there were insufficient assets to pay workers in full under Articles 113 and 127.²¹⁹

Vietnam

The 1993 Vietnamese Bankruptcy Law adopted the same priority scheme as in the 1986 Chinese Bankruptcy Law. Pursuant to Section 38, secured claims were entitled to be paid first up to the level of the value of the security. The priority scheme listed in Section 39 of the 1993 law provided for payment from the assets of the estate to be as follows: the costs and expense of the bankruptcy proceedings; labor claims (defined as covering unpaid wages, termination of employment allowance, social insurance as determined by the law and other rights pursuant to a collective or individual labor agreement); tax claims; and then general unsecured creditors.

The 2002 Draft Vietnamese Bankruptcy Law adopted this same scheme. Section 26 preserved the secured creditors' right to be paid in full up to the value of its security and Section 27 set out the same priority scheme for the preferred classes of creditors. The 2002 draft also included a new Section 28, which provided that claims at the same preferential rank should be paid proportionally based on the value of each claim.

Unlike the recent Chinese proposals, the 2004 Vietnamese Bankruptcy Law does not give workers any special protection greater than the priority under existing law. Article 35 of the 2004 Vietnamese Bankruptcy Law retains the priority for secured creditors over other creditors up to the value of the secured creditors' collateral and makes it clear that the payment will come from such assets. Bankruptcy expenses and workers' benefits also retain their order of priority pursuant to Article 37. However, the overall priority scheme in Article 37 deviates from its predecessor provisions by omitting any priority for tax claims. This change is in accordance with the modern trend in favor of cutting back on the categories of preferential claims in favor of maximizing payments to general unsecured claims.

²¹⁹ See Campbell, Korff & Eu Jin Chua, *China Sets Short Timetable for Bankruptcy Law Reform*, 18(8) CHINA L. & PRAC. 21, 21 (Oct. 2004) (raising a more general concern about the exercise of judicial discretion to protect workers' rights under the June 2004 Draft Chinese Bankruptcy Law).

VII. CROSS-BORDER INSOLVENCY ISSUES

Since it is becoming increasingly common for bankruptcies to have cross-border elements, modern insolvency systems must address both “inbound” and “outbound” cross-border insolvency issues. In the Chinese context, an inbound bankruptcy might involve a foreign representative (e.g., a trustee or a liquidator) who comes to China to seek recognition of a foreign bankruptcy, with perhaps the intention of gaining local cooperation in securing assets in China, and ultimately of obtaining permission to take such assets (or the proceeds from the sale of the assets) back to her foreign home where the primary bankruptcy proceeding is being held. An outgoing bankruptcy would involve the opposite scenario in which a representative from China would go overseas to seek recognition and cooperation from a foreign court. When considering these issues, judicial decisions may generally be divided into two paradigm approaches: the “territoriality approach” and the “universality approach.” If adopting the territoriality approach, a Chinese judge would refuse to recognize the extraterritorial application of a foreign jurisdiction’s laws and refuse to allow the foreign representative to claim the assets of the foreign debtor that are located within the Chinese court’s jurisdiction. In contrast, if adopting the universality approach, the Chinese judge would recognize the extraterritorial application of the foreign jurisdiction’s laws and allow the foreign representative to claim the assets of the foreign debtor that are located within the Chinese court’s jurisdiction.²²⁰

China

At present, none of the national PRC insolvency legislation includes provisions that specifically apply to the above scenarios.²²¹ When confronted with incoming cross-border insolvency issues, Chinese courts have traditionally adopted the territorial approach.²²² However, the situation is changing. Hong Kong liquidators have noted that over the last few years they increasingly have been able to secure the cooperation of their cross-border counterparts in Guangdong. Moreover, in one of the series of annual meetings held between Hong Kong and Beijing insolvency professionals, the Beijing team noted that recognition of a

²²⁰ For further discussion of the territoriality and universality approaches, see Charles D. Booth, *Living in Uncertain Times: The Need to Strengthen Hong Kong Transnational Insolvency Law*, 34 COLUMBIA J. TRANS’L L. 389 (1996).

²²¹ For a more detailed discussion of Chinese cross-border insolvency law, see Jingxia Shi, *Chinese Cross-Border Insolvencies: Current Issues and Future Developments*, 10 INT’L. INSOLVENCY R. 33. For a discussion of the approach adopted by Shenzhen, see Zhang & Booth, *supra* note 3, at 24-29.

²²² See, e.g., *Liwan District Construction Company v. Euro-America China Property Ltd.*, reported and commented on by Donald J. Lewis & Charles D. Booth, Case Comment, 6 CHINA L. & PRAC. 27 (1990).

Hong Kong liquidator might be more likely in a voluntary liquidation commenced by the company's shareholders or directors than in a compulsory winding up.²²³

The 2001 Draft Chinese Bankruptcy Law was the first draft that included a provision on cross-border insolvency, and all subsequent drafts have as well. Article 8 of the 2002 draft Chinese bankruptcy law explicitly provided that the draft law applies to a debtor's assets outside the PRC, and thus adopted a universality approach for outbound transactions.²²⁴ This provision has been retained in Article 7 of the October 2004 Draft Chinese Bankruptcy Law. It is a significant step for Chinese legislation to assert that it is extraterritorial in scope and the inclusion of such a provision will make it much easier for Chinese representatives to seek assets. However, this is the only mention of the extraterritoriality of Chinese bankruptcy law in the draft. Some thought should be given to whether the avoidance powers should also apply extraterritorially, as this is a separate issue from whether property worldwide is part of the estate.²²⁵

However, concerning inbound transactions, Article 8 of the 2002 draft was not as clearly universal. Rather, it provided that when, in the course of the foreign bankruptcy procedures, a foreign party applied for execution on the debtor's property located in the PRC, the People's Court *may* make a ruling of approval, except in the following cases:

- a) If there are no relevant treaties or reciprocal relations between the country and the PRC;
- b) If the application violates the public interests of the PRC;
- c) If the approval might impair the lawful interests or rights of the creditors in the PRC; and
- d) If there are other factors that the People's Court thinks ought to be taken into consideration.

Article 7 of the October 2004 draft retains this provision with two important amendments: (1) subsection (d) has been deleted (which is a change for the better because subsection (d) gave the local judge open-ended discretion); and (2) in the preamble, *may* has been changed to *shall*. This also cuts down on the court's discretion and will facilitate more cross-border cooperation. This provision improves upon existing Chinese

²²³ Meeting held in Beijing on Apr. 12, 2001. See Zhang & Booth, *Beijing's Initiative on Cross-Border Insolvency*, *supra* note 47, at 36.

²²⁴ In a recent case, a Hong Kong court held that China's current insolvency law was universal in scope and would be given recognition by the Hong Kong court. *CCIC Finance Ltd. v. Guangdong Int'l Trust & Inv. Corp. and Guangdong Int'l Trust & Inv. Corp. Hong Kong (Holdings) Ltd. (In Liq.)*, HCA 15651 of 1999 (July 31, 2001).

²²⁵ For a discussion of this issue in the Hong Kong context, see Charles D. Booth & Philip St. J. Smart, *The New Avoidance Powers under Hong Kong Insolvency Law: A Move from Territoriality to Extraterritoriality*, 34 INT'L LAW. 255 (2000).

bankruptcy law. Significantly, the rhetoric of the section moves away from the territoriality approach traditionally adopted by the PRC towards foreign insolvencies. However, due to the inclusion of subsection (a), Article 7 is unlikely to have much impact for many years because China has not entered into any relevant treaties or reciprocal relations on this topic. Not even China and Hong Kong have entered into a bilateral agreement on cross-border insolvencies.²²⁶ This type of provision is called a "reciprocity provision,"²²⁷ and, unfortunately, such provisions hamper cross-border cooperation.

A further provision that should be included in the legislation is one setting forth the documents that a foreign representative should produce to the Chinese courts to prove the existence of the foreign bankruptcy and gain recognition. This topic has come up frequently in the annual meetings of the Hong Kong and Beijing insolvency professionals. Recognition will be more likely if the legislation is very clear as to what documents must be submitted, who must sign them, and whether any official stamps are necessary.

Vietnam

Vietnam has not signed any cross-border insolvency treaties, and the 1993 Vietnamese Bankruptcy Law did not include any inbound or outbound cross-border insolvency provisions. However, cross-border insolvency issues were raised during the drafting process in the context of dealing with a bankrupt enterprise's assets overseas.²²⁸ Section 2 of the 2002 Draft Vietnamese Bankruptcy Law provided that the new law would apply to merchants operating in Vietnam and to their members operating outside Vietnam. The intention of this section was to adopt the universality approach and to assert extra-territorial application of Vietnamese bankruptcy laws over a merchant's property located outside Vietnam.²²⁹ The Vietnamese were aware that the effect of including such

²²⁶ See Zhang & Booth, *Beijing's Initiative on Cross-Border Insolvency*, *supra* note 47. This is one issue that the insolvency professionals from Hong Kong and Beijing are discussing.

²²⁷ Interestingly, the Law Reform Commission of Hong Kong has also suggested that recognition by Hong Kong should be based on reciprocity. THE LAW REFORM COMMISSION OF HONG KONG, REPORT ON THE WINDING UP PROVISIONS IN THE COMPANIES ORDINANCE 213 (July 1999). Although both Hong Kong and China are proposing a reciprocity requirement, they are approaching that position from different directions – China is moving from a territoriality approach, unlike Hong Kong, which is cutting back on its more universality-based approach. For a discussion of Hong Kong cross-border insolvency issues, see Booth, *supra* note 220.

²²⁸ See VIETNAMESE BANKRUPTCY LAW RESEARCH REPORT, *supra* note 4, at Part One, II, 5.4 ("Dealing with the bankrupt enterprise's residual assets overseas") (setting out the international approaches to the topic, but not discussing the Vietnamese position).

²²⁹ I learned this first-hand during the workshops I conducted in Hanoi, Vietnam, in June 2002. See *supra* note 14.

a position would depend on whether foreign countries decided to recognize the new Vietnamese bankruptcy law.²³⁰

Unfortunately, this assertion of the extra-territorial application of Vietnamese bankruptcy law in the 2002 draft was not included in the 2004 Vietnamese Bankruptcy Law. Article 4 of the 2004 law provides that the bankruptcy law shall apply to all enterprises and cooperatives that operate in Vietnam, except as otherwise provided in international conventions signed by Vietnam. There is no language in the Article extending the law's application to the assets of enterprises or cooperatives located overseas. Thus, the result is that the new law, like the 1993 law, is silent on both inbound and outbound cross-border insolvency issues. It is disappointing that Vietnam did not address these issues in the new law.

Article 4 of the 2004 Vietnamese Bankruptcy Law is also a successor provision to another line of provisions in Vietnamese bankruptcy law regarding the applicability of Vietnamese bankruptcy law over businesses involving foreign individuals and organizations (FIEs). Section 51 of the 1993 Vietnamese Bankruptcy Law provided that the bankruptcy law applied to a bankruptcy proceeding against businesses that involved foreign individuals and organizations except where an international treaty entered into by Vietnam provided otherwise. Article 2 of the Vietnamese Decree No. 189 further provided that the settlement of the bankruptcy of a business with partial or entire foreign investment shall comply with the 1993 Vietnamese Bankruptcy Law, the Vietnamese FIL, Vietnamese Decree No. 189, and other legal documents that provide detailed guidance on the settlement of bankruptcy in conformity with the specific nature of these businesses except as otherwise provided for in international treaties.²³¹ Article 4 has superseded these provisions: "businesses with foreign individuals and organizations" under the 1993 law are included within "enterprises" under the 2004 draft.

This matter has also been of concern to foreign companies with interests in Vietnamese FIEs. Where such foreign companies have run into financial problems, they have avoided resorting to the Vietnamese legal system by handling the matter "by way of a change in ownership of the investor offshore or else an agreement by the offshore liquidator to sell the equity interest in the Vietnamese licensed venture."²³² In this fashion, the foreign parties keep the Vietnamese FIE out of bankruptcy in Vietnam, thereby avoiding the application of the Vietnamese bankruptcy law.

²³⁰ See VIETNAMESE BANKRUPTCY LAW RESEARCH REPORT, *supra* note 4, at Part One, II, 5.4 ("Dealing with the bankrupt enterprise's residual assets overseas").

²³¹ International treaties have been incorporated into Section 99 of the 2002 Draft Vietnamese Bankruptcy Law, which also incorporated Section 51 of the 1993 law.

²³² *Vietnam* (Chapter 39), in INSOL, CROSS-BORDER INSOLVENCY: A GUIDE TO RECOGNITION AND ENFORCEMENT 231 (2003).

VIII. CONCLUSION

Drafting a bankruptcy law is never an easy task. The process is even more difficult for socialist countries with economies in transition that hope to use the law as an effective tool of market transformation. The task is further complicated by the conflicting government policies for giving special protection to the workers of SOEs that were established during the planned-economy period. Such has been the situation in both China and Vietnam as they have been reforming their bankruptcy laws.

China's proposed law and Vietnam's recently enacted law improve upon both countries' legislation. In China's case, it will also unify the existing bankruptcy law framework. These new laws are more detailed and comprehensive than their predecessors were, although during the law reform process some of the early aspirations (e.g., for expanding the scope of application) have given way to pragmatic conservatism, at times pulling back from more expansive coverage in the 2002 drafts. In the case of China, several important issues are still being debated.

China made significant innovations to its bankruptcy administration and corporate rescue procedures. The introduction of a professional administrator with the requisite experience and training should dramatically improve the efficiency of bankruptcies and reorganizations in China. The further introduction of a creditors' committee creates a mechanism to increase creditor involvement and provides a counterbalance to the administrator.

Vietnam adopted a more gradualist approach in which it tinkered with the basic administrative structure. The trustee committee has replaced the asset management and asset liquidation teams and the committee composition has changed, but the system retains much of the approach of the 1993 law. The major change to the corporate rescue process is the abolition of the requirement (in old Section 2 of the 1993 law) that before being eligible for bankruptcy relief, the enterprise must already have exhausted "all financial measures." Its deletion will improve the corporate reorganization process, but the new Vietnamese procedure still lacks the checks and balances of the Chinese approach and there is no "driver" of the process. Perhaps the "manager" post created in Vietnam will appeal to creditors, and they may be able to use it to transform the procedure.

It is one thing to say that the new laws are much better (they are), but quite another to predict that the number of bankruptcy cases will dramatically increase in the short run (probably not). In the aftermath of the Asian financial crisis, many countries in the region enacted new or revised corporate rescue laws, but there has not been a significant

increase in the number of cases commenced.²³³ This should not be surprising. Enacting a new bankruptcy/corporate rescue law is only the first step. For these laws to attract filings by debtors and creditors requires the existence and integration of many other factors. Thousands of professionals need to be trained in the workings of the new procedures – lawyers and accountants, of course, but also investment and banking advisors, valuation experts, and others. The judiciary must also be trained; judges handling bankruptcy cases need to be well versed not only in bankruptcy law, but also in company law, accounting, and real estate matters. In addition, the bankruptcy law will not function properly unless there are effective secured transactions, real property, and corporate governance legislation in place. Lastly, a corporate rescue culture must develop. The participants in the process must be willing to work together and to compromise, with a view to agreeing on the terms of a rescue proposal. Putting all of these factors in place can take years, if not decades. In China and Vietnam, this process can now begin.

²³³ See Report on RETA 5795: *Insolvency Law Reforms in the Asian and Pacific Region*, 1 L. & POLICY AT THE ASIAN DEVELOPMENT BANK 10 (2000).

