

INSOL Europe/LexisNexis coronavirus (COVID-19) Tracker of Insolvency Reforms—China

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Restructuring & Insolvency analysis: We look at the reforms to the insolvency law of China prompted by the coronavirus (COVID-19) pandemic. Written by Xiahong Chen, fellow of Bankruptcy Law and Enterprise Restructuring of Research Center of China University of Political Science and Law; Member of INSOL, INSOL Europe and ABI.

Introduction

At the beginning of 2020, the spreading of coronavirus had caused an obvious negative influence to almost every corner of the whole society in China. Huge number of companies had to face the cash flow obstacle during the struggle to survive during these difficult times. As a response to the epidemic, the policy-making system in China worked very hard to issue a lot of necessary policies to restart the economy.

Specifically, the Supreme People's Court of People's Republic of China, the main body of bankruptcy policy-making in China, had issued at least two important pieces of guidance for the judicial hearing of civil case concerning the coronavirus pandemic.

The first one was issued on 20 April 2020, which mainly focused on disputes hearing relating to enforcement of contract, employment relationships and consumer protection of medical production. The second one was issued on 19 May 2020, which had paid high attention to the hearing of enforcement of contract, further to the enforcement of financial support policy, to control coronavirus. In addition, a slight adjustment to the bankruptcy hearing policy has been made. This judicial guidance entered into force as soon as it was published.

The structure of this judicial guidance on 19 May 2020 relating to bankruptcy hearings is as follows.

Court-supervised negotiation between the debtor and those creditors before the opening of bankruptcy proceeding

If the debtor is not eligible to meet its obligation to pay the debt due because of the negative influence of coronavirus or the epidemic prevention and control measures, although creditors may apply to open bankruptcy proceedings, the court shall direct negotiation between the debtor and those creditors aiming to achieve new agreement such as payment by instalment, extension of the debt performance period, change of contract price, etc. Further, the court shall encourage the debtor to take necessary steps as early as possible including out-of-court mediation, out-of-court restructuring and pre-re-organisation to resolve the debt crisis at an early stage.

Distinguishing real causes of insolvency when examining bankruptcy criteria

When checking the bankruptcy criteria after the submission of a bankruptcy application, and before formally ordering the opening of bankruptcy proceedings, the court is obliged to find the real reason which caused the debtor's financial trouble.

If the debtor was insolvent only because of the epidemic situation or the epidemic prevention and control measures, and was in a healthy financial state before the outbreak of coronavirus (COVID-19), the court shall do its best to prevent the debtor from entering into bankruptcy proceedings.

However, after necessary and careful examination, if the court finds the debtor was already in trouble before the epidemic and had met the bankruptcy criteria which was enacted by Article 2 of the Enterprise Bankruptcy Law 2006 (hereafter referred as EBL 2006), the court should accept the bankruptcy application in time according to the EBL 2006 (see Practice Note: [China—GTD T restructuring and insolvency guide](#)).

Further promoting the link between execution and bankruptcy proceedings

During the execution procedure, if the court finds that the debtor meets the bankruptcy criteria due to the spreading of the epidemic but has potential rescue value, the court shall ask the creditors to open bankruptcy proceedings, according to the 'Converting from Execution to Bankruptcy' policy.

It is necessary to further explain the background of the 'Converting from Execution to Bankruptcy' policy here. It was introduced in the Judicial Interpretation of Civil Procedure Law in 2015, with the aim to enhance the value of collective payments orderly and efficiently in civil execution, if the debtor has more than one creditor and fails to fulfil its payment obligation.

In the newest judicial guidance, the motivation is to use the legal tools which were enacted in the EBL 2006 such as pausing of execution, stopping interest and payment, in order to preserve the rescue value and enlarge the breathing space of the debtor. The court shall play a significant role in guiding the debtor's re-organisation and comprehensive rescue from the financial trouble, and also protection the creditors' interests.

Further, if the auction procedure had been opened before the Converting from Execution to Bankruptcy, it could be continued after the court's Converting from Execution to Bankruptcy decision.

However, if the auction is completed, the subject of the auction will no longer be included in the debtor's property in the bankruptcy proceedings, but the auction proceeds shall be distributed in accordance with the bankruptcy proceedings according to law. The evaluation and audit report produced during the execution procedure, if it is within the valid time, could continue to be used in the bankruptcy procedure.

Extending the reorganisation period from maximum of nine months (according to EBL 2006) by another six months

Due to the negative impact of the epidemic prevention and control measures, if the eligible body such as the DIP or the administrator according to EBL 2006 could not submit the draft re-organisation plan on time within the maximum nine months' time-frame (six months plus three months extending) according to EBL 2006, Art 79, the court could permit extension by another maximum six months based on the application of debtor in DIP or the administrator, by considering the actual impact of the epidemic situation or epidemic prevention and control measures on the reorganisation procedure.

Moreover, the court should also be obliged to promote the negotiation between the debtor and creditors to amend the re-organisation plan or the settlement agreement, if those documents has entered the implementation stage, but the debtor finds it difficult to implement due to the impact of the epidemic situation or the epidemic prevention and control measures.

Normally, the failure to implement a re-organisation plan or the settlement agreement will cause a bankruptcy declaration and opening of the liquidation procedure according to EBL 2006, Art 93. However, in the 'Minutes of the National Bankruptcy Trial Work Conference' by the Supreme People's Court of P.R. China in 2018, it created a slight space for necessary amendment.

The afore-mentioned amendment of re-organisation plan or the settlement agreement shall be approved by the court. If the amendment only focuses on the adjustment of execution period, the court could rule directly based on the application by the debtor or creditors if it is not beyond six months.

Highlights of effective protection of creditors' substantive rights and procedural rights in bankruptcy proceedings

The court shall take necessary steps to reduce the negative influence of coronavirus on the exercise of creditors' substantive and procedural rights according to EBL 2006.

Firstly, the time limit on submission of creditors' claim could be re-arranged within the maximum legal time limitation, if it was influenced by the epidemic situation or the epidemic prevention and control measures.

Secondly, if the creditors failed to declare their claims and submit related supportive evidence on time during the epidemic, they could submit their claims as supplementary declarant within a maximum of ten days after the obstacle disappearing, without the burden of the cost of supplementary claims according to the EBL 2006.

Thirdly, with the purpose of guaranteeing the participation of creditors in the bankruptcy proceedings, such as hearing or creditor's meetings, any potential and necessary postponement of those procedures is allowed. In this situation, the administrator will be in charge of informing and explaining to those creditors 15 days in advance.

Maximising the debtor's ability to continue operations and the value of property disposal

In March 2019, the Supreme People's Court of People's Republic of China issued its third judicial interpretation concerning the EBL 2006.

According to Article.2 of the above-mentioned judicial interpretation, the re-organisation financing could be treated as mutual benefit debt. In the latest guidance, such arrangement is further emphasised to gain more financial support for the debtor in the re-organisation procedure.

It is highlighted that if the debtor is able to continue operations, or it has the ability to produce epidemic prevention materials, the court shall actively guide and support the administrator or the debtor in re-organisation procedure to continue the debtor's business, in accordance with Articles 26 and 61 of EBL 2006. Further, in maximising the debtor's production ability, the court shall make full use of Coordination Mechanism between Local Government and Court, which was a new trend in recent years to promote efficiency of bankruptcy procedures with the necessary assistance of local government at local level in China.

If there are obvious negative consequences to the price of the debtor's assets, the court has the duty to guide the administrator to properly evaluate the impact of the epidemic situation or epidemic prevention and control measures on asset disposal prices and accurately find the best time and method of disposal, with the purpose of avoiding any potential improper devaluation of asset values which would be harmful for the creditors' interest.

Promoting the efficient hearing of bankruptcy cases

On 25 April 2020, the Supreme People's Court of P.R. China had issued its Opinions on Promoting the Efficient Hearing of Bankruptcy Cases, which does not directly relate to coronavirus and highlight the information-based means in bankruptcy procedures.

In this guidance, it is again highlighted that the court shall further advance information-based means in bankruptcy procedures, such as announcement notices, claims declarations, creditor meetings, debtor property inquiry and disposal and finding of potential investors in re-organisation procedure, during the epidemic prevention and control period. Such high-tech based technology in bankruptcy procedures is believed to be helpful to further reduce the cost of bankruptcy proceedings, and improve the efficiency of bankruptcy proceedings.

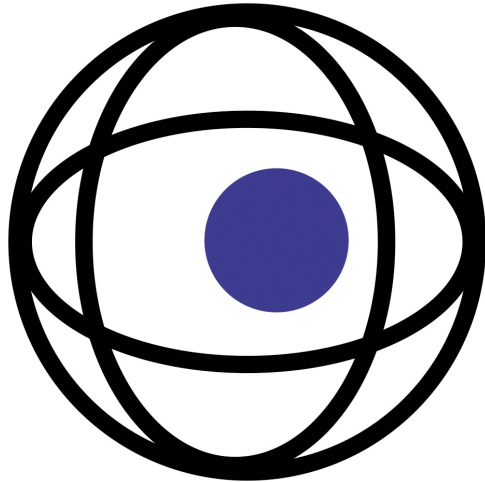
Conclusion

In the systemic response to coronavirus, there are also several other judicial policies related to the bankruptcy policy, even though most of them do not focus on bankruptcy procedure specifically. For example, in the Working Report of Supreme People's Court of P.R. China to the National People's Congress on 25 May 2020, the reporter had heightened the proper function of bankruptcy procedure and corporate rescue culture again. In the future, it is possible that other bankruptcy policies will be introduced if necessary to the recovery of economy.

As a scholar in bankruptcy law in China, I believe and sincerely hope that these bankruptcy policies can work well, so that most of the insolvent debtors during the epidemic can be rescued with proper enforcement of EBL 2006. It will not be an easy year, but these bankruptcy policies could be vital to the survival of the debtors and to a faster recovery of the whole economy .

INSOL Europe/LexisNexis Coronavirus Tracker of Insolvency Reforms

A tracker of insolvency reforms globally produced by LexisNexis in partnership with INSOL Europe is now available: [Coronavirus \(COVID-19\) Tracker of insolvency reforms globally](#).



INSOL EUROPE

We look at various countries worldwide which are expediting reforms to their restructuring and insolvency laws, temporarily suspending onerous insolvency law provisions, increasing limits for statutory demands, suspending enforcement powers and introducing other measures to deal with the coronavirus crisis. As the situation is rapidly evolving with more countries adding new measures daily, you should contact local lawyers in the relevant jurisdiction to check the current measures in force.

INSOL Europe webinars: COVID coffee breaks

INSOL Europe in partnership with LexisPSL are pleased to present a series of free webinars: 'COVID Coffee Breaks'.

The COVID Coffee Breaks are short, 20 minutes webinars, in which two or three INSOL Europe Country Coordinators share their personal experiences of the coronavirus crisis in their countries and give highlights of reforms and changes to their national insolvency framework to address the current crisis.

The webinars published to date (and available on demand) are accessible on INSOL Europe's website here: <https://www.insol-europe.org/publications/web-series>.