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Consumer Debt Issues - People's Republic of China (PRC)

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INSOL International
6-7 Queen Street, London, EC4N 1SP
Tel: +44 (0) 20 7248 3333 Fax: +44 (0) 20 7248 3384

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INSOL International sincerely thanks Roger Bischof for providing INSOL members with this very informative paper.

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Consumer Debt Issues – People’s Republic of China (PRC)

By Roger Bischof 罗杰*

INSOL Fellow, Managing Partner, BIRT, www.international-restructuring.com, PRC

1. Consumer insolvency regime

1.1 Introduction

At the national level, there is currently no personal bankruptcy law in the People’s Republic of China. Historically in China, bankruptcy constituted a criminal act which could even result in the death penalty when perpetrated multiple times.¹ Bankruptcy was described as “not permitted by heaven and earth, and an extraordinary crime against society”.² Furthermore, it has been a long Chinese tradition and custom to pass on debt to the next generations. For example it is common practice for a son to repay his father’s debt (父债子偿).³ Since this cultural heritage is deeply rooted in Chinese society, nowadays an individual would still lose face (没有面子) and experience considerable social disadvantages when facing bankruptcy proceedings.⁴ In addition, there have been concerns that a consumer bankruptcy system may allow those who go out of their way to try to avoid their obligations (老赖) to easily evade their debts. As a result, despite ongoing discussions, a personal insolvency regime has not yet been included in Chinese legislation.⁵ According to Art. 2 of the *Enterprise Bankruptcy Law (EBL) of the People’s Republic of China* (《中华人民共和国企业破产法》), the existing insolvency regime⁶ – which entered into force in June 2007, and was primarily⁷ inspired by rather creditor -friendly continental European models such as the Swiss Federal Code on Debt Enforcement and Bankruptcy (DEBA)⁸ – only applies to “enterprise legal persons” (corporates), hence excluding natural persons (consumers).

Although the concept of “individual bankruptcy” has to this date not yet been introduced by the Chinese legislator, consumer debt in China has been expanding rapidly in recent years,⁹ and there are a large number of individual bankruptcy cases in practice. This is partly also because founders,

* The views expressed in this paper are the views of the author and not of INSOL International, London.

¹ Hetzel, Chinesisches Konkursrecht, in: Jusletter 16 June 2014, para. 1.

² Pengsheng, The Discourse on Insolvency, in: Hegel / Carlitz (ed.), Writing and Law in Late Imperial China – Crime, Conflict and Judgment, 2007, 128.

³ Guo, The first personal bankruptcy case in China, 18 October 2019, available at: <https://leidenlawblog.nl/articles/first-personal-bankruptcy-case-in-china>.

⁴ Hetzel, Chinesisches Konkursrecht, in: Jusletter 16 June 2014, para. 7.

⁵ Instead the view prevailed that individuals should only be subject to the scope of the general principles of civil law (see Shaoping / Gebhardt, Bankruptcy Law of the People’s Republic of China, Zhong xin chu ban she, 2004, 266).

⁶ See also the judicial interpretations: Provisions (I) of the Supreme People’s Court on Several Issues concerning the Application of the Enterprise Bankruptcy Law of the People’s Republic of China

(最高人民法院关于适用《中华人民共和国企业破产法》若干问题的规定(一)), Provisions (II) of the Supreme

People’s Court on Several Issues concerning the Application of the Enterprise Bankruptcy Law of the People’s

Republic of China (最高人民法院关于适用《中华人民共和国企业破产法》若干问题的规定(二)), Provisions (III) of

the Supreme People’s Court on Several Issues Concerning the Application of the Enterprise Bankruptcy Law of the

People’s Republic of China (最高人民法院关于适用《中华人民共和国企业破产法》若干问题的规定(三)).

⁷ However, the included business reorganisation system (EBL, Chapter 8, Art. 70 et seq.) was drafted on the basis of drawing lessons from the chapter 11 proceedings under the U.S. Bankruptcy Code (Li / Wang Review of the PRC Bankruptcy Law in 2009, INSOL International Technical Series Issue No.11, 1, 3). Besides the chapter 11 like reorganisation proceedings, the law provides for compromise proceedings (EBL, Chapter 9, Art. 95 et seq.) and bankrupt liquidation proceedings (EBL, Chapter 10, Art. 107 et seq.).

⁸ Hetzel, Chinesisches Konkursrecht, in: Jusletter 16 June 2014, para. 1. However, for the avoidance of doubt, it should be noted that the Swiss counterpart applies to both legal and natural persons. The same holds true for other industrialized countries like Germany, France (Didier / Mailly, Small Practice Technical Paper Series, April 2020), UK (Lee, Small Practice Technical Paper Series, October 2019), Japan (Kondo / Miyamoto, INSOL International Small Practice Issues-Japan, November 2018), Singapore (Tong, INSOL International Smaller Practice Issues – Singapore, February 2013), Canada (Courage, INSOL International Smaller Practice Issues – Canada, June 2011), Czech Republic (Sprinz, INSOL International Small Practice Issues – Czech Republic, December 2018) and even Hong Kong (Ng / Chan, INSOL International Small Practice Issues–Hong Kong, June 2018).

⁹ By end of 2019 China’s household debt has increased to 128% of household income, and 56% of Chinese GDP (<https://rhg.com/research/china-household-debt>). Most of it is in form of mortgage debt but even credit card debt in China now exceeds US levels in absolute terms.

shareholders and managers of small and medium-sized companies (SMEs) must generally provide personal or family assets and guarantees as security for a company's debts. Such collaterals for taking out bank loans can mean that the individuals behind a SME borrower will be held personally liable if the company becomes insolvent, so invariably they may try to keep the company trading beyond a point in time when it ought to have been subjected to an insolvency event. Many cases involving unenforceable claims can only be closed by the court by "terminating the enforcement procedure", which has long been a historical burden of court enforcement and also affects the court's authority and credibility of the compulsory claim enforcement procedure. Against this background, the Chinese judiciary has carried out active exploration within the existing legal framework in creating case law to effectively implement a quasi-bankruptcy regime.

In addition, recently there have been some major policy developments and gradual steps towards the introduction of an individual bankruptcy regime, including broad high-level guidance at the national level, as well as pilot programs and cases in some provinces and regions in China.

On 27 February 2019, the "Opinions of the Supreme People's Court (SPC) on Deepening the Comprehensive Reform of the Judicial System of the People's Court (People's Court Fifth Five-year Reform Outline (2019-2023))"

(最高人民法院关于印发《最高人民法院关于深化人民法院司法体制综合配套改革的意见-人民法院第五个五年改革纲要(2019—2023)》) were published, which proposed "research to promote the establishment of an individual bankruptcy system and related supporting mechanisms".¹⁰

On 3 June 2019, the SPC published the "Opinions of the SPC on Deepening the Enforcement Reform and Improving the Permanent Mechanism for Solving Enforcement Difficulties - the Outline of People's Courts' Enforcement Work (2019-2023)"

(最高人民法院关于深化执行改革健全解决执行难长效机制的意见—人民法院执行工作纲要(2019—2023)) which stipulates at para. 11 that a pilot scheme equivalent to the functions of the personal bankruptcy system shall be implemented, so as to lay a practical foundation for the establishment of a personal bankruptcy system.

On 22 June 2019, the National Development and Reform Commission, together with the SPC and 12 other government departments, jointly issued the *Reform Plan for Accelerating Improvement of the Exit System for Market Participants* (Reform Plan) (加快完善市场主体退出制度改革方案) which has as its objective the gradual establishment of a personal bankruptcy regime. The Reform Plan states the following¹¹:

"The establishment of a personal bankruptcy system shall be researched, and the focus shall be on solving the problems of joint and several liability and security debts of natural persons arising from enterprise bankruptcy. It shall be specified that a natural person may be lawfully and reasonably discharged from liability for debts related to production and operations incurred for security and other reasons. It shall be gradually advanced to establish a system that a natural person may be lawfully and reasonably discharged from eligible consumer debts and to finally establish a comprehensive personal bankruptcy system. (The National Development and Reform Commission, the Ministry of Justice, the People's Bank of China, and the China Banking and Insurance Regulatory Commission shall be responsible based on the division of duties)"

In September 2019, the Wenzhou Intermediate Court in the city of Wenzhou, located in East China's Zhejiang Province, took the lead by publishing *Implementing Opinions on the Centralised Clean-up of Personal Debt* (关于个人债务集中清理实施意见) (Wenzhou Implementing Opinions).¹²

Subsequently, in October 2019, based on these Opinions, the Wenzhou Pingyang County Court (a first instance court) completed China's first centralised clean-up of personal debt case by approving a settlement agreement between a shareholder (Mr Cai) of an insolvent company and his four creditors.¹³ This landmark decision has widely been received, and is considered to be China's first

¹⁰ See Recital 46.

¹¹ Reform Plan, IV. 2.

¹² The Wenzhou Implementing Opinions consist of 44 articles.

¹³ 蔡先生 (2019) 浙0326执清3号. See section 5. below. Previously, the shareholder was ordered by another court to be jointly and severally liable for debt of the insolvent company.

individual bankruptcy case¹⁴ - although, as referred to above, Chinese courts have sometimes already previously found solutions within the existing legal framework.¹⁵ However, Mr Cai's case was the first one decided in accordance with the Wenzhou Implementing Opinions which appear to be the first framework of specific provisions relating to personal insolvency in China. Further details are set out in a separate section below.

In June 2020, the Standing Committee of the People's Congress of Shenzhen Municipality,¹⁶ published a new draft bill regarding the *Shenzhen Special Economic Zone Personal Bankruptcy Regulations* inviting public consultation (关于《深圳经济特区个人破产条例（征求意见稿）》公开征求意见的公告) (Shenzhen Draft Regulation). The Shenzhen draft regulation is said to be the first of its kind in China as it contains proposed personal insolvency provisions albeit for the Shenzhen Special Economic Zone alone.¹⁷ The corresponding *Regulations on Personal Bankruptcy in the Shenzhen Special Economic Zone - Explanatory note on the draft Exposure Draft* (关于《深圳经济特区个人破产条例（征求意见稿）》的说明) (Shenzhen Draft Regulation Explanatory Note) refers in I.(i) and II.(iv) to the proposed development of a personal insolvency regime similar to those in the UK, USA, Germany, Japan, Hong Kong and Taiwan, and has as its objective the creation of a modern market exit mechanism in line with these international standards.

Given the lack of a nationwide personal bankruptcy code, and the contents of the Wenzhou Implementing Opinions and the Shenzhen draft regulation, we set out below further details of these proposals. However, these proposals once implemented will only apply within the relevant municipalities (Wenzhou and Shenzhen Special Economic Zone). Nevertheless, they provide valuable guiding principles for resolving other cases involving individual debtors in China, and are worth being considered in particular with respect to the anticipated future passing of a nationwide separate law on this topic or a conceivable amendment of the EBL to govern consumers as well.

1.2 What are the consumer bankruptcy / restructuring processes available?

The Wenzhou Implementing Opinions provide for personal bankruptcy proceedings in the form of "centralised personal debt clean-up proceedings".¹⁸ Such proceedings can only be initiated when the debtor cannot fulfil a monetary obligation imposed by a valid court decision, and provided the debtor does not possess enough assets to repay the debt in full or clearly lacks the ability for repayment. In addition, some additional requirements must be met¹⁹ (see further details below). Whilst further details are set out below, in summary the Shenzhen Draft Regulation provides for reorganization proceedings,²⁰ composition proceedings²¹ and bankruptcy liquidation proceedings.²² ²³ In addition, the exposure draft also contains a separate chapter with summary proceedings.^{24, 25}

1.3 Which is the competent court or other authority to apply to for consumer insolvency proceedings?

Under the Wenzhou Implementing Opinions, the basic People's Court of the debtor's place of

¹⁴ Instead of many: Guo, The first personal bankruptcy case in China, 18 October 2019, available at: <https://leidenlawblog.nl/articles/first-personal-bankruptcy-case-in-china>.

¹⁵ E.g. Taizhou Intermediate People's Court in a case dated 29 April 2019 involving Mr Ke Shanwen (柯善文 (2019) 浙10破2号). While the Wenzhou judgement concerned a consensual payment plan, the Taizhou ruling even granted an immediate discharge with reference to Art. 120 of the EBL.

¹⁶ The high-tech city with 13 mio. inhabitants borders Hong Kong and is commonly known as China's Silicon Valley.

¹⁷ So explicitly Shenzhen Draft Regulation Explanatory Note III.(vii). Unlike the earlier Wenzhou Implementing Opinions, which were released by a court, the Shenzhen Draft Regulation is a product of a legislative body that is divided into thirteen chapters with 157 articles in total. Where the Regulation does not contain any specific rules, the EBL, the Civil Procedure Law and Chinese property law will be applicable (Shenzhen Draft Regulation, Art. 156).

¹⁸ Wenzhou Implementing Opinions, Art 1.

¹⁹ Wenzhou Implementing Opinions, Art. 6 and Art. 7.

²⁰ Shenzhen Draft Regulation, Chapter 8; Art. 88 et seq.

²¹ Shenzhen Draft Regulation, Chapter 9; Art. 114 et seq.

²² Shenzhen Draft Regulation, Chapter 10; Art. 124 et seq.

²³ Shenzhen Draft Regulation, Art. 2 and Art. 8.

²⁴ Shenzhen Draft Regulation, Chapter 11; Art. 145 et seq.

²⁵ In order to apply, Art. 145 requires that the relationship between creditors and debtor is clear, the property status of the debtor is clear, and the facts and circumstances of the personal bankruptcy case are simple.

residence, the court which is related to outstanding execution cases of the debtor, or the court which originally accepted and is hearing the relevant bankruptcy case of the enterprise is empowered to deal with the consumer insolvency proceedings. To be precise, the debtor may file a written application for centralised personal debt clean-up proceedings with the basic People's Court of the debtor's place of residence; if the debtor has no outstanding execution cases there, he may apply to the court in the Wenzhou municipality which has outstanding execution cases. Where an application for centralised personal debt clean-up proceedings is submitted in accordance with Art. 6 para. 1 and 2 of the Wenzhou Implementing Opinions, an application is required to be made to the People's Court that originally accepted the insolvency of the enterprise.²⁶

Under the Shenzhen Draft Regulation, the jurisdiction lies with the Intermediate People's Court of Shenzhen Municipality.²⁷

1.4 Who is the 'boss' in consumer insolvency proceedings (judge or administrator)?

Although the decision-making power regarding the resolution of the debtor's insolvency remains with the court, the court appoints an administrator to administer any personal insolvency case. The administrator plays a crucial role in the proceedings.²⁸

According to Art. 17 of the Wenzhou Implementing Opinions, for cases arising out of enterprise insolvency, the administrator appointed by a judge for the enterprise should also be the administrator for the natural person. For other cases, the people's court should appoint an administrator, or the debtor and creditors can jointly agree on a representative of the creditors selected by the creditors' meeting to act as the administrator. The debt settlement administrator is responsible for the transactional work in the individual debt settlement proceedings, as well as the work that the People's Court considers to be performed by the administrator. The latter shall report his work to the People's Court in a timely manner and accept the supervision of creditors.

The administrator's role is to supervise the debtor as well as to share information with the creditors. Anyone who finds that the debtor has violated the provisions of the Implementing Opinions may report to the administrator who may in turn apply to the People's Court to resume the execution of the original judgment. In addition, the administrator should inform all the creditors in writing within 20 days from the moment the court accepts a petition to open proceedings and make public announcements.²⁹

Under the Shenzhen Draft Regulation, the administrator is also appointed by the People's Court although creditors can make a recommendation to the court.³⁰ The administrator is supposed to perform its functions and duties in accordance with the Regulation and is supervised by the People's Court and the meeting of creditors³¹. On the basis of the bankrupt's application and the administrator's report, the People's Court will decide whether or not to discharge natural person's debt.

1.5 What legal and actual requirements are there to enter into consumer insolvency proceedings?

As mentioned in section 1.2 above, centralised personal debt clean-up proceedings in accordance with the Wenzhou Implementing Opinions require that the over-indebted natural person (debtor) is unable to fulfil a monetary obligation which was determined by a valid judgment and the debtor's assets are insufficient to pay all debtor debts or debtor is clearly insolvent. In addition, the Opinions require that the natural person meets one of the following alternative conditions:³²

- (i) the debtor is liable as a guarantor of an enterprise legal person that is subject to insolvency

²⁶ Wenzhou Implementing Opinions, Art. 8.

²⁷ Shenzhen Draft Regulation, Art. 4.

²⁸ Regarding the general requirements for acting as an administrator in China, see Xiuchao Yin, INSOL Collection of Practical Issues Important to Small Practitioners – People's Republic of China, December 2017 (in particular para. 7).

²⁹ Wenzhou Implementing Opinions, Art. 19.

³⁰ Shenzhen Draft Regulation, Art. 16 and 17.

³¹ Shenzhen Draft Regulation, Art. 37 and Art. 39.

³² Wenzhou Implementing Opinions, Art. 6.



proceedings or has been declared insolvent;

- (ii) the debtor is liable for the debt of an enterprise as a result of the denial of the corporate personality (piercing the corporate veil);
- (iii) the debtor is liable for the debt of unincorporated organisations;
- (iv) the debtor is unable to repay his debt because of hardship; and
- (v) the debtor has voluntarily proposed a repayment plan and has obtained the consent of all creditors.

Furthermore, in order to commence personal bankruptcy proceedings, the individual must meet the following criteria:³³

- (i) there are no other pending or decided cases outside Wenzhou which concern a monetary claim / payment unless the creditors outside Wenzhou agree to voluntarily participate in the personal bankruptcy proceedings;
- (ii) the debtor and his / her spouse have made a full and truthful declaration of their assets;
- (iii) the debtor's spouse agrees to investigations of his / her assets by a People's Court, including bank records for a certain number of years, and other family members should also cooperate with the investigation of their assets, if necessary; and
- (iv) the debtor agrees in writing not to engage in high consumption activities nor spending other than expenses that are essential for life and work which are prohibited under Art. 3 of the SPC's *Provisions on limiting high consumption and related consumption of executed persons* (最高人民法院关于限制被执行人高消费及有关消费的若干规定).

Lastly, the People's court may reject the application for individual insolvency proceedings if:³⁴

- (i) the debtor intentionally omitted, concealed, transferred property, or abandoned claims;
- (ii) the debtor's gambling, extravagant consumption and other unhealthy behaviours in the period from one year prior to the effective date of the judgment to the date of the application for insolvency proceedings may affect the fulfilment of the debtor's debts;
- (iii) the debtor has been fined, detained or criminally punished for refusing to execute a judgment or ruling;
- (iv) the debtor failed to reach an enforcement settlement with creditors to evade or delay execution; and
- (v) the debtor has applied for personal insolvency proceedings in Wenzhou within three years before applying this time.

The Shenzhen Draft Regulation differentiates between (a) conditions for a debtor to apply for personal insolvency and (b) conditions for a creditor to apply for insolvency of the debtor:³⁵

- (a) In order for a debtor³⁶ to be eligible to file for personal insolvency, the debtor:
 - (i) must be residing in the Shenzhen Special Economic Zone; and
 - (ii) must have been participating in the Shenzhen social insurance system for three consecutive years; and

³³ Wenzhou Implementing Opinions, Art. 7.

³⁴ Wenzhou Implementing Opinions, Art. 13.

³⁵ Shenzhen Draft Regulation, Art. 2 in conjunction with Art. 8.

³⁶ The spouse of the debtor may simultaneously apply for bankruptcy liquidation, composition or reorganisation proceedings without being required to meet the residency and social security contribution requirements.

- (iii) debtor's assets are insufficient to pay all the debts or if he / she is manifestly insolvent as a result of production and business, life and consumption.³⁷

Under these circumstances, the debtor is subject to composition or bankruptcy liquidation proceedings. If the debtor has predictable future income, he may apply for reorganisation proceedings.

- (b) When the debtor is unable to repay his liabilities as they fall due, the creditors who individually or jointly hold more than RMB 500'000 of matured claims against the debtor may apply to the People's Court for a bankruptcy liquidation, composition or reorganisation. The claim threshold serves to prevent small creditors from abusing the bankruptcy process.³⁸

1.6 Costs and timelines of the available procedures

Art. 11 of the Wenzhou Implementing Opinions provides that for the time being no court application fee is charged for the application for centralised personal debt clean-up proceedings. Art. 18 stipulates that during the trial period of these Opinions, the remuneration of the administrator and unpaid necessary expenses such as announcement fees in the centralised personal debt clean-up proceedings are paid with special financial subsidies by the government. Art. 27 further clarifies that the expenses incurred by creditors in participating in the centralised personal debt clean-up proceedings should not be borne by the debtor.

The timeline for filing of claims is from 30 days to three months from the date of the administrator's announcement.

Chapter V of the Shenzhen Draft Regulation deals with insolvency expenses. The following expenses incurred after the People's Court accepts a bankruptcy petition shall be bankruptcy expenses:

- (i) costs of litigation in bankruptcy cases;
- (ii) costs of administering, realizing and distributing the debtor's property;
- (iii) expenses and remuneration of the administrator; and
- (iv) other reasonable expenses incurred by the administrator in handling the bankruptcy case.³⁹ Moreover, Art. 58 of the Shenzhen Draft Regulation enumerates common debts.

Pursuant to Art. 12 of the Shenzhen Draft Regulation, the People's Court shall decide whether to accept the application within thirty days from the date of receipt of the application. If there are special circumstances, the time period may be extended for fifteen days.

2. Means testing for insolvent individuals

Under the Wenzhou Implementing Opinions, together with the application the individual needs to make full disclosure of the debtors assets and debts.⁴⁰ As mentioned in section 1.5 above, under certain circumstances the People's Court may reject the personal insolvency petition based on Art. 13 of the Wenzhou Implementing Opinions.

The amount of the debtor's income that he or she is allowed to keep is determined in accordance with the debt repayment plan to be approved by the creditors' meeting and the court. Pursuant to Art. 30 of the Wenzhou Implementing Opinions, after completion of the repayment plan, the debtor remains liable from his future income for the following liabilities unless the creditor consents to a claim reduction:

- (i) liability for personal injury arising from an intentional tort; and

³⁷ No application is possible if the business is illegal or excessive consumption results in the inability to pay off debts (Shenzhen Draft Regulation Explanatory Note, III(i)).

³⁸ Shenzhen Draft Regulation Explanatory Note, III(ii).

³⁹ Shenzhen Draft Regulation, Art. 57.

⁴⁰ Wenzhou Implementing Opinions, Art. 10.



- (ii) liability for child maintenance, alimonies and support obligations regarding the elderly.

Pursuant to Art. 35 of the Wenzhou Implementing Opinions, after a debtor initiates the personal debt clean-up proceeding, the court will issue a restraining order towards the applicant which prescribes that before the restoration of his / her credit, the debtor is not allowed to conduct the following acts except as otherwise provided by law or otherwise agreed by the parties:

- (i) high consumption and spending which is prohibited as non-essential for life and work in accordance with Art. 3 of the SPC Provisions concerning Restrictions on High Consumption and Related Consumption of Executed Persons (最高人民法院关于限制被执行人高消费及有关消费的若干规定),⁴¹ except for economy class air tickets and second-class high-speed rail travel;
- (ii) serving as legal representative or shareholder of a for-profit company;
- (iii) acting as legal representative, director or supervisor of State-owned enterprises (SOEs); and
- (iv) other acts as restricted by the People's Court.

If travelling abroad is required for work, this shall be pre-approved by the court.

Under the Shenzhen Draft Regulation, the debtor has an obligation to fully declare his / her property and income.⁴² From the date of the acceptance of the bankruptcy petition by the People's Court to the date where the latter rules on the discharge of the debtor's remaining debt, the debtor may not engage in the following acts of consumption:^{43, 44}

- (i) when traveling by means of transportation, choose business-class or first-class of airplanes, soft sleeper rail, above second-class ships, G-category high-speed trains or above first-class in any other high-speed train;
- (ii) spending in hotels, restaurants, nightclubs, golf courses and other places with a three-star rating or higher;
- (iii) purchase of real estate or motor vehicles;
- (iv) new construction, extension and renovation of houses;
- (v) tourism;
- (vi) to send children to high-tuition private schools;
- (vii) renting office space in high-end offices, hotels, apartments, etc.;
- (viii) paying high premiums for insurance and financial products; and
- (ix) other acts of consumption not essential to life and work.

⁴¹ High consumption activities are generally described in the relevant SPC provisions as follows:

- to take higher than economy/second class of airplanes, steamship and soft berth of trains.
- to have high consumption activities at star hotels, night clubs, golf courses, or other places.
- to purchase real estate, or to build, expand or luxuriously furnish houses.
- to rent high-end office buildings, hotels, apartments, or other places for conducting businesses.
- to purchase vehicles not necessary for business operations.
- to travel or take a vacation.
- to send children to high-cost private schools.
- to purchase high premium insurances and financial products.
- to take any seat in G-category high-speed train or above first-class in any other high-speed train, or to carry out any other consumption not necessary for life or work.

⁴² Shenzhen Draft Regulation, Art. 22 to Art. 26.

⁴³ Shenzhen Draft Regulation, Art. 19 and Art. 20.

⁴⁴ See also Shenzhen Draft Regulation Explanatory Note, III(iv).

In addition, during the said period, the debtor shall not hold the positions of a director, supervisor or senior manager of listed companies, non-listed public companies and financial institutions, and shall not engage in any activities prohibited by laws and regulations. The scope of exempted property is defined in Art. 46 of the Shenzhen Draft Regulation.⁴⁵

3. How are the various claims treated?

The Wenzhou Implementing Opinions do not clearly specify how the various claims⁴⁶ are treated. Art. 2 of the said Opinions provides that centralised personal debt clean-up proceedings follow the principle of autonomy of will. Hence, the relevant quorum of the creditors' meeting will be voting for or against the repayment plan provided by the debtor which includes the treatment of the different claims.⁴⁷

Pursuant to Art. 85 of the Shenzhen Draft Regulation, the resolution of the creditors' meeting shall be adopted by a majority of the creditors present at the meeting who have the right to vote and the creditors represented by them. The resolution shall be adopted by at least one half of the total amount of unsecured claims.

In *reorganization proceedings* - the draft reorganization plan shall also be submitted for approval to a meeting of creditors.⁴⁸ The draft reorganisation plan must comply with the requirements stipulated in Art. 97 and Art. 98 of the Shenzhen Draft Regulation. The voting is conducted in the following groups of creditors:⁴⁹

- (i) claims that have a security right in specified property of the debtor;
- (ii) alimony, maintenance, support and damages exclusively for personal indemnity;
- (iii) wages and medical, disability and pension claims;
- (vi) social insurance claims such as basic pension insurance and basic medical insurance; and
- (v) general claims.

The People's Court may, if necessary, decide to set up a small claims group within the group of general claims to vote on the draft reorganisation plan. In order for a plan to pass, it requires the approval of more than half of the creditors of the same voting group present at the meeting which represent two-thirds of the total amount of claims of the group.⁵⁰ The reorganisation plan is adopted by the creditors, when all voting groups approve the plan and it may subsequently be submitted to the People's Court for approval and termination of the reorganisation procedure.⁵¹ If the reorganisation plan is only approved by a part of the voting groups, it may nevertheless be approved by the People's Court upon request⁵² or the debtor will be declared bankrupt.⁵³ The reorganisation plan which was approved by the People's Court's is binding on the debtor and all.⁵⁴

In *composition proceedings*, the following claims shall be composition claims:⁵⁵

- (i) unsecured claims against the debtor that are existing at the time the bankruptcy petition is accepted by the People's Court;
- (ii) claims that are not dischargeable under these Regulations but in respect of which the relevant creditors have voluntarily waived the non-discharge treatment as a result of the composition;

⁴⁵ See also Shenzhen Draft Regulation Explanatory Note, III(vi).

⁴⁶ Wenzhou Implementing Opinions, Art. 20.

⁴⁷ Wenzhou Implementing Opinions, Art 22.

⁴⁸ Shenzhen Draft Regulation, Art. 89 et seq. and Art. 94.

⁴⁹ Shenzhen Draft Regulation, Art. 99.

⁵⁰ Shenzhen Draft Regulation, Art. 100.

⁵¹ Shenzhen Draft Regulation, Art. 101.

⁵² Shenzhen Draft Regulation, Art. 102.

⁵³ Shenzhen Draft Regulation, Art. 103.

⁵⁴ Shenzhen Draft Regulation, Art. 106.

⁵⁵ Shenzhen Draft Regulation, Art. 118.

- (iii) claims for which the creditors have voluntarily waived their security interest or statutory priority as a result of the composition; and
- (iv) other claims for which the creditors have voluntarily waived their priority rights as a result of the composition.

A resolution of the meeting of creditors on a composition agreement shall be deemed to be adopted if it is approved by a majority of the voting creditors present at the meeting who represent at least two thirds of the total amount of the claims.

If the composition agreement involves the adjustment of secured claims, there shall be a secured claims group and the secured creditors affected by the adjustment shall vote on it. The part of the composition agreement relating to the adjustment of the secured claims shall be deemed to be adopted if it is approved by a majority of the secured creditors subject to the adjustment who represent at least two thirds of the total amount of the composition claims.⁵⁶

In *bankrupt liquidation proceedings*, where a People's Court decides to declare a debtor bankrupt in accordance with the Regulation, a right holder having security interest over a particular property of the debtor may, at any time, submit a request to the administrator to exercise its right to priority payment by disposing of that particular property.

If the creditor is not fully paid by exercising its right to priority payment, the unpaid claim is treated as an ordinary claim; if the creditor waives its right to priority payment, the claim is treated as an ordinary claim.⁵⁷

After the bankruptcy estate has given priority to the discharge of bankruptcy expenses and debts incurred for the common good of creditors, other debts shall be discharged in the following order:⁵⁸

- (i) alimony, child support and maintenance payments owed by the bankrupt;
- (ii) wages and medical, disability and pension expenses owed by bankrupt individual business owners to their employees, including basic pension insurance, basic medical insurance and other social insurance expenses that shall be allocated to the employees' personal accounts, as well as compensation and personal injury damages that shall be paid to the employees in accordance with the law; and
- (iii) ordinary bankruptcy claims.

Where the bankruptcy estate is insufficient to satisfy the same group of claims *pari passu*, distributions shall be made proportionally.

Once approved, debtors will spend at least a three-year supervised probationary period in which their expenditure is monitored before part or all of their liabilities will be wiped clean.⁵⁹

Pursuant to Art. 136 of the Shenzhen Draft Regulation, the following debts shall not be forgiven unless they are voluntarily waived by the creditor:

- (i) damages arising from intentional or gross negligent violation of the physical rights or the right to life of another person;
- (ii) damages for property damage arising from malicious torts;
- (iii) alimony, maintenance and support payments based on legal status;
- (iv) claims for remuneration and repayment of advances based on an employment relationship;
- (v) claims of which the insolvent has knowledge, but which are not recorded in the register of

⁵⁶ Shenzhen Draft Regulation, Art. 121.

⁵⁷ Shenzhen Draft Regulation, Art. 126.

⁵⁸ Shenzhen Draft Regulation, Art. 129.

⁵⁹ Shenzhen Draft Regulation, Art. 135.

debts unless the creditor has knowledge of a declaration of insolvency;

- (vi) student education loans;
- (vii) fines, penalties and confiscation of property;
- (viii) taxes owed by the debtor; and
- (ix) other debts that may not be discharged according to law.

4. What changes and reforms are needed?

As described at the outset, it comes with little surprise that PRC law has to this date never implemented a personal bankruptcy regime given that Chinese culture has historically insisted on the payment of liabilities in full, even over the course of several generations. Hence, cultural circumstances explain the absence of the possibility for an individual debtor to file for bankruptcy.

Against this background, the most recent reform proposals and developments with respect to local Chinese insolvency laws highlighted in this paper – in particular the Wenzhou Implementing Opinions⁶⁰ and the corresponding leading case⁶¹ as well as the Shenzhen Draft Regulation – merit even greater attention and are a positive and welcome step forward in terms of building a modern and healthy consumer debt relief and market exit system. While the said rules providing for a fresh start will for the time being only apply in the respective municipalities, they act as valuable prototypes and pilot schemes for other parts of the country. It remains to be seen how fast other cities and provinces of China will adopt similar regimes. At this point it may ultimately be the case that in a few years from now China will have a national codified law for personal insolvency. There will be plenty of further deliberation and probably some opposition due to the risk that the new regime may get abused by individuals for the malicious evasion of their debt. However, in light of the fact that China is in the process of gradually updating its economy from manufacturing-intense industry to innovation and services, China will overcome these obstacles and a golden age for China's insolvency laws lies well ahead of us. In particular, bankruptcy protection for unfortunate founders and managers of start-ups and SMEs who can have (part of) their debt forgiven by creditors will further boost this transformation and the entrepreneurial spirit.

5. Court Approved Settlement in respect of Mr Cai: Report of the Wenzhou Case⁶²

Responding to the expectations in the reform proposals issued in 2019,⁶³ the Wenzhou Intermediate People's Court on 9th October 2019, together with its lower county court (same level as a district court), completed China's first centralised clean-up of personal debt case (which has equivalent functions and procedures as personal bankruptcy) by approving a debt-settlement agreement between an individual and his creditors under the current law.

According to the circular issued by the Wenzhou Intermediate People's Court, a debtor surnamed Mr Cai was ordered only to pay all his creditors RMB 32'000 in one lump sum within 18 months in full and final settlement, equal to a rate of 1.5% of the entire debts of RMB 2.14 million, due to his lack of solvency. Mr Cai in the meantime also promised to his four creditors that within six years from the date of completion of the aforesaid debt payment plan, in the event that the annual income of his family exceeded RMB 120'000 during such period, 50% of the excess would be used to pay off the outstanding debts of the creditors.

In the case at hand, Mr Cai was one of the shareholders of a bankrupt enterprise in Wenzhou, and pursuant to a Court judgment was jointly and severally liable for the debts of the bankrupt enterprise. Mr Cai only held 1% of the equity of a machinery company and owned a scrapped motorcycle as well as few minor cash deposits. Additionally, Mr Cai's monthly income from the

⁶⁰ However, as stated there are some limitations with respect to the Wenzhou Implementing Opinion. For example, these Opinions only allow the commencement of proceedings when there is a monetary judgment delivered by a court, usually when the subsequent enforcement process encounters difficulties. In other words, the court in Wenzhou would not accept a voluntary petition filed by a debtor without a valid judgment.

⁶¹ See section 5 below.

⁶² 蔡先生 (2019) 浙0326执清3号.

⁶³ See section 1.1 above.



machinery company was RMB 4'000 while his spouse's monthly income was approximately RMB 4'000. Mr Cai had been suffering from high blood pressure and kidney disease for a long time, his medical expenses were significant, and he needed to pay the university tuition fees and living expenses of his child. The family was unable to make ends meet and was unable to pay off the large debts owed.

Pursuant to the court judgment, Mr Cai who was not the major shareholder of the bankrupt enterprise, was held jointly and severally liable for the corporate debts.

However, Mr Cai was not included in the "List of Dishonest Debtors" (失信被执行人名单). If he had been a Dishonest Debtor, he could not have applied for the centralised clean-up of personal debt. The court stated that the "centralised clean-up of personal debt" is aimed to protect "honest and unfortunate" people, rather than 'deadbeats' ("Lao Lai" in Chinese). In order to prevent the debtor from escaping his debts, the court took the three following additional measures to avoid Mr Cai "exploiting an advantage":

First, comprehensive investigation of the debtor's property - To prevent the debtor from escaping debts or conducting other dishonest behaviours, the bankruptcy administrator appointed by the court investigated the assets of the family in detail, including bank deposits, real estate, vehicles, insurance, equity, assets in Alipay and on other payment platforms of the debtor and his spouse.

Second, full protection of the creditors' rights to know and address inquiries to the debtor - Creditors raised detailed questions concerning the debtor's assets and debts during the creditors' meeting and the debtor replied to each question raised.

Third, strict implementation of a supervision mechanism - To ensure that all creditors will be compensated fairly, the debtor has been required to abide by the behavioural restraining order issued by the court. He should also report the annual household income and debt repayment to the court or the bankruptcy administrator prior to 31st December of each year.

Furthermore, the court and the debtor reached an agreement that within six years from the date when the centralised clean-up plan of personal debts is fulfilled, if the debtor is found to have any undeclared major assets, or if any fraudulent acts or malicious reduction of the debtor's assets becomes known or other debt evasion acts occur, the creditors are entitled to claim for the entire debts that were owing originally.

As the applied legal basis of the first trial case, the Wenzhou Implementing Opinions allow enforcement proceedings to be converted into centralised clean-up of personal debt proceedings which is clearly defined as a special procedure during the enforcement process. In accordance with the enforcement system and with reference to the principles and spirit of individual bankruptcy, a personal debt repayment / settlement plan will be formed within the existing legal framework to achieve the purpose of effective withdrawal by the individual debtor from the enforcement process and to rehabilitate the credit of the debtor.



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