Global Restructuring and Insolvency Guide - China

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# Initial Considerations

## Can you take security over all types of assets, including accounts receivable?

**Dissolution proceedings**

Generally, yes.

**Bankruptcy proceedings**

Yes. However, an administrator has the right to petition the court to nullify the security if such security is given for originally unsecured debts within one year before the court accepts the application for bankruptcy.

## What is the nature of the insolvency process?

**Dissolution proceedings**

It is a company law process. Dissolution proceedings can be initiated either voluntarily or ordered by the court at the application of qualified shareholders, creditors, directors and other stakeholders.

Under People's Republic of China (PRC)  law, the following reasons could result in the dissolution of a company:

The term of business operation prescribed by the articles of association (AOA) expires, or any situations for dissolution prescribed in the AOA apply.

The shareholders' general meeting resolves to dissolve the company.

It is necessary to dissolve the company due to a merger or demerger.

According to law, the business license is canceled, or the company is ordered to close down.

Where a company meets severe difficulties in its operations or management such that the interests of the shareholders will be severely undermined if the company continues to exist and the difficulties cannot otherwise be solved, the shareholders who hold 10% or more of the voting rights of the company may lead to the court to dissolve the company.

Further, as per judicial interpretations, the above-mentioned serious difficulties may particularly include corporate deadlock — for example, no shareholder meeting could be held in the past two consecutive years, or no valid shareholder resolution could be passed in the past two consecutive years, or there is a long-term and unresolvable conflict among directors that results in serious difficulty in terms of management.

**Bankruptcy proceedings**

It is a bankruptcy law process. If a company cannot pay off its due debts and its assets are not enough to discharge all the debts, or it apparently lacks the ability to pay off the debts, bankruptcy proceedings can be triggered.

There are three types of bankruptcy proceedings:

Bankruptcy liquidation: Either the creditor or the debtor can submit an application to the court to initiate the bankruptcy liquidation proceedings. In addition, under the dissolution proceedings, if the liquidation group finds that the properties of the company are not adequate to pay off the debts after liquidating the properties of the company and producing balance sheets and checklists of properties, it will file an application to the court to announce the company's bankruptcy. The proceedings commence when the court declares a debtor bankrupt. After the proceedings, the company will eventually cease to exist.

Settlement: A debtor may apply for settlement directly with the court or after the court accepts the application for bankruptcy and before it is declared bankrupt, may apply to the court for settlement. When applying for settlement, the debtor will put forward a draft settlement agreement for approval by the creditors' meeting and affirmation by the court, which, if passed, will have the effect of terminating the bankruptcy proceedings and allowing the debtor to emerge from the proceedings intact. A debtor will pay off its debts according to the conditions stipulated by the settlement agreement. Where a debtor is unable or fails to implement the settlement agreement, the court will, upon request of the creditor, terminate the implementation of the settlement agreement, announce the debtor bankrupt and initiate the bankruptcy liquidation proceedings.

Revival: Either the creditor or the debtor can apply to the court to initiate the revival proceedings. The debts will be put under a moratorium to revive the company. Under the revival proceedings, the debtor will implement a revival plan worked out either by itself or the administrator. Where a debtor fails or refuses to implement the revival plan, the court may, upon request of the administrator or interested party, terminate the implementation of the revival plan, announce the debtor bankrupt and initiate the bankruptcy liquidation proceedings.

The revival proceedings are advantageous to a debtor as they allow the debtor to continue to operate its business and defer repayments of its debts or even have its debts deducted. In such proceedings, the debtor is able to relieve its financial pressure and obtain chances to get out of the distress of being bankrupted.

## What is the solvency requirement for a company to file a case in this jurisdiction?

**Dissolution proceedings**

If the dissolution proceedings are triggered due to the above-mentioned events (1), (2), (4) and (5), a liquidation group will be formed to conduct liquidation proceedings. Generally, the company will be solvent under the dissolution proceedings. However, if the liquidation group finds that the company's assets are insufficient to pay off its debts, it will file a bankruptcy application to the courts and the dissolution proceedings would become bankruptcy proceedings.

**Bankruptcy proceedings**

The solvency requirement for initiating the bankruptcy proceedings is if the debtor fails to pay off its due debts and its assets are not enough to pay off all the debts or is obviously incapable of paying off its debts.

When the above-mentioned requirement is satisfied, the court can initiate revival or bankruptcy liquidation proceedings upon application from either the debtor or creditor. However, the settlement proceedings can only be initiated by the court upon application from the debtor.

## Is there a requirement to demonstrate COMI ("centre of main interests") for a company to file a case in this country?

**Dissolution proceedings**

No.

The liquidation group, appointed by the court or by the company itself in accordance with the applicable laws, should prepare balance sheets and property lists that cover all the assets and property of the company under dissolution proceedings, including overseas assets. However, there is no mandatory requirement to demonstrate COMI. Instead, under PRC laws, the court at the place of the company's domicile has jurisdiction over company dissolution cases. The domicile of a company refers to where the principal office of a company is located. Where the principal office location is unclear, the court at the place where the company is registered has jurisdiction.

**Bankruptcy proceedings**

No.

The court at the place where the debtor is domiciled has jurisdiction over the bankruptcy case. The domicile of a company refers to where the principal office of a company is located. Where the principal office is unclear, the court at the place where the company is registered has jurisdiction.

The effects of bankruptcy proceedings can extend to the debtor's assets outside of China.

## Is restructuring of both secured and unsecured claims possible?

**Dissolution proceedings**

It is not prohibited by law but it is rather unlikely in reality unless the creditors find a strong reason to agree to a restructuring.

**Bankruptcy proceedings**

It is possible, subject to creditors' consent.

## Are the claims of creditors and shareholders put into separate classes for purposes of voting and treatment under the plan or scheme?

**Dissolution proceedings**

There is no classification of creditors. The classification of shareholders is outlined in the AOA.

**Bankruptcy proceedings**

Creditors are classified into different groups based on their claims categories, which are as follows:

Employee claims

Social security claims and tax claims

Unsecured claims

Prior to the distribution of the existing assets to the above-mentioned creditors, a creditor of a secured asset is entitled to a priority right to receive repayment guaranteed by their secured asset.

In addition, bankruptcy expenses, as well as the following community debts, will be paid at any time during the bankruptcy proceedings:

Debts generated when the debtor or administrator requests that the counterparty perform a contract that is not fulfilled completely by both parties

Debts generated from management of the debtor's assets without authority (negotiorum gestio)

Debts generated as a result of unjustified enrichment

Expenses incurred for the continuance of business operations, social insurance premiums, etc.

Debts generated from damages that occurred during the performance of an administrator's duty

Debts generated from damages due to the debtor's assets

Where the debtor's assets are not sufficient to pay off all the bankruptcy expenses and community debts, the bankruptcy expenses will be paid as a priority.

There is no classification of shareholders unless provided in the AOA.

## Is shareholder approval needed to commence a case? Are shareholders entitled to vote on a plan?

**Dissolution proceedings**

Shareholder approval is not required to commence the case. Neither does PRC company law prescribe the shareholders' entitlement to vote on a plan.

That said, after the company's liquidation is completed, the liquidation group will make a liquidation report and submit it to the shareholders' meeting, the shareholders' assembly, the people's court for confirmation, and the company registration authority for deregistration. The liquidation group will also make a public announcement regarding the company's closure.

**Bankruptcy proceedings**

Shareholders' voting approvals are not required to commence the case. In revival proceedings, the representatives of the shareholders may attend the creditors' meeting to discuss a draft revival plan. If a draft revival plan involves the adjustment of the rights and interests of the shareholders, a group of shareholders will be formed to vote on this issue.

## Is there an ability to bind minority dissenting creditors (i.e., cramdown)?

**Dissolution proceedings**

N/A

No creditor voting is applied under dissolution proceedings.

**Bankruptcy proceedings**

Yes. Matters that require the creditors' approval are usually passed by a majority (over one-half), or supermajority (over two-thirds) of creditors or are subject to a court order. The decisions made through a creditors' vote or court order can bind minority dissenting creditors.

# Commencing the Process

## Who can commence?

**Dissolution proceedings**

A company can commence the process voluntarily. Under certain circumstances, the court can also order the process to be commenced upon an application submitted by qualified shareholders, creditors, directors and other stakeholders.

**Bankruptcy proceedings**

Bankruptcy liquidation proceedings or revival proceedings can be initiated by the court upon the application of any of the following:

A debtor or creditor

A liquidation group involuntary liquidation proceedings

A creditor in a bankruptcy settlement where the company fails to duly perform the settlement agreement

An administrator/person of interest where the company fails to duly implement the revival plan

Settlement proceedings can be initiated and hosted by the court upon a debtor's application.

The court can initiate revival proceedings upon the application of debtors and creditors.

## Is shareholder's consent required to commence proceeding?

**Dissolution proceedings**

Pursuant to PRC company law, for limited liability companies, the decision to dissolve a company requires approval from shareholders who hold two-thirds or more of the voting rights. For companies limited by shares, the decision to dissolve a company requires approval from shareholders who hold two-thirds or more of the shareholders' voting rights present in the shareholders' meeting.

In addition, if the company suffers substantial difficulties in its operations or management,  and (i) the shareholders' interests face heavy losses if the company continues to exist. and (ii) the difficulties cannot be solved by any other means, shareholders who hold 10% or more of the voting rights may apply to the court to dissolve the company.

**Bankruptcy proceedings**

When the company initiates the bankruptcy proceedings, the decision requires the approval of the shareholders at a meeting. However, there is no mandatory threshold o for shareholders' voting for approval. Therefore, the decision to file a bankruptcy application should be made in accordance with the AOA of the company. In practice, an application for bankruptcy is a material matter for the company, which may require approval from shareholders who hold two-thirds or more of the voting rights.

On the other hand, where the bankruptcy proceedings are initiated by the creditors and approved by the court, there is no need to obtain shareholder approval.

## Is there an ability to consolidate group estates?

**Dissolution proceedings**

No

**Bankruptcy proceedings**

Yes. When the legal personalities of affiliated companies are highly confused, and distinguishing their property would incur significant costs and severely jeopardize the fair repayment interests of creditors, the court may decide to consolidate the bankruptcy of the affiliated companies.

## Is there any court involvement?

**Dissolution proceedings**

For voluntary dissolution, court involvement is not required to commence the process. For involuntary court-ordered dissolution, the process is commenced by order of the court.

In both voluntary and involuntary dissolutions, court involvement can be sought if a liquidation group is not formed within the time limit specified, in case of intentionally deferred liquidation, or where there are other illegal liquidation acts.

**Bankruptcy proceedings**

The court reviews the application for bankruptcy and decides whether to accept the application. If the court decides to accept the application for bankruptcy, it appoints an administrator. The court supervises each stage of the bankruptcy proceedings.

## Who manages the debtor?

**Dissolution proceedings**

The liquidation group formed by the company itself or designated by the court.

**Bankruptcy proceedings**

The court designates the administrator.

That said, in revival proceedings, the company can manage its assets and business operations on its own under the administrator's supervision and can work out a revival plan itself.

## What is level of disclosure of process to voting creditors?

**Dissolution proceedings**

Creditors have no voting rights in dissolution proceedings. However, the liquidation group will notify the creditors within 10 days of its formation.

**Bankruptcy proceedings**

Creditors will be notified of the commencement of the bankruptcy proceedings. All claims against the debtor, any revival plan, settlement agreements and distribution arrangements require significant disclosures to creditors for voting at the creditors' meeting.

## What entities are excluded from customary insolvency or reorganisation proceedings, and what legislation applies to them?

**Dissolution proceedings**

According to PRC law, dissolution proceedings under PRC company law apply to limited liability companies and companies limited by shares (including listed companies) established within China. The dissolution of other entities is governed by other legislation. For example, a partnership enterprise is dissolved according to the PRC Partnership Enterprise Law.

**Bankruptcy proceedings**

The PRC Enterprise Bankruptcy Law applies to enterprise legal persons, including limited liability companies and companies limited by shares.

For other organizations that are not enterprise legal persons, such as a partnership enterprise, their bankruptcy liquidation is governed mutatis mutandis by the procedure as prescribed by the PRC Enterprise Bankruptcy Law.

## How long does it generally take for a creditor to commence the procedure?

**Dissolution proceedings**

N/A.

**Bankruptcy proceedings**

When a creditor makes an application for bankruptcy, the court will notify the debtor concerned within five days from the date it receives the application. If the debtor has objections to the application, it will put forward its objections to the court within seven days from the date it receives the notification from the court. The court will decide whether to accept the bankruptcy application within 10 days after the period for raising objections expires.

Except for the circumstances specified in the preceding paragraph, the court will decide whether to accept an application for bankruptcy within 15 days from the date it receives the application.

However, in practice, PRC courts usually take a long time (months or years) to take bankruptcy applications.

# Effect of Process

## Does debtor remain in possession with continuation of incumbent management control?

**Dissolution proceedings**

The company will be under the control of the liquidation group, which usually consists of the incumbent management.

**Bankruptcy proceedings**

Generally, the company will be under the control of the administrator. However, during the revival proceedings, the debtor may, through its application and upon approval by the court, manage its assets and business operations on its own under the administrator's supervision.

## What is the stay/moratorium regime (if any)? Is the stay or moratorium worldwide?

**Dissolution proceedings**

During the declaration period, when the creditors declare their rights to the liquidation group, the liquidation group will not settle any creditor rights.

Yes, the stay/moratorium is worldwide.

**Bankruptcy proceedings**

Upon the acceptance of a bankruptcy application by the court, an automatic stay will be triggered in the following respects:

Payment of debts made by the debtor to some of the creditors will be invalid.

Any preservation measures of the debtor's assets will be discontinued and enforcement of the debtor's assets will be suspended.

All commenced and pending litigation or arbitration proceedings involving the debtor will be suspended. Such proceedings will continue after the administrator has taken over the debtor's assets.

Yes, the stay/moratorium is worldwide.

## Is there a provision for debtor in possession or rescuer financing or superpriority or priming financing?

**Dissolution proceedings**

No.

**Bankruptcy proceedings**

No.

## Can procedure be used to implement a debt-to-equity swap?

**Dissolution proceedings**

No.

**Bankruptcy proceedings**

Yes.

Creditor rights can be converted into equity during the revival or settlement proceedings.

## Are third party releases available?

**Dissolution proceedings**

No.

**Bankruptcy proceedings**

This is not applicable under bankruptcy liquidation proceedings. In bankruptcy settlement and revival processes, however, third-party releases may be available upon the consent of creditors.

## Are the proceedings recognised abroad?

**Dissolution proceedings**

This would depend on where the recognition is sought.

**Bankruptcy proceedings**

This depends on the regimes abroad.

## Has the UNCITRAL Model Law been adopted?

**Dissolution proceedings**

No.

**Bankruptcy proceedings**

No.

## Can a debtor continue to carry on business during insolvency proceedings?

**Dissolution proceedings**

A debtor continues to exist but cannot carry on any new business unconnected to the liquidation.

**Bankruptcy proceedings**

The creditors' meeting can decide whether the debtor can continue or must discontinue its business operations. Before the first creditors' meeting is held, the administrator, subject to approval by the court, can make the decision.

# Other Factors

## Are there any wrongful or insolvent trading restrictions and what is the directors' liability?

**Dissolution proceedings**

N/A

That said, there are detailed provisions under PRC company law. However, PRC company law clarifies that any member of a liquidation group who causes loss to the company or any of its creditors, either intentionally or due to gross negligence, is liable to compensate the affected party.

**Bankruptcy proceedings**

N/A

That said, where the debtor trades at zero price or an unreasonably low price, or provides property security to unsecured debts, pays off undue debts or abdicates debts owed to it within one year before the court accepts the application for bankruptcy, an administrator will have the right to request that the court nullify such acts. In addition, if a debtor commits such acts, harming the interests of its creditors, the legal representative of the debtor and the person who is directly responsible will bear liability for compensation.

## What is the order of priority of claims?

**Dissolution proceedings**

Claims shall be paid off in the following order:

Liquidation expenses

Wages of employees

Social insurance premiums and legal indemnities

Outstanding taxes

The debts of the company

After paying off the above claims, the remaining properties of the company will be distributed among the shareholders.

If any claims cannot be fully discharged, it shall turn into a bankruptcy proceeding.

**Bankruptcy proceedings**

After having discharged all the security interests created over its assets, the insolvent company's assets will be applied to settle the claims in the following sequence:

Bankruptcy expenses and collective debts using the company's assets

Wages, medical subsidies, disability subsidies and compensation owed to employees by the company and any other compensation required to be paid to employees pursuant to laws and administrative regulations

Social security expenses other than those mentioned in the preceding item as owed by the company to social security funds and unpaid taxes of the company

Normal unsecured creditor claims

## Do pension liabilities have any priority over other unsecured claims?

**Dissolution proceedings**

Yes. See the order of priority of claims above.

**Bankruptcy proceedings**

Yes. See the order of priority of claims above.

## Is it possible to challenge prior transactions?

**Dissolution proceedings**

Yes, contract law rules and principles apply. For example, under the PRC Civil Code, a contract will be null and void under any of the following circumstances:

The contract violates the compulsory provisions of laws and administrative regulations.

The contract goes against public order and good morals.

The contract is executed based on malicious collusion to damage the legitimate interests of a third party.

The contract is executed based on the false expression of intent.

**Bankruptcy proceedings**

Besides grounds under contract law, the administrator has the right to apply to the court to invalidate the following acts if the act involving the debtor's assets was committed within one year before the court accepted the bankruptcy application:

Uncompensated transfers of assets

Transactions executed at clearly unreasonable prices

Charge of assets as collateral for nonsecured debts

Prepayment of debts that are not due

Any waiver of creditor rights

If the debtor is unable to repay its due debts and its assets are insufficient for the settlement of all debts, or where it is clearly insolvent but still makes a debt payment to any individual creditor during the six months before the court accepted the bankruptcy application, the administrator has the right to apply to the court to declare the act invalid, unless any such debt settlement is for the benefit of the debtor's assets.

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