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# A Study on the Protection of the Creditors' Interests in the Corporate Reorganization: Pursuing the Balance Between the Interests of the Creditors and Others

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# 회사정리에 있어서의 채권자 이익 보호에 관한 연구

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**A STUDY ON THE PROTECTION OF THE CREDITORS' INTERESTS IN THE CORPORATE REORGANIZATION: PURSUING THE BALANCE BETWEEN THE INTERESTS OF THE CREDITORS AND OTHERS**

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## ABSTRACT

As business failure is the universal feature of competitive markets, effective insolvency and creditor rights systems are the fundamental building blocks of sustainable development. While there are a wide variety of national insolvency regimes, all effective systems provide clear proceedings to manage financial distress, facilitate predictable risk sharing and establish a binding, collective proceeding to maximize the value of a firm's assets, whether as a going concern or in liquidation. The existence of such a framework facilitates access to credit and underpins contract enforcement. Hence, effective insolvency and creditor rights systems are important to both domestic and international investors and creditors, and are crucial to reducing the risks of financial instability and handling financial crises when they occur.

Since the 1970s a great reformation has sprung up in the field of the Bankruptcy Law. United States, France, England, Germany and other western countries established new bankruptcy laws to replace the old ones, or amended the old ones boldly in succession. The core of this bankruptcy law reformation is establishing

and consummating the reorganization system. The reorganization system, as one of the important bankruptcy systems juxtaposing the bankruptcy liquidation system and the bankruptcy reconciliation system, is a preventive system that tries to help the debtors actively and urge them to revive. The emergence of the reorganization system indicates that the system itself changes from the liquidating model to the reconstructive model. Just because the new system can make up the shortcomings of the traditional bankruptcy system, people bestow quite effective estimates upon it.

But any legal system cannot absolutely balance the interests of all parties, so neither does the reorganization system. For example, in the system there are conflicts between the value of keeping the social interests by urging the debtors to revive and the aim of protecting the creditors' interests. On one side, the debtors certainly hope to postpone and decrease their debts in order to abate their financial burden and reorganize their corporations as soon as possible; on the other side, the creditors also hope to receive sufficient compensations early. So, can such conflicts be conciliated? How can we conciliate them? With these questions I want to discuss the creditors' interests and the protective methods with regard to their interests during the course of the corporate reorganization.

Chapter Ⅰ talks about the evolution of the bankruptcy law and points out the change of the value of the bankruptcy law system. The reorganization system is a certain outcome with the development of the bankruptcy law. When the liquidation system or the reconciliation system cannot resolve the problem of the debtors' debts felicitously, the reorganization system is devised. It is a new approach to

protect the creditors' interests and rights. Only with a successful reorganization can the creditors acquire enough indemnity. However, with the development of the society, we have to pay more attention to the social interests and other similar things besides the creditors' interests. So in my this dissertation I want to expatiate that the development of the reorganization system cannot deviate from the protection of the creditors' interests because that only by protecting the creditors' interests can the reorganization plan get the creditors' assistance and can the purpose of the reorganization plan be achieved.

Chapter Ⅱ discusses the theoretical foundation of protecting the creditors' interests during the course of corporate reorganization. This dissertation considers that the theoretical foundation should be the Interests Balance Principle. This chapter discusses 3 aspects: 1) the basic point of the balance—the confirmation of the reorganization claims; 2) the necessity of the interests balance and; 3) the possibility of achieving the interests balance.

Chapter Ⅲ demonstrates the exterior balance between the creditors and the reorganization proceedings. As to the startup mechanism of the reorganization proceedings, the most important thing for us to know is how to put the corporation with the necessity and the possibility of the reorganization into the reorganization proceedings, and how to exclude the corporation with no hope to revive. The startup mechanism is the first phase to protect the creditors' interests, and this phase is also the most important and significant one. If we are off our guard at this phase, maybe there will be a lot of future trouble and the creditor will come a howler.

Then the dissertation discusses the important problems about the supervisory mechanism of the reorganization proceedings, such as: 1) the legal position, the rights and the restrictions of the business institution during the course of reorganization; 2) the significance of the supervisory institution and its authority and; 3) the foundation and the authority of the creditors' self-government institution. As to the core of the reorganization proceedings—the reorganization plan, the establishment and enforcement of the reorganization plan are the things that impact the creditors' interest the most. So the proceedings of establishing should be exoteric and transparent, and the content of the plan should incarnate the creditors' will. To achieve such purposes, the reorganization plan should be up to the best interests of the creditors' principle, the fair play principle and the utterly priority principle. And the reorganization laws should also use the interest balance principle to conciliate the interest conflicts among the different creditors.

Chapter Ⅳ discusses the interior balance among the creditors. In the corporate reorganization, there are a lot of conflicts not only between the creditors and other interested parties, but also among the creditors in the interior. Every creditor has the motivation to be discharged fully and on time. Thus the reorganization laws and regulations also have to conciliate the interests conflicts among the different sorts of creditors. In my opinion, the automatic stay system and the right of rescission are both systems of protecting the creditors' interests equally and show the adjustment and balance to the whole creditors and to the individual creditor.

Chapter Ⅴ introduces the Korean reorganization system. On March 21, 2005, the Korean government finally promulgated the examined draft and named it as the

"Act on Rehabilitation and Bankruptcy of Debtors," and the original three insolvency laws were all combined into one. This new unified law has come into practice on April 1, 2006. After introducing the evolution of the Korean reorganization system in brief, the outstanding points of this new enacted law are introduced one by one.

Chapter Ⅵ reviews the corporate reorganization system in China's mainland. Strictly speaking, there was no modern corporate reorganization system until the amended the People's Republic of China, Enterprise Bankruptcy Law of August 27, 2006. The reorganization system in this fresh amended law has great significance both in the theoretical and the practical sense.

Finally, chapter Ⅶ ingeminates that since the reorganization system appeared, the problems such as how to go along with an effective reorganization and how to ensure the successful reorganization have always been the jurisprudents' purposes, and the creditors' best hopes at the same time. The purpose of the reorganization system is promoting the debtors to revive and then the interests of the society can also be maintained. This kind of purpose shows the modern society is intervening in the economy with its public power, but "public intervention" has to be restricted within a certain boundary—that means, the creditors' interests should not be damaged. Therefore, the development of the reorganization system cannot deviate from the protection of the creditors' interests. I hope and deeply believe that the reorganization system will surely take root in China and thrive in the future!

# Ⅰ. INTRODUCTION

## A. OVERVIEW

When we look back on the history of the bankruptcy legal system, it is not difficult for us to find that during the expanse of time the value of the bankruptcy legislation has experienced much evolution. At the very beginning, the absolute protectionism to the creditors was executed, and then the debtors' interests were given the same attention as the creditors'; In final, the social interests were thought of an uppermost value object. There were scholars who called the evolution as "from compulsive to voluntary and to politic bankruptcy,"[1] and scholars who generalized the process as "from liquidation to reorganization,"[2] and also ones who differentiated the bankruptcy into liquidation mode and reconstruction mode.[3] Undoubtedly, the evolution of the value of the bankruptcy legislation is a certain outcome of the development of the social economy and it represents the progress of the bankruptcy system while on the other side it also shows the creditor's status

[1] Cui Zhiyuan, "Meiguo Pochanfa Di 11 Zhang de Lishi Yanjin ji Lilun Yiyi [the Historical Evolution and Academic Significance of the Chapter 11 of the American Bankruptcy Code]," Jingji Shehui Tizhi Bijiao Vol. 1 [Comparison of Economic and Social System], Zhongguo Jingji Shehui Tizhi Bijiao Zazhishe [Comparison of Economic and Social System Periodical Press of China] (1996), at 33.

[2] Luo Jianxun, 「Gongsi Ruhe Chongzheng」 [How do the Company Reorganize], Zhongguo Taibei YongRan Wenhua Chuban Gufen Youxian Gongsi [YongRan Cultrue Ltd. of Taibei, China] (1994), at 40.

[3] Yu Shui, "Riben Daochan Fazhi de Xianzhuang yu Keti [the Actuality and Problem of the Japanese Insolvency Law]," (translation) Waiguofa Yiping Vol. 2 [Translation and Comment on the Foreign Laws], Zhongguo Shehui Kexue Chubanshe [China Social Science Press] (1995), at 53.

gets gradually weaker.

Since the bankruptcy system was born, different countries have experienced different changes at different periods, some even at the same period. In general, according to the line of bankruptcy exemption system, there are two stages during the evolution of the bankruptcy law. Before the bankruptcy exemption system the important point of the bankruptcy legislation was how to protect the creditors' claims, and at that time the bankruptcy system existed completely just as the tool of executing the creditors' claims.[4] Although the debtors' status improved continually, it was impossible for them to get remedied and their interests taken into account by the bankruptcy proceedings. In order to prevent the priority of execution of several claims and realize the fair distribution, the creditors' desires were the main force of urging bankruptcy at that time. After the bankruptcy exemption system appeared, it became a strong impetus of natural persons to bankrupt because of the exemption system could bring benefits to the debtors. And also with the establishment of the free property system and the voluntary bankruptcy system,[5] the center of the bankruptcy law began to incline to the debtors and the attention to the debtors' interest became one of the valuable objects of the bankruptcy law. As to the corporations, when the investors' limited liabilities were confirmed by the law, the regulations of the limited liabilities were put into practice, instead of using the bankruptcy proceedings to achieve the exemption interests. Under such circumstance the debtor had scarcely any motivation to start the bankruptcy

[4] Douglas G. Baird & Thomas H. Jackson, 「Cases, Problems, and Materials on Bankruptcy」 Little, Brown and Company (1985), at 22~23.

[5] The article of the "voluntary bankruptcy system" was first regulated in the Bankruptcy Law that the U.S. Congress passed in 1841.

proceedings and he could go ahead with his business according to the “limited liability” without any worries. Even the corporation was close to the bankruptcy while the creditors had to be up against the truth of having no assets to be distributed. Thus at the same time of distributing the debtor’s limited assets, affording the optional bankruptcy prevention system to the debtors who have hopes to revive has become one object of the bankruptcy legislation. The emergence of the reorganization system is just the outcome that the bankruptcy law pursues. This new system considers not only the interests of the creditors and the debtors, but also all the subjects’ interests that might be affected by the debtor’s bankruptcy. This also offers the institutional support for the social interests. Its emergence makes the valuable objects of the bankruptcy law appear multiplex. Different countries and regions have their different legislation modes. There are altogether three legislation modes in the world now: a) the reorganization system is regulated in the company law, such as England before 1986 and Taiwan of China; b) the reorganization system is regulated in the bankruptcy law, such as America and England after 1986 and c) the reorganization law is enacted separate, such as Japan.

## B. BRIEF INTRODUCTIONS TO DIFFERENT COUNTRIES

### 1. ENGLAND

England is the motherland of the reorganization system. The reorganization

system was first established in Company Law in 1929, and when the law was amended again in 1948 the Arrangement and Reconstruction was formally radicated.[6] After the Cork Report of 1982 and the Insolvency Act of 1986, the natural person's bankruptcy in the bankruptcy law and the corporate bankruptcy in the company law were combined and the reorganization system was established. According to the Insolvency Act, there are four choices for the corporation in mess: a) receivership; b) administrative receivership; c) company voluntary arrangement and d) administration. The administration proceedings are similar to the reorganization proceedings the most. The receivership proceedings and the administrative receivership proceedings can both be considered as liquidation proceedings and the company voluntary arrangement proceedings are informal proceedings like the conciliation even more. The administration proceedings make the administrator manage the corporation in behalf of the creditors with unsecured claims and the corporation itself, prevents the creditors from executing the corporate assets by force, restricts the creditors with secured claims to execute the security interest and urges the corporation improve its management in order to revive. British scholars also consider the administration proceedings the same as the Bankruptcy Code 11 of USA.[7]

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[6] Yuan Kunxiang,「Gongsi Chongzheng Zhidu zhi Bijiao Yanjiu」[A Comparative Study on the Corporation Reorganization System], Zhongguo Taibei SanMin Shudian [SanMin Bookstore of Taibei, China] (1984), at 1~6.

[7] Edward Bailey, Hugo Groves, Cormac Smith,「Corporate Insolvency: Law and Practice,」London: Butterworths (2001), at 119.

## 2. UNITED STATES

United States is the first country that regulated the reorganization system by numbers and the reorganization system in the U.S. is most advanced and perfect in the world to date. The reorganization system first existed in the Equity Receivership.[8] Although the article 12 of the Bankruptcy Act of 1898[9] was called "composition," it was only applied to solve the simple dissensions. When the corporations with complex capital structure could not discharge their debts, especially the railway corporation and the public utility at that time, there would be large influence to the society if the bankruptcy statutes were applied. Therefore, the equity court offered the license of setting the assets administrator to those corporations. They could save the corporations from bankruptcy and maintain their business at the same time. But the proceedings cost much time and money and the court could not constrain those creditors with objection. The Congress of the United States added Code 8 "Debtor's Relief Act"(Article 77) to the bankruptcy law in 1933 and Article 77B "Corporate Reorganization" in 1934.[10] Thus the reorganization system became an important part of the bankruptcy law formally. In 1938 the Congress amended the bankruptcy law roundly and passed the Chandler

[8] Li Yongjun,「Pochan Chongzheng Zhidu Yanjiu」[A Research on the Reorganization System], Zhongguo Renmin Gong'an Dxue Chubanshe [Chinese People's Republic Security University Press] (1996), at 17.

[9] The Bankruptcy Act of 1898 ("Nelson Act", July 1, 1898, ch. 541, 30 Stat. 544) was the first United States Act of Congress involving Bankruptcy that gave companies an option of being protected from creditors. Previous attempts at federal bankruptcy laws had lasted at most a few years. *See*, for the Bankruptcy Act of 1898, David A. Skeel, Jr.,「Debt's Dominion: A History of Bankruptcy Law in America」, Princeton University Press (2001).

[10] *Ibid* at 18.

Act. This act extended to Article 77B to Bankruptcy Code 10 “Corporate Reorganization”(mainly for the big public issued corporations) and amended Code 11 “Arrangement”(mainly for the small closed enterprises, such as corporations, partnerships and individuals) and Code 12 “Real Property Arrangements by Persons Other Than Corporations.” The Congress founded the Bankruptcy Law Committee in 1970 and passed the again amended Bankruptcy Law in 1978—that is the Federal Bankruptcy Reform Act of 1978.[11] The most important and essential amendment is the combination of the quondam Code 8, Code 10, Code 11 and Code 12 into the new Code 11. Code 11 became a unitive “reorganization system” and it can be applied by the natural person, the corporation and the partnership. Debtors or other relevant people need not choose the Code 10 or 11 any more and different types of creditors’ interests can be balanced better. The application proceedings are simple and convenient and the conversion between the proceedings are quite flexible. In this sense the reorganization system of the United States is thought of a typical representative and affects other countries’ legislation to a large

[11] The Bankruptcy Reform Act of 1978 (Pub. L. 95-598, 92 Stat. 2549, November 6, 1978) is a United States Act of Congress regulating Bankruptcy. The current Bankruptcy Code was enacted in 1978 by § 101 of the Act which generally became effective on October 1, 1979. The current Code completely replaced the former Bankruptcy Act of 1898, sometimes called the “Nelson Act” (Act of July 1, 1898, ch 541, 30 Stat. 544).

However, the most comprehensive piece of bankruptcy legislation since the 1978 Act, the Bankruptcy Reform Act of 1994 (Public Law 103-394, October 22, 1994) was signed into law by President Clinton on October 22 1994. The 1994 Act contains many provisions, for both business and consumer bankruptcy, including: provisions to expedite bankruptcy proceedings; provisions to encourage individual debtors to use Chapter 13 to reschedule their debts rather than use Chapter 7 to liquidate; provisions to aid creditors in recovering claims against bankruptcy estates; creation of a National Bankruptcy Commission to investigate further changes in bankruptcy law; ect. In November 1997, the National Bankruptcy Review Commission completed an extensive and detailed report on bankruptcy reform. Most recently, President George W. Bush signed on April 19, 2005 the Bankruptcy Abuse Prevention and Consumer Pretection Act(BAPCA) of 2005 into law. The BAPCA became effective on October 17, 2005.

extent.

### 3. FRANCE

The real modern bankruptcy system in France originated from the bankruptcy regulations specifically written in the Code of Mercantile Law of 1807. Through several amendments the judicial liquidation system was finally set up in 1889 as the assistant bankruptcy proceedings. But the reorganization system has been all long regulated in the Code of Mercantile Law until the bankruptcy law reformation of 1967. The bankruptcy law of 1967 regulated a series of measures that availed to the enterprise reorganization. If there was a possibility for the enterprise to revive the suspense proceedings and the judicial reorganization proceedings could be applied.[12] The bankruptcy law of 1967 strengthened the power of the judges and the inquisitors. But there were no preventive proceedings in this law and the time of the suspense proceedings were too short for considering whether there was a possibility of resuscitation. Then the No. 148 statute in 1984 and the No. 98（loi 85-du 25 janvier 1985, le redressement et la liquidation judiciaire des entreprises）, No. 99 statute in 1985 improved the bankruptcy law further. The Article 1 of the No. 98 statute made clear the purpose—rescue the enterprise, maintain the management and discharge the debts—of this statute from the very beginning. The prepositive reorganization proceedings and the preferential social interests are two

[12] Shen Daming & Zheng Shujun,「Bijiao Pochanfa Chulun」[An Introduction on the Comparative Bankruptcy Law], Zhongguo Duiwai Maoyi Jiaoyu Chubanshe [International Business Education Press of China] (1993), at 215.

material breakthroughs in system.

### 4. JAPAN

The Corporation Regeneration Law of 1952 is the representative of the reorganization system in Japan now. In order to attract the foreign capital, the Corporate Reorganization Law was established in 1952 after the World War Ⅱ, imitating the reorganization system of the Bankruptcy Law the United States.[13] But this law laid particular stress on the proceedings and it lacked entitative regulations, especially those of protecting the enterprises to go on with their business during the reorganization period. The Japanese Congress passed the Civil Rehabilitation Law in 1999 based on the deteriorating economy and amended it in 2000. Although it was originally planned for the middle or small-sized enterprises, many big-sized enterprises even prefer this law because of its simple proceedings and strong reconstruction measure. As to the corporate reorganization the regeneration proceedings and the rehabilitation proceedings are coordinate proceedings in Japan now.

### 5. TAIWAN DISTRICT OF CHINA

In 1960, the Taiwan TangRong Ironworks Ltd. (the biggest ironworks in Taiwan)

[13] Li Yongjun,「Pochan Chongzheng Zhidu Yanjiu」[A Research on the Reorganization System], Zhongguo Renmin Gong'an Dxue Chubanshe [Chinese People's Republic Security University Press] (1996), at 17.

wanted to borrow money from the financial institution because of its difficult business status, only receiving the refusal. Later TangRong asked the local government for help. Since there were no regulations about the corporate reorganization then the government had to quote the General Mobilization Statute and enacted the Significant Manufacture Enterprise Rescue Statute to solve this case.[14] The Rescue Statute regulated that "when the corporations dealing with the important manufacture or traffic whose productions or services are necessary interiorly or surely have their markets overseas have the possibility of shutdown while they still have their reorganization values, they can ask for the rescue to the administration office." The local government then enacted the corporate reorganization system as Code 5 Section 10 of the Company Law in 1966 and amended it again in 1970.[15] The latest amendment was in the November 2001.

### 6. KOREA

The regulations about the corporate reorganization originally emerged in the article of the old Commercial Law.[16] According to the old Commercial Law, the reorganization plan has to achieve the agreements of all the creditors and the

[14] Li Yongjun,「Pochan Chongzheng Zhidu Yanjiu」[A Research on the Reorganization System], Zhongguo Renmin Gong'an Daxue Chubanshe [Chinese People's Republic Security University Press] (1996), at 16.

[15] Huang Chuankou, "Gongsi Chongzheng zhi Yanjiu [A Study on the Corporate Reorganizaiton]," Mingzhuan Xuebao, Vol. 25 [MingZhuan Study Journal], Mingzhuan Xuebao Zazhishe [MingZhuan Periodical Press] (1988), at 6.

[16] Xu Changrong, "An Analysis on the Legal Tropism of the Corporate Reorganization System," http://www.deheng.com.cn/asp/PAPER/html/200552415481512.htm (last visited on May 26, 2007). The old Commercial Law which was the effective Japanese law in Korea under the rule of the Japanese Imperialism had been in effect in Korea until the year of 1962 when the Korean government enacted the Korean Commercial Code.

variation of the reorganization institution has to abide by the common regulations of the company law. But in practice, the consequent operations are quite inconvenient because of the imperfect procedural regulations and the circumstances of the debtors' abusing of the reorganization proceedings in order to postpone their debts are quite frequently seen. Therefore, the legislators thought that it was very necessary to enact special laws and regulations to rescue the enterprises additionally. The contents about the corporate reorganization were deleted from the commercial law when the commercial code proposal was examined in 1961.[17] Basically speaking, the insolvency law system consists of three laws: the Bankruptcy Act, the Composition Act, and the Corporate Reorganization Act.[18] These three basic insolvency laws were enacted in 1962 and have been modified several times to reflect the reality of the Korean economy. However, these basic insolvency laws have received a lot of criticisms. Among all the amendments, the one carried through by the Korean government after accepting the recommendation of the International Monetary Fund (the "IMF") to modify the outdated insolvency laws during the period of economic crisis was quite outstanding. The IMF and the World Bank requested the Korean government to modify and complete the insolvency laws at the same time of offering the support of foreign exchange.[19] The material change has appeared in the Korean corporate reorganization laws at the aspect of the substantial rules and the setup of the

[17] Korean government enacted the Korean Commercial Code in January 20, 1962 as act number of 1000.
[18] Yong Seok Park, "Unified Insolvency Law of Korea," Journal of Korean Law, Vol. 3, No. 2 (2003), at 163, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=652881 (last visited on May 25, 2007).
[19] *Ibid.*

reorganization institutions through the amendments of 1998 and 1999. But the amendments as to the corporate reorganization laws after the financial crisis have always been proceeded. On March 31, 2005 the Korean government finally promulgated the examined draft and named it as the Act on Rehabilitation and Bankruptcy of Debtors,[20] and the original three insolvency laws were all combined into one. This new unified law has come into force on April 1, 2006.[21]

## C. REVIEW

Although the reorganization systems in different countries and regions have their own histories their emergences and developments are joined with big-sized enterprises closely. The big-sized enterprises are the foundation of the economy in one country and once they have the possibility of insolvency, not only the creditors, the shareholders but also the social economy will be affected. Establishing the reorganization and rescuing the enterprises in a predicament are paid attention by different countries and accord with the trend of the reform and development of the modern bankruptcy law.

The reorganization system and the conciliation system before it shake the traditional bankruptcy and cause the historic change of it. They initiate a new way of reconstruction of the enterprise in a mess on the premise of discharging the debts

[20] It is also called the Unified Insolvency Law in Korea.
[21] Dong Woo Seo & Hong Kee Kim, "the Asia-Pacific Restructuring and Insolvency Guide 2006--Republic of Korea," at 98, www.adb.org/Documents/Guidelines/restructuring-insolvency/chap4-8.pdf (last visited on May 25, 2007).

fairly. If we compare the conciliation system is the first revolution to the traditional bankruptcy, then the reorganization system is the second one. But the conciliation mainly pays attention to the adjustment of the creditors and the debtors and the conciliation agreement is only a plan to discharge without the items relating to the debtor's internal affairs. Thus, the simple conciliation system only takes the temporary solution and works restrictedly at the points of preventing the bankruptcy and rescuing the enterprise. Differently, the reorganization system gets over the limitation of the conciliation. It is an active system and rescues the debtors actively by adjusting the debtor's internal affairs and improving the management. There are other differences between these two systems although they are both the denials against the traditional bankruptcy:[22] a) different intentions. Besides the same purpose of preventing the debtor's bankruptcy, the conciliation system doesn't care about the debtor's fate subjectively and it is only the external result if the debtor can survive after the conciliation agreement. The reorganization system goes deep into the enterprise and takes the effective methods to reorganize the enterprise actively. Urging the enterprise to revive is also the purpose of the reorganization system. b) different objects. The corporation, the partnership, the person and so on can all apply the conciliation system but in many countries (except United States) the object of the reorganization system is restricted within the corporations. c) different proposers. As to the conciliation system, many countries regulate that only the debtor can be the proposer but the creditor, the

[22] Anonymity, "The Reorganization System, the Reconciliation System and the Liquidation System," http://www.goodlawyer.cn/fbbs/dispbbs.asp?boardID=4&ID=45867&page=6 (last visited on June 17, 2007).

shareholder or the directorate can propose all the reorganization application besides the debtor in the reorganization proceedings. d) different causes of the proceedings. Comparing with the conciliation, the cause of the reorganization is broader. This means besides the bankruptcy cause, if there is any danger or possibility of being incapable of paying the reorganization proceedings can also be started up. e) different effectiveness. The effectiveness of the reorganization proceedings is higher than the conciliation's. Once the court rules the reorganization all other proceedings such as bankruptcy, conciliation and forcible execution should stop. The conciliation agreement confirmed by the court cannot prevent the creditors with secured claims or priority yet, while all the creditors should obey the reorganization proceedings once the proceedings are started up.

The reorganization system considers not only the interests of the creditors and the debtors but also all the interests subjects that maybe affected by the debtor's bankruptcy and offers the institutional support to the social interests. Its emergence makes the valuable objects of the bankruptcy law appear multiplex. Harmonizing the conflicts among the multiplex valuable objects is a difficult problem of the bankruptcy law. Once the reorganization proceedings are started up the automatic stay system will postpone the debts and give the debtor opportunity to survive. But in practice the reorganization system has been the debtor's tool to prevent the creditor from executing separately to some extent and the debtors have even more positivity than the creditors. There were altogether more than 1.43 million bankruptcy petition cases (includes the cases filed according to the Code 7 and

Code 11) in America in 1998 and there were only 847 cases filed by the creditors.[23] It is quite clear that there is conflict between the valuable object of the reorganization system and the protection of the creditors' interests.

In my opinion, the valuable object of the reorganization system of urging the debtors to revive in order to maintain the social interest and the protection of the creditors' interest will certainly conflict. The debtors hope to stay and decrease the expenses of the reorganization claims and achieve the success of the reorganization. On the other hand, creditors hope their reorganization claims can be discharged adequately as soon as possible lest they suffer the loss due to the partial release or delayed performance. However, such conflict can be conciliated since with only the protection of the creditors' interests can we get the creditors' assistance and then achieve the object of the reorganization; Also, and only with a successful reorganization can the creditors gain sufficient protection. What the reorganization system is seeking for is not the balance between the creditors and the debtors, but the new balance aiding the social power. Maintainting the equilibrium of the three-dimensional forces has become the arduous work of the reorganization legislation now. This dissertation discusses how the legislation should protect the creditors' interests based on such point.

[23] David S. Kennedy, James E. Bailey, Ⅲ, R. Spencer Clift, Ⅲ, "The Involuntary Bankruptcy Process: A Study of The Relevant Statutory and Procedural Provisions and Related Matters," 31 University of Memphis Law Review 1 (2000), at 3.

# Ⅱ. THE THEORETICAL FOUNDATION OF THE INTERESTS BALANCE

## A. OVERVIEW

The multiplex value objects of the reorganization system make the interests (such as the creditors' interests, the debtors' interests and the social interests) coexist during the whole process. All the parties have conflicting interests with each other while they have unanimous interests sometimes. They can achieve their purposes if the reorganization is successful, but they will certainly lose their money if the reorganization is aborted. The creditors are always at a disadvantage in the reorganization process relative to other interest subjects and their interests are most easily infringed upon. Therefore, the protection of the creditors' interests should be considered well during the course of system designing, instead of being remedied after the probable abortive reorganization.

One of the main effects of the law is adjusting and conciliating the conflicting interests of the various sides.[24] And it is wrong to lean to one side or ignore it excessively. In the course of corporate reorganization system designing, the creditors' interests also should be protected while the other subjects' interests cannot be ignored. The principle of conciliating the conflicting interests between

[24] Edgar Bodenheimer (translated by Deng Zhenglai & Ji Jingwu), Jurisprudence:「the Philosophy and Method of the Law」 Huaxia Chubanshe [Huaxia Press] (1987), at 383.

the reorganization creditors and the other interest subjects is balancing the interests. In this sense, the academic foundation of protecting the reorganization creditors is balancing the interests. Therefore, this chapter mainly expatiates on the protection of the creditors' interests during the course of corporate reorganization in the following aspects: confirming the reorganization claims; the interest conflicts among the reorganization creditors and the other interest subjects; the necessity and the feasibility of balancing the interests.

## B. BASIC POINTS: CONFIRMING THE REORGANIZATION CLAIMS

### 1. THE REORGANIZATION CLAIMS

The reorganization law combines the characteristic of both the procedural law and the substantial law.[25] Thus, in the aspect of the formal sense the reorganization claims mean those property claims declared and executed according to the reorganization proceedings and in the aspect of the essential sense the reorganization claims mean those property claims against the debtor before the reorganization ruling. At the point of legislation the latter conception is generally adopted.[26]

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[25] Li Yongjun,「Pochan Chongzheng Zhidu Yanjiu」[A Research on the Reorganization System], Zhongguo Renmin Gong'an Dxue Chubanshe [Chinese People's Republic Security University Press] (1996), at 157.

[26] *See* the Japanese Corporation Regeneration Law, Article 102: "the reorganization claims refer to

The reorganization claims of the essential sense include these significations hereinafter:[27] a) the reorganization claims occur before the reorganization ruling. Actually, this means that the cause of the claim occurs before the ruling without reference to whether the claim has gone into effect when the reorganization proceedings start. So the claims with time limit or condition are all reorganization ones and generally those occur after the reorganization ruling are not. But as the exception, the law also considers that some claims occurring after the reorganization ruling as reorganization claims in order to show the justice, such as claims caused by the well-meaning payment of the drawee or accepter who do not know the fact of the reorganization of the remitter or the endorser;[28] b) the reorganization claims are property claims. That means they are claims that are expressed directly or can be measured by money; c) the reorganization claims are protected by law and can be executed forcibly. Repealed claims, null claims, claims caused by illegal reasons and claims whose subject matters are forbidden to execute are not reorganization claims. As to the claims that exceed the limitation of actions, there are several opinions. Some scholars consider that the creditor can still get the refund before the debtor's deraignment and the claim can be declared as reorganization claim; some scholars consider that the claim will be rejected to pay at the time of examination because it has exceeded the limitation of actions and

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those property claims to the corporations on the basis of the reasons prior to the startup of the reorganization proceedings."

[27] Li Yongjun,「Pochan Chongzheng Zhidu Yanjiu」[A Research on the Reorganization System], Zhongguo Renmin Gong'an Dxue Chubanshe [Chinese People's Republic Security University Press] (1996), at 158~161.

[28] *See* the Japanese Corporation Regeneration Law, Article 105. Quoted from: Li Yongjun,「Pochan Chongzheng Zhidu Yanjiu」[A Research on the Reorganization System], Zhongguo Renmin Gong'an Dxue Chubanshe [Chinese People's Republic Security University Press] (1996), at 160.

thus it cannot be thought of as reorganization claim.[29] I consider that such claims have lost the right of being protected by law and can't be classified as reorganization claims. It is almost an imposition to the debtor if we admit such claims as reorganization claims because the debtor already does not have the legal obligation of performing.

Since reorganization claims are restricted to claims occurring before the reorganization ruling, how should we treat those expenses and debts that are for the common interests of the whole creditors and the shareholders after the reorganization ruling? The Japanese Corporation Regeneration Law calls them "the common claims"[30] and the Company Act of Taiwan District of China calls them "the reorganization liabilities"[31] while the Federal Bankruptcy Reform Act of the United States calls them "the administrative expenses."[32] But the German Insolvency Law (Insolvenzordnung) advances the conceptions of "the proceedings

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[29] Chen Zongrong,「Pochan Fa」[the Bankruptcy Law], Zhongguo Taiwan SanMin Shuju [SanMin Press of Taiwan, China] (1986), at 295.

[30] *See* the Japanese Corporation Regeneration Law, Article 208: "The common includes that: (1) the expenses of judgment for the common interests of the reorganization creditors, the person with the reorganization hypothec and the shareholders; (2) the expenses of the corporate business and management after the startup of the reorganization proceedings; (3) the expenses of executing the reorganization plan, but those occur after the termination of the reorganization proceedings are excluded; (4) the rewards, expenses and recompenses that should be paid according to the Article 285 and Article 287; (5) the claims of the administrator or the director of the corporation as to the behavior about the corporate business and properties according to his rights or authorities after the startup of the reorganization proceedings; (6) the claims according to the unjust enrichments or other similar behaviors to the corporation after the startup of the reorganization proceedings; (7) the claims of the relative party when the administrator performs his debts according to the Article 103."

[31] *See* the Company Act of Taiwan District of China, Article 312: "The following debts incurred during the reorganization of the company shall have preference for repayment over the rights of creditors in reorganization: 1.Debts incurred for continued operation of the business of the company; and 2.Expenses incurred in the process of reorganization. The aforesaid right of preference for repayment shall not be prejudiced on account of a ruling for termination of reorganization."

[32] *See* the U.S. Federal Bankruptcy Code, Article 503. The title of it is "§ 503. Allowance of administrative expenses."

expenses" and "the consortium liabilities."[33] Actually the expenses and liabilities that occur after the reorganization ruling are both the obligations of the reorganization corporation and they are both the creditors' rights. It is meaningless for us to distinguish between the expenses and liabilities after the reorganization ruling because the expenses and liabilities at that time are both for the reorganization proceedings and should be treated equally. In my opinion, "the common claims" is a felicitous expression and it can be distinguished from the reorganization claims.

One thing that has to be pointed out is that some claims that occur before the reorganization ruling can also be common claims just as those reorganization claims occurring after the ruling, such as the property-maintaining expenses of the reorganization corporation during the interval of reorganization application and reorganization proceedings which are regulated in the Japanese Corporation Regeneration Law and the Company Act of Taiwan District of China; and the wages owed to employees before the reorganization proceedings which are regulated in the Japanese Corporation Regeneration Law and the French Enterprise Judicial Reorganization and Liquidation Law.[34]

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[33] *See* the German Insolvency Law (Insolvenzordnung), Article 54: "The following shall be deemed costs of the insolvency proceedings: 1. the court fees in respect of the insolvency proceedings; 2. the remuneration earned and the expenses incurred by the temporary insolvency administrator, by the insolvency administrator and by the members of the creditors' committee."

[34] *See Supra* footnote 31 and the Japanese Corporation Regeneration Law, Article 67 and Article 104. Quoted from: Li Yongjun,「Pochan Chongzheng Zhidu Yanjiu」[A Research on the Reorganization System], Zhongguo Renmin Gong'an Dxue Chubanshe [Chinese People's Republic Security University Press] (1996), at 165. And the French Commercial Code, Article L621-32: "Debts legally arising after the decision to commence insolvency proceedings shall be paid when they become due where trading is continued. Where the whole of the undertaking is sold or, if trading is continued, where the debts are not paid on becoming due, they shall be paid with priority over all other debts, whether or not privileged or secured, except the privileged debts specified in Articles L.143-10, L.143-11, L.742-6 and L.751-15 of the Employment Code."

Another related thing worth paying attention to is excluded claims. Such claims are those that are foreclosed out of the reorganization claims. The Japanese Corporation Regeneration Law names them “the subordinated regeneration claims.”[35] The excluded claims can occur before the reorganization ruling, as well as after the ruling and there are mainly these claims hereinafter: a) the interests after the reorganization ruling; b) the expenses for taking part in the reorganization proceedings; c) the compensations for not performing the contract after the reorganization ruling and d) the fines and penalties. They are claims of the public law and will never be the reorganization claims whether they occur before of after the reorganization ruling. According to the Japanese Corporation Regeneration Law, the claims like a), b) and c) can be executed after the whole reorganization and I think the regulation is rational and can be used for reference. Some scholars consider that these claims cannot be executed since the reorganization proceedings have the effectiveness of ending the creditors’ claims. Actually, the new legislations in United States, Germany and Taiwan of China all allow these claims to be executed as subordinated claims.[36]

The reorganization claims can be classified into three categories: the preferential reorganization claims, the secured reorganization claims and the unsecured reorganization claims.

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[35] Nagashima Ohno & Tsunematsu, “Legal issues: Japan,” at 52, http://www.adb.org/Documents/Reports/Restructuring_Asia/Japan.pdf (last visited on June 17, 2007).

[36] Chen Rongzong,「Pochan Fa」[the Bankruptcy Law], Zhongguo Taibei SanMin Shudian [SanMin Bookstore of Taibei, China] (1986), at 295. Quoted from: Li Yongjun,「Pochan Chongzheng Zhidu Yanjiu」[A Research on the Reorganization System], Zhongguo Renmin Gong’an Dxue Chubanshe [Chinese People’s Republic Security University Press] (1996), at 160.

## 2. THE PREFERENTIAL REORGANIZAITON CLAIMS

### 1) Overview

The preferential reorganization claims belong to the priority. We can classify the priorities into different kinds according to the different criteria. For example, they are the ordinary priority (e.g. the priority of the employee's wage and the social insurance) and the special priority (e.g. the priority of the estate construction) according to the objects of the priority; the priority of civil law and the priority of special law (e.g. the vessel priority) or the priority of public law (e.g. the tax priority) and the priority of private law, according to the legal foundation of the priority. The priority system roots in the Roman law. Now the legislations about the priority are not uniform and generally speaking there are two modes in the world. The French Mode admits the priority is an independent right and lists the ordinary priority of the chattel and real property and the special priority of the chattel and real property. Meanwhile the German Mode considers the priority is the effectiveness of particular claims and not an independent right.[37] There is no clear priority system in the Anglo-American law system while some liens contain the matter of the priority such as the landlord's statutory lien and the mechanic's lien. In China the priority hasn't been admitted as an independent right and some

[37] While Japan follows the Germany on other systems it adopts the French Mode on the priority system and admits the independence of the priority. E.g. the Japanese Civil Code, Article 306: "(General Statutory Lien) A person who has a claim that arose from the causes listed below shall have a statutory lien over the entire property of the obligor: (i) Expenses for the common benefit; (ii) An employer-employee relationship; (iii) Funeral expenses; or (iv) The supply of daily necessaries."

regulations about the priority only exist in some special laws and regulations.[38] With the above introduction to the priority I only want to point out that the priority has its own independent meaning in the corporate reorganization proceedings without discussing the character of the priority and the advantages and disadvantages of the priority system. Actually, under the circumstance of enough possession to discharge all the claims there is no interests conflict among the creditors and it is meaningless for the creditors to get refund. But the point is that under the circumstance of the debtor's insolvency some creditors will certainly get little refund and even nothing if the early-come creditors could execute their claims early. Different claims, such as the workers' wages, the social insurances and the national taxes have their own meanings to different creditors and need the special protection by the law. Therefore, it is quite important to establish the discharging sequence of the claims or the priority system in order to realize the justice idea of the law and protect the special creditors at the same time. Then, what are the preferential reorganization claims? Theoretically, the special priorities regulated in

[38] Such as the Security Law, Article 56: "Where a listed company is in one of the following circumstances, the stock exchange shall decide to terminate the listing and trading of its shares: 1. there is a change in the total share capital, equity distribution, etc., of the company and the listing conditions are no longer fulfilled, and still fails to reach the listing conditions within the time limit stipulated by the stock exchange; 2. the company fails to disclose its financial status as required or there are falsehoods in the financial and accounting reports, and the company fails to make correction; 3. the company has suffered continuous losses for the most recent three years, and is unable to become profitable within the subsequent year; 4. the company is dissolved or declared bankrupt; or 5. other circumstances stipulated in the listing rules of the stock exchange."

And the Contract Law, Article 286: "If the employer fails to pay the price as agreed, the contractor may demand that the employer pay within a reasonable period of time. If the employer has not paid the price after the expiration of the time period, the contractor may reach an agreement with him to convert the project into its monetary value or he may apply to a people's court to have the project auctioned off according to law, unless, in light of the nature of the construction project, it is not suited to being converted into its monetary value or auctioned off. The price for the construction project shall be paid on a priority basis from the proceeds of the conversion into its monetary value or the auction."

the substantial laws[39] should all be attributed to the preferential reorganization claims except the common claims. And which claims can be listed into the preferential reorganization claims as the ordinary priorities is a problem worthy of research. It is also the center of the bankruptcy law and the reorganization system. Although different countries have different practices in different periods it is a common way of all the countries to cheat the employees' stipend claims and the national tax claims as the preferential reorganization claims.

**2) The Employees' Stipend Claims**

The equality of the civil law is only the formal equality and it cannot prevent the virtual inequality caused by the civil subjects with different experiences, intelligences, opportunities and social classes. The employees in the enterprises are in the dry tree essentially and their wages affect their basic human needs directly. If the employees' stipend claims are treated the same as other creditors' claims according to the equality principle the employees' money is almost deprived. The employees' stipends are inviolable and should be protected particularly in order to realize the social justice.[40] Establishment of the preferential status of the employees' stipend claims shows the particular protection of the employees of the bankruptcy law.

Certainly, it is impossible for different countries to treat the employees' stipend claims in the same way. The legislation in France admits the absolute priority of the

[39] Such as the priorities listed in *Supra* footnote 38.

[40] Wang Zejian,「Minfa Xueshuo yu Panli Yanjiu」[the Civil Law Theory and the Case Study], Zhongguo Zhengfa Daxue Chubanshe [China University of Police and Law Press] (1998), at 502.

employees' stipend claims, even more preferential than the common claims.[41] The Japanese Corporation Regeneration Law lists this kind of claims into the common claims to be discharged preferentially.[42] And the employees' stipend claims only have the relative priority in Germany, England and America, listing behind the common claims.[43]

In Korea, before 1995, there was the provision of retirement allowance, which was the total amount of retirement allowance that was guaranteed to be paid out in preference to any kind of liabilities, even to the claims secured by pledges or mortgages as to the total property of an employer. But it was adjudged by the Constitutional Court, to be not coincident with the constitution. So it was amended on December 24, 1997. The Constitutional Court judged that guaranteeing total retirement allowance to be paid out would make the financial institutions incapable

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41) *See* The French Commercial Code, Article L621-130: "Claims pursuant to a contract of employment shall be guaranteed in the event of an administrative order or court-ordered winding-up: 1. by the preferential right established under Articles L. 143-10, L. 143-11, L. 742-6 and L. 751-15 of the Employment Code on the grounds and for the amounts defined therein and; 2. by the preferential right established in Article 2101 (4) and Article 2104 (2) of the Civil Code."

42) *See* the Japanese Corporation Regeneration Law, Article 119. Quoted from: Li Yongjun, 「Pochan Chongzheng Zhidu Yanjiu」 [A Research on the Reorganization System], Zhongguo Renmin Gong'an Dxue Chubanshe [Chinese People's Republic Security University Press] (1996), at 164~165.

43) For example, *see* the Bankruptcy Law of Taiwan District, Article 119: "The bankruptcy administrator should prompt the table of the creditors' claims and the table of the assets that regulated in Article 94 at the creditors' meeting, and the administrator should report the status of the bankruptcy proceedings. When the debtor has the conciliation project, the bankruptcy administrator should also prompt it."

The U.K. Insolvency Act, Article 175: "Preferential debts (general provision)

(1) In a winding up the company's preferential debts (within the meaning given by section 386 in Part XII) shall be paid in priority to all other debts.

(2) Preferential debts -

(a) rank equally among themselves after the expenses of the winding up and shall be paid in full, unless the assets are insufficient to meet them, in which case they abate in equal proportions; and

(b) so far as the assets of the company available for payment of general creditors are insufficient to meet them, have priority over the claims of holders of debentures secured by, or holders of, any floating charge created by the company, and shall be paid accordingly out of any property comprised in or subject to that change."

of estimating the asset value of the pledges or mortgages, because they cannot calculate the future value of total retirement allowances which should be counted and excluded first from the price value of the pledges or mortgages. Nowadays, retirement allowance is regulated by Employee's Retirement Allowance Security Act. This Act contains corporate pension. Employees may suffer large losses in retirement allowance in the event of bankruptcy. Since the obligation on firms to reserve the funds for retirement allowances is hard to fulfill, it would be more meaningful to switch from retirement allowance to corporate pension, because corporate pension plans managed by financial institutions should be safer. And the Labor Standards Act of 2007 sets the absolute priority and the relative priority of the employees' stipend claims. It regulates that wages, accident compensation, and other claims arising from employment shall be paid in preference to taxes, public charges, or other claims except for claims secured by pledges or mortgages on the whole property of an employer. But the claims of wages within the last 3 months, and the claims of the accident compensation allowance are considered as those with absolute priority and shall be discharged in preference to any claims.[44)]

There are usually some restrictions to the employees' stipend claims, which means only those stipend claims occurring during the statutory period before the bankruptcy proceedings or the reorganization proceedings can be treated as preferential reorganization claims, otherwise they are ordinary claims. France, Japan, Switzerland and most other countries regulate the statutory period of 6

[44)] *See* the Korean Labor Standards Act (2007), Article 38(1) and (2).

months while England regulates that of 4 months and America 90 days.[45)]

### 3) The National Tax Claims

Tax is the lifeline of one country and the national administration cannot do anything without tax. Compared with other ordinary claims, the subject of the tax claims is the country and the legal foundation of such claims is the public law. Although national tax claims have the advantage of often being forecasted and often being able to avoid adverse situations it doesn't mean that national tax claims shouldn't be one of the preferential reorganization claims. Reversely, most countries admit the priority of the tax claims, even put them to the most preferential statute[46)] because of the character of commonweal of the tax.

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[45)] *See* the U.S. Federal Bankruptcy Code, Article 507 (a) (3): "(3) Third, allowed unsecured claims, but only to the extent of $4,000 for each individual or corporation, as the case may be, earned within 90 days before the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurs first, for—

(A) wages, salaries, or commissions, including vacation, severance, and sick leave pay earned by an individual; or

(B) sales commissions earned by an individual or by a corporation with only 1 employee, acting as an independent contractor in the sale of goods or services for the debtor in the ordinary course of the debtor's business if, and only if, during the 12 months preceding that date, at least 75 percent of the amount that the individual or corporation earned by acting as an independent contractor in the sale of goods or services was earned from the debtor." But the period of 90 days is only applied to the wages; as to the employees' benefit claims the period covers 180 days.

[46)] *See* the U.S. Bankruptcy Reform Act, Article 507 (a) (8): "(8) Eighth, allowed unsecured claims of governmental units, only to the extent that such claims are for—

(A) a tax on or measured by income or gross receipts—

(i) for a taxable year ending on or before the date of the filing of the petition for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition;

(ii) assessed within 240 days, plus any time plus 30 days during which an offer in compromise with respect to such tax that was made within 240 days after such assessment was pending, before the date of the filing of the petition; or

(iii) other than a tax of a kind specified in section 523 (a)(1)(B) or 523 (a)(1)(C) of this title, not assessed before, but assessable, under applicable law or by agreement, after, the commencement of the case;

(B) a property tax assessed before the commencement of the case and last payable without penalty after one year before the date of the filing of the petition;

Theoretically, the governments sometimes lack the motivation to forecast or avoid the risks although they have the abilities since the governments don't suffer the risks and finally they will transfer the risks to the taxpayers.[47] That means the loss of the government in the bankruptcy case will finally become the taxpayers' loss through the way of enhancing the tax. However, the effect on the ordinary social taxpayers is rather little in some sense and the innocent taxpayers will not increase their supervisory degree against the particular debtors or make special efforts to avoid such risks. But if the tax claims are set as the preferential claims, the ordinary creditors' supervisory degree and positivity to prevent the risks will reversely increase and the losing probability of the social claims will decrease

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(C) a tax required to be collected or withheld and for which the debtor is liable in whatever capacity;

(D) an employment tax on a wage, salary, or commission of a kind specified in paragraph (3) of this subsection earned from the debtor before the date of the filing of the petition, whether or not actually paid before such date, for which a return is last due, under applicable law or under any extension, after three years before the date of the filing of the petition;

(E) an excise tax on—

(i) a transaction occurring before the date of the filing of the petition for which a return, if required, is last due, under applicable law or under any extension, after three years before the date of the filing of the petition; or

(ii) if a return is not required, a transaction occurring during the three years immediately preceding the date of the filing of the petition;

(F) a customs duty arising out of the importation of merchandise—

(i) entered for consumption within one year before the date of the filing of the petition;

(ii) covered by an entry liquidated or reliquidated within one year before the date of the filing of the petition; or

(iii) entered for consumption within four years before the date of the filing of the petition but unliquidated on such date, if the Secretary of the Treasury certifies that failure to liquidate such entry was due to an investigation pending on such date into assessment of antidumping or countervailing duties or fraud, or if information needed for the proper appraisement or classification of such merchandise was not available to the appropriate customs officer before such date; or

(G) a penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss."

47) Han Changyin, "Pochan Youxianquan de Gonggong Zhengce Jichu［The Basic of the Public Policy of the Bankruptcy Priority]," Zhongguo Faxue Vol. 3［China's Law］, Zhongguo Faxue Zazhishe［China's Law Periodical Press] (2002), at 32.

consequently.

On the other hand, the amount of the national tax claims is often quite large and once the tax claims are discharged as the preferential claims the ordinary creditors' claims will not be ensured then. Thus, countries such as Australia, Germany and Austria abolished the priority of tax claims. For example, according to the Australian Company Law there are two preferential claims prior to the ordinary unsecured claims: a) the expenses of the bankruptcy liquidation and other bankruptcy proceedings and b) the workers' possession rights and interests, wages, retirement pensions and compensations included.[48] Such legislation reform certainly provides a new point of view for us to settle the claims more properly.

### 3. THE SECURED REORGANIZATION CLAIMS

#### 1) Overview

The secured reorganization claims here are those claims occurring before the reorganization ruling secured by the property while the claims secured by the guarantors are excluded.[49]

Although the security by people is one sort of the two basic forms of the securities, the claims of the principal creditor are treated as the ordinary unsecured

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[48] Keturah Whiteford, First among Equals: "Priority Creditors on Winding Up in China and Australia." Quoted from: Wang Weiguo (as the chief editor), 「Zhongguo Zhengquanfa Pochanfa Gaige」［The Reformation of the Securities Law and the Bankruptcy Law in China］, Zhongguo Zhengfa Daxue Chubanshe［China University of Police and Law Press］(1999), at 105~106.

[49] Dai Rui, "The Restrictions to the Priority of the Secured Claims in the Bankruptcy Reconciliation System and Reorganization System," http://www2.zzu.edu.cn/lawc/Article_Show. asp?ArticleID=102 (last visited on June 17, 2007).

claims when the principal debtor doesn't perform his obligation and his guarantor is in insolvency in the bankruptcy proceedings or reorganization proceedings. That means the claims secured by people do not have any priority in the bankruptcy law. However the claims secured by the property take the advantage of being discharged, compared with the above claims.

Another thing that should be paid attention to is that the property here only refers to the debtor's own property, and the claims secured by the property provided by the third party cannot be treated as the secured reorganization claims, either.[50] The third party is not the subject of the reorganization proceedings and the property it provides doesn't belong to the reorganization corporation. Those claims secured by the property of the third party should be executed according to the Security Law.

When the corporation (the reorganization corporation) provides the property for other people (the debtor) as security[51] and the property is not enough for discharging the secured claim, the rest part of the claim cannot be required as the unsecured claim because the reorganization corporation is not the principal debtor. And if the creditor with the secured reorganization claims waives his priority in discharging, his claims cannot be transferred into the unsecured reorganization claims because there is only security relationship between the reorganization corporation and the creditor, not the obligation relationship.

Thus we can find that the secured reorganization claims are the reflections of those claims occurring before the reorganization proceedings according to the Civil

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[50] David G. Epstein, Steve H. Nickles, James J. White,「Bankruptcy (translation)」Translated by Han Changyin and other people, Zhongguo Zhengfa Daxue Chubanshe [China University of Police and Law Press] (2003), at 760.

[51] The reorganization secured claim comes into existence then.

Law in fact. As to the typical security rights such as mortgage rights, pledge rights and lien rights there are no doubts for them to be secured reorganization claims and I want to discuss the points hereinafter.

**2) The Assessment of the Secured Property**

In the circumstance of corporate reorganization the person to whom the security is provided has to execute his rights according to the reorganization proceedings. So how to confirm the value of the secured properties? Theoretically speaking, the person to whom the security is provided can only receive the payment from the proceeds of the guaranty to the extent of his claims. As to the portion exceeding the value of the mortgaged property, the pledged property or the lien articles of the secured claims or the portion exceeding the balance of the secured properties after deduction, the creditors should execute their rights as the unsecured claims. Thus the assessment affects the value of the secured property directly and then affects the creditors' rights directly. The reorganization corporation will have relative little burden if the assessment of the secured property is low while it is not so beneficial to the creditors' interests. Therefore it is important for people to decide the accurate criterion of the assessment to pay attention to both the creditors' interests and the corporate reorganization.

The value of the secured property cannot be confirmed by auction since the secured property is still used by the company in the reorganization. According to the regulations in Japanese Corporation Regeneration Law the value of the secured property at that time should be assessed in term of the company's continued

business[52] and the criterion of the company's continued business is actually the company's ability of achieving the money in the future. Because the purpose of the corporate reorganization is reviving the debtor, keeping the company's continuous business is surely the primary condition to achieve this purpose. Moreover, there are measures to support the company's revival such as freezing, reducing the creditors' rights and in a certain sense these measures can be considered as the investment and sacrifice of the creditors to the corporate reorganization.

When we calculate the value of the secured property on the base of the company's ability of achieving money in the future, it is important for us to decide a datum mark in order to avoid the possible dispute. Since the reorganization claims should be discharged according to the reorganization proceedings and the conditions of the discharging should follow the reorganization plan, the datum mark of the assessment of the secured property should be the time when the reorganization plan is approbated. But it is rather difficult to practice this datum mark because the value of the secured property cannot be doped out at the time of the drawing up of the reorganization plan. Thus it is better to consider the datum mark as the start of the reorganization plan.

### 3) The Confirmation of the Claims Secured by the Mortgage up to a Maximum Amount

The mortgage up to a maximum amount refers to the special mortgage right that

[52] *See* the Japanese Corporation Regeneration Law, Article 124(2). Quoted from: Wang Wenyu & Bai Meifang, "Cong Jingji Guandian Lun Woguo Gongsi Chongzheng Zhidu［A Discussion on the Reorganization System from the Aspect of Economy］," http://nr.stpi.org.tw/ejournal/ ProceedingC/ v10n4/516-549.pdf (last visited on June 17, 2007).

is secured by the mortgaged property of the debtor or the third party for the creditor's unspecific but continuous rights in a certain scope and is settled a maximum amount on it.[53] Compared with other ordinary mortgages, the mortgage up to a maximum amount provides the guaranty for the continuous obligations in a certain period in the future. The obligations it secured are uncertain in terms of emergence, type or number. Thus there has to be an accounting period to confirm the actual claims that have been secured. Before the accounting period, if the company receives reorganization ruling, how to confirm the claims that secured by the mortgage up to a maximum amount is a problem worthy of being studied.

As to the problem whether the claims secured by the mortgage up to a maximum amount can be confirmed with the start-up of the corporate reorganization proceedings, take the example of Japan where there are two viewpoints of the scholars: a) this kind of claim is not confirmed with the start-up of the reorganization proceedings. The 20th paragraph of article 398 of the Japanese Civil Code does not consider the start-up of the reorganization proceedings as the statutory reason of this claim. The purpose of the corporate reorganization proceedings is continuing the corporate business and the reorganization company still has the right to do its business, thus there is no necessity to end the mortgage contract and confirm the claim; b) this kind of claim is confirmed since the reorganization proceedings start up. The secured reorganization claims should be confirmed because of the reorganization ruling and be discharged according to the reorganization plan. The creditors' secured reorganization claims will lose their

[53] Liang Huixing,「Zhongguo Wuquanfa Yanjiu」［Researches on China's Reality of law］, Zhongguo Falv Chubanshe［Law Press of China］(1998), at 912.

qualifications if the claims have not been filed or listed in the reorganization plan.[54] Therefore once the reorganization proceedings start up the continuous trust business contract should certainly be ended and the mortgage up to a maximum amount will be confirmed since it loses its function with the start-up of the reorganization proceedings. And the early confirmation of the claim secured by the mortgage up to a maximum amount is helpful to the process of the reorganization proceedings in practice. Apparently the first viewpoint will make the creditors with the subordinated claims suffer some losses and the second viewpoint pays more attention to the stabilization of the reorganization proceedings. But in my opinion the second one is more advisable as we think carefully about the characteristic of the mortgage up to a maximum amount and the purpose of the corporate reorganization system. The claims secured with the mortgage up to a maximum amount occur with the continuous legal relationship and the mortgage should be confirmed when the contract ends unless there is a promissory existence period. And views from the purpose of pursuing the company's revival of the corporate reorganization system, the mortgage up to a maximum amount secures the claims because of the company's continuous business and it is generally the source of the company's business capital, such a business capital will certainly be cut off with the end of the continuous business relationship. This is apparently against the purpose of the corporate reorganization system.

Another thing that should be paid attention to is the security scope of the

[54] *See* the Japanese Corporation Regeneration Law, Article 240. Quoted from: Wang Yong & Sun Zhaohui, "Gongsi Chongzu zhong de Guquan Biandong Wenti［The Problem of the Alteration of the Shareholders' Rights in the Corporate Regroupment］," http://www.jcrb.com/zyw/n55/ca469357.htm (last visited on June 17, 2007).

mortgage up to a maximum amount. Generally speaking, the scope of security by means of a mortgage shall cover the principal obligation, interest, liquidated damages, compensatory damages and expenses for realization of mortgage rights.[55] Under the circumstance of the corporate reorganization, there are different regulations in the world.[56] I think in order to protect the creditors with the subordinated claims and to ensure the reorganization proceedings to continue successfully the interest, liquidated damages, compensatory damages and expenses for realization of ordinary mortgage rights after the reorganization ruling should not be listed in the scope of security. But as to the mortgage up to a maximum amount, based on the problem that has been discussed above, if the principal obligation, interest, liquidated damages, compensatory damages and similar things that are secured by the mortgage up to a maximum amount do not exceed the maximal limitation, they can all be secured reorganization claims and only those parts in excess of the limitation are unsecured reorganization claims.

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[55] PRC, Security Law, Article 46: "The fees charged for securities trading must be reasonable. The charging items, charging standards and charging methods shall be made public. The charging items, charging standards and administration methods for securities trading shall be centrally prescribed by the relevant competent department of the State Council."

[56] For example, *see* the Japanese Corporation Regeneration Law, Article 123: "The interests, the compensations or the claims caused by the nonperformance during the period of 1 year after the startup of the corporate reorganization proceedings can turn into the secured reorganization claims."

And the Company Act of Taiwan District of China, Article 296: "All rights of creditors of the company established prior to the ruling for reorganization shall be rights of creditors in reorganization; all rights with preference for repayment according to law shall be preferred rights of creditors in reorganization; all rights secured by mortgages, pledges or rights of retention shall be secured rights of creditors in reorganization; and all rights without such security shall be rights of creditors without security. All such rights of creditors shall not be exercised unless in a accordance with reorganization procedures. The provisions of the Bankruptcy Law relating to the rights of creditors in bankruptcy, with the exception of provisions governing right of discriminative, and preferential rights shall apply mutatis mutandis to the aforesaid rights of creditors. Rights of retrieval, rescission or set off shall be exercised against the reorganizers."

## 4. THE UNSECURED REORGANIZATION CLAIMS

### 1) Overview

All the other claims except the above discussed 2 and 3 are unsecured reorganization claims. Compared with the preferential reorganization claims and the secured reorganization claims, this kind of claims has relative low statute in the reorganization proceedings. Thus we have to protect the creditors with the unsecured reorganization claims particularly. There are several points for us to pay attention to, such as claims subjected to conditions or having a term, claims incurred as a result of the continued supply contract, and claims with several debtors. I will discuss them in detail.

### 2) Claims Subject to Conditions or Having a Term

Creditors with claims subject to conditions or having a term cannot execute their rights of claim originally because the conditions have not been confirmed or the term has not come when the reorganization ruling is made. But since the claims exist prior to the corporate reorganization ruling they still belong to the reorganization claims and can be executed according to the reorganization proceedings. These claims will lose their qualifications after the end of the reorganization proceedings if they have not been filed or listed in the reorganization plan for discharging. In other words, creditors with claims subject to conditions or having a term execute their rights according to the reorganization proceedings and it will not affect the confirmations or extinguishments of those

claims on account of whether the conditions or the terms come or not.[57)]

### 3) Claims Incurred as a Result of the Continued Supply Contract

The continued supply contract is one kind of the sales and purchase contracts and it refers to a contract where the seller supplies a certain kind of goods continuously during a certain period at a certain price to the buyer.[58)] It still belongs

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[57)] For example, *See* the Company Act of Taiwan District of China, Article 296(2), 179 and 180.

Article 296(2): "The provisions of the Bankruptcy Law relating to the rights of creditors in bankruptcy, with the exception of provisions governing right of discriminative, and preferential rights shall apply mutatis mutandis to the aforesaid rights of creditors."

Article 179: "Except in the circumstances set forth in Item 3, Article 157 hereof, a shareholder shall have one voting power in respect of each share in his/her/its possession. The shares shall have no voting power under any of the following circumstances: 1. the share(s) of a company that are held by the issuing company itself in accordance with the laws; 2. the shares of a holding company that are held by its subordinate company, where the total number of voting shares or total shares equity held by the holding company in such a subordinate company represents more than one half of the total number of voting shares or the total shares equity of such a subordinate company; or 3. the shares of a holding company and its subordinate company(ies) that are held by another company, where the total number of the shares or total shares equity of that company held by the holding company and its subordinate company(ies) directly or indirectly represents more than one half of the total number of voting shares or the total share equity of such a company."

Article 180: "The shares held by shareholders having no voting right shall not be counted in the total number of issued shares while adopting a resolution at a meeting of shareholders. In passing a resolution at a shareholders' meeting, shares for which voting right cannot be exercised as provided in Article 178 shall not be counted in the number of votes of shareholders present at the meeting."

[58)] E.g. PRC, Contract Law, Article 176~184.

Article 176: A contract for the supply and consumption of electricity is a contract by which the electricity supplier agrees to supply electricity to an electricity consumer and the electricity consumer agrees to pay electricity charges.

Article 177: A contract for the supply and consumption of electricity shall include terms such as the method, quality and time of electricity supply, the volume, place and nature of electricity consumption, the metering method, the electricity tariff and method of settling the electricity charges, the responsibility for maintenance of the electricity supply and consumption facilities, etc.

Article 178: The place of performance of a contract for the supply and consumption of electricity shall be that agreed upon by the parties. If the parties have not stipulated the place of performance or such place has not been stipulated explicitly, the place of performance shall be the point marking the boundary between each party's property rights to the electricity supply facilities.

Article 179: The electricity supplier shall safely supply power in accordance with State-stipulated electricity quality standards and as agreed by the parties. If the electricity supplier fails to safely supply power in accordance with State-stipulated electricity quality standards and as agreed by the parties, resulting in losses for the electricity consumer, the electricity supplier is liable for damages.

Article 180: If the electricity supplier needs to interrupt electricity supplies due to reasons such as a scheduled or non-scheduled overhaul of electric supply facilities, restriction of electricity

to the simplex sales and purchase contract and is not the combination of several separate contracts. Under the general circumstance, once one of the two parties does not perform his or her duty the other party can execute his defense right of simultaneous performance by this reason. But the problem is that when the buyer is ruled to corporate reorganization, can the seller make a claim for not performing the debts of the buyer? In my opinion, although the continued supply contract belongs to the simplex sales and purchase contract, the prices of different periods have not been confirmed at the beginning of the formation of the contract and the time of the formation of the price should base on the accounting period differently. Thus, claims with accounting period prior to the reorganization ruling are reorganization claims and those with accounting period after the reorganization ruling are common claims.

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supply according to law or illegal use of electricity by the consumer, etc., he shall notify the electricity consumer in advance in accordance with relevant State regulations. If the electricity supplier fails to notify the electricity consumer in advance of the interruption of electricity supply, resulting in losses for the electricity consumer, the electricity supplier is liable for damages.

Article 181: If a power outage occurs due to a natural disaster or other such reason, the electricity supplier shall effect emergency repairs in a timely manner in accordance with relevant State regulations. If the electricity supplier fails to effect emergency repairs in a timely manner, resulting in losses for the electricity consumer, the electricity supplier is liable for damages.

Article 182: The electricity consumer shall pay the electricity charges in a timely manner in accordance with relevant State regulations and as agreed by the parties. If the electricity consumer fails to pay the electricity charges on time, he shall pay liquidated damages as agreed. If the electricity consumer fails to pay the electricity charges and liquidated damages within a reasonable period of time after being reminded to do so, the electricity supplier may suspend electricity supplies in accordance with the procedures stipulated in State regulations.

Article 183: The electricity consumer shall safely consume electricity in accordance with relevant State regulations and as agreed by the parties. If the electricity consumer fails to safely consume electricity in accordance with relevant State regulations and as agreed by the parties, resulting in losses for the electricity supplier, the electricity consumer is liable for damages.

Article 184: With respect to contracts for the supply and consumption of water, gas and heat, reference shall be made to the relevant provisions concerning contracts for the supply and consumption of electricity.

**4) Claims with Several Debtors**

As to the claims with several debtors, there is more than one debtor to perform the liability to the same objective.[59] Concretely speaking, these claims can be divided into two types: a) the performances to the liability of the debtors are partible and b) the debtors should separately perform the whole claim to the creditor, such as the joint liability. In the former circumstance, when one of the debtors accepts the reorganization ruling, according to the reorganization proceedings the creditor can execute his rights that the debtor has to be responsible for. Other debtors have no liability and they do not have the rights of indemnification against each other. In the latter circumstance, since the debtors have their own liability to perform the whole claim the creditor can request anyone of the debtors to perform, thus there must be the relationship of indemnification among the debtors. So when all the debtors or a part of them accept the reorganization ruling how could the creditor execute his rights?

Whether it is all the debtors or one or some of the debtors, whether it is the guarantor or the person who hold the principal obligation, whether the debtors start up the reorganization proceedings at the same time or successively, the creditor can in all cases take part in the reorganization proceedings with his claims amount of the time of the start-up.[60] The claims amount here refers to the amount that exists at the reorganization ruling, not the time of the claims' original existence. Thus, if the creditor has been discharged because of other proceedings he can still execute

[59] Li Yongjun,「Pochan Chongzheng Zhidu Yanjiu」［A Research on the Reorganization System］, Zhongguo Renmin Gong'an Dxue Chubanshe［Chinese People's Republic Security University Press］(1996), at 169~170.

[60] *See Supra* footnote 56 for the relative content of the Company Act of Taiwan District of China.

his rights according to his claims at the time of the reorganization ruling before he is discharged fully, but if his discharged money according to the reorganization exceeds the rest of his claims amount, it has to be returned to the reorganization corporation as the unjust enrichment.

## C. THE NECESSITY OF THE INTERESTS BALANCE

### 1. OVERVIEW

Simply put, interests can be regarded as the satisfaction to people's requirements. The popular existence of interests is the important condition of the social existence and development. All things that people struggle for are related to their interests[61] and the function of the law to the society is realized mainly through the adjustment and control of the interests. The law came into existence because of the demand of the interests balance and has been developed along with the change of the interests relationship. It is impossible for the law to come into being or develop without interests. Many scholars consider the interests balance as the purpose and task of the law while they don't point out how to balance the conflicting interests and in fact it is rather difficult for them to answer this question. So legislators and judges should make effort to achieve the balance both in the legislation and the judicial practice. If legislators cannot conciliate the conflict of the different interests in the

[61] Karl Marx and Frederick Engels,「Makesi Enggesi Quanji, Diyi Juan」［The Collected Edition of Marx and Engels, Vol.Ⅰ］, Zhongguo Renmin Chubanshe［People Press of China］(1972), at 82.

material legal system it will also be difficult to achieve the balance through the legal interpretation and legal application. The interests in the corporate reorganization system should also be treated carefully.

## 2. THE MULTI PARTIES AND THEIR INTERESTS IN THE CORPORATE REORGANIZATION

### 1) Overview

Although the reorganization system regards the protection of the social interests as its own task it cannot ignore the interests of creditors, debtors or other parties and the idea of protecting the creditors and rescuing the debtors that is originally advocated by the bankruptcy law hasn't ceased its activities (otherwise there is no possibility of the naissance of the reorganization system). That means when the debtors are in insolvency or in danger of insolvency the interests that the reorganization system should pay attention to include the social interests, the creditors' interests, the debtors' interests, the shareholders' interests, the employees' interests and other subjects' interests.

### 2) The Social Interests

The modern enterprises actually can be understood in three aspects: a) they are the aggregations of the possessions; b) they are the aggregations of the trade relationships; c) they are the aggregations of the interests. These three aspects make

the enterprises the entities with the social economic function.[62] In the modern society the big corporation is increasingly becoming the outstanding mode of all kinds of social relationships. It not only decides selections, quantities and qualities of the most important goods and services in the market but also controls the manufacture market, the capital market and the service market; it not only controls the fates of hundreds and thousands of employees but also pays a high amount of tax to the government. The bigger the corporation is, the more social economic functions the enterprise shoulders. The social influence of the big enterprise in the economy area is quite huge and it is never excessive to call modern corporations "the invisible empires" and their presidents and directors "the modern emperors."[63] Thus, once the big-sized corporation is in insolvency the coming Domino Effect will affect people ranging from creditors, shareholders and employees with direct relationship to providers and customers of the corporation. Even the social economic order may be impacted because of the emergence of a lot of unemployed workers and the governmental interest will be impacted because of the decreased taxes and increased unemployment benefits. The establishment of the reorganization system in many countries is just a measure to avoid or lessen the possible negative influence on the social stabilization based on the understanding of a series of related effects of the bankruptcy or insolvency of the big-sized corporations. In this sense, the reorganization is the system that puts the social

[62] Wang Weiguo, "Lun Chongzheng Zhidu［The Reorganization System］," Faxue Yanjiu Vol.6［Law Research］, Zhongguo Faxue Yanjiu Zazhishe［Law Research Periodical Press of China］(1996), at 90~91.

[63] Liu Junhai,「Gongsi de Shehui Zeren」［The Social Liabilities of the Company］, Zhongguo Falv Chubanshe［Law Press of China］(1999), at 18.

interests on the primacy.

**3) The Debtors' Interests**

The reorganization system protects the social interests through avoiding the bankruptcies of corporations and pins its hope of protecting the social interests on the revival of corporations. In fact, only when the debtors revive corporations from the mess, can the purpose of protecting the social interests be realized. Thus, in the corporate reorganization proceedings the debtors' interests are mainly the maintainance of the business and the continuation of the enterprises. Of course the protection of debtors' interests of the reorganization proceedings is not unconditional and usually only the debtors with revivable possibility can take the advantages.

**4) The Creditors' Interests**

Under the normal circumstances the company laws and regulations provide two methods for the protection of the creditors' interests besides the contract on the civil law: a) the abidance of the public principle of the corporate affairs and b) the carrying out of the corporate capital maintenance principle and when the corporation comes into the bankruptcy liquidation, the bankruptcy liquidation regulations are executed.[64] The reorganization system provides a new way to protect the creditors' interests by avoiding the waste of resources and improve the

[64] Wang Weiguo, "Lun Chongzheng Zhidu［The Reorganization System］," Faxue Yanjiu Vol.6［Law Research］, Zhongguo Faxue Yanjiu Zazhishe［Law Research Periodical Press of China］(1996), at 91.

creditors' possible part on the base of fair discharging. Of course the premises of this protection are successful reorganization. The aborted reorganization will only bring the time-killing reorganization proceedings and the expensive reorganization expenses and then the creditors will suffer more serious loss than the bankruptcy liquidation. So countries make some restrictions in order to ensure the success of the reorganization, such as the restriction which regulates that all creditors should execute their rights according to the reorganization proceedings, especially the creditors with preferential or secured reorganization claims. In one word, the process of the reorganization proceedings depends on creditors' assistances and the success depends on the protection of creditors.

**5) The Shareholders' Interests**

Compared with corporate creditors, shareholders are another kind of interest parties with different characteristics, different rights and liabilities and different legal status. The traditional company law considers that the shareholder is the owner of the corporation and the corporation should work for the best of the shareholders while the modern company law rarely considers shareholder as the sole owner. Many scholars now think that the company is an aggregation combined by contract.[65] In my opinion, the shareholders share the same interests as the company but the company should also pay attention to the interests of the creditors, the employees and other non-shareholders besides the shareholders' interests. The

[65] For example, the American scholar Robert W· Hamilton considers the company as a nexus of contracts. Quoted from: Deng Feng, "Chonggou Gongsi Lilun de Yige Kuangjia [The Reconstruction of the Corporate Theories]," http://article.chinalawinfo.com/article/user/article_display.asp?ArticleID=30823#m32 (last visited on June 17, 2007).

company and the shareholders are two subjects after all. When the corporation is in mess and goes through the reorganization it is still necessary to protect the shareholders' interests although the latter almost get nothing when the company starts up the reorganization proceedings. But if the reorganization can make the shareholders get even a little share benefits they will be interested in the reorganization. The shareholders can make profits if the reorganization is successful and it is the creditors who suffer all the loss if it is aborted.

**6) The Employees' Interests**

The employees also devote their management, labor, expertise and loyalty to the company besides the shareholders' capital investment. So when the corporation needs reorganization the employees' interests should also be protected. And in addition, the employees' interests tie up the social labor order and the social stabilization.[66] The employees are surely the infirm party compared with the company and the protection of the infirm emphasized by the modern civil law should be showed in the corporate reorganization. Of course if the company owes the employees salaries the employees then should have the status of creditors.

## 3. REVIEW: THE CONFLICTS AMONG THE INTERESTS PARTIES IN CORPORATE REORGANIZATION

As I have discussed above there are multi interests subjects in the corporate

[66] Xu Guangdong & Xi Tao, "The Revolution of the Bankruptcy Law," http://cn.biz.yahoo.com/060919/16/j6ot.html (last visited on June 17, 2007).

reorganization proceedings and the reorganization proceedings should protect all the subjects' interests. Thus, there must be a lot of conflicts and struggles through the entire process. During the whole reorganization proceedings every subject hopes for his best interests and because of people's inherent self-interest and rational behavior the conflicts are unavoidable.[67)]

There are two categories of interest conflicts in corporate reorganization: a) the conflicts that existed before the reorganization proceedings already, such as the conflict between the company's creditors and the company, the conflict between the company's creditors and the shareholders, the conflict between the shareholders and the employees, the conflict between the company and the employees and so on. This kind of conflict will continue in the reorganization proceedings because of the continuous corporate business; b) the conflicts based on the emergence of new interest subjects after the startup of the reorganization, such as the conflict between the company and the providers, the conflict between the company and the customers, the conflict between the company and the society and so on.[68)] It is obvious that the interests conflicts in the reorganization proceedings are much more complex than those before the proceedings. Viewed from the creditors' point, since the shareholders and the corporation have similar interests to a certain extent and the same applies to the employees and the society, the major task of protecting the creditors' interests is how to balance the conflict between the creditors and the

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67) Wang Wenyu,「Minshangfa Lilun yu Jingji Fenxi」[The Theories and the Economic Analysis of the Civil Law], Zhongguo Zhengfa Daxue Chubanshe [China University of Police and Law Press] (2002), at 8~9.

68) Lin Xiaonie, "Gudong Liyi de Chongtu yu Pingheng [The Conflicts and Balance of the Shareholders' Interests]," Faxue Pinglun Vol. 1[Law Review], Zhongguo Faxue Pinglun Bianjibu [Law Review Newsroom of China] (2001), at 47~54.

debtors and the conflict between the creditors and the society. If those conflicts are not controlled they will sharpen and bring damages to the subjects and even the reorganization will be aborted. Therefore, to ensure the reorganization proceedings to go on wheels and finally achieve the reorganization purpose the interests balance should be treated as the theoretical foundation of the reorganization system all along.

## D. THE POSSIBILITY OF ACHIEVING THE INTERESTS BALANCE

### 1. OVERVIEW

The interests conflicts bring the necessity of the reorganization system and the cooperation makes it possible to realize the reorganization. Although the conflict between the protection of the creditors' interests and the reorganization purpose of urging the debtors to revive and consequently protecting the social interests is unavoidable, this conflict is still reconcilable.[69] The successful reorganization is obviously an outcome of multi-win: the creditors' claims can be discharged more than the bankruptcy liquidation; the debtors can avoid the fate of been liquidated; the employees can keep their positions and job opportunities; the shareholders can keep their investments and other interests subjects directly or indirectly related to

[69] Qian Weiqing, "Liyi Chongtu de Zhidu Yueshu Jizhi［The Institutional Adjustment to the Interests Conflicts］," http://www.jcrb.com/zyw/n60/ca476144.htm (last visited on June 17, 2007).

the debtors can benefit from the reorganization. We can say that the protection of the creditors' interests and the realization of the reorganization purpose conflict with each other but at the same time depend on each other.

## 2. VIEW FROM THE POINT OF THE PURPOSE OF CORPORATE REORGANIZATION

The purpose of reorganization is rescuing the corporations in insolvency or in danger of insolvency and consequently protecting the social interest.[70] When the corporation applies to the court for reorganization, the crisis of the corporation is undoubtedly declared to the society and the creditors will consequentially ask for executing their claims in succession. To ensure that the reorganization plan to be proceeds successfully and the purpose of the reorganization is achieved, the reorganization claims of the creditors are restricted in the reorganization proceedings. The restrictions to the creditors' reorganization claims mainly include two aspects: a) the claims have to be confirmed according to the procedures such as filing; b) the claims have to be discharged according to the reorganization plan, not the compulsive execution procedure as ordinary claims.

Anyway, as to the purpose of corporate reorganization, the restrictions of the creditors or the creditors' concessions are actually based on the requirement of the creditors' own interests besides the consideration of the social interests of the

[70] Li Yongjun,「Pochan Chongzheng Zhidu Yanjiu」［A Research on the Reorganization System］, Zhongguo Renmin Gong'an Dxue Chubanshe［Chinese People's Republic Security University Press］(1996), at 44.

reorganization system. Therefore the reorganization system has enough power to bargain with the creditors.

### 3. VIEW FROM THE POINT OF PROTECTION OF THE CREDITORS

To ensure the reorganization to be successful the debtors are authorized to possess, use and dispose of the possessions and continue the business while in the bankruptcy proceedings the debtors' possessions are controlled by the bankruptcy administrator. And all the creditors should execute their rights according to the reorganization laws, including the secured claims. The third point is when the reorganization plan hasn't been adopted the debtors or the administrator can directly apply for the approval of the court without the creditors' vote.[71] These things all threaten the creditors' discharging so why do the creditors accept the reorganization?

The creditors can also benefit from the corporate reorganization while sacrificing for the proceedings. They can get money from the trades if the company continues the business; for creditors with secured claims, since the secured properties are always the workshops or the machines, the value of these properties when they are put into manufacture will far exceed the value from auctions; for ordinary creditors, the value of the corporate properties when the corporation continues the business will be more than that in the case of liquidation. In one word, the company in

[71] Wang Weiguo, "Lun Chongzheng Zhidu［The Reorganization System］," Faxue Yanjiu Vol.6 ［Law Research］, Zhongguo Faxue Yanjiu Zazhishe［Law Research Periodical Press of China］ (1996), at 93.

business will bring more benefits to the creditors. Thus there is possibility for the creditors to accept the reorganization.

# Ⅲ. THE EXTERIOR BALANCE BETWEEN THE CREDITORS AND THE REORGANIZATION PROCEEDINGS

## A. OVERVIEW

Rescuing the debtor and consequently protecting the social interests are the ultimate purposes of the corporate reorganization system. If we consider the important point of rescuing the debtor as how to maintain the debtor's business, the powerful protection of the creditors is the assurance of the effective reorganization system. To maintain the debtor's business, the reorganization proceedings have to restrict the creditors' rights and in some sense this kind of restriction is the sacrifice that the creditors have to make in order to pursue their final interests.

But the reorganization system should be designed on the basis of the principle of not impairing the creditors' interests and ensuring the payments to the creditors are not less than those in the bankruptcy liquidation proceedings. Otherwise the creditors may retort because of their limited self-surrenders and sacrifices, and the reorganization proceedings may be consequently aborted. In other words, the restrictions of the creditors' rights should also be based on the respect to and protection of the creditors.

The reorganization proceedings are actually the proceedings that combine the

restrictions of the creditors with the goal to rescue the debtors and the creditors' anti-restrictions that protect their own interests. The opposite but also consistent relationship between the restrictions and the anti-restrictions is reflected through the entire reorganization proceedings. Every effective design of the reorganization system is actually the result of the legislators' careful consideration after balancing the interests of every party. Moreover, the creditors take a relative infirm status during the whole course of pursuing the successful reorganization. They should be paid more attention to according to the interests balance principle and only then will they always stay with the reorganization proceedings.

However, the theory is one thing and the practice is another thing. It is rather difficult for people to put theory into practice. Specifically speaking, with an eye on the protection of the creditors, there are mainly three problems for us to settle: a) the start-up mechanism of the reorganization proceedings; b) the corporate reorganization institutions during the course of the reorganization proceedings and c) the establishment and execution of the reorganization plan. These three problems have different meanings to the protection of the creditors.

## B. THE CREDITORS AND THE START-UP MECHANISM OF THE REORGANIZATION

### 1. OVERVIEW

What kind of corporation can carry through the reorganization proceedings? Who can advance the corporate reorganization application? And how would the courts make the reorganization ruling? All these questions look simple while they have close connection with the success or failure of the corporate reorganization and also with the protections of the creditors. The start-up mechanism is the first and the most important moment of protecting the creditors' interests. The point is how to let the corporations with the necessity and possibility of reorganization enter the proceedings and exclude the hopeless corporations. If the criterion is not held well in this stage, the proceedings may be abused and the creditors may suffer a lot of loss. Thus, the legislations in many countries have paid high attention to the start-up mechanism of the reorganization proceedings and tried best to prevent the disqualified corporations from the proceedings.

### 2. THE REORGANIZATION APPLICATION

#### 1) Overview

The reorganization legislations in many countries provide the right to apply for the reorganization proceedings for the multi parties in order to stimulate the

interests subjects to cooperate for the reorganization. Generally speaking, the parties who have the right to apply for the reorganization mainly are these parties hereinafter:

**2) The Debtor**

Because the reorganization proceedings consider its own purpose as rescuing the debtors, the debtors know well about their financial status and whether there is possibility or value of the corporate reconstruction and continued business. Thus, when the debtors have the reorganization reason, the legislations in all those countries regulate that the debtors have the right to apply for the reorganization in principles.[72)]

**3) The Creditor**

Although the creditors have the qualification of advancing the reorganization application, most of the countries require that their claims have to reach the statutory proportion. For example, only those creditors who occupy the claims

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[72)] For example, *See* the U.S. Federal Bankruptcy Code, Article 301: "A voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter. The commencement of a voluntary case under a chapter of this title constitutes an order for relief under such chapter."

The Company Act of Taiwan District of China, Article 282: "Where a company which publicly issues shares or corporate bonds suspends its business due to financial difficulty or there is an apprehension of suspension of business thereof, but there is a possibility for the company to be constructed or rehabilitated, the company or any of the following interested parties may apply to the court for reorganization: 1. Shareholders who have been continuously holding shares representing ten per cent or more of the total number of issued shares for a period of six months or longer; or 2. Creditors of the company who have claims equivalent to ten per cent or more of the capital from the total number of issued shares. For filing the reorganization application by a company under the preceding Paragraph, the Board of Directors of the company shall adopt a resolution by a majority vote of the directors present at a meeting of the Board of Directors attended by over two-thirds of all directors."

corresponding to 1/10 of the capital can advance the reorganization application. The Federal Bankruptcy Code of the United States requires that if the total number of creditors is less than 12, they cannot advance the reorganization application to the debtors separately unless one of these creditors holds claims of more than $ 11,625; and if there are at least 12 creditors, then there have to be at least 3 creditors with their total claims more than $ 11,625.[73] The PRC,[74] State Enterprise Insolvency Law (Trial Implementation) and the PRC, Enterprise Bankruptcy Law that became effective as of June 1, 2007 have no relevant regulations.

**4) The Capital Contributor**

It mainly refers to corporate shareholder. Allowing the capital contributors to apply for the reorganization is one of the main differences between the reorganization proceedings and the bankruptcy liquidation proceedings or the conciliation proceedings, and it reflects the purpose of mobilizing all possible factors to rescue the debtors of the reorganization proceedings. Same as the creditors, the capital contributors cannot advance the reorganization application unless they meet certain qualification. The Company Act of Taiwan District of China regulates that those shareholders who hold more than 10% of the listed

[73] *See* the U.S. Federal Bankruptcy Code, Article 303 (b)(1), (2): "(b) An involuntary case against a person is commenced by the filing with the bankruptcy court of a petition under chapter 7 or 11 of this title—

(1) by three or more entities, each of which is either a holder of a claim against such person that is not contingent as to liability or the subject of a bona fide dispute, or an indenture trustee representing such a holder, if such claims aggregate at least $10,000 more than the value of any lien on property of the debtor securing such claims held by the holders of such claims;

(2) if there are fewer than 12 such holders, excluding any employee or insider of such person and any transferee of a transfer that is voidable under section 544, 545, 547, 548, 549, or 724 (a) of this title, by one or more of such holders that hold in the aggregate at least $10,000 of such claims."

[74] People's Republic of China.

shares for more than 6 continuous months can advance the reorganization application.[75] Similarly, capital contributor whose amount of capital contribution accounts for more than one-tenth of the registered capital of the debtor may apply to the people's court for reorganization after the people's court has accepted the bankruptcy application and before the people's court declares the debtor bankrupt.[76]

**5) The National Institution**

This kind of the right subject is French characteristic. The court can start up the reorganization proceedings according to its own authority or the inquisitor's application.[77]

Since the purpose of the corporate reorganization is rescuing the debtors, it is certain for the debtors to apply for the reorganization. But as to the creditors the qualification of advancing the reorganization application has a quite important significance. Without the qualification, the debtors may apply for the

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[75] *See* the relative content of the Company Act of Taiwan District of China in the footnote 68 of this dissertation.

[76] *See* the PRC, Enterprise Bankruptcy Law, Article 70: "A debtor or a creditor may directly apply to the people's court for reorganization of the debtor pursuant to the provisions hereof. If the creditor applies for bankruptcy liquidation of the debtor, the debtor or the capital contributor whose amount of capital contribution accounts for more than one-tenth of the registered capital of the debtor may apply to the people's court for reorganization after the people's court has accepted the bankruptcy application and before the people's court declares the debtor bankrupt."

[77] *See* The French Commercial Code, Article L621-2: "The procedure may likewise be commenced on a summons by a creditor, whatever the nature of the debt. Nevertheless, subject to Articles L.621-14 and L.621-15, the said procedure shall not be commenced against an agricultural undertaking not incorporated in the form of a commercial company unless an application shall first have been made to the Presiding Judge of the Tribunal d'instance for the appointment of a mediator, pursuant to Article L.351-2 of the Rural Code. The Court may also take charge of the procedure ex officio, or on an application may be made by the Procureur de la République. The works council or, if none, the personnel delegates may notify the Presiding Judge or the Procureur de la République of any fact proving that the undertaking is insolvent."

reorganization only under rather deteriorative situation and at that time there may be little corporate properties for discharging. Then it is certainly difficult for the creditors to support the corporate reorganization. Thus, the creditors can start up the reorganization proceedings on time if they can advance the reorganization application. Moreover, the start-up of the reorganization proceedings does not depend on the appearance of the bankruptcy reason and the creditors have more motivation to start up the reorganization proceedings at the very beginning of the debtor's mess.

### 3. THE EXAMINATION OF THE COURT

#### 1) The Status of the Court in the Corporate Reorganization

From the reorganization application to the end of the whole proceedings, the balance of the different interests is apparently not easy to satisfactorily achieve with only the self-help of the reorganization parties. Therefore, there must be a neutral supervisor to interfere in the reorganization proceedings actively and then deal with the corporate affairs fairly. Only the court can be such a supervisor. In this sense the court is also the supervisory institution during the reorganization course.[78)]

The court supervises the corporate reorganization because the court has its own authority and justness as a national justice institution. On the other hand, the idiosyncratic characteristics of the corporate reorganization proceedings are also

[78)] But strictly speaking, the court cannot be the supervisory institution in the corporate reorganization because it also judges the reorganization cases and executes the jurisdiction.

the reasons. First, the reorganization proceedings combine the procedural law and the substantial law and the court is obviously the best entity to execute the legal regulations as the national judicial institution; Secondly, in view of the application motivations of the reorganization parties, not only the debtors but also the creditors hope to maintain the corporate business with the help of the judicial power and avoid the company's bankruptcy liquidation and consequently get more distribution than in the case of the corporate bankruptcy liquidation. Only relying on the court can this purpose be realized; Thirdly, there are many reorganization affairs to judge during the course of reorganization and whether the dealing is just and reasonable seriously affects the process and results of the reorganization. The court is needed to judge the reorganization affairs due to its authority and the legal spirit; Lastly, the administration and supervision of the professional administrator are executed under the authorization of the court and obviously they are not at the same level as the behaviors of the court. Just based on this, I consider that although the court has quite strong function of supervising, it should not act as the supervisor because the court also judges the reorganization case and executes its legal authority.

**2) The Examination of the Court of the Reorganization Application**

The examination of the court of the reorganization application is the key to successful reorganization. The court has to examine the reorganization application after its acceptance. Although the requirements of the reorganization application are different in different countries, the contents of the examination commonly include the formal factors and the essential factors.

Generally speaking, the formal examination mainly includes: a) whether the corporation belongs to the reorganization object regulated by the law; b) whether the court that has accepted the case has the authority to the reorganization affair; c) whether the applicant has the right and ability; d) whether the application has been advanced and the statutory affairs have been set out; e) whether the corporation that applies for the reorganization has decided on bankruptcy liquidation or conciliation and f) whether the applicant has paid for the application. If the formal factors measure up the regulation, the court will carry through the essential examination stage.

The essential examination mainly involves whether there is reason for reorganization in the corporation, or, in other words, whether the corporation has the necessity and possibility of reorganization. Thus, the court should know well about the company's business and finance and investigate the company's actual situation before making judgment. Compared with the formal examination, the essential examination is more complex and difficult to execute. It can be said that the essential examination is the key to corporate reorganization. Based on the ability of the court and the difficulty of the judgment, the legislations in many countries have regulated that the court can adopt several measures to judge accurately on time. These measures are:

**a. consult the administrative institutions**

The relevant company's administrative institutions have the liability to supervise the company and provide the suggestions and ideas to the court according to their

professional knowledge and experiences. But after all they are national administrative institutions and they are only the consultants of the court. They cannot participate in the corporate reorganization proceedings with the characteristic of private law and neither can they effect the judgment of the court with their authorities.[79)]

**b. appoint the inspectors**

The inspectors have to inquire after the company's facts and provide information, material and suggestion as to the company's finance, relationship with the employees, the future of the reorganization, the reorganization reason and other affairs. The inspectors are not compulsory and they are appointed temporarily by the court when it is necessary. Taiwan of China and Japan has regulated about this point in detail.[80)]

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79) For example, *see* the Japanese Corporation Regeneration Law, Article 35: "The court should inform the administrative office, the revenue chief of the corporation when there is the application of the reorganization proceedings. The court can also consult with the administrative office of supervising the corporate business when it thinks it is necessary."

80) For example, *See* the Company Act of Taiwan District of China, Article 285: "In addition to the requests for opinions as provided in the preceding article, the court may also select and appoint a person with specialized knowledge or experience in the operation of the business of the company but without any interest therein as the inspector who shall, within thirty days after appointment, complete the following examinations and submit a report accordingly: 1. The actual business, financial condition, and evaluation of the assets of the company; 2. To examine in the light of the analysis of the business and financial conditions, the assets and production equipment of the company to see whether the reconstruction or rehabilitation of the company is possible or not; 3. To examine the merits and demerits of the previous business operation of the company and the records of management of the operation by the responsible person of the company to see whether there was any neglect or improper practices; 4. To examine whether there is any fraudulent or false statement in the application; 5. To examine the feasibility of the reorganization proposal, if the applicant is the company; and 6. To examine other relevant reorganization proposals. The inspector may inspect all books, records of accounts, documents and property relating to the business or finance of the company. The directors, supervisors, managerial personnel, or other staff personnel shall have the obligation to answer the enquiries made by the inspector regarding the operation and financial activities. Directors, supervisors, managerial officers and other employees of the company who refuse the aforesaid examination or refuse to answer the aforesaid questions without reason or

**c. inform the company for which application is advanced and hear the company's opinions**

When the creditors or other parties with the right to apply the corporate reorganization advance the reorganization application to the court, the court has to inform that company and hear its opinion as reference.

After the essential examination the corporate reorganization will be ruled if the court considers that the reorganization is up to the legal conditions.

**3) The Prevention of the Company's Abuse of the Preservation Measures**

There will be a period after the court's acceptance of the reorganization but before the decision of the court. Since the corporate reorganization plan will always alter the rights of the creditors, the shareholders and the company's principals will bear the liabilities of not managing the company well. The relevant interested parties may act adversely to the company for their own interests and then the company may lose its reorganization value when the reorganization is ruled. Thus the legislations in different countries have all regulated corresponding preservation measures.

Theoretically, the adverse behaviors of the interested parties after the reorganization application but before the reorganization ruling usually aim at the corporate properties, and the subject may be the reorganization company itself, or the company's creditors. To ensure that the company's properties do not decrease, the preservation measures of different legislations mainly include: a) the

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make false statements shall be severally subject to a fine not less than NT$(the monetary unit of Taiwan, China) 20,000 but not more than NT$ 100,000."

preservation of the company's properties. When reorganization has been applied for bang a company, especially when the shareholders or the creditors advance the reorganization application, the principals may dispose of the company's properties or set the securities for their own claims. Thus the preservation of the company's properties is quite necessa;[81] b) the restriction of the corporate business. The reorganization application shows that the corporate business has been in mess or in danger of being bankruptcy liquidated. Thus, the company's business should be properly restricted to ensure that the reorganization proceedings carry through successfully. For example, the quantity of the production should be restricted in order to avoid the increasingly unmarketable situation; c) the restriction of the company's behaviors of performing its debts and of the creditors' behaviors of executing their claims. Such behaviors will only make the company's financial situation worse and consequently the reorganization purpose will surely not be achieved. The creditors' behaviors of executing their claims to the company should refer to those out of the litigation. As to how to restrict specifically, the Japanese laws and regulations provide the right to the preservation administrator;[82] d) the suspense of the bankruptcy liquidation proceedings, the conciliation proceedings and the compulsive execution proceedings and e) the prohibition of the transfer of the company's inscribed shares.

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81) For example, *see* the Japanese Corporation Regeneration Law, Article 39 (1): "The court can order the preservation to actions to the corporate business and properties according to the application of the interested parties or its own authority before its ruling of the reorganization proceedings."

82) *See* the Japanese Corporation Regeneration Law, Article 40, 41 and 42. Quoted from: Wang Weiguo, "Lun Chongzheng Qiye de Yingye Shouquan Zhidu［A Research on the Business Warrant System of the Reorganization Enterprise］," Bijiaofa Yanjiu Vol. 1［Comparative Law］, Zhongguo Zhengfa Daxue Bijiaofa Yanjiu Bianjibu［China University of Police and Law Press Comparative Law Newsroom］(1998), at 76.

Compared with other countries, both United States and Canada adopt the automatic stay system after the reorganization application against the procedures or the behaviors that are harmful to the reorganization, not the preservation measures according to the application of the interested parties or the authority of the court.[83] This kind of legislation can be thought as an advanced one. It is quite useful to urge the reorganization to succeed while it can also be the cause of abusing the reorganization proceedings.

The preservation measure is actually a double-edged sword in the reorganization proceedings. It can safeguard the reorganization company's properties and ensure the justness among all the creditors while it can also be used by the debtors to escape the debts because of its function of suspending the debts. It is absolutely impossible for the reorganization to go on successfully without the creditors' support. Therefore, the courts have to consider the relief to the creditors when they adopt the preservation measures, otherwise the unbalanced interests will cause the creditors' oppositions and then the failure of reorganization.

First of all, the preservation period should not be too long because the preservation measures are provisional and the long preservation period will be harmful to the creditors. It is necessary for the legislation to restrict the period properly.[84] Secondly, the performance of the preservation measures has to work

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[83] The automatic stay system will be discussed in infra Chapter Ⅳ.

[84] For example, *see* the Company Act of Taiwan District of China, Article 287: "Prior to rendition of a ruling for reorganization of a company, the court may, at the request of the company or an interested party or ex officio, render a ruling for the following disposal: 1. Disposal for preservation of the company's property; 2. Restriction on the business of the company; 3. Restriction on performance of obligation of the company and exercise of claim against the company; 4. Suspension of proceedings for bankruptcy, com- position, or compulsory execution and others; 5. Prohibition of transfer of registered share certificates; and 6. Assessment of the liabilities of

based on the principle of not impairing the creditors' interests. It requires the courts to consider the protections of the creditors thoroughly when they decide to adopt the preservation measures. And if the creditors think that the preservation decision of the court has damaged them improperly, they should be provided with the rights of asking the court to change or rescind.[85] Lastly, the debtors' rights of rescinding the reorganization application should be restricted. This right will certainly bring the abused reorganization application. Once the court adopts the preservation measures, the debtor's properties are under the supervision and management of the court. No creditors can execute the claims unless the preservation measures are of no effect. But if the debtor rescinds his reorganization application after the preservation measures have been adopted in order to escape his debts, the creditors will suffer a lot of loss because of the debtor's abuse. Therefore, as to the reorganization application, although the court cannot prohibit the debtors from rescinding, the permission of the court is necessary when the preservation measures have been adopted.

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responsible persons of the company to compensate the company for loss or damage and preservation of their property. The term of validity of the ruling to be made under the preceding Paragraph shall not exceed 90 days, unless otherwise fixed by the court; and may be extended when necessary by the court at the request of the company or an interest party provided that the duration of each extension shall not exceed 90 days. In case the ruling for dismissing a company reorganization application becomes final prior to the expiry of the term of validity referred to in the preceding Paragraph, then the ruling rendered under Paragraph I under this Article shall become null and void. In rendering a ruling under the provisions of Paragraph I of this Article, the court shall inform, by a notice, the authority in charge of securities affairs and the central authority in charge of the relevant end enterprise."

[85] Hu Jian, "Riben Pochan Falv Zhidu (The Japanese Bankruptcy Law)," http://www.japanlawinfo.com/news.asp?id=590 (last visited on May 6, 2007).

## C. THE CREDITORS AND THE REORGANIZATION INSTITUTIONS

### 1. OVERVIEW

The company's continued business and regeneration are the basic purposes of the corporate reorganization system and the reorganization proceedings are designed to select those companies with survival ability and possibility. As to the corporations after the reorganization ruling, there are many complex problems in the whole proceedings and the different reorganization institutions play important roles in protecting the creditors' interests. The institutions in the reorganization proceedings can be considered as the "backbone" of the whole proceedings.[86] Although the legislation modes and procedural institutions are quite different in different countries, there is a common point that has been discussed above. The court plays an important role in the reorganization proceedings and it can be considered as the "backbone" because it conducts the process of the whole reorganization proceedings and leads and supervises the activities of other institutions. Besides the court, which institutions should also be set up in the reorganization proceedings? These three procedural institutions are generally set up during the corporate reorganization process in different countries and districts hereinafter: the first one is the business institution; secondly, the supervisory

[86] Tang Weijian,「Pochan Chengxu yu Pochan Lifa Yanjiu」[The Bankruptcy Proceedings and the Bankruptcy Legislation], Zhongguo Renmin Fayuan Chubanshe [Court Press of China] (2001), at 425.

institution and the last one is the creditors' self-governing institution. They are all necessary to the process of the reorganization proceedings. The business institution is actually the execution institution of the corporate reorganization and it can ensure the company's continued business. It is the very emphasis of the whole reorganization and without it the proceedings may be aborted; similarly, without the supervisory institution or the self-governing institution it is difficult to imagine that the interests of the creditors and other interested parties can get effective and practical protections, and finally the purpose of the reorganization will go by the board.

## 2. THE BUSINESS INSTITUTION DURING THE CORPORATE REORGANIZATION PERIOD

### 1) General Proceedings

The only sequel of the traditional bankruptcy liquidation proceedings is liquidation distribution and in principle the debtors cannot continue their businesses after the start-up of the proceedings. Once the proceedings start up the debtor will lose his rights of administrating and disposing of his properties as the bankrupt. These rights will be transferred to the bankruptcy administrators. But the reorganization proceedings have the different purpose of maintaining the debtor's business and urging the debtor to revive. Thus the business institution has to be set up in the reorganization proceedings to ensure the debtor's revival.

**2) The Legislation Modes of the Business Institution and the Analysis**

The business institution during the corporate reorganization period refers to the institution that takes charge in the management and the disposition of the company's properties and the drafting and execution of the reorganization plan. The countries and districts regulate the business institutions in different names. For example, it is called the "debtor in possession"(DIP) or the "trustee" in America and "administrator" in England, France, Germany and Japan[87] while it is called the "reorganizer" in Taiwan District of China.[88] Actually there are also regulations

[87] For example, *See* the U.K. Insolvency Act, Article 13: "(1) The administrator of a company shall be appointed Appointment either by the administration order or by an order under the new subsection…" And the French Commercial Code, Article L621-8: "In the initial judgment, the court appoints the insolvency judge and two legal agents to act as the administrator and the creditors' representative. It invites the works council or, failing that, the workers' delegates or, failing that, the employees, to designate a representative from among the employees. The employees elect their representative via a one-round secret ballot for a single candidate.

Either at its own initiative, or at the behest of the Public Prosecutor, the court may appoint several administrators and creditors' representatives.

The court-appointed receiver may request the appointment of one or more experts.

The court-appointed receiver shall send the mayor of the commune and the chairman of the public undertaking for inter communal cooperation, if one exists, a recorded-delivery registered letter informing them that judicial administration proceedings have been initiated against a company having its registered office in the commune.

When proceedings are brought against a legal entity, no relative of the chief executive or a senior manager, up to the fourth degree inclusive, shall be appointed to any of the functions provided for in the present Article unless such a provision would prevent the appointment of a staff representative.

If no staff representative can be appointed, the chief executive shall draft a report to that effect.

If there is no works council and no workers' delegate, the staff representative shall exercise the functions entrusted to them by the provisions of the first chapter."

[88] *See* the Company Act of Taiwan District of China, Article 290: "The reorganizers of the company shall be selected and appointed by the court from among the relevant experts recommended by creditors, shareholders, directors, the central authority in charge of the relevant end enterprise, and/or the authority in charge of securities affairs. The provisions set out in Article 30 hereof shall apply mutatis mutandis to reorganizers. In the meeting of interested parties, if the result of the voting conducted in groups under Article 302 shows that two or more groups prefer a change of reorganizers, a list of candidates may be submitted to the court along with an application for such change. In case there is a plural number of reorganizers, execution of all matters relating to reorganization shall be effected by a majority vote of them. In the execution of duties, the reorganizers shall act under the supervision of the reorganization supervisors. In case a reorganizer Acts in violation of the laws or improperly, the reorganization supervisors may apply to the count for discharging his/her office and selecting a new one. In the execution of duties, the reorganizers

similar to the debtor in possession of America in Japan and Germany.[89] In view of legislation there are three modes of setting up the business institution in the world.

**a. the alternative business institution mode**

This mode regulates that either the debtor in possession or the administrator can act as the business institution during the corporate reorganization period. But they are exclusive subjects. The Federal Bankruptcy Code of the United States is representative of this legislation mode. It changes the regulation of compulsive trustee of the Chandler Act of 1938 and introduces the conception of debtor's own reorganization and consequently makes the debtor in possession become the emphasis of the reorganization system. That means, during the reorganization period the company's administrators still possess the properties, manage the company and execute the reorganization proceedings if the interested parties do not apply to the court to appoint the trustee in principle, without the ruling of the court. But the interested parties can apply for the trustee at any time after the start-up of the reorganization proceedings but before adoption of the reorganization plan. According to the Article 1104 of the Federal Bankruptcy Code of the United States,

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shall secure the prior consent of the reorganization supervisor: 1. Disposal of property of the company outside the scope of its business; 2. Change of the business of the company or in the ways of operation; 3. Contract of loans; 4. Conclusion or rescission of important or long term contracts, the scope of which shall be determined by the reorganization supervisor; 5. Proceeding in litigation or arbitration; 6. Waiver or assignment of rights of the company; 7. Dealing in cases where others exercise rights of retrieval, rescission or set-off; 8. Appointment and removal of important officers of the company; and 9. Other acts restricted by the court."

[89] For example, *see* the German Insolvency Law (Insolvenzordnung), Article 270 (1): "The debtor may manage and dispose of the assets involved in insolvency proceedings under surveillance by a custodian if the insolvency court orders such personal management while deciding on the opening of the insolvency proceedings. Such proceedings shall be subject to the general provisions unless this part provides otherwise."

the court shall order the appointment of a trustee—(a) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor; or (b) if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor.

The Japanese Civil Rehabilitation Law also adopts the reorganization system of the self-reconstruction style on the basis of the Federal Bankruptcy Code of the United States and its regulations about the business institution absolutely imitate the American mode.[90)]

**b. the paratactic business institution mode**

This mode regulates that the business institution is in the charge of the administrator and the debtor during the corporate reorganization period. The French No. 98 Statute in 1985 is representative of this mode. Once the reorganization ruling is made, the observation period begins and the corporate business can still carry through.[91)] The judicial administrator can supervise the debtor's business activities or take on full of partial management of the enterprise

[90)] *See* the Japanese Civil Rehabilitation Law, Article 38 (2): "The rehabilitation debtor has the right of honest execution of the business and property to all the creditors after the startup of the rehabilitation proceedings."

[91)] *See* the French Commercial Code, Article L621-26: "The activity of the undertaking shall be continued during the observation period, subject to the provisions of Articles L.621-27 to L.621-35."

according to the appointment of the court. The debtor can continue to manage and dispose of his properties and execute the rights that have not been included in the administrator's authority. Although the paratactic mode of France permits the debtor to proceed to self-management, this flexibility is on the basis of the safe foundation of the administrator's restriction of the debtor. In other words, the debtor's rights lie on the administrator's authorities granted by the court. And the court can change the administrator's tasks according to the authority of the court itself or the application of the administrator, the creditor representative or the inquisitor at any time.[92] This phenomenon is closely related to the reorganization mode of court standard. And actually in France it is the court that controls the appointment of the business manager of the reorganization corporations and the advancing of the reorganization plan. Although this court standard mode can avoid the procedural waste because of the interests conflicts and asymmetric information, its excessive centralization of power has deviated from the market mechanism. It is rather difficult to operate this kind of legislation and there is seldom case of successful corporate reorganization according to the judicial reorganization proceedings in practice in France.[93]

[92] Shen Daming & Zheng Shujun,「Bijiao Pochanfa Chulun」[An Introduction on the Comparative Bankruptcy Law], Zhongguo Duiwai Maoyi Jiaoyu Chubanshe [International Business Education Press of China] (1993), at 256.

[93] Kevin M. J. Kaiser, "European Bankruptcy Law: Implications for Corporations Facing Financial Distress," Financial Management, Financial Management Press (1996), Vol. 25, at 71~73.

**c. the single business institution mode**

This mode regulates that only the administrator appointed by the court can be the business institution during the corporate reorganization period and the company's managers cannot continue to administer the business any more during the period. The British Insolvency Act, the Japanese Corporation Regeneration Law and the Company Act of Taiwan District of China all adopt the single business institution mode. For example, according to the British Insolvency Act, once the administrative order is made any administrative person who has taken possession of the company should demit his position and any person who has taken possession of a part of the corporate properties should demit his position, responding to the administrator's requirement.[94] Also there are similar regulations in the Japanese

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[94] *See* the U.K. Insolvency Act, Article 11: "(1) On the making of an administrative order-

(a) any petition for the winding up of the company shall be dismissed, and

(b) any administrative receiver of the company shall vacate office.

(2) Where an administration order has been made, any receiver of part of the company's property shall vacate office on being required to do so by the administrator.

(3) During the period for which an administration order is in force-

(a) no resolution may be passed or order made for the winding up of the company;

(b) no administrative receiver of the company may be appointed;

(c) no other steps may be taken to enforce any security over the company's possession under any hire-purchase agreement, except with the consent of the administrator or with leave of the court and the subject (where the court gives leave) to such terms as the courts may impose; and

(d) no other proceedings and no execution or other legal process may be commenced or continued, and no distress may be levied, against the company or its property except with the consent of the administrator or the leave of the court and subject (where the court gives leave) to terms as aforesaid.

(4) Where at any time an administrative receiver of the company has vacated office under subsection (1)(b), or a receiver or part of the company's property has vacated office under subsection (2)-

(a) his remuneration and any expenses properly incurred by him, and

(b) any indemnity to which he is entitled out of the assets of the company, shall be charged on and (subject to subsection (3) above) paid out of any property of the company which was in his custody or under his control at that time in priority to any security held by the person by or on whose behalf he was appointed.

(5) Neither an administrative receiver who vacates office under subsection (1)(b) nor a receiver who vacates office under subsection (2) is required on or after so vacating office to take any steps for the purpose of complying with any duty imposed on him by section 40 or 59 of this Act (duty to

laws[95] and the Taiwan District laws.[96]

**d. review**

These three legislation modes about the business institution during the reorganization period discussed above have their own merits and demerits respectively. Undoubtedly, the American mode can improve the efficiency of the reorganization proceedings and the probability of the successful corporate reorganization while it is deficient in the aspect of justness. The single business institution mode is apparently propitious to the justness but has a relative low efficiency in urging the company to revive and realizing the corporate regeneration. Thus the paratactic business institution mode seems to give enough attention to both the efficiency and the justness. But actually it lacks maneuverability because in the corporate reorganization proceedings the efficiency and the justness are born to be inconsistent and it is quite difficult to conciliate them.

In my opinion, since justness and efficiency have unavoidable conflicts in the

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pay preferential creditors)."

And Article 13: "(1) The administrator of a company shall be appointed Appointment either by the administration order or by an order under the new subsection.

(2) If the vacancy occurs by death, resignation or otherwise in the office of the administrator, the court may be order fill the vacancy.

(3) An application for an order under subsection (2) may be made-

(a) by any continuing administrator of the company; or

(b) where there is no such administrator, by the creditors' committee established under section 26 below; or

(c) where there is no such administrator and no such committee, by the company or the directors or by any creditor or creditors of the company or

(d) by the Bank of England."

95) *See* the Japanese Corporation Regeneration Law, Article 53: "The administrator has the exclusive right of executing the corporate business and the properties when there is the ruling of generation proceedings," Article 94: "The administrator should be selected and appointed from those people who have the proper qualification."

96) *See supra* footnote 88.

corporate reorganization, it is necessary to give priority to either efficiency or justness while the other purpose is also considered. And as to the value of the reorganization system it is obvious for us to pay more attention to the efficiency. In other words, the most important thing to consider in the reorganization proceedings is how to achieve a successful and effective reorganization and the second thing is to protect the interested parties equally. Therefore the alternative business institution mode is most accordant to the original purpose of the reorganization system and in principle the company's business institution during the reorganization period should be controlled by the managers of the debtor company.

There are at least four advantages hereinafter of the mode of debtor in possession: first, it can urge the company in mess to apply for the reorganization as soon as possible and revive through the reorganization;[97] secondly, it can exert the debtor company manager's advantage of knowing well about the corporate business situation and operation details; thirdly, the managers of the debtor company have the best motivation of rescuing the company most; finally, the managers of the debtor company have the possibility to create the feasible reorganization plan and proceed to it most.

Of course, such regulations may threaten the interests of the creditors and other interested parties. Just as Montesquieu says in his "the Spirit of Laws,"[98] authority must be made to restrict authority in order to prevent the abuse. The corresponding supervisory mechanism has to be set up and the reorganization proceedings should

[97] Michelle J. White, "The Cost of Corporate Bankruptcy: A. U. S.-European Comparision," Cambridge University Press, New York (1996), at 478~479.

[98] Montesquieu,「Lun Fa de Jingshen」［The Spirit of Laws］, translated by Zhang Yanqiu, Zhongguo Shangwu Yinshuguan［the Commercial Press］(1961), at 154.

be supervised by the outside supervisors and at the same time the original manager's controlling right of the debtor company's continued business should be kept. Only with such measures can the interests of the creditors and other interested parties be protected equally on the basis of efficient reorganization and can the interests balance be realized.

**3) The Legal Status of the Business Institution**

Whether it is controlled by the administrator or by the original company's managers, the business institution during the corporate reorganization period is different from the original company's execution institution—the board of directors. The board of directors is elected by the shareholders and should be responsible for the company and its shareholders' meeting. The board of directors only represents the interests of the company and its shareholders due to its characteristic of the company's statutory administrative institution. But the business institution has to be responsible for the court and accept the supervision of the court, and it pursues not only the best interest of the enterprise but also the interests of the creditors, the shareholders, the employees and the other interested parties. Besides the company's continued business, the business institution also has to take charge of the formulation and execution of the reorganization plan. Another thing that has to be pointed out is that although the business institution is similar to the bankruptcy administrator (liquidator) in the bankruptcy liquidation, the two institutions should not be equally regarded because the bankruptcy administrator only has the right to manage and dispose of the bankruptcy property and is not related to the company's

business and the reorganization plan while the business institution holds the company's continued business as its core task.[99)]

As to the legal status of the business institution during the reorganization period there are altogether three viewpoints: a) the business institution is the execution institution of the interested parties and it should be responsible for the reorganization company's business and management. It is the proxy of the interested parties, but not the representative of the reorganization corporation; b) the business institution is appointed by the court as the national institution and should execute the corporate reorganization affairs in accordance with the laws and regulations. The authorities of the business institution come from the legal regulations, not the proxy of the civil law, and its effect applies to the company and all the interested parties; c) the relationship between the business institution and the reorganization company is a kind of fiduciary relationship and the business institution actually act the liability of the fiduciary.[100)] However, these viewpoints have their own defections. As to the first viewpoint, the business institution is apparently not the proxy of the reorganization corporation, the creditors and the court because it acts the legal behaviors in its own name. Moreover, the proxy cannot act as the common agent of the parties with conflicting interests. The defection of the second viewpoint is that although the business institution is appointed by the court, it is only a temporary institution for the company's revival.

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[99)] But the legal status of the business institution is basically same as the bankruptcy administrator after all.

[100)] Li Yongjun,「Pochan Chongzheng Zhidu Yanjiu」[A Research on the Reorganization System], Zhongguo Renmin Gong'an Dxue Chubanshe [Chinese People's Republic Security University Press] (1996), at 117.

Its liabilities will end with the end of the reorganization proceedings and cannot be regarded as a national execution institution. And as to the third viewpoint, since the business institution is appointed by the court, and not trusted directly by the reorganization company, even if the business institution is regarded as a fiduciary, it should be the fiduciary of the court.[101)]

The Federal Bankruptcy Code of the United States introduces the trust relationship of the property law into the bankruptcy law and calls the person who collects, arranges, sells and distributes the bankruptcy properties the “trustee.” The trustees are sorted into three types: a) the official trustee of the American government. They belong to the officials appointed by the government and their main duty is to supervise and manage work of the interim trustee and the formal trustee; b) the interim trustee. They are appointed by the official trustee after the start-up of the bankruptcy proceedings but before the appointment of formal trustee; c) the formal trustee. They are elected by the creditors’ meeting to collect, arrange, sell and distribute the bankruptcy properties. The trustee we usually refer to is the formal trustee. In order to ensure that the trustee works effectively, the Bankruptcy Code provides three identities to the trustee. Those are the identity of creditors with secured claims, the identity of the bona fide purchaser of the real property and the identity of the creditors with ordinary claims. These identities are not the true ones of the trustee because the trustee is actually an outsider who provides professional

[101)] D. G. Epstein & M. M. Sheinfeld,「Business Reorganization under the Bankruptcy Code,」 p52. Quoted from: Wang Weiguo, “Lun Chongzheng Qiye de Yingye Shouquan Zhidu［A Research on the Business Warrant System of the Reorganization Enterprise］,” Bijiaofa Yanjiu Vol. 1 ［Comparative Law］, Zhongguo Zhengfa Daxue Bijiaofa Yanjiu Bianjibu［China University of Police and Law Press Comparative Law Newsroom］(1998), at 74.

service. The purpose of the Bankruptcy Code is ensuring the trustee to execute his authority in accordance with the laws.[102] In other words, according to the American Bankruptcy Code, the trustee only provides his professional service to get the payment and has an independent status in the legal proceedings although he is the representative of the creditors on the surface.[103]

In my opinion, the business institution during the corporate reorganization period is a special institution that is responsible for the management and disposition of the corporate properties and the formulation and execution of the reorganization plan and it has a relatively independent legal status. Although the name of the "relatively independent special institution" is a little vague, it can explain the independence of the interests of all the parties and the relationship between the business institution and the court, and it can settle the problems of other viewpoints consequently.

#### 4) The Rights and Relative Restrictions of the Business Institution

##### a. overview

The rights of the business institution should be created to ensure the corporate reorganization to effectively proceed and the core right is certainly the management right to continue the company's business. Generally speaking, the rights of the

[102] Pan Qi,「Meiguo Pochanfa」[The American Bankruptcy Law], Zhongguo Falv Chubanshe［Law Press of China］(1999), at 22, 143~144.

[103] Differently, the U.K. Insolvency Act regulates that the administrator be regarded as the proxy of the corporation when he exercise his rights. *See* the U.K. Insolvency Act, Article 14(5): "(5) In exercising his powers the administrator is deemed to act as the company's agent."

business institution can be summarized into four aspects: the right of management of the corporate business, the right of disposition of the corporate property, the right of formulation and execution of the reorganization plan and the right of obtainment of the payment. The British Insolvency Act has regulated the relative comprehensive articles as to the rights of the business institution and it basically includes all the aspects.[104)]

The rights of the business institution not only affect the outcome of the corporate reorganization, but also have a close relationship with the interests of all the parties, especially the creditors. On one hand, since the company has been in the financial mess, and also because of the creditors' possible congregative action of recovering, it is necessary to authorize the business institution particularly to proceed on the corporate reorganization. On the other hand, the creditors' interests also have to be considered and then the rights of the business institution have to be restricted. The opportunity of the company's continued business and reorganization cannot be

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104) *See* the U. K. Insolvency Act, Article 14: "(1) The administrator of a company-

(a) may do all such things as may be necessary for the management of the affairs, business and property of the company, and

(b) without prejudice to the generality of paragraph (a), has the powers specified in Schedule 1 to this Act; and in the application of that Schedule to the administrator of a company the words"he" and "him" refer to the administrator.

(2) The administrator also has the power-

(a) to remove directors of the company and to appoint any person to be director of it, whether to fill a vacancy or otherwise, and

(b) to call any meeting of the members or creditors of the company.

(3) The administrator may apply to the court for directions in relation to any particular matter arising in connection with the carrying out of his functions.

(4) Any power conferred on the company or its officers , whether by this Act or the Companies Act or by the memorandum or articles of association, which could be exercised in such a way as to interfere with the exercise by the administrator of his powers is not exercisable except with the consent of the administrator, which may be given either generally or in relation to particular cases.

(5) In exercising his powers the administrator is deemed to act as the company's agent.

(6) A person dealing with the administrator in good faith and for value is not concerned to inquire whether the administrator is acting within this powers."

realized at a cost of sacrificing the creditors' interests. But it is just this kind of tense relationship between the right of management of the business institution and the right of controlling of the creditors that brings the possibility of conciliating the interested parties and establishes the base of a feasible and equal reorganization plan. I will discuss the special rights of the business institution and its restrictions to it hereinafter.

**b. the possession, use and disposition of the corporate properties**

Possessing, using and disposing of the corporate properties are the premises and bases of the company's business, and these rights of the business institution will certainly conflict with the discharging interests of the creditors with ordinary claims and the execution of the secured properties of the creditors with secured claims. The ordinary creditors are protected by the restrictions of the business institution on the use, sale or lease the corporate properties out of the company's daily business.[105] And as to the creditors with secured claims, although their rights of disposition of the secured properties are prohibited in principle, the business institution cannot dispose of the secured properties arbitrarily, either.[106]

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[105] *See* the U.S. Federal Bankruptcy Code, Article 364 (b), (c): "(b) The court, after notice and a hearing, may authorize the trustee to obtain unsecured credit or to incur unsecured debt other than under subsection (a) of this section, allowable under section 503 (b)(1) of this title as an administrative expense.

(c) If the trustee is unable to obtain unsecured credit allowable under section 503 (b)(1) of this title as an administrative expense, the court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt—

(1) with priority over any or all administrative expenses of the kind specified in section 503 (b) or 507 (b) of this title;

(2) secured by a lien on property of the estate that is not otherwise subject to a lien; or

(3) secured by a junior lien on property of the estate that is subject to a lien."

[106] *See* the U.S. Federal Bankruptcy Code, Article 363 (c)(2): "(2) The trustee may not use, sell, or lease cash collateral under paragraph (1) of this subsection unless—

**c. the acquisition of the new capital**

One of the most important problems that the reorganization corporation faces is how to acquire capital for the company's continued business and the reorganization proceedings. Generally speaking, the reorganization corporation can get the new capital through increasing the capital, disposing of the company's properties, taking the loans or other measures. But because at that time the corporation has been in the financial mess and has a relative low credit, its original shareholders will mostly be reluctant to subscribe any more when the corporation tries to increase the capital; its original creditors care about the discharging to their claims and will not provide the capital to the corporation, either; and it is also difficult to borrow money from the third party. The only measure to acquire new capital is strengthening the protection of the new creditors. It means that the corporation should provide a relatively preferred status or security to the new creditors. Thus the original creditors' interests will certainly be affected. It is important to balance their interests and not only protect the new creditors' interests on the premise of acquiring the new capital but also pay attention to the original creditors' interests. The different laws in different countries all regard the claims that occur with the behaviors of raising new capital of the reorganization corporation as the common claims, and provide a preferential right to these claims in order to increase people's willingness of offering capital to the reorganization corporation and increase the possibility of a successful reorganization.[107)]

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(A) each entity that has an interest in such cash collateral consents; or

(B) the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of this section."

[107)] For example, *see* the U. K. Insolvency Act, Article 19: "(1) The administrator of the company may

**d. the performance and termination of the bilateral contract**

Whether the bilateral contract that exists already but has not been performed or not fully performed prior to the reorganization proceedings is still to be performed or not is quite significant to the reorganization corporation. That is because the

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at any time be removed from office by order of the court and may, in the prescribed circumstances, resign his office by giving notice of his resignation to the court.

(2) The administrator will vacate office if-

(a) he creases to be qualified to act as an insolvency practitioner in relation to the company, or

(b) the administration order is discharges.

(3) Where at any time a person ceases to be administrator, the following subsections apply. apply.

(4) His remuneration and any expenses properly incurred by his shall be charged on and paid out of any property of the company which is in his custody or under his control at that time in priority to any security to which section 15(1) then applies.

(5) Any sums payable in respect of debts or liabilities incurred, while he was administrator, under contracts entered into ... by him or a predecessor of his in the carrying out of his or the predecessor's functions shall be charged on and paid out of any such property as is mentioned in subsection (4) in priority to any charge arising under that subsection.

(6) Any sums payable in respect of liabilities incurred, while he was administrator, under contracts of employment adopted by him or a predecessor of his in the carrying out of his or the predecessor's functions shall, to the extent that the liabilities are qualifying liabilities, be charged on and paid out of any such property as is mentioned in subsection (4) and enjoy the same priority as any sums to which subsection (5) applies.

For this purpose, the administrator is not to be taken to have adopted a contract of employment by reason of anything done or omitted to be done within 14 days after his appointment.

(7) For the purposes of subsection (6), a liability under a contract of employment is a qualifying liability if-

(a) it is a liability to pay a sum by way of wages or salary or contribution to an occupational pension scheme, and

(b) it is in respect of services rendered wholly or partly after the adoption of the contract.

(8) There shall be disregarded for the purposes of subsection (6) so much of any qualifying liability as represents payment in respect of services rendered before the adoption of the contract.

(9) For the purposes of subsections (7) and (8)-

(a) wages or salary payable in respect of a period of holiday or absence from work through sickness or other good cause are deemed to be wages or (as the case may be) salary in respect of services rendered in that period, and

(b) a sum payable in lieu of holiday is deemed to be wages or (as the case may be) salary in respect of services rendered in the period by reference to which the holiday entitlement arose.

(10) In subsection (9)(a), the reference to wages or salary payable in respect of a period of holiday includes any sums which, if they had been paid, would have been treated for the purposes of the enactments relating to social security as earnings in respect of that period."

And the Company Act of Taiwan District of China, Article 312: "The following debts incurred during the reorganization of the company shall have preference for repayment over the rights of creditors in reorganization: 1. Debts incurred for continued operation of the business of the company; and 2. Expenses incurred in the process of reorganization. The aforesaid right of preference for repayment shall not be prejudiced on account of a ruling for termination of reorganization."

bilateral contract has the characteristic of admixture and it may relates to the property rights and debts at the same time. The reorganization legislations in different countries all provide the option of deciding the dissolution or continued performance of such contract to the business institution of the reorganization corporation in order to help the reorganization corporation to avoid those contracts that may bring burdens to the corporation and continue to perform those contracts that benefit the corporation.[108] While providing the option to the business institution, the laws also restrict this option in order to protect the opposite parties. These restrictions mainly include: ⅰ) the option of the business institution should get the agreement of the court. For example, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor;[109] ⅱ) the opposite party is provided the right of interpellation. It means that when the business institution has not showed its decision of the dissolution or continued performance, the opposite party can require the business institution to make its declaration. And if the business institution does not declare within a

[108] Foe example, *see* the PRC. Enterprise Bankruptcy Law, Article 18: "After the people's court has accepted the bankruptcy application, the administrator shall have the right to decide the dissolution or continued performance of any contract established prior to the acceptance of the bankruptcy application and not fully performed by both the debtor and the counterparty upon notice to the counterparty. If the administrator fails to notify the counterparty within two months of the acceptance of the bankruptcy application or fails to reply within 30 days of receipt of the counterparty's demand, the contract shall be deemed dissolved. If the administrator decides to continue to perform the contract, the counterparty shall do so but it has the right to demand the administrator to provide security. If the administrator fails to provide security, the contract shall be deemed dissolved." And the U.S. Federal Bankruptcy Code, Article 365 (f) (2) (A): "(A) the trustee assumes such contract or lease in accordance with the provisions of this section; …" and (c) (2): "(2) such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor."

[109] *See* the U.S. Federal Bankruptcy Code, Article 365 (a): "(a) Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor."

regulated period, the contract is deemed to be abandoned.[110] iii) if the business institution chooses the continued performance, the expenses of performing this contract are treated as the first priority of unsecured claims.[111]

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[110] For example, *see* the U.S. Federal Bankruptcy Code, Article 365 (d) (4): "(4) Notwithstanding paragraphs (1) and (2), in a case under any chapter of this title, if the trustee does not assume or reject an unexpired lease of nonresidential real property under which the debtor is the lessee within 60 days after the date of the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such lease is deemed rejected, and the trustee shall immediately surrender such nonresidential real property to the lessor."

And the French Commercial Code, Article L621-28: "The receiver alone shall have power to perform existing contracts by supplying the service promised to the debtor's other contracting party. The contract shall be automatically terminated where notice to the receiver shall have produced no response within a month. Before the expiration of the said period, the insolvency judge may give the receiver a shorter period or grant a longer one, not exceeding two months, to make the position clear.

Where the consideration consists of payment of a sum of money, the said sum must be paid in cash, unless the receiver obtains the agreement of the other party to the debtor's contract to accept payment by instalments. In the light of the documents in their possession, receivers must ensure when applying for enforcement that they will be holding the necessary funds. Where the contract provides for performance by stages or payment by instalments, the receiver must terminate it if it appears that the necessary funds will not be held to fulfil the obligations of the next stage.

In the event of failure to pay in accordance with the conditions defined in the preceding sub-paragraph and in the absence of the other contracting party's agreement to continue the contractual relations, the contract shall be automatically rescinded and the Parquet, the receiver, the creditors' representative or a supervisor may apply to the Court for an order ending the period of observation.

The other contracting party must perform the relevant obligations notwithstanding the non-performance by the debtor of obligations arising before the decision to commence insolvency proceedings. Non-performance of the said obligations shall entitle creditors only to a declaration that the same are included in the debtor's liabilities to them.

If the receiver shall not exercise the right to continue the contract, non-performance may give rise to an award of damages the amount of which shall be included in the liabilities for the benefit of the other party. The latter may nevertheless defer the repayment of any surplus sums paid by the debtor in performance of the contract until a decision has been given on the award of damages. Notwithstanding any legal or contractual provision, no joint liability, rescission or termination of the contract shall result from the mere fact that proceedings for an administrative order have been commenced. The provisions of this Article shall not apply to contracts of employment. "

[111] For example, *see* the relative content of the French Commercial Code in the footnote *ibid* and the U.S. Federal Bankruptcy Code, Article 365 (g): "(g) Except as provided in subsections (h)(2) and (i)(2) of this section, the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease—

(1) if such contract or lease has not been assumed under this section or under a plan confirmed under chapter 9, 11, 12, or 13 of this title, immediately before the date of the filing of the petition; or

(2) if such contract or lease has been assumed under this section or under a plan confirmed under chapter 9, 11, 12, or 13 of this title—

(A) if before such rejection the case has not been converted under section 1112, 1208, or 1307

**e. the modification and termination of the labor contract**

The corporate reorganization regards the company's revival as its purpose and a successful reorganization will bring benefits not only to the company's original employees but also to the unemployed people in the society. Generally speaking, there is no conflict between the corporate reorganization and the workers. But it does not mean that the purpose of the corporate reorganization is always in accordance with the workers' interests. During the corporate reorganization period, it is unavoidable to cut down some employees to ensure an efficient reorganization. On the other hand, the laws have regulated the corresponding conditions and procedures to protect the employees' interests while providing the right of decreasing the number of employees to the business institution.[112)]

## 3. THE SUPERVISORY INSTITUTION DURING THE CORPORATE REORGANIZATION PERIOD

### 1) The Significance of the Supervisory Institution

The corporate reorganization is a quite complex piece of social work and it is related to the private interests of all the parties and the common interests. The

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of this title, at the time of such rejection; or

(B) if before such rejection the case has been converted under section 1112, 1208, or 1307 of this title—

(i) immediately before the date of such conversion, if such contract or lease was assumed before such conversion; or

(ii) at the time of such rejection, if such contract or lease was assumed after such conversion."

112) For example, *see* the French Commercial Code, Article L621-38: "Any sum paid by an association such as is mentioned in Article L.143-11-4 of the Employment Code pursuant to Articles L.143-11-1 to L.143-11-3 thereof must be declared to the tax authority."

outcome of the reorganization will certainly affect the interested parties, even the social stability. Thus the right supervisory mechanism is needed to ensure the efficiency and the justness of the reorganization proceedings. It is difficult for us to image that the corporate business institution will achieve the trust and support of the creditors, the shareholders, the providers and other parties and then burden the whole reorganization without the supervision or the sufficient supervision. In a word, establishing a scientific, feasible and efficient supervisory mechanism has important theoretical significance and practical significance in preventing the business institution from abusing its rights and ensuring the justness and efficiency of the corporate reorganization proceedings.

As to the material contents of the supervisory mechanism, the regulations in different countries can be differentiated as the inside supervision, the legal supervision and the outside supervision. The inside supervision refers to the administrator's high-criterion duty of care.[113] During the corporate reorganization period the business institution should pay more attention to the company's continued business, the disposition of the corporate properties and the formulation and execution of the reorganization plan than ordinary person. The legal supervision refers to the property security system and the legal liability that is set up to restrict the administrator's behavior. The property security system is usually

[113] For example, *see* the Company Act of Taiwan District of China, Article 313: "Inspectors, reorganization supervisors and reorganizers shall perform their duties with the care of good administrators. Their remuneration shall be determined by the court in consideration of the nature of their duties. An inspector, reorganization supervisor or reorganizer who violates law or ordinance in the performance of his duties, thereby causing loss or damage to the company, shall compensate the company. Inspectors, reorganization supervisors or reorganizers who make a false statement or record of their acts within the scope of duties shall be severally subject to imprisonment for a period not exceeding one year, detention and/or a fine not exceeding NT$60,000."

used when the bankruptcy administrator is appointed and it requires the administrator to provide some properties to be the security. This system plays an active role in ensuring that the administrator executes his duty. The legal liability includes the civil liability, the administrative liability and the criminal liability. Moreover, many countries regulate the bankruptcy crime.

Although the inside supervision and the legal supervision can do well in supervising the business institution, people's self-conscious behavior and the stateliness of the laws may be the best supervision and the last choice to some extent. But as to the complex reorganization proceedings, it is impossible for us to depend only on such ex post facto remedy to ensure a fair and efficient reorganization. The business institution of the corporate reorganization may damage the creditors' interests by virtue of their sufficient information and rights. Therefore the outside supervisory institution should be set up to be responsible for the reorganization proceedings.

**2) The Rights of the Supervisory Institution**

Generally speaking, the members of the supervisory are chosen and appointed by the court from those people or legal persons who have the professional knowledge and management experience, and these members should have no relationship with the reorganization corporation. According to the provisions regulated in the Company Act of Taiwan District of China, the rights of the supervisory institution are different in different countries and districts and they commonly include: a) supervise the business institution to execute its duty during the reorganization

period;[114] b) approve the behavior of the business institution in advance; c) supervise the corporate business and management and the takeover of the right of property disposition;[115] d) accept the filing of the reorganization claims and shareholders' rights;[116] e) apply to the court for the necessary disposition;[117] f) convene, inform and preside over the meeting of the interested parties[118] and g)

[114] *See* the Company Act of Taiwan District of China, Article 290(4): "In case there is a plural number of reorganizers, execution of all matters relating to reorganization shall be effected by a majority vote of them."

[115] *Ibid* Article 293: "After delivery of the ruling for reorganization of the company, the operation of the business of the company and the power of controlling and disposing of the property thereof shall be transferred to reorganizers, and the reorganization supervisor shall supervise such transfer, which shall then be reported to the court. Upon such transfer, the shareholders' meeting, directors and supervisors shall cease to perform their duties and to exercise their powers. At the time of the aforesaid transfer, the directors and managerial officers of the company shall hand over to the reorganizers all statements and records of accounts and documents relating to the business and finance of the company and all property thereof. The directors, supervisors, managerial personnel, or other staff personnel shall have the obligation to answer the enquiries made by the reorganization supervisors or reorganizers regarding the operation and financial activities. Directors, supervisors, managerial officers or other members of the staff of the company, for any of the following acts, shall be severally subject to imprisonment for a period not exceeding one year, detention and/or a fine not exceeding NT$60,000: 1. Refusal to transfer; 2. Concealment, destruction or damage of statements, records of accounts or documents relating to the business or financial condition of the company; 3. Concealment, destruction, or removal of property of the company, or the disposal of such property a manner prejudicial to creditors; 4. Refusal to answer questions mentioned in the aforesaid paragraph without reason; and 5. Fabrication of debts or acknowledgement of untrue debts."

[116] *Ibid* Article 297: "All creditors in reorganization shall produce documents to sufficiently prove the existence of their rights for declaring their rights to the reorganization supervisor and, if so declared, the prescription is interrupted and, if not declared, no repayment shall be made according to the reorganization procedures. Rights of registered shareholders of the company shall be based on records in the shareholders' roster. The provision of the preceding paragraph governing declaration shall apply mutatis mutandis to rights of unregistered shareholders and, if not declared, no such right shall be exercised according to the procedures of reorganization. In case of failure to declare as provided in the two preceding paragraphs for causes not attributable to the persons of whom declaration is required, such persons may make good the declaration within fifteen days after extinction of the cause; however, no declaration shall be accepted after the reorganization plan has been adopted at a meeting of the concerned parties."

[117] *Ibid* Article 295: "The disposition made by the court in accordance with the provisions of Article 287, Paragraph 1, Items 1, 2, 5 and 6 shall remain in effect regardless of the ruling for reorganization, and in the absence of such disposition, the court may still render such rulings on the application of an interested party or the reorganization supervisor or ex officio after having rendered the ruling for reorganization."

[118] *Ibid* Article 300(2): "The reorganization supervisor shall be the chairman of all meetings of concerned persons and shall convene all such meetings with the exception of the first meeting."

report the modification and termination reason of the reorganization plan to the court.[119)]

Similar as the member of the business institution, the member of the supervisory institution should also perform his supervision liability with a well will and he has to be responsible for the improper behavior that damages the reorganization corporation.

## 4. THE CREDITORS' SELF-GOVERNMENT INSTITUTION DURING THE CORPORATE REORGANIZATION PERIOD

### 1) The Status of the Creditors' Self-government Institution

The modern bankruptcy laws in most countries have set up the creditors' meeting—the basic form of the creditors' self-government institution.[120)] As a declaration institution, the creditors' meeting can not only support the process of the bankruptcy proceedings but also protect every creditor to execute his rights equally. The only way of the creditors to express their common interests is constituting and convening the creditors' meeting. According to the regulations of

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[119)] *Ibid* Article 306(1): "In case the plan of reorganization is not adopted by the groups with voting right at the meeting of persons concerned, the reorganization supervisor shall forthwith report to the court and the court may direct modification or alteration on fair and reasonable principle and order the meeting of persons concerned to reconsider the plan within one month." And (3): "In case the plan of reorganization mentioned in the first paragraph of the preceding article or in the preceding paragraph cannot or need not be executed on account of change in circumstances or for a good cause, the court may, on application of the reorganization supervisor, reorganizers, or persons concerned, render a ruling to order the meeting of persons concerned to reconsider. In case there is obviously no possibility of or necessity for reorganization, the court may render a ruling for termination of reorganization."

[120)] But there are also some countries that haven't set up the creditors' meeting, such as France and Italy.

the bankruptcy laws in most countries, the first creditors' meeting has to be convened by the court within the statutory period after the start-up of the bankruptcy proceedings and it is often called the statutory creditors' meeting. Other creditors' meetings are only convened when it is necessary—for the need of proceeding on the bankruptcy proceedings and protecting the interest of the creditors as a whole. And the necessary circumstances generally include: a) the court decides to convene; b) the president of the creditors' meeting decides to convene; c) bankruptcy administrator or the supervisor requests to convene and d) the creditors account for more than a certain proportion request to convene. We can find that the creditors' meeting is not frequently convened daily. And some countries set up the creditors committee to execute the rights of the creditors as a whole as the representative. The creditors' meeting and the creditors committee are both set up in most countries while Japan and Taiwan District of China set up the interested parties' meeting more and America only set up the creditors committee and the shareholders committee. The creditors' self-government institution not only provides the opportunity of protecting their own interests to the creditors but also makes the condition of getting the creditors' cooperation to the court and the business institution. In my opinion, it is quite necessary to set up the creditors committee besides the creditors' meeting and the interested parties' meeting. The creditors' meeting and the interested parties' meeting are constituted by all the creditors or the interested parties and it is actually difficult for them to supervise together. These two institutions are not the standing bodies, either. It is impossible for them to supervise in time. The creditors committee can remedy this defection

and avoid the shortcoming of low efficiency and huge business cost of the creditors' meeting or the interested parties' meeting. According to American scholars' research, the function of the creditors committee is not apparent and even in some small cases the creditors committee is not set up in accordance with the laws and regulations in fact.[121)]

**2) The Establishment and Rights of the Creditors' Self-government Institution**

Establishing the creditors' self-government institution is the duty of the court in the reorganization proceedings. For example, according to the Japanese Corporation Reorganization Law, the Company Act of Taiwan District of China and the British Insolvency Act, the court should decide the date of the first interested parties' meeting or the creditors' meeting at the same time of the corporate reorganization ruling.[122)] And the Federal Bankruptcy Code of the United

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[121)] David G. Epstein, Steve H. Nickles, James J. White,「Bankruptcy」Translated by Han Changyin and other people, Zhongguo Zhengfa Daxue Chubanshe［China University of Police and Law Press］(2003), at 748.

[122)] *See* the Company Act of Taiwan District of China, Article 291: "After rendering a ruling of company reorganization, the court shall publish the following particulars by means of a public notice:

1. The text and the date of the ruling of company reorganization;
2. The name or title and the domicile or address of the reorganization supervisor and the reorganizers;
3. The period, date and place as fixed in accordance with the provisions of Paragraph I, Article 289 hereof; and
4. The legal consequences which may result from the negligence of the creditors and shareholders of bearer share certificates of the company to declare their claims and rights. The court shall still be obligated to serve notice in writing of the ruling and the particulars contained therein to the reorganization supervisor, the reorganizers, the company and the known creditors and the shareholders. At the time the court sends the aforesaid notice of ruling to the company, the court shall send a court clerk to write down in the accounting books the account-closing decision, to affix thereon his signature or seal, and to write down a brief statement describing the condition of such accounting books."

States regulates that the federal trustee should establish the unsecured creditors' meeting in time after the court's reorganization ruling, and the other creditors' meeting or the shareholders' meeting can also be established at that time.[123] The members of the interested parties' meeting include the creditors and the shareholders in principle. The creditors' meeting and the creditors committee can also include people other than the creditors.

As to the rights of the creditors' self-government institution, there are different regulations in different countries and districts and the most important rights are

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And Article 289: "At the time of ruling for reorganizers, the court shall select and appoint a person with specialized knowledge and experience in the operation of the business of such company or a banking institution as reorganization supervisor and decide on the following matters: 1. The period and place for declaring rights of creditors and shareholders, and the period shall not be less than ten days nor more than thirty days from the date of ruling;

2. The date and place to examine rights of creditors and shareholders thus declared, and the date shall be within ten days of the date of expiration of the aforesaid period for declaration; and 3. The date and place of the first meeting of parties concerned, and the date shall be within 30 days of the date after expiration of the period for declaration mentioned in Item 1. The aforesaid reorganization supervisor shall act under the supervision of the court and may be discharged by the court at any time. In case there is a plural number of reorganization supervisors, supervision on the execution of all matters relating to reorganization shall be effected by a majority vote of them."

The U. K. Insolvency Act, Article 23: "(1) Where an administration order has been made, the Statement of administrator shall, within 3 months(or such longer period as the court may allow)after the making of the order-

(a) send to the registrar of companies, the Bank of England and (so far as he is aware of their addresses) to all creditors a statement of his proposals for achieving the purpose or purposes specified in the order, and

(b) lay a copy of the statement before a meeting of the company's creditors summoned for the purpose on not less than 14days' notice.

(2) The administrator shall also, within 3 months(or such longer period as the court may allow) after the making of the order, either-

(a) send a copy of the statement(so far as he is aware of their addresses)to all members of the company, or

(b) publish in the prescribed manner a notice stating an address to which members of the company should write for copies of the statement to be sent to them free of charge

(3) If the administrator without reasonable excuse fails to comply with this section, he is liable to a fine and, for continues contravention, to a daily default fine."

[123] *See* the U.S. Federal Bankruptcy Code, Article 1102 (a) (1): "(1) Except as provided in paragraph (3), as soon as practicable after the order for relief under chapter 11 of this title, the United States trustee shall appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate."

checking and voting the reorganization plan. In my opinion, the creditors' function of taking part in the reorganization proceedings and supervising its process independently should be strengthened in order to ensure that the reorganization proceedings do not depart from the point of protecting the creditors.

## D. THE CREDITORS AND THE REORGANIZATION PLAN

### 1. OVERVIEW

The reorganization proceedings are designed to rescue the debtors and help them to go out of the mess. The first thing to realize the purpose of the reorganization is ensuring the debtor's continued business. Only the continued business can maintain the company's value of business and ensure the company to achieve a successful reorganization. The reorganization plan is the just thing for maintaining the corporate business because it is the most important legal document in the reorganization proceedings and the foundation of the continued business of the corporate business institution. The feasibility and rationality affects not only the process of the reorganization proceedings, but also the interests of the creditors, the shareholders and all the other interested parties. The reorganization plan can be regarded as the agreement of all the interested parties of the reorganization proceedings through the negotiations and the concessions, and it can also be regarded as the guideline for all the parties to strive for the company's revival. In

other words, the reorganization plan is the core of the whole reorganization proceedings.

The reorganization plan refers to the agreement made in accordance with the reorganization proceedings for maintaining the debtor's continued business, liquidating the debts and trying for the revival.[124] The reorganization plan is different from the agreements made by the debtors and the creditors through the conciliation out of the court. As to the latter kind of the agreements, they become effective only on the basis of all the creditors' approvals and their executions are not so simple because there is no statutory procedure or the court's supervision. However, the reorganization plan is created by the different interested parties with the court as a presider. The court can approve the reorganization proceedings by force according to the laws, even when there are opponent creditors. Just because the court presides and supervises the whole reorganization proceedings, promotes the interested parties to come to terms and creates the feasible reorganization plan, the debtor company's revival can proceed smoothly. The purpose of the reorganization plan is the utmost efficiency on the basis of equity.

[124] Li Yongjun,「Pochan Falv Zhidu」［the Bankruptcy Law］, Zhongguo Fazhi Chubanshe［China Legal Publishing House］(2000), at 290.

## 2. THE FORMULATION OF THE REORGANIZATION PLAN

### 1) The Framer of the Reorganization Plan

There are different legislation modes in different countries and districts. Generally speaking, there are approximately three modes hereinafter: a) the reorganization is framed by the debtor in principle and by other people as the exception. America is the representative of this mode and regulates that the creditors, the trustees, the creditors committee and the shareholders can all file the reorganization plan under some circumstances;[125] b) the reorganization plan is framed by the administrator in principle and by other people as the exception.

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[125] *See* the U.S. Federal Bankruptcy Code, Article 1121: " § 1121.Who may file a plan

(a) The debtor may file a plan with a petition commencing a voluntary case, or at any time in a voluntary case or an involuntary case.

(b) Except as otherwise provided in this section, only the debtor may file a plan until after 120 days after the date of the order for relief under this chapter.

(c) Any party in interest, including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may file a plan if and only if—

(1) a trustee has been appointed under this chapter;

(2) the debtor has not filed a plan before 120 days after the date of the order for relief under this chapter; or

(3) the debtor has not filed a plan that has been accepted, before 180 days after the date of the order for relief under this chapter, by each class of claims or interests that is impaired under the plan.

(d) On request of a party in interest made within the respective periods specified in subsections (b) and (c) of this section and after notice and a hearing, the court may for cause reduce or increase the 120-day period or the 180-day period referred to in this section.

(e) In a case in which the debtor is a small business and elects to be considered a small business—

(1) only the debtor may file a plan until after 100 days after the date of the order for relief under this chapter;

(2) all plans shall be filed within 160 days after the date of the order for relief; and

(3) on request of a party in interest made within the respective periods specified in paragraphs (1) and (2) and after notice and a hearing, the court may—

(A) reduce the 100-day period or the 160-day period specified in paragraph (1) or (2) for cause; and

(B) increase the 100-day period specified in paragraph (1) if the debtor shows that the need for an increase is caused by circumstances for which the debtor should not be held accountable. "

Japan is the representative of this mode and the company, the creditors who apply for the regeneration and the shareholders are listed as "other people;"[126] and c) the reorganization plan can only be framed by the administrator or the reorganizer. France and Taiwan District of China are the representatives of this mode.[127]

The formulation of the reorganization plan usually connects with the business institution during the reorganization period and the legislations above show the relationship, too. It means that as to the framer of the reorganization plan, the principle of "who is in charge, who files" is generally used. According to this principle, the debtor can file the reorganization plan if he manages the properties and business himself during the reorganization period; the administrator can file the plan if he is in charge of the properties and business. In my opinion, it is better to adopt the mode that the administrator acts as the main framer of the reorganization plan and the debtor as the assistant. Thus, the debtor's advantage of knowing well about its own properties and financial situation and the administrator's advantage of professional knowledge can both be exerted well.

**2) The Contents of the Reorganization Plan**

The contents of the reorganization plan should be approved by the creditors and shareholders and should be feasible to be executed. Moreover, the plan should also

[126] *See* the Japanese Corporation Regeneration Law, Article 189 (1): "The administrator should establish the draft of the reorganization plan within the period regulated by the court after the application period of the reorganization claims, and advance the draft to the court."

[127] For example, *See* the Company Act of Taiwan District of China, Article 303: "The reorganizers shall draw up a plan of reorganization and submit same together with reports and statements of business and finance of he company to the first meeting of concerned persons for examination. In the event of a change of reorganizers as provided in Article 290, the reorganization plan shall be submitted by newly appointed reorganizers within one month."

be created on the premise of paying attention to the utmost of the creditors' interests. America and Japan distinguished the contents of the reorganization plan into affairs that are absolutely necessary to record and affairs that are relatively necessary to record. If there is a lack of the former affairs, the reorganization plan will be regarded as illegal and the court will not approve it. Other countries have no such regulations of distinguishing the contents in the bankruptcy laws and only list the required contents.[128)]

The legislation mode of America and Japan is better than the other because such regulations are quite simple and clear for people to find what is absolutely necessary in the proceedings and then to practice. For example, the Federal Bankruptcy Code of the United States regulates that there are altogether seven kinds of affairs the plan should record: a) classes of claims and classes of interests; b) specify any class of claims or interests that is not impaired under the plan; c) specify the treatment of any class of claims or interests that is impaired under the plan; d) provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable

128) *See* the Company Act of Taiwan District of China, Article 304: "The following particulars, if any, in the reorganization of a company, shall be stated clearly in the reorganization plan: 1. Changes in rights of any or all creditors in reorganization or shareholders; 2. Changes in part or all of the business; 3. Disposal of property; 4. Ways and means of paying debts and the financial source thereof; 5. Standards and methods of valuation of assets of the company; 6. Alteration of the Articles of Incorporation of the company; 7. Readjustment or reduction of employees; 8. Issue of new shares or corporate bonds; and 9. Other necessary matters. Subject to the deadline date for discharge of all liabilities otherwise fixed, the duration for execution of the company reorganization plan shall not exceed one year as calculated from the date on which the court ruling of approval of the reorganization plan becomes final. In case the reorganization plan can not be completed as scheduled with good cause shown, an application for extension may be filed, with prior consent of the reorganization supervisors, with the court for a court ruling of extension provided, however, that if the reorganization plan is still not completed upon expiry of the extended period, then the court may, ex officio or at the petition of interested party or parties, render a ruling of termination of the company reorganization plan."

treatment of such particular claim or interest; e) provide adequate means for the plan's implementation; f) provide for the inclusion in the charter of the debtor, …, of a provision prohibiting the issuance of nonvoting equity securities, and providing, as to the several classes of securities possessing voting power, an appropriate distribution of such power among such classes, including, in the case of any class of equity securities having a preference over another class of equity securities with respect to dividends, adequate provisions for the election of directors representing such preferred class in the event of default in the payment of such dividends and g) contain only provisions that are consistent with the interests of creditors and equity security holders and with public policy with respect to the manner of selection of any officer, director, or trustee under the plan and any successor to such officer, director, or trustee.[129)] And in the Japanese Corporation

[129)] *See* the U.S. Federal Bankruptcy Code, Article 1123 (a): "(a) Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall—

(1) designate, subject to section 1122 of this title, classes of claims, other than claims of a kind specified in section 507 (a)(1), 507 (a)(2), or 507 (a)(8) of this title, and classes of interests;

(2) specify any class of claims or interests that is not impaired under the plan;

(3) specify the treatment of any class of claims or interests that is impaired under the plan;

(4) provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest;

(5) provide adequate means for the plan's implementation, such as—

(A) retention by the debtor of all or any part of the property of the estate;

(B) transfer of all or any part of the property of the estate to one or more entities, whether organized before or after the confirmation of such plan;

(C) merger or consolidation of the debtor with one or more persons;

(D) sale of all or any part of the property of the estate, either subject to or free of any lien, or the distribution of all or any part of the property of the estate among those having an interest in such property of the estate;

(E) satisfaction or modification of any lien;

(F) cancellation or modification of any indenture or similar instrument;

(G) curing or waiving of any default;

(H) extension of a maturity date or a change in an interest rate or other term of outstanding securities;

(I) amendment of the debtor's charter; or

(J) issuance of securities of the debtor, or of any entity referred to in subparagraph (B) or (C) of this paragraph, for cash, for property, for existing securities, or in exchange for claims or

Regeneration Law, there are mainly three kinds of absolutely necessary affairs.[130)]

The conclusion that the contents hereinafter are quite necessary to record can be drawn on the basis of studying the regulations above: a) the project of management; b) the classes of claims; c) the project of adjusting the claims; d) the project of discharging the claims; e) the implementation term of the reorganization plan and f) other projects that benefit the corporate reorganization.

### 3. THE ADOPTION OF THE REORGANIZATION PLAN

#### 1) The Grouping

The feasibility and equity of the reorganization plan affect not only the outcome of the corporate reorganization but also the interests of the creditors and shareholders. Therefore, the reorganization plan must be examined and approved by the creditors and the shareholders through voting after the administrator or the debtor has filed it. At the end, the creditors and the shareholders shall be grouped to vote. It means that the creditors and the shareholders vote separately in the groups

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interests, or for any other appropriate purpose;

(6) provide for the inclusion in the charter of the debtor, if the debtor is a corporation, or of any corporation referred to in paragraph (5)(B) or (5)(C) of this subsection, of a provision prohibiting the issuance of nonvoting equity securities, and providing, as to the several classes of securities possessing voting power, an appropriate distribution of such power among such classes, including, in the case of any class of equity securities having a preference over another class of equity securities with respect to dividends, adequate provisions for the election of directors representing such preferred class in the event of default in the payment of such dividends; and

(7) contain only provisions that are consistent with the interests of creditors and equity security holders and with public policy with respect to the manner of selection of any officer, director, or trustee under the plan and any successor to such officer, director, or trustee."

130) *See* the Japanese Corporation Regeneration Law, Article 211. Quoted from: Anonymity, "The Reorganization Procedure," http://61.152.238.85/pochan/neirong/a16.html (last visited on June 17, 2007).

according to a certain criterion and then get the result of voting depends on the results of all the groups.

**a. the principle of grouping**

Generally the creditors and the shareholders are grouped by their status and the discharging order in the bankruptcy proceedings. It means that the interests of all the members in the same group should be same in fact and the claims with different characteristic should be grouped differently. For example, the creditors with secured claims are in one group, the creditors with labor claims are in one group, and the same applies to the creditors with tax claims and ordinary creditors. As to the ordinary creditors, sometimes it is necessary to group them further because of different amounts of their claims or different characteristic of their claims (such as the commercial claims and the debit claims). For example, the China's new Enterprise Bankruptcy Law has regulated that "if necessary, the people's court may decide to set up a small claims group within the ordinary claims group to vote on the draft reorganization plan."[131] Such regulations may benefit the reorganization proceedings and increase the efficiency of the reorganization.

**b. the criterion of grouping**

Although the principles of grouping in different countries and districts are basically similar, the criteria are not the same. The legislation modes include two

[131] *See* PRC. Enterprise Bankruptcy Law, Article 82, Paragraph 2: "…If necessary, the people's court may decide to set up a small claims group within the ordinary claims group to vote on the draft reorganization plan."

types: ⅰ) the compulsive grouping and ⅱ) discretionary grouping. In the first kind of the mode, the laws regulate the criteria of grouping clearly and neither the court nor the reorganization parties can change them. For example, the Company Act of Taiwan District of China has regulated that the creditors and the shareholders can be grouped into four kinds: the creditors with the preferential reorganization claims; the creditors with the secured reorganization claims; the ordinary creditors and the shareholders.[132] In the second kind of the mode, the court or the reorganization parties can change the criteria of grouping according to the fact.[133] And the creditors and shareholders are usually grouped into five kinds in the American reorganization practice according to: the secured claims; the preferential claims; the ordinary claims; the subordinated claims and the shareholdings.

The discretionary grouping can ensure that the members in one group have the same interests more and then benefit the approval of the reorganization plan more.

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[132] *See* the Company Act of Taiwan District of China, Article 298: "The reorganization supervisor shall, after the expiration of the period for declaring rights, in accordance with findings in the preliminary examination, prepare lists of preferred creditors in reorganization secured creditors in reorganization, unsecured creditors in reorganization and shareholders respectively, stating therein the nature of their rights, sums of money and number of votes, and shall submit a report to the court, keep all of the above at a suitable place, and publicly announce the date and place of such keeping so that the creditors in reorganization, shareholders and other interested persons may inspect, all to be done three days before the date mentioned in Article 289, Paragraph 1, Item 2. The number of votes of creditors in reorganization shall be determined in proportion to the amounts of money involved in their credits. The number of votes of shareholders shall be provided in the Articles of Incorporation." And Article 302: "At the meeting of concerned persons, the voting right shall be exercised in groups of claimants as provided in Article 298, Paragraph 1, and resolutions shall be adopted by a majority vote of over one-half of the aggregate votes of different groups. In the event that there is no net value of capital of the company, the shareholders group shall not exercise voting right."

[133] Li Shuguang & He Dan, "Pochanfa Lifa Ruogan Zhongda Wenti de Guoji Bijiao［The International Comparison to the Important Problems of the Bankruptcy Legislation］," http:// www.chinainsol. org/ Article_Show.asp?ArticleID=902 (last visited on May 8, 2007) .

**2) The Vote**

After the grouping, the reorganization plan should be voted by all the groups and there are two legislation modes about the vote. Japan and Taiwan District of China both adopts the single criterion of voting as the representatives. Once the amount of the voting rights represented by the persons who approve the reorganization plan reaches the statutory proportion, the reorganization plan is regarded as being approved.[134] And America adopts the double criteria of voting as the representatives. Only when the number of the people and the amount of the claims they represent both reach the statutory proportion is the reorganization plan regarded as being approved.[135]

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[134] For example, *see* the Company Act of Taiwan District of China, Article 302: "At the meeting of concerned persons, the voting right shall be exercised in groups of claimants as provided in Article 298, Paragraph 1, and resolutions shall be adopted by a majority vote of over one-half of the aggregate votes of different groups.In the event that there is no net value of capital of the company, the shareholders group shall not exercise voting right."

[135] *See* the U.S. Federal Bankruptcy Code, Article 1126: " § 1126. Acceptance of plan

(a) The holder of a claim or interest allowed under section 502 of this title may accept or reject a plan. If the United States is a creditor or equity security holder, the Secretary of the Treasury may accept or reject the plan on behalf of the United States.

(b) For the purposes of subsections (c) and (d) of this section, a holder of a claim or interest that has accepted or rejected the plan before the commencement of the case under this title is deemed to have accepted or rejected such plan, as the case may be, if—

(1) the solicitation of such acceptance or rejection was in compliance with any applicable nonbankruptcy law, rule, or regulation governing the adequacy of disclosure in connection with such solicitation; or

(2) if there is not any such law, rule, or regulation, such acceptance or rejection was solicited after disclosure to such holder of adequate information, as defined in section 1125 (a) of this title.

(c) A class of claims has accepted a plan if such plan has been accepted by creditors, other than any entity designated under subsection (e) of this section, that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors, other than any entity designated under subsection (e) of this section, that have accepted or rejected such plan.

(d) A class of interests has accepted a plan if such plan has been accepted by holders of such interests, other than any entity designated under subsection (e) of this section, that hold at least two-thirds in amount of the allowed interests of such class held by holders of such interests, other than any entity designated under subsection (e) of this section, that have accepted or rejected such plan.

(e) On request of a party in interest, and after notice and a hearing, the court may designate any

It is obvious that the double criteria of voting is more reasonable than the single criterion of voting because the former mode can avoid the possibility of the voting outcome being controlled by the few big creditors or shareholders.

## 4. THE APPROVAL OF THE REORGANIZATION PLAN

### 1) Overview

A reorganization plan has to be approved by the court to acquire its legal efficacy after it has been adopted by the creditors and shareholders of different groups. The approval of the reorganization plan of the court is the necessary condition of the reorganization plan becoming effective and is the important representation of the judicial authority in the reorganization proceedings. Besides the ordinary approval of the reorganization plan under the circumstance that all the groups have adopted the plan, the court can also approve the reorganization plan without the agreement of all the groups according to a certain criterion. The latter is called the compulsive approval. One thing that has to be pointed out is that the court has to execute its authority of approving within the limitation regulated by the law. If a reorganization plan has not been adopted by all the groups, and neither

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entity whose acceptance or rejection of such plan was not in good faith, or was not solicited or procured in good faith or in accordance with the provisions of this title.

(f) Notwithstanding any other provision of this section, a class that is not impaired under a plan, and each holder of a claim or interest of such class, are conclusively presumed to have accepted the plan, and solicitation of acceptances with respect to such class from the holders of claims or interests of such class is not required.

(g) Notwithstanding any other provision of this section, a class is deemed not to have accepted a plan if such plan provides that the claims or interests of such class do not entitle the holders of such claims or interests to receive or retain any property under the plan on account of such claims or interests. ”

of the legal compulsive conditions exists, the court can only rule the termination of the reorganization proceedings.

**2) The Natural Approval**

As to the reorganization plan that has been adopted by all the groups of the creditors and the shareholders, the court will usually examine the procedure and measure of voting and the feasibility of the plan and confirm whether the contents are legal and fair before the court's approval. All things that the court examines or confirms are actually the conditions for the court to approve the reorganization plan. The Federal Bankruptcy Code of the United States further regulates that the court has to hold the hearing to hear the opinions of all the interested parties before the court's confirmation. As to the contents of the confirmation, the Federal Bankruptcy Code of the United States also regulates in most details among laws of different countries and districts.[136)]

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[136)] *See* the U.S. Federal Bankruptcy Code, Article 1129 (a) (1)~(13): "(a) The court shall confirm a plan only if all of the following requirements are met:
(1) The plan complies with the applicable provisions of this title.
(2) The proponent of the plan complies with the applicable provisions of this title.
(3) The plan has been proposed in good faith and not by any means forbidden by law.
(4) Any payment made or to be made by the proponent, by the debtor, or by a person issuing securities or acquiring property under the plan, for services or for costs and expenses in or in connection with the case, or in connection with the plan and incident to the case, has been approved by, or is subject to the approval of, the court as reasonable.
(5)
(A)
(i) The proponent of the plan has disclosed the identity and affiliations of any individual proposed to serve, after confirmation of the plan, as a director, officer, or voting trustee of the debtor, an affiliate of the debtor participating in a joint plan with the debtor, or a successor to the debtor under the plan; and
(ii) the appointment to, or continuance in, such office of such individual, is consistent with the interests of creditors and equity security holders and with public policy; and
(B) the proponent of the plan has disclosed the identity of any insider that will be employed or retained by the reorganized debtor, and the nature of any compensation for such insider.
(6) Any governmental regulatory commission with jurisdiction, after confirmation of the plan,

Studying the regulations in America, Japan and other countries and districts, there are mainly these requirements for the reorganization plan to meet to go through the court's confirmation: a) whether the reorganization plan accords with

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over the rates of the debtor has approved any rate change provided for in the plan, or such rate change is expressly conditioned on such approval.

(7) With respect to each impaired class of claims or interests—

(A) each holder of a claim or interest of such class—

(i) has accepted the plan; or

(ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date; or

(B) if section 1111 (b)(2) of this title applies to the claims of such class, each holder of a claim of such class will receive or retain under the plan on account of such claim property of a value, as of the effective date of the plan, that is not less than the value of such holder's interest in the estate's interest in the property that secures such claims.

(8) With respect to each class of claims or interests—

(A) such class has accepted the plan; or

(B) such class is not impaired under the plan.

(9) Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that—

(A) with respect to a claim of a kind specified in section 507 (a)(1) or 507 (a)(2) of this title, on the effective date of the plan, the holder of such claim will receive on account of such claim cash equal to the allowed amount of such claim;

(B) with respect to a class of claims of a kind specified in section 507 (a)(3), 507 (a)(4), 507 (a)(5), 507 (a)(6), or 507 (a)(7) of this title, each holder of a claim of such class will receive—

(i) if such class has accepted the plan, deferred cash payments of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) if such class has not accepted the plan, cash on the effective date of the plan equal to the allowed amount of such claim; and

(C) with respect to a claim of a kind specified in section 507 (a)(8) of this title, the holder of such claim will receive on account of such claim deferred cash payments, over a period not exceeding six years after the date of assessment of such claim, of a value, as of the effective date of the plan, equal to the allowed amount of such claim.

(10) If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider.

(11) Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.

(12) All fees payable under section 1930 of title 28, as determined by the court at the hearing on confirmation of the plan, have been paid or the plan provides for the payment of all such fees on the effective date of the plan.

(13) The plan provides for the continuation after its effective date of payment of all retiree benefits, as that term is defined in section 1114 of this title, at the level established pursuant to subsection (e)(1)(B) or (g) of section 1114 of this title, at any time prior to confirmation of the plan, for the duration of the period the debtor has obligated itself to provide such benefits."

the laws and regulations, the contents and procedure included; b) whether the reorganization plan has been created in a fair and honest way and c) whether the reorganization plan accords with the principle of the utmost of the creditors' interest; or, in other words, whether the creditors can be discharged more than in the bankruptcy liquidation proceedings.

**3) The Compulsive Approval**

As I have discussed above, the compulsive approval shows the interference of the judicial authority to the reorganization plan and it is one of the most important differences of the reorganization proceedings from the conciliation proceedings. The compulsive approval is also created because of the purpose of the reorganization system. The core of the reorganization system is bringing more benefits to the interested parties compared with under the liquidation system. Thus, the compulsive approval accords with the essential interests of the parties in the reorganization proceedings. This kind of approval is not only reasonable, but also effective.

There must be some conditions for the court to rule the compulsive approval. First, there should be at least one group that will accept the draft reorganization plan whose interests have been affected. Secondly, the draft reorganization plan should accords with the principle of the utmost of the creditors' interests. This principle is used to protect the oppositions to the draft reorganization plan. Thirdly, the draft reorganization plan should accords with the principle of fair treatments. It means that the creditors who have the same rank should be discharged pro rata.

#### 4) The Efficacy of the Approval

Once the reorganization plan is approved by the court, the legal efficacies will come into existence hereinafter: whether the interested party has attended the meetings or not, whether the party agrees the draft reorganization plan or not, he cannot advance the opinions different from the reorganization plan; if there is liability of paying in the reorganization plan and it adapts to be executed compulsively, it is certainly to be executed; when the reorganization proceedings have transferred from the bankruptcy liquidation proceedings or the conciliation proceedings, the suspended liquidation or conciliation proceedings should end and those suspended procedures such as the compulsive execution, the automatic stay and the auction should all end.

### 5. THE EXECUTION OF THE REORGANIZATION PLAN

#### 1) The Executor of the Reorganization Plan

The execution is the last stage of the reorganization proceedings and it relates to the realization of the purpose of the reorganization directly. Thus, the executor plays an important role in the reorganization proceedings.

The executor and the appointment of the business institution have a close relationship. There are usually two options: a) the debtor and b) the administrator or the reorganizer. The debtor has his advantage of knowing well about the company's situation to act as the executor[137] and the administrator or the

[137] *See* the U.S Federal Bankruptcy Law, Article 1141: "(a) Except as provided in subsections (d)(2)

reorganizer has the advantage of the identity as the third party to make the reorganization proceedings much safer and fairer.[138] In my opinion, it is certain that the debtor will benefit the execution of the plan as the executor, but it will also unavoidably damage the interested parties' interests. Therefore, the supervision of the supervisory institution should be strengthened in the execution of the reorganization plan.

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and (d)(3) of this section, the provisions of a confirmed plan bind the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the plan and whether or not such creditor, equity security holder, or general partner has accepted the plan.

(b) Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.

(c) Except as provided in subsections (d)(2) and (d)(3) of this section and except as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor.

(d)

(1) Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the confirmation of a plan—

(A) discharges the debtor from any debt that arose before the date of such confirmation, and any debt of a kind specified in section 502 (g), 502 (h), or 502 (i) of this title, whether or not—

(i) a proof of the claim based on such debt is filed or deemed filed under section 501 of this title;

(ii) such claim is allowed under section 502 of this title; or

(iii) the holder of such claim has accepted the plan; and

(B) terminates all rights and interests of equity security holders and general partners provided for by the plan.

(2) The confirmation of a plan does not discharge an individual debtor from any debt excepted from discharge under section 523 of this title.

(3) The confirmation of a plan does not discharge a debtor if—

(A) the plan provides for the liquidation of all or substantially all of the property of the estate;

(B) the debtor does not engage in business after consummation of the plan; and

(C) the debtor would be denied a discharge under section 727 (a) of this title if the case were a case under chapter 7 of this title.

(4) The court may approve a written waiver of discharge executed by the debtor after the order for relief under this chapter."

[138] *See* the Japanese Corporation Regeneration Law, Article 247: "…the administrator should execute the reorganization plan as soon as possible when there is the ruling of confirming the reorganization plan."

**2) The Principles of the Execution of the Reorganization Plan**

The executor should follow the principles hereinafter when they execute the reorganization plan: a) the general execution principle. The executor should execute across-the-board and properly according to the regulations of the reorganization plan without any change to the plan. b) collective execution principle. When there are several executors, the Democratic Centralism should be used to control the executors' actions and they should follow the opinion that more than a half of them hold.[139] c) efficiency principle. The executor should execute the tasks of the reorganization plan on time after the approval of the plan and has to complete the execution within the period that the reorganization plan regulates. And the execution should not be stopped at any time.

**3) The Supervision to the Execution of the Reorganization Plan**

Whether the reorganization plan is executed by the debtor or by the administrator, the supervisory institution has the right to supervise the execution all along in order to ensure that the executor performs his liability of executing across-the-board and dutifully. The responsibilities of the supervisory institution mainly include: executing its right of supervision in the situation of the execution of the reorganization plan and the financial situation of the enterprise during the supervisory period regulated by the reorganization plan; requiring the executor to report about the execution of the reorganization plan and the financial situation of the enterprise; correcting the executor's illegal behaviors in time; handing in the

[139] *See supra* footnote 88.

supervision report to the court when its period of supervision expires.

# Ⅳ. THE INTERIOR BALANCE AMONG THE CREDITORS

## A. OVERVIEW

There are different sorts of creditors in the corporate reorganization. For example, there are secured creditors and unsecured creditors according to whether the claims have been secured; and there are creditors before the reorganization ruling and creditors after the reorganization ruling (or the common interests creditors) according to the time of the claims' occurrence. Although the interests of all creditors should be protected this dissertation just wants to discuss the protection of the claims occurring before the reorganization ruling since there are relatively thorough protections of those after the ruling.

I have also discussed that there are conflicts between the protection of the creditors and the objective of the corporation in the corporate reorganization while there is possibility of conciliating, too. Conciliating the conflicts based on the Interests Balance Principle is the best choice of the reorganization laws. We can consider that the whole reorganization proceedings combine the restriction of the creditors' rights and the anti-restriction of the creditors to protect their own interests from the beginning of the reorganization proceedings to the business during the period and then to the end of the proceedings. Thus every institutional

design of the reorganization proceedings has to respect the creditors' interests and strengthen the protections of them on the premise of insuring the objective of the reorganization; otherwise the reorganization proceedings probably can't proceed with the creditors' oppositions and the corporate reorganization will become a visionary hope.

There are also conflicts among the creditors. The corporate reorganization is a positive rescue to the corporation in mess and cannot discharge every creditor's claims.[140] But each creditor still hopes all his claims to be discharged on time and has the incentive to realize his claims first. Therefore the reorganization law has to conciliate the conflicts among the different sorts of the creditors based on the Interests Balance Principle, too. At the same time the relevant system is necessary in order to prevent the individual creditor from executing his claims preemptively.

In my opinion the automatic stay and the right of rescission are both the system of protecting the creditors' interests equally and the system of showing the adjustment and balance of the creditors as a whole and the individual creditor.

[140] Otherwise there is no possibility to reorganize the corporation if it can discharge all the claims.

## B. THE AUTOMATIC STAY SYSTEM

### 1. THE FOUNDATION OF THE EMERGENCE OF THE AUTOMATIC STAY SYSTEM

The automatic stay can also be called the automatic suspense. It is a common system of the bankruptcy liquidation proceedings, the conciliation proceedings and the reorganization proceedings and it refers to the regulation that once any one of the above three proceedings starts up all the other procedure or behavior to the debtor's possessions should automatically stop.[141] Compared with the automatic stay system in the bankruptcy liquidation proceedings and the conciliation proceedings, the automatic stay system in the reorganization proceedings can not only prevent the individual creditor's separate demand of discharging after the start-up of the proceedings but also avoid the influence on the debtor's continuative business caused by the individual creditor's demand of discharging. Thus the automatic stay system can make the corporation in the reorganization keep the same state as before the reorganization and get the real opportunity of relaxing and consequently put all its energy to the reorganization affairs.

Undeniably, the relationships of the rights and liabilities that are related to the corporate reorganization mostly belong to the relationships in the sense of private rights and liabilities and the laws and statutes cannot change such appointments in

[141] David G. Epstein, Steve H. Nickles, James J. White,「Bankruptcy」(translation). Translated by Han Changyin and other people, Zhongguo Zhengfa Daxue Chubanshe［China University of Police and Law Press］(2003), at 61.

this sense. Therefore, the reorganization system has to be designed to ensure the creditors' interests structure not to change thoroughly and ensure the already existing economic relationship and property relationship between the creditors and the debtors not to be influenced thoroughly because of the process of the reorganization proceedings. But it is quite important for us to notice that the start-up of the reorganization proceedings threatens directly the creditors' (especially the creditors with secured claims) interests, particularly with the purpose of rescuing the debtors positively, and the points such as whether the creditors' claims can be discharged and how much can be discharged are actually the unknown things. Under such circumstance the inherent self-benefit will certainly urge the creditors to pursue their individual rights and execute preemptively, even depredate the debtors' possessions.[142] If the debtors have enough possessions to discharge all the claims there would be no problem but the point is that when the corporation is applied for the reorganization it is generally in mess and does not have the ability to discharge all the debts, and even it has to continue its business in order to reorganize and revive at that time. Thus the individual creditor's preemptive behaviors are serious threats not only to the corporation but also to the other creditors. The automatic stay system can ensure the corporation to continue its business after the start-up of the reorganization proceedings and operates a lot to rescue the debtors.

As to the protection to the creditors' interests, the function of the automatic stay system is more obvious. It prohibits all the behaviors that are executed directly to

142) *Ibid*.

the debtors' possessions or are required for the debtors and carries through the idea of protecting all the creditors equally during the corporate reorganization proceedings, thus consequently realizes not only the interests balance among all the creditors but also between the creditors and the debtors. Moreover, the function of the automatic stay system can also help the court to supervise and instruct the corporation in the reorganization.[143)]

## 2. THE LEGISLATIONS OF THE AUTOMATIC STAY SYSTEM

### 1) Overview

There are mainly two types of the legislation about the legal effect of the automatic stay system. One is the mode of automatic effect and the other is the mode of adjudicated effect. I will explain these two modes hereinafter.

### 2) The Mode of Automatic Effect

Once the reorganization is applied for the effect of the stay will automatically occur without any special application for the stay or any order. That means the reorganization application can bring the automatic stay itself. England and America are the representatives of this mode. For example, according to the regulations of the British Insolvency Act, from the application for the administration to the time when the application is approved or overruled the rights to the secured property cannot be executed, the corporate temporary possessions caused by the finance

143) Elizabeth Warren & Jay Lawrence Westbrook,「The Law of Debtor and Creditors,」Little, Brown and Company (1996), at 234.

lease agreements cannot be occupied again, the other proceedings cannot be sued or continued and the corporation and its properties cannot be sealed up, but the situations with the permission of the court are excluded.[144)]

[144)] *See* the U. K. Insolvency Act, Article 10: "(1) During the period beginning with the presentation of a petition for an administration order and ending with the making of such an order or the dismissal of the petition-

(a) no resolution may be passed or order made for the winding up of the company;

(b) no steps may be taken to enforce any security over the company's property, or to repossess goods in the company's possession under any hire-purchase agreement, except with the leave of the court and subject to such terms as the court may impose; and

(c) no other proceedings and no execution or other legal process may be commenced or continued, and no distress may be levied, against the company and its property except with the leave of the court and subject to such terms as aforesaid.

(2) Nothing in subsection (1) requires the leave of the court -

(a) for the presentation of a petition for the winding up of the company,

(b) for the appointment of an administrative receiver of the company, or

(c) for the carrying out by such a receiver (whenever appointed) of any of his functions.

(3) Where-

(a) a petition for an administration order is presented at a time when there is an administrative receiver of the company, and

(b) that person by or on whose behalf the receiver was appointed has not consented to the making of the order, the period mentioned in subsection (1) is deemed no to begin unless and until that person so consents.

(4) References in this section and the next hire-purchase agreements include conditional sale agreements, chattel leasing agreements and retention of title agreements.

(5) In the application of this section and the next to Scotland, references to execution being commenced or continued include references to diligence being carried out or continued, and references to distress being levied or omitted."

And Article 11: "(1) On the making of an administrative order-

(a) any petition for the winding up of the company shall be dismissed, and

(b) any administrative receiver of the company shall vacate office.

(2) Where an administration order has been made, any receiver of part of the company's property shall vacate office on being required to do so by the administrator.

(3) During the period for which an administration order is in force-

(a) no resolution may be passed or order made for the winding up of the company;

(b) no administrative receiver of the company may be appointed;

(c) no other steps may be taken to enforce any security over the company's possession under any hire-purchase agreement, except with the consent of the administrator or with leave of the court and the subject (where the court gives leave) to such terms as the courts may impose; and

(d) no other proceedings and no execution or other legal process may be commenced or continued, and no distress may be levied, against the company or its property except with the consent of the administrator or the leave of the court and subject (where the court gives leave) to terms as aforesaid.

(4) Where at any time an administrative receiver of the company has vacated office under subsection (1)(b), or a receiver or part of the company's property has vacated office under subsection (2)-

(a) his remuneration and any expenses properly incurred by him, and

### 3) The Mode of Adjudicated Effect

The application doesn't bring the effect of automatic stay and only according to the order of the court or the reorganization ruling will the effect occur. Japan and Taiwan of China are the representatives of this mode.[145)]

In my view the above legislation modes show the different legislation policies. The mode of automatic effect emphasizes particularly the protection of the creditors and society while the mode of adjudicated effect emphasizes particularly the balance between the creditors and the debtors. As to the purpose of protecting the creditors equally and preventing the individual creditor from executing preemptively, the mode of automatic effect is apparently better than the mode of adjudicated effect.

## 3. THE APPLICATION OF THE AUTOMATIC STAY

Theoretically, the behaviors of the automatic stay can be classified into two categories: a) the procedural behavior and b) the material behavior. The former means that once the reorganization proceedings start up the effect of automatic stay will occur to those procedures such as the bankruptcy, conciliation, compulsive

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(b) any indemnity to which he is entitled out of the assets of the company, shall be charged on and (subject to subsection (3) above) paid out of any property of the company which was in his custody or under his control at that time in priority to any security held by the person by or on whose behalf he was appointed.

(5) Neither an administrative receiver who vacates office under subsection (1)(b) nor a receiver who vacates office under subsection (2) is required on or after so vacating office to take any steps for the purpose of complying with any duty imposed on him by section 40 or 59 of this Act (duty to pay preferential creditors)."

145) For example, *See* the Company Act of Taiwan District of China, Article 294: "After a ruling for reorganization is rendered, all procedures of bankruptcy, composition, compulsory execution and other litigation involving property shall be suspended in due course."

execution and the litigations about the property relationships. But those civil actions or arbitration that have started up but haven't ended can continue their process after the administrator takes over the debtor's possessions. And the material behavior of the automatic stay refers to the restriction of the execution of the rights of the creditors and the third party. As to the creditors, all of them have to declare their claims according to the reorganization proceedings and be discharged according to the reorganization plan and as to the third party, the restrictions to their rights mainly appear as: a) the business institution of the reorganization can decide the dissolution or continued performance of any contract established prior to the reorganization proceedings and not fully performed and b) the shareholders cannot require for the interests distribution after the reorganization proceedings start up. And the directors, the managers and other senior employees cannot transfer their individual shareholders to the other people without the agreement of the court. The automatic stay to the procedures or behaviors about the debtor's possessions will continue unless the automatic stay is dissolved.

The enumeration of the Federal Bankruptcy Code of America is the most exhaustive example in the world. There are altogether eight behaviors that have been enumerated and these behaviors are:[146] (1) the commencement or

[146] *See* the U.S. Federal Bankruptcy Code, Article 362(a): "(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of—

(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;

(3) any act to obtain possession of property of the estate or of property from the estate or to

continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title; (2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title; (3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate; (4) any act to create, perfect, or enforce any lien against property of the estate; (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title; (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title; (7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and (8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor. It shows that the Federal Bankruptcy Code regulates quite widely to the automatic stay and almost any behavior of realizing the claims is prohibited.

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exercise control over property of the estate;

(4) any act to create, perfect, or enforce any lien against property of the estate;

(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and

(8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor."

The automatic stay system can prevent the claims of any one in any way and it just prevents the particular behaviors, not aiming at a kind of people. And the protection provided by the automatic stay system only is applied to the debtor's possessions, not the other people. But the American courts can prohibit the litigations or other proceedings to the third party related to the debtor in order to exclude the litigations or proceedings that will probably block the reorganization proceedings.[147)]

There are regulations about the automatic stay in the China's Bankruptcy Law of 1986. First, after the court has accepted the bankruptcy application any other civil executive procedure will be suspended and the debtor's repayment to the partial creditors will be void. Secondly, the deposit bank cannot distrain the debtor's money for the loan and it should return the distrained money. Thirdly, the creditors with secured property cannot execute their rights without the agreement of the court after the court accepted the bankruptcy application until the bankruptcy declaration.[148)]

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147) *See* the U.S. Federal Bankruptcy Code, Article 105(a): "(a) The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process."

148) *See* the State Enterprise Insolvency Law of China (Trial Implementation), Article 11: "After the People's Courts have accepted an insolvency case, the court must stay the execution of civil procedures relating to the property of the debtor."

Article 12: "After the People's Courts have accepted the insolvency case, except insofar as is necessary for its normal operation and production, partial repayments to creditors by the debtor are invalid."

Supreme People's Court, Questions on the <People's Republic of China, State Enterprise Insolvency Law (Trial Implementation)> Opinion, Article 21: "After a bank at which a debtor has an account receives notice from the People's Court, it may not deduct or transfer funds from deposits that the debtor has already made or from remittances received to repay loans. Deductions or transferrals shall be void, and funds deducted or transferred must be returned. If a bank refuses to return such funds, the People's Court shall order that they be returned and shall formulate and

We can notice several disadvantages of China's present regulations. The effect of the automatic stay begins from the time of the acceptance by the court, not the time of bankruptcy application, thus the creditors who have the advantage of getting the information or have good relationship with the debtor can take the preemptive actions. And there is no automatic stay regulation about the tax that is always interpreted not to be restricted by the automatic stay. It is apparently unfair to other creditors and in other countries the national tax is also restricted by the automatic stay system such as Japan.[149)]

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issue an enforcement assistance notice to such bank, and may penalize relevant personnel and directly responsible parties in accordance with the provisions in Articles 102 and 104 of the Civil Procedure Law."

And Article 39: "After reorganization, where an enterprise is able to repay debts on time, it may only repay them in accordance with the term and amounts in the reconciliation agreement. However, the repayment of debts that are secured with property and for which priority rights have not been renounced shall not be so restricted. During the time after an insolvency case has been accepted by the court but before insolvency has been declared without the consent of the People's Court, the creditor of a loan secured may not exercise priority rights."

Supreme People's Court, Several Issues on Trial of Enterprise Bankruptcy Cases Provisions of China, Article 20: "After the people's court accepts an enterprise bankruptcy case, all other civil enforcement procedures against the property of the debtor shall be stayed. Other debt dispute cases in which the debtor is named as the defendant shall, depending on the different circumstances set forth below, be handled as follows: (1) if the trial of the case has been completed but enforcement remains pending, the enforcement shall be stayed and the creditor shall, on the strength of the effective legal document, file his claim with the people's court that accepted the bankruptcy case; (2) if the trial of the case has not been completed and there are no other defendants or intervenors without independent right of claim, the proceedings shall be stayed and the creditor shall file his claim with the people's court that accepted the bankruptcy case; the proceedings shall be concluded upon the enterprise being declared bankrupt; (3) if the trial of the case has not been completed and there are other defendants or intervenors without independent right of claim, the proceedings shall be stayed and the creditor shall file his claim with the people's court that accepted the bankruptcy case; the trial of the case shall resume upon conclusion of the bankruptcy procedure; (4) the trial of debt dispute cases in which the debtor is an accessory debtor shall continue."

149) *See* the Japanese Corporation Regeneration Law, Article 67. Quoted from: Wang Weiguo, "Lun Chongzheng Qiye de Yingye Shouquan Zhidu［A Research on the Business Warrant System of the Reorganization Enterprise］," Bijiaofa Yanjiu Vol. 1 ［Comparative Law］, Zhongguo Zhengfa Daxue Bijiaofa Yanjiu Bianjibu ［China University of Police and Law Press Comparative Law Newsroom］(1998), at footnote 18.

## 4. THE EXCEPTION OF THE AUTOMATIC STAY

### 1) Overview

Under some circumstances the law sets some regulations about the exception of the automatic stay in order to protect the necessary balance among the creditors and pay attention to the special interests of some creditors. The Bankruptcy Code of America enumerates altogether 18 situations as Article 362(b) and these situations can be concluded as 3 sorts.

### 2) Criminal Proceedings

The criminal proceedings will not affect the debtor's creditors because the American law regulates that the incidental civil claims cannot be judged at the same time of the criminal proceedings. So the debtor's criminal proceedings will not be affected by the automatic stay system.

### 3) Some Administrative Behaviors of the Government to Perform the Administrative Laws and Statutes[150)]

These administrative actions do not belong to the debtor's liabilities related to the property or business and the government sues just for the public safety and

[150)] *See* the U.S. Federal Bankruptcy Code, Article 362(b)(4), (5): "(4) under paragraph (1), (2), (3), or (6) of subsection (a) of this section, of the commencement or continuation of an action or proceeding by a governmental unit or any organization exercising authority under the Convention on the Prohibition of the Development, Production, Stockpiling and Use of Chemical Weapons and on Their Destruction, opened for signature on January 13, 1993, to enforce such governmental unit's or organization's police and regulatory power, including the enforcement of a judgment other than a money judgment, obtained in an action or proceeding by the governmental unit to enforce such governmental unit's or organization's police or regulatory power; (5) Repealed. Pub. L. 105–277, div. I, title VI, § 603(1), Oct. 21, 1998, 112 Stat. 2681–866."

health, not for protecting its own money in the debtor's possessions. Of course the government doesn't take the advantage of preferences and the executions of money are not the exceptions.

#### 4) Some Particular Behaviors that will not Decrease the Debtor's Possessions

For example, the creditors with the check signed by the debtor can continue to deposit it to the bank or send the payment notice to the debtor. Such behaviors only confirm the creditor's rights and the creditor cannot get money indeed.[151)]

Although the Bankruptcy Code enumerates 18 exceptions the judges actually have the rights to decide freely.[152)] The consideration of the Bankruptcy Code is quite thorough but in my opinion maybe it is not so necessary to regulate so concretely and other countries haven't enumerate so much as America.[153)] And it is a pity that there is no regulation about this point in China's present Bankruptcy Law.

### 5. THE RELIEF OF THE AUTOMATIC STAY

According to the automatic stay principle, the creditors cannot do anything that may decrease the debtor's possessions. Although this principle can prevent the individual creditor from preemptively executing and consequently protect the

[151)] Pan Qi:「Meiguo Pochanfa」［The American Bankruptcy Law］, Zhongguo Falv Chubanshe［Law Press of China］(1999), at 15.
[152)] *See Supra* footnote 147.
[153)] There is only the regulation of principle in the Japanese Corporation Regeneration Law.

debtor, the possibility of some creditors' rights be unreasonably weakened is still unavoidable. Thus the adequate protection principle is created to balance these creditors' interests. Generally speaking, only the creditors with secured claims can apply to the court for lifting the automatic stay.[154] As to these creditors, the automatic stay temporarily prevents them from executing their rights with secured property and consequently costs their interests because of the "endless" time and the devaluation of the secured property.

There are two situations regulated in the Federal Bankruptcy Code of America: a) the debtor does not have an equity in the property and the property is not necessary to an effective reorganization and b) the creditor's interest in the property is lack of adequate protection.[155] And besides the above causes the bankruptcy filing or reorganization filing with bad faith can also bring the relief of the automatic stay. The debtor's application that exceeds the purpose of the litigation is the abuse to the bankruptcy or reorganization proceedings and the application itself can be the cause. The Fifth Circuit explained in the case of Matter of Little Creek Development Co. as "Every bankruptcy statute since 1898 has incorporated literally, or by judicial interpretation, a standard of good faith for the commencement, prosecution, and confirmation of bankruptcy proceedings."

Both the creditors with secured claims and the creditors with unsecured claims should be restricted by the automatic stay system according to the American law

[154] The excuse for the creditors with unsecured claims is seldom accepted by the court unless it is more appropriate for the claim to be liquidated in other courts than in the bankruptcy court, or because of the bad faith filing of the bankruptcy.

[155] The concept of "adequate protection" originates from the Fifth Amendment of the United States Constitution and the policy of "the creditors with secured claims cannot be deprived of the interests of negotiating."

while the former can get more adequate protection than the latter.

## C. THE RIGHT OF RESCISSION

### 1. THE FOUNDATION OF THE EMERGENCE OF THE RIGHT OF RESCISSION

There is no difference between the right of rescission in the reorganization proceedings and the one in the bankruptcy liquidation proceedings,[156] so generally many countries apply the regulations in the bankruptcy proceedings. As I have discussed above, the automatic stay system can prevent the creditors from executing the debts after the start-up of the reorganization proceedings, but it is helpless to those behaviors before the reorganization application. Although it is reasonable for the individual creditor to have the motive of executing his own claims preemptively when he knows the debtor's deteriorated economic state earlier than other creditors, his preemptive execution will certainly damage the creditors' holistic interests and the social interests and breach the value purpose of the reorganization system. Therefore, it is necessary to introduce the right of rescission into the corporate reorganization proceedings. The right of rescission in the corporate reorganization denies some of the debtor's behaviors before the

[156] Wang Shihu, "Shilun Pochanfa shangde Chexiaoquan［A Research on the Right of Rescission of the Bankruptcy Law］," Xiandai Faxue Vol. 3［Modern Law］, Zhongguo Xinan Zhengfa Daxue Xiandai Faxue Bianjibu［Southwest University of Political Science and Law Modern Law Newsroom of China］(1998), at 49~53.

reorganization application and pursues the equity.

The right of rescission is based on the respects to all the existing rights and the restrictions to the special rights,[157] and it appears when the reorganization proceedings start up. All the debtor's behaviors are allowed without the start-up because out of the reorganization proceedings the debtor should discharge his legal debts and the creditor has several rights to force the debtor to perform the debts. The right of rescission is alike as the automatic stay and they are both created for protecting the creditors equally and preventing the individual creditor from preemptively executing the claims. But the automatic stay only has the efficacy to the behaviors in the future while the right of rescission has the retroactive effect. Just because of the two systems the idea of protecting the creditors equally of the reorganization can be carried through the whole proceedings and without any one of them the preemptive behavior of the individual creditor will not be prevented effectively.

The right of rescission system in the corporate reorganization achieves the purpose of protecting all the creditors equally through denying some of the creditor's behaviors before the reorganization application. Although the execution of the right of rescission maybe put the negative effect to some innocent creditors, it is quite necessary to most of the creditors and its existence can weaken the creditor's motivation of acting the fraudulent or preferential trades with the debtor and consequently promoting people's confidence to the credit system.

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[157] Roy Goode, 「Principles of Corporate Insolvency Law,」 West & Maxwell (1997), at 343.

## 2. THE COMPOSING ELEMENTS OF THE RIGHT OF RESCISSION

There are many theories about the composing elements of the right of the rescission and the comparatively general opinion is that there are three composing elements. But what are these three composing elements? There is not a unitive theory yet. Some scholars think that the three elements are: a) the debtor's behavior of damaging the creditor's interests before the start-up of the bankruptcy proceedings; b) the behavior happens within the statutory period before the start-up of the bankruptcy proceedings and c) the party has the bad faith.[158] Some scholars think that they are: a) the behavior damages the other creditor's interests; b) the debtor is actually in insolvency and c) the behavior happens within the suspect period before the formal start-up of the bankruptcy proceedings.[159] As I think, the right of the rescission in the corporate reorganization proceedings should has these four elements hereinafter: a) the behavior that can be rescinded must be acted before the reorganization application; b) the behavior must damage other creditor's interests; c) there must be the third party who benefits from the behavior and d) the behavior must happen within the statutory period.

As to the problem of whether the bad faith of the debtor should be one of the composing elements of the right of rescission, in my opinion it is relates to the protection of other creditors and the maintaining of the business safety. We can distinguish the debtor's behaviors into the behaviors with costs and the behaviors

[158] Li Yongjun,「Pochan Falv Zhidu」［the Bankruptcy Law］, Zhongguo Fazhi Chubanshe［China Legal Publishing House］(2000), at 259~261.

[159] Shi Jingxia,「Kuaguo Pochan Yanjiu」［A research on the Cross-border Insolvency］, Wuhan Daxue Chubanshe［Wuhan University Press］(1999), at 270~271.

with no cost. In the circumstance of the behaviors with no cost, we need not to think about the debtor's subjective reason and in the circumstance of the behaviors with costs, it is necessary for us to research on the debtor's subjective reason, that means the debtor should have the subjective intention to provide the interests to some special creditor. And whether the other creditors know about it has no relationship. Thus, not only the other creditors' interests are protected, but also the business safety.

### 3. THE APPLICATION SCOPE OF THE RIGHT OF RESCISSION

#### 1) Overview

Although there are different regulations of the different legislations on the application scope of the right of rescission, the complex behaviors that can be executed of the right of rescission mainly include the preference and the fraudulent transfer.

#### 2) The Preference

The preference can also be called the favorable behaviors and it means that during the statutory period prior to the reorganization application, under the circumstance of the debtor's situation of being in insolvency, the debtor transfers his properties or rights and interests to the special creditor because of the creditor's claim that has already existed, and this transfer make the special creditor get more than that will be discharged according to the reorganization proceedings. The

preference increase the individual creditor's interests and the purpose of applying the right of rescission to the preference is preventing the creditors from suing for distributing the debtor company's possessions and consequently realizing the protection of all the creditors fairly.

There are altogether six conditions of the preference that can be applied of the right of rescission in America[160] and actually in the judicial practice, the most typical preference mainly appears as: a) provide the security to the claims that haven't the security originally and b) discharge the claims that are not mature in advance.

### 3) The Fraudulent Transfer

The fraudulent transfer refers to the behavior of property transfer acted by the debtor during the statutory period prior to the reorganization application and this kind of behavior views damaging other creditors' interests as its purpose. Comparing with the preference, the fraudulent transfer not only decreases the discharged amount of all the creditors as a whole, but also brings the more unfair

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[160] *See* the U.S. Federal Bankruptcy Code, Article 547 (b): "(b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property—
(1) to or for the benefit of a creditor;
(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
(3) made while the debtor was insolvent;
(4) made—
(A) on or within 90 days before the date of the filing of the petition; or
(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
(5) that enables such creditor to receive more than such creditor would receive if—
(A) the case were a case under chapter 7 of this title;
(B) the transfer had not been made; and
(C) such creditor received payment of such debt to the extent provided by the provisions of this title."

outcome to other creditors as a kind of fraudulent behavior. Under the circumstance of preference, the debtor and the creditor who get the favorable discharging have not the intention of fraud and the preference has not decrease the discharged amount of the whole creditors. As to the fraudulent transfer, it is prohibited not only in the bankruptcy liquidation or the reorganization, but also in the daily business.

In the circumstance of the fraudulent transfer, the administrator can take back the properties or the corresponding value from the direct transferee or other subsequent transferee. But the administrator cannot execute such rights from any subsequent transferee that with a good faith and knows nothing about the fraud and has paid the corresponding cost.

# Ⅴ. THE REORGANIZATION SYSTEM IN KOREA

## A. THE EVOLUTION OF THE KOREAN REORGANIZATION SYSTEM

The regulations about the corporate reorganization originally emerged in the article of the old Commercial Law.[161] According to the old Commercial Law, the reorganization plan has to achieve the agreements of all the creditors and the variation of the reorganization institution has to abide by the common regulations of the company law. But in the practices, the consequent operations are quite inconvenient just because of the imperfect procedural regulations and the circumstances of the debtors' abusing of the reorganization proceedings in order to postpone their debts are quite frequently seen. Therefore, the legislators thought that it was very necessary to enact special laws and regulations to rescue the enterprises additionally and the contents about the corporate reorganization were deleted from the commercial law when the commercial law proposal was examined in 1961. Basically speaking, the insolvency law system consists of three laws: the Bankruptcy Act, the Composition Act and the Corporate Reorganization Act.[162] These three basic insolvency laws were enacted in 1962 and have been modified several times to reflect the reality of the Korean economy. However, these basic

[161] *See Supra* footnote 16.
[162] *See Supra* footnote 18.

insolvency laws have received criticism in that: a) the rehabilitation procedure is bifurcated into the proceedings under the Corporate Reorganization Act and the Composition Act, resulting in unequal outcome depending on the two proceedings; b) the Composition Act proceeding, in most cases, is inefficient, and c) the laws, in comparison to the international insolvency system, are outdated.[163)]

And among all the amendments, the one carried through by the Korean government after accepting the recommendation of the International Monetary Fund (the "IMF") to modify the outdated insolvency laws during the period of economic crisis was quite outstanding. The basic conceptions and viewpoints of the reorganization system have changed greatly.

In 1996, two cases of corporate reorganization brought the great attention of all the aspects of the Korean society. After the NONNO Ltd. being permitted to reorganize,[164)] the mature commercial postal orders faced the circumstance of being unable to pay again and the owner of the enterprise committed suicide and the managers escaped; another subject is the SEOJU Ltd., it issued a lot of postal orders without the permission of the court and could not pay for them, either. And the big-sized enterprises and plutocrat groups closed down in succession after the bankruptcy of HanBo Group in 1997.[165)] Then the nose-diving stock prices, the rapidly increased exchange rate and the number of the unemployed people appeared consequently. The Korean government had to signed the emergent

163) *Ibid*.
164) Xu Changrong, "An Analysis on the Legal Tropism of the Corporate Reorganization System," http://www.deheng.com.cn/asp/PAPER/html/200552415481512.htm (last visited on May 26, 2007).
165) Anonymity, "The Revelation to the Development of Chinese Enterprises from the Crises of the Korean Big-sized Enterprises," http://pm.aura.cn/bbs/dispbbs.asp?boardid=19&id=113970&star=1&page=9 (last visited on June 17, 2007).

convention with the IMF to resolve the economic crises. The insolvency law system in Korea was considered not able to deal with and keep away the frequent events of closing down of the enterprises and was criticized from different aspects about its limitations and problems. Some scholars concluded the main reasons as the following four points: a) the designs of the insolvency procedures lacked of the efficiency; b) the courts lacked of the understanding on the practical problems of the businesses of the enterprises and the degree of the court's specialization was relatively bad; c) the enterprises were reluctant to carry through the insolvency proceedings and tried their best to cover the situation of bad business and d) the bank creditors ignored the reasonable measures to realize their claims efficiently. And just during this period, the IMF and the World Bank requested the Korean government to modify and complete the insolvency laws at the same time of offering the support of foreign exchange.

Under such a background, the Korean Ministry of Finance and Economy entrusted the Korean Development Institute (KDI) with the investigation and research on the Korean reorganization system and the topics of the research were "the improving project on the corporate reorganization system and the composition system" and "the research on the corporate rehabilitation legal system." The Korean government summarized the judicial practices of the corporate reorganization on the basis of the problems and the limitations that exposed in this economic crisis and amended the corporate reorganization law in February 1998 after studying the international experiences. And the Korean Supreme Court then amended the reorganizations regulations thoroughly in Mar. of the same year and

enacted and promulgated the rules and regulations about the corporate reorganization in April 1998. Later, there was another amendment in December 1999.

The main contents of the amendments can be stated as the following: a) strengthening the objectivity of the judgment criteria of the startup and existence of the reorganization proceedings, such as modified the condition of the startup of the reorganization proceedings from “having the hope of restructuring” to “having the economic value of restructuring;” b) strengthening the specialization and the justness of the courts, such as the management committee was established in the courts appointed by the Korean Supreme Court; and c) strengthening the creditors’ rights and actions in order to emphasize the equity, such as the new established creditors’ assembly.[166)]

The material change have appeared in the Korean corporate reorganization laws at the aspect of the substantial rules and the setup of the reorganization institutions through the amendments of 1998 and 1999. But the amendments as to the corporate reorganization laws after the financial crisis have always been proceeded.

On December 30, 2000, the Ministry of Justice (the “MOJ”) received the final draft of a recommendation for insolvency laws from the consortium composed of Shin & Kim; Orrick, Herrington & Sutcliffe LLP; and Bingham & Dana, which consortium was selected through the MOJ’s international bidding procedure. And almost at the same time, the Korean Development Institution advanced the report

166) Xu Changrong, “An Analysis on the Legal Tropism of the Corporate Reorganization System,” http://www.deheng.com.cn/asp/PAPER/html/200552415481512.htm (last visited on May 26, 2007).

after 4-years' investigation and research with the entrustment of the Korean Ministry of Finance and Economy. The Committee for Insolvency Law Reform was formed to review such draft and this Committee was comprised of law professors, judges from the Supreme Court and the bankruptcy department of Seoul District Court, and the members from the Ministry of Finance and Economy, the Korea Federation of Banks, the Federation of Korean Industries and so on. The new Korean insolvency law was drafted in November 2002 and submitted to the National Assembly of Korea in February 2003 after the careful and thorough discussions of the Committee.

On March 21, 2005 the Korean government finally promulgated the examined draft and named it as the Act on Rehabilitation and Bankruptcy of Debtors[167] and the original three insolvency laws were all combined into one. This new unified law has come into force on April 1, 2006.[168] Actually, in this new law two corporate insolvency proceedings are provided for, they are the bankruptcy proceedings and the rehabilitation proceedings. And the principles on the bankruptcy proceedings were adopted from the German legal system while the principles on the rehabilitation proceedings were largely modeled on the US federal law.

[167] *See Supra* footnote 20.
[168] *See Supra* footnote 21.

## B. THE VALUABLE POINTS OF THE REORGANIZATION SYSTEM IN THE UNIFIED INSOLVENCY LAW

### 1. OVERVIEW

Since the procedures about insolvency were regulated in different statutes in Korea before, they have always been subject to the criticisms of having different subject matters and purposes and the consequently decreased efficiencies. The Unified Insolvency Act is a landmark that unifies those different statutes and provides the more efficient insolvency procedures as a whole. The composition procedure is abrogated because that it is considered as an ineffective mechanism as to the reorganization in practice while the corporate reorganization procedure is streamlined instead in the new act.[169)]

There are several outstanding characteristics of the new Unified Insolvency Act, summarized as the following.

### 2. THE OUTSTANDING CHARACTERISTICS

#### 1) The Abandoned Territorial Principle

Compared with the original Bankruptcy Act and the Corporate Reorganization Act, the new Unified Insolvency Act abandons the territorial principle and provides

[169)] Xu Changrong, "An Analysis on the Legal Tropism of the Corporate Reorganization System," http://www.deheng.com.cn/asp/PAPER/html/200552415481512.htm (last visited on May 26, 2007).

for a whole chapter that recognizes and support the insolvency procedures initiated in a foreign country. According to the original laws and regulations against the properties located in Korea, the insolvency procedures commence in Korea are effective only in Korea and those commence in a foreign country are ineffective. But the new Unified Insolvency Act does not agree with the original laws and regulates the international insolvency in its Chapter 5, which has the similar purpose to the procedures of the Federal Bankruptcy Code of the United States.[170)]

**2) The Introduced Stay Order System**

The Unified Insolvency Act introduces the stay order system roundly. Under the original Corporate Reorganization Act, the court is required to render the stay order because of the creditors' specific activities for a period of time. According to the new act, the court can prohibit the creditors from executing the debts after the corporation is applied for reorganization until the court's approval of the reorganization proceedings, and the basis of the prohibition of the creditors is quite comprehensive, covering the scope from filing the lawsuits to executing the enforcement actions.

**3) The Possibly appointed representative of the debtor corporation**

The Unified Insolvency Act rules that the representative of the debtor corporation can be appointed as the receiver while the original Corporate

[170)] Here the points from "a" to "h" are concluded from the article of Sang Goo Han, "New Unified Insolvency Act," http://www.asialaw.com/default.asp?page=14&ISS=14978&SID=499948 (last visited on June 17, 2007).

Reorganization Act excludes the incumbent managers of the debtor corporation from becoming the receivers before the startup of the reorganization proceedings. The new provisions in the Unified Insolvency Act are designed to avoid the possible bankruptcy of the debtor corporation because of its managers' fear of being excluded from the receivership and the consequent reluctance to apply for the reorganization proceedings. Also, the provisions are expected to assure the continuous management of the debtor corporation.

**4) The Creditors' Committee**

According to the new Unified Insolvency Act, the creditors' committee has to be established and will have quite strong authorities. For example, the committee can require an investigation into the management of the debtor corporation and can require a variety of information from the debtor.

**5) The simplified procedures**

The new Unified Insolvency Act simplifies the procedures of examining and confirming the debts during the course of reorganization proceedings, comparing with the original regulations.

**6) The Guaranteed Liquidation Value**

The new Unified Insolvency Act rules guarantees the liquidation value of reorganization claims and the court can confirm the reorganization plan according to the new provisions while the original Corporate Reorganization Act does not

guarantee such values. And the discharging methods that stated in the reorganization plan are not more disadvantageous than those under the circumstance of the liquidation of the debtor corporation.

**7) The Extended Scope of the Exempted Assets**

The new Unified Insolvency Act extends the scope of the exempted assets of the bankrupts in order to ensure their basic living requirements while the scope of the similar regulations in the original Bankruptcy Act was rather limited.

**8) The Rehabilitation Procedures to Individuals**

The new Unified Insolvency Act follows the old laws and regulations and still provides the rehabilitation procedures to the individual creditor, with some amendments to the old regulations. For example, the new act decreases the maximum discharging period from eight years to five years; and the new act introduces the minimum discharging system according to which the total discharging amount in a discharging plan has to be at least 3% or 5% of the total debts.

### 3. THE REGULATIONS ON PROTECTING THE CREDITORS' INTERESTS

#### 1) The Principle of Guaranteeing the Liquidation Value of Reorganization Claims

The Article 243 ① 4 of the new Unified Insolvency Act establishes the principle of guaranteeing the liquidation value of reorganization claims.[171] It rules that the discharging methods that according to the reorganization plan should be not more disadvantageous than those under the circumstance of the bankruptcy liquidation of the debtor corporation, unless the creditor agrees. As to this clause, we can find that the principle is adopted to all the claims, including the ordinary claims without the secured properties and the secured claims and the exception is that the creditor agree to abandon the principle.

When we judge whether the reorganization system reflects the value of equity, the total amount that can be achieved through the reorganization proceedings and that through the liquidation proceedings can be considered as the important criteria. That means, the value of equity can be thought of being achieving when the creditors acquire more through the reorganization proceedings than the possible amount that they may get through the liquidation proceedings.

And the value of equity of the reorganization system is concentratively embodied on the problem of approving the reorganization plan compulsively. If the

[171] Xu Changrong, "An Analysis on the Legal Tropism of the Corporate Reorganization System," http://www.deheng.com.cn/asp/PAPER/html/200552415481512.htm (last visited on May 26, 2007).

reorganization proceedings and plan cannot be approved without the agreement of every creditor, then every creditor will insist his opinion in order to achieve the advantageous treatment in the reorganization distribution. Therefore, the laws and regulations grant the right of approving the reorganization plan compulsively to the judge. At the same time, in order to protect the creditors' interests, the reorganization plan has to ensure the creditors to acquire enough discharging amount, at least not less than that can be discharged through the liquidation proceedings,[172] otherwise the creditors will surely not agree the reorganization plan. In other words, if the value of business that will be saved only belongs to the debtor and the creditors will not benefit from it, the creditors would rather choose the liquidation distribution instead of agreeing the reorganization plan.

The Federal Bankruptcy Code of the United States rules the principle of guaranteeing the liquidation value of reorganization claims as the important and necessary condition of approving the reorganization plan compulsively and this principle is also regarded as the most essential principle in the practice. But the original Korean Corporate Reorganization Act did not establish this principle, either the judicial interpretation of the Korean Supreme Court.[173] Although in the only ruling of the Supreme Court in January 2000 that mentioned this principle, the principle of guaranteeing the liquidation value of reorganization claims was

[172] Gan Peizhong, "Lun Jiejian Guowai Lifa Jishu, Jianli Woguo Wanshan de Qiye Zhengdun Zhidu ［Improving China's Enterprise Restructuring System by Using the Foreign Legislation Techniques］," Beijing Daxue Xuebao ［Peking University Research Journal］, Beijing Daxue Xuebao Bianjibu ［Peking University Research Journal Newsroom］, April 1993.

[173] Dong Woo Seo & Hong Kee Kim, "the Asia-Pacific Restructuring and Insolvency Guide 2006--Republic of Korea," at 100, www.adb.org/Documents/Guidelines/restructuring-insolvency/chap4-8.pdf (last visited on May 25, 2007).

actually denied. Thus, some scholars advanced their strict criticisms and considered that the content of this ruling apparently disobeyed the regulation on the protection of the right of property of the Korean Constitution. The Corporate Reorganization Act has not endowed anyone with the right of damaging the creditors' interests that they may be acquire even in the liquidation and the court cannot dispose the properties of individual creditor arbitrarily. Even though such dispositions accord with the public interests, the creditor should be compensated reasonably.[174] On one hand, the reason of the startup and existence of the reorganization proceedings is considered that the business value is higher that the liquidation value while on the other hand, the individual creditor only get the lower discharging amount than they may get through the liquidation proceedings. The outcome is undoubted that the rest part that the creditor should be discharged be transferred to other creditors or shareholders.

Therefore, in order to make up the shortcoming of the legislation, the new Unified Insolvency Act establishes the principle of guaranteeing the liquidation value of reorganization claims and rules the exceptions at the same time. But there are still some viewpoints that consider the exceptions will give the chance and approach of forcing the creditors to agree the reorganization plan to the court and this principle will finally be null. However, we can find that the new act has made great efforts on protecting the creditors' interests and pursuing the value of equity.

[174] Bon Chen Gu, "The Economic Analysis and Improvement Project on the Enterprise Exit," http://www.kdi.re.kr/kdi/report/report_read05.jsp?1=1&pub_no=1797 (last visited on May 27, 2007).

### 2) The Creditors' Collegium (The Creditors' Committee)

The reorganization proceedings influence the creditors' interests and statuses great. It can be concluded that the corporate reorganization will surely fail without the creditors' assistances and supports. There was no institute that settled to collect and transfer the creditors' opinions in the Korean reorganization proceedings before and consequently the interests conflicts among the creditors were not harmonized effectively and the creditors' interests were not protected effectively, either.[175] The new system of Creditors' Collegium was established in order to protect the creditors' interests better and enhance the creditors' statuses in the proceedings when the Corporate Reorganization Act was amended in February 1998.[176] The Creditors' Collegium is constituted by the primary creditors within one week after the application of the reorganization proceedings as the institution of transferring the information between the court and the creditors and its main function is harmonizing the interests conflicts among the creditors and advancing the relative opinions to the court. And after the reorganization plan is approved, the creditors can apply for the termination of the reorganization proceedings to the court if there is no feasibility of the reorganization plan. The creditors can also apply for the termination of the reorganization proceedings to the court if the reorganization corporation discharges the debts successfully. Thus, the creditors' opportunity of advancing their opinions has been increased.

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[175] Xu Changrong, "An Analysis on the Legal Tropism of the Corporate Reorganization System," http://www.deheng.com.cn/asp/PAPER/html/200552415481512.htm (last visited on May 26, 2007).

[176] Seong Keun Choi, "The Function and Roll of Creditors' Committee in Reorganization Procedure," The Comparative Judicature, Vol. 11(1) (2003).

It is important to point out that the Creditors' Collegium is not a reorganization supervisory institution and only has its limited rights of self-government. In Korea, the courts act as the reorganization supervisory subject and appoint the reorganization administrators.[177] The reorganization administrators have to be responsible for the court and submit the reports to the court, their authorities also have to be admitted by the court. But the supervision of the courts in the practice is generally limited and passive. It is rather possible for the administrators to abuse their authorities and damage the creditors' interests just because that the judges always only listen to the administrator's report and seldom go to the reorganization corporation themselves. Therefore, the Creditors' Collegium can consolidate the creditors' statuses in the reorganization proceedings and protect the creditors' interests and consequently realize the value of equity during the corporate reorganization.[178] However, the protection of the creditors' interests is still quite weak. Some scholars think that the execution of the right of the Creditors' Collegium will only be formalistic and they advance that the Creditors' Collegium should be endowed with the right of supervision to the reorganization proceedings. The new act has strengthened the rights of the Creditors' Collegium.

As to the system of creditors' committee that has already been adopted in United States, Germany and Japan, the introduced system of Creditors' Collegium in 1998 is actually the acculturation now in Korea. How to strengthen the indigenous

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[177] Xu Changrong, "An Analysis on the Legal Tropism of the Corporate Reorganization System," http://www.deheng.com.cn/asp/PAPER/html/200552415481512.htm (last visited on May 26, 2007).

[178] Jae Hyung Kim, "A Proposal for the Enactment of a Consolidated Insolvency Act," The Comparative Judicature, Vol. 10(1) (2003), at 66~67.

Creditors' Clooegium system and how to study the merits of the creditors' committee system are still the problems of the jurisprudents and although the creditors' committee system adapts to the Korean situation, its merits and demerits should be surveyed and whether it will be introduced to Korea should still be considered.[179)]




[179)] *Ibid.* at 67.

# Ⅵ. THE REVIEW AND SUGGESTIONS ON CHINA'S REORGANIZATION SYSTEM

## A. OVERVIEW

Since the 1970s a great reformation has sprung up in the field of the Bankruptcy Law. United States, France, England, Germany and other western countries established new bankruptcy laws to replace the old ones, or amended the old ones boldly in succession. The core of this bankruptcy law reformation is establishing and consummating the reorganization system. The reorganization system, as one of the important bankruptcy systems juxtaposing the bankruptcy liquidation system and the bankruptcy reconciliation system, is a preventive system that tries to help the debtors and urge them to revive. The emergence of the reorganization system indicates that the system itself changes from the liquidating model to the reconstructive model. Just because the new system can correct the shortcoming of the traditional bankruptcy system, people bestow quite good appraisement upon it.

It is well known that China (the mainland) has already enacted the "People's Republic of China, State Enterprise Insolvency Law (Trial Implementation)" (the "Enterprise Insolvency Law" for short hereinafter), which was applied to the state-owned enterprises in 1986. And the amended Civil Procedure Law regulated the bankruptcy issues as chapter 19 in 1991. Moreover, the State Council, the

Supreme People's Court and the provinces all enacted a series of administrative regulations, judicial interpretations and regional regulations in succession. All these laws, regulations and judicial interpretations have played an important role in standardizing the enterprise bankruptcy behavior, judging the bankruptcy cases fairly, protecting the interests of the creditors and debtors and maintaining the market economic order of the socialism. But there are many defections in the Enterprise Insolvency Law because of the limitation of the historical conditions and the weakness of the theories and thus this Enterprise Insolvency Law cannot adapt to the development of the economy any more. It is fortunate that the new PRC, Enterprise Bankruptcy Law was finally adopted at the 23rd Session of the Standing Committee of the 10th National People's Congress on 27 August 2006 and has been effective as of June 1, 2007 after more than ten years since it was first drafted in 1994. Whether in the aspect of the content and the system or in the aspect of the guideline and the idea, this new Enterprise Bankruptcy Law is quite different from the old Enterprise Insolvency Law. The introduced reorganization system can be considered as the most remarkable event. This system is introduced to rescue the enterprises that face the predicaments and to urge them to avoid the bankruptcy liquidation and consequently revive.[180)]

However, the rectification system that regulated in the Enterprise Insolvency Law and the enterprise rectifications out of the court that existed largely in practice in the past years actually have the element of the reorganization to a certain extent.

[180)] Jia Zhijie, “Zhonghua Renmin Gongheguo Qiye Pochanfa Caoan de Shuoming”［The Explanation on the draft of PRC. Enterprise Bankruptcy Law］at the 10th Session of the Standing Committee of the 10th National People's Congress, http://www.intereconomiclaw.com/article/default.asp?id=180 (last visited on June 17, 2007).

It is necessary to review the development of China's reorganization system. And the new Enterprise Bankruptcy Law has been effective as of June 1, 2007. What is the difference of the regulations of the reorganization system in the new law compared with the developed reorganization system in other countries? And are the regulations about the protection of the creditors' interests logical? I will discuss such points hereinafter.

## B. THE NOMINAL "REORGANIZATION" SYSTEM IN CHINA'S ENTERPRISE INSOLVENCY LAW

### 1. THE RECTIFICATION SYSTEM AND THE REORGANIZATION SYSTEM

Although the Enterprise Insolvency Law of 1986 specially regulated the enterprise rectification system in chapter four--"Conciliation and Reorganization" and some scholars consider that it can be called China's bankruptcy reorganization system,[181] in my opinion the "reorganization" that regulated in the Enterprise Insolvency Law is not an independent procedure and it is only a part of the conciliation system. That means the "reorganization" is only the measure to achieve the purpose of conciliation agreement and does not have the basic

[181] Tang Weijian,「Pochan Chengxu yu Pochan Lifa Yanjiu」[The Bankruptcy Proceedings and the Bankruptcy Legislation], Zhongguo Renmin Fayuan Chubanshe [Court Press of China] (2001), at 383.

characteristics of the true reorganization system. That is why I would like to call it the “rectification system” while many people even the government have translated it as “reorganization system.”[182] And it is important to point out that the rectification system is quite different from the reorganization system.

First, the rectification in the Enterprise Insolvency Law of 1986 and the conciliation are almost combined.[183] In the western countries, the reorganization system and the conciliation system are two quite different bankruptcy preventive systems. The reorganization system rescues the debtors positively while the conciliation system only prevents the debtors from their bankruptcy negatively. But only after the superior department in charge of the insolvent enterprise advances the rectification application can the enterprise itself advance the conciliation agreement draft to the creditors’ meeting,[184] and the enterprise will not have the right to advance the conciliation application without the rectification application of the superior department. We can find that it actually takes the rectification application of the superior department in charge of the insolvent enterprise as the premise of the conciliation of the enterprise with the creditors. Moreover, after the rectification application of the superior department and the conciliation agreement draft of the enterprise, only after the conciliation agreement between the enterprise and the creditors is approved by the court can the bankruptcy proceedings be

[182] But I only call the system in the Enterprise Insolvency Law of 1986 and in the new PRC. Enterprise Bankruptcy Law the real reorganization system has been established.

[183] Tang Weijian, “The Comments on the Enterprises Insolvency Law,” http://www.civillaw.com.cn/Article/default.asp?id=9392 (last visited on June 17, 2007).

[184] *See* the Enterprise Insolvency Law of 1986, Article 18: “After presenting an application for reorganization, the enterprise shall submit a draft reconciliation agreement to the creditors' meeting. The draft reconciliation agreement shall stipulate the period within which the enterprise must repay its debts.”

suspended and can the enterprise rectification be executed. Here the conciliation becomes the premise of the rectification. In a word, the Enterprise Insolvency Law of 1986 combined these two systems and denied their own independence as different bankruptcy preventive systems. The function of the rectification has been restricted because of the combination.

Second, the rectification proceedings only start up on the premise of the bankruptcy proceedings. The application of the modern reorganization system can be advanced under the statutory circumstance and the bankruptcy proceedings are not the premise because the reorganization itself is an independent system. But as we can find in the Enterprise Insolvency Law of 1986, the rectification application can only be advanced by the superior department after the start-up of the bankruptcy proceedings,[185] and only under the circumstance of the creditors advancing the bankruptcy application can the rectification proceedings be applied. Such regulations actually deprive the right of applying for the rectification actively of the enterprise and increase the difficulty of the rectification.

Third, the applicant and the president are both the superior department in charge of the insolvent enterprise. The application of the modern reorganization system can be advanced under the statutory circumstance and the bankruptcy proceedings are not the premise because the reorganization itself is an independent system. But as we can find in the Enterprise Insolvency Law of 1986, the rectification application can only be advanced by the superior department after the start-up of

185) *Ibid*.

the bankruptcy proceedings.[186] Moreover, the rectification of the enterprise is also under the lead of the superior department. Such regulations and practices are quite different from the modern corporate reorganization and such regulations in the Enterprise Insolvency Law of 1986 indicate the administrative subjection relationship between the enterprise and the government department of the planned economy and the obvious administrative characteristic. Thus the outcome is certainly the nominal rectification as a kind of government behavior.

Finally, the creditors have no power in the rectification system. The creditors do not have the right to speak and decide and they can only be informed of the rectification affairs[187] while in the modern reorganization system the creditors have the right of voting and they can protect their own interests through the execution of their rights.

## 2. THE ANALYSIS ON THE DISUSE OF THE RECTIFICATION SYSTEM

More than 20 years have passed since the Enterprise Insolvency Law of 1986 was enacted, but there were few cases at first and since the 90s of the 20th century the bankruptcy began to be the main way to exit the market of the enterprises after

186) Tang Weijian, "A Summarization on the Proseminar of Enterprise Bankruptcy and reorganization," http://www.civillaw.com.cn/Article/default.asp?id=9570 (last visited on June 17, 2007).

187) *See* the Enterprise Insolvency Law of 1986, Article 20: "The superior department in charge of the enterprise will be responsible for directing the reorganization. The enterprise reorganization plan shall be passed to a meeting of employee representatives for discussion. The circumstances of reorganising the enterprise shall be reported to the employees' meeting and the opinions of the its members shall be solicited. The circumstances of the enterprises' reorganization shall be reported periodically to the creditors' meeting."

the introduction of the market competition mechanism. From 1989 to 1993 there were only 1153 enterprise bankruptcy cases in the whole country while from 1994 to 1997 the number was 15,479 and from 1998 to 2003 the enterprise bankruptcy cases accepted by the court were almost 6,000 per year.[188] But in all of these cases there was almost no case that suspended the bankruptcy liquidation proceedings because of the conciliation and rectification proceedings. Why was the conciliation and rectification system on the shelf and not used by the judicial practice? I think the reasons are: first, the defections of this mixed procedure regulated by the original Enterprise Insolvency Law and secondly, the restriction of China's real situation.[189]

The first reason has been discussed above and as to the second reason, China's real situation really restricted the application of the rectification system. After the State Council, Problems Concerning Trial Bankruptcy of State-owned Enterprises Thereof in Various Cities Circular of 1994, the bankruptcy cases increased suddenly, but most of the cases belong to the state-owned enterprises policy bankruptcy. The so-called policy bankruptcy is also called the planned bankruptcy[190] and it particularly refers to the bankruptcy of the state-owned enterprises that have been listed in the national plan of adjustment. The policy bankruptcy is the production of that special period in which China's economy turned from the planned economy to the market economy. The policy bankruptcy

[188] Tang Weijian, "The Comments on the Enterprises Insolvency Law," http://www.civillaw.com.cn/Article/default.asp?id=9392 (last visited on June 17, 2007).

[189] Peng Ningyan, "The Reformation and Improvement of the Bankruptcy Reorganization Proceedings," http://www.law-gun.com/Article_Show.asp?ArticleID=3746 (last visited on June 17, 2007).

[190] Comparing with the policy bankruptcy, the bankruptcy of ordinary enterprise can be called as the bankruptcy out of plan.

has its own characteristics: a) the confirmation of the bankruptcy properties and the preferential claims and b) the cancellation after verification of the bankruptcy claims of the commercial banks. Specially speaking, the secured properties of the enterprise still belong to the bankruptcy properties and the rights of exclusion are restricted. The expenses for the resettlement of the staff and workers are treated as the preferential claims and because the bankruptcy properties are used to settle the staff and workers the state-owned commercial banks suffer a lot of losses and consequently their claim-discharging rate decreases greatly. Therefore, the State Council particularly regulated that the bankruptcy claims of the state-owned commercial banks could be cancelled after verification in the planned state-owned enterprise bankruptcy cases and they were independent of the judicial proceedings.[191] In such cases the state-owned enterprises were always considered as hopeless to revive and it was impossible for their superior department to advance the rectification application, and because the market economic had not set up at that time yet, the creditors held the negative attitude to the discharging somewhat and were not aware of their concessions and the possible interests in the rectification, thus they basically held the opponent opinions on the conciliation agreement draft advanced by the debtors and consequently it was difficult for the conciliation and the rectification to come into existence.

[191] Sun Yingzheng (as the chief editor), 「Pochanfa Falv Yuanli yu Shizheng Jiexi」［The Legal Theory and Demonstrational Analysis of the Bankruptcy Law］, Renmin Fayuan Chubanshe［Court Press of China］(2004), at 18~19.

## C. THE INTRODUCED REORGANIZATION SYSTEM IN CHINA'S NEW BANKRUPTCY LAW OF 2006

### 1. THE SIGNIFICANCE OF INTRODUCING THE REORGANIZATION SYSTEM TO CHINA

As I have discussed above the Enterprise Insolvency Law of 1986 is the production of the planned economy and is full of the administrative characteristics. The bankruptcy then is totally under the lead of the government. Because the Enterprise Insolvency Law lacks the possibility to practice, many bankruptcy cases are judged by the policies and the Enterprise Insolvency Law has already lost its function as an independent legal procedure. The Enterprise Bankruptcy Law itself has been declared as "bankruptcy" indeed.[192)]

Therefore, enacting a unitive bankruptcy that adapts to the development of the market economy has great theoretical significance and practical significance undoubtedly. Finally the new Enterprise Bankruptcy Law has been adopted at the 23rd Session of the Standing Committee of the 10th National People's Congress on August 27, 2006 and has been effective as of June 1, 2007 after more than ten years since it was first drafted in 1994. The new Enterprise Bankruptcy Law introduces the reorganization system and has constructed a theoretical system that includes three interrelated but also independent stand alone systems—the bankruptcy liquidation, the bankruptcy conciliation and the bankruptcy reorganization.

[192)] Li Yongjun,「Pochan Falv Zhidu」［the Bankruptcy Law］, Zhongguo Fazhi Chubanshe［China Legal Publishing House］(2000), at 25~26.

Under the current circumstance, the corporate reorganization system is quite significant to those state-owned enterprises in mess, whose essential problem is the structure. Most of those enterprises have advanced technology, the strength to compete and the market. The best method to settle their problems is not the declaration of bankruptcy, but the reorganization and through successful reorganization, those enterprises can revive and protect the employees' interests and consequently maintain the social interests.

## 2. THE ATTENTION TO THE CREDITORS' INTERESTS OF THE NEW BANKRUPTCY LAW

### 1) Overview

Protecting the creditors' interests is the original motivation of the bankruptcy system. All the designs and conformations of the principles, the systems and the proceedings cannot deviate from the point of protecting the creditors' interests. Although the primary task of the reorganization system is realizing the revival of the enterprise, it does not mean that the reorganization system ignores the protection of the creditors' interests. Contrarily, the protection of the reorganization system hasn't been decreased.

China's new Enterprise Bankruptcy Law regulates the "reorganization" as chapter 8 and considers it as an independent procedure. The articles cover the contents from the application and examination of the reorganization to the business during the reorganization period, from the formulation, the approval of the

reorganization plan to the execution of the reorganization plan. And as to the protection of the creditors, these regulations hereinafter are outstanding.

**2) Outstanding Characteristics**

**a. the broadened reorganization reason**

The Bankruptcy Law broadens the reorganization reason in order to increase the possibility of a successful reorganization. It regulates that "if an enterprise legal person is unable to discharge its debts as they fall due and its assets are insufficient to discharge its debts in full, or if it obviously lacks the ability to discharge its debts, it shall settle the debts in accordance with the provisions hereof." And "If an enterprise legal person falls into the circumstance prescribed in the preceding paragraph or is obviously likely to lose the ability to discharge its debts, it may undergo reorganization in accordance with this Law."[193)]

**b. the improved possibility of the reorganization plan**

To ensure the reorganization plan be feasible and be approved successfully, the Bankruptcy Law regulates that "if the debtor manages its property and business affairs on its own, the draft reorganization plan shall be prepared by the debtor" and "if the administrator is responsible for the management of the property and

193) *See* the PRC new Enterprise Bankruptcy Law, Article 2: "If an enterprise legal person is unable to discharge its debts as they fall due and its assets are insufficient to discharge its debts in full, or if it obviously lacks the ability to discharge its debts, it shall settle the debts in accordance with the provisions hereof. If an enterprise legal person falls into the circumstance prescribed in the preceding paragraph or is obviously likely to lose the ability to discharge its debts, it may undergo reorganization in accordance with this Law."

business affairs, the draft reorganization plan shall be prepared by the administrator."[194] Thus, not only the debtor's advantage of knowing well about his own properties and financial conditions but also the administrator's advantage of professional knowledge has been considered.

**c. the ensured maximization of the creditors' interests**

To protect the best of the creditors' interests, the Bankruptcy Law regulates the vote principle of the reorganization plan and adopts both the criteria of the people's number of people and the claims amount. According to this principle, "If the draft reorganization plan is agreed by a majority of the creditors of the same voting group attending the meeting and the amount of claims represented by such creditors accounts for more than two-thirds of the total amount of claims of the group, the draft reorganization plan shall be deemed to have been adopted by that group."[195] And "The reorganization plan shall be deemed to have been adopted when all voting groups have adopted the draft reorganization plan."[196] To increase the possibility of being approved of the reorganization plan, the Bankruptcy Law also provides the judicial discretion to the court and the court can approve the draft reorganization plan that meets a certain conditions forcedly.[197]

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[194] *Ibid* Article 80: "If the debtor manages its property and business affairs on its own, the draft reorganization plan shall be prepared by the debtor. If the administrator is responsible for the management of the property and business affairs, the draft reorganization plan shall be prepared by the administrator."

[195] *Ibid* Article 84, Paragraph 2: "If the draft reorganization plan is agreed by a majority of the creditors of the same voting group attending the meeting and the amount of claims represented by such creditors accounts for more than two-thirds of the total amount of claims of the group, the draft reorganization plan shall be deemed to have been adopted by that group."

[196] *Ibid* Article 86, Paragraph 1: "The reorganization plan shall be deemed to have been adopted when all voting groups have adopted the draft reorganization plan."

[197] *Ibid* Article 87: "If any of the voting groups does not adopt the draft reorganization plan, the

**d. the well protected creditors with the secured property**

As to the protections to the creditors, "during the reorganization period, exercise of security rights over specific property of the debtor shall be suspended. However, if there is a possibility for the security to be damaged or significantly reduced in value to the extent that the rights of the security right holder may be prejudiced, the holder of the security right may request the people's court for resumption of the exercise of the security rights."[198)]

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debtor or the administrator may consult the voting group that does not adopt the draft reorganization plan. Such voting group may vote once again after the consultation. The result of the consultation shall not prejudice the interests of other voting groups. If the voting group that does not adopt the draft reorganization plan refuses to vote once again or if it votes once again but still does not adopt the draft reorganization plan, the debtor or the administrator may apply to the people's court for approval of the draft reorganization plan provided that the draft reorganization plan meets the following conditions: pursuant to the draft reorganization plan, the claims under Item (1) of Paragraph One of Article 82 hereof will be fully repaid by the specific property and the losses arising from delay of repayment will be equitably compensated and its security right has not been materially prejudiced, or the voting group has adopted the draft reorganization plan; pursuant to the draft reorganization plan, the claims under Items (2) and (3) of Paragraph One of Article 82 hereof will be fully repaid, or the corresponding voting group has adopted the draft reorganization plan; the repayment percentage entitled by the ordinary claims pursuant to the draft reorganization plan is not lower than the repayment percentage entitled by such claims pursuant to the bankruptcy liquidation proceedings atthe time when the draft reorganization plan is submitted for approval, or the corresponding voting group has adopted the draft reorganization plan; the adjustment to the interests of the capital contributors under the draft reorganization plan is fair and equitable, or the group of capital contributors has adopted the draft reorganization plan; the draft reorganization plan treats the members of the same voting group fairly, and the order of repayment provided therein does not violate the provisions of Article 113 hereof; and the business plan of the debtor is feasible. If the people's court believes upon examination that the draft reorganization plan is in conformity with the provision of the preceding paragraph, it shall rule the approval thereof within 30 days of receipt of the application, terminate the reorganization proceedings and make an announcement thereof."

198) *Ibid* Article 75, Paragraph 1: "During the reorganization period, exercise of security rights over specific property of the debtor shall be suspended. However, if there is a possibility for the security to be damaged or significantly reduced in value to the extent that the rights of the security right holder may be prejudiced, the holder of the security right may request the people's court for resumption of the exercise of the security rights. "

**e. the statutory circumstances of terminating the reorganization proceedings**

During the reorganization period, if any of the following circumstances occurs, the people's court shall rule to terminate the reorganization proceedings and declare the debtor bankrupt upon the request of the administrator or the interested parties: (1) business conditions and property conditions of the debtor continue to deteriorate without the possibility of being remedied; (2) the debtor acts to defraud or maliciously reduce the debtor's property or otherwise in a manner obviously detrimental to the creditors; or (3) the debtor's conduct makes it impossible for the administrator to perform its duties.[199)]

## 3. SUGGESTIONS

### 1) Overview

Although the reorganization system is introduced in the China's new Enterprise Bankruptcy Law and the regulations on protecting the creditors' interests are undoubtedly right, comparing with the advanced reorganization systems in other countries and districts, there are only 25 articles about the reorganization in the new law and they are a little too simplified and principled for the practice. To prevent the abuse of the procedure and protect the creditors' interests the principle

[199)] *Ibid* Article 78: "During the reorganization period, if any of the following circumstances occurs, the people's court shall rule to terminate the reorganization proceedings and declare the debtor bankrupt upon the request of the administrator or the interested parties: business conditions and property conditions of the debtor continue to deteriorate without the possibility of being remedied; the debtor acts to defraud or maliciously reduce the debtor's property or otherwise in a manner obviously detrimental to the creditors; or the debtor's conduct makes it impossible for the administrator to perform its duties."

of “efficiency first and equity be considered” has to be insisted on to design and apply the reorganization system. I think these points hereinafter should be paid attention to.

**2) The Adequate Protection of the Creditors**

The creditors with the secured reorganization claims are the same as the ordinary creditors in the reorganization proceedings and they have to execute their rights according to the proceedings. We can say that in the reorganization proceedings the creditors with the secured reorganization claims are actually facing the biggest risk and it is necessary to protect them in particular. The interests of the creditors with the secured reorganization claims limit the value of the secured property and this value may be decreased because of the realization of the more preferential security on the secured property, and may also be decreased because of the reduced market price of the secured. That means it is very possible for the creditors’ security rights to be decreased. The China’s new Enterprise Bankruptcy Law only regulates the protection and the protection should be strengthened.

**3) The Small Claims**

Discharging the small claims in time can simplify the reorganization proceedings and decrease the expenses of the filing, investigating and confirming of the small claims. And on the other hand, the total amount of the discharged small claims is almost little comparing with the other claims. Many countries regulate that the

small claims can be discharged at any time.[200] The new Enterprise Bankruptcy Law only regulates the small claims as "if necessary, the people's court may decide to set up a small claims group within the ordinary claims group to vote on the draft reorganization plan."[201] I think it is necessary to pay more attention to this problem.

**4) The Protection of the New Capital**

How to acquire new capital for maintaining the company's business and carrying through on the reorganization proceedings is one of the primary problems that the reorganization corporations face since they start the proceedings. The protection of the provider of the new capital should be strengthened to raise the required money. There are detailed and stretchy regulations in the Federal Bankruptcy Code of the United States while it is silent in China's current law.

[200] For example, *See* The French Commercial Code, Article L621-78: "I. By way of exception to the provisions of Articles L.621-76 and L.621-77, the following debts shall not be subject to any discount or time to pay:

1. Privileged debts as specified in Articles L.143-10, L.143-11, L.742-6 and L.751-15 of the Employment Code;

2. Privileged debts arising from a contract of employment, as specified in Article 2101 (4) and Article 2104 (2) of the Civil Code, where the total amount thereof has not been advanced by the institutions mentioned in Article L.143-11-4 of the Employment Code or subrogated.

II. Within a limit of 5% of the estimated liabilities, lesser debts, taken in ascending order as to the amount thereof, which shall not exceed a sum to be fixed by decree, shall be repaid without discount or time to pay. This provision shall not apply where the total amount of the debts owed to any one person exceeds one tenth of the aforementioned percentage or where subrogation has been agreed or a payment made by a person other than the debtor. "

[201] *See* the PRC Enterprise Bankruptcy Law, Article 82, Paragraph 2: "If necessary, the people's court may decide to set up a small claims group within the ordinary claims group to vote on the draft reorganization plan."

# Ⅶ. CONCLUSION

After the discussion above, we can draw the conclusion from this dissertation that there are conflicts in the reorganization system and during the whole corporate reorganization proceedings, such as the conflict between the valuable objective of the reorganization system and the protection of the creditors' interests, the conflict between the creditors and the debtors, the conflict between the reorganization corporation and the society and so on. All these conflicts can be conciliated because the protection of the creditors' interests is still the inherent characteristic and requirement of the reorganization system. The development of the reorganization system cannot deviate from the protection of the creditors' interests. Only with the creditors' support and assistance can the reorganization proceedings go along and can the purpose of the reorganization plan be achieved. On the other side, the creditors can be discharged and achieve more only with the successful reorganization proceedings.

Before the emergence of the reorganization system, the creditors had a sovereign position in the bankruptcy proceedings all along and almost all of the systems in the bankruptcy proceedings were designed for the creditors' best interests. After the emergence of the reorganization system, the execution of the creditors' interests is restricted much because of the incline to the debtors and the society of the value of the reorganization system and the creditors' status has been challenged.

Compared with the other creditors, the existence of the corporate limited liability makes it much easier to damage the creditors' interests of the corporation. Although there are different kinds of measures to protect the creditors' interests that are provided by the company law and the basic civil law, the destiny of being judged to bankrupt of the corporation cannot be gotten rid of always. In the traditional bankruptcy liquidation system, the debtors, the creditors and even the country will suffer their losses to different extent and such losses may exceed the benefits that the liquidation system brings to them. And although every creditor has the opportunity of being discharged equally, the outcome is that they can only achieve a part of the claims, or even no achievements at last. Thus, the bankruptcy liquidation system is surely not the best choice for the corporate creditors, as their claims cannot be discharged finally like they wish.

Therefore, in my opinion, under the circumstance that the claims cannot be discharged according to the company law and the civil law, the bankruptcy liquidation system should not be the only measure to resolve the problems of the corporations in mess. There have to be different measures that the creditors can choose from. Compared with the bankruptcy liquidation system, the bankruptcy reconciliation system and the regrouping out of the court, the corporate reorganization system has its own advantages while it has the limitations at the same time.

As to the reorganization system, the debtors, the creditors, the society and other interested parties can all avoid the losses if the reorganization achieves the success. But the outcome is that the creditors may get much less than under bankruptcy

liquidation because of the high expenses of the reorganization proceedings if the reorganization fails while the debtors and the country will at most suffer the same losses as under bankruptcy liquidation. Thus it is obvious that only the creditors face risks in the reorganization proceedings compared with the liquidation proceedings. The creditors will surely consider the whole situation quite carefully and they will abandon the reorganization if there is any possibility of failing after the reorganization. But if we pay more attention to the objective of the corporate reorganization, the reorganization reason and the reorganization procedures, and make more effort to realize the reorganization of those corporations with the necessity and the possibility, the reorganization can be considered as an ideal choice of protecting the creditors' interests. The corporate reorganization is a new way to protect the creditors.

In the reorganization system, it is required to pay adequate attention to the creditors' interests when the reorganization system is designed, or when the reorganization proceedings are going along. It is also required to make the creditors believe the feasibility of the reorganization. In other words, a believable reorganization system should be one that can protect the creditors' basic rights and ensure the creditors get adequate information to supervise the process of the reorganization proceedings. Otherwise, the creditors' reluctance will certainly bring the deadlock of the reorganization proceedings.

The creditors' interests should be protected not only in theory and the design of the reorganization system, but also in the reorganization practice. And the reorganization practices in many countries have proved this point powerfully.

Generally speaking, in the countries that give the comparatively adequate protections to the creditors, the probability of a successful reorganization is higher.[202] For example, because the reorganization legislation regards the rescue of the enterprises and the maintenance of the business as the most important purposes, it excludes the debtors, the creditors and the shareholders out of the reorganization proceedings. The court is authorized to go along with the whole reorganization proceedings, and the regrouping and arrangement of the new assets and the debts are also under the control of the courts. Thus, there is little effect of the bankruptcy reorganization system in France and most of the bankruptcy cases in France end as the bankruptcy liquidation.[203]

In a word, how to proceed on the efficient reorganization and then ensure the successful corporate reorganization are always the social purposes and the creditors' best hopes. The purpose of the reorganization system is promoting the debtors to revive, and then the interests of the society can also be protected. This kind of purpose shows the modern society is intervening in the economy with its public power, but the "public intervention" has to be restricted within a certain bound—that means, the creditors' interests should not be damaged. Therefore, the development of the reorganization system cannot deviate from the protection of the creditors' interests.

The interests can be regarded as the satisfaction to people's requirements. The popular existence of the interests is the important condition of the social existence

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[202] Tang Weijian, Tang Weijian,「Pochan Chengxu yu Pochan Lifa Yanjiu」[The Bankruptcy Proceedings and the Bankruptcy Legislation], Zhongguo Renmin Fayuan Chubanshe [Court Press of China] (2001), at 378~379.

[203] *Ibid.*

and development. All the things that people struggle for are related to their interests and the function to the society of the law is realized mainly through the adjustment and control of the interests. The law came into existence because of the demand of the interests balance and has been developed along with the change of the interests relationship. It is impossible for the law to come into being or develop without the interests. Many scholars consider the interests balance as the purpose and task of the law while they don't point out how to balance the conflicting interests and in fact it is rather difficult for them to answer the question. So the legislators and the judges should make effort to achieve the balance both in the legislation and the judicial practice. If the legislators cannot conciliate the conflict of the different interests in the material legal system it will also be difficult to achieve the balance through the legal interpretation and legal application. The interests in the corporate reorganization system should also be treated carefully.

The multiplex value objects of the reorganization system make the interests coexist during the whole process. All the stakeholders are conflicting with each other while they share the same interests sometimes. They can achieve their purposes if the reorganization is successful, but they will certainly lose their money if the reorganization is aborted. The creditors are always at a disadvantage in the reorganization process relative to other interested parties and their interests are most easily infringed upon. Therefore, the protection of the creditors' interests should be carefully considered during the course of system designing, instead of being remedied after the probable abortive reorganization.

With an eye on the protection of the creditors, besides the confirmation of the

reorganization claims, there are mainly three problems for us to settle: the start-up mechanism of the reorganization proceedings, the corporate reorganization institutions during the course of the reorganization proceedings and the establishment and execution of the reorganization plan. One thing we have to pay attention to is that the court conducts and supervise the whole corporate reorganization proceedings always. However, it should not intervene too much because the corporate reorganization is judicial proceedings after all. Thus, how to conciliate the role of the court during the course of the reorganization has been an important problem, especially in terms of the protection of the creditors' interests. And as to the interior balance of the creditors themselves, the automatic stay and the right of rescission are both the systems of protecting the creditors' interests equally and showing the adjustment and balance to all the creditors in a whole and each individual creditor.

During the period of turning from the planned economy to the market economy, and facing the situation of so many state-owned enterprises in trouble and the incomplete social security system, it seems to be in our best interest to have introduced the reorganization system to China in the new Enterprise Bankruptcy Law. After China's new Enterprise Bankruptcy Law went into effect, the Bao Shuo Ltd. of HeBei Province is the first entity that apply the reorganization system in China, and the first meeting of the creditors will be held on June 25, 2007. We are waiting to observe the first reorganization case as it has its epoch-making meaning. However, the practice of the newly introduced reorganization system in this case and the theoretical development of the system cannot deviate from the protection of

the creditors' interests. Without the recognition of the protection of the creditors' interests, there would not be a successful corporate reorganization.

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# 회사정리에 있어서의 채권자 이익 보호에 관한 연구

시장에 있어서의 경쟁은 필수불가결한 요소이며, 이러한 경쟁으로 인하여 기업의 경영의 실패 가능성은 항상 존재한다. 특히 기업의 파산과 그에 따른 채권자의 권리보호 제도는 전체적인 시장의 발전을 유도하는 중요한 요인이 되고 있다. 세계 각국은 자국에 맞는 파산제도를 가지고 있고 이러한 각국의 파산제도는 채권자보호절차를 보다 명확하게 규정함으로써 시장의 위기를 관리하고 있다. 결국 파산제도는 기업의 잔여재산이 얼마나 존재하는지의 여부를 묻지 않고 기업금융의 불안정을 방지하고, 국내외 투자자는 물론 기업의 채권자에게 어느 정도 경제적 신뢰를 마련하는 기틀을 제공한다

파산제도는 세계적으로 1970 년대를 거치면 획기적으로 변화를 겪게 되었다. 미국, 프랑스, 영국, 독일 등 서방국가들은 계속해서 새로운 파산법을 제정하거나 기존의 파산법을 대대적으로 개정하였다. 이러한 파산법의 제정 및 개정은 회사정리제도를 중심으로 이루어졌고, 회사정리제도는 적극적인 파산의 예방적 기능을 충실하게 수행하여 왔다.

그러나 아무리 회사의 갱생을 목적으로 하는 회사정리제도라고 하더라도 회사와 채권자 간의 이익을 모두 충족시킬 수는 없는 것이 현실이다. 그러니까 채무자인 기업을 구제함으로써 사회이익을 보호하는 것과 채권자의 이익을 보호하는 것은 사실상 모순이라고 할 것이다. 즉, 채무자의 입장에서는 채무를 연기하거나 경감함으로써 재정상의 부담을

줄이면서 기업을 재건하고자 하는 반면에 채권자는 자신의 채권을 완전하게 확보하기를 원하는 것이 현실이라는 것이다. 그러면 이러한 채권자와 채무자 기업간의 이익의 충돌은 어떻게 조정하여야 할 것인가? 본 논문은 이러한 기본적인 질문에 답하기 위하여 회사정리 제도에 있어서의 채권자 이익보호에 관한 사항을 다루고 있다.

이 논문의 제 1 장 머리말에서는 파산법의 발전과정을 회사정리제도를 중심으로 살펴보고자 한다. 정리제도는 파산법의 발전 중 필연적인 결과로 나타나게 된 제도이다. 즉 정리제도는 청산제도 또는 화해제도가 채무문제를 적절하게 해결하지 못함으로써 탄생하게 된 것으로서 채권자의 이익을 보다 합리적으로 보호하는 수단으로서 작용한다는 것이다. 이러한 개념을 전제로 본 장에서는 파산 제도의 출현이래 여러 국가에서 나타난 변화들을 검토하고 있다. 특히 이러한 변화는 파산면책제도 전후를 구분하여 분석하고자 하였으며, 각국의 입법례를 영국, 중국 및 대만, 그리고 미국와 일본의 경우를 중심으로 살펴보았다.

이러한 검토를 토대로 정리제도에 있어 채권자의 이익과 채무자 기업의 이익충돌의 원만한 해결방안을 제시하고자 하였다. 이러한 해결방안은 구체적으로 회사정리제도의 궁극적인 목적이 채권자나 채무자의 이익보호에 있다기 보다는 제 3 당사자라고 할 수 있는 사회 전체적인 이익을 보호한다는 데에 있다는 것을 전제로 한다.

제 2 장은 회사정리 중 채권자 이익보호를 위한 이론적 기초를 다루고 있다. 실질적으로 정리채권은 정리개시 이전에 발생한 재산적 청구권으로서 법률에 의한 강제집행이 가능하다. 이 곳에서는

정리채권을 우선정리채권, 담보가 있는 정리채권, 담보가 없는 정리채권으로 나누어 각각의 법률적 문제를 검토하고자 한다. 그리고 각 정리채권의 이익평형의 필요성과 이익평형의 실행 가능성을 여러 각도에서 살펴보고자 한다.

제 3 장에서는 회사정리의 구체적 절차에 관한 사항과 채권자의 지위를 살펴보고 있다. 사실 회사정리에 있어서 가장 중요한 문제가 채권자를 어떻게 보호할 것인가에 있다. 따라서 이 장에서는 회사정리 절차에 있어 나타날 수 있는 문제를 집중해서 다루고자 한다. 특히 정리과정에 있어서의 기관의 법률적 지위 및 권리와 그 제한, 감독기구의 권한, 그리고 채권자 자치기구의 조직과 권한에 관한 사항을 구체적으로 다루고자 한다.

제 4 장은 채권자 내부의 이익 평형에 관한 사항을 다루고자 한다. 회사정리 중에는 채권자와 다른 이익주체간의 관계는 물론이거니와 채권자 내부에 있어서도 상호간에 이익의 충돌문제가 발생한다. 따라서 이 장에서는 이러한 문제를 해결하기 위한 방안을 강구하고자 한다.

2005 년 3 월 21 일에, 한국정부는 통합도산법을 반포했다. 이 새로운 법률은 2006 년 4 월 1 일부터 이미 효력이 발생한다. 제 5 장은 한국의 회사정리제도의 발전을 간단히 소개한 후에, 통합도산법의 돌출적 장점을 하나씩으로 소개한다.

제 6 장은 중국의 회사정리제도를 매우 구체적으로 분석하고 있다. 사실 2006 년 중국의 기업파산법의 개정이 이루어지기 전까지 중국에는 현대적인 회사정리제도가 존재하지 않았다. 따라서 이장에서는 2006 년 이전에 존재하던 유명무실했던 정리제도와 2006 년 중국의 기업파산법의

개정으로 도입된 새로운 정리제도를 구체적으로 분석하고자 하였다. 사실 1986 년 중화인민공화국 기업파산법은 실제로 국유기업에게 적용하였고, 1991 년의 수정 민사소송법에서는 국유기업 이외의 민영 기업에 있어서의 파산에 관한 사항을 다루고 있었다. 이후 다양한 법률의 제정 및 개정을 통하여 파산 관련제도를 정비하였다. 그리고 2006 년 8 월에 제 10 차 전국인민대표대회 상무위원회 제 23 회 회의에서 기업파산법이 통과됨으로써 2007 년 6 월부터 새로운 정리제도가 그 효력을 발생하게 되었다. 이장에서는 이 새로운 회사정리제도를 살펴보고 또 그 문제점과 개선방안을 제시하고자 한다.

제 7 장은 결론의 장으로서 정리제도의 탄생에서부터 현재에 이르기까지의 구체적 내용 검토를 전제로 성공적인 회사정리제도의 지속적 발전 방안을 제시하고자 하였다. 특히 정리제도의 발전은 채권자 보호에 중점을 두고 이루어져야 할 것이며, 이를 위한 발전적 제언을 하고자 한다. 마지막으로 본 논문이 중국의 회사정리제도 발전에 기여할 수 있는 방안을 마련하고자 한다.

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