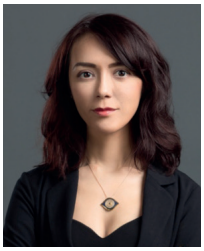

Recent developments in cross-border insolvency practice in China

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In 2023, there was a significant development in the judicial practice of cross-border insolvency in China. The Standing Committee of the National People's Congress (NPC) classified the revision of the Enterprise Bankruptcy Law of the People's Republic of China as the first category of legislative planning. As a result, a systematic cross-border insolvency regime may soon be presented in the new insolvency law in the form of a special chapter. Meanwhile, Chinese courts have recently recognised and assisted German and Japanese insolvency proceedings, marking a significant breakthrough in the recognition and assistance of extra-territorial insolvency proceedings. This provides a mutually beneficial basis for subsequent cross-border insolvency cooperation. Furthermore, the High Court of Hong Kong has ruled that the Keepwell Agreement obligations are binding on the Keepwell provider in Chinese mainland, providing overseas creditors with avenues of redress. The offshore reorganisation of several Chinese real estate companies has brought the issue of cross-border insolvency to public attention.

Introduction

Currently, the only legal basis for cross-border insolvency in the Chinese mainland is offered by The Enterprise Bankruptcy Law of the People's Republic of China (EBL), Article 5. In judicial practice, judgments are typically made based on the "principle of reciprocity".[1] This means that the decision is based either on whether there is reciprocity between the countries, or on legal presumptions to determine if the extraterritorial country has a reciprocal relationship with China.

The Civil Procedure Law of the People's Republic of China, Article 300 is used to determine whether a case violates China's basic principles, damages the sovereignty of the state, or harms social interests.[2] However, the cross-border insolvency provisions are often too abstract and abbreviated, leading to practical difficulties in applying them in the Chinese mainland.

Chinese courts have been making efforts to address the inadequacies of the current cross-border insolvency rules. On September 7, 2023, the legislative plan of the 14th Standing Committee of the National People's Congress was announced, and amendment of the EBL was included in the first category of "draft laws with relatively mature conditions and intended to be submitted for review during the term of office".[3] It is entirely possible that a systematic cross-border insolvency system may be presented in the form of a special chapter in the new insolvency law.

The second section of this article elaborates on the breakthrough progress made by the Chinese courts in recognising and assisting extraterritorial insolvency proceedings; the further development of cross-border insolvency recognition review standards, and the provision of a mutually beneficial foundation for subsequent cooperation in cross-border insolvency.

The third section analyses the judgment of the High Court of Hong Kong on the binding force of the Keepwell Agreement, and proposes the remedies of overseas creditors to the parent company in Chinese mainland. The fourth section analyses the current judicial practice of debt restructuring under the BVI framework. Several major cross-border restructuring cases of Chinese real estate enterprises have attracted attention from various sectors of society to the legal system and judicial practice of cross-border insolvency.

Recognition of foreign insolvency proceedings

In 2023, China's cross-border insolvency practice made breakthrough progress at the individual case level. Chinese courts are expanding their recognition and scope of assistance for foreign insolvency proceedings and have become aware of significant differences between cross-border insolvency recognition and assistance and the recognition and enforcement of general foreign-related civil and commercial judgments. They are actively exploring and improving the review standards for recognising foreign insolvency proceedings in individual case practice.

The **Aachen Regional Court case** was the first instance in which China applied Article 5 of the EBL to recognise German insolvency proceedings.[4] In this case, where there was neither an international treaty of mutual recognition and enforcement of insolvency proceedings nor de facto reciprocity between Germany and China, the Beijing First Intermediate People's Court effectively promoted the determination of the validity of cross-border insolvency proceedings through the legal presumption of the existence of reciprocity between the two parties. On January 1, 2011, the Aachen Local Court, Germany, issued an insolvency judgment opening the insolvency proceedings of LY Co, Ltd. and appointed Dr. Andreas Ringstmeier as the insolvency administrator.

In order to liquidate the assets of LY Co, Ltd. in Beijing, China, the insolvency administrator filed an application for recognition and assistance with the Beijing First Intermediate People's Court, requesting the Beijing First Intermediate People's Court to recognise the insolvency judgment issued by the Aachen Local Court and to recognise the status of the insolvency administrator and allow it to perform its duties in China.[5] There was no international treaty concluded or jointly participated in by China and Germany, so the case needed to be considered on the basis of the principle of reciprocity.

The Beijing First Intermediate People's Court held that although Germany had not actually recognised the insolvency proceedings initiated by China, according to the provisions of the German insolvency law, the Chinese insolvency proceedings could be recognised in Germany, and at the same time, there was no evidence to prove that there were circumstances in which Germany refused to recognise the insolvency proceedings in China, thus it could be concluded that there was a relationship of reciprocity between China and Germany. On January 16, 2023, the Beijing First Intermediate People's Court ruled that it recognised the status of the German insolvency administrator and allowed him to perform his duties in China in accordance with the law.

The **Tokyo District Court case** was the first case in China to recognise Japan's civil rehabilitation procedure under Article 5 of the EBL. This case clarifies for the first time that the precedent of mutual non-recognition of civil and commercial judgments between China and Japan does not necessarily apply to cross-border insolvency cases, reflecting the more flexible and open attitude of the Chinese courts in determining a mutual relationship in cross-border insolvency cases, which is of great significance to cross-border insolvency.

In this case, the Shanghai Third Intermediate People's Court comprehensively examined whether the Japanese insolvency proceedings involved in the case had collective characteristics, whether there was legal reciprocity between China and Japan, whether there were grounds for non-recognition, and the identity and position of the Japanese administrator.[6] Given the precedent of mutual non-recognition of civil and commercial judgments between the Chinese mainland and Japan, the resulting recognition of Japanese civil rehabilitation proceedings by the Shanghai Third Intermediate People's Court reflects the open attitude of the Chinese courts. In practice, the standards for cross-border insolvency recognition review in the Chinese mainland are proven to have been improved.

Remedies for offshore creditors in the Keepwell agreements

On May 18, 2023 and June 15, 2023, respectively, the High Court of the Hong Kong Special Administrative Region issued two landmark judgments on the enforceability of the Keepwell Agreement and the Equity Interest Purchase Undertaking (EIPU) in two related cases, namely *Nuoxi Capital Ltd & ors v Peking University Founder Group Company Limited*[7] and *Citicorp International Limited v Tsinghua Unigroup Co., Ltd.*[8] The key issues in these cases were whether the Keepwell Agreement and the EIPU were binding and enforceable against the Keepwell provider in the Chinese mainland, and what remedies would be available from the Hong Kong courts in the event of a breach of the agreement by the Keepwell provider.

In these cases, the High Court of Hong Kong expressly recognised that the obligations in the Keepwell Agreement and the EIPU were binding and enforceable against the Keepwell Provider. Although the factual circumstances of the two cases were very similar, the timing of the facts (i.e., whether the breach occurred before or after the Provider's reorganisation proceedings in the Chinese mainland) resulted in conflicting judgments in the two cases. Under the terms of the Keepwell Agreement and the EIPU, the defendant company was required to use its best efforts to obtain regulatory approvals for the performance of its obligations to the Keepwell Agreement. If a default occurs after the Mainland Provider has entered into insolvency proceedings, the Mainland Provider is unable to obtain regulatory approval even with its best efforts, at which point the Keepwell Obligations shall be waived.

Taking the above cases into account, we suggest that offshore creditors may consider the following remedies: firstly, if the Chinese mainland parent company has not yet commenced insolvency proceedings but has triggered a default under the Keepwell Agreement, the offshore creditors should commence court proceedings as soon as possible to obtain a valid judgment and increase the likelihood of obtaining a final judgment before the Chinese mainland parent company commences insolvency proceedings.

Subsequently, the offshore creditor can apply for recognition and enforcement of the extraterritorial judgment in the mainland to secure its claim against the mainland parent company. Even if the Chinese mainland parent company enters into insolvency proceedings at a later stage, the offshore creditors are entitled to file their claims with the insolvency administrator after the recognition and enforcement of the judgment.

Secondly, if the default under the Keepwell Agreement occurs after the mainland parent company enters into insolvency proceedings, the offshore creditor, considering the litigation costs, may still attempt to obtain a foreign judgment and take subsequent legal action in the Chinese mainland, including filing its claim directly with the mainland insolvency administrator or, if the administrator rejects the filing, commencing legal proceedings (including applying for recognition of the foreign judgment) to have its claim confirmed by the mainland insolvency court.

BVI company's overseas debt restructuring

Most of China's large real estate companies are established and operated with cross-border equity nested BVI structures, registered or listed outside of China, with their principal assets and operations in China and their debt spread both inside and outside of the country. During the murky time of China's real estate market, China's struggling mainland real estate enterprises have successively sought cross-border insolvency judicial assistance from the US courts in their offshore dollar restructuring process.

In August 2023, China Evergrande Group filed a petition with the US Insolvency Court for the Southern District of New York pursuant

to Chapter 15 of the US Insolvency Code for recognition of the insolvency proceedings commenced by the Group in the British Virgin Islands (BVI) and Hong Kong in April and July of the same year, respectively. In September 2023, the China Sunac Group also filed a petition in the US Insolvency Court for the Southern District of New York, seeking recognition of their debt restructuring proceedings in Hong Kong and the granting of mutual legal assistance measures.

In December 2023, the China Aoyuan Property Group filed a petition in the US Insolvency Court for the Southern District of New York pursuant to Chapter 15 of the US. The bankruptcy law is seeking recognition of an extraterritorial debt restructuring proceeding and the granting of judicial assistance.

Conclusion

Cross-border insolvency in China is a trending topic, and this article conducts a thorough analysis of the recent progress of cross-border insolvency legislation and judicial practice in China. We can observe that with the orderly progress of the revision of the Enterprise Bankruptcy Law, Chinese courts are facing the increasing demands of international cooperation in cross-border insolvency with more and more active and open judicial concepts, and it is expected that in the future, the Chinese mainland will establish a perfect cross-border insolvency system to properly solve the debtor and creditor problems arising from international investment and economic and trade exchanges, and to create a safe and stable economic environment.

Notes

1. The Enterprise Bankruptcy Law of the People's Republic of China, Article 5.
2. The Civil Procedure Law of the People's Republic of China (Amended in 2023), Article 300.
3. NPC, 'Legislative Program of the Standing Committee of the Fourteenth National People's Congress' (NPC,7 September 2023) http://www.npc.gov.cn/npc/c2/c30834/202309/t20230908_431613.html#top1
4. Rheinland Limited Bankruptcy Case, January 1, (2011), 91IE5/10.
5. Civil Ruling of Beijing First Intermediate People's Court, (2022) Jing 01 Poshen No. 786.
6. Civil Ruling of the Third Intermediate People's Court of Shanghai, (2021) Hu 03 Xie Wai Ren No. 1.
7. Nuoxi Capital Ltd & ors v. Peking University Founder Group Company Limited, [2023] HKCFI 1350.
8. Citicorp International Limited v. Tsinghua Unigroup Co., Ltd.,[2023] HKCFI 1572.

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