Cross-Border Insolvency:
A Comparative Study of Chinese and the U.S. legislations

by

Ran Gao

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Graduate Department of Faculty of Law
University of Toronto

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Ran Gao
Faculty of Law
University of Toronto

Abstract

This thesis offers a comparative study of Chinese and the U.S. legislations on the issue of cross-border insolvency. China has included one article concerning this issue in its Enterprise Bankruptcy Law promulgated in 2006. Four years after that, when facing a real case, it is found that the legislation is too preliminary to be used. In the meantime, great efforts have been made among many western countries in order to promote international cooperation on this issue. The United States is one of the most active countries. This thesis analyzes the Chinese version of cross-border insolvency legislation, factor by factor. It also does case study of mostly U.S. cases and some other countries’ cases and tries to find out how the courts interpret the corresponding factors. In doing so, it hopes to improve the Chinese legislation by taking international experience as reference.
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I. Introduction

An increase in the number of multinational companies leads inevitably to an increase in the number of multinational bankruptcies. This thesis deals with the multinational bankruptcy issue which is a branch of the conflict of laws commonly referred to as “cross-border insolvency law” or “international insolvency (or bankruptcy) law”. The conflict-of-law rules concerning cross-border insolvencies fall under two main categories: 1) the rules governing the jurisdiction of one country’s courts over insolvent companies and individuals (“jurisdictional rules”) and; 2) the rules governing the recognition of foreign insolvency proceedings, the state of corporate groups, and the treatment of country-based assets and liabilities of such entities (“recognition and enforcement rules”). Both types of problem are of great practical importance and arise on a daily basis. However, the second category—the recognition and enforcement of foreign insolvency orders—has triggered more disputes over this matter.

Worldwide, cross-border insolvency is a relatively new and difficult area compared to the lone-history bankruptcy laws. In the process of economic globalization, many multinationals emerge; and as they compete in a free market, some of them inevitably become bankrupt. Since these corporations manage products or deliver services in more

than one country, their assets are scattered in more than one country as well. When these assets become bankruptcy estate, the question arises as to which country has the jurisdiction to initiate a bankruptcy proceeding. Are these assets subject to the laws of the country of the corporation or are they subject to laws of the country where such assets are located? If all the bankruptcy estate worldwide is subject to laws of one country, who is going to protect the interests of foreign creditors? If the assets are subject to the laws of located countries, the problem of recognition and enforcement of other countries arises. This is because although economy has integrated throughout the world, the legal systems vary and aim at protecting local creditors. Given the diversity in domestic legislations attributable to different political goals and cultural expectations, the realm of cross-border bankruptcy has been full of chaos over a long period of time. There is not a universal practice of cross-border insolvency.

Over the past 25 years, many efforts have been made to bring about greater harmonized rules for the recognition of cross-border insolvency proceedings. So far, the two most salient achievements in this field are the European Union Regulation on Insolvency Proceedings (EU Regulation) and the UNCITRAL Model Law on Cross-Border Insolvency.

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Insolvency (Model Law). The EU Regulation was opened for signature in 1995 and adopted in 2000. It is applicable only to EU members and covers jurisdictional, recognition, and choice-of-law issues. The Regulation distinguishes between insolvency proceedings initiated in a member country that is a debtor’s centre of main interest (COMI) and proceedings brought in a non-COMI member country. An order made in a COMI jurisdiction is binding on all EU members and entitles the insolvency administrator to take control of the debtor’s assets located in other member countries, to realize the assets, and to distribute the proceeds according to the distributional rules given by COMI jurisdiction unless otherwise provided in the regulation. A judgment rendered by a national tribunal that a debtor’s COMI is situated in its territory must be recognized by all other member states\(^5\), and can only be refused recognition on the ground of public policy\(^6\).

The Model Law is probably more important for international harmonization goals of this problem. It was approved by the UN in 1997 and has been adopted (with certain

\(^5\) Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, s16(1): Any judgment opening insolvency proceedings handed down by a court of a Member State which has jurisdiction pursuant to Article 3 shall be recognized in all the other Member States from the time that it becomes effective in the State of the opening of proceedings. This rule shall also apply where, on account of his capacity, insolvency proceedings cannot be brought against the debtor in other Member States.

\(^6\) Council regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings, s26(1): Any Member State may refuse to recognize insolvency proceedings opened in another Member State or to enforce a judgment handed down in the context of such proceedings where the effects of such recognition or enforcement would be manifestly contrary to that State’s public policy, in particular its fundamental principles or the constitutional rights and liberties of the individual.
variations) in the United States, Canada, Mexico, Japan and several other countries. Adoption is pending in the United Kingdom and Australia, as well as other countries with significant international economic interests\textsuperscript{7}. The Model Law does not deal with choice of law and other controversial issues. It focuses its attention on questions related to the recognition of foreign bankruptcy proceedings and the protection of the assets of foreign estates. Substantively, the Model Law is in essence complies with the EU Regulation. It also distinguishes between a “foreign main proceeding” and a “foreign nonmain proceeding” and adopts the COMI test to determine whether a foreign bankruptcy proceeding is a “foreign main proceeding” or a “foreign nonmain proceeding”. However, under the Model Law, courts are not bound by the judgment of foreign main proceeding or foreign nonmain proceeding made in another Model Law jurisdiction and are free to make their own decisions\textsuperscript{8}. This is the case in the United States under Chapter 15 of the Bankruptcy Code\textsuperscript{9}.

However, neither the EU Regulation nor the Model Law can be omnipotent in practice. The EU Regulation is a regional law and depends heavily on the tight economic and political relationships between EU members. Depart from the strong relationships, one cannot imagine, at this time, one country would recognize and enforce a foreign

\textsuperscript{7} United States Courts, online: <http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter15.aspx>.


\textsuperscript{9} The Chapter 15 of the US Bankruptcy Code will be discussed in detail in later part of this article.
judgment relating to the interests of its own creditors without any conditions. Moreover, both the EU Regulation and the Model Law focus on the debtor’s COMI. However, in the case of giant multinationals—such as Nortel, which owns more than 140 affiliates operating in more than 150 countries in the world—it would not be an easy task to determine the debtor’s COMI. In the Nortel case, the Model Law was not applicable because of the multi-jurisdictional nature of operations—the Canadian parent company said they were the COMI; the US company said they were the COMI; the UK company said they were the COMI. Because of this, the lawyers filed bankruptcy protection separately in three jurisdictions—Canada, US and Europe. To protect the creditors of other countries, the courts of those countries should supervise the bankruptcy proceedings of the Canadian, US or European court.

Despite the active international probe into the cross-border-insolvency issue, China did not pay much attention to this issue until 2000. Before that, Chinese bankruptcy courts would use the provisions on foreign-related proceedings stipulated in the 1991 Civil Procedural Law when confronted with bankruptcy cases involving foreign elements. Moreover, the bankruptcy law adopted in 1986 only applied to state-owned enterprises. There was little theoretical understanding and practical experience in cross-border-insolvency issues. At the same time, in Shenzhen, a Special Economic Zone\textsuperscript{10} in China, bankruptcy provisions for foreign-related enterprises have been

\textsuperscript{10} Special Economic Zones, including Shenzhen, Zhuhai, Xiamen and Shantou, are created by Chinese
developed at a local level in its local regulation\textsuperscript{11}. Some of its legal practice in this area is still worthwhile for us to review in this article.

In recent years, as a result of foreign investment and trade, and the globalized production and distribution of goods and services, it is unavoidable for Chinese courts to face more cross-border cases. In order to face the new circumstances\textsuperscript{12}, China has promulgated a new bankruptcy law in 2006. One notable feature of this law is the appearance of a provision of cross-border insolvency. Although the solitary article on cross border insolvency symbolizes a big step forward for Chinese bankruptcy legislation, it is still a very preliminary provision. In the formulation of the law, a Chinese scholar contributed a whole Chapter on cross border insolvency suggesting that a whole chapter should be allowed in order to devise a framework under which the Chinese courts and foreign counterparts could cooperate on cross-border cases. However, for reasons that are not clear, the advice was turned down.

To justify the current legislation (rather than a whole chapter that provides more detailed rules to this issue), the lawmakers might think that cross-border insolvency cases would not be highly likely to arise in China in a foreseeable future. After all, China has just have

\footnotesize{government in southeast coastal areas of China in 1979 where foreign investment enjoys preferential treatment. Shenzhen has the largest foreign investment in China.}
\footnotesize{12} Apart from domestic need, new circumstances include external pressure from the US and EU, who were lobbying for a new bankruptcy law in order to recognize China as a free market.
its “modern” bankruptcy law (comparing to the old bankruptcy law promulgated in 1986 which only applies to state-owned enterprises) and many issues are new. They would not spend too much money and efforts on an issue that happens less frequently. This may be a wise decision since economically speaking, if an issue subject to the law is unlikely to arise, a standard is preferable because it can save “the costs of giving the content of the law”\(^\text{13}\); if the issue would be frequent, a rule is better because it avoids the costs of getting advise or reflecting whether the issue falls into a standard\(^\text{14}\).

However, as we will see below, there was a cross-border insolvency case arising in China four years after the new bankruptcy law has taken into effect. With the rapid development of transnational corporations, we can foresee that there would be more such cases in the future. Therefore, this thesis would argue that it is beneficial if China would have a set of rules that governs the issue rather than apply the principles every time the issue arises. If there is no such rules, the standard would be apply again and again in the future when there are more alike cases, which would be very inefficient. The other reason I prefer a specific rule on this issue is that there is no precedent in China. The statutes are the only legal basis of adjudicators. Certainty of the background law is a very important for enterprises when they are making business decisions. Considering creditors have the right


\(^{14}\) Ibid. Kaplow uses the terms “rules” and “standard” to refer to laws that “may entail an advance determination of what conduct is permissible, leaving only factual issues for the adjudicator” and laws that “may entail leaving both specification of what conduct is permissible and factual issues for the adjudicator”, respectively. In this thesis, “principle” equals to “standard” under Kaplow’s definition.
to know which country’s law applies when a company cannot pay its debts before the company goes to bankrupt, a specific rule must be needed on this issue.

Article 5 is the only provision dealing with cross-border insolvency in the 2006 Bankruptcy Law. It has two paragraphs dealing with the effects of both outbound and inbound proceedings. Nevertheless, article 5 has just set out a principle. When it comes to practice, the adjudicator needs to decide what facts are permissible. In May 2010, the creditor of Tai Zi Nai Inc., Citibank (China) filed a bankruptcy petition in the court of Cayman Islands. The court appointed an interim liquidator to liquidate the assets of Tai Zi Nai located in and out of China. The case is still pending at this time. This case could be the first cross-border insolvency case after the 2006 Bankruptcy Law has come into effect. As far as the author concerned, the law makers may leave the issue of application of this law to the adjudicator, but in real cases, the court has no clue of what to do with the foreign bankruptcy judgment, leaving article 5 with little practical meaning. Therefore, establishing specific rules of cross-border insolvency is an urgent task for Chinese legislation.

Some leading scholars in China\textsuperscript{15} suggest that China should follow the EU practice or adopt the Model Law form to deal with the cross-border insolvency issues. It is submitted that China can refer to some valuable international experiences. However, as mentioned

\textsuperscript{15} See Shi Jingxia, Zhang Ling \textit{et al.}. 
above, the EU mode may not be suitable for China given the economic, political and social considerations. This thesis tries to examine a mode of cross-border insolvency specifically suited for China by referring to international practices, especially the US (adopted the Model Law) and the Model Law.

As we will see in the definitions part, in transnational bankruptcy, territorialism involves seizure of assets by the court where bankruptcy is filed and distribution of the assets according to local rules; while universalism means bankruptcy is dealt within a primary jurisdiction and other jurisdictions turn the assets to the primary jurisdiction. The law of the primary jurisdiction is used in universalism. Many articles has argued that universalism is more efficient than territorialism in terms of distribution of assets when there is a bankruptcy (ex post effect) and in terms of allocation of capital (ex ante effect)\(^\text{16}\). From the meaning of universalism, it is not hard to see it requires international cooperation on this issue. This is the reason why this thesis focuses on the United States transnational bankruptcy law. The United States is generally acknowledged that “American statutory law goes further than the law of any other industrialized nation in authorizing cooperation with foreign insolvency regimes\(^\text{17}\).” A review of laws of other main countries shows that although there are some limited instances of cooperation, the


dominant approach to transnational bankruptcies remains territorial, and the laws of the United States can be fairly characterized as the most universalist among the western countries. Thus, taking the US law as an example of comparison to Chinese cross-border insolvency law may set a fairly high benchmark for Chinese legislation.

This thesis involves four main parts. First, I will give a review of the history of how the Chinese court dealt with bankruptcy cases with a foreign element before the 2006 Bankruptcy Law was promulgated. There were a few cases decided by Guangdong court which merit a review. Second, I will examine the current system by looking at Article 5 of 2006 Bankruptcy Law dealing with cross-border insolvency and the Taizinai case. Then, I will refer to the Model Law and the practice of the US and make my argument that China should adopt the Model Law. By “adopting the Model Law”, I mean China should interpret the current Article 5 into more details and put into a newly-created COMI system. Finally, after a review of the international practices, I will propose a model that adapts such system to the current conditions in China and point out potential problems in the way of adopting it. By making such efforts, hopefully this article would contribute some ideas to the future legislation on this issue especially on the problem of jurisdiction and of recognition and enforcement of foreign bankruptcy judgment.

II. The history and status quo of Chinese cross-border insolvency

1. History

The Chinese government launched the Reform and Opening Up policy at the end of 1978 which placed China on the track socialist market economy and depart from the centralized planned economy. With more foreign-funded enterprises in China, the cross-border failure of these enterprises also came to China. However, at the national level, there was no explicit legislation on cross-border insolvency prior to the 2006 Bankruptcy Law. The previous version of the Chinese bankruptcy law, the 1986 Bankruptcy Law, only applied to state-owned enterprises and excluded all foreign investments. When faced with foreign related bankruptcy cases, Chinese courts would turn to the bankruptcy sections and Part IV (Special Regulations concerning Foreign-related Civil Procedures) of the 1991 Civil Procedure Law. However, these

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sections were too general to deal with the specific cross-border insolvency issues. Other laws and regulations concerning foreign-funded enterprises remained silent on the issue of liquidation of these companies. In 2003, Judicial Interpretation promulgated by the Supreme People’s Court\textsuperscript{21} Article 73 stated that a liquidation team should pursue the bankrupt company’s properties situated outside the territory of China. The Supreme Court seemed to draw attention to the issue but it did not address how to facilitate the pursuit of those properties by the liquidation team\textsuperscript{22}. Fortunately, there were few such cases in China.

However, in Shenzhen, a Special Economic Zone of China, there were regulations at the local level concerning the bankruptcy of foreign-funded enterprises. Said regulations stated that a foreign bankruptcy judgment had no effect against the properties of the debtor situated in Shenzhen; but that a Chinese judgment could include all assets of the debtor.\textsuperscript{23} From these provisions it was clear that the rationale was to protect the interests of Chinese debtors and creditors. In consideration of the background at the time, this approach was understandable since China was in the process of economic transition and

\textsuperscript{21} Provisions on Some Issues Concerning the Trials of Enterprise Bankruptcy Case of the Supreme People’s Court of China (Interpretation No. 23 [2002] of the SPC) was adopted at the 1232nd meeting of the Judicial Committee of the Supreme People’s Court on July 18, 2002, and came into effect as of 1 September 2002.


emphasized the protection of state sovereignty and the interest of Chinese creditors. However, this might not have been fair to some creditors since it set out double standards. What is worse, since Chinese courts did not recognize a foreign bankruptcy judgment, the trustee had to file another bankruptcy proceeding in China to access to the assets located in China. Such duplicated proceedings increased bankruptcy expenses and reduced the amount of payments for the creditors involved\(^24\). Also, this approach was unappealing in terms of international cooperation.

When foreign trustees or creditors pursued the debtor’s assets in China, share transfer was a preferred approach rather than a direct turn over of the assets\(^25\). In practice, there were several leading cases concerning foreign-funded enterprises. However, due to lack of legal basis of to recognize and enforce a foreign bankruptcy judgment, these cases were either dealt with by non-formal bankruptcy proceedings or refusing to recognizing foreign trustees or treating Chinese and Foreign creditors unequally. These cases are *The LMK Nam Sang Dyeing Case, Liwan District Construction Company Case* and *BCCI (Shenzhen Branch) Case*.

The only case in which a Chinese court recognized a foreign bankruptcy judgment was the *B&T case*. The court recognized bankruptcy judgments made by Italian courts based

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\(^{25}\) *Ibid*. 
on the Treaty on Judicial Assistance in Civil Matters between the People’s Republic of China and the Republic of Italy (‘The Sino-Italy Treaty’).

2. Status quo

The new Enterprise Bankruptcy Law promulgated in August 2006 does not distinguish state-owned enterprises from other enterprises any more and it applies to all kinds of enterprises that go insolvent of bankrupt. Article 133 states that “before this law comes into effect, the special issues related to state-owned enterprises that fall in the types and time limit prescribed by the State Council shall be governed by the relevant regulations made by the State Council” \(^{26}\). This article implies that state-owned enterprises bankruptcy cases should be governed by the new law after it comes into effect.

In the new Enterprise Bankruptcy Law, Article 5 is the only provision dealing with cross-border insolvency. It states that:

\[
\text{The procedures for bankruptcy which have been initiated according to the present Law shall have binding effect over the assets of the relevant debtor beyond the territory of the People’s Republic of China.}
\]

\[
\text{Where any legally effective judgment or ruling made by a foreign court involves any debtor’s assets within the territory of the People’s Republic of China and if the representatives applies to or requests the people’s court to}
\]

\(^{26}\) Enterprise Bankruptcy Law of China, 2006, c 12, s 133.
recognize or enforce it, the people’s court shall, according to the relevant international treaties that China has concluded or acceded to or according to the principles of reciprocity, conduct an examination thereon and, when believing that it does not violate the basic principles of the laws of the People’s Republic of China, does not damage the sovereignty, safety or social public interests of the state, does not damage the legitimate rights and interests of the creditors within the territory of the People’s Republic of China, grant recognition and permission for enforcement.

The provision stipulates the effect of both outbound and inbound proceedings. First paragraph states that any bankruptcy procedure initiated in China has binding effects on the assets of the involved debtor beyond the territory of China\(^\text{27}\). That means that the bankruptcy estate includes not only the debtor’s assets within the territory of China, but also extraterritorial assets. Assets located within and out of China should be dealt with and put into one pool of assets available for distribution to creditors according to the provisions of the new law. In judicial practice, realization of the legal effect usually relies on the corresponding laws and regulations of the other countries involved or recognition from those jurisdictions. This paragraph also implies that a) debtors of the debtor or holders of the debtor’s assets, including those outside China, should repay their debts or

hand over the assets to the bankruptcy administrator; b) properties of the debtor should be released from the extraterritorial property stay and the execution of properties should be discontinued after the Chinese bankruptcy proceeding has begun; c) civil actions or arbitrations related to the relevant debtor that have not been conclude overseas should be discontinued until the administrator takes over the assets; and d) after the Chinese court has initiated a bankruptcy proceeding, any preference using the extraterritorial assets shall be invalidated.28

The second paragraph states that China shall recognize and enforce a foreign bankruptcy judgment after an examination conducted by the Chinese courts. The initiation of the examination procedure is based on international treaties between China and the relevant foreign jurisdiction or the principle of reciprocity. It seems to indicate that when there is no international treaty or the principle of reciprocity, the Chinese court can refuse to recognize or enforce foreign bankruptcy proceedings. If there are treaties or the principle of reciprocity, the court should further make sure, through examination, that the foreign bankruptcy proceedings do not violate the basic principles of Chinese law, that they do not damage the sovereignty, safety or social public interests of the state and that it does not damage the legitimate rights and interests of the creditors within the territory of China. If there is none of the above, the court would recognize or enforce the foreign

28 X. Wang, Bankruptcy Law (Beijing: Renmin University Press, 2007) at 31-41.
bankruptcy judgment; otherwise, no recognition or enforcement is granted\textsuperscript{29}.

Article 5 is a gap-filling law in Chinese bankruptcy law enabling a big step forward. It provides a legal basis for cross-border insolvencies which can help to encourage capital flow into China and the Chinese investors to inject their capital to other countries without the worry of inequality of distribution.

The first paragraph states that a bankruptcy judgment made by a Chinese court has extraterritorial effect. Although it really depends on the bankruptcy law of a foreign jurisdiction whether or not it would recognize the Chinese judgment, it is necessary even if not sufficient for a country to defer to a foreign law that the foreign country intended for the foreign law to have extraterritorial effect. Therefore, even if the Chinese statement that its law has extraterritorial effect may not be sufficient for a foreign country to defer to Chinese law, it is necessary for it.

The second paragraph states that China should recognize a foreign judgment under several conditions. These conditions are general and vague and need to be interpreted by the Supreme Court in order for it to be specific rules in practice. Moreover, it only confines the premises of recognition to having treaties or principle of reciprocity. If the related country has neither treaties nor reciprocity tradition with China, the proceedings in that country cannot be recognized for sure. Since China has treaties or agreement on

\textsuperscript{29} \textit{Ibid.}
reciprocity with very few countries, the scope of this article is too narrow. There should be more ways for the court to operate the recognition process.

No cross-border insolvency case had been filed in China until 2010. In March 2010, a Chinese company, Taizinai, received a bankruptcy order from the Court of Cayman Islands. The debtor, Taizinai, is a company registered in Cayman Islands (for taxation reasons) but operates wholly in China and has all its assets in China. Its business is dairy production. Due to its fast expansion of its business, it went insolvent. In 2006, three investment banks (Actis, Goldman Sachs and Morgan Stanley) jointly injected capital of 73 million USD to Taizinai, but they signed a Valuation Adjustment Mechanism (VAM) with the debtor. It is stated in the VAM that after three years if the sales revenue increases by 50%, the three investment bank can give up some of their shares; if the sales revenue increases by less than 30%, the founder of the company and the controlling shareholder Li Tuchun would lose his controlling position in the company.

After the joint injection, in 2007, Citibank gave the debtor unsecured low-interest loans. However, after three years, the debtor did not meet the condition in VAM and it went insolvent again. The three investment banks promised to inject 450 million and Li should give up his shares of 61.6%.

In 2009, Hu Nan provincial government decided to transfer the management of Taizinai to Gaoke Dairy Inc. in the form of leasing operation. Gaoke Dairy is the trustee and Li is
the beneficiary. The government also made an agreement with the three investment banks that the 61.6% of the company shares are in trust.

However, the debtor could not repay the loans from Citibank. Thus Citibank filed a bankruptcy petition to the Cayman Islands court against the debtor. The court has appointed an interim litigator to litigate all the assets of the debtor. The Cayman Islands court made a bankruptcy order. Since all the assets of Taizinai locate in China, when the litigator comes to China, the Chinese court would face the issue of recognition of foreign proceedings. This elicited so much attention from both scholars and practitioners. Under the current law, although it has stipulated several factors when a court considering and evaluating a foreign judgment, it heavily relies on the court’s discretion because of the lack of specific and operable standard of each factor; neither are there any cases happening before. In this case, Chinese court can either cooperate with the litigator appointed by Cayman Islands or put the order aside. However, in both cases it is not desirable for Chinese court. If the Chinese court recognizes the order and cooperates with the foreign litigator, as some Chinese scholars suggested, it would be unfair to most Chinese creditors because the debtor is wholly operated in China and has all its assets in China, and Article 5 is promulgated in 2006 and many of the debts happened before that time. Thus they had no idea this would happen when they lent money to Taizinai. If the Chinese court puts this case aside, it might not be consistent with the original intention of the 2006 Bankruptcy Law, specifically Article 5, which commands the courts to willingly
cooperate internationally and an establishment of market economy. Therefore, this is a dilemma for China.

The following parts of this thesis go like this: after a general introduction to some theories and concepts of transnational bankruptcy, I would like address the problem in Taizina first, which is a problem of “letterbox” company. Comparing to the US bankruptcy law, it is found that there are some cases that are substantially similar to what happened in Taizina. The debtors in both US cases and Taizina are letterbox companies registered in Cayman Islands and lack of general business activities there. Then, since the problem of Article 5 is lack of operable specifics, I will separate the article and each factor stated in the second paragraph, and try to find if there are specifically interpreted counterparts in the US law that are worth to be learned by China because the US is a typical country that adopts the Model Law and some of its cases have provided very specific standard of operation. Then, since the Chinese law only states the factors should be considered during recognition, and it does not address any other important issues of international bankruptcy, such as cooperation with foreign courts, I would suggest that the legislature should be improved to include these important issues for a better operation of cross-border insolvency. To address these problems, this thesis will look at the US international bankruptcy system which is worthwhile for China to learn. Besides the case where the US court as a home court, Chapter 15 regulating ancillary proceedings, which replaces section 304, is the section that we are going to see in great details.
III. Some Theories and Definitions

As what we have discussed in the former part, an increasing number of multinational companies leads inevitably to an increasing number of multinational bankruptcies. Since it was often seen as a last chance to get value from a soon-to-be-liquidated business, bankruptcy used to be one of the most nationalistic areas of law. Each country followed a “grab rule”: seizing local assets and distributing them to the claimants in a local proceeding, with little concern about the overall result for the company or other claimants outside the domestic jurisdiction\textsuperscript{30}. However, the increasing number of international bankruptcy cases brought the emergence of a series of legal reforms that produce a dramatic shift in point of view.

There were two main theoretical approaches to international bankruptcy: territorialism and universalism. In general terms, territorialism has been associated with the “grab rule,” by which means each country would seize local assets and apply them for the benefit of local creditors, with little or no regard for foreign proceedings\textsuperscript{31}. By contrast, universalism has been understood as a system where one central court administers the bankruptcy of a debtor on a worldwide basis with the help and cooperation of courts in each affected country. A majority of experts in the field agree that universalism is the


right long-term approach. They also agree that it will take some time to achieve. Some of them believe that modified territorialism is the best interim approach; but most of them are inclined to modified universalism\textsuperscript{32}. American Law Institute adopted this view and explains modified universalism in its Principles for Cooperation as “universalism tempered by a sense of what is practical as the current stage of international legal development…”\textsuperscript{33}

The problem of the bankruptcy of a multinational often involves two central aspects: choice of forum and choice of law. The problem of choice of forum arises only in a modified universalism system. This is because in a territorial system every court administers the assets it controls, while in a fully realized universalist system the administering court is chosen by a internationally agreed set of rules. Choice of forum does not mean that only one court is chosen to deal with the case. It means a choice of a primary forum to be the leading court to administer the case. That court is the court in the jurisdiction that is deemed to be the company’s “home” country, typically the country where the “center of main interests” of the company locates\textsuperscript{34}. The proceeding in the debtor’s home country, often called the “main proceeding”, will always be a full

bankruptcy proceeding under its domestic law. The judicial proceeding in other countries may be “parallel proceedings” or “ancillary proceedings”. “Parallel proceedings” means a bankruptcy proceeding where the other courts have full bankruptcy cases involving the same company. Ancillary proceedings in other courts are designed solely to assist the primary court. Either approach can be used to cooperate in a system of modified universalism, though the ancillary approach is more efficient at meeting universalist objectives because it avoids the cost of dual proceedings.

In the absence of a legal framework for cooperation, a practice of creating “protocols” has begun to emerge, as we will discuss in the Maxwell case later. Protocols are agreements among major stakeholder groups as to how a multinational bankruptcy will be managed. The development of these protocols has not only facilitated the resolution of the cases concerned, but also creating a database of experience that is highly useful to the improvement of an international bankruptcy regime.

37 Ibid.
IV. The US Bankruptcy Law and Comparative Study of Chinese Law

1. US court as home court

In order for other countries to defer to US bankruptcy courts judgment, the US courts must assert worldwide jurisdictions of US bankrupts. The US Bankruptcy Code and case law both illustrate the broad reach of US jurisdiction claims with respect to the debtor’s property. The illustrative case is In re McLean Industries, Inc. The Chinese counterpart of this provision is the first paragraph of Article 5. It states that “the procedures for bankruptcy which have been initiated according to the present law shall have binding effect over the assets of the relevant debtor beyond the territory of the PRC”. It uses the same approach with the US Bankruptcy Code which asserts jurisdiction over the assets of the bankrupt “wherever located” in the world. A number of other countries use the same rule, such as UK, France and Canada. However, none of the laws of these countries address the problem of what if the country where the bankrupt’s assets located refuses to hand over the assets to these countries. But as we have discussed above, the assertion is a necessary condition for a country to defer to a foreign law.

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38 Ibid at 844.
2. *US court as cooperating court: The UNCITRAL Model Law on Cross-Border Insolvency and Chapter 15 of the US Bankruptcy Code*

The UNCITRAL Model Law on Cross-Border Insolvency was promulgated by the United Nations Commission on International Trade Law in 1997. It is an important effort for international harmonization of cross-border insolvency. As of 2008, it had been adopted in 15 countries including the United States, the United Kingdom, Japan, Mexico, South Africa, and other smaller countries. Canada also incorporated a modified version of the Model Law. The Model Law focuses its attention on issues relating to the recognition of foreign insolvency proceedings and the protection of the assets of foreign estates. For this purpose, the Model Law addresses four steps for a successful international insolvency: 1) access by the foreign representative to the local insolvency courts; 2) recognition of the status of the foreign representatives when the conditions are met; 3) assistance to the foreign representatives by granting orders for the stay of proceedings against local assets of the foreign debtor; and 4) cooperation between the courts of the granting state and the foreign state.

The Model Law distinguishes between a “foreign main proceeding” and a “foreign

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nonmain proceeding” and adopts the COMI test to determine whether a foreign bankruptcy proceeding is a foreign main proceeding or a foreign nonmain proceeding. However, under the Model Law, courts are not bound by the COMI/ non-COMI determination made in another Model Law jurisdiction and are therefore free to make their own decisions\textsuperscript{43}.

The United States was very active participating in the development of the Model Law. After some political struggle, the Model Law was adopted as part of the 2005 Amendments, becoming Chapter 15 of the Bankruptcy Code\textsuperscript{44}.

Chapter 15 of the US Bankruptcy Code is the US domestic adoption of the Model Law intended to encourage enactment of the Model Law around the world. It replaces section 304 of the Bankruptcy Code but it retains the common law approach of using an ancillary proceeding as the vehicle of cooperation, but it also permits parallel proceedings\textsuperscript{45}.

Consistent with the Model Law, the purpose of Chapter 15 is “to provide effective mechanisms for dealing with insolvency cases involving debtors, assets, claimants, and other parties of interest involving more than one country”\textsuperscript{46}.

Generally, a case under Chapter 15 is an ancillary proceeding to a primary proceeding

\textsuperscript{43} Ibid at 828.
\textsuperscript{45} Ibid.
\textsuperscript{46} United States Courts, online: <http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter15.aspx>.
brought in another country, usually the debtor’s home country. It contemplates cooperation with foreign main proceedings, which are proceedings in the country where is locate the COMI of the debtor. It also stipulates that a US court may authorize a trustee to act in a foreign country representing a US bankruptcy estate.

The ancillary proceeding under Chapter 15 is commenced by a foreign representative filing a petition of recognizing a foreign proceeding under section 1515. The US court then may recognize the foreign proceeding as either a “foreign main proceeding” or a “foreign nonmain proceeding”. Recognition will be granted quickly in most cases using various presumptions under 1516-17. Upon recognition, an automatic stay goes into effect within the US and the court is given broad powers, including the grant of additional injunctive relief, the use of US discovery tools, and the turnover of assets within its control to the foreign representative, who is also empowered to operate the debtor’s business.

Foreign nonmain proceedings, pending in countries where the debtor had an “establishment,” are granted only quite limited recognition and cooperation. The foreign representative is required to make full disclosure to the US bankruptcy court of

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47 11 U.S.C. c 1, §101(23): the term “foreign proceeding” means a collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation. U.S.C., Title 11, c 15, §1502(4): “foreign main proceeding” means a foreign proceeding pending in the country where the debtor has the center of its main interests.


49 11 U.S.C. c 1, §101(24): the term “foreign representative” means a person or body, including a person or body appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor’s assets or affairs or to act as a representative of such foreign proceeding.


51 11 U.S.C. c 15, §1521(c).
the status of proceedings elsewhere in the world to keep the information up to date. Chapter 15 explicitly allows foreign creditors to participate in US bankruptcy cases and prohibits discrimination against foreign creditors. It also set to promote cooperation and communication between US court and foreign courts in cross-border cases as one of the most important goal\textsuperscript{52}.

Recognition under Chapter 15 has been granted to the great majority of foreign representatives that have sought it. However, a considerable controversy has arisen when recognition has been sought for proceedings in countries where the debtor has little presence beyond its articles of incorporation\textsuperscript{53}. A US case is going to be discussed in the following. In this case, the debtor registered it offices in Cayman Islands but had no other business activities there. The court refused to recognize the liquidation proceedings pending in Cayman Islands either as foreign main proceedings or as foreign nonmain proceedings. This case is very much like the Taizinai case happened recently in China. The thesis argues that if China adopts the COMI test, the US case may provide guidance to solve the case in China.

\textsuperscript{52} United States Courts, online: <http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter15.aspx>.

1) Recognition of a foreign proceeding of a “letterbox” company: Bear Stearns\textsuperscript{54} and Basis Yield Alpha Fund\textsuperscript{55}

\textbf{a. Bear Stearns}

The Funds (Enhanced Fund and High-Grade Fund) are both Cayman Islands exempted limited liability companies with registered offices in the Cayman Islands. The administrator of the Funds is a Massachusetts corporation. The books and records of the Funds are maintained and stored in Delaware by the Administrator. Its investment manager is a corporation formed under the laws of the New York State. The assets managed by the investment manager are located within the Southern District of New York. Other assets of the Funds consist of receivables from broker dealers and all are also located within this judicial district. The investor registers in Dublin, Ireland by an affiliate of the Administrator. In 2007, based on the poor performance of the Funds, the Cayman Grand Court entered orders appointing the petitioner to liquidate the Funds. The petitioner of the Funds filed petitions pursuant to section 1515 of title 11 of the US Bankruptcy Code for orders recognizing the liquidation (the foreign proceedings) of the Funds in the Grand Court of the Cayman Islands as foreign main proceedings pursuant to section 1517 of the Bankruptcy Code, and thereby granting related relief. In the alternative, if the US court finds that the foreign proceedings are not eligible for recognition.

\textsuperscript{54} In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd, 374 B.R.122, (Bankr. S.D.N.Y. 2007).
\textsuperscript{55} In re Basis Yield Alpha Fund (Master), 381 B.R. 37 (Bankr. S.D.N.Y. 2008).
recognition as foreign main proceedings, petitioners seek recognition of the foreign proceedings as foreign nonmain proceedings, as defined in section 1502(5) and seek relative relief.

In the judgment the Judge cited two articles and said that recognition must be coded as either main or nonmain. Otherwise the foreign proceeding is insufficient to be eligible for recognition under Chapter 15 because there are substantial distinctions between the main and nonmain proceedings and the consequences are different.

A foreign main proceeding is defined as a “proceeding pending in the country where the debtor has the center of its main interests”\textsuperscript{56}. A foreign nonmain proceeding means any other proceeding “pending in a country where the debtor has an establishment”\textsuperscript{57}. “Establishment” means “any place of operation where the debtor carries out a nontransitory economic activity”\textsuperscript{58}.

Section 1516(c) provides that “in the absence of evidence to the contrary, the debtor’s registered office, … is presumed to be the center of the debtor’s main interests”\textsuperscript{59}. This statutory presumption that foreign debtor’s registered office is also its center of main interest is included for speed and convenience of proof in cases in which there is no serious controversy. Presumption is not preferred alternative where there is a separation

\begin{itemize}
  \item \textsuperscript{56} 11 U.S.C. c 15, § 1502(4).
  \item \textsuperscript{57} 11 U.S.C. c 15, § 1502(5).
  \item \textsuperscript{58} 11 U.S.C. c 15, § 1502(2).
  \item \textsuperscript{59} 11 U.S.C. c 15, § 1516(c).
\end{itemize}
between a corporation’s jurisdiction of incorporation and its real seat. While there is statutory presumption that foreign debtor’s registered office is also center of main interest, burdened is on foreign representative to prove that foreign debtor’s center of main interest is in same country as its registered office, where foreign proceeding is in the country of registered office and there is evidence that center of main interests might be elsewhere.

The Bankruptcy Code does not state what type of evidence is required to rebut the presumption that the debtor’s place of registration or incorporation. Various factors could be relevant to such a determination, including: the location of the debtor’s headquarters; the location of those who actually manage the debtor; the location of the debtor’s primary assets; the location of the majority of the debtor’s creditors or of a majority of the creditors who would be affected by the case; and/or the jurisdiction whose law would apply to most disputes. This presumption may be overcome especially in case of “letterbox” company not carrying out any business in territory in which its registered office is situated.

Section 1516(c) presumes that the COMI is the place of the debtor’s registered office but only “in the absence of evidence to the contrary”. In this case, the petitioners’ pleadings provide the evidence to the contrary, namely, the Funds’ COMI is in the United States rather than the Cayman Islands. The only connection with the Cayman Islands that the
Funds have is the fact that they are registered there. The court would not recognize liquidation proceedings in the Cayman Islands as foreign main proceedings, even though the companies’ registered office was located in the Cayman Islands. Facts disclose in petitions, including fact companies had no employees or managers in the Cayman Islands, that companies’ investment manager was located in New York, that administrator that ran companies’ back-office operations was in the United States, along with companies’ books and records prior to commencement of foreign proceedings, and that all of companies’ liquid assets were located in United States, were sufficient to rebut statutory presumption that companies’ registered office was also their center of main interest.

The court refused to recognize the foreign proceeding pending in Cayman Islands even as a foreign nonmain proceeding. To recognize the foreign proceedings as nonmain proceedings, there must be an “establishment” in the Cayman Islands for the conduct of nontransitory economic activity, i.e., a local place of business. There was no related nontransitory economic activity being conducted by companies locally in the Cayman Islands, and cash account funds on deposit in the Cayman Islands was moved there after the foreign proceedings were initiated. Therefore, there was no “establishment” in the Cayman Islands.

Accordingly, since the foreign proceedings are not pending in a country where the Funds have their COMI or where they have an establishment, the foreign proceedings are not

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60 11 U.S.C. c 15, § 1502(5).
eligible for relief as main or nonmain proceedings under Chapter 15.

**b. Basis Yield Alpha Fund**

As we have already seen in the previous case, the term “establishment” sought to use an objective test of economic presence, as opposed to “letterbox” companies, as a basis for obtaining recognition. In this case, although the court does not give a clear signal of what exactly constitutes “nontransitory economic activity,” the decision indicates what does not. The court noted in passing that the materials presented by the joint provisional liquidators of Cayman Islands proceedings did not present sufficient facts to permit the court to determine whether the debtor maintained an establishment there. The submission does not say anything about what the nature or extent of the business activity being conducted by the debtor in the Cayman Islands might be, whether there were employees or managers there, or from whence funds of the debtor were in fact managed\(^6\).

**c. Reflection on Taizinai**

The definition of “establishment” is no small matter. A proceeding cannot qualify as a nonmain proceeding unless it is pending where the debtor has an establishment. To qualify for relief in the absence of evidence of the presence of an establishment in the country where the proceeding is pending, the representative will need to present evidence

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\(^6\) In re Basis Yield Aloha Fund (Master), 381 B.R. 37, 42 (Bankr. S.D.N.Y. 2008).
that the host country is the debtor’s COMI62. As we have already known from the previous stated facts of Taizinai, Taizinai operated wholly in China and has all its assets and a majority of creditors in China. Thus, if China adopts the concept of “establishment” like the US law, the Cayman Island is neither the place where the debtor has its COMI nor the place where the debtor has an establishment since Taizinai does not have an economic entity in Cayman Islands. Formerly, it might have been believed that the presumption in favor of place of registration or incorporation would be sufficient to establish a country as the debtor’s center of main interest, but it is no longer a fair assumption any more63. It does not meet the test in Bear Sterns when determining whether a registered office is the COMI. The debtor’s headquarters is in China; the company is managed wholly in China; the debtor’s primary assets locate in China; the majority of the debtor’s creditors or of a majority of the creditors who would be affected by the case are in China; the company is governed by Chinese law. None of these is in Cayman Island except the registered office. Therefore, in Taizinai, if China has establish a legal system like the US, the court has the power to refuse to recognize the proceeding pending in the Cayman Islands court as either a foreign main or nonmain proceeding; and therefore it has the power to refuse to enforce the bankruptcy order made by the Cayman Islands court against Taizinai.

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62 Hon. Leif M. Clark, Ancillary and Other Cross-Border Insolvency Cases Under Chapter 15 of the Bankruptcy Code, (Newark, NJ: LexisNexis Matthew Bender, 2008) at Section 4 [3].

63 Ibid.
2) **Legitimate rights and interests of the creditors: Section 304 of US Bankruptcy Code**

Although section 304 of the Bankruptcy Code has been replaced by Chapter 15, some cases decided under section 304 will likely remain important precedents under the new Chapter 15. More importantly, in considering improvement of Chinese bankruptcy law Article 5, section 304 is more similar to its Chinese counterpart than Chapter 15. Cases like *Telecom Argentina* (discussed below) explain the requirements in section 304 in detail. A careful review of this case may be very useful in interpreting the Chinese provision.

Section 304(c) enumerates six factors as guidance to the court in evaluating a petition of recognition of foreign proceedings. It says: “in determining whether to grant relief under subsection (b) of this section, the court shall be guided by what will best assure an economical and expeditious administration of such estate, consistent with - (1) just treatment of all holders of claims against or interests in such estate; (2) protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding; (3) prevention of preferential or fraudulent dispositions of property of such estate; (4) distribution of proceeds of such estate substantially in accordance with the order prescribed by this title; (5) comity; and (6) if appropriate, the provision of an opportunity for a fresh start for the individual that such
foreign proceeding concerns. Section 304(c) could be read to mean the US court would cooperate only when the provisions of the other law were not different in any way that would adversely affect some US creditors, which would mean the US court would rarely cooperate. Facing with two conflict policy goals — international cooperation and protection of US creditors — legislators simply incorporated them and left the problem to the courts to sort out. In Telecom Argentina, the court explicitly abandoned the narrow interpretation. In rebut of the appellant’s argument that the court should not grant comity because they would receive a smaller distribution in the foreign jurisdiction than they would receive under US law, the court says that: “comity does not require that foreign proceedings afford a creditor identical protections as under US bankruptcy law… so long as the other §304(c) factors are satisfied, the statute does not require that the amount of a distribution in a foreign insolvency proceeding be equal to the hypothetical amount the creditor would have received in a proceeding under US law.” In other words, it adopted the view that section 304 required only a general similarity to US law.

In Chinese bankruptcy law Article 5, there is also a similar requirement in paragraph two. It stipulates that where a foreign representative applies the Chinese court to recognize or enforce a foreign judgment, the court shall grant recognition unless the judgment

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64 11 U.S.C. c 3, § 304 (repealed).

65 In re Board of Directors of Telecom Argentina, S.A., 528 F.3d 162 (2d Cir. 2008).
damages the legitimate rights and interests of Chinese creditors. In interpretation of this requirement, we should not interpret it narrowly. Legitimate rights and interests of Chinese creditors should not be seen to be damaged merely because the amount of distribution in a foreign proceeding is not equal to the hypothetical amount the creditors would have received in a domestic Chinese proceeding. Legitimate rights and interests should be interpreted as no prejudice or discrimination towards Chinese creditors. As long as there is no abusive, fraudulent, or discriminatory impact towards Chinese creditors, this requirement should be satisfied and the Chinese court should not refuse to recognize a foreign judgment based on this reason.

3) **International Treaties and Agreements Preemption: Section 1503**

Section 1503 of the US Bankruptcy Code states that “to the extent that this chapter conflicts with an obligation of the United States arising out of any treaty of other form of agreement to which it is a party with one or more other countries, the requirements of the treaty of agreement prevail.” This section expresses the principle of supremacy of international obligations over internal law. This is an adoption of the Model Law acknowledgment in article 3. Of course, the first obligation of a court is to seek interpretations which prevent conflict, if possible.

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66 Enterprise Bankruptcy Law of China, 2006, c 1, s 5.
In the Chinese legislation, Article 5 also contains a similar statement, saying that when the foreign representatives petition the court to recognize a foreign judgment, “the people’s court shall, according to the relevant international treaties that China has concluded or acceded to or according to the principles of reciprocity… grant recognition…”69 Although the Chinese legislation does not say international treaties and agreement as preemption, international treaties play a significant role in recognizing foreign proceedings. In the B&T case mentioned above, even without any formal legislations of cross-border insolvency, the Chinese court recognize and enforce the judgment made by the Italian court base on a Sino-Italian treaty. China has not signed international treaties with many countries70. If there is a treaty, a Chinese court should examine a foreign proceeding according to these treaties. Items of examination are often procedural matters rather than substantive matters71. These items often are: right jurisdiction, conclusiveness and enforcement of the decision, fairness of judicial proceedings, no conflicting judgment or litigation in China and reserve clause of public power72.

The statute also states that, in addition to the international treaties, a Chinese court can

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69 Enterprise Bankruptcy Law of China, 2006, c 1, s 5.
70 By 14 August 2006, China had signed 29 bilateral treaties on judicial assistance in civil and business matters with countries such as France and Poland, and a treaty signed with Singapore which does not include acknowledgment of judgments.
also examine a foreign proceeding “according to the principle of reciprocity”. For those countries which do not sign bilateral or international treaties, this principle is designed by the legislator to be used. The manners of reciprocity should be decided by precedents or customary law. When there is neither, a Chinese scholar suggests that what China has adopted is that there is no reciprocity without evidence to the contrary. In general, the principle of reciprocity states that favors, benefits, or penalties that are granted by one state to the citizens or legal entities of another, should be returned in kind. Some scholars suggest that similar reciprocal benefits should be given to countries adopted the Model law and countries whose statutes states similar factors when evaluating a foreign proceeding.  

4) Public Policy  

Section 1506 of Chapter 15 is the public policy exception. It states that the court has the power to refuse to take an action governed by this chapter if the action is manifestly contrary to the public policy of the United States. The Model Law also includes a public policy exception. The Legislative Guide cautions that the public policy exception should not be applied broadly, noting that “international cooperation would be unduly

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74 Online: <http://en.wikipedia.org/wiki/Reciprocity_(international_relations)>.

77 UNCITRAL Model Law on Cross-Border Insolvency, Article 6, *reprinted in* App. B.
hampered if ‘public policy’ were to be understood in an extensive manner.” The language used in the statute expresses such a restrictive approach, providing that the exception should be used only when the action to be taken would be “manifestly contrary” to the public policy of the United States. The use of the term “manifestly” reflects intent that the public policy exception be narrowly construed, namely, the exception can only be used to policies which are fundamental US policies.

For example, in In re Ephedra Products Liability Litigation, the inability to have a jury trial in another country, where one could be had in the US, was not manifestly contrary to the public policy of the US so long as the claimants received fair treatment, even though the right to a jury trial in the US is a constitutionally protected right. In Klytie's Development, the objecting parties contended that US investors may receive less in the Receivership Proceeding, which will include creditors from Canada and Israel, than what these local investors would receive from the local court or the Federal Court. The court found this argument unpersuasive. All wronged investors should share in the assets accumulate in the Receivership Proceeding, regardless of nationality or locale. The court also found potential costs of administration of the foreign proceeding to be insufficient to

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78 Legislative Guide, 88.
raise a public policy concern\textsuperscript{81}.

The Chinese legislation also contains a public policy statement. It says that a foreign proceeding should not “violate the basic principles of the laws of the PRC, damage the sovereignty, safety or social public interests of the state” in order to be recognized by a Chinese court\textsuperscript{82}. In China we call this a “public policy reserve clause”. This clause gives the court big discretion of what constitute “public policy”. It is submitted that either by following international experience or by Chinese legal jurisprudence, public policy should be understood and applied narrowly. This thesis agrees with what have been said above that only when the fundamental principles of law are breached, can the court reject a foreign proceeding for the reason of breach of public policy. The threshold should be very high. The court should not use public policy reserve clause to refuse to recognize only because laws of two countries are different. The jurisprudence here may be that the petition of a foreign representative might be the only way for a foreign bankruptcy proceeding to be recognized and enforced in China. If the Chinese court rejects their petition easily based on the public policy reserve clause, they would have hardly any other ways of remedy. To cooperate internationally on the bankruptcy issues, public policy should be interpreted narrowly.

\textsuperscript{81} Petition of Ernest & Young, Inc., as Receiver of Klytie’s Development, Inc., 383 B.R. 773 (Bankr. D. Colo. 2008)

\textsuperscript{82} Enterprise Bankruptcy Law of China, 2006, c 1, s 5.
3. **English Case: McGrath v. Riddell**\(^{83}\)

In this section, we are going to see an English case. The United States is not involved in this case but it is still worthwhile in the study of this thesis. On the merits, the decision addresses one of the most difficult international issues: how to cooperate when each country has somewhat different priority rules.

In this case, the Australian judge has sent a letter of request to the High Court in London, asking that the liquidators appointed in England be directed to remit the assets to the Australian liquidators for distribution. It is agreed that if the English assets are sent to Australia, the outcome for creditors will be different from what it would have been if they had been distributed under the 1986 Act. The lower court refused to remit the assets to Australia. The Australian liquidators appealed. The question of this appeal is whether the English court can and should accede to that request.

The appeal is allowed. Section 426(4) and section 426(5) of the Insolvency Act 1986 gives the court jurisdiction to accede to the request of the Australian court and, on the facts of the case, the court ought to accede to that request because Australia is a “relevant country or territory”\(^{84}\). The exercise of the s426 so as to direct the remission of the assets to Australia would not constitute the misapplication of the English insolvency scheme. To

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\(^{84}\) The Secretary of State has power to designate a country as a “relevant country” under 426 (11). Australia has been designated as “relevant”, but the United States has not been so designated.
hold that the power under the section to direct the remission of assets from the country where an ancillary liquidation is being conducted (England) to the country where the principal liquidation is being conducted (Australia) cannot be exercised if the effect would be to reduce the amount of dividends receivable in England by any class of creditors would be to deprive the section of much of its intended potential to enable a single universal scheme for insolvency distribution to be achieved. There might be circumstances where a refusal to remit assets pursuant to such a request might be justified, but only when there is unacceptable discriminatory or otherwise contrary to public policy in the Australian statutory provisions. Simply relying on the fact that under the Australian insolvency scheme there would be a significant class or classes of preferential creditors whose debts would not have priority under the English insolvency scheme was not sufficient to justify a refusal. The court has jurisdiction to direct remittal of the English assets, despite of any differences between the English and Foreign systems of distribution.

This case states that different priority rules in laws of different countries does not impede recognizing foreign proceedings in international cooperation. This echoes to the part of “Legitimate Rights and Interests of Creditors” in the Chinese legislation that the legitimate rights and interests should not be seen to be damaged only because of the different priority rules. If only the foreign proceeding under foreign bankruptcy law is not discriminatory or contrary to public policies, international cooperation is encouraged.
However, the limitation of this case is that the decision is based on a “relevant country or territory” since Australia has been designated so by the Secretary of State. When applied to China, there may not be a country which is a “relevant country or territory” to China.

4. A new legal practice: protocol negotiated and agreed by parties about international cooperation

This part is concerning a new practice in cross-border insolvency, namely, to reach an agreement between the parties involved in the cross-border insolvency case in the matters such as recognition and enforcement of a foreign judgment.

This approach operates like the Sino-Italy treaty in the B&T case while it is much narrower, more specific and easier to reach an agreement. I would argue this is a promising approach for countries like China where there is not a comprehensive system of cross-border insolvency. The In re Maxwell Communication Corporation plc case is a leading case of this approach.

The approach of reaching an agreement between the parties involved in a cross border insolvency case developed as a new solution because the management of transnational insolvencies is concededly underdeveloped. In cross-border insolvency cases, there are many issues in a bankruptcy case that may require determination of the applicable bankruptcy law. There are three areas are most crucial: avoiding powers, distribution (priority) rules, and discharge. However, there are very few countries have statutory
provisions or case laws addressing choice of law for any of the three. Chapter 15 of the US Bankruptcy Code is silent on the subject\(^{85}\). The Maxwell solved one of the issues—avoiding power—by reaching an agreement between the two countries when the laws governing the avoiding power contradict. This case has been cited in many articles.

Maxwell alleges that in the fall of 1911, less than 90 days before its Chapter 11 filing, it made several transfers to three European banks with whom it had credit arrangements. The preference was likely to be avoidable under section 547 of the US bankruptcy Code, but likely to be unavoidable under section 239 of the English Insolvency Act 1986\(^{86}\). The American judge and the English judge authorized the examiner (US) and the administrators (UK) to coordinate their efforts pursuant to a so-called Protocol, an agreement between the examiner and the administrators. In approving the Protocol, the American judge recognized the English administrators as the corporate governance of the debtor-in-possession\(^{87}\). They treat all of Maxwell’s assets as a single pool and leave them under Maxwell’s control for distribution to claimants. This recognition was motivated not only by the need for cooperation but also because Maxwell had more business relations with England\(^{88}\). The plan and scheme are independent documents and were filed by the administrators in the United States and English courts respectively. They allow creditors


\(^{86}\) Ibid at 874.

\(^{87}\) In re Maxwell Communication corp. plc, 93 F.3d 1036 (2d Cir. 1996).

to submit a claim in either jurisdiction. The plan and scheme resolve many substantive and procedural differences in the insolvency laws of the two jurisdictions, such as the choice of law and the time limits for submitting claims. These joint efforts resulted in what has been described as a “remarkable sequence of events leading to perhaps the first world-wide plan of orderly liquidation ever achieved.”

The judge in Maxwell addresses “Comity” and “Cooperation and Harmonization”. He cites the definition of comity provided by Justice Gray in Hilton v. Guyot: “comity, in the legal sense, is neither a matter of absolute obligation, on the one hand, nor of mere courtesy and good will, upon the other. But it is the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws.” Comity is a guide where the issues are entangled in international relations. It is a prevalent doctrine of international law. Since it is underdeveloped in the area of international insolvency, comity must be considered. The analysis must consider the international system as a whole in addition to the interests of the individual states, because the effective

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functioning of that system is to the advantage of all the affected jurisdictions\textsuperscript{92}.

The parallel proceedings in the English and American courts have resulted in a high level of international cooperation and a significant degree of harmonization of the laws of the two countries. The affected parties agreed to the plan and scheme despite differences in the two bankruptcy laws. Although there were substantive and procedural inconsistencies, the distribution mechanism established by them allowed Maxwell’s assets to be pooled together and sold as going concerns, maximizing the return to creditors. Moreover, by not requiring creditors to file claims in both countries, the arrangement avoided superfluous proceedings on a same issue and eliminated many inefficiency problems.

The American judge in Maxwell commented the accomplishments of the Protocol as “very well worth preserving and advancing\textsuperscript{93}”. The court concluded that where a dispute involving conflicting avoidance laws arises in the context of parallel bankruptcy proceedings that have already achieved substantial reconciliation between the two sits of laws, comity encourages cooperation and prevents the US court from selfishly applying its law to the circumstances where more direct interest is in another country\textsuperscript{94}.

One important lesson we learn from Maxwell is that Protocol of cooperation in the administration of an international case are crucial to the achievement of a satisfactory

\textsuperscript{92} In re Maxwell Communication corp. plc, 93 F.3d 1036 (2d Cir. 1996).
\textsuperscript{93} Ibid.
\textsuperscript{94} Ibid.
result in the absence of effective legal rules. Looking at the Chinese legislation of cross-border insolvency, when there are no treaties or reciprocal history between China and the other country, the Protocol is an ideal approach to be employed by Chinese court. Actually, very few countries have signed treaties with China while Chinese enterprises scatter in more and more countries in the world. When these enterprises in the countries having no treaties with China are facing bankruptcy issues, reaching an agreement like the Protocol in the Maxwell may be very effective. It is practical in operation and flexible in harmonizing substantive and procedural inconsistencies of different laws of different countries. However, the only requirement for the courts is the effective communications between the courts of countries involved.

Communication among the administrating authorities of the countries involved is one of the most essential elements of cooperation in cross-border insolvency cases. The Model Law and the US Bankruptcy Code both expressly encourage direct communication between courts in multinational bankruptcy cases. Section 1525 and section 1526 authorize direct communication between courts and bankruptcy trustees. The American Law Institute Principles also gave a strong endorsement to such communications. In the ALI Principles of Cooperation among the NAFTA Countries Procedure Principles 10 and 57 and Appendix B, it provides a set of guidelines for courts and lawyers to use in a

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cross-border case. These Guidelines are intended to enhance coordination and harmonization of insolvency proceedings that involve more than one country through communications among the jurisdictions involved. It also indicates that the application of the Guidelines between Canada and the US is very different from the communication rules with Mexico. Nevertheless, a Mexican court may choose to adopt some or all of these Guidelines. The Guidelines are not rigid, they are meant to be adapted and modified to fit the circumstances of individual cases and to change and evolve as the international community gaining new experience working together. They are not detailed into issues that depend on the law and practice in each jurisdiction and should be in consistent with local procedures and local ethical requirements. However, these Guidelines are approaches that are likely to be highly useful in achieving efficient and just resolutions of cross-border insolvency issues and therefore are recommended. The International Insolvency Institute is in the process of translating the ALI Guidelines into a number of languages for use all over the world. This indicates that if China adopts the system of ancillary proceedings of cross-border insolvency, the Guidelines could be adopted as a reference for the communication method between a Chinese court and a foreign court. Of course, China could make adaptations in order to fit the circumstances of particular cases and customs.

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97 Ibid at 115.
98 Ibid at 116.
V. International Law Reform and the Difficulties of China to Reform

A number of international institutions, notable the International Monetary Fund and the World Bank, have gotten interested in reform of bankruptcy laws, both domestic and international\(^99\). Law reform organizations have also developed projects in international bankruptcy cooperation. These projects have focused on cooperation among courts in managing cross-border insolvency cases\(^{100}\). We have discussed earlier the Model Law on Cross-Border Insolvencies promulgated by the United Nations Commission on International Trade Law (UNCITRAL), the law based on which Chapter 15 of the Bankruptcy Code has been made. Unlike a treaty of convention, the Model Law is provided for adoption for every country in the world in the hope that its adoption by a number of countries will begin the process of cooperation and result in harmonization eventually\(^\text{101}\).

The Transnational Insolvency Project of the American Law Institute was also mentioned earlier in this thesis. Its purpose is to beyond the Model Law to improve cooperation among the three NAFTA countries, Canada, Mexico and the United States, in multinational bankruptcies. The reason why a regional effort like this Project could go


\(^{100}\) *Ibid.*

\(^{101}\) *Ibid.*
beyond the Model Law is the fact that the countries involved and their laws are known factors and were not greatly different from one another\textsuperscript{102}. The project has produced authoritative summaries of the bankruptcy laws of each of the three countries and a statement of Principles of Cooperation. The essence of the ALI Principles is the idea of looking at each case from a global perspective. Each principle is designed to encourage the courts and the parties to look at such cases overall, seeking the best results for the creditors despite that there are differences among local laws\textsuperscript{103}.

We have also mentioned above that the European Union has adopted a bankruptcy regulation, which is a law issued at the European level that is binding on all member countries and enforceable in their courts. The most important feature of the EU regulation is that it is subject to uniform interpretation through the European Court of Justice. Thus it offers the first example of a truly international bankruptcy regime\textsuperscript{104}.

However, taking only a general look at all the fruits and results of international cooperation experience, it is not difficult to find that the success of these reforms are based on very tight regional economic relations. The efforts of EU and NAFTA countries are the next stage of the Model Law. In \textit{McGrath v. Riddell}, UK and Australia are “relevant countries or territories”. There is no need to repeat the high level of integration


\textsuperscript{103} \textit{Ibid.}

of the EU. Although NAFTA countries does not carry economic integration as far as the EU, the regional economic systems requires increasing coordina
tion, if not harmonization, of commercial laws. And it should be noted that the Canadian and United States courts have been especially cooperative with each other.

China does not have economic relations as close as the relations between EU countries or the relations between NAFTA countries. Neither does China have “relevant countries or territories” like UK and Australia. Although China is very active in the world economy, it does not belong to any regional associations. Its legal system is unique in a sense that the lawmakers took the special Chinese circumstances into consideration and called it “socialist legal system with Chinese characteristics”. Therefore, it is harder for China to adopt a cross-border bankruptcy system that requires that legislations in different countries cannot vary too much and that a high level of international cooperation is needed. The possible areas that China may cooperate with easier are Hong Kong and Taiwan. Taiwan’s law is different from the mainland’s, but the mainland’s legislation used Taiwan’s law for reference when the law was first made. The Chinese law and Taiwanese law have a common origin and their basic principles are much the same. Although Hong Kong’s law must be different from the mainland’s law since Hong Kong is a common law jurisdiction, the regional economic and political relationships and connections make cooperation much easier. For other jurisdictions, more efforts are needed and more problems might be encountered.
Nevertheless, treaties and protocols are possible to be reached as long as the law makers provide more specific rules to the system and therefore add certainty to the law. Certainty of law is important to this issue because cooperation has to act in the “shadow of law”. If parties know what the background law is, namely, when the law is a known factor to parties, it is easier for them to negotiate. If the parties do not know what the law is because of uncertainty about cross-border insolvency, then it is hard to see how they would bargain. Thus, this goes back to the question of how to develop the Chinese cross-border insolvency system. When it is certain enough for other parties, reaching a treaty or protocols to cooperate is more possible. Communication and cooperation are always encouraged in such cases, as long as a foreign proceeding is good for all the creditors and the overall result in the long run.

VI. Suggestions for Chinese Cross-Border Insolvency Legislation

To sum up, besides some improvement of Article 5, the thesis suggests that China should adopt the ancillary proceedings like it is regulated in Chapter 15 of the US Bankruptcy Code.

Generally speaking, Article 5 is a big step forward in the Chinese cross-border legislation. This provision is a breakthrough from “no provisions at all” to “having one provision”.
And the elements stated in the provision regulate important aspects despite of the lack of interpretations. Paragraph one of Article 5 should be kept. Although the extraterritorial effect of a Chinese bankruptcy proceeding depends on recognition of a foreign country, this paragraph is necessary. It is the starting point of cross-border insolvency and it sets a premise of recognition of a foreign bankruptcy proceeding.

In the second paragraph of Article 5, there are many factors to be interpreted. “Legitimate rights and interests of creditors” does not require the creditors receive no less repayment than they would if they were repaid under their domestic laws. If only there is no prejudice and discrimination against these creditors, their legitimate rights and interests are not damaged. “Public policy” gives the court big discretion, but it needs to be interpreted very narrowly and should be used in very few cases. This paragraph also states that the court should examine these factors base on the relevant international treaties or the principle of reciprocity. This indicates that if there are no international treaties or principle of reciprocity, the court could refuse to recognize a foreign proceeding. Since China does not have treaties or the principle of reciprocity with many countries, I would argue that this approach is too rigid and too narrow. It is not good for international cooperation. This thesis would argue that besides the Article 5, China should adopt the COMI test to determine foreign main and nonmain proceedings.

We should establish a system that foreign representatives can petition to the Chinese
court for recognition of “foreign main proceedings” or “foreign nonmain proceedings”. For a foreign main proceeding, the foreign representative must prove the center of main interest locates in that country. For a foreign nonmain proceeding, there must be an “establishment” in that country, which means “any place of operation where the debtor carries out a nontransitory economic entity”. The country where the registered office of a company locates presumed to be the center of main interest unless there is evidence to the contrary. To rebut this presumption, the court could apply the test provided in the Bear Stearns case but the onus of proof is on the foreign representative. Thus, if this approach is adopted by China, China would have legal basis to refuse to recognize the order made by the Cayman Islands court since none of the related interests of Taizinai is in the Cayman Islands.

Protocol of cooperation is very effective to achieve an ideal result when there are no effective legal rules. When there is no treaty or principle of reciprocity, nor can the ancillary proceedings progress, a protocol, namely an agreement between the two courts of two different countries, is a good way of administrating an international bankruptcy case. A protocol is flexible and good for cooperation as long as there is effective communication between two courts. To promote effective communications, the Guideline in the ALI Principles of Cooperation among the NAFTA Countries may be a good reference.
The problem for China to adopt what has been said above is that China has no economic relationship as close as those of NAFTA countries or of EU. Neither is the Chinese law similar to laws of any countries in the world except some areas like Hong Kong and Taiwan. China needs to do more communication work in order to cooperate with other countries than US or EU countries for this reason. Other than that, the improvement of the underdeveloped cross-border insolvency system of China should never stop.

**VII. Conclusion**

Cross-border insolvency is a relatively new area of law worldwide. Scholars and professionals are on their way probing into this area trying to find a better solution of international bankruptcy. It is an even newer area in China. Even a bankruptcy law for a free market is a recent phenomenon in China, an article regarding cross-border insolvency is indeed a big progress in the bankruptcy legislation. Looking through Chinese literatures about cross-border insolvency, besides the fact that there are very few experts studying on this new area, the studies mainly focus on theoretical studies and few of them provides specific and practical suggestions. By doing a number of case studies, this thesis hopes to provide actual guidance in this area. When the first cross-border insolvency case (*Taizinai*) happened in China, it almost had a shocking effect. None of the experts or the management team knew what to do. This brings out the urgency that a more sophisticated law on cross-border insolvency must be promoted. Of course there are
numbers of difficulties and impracticalness by adopting the approaches this thesis is promoting. This thesis means to bring some new materials and foreign experience into Chinese cross-border insolvency studies. Hopefully, it would contribute to the development of Chinese cross-border insolvency more or less.