

# China Supreme Court clarifies the criteria for filing a bankruptcy case

## Description

On September 9, 2011, China Supreme Court issued its first judicial interpretation on China Bankruptcy Law clarifying under what conditions a China court should accept a bankruptcy case filed by related parties.

Article 2 of China Bankruptcy Law sets out the criteria for triggering bankruptcy proceedings (inclusive of reorganization, composition and bankruptcy) against a company with a court, according to which, bankruptcy proceedings can be commenced against a company when the company " (1) is unable to settle its debts as they fall due, AND (2) its assets are insufficient to pay off all its debts or it is obviously lacking in ability to pay off its debts". But such requirements have been criticized by commentators for being vague and ambiguous.

This new Interpretation is apparently aimed to respond to such criticism by giving more detailed guidelines for courts to entertain insolvency case filing, amid the lingering world financial crisis which has caused many firms to go bust.

Here are the major points in the Interpretation.

1. The Interpretation makes it clear that debtor's defence that the person (natural or legal) that is jointly and severally liable for its debts is still solvent shall not hold. Courts shall disregard such defence.
2. When all the following conditions are met, courts can determine that the debtor "is unable to settle its debts as they fall due": (1) the creditor-debtor relationship is legally created; (2) the period for performance of debt obligation has expired; and (3) the debtor has failed to repay the debt in full.
3. Courts can determine that the debtor's "assets is insufficient to pay off all its debts" if debtor's balance sheet, or audit report/asset appraisal report and the like shows that all its assets are not sufficient to pay off all its debts, unless counter-evidences otherwise proves that the debtor's assets can cover all its debts. This means that courts may rely on either balance sheet or audit or asset appraisal report to arrive at their decision.
4. Though the debtor's balance sheet shows the value of its assets is greater than the amount of its debts, courts shall determine that the debtor "is obviously lacking the ability to pay off its debts" upon finding of existence of any of the following circumstances: (1) the debtor cannot pay off its debts, because it is in great shortage of funds or its assets cannot be cashed in, and therefore ; (2) the debtor cannot pay off its debts, because the legal representative is nowhere and there is no any other person to manage debtor's assets; (3) the debtor cannot pay off its debts after other courts carry out compulsory judgment enforcement; (4) the debtor has been losing money for long and a turnaround is difficult, and therefore cannot pay off its debts, and (5) other circumstances giving rise to debtor's inability to pay off its debts.
5. Where the debtor has been dissolved without liquidation or has not been completely liquidated in

reasonable time period, and the debtor fails to prove that statutory conditions for insolvency are not present in its case within the statutory period of challenge availed under Bankruptcy Law after a creditor files an insolvency petition to court against it, the court may accept the case filing.

6 A creditor upon filing a bankruptcy petition with a court shall present evidences that proves that the debtor is unable to repay its debts that become due. If the debtor fails to submit its challenge to such petition within the statutory time period (7 days of court notice) or its challenge is not warranted, the court shall accept creditor's application.

Here it shall be noted that to file a bankruptcy application with courts, the burden of proof on the part of the creditor lies with proving the fact that debtor is unable to pay off its debts when such debts come due. In other words, creditors are not required to further prove either "debtor's assets are insufficient to pay off all its debts" or "the debtor is obviously lacking in ability to pay off its debts".

For the original Chinese text of this Interpretation, please click [here](#).

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