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New Judicial Interpretation of Enterprises Insolvency Law

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Enterprises Insolvency Act (“EIA”) und Supreme Court’s Interpretation

On 16 September 2013 the new Judicial Interpretation of the Chinese Supreme People’s court (“**SPC**”) concerning the application of the Enterprises Insolvency Act (“**EIA**”) came into force. With this new Judicial Interpretation, the SPC is continuing its efforts to improve the implementation of the EIA. After the first Judicial Interpretation was adopted in this respect in 2011 (“SPC-Interpretation I”), the new regulation is referred to as “SPC-Interpretation II”.

The new SPC-Interpretation II focuses on the term of “insolvency assets” and sets forth detailed rules on treatments of related assets and rights, in particular with respect to the insolvency rescission, the right of return of a third party, the retention of ownership as well as the offsetting right of a creditor.

The EIA contains the definition of the term “insolvency assets”, which, however, provoked a lot of criticism due to its inaccuracy. The SPC-Interpretation II tries to repair this weakness by clarifying that, in addition to money and materials, all assets and rights which may be valued with money and be transferable according to law and are in property of debtor shall be classified among the insolvency assets.

According to the EIA, the insolvency rescission is one of the competences of an insolvency administrator. However, in practice arises often the question, what if the insolvency administrator fails to carry out the insolvency rescission. In this regard, the SPC-Interpretation II highlights, among others, in particular the liability of an insolvency administrator and the possibility of creditors to file law suits. According to this new regulation, an insolvency administrator has to make up for the damage, if his failure to insolvency rescission has led to the loss of the insolvency assets. Furthermore, creditors are giv-

Definition of Insolvency Assets

Insolvency Rescission

en the possibility, in case of default of the insolvency administrator, to file action directly and apply for the return of assets to the insolvency assets.

In practice, the retention of ownership is often problematic, if the buyer or the seller has become insolvent unexpectedly. The EIA says almost nothing about this issue. The SPC-Interpretation II, however, contains several detailed rules which all refer to the practical situations. In principle, an insolvency administrator has the right to choose to terminate the sales contract or to continue it if the ownership has not been transferred and both parties of the sales contract still have to perform mutually.

The EIA allows that a creditor may set off its obligation against the debtor with his own claim on the debtor. This favors the creditor to his best advantage, in particular, since the creditor can avoid the unfavorable result, namely having to fulfill his liability in full to the debtor while accepting a disproportionately low percentage of the distribution of the insolvency assets. The SPC-Interpretation II gives more rules and provides creditors more protection, e.g. by allowing creditors to file law suits against the insolvency administrator, if the administrator refused his application of offsetting; however, this law suit must be filed in time.

In addition, the SPC-Interpretation II contains plenty of implementing rules regarding many other aspects such as the statute of limitations, the court jurisdiction and the liability of the management of the company concerned.

The SPC-Interpretation I and II clearly refer to the individual points in the EIA, namely in the order of the law text. Consequently, it is expected that the SPC would adopt further judicial interpretations for the purpose of the application and implementation of the Enterprises Insolvency Act in the near future.

Retention of Ownership in Sales Contract

Offsetting of Liability against Claims

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