

# “A comparative review of bankruptcy reforms in the USA, the UK, China and Malaysia”

AUTHORS	Enoch K. Beraho
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## SECTION 1. Macroeconomic processes and regional economies management

Enoch K. Beraho (USA)

### A comparative review of bankruptcy reforms in the USA, the UK, China and Malaysia

#### Abstract

This study explores ways in which selected countries employ different bankruptcy and insolvency approaches to solve their economic problems. The purpose of this paper, therefore, is to study the influence country culture and legal systems have on bankruptcy management. To accomplish this purpose bankruptcy data and legal practices of different countries were obtained from those countries' websites and various published documents. The data were examined and compared, noting similarities and differences in legal structures among the countries studied. It was found that, whereas the aim of bankruptcy laws was to remedy the countries' economic problems, the approaches taken differed markedly from one country to another.

In many cases, it was difficult to access bankruptcy data mainly because such data were not published on Internet and no other reliable documents were available. Using available data, the author examined current literature on this subject and found little or no prior research work done in the areas relating to a country's cultural values and its bankruptcy management practices. In that sense this study is warranted. Furthermore, effective bankruptcy management in many nations seems to have benefited those countries. Based on that positive experience, it is expected that reforms across the globe may ensue. This paper identifies new and specific ways some countries have used focused strategies to achieve certain political and economic outcomes. In China the focus is on creating friendly investment environment to attract Foreign Direct Investment (FDI). Whereas in the US, the focus is reducing bankruptcy filings at any cost to boost business profitability. Essentially, lobbyists influenced legal reforms. This does not appear to be the case with the China new bankruptcy.

**Keywords:** bankruptcy, Chinese bankruptcy, US bankruptcy, FDI and bankruptcy, economy and bankruptcy, bankruptcy as strategy, bankruptcy reforms.

**JEL Classification:** M10.

#### Introduction

Over the last decade, the world has experienced economic difficulties. But some countries experienced more financial stress than others. In response to these economic hardships, most countries responded by reforming their legal systems to cope with their domestic financial problems. Even countries like China which had socialist practices began to reform their legal systems to allow market forces to play out in order to gain confidence of foreign investors (Eisebach, 2007; Dobbs et al., 2004). Dobbs (2005) also criticized the lobby culture of US political system. He said that big businesses virtually own and Congress and the Law Makers). The US, Canadian and British systems are much more detailed and expansive than those of Eastern Europe, China, S. Korea and Malaysia (InterNet BL, 2007; Chung, 2007; Zhou, 2006). Different countries emphasize different bankruptcy practices, consistent with their social and legal systems. The extent of those practices seem to be related to the stage of development of those systems.

What is apparent is that no system is static. There are changes in virtually all countries, although dif-

ferent counties have initiated more changes than the others. The differences in reform approaches are expected because of the historical differences among the regions of the world. To highlight the pace of reforms in different countries, a few major countries were selected to exemplify regional differences in general and national trends in particular. The countries chosen represent different economic and political structures. Martin (2005) studied the reasons why so many nations have hastened the pace of bankruptcy law reforms in their respective countries. The author found that there is always some kind of economic crisis. Following that realization, countries ask themselves whether or not current legal systems can adequately handle the increase in corporate and bank failure. Failure does not have to occur, before reform is called for. Credible indication that the national economy is in trouble or would soon be in trouble is enough to trigger movement towards reform.

#### 1. Beginnings of bankruptcys

Although the Romans and the English are credited with origination and evolution of the bankruptcy legal systems, it seems that the notion of bankruptcy predates even the Roman bankruptcy procedures. If

the bible is looked at as a legitimate compilation of historical events, it becomes the earliest document on bankruptcy as a management tool to control the economy and allow citizens and businesses to avoid financial catastrophe and have new beginning. In the book of Deuteronomy, Chapter 15, Verses 1-2, it is written that Moses brought home God's law, from the mountain of the burning bush, to the Israelites and counseled them to forgive debts every seven years. Moses counsel was "*At the end of every seven years, thou shalt make a release*" (legalhelpers.com). Amazingly, Moses also describes a system of redemption after foreclosure that is very similar to that in effect today (bankruptcyrep.com).

Bankruptcy contemplates the "forgiveness" of debt. The Bible, likewise, contains debt forgiveness laws. Under U.S. law, a debtor may only receive a discharge of debts in a Chapter 7 bankruptcy once every eight years. Under Biblical law, the release of debts came at the end of seven years as stated below (The Bible; Tozer and Lofstedt, 2007):

*"At the end of every seven years you shall grant a release of debts. And this is the form of the release: Every creditor who has lent anything to his neighbor shall release it; he shall not require it of his neighbor or his brother, because it is called the LORD's release"* (Deuteronomy 15:1-2).

The Bible refers to debt as a type of bondage: *"...the borrower is a slave to the lender"* (Proverbs 22:7). Thus, the debtor is a slave to the creditor. Interestingly, the Bible declares, at the end of the sixth year:

*"...in the seventh year you shall let [your Hebrew slave] go free from you. And when you send him away free from you, you shall not let him go away empty-handed; but you shall supply him liberally from your flock..."* (Deuteronomy 15:12-14).

Modern bankruptcy laws, like the Biblical provision above, allow debtors to keep certain property when they file for bankruptcy. This gives debtors a fresh start and discourages debtors from going into debt-bondage again, after the bankruptcy is over, in order to survive (Tozer and Lofstedt). Bankruptcy has been around for over two thousand years. After Moses' bankruptcy command, the Romans have the first written history on the subject (McCartney Law Firm). In ancient Rome or Italy (later), money lenders conducted their trade from benches set up in town squares. Ancient records show that any merchant who failed to pay another merchant had his bench broken, sometimes over his head. This practice was meant to put the merchants out of misery of owing debt, by just forcing them out of business. The custom of breaking the bench became prevalent and

insolvency became associated with a broken bench, *banca rotta*, in Italian, eventually became *bankrott* in German, *banqueroute*, in French and *bankrupt* in English. Later on, during the Middle Ages, the incidence of bankruptcies increased and prompted the need for an organized bankruptcy procedure.

The word "bankruptcy" is believed to have originated from ancient Latin verbiage describing a "broken bench". *Bancus*, a the tradesman's counter, and *ruptus*, meant broken or rotten, denoting one whose place business was broken or gone. In medieval Italy, *banca rotta* evolved from the Roman equivalent of *bancus ruptus*. Other sources say that the practice of breaking the bench of the bankrupt was still practiced in Italy between the 9th and 14th centuries. During that period whenever a man did not pay his debts, it was assumed that he refused. His creditors, then, were allowed, by law, to go into his house or workplace and destroy his workbench and that would be the end of that debt. The expressions *banca rotta* or *bancus ruptus* combined to become "bankruptcy" we know today.

Roman law provided for the sequestration (mission in bona) of a debtor's estate to be sold to satisfy a creditors' unpaid judgment (*venditio bonorum*). When proceedings of this type caused loss of civil rights, the law was amended to allow a debtor some privilege of voluntarily relinquishing assets to creditors by petitioning a magistrate (*cessio bonorum*). Essentially the Roman law set stage for balancing interests of the debtors and the creditors in the interest of the economic health of the nation. Behind this central idea was enactment of legislation to provide procedures for the adjustment of debts in order to avoid liquidation and for the rehabilitation of insolvent debtors. But past bankruptcy was coupled with the loss of civil rights and imposition of penalties upon fraudulent debtors. For that reason, the designation bankrupt came to be associated with dishonesty, casting a stigma on persons who were declared bankrupts.

The first definitive "bankruptcy laws" were established in England during the 16th century. Back then, bankruptcy was considered a criminal offense. Even today in England the bankruptcy laws are strict and debtors are not left with much for their own, after declaring bankruptcy. Loss of job, divorce, unforeseen medical problems, or the rocket launch of interest rates on credit cards or loans, could leave English debtors in a bad spot (legalhelpers.com). Modern bankruptcy laws have been formed from modification of several historical strands (*britannica.com*). Arising from those nascent legal frameworks of the past, are the world's diverse bankruptcy systems practiced to today. Modern bankruptcy laws are centered around preventive

composition, arrangements, or corporate reorganizations. Some legal systems distinguish between insolvency and bankruptcy and others don't even mention insolvency. In the latter systems, all problems relevant to failure to pay debt are dealt with under bankruptcy. In general, though, insolvency indicates the inability to meet debts. While, bankruptcy, on the other hand, results from a legal adjudication that the debtor has filed a petition or that creditors have filed a petition against the debtor. In the US, there have been several amendments to the bankruptcy code which is enshrined in the constitution under uniform laws.

Continual amendments to the bankruptcy laws have led to a number of different bankruptcy legal systems which have evolved independently from the past. But a common thread runs through all of them. The legislations are meant to salvage an enterprise in financial difficulties and give it an opportunity to remain viable and maintain employment opportunities and protect members of the labor force. So, it can be said that different bankruptcy law systems are different approaches meant to accomplish the same purpose: that is to help the economy by protecting businesses and individuals from suffering debilitating financial hardships. The enterprise or an individual is allowed a chance to start over without being burdened with debt of the past. What comes first: culture or law? Many scholars have debated the issue of whether culture shapes law or the other way around. One of the authors who have written comprehensively on evolution of bankruptcy law is Martin (2005). The author noted that, throughout history, culture has taken the leading role through changing norms. Successive societal values also are responsible for the changes, in the law, that evolve. These changes specify what laws are necessary and appropriate in that period and country. That is why major changes in economic and political changes inspire legal reforms, too. From this understanding, it is not surprising that different countries reform their legal systems at different rates and varying intensity.

The following are the objectives of this study:

1. To study trends in the bankruptcy reform laws worldwide.
2. To study types and rates of change across different legal and social systems worldwide.

**1.1. Review of literature.** Literature has shown that bankruptcies are on the increase all over the world. But they have risen more steeply in the US because of American corporate greed (Dobbs, 12/04). According to Dobbs formerly of CNN News, greedy corporations are exporting American jobs overseas, thus contributing to unemployment less manufactur-

ing base and financial hardships in the USA. Observers who hold views similar to Dobbs', claims that US corporations only care for profits and do not care for the welfare of their people. Most major corporations have established manufacturing plants in cheap labor countries like Mexico, China, S. Korea and Malaysia. For example, HP has outsourced its sales representative to India. Indeed, today, it is difficult to find goods made in the USA. Brazil, China and India are some of the countries of choice when it comes to banking, technological, financial services as well as manufacturing operations for US companies. But then bankruptcies are on the upward trend even in countries where US outsources operations. Furthermore, it should be noted that even communist or socialist countries like the Ukraine, China and Russia are experiencing a surge in bankruptcies or insolvencies as they are called in European countries. Significant deterioration in a country's economy and surges in bankruptcy filings usually trigger legal reforms in those countries.

The U.S. bankruptcy system was brought about by the country's capitalist system which rewards entrepreneurialism backed by great consumer spending. It seems reasonable that such a system should incorporate a forgiving bankruptcy system in order to encourage and sustain high consumer spending. The same forgiving bankruptcy system would allow business reorganization, encourage risk taking and economic growth. Forgiving bankrupt individuals and businesses keeps capitalism alive and able to renew itself overtime and the concept of a new start is central to proper functioning of any meaningful bankruptcy system (Martin). Bankrupt individuals and businesses would worry less if they know that if they fall in financial problems, they would not be obliterated from the economic map. But would have a change to start all again or reorganize and survive the financial catastrophe (Braucher, 2006). Actually, bankruptcy may not be all bad. This view is supported by Matur (January, 2007) who cited research which found that one of the best ways to encourage people to start businesses is to have lenient bankruptcy laws.

In pursuit of its capitalist ideals, the USA has done more than any other country in reforming and implementing Bankruptcy Laws. A new bankruptcy reform law was enacted in 2004 and took effect on October 17, 2005. After its implementation, bankruptcy filing trends reversed course immediately, beginning with November 2005. Total annual filings have been much lower ever since. Total business and non-business bankruptcy filings from 2000 to 2008 show that, although there was steady increase in bankruptcy filing in the years preceding implementation of the new law, there was a sudden surge



in filings in 2005. This surge is explained by examination of monthly filing statistics which show that most of the surge was recorded in September and the first two weeks of October 2005 as filers rushed to beat the October 17, 2005 deadline (American Bankruptcy Institute, 2006; Egan, 2005). In general, filings had an upward trend for all the years up to October 2005, the year in which the new reform law was implemented. After that, they went substantially down beginning soon after the new law took effect and continuing to the year 2006 because the New Bankruptcy Law made it harder for some people to file (American Bankruptcy Institute, BankruptcyAction.com., July 24, 2007).

**1.2. The US bankruptcy reform law of 2005.** Excerpts from the actual mechanism and the detailed implementation process, of the new law, are summarized below under the “Five Big Changes”. The law has been described as the new harsher bankruptcy law. In fact it clearly favors credit issuers and mortgage lenders and penalizes consumers (US Courts, and BankruptcyAction.com.)

**1.3. The Five Big Changes in the New law.** Although there are many changes, bankruptcy remains a federal court process started by filing a petition. It is administered by a trustee, whom debtors meet at a meeting of creditors pursuant to Code Section 341 (BankruptcyAction.com, 2005; American Bankruptcy Institute, 2006 & 2007; and Essemeier, 2009; South-DeRose, 2005). The following is a summary of new categories of requirements:

1. A pre-filing credit counseling is required of all potential filers. Under this new requirement, individual creditors must attend a counseling session and obtain a certificate to accompany a petition for nay chapter relief.
2. Establishing a needs test based bankruptcy. The new law examines critically the needs a filer has. The need assessment is based on the median income of the filer’s state. If the filer’s income is below the mean income of the state the filer lives in, the judge allows the debtor to file for bankruptcy Chapter 13 which is for individuals with verifiable regular income. The type of bankruptcy will depend on the filer’s financial situation. If a filer’s disposable income is greater than that of his or her state, the debtor must work out a plan to repay.
3. Discouraging repeat cases. A debtor who previously filed for bankruptcy is not allowed to file again until 8 years have passed in Chapter 7 cases or 5 years in Chapter 13 cases.
4. Paying more in Chapter 13 (chapter for individuals). If a debtor’s income for the 6 months preceding the filing of bankruptcy is greater

than the median income in the state, a 5 year Chapter 13 repayment plan must be worked out. Amount of plan payments is based on Internal Revenue Service’s allowances and other allowances. Deduction of expenses are determined in accordance with the Means Test.

5. Additional rights of secured creditors. Automatic stay provision, which stops creditors while case is pending, is terminated if debt is not reaffirmed. Reaffirmation is in the form of a debtor filing and performing under a statement of intention.

**1.4. Trends in global bankruptcy reforms.** Bankruptcy filings are not limited to USA. Although the US has engineered comprehensive reform which is viewed by some researchers as radical. During the period the US was reforming its laws, some European countries were also actively reviewing their respective filing trends which, in most cases, were increasing sharply. Consequently most European countries implemented some reforms. Even some socialist countries like China, and other countries which were known to be pro-workers and against capitalism, reformed their bankruptcy laws to favor businesses a lot more than before. But their reforms were slow and limited in comparison to US’s sweeping changes in favor of credit issuers, mortgage lenders and other personal loan providers. Inclination of the US Congress to favor big businesses was inspired by heavy, relentless and expensive lobby mounted by the financial institutions which wanted a stringent law to minimize bankruptcy filings.

**1.5. Effects of country culture on bankruptcy perception.** It appears also, that the propensity to file is influenced by the economic culture of a country. In the US citizens are less likely to exercise restraint if it becomes apparent that they are financially hard up. Varona (July 2007) reported that the concept of consumer bankruptcy and “fresh start” is new in Europe. Demark spearheaded it in 1984. In France and Malaysia, the law focuses on the consumers’ indebtedness rather than their insolvency. Whereas, in the US, the law is based on the debtor’s ability to pay. Hence the new “means to pay provision” of the reformed law. In all the countries studied, it was noted that reforms were not limited to domestic insolvencies. In fact, most European countries and the US are using the newly reformed Chapter 15 provision of the new law, which addresses across boarder insolvency to revolve international bankruptcy situations. Spain is viewed as different from other European countries. Varona (9/07) says that there is no consumer bankruptcy provisions in Spain’s insolvency laws which was enacted in 2003.

But the European Union is highly rated for its consumer protection against credit market. Varona said

that the Spanish are reluctant to file while that is not the case in the US. In fact Kilborn said many scholars (arguably) referred to Americans as shameless when it comes to filing for bankruptcy. But he found examples in Japan and other countries which showed that US is not alone when it comes to greed although those other countries are still behind US in the index of individual's or a business' propensity to frivolously file for bankruptcy. It is thought that many Americans file for bankruptcy even when they could put off filing (creditslips.com). This attitude may have come about as a result of less stigma being associated with bankruptcy. It is possible that filers do not have a compaction of conscience over filing for bankruptcy because they see the law overly favoring businesses and creditors. It has been noted, too, that no reforms can encompass all types of bankruptcy filers. According to Kilborn (9/07), as soon as European states adopted laws that offer relief to insolvent individuals, another group arose. This is the group of individuals who are so broke that they cannot pay even a filing fee. They are known as "Nina debtors". They have no income, and assets for creditors to take.

**1.6. Bankruptcy reforms in England and Wales.** Bankruptcies in England and Wales showed a steady increase per quarter for the years 2005 and 2006. Bankruptcy statistics are organized in two categories:

1. Company liquidation which is comprised of compulsory and creditor or voluntary based.
2. Individuals filings which fall under either bankruptcies or individual voluntary arrangements (IVAs).

**1.7. Bankruptcy and insolvency reform in Scotland.** Scottish law recognizes that it is very important to have fair solutions for individuals suffering from severe debt problems. For example, the debt arrangement scheme, empowers individuals to deal with their own multiple debt problems with practical support. There are two main personal insolvency regimes in the UK: one for [England and Wales](#) and another for [Scotland](#). In England and Wales the majority of personal insolvencies are "bankruptcies". The remainder are [Individual Voluntary Arrangements](#) or IVAs, which are arrangements between the debtor and his or her creditors for the payment of the debts on different terms: for example by installments, or over a period of time. These two forms of insolvency have close equivalents in Scotland, where bankruptcies are known as sequestrations which equivalent to IVAs are protected trust deeds, or PTDs.

**1.8. Bankruptcy reform in Malaysia.** The Malaysian Bankruptcy Act 1967 was amended in the year 2003 (Asnawi, 2007) and came into force on October

1, 2003. The following are the essential changes the law brought (e-Insolvency, 2005):

- ◆ A change in the title of the Official Assignee Malaysia to the Director-General Insolvency Malaysia (DGI).
- ◆ A requirement for a petitioning creditor to prove to the Court that he or she had exhausted all avenues to recover debts owed to him or her by the debtor before he or she can commence any bankruptcy action against a 'social guarantor'.
- ◆ An increase in the minimum debt which qualifies a person to be declared bankrupt from RM10,000 to RM30,000.
- ◆ Stopping the calculation of the rate of interest on the date of the receiving order granted by the court in cases where the interest is not reserved or agreed upon.
- ◆ Conferring powers of a Commissioner of Police to the DGI and the powers of a police officer on the investigation officers to facilitate investigation, prosecution and enforcement.

### **1.9. Personal insolvency procedures in Malaysia.**

The personal insolvency procedures that apply in Malaysia are contained in the Bankruptcy Act 1967. A debtor can become bankrupt through either a debtor's petition or a creditor's petition. There is a summary administration available for small bankruptcies. A debtor can also avail himself/herself of a composition (mutual agreement or settlement) as an alternative scheme to bankruptcy. The Official Assignee administers all personal insolvency administrations Corporate Insolvency Procedures. The following insolvency procedures are available under the Companies Act of 1965:

- ◆ Pt 7 Arrangements and Reconstructions.
- ◆ Pt 8 Receivers and Managers.
- ◆ Pt 10 Winding Up.

Winding-up can be a court procedure or a voluntary procedures (under the control of members for a solvent company or under the control of creditors for an insolvent company). Private practitioners can be appointed by, in windings-up, for instance, the Official Receiver can act as a liquidator and is a default liquidator if no other liquidator is acting.

**1.10. Role played by the Court.** The general powers of the Court in Bankruptcy are included in s91 of the Bankruptcy Act 1967. The Court has a general oversight role in relation to corporate insolvency procedures, especially where the court has appointed a liquidator.

**1.11. Chinese and Vietnamese bankruptcy reform, 2007.** For China's program of economic reform, which sees the country opening its doors to the out-

side world, its newly passed bankruptcy law has twofold significance: to boost its credit market as it gives full access to foreign lenders, and to deal a final blow to the “iron rice bowl” employment system at its state-owned enterprises (SOEs) (Zhou, 2007; Eisenbach, 2007; Credit-to-Cash Advisor, 2007). Following its commitment to accession to the World Trade Organization (WTO), China opened its banking sector to foreign lenders, which will then compete with their Chinese rivals on an equal footing. This will no doubt boost the development of China’s credit market. But such development requires a legal basis, and that is where the new bankruptcy law comes into play. The law, which became effective on June 1, 2007, gives creditors’ claims top priority when the debtors undertake the process of liquidation, which is more in line with the international practice. This would certainly give foreign banks some legal assurance when issuing yuan loans, particularly to SOEs (InterNet Bankruptcy Library ‘IBL’, 1986). Executives of domestic lenders, particularly the four big state-owned banks – the Industrial and Commercial Bank of China, Bank of China, China Construction Bank and the Agricultural Bank of China – will also applaud the new law. The banks have had to dispatch “policy loans” on government orders to SOEs, and they suffer badly when their debtors become bankrupt.

## 2. Methodology

Information used in this comparative study was obtained from published reports and websites of the countries studied and also from the Internet. From those sources it was possible to compile pertinent qualitative and quantitative data. To illustrate the notion that bankruptcy practices are shaped by the culture of each nation, we will present similarities and differences in those countries’ legal reform structures. The countries chosen exhibit diversity in terms of political and economic systems. The countries are: the USA, the UK, China, and Malaysia. The USA and the UK represent Western economic and political orientation while China and Malaysia are from the far east region of the world. It should be pointed out, though, that each group of the countries chosen share more commonality within itself and exhibit major differences with the other group. The reason being that these countries have different economic and legal systems which have evolved locally over time. Consequently, they have been pursuing bankruptcy reforms in response to their unique economic problems.

**2.1. Discussion: Chinese and American Reform Laws Compared and Contrasted.** Although the study covers the USA, the UK, China and Malaysia, only China and the USA have recently enacted far

reaching reforms. Their reforms have major similarities and differences which are heightened in the tables below. The Chinese Enterprise Law is compared, side by side, with the American Title 11 Federal Bankruptcy Law.

A good bankruptcy law can establish effective market constraints, push enterprises to improve governance, and stick to the principle of paying off obligations, as well as protecting the creditors’ and debtors’ rights. Nowadays in China, most of the collateral creditors are banks. Because the banks’ claims are given a low priority, they became excessively cautious in lending, resulting in a credit crunch on mid-sized and small enterprises. From this viewpoint, the new bankruptcy law is expected to help boost China’s credit market. In this sense, it will also likely help foster the social value of respecting credit, which is lacking in traditional Chinese culture. The new law will apply to all sorts of companies, including listed and non-listed companies, domestic and foreign companies, privately run or state-owned, as well as financial institutions.

The law epitomizes the gradual nature of China’s market-oriented economic reform, which has largely centered on figuring out a viable way to close down insolvent SOEs. In theory, the current bankruptcy law also acknowledges that claims in liquidation should be given priority. In practice, however, the priority has in effect been subordinated by the so-called “policy bankruptcy”, or bankruptcy ordered and administered by the government, which trumps the protection of creditors. Under current law, courts must get permits from the government before triggering the bankruptcy process. The new law ushers in the professional “bankruptcy manager” system in line with international business practice. Some analysts liken the reorganization practice to that under Chapter 11 of United States Bankruptcy Code (Chung, 2007). Nevertheless, the new law is still a compromise between implementing an international standard and concern over social unrest. The government has implemented the new law cautiously. It exempted from the new law, an additional 2,116 SOEs already lining up for “policy bankruptcy” to enjoy the “Last Supper” until the end of 2008. Under some “special circumstances”, the priority will be given to workers’ obligations. The “caveat” addresses the interests of marginalized people during the transition to a free-market economy. The tables below draw comparison between the reforms for China and the US. New Chinese Bankruptcy Law effective June 1, 2007. Table 1 below displays forms of relief as well as scope of the application of the law. The Chinese Enterprise law has three forms: restructuring, liquidation and conciliation. Whereas the America Law has only two forms: re-



structuring and liquidation. In regard to scope, the Chinese Enterprise Law applies to state-owned and private corporate entities, but not to partnerships or individuals. But the American one applies to all

forms of companies, as well as individuals. Also and the Chinese and American reforms creditors can force a debtor to file for bankruptcy, subject to conditions set forth in the form provisions.

Table 1. Comparison of the US and Chinese bankruptcy reform

	China's Enterprise Bankruptcy Law	U.S. Title 11 Federal Bankruptcy Law
Forms of relief	Three forms: restructuring, liquidation and conciliation.	Two forms: restructuring and liquidation. China's conciliation relief might be analogous to informal compositions (workouts) and out-of-court wind-downs in the US.
Scope	Applies to state-owned and private corporate entities, but not to partnerships or individuals.	Applies to all forms of companies, as well as individuals.
Insolvency requirements, voluntary bankruptcy	Debtor may file for any form of relief if it meets two requirements: (1) it is unable to pay its debts when due; and (2) its total liability exceed the value of its assets.	There is no insolvency requirement for a business to file a voluntary bankruptcy petition.
Involuntary bankruptcy requirements	Creditors may force a debtor into bankruptcy if the debtor is unable to pay its debts when due. No requirements for reliabilities versus assets.	An <b>involuntary bankruptcy</b> petition can be filed by creditors if the creditor(s): <ul style="list-style-type: none"> <li>◆ Have undisputed accounts totaling more than \$10,000;</li> <li>◆ Can prove the debtor is not paying the majority of his /her non-disputed accounts as they become due; and</li> <li>◆ Makes the involuntary petition "in good faith".</li> </ul>
Administration of estate	People's Court appoints an Administrator when the bankruptcy is accepted by the Court. Debtor may request court's permission to management the estate under supervision of the Administrator.	Bankruptcy Court appoints a trustee when the bankruptcy is filed. In most organizations, however, the debtor automatically assumes the identity of " <b>debtor in possession</b> " and continues to operate the business and maintain control of its assets.
<b>Automatic stay</b>	Takes effect upon the Court's acceptance of the bankruptcy application. There is a potential 15-day gap between filling and acceptance during which creditors can continue to pursue collection efforts.	Stay of creditor actions against the debtor automatically goes into effect when the bankruptcy petition is filed.

Both the Chinese and the American reforms protect creditors against fraudulent transactions. In Table 2 below, all transactions which take place during or immediately before filing for bankruptcy are scruti-

nized. Funds illegally paid may be recovered and paid to creditors if a debtor is found to have deliberately made purchases or paid to non-creditor accounts some money just before filing.

Table 2. Comparison of the US and Chinese bankruptcy reform  
(Avoidance, Executory)

	China's Enterprise Bankruptcy Law	US Title 11 Federal Bankruptcy Law
<b>Avoidance Powers</b>	Administrator can recover assets transferred during a specific time period <b>prior to the acceptance</b> of the bankruptcy application. These fall into three categories: <ul style="list-style-type: none"> <li>◆ Debt payments made during six months prior to bankruptcy acceptance and while debtor was insolvent (as defined in the law).</li> <li>◆ Transfers <b>indicative of fraud</b> made during one year prior to acceptance of bankruptcy case (for instance, a transaction at an unreasonably low price).</li> <li>◆ Transfers involving <b>actual fraud</b> (for instance fabricating debtors or hiding property to avoid obligation of debt).</li> </ul>	Trustee or debtor-in-possession can undo a transfer of assets made during a specific time period prior to the filing of the bankruptcy petition (called <b>preferences</b> ). There are three types of preference: <ul style="list-style-type: none"> <li>◆ Insider transfers made within, usually, one year prior to bankruptcy filing.</li> <li>◆ Fraudulent transfers made within one year (or up to seven years in some states) prior to bankruptcy filing.</li> <li>◆ Non-insider transfers – the most common – made within 90 days prior to bankruptcy filing.</li> </ul>
<b>Executory Contracts</b>	Administrator (or debtor) is allowed to assume or reject executory contracts.	The trustee (or debtor) is allowed to assume or reject executory contracts.
<b>Reclamation</b>	Suppliers of goods dispatched for delivery before the bankruptcy may take back those goods if the full price has not yet been paid.	Suppliers may reclaim goods sold to the debtor "in the ordinary course of business" where the debtor was insolvent and received the goods within 45 days prior to commencement of the bankruptcy case.
<b>Setoff</b>	A creditor owing debts to the debtor may request the ability to offset them against what the debtor owes them. Setoff is not allowed in some circumstances.	Setoff of mutual pre-petition obligations is under the jurisdiction of state law.

Table 3 below shows that Chinese law barely protects creditors. It suspends collateral rights of creditors during reorganization, although under possible loss of value, the creditor may apply to the court for temporary collection activity. On the contrary, US courts do not suspend collateral protection of secured creditors. In this insistence, the US system gives more priority to

creditors than does the Chinese bankruptcy system. But in both the Chinese and the American systems, debts are declared. The main difference is that under the Chinese law, creditors are the ones to declare debts except for employee related debts. In the US it is the debtor who must submit a schedule showing debts owed, amounts and to whom debts are owed.



Table 3. Comparison of the US and Chinese bankruptcy reform  
(Post-Petition Finance, Adequate Protection)

	China's Enterprise Bankruptcy Law	US Title 11 Federal Bankruptcy Law
Post-Petition Financing	The Administrator or debtor (if provided rights to oversee the business) may obtain loans (grant liens) in order to continue operations. The law does not specify that such liens can only be granted on unencumbered assets.	If the debtor can demonstrate that financing could not be procured on any other basis, the Court can, subject to certain limitations, authorize the debtor to grant the <a href="#">debtor-in-possession lender</a> a lien that has priority over pre-bankruptcy secured creditors and a claim with super-priority over administrative expenses (including vendor and employee claims).
Adequate Protection	Collateral rights of secured creditors are suspended during reorganization. In cases where collateral value may be decreased in such a way that it hurts the rights of the secured creditor, the creditor can request the People's Court allow resumption of its collateral rights. Law does not, however, elaborate on how such protection will be provided.	Secured creditors may seek adequate protection or seek relief from stay where collateral value may decrease. Adequate protection is spelled out and includes such methods as periodic cash payments, additional or replacement liens, or other relief that supplies the "indubitable equivalent" of the creditor's interest.
Determining Debts Owed	All creditors must declare any debts owed (with the exception of employee-related debts) within a time frame provided by the People's Court. Creditors must provide a written explanation of the claim as well as evidence supporting it.	The debtor provides a schedule of debts to the Bankruptcy Court. Only those creditors whose debts are not listed, or that are listed as disputed, contingent or unliquidated, are required to file a <a href="#">proof of claim</a> prior to a <a href="#">bar date</a> set by the Court.
Administrative Expenses	Makes a distinction between two types of administrative costs: expenses directly related to the bankruptcy filing and requirements, and "debts of common benefit", which include costs to continue the company during the adjudication of the bankruptcy. Both costs are to be paid "when they occur", with bankruptcy costs taking precedence where assets are insufficient to pay both.	Gives priority for payment of reasonable and necessary <a href="#">administrative expenses</a> , which are to be paid in full from the estate's unencumbered assets.

Table 4 shows that the Chinese law allows all creditors to be members of a committee meeting. In the US, the trustee forms a committee of creditors from unsecured creditors. Once formed, the Chinese and American committees play similar roles in management of bankruptcy petition.

Also, from Table 4, it can be seen that the Chinese law recognizes 4 classes of creditors while the US recognizes 5 claims, instead of creditors. Both give secured creditors top priority. There is no provision for share holders or cost of bankruptcy in the Chinese provisions.

Table 4. Comparison of the US and Chinese bankruptcy reform  
(Creditors' Committee, Reorganization Plan)

	China's Enterprise Bankruptcy Law	US Title 11 Federal Bankruptcy Law
Creditors' Committee	All creditors with lawfully declared credits are members of the Creditors' Meeting, which has duties similar to those of the U.S. Creditor's Committee. The Creditor's Meeting has the ability to establish a Creditors' Committee of no more than nine members, one of whom must represent the debtor's employees.	The trustee appoints unsecured creditors (usually selected from the 20 largest) to an Unsecured Creditor's Committee, which is purely voluntary. There is no limit to the number of members, although the Committee generally consists of three to nine creditors.
Submission of Reorganization Plan	Draft reorganization plan to be submitted within six months after the Court has accepted the case. The court may extend the period for three months upon showing good cause. If the plan is not submitted in a timely fashion, then reorganization is terminated and the debtor is declared bankrupt – to be liquidated. There is no provision for submission of competing plans by creditors and/or shareholders.	Debtor has exclusive right to submit reorganization plan for 120 days post bankruptcy filing. Once this period has expired, a creditor or the trustee may file a "competing" plan for consideration by the creditors and Court.
Claim Classes (Paid 1st to Last)	Four classes of creditors: <ul style="list-style-type: none"> <li>secured creditors;</li> <li>employees;</li> <li>tax creditors;</li> <li>ordinary creditors.</li> </ul>	Basically five classes of claims: <ul style="list-style-type: none"> <li>secured creditor claims;</li> <li>administrative expenses (costs of the bankruptcy);</li> <li>pre-petition priority claims (includes wages);</li> <li>general unsecured creditors claims;</li> <li>shareholder claims.</li> </ul>

Finally, Table 5 shows that both the Chinese and American bankruptcy laws recognize the UN drafted Model Law on Cross-border bankruptcy protection (UN Commission, 1997). An entity which files for bankruptcy in another country is assumed bankrupt also in the People Republic of

China or the US. That is one of the benefits of the Chinese reform law because with this UN facilitated model law, creditors from other countries have a chance of pursuing bankrupt companies which may seek to hide assets in China, the USA or any other country.

Table 5. Comparison of the US and Chinese bankruptcy reform  
(Approval of Reorganization Plan, Cram Down)

	China's Enterprise Bankruptcy Law	US Title 11 Federal Bankruptcy Law
Approval of <a href="#">Reorganization Plan</a>	Plan must receive approval of more than half the number of creditors in <i>each class present at the meeting</i> and more than two-thirds of the total amount of claims in each class.	Debtor has 180 days after filing of petition to obtain acceptances to reorganization plan (Court must first approve Disclosure Statement). All creditors have the right to vote. Court holds Confirmation Hearing and if no timely objections by any creditors, determines whether to confirm the plan.
<a href="#">Cram Down</a>	Permits the Court to approve the reorganization plan over a dissenting class of creditors where: <ol style="list-style-type: none"> <li>1. Secured creditors, employees and tax creditors are either unimpaired or have voted in favor of the plan; and</li> <li>2. Ordinary creditors receive at least as much as they would under a liquidation; and</li> <li>3. Equity holders have been treated fairly or voted to approve the plan; and</li> <li>4. Members of the same voting class are treated fairly and equally; and</li> <li>5. The debtor's business plan is feasible.</li> </ol>	If all requirements for confirmation are met, except that not all classes of claims have accepted the plan, the Court may still approve the plan provided that certain requirements are met. The basic requirement is that the plan is fair and equitable with respect to each class of claims or interests that has not accepted the plan. Fair and equitable is further defined to ensure that each member of the class will receive a value that is not less than the amount that such holder would receive or retain if the debtor were liquidated under <a href="#">Chapter 7</a> .
Cross-Border Insolvency	Recognizes foreign proceedings and provides that parties may apply to the People's Court for recognition and enforcement of a bankruptcy judgment made in a foreign court that involves debtor property located in the PRC.	Incorporates the <a href="#">Model Law on Cross Border Insolvency</a> drafted by the United Nations Commission on International Trade and Law.

## Conclusion

A review of bankruptcy reforms across major countries shows that all major countries have enacted bankruptcy reforms to varying degrees. Some countries such as China, Malaysia and the US made substantial changes in their bankruptcy legal systems. In fact the US overhauled the bankruptcy system and gave it a new makeover. In so doing, the resulting reform procedures in the bankruptcy filing process clearly favor big businesses and penalizes the middle class and low income debtors. The severe reforms were inspired by heavy, relentless and expensive lobby mounted by financial mortgage lenders and other consumer credit issuers. The new law makes it very difficult for a debtor to be forgiven debt unless the filer is under extremely dire circumstances. UK did not enact far reaching bankruptcy laws even though the country's bankruptcy filings went up as they did in many countries in the world. Only China, Malaysia and the US made substantial changes as they reformed their laws. Even then Malaysia did not go as far as China did in initiating reforms. In Malaysia, filing for bankruptcy is made harder by a high debt requirement. A major difference between the US and Malaysia is that in the US it is the debtor's ability to pay that qualifies one to file or not. Whereas in Malaysia, it is how much debt one has incurred that qualifies a debtor. That is the reason why recently, in Malaysia, the minimum debt to file has been raised from RM10,000 to RM30,000 (about US\$3,050 to \$9,250). That means that debtors with less than US\$9,250 in debt cannot file for bankruptcy even if they have no means to pay. The requirement

for a minimum amount of debt to qualify for bankruptcy is unique to Malaysia and France. Not only that, the government has created an office of Inspector General of Insolvencies (IGI) and given that position "police power" to arrest and prosecute violators.

China reformed its bankruptcy laws to allow non-residents to file and reassure foreign investors that they, too, can benefit from the new law. Furthermore, the new law treats workers and SOEs equally well. The old law leaned more towards the SOEs. The new law, therefore, helps reduce the probability of worker revolt when they are laid off, cannot pay their bills and are not allowed to file for bankruptcy. In that regard, the reforms help the workers and the SOEs to extent they qualify. Everything considered, though, all the countries studied show that they reformed their laws with the intention of consumers and creditors. That is why the US reformed law which took effect on October 17, 2005, is dubbed *The Bankruptcy Abuse Prevention and Consumer Protector Act (BAPCPA)*. So far, in the US, it appears the only group protected are the creditors. The US and Malaysian reforms protected creditors a lot more than they did debtors. The reforms are still evolving at different paces and intensity in different countries. The common catalyst for the observed changes in bankruptcy laws, being initiated worldwide, is the uncertainty of economic downturn being experienced globally. In view of the worldwide reforms trends, it should be noted that, the UN Cross-Border Model Bankruptcy Reform Law enacted to guide international bankruptcy management, is bound to be easier to be helpful.

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