

The Bad-Assets of Banks and Corporate Rescue in China

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I. Overview on Debt Problem of SOEs

1. Situation of Assets and Liabilities of SOEs

Since 1990s, debt problem has been conspicuous and restricted the reform and the development of Chinese State-Owned Enterprises (SOEs). An investigation in capital and liabilities of SOEs (trade and financial enterprises included) made by the State Assets Administration in 1994 shows that the liabilities-to-assets ratio (total liabilities to total assets) of SOEs reached 75.1% at that time, in which about 63.9% of SOEs were in the condition of highly indebted operation (the liabilities-to-assets ratio was between 60-100%), and 22.5% of the SOEs were over-indebted with tremendous risk of insolvency.¹

According to the statistics from another comparatively overall investigation covering 302,000 SOEs carried out in 1995, the average liabilities-to-assets ratio was 69.3%; if the actual losses in the guise of receivables had been deducted from the total assets, the real liabilities-to-assets ratio would be 76.1%, while the liabilities-to-assets ratio of these SOEs was just 38.7% in 1980. That is to say, the liabilities to assets ratio was doubled in the 15 years. There were 51,000 SOEs with the liabilities-to-assets ratio above 100%, meanwhile, 61,000 SOEs with liabilities-to-assets ratio 100% or more with booking losses beyond the owners' equities and were *de facto* insolvent. The above distressed SOEs amounted to 112,000 in total, accounting for 37.1% of all the SOEs involved in the investigation.²

According to Table 1, the SOEs' assets accounted for about 60% of the total assets, and the SOEs' liabilities accounted for about 80% of the total liabilities. Therefore, to a great extent, the situation of the overall economic functioning is subject to the condition of the SOEs' assets and liabilities, which indicates that it is especially significant to solve the problem of the distress of SOEs for the economic development in China.

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¹ Wu Xiaoling, *Study Report on Debt-restructuring of State-owned Sector in China*, China Finance Press, January, 1997, Page 1-2.

² Zhang Yunting, *Debt-restructuring of State-owned Enterprises*, Shanghai Finance and Economics Press, 2000, Page 68. Concerning the statistics on assets and liabilities of SOEs in that period, also refer to Lu Liling and Shen Ying, *Debt-treatment in Reorganizing State-owned Enterprises*, Economical Science Press, 1997, Page 2-13; Zhang Chunling, *Issues on Debts of State-owned Enterprises*, China Economics (1996), Beijing Tianze Economic Institution, Shanghai People's Press, 1997, Page 1.

Table 1 Comparison of the Ratio of Various Industrial Enterprises in 1995

Owner-type	Total Assets	Total Liabilities	Liabilities-to-assets Ratio
SOEs	47472.06	31149.10	65.6% 74.2%*
Collective-Owned Enterprises	14360.07	10175.63	70.9
Share-holding Enterprises	4382.39	2405.96	54.9
Foreign-invested Enterprises	5798.22	3162.79	54.5
Enterprises Invested by Hong Kong, Macao, and Taiwan	6258.11	3891.94	62.2
All the Enterprises	78270.85	50785.42	64.8

From the Statistic Yearbook of China 1996

* The data in the brackets is the liabilities-to-assets ratio, which was obtained after the actual losses in the guise of receivables had been deducted from the total assets.

According to Table 2, the proportion of SOEs' credit in the total domestic credit was higher than that of SOEs' assets in total domestic assets. In other words, the preservation of the 80% credit in the country was subject to the 60% of SOEs' assets. Consequently, it is of vital importance for the quality and safety of banks' credit assets in China to solve the problem of the distress of SOEs and improve the quality of SOEs' assets.

Table 2 The Proportion of Quantity of SOEs and Credit in 1996

Quantity of SOEs	Total 10 thousand In which the large-sized % the medium-sized % the small-sized %	11.38 5.97 13.18 80.85
Credit	The Proportion of SOEs' Credit in Total Domestic Credit %	81.37
Assets	The Proportion of SOEs' Assets in Total Domestic Assets %	58.61

From The Statistic Yearbook of China (1996), the Financial Yearbook of China (1997)

2. Conditions of Banks' Bad Assets

The issue of debt distress of SOEs is closely related to the conditions of banks' bad assets. Since the economic reform and opening to the outside world, the credit relationship between SOEs and banks, and the forming of banks' bad assets have gone through the following three stages.

The first stage: before 1983. At that time when the economic reform just started, there was no concept

□

of commercial bank. All the banks then performed as cashiers of the financial department of the government. The fixed assets and floating funds of SOEs all relied on fiscal allocation. Only were the excess of the allocation quotas and some occasional investment for fixed assets borrowed from banks. The amount of total loans for the nationwide industrial enterprises were RMB 48.7 billion in 1980, and increased to 52.7 billion in 1982, RMB 59.7 billion in 1983, and the banks had no bad assets incurred by loans to SOEs.

The second stage: from 1984 to 1990. During this period, with the market elements increasing, the credit relationship between SOEs and banks and the concept of commercial banks emerged. The so-called “shifting from allocation to loans” (“*bo-gai-dai*”), by which the investment in infrastructure construction came from bank loans rather than from the fiscal allocation, was one of the major measures in the investment system reform. Since the major capital of the enterprises relied on loans from the banks, the scale of the bank credit expanded rapidly, and bad loans were hence formed. In most years of this stage, the ratio of the bad assets to total assets of the banks was less than 10%, and until the end of 1980s the ratio just arrived at about 15% (the amount of the total bad assets was less than RMB 200 billion).

The third stage: from 1991 to 1998. It is the period that during which the amount of bad assets of banks swelled dramatically. According to the calculation of some specialists, the amount of SOEs’ bad debts increased five times in the five years from 1991 to 1995, which was RMB 213.3 billion, 420.6 billion, 547.7 billion, 853.4 billion, and 1059.8 billion respectively. Accordingly, the amount of banks’ bad assets increased about four times in the five years. Of the new bad assets, the amount due to the foam of real estate and stock market in the overheated economy accounted for 32%, and the amount due to debt distress in SOEs accounted for 48%. Among the bad assets caused by the distress of SOEs, about one-third was caused by the loans made for the sake of social stability in light of the administrative orders, about one-third bad debts resulted from production loans made for the sake of relieving the enterprises’ distress, over one-sixth debts were written off because of some enterprises’ bankruptcy, and another one-sixth was bad debts resulted from false operation and sightless loans of the banks.³

According to the estimate of the specialists, in 1994 two-thirds of the total debts of SOEs owed to the banks.⁴ According to the statistics of utilizing state funds in the Financial Yearbook of China 1996, the loans to SOEs accounted for 58.73% of the total loans. Moreover, according to the Economic Yearbook of China 1996, the ratio of profit & tax to capital of the financially independent SOEs was 24.8% in 1980, 23.8% in 1985, 12.4% in 1990, 8.01% in 1995 respectively. In other words, about 60% of bank loans had been invested in some inefficient and low profits SOEs.

It is shown in an investigation that the amount of bad loans reached 22.65% of the outstanding loans in the period in the commercial banks’ credit assets in 1995. Of the amount of bad loans, over-due loans accounted for 13.99%, non-performing loans 6.67%, and bad debts 1.99% in all the loans of the same period. However, the actual situation was much worse than those figures.⁵ According to a typical survey, there were considerable loans that were not included in bad loans, which kept operating by taking advantage of the

³ Fan Gang, *ibid.*, Page 102-103.

⁴ Fan Gang, *ibid.*, Page 64.

⁵ Lu Liling and Shen Ying, *ibid.*, Page 16-17.

“rolling approach”, a way that the banks made new loans to the enterprises to pay off the old loans. Furthermore, about 60% of the non-performing loans had turned into bad debts. Thus, on the basis of the calculation, the actual proportion of bad debts in the outstanding loans in the corresponding period would have reached to 5.99%.

In 1995, China promulgated the Commercial Bank Law, making legal requirements for the safety of bank assets. Aiming at the mess of bad assets in commercial banks that were increasing strikingly, the Central Bank strengthened the control and supervision over the commercial banks and demanded that the ratio of all the commercial banks’ bad assets be dropped by 2-3% each year. Under this pressure, the commercial banks came up with two “countermeasures”. One was called “shifting loans”, i.e., concealing the real bad assets artificially in the book entries by making new loans to pay off the old loans, which in fact accumulated the potential financial crisis. Another was called “reluctant to loan”, i.e., no loan would be made unless there was 100 per cent certainty of repayment, a practice which not only led to considerable interest losses (some of the losses were shifted to the Central Bank by increasing the bank deposit reserves), but also worsened the distress of SOEs, which would finally result in the loss of bank assets.

Table 3 Proportion of Bad Assets of Banks in Some Countries/Regions in Asia

Countries /Regions	The Present Proportion □% □	The Proportion at the Peak □% □	The Bad Assets at the Peak to GDP □% □
Singapore	2.0	>8	9
Hong Kong	2.1	>8	13
India	17.0	15	4
Philippines	3.4	10~15	7
Malaysia	5.6	>20	28
China	20.0	>25	24
Indonesia	9.2	40	25
Korea	14.0	>25	34
Thailand	18.0	>25	40

From: IMF, Goldman Sachs.⁶

The large proportion of banks’ bad assets was one of the major factors that caused the Asian financial storm in 1997-1998, which had stroked the economies of Thailand, Korea, Malaysia and Indonesia heavily. The financial sectors of China escaped the crisis by sheer luck due to some reasons such as the relatively closed financial market. However, it had inevitably borne the depression for several years. It can be seen in Table 3 that the proportion of bad assets of the banks in China was in a higher position among the Asian countries. Since there are still various many unstable factors in the economy of the world at present, some specialists appealed that we should not underestimate the potentiality of global financial turbulence, even

⁶ Quoted from Lei Jiashu, *Financial Safety of China---Issue on the Level of System and Operation*, Economic Science Press, 2000, Page 188.

crisis, that is likely to break out in the coming years. Therefore, to ensure the development of a stable and healthy economy of China in the future, it is of great significance to take efforts to solve the problem of the distressed SOEs and improve the quality of banks' assets.

II. The State's Acts in Dealing with SOE Distress

Realizing the great negative impact of SOEs' high indebtedness on national economic development and institutional innovation in state-owned sector, the government is determined to resolve the problems of the huge bad debts. The government hopes to resolve three major problems in one package through debt restructuring of the national economy, i.e., debts, personnel redundancy and social burden, so as to make substantive progress in the reform of the SOEs and the financial system, achieve the strategic adjustment of state-owned sector, and establish and develop the socialist market economy.

1. Clearing up "Triangle Debts"—Chain Debts

In fact, since the third quarter of 1988, Chinese government started to make great effort to clear up the SOEs' debts macroscopically. Led by the local governments and specialized banks the campaign of clearing up the "triangle debts" was launched in a great scale. After 1990, the "Triangle Debts" Clearing-up Office, set up by the State Council especially, had utilized various administrative methods together with a great deal of the debts' clearing-up funds injected by the finance and banks (the funds reached to RMB 33.05 billion in 1991) with a hope to undo the debt chain one by one. This kind of organized central administrative policy of debts clearing up was effective in a short term (for example, in 1991 the fund of 1 *yuan* could clear up the defaulted debts of 4.1 *yuan*). However, as the complexity of the debt roots was underestimated, the above measures could not prevent the new debt chain from forming, and the administrative debt clearing-up turned into administrative financing to some extent. As a result, the People's Bank of China stopped the practice of "financing for debt clearing-up" in 1993. But the clearing-up of the "triangle debts" has aroused people's attention to the issue of the enterprises' debts, and it initiated the study on the issue in the level of policy and law in China. Some organizations that could meet the requirements of market were set up, such as the Debt Trading Credit Center in Liaoning Province, which is still playing a role in debt clearing-up now.

At present, it is still very serious for the SOEs owing debts due to each other. There are a great deal of accounts receivable and accounts payable booked in almost every SOE, which could not be received or would not be paid for a long time. It is estimated that the debts of the SOEs in the country defaulted with each other have reached to RMB 800 billion.⁷

2. M&A and Bankruptcy under the Capital Structure Optimization Program (CSOP)

The debt restructuring in a large scale by the central government began with the CSOP carried out in 18

⁷ Zhang Yunting, *Debt Restructuring of State-owned Enterprises*, Shanghai Finance and Economics Press, 2000, Page 138.

large pilot cities in 1994. Inspired by the successful practice of merger since 1989, the central government issued a series of administrative rules and regulations to implement CSOP, which stressed that bankruptcy should be normative, merger should be encouraged, and both would be favored in policy preferences. This kind of debt restructuring utilized several approaches synthetically such as bankruptcy, merger, and financial funding, write-off of bank debts, and returning from “the fiscal allocation to bank loans” to “bank loans to investment”. In addition, according to the policies, enterprises that bore relatively heavy burden of debts and were not qualified to be merged could reduce their employees, and the loan interests of the enterprises owing to the banks could also be reduced. At the end of 1996, the funds with the principal and interests from “allocation to bank loans” amounting to RMB 24.2 billion were switched into state capital funds, which was used to handle the problems thoroughly in special industries such as coal industry, military industry, water and electricity industry. Furthermore, the sum of RMB 30 or 40 billion from central finance was taken out each year to make up for the losses of SOEs.

Since July 1, 1994, the practice of replenishing operating funds to state-owned industrial enterprises was carried out in the pilot cities, which required the enterprises to use a certain proportion of profits after taxes to supplement their working funds before drawing surplus accumulation funds, and meanwhile, the financial departments at the same level were required to allocate 15% of total income revenue turned in by the enterprises to supplement their working funds. In fact, even 100% of the income taxes were returned to the SOEs in many cities. However, the practice of financing directly with the financial increased capital alone was not satisfactory.

Circular Concerning Carrying Out State Owned Enterprise Bankruptcy in Some Cities (Guo Fa, 1994 No. 59), issued by the State Council in October, 1994, stipulated that normative bankruptcy of the state-owned industrial enterprises (SIEs) in the 18 pilot cities should be carried out under the principle that the employees of the SIEs should be settled first before going bankrupt. Moreover, many problems of the insolvent SIEs were stipulated specifically in the Circular, such as the disposal concerning the right of land using, properties of insolvent enterprises, the settlement of the workers of the insolvent enterprises, the credit losses of banks due to the insolvency, and complete take-over, restructuring of the insolvent SIEs, and organization and administration, etc. This indicated that the central government decided to utilize the land using right and the net assets increase (even stock) of the state owned banks to pay off those past debts in the way of enterprise bankruptcy, which included the hidden debts such as annuities, compensation for giving up the status as the workers of SOEs, and other rights based on the SOE worker status, for example, the right of obtaining employment again. The specific approach was: (i) using the income of the sale of the right of land using and payment got by cashing the insolvent properties to settle the workers; (ii) writing off the losses of the banks after verification by the bad debt reserves quotas controlled and used by the People’s Bank of China (PBC) and STEC. In November 1994, the Supreme People’s Court issued *Urgent Notice Concerning Problems in Enterprise Bankruptcy Cases Heard in the People’s Courts*, in order to carry out Guo Fa, 1994 No.59.⁸ Thus, a set of procedures called “Planned Bankruptcy” was in fact created out of the bankruptcy proceedings of the current law.

⁸ Fa Fa, 1997 No. 2, *Notice Regarding Notable Issues Pertaining to Current Enterprise Bankruptcy Cases Heard in the People’s Courts*, issued by the Supreme People’s Court on March 6, 1997, further stipulated how to carry out the related decrees issued by the State Council.

The approach gradually spread in the country. The number of pilot cities increased to 56 in 1996, and 111 in 1997, and the amount of bad debt reserves quotas increased from RMB 7 billion in 1995 to 20 billion in 1996, and again from 30 billion in 1997 to 40 billion in 1998.

Meanwhile, the central government promulgated a series of normative decrees regarding “Planned Bankruptcy” in the CSOP. In July 1996, SETC and PBOC issued *Notice on Some Issues Arising in the Experimental Merger and Bankruptcy of SOEs* (Guo Jing Mao Qi, 1996 No. 492), which stipulated provisions concerning the mechanism of “Merger and Bankruptcy; Employee Reduction and Efficiency Increasing”, the rescue of insolvent SOEs on the verge of bankruptcy, bank representatives participating in making the bankruptcy plans, settlement of the workers, writing off the non-performing and bad debts, bankruptcy of domestic/foreign trade enterprises, and coordination between the departments of government, etc. Moreover, it arguably provided that property under mortgage could be used to settle the workers. *Supplementary Notice on Problems Pertaining to the Trial Implementation of the State-Owned Enterprise Merger and Bankruptcy and Re-Employment in Certain Cities* (Guo Fa, 1997 No. 10), issued by the State Council in March, 1997, stipulated specifically the following problems, such as organization and administration of experimental implementation, planning, examination and approval, preparation for bankruptcy, assets valuation, disposal of insolvent properties, settlement of workers, bad debts write-off, investigation into the responsibility for insolvency, lay-off and disposition, reduction and exemption of interests, and so on.⁹

It needs to be noticed that, according to these documents, the merger of enterprises was emphasized as an important measure, which could be used in conjunction with bankruptcy or by itself. The mergers could enjoy the preference in policies such as suspending debt interests, exemption of debt interests, repayment before the income tax, and extending credit maturity. Furthermore, the enterprises in the CSOP could be favored with the preference of writing off the debts according to the sum approved. In reality, many local

⁹ Relevant documents include, Cai Gong Zi 1996 No. 226, *Interim Provisions Concerning Several Financial Problems on Experimental Bankruptcy of SOEs*, issued by the Ministry of Finance; Guo Jing Mao Qi, 1997 No. 257, *Circular on Assignment of Pre-allocation of Reservation to Write off the Bad Debts and Planning on Merger and Bankruptcy of Enterprises and Re-Employment*, issued by the State Economy and Trade Commission; Cai Ji Zi 1997 No.15, *Several Regulations on Debts Repayment of Central Infrastructure Construction Funds within the Budget by SOEs in Experimental Bankruptcy*, issued by the Ministry of Finance; Cai Gong Zi 1996 No. 224, *Notice of Several Financial Problems on Experimental Bankruptcy of SOEs*, issued by the Ministry of Finance; Lao Bu Zi 1996 No.7, *Notice on Ensuring the Living Standard of Workers of Distressed State-Owned Enterprises, Rescuing Themselves by Production and Settlement of the Workers*, issued the Ministry of Labor; Yin Fa, 1995 No. 130, *Circular on Handling Bank Loans and Interests after Encouraging and Supporting Better-Performing SOEs in the 18 Pilot Cities to Acquire the Distressed State-Owned Industrial Enterprises*, issued by the People’s Bank of China, SETC and Ministry of Finance; Cai Kuai Zi, 1995 No. 19, *Circular on Handling the Accounts of Bank Loans and Interests after Acquisition of the Distressed State-Owned Industrial Enterprises by Better-Performing SOEs*, issued by the Ministry of Finance; Lao Bu Fa, 1995 No.43, *Notice on Applying the Project of Re-Employment*, issued by the Ministry of Labor; Guo Jing Mao Qi, 1995 No.184, *Opinions on Separating Enterprises from Running Social Welfare Businesses and Arranging the Surplus Personnel in Several Cities*, issued by the State Economy and Trade Commission, the State Education Commission, the Ministry of Labor, the Ministry of Finance, the Ministry of Sanitation; Guo Zi Fa, 1994 No.90, *Notice on Ensuring Administration of State-Owned Assets in the Process of Enterprise Bankruptcy*, issued the State Administration Bureau of State-Owned Assets; Cai Shui Zi, 1994 No.001, *Notice on Favorable Policies for the Income Taxes of Enterprises*, issued by the Ministry of Finance and the State Revenue Headquarters; Ti Gai Jing, 1989 No.38, *Provisional Measures Governing Enterprise Merger*, issued jointly by the State Commission for System Reform, the State Planning Commission, the Ministry of Finance, and the State Administration of State-Owned Assets, etc.

approaches were adopted in insolvent enterprises, such as “bankruptcy first, then merged”, “combining bankruptcy with mergers” (“purchasing whole”), “splitting first, then going bankrupt” etc., which in effect led to the low repayment rate to creditor banks when the enterprises went bankrupt. Lack of the bad debts write-off quotas allocated administratively, the bad debts of banks increased distinctly. Under the claims of the commercial banks, Guo Fa, 1997 No. 10 discouraged the practice that the enterprises went bankrupt through “purchasing whole”, and reduced the number of insolvent enterprises that did not involve mergers or were not qualified to write off the bad debts. Meanwhile, the document expanded the range of the cities in the CSOP and increased the write-off quotas, which in fact encouraged the restructuring in the form of merger while taking efforts to restrain the practice from shirking responsibility for creditors through going bankrupt. Based on the debt-undertaking mergers, some mergers by market means such as cash-purchasing mergers, stock-absorbing mergers, and stock-holding mergers were created in practice, which promoted the debt restructuring. Meanwhile, encouraged by the Guo Fa, 1994 No. 59, the approach of hive down was widely used to save profitable assets of the enterprises.¹⁰ Of course, many cases were not real restructuring and violated legal procedures. Therefore, Article 90th of *Contract Law of the People’s Republic of China*, effective in October 1999, stipulates explicitly and strictly the issue of assumption of debt obligations after the separation or mergers, which has actually banned in shirking the responsibility for creditors through merger or hive down.¹¹

At the beginning of 1998, the State Council proposed that three years be spent in reforming, restructuring, transforming, and strengthening the management of the SOEs to relieve most of the loss-makers among large & middle-sized SOEs out of the distress. In September 1999, the Decision of Several Significant Issues on the Reform and Development of State-owned Enterprises made at the 4th plenary meeting of the 15th Central Committee of the Chinese Communist Party required that the bad debt write-off reserve fund of the bank be increased to support merger and bankruptcy of the large & middle-sized SOEs, and close the out-of-resources mines, and lay particular stress on the major industries. As a result, bankruptcy again received much attention. However, from 1999 to 2000, there was a big change in the CSOP, in which the write-off quota was no longer fixed and the general office of the four banks was able to negotiate with the SETC to decide the list of the enterprises that were going to enter into bankruptcy. The total sum of write-off quota in fact was RMB 18 billion in 1999, which focused on the bankruptcy cases of the money-losing large-sized SOEs.

On the basis of the data gained by the SETC, there were 3,365 SOEs all over the country from 1996 to 2000 that went bankrupt according to the CSOP, while the number of the settled bankruptcy cases of SOEs all over the country reached 12,181 from 1997 to 2000. It means that more than 70% of the SOEs’

¹⁰Article 8th of Guo Fa, 1994 No. 59 stipulates, “If the bankruptcy has been consented by the creditor(s) whose credits amount to more than two-thirds of the total debts of the enterprise and approved by the government of the county municipal district, where the insolvent enterprises were located, profitable assets can be hived off from the enterprise going bankruptcy. The enterprises established after the hive down shall assume the debts of the old enterprise according to the agreed proportion.”

¹¹ Article 90th of *Contract Law* of the People’s Republic of China, effective in October, 1999, stipulates that “If one party to a contract is merged after the contract has been entered into, the legal person or other organization established after the merger shall exercise the contract rights and perform the contract obligations. If one party is hived off after the contract has been concluded, the legal persons or other organization thus established after the hive down shall exercise the contractual rights or assume the contractual obligations jointly and severally unless the creditor and the debtor have agreed on it.”

bankruptcy were not implemented according to the CSOP and the capacity of the Planned Bankruptcy in the controlled scale of the SOEs' bankruptcy is limited.

In the process of enforcement of the Planned Bankruptcy, the banks have showed their strong discontent. In November 1996, it was pointed out at the joint meeting of the presidents of financial claim management banks in the country that according to the investigation of 145 bankruptcy cases of the state-owned enterprises of 35 provinces, the general liabilities-to-assets ratio was very high (about 165%) while the general rate of payment was very low (the average rate nominally was only 9.2%), in which the state-owned banks suffered damages heavily. The prominent problems reported in the meeting were that: (1) the enterprise bankruptcy had gone beyond the stipulated areas, and the bankruptcy took place everywhere; (2) the local protection was so serious that it had damaged the legal rights of creditors; (3) the methods of artificially going bankrupt and truly dodging creditors such as "hive down first, then going bankrupt" and "absolute division between the new enterprises and old ones" were practiced in the enterprise bankruptcy; (4) the drain on the state-owned assets was serious; and (5) the costs for the bankruptcy were too expensive. Then it was proposed at the meeting that we explore actively a specific method of restructuring the enterprises' assets in which the creditors can participate beyond the bankruptcy proceedings, and encourage more mergers and less bankruptcy. And it was also pointed out at the meeting that it was not a rational method for the bank to pay off all the costs of the enterprises' reform and we need to study and seek for a new way in which the financial department and the enterprises' investors together with the banks shall take the responsibility to pay off the costs of the enterprises' reform.¹²

3. Intensive Operation of the Bad Assets by State-Owned Banks (SOBs)

Affected by the Asian Financial Storm, the central government in 1998 began to put the focus of the Debts-restructuring on the Bank-restructuring in order to resolve the banks' bad assets that accounted for 20-25% of the banks' total assets. The central government formulated a series of policies to assist enterprise restructuring such as spreading moderately the mechanism of directing bank and debt-equity swap practice, etc.

Under the impact of the expansionary public finance policies these years, the debt scale and the debt structure of the central government formed over a short time have made people anxious. The financial resources that can be used directly for relieving the distress of enterprises and restructuring the banks are very limited, and the practice that dispatching the non-finance resources through administrative measures is not as rapid and effective as before due to the legal regulations. In 1998, the Ministry of Finance issued special state-bond of RMB 260 billion in order to make up one half of the bad debts of the four commercial banks in the year. After that, the Ministry of Finance invested RMB 40 billion in 1999 to set up four Financial Assets Management Companies (AMC) to take over the bad assets (RMB 1200 billion) hived off from the corresponding state-owned commercial banks and loaned before the end of 1995. The Ministry of Finance hoped that the AMC could promote the reform and relief of the SOEs while activating the bad assets.

¹² The Accessories of Yin Fa, 1996 No.413, *Notice on Issuing "the Summary of the National Joint Meeting of Presidents on Management of Financial Claims"*, issued by the People's Bank of China.

It was virtually the beginning of using the state assets in stock (bank resources) in a large scale.

Among the 601 enterprises recommended to the AMC and Development Bank by SETC, there are 508 enterprises decided to carry out debt-equity swap, and the total number of the debts amounted to RMB 408 billion and accounted for 29% of the loans (worth RMB 1393.9 billion) hived off from the commercial banks and the Development Bank. By the end of the first half of 2001, the State Council has approved 483 enterprises to carry out the debt-equity swap after the joint examination of SETC, the Ministry of Finance and the People's Bank of China. The total involved debts for equity swap amounted to RMB 294 billion. And there are 60 new companies among the 483 enterprises that have been registered in accordance with the law.¹³

However, the debt-equity swap practice is more like a kind of administrative plan. In the 90% of those agreements, the enterprises were required to buyback all the stock equity within 5-7 years and the local governments were demanded to promise that the enterprises must be separated from the functions of running the social welfare business. But in fact these demands are difficult to be carried out. However, with the primary business goal of preserving the assets and decreasing the losses as much as possible, the AMC made great efforts to take over and deal with the bank's bad assets with the strong support of the central government. In November 2000, *the Rule of the Finance Assets Management Company* issued by the State Council strengthened the status of the AMC in the aspects of the business scope, the preferential policies and the protection of the legal rights. Moreover, the headquarters of each commercial bank had the right to dispose and use the most reserve funds for the bad debts themselves with the modification of the CSOP in 1999. Besides, the Ministry of Finance made the limitation flexible at the beginning of 2001, which formerly required that the reserve funds for the bad debts be effectively capped at 1% of the portfolio. The commercialization of the state financial creditors has built up the creditors' motivation of participating in the enterprises' debt restructuring, strengthened their status in the enterprises' debt restructuring and promoted the market operation of such aspects as the capital resources of the debt restructuring, the adjustment of the debt relationships, the decrease and share of the losses in the restructuring, and the loss allocation after the restructuring. For example, Shanghai sub-branch of the Bank of China was an example that the state-owned bank could transfer its claims to stock-holding bank when it transferred its loan contractual claims worth 100 million to Shanghai Sub-branch of Guangdong Development Bank in August 1998. The practice of the claim auction and judicial auction of incorporated stock also took place in Shanghai. At the same time, in accordance with the fast growth of citizens' income and deposits in our country in the past 20 years, the central government is continuously developing the capital market, encouraging the enterprises to finance directly, and letting the non-governmental capital help the unlisted enterprises which have good economic benefits and potential of development but have been bothered by the high indebtedness. For example, Nanning Chemical Co. Ltd. is the first unlisted company issued 150 millions convertible bonds formally in August 1998.

There is another question concerning the debt-equity swap practice with administrative plan

¹³ Industrial Policy Department of SETC, *Progress in the Implementation of the Debt-Equity Swap*, in *Economy and Trade Guidance of China*, the 8th edition, 2001, Page 12.

characteristic that the range of application is extremely limited. There are more than 100 thousands SOEs all over the country, but the number of the enterprises which could carry out the debt-equity swap was less than 5%. Ten thousands of the middle and small-sized local enterprises would not like to wait for death. The local financial resources were also limited because the local governments have no right to issue the public bonds. Restricted by the laws and guided by the polices, many local governments had to seek for more flexible approaches to handle individual cases within the framework of the law in accordance with the debt structure of each enterprise. Enterprises and governments began to attach importance to the interests of the financial creditors and divert their attention on the capital market and title market, while emphasizing on the satisfaction of the society's claim such as the claim of the workers to be settled. Some local governments now are not confined to settling the debts once for all any more and they are seeking actively for the optimization of assets, expansion of capital and long-term benefits together with the creditors. Sometimes the participants of the restructuring include the investors who are not native to the locality such as foreign businessmen and nonnative businessmen. As a result, some new approaches of debt restructuring come into being. We can find an epitome of the developmental tendency from the "Changchun Approach" and new cases of other places, which will be introduced in the following report.

4. Government-Dominant Debt Restructuring

To explore approaches of debt restructuring, Guo Fa, 1994 No. 59 stipulated that the government of the county or municipal district of the insolvent enterprises could restructure the enterprises with the measures of reorganizing the managers, changing the form of the operation of the assets of enterprises, and guiding the adjustment of the structure of enterprises. According to the relatively common approaches, the basic idea of debt restructuring of enterprises is to start with two channels: adjustment of debts in stock and injection of increased assets.

At first, for the adjustment of debts in stock, "emphasis should be given on clearing up system related debts through various forms of debt-equity swap adopted within the state-owned sector (mainly referring to the debts due to the finance, enterprises or employees) in order to activate stock assets of state-owned enterprises".¹⁴ There were several main approaches in the practice such as converting the financial debts into equity (switching from loans to investments, converting loans by municipal financial departments and local taxes in arrears that enterprises owed to localities into state equity capital injected into enterprises), converting funds raised from employees into employee-holding internal stocks, converting the inter-enterprises debts into equity, suspending payment of certain bad debts and interests, separating non-performing assets from the enterprises and entrusting them to a trustee institute, trading the claims of banks at a discount or writing off the debts directly.

In the second place, while injecting new capitals we should focus on establishing a new mechanism, and we should renovate the system of enterprises and promote all the relevant reforms. There were several main approaches in practice such as debt trusteeship, listing through enterprise restructuring, raising State-owned Enterprise Promoting Fund, and promoting actively the transfer of state-owned property.

¹⁴ Tang Jian, *Types and Cases on Assets Restructuring of Enterprises of China*, Sichuan University Press, 1998, Page 160. Also refer to: *Study on Debt-restructuring of State-owned Sector in China*, China Finance Press, January, 1997.

During the period, the local governments explored boldly and developed some additional approaches such as:

(1) Debt trusteeship. In practice, there were several types of trusteeships, such as Hainan approach of the governmental trustee, Guangfayuan approach in which the non-bank financial institutions were the trustees, Xian approach, which accumulated the experience that intermediate investment institutions jointly contributed funds to form trusteeship institutions, and Jiangxi approach, a practice that the money-losing enterprises were entrusted to better-performing SOEs first, then acquired by the better-performing SOEs later etc.¹⁵

(2) Converting debts owing to employees into employee-holding internal stocks. For example, not only the debts such as wages, welfare funds, bonus, funds for the welfare of employees, and funds for public welfare, but also funds raised from employees or funds for security of risks, and debts owed to the employees who paid debts for the enterprises could be converted into stocks.¹⁶

(3) Freezing the debts. The government promised to use the income of assets (including the income receivable of public finance) to pay off the frozen debts. It is known as the approach of Shaoguan in Guangdong province in 1996, solidifying the debts and reconstructing the mechanism.¹⁷

(4) “Marketing negotiation”, i.e., under the coordination of the government, multi-parties assumed the debts according to the agreed sum and manner.¹⁸ The practice in Taian, Shandong province was a case in point.

(5) Transferring the claims of banks via the third parties. It is known as “the Return and Sale of the Mortgaged Assets”(RSMA), which is the practice in Jinan Monosodium Glutamate Factory, in Shandong province in 1996.¹⁹

Under the macro guidance of the central government and the micro efforts of the related parties, the liabilities-to-assets ratio of the SOEs declined yearly, and reached to 64.41% in 1998. The listing of some SOEs, joint investment of the non-SOEs, cooperation with non-SOEs, collectivization of SOEs, sale of the medium & small-sized SOEs also contributed to the decline. However, the liabilities-to-assets ratio in the old industry districts still remains high, the situation of the loss of the SOEs is still serious, and especially the assets of banks keep on deteriorating.

¹⁵ See Zhang Yunting, *Debt-restructuring of State-owned Enterprises*, Shanghai Finance and Economics Press, 2000, Page215-217; Tang Jian, *Types and Cases on Assets Restructuring of Enterprises of China*, Sichuan University Press,1998, Page 166; Financial Institution of PBC: *Debt Restructuring of SOEs and Assets Protection of Banks*, Economics Science Press, 1998, Page153.

¹⁶ See Zhang Yunting, *Debt-restructuring of State-owned Enterprises*, Shanghai Finance and Economics Press, 2000, Page140-142.

¹⁷ Li Yousheng, etc., *Practices of Assets and Debt Restructuring of SOEs*, Shenyang Press, 1998, Page 260-264.

¹⁸ Zhang Yunting, *ibid.*, Page237-243; Chi Fulin, *SOEs Reform and Debts*, Foreign Languages Press, 1998, Page 210-212. In the case of foreign trade corporation of livestock product in Taian, Shandong, the bank, the enterprises and the government agreed to restructure the debts of the enterprises through the approach of “part of stock assets activated, part of stock assets discharged, part of stock assets written off”, which means that the activated assets by hive down were used to repay the debts of RMB 6 million, the debts of RMB 1.5 million was repaid through bankruptcy, and the rest debts of RMB 15 million were written off with approval.

¹⁹ Financial Institution of PBC, *Debt Restructuring of SOEs and Assets Protection of Banks*, Economics Science Press, 1998, Page247-253. The so called RSMA means that the bank transfers the profitable assets pledged by the enterprise when getting loans to a third party, who assumed the secured debts.

Obviously, most debt restructuring in this period were initiated or driven by the departments of the government in charge of the enterprises, who tried their best to utilize governmental resources and policy tools to adjust the relationships among financial department, banks, state management company, enterprises and the employees concerning their claims and debts in order to settle the bad debts once for all and decrease the liabilities-to-assets ratio of the enterprises. However, the future income or efficiency of post-restructuring were not taken into consideration in most of the approaches, and the banks lacked the participating enthusiasm and often bore the net losses of the restructuring passively, not only in the normative restructuring, but also in the less normative restructuring. In this period, debt restructuring of the enterprises was prone to transfer the costs of rescuing the enterprises to the banks. It was quite common that the restructuring was short of transparency and mechanism of negotiation with bank creditors, which was in some degree worsened by the resistance from the banks and mechanism of banks' over self-protection.

Generally speaking, the passive comments from the banks on the above approaches of the debts restructuring of SOEs were more than the positive ones. In 1998, the Financial Research Institute of the People's Bank of China (PBC) cooperated with the subsidiary banks in 16 provinces, and published the report of *Debt Restructuring of SOEs and Assets Protection of Banks*. Based on the survey of more than 100 plants, five points of negative impact regarding the debt restructuring of SOEs were discussed in the report: (i) the passive position of banks in effect increased the degree of difficulty in protecting banks' assets; (ii) the approaches of debt restructuring were taken advantage of to suspend and shirk or default the claims of banks; (iii) sometimes the liabilities-to-assets ratio after the restructuring remained high, and the risk of banks' assets increased rather than decreased; (iv) since the abilities of performance of some SOEs were not reinforced after the restructuring, the quality of bank assets did not increase much, and some even declined; (v) the ratio of the bank assets repayment was very little, and it led great losses to banks. Besides, several advisable suggestions were given in the report on the policy. For instance, it is suggested that encouraging the transformation of enterprises and protecting the assets of banks be two basic points; bad loans be assumed and transformed by government, enterprises, and banks jointly; and thoughts be widened to activate assets in stock and transfer the risks of present assets in stock through various means, etc.²⁰

III. Market-Dominant Debt Restructuring

The various approaches that the government adopted in the past years bear two common characteristics: firstly, overly relying upon governmental measures, and secondly, overly relying upon fiscal resources. In fact both the governmental measures and fiscal resources are limited. This is one of the major reasons why for a long time the corporate rescue has walked with difficulties and the record of banks' bad assets has stand high. In order to get rid of this puzzle we should shift to adopt more market measures and explore more market resources. The so-called "Changchun approach", that appeared in recent years bearing the character

²⁰ Financial Institution of PBC, *Debt Restructuring of SOEs and Assets Protection of Banks*, Economics Science Press, 1998, Page10-12.

of market-dominant rescue, is a remarkable paradigm.

1. Background of Changchun Approach

Changchun City, located in Northeast China, is an old industrial city with the majority of stated-owned enterprises (SOE) and assets. In the past two decades, the local SOEs endured their hard times because of heavy-burdened debts, redundant workers, low quality assets, inflexible management system, obsolete technology and equipment. And the debt burden was the key factor to hinder the enterprises from restructuring assets, obtaining new technology and improving management system. But among their fixed assets many Changchun's SOEs had profitable assets which could produce marketable goods. Only because of their debt burden and lack of money, the SOEs could do nothing but put the profitable assets aside. Thus the SOEs were in insolvency, the trademarks and names of the SOEs were forgotten, and the market resources were lost. In the end, the unavoidable consequence was assets wasting, bankruptcy, unemployment, and credit losing.

In 1995, Changchun City began to look for ways to rescue the profitable assets of insolvent SOEs. At the beginning, Changchun used administrative power to hive the profitable assets off from the old enterprises, the approach popular at that time, and registered new companies. But soon they found that their practice was against law and there was no way to cut the joint liability between the new enterprises and the old ones, so that the profitable assets could not get rid of the former debts inevitably. Thus, since 1996, a new approach, so-called "Purchase-Sale Restructuring" (PSR), came into being. Under the mediation of Changchun Government, some SOEs negotiated with banks (the main creditors) for rescuing the profitable assets and restructuring debts of the SOEs. Some successful cases appeared after 1997.

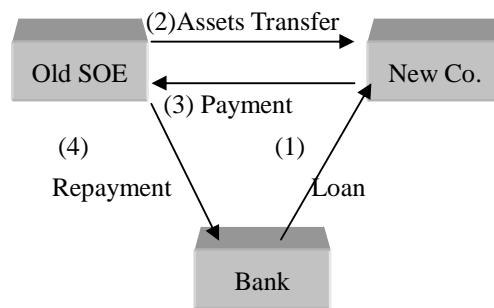
In 1999, through summing up the past experience, Changchun proposed three principles in enterprise assets and debt restructuring: (i) capital marketing and floating principle; (ii) law abiding principle in the procedure of assets transfer; and (iii) principle of protecting creditors at the highest degree when actively negotiating with creditors. Following the principles, a set of relatively complete restructuring approach has gradually been created. Before July 2001, there were about 40 Changchun's SOEs adopted the approach to restructure themselves and some were successful. In 2000, the officials from the State Economy and Trade Commission went to Changchun several times for survey and study, and some local governments also sent people to Changchun to learn the experience. Therefore, this approach, so-called locally "Purchase-Sale Restructuring"(PSR) and nationally "Changchun Approach", began attracting people's attention from other places of China as well as the world. In July 2001, a team composed of scholars and specialists from Beijing and Hong Kong investigated and studied "Changchun Approach" in Changchun City. Before that, a paper by Professor Wang Weiguo on "Changchun Approach" received attention and positive comments at an international forum in Vancouver, Canada.

2. The Basic Features of "Purchase-Sale Restructuring"

Based on our research of typical cases and description by Changchun government, some banks and enterprises, we can sum up the basic points of PSR in Changchun as follows:

□□

- The old enterprise who will adopt PSR shall be a SOE which is in insolvency but has profitable assets by which profits can be produced.
- Before PSR, the government should set up a new company, usually a wholly stated-owned company. The investment is often in the form of cash, sometimes plus the right of using land. After assets transaction, the company shall gradually covert into a multiple-shareholder company.
- The new company purchases profitable assets from the old enterprise. A relatively typical transaction arrangement is that the new company, the old enterprise and the primary creditors, (usually a bank who has two thirds of claims of the total debts of the old enterprise), enter into an agreement in a package concerning the old enterprise's profitable assets valuation and transfer, and the sale of the assets and debt payment on the basis of full negotiation. The framework of the agreement can be illustrated in the following graph:



Graph 2-1 Assets Transaction Arrangement in PSR

The transaction shown by the above graph mainly includes four stages: (1) The bank provides a loan to the new company to buy the profitable assets from the old enterprise, and the loan is almost equivalent to the assessed price of the profitable assets. (2) The old enterprise transferred its profitable assets to the new company at the contractual price. (3) The new company gives consideration to the old enterprise by the loan provided by the bank. (4) The old enterprise uses the money obtained to pay debts to the bank.

- In the practice of the above assets transaction, the following measures are usually taken:
 - Assessing the old enterprise in every aspect, mainly in profitable assets and product market. The targeted enterprise shall present a plan of restructuring. And the plan shall be discussed and proved by the relevant government departments.
 - Abiding by law strictly in assets transaction. Firstly, the valuation of profitable assets shall be done by an authorized body. And the valuation result shall get consent of the Administration of State-owned Assets and the creditor (usually the primary creditor). Secondly, the plan shall get consent of the workers' congress of the old enterprise. Thirdly, the transaction shall be done in the Center of Title Transaction. After the agreement becomes effective, both parties should deliver assets and money to each other according to the list of assets valuation.
 - Resolving the problems of workers' thoughts by the Communist Party of China and the Trade Union to obtain workers' support and participation.
- The majority of workers from the old enterprise shall work for the new company, and shall sign a

labor contract with the new company.

- The new company gets floating assets in various ways and uses the assigned profitable assets to produce marketable products. Thereafter, it shall reform its property right system and convert itself into a multi-shareholder enterprise such as share-issuing enterprise, shareholding cooperative enterprise, enterprise group, sino-foreign joint venture and cooperative enterprise.
- Proper disposition of the old enterprise’s residual assets. To those that are not effective for operation, bankruptcy shall be conducted. Those that are still effective for operation may remain. The new company may support the old enterprise in business or restructure it later at proper time concerning the residual assets.

3. The Effects of “Purchase-Sale Restructuring”

From our case study on 6 enterprises that have practised PSR, we can see that Changchun approach has achieved “multi-wins” for the debtor, local government and primary creditor. In general, this kind of restructuring has the following effects.

(1) The Effects on Assets

The profitable assets have shaken off the yoke of debts of the old enterprise and have gained the necessary funds for keeping on operating. The new enterprise has a better goodwill and capacity for financing, so it can make the profitable assets operate regularly and make profits. The new enterprise can expand its business by means of transforming into stock-holding company, cooperation and merger, etc.

The key point of the Purchase Sale Restructuring Approach of Changchun is focused on the increasing value of the profitable assets. As shown in Table 4, after the new enterprise purchased the assets of the old enterprise by the means of the government putting in funds and the bank supplying loans, and operated for a period of time, the value of the assets all have a remarkable increase. According to the formula “debt/net assets*100%=the liabilities-to-assets ratio”, under the condition that the liabilities are unchanged, the way of decrease the liabilities-to-assets ratio depends mainly on the increase of assets. However in reality, the principal debts always bring about interest debts and other debts (such as liquidated damages), and the market risks can also cause some unexpected debts, (such as accidents liability and product liability). So, in addition to paying off the debts on time, it is an important approach to keep good financial situation and gain increased assets not at the price of increased debts.

Table 4: Assets of New Enterprises in the Cases of Purchase-Sale Restructuring Approach of Changchun

Unit: million (RMB)

Name Item	Special Vehicle Co.	Printing Machine Co.	Vehicle Lamp Co.	No.2 Machine Tool Co.	Electric Furnace Co.	Kelon Co.
Government Investment	11.9	9.76	3.33	10.5	17.55	0.5

□□

Loans from Banks	9.56	24.28	21.58	17.69	15	12.83
Purchased Assets	9.56	42.56	21.58	17.69	22.65	33.5
Current Assets	53.17	58.33	39.46	33.92	61.15	
Debt/Assets Ratio	56%	59%	86%	67%	52%	
Investment in Others		12	24.75	0.1		
Transformation into Stock-Holding Companies		Completed		Under Consideration		

In the above cases, the increased assets of the new corporation are from, firstly, the floating assets and the intangible assets formed in the operation of the enterprise; secondly, the new assets got by investment of the business income; thirdly, the new investment brought about by enterprise re-capitalization. Besides, an important reason is that while the new enterprise purchased the tangible assets of the old enterprise, the new enterprise also gained some intangible assets of the old enterprise for free, such as the organization and management system of the enterprise, the system of technology support, the enterprise culture, the fame in the market, and the sale networks, etc., which contributed much to the value of the modern enterprise. It is obvious that these elements can neither create values nor be converted into cash for sale when an enterprise stops operating or in solvency. Therefore, rescuing the profitable assets of an enterprise in distress not only simply means making full use of the unused plants and equipment, but more importantly making the knowledge capital and relation capital, related with those profitable assets, keep functioning. Thus, we can compare the purchase of the profitable assets of an enterprise to the purchase of a well-trained living horse, that is to say, purchasing the profitable assets of an old enterprise may have the effect of “getting twice the result with half effort”, compared with investment in purchasing land and setting up a new factory. And it is necessary to invest a large sum of money in “software”, including the costs of perfecting enterprise system and developing the market, in order to be competitive in the market and gain the capacity to make profits.

From the point of the view of macro-economy, one more point to which we need pay attention is that the profitable assets, including hardware and software, are all social resources, but the supply of these resources is limited and even rare. To realize the economy increase, it is not only necessary to develop new resources, but also essential to protect and make full use of the existing resources. If we let the existing resources run off while developing the new resources, then the benefits of the increased amount gained by the development will be decreased or set off by the loss of the existing resources. For instance, the land, occupied by the enterprise in distress, is a sum of rare resources. If the increased need for the land did not take advantage of the land resources, then there would lead claims to the reserved cultivable lands.

In the above cases, we have seen in some cases that the existing capital has been successfully utilized. For example, Changchun Vehicle Lamps Corporation, on the basis of purchasing the assets RMB 20 million of the old enterprise with the investment of RMB 3 million from the government, made use of the technology and market resources of the old plant to attract the outside investment, and has formed the assets scale of RMB 1.2 billion. Changchun Printing Machine Corporation retained a group of special technologists with high quality, while purchasing the tangible assets of the Printing Machine Plant, which laid a foundation for future upgrading products and enlarging the assets scale. Changchun No.2 Machine

Tool Corporation has utilized the land resources to exchange for funds and gained increased capital of RMB 1.2 billion, which enabled the advantage accumulated from former technology transformation to get rid of the financial difficulties, and has realized its real market position and made profits. And Changchun Electric Furnace Corporation took advantage of the income earned by activating the land assets to cooperate with foreign enterprise to develop new products, which has laid a good foundation for the development of the enterprise.

The above cases show that since the new enterprise still bore a heavy bank debt after purchasing the profitable assets from the old enterprise, in a period, the sources of funds mainly depend on absorbing the outside investment and activating the land assets in addition to the sale income. If the new corporation can keep good financial situation and remarkable business achievement, then it may get loans from banks soon. For instance, Special Vehicle Corporation and Electric Furnace Cooperation have recently got loans from banks, which is a good case in point.

It needs to be pointed out that in the “Purchase Sale Restructuring Approach” of Changchun, the purchasers are all newly set up state-owned enterprises by the government solely, and the usual merging method of attracting outside purchasers is not adopted. The benefits of Changchun Approach are:

- (1) Decreasing the cost of the negotiation;
- (2) Avoiding the integrating cost after merger;
- (3) Beneficial to settlement of the workers of the old enterprise;
- (4) Leaving enough room for the future stock-holding transformation and pooling capital.

The disadvantages of this approach are the single source of depending upon the government, the investment sources are limited and the future reformation may incur some cost of negotiation. According to the introduction of the Commission of Economy and Trade of Changchun, in a recent case of restructuring, the new enterprise is a corporation with multi holders.

(2) The Effects on Debts and Claims

The primary creditors, that is, the banks, got the new claim to the new enterprises. This claim is considered high quality assets. At the same time, the old enterprises paid part of the debts owed to the banks, so the same amount of bad debts have been deducted from the banks' bad debts. The creditors can get a higher rate of repayment in this way than by the way of bankruptcy liquidation.

There is a common point in the debts of the state-owned enterprises, that is, there is always one primary bank creditor who held the most claims among the creditors. As shown from the Table 5 below, in the above-mentioned cases, the average proportion of the amount of the primary bank claims to the total debts is 63%.

Table 5 Repayment to the Primary Bank Creditors in the Cases of Purchase-Sale Restructuring Approach of Changchun.

Unit: million (RMB)

Name	Special	Printing	Vehicle	No.2	Electric	Sugar	
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Item	Vehicle Plant	Machine Plant	Lamp Plant	Machine Tool Plant	Furnace Plant	& Wine Co.	Average
Total Debts of Enterprises	130	91.13	104.84	126.15	128.32	109.53	114.50
The Amount of Primary Bank Claims*	58.54	55.57	60.25	106.11	42.59	62.146	64.20
Proportion in the Total Debts of Enterprises	62%	69%	57%	84%	33%	57%	60%
Paid Debts	9.56	24.28	21.58	20.69	15	12.83	17.32
The Rate of Repayment	20%	43.6%	35.8%	19.5%	35%	21%	29%
Claims to the New Co.	9.56	24.28	21.58	17.69	15	12.83	16.82

*The primary bank creditor here mainly refers to the Industrial and Commercial Bank except that Special Vehicle Plant had two major bank creditors: the Industrial and Commercial Bank and the Construction Bank.

Generally, the more claims the creditor holds to one enterprise, the more losses he will bear when the enterprise goes bankrupt, so he will benefit more from rescuing the enterprise. So when conditions are proper, the primary creditor is active in rescuing the enterprise. However, any one will have to consider the rate of input and output when rescuing an enterprise. When an enterprise is in distress, the benefit to the creditor is judged by decrease of losses he may get.

It is reported that “the total amount of the assets of the enterprises, who entered into the bankrupt proceeding was RMB 37 billion in 1996, the total amount of the debts was RMB 540 billion, and the average liabilities-to-assets ratio was 148%. And most debts were loans owed to the state commercial banks. The repayment rate of those enterprises who had finished or entered into the bankrupt proceedings was 5%. To banks, these loans to such enterprises have become non-performing or bad debts.”²¹ The reasons why the rate of repayment was so low are as follows:

- (1) The unavoidable losses of the assets in liquidation. In other words, there is a big difference between the evaluated value of the assets and the cash value of the assets.
- (2) A large amount of expenses used to settle the workers and a large sum of bankrupt expenses.
- (3) The priority of the laborer claim and taxes claim.
- (4) The difficulties in cashing the mortgaged fixed assets, expenses cashing the fixed assets as well as the deduction from the income of the land.²²
- (5) The abnormal conducts of the enterprises as well as those of the insiders of the enterprises, (such as maliciously dodging debts, corruption and wastes, etc.)

In the above cases of Changchun, all the restructuring transactions followed a rule, that is, the bank loaned a certain sum of money but got double income. One income is the claim to the new enterprise, and the other is the payment for the debts by the old enterprise. On the one hand, the bank has the stable interest income and reliable security to the debts that the new enterprise owed to the bank. On the other hand, the old

²¹ Fan Gang, *Financial Development and Enterprise Reform*, Economic Science Press, 2000 edition, Page 105.

²² Most right of using the land of the state-owned enterprise is allocated. In accordance with the relevant stipulations, the revenue of the land shall be submitted to the local finance when trading the buildings on the land.

enterprise paid the debts owed to the bank, and the rate of repayment is higher than the rate by bankruptcy liquidation.

As we can see from Table 2-5, in the six cases, the primary bank creditor got repayment from the old enterprise, and the highest rate of repayment is 43.6%, and the lowest is nearly 20%, and the average rate has reached to 29%, which is higher by 24% than the average rate of repayment by bankruptcy liquidation. In other words, in the above six cases of debt restructuring, the banks have taken back nearly RMB 1 billion bad debts more than in bankruptcy liquidation in total.

(3) The Effects to the Workers

The workers of the old enterprise have retained their employment. Moreover, the salary of the workers has generally increased after they enter the new enterprise.

The key to the rescuing enterprise is the profitable assets. To keep the profitable assets existing and developing is the basic prerequisite for protecting the creditor’s benefits and the workers’ employment. In order to protect the profitable assets, the creditor has to make some concessions, so do the workers. We can not demand the new enterprise to accept all the workers of the old enterprise. The new enterprise should take a reasonable settlement rate on the principle of optimizing the human resources and saving costs. Otherwise, once the new enterprise is pulled down by overstaff, all the workers will be out of work.

As we can see that during the process of Purchase-Sale Restructuring Approach of Changchun, both the government and the workers are rational. Firstly, the government did not force the new enterprise to take the workers of the old enterprise by assigning a certain quota. On the contrary, the government actively helped the old enterprise to settle the workers in different ways, (for instance, the case of No.2 Machine Tool Plant). Secondly, before restructuring, since the enterprise communicated and entered into an agreement with the workers through the workers’ congress, the workers generally could accept the settlement plan. As a result, there is no such a case in which the new enterprise was compelled to accept all the workers of the old enterprise.

Table 6: Settlement of the Workers in the Cases of “Purchase-Sale Restructuring” Approach in Changchun

Name Item	Special Vehicle Co.	Printing Machine Co.	Vehicle Lamp Co.	No.2 Machine Tool Co.	Electric Furnace Co.	Kelon Co.	Average
Number of Waiting for Settlement	1200	1371	767	1207	1495	765	1134
Number of Settled Workers	821	960	378	700	460	452	629
Rate of Settlement	56%	70%	49%	58%	31%	59%	54%

Table 7: The Hive Down of Profitable Assets of Old Enterprise in the Cases of “Purchase-Sale Restructuring” Approach in Changchun

Unit: million (RMB)

Name Item	Special Vehicle Plant	Printing Machine Plant	Vehicle Lamp Plant	No.2 Machine Tool Plant	Electric Furnace Plant	Sugar & Wine Co.	Average
Total Amount of Assets	66.34	78.27	91.84	84.22	84.37	129.1	74.96
Amount of Assets Hived-off	9.56	42.56	21.58	17.98	15	33.5	23.36
Rate of Hived-off Assets	14%	54%	23%	21%	18%	26%	26%

Generally speaking, the rate of the new enterprise of accepting the workers of the old enterprise is determined by the following:

- (1) The necessary labor for operating the profitable assets;
- (2) The increased labor that the new enterprise can attract for the future development; and
- (3) The conditions that on which the rest of the workers could be settled through other means.

Because the new enterprise only purchased part of the assets of the old enterprise (from 14% to 54%, with the average 26%, see Table 7), therefore, the new enterprise can only accept part of the workers of the old enterprise (from 31% to 70% with the average 54%, see Table 6). Anyway, by comparison, the rate of accepted staff and workers is twice more than the rate of the purchased assets.

(4) The Effects on Society

The government has realized its aim of activating the state-owned assets in stock, keeping staff and workers employed and social stable with a small sum of money. And the government can get taxes revenue from the new enterprise.

As we can see in Table 2-5, the total amount of the government’s input of capital in the six enterprises to rescue the enterprise is RMB 19.73 million. And the rescued profitable assets amount to RMB 130.70 million, and 16,741 staff and workers are employed directly with the profitable assets. In the average, each input of RMB 10,000 can rescue the assets amounting to RMB 150.000, and settle 8.5 workers. Moreover, it can not be estimated that the increase of the value of assets and the progress of the technology, i.e., keeping the technological equipment and the specialists so as to lay a foundation for the progress of the technology.

After half of the workers in the old enterprise are settled in the new corporation, it relieved the pressure of the government and society to settle the employment and living of the rest staff and workers. This contributed much to the problem of settlement of the workers in the state-owned enterprises through various channels. Besides, the activation of the profitable assets of the old enterprise has also benefited the local economic flourishing and increase of the financial revenue. In the above cases, the taxes that the new enterprise paid annually are considerable (see Table 8 below). According to the tax system of China, any enterprise engaged in commodity transaction or services should pay circulation tax, and pay income tax when there are profits as well as other kinds of taxes. In fact, the taxes that new enterprise has turned over

annually are far more than the profits after the taxes.

Table 8: Taxes Paid by New Companies in Changchun Debt Restructuring Cases

Unit: million (RMB)

Name Item	Special Vehicle Co.	Printing Machine Co.	Vehicle Lamp Co.	No.2 Machine Tool Co.	Electric Furnace Co.	Kelon Co.	Total
Accumulated Taxes Paid	0.37	6.16	0.98	1.62	*	**	9.13

* Electric Furnace Co. is allowed to postpone its taxes in 2000, and may begin to pay taxes in 2001.

** Kelon has no business income currently.

4. Comparison of the “Purchase-Sale Restructuring” Approach with Other Approaches of Debt Restructuring

Up to now, the approaches of debt restructuring in China may be categorized into two types. One is based on debts, and the other on assets.

(1) The Restructuring Mode focused on Debts

The restructuring mode based on the debt focuses on the existing debts of the enterprise, and it tries to make the enterprise revive by decreasing or clearing up the debts. The main methods of this approach include administrative pay-off, putting in assets to write off the debts, debt transformation and bankruptcy liquidation.

Administrative pay-off. Administrative agencies of each level encouraged specialized banks and state-owned enterprises to concentrate on clearing up the inter-enterprises debts and the debts between the banks and the enterprises gradually according to the plans, in an organized way in a certain period. The most typical method was clearing up the triangle debts of China at the end of the 1980’s and in the early of the 1990’s. Although this method can quickly clear up a series of debts with a concentrated effort in a certain period of time, it may soften the restriction of the enterprise budget, which may contribute to the enterprise’s thoughts that “it is beneficial to default in debts, and it is a loss to pay debts” and enterprises tended to rely on the “finance to pay the bills”. As a result, a new large scale of debts was accumulated.

Putting in funds to write off the debts. The finance and banks utilized the state inventory capital to share the accumulated debts. For example, the state bank drew the reserves for non-performing or bad debts to write off the bad debts; and the government returned the taxes that the enterprise turned over to replenish the debt repayment funds. These methods played some role in resolving the problem of the enterprise debts to some extent, but very limited. Firstly, the amount of the bank reserves for non-performing and bad debts is small. It must be first used to deal with the bad debts incurred by enterprise bankruptcy. With many enterprises going bankrupt, the banks had no sufficient funds to actively discharge the enterprises from the debts. Secondly, the room of the financial in-put is very

small, for the reason that most local finances were in the situation unable to make the ends meet. And many enterprises were in distress because of the losses and stopped production for a long time, so there were no tax returns. Moreover, too many financial in-put may cause the problem of “soft budget restriction”.

Debt transformation. Debt transformation includes “debts converted into stocks” and “debts converted into debts”. There are four specific methods in “debts converted into stocks”:

1) The bank debts have been converted into stocks. The four financial assets management corporations have begun to do this job from 1999;

2) The inter-enterprises debts have been transformed into stocks. This is a debt disposal method adopting market principles, and it has a full development potential. Now, cases of adopting this method to resolve the inter-enterprises debts are few.

3) Transforming the debts of the inside staff and workers into stocks. Transforming the wages that enterprises owed to the workers and the compensation for giving up the status of the state-owned enterprise permanent staff into stocks, and the insider staff and workers hold stocks. It is a measure taken by the distressed enterprises to decrease the debts, when the enterprise is carrying out the transformation into stock-holding company.

4) Transforming “allocation of funds into loans” into “loans into investment”. It is a special measure taken to deal with the special debts formed in special forms and special periods. There is a strict limit to adopt the method.²³ In fact, “debts converted into debts” is the innovation of debts in *Contract Law*, i.e., the party that bore the debts is changed. For example, the debts formed when the enterprise was engaged in the community affairs are transformed into the financial debts; companies in the lower level bear the debts of the companies in the high level or vice versa.

The method of debts transformed into stocks is the most popular one currently. Its characteristics are that the transformation of the bad claim into stock rights leads to the increase of the total amount of the enterprise shares and the decrease of the value of each share. Thus, in fact, the original investors also made some sacrifices to realize the allocation of the risks of management failure and losses between investors and creditors. The advantages of this method are as follows:

- This method has changed the booked assets situation of the enterprise, which is good to improve the credit of the enterprise and enhance the enterprise financing capacity.
- This method has decreased the financial cost (the interests of loans), increased the profits in the enterprise benefit of the current period (or decrease the losses of the same period). Nevertheless, “debts converted into stocks” did not involve assets input (money or materials), so it is only a temporary measure. To have the substantial effect, it must be combined with other measures of

²³ “Allocation of funds transformed into loans” means that in the early 1980’s, to change the situation of the unified state revenue and expenditure and the enterprise enjoying the “big pot meals” of state finance in the planned economy, the state changed allocated funds for enterprises into loans from banks. As a result, some of the state-owned enterprises are established only with loan investment, but no input of capital funds. These enterprises bore heavy debts.

“Loans transformed into investment” means that in the middle of 1990, to resolve the debts of the enterprises without capital funds, the state changed the booked investment loan for the capital construction and all kinds of financial borrowing of the enterprise into state investment, so that it can decrease the debt ratio. By the end of 1996, the state changed the principal loan and interests, changing the allocated funds, amounting to RMB 242 billion of the 131 enterprises, into the state capital funds.

improving the assets situation.

Bankruptcy liquidation. It is the most complete method to clear up the debts. However, bankruptcy liquidation is at the cost of the death of an enterprise legal entity, and it is not a method of rescuing enterprises. Bankruptcy liquidation also leads to the value of the assets running off and the increase of unemployment and other negative results. Certainly, it can be a kind of methods of rescuing enterprise by selling the assets of bankrupt enterprise in whole in the bankruptcy liquidation. Nevertheless, this method is always abused in China, which damaged the interests of banks. So it was defined as “false bankruptcy, real debt dodge” by No.10 document of the State Council in 1997. According to this document, only when the insolvent enterprise really stopped production and closed (legal entity deprived), the right of using land and property were sold in auction for cash, and the workers were settled, could it be called a qualified bankruptcy. If so, then it is impossible to rescue the enterprise in the pure meaning of assets, at least not now.

(2) The Restructuring Mode focused on Assets

The restructuring mode based on assets pays attention to the inventory assets of the enterprise. It tries to make the enterprise revive by the way of activating the profitable assets. The main methods of this mode are loans, increasing assets, merger, tax reduction and exemption or tax return.

Loans and increasing assets are the method of directly putting the increased funds into enterprises. This method may resolve the present funds shortage of enterprises and improve the producing situation and financial situation of the enterprise. However, the increase of the loans may lead to the increase of the debts. On the one hand, to an enterprise in distress, this method although can improve the producing situation of the enterprise for a short time, it is no use improving the financial situation. Moreover, it is difficult for a distressed enterprise to get loans from banks. On the other hand, though the increased funds may improve the financial situation of the enterprise, they can not decrease the debt burden of the enterprises. When an enterprise has the heavy burden of debts, investors seldom have motive to invest in such enterprise. The law shall not allow the enterprises, (such as the listed companies), to increase funds when losses occurred. So this method is usually adopted when the enterprise is at the early stage of the distress and the distress is not serious, and the prospect of the management is bright.

Merger. It refers to merger and acquisition. It is the property right transaction in which one enterprise bears the assets and debts of the other in general. In China, as a method to realize the state-owned enterprise of getting rid of the distress, merger means an enterprise, whose assets and management are in good condition, purchases the enterprise in distress in whole. This measure is regarded as an important way of rescuing the enterprise in distress under the direction of the government for a long time. The merger mainly takes such ways as bearing the debts, purchasing, absorbing shares and holding shares. In recent years, there appeared mergers like purchasing the “shell” to list in a stock exchange, lever purchasing and other mergers and acquisitions.

The merger method of bearing debts is the main method for the enterprise to get rid of the distress

under the main conduct of the government. 70% of the total cases of mergers and acquisitions are taken in this way.²⁴ The two parties in the merger are usually the state-owned enterprises under the same authority department. The adopted methods are either government allocation for funds without payment, or purchasing individual assets, that is, the purchaser got all assets and the management right of the targeted enterprise on the consideration of bearing all the debts. Among all these merging methods, the purchaser not only bore the booked debts of the targeted enterprise, but also assumed the hidden debts, such as, settling the workers and social security liabilities. In reality, the merger of good enterprise with the enterprise in distress always made the former bear the heavy debt burden of the latter. Although No.10 document of the State Council in 1997 provides that the enterprise with superiority purchased an enterprise that was at a loss for three successive years may be entitled to exemption of the interests of the original loans owed by the merged enterprise, and the principal may be repaid in five years (and may get one or two years extension if really difficult), it could not remarkably improve the financial situation and credit of the merged enterprise, and it also could not prevent other non-bank creditors from claiming payments of debts, and the assets of the enterprise were still fettered by the heavy debts. In fact, some enterprises not only were still in distress, but also involved the good enterprises in difficulty because of debts and lawsuits.

Tax deduction and exemption and tax return are in fact a kind of subsidy of the local governments by using the financial revenue of the current period (such as local taxes and the fees for land concession). In rescuing the distressed enterprises, these methods may be used as auxiliary methods to improve the quality of the assets of enterprises. However, the sum reduced, exempted and returned is limited, it is not enough to resolve the distress of the enterprises solely in this way.

(3) The Characteristics of the Purchase-Sale Restructuring Approach of Changchun

Firstly, the Purchase-Sale Restructuring Approach differs from the debt-restructuring mode based on the debts. It does not pay attention to the existing enterprise debts, but to the existing assets of the enterprises. And it is different from the common repayment approach of debt restructuring, which keeps the profitable assets remain in the old enterprises, and tries to decrease the debts imposed on these assets. Practice proves that when an enterprise bears too many debts, the cost of decreasing the debts is higher and it is difficult to decrease the debts. The local governments and enterprises who adopted this restructuring approach tried every means to strive for the financial resources to reduce debts, but it is often in vain or getting half the result with twice the effort. In Changchun approach, the large amount of debts were set aside, and to rescue the productivity (profitable assets and human resources/labor) from the heavy debts by the way of purchasing.

**Table 9: Comparison between Debts of Old SOEs and Profitable Assets
in the Changchun “Purchase-Sale Restructuring” Cases**

Unit: million(RMB)

Name	Special Vehicle	Printing Machine	Vehicle Lamp	No.2 Machine	Electric FurnacePl	Sugar and Wine	Average
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²⁴ Zhang Yunting, *The Debt Restructuring of the State-Owned Enterprises*, Financial and Economic University of Shanghai Press, 2000 edition, Page 138.

Item	Plant	Plant	Plant	Tool Plant	ant	Co.	
Total Liabilities	130.00	91.13	104.84	126.15	128.32	109.53	114.5
Total Assets	66.34	78.27	91.84	84.22	84.37	129.1	74.96
Liabilities-to-Assets Ratio	196%	116%	114%	150%	152%	85%	136%
Purchased Profitable assets	9.56	42.56	21.58	17.98	15	33.5	23.36
Purchased Assets to Total Liabilities	7%	47%	22%	17%	12%	31%	23%

Even though the government has some financial resources, it has to consider two different choices: transforming assets or transforming debts. When the existing debts are much more than the existing assets, the cost of the transforming assets obviously is less than the transformation of debts. According to the data in Table 9, if the approach of putting in funds to pay off the debts is adopted, in order to make the average debt ratio to profitable assets of the six enterprises decline to 60%, every enterprise had to deduct the debts RMB 1 billion, and the cost is four times more than that of taking “Purchase-Sale Approach”.

In practice, if the method of transforming debts is adopted, it must be attempting nothing and accomplishing in the end nothing because of the shortage of the funds. And the outcome is, on the one hand, the debts can not be paid off, and on the other hand, the productivity and the value of the profitable assets would be wasted gradually due to the long-time leaving unused.

Secondly, compared with the other debt restructuring approaches based on the assets, the characteristics of the Purchase-Sale Approach of Changchun are that the hive down of the profitable assets from the debts of the enterprise has been realized and the profitable assets have also been hived off from the non-profitable assets. The debt burden of the assets has been lessened and the operating cost of the assets has been reduced (such as the expenses in maintaining the non-profitable assets). So the difference of the Purchase-Sale Restructuring Approach from the approaches of putting in funds and mergers is that the hive down of the profitable assets have powerful capacity to expand capitals. Sometimes, such assets may become the targets of the enterprise merger. Since these assets have no heavy debt burden and any related non-profitable assets, the efficiency of getting these assets merged is remarkably better than that of purchasing the old enterprise in whole.

In the past practice, there was an approach of “partial merger upon consideration”. There are some points in common between this approach and Changchun Approach. In this kind of merger, the purchaser only bears part of the debts, and gains part of the assets and the whole management right with the consideration of providing technology and management. The targeted corporation is still an independent legal entity, which has independent accounting and assumes sole responsibility for its profits and losses. However, the difference is that this kind of merger still binds the benefits of the merged assets with the other assets and debts of the targeted corporation. Thus, although the property right is hived off, the management body is still the original entity. Neither the merged assets can be made full use to gain management benefits without the fetter of the other assets, nor it can solely get

outside investment through transformation into stock-holding company, or other means. The hive down of profitable assets in Changchun Approach is completely independent. So it can not only independently be made full use to gain management benefits, but also can attract outside investment or co-operation.

5. Legal Analysis of the Purchase-Sale Restructuring Approach

(1) The Legality of Assets Transfer

In 1990's, there was a prevailing practice of the enterprises on the verge of bankruptcy that dodged the debts by hive down. Specifically speaking, part of the assets, which are usually the profitable/profitable assets were picked out and hived off, and then were covered with "a legal entity coat" so as to cut off the relation with the enterprise debts. In many bankruptcy cases, the creditors found that many of the assets of the bankruptcy enterprises were transferred in this way before entering the bankruptcy proceedings. In November 1996, it was pointed out at the national liaison meeting of the presidents of financial claim management banks that "in some local enterprise bankruptcy, the methods of 'hive down first, then bankruptcy', 'cutting off the new enterprise from the old' were adopted, which led to false bankruptcy, but real dodge from debts, and caused the claim banks to suffer great losses." For example, in a certain city of Middle South, "seven commercial wholesale enterprises adopted the practice of 'cutting the new enterprise off from the old one', and the new enterprises took away 46.8% of the assets, but only bore 8.3% of the debts, which caused the Industrial and Commercial Bank of China alone to have bad loans increased RMB 3.14 billion and dead loans RMB 1.17 billion." In a county of Northeast, "there were 52 enterprises that applied for bankruptcy in the first half of the year of 1996, among which there were only 18 enterprises adopting merger, reconciliation and restructuring. 34 enterprises entered the bankruptcy proceedings, and made a concentrated effort to apply to the same court for bankruptcy in a week without the acknowledgement of the bank."²⁵

According to the Article 35 of *Enterprise Bankruptcy Law* of the People's Republic of China (for Trial Implementation), promulgated in 1985, it is invalid to transfer assets without consideration, and only the liquidators have right to recover. But it is difficult for the creditors to apply this provision, because only the liquidators can exercise this right to recover, but the liquidators are usually appointed by the local government. If the hive down of the enterprise was authorized or with the tacit permission by the local government, then how could the creditors hope the liquidators to recover the assets which had been transferred to the new legal entity? Under this situation, the creditors had no way to protect their own interests.

In order to resolve this problem, the article 90 of the *Contract Law* of People's Republic of China, which was promulgated in 1999, stipulates a new regulation, that is, one party hives off after the contract has been entered into, the hived off legal entity or other organizations enjoy a joint right and

²⁵ The annex of information of the People's Bank of China on printing and distributing the summary of the state liaison meeting of the presidents of financial credit management banks (Bank Issued{1996} No.413).

bear a joint liability of the contract. According to this regulation, although liquidators did not recover the hived-off assets, the creditors may have the right to sue or by other legal proceedings to demand the hived-off legal entity to bear the joint liability of the debts.

In Changchun Purchase-Sale Approach, the case is quite different. Firstly, before the old enterprise sold the assets, it disclosed the information to the bank and negotiated with the bank again until reaching an agreement with the bank. Secondly, the old enterprise got corresponding consideration when transferring the assets to the new enterprise and the price was evaluated by the legal qualified valuation institution and agreed by the creditor. Since the old enterprise transferred the assets with consideration, the total value of the assets did not decrease, so the interests of the creditors were not harmed. To put it in another way, it is a kind of sales contract. As long as the contract is not in violation against the provisions of the article 48 to the article 54 of the *Contract Law* concerning void or voidable contracts, then it is valid.

As to the transfer of the right of using land, one method in Changchun Approach is that the government assigned the right of using the land of the old enterprise to the new enterprise. The other method is the government offered the land using right to the new enterprise, but did not charge the cession fee temporarily. According to the current stipulations, these two kinds of methods are permissible.²⁶ The advantage of the first method is that the new enterprise need not pay for the land cost, but there are some restrictions when developing and managing the land in future. The advantage of the second is that the right of using the land can directly be exercised to develop and manage the land, though the owed cession fees become the debts in the account book of the enterprise. Thus, to adopt which method should be decided according to the requirements of using land and financial situation of the enterprise. It needs to be pointed out that, according to the current stipulations, when the state-owned enterprises go bankrupt, the original allocated right of using land is not counted as bankruptcy property, but taken back and disposed by the government (and the cession fees of the land are counted as financial revenue of the local government). If the enterprise is the experimental enterprise according to the rule of the State Council on the experimental enterprises upon optimizing the capital structure of the enterprise and enterprise bankruptcy, the right of using the land should be

²⁶Article 3 of the rule of *Interim Provisions on Allocation of Land Using Right in State-Owned Enterprise Reform* issued by the State Land Administration Department on February 17, 1998 stipulates that “the right of using land involved in the state-owned enterprise reform can be disposed in different ways, such as conveying the land using right, leasing the land, the state subscribing with the right of using the land, and keeping allocated land based on different forms and situations”. Article 2 of *Several Opinions on Strengthening the Administration of the Land Resources to Promote the Reform and Development of the State-Owned Enterprises*, issued by the State Land Resources Department on November 25, 1999 stipulates that “in state-owned enterprise reform, under the approval of the land administration bureau, different ways of disposing and managing the land resources may be adopted, according to the different requirements of the profession, enterprise types, and reform. . . (□) The enterprises that are carrying out the state planned key projects of technological reform, the original allocated land can be used continually as the allocated land, and also can be used as investment (stocks) to put in land resources to the enterprises. As to the other enterprises, who are developing products and improving the technology with the matured technology, the original land can be disposed in the way of conveyance, and the revenue can be counted as the accounts payable and temporarily stay in enterprises to be used completely for the technology improvement, refer to the administration of the loans for technology improvement.”

conveyed, and the conveyance fees should be used to settle the workers.²⁷

(2) The Protection to the Primary Creditors

Different from the above-mentioned method of enterprise hive down, the Purchase-Sale Debt Restructuring Approach of Changchun provides enough opportunity for the primary creditors and other transaction parties to negotiate face to face so that they can reach to an agreement based on the understanding. Obviously, in this type of restructuring, it is impossible to transfer the assets without the consent of the bank, because the first stage of these series of transactions is the bank loan to the new enterprise.

It is worth notice that the enterprise has been insolvent and may apply for bankruptcy when restructuring. So the protection to the primary creditors should be considered under this kind of circumstances. In other words, the liquidation test, which was created in the *Bankruptcy Act* of the USA in 1978, should be used to test the best interests of the creditor.²⁸ In view of current enterprise bankruptcy practice of China, the legal protection to the creditors restrained by the urgent requirements to settle the workers. According to the rules of the State Council on the bankruptcy of the state-owned enterprises from 1994, all the assets of the enterprises must be used to realize the social-policy aims, that is, settling the workers and keeping the social stable. So the creditors can foresee that the repayment in the bankruptcy liquidation is very limited (usually the rate of repayment is 0 to 10%). By contrast, the rate of repayment of the primary creditors in Purchase-Sale Approach of Changchun is much higher than that in liquidation. For instance, in the above mentioned six cases, the average rate of repayment is 26%, and the highest is up to 44.6%. Of course, the bank put in a certain amount of funds to attain this object. But it is an irrefutable fact that the bank gained some good assets, and wrote off some bad debts, when putting in funds. The reason why there are good assets formed is that the debtor of the funds, that is, the new enterprise, has good assets and management prospect. Moreover, the bank can raise mortgage on the purchased profitable assets, such as fixed assets and the purchased right of using the land put in by the government. If the new corporation gains incremental investment from the market, the claim interest of the bank is more guaranteed.

As Article 46 of the *General Rules of Loan*, which was enacted by the People's Bank of China in June 1996, stipulates that "the lender has the right to take part in the debt restructuring of the enterprise in merger, bankruptcy, and transformation into stock-holding system and ask the borrower to fulfill the repayment of the principal debts and interests." In the debt restructuring, the enterprise, as the borrower in the loan, has responsibility to respect the legal rights of the lender. When an enterprise owes debts to several financial institutions, it shall bear the same liability to all lenders. And only when all the lenders' rights have been respected have the liabilities of the enterprise been fulfilled. Specifically

²⁷ See Article 58 of *Land Administration Law* of the People's Republic of China, and Article 6 of *Interim Provisions on Administration of the Allocated Land Using Right in the State-Owned Enterprise Reform*, the State Land Administration Bureau (February 17th, 1998).

²⁸ Article 1129(a)(7), Chapter 11 of the US Code. As John C. Anderson pointed out that "the test of the creditors' best interests is liquidation test, that is, the repayment that the creditor can gain according to the restructuring project should be more than that he can get in liquidation." (John C. Anderson, Chapter 11 Restructurings, 1993 edition, p. 1-20)

speaking, in the purchase-sale debt restructuring, the old enterprise should invite all the lenders to take part in the negotiation and inform them of the relevant affairs. As to whether each lender likes to loan to the new enterprise and get corresponding amount of repayment from the old enterprise and the amount of the new loan supplied by each lender, it is all up to the parties to be decided in the negotiation. If the borrower breaches its duty in restructuring, he will be punished by withholding the loans according to Article 70, section 2 of the *General Rules of Loan*.²⁹ Nevertheless, this punishment is inapplicable to the third party, i.e., the new corporation who purchased the assets.

(3) Fairness to the Middle and Small Creditors

If anyone doubts about the Purchase-Sale Debt Restructuring Approach of Changchun, the fair treatment to the middle and small creditors may be a focus. The middle and small creditors are usually the commercial creditors, such as the raw material suppliers, the construction businessmen etc. Indeed, there are no positions for the middle and small creditors in the restructuring transactions as shown in Table 2-1 in the Purchase-Sale Debt Restructuring Approach of Changchun. From the result of the transactions, there is no payment made to them. Moreover, with the decrease of the assets of the old enterprise, the opportunity for them to make a claim in civil execution proceedings is small. That is why some people blamed this restructuring approach for sacrificing the interests of the middle and small creditors.

Actually, we can not draw such a simple conclusion. We need to conduct a deep investigation.

First, of the transferred assets have already been mortgaged to the major creditors, the middle and small creditors have no opportunity to recover them. Even in the bankruptcy proceedings, the security creditors have the priority over the repayment with the mortgaged assets. It is beyond reproach that if the security creditor agrees his debtor to transfer the mortgaged assets to the third person, and get paid in the transferring transaction. According to Article 49 of the *Security Law* of People's Republic of China, after the mortgagor informs the mortgagee, he can transfer the mortgage, the money that gained from the transfer should be paid for the debts of the mortgagor first. In practice, the main assets of the many debtors have become the mortgage of the primary creditors. The remainder that can be recovered by the middle and small creditors, without security, is usually few.

Of course, according to the stipulation of the law, the non-security creditors can recover the exceeded part that the value of the mortgage is more than the debt amount. However, it is a question to determine the existing of this excess. On the one hand, in each restructuring case, the bank debts had not been paid off. On the other hand, the going-concern value of the special production line of the industrial enterprise will be much devaluated in the auction in the market or in the division sale, so it is very difficult to prove the fact that the primary creditors gain illegal interests.

²⁹ Article 70, Section 2 of the *General Rules of Loan* stipulates that "the borrower violates any other provisions in Chapter 9 of this general rule, which leads to the failure to repay the debts, the lender may stop loans and take back the original loans ahead of time. The borrower and the person in charge or other individual who causes the losses of the assets should bear the liability of paying all the compensation or part of them. Prior to the fulfillment of the liability, any other lender shall not loan to him."

Second, if there is no mortgage on the main assets, and the insolvent enterprise has not entered into the bankruptcy proceedings, then the rule of the game is individual repayment, which means that the law encourages the practice that the swift-footed arrive first. In China, at present, it is a common phenomenon that it is difficult to sell the production line of the distressed enterprise in division. Because it may result in much value wasted. However, neither the middle and small creditors nor the court can easily find a purchaser who is willing to purchase the assets in whole. The transaction cost is considerable. That is why the middle and small creditors can not get paid with these assets before the large creditor gets payment. In this case, if the primary creditors are prohibited from rescuing these assets as the going-concern entity, while the middle and small creditors can not give any help, then the fate of the enterprise in distress is bankruptcy and close-down. This result has no good to anyone. In the current bankruptcy proceedings for state-owned enterprises, the opportunity of getting the payment for the common creditors, (middle and small creditors usually belong to this type), is small. So, from the view of substantial justice, in the restructuring, it is more reasonable to carry out the rule of “all participants getting benefit” (i.e. who that takes out money to save the enterprise shall benefit from it) than the situation in which “everyone waits for a free lift”, (which leads to the fact that no one gets the lift).

According to the current *Enterprise Bankruptcy Law*, the individual repayment for the due debts before the court accepts the case is not restricted by the bankruptcy proceedings. So if there is no legal revocable reason, other creditors can not revoke the individual repayment in the later bankruptcy proceeding.³⁰ Of course, in theory, the middle and small creditors may apply for bankruptcy to stop the individual repayment that the enterprise pays to the primary creditors before the transfer of the assets. Nevertheless, there are many restrictions for the creditor to apply the debtor bankruptcy in the current bankruptcy practice of China. It should be paid more attention to the proceeding obstacles that the court set when it accepts the application of a case. For example, in some areas, the court requires submitting the settlement plan of the workers when applying for the state-owned enterprise bankruptcy. Obviously, it is difficult for the creditors to do so. The other restriction is the market relation. At present, Chinese market is the buyer's market, the customer resources are the living conditions for enterprises. The supplier always worries the fact that his voluntary application for the bankruptcy of his primary debtor will make him lose many clients, because the image of “cold-bloodness” may frighten the clients away.

Nevertheless, as we can not say that the interests of the middle and small creditors can be ignored just as we can not agree with the law that the weak are the pray of the strong. Justice and balance are always the basic rules of the commercial society. In the debt restructuring practice of Changchun, the middle and small creditors let their voice be heard by some means. For example, in some cases, the new corporation is troubled continuously by the middle and small creditors, who require it to bear the debts

³⁰ Nevertheless, the draftsmen of the new bankruptcy law of china advocated restrictions on the individual repayment before bankruptcy. There are such stipulations as: in the six months before the court accepts the bankruptcy case, though he debtor knows that he can not repay the debts, still pays to some individual creditor so as to damage the interests of the other creditors, the administrator has right to apply the court to revoke the payment.” If this stipulation had been adopted, this debt restructuring of individual repayment to the primary creditor will be challenged by the application of bankruptcy in six months.

of the old enterprise. The remedy that the new corporation provided to them is to keep a long-term contractual relation and give some preferential treatment. Some of them accepted this deal. In fact, they are not contented with such deal, but they understand that they have no choice but accept the sad reality under the current legal system.

Third, with a further analysis, we can find that the claims of the middle and small creditors can be categorized into two types:

a) The claims that need to be paid with the bankruptcy assets in bankruptcy proceeding are as follows:

- Unsecured claims (including non-security assets, no guarantors);
- Secured claims but the secured assets are not enough to pay off the debts.
- The recourse right of the joint debtor of the old enterprise because it substituted for paying off the debts. These claims are expected to be paid off with the bankruptcy assets of the old enterprise. And it is in the last order to be paid in the bankruptcy distribution, so the decrease of the old enterprise assets means the damage of their payment interests.

b) The claims that need not be paid with the old enterprise assets in the bankruptcy proceedings. There are two types:

- The claims secured by adequate property (such as mortgage, lien);
- The claims that the guarantor has adequate capacity to pay off the debts. The interests of this kind of creditors will not be influenced by the floating of the assets in the debt restructuring.

Fourth, generally speaking, in the assets transaction practice of the enterprise debt restructuring, there may appear following conducts:

a) The old enterprise individually pays the primary creditors and the workers with the money gained in transferring the profitable assets.³¹ Although it is individual repayment, and it does harm to the other creditors, it is not illegal according to the current law in China.

b) The old enterprise transfers the assets or leased the assets, but the opposing party has not paid the consideration or rent yet. It actually may be regarded as free use without charge. But since there is a payment liability, after the old enterprise goes bankrupt, the liquidators may recourse the owed funds from the transferee and the leaseholder.

c) The old enterprise uses part of the machines and equipment as investment in the new enterprise. The right of the investment still belongs to the old enterprise, and it is counted as the bankruptcy assets when the old enterprise goes bankrupt.

d) Part of the assets of the old enterprise is allocated to other enterprises without payment. In this situation, the creditor may claim legal remedy. Any free appropriation of the enterprise assets is restricted by Article 35 of the *Enterprise Bankruptcy Law*. Moreover, if the practice of hive down is adopted, it shall be subject to Article 90 of *Contract Law*. Therefore, except for the first situation, the interests of the creditors can be protected by the law.

³¹ The individual repayment to the workers and staff included wages payable, welfare funds, housing turnover funds, special funds payable, etc.

Fifth, in the cases of Purchase-Sale Debt Restructuring Approach of Changchun, the method of “three parties negotiating and the government assisting” was adopted. During the negotiation, the parties did not inform or disclose to the middle and small creditors the relevant affairs about the debt restructuring. Since the transfer of the assets gained the permission of the workers’ congress, the rights of the workers are considered and protected fully in the restructuring. In the current bankruptcy practice, the government and the court took priority over the workers, while the middle and small creditors had no chance to express their objection and improve their positions in the bankruptcy distribution. This situation is reflected in the interest order in the debt restructuring out of court. However, different from the bankruptcy proceedings, in the restructuring out of court, the claim right of the creditors, who did not take part in the negotiation, would not be wiped out. So in the above-mentioned cases of Changchun, it is understandable that some creditors demanded the new enterprise to pay the debts of the old enterprise even sued the new enterprise for the debts. We can say that the current method can not adequately protect the middle and small creditors’ right to be informed and right to object in restructuring, and it is not fair enough and also brings about the cost of coping with the aftermath to the new enterprise.

Sixth, in some cases of Purchase-Sale Restructuring Approach of Changchun, the new enterprise provided new business opportunity for the middle and small creditors of the old enterprise, who are mainly suppliers of the raw materials and accessories, such as continuously purchasing raw materials, keeping cooperation in products, which made them get benefits indirectly from the enterprise debt restructuring. In some cases, the new enterprise also gave preferential treatment to these “old clients” in price and other transaction conditions. It is reported that some creditors showed understanding and positive co-operation, because if the old enterprise went bankrupt without restructuring, the middle and small creditors could hardly get anything after settling the workers, paying the priority creditors and turning over taxes. Moreover, the bankruptcy of the old enterprise means the decrease of their business clients and stopped co-operation. By contrast, the restructuring may bring more benefits than the liquidation in the bankruptcy proceedings.

With the above analysis, in the enterprise debt restructuring out of court, the enterprise in distress would bear the transaction costs of individual negotiation with many creditors, because of the shortage of the consistent and mandatory proceeding system. If sacrificing the efficiency to realize the proceeding justice, the final result is that every party loses. However, the short-term efficiency at the price of justice will damage the long-term efficiency in the market. The interests of the middle and small creditors and the interests of the new enterprise, the old enterprise, the bank creditors, the workers and the government are not balanced in fact. The former is basically in a disadvantageous position, such as detained payment, inadequate information and lack of opportunity in participation in the negotiation. Moreover, it is important that the transfer of the assets in restructuring was based on the latter’s interests, and the possibility of damages to the former’s interests was ignored. This situation will lead the middle and small creditors to decrease the trust in the current legal system, which may cause them to seek other kinds of protective measures, such as lump-sum payment transaction or endless claims for debts or lawsuits. As a result, it will increase the cost of the market transaction. And it may also make the suppliers of marketable products unwilling to sell on credit to the state-owned enterprises that owed

much to banks.

(4) Consideration about the Interests of the workers

In China, the problem of settling the workers is one of important concerns of the current policy makers. It is important to consider the interests of the workers not only in the bankruptcy proceeding but also in the debt restructuring out of court. In the case of restructuring out of court, it must be more careful to settle the problems concerning staff and workers, because after the court makes the decision of distribution, it is mandatory to all the interested parties. However, the disposal agreement made in the debt restructuring is not mandatory to the workers. And the workers in state-owned enterprises normally thought that they were the owners of these assets. Obviously, the assets transfer agreement were discussed and passed by the workers' congress in the cases of Purchase-Sale Restructuring Approach of Changchun, and the majority staff and workers were employed by the new enterprise. It is understandable that the workers concerned much about employment. The transfer of the profitable assets brought about new employment opportunity in this assets transaction, and the workers became the first beneficiaries. Moreover, keeping employed is closely related with social stability, so the local government is a beneficiary too.

Generally speaking, the workers employed by the new corporation could not automatically cut off their special labor relations with the state. Because of system of low wages and high welfare, named "iron bowel" in the planned economy, the depreciation of the labor was actually put in "the big pot" of the finance. Now, if the state wanted to break the "iron bowel" and take the "big pot meal" away, then the state had to pay the workers compensation for it. However, the finance has no capacity to bear this debts left behind by the history. The assets of the enterprise are the only guarantee. So if the enterprise is the solely state-owned enterprise, on the one hand, the workers can clearly distinguish the old historical debts with the state from the labor contract with the new enterprise; on the other hand, they would not abandon their status of the state-owned enterprise permanent staff easily just because they were hired by the new enterprise. So, if the state wants to get rid of the original labor relationship, it must pay compensation. When the new corporation carries out transformation into stock-holding system, it is permissible to compensate the workers either in the approach of converting the existing assets prior to the transformation to compensate the workers then converting this part of assets into shares held by the workers, or in the approach of converting the state assets into shares, then using these shares to compensate the workers.³²

(5) Proper Consideration about the Market Environment

As to the market environment, people usually pay attention to the functions of the government. According to the views of some scholars, there are too much government participation in the Purchase-Sale Restructuring Approach of Changchun, so it is against the "principle of free contract".

³² It needs to be pointed out that, if the profitable assets were not separated from the debts, converting the assets into shares to compensate the workers means cheating the workers into abandoning their rights of claiming compensation with the bad assets. It is unfair. Because when insolvent, the enterprise's net assets are zero or negative.

This idea is too general. At first, we must realize that the government is the owner of the enterprise in distress. In the market economy, nobody will deny the right of the owner to take part in the restructuring process involving his property. Secondly, in the practice of Changchun, the local government is the main investor. It took out money to save the enterprise, at the same time it saved the creditors. It is legal according to the law of China. Thirdly, during the negotiating process, Changchun government respected the free contractual right of the parties, especially that of the primary creditors. Since the local branch of the state commercial bank is independent to the local government, and it is up to the bank to agree to the assets transaction. The interference of the local government in the transaction is little. Fourthly, when there is conflict of interests of the parties and multiple administrations, the coordination of the local special department can decrease much cost of the transaction and improve the efficiency of rescuing the enterprise. It is proved by the experience of the many countries, including China.³³

Another element that people pay attention to is the market environment. Good faith is an important principle in market transaction. The legal policy of current contract law and bankruptcy law restraining default conducts, but it does not prohibit flexible methods to resolve the dead and bad debts by negotiation. As advocated by economists, every operating body should bear the liability by itself, and it should not externalize the costs and the risks, that is, transferring the costs and risks to other market participants. Nevertheless, in reality, this saying is not absolutely right. We have good reasons to believe that the healthy economy indeed needs a social mechanism to resolve the unexpected market risks. It is good to encourage parties to resolve the problems caused by the enterprise bankruptcy via negotiation. The effective running of this mechanism depends on a series of legal regulations, and it is critical to give fair opportunity to participate and increase transparency. Practice has proved that the common interests between the parties are only the objective basis for agreement. Without good faith, it is impossible to reach unanimous restructuring agreement through negotiation. We can say that the trust between the bank and enterprise and the trust between the managers and the workers are the key to the success of the restructuring.

In the view of market credit, giving the middle and small creditors an opportunity to take part in restructuring is not only good to the balance of the interests between the parties, but also good to the credit of the restructuring enterprise. After all, the successive relationship of the assets between the old enterprise and the new is well known. The method of ignoring the middle and small creditors, (called operating in a black box), negotiation among the minority and damaging the interests of the majority, will make the enterprise fall into the discredit of harming others to benefit oneself. So, the debt restructuring of the enterprise should seek the interest coordination in the greatest degree. And the government department, who guides and helps the enterprise to restructure, should try to remain neutral in protecting the interests of all the parties. Moreover, protecting the middle and small creditors to a great extent means safeguarding the credit of the local market, and promoting investment and business.

³³ The government of Changchun set up an Enterprise Reform and Economic Structure Restructuring Office, led by a vice-mayor, to provide remarkable policy guidance and coordination in the debt restructuring.

4. Summary

According to the analyses above, with reference to foreign experience, some key concepts in debt restructuring of SOEs of China can be theoretically summed up as follows:

1. To be specific, the most contribution of the practices of debt restructuring either in Changchun or in Helongjiang has not only provided some kind of approaches for reference, but also proved a simple and profound truth that we should keep on developing and utilizing **market methods and market resources** rather than simply rely on the policy tools and governmental resources to rescue the SOEs.
2. If we say that the approaches of Changchun used the transferability of assets successfully, then the case of Helongjiang Glass Factory used the transferability of creditor's rights effectively. The **market transaction of assets and that of claims** is of significance in using market means and resources to restructure the debts of SOEs.
3. Of course, **governmental functions and state-owned economic resources** are also very important. As to the functions of government, the **function of owner and that of coordinator** are the most basic. The goal of the function of being owner is to push assets of the enterprises into market. The process of assets transaction in the debt restructuring is in some degree the process of putting state-owned assets into market. It is impossible for the problems concerning the debts of SOEs and settlement of workers of SOEs etc. to be put into market if the state-owned assets are not put into market. The primary significance of the function of being coordinator lies in promoting the negotiation between the related parties and eliminating sorts of obstacles and resistance from governmental power system. In order to carry out these functions more effectively, it is considerable to establish a kind of **special government agency**. To avoid repeating the old manner of the government taking care of everything, it needs to clarify the tasks and functions of such a special agency by virtue of laws and regulations.
4. As to the function of resources of state-owned sector, two main parts need to be paid attention to in the process of debt restructuring: **resources in stock and increased resources**. There are two most important kinds of resources in stock. One is aggregated working assets such as all kinds of economic resources tangible or intangible, monetary or material, substantial or manpower, listed in the book or not in the book which may contribute directly or indirectly to the profits of the enterprises. Another is the right of using land. Meanwhile, increased resources comprise of two parts. One is financial revenue received, and the other is financial revenue receivable. The received is invested mainly in the way of direct or indirect financial funds or financing, while the receivable is invested in the form of reduction, postponement and exemption of taxes payable and fees for transferring the right of using land etc. Besides, the financial policy, industrial policy, basic infrastructure construction, financing technical innovation, and social insurance made by the State should provide favorable conditions for rehabilitation of SOEs.
5. The valuation of assets and business prospects of enterprises before the restructuring of the enterprises is critical for the success of the restructuring. It should be noted that the valuation could not be solely made based on the financial statement or the achievement in the production and sale. In the valuation of assets and business anticipation, the comparison between **going-concern value and liquidation value** should be paid attention to, and the ability of

production, occupied shares in market, competition, profits, technology exploitation, investment attraction should be evaluated synthetically.

6. **Restructuring plan** is the result of the negotiation among multi-parties. The disclosure of information during the restructuring is one of the most important conditions needed to get the assistance of the creditors. Restructuring plan should be approved by multi-parties such as the workers, the department of government in charge, and the creditors. The plan should be made according to the concept and methods of market transaction, and based on equality and willingness. In the making and execution of the restructuring plan, *intermediaries* such as lawyers, accountant, assets assessor, investment consulting company, and assets entrust company etc., will play an important role.
7. It is especially important for restructuring and recovery of SOEs to respect well enough the **workers' democratic rights and labor rights**. It is not only because of the special position of workers of SOEs based on the historical and legal reason,³⁴ but also because of the special contribution of their technology, organization, discipline, and perfect characters to the intangible assets of the enterprises.
8. **Concession of the creditors and input of increased assets** are two conditions indispensable to successful restructuring and rescuing of enterprises. Creditors should make certain about their boundaries of concession contrasted with the rate of repayment in the case of bankruptcy liquidation. Creditors' overemphasis on their own interests and persistence in non-concession is in fact irresponsible for their own interests. To save their interests at the same time of rescuing the enterprises, the creditors should do their best to "inject blood" into the enterprises in all kinds of ways. Meanwhile, it is feasible and beneficial to introduce investment from third parties in many ways.
9. It is only the beginning of recovery of the enterprises to improve their financial positions through debt restructuring. To gain the survival and development in a long term, the enterprises should carry out their **re-capitalization and technology improvement**, optimize their mechanism of operation and strengthen their positions in the market continuously. The re-capitalization of the enterprises can go along with the transformation of SOEs in line with the stock system.
10. Since before the restructuring, the old enterprises were insolvent and part of the assets were ineffective, it is an inevitable and unavoidable fact that creditors' rights will be devalued. Therefore, one of the tasks is to **allocate the losses of the creditor's claims impartially**. One form of the allocation is to dispose of the creditor's claims at a discount in the transaction. The other is to extinguish the claims after the bankruptcy liquidation of the old enterprises.
11. The principle that **"participants are benefited"** from the debt restructuring is good to encourage the transfer of constructive assets and active concession of creditor's claims, which may save the cost of the negotiation. It should be noted that all the creditors should be given the equal opportunities to participate in the restructuring.
12. In short, the **coordination of multi-goals** should be achieved in the debt restructuring of enterprises. In various debts restructuring of enterprises hitherto, there are three goals to be

³⁴ Article 9 of *State-owned Industrial Enterprises Law* of the People's Republic of China, still effective now, stipulates: "The state safeguards the owner position of workers, and the lawful rights and interests of workers are protected by the law." Article 10 stipulates: "Democratic management is implemented in the form of workers' representative assembly and other forms."

attained. The first one is to relieve the distressed enterprises (or at least to rescue the profitable assets of the distressed enterprises); the second is to keep employment and settle the workers; the third is to protect the claims of financial creditors, especially those of bank creditors. All the goals are the social issues that lead great pressure to the government at present, and the practice has proved that the three goals can be attained in one go. However, few people place the achievement of *fair repayment to all creditors* in the prominent or at least an important position. The issue of the achievement of fair repayment to all creditors may be not urgent to the government at the moment, but for a long run it should be attached importance, because fairness and good faith are vital to establish a healthy and efficient market. Therefore, how to realize the coordinated achievement of the three goals is a topic waiting for further study.