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Bankruptcy Reorganization in China and the United States: Cautions for the Comparativist*

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Abstract: In the late 1930's Americans developed their first comprehensive law of bankruptcy reorganization. In larger cases, that law provided for the appointment of a trustee and seizure of control of the business from the business's prior control group. In 1978, that was all changed: the prototype in the United States now leaves the "debtor in possession" charged with operating the business for the benefit of the business's creditors. In this and many other ways, America's law differs substantially from China's relatively-new bankruptcy law. This article briefly looks at some of the stronger differences between the two systems and gives some background to how and why the American system evolved from the older model to the newer one. While we might easily identify many fundamental differences between the American and Chinese systems, drawing normative policy recommendations from those differences is a much more challenging task. One might, of course, be tempted to do so anyway. But the differing cultural, legal, and economic contexts within which bankruptcy reorganization exists suggests that one so tempted should proceed very cautiously and, perhaps, with an extra measure of modesty as well.

Key Words: Bankruptcy Reorganization, Debtor in Possession, Business Control

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Introduction

Studying the law of other legal systems is becoming increasingly important in a globalized world. But it is not easy. Any legal system is embedded within, and reflects, the culture and history of the place where it operates; foreigners -- even those with command of the language -- have very limited access to a deep understanding of another country's system. The more distant the history and traditions of the foreign country, the more impenetrable will the legal system be to outsiders.

So it is with the Chinese legal system and, in particular, its new law governing bankruptcy. While there is a good English translation of the law, the language often does not map well. But far more important, the Chinese bankruptcy law exists within a legal tradition that can only be described as alien to that of the United States.[1]

I had the unique opportunity during Fall 2007 to teach the American law of business reorganizations in China, a mere three months after China's new bankruptcy law became effective. The course was in English, and delivered to a group of very talented Chinese lawyers in an LL.M. Program that is a collaboration of Temple University in Philadelphia and Tsinghua University in Beijing. While I was incapable of teaching the Chinese law, it was inescapably relevant to our study of the American system, if only in its sharp contrasts with American law. Comparing the Chinese law with the American law, even in a crude way, offered me insights into the American system that would be far more difficult to perceive otherwise.

What stood out beyond all other differences was, perhaps, the American system's different way of treating business debtors in reorganization cases. Those differences, and their policy implications, are important for both the American and the Chinese systems. It seemed worthwhile to briefly outline those aspects of the American system that seem so different so that they might offer some insights for Chinese lawyers about their system in much the same way the Chinese system offered insights to me.

The second Part of this short article will be a sketch of the broad differences within the two systems, insofar as they concern the business debtor's control over the reorganization and related power *vis a vis* its creditors. The third part will then briefly consider the historic and ideological sources for the American approach, its weaknesses, and its implications for addressing the problems of financially distressed businesses.

Part II

A. Orientation

At the outset, one would expect Chinese bankruptcy law to be very different from the law in the United States. China's bankruptcy law was drafted against a very different set of economic and legal assumptions. It was drafted in the context of an economy that still includes many State Owned Enterprises (SOEs) on whom employees are far more dependent than employees in the US, and whose economic demise can spell a deeper disaster for those people dependent on them. In such an environment, one expects the State to have a greater interest in involving itself in the

1. Simple examples can suffice. China's highest court has over 300 judges while the United States Supreme Court has nine; China follows an inquisitorial trial system while that of the United States can be described as finding truth through battle, and China's Constitution might be better viewed as a planning document than a set of constraints applicable to all those who wield power. See generally Daniel C.K. Chow, The Legal system of the People's Republic of China in a Nutshell (West Group 2003).

financial problems of its businesses. At a more basic level, China's underlying theory of the State and its relationship to its citizens, the relationships of its citizens to one another, and the legal system that emerges from a collectivist rather than individualistic set of assumptions, inevitably informs and sharpens one's understanding of the workings of Chinese law. Someone from a culture not immersed in these assumptions will have great difficulty understanding the new law, if it is even possible to do so.

So it is with the American system. The United States has a near-religious faith in the free market and this faith grew during the 1970's and 1980's. It may be the only modern industrialized country in the world without strong job security for working men and women.[2] It has a very weak social safety net. The American image tends toward individualist, demanding of most citizens that they fend for themselves. There is a deep suspicion of government involvement in economic matters that probably grew with the new faith in the free market.

The 1978 Bankruptcy Reform Act ("the Code") was a wholesale revision of the 1898 Bankruptcy Act that had, itself, been deeply revised in the 1930's during the Great Depression. Efforts to revise the American law began in 1970, at the same time that consumer and environmental law were increasingly being recognized in Congress and the courts,[3] and at the very beginning of the counterpoint movement that would become known as "law and economics".[4] While American bankruptcy law was changed in minor ways several times after 1978 and substantially revised in 1984 and 2005, none of the post-1978 revisions addressed in a fundamental way the relationship between the business debtor and its creditors, and the debtor and the reorganization process itself.

B. Control of Legal Status

1. Filing is Bankruptcy

An American reorganization case *formally* begins when the debtor or a creditor files a bankruptcy petition.[5] It is arguably the same in the Chinese system.[6] But even at this threshold level, the two systems could scarcely be more different.

In the United States, the filing *is* the "order for relief" in a voluntary case.[7] That means that the debtor can alter its legal status *vis a vis* its creditors by an act of its will. Having near complete control of the timing,[8] the debtor can therefore useBand threaten to useBthe voluntary filing strategically. Much like its American counterpart,[9] the Chinese law requires that the debtor's application contain many specifics. But, significantly, in China's bankruptcy law, the debtor "applies" for bankruptcy[10] and the law contemplates an "acceptance" of the bankruptcy

2. See Stewart Macaulay, John Kidwell, and William Whitford, Contracts: Law in Action 336 (2003).
3. See Ralph Nader, Unsafe at Any Speed: The Designed-in Dangers of the American Automobile (1965); Rachel Carson, Silent Spring (1962).
4. See Richard Posner, Economic Analysis of Law (1973); Arthur Alan Leff, Economic Analysis of Law: Some Realism About Nominalism, 60 Va. L. Rev. 451 (1974).
5. 11 U.S.C. §301 (2000).
6. Article 7 provides that "Where the debtor fails to pay off its due debts, it may file an application with the people's court for revival or bankrupt liquidation."
7. 11 U.S.C. §301 (2000) ("The commencement of a voluntary case under a chapter of this title constitutes an order for relief under such chapter.")
8. The literature makes it clear that, while the debtor may have legal control over the decision to file, others can come close to controlling that decision through their leverage. See, e.g., David A. Skeel, Jr, Creditors' Ball: The "New" New Corporate Governance in Chapter 11, 152 U Pa L Rev 917 (2003).
9. Most of the specifics required under American bankruptcy law are specified in the local rules and (effectively) in sample forms.
10. Article 8.

petition in every case, generally within 15 days of receipt of the application.[11]

The implication of this difference is important: unlike its American counterpart, the Chinese court need not "accept" the application[12] and, given this, one can imagine at least some creditors attempting to persuade the court to keep the debtor out of bankruptcy in some cases. In China, to achieve the change in legal status, the debtor has to sustain a burden of meeting the legal criteria that are a predicate for bankruptcy. In the United States, the status of bankruptcy in voluntary cases is almost entirely in control of the debtor.[13]

2. Insolvency Is Not Required

It often comes as a surprise to students of American bankruptcy law that no form of insolvency is required before a business debtor can enter bankruptcy through a voluntary petition.[14] Put differently, a business that is perfectly healthy financially can begin an American bankruptcy proceeding.[15] This has led both to abuse[16] and to innovative uses of bankruptcy such as John Manville=s use of the bankruptcy process to address its pervasive products liability problem in the 1980's.[17] But, perhaps equally important, the absence of such threshold criteria further vests the decision about bankruptcy status in the debtor, and eliminates the front-end complexity of proving (or defending) a "need" for bankruptcy.

China's law requires an "acceptance" of the bankruptcy application in a voluntary case and, presumably, an adjudication that the debtor is properly within the bankruptcy system. The general criteria, familiar to those in the field, are roughly equitable insolvency (generally not paying debts as they become due)[18] and bankruptcy insolvency.[19] Apparently, some evidence that the debtor meets the criteria will be required. This will entail at least some expense and delay and, of course, a debtor will never be certain that its application will result in "acceptance" of the application. Its ability to threaten a bankruptcy filing or to use voluntary bankruptcy in a strategic way is vastly inferior to that of a debtor with access to American bankruptcy law.

3. Debtor Leverage Implications

The implications of these major differences are deep and pervasive. One immediate ramification of the American debtor's power is the automatic stay. At the moment the debtor files its petition, an automatic stay, purporting to be effective all over the world,[20] arises by operation of law.[21] This allows the debtor to stop a pursuing creditor dead in its tracks[22] and convert the

11. Article 10.
12. Article 12.
13. There are limits in the United States: one cannot file a bankruptcy petition in "bad faith", and a voluntary filing is open to such a challenge. See, e.g.,In re SGL Carbon Corporation, 200 F. 3d 154 (3d Cir. 1999). But successful challenges are few and far between, Elizabeth Warren and Jay Lawrence Westbrook, The Law of Debtors and Creditors 430 (5th ed. 2006). Perhaps as important, they are challenges that require creditors to take the initiative and sustain their argument to the satisfaction of the court.
14. See J. Trost, G. Treister, L. Forman, K. Klee, R. Levin, Resource Materials: The New Federal Bankruptcy Code, 251 (1979) (hereinafter Resource Materials).
15. All filings are subject to a challenge on the basis of bad faith.
16. See, e.g., In re SGL Corporation, 200 F. 3d 154 (3d Cir. 1999).
17. See David A. Skeel, Vern Countryman and the Path of Progressive (and Populist) Bankruptcy Scholarship, 101 Harv. L. Rev. 1075, 1097 (2000).
18. Article 2 expresses the concept "Where an enterprise legal person fails to clear off its debts as due…or if it is obviously incapable of clearing off its debts".
19. Article 2 includes the language "and if its assets are not enough to pay off all the debts".
20. 11 U.S.C. §541(a)(1).
21. 11 U.S.C. §362.
22. Once the creditor is on notice of the bankruptcy case (the debtor's lawyer will ensure that notice gets to pursuing creditors), further pursuit of the debtor can result in sanctions for contempt of court and damages for the debtor. See, e.g., Nissan Motor Acceptance Corp. v. Baker, 239 B.R. 484 (N. D. Tex. 1999).

expense the creditor has sustained in chasing the debtor into a wasted expense. As one would expect from the logic of the Chinese system, China's analog to the automatic stay does not arise until the court accepts the application.[23]

In addition, in the United States, the act of filing the petition creates a bankruptcy estate consisting of all the debtor's property, broadly defined;[24] the automatic stay enjoins creditors from disturbing that property.[25] Once again, China's law produces a similar result only from the time the court accepts the application.[26]

In the United States, the debtor's unilateral (and largely unfettered) ability to deeply alter its legal status and to confer onto itself powers that it lacks outside of bankruptcy is a form of leverage that operates independently of the actual bankruptcy filing. By filing a bankruptcy petition, the debtor acquires the power to avoid various pre-petition transfers including seizures of the debtor's property and payments extracted by threat of legal seizure. The debtor's exercise of these powers can convert a creditor's sunk costs on collection efforts into wasted expense. Whether consciously or unconsciously, the American formulation seems designed to generate a negotiation among the debtor in distress and its creditors, a negotiation that would be far less likely were the debtor not to have nearly complete control over its entering bankruptcy.

Knowledgeable players know these basics and therefore will consider them when deciding how best to collect their debts. Most creditor seizures will be preceded by some communications with the debtor, if only dunning letters. Seizing property costs money, some of which may not be recoverable; a creditor can generally get a better net return if the debtor can be convinced to pay voluntarily. The content of these negotiations will be far richer because the debtor has the power to shift the tables by filing a bankruptcy petition.

Because the debtor can *always* make a realistic threat of voluntary bankruptcy, the creditor's eventual Chapter 7 distribution (whatever it might be projected to be) becomes a reference point almost as important as the face value of the debt for that negotiation. One can see the enhanced potential for compromise because bankruptcy law injects a counterweight into the negotiation that would be absent otherwise. The Chinese system offers no comparable negotiating tool to the debtor, at least on the face of it.[27]

C. Business Control within the Reorganization

Like former Chapter X of the American Bankruptcy Act,[28] a Chinese business bankruptcy has, at its center, a bankruptcy administrator in whom the law seems to place most of the decisions that will affect the future direction of the business.[29] American bankruptcy law took a major departure from that model in the 1978 Bankruptcy Code by giving the "Debtor in Possession" ("DIP") the powers of the bankruptcy trustee and having that debtor in possession substitute for a court-appointed trustee in nearly all cases.[30] Moreover, under the Code, the DIP is permitted to

23. See, e.g., Articles 16 and 20.
24. 11 U.S.C. §541.
25. 11 U.S.C. §362(a)(3).
26. E.g., Articles 17 and 18.
27. Whether, owing to different cultural practices, Chinese debtors and creditors negotiate more (or less) than their American counterparts when the debtor encounters financial distress is unknown. It seems clear, however that, all things being equal, the American system has facilitated or encouraged negotiation by altering a playing field that would, in the absence of a debtor- controlled bankruptcy process, be very unbalanced.
28. Act of June 22, 1938, ch. 575, 52 Stat. 840, repealed by Pub. L. No. 95-598, 92 Stat. 2549, 2682 (1978).
29. E.g., Articles 13, 17, 18.
30. See Resource Materials, supra n.14, at 265-69.

run the business and enter into "ordinary course" transactions as it sees fit.[31]

Allowing the DIP to substitute for the trustee, of course, saves money for the estate. A trustee would nearly always be an add-on expense (at least until the ranks of management were trimmed). For any but a very simple business, there would be a substantial learning curve for a new manager that would produce an interruption of the normal routine of the business.[32] Whether these savings offset the substantial problems this arrangement brings is the real question.[33]

Most obviously, many would say that the DIP is precisely the *wrong* person to continue to run the business. After all, the argument goes, this is the team that was instrumental in bringing on financial woes; to allow them to continueBmuch less to continue with an enhanced set of legal tools, is to force creditors to throw good money after bad. Defenders might argue that not *all* financial distress is the result of bad management decisions and. in those cases where outside forces have played a major role, positive harm would result to creditors from replacing the debtor's management team. American law seems partly to reflect a view that the negative effects even of bad management are offset by the speed and saved expense of leaving the debtor's management in place.

There is also a very practical and difficult conceptual problem with debtor control. The DIP is a different legal entity than was the debtor that preceded it. The trustee, in whose shoes the DIP stands, is a fiduciary for the debtor's creditors. Is it possible for the DIP, who may have had an antagonistic relationship with its creditors before the filing, to selflessly act in their best interests after the filing? Not doing so, at least in an obvious way, can be grounds for the appointment of a trustee.[34] But between these extreme cases and the fiduciary ideal, slippage -- perhaps extreme slippage -- is bound to occur. Are the negative effects offset by the positive ones? No one really knows.

D. Control over the Reorganization Plan

The Bankruptcy Code gives the Debtor an Aexclusivity period@ within which to file a Plan of Reorganization.[35] During that period, while the debtor is running the business, it is also attempting to reshape its future through some sort of business plan and to create around that plan a Reorganization Plan to implement it. Other parties to the reorganization have no access to the business planning of the debtor,[36] and the DIP often does not present its Reorganization Plan until the end of the 120 day period. After that, the DIP has another 60 days while creditors react to it.[37]

Vesting the DIP with this planning period can, in bad cases, simply hold creditors at bay for an additional 6 months as the Debtor slides further downhill. Both businesses that are potentially viable, and businesses that are hopeless have this ability under the Code to effectively postpone the day of reckoning; there is no mechanism within the Code for an independent assessment of a business's potential viability.[38] Management has many personal economic incentives to be

31. 11 U.S.C. §363(c)(1).
32. H.R. REP. 95-595, 1978 U.S.C.C.A.N. 5963 (hereinafter cited as "House Report"), at 233.
33. This question has dogged US commentators for years. See Lynn LoPucki, The Debtor in Full Control: Systems Failure Under Chapter 11 of the Bankruptcy Code (First and Second Installments), 57 Am. Bankr. L. J. 99 and 247 (1983).
34. E.g., In re Sharon Steel Corp., 871 F.2d 1217 (3rd Cir. 1989).
35. 11 U.S.C. §1121(c).
36. See Lynn M. LoPucki and William C. Whitford, Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies, 141 U. Pa. L. Rev. 669, 692 (1993).
37. 11 U.S.C. §1121(c)(3).
38. See Lynn LoPucki, supra n.33, 258-61.

optimistic.[39]

E. Control of Venue

China's law places venue where the debtor is domiciled, apparently supplying little or no choice about where to file the bankruptcy case. The law in the United States is very different in that it permits a considerable amount of choice about where an enterprise might file its Chapter 11 case. Among other places, the case might be filed where the debtor has its principal place of business, where its assets have been located for the 180 days prior to the filing, or where it is domiciled which, under American law, includes the place where it is incorporated. Combined with the control the debtor has over when to file, and over the estate once the case is filed, this difference makes the two systems stand in very stark contrast.

In the business bankruptcy area, venue shopping in the United States has become a focus of heated debate. In America's largely voluntary business bankruptcy system, it is clear from the empirical data that those who control the corporate debtor are choosing where to file for strategic reasons. The debate is about why they are doing so and whether this is a good thing.[40] With venue largely fixed by law in China, this is a debate that would be unlikely to arise there.

F. Summary of Significant Control Issues

The American debtor can almost completely control its own legal status by the simple filing of a bankruptcy petition. It has at least some choices about where to file a bankruptcy petition, and the evidence shows that debtors use that choice strategically. Once within the protection of the bankruptcy system, the American debtor typically retains control over the business and the process of formulating a plan of reorganization. It has the powers and responsibilities of a trustee in bankruptcy, which is to say, it acquires bankruptcy powers that debtors do not enjoy outside the bankruptcy process.

In these respects, China's system could scarcely be more different. There, in a voluntary case, the debtor applies for bankruptcy protection and its application may or may not be accepted. The place where the application should be filed is fixed, at least relative to the United States system. Once in bankruptcy, the debtor will surrender control of the business to an administrator. As compared with the United States, Chinese debtors have few incentives to file voluntary bankruptcy petitions and, one would expect, that the proportion of debtors voluntarily filing for bankruptcy will be far lower than in the United States.

Part III

Congress put substantially more power into the hands of the debtor in the 1978 rewriting of the bankruptcy law. Before that, the system far more resembled the Chinese system.[41] There is an array of empirical and ideological assumptions that seems to support these choices.

The 1978 Bankruptcy Code brought former Chapters X, XI, and XII into a new Chapter 11.

39. See Robert Weber, Can the Sauvegarde Reform Save French Bankruptcy Law?: A Comparative Look at Chapter 11 and French Bankruptcy Law From an Agency Cost Perspective, 27 Mich. J. Int'l L. 257, 261-65 (2005).

40. Professor LoPucki is the primary critic of business forum shopping for desirable bankruptcy venues. See Lynn M. LoPucki, Courting Failure: How Competition for Big Cases Is Corrupting the Bankruptcy Courts (2005). A critical appraisal of the book is Kenneth Ayotte and David A. Skeel, Jr., An Efficiency-based Explanation for Current Corporate Reorganization, 73 U. Chi L. Rev. 425 (2006).

41. Chapter X was designed for large public corporations and was described by Congress as "rigid". House Report, supra n.32, 221-22.

In the process, the consolidation opted for the practice from former Chapter XI of leaving the debtor in charge and running the business after the filing. Congress left a substantial record of its reasons for this substantial change. As mentioned earlier, Congress believed that in many cases creditors would benefit from the saved expenses of a trustee and the business continuity that would result from no change in management.

But at least conceptually, bankruptcy is creditor-driven. Indeed, Congress recognized that the conceptual source for the bankruptcy process was that of creditor control over a "trust" consisting of the insolvent debtor's assets. The assets of an insolvent debtor "belonged" to its creditors in part because non-bankruptcy law (in the form of what is called the "absolute priority rule") put creditor interests ahead of the debtor's owners' interests in any distribution. Conceptually, the bankruptcy process simply created a trust consisting of those assets and put a "trustee" in charge of administering them for the benefit of the creditors. Logically, creditors ought to be in ultimate control of the trust (the bankruptcy estate) and the debtor should have very little to do with any of it. There were several sources for Congress's move from a largely "creditor control" system to a "debtor control" system in 1978.

First, Congress found that under the old law creditors did not exercise their rights of control, reporting that "Creditor control in bankruptcy is a myth". The result was that in cases where there were assets available, lawyers took over and the real beneficiaries in large cases were those who administered them. Secondly, Congress recognized that the rationale for business reorganizations is to capture the going concern value of the business. That means rehabilitating the business rather than carving it up and selling it and this, in turn, would often require the presence of the debtor and its management in order to maintain the business and thereby derive its going concern value. Perhaps more important, Congress believed that speed in the process of reorganization would be increased by leaving the debtor in control. Finally, Congress believed that the reorganization process ought to be entered before it is too late to be of help.[42] The combination of these ideas explains a great deal, including the tenacity with which debtor control remains in the American bankruptcy system despite a flood of criticism from many different perspectives.[43]

The "debtor control" aspects of the Code can perhaps be best explained as a group of policy decisions that Congress thought would make it easy and relatively painless for the management of troubled debtors to use bankruptcy. Financially- troubled debtors might use it directly, in an effort to reorganize, or use the law indirectly as leverage to reorganize without entering bankruptcy at all. Since the debtor and its management will, typically, remain in control, those in central management who will make the bankruptcy decision will not fear for immediate loss of their power or jobs.

Because management's future is directly related to that of the business's owners, the possibility of using the bankruptcy law for effective rehabilitation becomes a positive incentive for entering bankruptcy in the first place. But these incentives might be incomplete unless management and owners were able to share in any positive outcome produced by the decision to seek bankruptcy protection. Congress added these incentives through its approach to formal rules for a Plan of Reorganization.

A central conceptual question in a reorganization case involving an operating (but insolvent)

42. House Report, supra n.32, at 231.
43. The criticism began in the early 1980's with two empirically-based articles that argued that the new Code had shifted from a "creditor control" system under the 1898 Act and its amendments to one of "debtor in full control".

business is whether the absolute priority rule should require that creditors get the going concern value of the insolvent business or, alternatively, only its (smaller) liquidation value. The practical aspects of this choice overshadow the conceptual. If creditors in a reorganization are entitled only to the liquidation value, the reorganization process will be of no benefit to them. If, on the other hand, creditors are entitled to the entire going concern value, then the owners have no interest in the reorganization in the first place and have no reason to offer any help in the rehabilitation.[44]

Congress seemed to believe that this core question -- whether (and to what extent) creditors should be entitled to going concern value in a reorganization -- would better be answered through negotiation than through either litigation or strict rules. In typical American fashion, Congress therefore created a process designed to produce negotiated outcomes on this centrally-important question. To make a very complicated set of provisions overly-simple, the Code provides that the absolute priority rule need not operate if the Plan of Reorganization is agreed to by all the voting classes within the Chapter 11 case. This means that ownership can share in the going concern value if it can get its creditors to agree to the Plan; not so if the Plan must be forced on even one class of creditors.

The confirmation rules reinforce the central place of negotiated outcomes in modern American bankruptcy law. The leverage the debtor acquires from the existence of the bankruptcy law in its current form tends to make negotiation with creditors more possible; the confirmation rules give the debtor substantial motivation to reach an ultimate outcome that its creditors can agree to. The underlying design, to encourage negotiated outcomes, reflects an underlying belief that negotiated outcomes are, *as a policy matter*, better than outcomes generated by other means, particularly perhaps, those determined by government officials.45 This may be a peculiarly American view.

Conclusion

In 1978, Congress concluded that creditors did not exercise the control that had been a premise of the earlier system, so it moved to a system commonly described as “debtor control”. As designed, China’s bankruptcy system does not contain the kinds of incentives the American system has to induce troubled debtors voluntarily to enter the bankruptcy system. Bankruptcy in China implies outside supervision of the debtor, and limitations on debtor access. The deep cultural differences between China and the United States makes it hazardous to guess whether creditors in China will behave differently -- whether they will initiate bankruptcy when it is “needed” -- than did those creditors that existed in the United States from 1938 through 1978. Data may ultimately show whether Chinese reorganizations begin soon enough to be successful.

In the United States, Debtor control and largely-absent governmental supervision means that many debtors enter Chapter 11 when they are not economically viable, that is, when they *should be* in liquidation. Indeed, researchers have identified that one of the central problems is the

44. It is very debatable whether incentives such as these work the way one might anticipate. Managers and owners, for example, might be induced to cooperate by not being discharged immediately, or by being offered other benefits. Whether adding the promise of a share in the future business is necessary to optimize management’s incentives is an imponderable.

45 The extreme version of this view is the argument that bankruptcy law is not needed at all; that parties ought to be able to contract for the insolvency regime they desire. The policy soundness of negotiated outcomes depends critically on the fair participation of all affected parties. Both the “contract bankruptcy” idea and the current system have been criticized as omitting important parties from a fair negotiation. See, e.g., Susan Block-Lieb, The Logic and Limits of Contract Bankruptcy, 2001 U. Ill. L. Rev. 503 (2001).

absence of any mechanism to end businesses that are not economically viable when they enter Chapter 11. The American system, in effect, supports businesses that are not *economically* viable for a time period before concluding under bankruptcy law that they are not *legally* viable and turning them to liquidation. In that passage of time, there is likely some deterioration of the value ultimately distributed to creditors. More intrusive supervision of the debtor something that seems more likely under the Chinese systemBcould reduce this problem.

But in this respect, the American system indirectly delivers a benefit that is sometimes overlooked by those who analyze the law solely in its capacity to deliver returns to creditors.[46]

The end of a business, particularly a large one, produces economic shock that affects not only creditors but non-creditor Adependents@ ranging from trade suppliers to corner employee lunch stands. Every country's economic system has mechanisms to soften the effects of such economic shocks. In the United States, unemployment compensation is probably the most visible example, but job training programs, small business loans, and other programs fill various needs within the American system. If one looks at American bankruptcy as a component of this set of policies, one brings a different set of criteria to evaluating it.

Bankruptcy reorganization in the United States can be seen as a *de facto* component of that safety net, a shock-absorber for sudden economic change. As long as a business is *legally* viable (that is, as long as it cannot be put involuntarily into Chapter 7), the U.S. system will postpone its liquidation, usually for at least 6 months but usually more. Those businesses that successfully reorganize will have eventually delivered the going concern value that is one of the underlying premises for reorganization in the first place, and continued to nurture the non-creditor interests that depend on them.

But even non-economically viable businesses are effectively permitted under American bankruptcy law to limp on for a period, sustained by hope. Even here, reorganization arguably has performed a positive service for those touched by these non-viable businesses as well. A Chapter 11 petition can act as a formal signal by a distressed debtor that in a year or so it is possible that it will end its operations through liquidation. Such a signal will inevitably come earlier than a notice of liquidation and, in that extra time, those dependent on the business -- creditor and non-creditor alike -- will have had a better chance to adjust to the now-clearly unstable economic reality. While adjustment time is not an actual distribution, it is nonetheless helpful to those who cannot adjust to economic change as rapidly as change might occur.[47]

If reorganization bankruptcy is to deliver this kind of indirect benefit even for businesses that ultimately collapse, it is essential that the business enter reorganization soon enough, while it is

46. There has been a very rich literature in the United States debating the "true nature" of bankruptcy. A particularly good debate is Elizabeth Warren, Bankruptcy Policy, 54 U. Chi. L. Rev. 775 (1987) versus Douglas Baird, Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren, 54 U. Chi. L. Rev. 815 (1987).

47. It is easy to criticize this position. Among other things, it tends to collapse the distinction between those having a contract and those without one, and the "benefits" for non-creditors will likely come at the expense of the actual creditor distributions that will suffer during the time the debtor was in (but "should not have been in") reorganization. I don't find any of this particularly troubling: there is no first principle that dictates what given creditors should receive where their contracting partner has encountered a financial disaster. The positive law determines what contracting parties are ultimately expecting, and bankruptcy law can legitimately alter creditors' non-bankruptcy expectations once a debtor enters bankruptcy. While no one has proposed that non-creditors receive actual distributions in reorganization cases, some are undoubtedly "beneficiaries" of the reorganization process. Several commentators have suggested a more "visible" role for them. See, e.g., Karen Gross, Failure and Forgiveness: Rebalancing the Bankruptcy System (1997); Nathalie Martin, Noneconomic Interests in Bankruptcy: Standing on the Outside Looking In, 59 Ohio St. L. J. 429 (1998).

legally viable. That is, reorganization must not be hopeless.[48] It is here, using a broader vision of reorganization's beneficiaries than is conventional, that moving to a system of debtor control may have made a substantial difference in the United States.

Congress intended to increase the use of the reorganization process and there is no doubt it succeeded. Reorganization filings surged in the wake of the 1978 Bankruptcy Code and have shown no signs of diminishing. Nearly all reorganization filings are voluntary. Very few of those cases are converted to liquidations prior to the end of the exclusivity period.

At worst, the reorganization system in the United States signals to all those involved with the business that they should proceed with caution and might do well making other economic plans. It allows creditors and non-creditors alike the time to adjust to a different economic future, one that will almost inevitably be less dependent on the debtor. Viewed as a system supplying economic adjustment time to those dependent on financially-troubled businesses, one can call the highly-criticized American reorganization system a success.[49]

In a country with a strong historic suspicion of government involvement in economic matters, one would expect a relatively weak governmental safety net. In such a context, a reorganization system that supports non-economically viable businesses for a time might well be important to overall economic well-being. Congress may have inadvertently added to the safety net by creating a reorganization process that is frequently used, inevitably time-consuming, and debtor-driven. China has a very different tradition of government involvement in business matters and, no doubt, has a very different set of policies designed to protect its citizens from economic shocks. Its bankruptcy law is also quite different and, undoubtedly, deliberately so.

Does the American experience with debtor control have anything useful to contribute to China's understanding of its own law or of the inevitable imperfections in that law? Given the very different economic, cultural, and legal contexts for the two systems, reformers might well be urged to proceed with extreme caution.

（初审编辑：王承志）

48. Unsecured creditors can move to convert a case to Chapter 7 but will succeed only if a reorganization is demonstrably futile. See Warren & Westbrook, supra n.13, 429-30.

49. A perception of these indirect benefits partly explains the debates between those vying for "contract bankruptcy" and those opposing it. Allowing creditors and the debtor to avoid the bankruptcy process by contracting for a distribution in advance will inevitably exclude the non-creditors from the process but it will also exclude many creditors as well. The speed and returns to creditors that these systems theoretically promise come at the expense of the wider group of beneficiaries of the bankruptcy process as broadly conceived.