

## THE PROBLEMS OF CROSS-BORDER PERSONAL BANKRUPTCY IN RUSSIAN AND CHINESE LEGISLATION AND PRACTICE

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### Abstract.

The subject of the article is the legal and practical problems of cross-border personal bankruptcy in Russia and China.

The main goal of this work is to analyze the major issues and obstacles in recognition and enforcement of Russian individual bankruptcy decisions in China and introduce it to Russian scholars and legal professionals.

The methodological basis is analysis of the Russian and Chinese legislation, judicial practice and special literature

The results, scope of application. This article discusses the possibility of applying the provisions of the Federal Law *On Insolvency (Bankruptcy)* to the Chinese nationals registered as individual entrepreneurs in Russia. The article also reviews the Chinese legal regulation and offers recommendations on execution of the court judgments on bankruptcy and collection of debts from the PRC nationals. Existing Russian legislation allows to recognize the foreign nationals as bankrupts. The provisions on the cross-border insolvency also apply to them. The bankruptcy in China is not applied currently to the individuals, although theoretically it may affect their property sphere during the bankruptcy of an individual private enterprise.

Conclusions. The cross-border insolvency of the Chinese nationals encounters obstacles on three levels. Firstly, the awards of the Russian arbitration courts have not been practically enforced in PRC due to inadequate notification of the Chinese party in the case. Secondly, Chinese courts in principle are extremely reluctant in recognizing foreign judgments on bankruptcy, such cases are exceptional. Thirdly, there is no personal bankruptcy institution in the PRC, while similar procedures like bankruptcy of individual private enterprises are not applied in reality, and there are no legislative prospects for the personal bankruptcy in the nearest future. Therefore, when conducting the bankruptcy procedure for the Chinese nationals on the Russian territory, one can only count on their property located on this side of the border.

**Key words:** cross-border insolvency; personal bankruptcy; bankruptcy of individuals; China; People's Republic of China; recognition of the court judgments.

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### Introduction

Economic cooperation between Russia and China is developing at the level of public corporations and private companies, as well as individual entrepreneurs, leading daily trading. A lot of Chinese citizens are engaged in entrepreneurial activity on the territory of Russia, often getting into losses and find themselves unable to meet creditors' claims. With the introduction of Russian citizens in the practice of the institution of bankruptcy there was a question about the

possibility of its application to foreigners, in particular to the citizens of the jurisdictions which are not familiar with the institution, including the People's Republic of China.

### **1. Recognition of Chinese citizens going bankrupt in Russia**

According to Art. 25 of the Civil Code of the Russian Federation<sup>1</sup> (hereinafter - Civil Code), citizen unable to meet claims of creditors on monetary obligations and (or) to fulfill the obligation to make compulsory payments, may be recognized as insolvent (bankrupt) by decision of the arbitration court. Art. 1 of the Federal law "On insolvency (bankruptcy)"<sup>2</sup> states that the relations connected with the insolvency (bankruptcy) of citizens, including individual entrepreneurs, are regulated by this law. In Art. 2 of the Act provides a definition of the debtor as a citizen, including individual entrepreneur or legal entity who find themselves unable to meet the demands of creditors on monetary obligations, the payment of severance and (or) on remuneration of persons employed or working under an employment contract, and (or) to fulfill the obligation to make mandatory payments for a period established by this Federal law. Thus, the above legal norms connect the bankruptcy to a citizen status.

The concept of a citizen is contained in Art. 5 of the Federal Law from 31.05.2002 № 62-FZ "On Citizenship of the Russian Federation"<sup>3</sup>, which states that "Russian citizens are persons having the citizenship of the Russian Federation on the day of entry into force of this Federal Law, as well as persons who have acquired citizenship of the Russian Federation in accordance with the Federal Law". However, in accordance with Part 3 of Art. 62 of the Constitution of the Russian Federation<sup>4</sup> foreign citizens enjoy in the Russian Federation the rights and obligations as citizens of the Russian Federation, except as required by federal law or the Russian Federation international treaty. This principle of the national regime is confirmed in Art. 4 of the Federal Law № 115-FZ of 25.07.2002 "On the Legal Status of Foreign Citizens in the Russian Federation"<sup>5</sup> and v. 1196 Civil Code of the Russian Federation.

Thus, the provisions of the Federal Law of 26.10.2002 №127-FZ "On insolvency (bankruptcy)" shall not apply to foreign nationals only if there is an outright ban in the current legislation. Federal Laws "On Insolvency (Bankruptcy)", "On Legal Status of Foreign Citizens in the Russian Federation" does not provide for any restrictions or prohibitions on bankruptcy proceedings in respect of foreign citizens registered in the Russian Federation as individual entrepreneurs. Furthermore, Art. 1 of the Federal Law "On insolvency (bankruptcy)" allows the cross-border bankruptcy, which also confirms the possibility of bankruptcy of foreign citizens - individual entrepreneurs in accordance with international treaties, as well as on the basis of reciprocity.

In private international law, the term "*cross-border insolvency (bankruptcy)*" means the failure of the debtor located in a different legal order than its assets and (or) the creditors. Recognition of foreign bankruptcies is to promote and emerged on the territory of one state the legal consequences of maintenance and (or) the termination of the bankruptcy proceedings in the territory of a State where the assets and the creditors of the debtor are located, in the form in what those consequences would arise in the State court that CSOs initiated bankruptcy proceedings [1, p. 19-39].

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<sup>1</sup> Гражданский кодекс Российской Федерации (часть первая) от 30.11.1994 N 51-ФЗ (ред. от 07.02.2017) // Собрание законодательства РФ. 05.12.1994. N 32. Ст. 3301.

<sup>2</sup> О несостоятельности (банкротстве) : Федеральный закон от 26.10.2002 N 127-ФЗ (ред. от 03.07.2016) (с изм. и доп., вступ. в силу с 01.01.2017) // Собрание законодательства РФ. 28.10.2002. N 43. Ст. 4190.

<sup>3</sup> О гражданстве Российской Федерации : Федеральный закон от 31.05.2002 N 62-ФЗ (ред. от 01.05.2016) // Собрание законодательства РФ. 03.06.2002. N 22. Ст. 2031.

<sup>4</sup> Конституция Российской Федерации : принята всенародным голосованием 12.12.1993 (с учетом поправок, внесенных Законами РФ о поправках к Конституции РФ от 30.12.2008 N 6-ФКЗ, от 30.12.2008 N 7-ФКЗ, от 05.02.2014 N 2-ФКЗ, от 21.07.2014 N 11-ФКЗ) // Собрание законодательства РФ. 04.08.2014. N 31. Ст. 4398.

<sup>5</sup> О правовом положении иностранных граждан в Российской Федерации : Федеральный закон от 25.07.2002 N 115-ФЗ (ред. от 03.07.2016) (с изм. и доп., вступ. в силу с 31.07.2016) // Собрание законодательства РФ. 29.07.2002. N 30. Ст. 3032.

Thus, the current Russian legislation allows the recognition of bankrupt foreign nationals. They also apply provisions on cross-border bankruptcy. In the absence of a special international agreement on mutual recognition of decisions on bankruptcy the reciprocity principle acts, the implementation of which is largely dependent on national legal bankruptcy regime adopted in the State.

## **2. Bankruptcy of natural persons in the People's Republic of China**

The "Bankruptcy Law" in 2006, based on a doctrine of "bankrupt businessmen" functions in China and only provides for the bankruptcy of enterprises [2, p. 71]. During the preparation of the law the possibility of introducing the institute of bankruptcy of citizens (at least, entrepreneurs and members of the associations) has been discussed, but the legislator considered that the conditions were not yet ripe [3, c. 90]. Firstly, for the Chinese people did not have outstripping demand at that time (like in the US and other developed countries), so the credit burden did not threaten the solvency of the citizens. Secondly, by the time of the adoption of the law "On Bankruptcy" in China, there was no system for registering property of citizens and credit ratings required for the introduction of bankruptcy of individuals. Thirdly, there was no unified database of debtors database and information exchange system in the banking sector [4, c. 91]. It was believed that in these conditions the assumption bankruptcy of individuals would lead to abuse by debtors and massive evasion of debt [5, c. 188].

The cautious attitude of the Chinese authorities to bankruptcy is not only due to the socialist ideology, but also has a deep cultural background. Bankruptcy is a very sensitive topic for the traditional sense of justice, leading to a "loss of face." In the Confucian legal culture rooted idea of mandatory debt repayment (欠债还钱, «good turn deserves another") and even on the responsibility for the debts of parents of children (父债子还), which is in direct contradiction with the exemption from responsibility as one of the consequences bankruptcy [3, c. 94]. Due to the traditional legal psychology Chinese society does not accept the institutions of civil procedure of limitation of liability and does not sympathize with his difficulties in the debtor [6, c. 165].

Currently, Chinese science is dominated by the view that the introduction of bankruptcy of citizens is overdue because of the consumer lending boom, the creation of a state registration of real estate, databases of banks and the introduction of credit ratings of citizens. Individuals are increasingly acting as entrepreneurs, creating a "company of one person" and engaging in this as in the credit relationship [7, p. 45]. Chinese lawyers also note that the absence of the Chinese Institute of Legislation of citizens bankruptcy creates problems in economic relations with foreign participation and hinders the integration of China into the world economy [5, p. 190].

However, the Law of the PRC "On Bankruptcy enterprises" in accordance with its Article 2 applies only to companies with legal personality. In accordance with the explanations of the Supreme People's China Court, procedure of bankruptcy and liquidation provided by the Law of the PRC "On Bankruptcy of enterprises" may be similarly applied in the case of failure of individual private enterprise to fulfill obligations for which the due date has already come, when failure of the debtor to pay off property all obligations. After these procedures are completed, the creditor of an individual private enterprise has the right to demand a restitution of the remaining debt to the founder of an individual private enterprise.

Thus, at present, the institution of bankruptcy in the PRC does not apply to citizens, although it may affect their property sphere in the process of bankruptcy of an individual private enterprise. The absence of the Chinese Institute of the citizens of bankruptcy can be the basis for the application of the public policy exception to the refusal to recognize the decisions of Russian courts on bankruptcy of Chinese citizens. At the same time, there are other factors that determine the possibility of implementing cross-border bankruptcy of Chinese citizens at the stage of recognizing the decisions of Russian arbitration courts.

## **3. Recognition of foreign decisions about individuals' bankruptcy in China**

In accordance with the provisions of Art. 265-267 Code of Civil Procedure of the PRC, the party or the foreign court may appeal to the Chinese People's Court of the middle stage of the

recognition and enforcement of the decision and determination of the foreign court on the basis of agreement between China and a foreign country of an international treaty or reciprocity. If such a decision is not contrary to the basic principles of Chinese law does not violate the national sovereignty, security and public interest, the relevant people's court recognizes its validity, and if necessary shall issue a writ of execution under Art. 5 of the Law of the PRC "On Bankruptcy of enterprises" provides a similar rule for the recognition of the "handed down by foreign courts and entered into force the decisions and determinations of the bankruptcy relating to the debtor's property in the territory of the PRC". Such judicial acts are subject to recognition and enforcement in accordance with an international treaty or the principle of reciprocity if they do not contradict the basic principles of Chinese law, state sovereignty, security and public interest, and do not violate the lawful rights and interests of the debtor on the territory of the PRC. According to Professor Lee, the drafting committee members the draft law "On Bankruptcy of enterprises" to ensure its enforceability is required to develop detailed procedures for cross-border bankruptcy edition interpretation of acts and the conclusion of special agreements on legal assistance, and in the future - the creation of a special on cross-border insolvency law [9, p. 99].

In practice, cases of recognition by Chinese courts of foreign bankruptcies are rare and are the property of history. Thus, in 2001 Foshan court on the basis of Sino-Italian agreement on legal assistance in civil cases [10, c. 126] declared the decision of the Court of Milan (Italy), the bankruptcy of the Italian company with limited liability «EN Group SPA» at the request of the Italian company is «B & T Ceramic Group SRL» [9]. The reason for treatment was the illegal alienation of the company's bankruptcy under 98% stake in its subsidiary of the Chinese Side of Enterprise Hong Kong company, whereas according to the decision of the Italian court all property E. N. It has been transferred to the ownership of B & T [11]. This decision marked the first recognition of the Chinese foreign court decision on bankruptcy. In this case, and later in China "On Bankruptcy of enterprises" Act, was securing the principle of limited universalism, according to which the Chinese court recognizes judgments and decisions of foreign court taken under the base of *produ zvodstv* and bankruptcy proceedings in the country of domicile debtor [12, c. 20]. Even the recognition of decisions of courts of Hong Kong for bankruptcy (Special Administrative th arrondissement Kong (Hong Kong) is a relatively autonomous jurisdiction) faces in the PRC significant obstacles [see. Implied. 13, 14].

Russian recognition of arbitration decisions on bankruptcy (including individuals) in China so far has no precedent, but even hypothetically associated with a variety of general and specific problems. The common problem concerns the recognition in China of all decisions of Russian arbitration courts.

In accordance with paragraph 3 of Article 253 of the Arbitration Procedure Code, in cases where foreign persons involved in the case considered by the Arbitration Court of the Russian Federation, are living outside the Russian Federation, such a person shall be notified of the trial determination of the arbitral tribunal by sending instructions to the institution Justice or other competent authority of a foreign state. Consequently, the Russian arbitration court may notify of the proceedings are chinese th side , participating th in the territory of Russia , only directions by order to the Ministry of Justice of China, and this form of notification is exceptional. Thus, the Supreme People's Court in 2005 explained that the reference in the decision of the Arbitration Court of the Russian Ulyanovsk region indication of proper notice of the parties of the time and date of the hearing vague and does not allow to determine whether that notification requirements of the Agreement on Legal Assistance. [11] Thus, if the Russian arbitration court did not notify the Chinese side by the Ministry of Justice of Russia and China, the Chinese court explicitly refuses to recognize the award. In this real life of one such notification in practice it can reach half a year that does not correspond to the terms of cases provided for in the Arbitrazh Procedure Code.

The special problem of recognition in China of Russian decisions on bankruptcy is already established contact in the absence of legislation of Chinese institute of bankruptcy of individuals,

which can apply the public policy exception provided for in Sec. 5, Art. 20 of the Treaty and Article. "On Bankruptcy enterprises" 5 of Chinese Law to a Russian decision. Western experts explain the fact that in the period of the adoption of the law of China remained at an early stage of transition from a planned to a market economy, which was not much space for either consumer credit, nor for those caused by the bankruptcy of citizens [ 15 , c . 112-113] . As a result of the institution of bankruptcy exists in a truncated version, and is not able to help in resolving the debt load of individual entrepreneurs and ordinary consumers. At the same time, the introduction of bankruptcy of citizens in a country of 1.3 billion people and the prevailing traditional sense of justice seems a trivial task [16, c . 7-8] .

### **Conclusion**

The cross-border bankruptcy of Chinese citizens encounters obstacles at three levels. First, the decisions of the Russian courts of arbitration in the PRC are not executed due to improper notification of the Chinese side in the case. This problem requires a change in the order stipulated by international treaties of the notification, or speed up the justice ministries of the two countries or changes in China's judicial practice. Second, Chinese courts are extremely reluctant to recognize foreign decisions on bankruptcy, in principle, such cases are exceptional even with closely related (Hong Kong), or economically important (USA) jurisdictions. In this regard, one can only hope for the development of Chinese Bankruptcy Institute and the civil circulation as a whole, which is limited for ideological reasons and fear of undermining social stability. Thirdly, there is no institution of bankruptcy of physical persons in China. Thus, during the bankruptcy proceedings of Chinese citizens on Russian territory one can realistically expect only on their property located on this side of the border.

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