

Enhancing Protection for Supplier Creditors in Chinese Bankruptcy Proceedings: Perspectives from U.S. Experience

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I. INTRODUCTION

Among the many public policy rationales of the bankruptcy code, an important one is “[p]reserving troubled companies when rehabilitation maximizes value to creditors.”¹ For retail companies entering bankruptcy, this goal has a more unique application than in other types of bankruptcy cases. The reason for this uniqueness lies in the interdependent relationship between retail companies, the debtor, and suppliers, as creditors.²

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1. ABA, *Bankruptcy: Overview* (Aug 23, 2022), https://www.americanbar.org/groups/gpsolo/publications/gpsolo_ereport/2022/august-2022/bankruptcy-overview/ [<https://perma.cc/ML6K-5839>].

2. See generally Nirmalya Kumar, *The Power of Trust in Manufacturer-Retailer Relationships*, HARV. BUS. REV. Nov./Dec. 1996, at 92 (indicating that although there are varying degrees of exploiting one’s advantageous position to harm the interests of the other party among different manufacturers and retailers, the relationship between the two is close and inseparable).

For retail companies, their operation and success depend on their ability to continually provide product to the market and customers.³ A stable operation thus greatly depends on whether the supplier, as a creditor, can continue to provide goods. However, suppliers are typically less motivated to keep doing so since their debts are usually unsecured.

In recent years, both the United States and China have faced large-scale retail company operational and bankruptcy crises.⁴ Despite the two countries geographical differences and differing bankruptcy legal systems, both are facing similar issues.⁵

Part II of this Note will introduce the overall structure and history of bankruptcy laws in China and the United States, the specific provisions related to suppliers in retail company bankruptcy cases in both countries, and concerns about the bankruptcy risks of the retail industry. Part III of this Note will explore the specific application and effects of the relevant bankruptcy rules in retail company bankruptcy in China and the United States. Finally, Part IV of this Note will provide suggestions and conclusions on how Chinese bankruptcy law can further change to better address these issues.

II. BACKGROUND

A. Supplier Creditor under Chinese Bankruptcy Law

China enacted its first “Enterprise Bankruptcy Law” on August 27, 2006, and since then, legislative bodies have not revised the bankruptcy law.⁶ In practice, aspects not fully covered by the bankruptcy law have been addressed primarily through various judicial interpretations, meeting minutes, and memorandums issued by the Supreme People’s Court.⁷

As China’s highest legislative body, the Standing Committee of the National People’s Congress (NPC), released the legislative plan of the 14th Standing Committee in September 2023.⁸ The plan explicitly categorizes the amendment of the Enterprise Bankruptcy Law as a first-class issue, meaning “a draft law with relatively mature conditions intended to be submitted for consideration during the tenure.”⁹ As early as 2019, the NPC Financial and Economic Committee started preparing the revision drafts of the existing Enterprise

3. *Why Supplier Engagement Is Critical for Business Success*, ADVANTAGE (Jan. 25, 2021), <https://www.advantagegroup.com/partnerships/why-supplier-engagement-is-critical-for-business-success/> [https://perma.cc/5LGN-XPKE] [hereinafter *Why Supplier Engagement is Critical*].

4. For an observation on the U.S. market, see, e.g., Bradford J. Sandler & Jonathan J. Kim, *Navigating the Retail Apocalypse*, 262 N.Y. L.J. 59 (2019); see also *The Retail Evolution’s Great Acceleration—How To Maneuver in the Pandemic-Driven Recession*, DELOITTE, <https://www2.deloitte.com/us/en/pages/consumer-business/articles/retail-recession.html> [https://perma.cc/P99T-JG3T] [hereinafter *The Retail Evolution’s Greatest Acceleration*].

5. See generally sources cited *supra* note 4.

6. Wang Weiguo (王卫国), *新破产法：一部与时俱进的破产法* [*The New Bankruptcy Law: Progressive Legislation for the Times*], OFF. WEBSITE OF NAT’L PEOPLE’S CONGRESS, http://www.npc.gov.cn/zgrdw/npc/xinwen/rdl/fzjs/2007-02/28/content_358559.htm (on file with the *Journal of Corporation Law*).

7. *Analysis on Several Issues Concerning the Application of the <PRC Enterprise Bankruptcy Law> (III)*, JUNHE (Apr. 4, 2019), <https://www.junhe.com/law-reviews/926> (on file with the *Journal of Corporation Law*).

8. Xinhua News Agency, 十四届全国人大常委会立法规划 [*Legislative plan of the 14th Standing Committee*], XINHUA NEWS NET (Sept. 7, 2023), http://www.news.cn/politics/2023-09/07/c_1129851114.htm (on file with the *Journal of Corporation Law*). Xinhua News Net (Agency) is the official state news agency of the People’s Republic of China and the largest media organ in China.

9. *Id.*

Bankruptcy Law.¹⁰ It is thus foreseeable that the first significant amendment since the enactment of the law is gradually approaching.¹¹

Currently, Article 18 of the Enterprise Bankruptcy Law of the People's Republic of China is the most commonly used provision in Chinese law governing the relationship between retail companies and suppliers.¹² According to Article 18, the administrator, after the court accepts the bankruptcy application, shall have the authority to decide whether to rescind or continue to perform a contract that was concluded before acceptance but remains to be fulfilled by both the debtor and the other party.¹³

Under the provisions of Article 18, vendors who signed a contract with the debtor before entering bankruptcy and where both parties have unfulfilled obligations, the administrator can handle them in three ways:¹⁴

The first option is to terminate the contract.¹⁵ Any debts arising from the original contract after termination will be treated as unsecured debts and settled according to the reorganization plan.¹⁶

The second option is to “confirm” the contract.¹⁷ The administrator may assume (“confirm” under Chinese law) the contract, and it will remain valid for both parties.¹⁸ The vendor will be obligated to continue supplying goods under the contract. Payments under the contract are treated as “debts incurred for the common good of creditors.”¹⁹ However, the counterparty will then have a right to request the administrator provide security for the performance of the contract, and, if the administrator refuse to do so, the contract will be rescinded and switch back to the situation of termination.²⁰

10. 全国人民代表大会财政经济委员会 关于第十三届全国人民代表大会第五次会议 主席团交付审议的代表提出的议案 审议结果的报告 [*Finance and Economics Committee of the National People's Congress Report on the Review Results of Proposals Submitted by Delegates to the Presidium for Consideration at the Fifth Session of The Thirteenth National People's Congress*], NPC FIN. & ECON. COMM. (Oct. 27, 2022), http://www.npc.gov.cn/rdxwzx/xwzx2023/xwzx2023014/202301/t20230129_423051.html [<https://perma.cc/DV8A-LZBA>].

11. *See id.* (discussing the ongoing efforts to revise the Enterprise Bankruptcy Law).

12. Qiye Pochanfa (企业破产法) [*Enterprise Bankruptcy Law*] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007) art. 18 P.R.C. LAWS [hereinafter Art. 18 P.R.C. LAWS].

13. *Id.* This is referred to as “Continuation of Contract,” (继续履行合同) in Chinese law practice and is widely applied to contracts when the debtor and the counterparty still have obligations to each other when the debtor entering bankruptcy process and these contracts were signed before but remain unfulfilled. *Id.*

14. *Id.* The Enterprise Bankruptcy Law does not use the concept of “trustee” as found in the U.S. bankruptcy system; instead, it adopts the term “administrator.” The selection, appointment, and powers of the administrator are governed by Chapter 3 of the Enterprise Bankruptcy Law, functioning similarly to a trustee in U.S. bankruptcy system. *Id.*

15. *Id.*

16. Art. 18 P.R.C. LAWS, *supra* note 12 (an unsecured supplier's debt will be considered an “ordinary bankruptcy claim” and shall be paid only after all the priority claims).

17. *Id.*

18. *Id.*

19. Qiye Pochanfa (企业破产法) [*Enterprise Bankruptcy Law*] *supra* note 12, art. 42–43 P.R.C. LAWS (The concept “debts incurred for the common good of creditors” is defined in Article 42 of the Enterprise Bankruptcy Law of the People's Republic of China, and according to Article 43, “the debts incurred for the common good of creditors shall be paid off with the debtor's property at any time”).

20. Art. 18 P.R.C. LAWS, *supra* note 12. The second subsection of Article 18 of the Enterprise Bankruptcy Law of the People's Republic of China states that “[w]here the administrator decides that performance of the contract be continued, the other party shall comply; however, the other party shall have the right to request the

The third option is called “Intermediate Approach.”²¹ The administrator can take a middle-ground approach. Initially, they may choose not to confirm (or “assume”) the contract.²² Then, starting from the date the court accepts the bankruptcy application, a new contract similar in content to the original one will be signed with the vendor.²³ In this case, the debts under the original contract are settled as unsecured debts. At the same time, a new obligation to pay has been made based on the new contract, and the debt caused by this new obligation will be considered as debts incurred for the common good of creditors.²⁴

In practice, for suppliers who want to participate in the debtor’s bankruptcy proceedings based on pre-existing supply relationships, Article 18 is the only choice. However, the overly simplistic wording of this Article and the lack of related rules have led to significant uncertainty, resulting in numerous criticisms.²⁵

B. Supplier Creditor under U.S. Bankruptcy Code

A similar rule to Article 18 can be found in U.S. bankruptcy code, specifically in 11 U.S.C. § 365, which deals with Executory Contracts.²⁶ There are also three ways a trustee can deal with the executory.²⁷

The first is *assumption*.²⁸ The assumption of executory contract means to “continue[] both parties’ obligations, and provides priority for the counter-party with regard to the future obligations owed by the debtor to ensure that it [is] fair to compel the counter-party to continue under the contract notwithstanding the bankruptcy.”²⁹ The Bankruptcy Code does not expressly deal with the consequence of assumption, but it is clear from case laws that under this circumstance, the contract will still be valid for both parties and the debt under the contract will have an administrative expense priority.³⁰

The second way is rejection.³¹ Rejection means it will “relieve[] the debtor of its future performance obligations . . . the debtor’s decision to reject a contract operates as a

administrator to provide guaranty. Where the administrator refuses to do so, the contract shall be deemed to be rescinded.” *Id.*

21. *Id.*

22. This method has been extensively used in practice. Since public information often does not disclose the full list of contracts signed before the bankruptcy process starts and the list of contracts signed after the acceptance of the restructuring application, it is difficult to make the comparison based on public data. However, this method is widely used in the practice of bankruptcy in China, including the restructuring of three listed companies under Hainan Airlines Group, which all adopted this method.

23. *Id.*

24. *Id.*

25. See generally Dongsheng Yu (余冬生), 论破产法中待履行合同的解除权 [*The Right to Terminate Pending Contracts in Bankruptcy*], 147 北方法学 [N. L.] 147 (2023).

26. 11 U.S.C. § 365.

27. *Id.*

28. *Id.* § 365(a).

29. Lead Article: *Does Assuming a Contract in Bankruptcy Waive Later Attacks on the Contract?*, QUINN EMANUEL (Oct. 17, 2022), <https://www.quinnemanuel.com/the-firm/publications/lead-article-does-assuming-a-contract-in-bankruptcy-waive-later-attacks-on-the-contract/> [https://perma.cc/JDL8-NL23] [hereinafter *Assuming a Contract in Bankruptcy*].

30. *When the Other Party to Your Contract Files for Bankruptcy*, BROWN CONNERY, LLP (June 17, 2024), <https://brownconnery.com/when-the-other-party-to-your-contract-files-for-bankruptcy/> [https://perma.cc/642D-MTY2].

31. 11 U.S.C. § 365(a).

breach as of the date of the bankruptcy filing, allowing the counterparty to make claims against the debtor for that breach, albeit in the form of a claim in the bankruptcy.”³² Although there are some diversions depends on the type of contract regarding the consequence of rejection but, normally, it will be considered as a breach.³³

The third way is assignment.³⁴ Assignment means the debtor will assign its rights and obligations under the executory contract to a new party. By doing so, the debtor “may avoid its responsibilities under the contract . . . while also managing to avoid a claim against [itself] in the bankruptcy”³⁵

In the scenario involving a supplier and a debtor, if a supplier’s executory contract is assumed by the trustee after entering bankruptcy, the contract will continue to be performed, and the supplier will enjoy administrative expense priority.³⁶ If the contract is rejected, it will be equivalent to a breach by the debtor, and the supplier can seek remedies based on this rejection.³⁷ If the contract is assigned, it can continue to be performed between different parties, and unlike in non-bankruptcy contract law, the assignor under § 365(k) does not need to assume any further liability.³⁸

Surprisingly, even though the rules related to executory contracts in § 365 are already quite sophisticated, the term “executory contract” is not defined in the bankruptcy code. According to the legislative history, “though there is no precise definition of what contracts are executory, it generally includes contracts on which performance is due to some extent on both sides.”³⁹

From a practical perspective, the most widely accepted definition of an executory contract is “a contract where there remains unperformed material obligations by both parties at the time the bankruptcy is filed. In other words, failure by either party to perform would amount to a **material** breach excusing the performance of the other party.”⁴⁰ Although there may be disputes regarding the definition of this concept, this Note will use the above-cited definition. When a retailer enters bankruptcy, both the supplier (who was obliged to provide product to the debtor for selling) and the debtor (the retailer, who was obliged to pay for the product) have material outstanding obligations such that “failure by either party to perform would amount to a **material** breach excusing the performance of the other party.”⁴¹

According to 11 U.S.C. § 365(a), the bankruptcy court shall approve assumption or rejection of an executory contract.⁴² Therefore, how the bankruptcy court applies standards

32. *See Assuming a Contract in Bankruptcy*, *supra* note 29.

33. *See, e.g., Mission Prod. Holdings, Inc. v. Tempnology, LLC*, 587 U.S. 370, 379 (2019) (“Rejection of a contract—any contract—in bankruptcy operates not as a rescission but as a breach.”).

34. 11 U.S.C. § 365(k).

35. Theresa J. Pulley Radwan, *Limitations on Assumption and Assignment of Executory Contracts by Applicable Law*, 31 N.M. L. REV. 299, 300 (2001).

36. *Id.* at 317 n.111.

37. *Id.* at 302.

38. *Id.* at 300.

39. 3 COLLIER BANKRUPTCY PRACTICE GUIDE ¶ 68.03 (2023) (citing H.R. Rep. No. 595, 95th Cong., 1st Sess. 347 (1977)).

40. PRACTICAL LAW BANKRUPTCY & RESTRUCTURING AND PRACTICAL LAW FINANCE, EXECUTORY CONTRACTS AND LEASES, Westlaw (database updated Aug. 13, 2021).

41. *Id.*

42. 11 U.S.C. § 365(a).

of review to determine executory contracts will hugely impact the trustee's criteria. If the criteria adopted by the trustee conflicts with the court's standard of review, the court will not approve the trustee's decision.⁴³

Prior to the modern bankruptcy code, most courts, when handling bankruptcy cases under the Bankruptcy Act of 1898 were applying the "business judgment" test.⁴⁴ Under this test, courts defer to the debtor's business judgment in deciding whether to assume or reject executory contracts, unless the decision is "taken in bad faith or in gross abuse of the bankrupt's retained business discretion."⁴⁵ In other words, the court must decide whether the debtor's decision is so unreasonable that no person would reasonably believe the decision was based on fair, good faith business judgment.

In addition to the business judgment test, there is also a "burdensome" test.⁴⁶ For example, suppose "A" rents its warehouse to "B" for \$5,000 per month. A filed for bankruptcy during the lease period. If B generates a \$5,000 profit for A every month without incurring additional costs, which means the contract is not "burdensome" for A, then A's contract with B should be assumed.⁴⁷ However, if C offers \$7,000 to lease the warehouse and A, based on the business judgment test chooses not to assume its contract with B, the contract will still be enforceable since it will be maximizing the overall profit.⁴⁸

The courts have also applied a "balancing" test.⁴⁹ For instance, in the case of *In re Petur U.S.A. Instrument Co.*, the court did not approve the trustee's decision not to assume a contract based on the business judgment test.⁵⁰ The court believed that the creditor's entire business was "based upon" that contract, and if the contract was not assumed, "ensuing damages will far outweigh any benefit to the debtor or to its creditors."⁵¹

Later in 1978, after the enactment of the bankruptcy code, the business judgment test became the majority approach.⁵² However, in practice, the business judgment test has

43. *Id.*

44. DAVID G. EPSTEIN, STEVE H. NICKLES & JAMES J. WHITE, BANKRUPTCY 243-44 (West Pub. Co., 1992).

45. *In re Richmond Metal Finishers, Inc.*, 756 F.2d 1043, 1046 (4th Cir. 1985).

46. See, e.g., Benjamin Weintraub & Alan N. Resnick, *From the Bankruptcy Courts: What is an Executory Contract? A Challenge to the Countryman Test*, 15 UNIF. COM. CODE L.J. 273, 273 (1983) (discussing the goal of preventing "burdensome" contracts from being imposed on the bankruptcy estate); see also Bob Richards, Farrington Yates & Chris Soper, *Executory Contracts in Bankruptcy (United States)*, ASS'N OF CORP. COUNS. (Oct. 1, 2012), <https://www.acc.com/resource-library/executory-contracts-bankruptcy-united-states> [https://perma.cc/CHV3-DK3C].

47. See Jonathan Friedland, Robert Glantz & Jack O'Connor, *Dealing with Corporate Distress 17: Focus on Assuming & Rejecting Executory Contracts and Unexpired Leases in Bankruptcy*, DISTRESSED ASSET CENT. (Dec. 20, 2022), <https://www.dailydac.com/assuming-rejecting-executory-contracts-unexpired-leases-in-bankruptcy/> [https://perma.cc/Z9RE-LGZ9] (discussing the debtor's ability to reject contracts that are not beneficial to the estate, which the debtor would otherwise be required to perform outside of bankruptcy).

48. *Id.*

49. *Id.* There are also the "enhancement of the estate" and the "benefit to the estate" tests but neither of those are considered as a major approach so will not be discussed here. See David G. Epstein & Steve H. Nickles, *National Bankruptcy Review Commission's Section 365 Recommendations and the 'Larger Conceptual Issues'*, 102 DICK. L. REV. 679, 694 (1998).

50. *In re Petur U.S.A. Instrument Co.*, 35 B.R. 561, 564 (Bankr. W.D. Wash. 1983).

51. *Id.* at 562.

52. 11 U.S.C. § 365(a); *Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043, 1046-47 (4th Cir. 1985); *In re Parking Mgmt.*, 620 B.R. 544, 552-53 (Bankr. D. Md. 2020); *In re Old Carco LLC*, 406 B.R. 180, 188 (Bankr. S.D.N.Y. 2009).

faced long-lasting criticism.⁵³ The test provides the trustee with excessive and overly vague discretionary powers, and the court barely disrupts the decision.⁵⁴

C. Critical Vendor Payment under U.S. Bankruptcy Code

In the bankruptcy code, there are certain provisions that can, to some extent, help vendors take limited measures to protect their interests while waiting for the trustee to make a decision regarding the assumption of contracts under § 365.⁵⁵ For example, the 2005 Act amended the bankruptcy code to “provide for a newly created administrative priority claim to vendors for certain goods delivered to a debtor within 20 days prior to the bankruptcy filing.”⁵⁶ However, in practice, the most widely used mechanism to protect supplier rights is a system that does not exist in the bankruptcy code but has been developed and refined through numerous precedents: the critical vendor payment.⁵⁷

The common law basis for critical vendor payment is the “doctrine of necessity” that was established by the Supreme Court.⁵⁸ The benefit of becoming a critical vendor is that regardless of whether the bankruptcy reorganization is successful or not, the supplier can negotiate with the debtor for an separate agreement that allows the debtor to immediately make a full payment to the critical vendor’s prepetition claims.⁵⁹

If a critical vendor continues to supply goods to the debtor during bankruptcy, they will be given priority in receiving payment for part or all their prepetition claims.⁶⁰ If the reorganization fails and the proceeding shifts to liquidation, the accounts receivable generated by the critical vendor for supplying goods during bankruptcy will also be treated as priority expenses, receiving higher priority in payment compared to general unsecured claims.⁶¹

53. See *In re Petur U.S.A. Instrument Co.*, 35 B.R. at 563–64.

54. For example, the court in *Johnson v. Fairco Corp.* described this test as a “lax standard” so that “[o]nly where the debtor’s actions are in bad faith or in gross abuse of its managerial discretion should the decision be disturbed.” *Johnson v. Fairco Corp.*, 61 B.R. 317, 320 (N.D. Ill. 1986); see also *In re Cent. Fla. Fuels, Inc.*, 89 B.R. 242, 245 (Bankr. M.D. Fla. 1998) (stating that “[t]he decision to assume or reject an executory contract is usually left entirely to the debtor” and “the Court should give perfunctory approval of the decision subject only to review under the business judgment rule”).

55. See 7 COLLIER BANKRUPTCY PRACTICE GUIDE ¶ 134.05 (2023) (discussing available avenues for vendors to protect their interests).

56. *Id.*

57. Kennedy Bodnarek, *Critical Vendors in the Retail Apocalypse: How the Economic Crunch Exacerbates the Need for Critical Vendor Codification*, 37 EMORY BANKR. DEVS. J. 139, 141 (2020).

58. *Id.* at 142–44 (explaining how § 363(b) and § 105(a) of the Code are utilized in critical vendor payments).

59. See Bill Siegal, *Critical Vendor Treatment in Bankruptcy*, COWLES THOMPSON (Sept. 18, 2024), <https://www.cowlsthompson.com/resources/practice/bankruptcy/critical-vendor-treatment-in-bankruptcy/> [<https://perma.cc/W934-P7MS>] (stating that “[i]f a debtor deems a vendor critical to its reorganization, the debtor can offer to pay the vendor its pre-petition claim conditioned on the vendor continuing to supply the debtor with goods or services on the same credit terms as were in place prior to the bankruptcy filing going forward and that it will be timely paid”).

60. *Id.*

61. *Id.*

Critical vendors also share risks with the debtor.⁶² For example, if the prepetition claim is not fully paid by the debtor, the supplier may need to give up some contractual right for further claims and the supplier will also not be protected by the preference actions which are permitted by the bankruptcy code.⁶³ However, in practice, the decision to grant or deny a critical vendor payment motion is ultimately at the discretion of the bankruptcy court.⁶⁴

In Illinois, a three-step test for critical vendor payments was established in the *Kmart* case.⁶⁵ The first element is the payments of prepetition debt must be necessary for a successful reorganization.⁶⁶ The second element is after the payment, other disfavored vendors would be better off or at least no worse off.⁶⁷ Thirdly, if the outstanding prepetition debt was not paid, the vendor in question would cease doing business with the debtor.⁶⁸

In Texas, the three-step test is as follows. First, it must be critical for the debtor to make the payment.⁶⁹ Secondly, “unless the debtor pays the vendor’s prepetition claim, the debtor risks the going concern of the business disproportionate to the vendor’s claim.”⁷⁰ Third, the debtor has no other choice but to pay the vendor’s prepetition claim, whether from practical or legal perspective.⁷¹

Virginia also applies a three-element test.⁷² The standard for this test is first, the payment must be necessary to the success of reorganization; second, payment relies on a sound business judgment; and third, “the payment does not result in unfair prejudice to other creditors.”⁷³

In New York, judges did not construct any specific factor- or element-based test, but they deemed that “[c]learly, the ‘necessity of payment’ doctrine is applicable to the instant dispute” because the debtor needed to find a way to pay essential pre-petition claims that could have an effect on its ability to reorganize.⁷⁴

Even though different jurisdictions adopt various tests, the same policy reasons are commonly considered by courts. First, critical vendor payments, as an exception in bankruptcy law, must be necessary and thoroughly justified to maintain fairness in the bankruptcy proceedings.⁷⁵ Second, such payments should also benefit other parties or at least

62. For a discussion of various risks borne by critical vendors, see *Doing Business With A Client In Chapter 11—Critical Facts for Critical Vendors*, HENDERSHOT COWART P.C. (Dec. 1, 2021), <https://www.hchlawyers.com/blog/2021/december/doing-business-with-a-client-in-chapter-11-criti/> [<https://perma.cc/4FRD-7RZZ>].

63. *Id.*

64. *Id.*

65. See Bodnarek, *supra* note 57, at 145 (discussing how the *Kmart* decision “establishe[d] a three-prong test for critical vendor payment”); see also *In re Kmart Corp.*, 359 F.3d 866, 872–73 (7th Cir. 2004) (explaining how critical-vendor orders guarantee deliveries, thereby preventing a retailer’s collapse).

66. Bodnarek, *supra* note 57, at 145.

67. *Id.*

68. *Id.*

69. *In re CoServ, LLC*, 273 B.R. 487, 498 (Bankr. N.D. Tex. 2002).

70. Bodnarek, *supra* note 57, at 148.

71. *Id.* at 148–49.

72. *In re United Am., Inc.*, 327 B.R. 776, 782 (Bankr. E.D. Va. 2005).

73. Bodnarek, *supra* note 57, at 156.

74. *In re Ionosphere Clubs, Inc.*, 98 B.R. 174, 176 (Bankr. S.D.N.Y. 1989).

75. See generally Alan N. Resnick, *The Future of the Doctrine of Necessity and Critical-Vendor Payments in Chapter 11 Cases*, 47 B.C. L. REV. 183 (2005) (discussing the gradual narrowing of the doctrine and the necessity of procedural safeguards).

not burden them. This includes facilitating the completion of the bankruptcy process and possibly improving other creditors' financial benefit.⁷⁶

D. Retail Company

Due to differences in the way China and the United States collect macroeconomic data, there are variations in how they define retail companies within their respective territories.

In China, according to data from the Fourth National Economic Census published by the National Bureau of Statistics of People's Republic of China ("National Bureau of Statistics"), in November 2019, the retail industry encompassed sales activities primarily aimed at end consumers, such as residents, through outlets like department stores, supermarkets, specialty retail shops, brand-exclusive stores, and street vendors.⁷⁷ It also included sales activities conducted through methods like the internet, postal services, telephone orders, and vending machines.⁷⁸ Additionally, it encompassed stores that sell processed food on-site and products like "grains, seeds . . . and machinery" which are not considered retail activities.⁷⁹ Most retailers in this category own the goods they sell, but some act as agents for others, either through consignment sales or commission-based sales.⁸⁰

According to the "Classification Catalog of Retail Formats for Statistical Purposes" published by the National Bureau of Statistics, "retail business model[s]" refer to different operational forms formed by retail enterprises (units, individual businesses) to meet various consumer needs.⁸¹ They can generally be divided into two categories: those with physical stores and those without. Based on the classification principles of retail formats, specific categories include convenience stores, supermarkets, mobile vendor retail, and others.⁸²

Similar to the National Bureau of Statistics' definition of the retail industry, the United States relies on the United States Census Bureau for its definition of the retail sector.⁸³

According to the North American Industry Classification System ("NAICS") code 44-45 and the recognition by the United States Bureau of Labor Statistics, the retail trade sector consists of "establishments engaged in retailing merchandise, generally without transformation, and rendering services incidental to the sale of merchandise."⁸⁴ The

76. *Id.* at 185 ("This, in turn, inures to the benefit of all parties in interest.").

77. 第四次全国经济普查公报第四号 [*Bulletin of the Fourth National Economic Census (No. 4)*], 国家统计局 [NAT'L BUREAU OF STATISTICS] (2019) (China), http://www.stats.gov.cn/xxgk/sjfb/tjgb2020/201911/t20191120_1768647.html [<https://perma.cc/P2EN-XXRS>]; see also 九、贸易统计 [*Trade Statistics*], 国家统计局 [NAT'L BUREAU OF STATISTICS] (2019) (China), http://www.stats.gov.cn/hd/cjwtd/202302/t20230207_1902274.html [<https://perma.cc/S5PG-X5Z3>] (providing Q&A around the released statistics).

78. *Id.*

79. See *Trade Statistics*, *supra* note 77.

80. *Id.*

81. *Id.*

82. *Id.*

83. 2017 NAICS Definition Sector 44-45, U.S. CENSUS BUREAU, <https://www.census.gov/naics/?input=44&chart=2017&details=44> [<https://perma.cc/5XH5-H56D>] [hereinafter 2017 NAICS].

84. *Id.*; see also *Industries at a Glance Retail Trade: NAICS 44-45*, U.S. BUREAU OF LAB. STATS., <https://www.bls.gov/iag/tgs/iag44-45.htm> [<https://perma.cc/6EUB-YENB>] (discussing the industry classification further).

retailing process represents the final stage in the distribution of goods, with retailers primarily organized to sell merchandise in small quantities directly to the general public.

This sector encompasses two main categories of retailers: store-based retailers and non-store retailers.⁸⁵ NAICS also lists some typical sectors within the retail trade sector, including motor vehicle and parts dealers, miscellaneous store retailers, and non-store retailers.⁸⁶

From the definitions and industries listed by both China and the United States in the retail sector, despite the differences in wording, they both acknowledge similar fundamental characteristics of retail businesses. These characteristics include that (1) retail businesses do not primarily engage in the production of goods themselves, and (2) they generate profits by selling goods to the public or end consumers and providing additional services.⁸⁷

In this Note, the retail companies being analyzed adhere to these fundamental characteristics. That is, when a company's primary business model involves obtaining goods from third parties (the suppliers) and generating profits by selling them to the public or end consumers, it falls within the scope of the retail companies discussed in this Note. A classic example is Target.⁸⁸ Apart from its "Target Brand" listed on the website, all products sold in Target stores depend on third-party suppliers.⁸⁹ Target earns profits by selling these third-party goods. Companies that sell products to the market, either directly or through the sale of raw materials are outside the scope of this Note.

E. The Bankruptcy of Retailers is an Important Aspect of the Bankruptcy Legal System

According to data from the National Retail Federation, in 2024, the collective GDP impact generated by the 4.6 million retail establishments in the United States was \$5.3 trillion.⁹⁰ This statistic highlights the immense economic significance of the U.S. retail sector. Furthermore, the U.S. retail industry stands as the largest private-sector employer in the nation.⁹¹ It directly provides employment opportunities for approximately 32 million individuals.⁹² Beyond these direct hires, the industry's ripple effect is felt across the broader job market, supporting 55 million jobs in various related sectors, mainly their suppliers, collectively constituting a substantial 26.0% of the national total employment.⁹³

These numbers underscore the profound impact of the retail sector on the American economy, not only through its contributions to GDP but also as an important driver of employment opportunities for millions of individuals.⁹⁴

85. *See supra* notes 83–84.

86. *See 2017 NAICS, supra* note 83 (codes starting with 44 or 45 are industries within the retail trade sector).

87. *See supra* notes 6–15 (discussing the similar characteristics observed in both classification systems).

88. *Suppliers*, TARGET, <https://corporate.target.com/sustainability-governance/responsible-supply-chains/suppliers> [https://perma.cc/8Y5Y-VTX4].

89. *Id.*

90. THE ECONOMIC IMPACT OF THE US RETAIL INDUSTRY 1, tbl.E-1, 4, tbl.E-4 (2024), https://5447ef72a1918787c638-f401d17819b7723bf503905fe6b22b93.ssl.cf1.rack-cdn.com/pdf/NRF_RetailsImpactReport_March2024.pdf [https://perma.cc/YF2A-NLEH].

91. *Id.*

92. *Id.*

93. *Id.*

94. *Id.*

For the Chinese market, the retail industry also holds a significant share of the economy.⁹⁵ According to an official report from the Ministry of Commerce of China, the retail industry is defined as a “foundational sector of the national economy.”⁹⁶ As of the end of 2019, the retail industry directly employed 61.5 million people.⁹⁷ In 2020, the retail industry reached a scale of over 4 trillion Chinese Yuan, accounting for approximately 4.07% of the GDP, making it the eighth-largest industry in the entire country.⁹⁸ This data underscores the substantial role of the retail industry in China’s economic landscape.

Based on data from both China and the United States, it is evident that the retail industry plays a significant role in economic development in both countries. It has also driven substantial employment opportunities within the retail sector itself and among upstream and downstream businesses. However, since the COVID-19 pandemic in 2019, the retail industry has faced severe challenges in both China and the United States.⁹⁹ In the United States, retail giants including Ascena Retail, J. Crew, Guitar Center, J.C. Penney, and Party City filed for bankruptcy during the pandemic.¹⁰⁰ In China, a notable example is the Better Life Group, which ranked 18th in the country’s retail industry in 2019 and filed for bankruptcy in 2023.¹⁰¹

In addition to the impact on the domestic economies and suppliers of retail bankruptcies in both China and the United States, there may also be consequences for cross-border suppliers within each country. For example, nearly half of J. Crew’s top 30 unsecured creditors were Chinese supplier companies.¹⁰² Similarly, in the case of Forever 21, eight of its top 20 unsecured creditors were Chinese supplier companies, with a total claim amount exceeding \$50 million dollars.¹⁰³ Therefore, if there is a resurgence or further intensification of the wave of retail bankruptcies, it can be anticipated that more cross-border creditor

95. MINISTRY OF COMMERCE OF THE PEOPLE’S REPUBLIC OF CHINA, 中国零售行业发展报告 2018/2019 [CHINA RETAIL INDUSTRY DEVELOPMENT REPORT 2018/2019] (2019) (China), <http://images.mofcom.gov.cn/ltfzs/201909/20190920083807922.pdf> [https://perma.cc/Z6PH-RVT8].

96. *Id.*

97. 零售业对我国经济社会的影响评估报告 [Assessment of The Impact Of The Retail Industry On China’s Economy And Society], CHINA CHAIN STORE & FRANCHISE ASS’N, (Oct. 26, 2021) (China), <http://ccfa.org.cn/portal/cn/xiangxi.jsp?id=442915&type=33> [https://perma.cc/666J-6GTP].

98. *Id.*

99. For observations on the U.S market, see *The Retail Evolution’s Greatest Acceleration*, *supra* note 4. Regarding China’s market, see Ellen Zhang & Joe Cash, *China’s Factory, Retail Sectors Skid as COVID Hits Growth*, REUTERS (Dec. 14, 2022), <https://www.reuters.com/world/china/chinas-factory-retail-sectors-skid-covid-hits-growth-2022-12-15/> [https://perma.cc/N68X-9R6B].

100. Andy Markowitz, *14 Iconic Retailers That Fell Into Pandemic Bankruptcy*, AARP (May 5, 2021), <https://www.aarp.org/money/credit-loans-debt/info-2020/bankrupt-retail-chain-store-list-is-growing.html> [https://perma.cc/T3C5-5B2J]; Caroline Jansen, *Party City to Close All Stores in Bankruptcy*, RETAIL DIVE (Dec. 23, 2024), <https://www.retaildive.com/news/party-city-chapter-11-bankruptcy-close-stores-liquidation/736219/> [https://perma.cc/QX9D-QB93]; Daphne Howland, *How Ascena Went Bankrupt*, RETAIL DIVE (July 23, 2020), <https://www.retaildive.com/news/how-ascena-went-bankrupt/582053/> [https://perma.cc/S8H9-NCX9].

101. See generally BETTER LIFE COMMERCIAL CHAIN CO., LTD., ANNOUNCEMENT ON BEING APPLIED FOR REORGANIZATION AND PRE-REORGANIZATION BY CREDITORS (2023), <https://file.finance.qq.com/finance/hs/pdf/2023/07/08/1217237149.PDF> [https://perma.cc/348F-N72H]. This document is publicly disclosed in accordance with the Shenzhen Stock Exchange “Stock Listing Rules.”

102. Du Jiang et al., *2020 U.S. Chapter 11 Bankruptcy Review: An Overview of the U.S. Market and the Retail Industry in the Face of the Pandemic*, JUNHE (Feb. 27, 2021), <https://www.junhe.com/law-reviews/1407> (on file with the *Journal of Corporation Law*).

103. *Id.*

claims may arise. Therefore, a comparative study of the rules in China and the United States regarding the protection of supplier creditors carries important practical significance. By analyzing the current challenges in China's bankruptcy protection system and drawing on U.S. experience, it will be possible to enhance the coordination of bankruptcy law practice in both countries and strengthen supplier creditor protection.

III. ANALYSIS

A. Challenges Under the Current Chinese Approach

The most common criticism of Article 18 arises from the ambiguity surrounding the criteria for making such determinations.¹⁰⁴ Bankruptcy law and related judicial interpretations do not provide a clear standard which administrators should follow to decide whether to assume the contract.¹⁰⁵ The only widely accepted principle, which has not been formally codified, is that all dispositions of the debtor's property in bankruptcy should be based on preserving and enhancing the value of the bankruptcy estate.¹⁰⁶ This principle is widely acknowledged by scholars and practitioners, but due to the lack of official recognition by either legislative bodies or the Supreme People's Court, even this vague guiding principle may not be a binding opinion in practice.¹⁰⁷

Additionally, Article 18 provides no remedy for creditors whose contract has been terminated by the administrator. According to Article 566 of civil code, remedies are available after the contract be rescinded.¹⁰⁸ However, the remedies listed in Article 566 only apply to rescissions caused by the circumstances outlined in Article 563.¹⁰⁹ The termination of a contract due to one party entering bankruptcy proceedings does not fall under the scenarios listed in Article 563.¹¹⁰ Therefore, contracts terminated based on Article 18 of the Enterprise Bankruptcy Law do not fall under the specific circumstances outlined in Article 563 and are thus not eligible for the remedies provided in Article 566.

Another possible interpretation is that, although the Enterprise Bankruptcy Law does not specify remedies for contracts terminated under Article 18, similar provisions in the Civil Code can be directly applied. However, the bankruptcy law is a special law under the *lex specialis* principle, and according to the principle, special laws take priority over general laws.¹¹¹ Thus, the general contract law remedies cannot be applied to contracts terminated under the Enterprise Bankruptcy Law Article 18.

104. Shimin Wu (武诗敏), 破产管理人待履行合同选择权行使的限制 [The Limitations on the Exercise of the Administrator's Right to Choose Whether to Continue Performing Contracts Awaiting Performance in Bankruptcy], 40 法商研究 [STUD. L. & BUS.] 158–59 (2023) (China).

105. *Id.*

106. Ming Qi (齐明), 论破产法中债务人财产保值增值原则 [The Principle for Bankruptcy Estate Maintaining], 12 清华法学 [TSINGHUA UNIV. L.J.] 159 (2018) (China).

107. *Id.*

108. Release from Contractual Agreements, art. 562 FADIAN (China); Legally-prescribed Release from Contract, art. 563 FADIAN (China).

109. The Legal Effect of Contract Termination, art. 566 FADIAN (China).

110. Legally-prescribed Release from Contract, art. 563 FADIAN (China).

111. Jianmiao Hu (胡建淼), *How to Apply Laws When There is a Conflict of Laws*, THE NAT'L PEOPLE'S CONG. OF THE PEOPLE'S REPUBLIC OF CHINA (Nov. 16, 2020), http://www.npc.gov.cn/npc/c2/c30834/202011/t20201116_308737.html [https://perma.cc/2WNA-4NMY].

The consequence of the lack of a clear standard is that the counterparties to contracts (creditors) can only wait and accept the decisions made by the administrator without any means to challenge or seek remedies for the administrator's determinations. This conclusion is reinforced by the fact that almost all plaintiffs who file lawsuits under Article 18, concerning the rejection of contracts, typically assert that their contracts do not fall within Article 18 of the Bankruptcy Law.¹¹² In other words, they argue that these contracts are not "contracts on which both parties have yet to perform," implying that the administrator lacks the authority to make a choice, rather than the administrator failing to meet any specific standard or exercise a proper choice.

In fact, the restrictions on the administrator's discretion under Article 18 of Enterprise Bankruptcy Law are mainly governed by the requirement in Article 69 of Enterprise Bankruptcy Law that "the administrator shall report to the creditors' committee."¹¹³ Additionally, according to Article 15 of the "Supreme People's Court Provisions on Several Issues Concerning the Application of the <PRC Enterprise Bankruptcy Law> (III)," when the administrator disposes of the debtor's major property as stipulated in Article 69 of the <PRC Enterprise Bankruptcy Law>, they must prepare a property management or price adjustment plan in advance and submit it to the creditors' meeting for a vote.¹¹⁴ If the creditors' meeting does not approve the plan, the administrator cannot proceed with the disposal.¹¹⁵

However, whether it is the reporting requirement under Article 69 of Enterprise Bankruptcy Law or the voting requirement established by the Supreme People's Court, these limitations do not restraint the administrator's discretion in this matter. In practice, most of the creditors' committee are controlled by powerful financial institute creditors, most of them are secured creditors.¹¹⁶ Secured creditors, who have collateral, may not be concerned about the small debtors like suppliers and the performance of day-to-day operating contracts because the only thing matters to them is the value of the collateral, which affects the amount they can recover.¹¹⁷

On the other hand, unsecured creditors, particularly when other contracts are confirmed to assume, may see the debts arising from those contracts initially on par with their unsecured claims, elevated to debts incurred for the common benefit of creditors that can

112. Shimin Wu (武诗敏), *supra* note 104, at 158.

113. Qiye Pochanfa (企业破产法), [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007), art. 18 & art. 69 P.R.C. LAWS.

114. Zuigao Renmin Fayuan Guanyu Shiyong <Zhonghua Renmin Gongheguo Qiye Pochan Fa> Ruogan Wenti De Guiding San, Fashi [2019] San Hao (最高人民法院关于适用《中华人民共和国企业破产法》若干问题的规定 (三), 法释 [2019] 3 号) [Provisions on Several Issues Concerning the Application of the <PRC Enterprise Bankruptcy Law>, Judicial Interpretation No. 3, art. 15 [2019]] (promulgated by the Judicial Comm. Sup. People's Ct., Mar. 27, 2019, effective Mar. 28, 2019).

115. *Id.*

116. Weihong Chi (池伟宏), 法庭外金融机构债委会与法庭内债委会的衔接 [The Coordination Between the Creditors Committee of Financial Institutions Outside of Court and the Official Committee within Court Proceedings], 天同律师事务所 [Tiantong L. Firm] (June 17, 2021), <https://mp.weixin.qq.com/s/ZOe9HjwSN7xptUPILVtrVA> [https://perma.cc/WJK9-9KW2] (indicating that a creditors' committee of financial institutions is primarily composed of creditors with larger claims. This committee effectively leverages its advantage in coordinating among creditors, thereby improving both the success rate and efficiency of having the reorganization plan approved by the creditors' meeting.).

117. *Id.*

be paid at any time.¹¹⁸ This can have implications for their standing in the restructuring process.¹¹⁹ Since potential change can be hurtful to their interests, they may have motivation to reject as many unperformed contracts as possible to have them treated as general unsecured claims.

For suppliers, waiting for the administrator to decide on whether their contracts will be assumed in a situation with such uncertain standards can be frustrating. On the other hand, the lack of clear guidance in bankruptcy law on how contracts that are terminated under Article 18 should be remedied further complicates the protection of supplier rights.¹²⁰ Under the provisions of Chinese Civil Code, terminated contracts can obtain remedies such as restoration of the original position, compensation, etc., as provided in Article 566 of the Civil Code and related rules.¹²¹ However, these remedies do not apply to contracts terminated under Article 18.¹²² This gap in remedies for contracts terminated under Article 18 has made it much harder for suppliers to protect their rights.

In summary, due to the lack of clear standard for administrators' decisions and the absence of specific remedies for contracts terminated under Article 18, the rights of suppliers become extremely challenging to protect once a creditor enters the bankruptcy process.

B. Challenges and Experiences from the U.S. Practice

The first critiques are about how the court should apply the business judgment test.¹²³ There are two levels of business judgment test regarding this issue. The first one is the court should go "beyond the traditional corporate law scope of inquiry and superimpose[] their own business judgment upon that of trustees and debtors in possession."¹²⁴ The other is the traditional business judgment approach, in which the court assumes that the decision is made on an informed basis, in good faith, and in honest belief that the decision is best for the company's interest.¹²⁵ The court should approve a decision "unless it finds that the debtor-in-possession's [(DIP)] conclusion that rejection would be 'advantageous is so manifestly unreasonable that it could not be based on sound business judgment, but only on bad faith, or whim or caprice.'"¹²⁶

The significant differences between the two tests may lead the court to make completely opposite determinations on the same issue. If the court takes the former approach, the decisions by the trustee and the DIP will be placed under great uncertainty. Similarly, the suppliers will be unable to predict whether their contracts will be assumed. However,

118. *Why Supplier Engagement is Critical*, *supra* note 3.

119. *Id.*

120. *See Chi*, *supra* note 116.

121. Art. 566, § 3 (2020) FADIAN (China) (indicating that "[a]fter the contract is terminated, if the contract has not yet been performed, the performance shall be terminated; if the contract has been performed, the party may request restoration to the original status or take other remedial measures according to the performance situation and the nature of the contract, and shall have the right to request compensation for losses" and that "[i]f a contract is terminated due to breach of contract, the party entitled to terminate the contract may request the breaching party to bear liability for breach of contract, unless otherwise agreed by the parties").

122. *See id.*

123. 7 COLLIER ON BANKRUPTCY ¶ 1108.07 (16th ed. 2024).

124. *Id.*

125. *In re Pomona Valley Med. Grp., Inc.*, 476 F.3d 665, 670 (9th Cir. 2007).

126. *Id.* (citing *Lubrizol Enter. v. Richmond Metal Finishers*, 756 F.2d 1043 (4th Cir. 1985)).

if the court applies the latter approach, suppliers will be in an extremely passive position since the trustee or DIP can decide to reject the executory contract between the supplier and the debtor for the most minimal reason, and the supplier has no way to predict how their contract will be handled.¹²⁷

The inconsistent reasoning and analysis displayed by the courts on issues related to the trustee and DIP's discretionary authority and the review standard of the business judgment test regarding the executory contracts is indeed confusing. However, amidst this uncertainty, many of the bankruptcy courts have provided guidance on how to apply the relatively vague concept of "business judgment." For example, in *In re Minges*, the court "suggested [that] the bankruptcy court was to put itself in the trustee's place and, accepting his or her assumptions and projections, test that decision-maker's exercise of business judgment."¹²⁸ In *Richmond Leasing*, the court considered factors like "the risks of the proposed transaction, the available alternatives, and the danger of prejudice"¹²⁹ Thus, although the confusion brought by the uncertainty of the business judgment test existed for a long time, some courts have found their way out by interpreting this standard using their discretion.¹³⁰ Therefore, the test is still a good starting point for legal analysis, but what needs improvement is how courts view specific cases within their discretion.

There are also other critiques.¹³¹ First, in normal corporate settings, fiduciary duties are primarily enforced by shareholders.¹³² Critics argue that the enforcement mechanisms for fiduciary duties in bankruptcy are not as robust or well-defined as in non-bankruptcy scenarios.¹³³ Critics also point out that while there is extensive judicial explication of fiduciary duties under Delaware corporate law, the application of these duties in bankruptcy cases is often neglected.¹³⁴ Questions arise about how these duties should be applied, who can enforce them, and how they interact with bankruptcy-specific remedial provisions.¹³⁵ However, these issues have sparked extensive discussion among scholars, and many have already proposed recommendations.¹³⁶

127. See Siegal, *supra* note 59 (discussing recent precedent infusing uncertainty into the doctrine).

128. D. Michael Lynn, *The Toolbox: The Business Judgment Rule*, BLOOMBERG L. (Mar. 4, 2015), <https://news.bloomberglaw.com/bankruptcy-law/the-toolbox-the-business-judgment-rule> (on file with the *Journal of Corporation Law*).

129. *Richmond Leasing Co. v. Cap. Bank, N.A.*, 762 F.2d 1303, 1312 n.11 (5th Cir. 1985).

130. See Lynn, *supra* note 128 (discussing the business judgement rule and other possible standards).

131. See generally Stephen J. Lubben, *Taking Corporate Bankruptcy Fiduciary Duties Seriously*, 49 J. CORP. L. 549 (2024) (discussing problems with Chapter 11 and fiduciary duties).

132. *Id.* at 561–62.

133. *Id.* at 562.

134. *Id.* at 553.

135. *Id.*

136. See generally Lubben, *supra* note 131 (indicating that the court should enhance the enforcement mechanisms for fiduciary duties in bankruptcy cases to address opportunism and unchecked behavior). Additionally, the author suggests a more active approach by DIP boards in considering specific steps to meet their fiduciary duties and maximize estate value in Chapter 11 reorganizations. *Id.*; see also John A. E. Pottow, *Fiduciary Duties in Bankruptcy and Insolvency* (Univ. of Mich. L. Sch. L. & Econ. Working Paper, Art. 135, 2018), https://repository.law.umich.edu/cgi/viewcontent.cgi?article=1246&context=law_econ_current (indicating that the court could take a replacement of the DIP fiduciary with an external trustee to manage the challenging fiduciary obligation of "internal" loyalty in the context of general default).

IV. RECOMMENDATION

As the first significant amendment is gradually approaching,¹³⁷ this will be the opportunity to address many legal gaps that have existed in practice since 2007, and to clarify the judicial interpretation related to bankruptcy law released by the Supreme People's Court in forms such as judicial interpretations and meeting briefs, making them explicit in the form of law. Thus, the amendment should consider making certain changes based on both on China's reality and the United States' experiences.

A. *Clarifying the Remedies for the Termination of Executory Contract*

The Civil Code of the People's Republic of China has clear provisions on the statutory termination and remedies of contracts and such rules are not reflected in the Enterprise Bankruptcy Law.¹³⁸ For supplier creditors, their profits and operations significantly rely on retail companies for secondary distribution in the market since they do not sell directly to consumers.¹³⁹ This makes the suppliers' business revenue primarily dependent on the operation of the retail companies.¹⁴⁰

In cases where suppliers terminate the executory contracts, the suppliers will not only lose their profits from the original contracts but will also face substantial losses due to the significant reduction in the realization of their claims.¹⁴¹ This undoubtedly exacerbates the bankruptcy risk of the suppliers themselves. On the other hand, if the bankruptcy law explicitly permits executory contracts that are terminated by the administrator due to bankruptcy proceedings to seek remedies, it would greatly impact the suppliers' capacity to sustain their operations while the debtor is undergoing bankruptcy.

According to both rules regarding contract termination under Chinese Civil Code and the provisions of 11 U.S.C. § 365(k) in United States bankruptcy code, the remedy for termination of contract will ultimately manifest as monetary compensation resulting from

137. See Xinhua News Agency, *supra* note 8.

138. See Civil Code § 3 (2020) (China).

139. See generally Matthew Ramirez, *Bimbo Bakeries: Business Model, SWOT Analysis, and Competitors 2024*, PITCHGRADE (May 8, 2024), <https://pitchgrade.com/companies/bimbo-bakeries> [<https://perma.cc/QGA4-6ZML>] (indicating that Grupo Bimbo is one of the world's largest bakery suppliers and its revenue depends on "the production and distribution of baked goods to retail customers, foodservice establishments, and convenience stores").

140. *Id.* In view of their reliance on these companies for their business model, the failure of these retail businesses is detrimental to the supplier.

141. The concept of the "actual realization rate" does not provide a reference value for determining the amount of payment creditors receive. In Chinese judicial practice, debtors often pay unsecured creditors with a certain amount of cash and settle the remaining debt with their stock. However, in the restructuring plan, they set a restructuring price far above the actual market value of the stock to achieve a nominal 100% realization rate. For an example of this practice, see ADMINISTRATOR OF PANGDA AUTOMOBILE TRADING GROUP CO., LTD., 庞大汽贸集团股份有限公司重整计划 [PANGDA AUTOMOBILE TRADING GROUP CO., LTD. TURNAROUND PLAN] (2019) (China), <http://qxb-pdf-oss-cache.qixin.com/AnBaseinfo/24394c5d2b67725e8391515db6c85efc.pdf>, pg. 23-4 (on file with the *Journal of Corporation Law*). In the 2019 restructuring of Pangda Group, the stock price set in the restructuring plan was 5.98 Chinese Yuan per share, but at the time the restructuring plan was disclosed, the public trading price of its stock was only 1.19 Chinese Yuan. *Id.* That being said, the actual realization rate for the unsecured creditor in this case is 19.8%, meaning that the creditors lost almost 80% of the monetary value of their credit. *Id.*

various forms of relief.¹⁴² In bankruptcy processing, this kind of monetary compensation will be settled as unsecured claims of the suppliers, together with their existing claims.¹⁴³

In practice, gaining the support of unsecured, small-amount creditors for the restructuring plan by fully compensating their minor claims is a common approach.¹⁴⁴ However, if remedies related to the termination of executory contracts were to be applied—whether following the existing Civil Code rules or a more specific rule solely for bankruptcy cases—it would substantially improve the protection available to supplier creditors and other small-amount creditors. Additionally, it could contribute to market stability. Thus, the Enterprise Bankruptcy Law should consider clarifying the remedies that can be sought after an executory contract is terminated in this upcoming amendment.

B. Clarifying the Legal Standard for the Administrators' Discretion on Executory Contract

As previously analyzed in this Note, the almost unrestrained discretionary power that the administrator currently holds over executory contracts under the existing Enterprise Bankruptcy Law has been widely criticized. Whether it is for the court, the creditors' committee, or individual supplier creditors to supervise the administrator, this upcoming amendment should consider specifying the standards with which the administrator should apply regarding the executory contract's determination.¹⁴⁵ Drawing from the existing experiences in the United States, the judgment method that stipulates this principle from a commercial rather than legal perspective can be adopted.¹⁴⁶ However, it should be modified according to the Enterprise Bankruptcy Law and the overall legal structure in China.

Firstly, the analysis approach for the business judgment test in the United States system is too vague and inconsistent, and there is no similar concept in Chinese law.¹⁴⁷ Therefore, it should be specified directly, such as requiring the administrator to determine the executory contracts based on a goal of ensuring the preservation and appreciation of the debtor's interests. Once these principles and rules are established, China's unified judicial system, where local and central courts are not independent of each other, will provide better conditions for implementing a nationwide test compared to the United States. Therefore, the revised business judgment test will maintain a high degree of uniformity, avoiding the inconsistencies in court standards currently faced by U.S. bankruptcy law.

142. See 11 U.S.C. § 365(k); see also Civil Code § 3 (2020) (China).

143. § 365(k); Civil Code § 3 (2020) (China).

144. SHANGHAI ADVANCED INSTITUTE OF FINANCE & CHINA ACADEMY OF FINANCIAL RESEARCH & GLOBAL FINANCE LEADERS FORUM, 中国上市公司破产重整白皮书 [BANKRUPTCY REORGANIZATION WHITE PAPER OF CHINESE LISTED COMPANIES] (2022) (China), <https://www.saif.sjtu.edu.cn/uploads/all-files/202301/17/1673945732126307.pdf>, pg. 12 (on file with the *Journal of Corporation Law*). From 2018 to 2021, among the 41 mainland China-listed companies included in the statistics, all have fully paid small unsecured creditors in cash in their restructuring plans. *Id.* In 31 of these companies, the amount limited to small unsecured creditors is below 500,000 Chinese Yuan (calculated based on the offshore exchange rate of Chinese Yuan to USD on November 3, 2023, it is approximately 68,439.70 USD). *Id.*

145. Xinhua News Agency, *supra* note 8.

146. *Supra* Part II.B.

147. *Id.*

Secondly, this standard should be higher than the requirements for the administrator in Article 27 of the current Enterprise Bankruptcy Law.¹⁴⁸ Also, it should clearly state in Article 27 that concerning matters of executory contracts, a higher standard applies to the administrator. Additionally, the standard should also be included in Article 18 so the standard will not only apply to the administrator but also to the debtor and any agency of the debtor regarding this issue.¹⁴⁹

In the U.S. bankruptcy system, fiduciary duty and the business judgment test apply not only to trustees but also to DIPs.¹⁵⁰ Many of China's large-scale bankruptcy reorganization cases, including those listed companies, have applied the DIP system under Articles 73 and 74 of the Enterprise Bankruptcy Law.¹⁵¹ Therefore, China should also consider including personnel who may bear responsibility under the DIP framework of U.S. bankruptcy law within the scope of the business judgment test.

Lastly, the assessment of "business judgment" in United States courts heavily relies on the court's discretion, a reality which is bolstered by the United States' common law tradition which supports such discretion. On the other hand, in China, which lacks this common law tradition, there is a greater necessity to explicitly define the criteria for this test in its legal system.¹⁵²

C. Introducing the Critical Vendor Payment

To "fairly settl[e] the credits and debts" is one of the most crucial goals in Chinese bankruptcy law.¹⁵³ This principle is not only about ensuring that all creditors are compensated in accordance with the order prescribed by bankruptcy law, but it should also be logically understood as permitting certain creditors to receive preferential treatment when their actions can lead to better overall results for all creditors or facilitate smoother progress in the debtor's bankruptcy proceedings. In essence, it is about balancing the interests of all stakeholders to achieve the best possible outcome.

Therefore, in combination with the relevant tests of critical vendor payment formed in the practice of U.S. bankruptcy law, the upcoming amendment should consider stipulating certain exceptional circumstances. That is, when full realization to certain creditors can (1) benefit all creditors, or (2) conspicuously facilitate the advancement of the debtor's bankruptcy proceedings, and (3) it is confirmed that the creditor is irreplaceable, the court should permit the creditor to receive realization that is more prioritized than its original order.

148. Enterprise Bankruptcy Law of the People's Republic of China (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006) art. 27 P.R.C. LAWS.

149. *Id.* art. 18.

150. *See supra* Part III.B.

151. Shan Minghao (单明皓), 浅议我国债务人自行管理制度的实践与完善 [Discussion on the Practice and Improvement DIP System in China], ALLBRIGHT L. (July 3, 2022), <https://www.allbright-law.com/CN/10475/5e235d433b930aef.aspx> [https://perma.cc/DR3R-NDTA].

152. *See generally* Int'l L. Note, *Chinese Common Law? Guiding Cases and Judicial Reform*, 129 HARV. L. REV. 2213 (2016) (explaining China's burgeoning common law system which has not developed a common law analog to the business judgment rule).

153. Enterprise Bankruptcy Law of the People's Republic of China (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006) art. 1 P.R.C. LAWS.

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V. CONCLUSION

Thus, drawing on the experience of U.S. bankruptcy law, China should consider revising relevant clauses that may affect the rights of supplier creditors in this upcoming legislative amendment. Such amendments will greatly enhance the practical impact of the Enterprise Bankruptcy Law.