

# The Demerit and Improvement of Trustee System in Enterprise Reorganization in China

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**Abstract.** Current trustee system in China has defects on the legislation in the area of system design and content arrangement. To bring the vitality of the trustee system into full play, the entire system needs to be improved. It is necessary not only to reasonably divide the functions of the courts and trustee, so as to ensure the fairness of the procedure. Moreover, it is necessary to build an intelligent selection platform for trustee to break geographical protection. By establishing a trustee's reward incentive and restraint system, forming a trustee's association, as well as improving the trustee's occupational insurance system to increase their business level and management efficiency.

**Keywords:** trustee, reorganization, bankruptcy system, German InsO.

## 1. Introduction

In the process of enterprise reorganization, trustee is the main promoter of the bankruptcy procedure and the specific executor of the bankruptcy affairs. The ability and quality of the trustee are the key factors for whether the bankruptcy process can be carried out smoothly and the enterprise can be reorganized and recovered. The plight of the trustee system in the reorganization process in our country determines the necessity and urgency of the system reform. The following analysis focuses on the role play and functional allocation of trustee in the reorganization process in China. It is proposed to clarify the duties and responsibilities between the trustee and the debtor, and use legal transplantation to promote the reorganization system.

## 2. Current status of the trustee system

### 2.1 The lack of independence of trustees

A trustee refers to a relatively independent and neutral individual or professional institution with statutory powers and duties, which is responsible for the operation of the enterprise, the management and disposal of bankruptcy assets, and the formulation and execution of bankruptcy plans in the bankruptcy procedure. The current trustee system is born out of the "liquidation group" referred to in the Civil Law, and the "liquidation group" is seriously affected by the "government-led" color. The trustee system is also unavoidably affected by it, reflecting a strong "court-led" color. This has also led to a misalignment of the roles and functions of the trustee and hindered the healthy development of the trustee team. Specially, an official appointment instead of democratic selection has led to the lack of "independence" of trustee. According to Article 22, paragraphs 1 and 2, of the Enterprise Bankruptcy Law, the trustee is appointed by the people's court. There are only three conditions which the creditor's meeting applies to the people's court for the replacement of the trustee: they cannot perform their duties according to law, they cannot perform their duties impartially, or other incompetence situation. Such "court-led model" can easily lead to corruption. The trustees do not rely on their professionalism and ability to obtain business, but on the relationship with judges. The creditors' meeting is only a temporary organization, after its establishment, it will not continuously monitor the behavior of the trustee. Therefore, in judicial practice, it is rare to apply for a change of trustee through a creditor meeting. Most trustees are

randomly designated by the court. Under such an institutional arrangement, the creditors' meeting has no way or right to distinguish the difference between a good trustee and a bad trustee.

## **2.2 The undermine the neutrality of trustees**

The lack of information disclosure obligations may undermine the "neutrality" of trustees. The Enterprise Bankruptcy Law" and judicial interpretation do not stipulate the trustee's obligation to disclose relevant information of the debtor to the creditor. When the debtor files an application for bankruptcy, he is obliged to submit to the court a statement of property status, a list of debts and claims, and relevant financial and accounting reports. However, these are only the information provided by the debtor unilaterally. Whether the trustee has conducted investigations and checked on this information and what the results are, the creditors will not be able to know unless the trustee voluntarily informs them. It would be difficult to generate substantial supervision of the trustee, when the creditor cannot fully understand the debtor's situation. From the perspective of the trustee, it is more about managing the enterprise and disposing of the property on behalf of the debtor, and the lack of responsibility to creditors will inevitably damage its "neutral" status.

## **2.3 The lack of professionalism of trustees**

The lack of appropriate industry's access standards has led trustees to lack "professionalism". According to Article 24 of the Enterprise Bankruptcy Law, the trustee is usually a social intermediary agency, a liquidation group composed of personnel from relevant departments or organs, or law firms, accounting firms, and bankruptcy clearing offices. In special circumstances, individuals can also serve as trustee, but individuals should take out professional liability insurance. Bankruptcy is both a legal issue and an economic issue.<sup>[1]</sup> Although the company applies for bankrupt, but continues to operate, in such case, the bankruptcy process will be adversely affected by the dynamic environment of the company's operations. As a result, the bankrupted enterprise needs to have certain business decision-making powers to maintain normal operations.<sup>[2]</sup> Therefore, the trustee must not only have legal knowledge to provide the necessary judicial governance; it must also understand the economic and provide effective business decisions. An institution or individual cannot have its qualifications as lawyers or accountants to determine their eligibility to qualify the level of the trustee. The Trustee should be a business expert with legal expertise, knowledge of management, and can diagnose the cause of the enterprise's crisis and provide the right "medicine".

## **2.4 The lack of activity of trustees**

The market reward incentive mechanism is replaced by officially designated remuneration, which has resulted in trustees lacking "activity". According to the Enterprise Bankruptcy Law provision of Article 28(2), the court determines the remuneration of the trustee. Article 2 of the Supreme People's Court's "Regulations on Determining the Compensation of Administrators in the Trial of Enterprise Bankruptcy Cases", the trustee's compensation is determined in proportion to the total value of the property finally settled by the debtor in a stepwise manner. The remuneration of the trustee needs to be included in liquidation plan or reorganization plan. Once these applications are approved by the court, the trustee can get definitive pay unless dereliction of his duty. Even though Article 9 of the Regulation point out that, when the court determines or adjusts the trustee's remuneration plan, it should consider the case complexity, trustee diligence and his contribution to reorganization etc. However, the court is not an active supervisor of the trustee and usually relies on the trustee's report for a passive supervision. In the absence of an effective incentive pay system, it may lead to a situation in which trustees report everything, they are not will to take responsibility, and lack motivation in the post-reorganization process.

### **3. Enlightenment for improving China's trustee system**

#### **3.1 Starting from the functions and duties of the trustee**

The functional scope of the courts and trustees should be reasonably divided to further ensure the fairness of procedures. In praxis, the absence of trustee's duties and offside of courts power are not uncommon. The reason lies in the unclear responsibilities between the both sides. The trustee's duties are to manage the enterprise and dispose of bankruptcy property, which involves the fundamental interests of creditors, debtors and shareholders. The court is not driven by interest in the bankruptcy proceedings. Therefore, a fair process must be provided creditors, debtors and shareholders with the right to participate in the proceedings, including the right to choose trustees. The bankruptcy proceedings involve not only judicial governance, but also business decisions. Court should adhere to the principle of neutrality, and they should not be allowed to interfere too much in bankruptcy proceedings, and should not make decisions that ought to have been made by the trustee. The trustee should prudently decide the internal management affairs of the debtor and disclose the debtor's information to creditors in accordance with the law. Only by maintaining the trustee's independent and strengthening its sense of responsibility can the procedure fairness be further achieved. Here the German Bankruptcy Law can be a reference for the reform of the trustee's system in China. Through the establishment of a "temporary creditor committee", the trustee can be selected through democratic elections by all involved parties. Legislation or judicial interpretation will be used to further refine the trustee's duties and increase more duties about to disclose relevant bankruptcy documents. <sup>[3]</sup>

#### **3.2 Build an intelligent platform for trustee's selection**

In bankruptcy cases, the trustee is usually selected by the local trustee's roster; in some developed provinces and cities, such as the Zhejiang High Court, a grading system of trustees and rules for competitive selection of trustees have been established.<sup>[4]</sup> Shandong High Court has also established a grading system and carried out grading management for trustees. However, the courts in the above two provinces only gave the trustee's name or contact information, and did not give a basic introduction to their professional experience and professional skills. At present, China has not yet established a national network for trustee's roster system. The selection of trustees is still hard to break the geographical limitations. In addition, the development of trustees team in different places is uneven, also the court's selection system for trustees is not uniform, which results quite differences in the trustee's profession and business abilities in different regions. Consideration should be given to establishing a unified national system for trustee management, set up an intelligent selection platform, including qualifications and credit information of trustee.

#### **3.3 Establishing a incentive and restraint system for trustees' pay**

Pay for trustees should be priced by the market. The fixed-standard payment stipulated by the current law does not combine the actual work and effect of the trustee, which cannot motivate the trustee.<sup>[5]</sup> In the "Minutes of the Meeting" of supreme people's court, it proposed that the court may determine the method of payment for trustee according circumstances. By author's opinion, where the case occurred, the size of the target, economic and social influence should be in considering. The payment of trustees should also take the trustee's grade, work effectiveness, and implementation results into account. The German "Bankruptcy Remuneration Regulations" can be a reference here, such as the number of creditors, more creditors indicate that the trustee's workload will be greater, and the pay should be more accordingly. Increase or reduce the reward based on job performance or statutory reasons, such as simple and clear debt and debt relations, settlement of creditors and debtors in the process. It is recommended that the court determine the basic payment, the floating reward is determined by creditors, debtors and shareholders. It can stimulate the trustee's initiative to improve the quality and efficiency of its supervision.

### 3.4 Establishing a national trustee's association and relevant insurance system

The trustee has the characteristics of comprehensive business and diversified functions. Existing Bar associations, Association of Accountants etc. unable to integrated management across different sectors in field, only the trustee to establish their own associations can do. The establishment of Trustees Association is conducive to the formulation of a unified business operation specifications; it is also conducive to the mutual exchanges of trustees nationwide, and can effectively protect the legal rights and interests of trustees, so as to achieve healthy competition of the trustee's team. Some cities in China have already established trustee's association, however, this can only exacerbate the imbalance in field of promotion of trustees between regions. In Germany, a national unified bankruptcy trustees association (VID) has been established. According to Article 3 of the association, the condition for joining the association is that members must have been engaged in trustee activities in the last 3 years, and they can submit certification documents such as appointment certificates to participate in 10 public and 2 closed enterprises bankruptcy proceedings. In addition, applicants also need to pass the VID's industry standard assessment (ISO: 9001) and take an oath to maintain their independence, transparency and a high sense of responsibility. It is recommended to refer to the German model: establish a national unified trustees association, determine membership eligibility through the association's constitution, and improve membership qualifications and business capabilities through regular training and assessment. In addition, in order to avoid the losses that trustees may cause in the performance of their duties, the state should encourage insurance companies to speed up the complete set of professional insurance systems. At present, China's trustee's professional liability insurance is still in backward, and the first case of trustee professional liability insurance appeared in 2018.<sup>[6]</sup> The construction of occupational insurance system still has a long way to go.

## 4. Conclusion

Due to the deficiencies in the legislative system design and content arrangement, the trustee system in the current reorganization's process is inefficient in China. It is suggested to clarify the different responsibilities and rights of all the parties involved in the procedure, so as to form the system of checks and balance between their rights. It would be expected, Enterprise Bankruptcy law will be revised and bring more efficiency to enterprise reorganization.

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