

How to Protect the Interests of Lessee after the Bankruptcy of Real Estate Enterprise?

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Abstract: Along with the deepening of supply-side structural revolution, the further cleaning up and disposal of "zombie enterprises" and elimination of overcapacity has become an important part of revolution. Nowadays, how to deal with "zombie enterprises" that is the pillar industries of the economy has become a top priority. The legal issues involved in the bankruptcy of real estate enterprise are numerous and complex, how to balance the interests of all parties and protect the interests of all creditors is the ultimate goal of bankruptcy acceptance courts and administrators. Among the numerous outstanding problems of the enterprise bankruptcy, to certain extent, the lessee with a large number of rental shops is considered as a special type of rights subject. Under the premise of maximizing the interest of creditor and protecting lessee's interest, how to exercise the right of contract termination properly to balance the interests of the parties concerned and maintain the security and stability of market transaction become an obvious practical problem. The purpose of this essay is to analyze relevant regulations in the Bankruptcy Law of China from the perspective of lessee and draw lessons from the protection measures for lessee in the world's bankruptcy system. Discussing when real estate enterprise bankrupts as lessor, how to balance the interests of the lessor and the lessee in a fair and reasonable way to resolve the contradiction between the lessee and the debtor.

Keywords: bankruptcy of real estate enterprise; interest of lessee; protection

1. Introduction

Clause 18, Bankruptcy Law of China stipulate that: "after the people's court accepts the bankruptcy petition, trustee in Bankruptcy has the right to terminate or continue to perform the contract which both party concerned in the contract have not fulfilled the contract yet, and inform the other party. Within two months after the court accepts the bankruptcy petition, or fails to reply within 30 days after receiving the notice from the other party, it shall be deemed to terminate the contract." The article gives trustee the right to choose whether further perform the contract which both parties unfulfilled or not. Lease contract is a main kind of contract both parties have not fulfilled in the bankruptcy proceedings of real estate enterprise. At this point, the interest of the lessee is entirely dependent on the trustee's option. In practice, the trustee often exercises the right of contract termination to thoroughly solve all the possible consequences of the leasing contract. However, the termination for the lessee, especially for those who has just signed a lease agreement, most part of term of the lease has not been fulfilled. If they invest amount of money to decorate the rental building, they will become the worst benefit victims. Therefore, most lessee will complain and unwilling to cooperate to move out from the place they rent. Furthermore, some lessee will take extreme measures against the bankruptcy proceedings and set obstacles for creditors to achieve their claims. In order to alleviate the contradiction between the

creditor and the lessee, eliminating conflict between the interests of the creditors and the interests of the lessee is a subject that needs to be seriously discussed.

2. The Bankruptcy of the Real Estate Enterprise and the Current Legal Protection for Lessee's Rights and Interests

For those bankrupt real estate enterprise who have completed most of the development projects. There are mainly two types lease contract involved: one kind is the shops which the real estate enterprise has not sell and signed contract with lessee directly before the bankruptcy; the other kind is unsold residential property developed by the real estate enterprise and signed contract with lessee. As for the part been leased out to lessee which belongs to the supporting facilities of the residential districts is the right of all the proprietors. It has nothing to do with the essay. This essay will discuss only the lease relationship which refers to the first situation above.

Article 18, Bankruptcy Law of China, entitles the trustee the right to continue or terminate the lease contract. Different options may bring great legal differences. Trustee may choose to continue to perform the lease contract, the trustee and the lessee shall continue to perform their respective rights and obligations in accordance with the original lease contract during the bankruptcy proceedings; when the assets of the debtor has been disposed, according to article 229, Contract Law of China: The change of

ownership during the lease term does not affect the validity of the lease contract. That is the rule "no break of lease with bargain". After the ownership of the lease item been transferred to the third party by trustee, the previous contract will continue to be valid for the new owner.

At the same time, the lessee can also exercise the preemptive right, and may consider whether to buy the premises. For lessee, if trustee choose to continue to perform the contract, that would be the most favorable result for lessee. This is, at the same time, maximum protection for lessee's interests.

However, in practical, in order to liquidate the assets of the debtor, and reduce the risks of transferring the assets which has unfulfilled lease contract during the auction proceedings. Generally, the trustee would choose to terminate the lease contract and the lessee cannot continue to rent the premises. Article 53, Bankruptcy Law of China stipulates that the trustee terminates the contract in accordance with the provisions of this law, the other party has rights to claim for damages as a result of the termination in the bankruptcy proceedings. The consequence of contract termination is the debtor shall be liable for damages. At this point, the lessee can only be ordinary creditor, that means they can only submit a claim filing their own losses, and to participate in the distribution of the property of the bankrupt enterprise, finally. Once entering into such a proceedings, the lessee's interests can hardly be guaranteed as the ordinary creditors after liquidating the bankruptcy costs, preferential claims and secured claims. In addition, the lessee shall have the right to demand the return of the prepaid rent, deposit and so on.

As it should be, the lessee has a special right in addition to exercise the right for damages, namely the right to withdraw. Article 38, Bankrupt Law of China, after the court accepts the bankruptcy petition, the debtor's possession of the property which is not belong to them, the owner of the property may be retrieved through trustee. The rule in this article is the right to withdraw. The right to withdraw is not newly created right of the bankruptcy law, it is already in civil law granting some reasonable right to obligee. The object of the right to withdraw, mainly refers to the accretion to the premises. For example, large amount of decoration and so on. The lessee shall have the right to require the trustee to return the necessary and beneficial fees arising from the accretion. If it is possible to dismantle the part, it may be required to be removed. The failure to dismantle the part may require the trustee to calculate the value of the lease item separately, and require that the auction item corresponding to this part be "retrieved". This part of the cost should be treated as a common benefits debt in the bankruptcy proceedings, and should not be allocated as bankruptcy property.

3. The Relevant Provisions on the Protection of Rights of Lessee in Bankruptcy Proceedings in the World

Different from the leading principle that trustee's right to terminate the lease contract, most of bankruptcy law of foreign countries stipulates limits for the trustee's right of termination refers to the lease contract which both parties fails to fulfill its obligation.

Legislative guide on insolvency law made by United Nations Commission on International Trade Law clearly point out that: purpose of bankruptcy law must rely on and safeguard the social legal values and social values so as to complement one another. That is to say, the bankruptcy law came into its own, but as part of the legal system, it should not conflict with other department, but should be in the same orbit. To balance and regulate itself for the whole society interests. On the premise of maximum maintaining the interests of creditors, Bankruptcy law should take each party concerned into consideration, balancing all parties interests, in order to realize the maximization of the bankruptcy property value instead of favoring the creditor in the legislation. It should be avoided that pursuing the maximization of property value blindly, resulting the unfair and just beneficial to creditor. This would be ultimately harm the legitimate interests of other parties, disrupting economic order and market discipline, and affect market transaction security.

The lease contract is one kind of the contract which is not fulfilled by both parties, and the national legislation has the special exception adjustment. Article 365, Bankruptcy Law of the United States of America stipulates strict limitations for debtors to exercise the right to terminate the lease contract.(2) The clause stipulates that although the debtor (real estate lessor) has the right to terminate the lease contract, the exercise of the right to discharge is extremely strict. It has a prerequisite condition for exercising termination right, unless lessee is willing to move out rental place, otherwise the debtor as the lessor cannot terminate the lease agreement. The bankruptcy law of Germany stipulates that debtor's lease of the house and the lease of the income refers to the premises will continue in a manner that is effective for the bankrupt property.(3) Relative to the legislative spirit of bankruptcy law of the United States, bankruptcy law of Germany pay more attention to the effective continuity of the contract and the protection of trade security. Japan's bankruptcy law stipulates that the general rules governing the performance of a contract are not applicable to a contract that sets the right to use and gain benefit. (4) Japan distinguishes the lease contract from other pending contracts for special treatment. In Taiwan, the bankruptcy law stipulates that the trustee has the right to terminate the lease contract when the lessee is bankrupt, and the trustee is not allowed to terminate the lease contract when the les-

sor fails. It stipulates two different situations respectively which make the provision, in balancing the rights and interests of each party, more perfect and reasonable.(5) The above mentioned, both the civil law countries and the common law system countries, the legislation in the bankruptcy proceedings is mainly concentrated in the limitation on the trustee's lease contract termination right. At the same time, no break of bargain as Principle, trustee can make the lease transfer with lease agreement. This may also complete the final purpose of liquidation of the bankruptcy property. In this process, the lessee can also choose to exercise the "preemptive right" and may even seek to maximize the interests of both the creditor and the lessee. This way, can reflect the final purpose of bankruptcy law, the disposal of bankruptcy assets, in accordance with law, safeguard the legitimate rights and interests of creditors, and can be very good to protect the interests of the lessee, and balance the rights and interests of parties concerned, maintain the safe and orderly law of market transactions.

It need to be pointed out that various countries take the principle of limitation on the trustee's right to terminate contract, but the application of rule of no break of bargain are not always in the same situation. Article 56 of bankruptcy of Japanese stipulated that, the opponent party to the debtor can register the leasing right in order to against the third party. Article 111 of bankruptcy law of Germany stipulated that the premises transferred by trustee for income, the transferee can terminate the lease contract within legal period. Obviously, bankruptcy of Japanese preferred to protect lessee's right. And it is almost the same that both bankruptcy law of China and Germany entitles the transferee to exercise right of contract termination within legal period.

4. The Improvement of Lessee's Right Protection

Once a real estate enterprise bankrupts, as a whole, the leasing contracts is complicated. It is relatively easy to deal with small business shops. However, as to those business shops with large area, they may have invested a lot of money on the decoration. Therefore, how to deal with situations above will be a crucial part for trustee. Without thorough consideration, trustee exercise the right of contract termination will lead to serious situations for both contract parties and unstable social situation.

How do trustee deal with such relationships? Naturally, the main reliance is still on legislative provisions. Compared with countries around the world, Bankruptcy Law of China have few relative clauses on above situations. There are still a lot of uncertainty on those problems. On the lease contract, the lessee is often at a disadvantage position. An unbalanced benefit situation is not fair for lessee. Legislation-perfect and the mechanism-sound

process is necessary in order to make the bankruptcy process more smooth.

4.1. Legislation

4.1.1. Limitation to the trustee's right of contract termination

Clause 18, Bankruptcy Law of China stipulate that: "after the people's court accepts the bankruptcy petition, trustee in Bankruptcy has the right to terminate or continue to perform the contract which both party concerned in the contract have not fulfilled the contract yet, and inform the other party. Within two months after the court accepts the bankruptcy petition, or fails to reply within 30 days after receiving the notice from the other party, it shall be deemed to terminate the contract." That means the termination of contract is preferred by trustee to continue to perform the contract. However, under what condition can trustee exercise the termination right is not clearly regulated. And there is almost no limitations to their right. This may be unfair. As for me, taking the legislation spirit of foreign countries into consideration, giving priority to the beneficial protection of creditor, achieving the ultimate goal of equal protection of every party's benefit concerned. Specifically, to the processing of the leasing contract, we should refer to the usual practice of most countries abroad, limitations to the termination right of trustee is necessary. The lease contract shall continue as far as possible and in the process of disposing of the bankruptcy property with rent. Maximum the value of the bankruptcy property, and also the interest of the trustee. We should divide the lease contracts into two kinds, one for short-term and the other for long-term. As for those short term contracts, it would be easy to deal with. As for those long-term contracts, finding the balance point between exercise the right of termination by trustee and protection the reasonable benefit of lessee will be the better way to solve the problem.

4.1.2. The definition of the scope of liquidating for lessee's damages

Once the trustee exercises the termination right, the lessee's loss is bound to occur. And the composition of its claim for damages includes not only the direct loss of the paid rent, decoration and other input losses, but also the expected loss of profits and other indirect losses. Given the bankruptcy liquidation of the discharge rate is low, the author thinks that "bankruptcy law" should be included all the above losses of lessee within the scope of the lessee's right, this may be more fair and reasonable. In order to lower the lessee's losses to a minimum. As to how to determine the indirect loss, it shall depend on whether the original lease contract has been terminated in advance. If there is no agreement, the lease interest shall be evaluated.

4.2. In practice

4.2.1. Separation of general creditor's right and priority creditor's right

As for the above loss of the lessee, it is necessary to consider whether there is a mortgage on the leased property. If there is a mortgage on the leased property and the mortgage is established before the lease contract, then the loss of the lessee shall be included in the general creditor's right, after the labor creditor's right, tax and priority creditor's right. If the lease contract occurs before the establishment of the mortgage, the order of the claims should be considered. Article 190, the Property Law of China stipulates that "if the mortgaged property has been leased before the conclusion of the mortgage contract, the original leasing relationship shall not be affected by the mortgage right". The mortgagee shall have priority to the mortgaged property after the debtor enters the bankruptcy proceedings, but the priority shall be given to the interests of the lessee after the lease relationship is generated. Due to the mortgagee in set up at the beginning of the mortgage right is knowing there lease of the mortgaged property, as a result, the creditor's rights of lessee shall be within the scope of mortgage priority "to the mortgagee has priority, rather than as an ordinary creditor's rights, round after the mortgagor priority claims, this kind of treatment of creditor's rights and the order is relatively more reasonable. If the mortgaged property is not enough to pay the lessee's creditor's right after realization, the insufficient part shall be included in the ordinary creditor's right.

4.2.2. Protection of the reasonable exercise of the lessee's right of retrieve

Article 38, the bankruptcy law stipulates the "right of retrieve" of creditors. In the lease contract, if the lessee did some decorations and other additions, he has the right to remove the removable addition. If unable to demolish some parts, those can be evaluated along during the evaluation process. In practice, it is not easy for the lessee to exercise the right of retrieve. The administrator shall protect and give full support to the lessee's right of return in accordance with the law.

4.2.3. Intensify the work of the trustee

To strengthen the protection of lessee's rights and interests, first of all, it is necessary to establish the conscious-

ness of fair and safe management of market transactions and improve the quality of trustees themselves. Entrenched in the purpose of the bankruptcy property as soon as possible, The concept which stuck in the mind of trustee is that, if the premise of the lease relationship does not remove may affect the leased property to liquidate, which may eventually lead to serious shrinkage value. the trustee can hardly considered the fundamental interests of the lessee's as creditors. Therefore, it requires trustee to take fully consideration in the practice and draw lessons from other countries' legislative spirit. Try to maintain the continuity of the leasing contract and try not exercise the right of termination will help to strike a balance between lessor and lessee; At the same time, trustee should try to frame the bridge of communication between the lessee and the bankruptcy property assignee, make better dialogue atmosphere with new lessor, the lessee will lease term, the lease item in the communication can reach equilibrium problems such as decorating, also is advantageous to the lessee reduce their losses.

In judicial practice, the issue of protection of the interests of vast majority of creditors is more discussed. However, as a group of creditors, the protection of interests of the lessee is also one of the most important aspects of the fairness of law. Whether it is the bankruptcy of the real estate enterprise or general type of business, the proceed of lease relationship is likely to be encountered. It is hoped that the proposal of this article would lead to the attention of relevant departments regarding to deal with leasing relationships in the proceeding of bankruptcy of enterprise. Furthermore, in order to provide guidelines to trustee and give them directions, it is necessary to make more detailed judicial interpretations or operational guidelines regarding on this issue.

References

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