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A balanced way for China's inter-regional cross-border insolvency cooperation

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Part I Introduction

1.01 This dissertation is about seeking solutions to China's inter-regional cross-border insolvency cooperation. Those solutions are developed mainly on the basis of two groups of comparative studies, including comparison among the cross-border insolvency systems of the four independent jurisdictions in China and comparison between the EU Insolvency Regulation and the UNCITRAL Model Law. In the end, it tentatively provides 10 original recommendations, accompanied with comments, which are entitled "China's Inter-regional Cross-border Insolvency Arrangement" ("CICIA").

1.1 Possibility of Cooperation on a Regional Level

1.02 Integration encourages people to move increasingly across borders. "They studied, worked, got married, had children, purchased property, divorced and died in a region other than the one they were from. Businesses started to offer their products and services across borders on a regular basis. They set up factories and subsidiaries in other regions and acquired companies there."¹ As result, the legal systems of individual jurisdiction become too integral a part to remain isolated. The entire European Union is "a form of cooperation between its Member States",² which is supervised and governed by its regional legal order. Meanwhile, China's integration was partly crystalized by the "one country, two systems" policy. As result, four independent jurisdictions (the Mainland³, Hong Kong, Macao and Taiwan) operate simultaneously and equally effectively within one country. That also gave rise to an inter-regional legal order, which involves the rules regulating the intersection between the Mainland and the three regions. The first intersection concerns interpretation of the constitutional document, i.e. the Basic Law, which is binding on the Mainland and the two SARs. The second intersection relates to the bilateral legal cooperation arrangements. (Please refer to Annex I for more detailed information.) The third intersection happens in the courtrooms of each region. For each decision involving inter-regional factors rendered, the courts make contribution to establishment of the inter-regional legal order.

1.03 What is essential to a regional legal order? Based on the EU's experience, it is loyalty and mutual trust. According to the Oxford English Dictionary, loyalty means faithful adherence to the sovereign or lawful government. In the EU, the principle of loyalty is embedded in the duty of sincere cooperation, which is now stipulated under Article 4(3) TEU (ex Article 10 EC, ex Article 5 EEC). It is a principle "central to the development of Union law since the 1960s and that it

¹ Reding, Viviane, From Maastricht to Lisbon: building a European area of Justice in small steps and great bounds, available at: http://europa.eu/rapid/press-release_SPEECH-13-960_nl.htm (Last visited on 14 June 2016)

² Weller, Matthias, Mutual Trust: in search of the future of European Union private international law, *Journal of Private International Law*, 2015, Vol. 11, No. 1, 64–102, p.73

³ In this whole dissertation the Mainland (China) purely serves as a geographic term to describe the geopolitical area under the jurisdiction of the People's Republic of China (P.R.C.), generally excluding the P.R.C. Special Administrative Regions of Hong Kong and Macao.

still shapes its structure today”⁴. The EU Commission indicated, “the whole EU legal system ... is based on mutual trust.”⁵ However, it is noteworthy that the origin of such cooperation was initiated by an agreement between five European states⁶ and Germany, while the bitter memory left by the World War II was still fresh. In fact, the first agreement to cooperate was founded upon distrust. At that time, France feared of emerging German industry compounded by Germany’s increasing share of European steel production and then proposed the Schuman Plan.⁷ The solidarity in coal and steel production could make any war between France and Germany “not merely unthinkable, but materially impossible”.⁸ The integration of the European Union, including judicial cooperation, was not achieved through a single plan. Nevertheless, it demonstrated that cooperation was also possible if the parties concerned were not in a faithful relationship but fully aware that an individual party was incapable of realizing certain goals alone. That probably explains why there are bilateral legal cooperation arrangements concluded between the Mainland and the three regions before a sense of rooted attachment to their country is fostered and trust in each other is completely built. To deal with a series of contemporary problems and realize a set of goals in the process of integration, it is in the common interest to cooperate and an individual region cannot manage alone. In China, the development of regional legal cooperation is continuing.⁹ Trust is most likely to evolve in contexts in which the parties find themselves in ongoing relationships.¹⁰

1.04 The possibility of inter-regional insolvency cooperation is also connected with the nature of cross-border insolvency. Insolvency proceedings touch upon one of the most long-standing and dynamic relations, which is the debtor-creditor relation. As a predominant metaphor, the limited assets of a debtor are usually described as fishes in a common pool and the creditors as self-interested fishermen.¹¹ The resources in the common pool would be diminished if they

⁴ Klamert, Marcus, *The Principle of Loyalty in EU*, Oxford University Press, 2014, p.1

⁵ European Commission, *Building Trust in Justice Systems in Europe* “Assises de la Justice” Forum to Shape the Future of EU Justice Policy (Press Release), 21 November 2013, available at: http://europa.eu/rapid/press-release_IP-13-1117_en.htm

⁶ The five European states are Belgium, Netherlands, Luxembourg, Italy and France.

⁷ Diebold, William, *The Schuman Plan: a study in economic cooperation, 1950-1959*, New York: Frederick A. Praeger for the Council on Foreign Relation, 1959, p.10

⁸ European Parliament, *Selection of Texts concerning Institutional Matters of the Community for 1950 - 1982*, Luxembourg: European Parliament, 1982, p.47

⁹ For instance, on 21 March 2016, the Executive Vice President of the Supreme People’s Court of the People’s Republic of China at the invitation of the Hong Kong Special Administrative Region (SAR) Government had a meeting with the Secretary for Justice of the Department of Justice of Hong Kong SAR. Both agreed to explore and take forward mutual legal assistance on civil and commercial matters.

¹⁰ Cook, Karen S., Hardin, Russell, Levi, Margaret, *Cooperation without Trust?*, Volume IX in the Russell Sage Foundation Series on Trust, 2005, p.4

¹¹ Block-Lieb, Susan, *Fishing in Muddy Waters: Clarifying the Common Pool Analogy As Applied to the Standard for Commencement of a Bankruptcy Case*, 42 Am. U. L. Rev. 337 1993, p.343; Jackson, Thomas, *The Logic and Limits of Bankruptcy Law*, 1986, p. 12-13; Baird, Douglas G., & Jackson, Thomas H., Adler Barry E., *Cases, Problems and Materials on Bankruptcy* (2nd ed.), Little, Brown and Company, 1990, p.20-30; Jackson, Thomas & Scott, Robert, *On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors’ Bargain*, 75 Va. L. Rev. 155, 1989, p.178.

could not be prevented from overuse by the individual creditors. The common pool problems are often viewed as a multi-player Prisoner's Dilemma game.¹² In the two-person game that is played only once, both players must cooperate in order to maximize their joint welfare;¹³ in the n-person one-shot game, welfare maximization occurs only if all n players cooperate.¹⁴ Accordingly, in order to ensure equal treatment of creditors and maximize value of the debtor's assets, insolvency proceedings are designed as a collective debt collection mechanism. Although the analogy of the assets of an insolvent debtor to a common pool used to be hotly debated among bankruptcy scholars,¹⁵ the conclusion that a need exists for the "collective remedy of bankruptcy" is hardly controversial on national level.¹⁶ As for cross-border insolvency, both the Model Law and the Regulation require that the proceedings must be collective.¹⁷ More importantly, given its nature, cross-border insolvency can possibly bring higher degree of cooperation than ordinary civil and commercial matters. For instance, Taiwan adopted differentiated attitudes towards the civil and commercial judgments rendered in the Mainland, Hong Kong and Macao (which will be explained in Part II), which have been changed in the approved draft of the Debt Clearance Act (the 2015 Draft) issued by the Judicial Yuan of Taiwan in June 2015 and passed by the Executive Yuan of Taiwan in April 2016. It is stipulated under the 2015 Draft that Taiwan intends to apply uniform rules in matters of recognition of cross-border insolvency proceedings regardless of its place of origins among China, Hong Kong, Macao and other foreign countries for equal treatment of creditors.¹⁸

1.2 Lack of a Regional Cross-border Insolvency Framework

1.05 Cooperation is accompanied with uncertainty over the future. Insolvency could be a conflict trigger. Insolvency law on the whole is a response to credit, which is "the disposition of one man to trust another".¹⁹ "The essence of credit

¹² Block-Lieb, Susan, Congress's Temptation to Defect: A Political and Economic Theory of Legislative Resolutions to Financial Common Pool Problems, 39 *Ariz. L. Rev.* 801, 1997, p. 811

¹³ Baird, Douglas G., ET AL., *Game Theory and the Law*, Harvard University Press, 1998, p.31-35

¹⁴ Molander, Per, The Prevalence of Free Riding, 36 *J. CONFLICT RESOL* 756, 1992, p. 759; See also Schelling, Thomas C., *Micromotives and Macrobehavior*, W. W. Norton & Company, 1978, p.218

¹⁵ Friedman, Alan E., The Economics of the Common Pool: Property Rights in Exhaustible Resources, 18 *UCLA L. REV.* 855, 1971, p.856; Countryman, Vern, The Concept of a Voidable Preference in Bankruptcy, 38 *VAND. L. REV.* 713, 1985, p.823-825; Carlson, David Gray, Philosophy in Bankruptcy, 85 *MICH. L. REV.* 1341, 1987; Roe, Mark J., Commentary on "On the Nature of Bankruptcy": Bankruptcy, Priority, and Economics, 75 *VA. L. REV.*,1989, p.219-220; Korobkin, Donald R., Contractarianism and the Normative Foundations of Bankruptcy Law, 71 *TEX. L. REV.* 541, 1993, p.553-559; Block-Lieb, Susan, Fishing in Muddy Waters: Clarifying the Common Pool Analogy As Applied to the Standard for Commencement of a Bankruptcy Case, 42 *Am. U. L. Rev.* 337 1993, p.412-432

¹⁶ Block-Lieb, Susan, Fishing in Muddy Waters: Clarifying the Common Pool Analogy As Applied to the Standard for Commencement of a Bankruptcy Case, 42 *Am. U. L. Rev.* 337 1993, p.346

¹⁷ The Model Law, article 2(a); the EC Regulation, recital (10), article 1(1); the EU Regulation (recast), recital (12), (14), article 1(1)

¹⁸ The 2015 Draft, article 319. Clarification to the 2015 Draft, Chapter VI, article 319.

¹⁹ Posner, Kenneth A., *Stalking the Black Swan: Research and Decision Making in a World of Extreme Volatility*, Columbia Business School Publishing, 2010, p. 17

system is people and firms that can be called debtors borrowing money”.²⁰ Insolvency law copes up with the risk that a debtor fails to observe the obligation to repay. If the risk of debtor’s default cannot be handled properly, that will incur distrust between creditors and debtors. Therefore, insolvency law basically helps to establish an enduring cooperative relationship between debtors and creditors. Cross-border insolvency adds complexity to the scenario because it involves creditors from the different jurisdictions and debtors’ fragmented assets governed by different rules. Under that circumstance, what kind of rules should apply? No individual jurisdictions intend to regulate every action or event that occurs anywhere and the law implemented in each of them has its boundaries, which are shaped through the recognition of claims of other jurisdictions.²¹ Hence, coordination of rules on a regional and international level is necessary in order to provide proper reference for cross-border insolvency cooperation for the benefit of long-term and reliable cross-border debtor-creditor relation. Moreover, in order to maintain an enduring regional cooperative relation, it is of significance to make arrangements for such conflict to be resolved in a smooth manner.

1.06 Unfortunately, coordination of rules on inter-regional insolvency proceedings cannot be found either in any local law of the respective jurisdiction or in any bilateral arrangements in China. In 2011, upon a request for recognition of the winding-up proceeding concerning *Norstar Automotive*, the High Court of Beijing referred a question to the Supreme People’s Court in order to make clear whether or not the winding-up order rendered by the High Court of Hong Kong can be recognized in the Mainland China. The Supreme People’s Court replied,

“In accordance with the Article 1 of Arrangement of the Supreme People's Court between the Mainland and the HKSAR on Reciprocal Recognition and Enforcement of the Decisions of Civil and Commercial Cases Pursuant to Choice of Court Agreements between Parties Concerned, the winding-up order in dispute does not fall within the ambit of the enforceable final judgment under the Arrangement and thus the Arrangement is irrelevant to this case. The Article 265 of the Civil Procedure Law and the Article 5 of the Enterprise Bankruptcy Law, which provide rules on recognition and enforcement of judgments rendered by the *foreign* courts, (bold and italics added by the author) cannot be applied to this case, either. The decision of your court that in accordance with the aforementioned legislation, recognition of the winding-up order in dispute can be granted is groundless.”²² (translated by the author)²³

1.07 It is noteworthy that the High Court of Beijing tended to recognize the HK winding-up order based on those rules applicable to foreign judgments. In fact,

²⁰ Jackson, Thomas H., *The Logic and Limits of Bankruptcy Law*, Washington D.C.: Beard Books, 2001, p.7

²¹ Ten Wolde, Mathijs, *The relativity of legal positions in cross-border situations: The foundations of private interregional law, private intra-community law and private international law*, in: *A commitment to Private International Law: Liber Amicorum Hans van Loon*, Secretary-General Hague Conference. Cambridge: Intersentia, International Law Series, 2013, p.575

²² [2011] Supreme People’s Court Civil Other No. 19

²³ In case otherwise indicated, the Chinese judgments in this dissertation are translated by the author.

the Supreme People's Court used to consider a court of SAR as a foreign factor as well.²⁴ In practice, the lower courts have followed this approach.²⁵ It is beyond doubt that no judges of the Mainland want to jeopardize the sovereignty of their motherland. Why then do they keep considering SARs as foreign-related in adjudicating the SAR-related cases? What is the real meaning of "foreign-related"?

1.08 The current confusion in essence reflects a continuing dilemma regarding the status of the SARs in matters of cross-border civil and commercial judicial interaction in China. Although Hong Kong has politically returned to P.R.C., a comprehensive legislative and judicial approach is still lacking. In the aforementioned Reply of the Supreme People's Court, recognition of the civil and commercial judgments rendered in Hong Kong is limited to some particular legal relationship as stated in a bilateral arrangement, which refers to a civil or commercial contract between the parties concerned, excluding a contract of employment or a contract to which a natural person is involved as a party for purposes of personal consumption, family affairs or other non-commercial purposes (the Mainland-HK Arrangement).²⁶ The insolvency proceedings are still not included. Therefore, it is lack of legal basis for the courts to make decision.²⁷ Those foreign-related rules were thus borrowed as alternatives to solve the problems. However, the Reply of the Supreme People's Court in 2011 seems to set the tone that they can no longer be deemed as effective legal basis in dealing with recognition of cross-border insolvency proceedings between the two regions from the perspective of the Mainland.

1.09 The scope of the arrangement concerning the mutual recognition and enforcement of judgments between the Mainland and Macao²⁸ is much wider. It covers the civil and commercial cases, including the labor disputes.²⁹ Although the insolvency proceedings are not literally excluded, Arrangement Between the Mainland and the Macao Special Administrative Region on the Mutual

²⁴ In the case of *Bank of China (Hong Kong) Limited versus Shantou Hongye (Group) Co., Ltd.*, ([2002] Supreme People's Court Final Civil Division IV No. 6), the Supreme People's Court stated ". . . as the HKSAR and the Mainland of China belong to different jurisdictions, according to Several Opinions of the Supreme People's Court on the Implementation of the General Rules of the Civil Code of People's Republic of China, Article 194, when the ***foreign-related*** (bold and italics added by the author) party to the contract makes a choice of the application law, the mandatory or prohibitory laws and regulations of P.R.C. can not be circumvented. . ."

²⁵ *Gu Laiyun and others versus Nardu Company Limited* [2006] Guangzhou Intermediate People's Court Civil Division IV First Instance No. 44, see also *Yong Zhe Express Service versus Hong Kong Woolworths Group (Asia) Ltd.*, [2009] Shanghai No.1 Intermediate People's Court Civil Division V (Commercial) First Instance No. 32

²⁶ 2006 Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and of the Hong Kong Special Administrative Region Pursuant to Choice of Court Agreements between Parties Concerned, article 3

²⁷ Gong, Xinyi, When Hong Kong Becomes SAR, Is the Mainland Ready? – Problems of Judgments Recognition in Cross-border Insolvency Matters, in: *International Insolvency Review*, Wiley-Blackwell, Vol. 20, Issue 1, 2011, pp. 59.

²⁸ Macao is spelled Macau in Portuguese. According to UN database, the official English version shall be Macao. Please visit <http://data.un.org/CountryProfile.aspx?crName=China,+Macao+SAR> (last visited on 14 June 2016)

²⁹ Arrangement Between the Mainland and the Macao Special Administrative Region on the Mutual Recognition and Enforcement of Civil and Commercial Judgments, article 1

Recognition and Enforcement of Civil and Commercial Judgments (the Mainland-Macao Arrangement) provides no specialized rules in dealing with recognition of the cross-border insolvency proceedings, which will cause problems because in accordance with the Article 20 of the Civil Procedure Code of Macao, the Macao courts shall have exclusive jurisdiction over the lawsuits concerning the bankruptcy or insolvency of legal persons, whose domicile is within Macao. In accordance with Article 11 of the Mainland-Macao Arrangement, if the matter verified in the judgment according to the laws of the requested region shall be subject to the exclusive jurisdiction of the requested court, the requested court should refuse to recognize it.³⁰ Therefore, the insolvency proceedings are in fact excluded from the bilateral recognition arrangement regime between the Mainland and Macao SAR.

1.10 Taiwan is a politically disputed territory. On the scenario of cross-strait legal cooperation, each side stipulated specialized rules in matters of recognition and enforcement of civil and commercial cases, which are parallel to the rules applicable to the foreign cases. In the Mainland, the judicial interpretations³¹ issued by the Supreme People's Court serve as the legal basis of recognition of Taiwan civil and commercial judgments. In Taiwan, the Mainland civil and commercial judgments are recognized based on Act Governing Relations between the People of the Taiwan Area and the Mainland Area.³² In 2009, the Mainland and Taiwan entered into the Agreement between Both Sides of the Taiwan Strait on Jointly Fighting against Crimes and Mutual Judicial Assistance. It is a general legal cooperation agreement that covers mutual judicial assistance in matters of criminal cases, service of documents, taking evidence as well as recognition and enforcement of civil cases and arbitral awards, in which rules concerning recognition of cross-strait insolvency proceedings have not been specified.

1.3 Main Research Questions

1.11 In pursuit of the solutions to China's inter-regional insolvency cooperation, the dissertation is mainly composed of five Parts that correspond to the following five research questions:

1.12 Question I: Why is it necessary to address the issue of cross-border insolvency in China?

After resumption of its sovereignty over Hong Kong and Macao as well as the uncertain cross-strait relationship between the Mainland and Taiwan, China becomes a country composed of peculiar political compounds, which results in

³⁰ Arrangement Between the Mainland and the Macao Special Administrative Region on the Mutual Recognition and Enforcement of Civil and Commercial Judgments, article 11 (1)

³¹ 1998 The Supreme People's Court The Provisions on the People's Court's Recognition of the Verdicts on Civil Cases Made by Courts of Taiwan Province, ([1998] Supreme People's Court Interpretation No.11); 2009 Supplementary Provisions of the Supreme People's Court on the People's Courts' Recognition of Civil Judgments of the Relevant Courts of the Taiwan Region, ([2009] Supreme People's Court Interpretation No.4).

³² The Mainland Act, article 74

four independent jurisdictions. That makes inter-regional legal cooperation a complicated but also a must topic. In Part I Introduction, the lack of rules regulating inter-regional cross-border insolvency and the possibility of cooperation has been sketched out.

1.13 Question II: What is the “one country, two systems” policy and its influences on inter-regional legal cooperation in China

By introducing the political and economic cooperation background, Part II illustrates birth and development of the “one country, two systems” policy and provides a general overview of the peculiar “four Chinas” composition. Further, it demonstrates the current arrangements of the legal cooperation in particular concerning civil and commercial cases among the four regions, from which insolvency is excluded. As settled consensus, their contents and development furnish indispensable references for further discussion on inter-regional cross-border insolvency cooperation in China.

1.14 Question III: What are the current cross-border insolvency systems among the four regions?

Part III introduces the cross-border insolvency legislation region by region. To make the introduction in a more systematic way, each of them will start with an overview of the general insolvency system. Further, it is to be followed by more detailed introduction of the individual cross-border insolvency system, which is mainly combined with the cases study and analysis. In the end, the individual features of the cross-border insolvency systems among the four regions will be compared and summarized and a comparative table (Annex III) is attached for a general overview of the cross-border insolvency system in the four regions.

1.15 Question IV: What is the difference between the Regulation and the Model Law on their key aspects?

Part IV conducts a comparative research between the Regulation and the UNICTRAL Model Law by laying emphasis on the key aspects, including jurisdiction (especially COMI), recognition and reliefs, enterprise groups as well as cooperation and communication. After having been operating over ten years, both the EC Regulation and the UNICTRAL Model Law are undergoing changes. In particular, the EC Regulation has been repealed through new substantive amendments, which brings in a recast EU Regulation. Meanwhile, the UNICTRAL Model Law has also been gradually developed by guides. Especially in 2013, the Guide to Enactment of the Model Law has been revised and retitled as Guide to Enactment and Interpretation. Therefore, the comparative research of the two international regimes will be conducted in the way of abundant literature review and cases analysis so that their similarities and differences in development can be explored in detail. In addition, a table of comparison (Annex IV) is attached to better illustrate the difference of the two regimes.

1.16 Question V: How to tailor those two international models into China’s context?

By referring to the current practice in China, Part V will attempt to find a balanced way between the Regulation and the Model Law and then tailor them into China's context, which is composed of ten recommendations attached with comments. Based on the result of the first round of comparison between the Regulation and the Model Law, I will conduct the second round of comparison in this part in order to further examine compatibility of the results with the Mainland and the SARs to check out which one better fits into China's situation or whether China should establish something new for its own regional regime. The range of the regional arrangement covers the guiding principle, the overriding objective, form and scope, recognition and reliefs, public policy, cooperation and communication (single debtor and enterprise groups), cross-border insolvency agreements, functional dispute settlement mechanism, inter-regional case register and a separate arrangement for cross-strait insolvency cooperation (between the Mainland and Taiwan), which is independent intermediaries.

1.4 Research Methodology

1.17 In search of the solutions, the following research methods have been applied:

Literary search:

The literary search encompassed exploration of relevant regional (including four regions in China) and international legislations as well as scientific and professional literature. In particular, for the recent developments in the related legislations both in China and in the EU, the relevant proposals and working documents have been examined.

Case study:

Both regional and international cases were collected to facilitate the research. On international level, they are mainly collected through both official case law databases, such as InfoCuria (case law database of the CJEU) and CLOUT (Case Law on UNCITRAL Texts information system), and specialized databases maintained by professional international organizations, such as European Insolvency Regulation Case Register of INSOL Europe and E-Library of International Insolvency Institute, which both contribute to sufficient sources of case law in matters of cross-border insolvency.

On regional level in China, it is more difficult to obtain the relevant information, in particular in the Mainland. On the one hand, there are no specialized case law databases with regard to cross-border insolvency or even insolvency. On the other hand, publicity of judgments is still at the primary stage in the Mainland. It was not until 1 January 2014 that the courts are mandatorily required to publish

their judgments on the internet in the Mainland.³³ The Supreme People's Court also established an internet portal as a central public access to the judgments of all levels,³⁴ on which the search engine can only trace cases from 1 January 2014. Besides, owing to complicated factors as to be explained in Part II, the amount of domestic insolvency cases is declining in general. I have personally attempted to look for insolvency cases on the central portal provided by the Supreme People's Court and found that the insolvency cases merely amounted to 0.4% of the total civil and commercial cases published on that portal and insolvency cases with cross-border factors are far rarer.

Despite of lack of or limited access to the related sources, efforts have been made by searching for additional supporting documents, such as articles published by the judges, as well as by analyzing the case law available from the counterpart courts, which involved in the parallel insolvency proceedings.

³³ The predecessor of the 2013 interpretation used to be Provisions on the Issuance of Judicial Documents on the Internet by the People's Courts, [2010] Judicial Interpretation No.48, which was passed by the Supreme People's Court in 2010. By then, it was stated that the courts may issue judgments on the internet ([2010] Judicial Interpretation No.48, Article 2). Now it has been replaced by the 2013 Interpretation, which provides that the courts should issue judgments on the internet. ([2013] Judicial Interpretation No.26, article 4).

³⁴ [2013] Judicial Interpretation No.26, Article 2; for the central internet portal, please visit: <http://www.court.gov.cn/zgcpwsw/zscqhz/> (Last visited on 14 June 2016)

