Prioritisation of Environmental Costs in Chinese Insolvency Law: Guiding Case No. 214 of the Supreme People's Court

Xingwei Li* and Xiaodan Wang**

Abstract: This analysis explores the landmark *Sancha Harbour* judgement, a Guiding Case designated by China's Supreme People's Court, which classifies environmental liabilities as common interest debts prioritised in insolvency proceedings. This judgement represents a pivotal development in Chinese insolvency law, setting a precedent that reflects the judiciary's growing emphasis on environmental protection, especially during corporate reorganisations. The analysis assesses the challenges of balancing economic growth with environmental responsibility and explores the broader implications of internalising environmental costs in insolvency cases. It also highlights the uncertainty surrounding the uniform application of the precedent and emphasises the need to integrate financial instruments such as environmental insurance and dedicated funds to manage these costs efficiently.

1. Introduction

In November 2023, the Supreme People's Court of China designated a judgement by the Shanghai 3rd Intermediate People's Court on the reorganisation of Shanghai Sancha Harbour Industrial Co., Ltd. as Guiding Case No. 214.[1] This marked the first time that environmental costs were recognised as common benefit debts in Chinese insolvency law, granting them priority over ordinary unsecured liabilities in insolvency proceedings.[2]

This constitutes a significant development in how environmental pollution is treated in cases of insolvency. Before the *Sancha Harbour* case, environmental liabilities were treated as regular unsecured claims without priority in liquidation proceedings.[3] If no insolvent company could pay these costs, the burden fell on the society or went

* Guildford School of Business and Law, London Metropolitan University, 166–220 Holloway Road, London N7 8DB (X.li1@londonmet.ac.uk; xli0318@outlook.com).

** Guangxi High People's Court, 121 Minzu Blvd, Nanning, Guangxi, China, 530088.

[1] Supreme Court 最高人民法院, 'No 214 Guiding Case: Bankruptcy Liquidation to Bankruptcy Reorganisation of Sancha Harbour' 指导性案例 214 号: 上海某某港实业有限公司破产清算转破产重整案 (The Gazette of the Supreme People's Court 最高人民法院公报 10 October 2023) <http://gongbao.court.gov.cn/Details/693b719c6707d655f8f4ccf1f93533.html> accessed 25 June 2024.

[2] Emily Lee and Karen Ho, 'China's New Enterprise Bankruptcy Law–A Great Leap Forward, but Just How Far?' (2010) 19 International Insolvency Review 170.

[3] *Re Heilongjiang Heihua Group 黑龙江黑化集团* [2019] Qiqihaer Court 02-10 2019 黑 02 破申 10 号, *Re Yunnan Yongren Tuanshan Copper Mine 云南永仁团山铜矿* [2017] Yongren Court 2327-1-2 云 2327 破 1 号之二.

unpaid.[4] Following the *Sancha Harbour* case, environmental costs in similar future cases may be classified as common benefit debts, ensuring they receive priority and obligating polluters to bear responsibility. Consequently, environmental costs are now internalised within the insolvency proceedings rather than externalised to society.

Guiding Cases are selected by the Supreme People's Court from prior judgements to clarify and develop legal rules in areas where legislation is vague or incomplete.[5] Courts at all levels are instructed to refer to them in similar cases, although they lack binding authority.[6] The designation of *Sancha Harbour* represents a significant judicial step towards incorporating environmental protection into insolvency practice by classifying environmental costs as common benefit debts.[7] This interpretation reflects China's national policy of balancing economic growth with environmental protection.[8] However, the impact of the Guiding Case remains limited due to its non-binding nature and the discretion afforded to judges.

This analysis first outlines the case background, examines its handling within the Chinese judicial system and then evaluates its significance and limitations as case law.

2. The *Sancha Harbour* Insolvency Case

Sancha Harbour, a medium-sized private company operating loading and unloading terminals on the Yangtze and Huangpu Rivers, faced severe insolvency in 2019 owing to its role as guarantor for other companies.[9] In November 2019, the Shanghai 3rd Intermediate People's Court of China accepted its insolvency application, initiating the reorganisation process.[10] According to the Reorganisation Plan of Sancha Harbour (Draft) issued in July 2022, 12 creditors submitted claims totalling over 1 billion yuan during the proceedings.[11]

During this period, an environmental rectification notice threatened to revoke the Port of Sancha's operating licence unless wastewater and dust control issues were resolved.[12] To prevent this, the bankruptcy administrator and the wharf lessee jointly financed the necessary environmental remediation, proposing these costs be

[4] In *Yongren Tuanshan Copper Mine* (n 3), the local government paid for remediation after the company's insolvency. In contrast, in *Heihua Group* (n 3), the costs remained unpaid and the contamination remained.
[5] Mo Zhang, 'Pushing the Envelope: Application of Guiding Cases in Chinese Courts and Development of Case Law in China' (2017) 26 Washington International Law Journal 270.
[6] Supreme Court 最高人民法院, 'Implementation Rules for the "Provisions of the Supreme People's Court on Case Guidance Work"' 最高人民法院关于案例指导工作的规定实施细则 (Supreme Court 2015) arts 8, 9.
[7] Supreme Court (n 1).
[8] Committee of the Communist Party of China 中国共产党中央委员会, *The 14th Five-Year Plan for Economic and Social Development of the People's Republic of China 国民经济和社会发展第十四个五年计划* (CCP,2021) s 2, ch 39.
[9] Shanghai 3rd Court 上海市第三中级人民法院, 'Reorganisation Plan of Sancha Harbour (Draft)' 重整计划草案 (July 2022) <https://pccz.court.gov.cn/pcajxxw/pcgg/ggxq?id=A805CD8CCAEF4C24A4C0BD60D976FA5F> accessed 3 July 2025.
[10] *Re Shanghai Sancha Harbour Industrial Co Ltd 上海三岔港有限公司* [2019] Shanghai 3rd Court 320.
[11] Shanghai 3rd Court (n 9).
[12] *Re Shanghai Sancha Harbour Industrial Co Ltd* (n 10).

classified as bankruptcy expenses in the reorganisation plan.[13] This ensured full coverage of environmental costs, avoided their transfer to society and preserved the port's operating licence.

Item	**Amount (Yuan)**
Total disposable property	86,495,355.32
Subtract: Bankruptcy costs	5,347,600
Remaining	81,147,755.32
Subtract: Common benefit debt (environmental costs)	587,100
Remaining	80,560,655.32
Subtract: Securing property claims	29,890,000
Remaining	50,670,655.32
Subtract: Tax claims	1,650,442.5
Remaining	49,020,212.82
Subtract: General claims group	49,020,212.82
Final Remaining Balance	0

Table I: Claims Settlement Distribution Programme Table

Table I presents the Claims Settlement Distribution Plan, which outlines the allocation of claims in this insolvency case. The plan was based on the draft reorganisation plan submitted to the Shanghai 3rd Intermediate People's Court in July 2022, following creditor approval. Given the company's severe financial distress, the plan strategically leveraged the geographic advantages of its terminal assets to help restore operational vitality and enhance creditor recovery.

[13] ibid.

The administrator determined that payment of environmental costs was essential to retain the company's operating licence. Without the licence, the company would not have been able to resume operations following reorganisation, leading to liquidation. Accordingly, the Shanghai 3rd Intermediate Court held that recognising environmental costs as common benefit debts was not merely discretionary but a necessary measure to ensure the company's survival and post-reorganisation value creation.[14] The court prioritised these costs because they were critical to continued operation.

The priority status of these costs reinforced the feasibility of the reorganisation plan, facilitating its approval by the Shanghai 3rd Intermediate Court. Since the plan has been largely implemented, the company has resolved its key business and port operation licence issues. Paying the environmental cost to secure the licence was essential to resuming operations and improving creditor recovery.[15]

3. Environmental Costs as Priority Claims in Insolvency Cases

3.1 Recognising Environmental Costs as Common Benefit Debts

Common benefit debts generally encompass liabilities incurred during insolvency proceedings that benefit all creditors.[16] Although China's Enterprise Bankruptcy Law does not offer a comprehensive definition of common benefit debts,[17] Chinese courts have ruled that such debts may include unauthorised property transfers following the acceptance of insolvency, property damage caused by the administrator and losses stemming from the administrator's misconduct or gross negligence.[18] However, the complexity of real-world insolvency cases means that many scenarios still fall outside these specified categories, leaving their classification subject to significant judicial discretion.[19]

Before the *Sancha Harbour* decision, environmental costs in insolvency were typically treated as ordinary unsecured liabilities, receiving low priority and often remaining unpaid. In *Sancha Harbour*, paying the environmental costs was essential for the company to continue operating, as it had a legal duty to conduct pollution control. These obligations remained in effect after the commencement of insolvency. They met the criteria for common benefit debts under Article 42(4) of the Enterprise Bankruptcy Law (EBL), which covers liabilities incurred to maintain the debtor's basic operations

[14] ibid.
[15] ibid.
[16] Xinxin Wang 王欣鑫, *Bankruptcy Law 破产法* (3rd edn, China Renmin University Press 中国人民大学出版社 2011) 290. Provision (III) of the Supreme People's Court on Several Issues Concerning the Application of the Enterprise Bankruptcy Law of the People's Republic of China, art 2(1). The term 'common benefit debts' is often defined as: (1) a generic term for debts incurred for the benefit of all creditors in insolvency proceedings; (2) debts incurred for the common benefit of all creditors in insolvency proceedings as a result of the administration, operation, disposition and distribution of the debtor's estate; or (3) debts incurred by the debtor and the administrator for the common benefit of all creditors in insolvency proceedings.
[17] Enterprise Bankruptcy Law 2006, art 42.
[18] Provisions (II) of the Supreme People's Court on Several Issues Concerning the Application of the Enterprise Bankruptcy Law of the People's Republic of China, arts 17, 32, 33.
[19] Yujia Jiang, 'The Curious Case of Inactive Bankruptcy Practice in China: A Comparative Study of US and Chinese Bankruptcy Law' (2014) 34 Northwestern Journal of International Law & Business 577. James Zhengliang Hu and Li Zhu, 'A Study on the Law on Maritime Bankruptcy in China' (2019) 23 The Asian Business Lawyer 36.

and management, and Article 2(1) of the Supreme People's Court Interpretation (III) on Several Issues Concerning the Application of the Enterprise Bankruptcy Law, which includes debts necessary for business continuity during reorganisation.[20] This treatment also reflects a broader shift in Chinese insolvency law towards incorporating environmental responsibility into the regulatory and adjudicative framework governing insolvency.

3.2 Establishing Priority Through *Sancha Harbour*

In the *Sancha Harbour* case, the Shanghai 3rd Intermediate Court accepted the classification of environmental costs as common benefit debts under the approved reorganisation plan. This reflected an understanding that such expenses may warrant priority in insolvency proceedings when necessary for regulatory compliance and business continuity.

Although the judgement did not include a separate legal analysis, the court's approval of the plan implied endorsement of this classification. The judgement stated that the plan enhanced creditor recovery, preserved business value and enabled continued operations.[21] This reasoning aligns with Article 42(4) of the EBL, which applies to liabilities incurred to sustain business activity.

Under Article 64 of the Environmental Protection Law, entities responsible for environmental damage are subject to tort liability under the Civil Code. Article 26 of the Port Law requires port operators to comply with environmental regulations and implement effective pollution prevention measures. Reinforcing these obligations, Articles 1232–1235 of the Civil Code mandate that parties responsible for environmental harm bear the costs of restoration and compensation.[22] In the *Sancha Harbour* case, the duty to remedy did not lapse with the initiation of insolvency proceedings; rather, it became essential to sustaining operations. Failure to address the environmental damage would have led to the revocation of *Sancha Harbour*'s terminal licence, effectively terminating the reorganisation and forcing liquidation. Thus, fulfilling these obligations was necessary to maintain operational capacity and protect creditor interests.

4. China's New Regime for Environmental Liabilities

The *Sancha Harbour* decision represents a significant development in recognising environmental compliance as essential for business continuity during insolvency. As the first Guiding Case to grant priority status to environmental liabilities, *Sancha Harbour* will set the standard for the treatment of similar claims in future insolvency cases. In particular, the decision indicates a shift towards internalising environmental costs in insolvency proceedings, supports China's policy goals on green development

[20] Enterprise Bankruptcy Law 2006, art 42(4); Provisions (III) of the Supreme People's Court on Several Issues Concerning the Application of the Enterprise Bankruptcy Law of the People's Republic of China 2019, No 3, art 2(1).
[21] Shanghai 3rd Court (n 10).
[22] For example, Environmental Protection Law 2014, arts 64–65; Port Law, art 26; Civil Code 2020, arts 1232, 1234, 1245.

in the Yangtze River Economic Belt and emphasises the environmental accountability of harbour enterprises.[23]

However, variations across regions, industries and case types—as well as systemic constraints within China's Guiding Case system—may constrain its broader impact.

4.1 Challenges in Prioritising Environmental Liabilities

In the *Sancha Harbour* case, environmental liabilities were classified as common benefit debts as a result of the direct link between environmental remediation and the company's operating licence. The Environmental Protection Department had issued a notice mandating environmental restoration, with the potential revocation of the company's licence in case of non-compliance. Fulfilling these obligations was essential for continued operations, influencing the decision to prioritise the associated costs.

By contrast, when environmental costs primarily serve a public interest function and are not critical to sustaining industrial activity, they are not necessarily prioritised in insolvency proceedings. For instance, in the case of *Guangxi Nonferrous Metal Recycling Co., Ltd.* (*Guangxi*), the closure of a company caused an electrolyte leak that endangered the health of 400,000 residents and posed risks to the downstream Guangdong region in the Xiangjiang River Basin.[24] Despite the urgent need for environmental clean-up, the creditors rejected the proposed costs and the courts classified the liabilities as ordinary unsecured debt.[25] Unlike *Sancha Harbour*, remediation was not directly linked to the company's ability to continue its operation. Thus, the prioritisation of environmental liabilities depends on case-specific factors. When remediation is essential to economic recovery, as in the case of *Sancha Harbour*, courts may treat these costs as common benefit debts. However, when environmental damage primarily affects public health and ecology without directly impacting business operations, courts defer to creditor interests and treat such liabilities as ordinary unsecured debt.

Regional economic structures also influence this approach. The Yangtze River Economic Belt contributes 40% of China's exports and its ports significantly impact the economy of the Yangtze River Delta.[26] As an essential port operator, *Sancha Harbour* directly supports the region's economy.[27] In this context, prioritising environmental liabilities was both commercially and legally justified, as failure to remedy would have resulted in the revocation of *Sancha Harbour*'s operating licence, with significant economic consequences for the region.[28]

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[23] Supreme Court (n 1).
[24] *Re Guangxi Nonferrous Recycled Metals Co Ltd 广西有色再生金属有限公司* [2015] Wuzhou Court 1–5 2015 梧民破字第 1 号
[25] ibid.
[26] Jan Jovy and Matthew Yang, 'The Yangtze River Delta – China's Leading Regional Economic Cluster' (PwC, 5 September 2024).
[27] ibid.
[28] The economic case for prioritising these liabilities in insolvency proceedings would be weaker in other river basins (e.g. the Pearl River Delta) or in less economically developed regions that prioritise economic growth over environmental protection.

Beyond regional factors, industry-specific characteristics can shape how environmental liabilities are prioritised in cases of insolvency. For instance, environmental costs affect the operational viability of port operators more than they do landfills and mines. The restoration work in mining typically begins after extraction is complete, when operating licences are no longer required.[29] Similarly, landfill restoration focuses on long-term public health concerns, such as groundwater and soil contamination, rather than protecting a company's operational viability or economic contribution.[30] Unlike in the *Sancha Harbour* case, where environmental remediation ensured the continued operation of the business, in mining and landfill cases there is a lack of direct connection between environmental costs and successful reorganisation. When environmental liabilities serve primarily social or ecological purposes rather than enhancing creditor returns, courts and creditors may be less inclined to prioritise them in insolvency proceedings.

In summary, the prioritisation of environmental liabilities in insolvency proceedings largely depends on economic, regional and industry-specific contexts, potentially limiting the future relevance of the *Sancha Harbour* decision.

4.2 Role and Limitations of Guiding Cases

The *Sancha Harbour* decision highlights both the role and limitations of China's Guiding Case system in addressing legal gaps, particularly in prioritising environmental liabilities during insolvency proceedings.

The first issue concerns the legal effect of Guiding Cases. As a civil law country, China relies primarily on codified statutes as its main source of legal authority, and Guiding Cases lack statutory binding force.[31] They are considered merely referential. As Zhang notes, this non-binding nature stems from China's legal tradition, which regards statutory law as the dominant source of law.[32] Jia further observes that local judges often disregard Guiding Cases due to their lack of enforceable authority,[33] emphasising that they lack 'legally binding force' and possess only minimal 'de facto binding force'.[34] This grants judges significant discretion in deciding whether to cite them, contributing to a low citation rate. Guiding Cases are directly cited by lower courts in fewer than 1% of cases,[35] while even their indirect citation rate—reflected in judicial reasoning—peaked at only 20% in their most active year.[36] These figures underscore the disparity between the system's theoretical intent and its practical

[29] Xinjuan Wu and others, 'Research Progress in Mining Ecological Restoration Technology' (2024) 1 Journal of Industrial Safety 1.
[30] Yu Wen and others, 'Remodelling of Abandoned Land: A Review of Landscape Regeneration and the Reconstruction of Urban Landfill Sites' (2023) 15 Sustainability 1–2.
[31] Xingliang Chen, 'China's Guiding Case System: A Study on the Mechanisms of Rule Formation' (2013) 1 Peking University Law Journal 226.
[32] Zhang (n 5) 298.
[33] Mark Jia, 'Chinese Common Law? Guiding Cases and Judicial Reform' (2016) 129 Harvard Law Review, 2217.
[34] 'Legally binding force' refers to enforceable obligations under law, whereas 'de facto binding force' denotes practical adhesion without legal enforceability: Zhang (n 5) 274.
[35] Mark Cohen, 'Spring Time for IPR Case Law in China' (China IPR, 12 March 2017) <https://chinaipr.com/2017/03/12/spring-time-for-ipr-case-law-in-china/> accessed 1 April 2025.
[36] Shucheng Wang, 'Guiding Cases and Bureaucratization of Judicial Precedents in China' (2019) 96 University of Pennsylvania Asian Law Review 99.

application.[37] Consequently, some scholars argue that although Guiding Cases hold interpretive value, their practical effectiveness remains limited, as they are neither law nor formal judicial interpretations.[38]

The second issue concerns the complexity of Guiding Cases, which often discourages judges from citing them unless the facts of the pending case closely align with those of the Guiding Case. Although the Provisions on the Work of Guiding Cases require local courts to refer to Guiding Cases in 'similar cases', neither 'reference' nor 'similarity' is clearly defined.[39] This lack of definitional clarity hinders consistent application, leading to judicial hesitation or varied interpretations in practice.[40] Local courts may also adopt divergent or context-specific approaches when selecting or applying Guiding Cases. Finder attributes the low citation rate to several factors, including a judicial culture that emphasises statutory law, limited training resources and the absence of enforcement mechanisms by the Supreme People's Court.[41] In effect, Guiding Cases tend to have binding force only when the 'necessary facts' are highly similar to those of the case at hand.[42] This strict standard further limits their applicability. In complex cases, judges may categorise certain facts as 'nonessential' in order to avoid citing Guiding Cases.[43]

In sum, due to the non-binding nature of Guiding Cases and their limited applicability to factually and legally similar circumstances, it remains uncertain whether *Sancha Harbour* will serve as precedent in future cases.

5. Proposal for Internalising Environmental Costs in Insolvency Proceedings

Regulatory adjustments within China's environmental governance may be required to effectively internalise environmental costs within insolvency proceedings. The approach adopted in the *Sancha Harbour* case provides a practical model for linking environmental obligations to business continuity.

In the *Sancha Harbour* case, fulfilling environmental obligations was critical for the company's continued operation, prompting both the administrator and creditors to support remediation efforts. This rationale should be extended to sectors (e.g. landfills and mining) where financial incentives for environmental restoration are typically weak. Regulatory authorities could strengthen this framework by making environmental compliance a condition for licence renewal or continued operations, particularly in high-risk industries where pollution poses serious public health or ecological risks, such as in the Pearl River Delta and the Beijing–Tianjin–Hebei areas.

While prioritising environmental liabilities in insolvency cases is necessary, it may not be sufficient to address all environmental costs. Additional mechanisms are needed to internalise these costs when companies become insolvent. For example, He and

[37] ibid.
[38] ibid.
[39] Benjamin M Chen and others, 'Detecting the Influence of the Chinese Guiding Cases: A Text Reuse Approach' (2024) 32 Artificial Intelligence and Law 482.
[40] ibid.
[41] Susan Finder, 'China's Evolving Case Law System in Practice' (2017) 9 Tsinghua China Law Review 8.
[42] Zhang (n 5) 283.
[43] ibid.

Liu advocate the use of environmental insurance and dedicated funds to internalise environmental costs in insolvency cases. Liu further emphasises that financial assurances—such as insurance, deposits and funds—are essential tools for internalising environmental costs.[44] Scholars in other jurisdictions support these approaches. According to Mackie and Besco, financial assurance is effective in the UK because enterprises must secure sufficient capital reserves to meet environmental liabilities before commencing operations.[45]

China could consider establishing a financial assurance system that includes insurance, funds and deposits, in which companies with environmental pollution risks would be required to secure adequate financial assurance before commencing operations. This would ensure that financial assurance can cover these expenses if environmental costs arise. Moreover, adopting these measures in conjunction with the prioritisation of environmental liabilities would ensure better management of environmental risks in insolvency and promote more sustainable outcomes for creditors and the environment alike.

6. Conclusion

The *Sancha Harbour* case marks a significant milestone in Chinese insolvency law by affirming the status of environmental liabilities as common interest debts with priority of payment. It sets a precedent underscoring the judiciary's growing emphasis on environmental protection, particularly in reorganisation proceedings. While the judgement aligns with the national policy of promoting sustainable development, it also underscores the complexities involved in balancing economic and environmental interests in insolvency cases.

This case further highlights the challenges such recognition may face as a precedent and the limitations of China's Guiding Case system. For future developments, Chinese lawmakers could consider several measures to internalise environmental costs in insolvency, including improving the regulatory link between environmental compliance and operating licences and establishing financial assurance mechanisms to ensure that polluters bear the cost of remediation, even in cases of insolvency. Although the *Sancha Harbour* case represents a notable advancement, it also demonstrates the need to strengthen environmental governance to address the intricate relationship between corporate failure and environmental harm.

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[44] Jing Liu, 'Risk-sharing Agreements to Cover Environmental Damage: Theory and Practice' (2018) 18 International Environmental Agreements: Politics, Law and Economics 272.

[45] Colin Mackie and Laurel Besco, 'Rethinking the Function of Financial Assurance for End-of-life Obligations' (2020) 50 Environmental Law Reporter 10582.