

Reorganization Cases under the New Bankruptcy Law of China

*Professor Wang Weiguo
China University of Political
Science and Law*



Background



- The New Enterprise Bankruptcy Law of China was enacted in 27 August 2006 and became effective in 1 June 2007.
- Aiming at corporate rescue, the Law founds reorganization proceeding which has got inspiration from legislations of US, UK, French, Germany, etc. with its own creative features.



Reorganization cases

- Since June 2007, there are several companies have stepped on the path of reorganization, e.g. Xianju Hospital (仙琚医院), Fenghua Group (风华集团), Jinhua Group (锦化集团), Datong Securities (大通证券), Fortune Security (财富证券), ST Haina (海纳), ST Changhua (沧化), ST Baoshuo (宝硕), S Xuangong (宣工), ST Chanling (长岭), ST Lanbao (兰宝), ST Hua Long (华龙), ST Ke Long (科龙), ST Xing Mei (星美), ST Zhong Liao (中辽), ST Bei Ya (北亚), ST Zhao Hua (朝华), ST Sannong (三农), ST Shengfang (圣方), etc.

Xianju Hospital

(仙居医院)

—The first reorganization case in China

Beijing

June 2007





- On 25 June 2007, Haidian District Court, Beijing, approved the reorganization plan of Beijing Xianju Procreation Healthy Hospital Limited Company (Xianju Hospital), in accordance with the newly issued Bankruptcy Law.
- This is the first case of reorganization in Mainland China.



Background

- Xianju Hospital established in 2004, with registered capital of 10 m RMB. Because of the bad management, by September 2006, it had 9.9 m assets and 21.5 m debts.
- In October 2006, the Hospital filed a bankruptcy petition and accepted by the court.
- 45 creditors filed claims in total of 22 m.
- Liquidation repayment for creditors would be less than 10%.

Purchaser



- The most valuable assets of the Hospital were the license of medical business and the fitment (5.5 m. in construction and 6.2 m. in equipments).
- Victoria Medical Investment Co. founded by overseas Chinese, came to purchase.



The Deal



- Victoria purchase the Hospital by zero pay on condition it got a compromise with the creditors.
- Victoria negotiated with the creditors one by one and signed agreement with each of them.
- Under the contracts, Victoria would pay the claims with various discount from 30% to 50%.



Deadlock with 5 SOEs

- 5 SOE creditor refused Victoria's offer insisting in 90% repayment by reason of limitation of state assets management.
- What the SOE heads concerned with was actually not the money but their "black gauze caps" (official positions).
 - It seemed no way to make agreement with them.
 - Anyway the solution was ready-to-wear in the Bankruptcy Law.

The Plan



- On 20 April 2007 the Hospital filed a petition for reorganization with a plan.
- According to the plan, all the agreed creditors would be paid in accordance with their pre-signed agreement and the 5 SOEs would be paid at the average rate of 41%.



The Result



- On 25 May the creditors' meeting was convened at the court. 34 creditors appeared, covering 75.56% of the filed creditors with 98% of the total claims ◦
- All the creditors voted for the plan except 4 SOEs.
- On 25 June 2007 the court approved the plan.



Some features



- Pre-package approach is applied.
- Investor plays an active role.
- Majority of creditors are realistic in concession.
- Court thinks much of corporate rescue.
- Judges are friendly to parties' solution and flexible in handling the procedure.



Question



- How do you evaluate the practice of separate negotiations? Is a plan based on deferent single agreements accordant to the principle of equitable treatment?



Fenghua Group

(风华集团)

—The first reorganization case in
Guangdong Province

Zhaoqing, Guangdong

March 2008



Background



- The Fenghua Hi-Tech Group Co., Ltd, a manufacturer of electronic components, Wholly State owned, established in 1996 with 12000 m RMB. registered capital and 9000 workers, holding 24.24% stocks of a listed company, the Fenghua Hi-Tech.
- Due to the recession of the industry, it became insolvent. Up to 30 July 2007 it owed 2.662 billion in total with net capital of -1.863 billion.



Hardship in negotiation



- March 2007 two creditors Zhaoqing Yinhua Co. and Zhaoqing Jinye Co. filed bankruptcy petition against Fenghua.
- In July 2007 Fenghua filed reorganization petition.
- At the creditors' meeting in January 2008 the reorganization plan failed to be passed. During the past months several discussion about the plan proved fruitless.



The favorable turn



- The State Assets Commission of Zhaoqing, a local government agency, involved and coordinated the parties to reach a compromise.
- According the agreed plan, Fenghua was going to raise 87700 m. for repay the claims: all the secured claims, workers' claims and tax claims would be paid in 100% and ordinary claims be paid by 21.95% *lump sum* in cash with the rest 78.15% discharged.
- As a result all the 9000 workers remained their jobs.



What are the gains?



- Judge Xie who dealt with this case made a comment on the benefits of the case:
 1. All the creditors got fully protected, more than the acquirable in liquidation, e.g. to ordinary claims the 21.95% repayment was higher than 17.58% in liquidation.
 2. The Group was rescued and its subsidiary Fenghua Hi-Tech, listed company, kept developing healthily.
 3. It served social stability by keeping 9000 jobs, in favor of 6000 families with 40000 people.



Some features



- The government is keen to rescue its SOEs and bankruptcy is a way to spur it to run actively in solving the problems.
- Raising money and paying *lump sum* is a simple and effective solution.
- Court has a favorable attitude to debtor's efforts for reorganization, especially a large number of workers involved.



Question



- How do you evaluate the involvement of government in the reorganization procedure? Can we ensure the creditors' interests to be fairly protected when local government plays an active role in rescuing a bankrupt company?



ST Canghua (ST 沧化)

—The first reorganization case with
“cram-down” rule adopted

Canghua, Hebei
January 2008



Background

- ST Canghua, a listed company, a large chemical manufacturer in Hebei province, producing PVC resin, with registered capital of 421.42 m RMB and 34.03% of the shares held by the local government.
- From 2003 it invested new production line of 400,000 ton PVC, with 2.33 b fund needed but 43.7 m obtained. It put 365.23 m cash flow from its daily business into the project and consequently cut its liquidity.



- In June 2006 construction of project stopped when 80% construction completed and 60% equipment installed.
- Since 2002, it had guaranteed 26.56 b banking loans for some relative companies, including 867 m for *ST Baosuo* that went bankrupt in Jan. 2007 and led judicial restraint on Canghua's assets.



■ Its production stopped in Sep. 2006 majorly and in May 2007 totally.



■ On the book by Apr. 2007 it had 28.92 b assets and 41.934 b liability, with 21.85 b loss.



The proceeding



- In Apr 2007 creditors filed bankruptcy petitions against ST Canghua and its mother company Canghua Group.
- A supervisor group, composed of law firm, accounting firm and consulting firms, was appointed in May and then became administrator in June for the two cases.
- ST Canghua filed reorganization petition in June.
- The first creditors' meeting held in August.





- 16 Nov., the Court ordered reorganization of ST Canghua and declared bankruptcy of Canghua Group.
- 21 Nov., administrator submitted plan.
- 10 – 15 Dec., votes were made by groups of investors, secured claims, tax claims, workers' claims and ordinary claims but failed to be passed.



A new comer



- 21 Dec., ST Canghua shares held by Canghua Group were auctioned and acquired by Taurus Energy, a listed company.
- 28 Dec., Taurus Energy promised in agreement with administrator and local government to invest 2 b RMB to rehabilitate the business of ST Canghua and further to complete the construction of new project.



The plan



- Among the 5.44 b total claims of 422 creditors only 0.94 b paid and 45 b cut. The lowest percentage of repayment was 11.33%.
- 2 Jan. 2008 the Court ruled to confirm the plan, with approval by the Supreme People's Court.
- The plan should be executed for 3 years.



The result



- When ruling of reorganization was disclosed by the Securities Supervisory Commission, the price of Canghua increased from 5.06 RMB to 9.72 RMB in Shanghai stock exchange.



- Holding 40.85% of control power, Taurus restructured Canghua's management.



Complaint from creditors



- Some banks as the major creditors complain that the 11.33% repayment is much lower than it should be. They also complain that the process of assets evaluation is not transparent so that the real liquidation value is unclear.



Treatment of unsecured claims

Case	Total amount	Pay rate
ST Zhaohua	1334 million	10%
ST Canghua	5440 million	11.33%
ST Baoshuo	4660 million	13%
ST Lanbao	1740 million	22%
ST Haina	5424.8 million	25.35%
Fenghua Group	2662 million	21.95%

Liquidation test for “cram-down”

- Such test is stipulated in US §1129(b)(2) and adopted in PRC §87(2). According to the rule, the plan may be crammed down on ordinary claim holders, if the plan provides that they will receive not less than that they would receive in liquidation.

Questions



- How to assure the receivable in liquidation is truly calculated so that to keep the cram-down rule from being abused?
- Further, how can creditors take part in the assets evaluation and even challenge the plan when they consider the rate of repayment is unfair?





“Always more solutions than difficulties.....”



THE END

普賢

