SPC Guiding Case No. 164: Substantive Consolidation Bankruptcy Reorganization of Jiangsu Suchun Wine Co., Ltd. and Its Affiliates

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Keywords

Civil / bankruptcy reorganization / substantive consolidation bankruptcy / investor trial production / balancing of interests / supervision

Holding

In the course of bankruptcy reorganization, where a bankrupt enterprise faces risks such as the loss of core high-quality assets including production licenses and the idling and depreciation of machinery and equipment, and the investor also wishes to gain a comprehensive understanding of the enterprise's operating strength through trial production, the administrator may apply to the people's court for the investor to first invest part of its funds to conduct trial production. The continued existence of a bankrupt enterprise's core assets directly affects the realization of the purpose of bankruptcy reorganization; where the administrator's application is conducive to restoring the bankrupt enterprise's ability to continue operating and to safeguarding the interests of all parties, and the trial production application conforms to the concept of bankruptcy protection, the people's court may, upon examination, approve it. At the same time, after the investor's trial production is approved, the investor shall accept the supervision of the people's court, the administrator, and the creditors, so as to fairly protect the lawful rights and interests of all parties.

Basic Facts

Jiangsu Suchun Wine Co., Ltd. ("Suchun Company") was the only enterprise in Suining County, Jiangsu Province that held an alcohol production license and had an important impact on local economic development. Since 2013, due to blind expansion and chaotic management, the enterprise suffered a rupture in its capital chain and triggered multiple lawsuits. Xuzhou Delong Biotechnology Co., Ltd. and Xuzhou Ruikang Food Technology Co., Ltd. were affiliated enterprises of Suchun Company, and all three companies were biotechnology companies engaged in deep processing of agricultural products. As of before the acceptance of the bankruptcy reorganization, the total assets of the three companies were RMB 125 million and the total liabilities were RMB 457 million, with an asset-liability ratio of 365.57%. On December 29, 2017, the three companies, on the ground of introducing investors and revitalizing the enterprises, separately applied to the People's Court of Suining County, Jiangsu Province ("Suining Court") for bankruptcy reorganization. After examination, the Suining Court held that the three companies had a good foundation and development prospects, that the alcohol production qualification was a scarce resource with reorganization value, and therefore, on January 12, 2018, separately ruled to accept the bankruptcy reorganization applications of the three companies. Because the three companies were highly commingled in operation, finance, personnel, and management, and the cost of distinguishing the property of each affiliated enterprise member was excessively high, in accordance with Article 32 of the Minutes of the National Court Bankruptcy Trial Work Conference and based on the administrator's application, the Suining Court ruled on June 25, 2018 that the three companies undergo substantive consolidation bankruptcy reorganization.

During the reorganization period, the investor Xuzhou Changqing Biotechnology Co., Ltd., after conducting an on-site investigation of the current status of Suchun Company, pointed out: Suchun Company had ceased production and operation for many years, and its core asset, the alcohol production license, had fallen out of annual review and faced the risk of loss; there also existed such circumstances affecting reorganization as the loss of employees, the idling and depreciation of machinery and equipment, and fire safety, environmental protection, and other safety hazards. At the same time, the original management of the enterprise had long been paralyzed and was incapable of continuing the relevant work, and the company had no available funds on its books for the administrator to resolve the crisis. In these circumstances, the administrator proposed a plan whereby the reorganization investor would first invest part of its funds to restore part of the enterprise's production capacity.

Judgment

On June 25, 2018, the People's Court of Suining County, Jiangsu Province rendered Civil Ruling (2018) Su 0324 Po No. 1, ruling that Jiangsu Suchun Wine Co., Ltd., Xuzhou Delong Biotechnology Co., Ltd., and Xuzhou Ruikang Food Technology Co., Ltd. undergo substantive consolidation bankruptcy reorganization. On July 5, 2019, the People's Court of Suining County, Jiangsu Province rendered Decision No. 4 of (2018) Su 0324 Po No. 1, approving the investor Xuzhou Changqing Biotechnology Co., Ltd. to conduct trial production. On November 30 and December 1, 2019, the second creditors' meeting of Jiangsu Suchun Wine Co., Ltd. was held, and the various creditor representative groups all adopted by vote the draft reorganization plan submitted by the bankruptcy administrator of Jiangsu Suchun Wine Co., Ltd. The bankruptcy administrator of Jiangsu Suchun Wine Co., Ltd. applied to the People's Court of Suining County, Jiangsu Province for approval of the draft reorganization plan of Jiangsu Suchun Wine Co., Ltd. In accordance with Article 86 of the Enterprise Bankruptcy Law, the People's Court of Suining County, Jiangsu Province rendered Ruling No. 1 of (2018) Su 0324 Po No. 1 on December 2, 2019: 1. approve the reorganization plan of Jiangsu Suchun Wine Co., Ltd.; 2. terminate the reorganization procedure of Jiangsu Suchun Wine Co., Ltd. At the same time, a two-month supervision period was reserved in accordance with the law.

Reasoning

The effective judgment held: the problems facing the debtor raised by the bankruptcy administrator genuinely existed. If the alcohol production license on which the enterprise relied for survival were lost, the enterprise's core assets would no longer exist and the reorganization would lose its meaning. Because the debtor currently did not have sufficient funds for the administrator to use, having the investor first invest funds to conduct trial production could resolve the difficulties faced by the enterprise in the reorganization process, and could also preserve and increase the value of the enterprise's assets, fully safeguard the interests of the debtor and the creditors, maintain social stability, and be more conducive to the enterprise's development after reorganization. The bankruptcy administrator's application conformed to the concept of bankruptcy protection and did not violate the relevant provisions of laws and regulations, and should be approved.

With respect to the issue of whether to allow the investor to conduct trial production, the court mainly considered the following factors before making its decision:

I. The necessity of trial production

First, the bankrupt enterprise faced a severe situation: first, Suchun Company faced the risk that, after ceasing production and operation, its alcohol production license would fall out of annual review and its production qualification would be canceled, and once this qualification was lost it would be difficult to obtain again, and the reorganization would also lose its meaning; second, the enterprise also faced external pressures such as environmental protection and fire safety acceptance and the damage to machinery and equipment from prolonged idling; third, the enterprise's internal technical personnel had been lost in large numbers, and employees faced livelihood difficulties due to the enterprise's suspension, which could easily

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trigger mass incidents; fourth, the management of the enterprise was paralyzed and incapable of continuing the relevant work, and the company had no available funds on its books for the administrator to resolve the crisis.

Second, the greatest risk for an investor participating in the reorganization procedure lies in the safety of the funds and assets invested; the investor hoped to gain a comprehensive understanding of the enterprise's actual situation and its production vitality and momentum through trial production, so as to provide a safeguard for resuming operations after reorganization.

Third, Suchun Company, as the former leading enterprise in the local biotechnology field, played a pivotal role in the optimization, transformation, and development of the regional industrial chain; under the demand of high-quality economic development, the local Party committee and government urgently needed the enterprise to restore production capacity, drive the development of upstream and downstream industries, resolve employment issues, and maintain social stability.

In sum, if the investor were not allowed to conduct trial production, it would cause huge and irreparable losses to the enterprise; once the alcohol production license was lost, the enterprise's core assets would no longer exist, and even if the reorganization ultimately succeeded, the enterprise would have lost its core competitiveness. Therefore, allowing the investor to conduct trial production was necessary and urgent.

II. The balancing of interests in trial production

A mature bankruptcy reorganization system should have the following benign effects: through reorganization, save an enterprise that is in distress but still has existence value, enable it to restore profitability and continue operating, safeguard the employment and survival rights of its employees, enable the reasonable satisfaction of creditors' claims, and realize the returns of investors, thereby fairly protecting the interests of all parties and realizing social stability and economic stability and development. Therefore, when balancing interests, some core value concepts must be fully considered in enterprise reorganization; these concepts are fairness and efficiency, and flexibility and predictability. Allowing the enterprise to conduct trial production can balance the interests of all parties: first, before the investor conducts trial production, the debtor's existing assets have already been audited and appraised and confirmed, and according to the investment agreement reached between the administrator and the investor, the amount and source of the debt satisfaction funds of the reorganized enterprise have also been determined, so there is no conflict between the investor's entry for trial production and the reorganized enterprise's satisfaction of debts; second, the investor's investment of part of its funds for trial production is conducive to the investor's full understanding of the enterprise's situation and operating capability, laying the foundation for the enterprise's development after reorganization; third, trial production can restore part of the production capacity of the reorganized enterprise and preserve and increase the value of the enterprise's high-quality assets; fourth, it can safeguard the creditors' claims from depreciation and increase the satisfaction ratio; fifth, the reorganized enterprise's restoration of a certain scale of production can also resolve such urgent problems as environmental protection, fire safety, and employee stability faced by the bankrupt enterprise due to its suspension, which is beneficial and harmless to the enterprise's reorganization.

III. The legal and theoretical basis of trial production

First, although the Enterprise Bankruptcy Law and related judicial interpretations contain no specific legal provision on whether an investor may enter early for trial production before taking over the enterprise, in order to realize the rescue function of the Bankruptcy Law, in specific circumstances, allowing an investor to enter for trial production and save a distressed enterprise through market-based and rule-of-law approaches conforms to the needs of China's bankruptcy trials.

Second, although the investor's trial production can resolve the problems facing the enterprise before the investor takes over the enterprise, in order to prevent the investor from adopting unreasonable production methods and harming the interests of other rights subjects in the bankruptcy reorganization, its trial

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production should still be subject to obtaining the approval or consent of the court or the creditors, and accept the supervision of the court, the administrator, and the creditors.

Third, because China's current bankruptcy law provisions are still imperfect, in bankruptcy trial work, people's courts should strengthen their awareness of serving the overall situation, consciously enhance the foresight and creativity of their work, use innovative thinking to resolve the new difficulties and new problems encountered in the bankruptcy reorganization process, and explore the provision of long-term safeguard mechanisms for enterprise bankruptcy reorganization.

In sum, in order to safeguard the interests of all parties and ensure that the reorganized enterprise can quickly resume work and production, and to realize the social and economic value of enterprise reorganization, the Suining Court, on the premise of obtaining the consent of the various interested parties, allowed the investor to enter early for trial production.

IV. The social value of trial production

First, the court's approval of the enterprise's trial production during the reorganization period, by carrying out the bankruptcy procedure and the enterprise's trial production simultaneously, can ensure the seamless connection and smooth transition between reorganization and the resumption of work and production, and fully safeguard the rebirth of enterprises that still have potential. Second, in the context of epidemic prevention and control, trial production helped the enterprise resolve difficulties in resuming work and production, enabling disinfection and epidemic-prevention materials to quickly support the front line, embodying the judicial responsibility of the people's court, creating a high-quality and efficient business environment for private enterprises within its jurisdiction, especially small, medium, and micro enterprises, and providing high-quality judicial safeguards for enterprises to resume work and production through precise judicial services. Third, the enterprise is a potential enterprise in the regional biotechnology field and has a significant role in promoting the optimization, transformation, and upgrading of the economic and industrial structure, adapting to the overall requirements of high-quality economic development.

Relevant Legal Provisions

Articles 1, 2, 26, and 86 of the Enterprise Bankruptcy Law of the People's Republic of China.

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