SPC Guiding Case No. 165: Application by the Bankruptcy Administrators of Chongqing Jinjiang Printing & Dyeing Co., Ltd. and Chongqing Chuanjiang Knitting & Textile Co., Ltd. for Substantive Consolidation Bankruptcy Liquidation

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Unofficial English translation prepared for reference only. The official Chinese text prevails.

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Keywords

Civil / bankruptcy liquidation / substantive consolidation bankruptcy / affiliated enterprises / hearing

Holding

1. When trying bankruptcy liquidation cases of affiliated enterprises, a people's court shall respect the independence of the corporate personality of affiliated enterprises and, in principle, separately examine whether each enterprise legal person has grounds for bankruptcy and apply a single bankruptcy procedure to each. Where there is a high degree of commingling of corporate personality among affiliated enterprises, the cost of distinguishing the property of each affiliated enterprise is excessively high, and the fair satisfaction interests of creditors are seriously harmed, the bankruptcy administrator may apply for substantive consolidation bankruptcy liquidation of the affiliated enterprises that have entered bankruptcy proceedings.

2. After receiving an application for substantive consolidation bankruptcy liquidation, a people's court shall promptly organize the applicant, the respondent, creditor representatives, and other interested parties for a hearing, and shall render a ruling in accordance with the law after comprehensively considering such factors as the degree and duration of commingling of assets among the affiliated enterprises, the interest relationships among the enterprises, the overall satisfaction interests of creditors, and the possibility of increasing the enterprises' chances of reorganization.

Basic Facts

On July 16, 2015, the People's Court of Jiangjin District, Chongqing ruled to accept the application for bankruptcy liquidation of Chongqing Jinjiang Printing & Dyeing Co., Ltd. ("Jinjiang Company"), and on September 14, 2015 lawfully appointed Chongqing Lida Law Firm as the administrator of Jinjiang Company. On June 1, 2016, the People's Court of Jiangjin District, Chongqing ruled to accept the application for bankruptcy liquidation of Chongqing Chuanjiang Knitting & Textile Co., Ltd. ("Chuanjiang Company"), and on June 12, 2016 lawfully appointed Chongqing Lida Law Firm as the administrator of Chuanjiang Company.

Jinjiang Company and Chuanjiang Company had the following affiliations: 1. Their actual controller was the same person, Feng Xiuqian. The controlling shareholder of Chuanjiang Company was Feng Xiuqian; the controlling shareholder of Jinjiang Company was Chuanjiang Company, and Feng Xiuqian was also a shareholder of Jinjiang Company, and the legal representative of both companies was Feng Xiuqian. Feng Xiuqian was in fact the actual controller of both companies. 2. Their production and business premises were commingled. Jinjiang Company's production and business premises were mainly in the industrial park of Guangxing Town, Jiangjin District; after Chuanjiang Company was converted into a trading company in 2012, it had no production workshop, and the warehouse it needed for its operations was shared with Jinjiang Company, and the raw materials it purchased all directly entered Jinjiang Company's warehouse. 3. Their personnel were commingled. The management personnel of Chuanjiang Company and Jinjiang

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Company overlapped, and in the later stage of the companies' development, the labor relations of all employees were with Jinjiang Company, but some employees still handled the affairs of Chuanjiang Company; in terms of the arrangement and management of personnel, the two companies were not completely independent. 4. Their main business was commingled. Jinjiang Company's main business income mainly came from printing and dyeing processing and the sale of finished fabrics, and from knitting and textile processing and product sales, while Chuanjiang Company's main business income came from the sale of knitting and textile yarn, cloth raw materials, and finished products. Most of Jinjiang Company's raw materials were purchased through Chuanjiang Company, and the processed products were also mainly resold to third parties through Chuanjiang Company, with Chuanjiang Company earning a certain price difference. 5. Their assets and liabilities were commingled. The two companies had a relatively high degree of commingling in the arrangement and use of operational property such as working capital, and both had relatively frequent transactions with Feng Xiuqian's personal account, which could not be strictly distinguished. There were also no clear agreements on the sharing of operating costs and the distribution of operating profits, which were often adjusted according to the actual profits and tax treatment needs. The two companies also had mutual guarantees for external borrowing.

On April 21 and November 14, 2016, the People's Court of Jiangjin District, Chongqing separately declared Jinjiang Company and Chuanjiang Company bankrupt. During the trial of the two cases, the administrators of Jinjiang Company and Chuanjiang Company, on the ground that the corporate personalities of the two companies were highly commingled and that the interests of creditors were seriously harmed, applied in writing for substantive consolidation bankruptcy liquidation of the two companies. On November 9, 2016, the People's Court of Jiangjin District, Chongqing held a hearing to hear the administrators' application. The joint entrusted agents of Jinjiang Company and Chuanjiang Company, the chairman of the creditors' meeting of Jinjiang Company, members of the creditors' committee, the chairman of the creditors' meeting of Chuanjiang Company, and others attended the hearing.

It was additionally found that the first creditors' meeting of Chuanjiang Company on August 5, 2016 and the second creditors' meeting of Jinjiang Company on November 18, 2016 both adopted by vote the report submitted by the administrators for substantive consolidation bankruptcy liquidation of Jinjiang Company and Chuanjiang Company.

Judgment

The People's Court of Jiangjin District, Chongqing rendered Civil Ruling No. 4 of (2015) Jin Fa Min Po Zi No. 00001 on November 18, 2016: carrying out substantive consolidation bankruptcy liquidation of Jinjiang Company and Chuanjiang Company. The People's Court of Jiangjin District, Chongqing rendered Civil Ruling No. 5 of (2015) Jin Fa Min Po Zi No. 00001 on November 21, 2016: recognizing the Distribution Plan for the Consolidated Liquidation Bankruptcy Property of Jinjiang Company and Chuanjiang Company. The People's Court of Jiangjin District, Chongqing rendered Civil Ruling No. 6 of (2015) Jin Fa Min Po Zi No. 00001 on January 10, 2017: terminating the bankruptcy procedures of Jinjiang Company and Chuanjiang Company.

Reasoning

The effective judgment held: a company, as an enterprise legal person, lawfully enjoys an independent corporate personality and independent corporate property. When trying enterprise bankruptcy cases, a people's court shall respect the independence of the enterprise legal personality. According to Article 2 of the Enterprise Bankruptcy Law, the bankruptcy of an enterprise legal person requires such grounds for bankruptcy as insolvency, being unable to repay all debts when due, or clearly lacking solvency. Therefore, an application for bankruptcy liquidation of affiliated enterprises should generally be subject to a separate examination of whether there are grounds for bankruptcy before deciding whether to accept each application separately. However, after accepting an enterprise bankruptcy, where it is discovered that the corporate personalities of affiliated enterprises are highly commingled, the claims and debts among the affiliated

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enterprises are difficult to separate, and the fair satisfaction interests of creditors are seriously harmed, substantive consolidation bankruptcy liquidation may be carried out for the affiliated enterprises. In this case, because Jinjiang Company was unable to repay its debts when due and its assets were insufficient to repay all its debts, the court ruled on July 16, 2015 to accept the application for bankruptcy liquidation of Jinjiang Company. Because Chuanjiang Company was unable to repay its debts when due and clearly lacked solvency, the court ruled on June 1, 2016 to accept the application for bankruptcy liquidation of Chuanjiang Company. During the trial, it was discovered that since the establishment of Jinjiang Company and Chuanjiang Company in 1994 and 2002 respectively, the personnel, business operations, and assets of the two companies were all actually controlled by Feng Xiuqian personally, and there was a high degree of commingling in business management, main business, and assets and liabilities; Jinjiang Company and Chuanjiang Company had already lost the independence of corporate property and the independence of corporate will, and this commingling was significant, extensive, and persistent through the period of bankruptcy liquidation in 2016; the corporate personalities of the two companies were highly commingled. In addition, Jinjiang Company and Chuanjiang Company could not be completely distinguished in terms of management costs, claims, and debts, and the authenticity could not be confirmed. At the same time, Chuanjiang Company's acts of transferring operating liabilities of RMB 85,252,480.23 to Jinjiang Company and settling external fundraising liabilities of RMB 21,266,615.90 to Jinjiang Company had already harmed the interests of Jinjiang Company and its creditors. According to the application for substantive consolidation bankruptcy liquidation by the administrators of Jinjiang Company and Chuanjiang Company, the court organized the applicant, the respondents, members of the creditors' committee, and other interested parties for a hearing, and found that the corporate personalities of the two companies were highly commingled, that the claims and debts of the two companies in their mutual operations could not be separated, and that separate liquidation would seriously harm the fair satisfaction interests of creditors. Therefore, the administrators' application for consolidated bankruptcy liquidation of Jinjiang Company and Chuanjiang Company satisfied the conditions for substantive consolidation.

Relevant Legal Provisions

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

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