

Analysis of the applicable standards for substantive merger bankruptcy of related enterprises

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Abstract: *The substantive merger system of affiliated enterprises plays an important role in the normal operation of the judicial procedure of China's bankruptcy law. But in the actual process, because of the lack of related legislation and judicial interpretation, courts in various places have no exact legal basis in adjudicating the merger bankruptcy case of affiliated enterprises. In our country, the courts are highly unanimous in recognizing the legitimacy and rationality of the standard of highly confused legal personality, but there are still some disputes on whether the other standards are applicable, which is easy to lead to disputes in judicial practice when the court is facing bankruptcy cases of affiliated enterprises. Therefore, the adaptation standards of merger and bankruptcy of affiliated companies need to be clarified.*

Keywords: *Affiliated enterprises; Substantive consolidation bankruptcy; Legal personality system; Applicable standard*

1. Introduction

The substantive merger bankruptcy system is a special legal system aimed at solving the problem of confusion of legal personality between affiliated enterprises, ensuring fair repayment of the overall interests of creditors, and enabling the bankruptcy proceedings to proceed smoothly. In China, there are a large number of bankruptcy cases of affiliated enterprises resolved through substantive consolidation. However, due to the lag in legislation, especially the lack of clear identification standards, sufficient theoretical basis, and a lack of systematic operating procedures, there have been theoretical divisions and controversies.

2. Necessity of substantial merger and bankruptcy of affiliated enterprises

With the development of the new era and the substantial improvement of the economic level, more large companies want to achieve the highest benefits and hope to reduce transaction costs and business risks and improve resource allocation through group management. Therefore, the existence of affiliated companies is the trend of The Times. The holding company in the group improperly transfers its assets, liabilities, resources, interests and other rights and obligations to different affiliated companies by taking advantage of its control over the group; This violates the rules of the market economy, so that each related company cannot assume their own limited liability, resulting in a variety of problems in the normal operation of the related company, and damage the rights and interests of related enterprises and their creditors. The emergence of these problems not only poses a great threat to China's current legal system of orderly, timely and fair settlement of bankruptcy property, but also to China's legal system of reorganization and rescue of bankruptcy property. As a result, it is difficult to effectively play their roles in the application of cancellation right and void system in bankruptcy law and the implementation of personality denial system and equitable subordination principle in company law. It is an important way to urgently merge and bankrupt related party companies.

2.1 Status quo of substantive merger and bankruptcy of affiliated enterprises

2.1.1 The regulatory capacity of insolvency resolution and ineffective mechanisms is extremely limited

Articles 31, 32 and 33 of the Enterprise Bankruptcy Law establish the bankruptcy revocation and invalidation system, which protects the legitimate rights and interests of creditors to a certain extent by denying the effect of the debtor's improper property reduction. However, the system of bankruptcy

cancellation and invalidation cannot effectively restrict the affiliated companies that are engaged in illegal transactions. In addition, due to the complicated relationships among the affiliated companies that conduct improper activities, it will be more difficult for the managers and creditors of the company to prove the company's illegal and disorderly behavior. Even if the proof can be successfully completed, the process of correcting the improper behavior of the affiliated enterprises one by one will cost a lot of human and financial resources. This will certainly dampen the enthusiasm of managers and creditors and the autonomous initiative to exercise their rights. In addition, according to the provisions of Article 128 of the Enterprise Bankruptcy Law, the liability of the bankruptcy cancellation and invalidation system should be borne by the debtor and his relevant responsible person; However, in our country's affiliated transactions, there are many kinds of creditor's rights losses caused by the debtor's default, and there are different illegal subjects, and too narrow the scope of responsibility will bring great space for other member enterprises to avoid risks, resulting in failure to meet our country's standard requirements for affiliated transactions[1]. To sum up, for related enterprises with efficient management and restriction, the application of bankruptcy revocation and invalidation system is not the best choice for the actual merger and bankruptcy of related enterprises.

2.2 The application value of substantive merger and bankruptcy of affiliated enterprises

2.2.1 It is conducive to improving the legal system and filling legal loopholes

Although the substantive merger rules play a very positive role in the handling of the bankruptcy cases of affiliated companies, in fact, the bankruptcy Law of China has not formulated relevant laws and regulations on the substantive merger bankruptcy rules. In reality, the court lacks the necessary legal basis to solve the difficult and complicated problems through the substantive merger bankruptcy rules, and the court will have objections to the understanding of the substantive merger bankruptcy rules, and there will be various practical dilemmas. And the applicable standard of joint enterprise substantive merger bankruptcy is conducive to make up for the shortcomings of existing legal norms, and has an important impact on promoting the integrity of the legal system.

2.2.2 It is conducive to fully practicing the principle of fair repayment and effectively protecting the interests of creditors

The actual merger and bankruptcy system of affiliated enterprises is to treat the assets of each internal employee as the assets of the enterprise as a whole without splitting and merging, which is conducive to comprehensively thinking about the creditor's and debt relations involved in affiliated enterprises, and then carrying out fair repayment of all debts. Related enterprises take advantage of their internal relationship to maliciously attack the behaviors that infringe on the legitimate repayment interests of creditors by means of mutual shareholding, personnel appointment and removal, etc., which will confuse the initial repayment order of creditors because of the above related behaviors, and the substantive merger bankruptcy rules strictly regulate the above improper related behaviors. The aim is to make the insolvency process efficient, clean and orderly, ensuring that everyone with claims receives the maximum fair settlement.

2.2.3 It is conducive to the efficient conduct of bankruptcy proceedings of affiliated enterprises and reduce the cost waste of parties in bankruptcy proceedings

The establishment of the bankruptcy system of substantive merger of affiliated enterprises is based on the efficiency and efficiency of the bankruptcy procedure. The efficient and reasonable application of substantive merger rules and the treatment of the total assets and all liabilities of affiliated enterprises as a single part of the bankruptcy property can make the bankruptcy procedure of affiliated enterprises no longer complicated and cumbersome as before. The simplification of the examination procedure for determining ownership of assets and the reduction of the steps for improper transaction activities have greatly reduced the time cost of insolvency proceedings, thus reducing the high cost of insolvency of the debtor's business, which is important for reducing the cost of participation of creditors and debtors in the insolvency process.

3. The dilemma of substantive merger and bankruptcy of affiliated enterprises

3.1 Related laws and regulations such as merger and bankruptcy of affiliated enterprises are unclear

From the perspective of the creation of the law and the classification of the types of issuance, there are some provisions on the merger bankruptcy of affiliated enterprises, but there are no clear provisions

on the nature, mode and consequences of the merger bankruptcy of affiliated enterprises. So far, the legislation on the substantive merger bankruptcy of affiliated enterprises has not received due attention. From the perspective of legal sources, at present, China's legislation does not take the highest level of law and judicial interpretation as a guide, but only takes documents, precedents and other auxiliary rules as a reference, which also causes corporate stakeholders to distrust laws and judicial interpretation. In practice, in order to avoid putting the court in a difficult position when trying a merger bankruptcy case, the article 2 of the Enterprise Bankruptcy Law on bankruptcy acceptance conditions is usually cited by most courts as the legal basis for merger bankruptcy. Combined with the actual situation, the mixed circumstances of affiliated enterprises vary greatly, and the realization of their diversification can only rely on documents, cases and other low-level legal systems and guiding cases to make decisions and court rulings. For dissidents, the above situation cannot completely persuade them.

3.2 Different bankruptcy standards for the merger of affiliated enterprises

Article 32 of the Minutes of the Meeting clarifies the principles and standards for the application of substantive merger, that is, the high degree of confusion of the personality of the legal person, the high cost of distinguishing the property of the members of the associated enterprises and the serious damage to the interests of creditors in fair repayment are the applicable standards, and the exception principle is adopted. However, in the bankruptcy trial of affiliated enterprises in China, due to certain gaps in legislation in this aspect and insufficient in-depth research on the legal system of merger and bankruptcy, the judgment standards of the court on merger and bankruptcy are not uniform enough. Especially before the promulgation of the Minutes of the Meeting, there were great differences in the identification standards for the merger and bankruptcy of affiliated enterprises, from the simple consideration of "highly confused legal personality" to the consideration of "interest protection", "liquidation efficiency", "economic order" and many other factors, resulting in great changes in the identification standards for the merger and bankruptcy of affiliated enterprises [2]. Judging from the data analysis of court judgment cases in recent years, the standard of high confusion of legal personality appears 100%, but the highest one among the other three standards is only just over 50%. It seems that in addition to the standard of high confusion of legal personality, other standards are chosen by the court, and there are no specific legal provisions to regulate judges. It can be seen that China's courts have not formed a unified standard for the application of substantive merger bankruptcy standards, which leads to the difficulty of unifying the standards of trial cases in local courts, which will inevitably lead to public dissatisfaction.

3.3 The review procedures for merger bankruptcy are not sound

Article 33 of the Minutes of the Meeting only clarifies that the court promptly notifies the interested parties and organizes the hearing after receiving the application for substantive merger, and requires that a decision on whether to merge be made within 30 days from the date of receipt of the application. In practice, there is a wide range of attitudes on whether to solicit creditors' opinions, some in accordance with the provisions of Article 61 (1) of the Enterprise Bankruptcy Law on the scope of duties of the creditors' meeting, the merger application of the relevant subject is submitted to the creditors' meeting and required to be approved in accordance with the majority of more than two-thirds of the claims represented by creditors, if it does not do so, it will not be merged. Others hear from creditors and other interested parties through a hearing process, and make a decision on whether to merge.

4. The solution to the problem of substantive merger of affiliated enterprises

4.1 To improve the legislation on the substantive consolidation insolvency regime

The definition and scope of application of relevant enterprises should be clearly defined. Various circles have different views on the definition of affiliated enterprises, and there are mainly the following views: The first view defines the affiliated enterprises as "a collection of two or more legal personalities with independent existence of business relationship or investment relationship", which takes business relationship or investment relationship as the core identification factor, so the scope of identification is too large for affiliated enterprises [3]. The second view is that "affiliated enterprise refers to an enterprise that has a subordinate relationship with other enterprises on the basis of equity and contract or is jointly affiliated to an enterprise and has independent legal status". The connection

point of the relationship between enterprises is defined as equity or contract relationship, but it may lack the understanding of other control means [4]. The third view regards affiliated enterprises as "multiple enterprises that have control and subordination relationship or important influence among each other through equity participation or capital penetration, contract mechanism or other means such as personnel chain or voting rights agreement". This concept defines the core elements of affiliated enterprises by listing inter-enterprise control means. It is a relatively complete and appropriate expression of related enterprises [5].

4.2 Accurately define the criteria applicable to substantive consolidated bankruptcy

The judgment that the personality is highly mixed among related enterprises is the main idea and the necessary factor to apply the rule. Although the financial management of affiliated enterprises is usually carried out independently, their actions are often limited by the controllers. In financial accounting, due to the mixed use of accounting credentials, books, reports and bank accounts of different member enterprises, it is difficult to effectively divide them. Whether it is confusion of assets or confusion of other factors, the degree of confusion is difficult to accurately quantify, therefore, it is possible to set a conclusive condition, if it is clear that the relevant company's assets, liabilities, business and other aspects of the expenditure are significantly inconsistent with the results achieved, or the relevant company has encountered irresistible obstacles and difficulties. Or there is solid evidence that the relevant company's business behavior is improper, then the relevant company can be substantially bankrupt.

The supplementary applicable judgment criteria should be clarified to leave room for discretion in individual cases. In specific cases, the confusion of personality should also be taken into account, and other applicable conditions should be comprehensively considered to determine the final applicable rule, which is also a prudent application of the essential merger and bankruptcy system. In the future judicial practice, problems such as the excessively high cost of property division among different shareholders within the enterprise, the damage to the fair repayment interests of creditors by a single treatment method, and the significant improvement of the trial efficiency of cases by a combined treatment method to further maximize the value of the enterprise can be clarified in judicial practice, but cannot be forced. It can also be identified in the judicial practice according to the characteristics of the enterprise itself. Similarly, in such a broad framework, a code of conduct can be clearly stated in a document such as the Judicial Interpretation. In this regard, we can make it clear in the future legislation through the relevant judicial interpretation and other ways, and on this basis, we can provide the bottom line, so that the court can have more discretion.

4.3 Improving the review system for mergers and bankruptcies

The Minutes make it clear that once the court has accepted a consolidated bankruptcy petition, it must immediately give notice to all stakeholders and organize a hearing. However, since the conclusions of the hearing will not directly affect the judges' rulings, and there is not enough opportunity to monitor their rulings, in order to protect the interests of the public, it is recommended that after the hearing, a majority of creditors participate in the voting system to ensure that the final consolidated bankruptcy case is recognized by the majority of creditors. In order to better solve the problems brought about by the merger bankruptcy, the relevant departments need to inform the creditors of this news as soon as possible. After the hearing, the authorities should carefully review each company's insolvency assets and make a reasonable assessment of its solvency, based on input from all participants. They also need to explain how the different insolvent companies are divided and what the different effects of these divisions will be. In exceptional circumstances, the court should ask experts to provide professional advice to help creditors make better decisions. In view of the fact that the ultimate purpose of substantive merger is to protect the fair interests of creditors, in deciding whether to carry out substantive merger, the will of creditors should be respected, and creditors should decide whether to proceed. When the majority of creditors raise objections to substantive merger or bankruptcy by holding creditors' meetings or other means, or when the majority of creditors have different opinions, The creditors have given up their claims on other properties of the related companies, and under the principle of autonomy of will, there is no need for a substantial merger or bankruptcy, and the court will not face great difficulties.

5. Conclusion

Legal scholars should analyze specific cases in practice, learn from the useful experience of foreign countries, and conduct in-depth discussions on issues such as the entity identification standard, the mode of commencement of proceedings, the judgment procedure, and the protection of the interests of Dissident in substantive merger bankruptcy, in order to protect the legitimate rights and interests of ordinary creditors to the greatest extent, and establish a substantive merger bankruptcy system suitable for China's reality.

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