

# *Case Study on the Insolvency Reorganization of Group X*

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**Abstract:** Bankruptcy reorganization system as a new attempt in the field of bankruptcy law has helped many enterprises to obtain regeneration. According to the current bankruptcy legal system and judicial practice, bankruptcy reorganization is distinguished into three different modes, namely, survival type, liquidation type and sale type, and the majority of the domestic reorganization practice has adopted the survival type reorganization system which retains the original enterprise shell. However, with the maturity of practice and theory, the sale type reorganization system, which does not stick to the form of retaining the shell of the original debtor's enterprise but focuses on saving the business of the insolvent enterprise in substance, has been gradually recognized. X Group's own situation is complicated, and the overall difficulty of insolvency reorganization is large, so the Group bases itself on the connection between the enterprises as well as the business situation, balances the interests of creditors of all parties, determines the optimal reorganization mode, delimits the precise scope of reorganization, and designs a well-thought-out reorganization model. The Group's complex situation, based on the connection with each enterprise and its business situation, balanced the interests of all creditors, determined the optimal reorganization model, delineated the precise scope of reorganization, designed a detailed plan, and carried out a standardized implementation so as to revitalize the Group, which is of great significance to the model of bankruptcy reorganization of large enterprises.

## 1. Introduction

In recent years, the number of enterprise bankruptcy cases has been on the rise, among which there are many large enterprises with reasons for bankruptcy but with commercial value and hope for regeneration. For this type of enterprises, bankruptcy reorganization procedure seems to be the optimal choice to help the enterprises to overcome the debt difficulties and restore their business capacity. X Group used to hold assets of 360 billion RMB, with many listed companies and subsidiaries under its umbrella, how to realize the reorganization of its assets, optimization of business resources and protection of creditor's interests to the greatest extent became the focus of attention of all parties. Considering the diverse assets and complex debt structure of the group's affiliates, Group X finally chose the reorganization plan of "sale-type reorganization + other property rights trust".[1]

## **2. Overview of the bankruptcy reorganization system**

### **2.1 Concept of bankruptcy reorganization system**

The bankruptcy reorganization system is a new system introduced by the Enterprise Bankruptcy Law specifically for enterprises that may have or have already had the reasons for bankruptcy in the coming period of time, but still have commercial value and hope for regeneration. The system involves the application of all interested parties and the participation of the court in debt restructuring and business reorganization under the auspices of the court, coordinating the interests of all creditors, and aiming to free the debtor from a financial crisis and ultimately restore the ability to operate. The connotation of this system is to make maximum use of the legal system to liquidate the debts and reorganize the business of enterprises that are insolvent but have hopes of salvaging themselves, so as to avoid directly activating the bankruptcy procedure.

The scope of application of the bankruptcy reorganization system is for enterprise legal persons, but because of the complexity of its operating procedures, the high costs required and the long time period, it is mostly applied to large enterprises in practice, while small and medium-sized enterprises generally adopt the reconciliation procedure.[2]

### **2.2 Classification of bankruptcy reorganization**

According to the current bankruptcy legal system and judicial practice, bankruptcy reorganization is generally divided into three different ways: survival, liquidation and sale.

#### **(1) Surviving Reorganization**

Survival type reorganization, also called traditional reorganization and shell reorganization, refers to the way to maintain the main business of the enterprise and make the enterprise survive through the way of debt relief or postponement of the due date of debt payment. This type of reorganization is mainly applicable to large enterprises whose main business is still profitable. While retaining some shareholders, a new strategic investor is introduced, and the original debts and liabilities are taken over by the surviving enterprise. This mode of liquidation can maximize the social and economic benefits of the enterprise, but there may be risks such as the inability to transfer the equity and the assumption of hidden debts.

#### **(2) Liquidation Reorganization**

Liquidatory reorganization refers to the formulation of a liquidation plan in the reorganization plan that gives priority to the debtor's property over the liquidation and distribution in bankruptcy liquidation, harmlessly cleans up the debts, maintains the survival of the legal personality, retains the enterprise's high-quality assets to the greatest extent possible, reduces the burden of the reorganizer, and adopts the most convenient way to settle debts, so that the investors can carry out the production and operation in a low-pressure environment, and achieves the effect of regaining a new life. This model is mainly applicable to enterprises with certain industry qualifications, and enterprises' fixed assets (such as properties and land use rights) are highly compatible with their business qualifications. Compared with the survival and sale reorganization programs, it is simple and direct, but the liquidation value is low for some enterprises, and the proportion of liquidation obtained in accordance with the liquidation procedures is easily disputed.

#### **(3) Sale Reorganization**

Reorganization by sale refers to the reorganization of the debtor's entire or major business valuable to the reorganization of the whole transfer, and the transfer of the proceeds of the consideration allocated to creditors to settle debts, the debtor's liquidation of the debtor written off, so that the debtor's business can be continued reorganization method. Sale-type reorganization gives up the existence of the enterprise, but retains the business assets of the enterprise, so that the

business can continue to exist. Sell-type reorganization is characterized by high efficiency and low cost, and does not retain the shell of the enterprise, the reorganization is completed at the same time, the debt is also cleaned up, so sell-type reorganization is gradually recognized for its unique advantages. Enterprises reorganized by way of sale are generally in possession of abundant assets, and once the whole enterprise is sold, it will quickly generate benefits; in terms of cost, enterprises in distress are generally large in scale and complex in capital composition.[3]

### **3. Brief description of the substantive consolidation and reorganization of Group X**

#### **3.1 Reasons for reorganization**

X Group was founded in 1986 by University B with an investment of 400,000 RMB. As once the largest university-run enterprise, over the past 30 years, X Group has developed into a diversified financial holding industrial group through continuous investments and acquisitions, with business covering information industry, healthcare, real estate, commerce and trade, education, finance and other sectors, and with a total of more than 400 companies and enterprises and institutions under its umbrella.

As of the end of 2018, X Group Company had a total asset size of 360.6 billion yuan, total liabilities of 295.1 billion yuan, and a net asset size of 65.5 billion yuan; a revenue of 133.3 billion yuan, a net profit of 1.49 billion yuan, and 38,000 employees at home and abroad, and it was ranked No. 5 of China's Top 100 Electronic Information Enterprises in 2018, and No. 138 of China's Top 500 Enterprises.

Unexpectedly, on December 2, 2019, this 360.6 billion assets of the company was unable to raise a 2 billion yuan of short-term bond repayment funds and declared default, and then the debt followed, a total of 24 bonds can not be liquidated, X Group was then applied by the creditors for bankruptcy and reorganization, and for the court ruled on February 19, 2020 to accept the decision, and appointed a liquidation group to act as the administrator.

#### **3.2 Reorganization process**

After accepting the bankruptcy application of Group X, the Central Court of Y formally issued a public notice to recruit strategic investors on April 20, 2020, and after comprehensive evaluation and multiple rounds of screening, the strategic investor consortium formed by Group A Company Limited, Group B Company Limited and Group C Company Limited became the reorganization investor of Group X. On April 30, 2021, the administrator and the strategic investors signed the Reorganization Investment Agreement. Group A entrusted its a life insurance company as the main body participating in the reorganization. On July 31, 2020, the Central Court of Y ruled to carry out substantive bankruptcy reorganization of the five companies under Group X. on June 28, 2021, the Central Court of Y confirmed that the Reorganization Plan formally came into effect, and on October 21, 2021, the New X Group was formally established.

#### **3.3 Content of the reorganization**

X Group owns more than 400 companies under its umbrella, with a complex asset structure of the Group's affiliates and flaws in the attribution of interests in some of the assets, a complex debt structure, a large number of types of creditors and different claims, making it difficult to satisfy the needs of all parties by means of a workable plan. Under such circumstances, the Group finally decided to adopt the "Reorganization by Sale + Other Beneficial Property Trust" plan for reorganization.

#### (1) Disposal-based reorganization plan

The assets of the five companies, including Group X, were categorized into retained assets and assets to be disposed of. Retained assets include equity and debt assets (including assets in the medical, financial and information technology segments) of the reorganized entity with the right to dispose of them, and they are also properties that still have value to investors, so they are directly placed in the new X Group with the consent of the investors, or directly acquired by the investors; assets to be disposed of mainly include assets with flawed ownership and obstacles to their division, which cannot be disposed of in a short period of time and therefore are not included in the consolidated statements. These inefficient assets cannot be disposed of within a short period of time, so they are not included in the consolidated financial statements and are temporarily retained within the reorganized entity.

Except for a small portion of the interests taken over by Group C Limited and other relevant entities, all the remaining retained assets were transferred to the new Group X. According to the creditors' choices of different settlement plans, finally, a life insurance company and Group D were assigned no less than 73% of the equity interests in Group X, and the remaining portion would be compensated by creditors choosing the option of debt settlement in exchange for shares.

#### (2) Debt settlement program

In order to satisfy the different claims of different creditors for debt settlement, Group X offered four different settlement programs. These include property-secured claims, ordinary claims, debt-for-equity and debt retention arrangements, and innovatively set up supplementary distribution of trust proceeds for creditors.

Claims secured by property are paid in priority within the value of the property to which they correspond to the guarantee and are settled in cash in a lump sum within 12 months from the date of the court's ruling on reorganization; if the value of the guaranteed property is insufficient to settle the debt, the unsettled portion as well as the claims with the guaranteed property in the next ranking are included in the ordinary claims for settlement. Other ordinary creditors can choose one of the three modes of "cash settlement + debt for shares, cash settlement, cash settlement + debt retention" to maximize the settlement ratio.

#### (3) Other Beneficial Property Trust Program

The assets to be disposed of by Group X are complex and mainly consist of properties with ownership defects or pending litigation, which cannot be properly disposed of within a short period of time, and a trust institution is entrusted to set up a trust plan for creditors to maximize the value of the properties. Group X entrusted b Trust Company, a subsidiary of Group A, with 100% equity interests in the New X Group and assets to be disposed of, and set up a trust property with creditors who have not been paid off in full as the beneficiaries. The trust property will be used to carry out the liquidation and disposal of the assets to be disposed of within the trust plan to clarify the ownership of the interests, and the property derived from the disposal will be used for the supplementary distribution of the claims after the payment of relevant expenses.

## 4. Interpretation of Group X's Insolvency Reorganization Model

### 4.1 Interpretation of the suitability of reorganization by sale

At present, the three most common reorganization modes in practice have their own advantages but also have their own limitations, why is the sale-type reorganization mode the optimal mode with the highest degree of suitability for Group X?

Firstly, Group X has long been engaged in a "power struggle" among its shareholders, with unclear shareholding structure boundaries and an imbalanced internal governance structure, so if it chooses the surviving reorganization model, whether it chooses to retain the original shareholding

structure or attract new investors, it will leave potential risks behind. Secondly, X Group's assets are huge, spanning information industry, medical care, real estate and other fields. The structure of each segment is relatively close and difficult to divide. In addition to the different attractiveness of each segment to investors, rash overall restructuring cannot maximize the value of high-quality segments, and may also lead to confusion among investors. However, if the disposal is directly split without detailed analysis, it will lead to asset disposal. However, if the disposal is split without detailed analysis, it will lead to uncertainty of the disposal period and uncontrollable risk of the assets. Finally, the high-quality segments of Group X, such as medical and IT, still have commercial value and are still attractive to many investors, and can further realize industrial optimization and upgrading by relying on investors with superior resources. Through the sale-type reorganization, it effectively solves the historical legacy problems and realizes the new and old division of assets.

#### **4.2 Interpretation of the Mode of Creating Other Beneficial Trust Property**

For investors in bankruptcy and reorganization of large enterprises, investors do not wish to acquire all assets, but wish to exclude non-core assets; for administrators, non-core assets will limit the timeliness of the entire bankruptcy and reorganization process, and such assets must be disposed of appropriately and in a timely manner; for creditors, the hasty disposal of non-core assets in the auction may result in the destruction and depreciation of the value of the assets and affect the value of the claims. Affect the value of claims. According to the relevant provisions of the Trust Law, once the trust property is set up, it no longer belongs to the principal and has nothing to do with the bankruptcy and reorganization of the enterprise, nor does it need to participate in the bankruptcy and liquidation of the enterprise. When the assets to be disposed of are set up as independent trust property, an effective distinction is realized from the retained assets. The landing of the Beifang Property Rights Trust Project has effectively resolved the demands of all parties, such as the timeliness of asset realization and risk isolation, and improved the liquidation rate, providing an optimal solution for maximizing the value of the underlying assets and safeguarding the legitimate rights and interests of creditors.

#### **4.3 Interpretation of the liquidation program**

The creditors of Group X are diversified and have different claims. The administrator has taken into account the feedback from the creditors' questionnaire survey and conducted several rounds of negotiations with investors, and finally formulated a settlement plan that fully protects the claims and flexibly matches the modes of settlement.

For secured creditors, priority is given to one-time cash settlement within the appraised value of the secured property; for ordinary creditors, the portion within 1 million yuan is fully settled, and the portion exceeding 1 million yuan is provided with three different settlement plans, namely, "cash settlement + debt for shares, cash settlement, cash settlement + debt retention", with a comprehensive settlement rate of up to about 61%; and the option of "cash settlement" is provided with a maximum of about 60% of the total amount of the debt. The maximum settlement rate can be about 61%; for creditors who choose "all-cash" settlement, the one-time cash settlement rate can be no less than 31%. At the same time, for creditors who choose to buy back their debts with shares, the plan also provides an unconditional premium buyback option by an investment entity with AAA credit rating, and specifies a clear exit mechanism for the underwriting of the buyback; lastly, the undistributed resources reserved for debt repayment and assets to be disposed of held by the trust plan will be supplemented for distribution upon the fulfillment of the conditions, so as to safeguard the rights and interests of the creditors to the maximum extent possible.

## **5. Revelation of Group X reorganization plan**

### **5.1 Preserving the interests of all parties as the first priority of bankruptcy reorganization**

The bankruptcy reorganization procedure involves a large number of subjects, and it is inevitable that the stakeholders will play games and compete with each other in the bankruptcy reorganization case. Therefore, the most ideal reorganization plan is to find a balance point after consultation, so that the balance of interests is not excessively tilted to any side, and the overall interests are maximized. Each subject of interest has the impulse to strive for more benefits for themselves: creditors want to get a higher rate of liquidation; debtors hope that creditors can maximize debt relief, retaining the value of the operation; investors want to be able to low input rate in exchange for a high rate of return. Reorganization is the process of seeking a win-win situation for all parties on the basis of common interests, and Group X's bankruptcy reorganization pioneered the model of "sale-type reorganization + property rights trust", which provided creditors with flexible and diversified liquidation solutions, and the withdrawal of Group X's original shareholders greatly ensured the efficiency of debt repayment; at the same time, the reorganization of the new Group X's business sectors provided the employees of the former Group X with the opportunity to be re-employed. At the same time, the reintegration of the new X Group's business segments also provided re-employment opportunities for the former X Group's employees and better coordinated the interests of all parties.

### **5.2 Solving reorganization problems with the most suitable reorganization plan**

The purpose of bankruptcy reorganization is to save the enterprise. In practice, it is necessary to formulate a well-thought-out bankruptcy plan according to the specific situation and expected goals of the enterprise, and if a more suitable bankruptcy mode can be chosen, there is no chance that the enterprise will be reborn. The bankruptcy reorganization model is not a single one, let alone a fixed one. Take the X Group reorganization case as an example, initially the X Group liquidation group's proposal was to adopt the "overall reorganization + consolidation reorganization" plan, but due to the group's business and its diversification, the net assets of accounts receivable of unknown origin accounted for a very high proportion, so the Ping An Group focuses on the two high-quality segments of finance and health, and further adjusts the reorganization plan as follows Ping An Group focused on two high-quality segments, finance and health, and further adjusted its reorganization plan to a "sale-type reorganization + property rights trust" model, which better solved the reorganization problem, provided debtors with multiple settlement options, and isolated unknown debt risks. The situations faced by enterprises in distress are different, and there is never an optimal formula to apply. It is necessary to understand and analyze the inherent advantages and disadvantages of different modes, and choose the most scientific way, which on the one hand can enable the company to get rid of the debt crisis, and on the other hand can better face the market again and play the effectiveness of reorganization.

### **5.3 Finding suitable quality investors to assist in reorganization**

Bankruptcy reorganization process involves the interests of security rights holders, ordinary creditors, tax claims, employee claims, new shareholders, old shareholders, so the strategic investor should have rich experience in reorganization investment projects, and its own business can assist the debtor to optimize and upgrade the structure of reorganization; secondly, the strategic investor must have better resources, such as the core technology, advanced management mode, strong financial strength, stronger investment and financing capabilities. Secondly, the strategic investor

must have better resource conditions, such as having more core technology, advanced management mode, strong financial strength, strong investment and financing ability, etc. Finally, the strategic investor should not only be able to bring in a large amount of capital, but also bring synergies and strategic layout effects to the invested enterprise. x Group reorganization was selected through many rounds of competitive selection before Group A Co., Group B Co. and Group C Co. stood out from the 29 intended investors. These three companies not only have excellent industrial foundation and governance capability, especially Ping An Group has rich business resources and experience in reorganization, but also can increase operating income through business synergy with Group X and generate greater value in the future.

#### 5.4 Attaching great importance to maintaining operating value

For enterprises in crisis, satisfying multiple interests through reorganization and restructuring is all driven by capital. The main basis of bankruptcy reorganization is the reorganization value, while the review of the reorganization plan focuses on the operating value of the enterprise itself. Enterprises in difficulty should focus on restoring the company's operation, and the reorganization investment is not only to repay debts, but also more importantly to realize normal production and operation as well as industrial upgrading and transformation in the future. Group X's health, finance and education segments still have operating value, and its high-quality segments are sufficient to support the requirements for the continuation of the business operated by the enterprise, and on the basis of which it has adopted the introduction of co-benefit debt financing and other means to avoid asset impairment, Group X's measures are undoubtedly successful. The measures taken by Group X are undoubtedly successful.

## 6. Conclusions

When the insolvency reorganization plan of Group X was made public, highlights such as the sale-based reorganization and the establishment of alternative trusts for creditors provided many lessons for the insolvency reorganization of large groups. The reorganization plan fully embodies the maximum protection of the interests of creditors, formulates a flexible liquidation plan, and gives creditors many choices. With full respect for the principles of marketization and the rule of law, Group X, on the basis of applying substantive consolidation, accurately delineated the scope of reorganization and made innovations in the light of the actual situation, which also made the reorganization plan more relevant to the actual situation and more enforceable.

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