THE IMPACT OF INTERNATIONAL CORPORATE GROUP BANKRUPTCY REGIME ON CHINA—THE PERSPECTIVE OF SUBSTANTIAL CONSOLIDATION THEORY

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Abstract

Current legislation in China regarding substantive consolidation in group insolvency cases is fraught with deficiencies, and the insolvency laws are not only lagging but also rife with contentious provisions. On one hand, the substantive criteria for application are muddled and the underlying meanings of these standards are rather ambiguous. On the other hand, there is a lack of procedural systematization, with a diversity of application subjects that lack consensus, a variety of application modes that require standardization, and jurisdictional rules that are full of gaps and in dire need of refinement. From a comparative law perspective, international legislation on corporate group insolvency exerts a multifaceted influence on China. The EU emphasizes procedural coordination but has limited application, the US has significantly developed the principle of substantive consolidation, and Germany's creditor protection provisions offer valuable lessons. In light of this, China shall undertake efforts on various fronts to construct these rules. It is essential to establish theoretical guidance that upholds the principles of fairness and the maximization of creditors' interests. Moreover, the substantive rules need to be improved to harmonize the system involving the denial of legal personality. Most importantly, procedural rules must be clarified to define the order of claimants, establish a rational mode of commencement, and achieve the centralization of jurisdiction. Only through such measures can the current challenges in the practice of substantive consolidation rules in group insolvency be effectively addressed.

Keywords: Substantive consolidation theory; legal personality denial; Company Law; Bankruptcy law.

I. INTRODUCTION

The "Treatment of Enterprise Groups in Bankruptcy," which is Part Three of the "Legislative Guide on Bankruptcy Law" formulated by the United Nations Commission on International Trade Law, points out in its "Glossary" that "substantive consolidation" means "treating

the assets and liabilities of two or more members of an enterprise group as components of a single bankruptcy estate."[1]

In the application of substantive rules, countries around the world have accumulated certain experience in the legislative process. The United States is the originator and main practitioner of the substantive consolidation bankruptcy rule. In the case of *In re Vecco Construction Industries, Inc.*[2], the judge summarized seven factors to be considered when deciding on substantive consolidation. The theoretical cornerstone of the American substantive consolidation regime is developed by Professor Adolf Berle, which states that if several shareholders establish a corporation following legal procedures, the corporation becomes a legal entity, in which case the legal facts of the corporation are consistent with the economic facts.[3]

From the perspective of procedural rules, the substantive consolidation is also based on the Enterprise Entity Doctrine (EED) created by Professor Adolph Berle in 1947,[4] according to which corporates with independent legal personality can be considered as
one corporate if there are sufficiently close economic relations between them. Procedural consolidation means that several insolvent corporations are tried together, but each enterprise still maintains its independent legal personality, and the proportion of debts to be discharged is determined separately. [5] Substantive consolidation differs from procedural consolidation in that the associated corporates are treated as a single entity, and the bankruptcy proceedings are conducted based on an equal distribution of assets and discharge of debts.

Returning to the theoretical research in China, there is still a lot of controversy in the academic circle as to whether the substantive

[1] United Nations Commission on International Trade Law (UNCITRAL), UNCITRAL LEGISLATIVE GUIDE ON INSOLVENCY LAW PART THREE: TREATMENT OF ENTERPRISE GROUPS IN INSOLVENCY 2 (2012), https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/leg-guide-insol-part3-ebook-e.pdf.

[2] *See In re* Vecco Construction Industries, Inc., 4 B.R. 407, 410 (Bankr. E. D. Va. 1980). And the factors include the difficulty in separating and identifying individual assets and liabilities; the existence of consolidated financial statements; the benefits of consolidation in a single geographical location; the commingling of assets and business operations; the identity of the rights and interests of different entities; the existence of obvious internal corporate debt guarantees and the transfer of assets.

[3] *See* Adolf Berle, *The Theory of Enterprise Entity*, 47 COLUM. L. REV. 343, 344 (1947). However, if the shareholders register the establishment of several corporates, even though each corporate has an independent legal status under the law, the corporates form an economic community by virtue of their affiliation, and the other corporates in fact become subordinate to the controlling corporate; from the point of view of the economic facts, these corporates should be regarded as one and the same subject.

[4] *Id.*

[5] PHILLIP BLUMBERG, THE LAW OF CORPORATE GROUPS, LITTLE BROWN & CO LAW & BUSINESS 401–02 (1985).

consolidation rules have room for application in the localized judicial application in China. Supporters believe that the reform of the rules can make up for the 'shortcomings' of the bankruptcy system and should be confirmed at the legislative level and that the substantive consolidation rules should be constructed by national conditions in terms of the conditions of application and the procedural requirements. The opponents have their views that there is a lack of legal basis for the creation of new bankruptcy rules in the current judicial practice. If such a situation meets the conditions of the corporate personality denial regime, it should be dealt with under the joint and several regimes in bankruptcy without the need to create a separate rule.[6] On the confirmation of the applicable standard, scholars believe that personality mixing as the only standard is too thin. Referring to the extra-territorial experience of the United Nations and the United States, Professor Xinxin Wang summarizes four criteria applicable to the rule, namely confusion of legal personality; fraudulent considerations; creditors' proceeds criterion; and the need for reorganization.[7] Scholar Yangguang Xu believes that personality confusion is the main criterion for adopting the rule, but it is still necessary to consider factors such as the difficulty of separating assets and liabilities and creditors' expected benefits.[8]

This study attempts to build on the theoretical research of international and Chinese scholars and then address three main questions. First, what international legislative experience in China is worth learning from? Secondly, how do we construct feasible and clear applicable standards for the current vague standards of substantive consolidation rules? Thirdly, how do we arrange and set up commencement subjects and commencement modes in substantive consolidation bankruptcy proceedings to protect and balance the interests of creditors of all parties?

[6] Li Yongjun & Li Dahe (李永军, 李大何), *Chongzheng Chengxu Kaishi de Tiaojian ji Sifa Shencha: dui "Hebing Chongzheng" de Zhiyi* (重整程序开始的条件及司法审查——对"合并重整"的质疑) [*The Conditions of the Reorganization Procedure Beginning and the Judicial Review of It: A Query about the "Merger Reorganization"*], 6 BEIJING HANGKONG HANGTIAN DAXUE XUEBAO (北京航空航天大学学报) [JOURNAL OF BEIJING UNIVERSITY OF AERONAUTICS AND ASTRONAUTICS (SOCIAL SCIENCES EDITION)] 48, 50 (2013).

[7] Wang Xinxin (王欣新), *Guanlian Qiye Shizhi Hebing Pochan Biaozhun Yanjiu* (关联企业实质合并破产标准研究) [Research on Substantive Consolidated Bankruptcy Standard for Affiliated Enterprises], 8 FALü SHIYONG (SIFA ANLI) (法律适用 (司法案例)) [JOURNAL OF LAW APPLICATION (JUDICIAL CASE)] 6, 8 (2017).

[8] Xu Yangguang (徐阳光), *Lun Guanlian Qiye Shizhi Hebing Pochan* (论关联企业实质合并破产) [*On Substantive Consolidation of Affiliated Enterprises in Bankruptcy*], 3 ZHONGWAI FAXUE (中外法学) [PEKING UNIVERSITY LAW JOURNAL] 818, 838 (2017).

II. LEGISLATIVE DEFICIENCIES IN THE CURRENT SUBSTANTIVE CONSOLIDATION RULES FOR GROUP BANKRUPTCY IN CHINA

A. *Reflections on the Legislative Effectiveness of Bankruptcy Law*

International corporate group bankruptcy issues, with their intertwined business activities, have spread globally, impacting bankruptcy legislation in China. Analyzing this impact is crucial for Chinese legal system improvement and its progress in economic globalization.

1. Reversal of Early Legislative Deficiencies

Legislation in China on enterprise group bankruptcy has long lagged. The 1991 Civil Procedure Law,[9] the 1993 Company Law,[10] the 2006 Enterprise Bankruptcy Law[11], and some judicial interpretations and local regulations of the Supreme People's Court have played a positive role in the reform of the economic system and the construction of the market economy. However, with the deepening of international exchanges, the existing laws are deficient in dealing with enterprise group bankruptcy cases, which is more obvious after the accession of China to the WTO.

The Enterprise Bankruptcy Law has been in force for more than 15 years since 2007 and has not been amended in that time. At present, only Part VI of Bankruptcy Minute issued by the Supreme Court in 2018 has made brief provisions on the issue of substantive consolidated bankruptcy of associated corporates.[12] The system is controversial in practice and academia, with divergent views on the specific meaning, principles of application, conditions of application, and factors to be considered. At the early stage of the application of the system of substantive consolidation of associated corporates, scholars such as Li Yongjun held that substantive consolidation of associated corporates was damaging to the principle of independent liability of legal persons and would be detrimental to the rights and interests of creditors, and that, in the absence of a basis in substantive and procedural law, the justification for substantive consolidated bankruptcy was questionable.[13]

[9] Minshi Susong Fa (民事诉讼法) [Civil Procedure Law] (promulgated by the Nat'l People's Cong., Apr. 9, 1991, effective Apr 9, 1991) (Chinalawinfo).

[10] Gongsi Fa (公司法) [Company Law] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 29, 1993, effective July 1, 1994) (Chinalawinfo).

[11] Qiye Pochan Fa (企业破产法) [Enterprise Bankruptcy Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007) (Chinalawinfo).

[12] Quanguo Fayuan Pochan Shenpan Gongzuo Huiyi Jiyao (全国法院破产审判工作会议纪要) [The Minutes of the National Court Work Conference on Bankruptcy Trials] (promulgated by Sup. People's Ct. Mar. 4, 2018, effective Mar. 4, 2018) [hereinafter Bankruptcy Minute].

[13] *See* Wang *supra* note 7.

2. New Legislative Thinking on Substantive Consolidation Doctrine

Compared with the bankruptcy of a single corporation, the bankruptcy violations of a corporate group are more difficult to deal with and more harmful. Therefore, Chinese scholars have attempted to research the standards applicable to the substantive consolidated bankruptcy of enterprise groups. Some scholars, like He Dan, believe there are mainly three applicable consolidated bankruptcy standards. He points out that in current judicial practice, China should expand the substantive consolidation standard for affiliated enterprise bankruptcy from the theory of unveiling the corporate veil and fraudulent transaction norms to a standard that includes the standard of difficulty in separating assets, the standard of creditors' expectation, and the standard of proceeds from bankruptcy administration to fully utilize the optimal function of substantive consolidation in solving enterprise group bankruptcy problems. [14] The best function of the substantive consolidation system in solving the enterprise group bankruptcy problem. Xiao Bin argues that in applying the substantive consolidation bankruptcy regime, a high-degree personality mixing of affiliated corporates is the core judgment condition, followed by providing auxiliary judgment standards for application and finally clarifying the circumstances that exclude the application of rules.[15]

Some scholars believe that the application of substantive consolidated bankruptcy of affiliated corporates mainly examines the legal personality of the legal person who is no longer independent. For example, Hao Zhen believes that the elements for the application of substantively consolidated bankruptcy are that although the affiliated corporates have their independent legal personality, they are all controlled by an actual controller, resulting in a high degree of mixing of their personalities, which is mainly manifested in the aspects of operation, finance, personnel and especially funds, etc. Therefore, it is difficult to differentiate the property and debt relations of the affiliated corporates from each other, or the cost of differentiation is too great, so they should be regarded as a single legal subject for consolidation and disposal.[16]

[14] He Dan (贺丹), *Pochan Shiti Hebing Sifa Caipan Biaozhun Fansi: Yige Bijiao de Shijiao* (破产实体合并司法裁判标准反思——一个比较的视角) [*Reflection on the Standard of Judicial Adjudication of Bankruptcy Entity Consolidation: A Comparative Perspective*], 3 ZHONGGUO ZHENGFA DAXUE XUEBAO (中国政法大学学报) [JOURNAL OF CUPL] 70, 86–87 (2017).

[15] Bin Xiao (肖彬), *Shizhi Hebing Pochan Guize de Lifa Goujian* (实质合并破产规则的立法构建) *[Legislative Construction of the Rules for Substantive Consolidated Bankruptcy*], 4 SHANDONG SHEHUI KEXUE (山东社会科学) [SHANDONG SOCIAL SCIENCES] 187, 190–92 (2021).

[16] Hao Zhen (郝振), *Shizhi Hebing Pochan de Chengxu Qidiong yu Zhixing Xianjie* (实质合并破产的程序启动与执行衔接) [*The Connection between the Initiation of the Procedure and the Enforcement of Substantive Consolidated Bankruptcy*], 11 RENMIN SIFA (人民司法) [PEOPLE'S JUDICATURE] 68, 69 (2020).

It can be seen from this that Chinese academics are not uniform in applying the criteria for substantive consolidation and bankruptcy of associated corporates in individual cases, but they have provided different perspectives and viewpoints for the establishment of the applicable criteria and provided a theoretical basis for the subsequent legislation.

3. Localized Application of Chinese Company Law Rules in Bankruptcy Proceedings

In China, the rules of Company Law and Enterprise Bankruptcy Law do not set up a special legal system specifically against the insolvencies of corporate groups. However, the judges in courts have formed a special judge-made rule based on judicial practice. That is trying to solve the problems of insolvencies of corporate groups through pre-existing rules in the Company Law and Enterprise Bankruptcy Law.[17] Hence, despite the emergence of novel bankruptcy cases, judges still try to solve the problems by traditional rules.

For instance, judges in China tend to deny the distinct juridical personality of the corporates when two corporates fall into high personality confusion, thus achieving an effect similar to the consequence that substantive consolidation doctrine does.[18] Despite the wealth of theory, there are still deficiencies in dealing with the bankruptcy of corporate groups in the judicial practice of China. The current minutes of the Supreme Court on the bankruptcy of corporate groups are problematic in terms of their legal nature, the lack of perfect rules for direct hearings, the inconsistent mode of commencement, and the problematic application conditions. In short, the current judicial practice has no direct legal provisions for the time being to regulate corporate group bankruptcy cases, which can only be achieved indirectly through the Company Law, which is a compromise caused by the lack of new legal rules in the existing law.

B. Substantive Issues: Confusion in the Selection of Criteria for Application

In China, article 32 of the Bankruptcy Minute provides comprehensive standards but no binding consensus in specific judicial practice. Therefore, in judicial practice, there are two standards for corporate group substantive consolidation - single and comprehensive.

[17] DING WENLIAN (丁文联), POCHAN CHENGXU ZHONGDE ZHENGCE MUBIAO YU LIYI PINGHENG (破产程序中的政策目标与利益平衡) [POLICY OBJECTIVES AND BALANCE OF INTERESTS IN BANKRUPTCY PROCEEDINGS] 23–37 (2008).

[18] Zhu Ciyun (朱慈蕴), *Gongsi Faren Ge Fouren Fali zai Muzi Gongsi Zhongde Yunyong* (公司法人格否认法理在母子公司中的运用) [*The Application of Company Law Personality Denial Jurisprudence in Parent-Subsidiary Corporates*], 5 FALü KEXUE (法律科学) [LEGAL SCIENCE] 40, 41–42 (1998).

Some courts, considering the Company Law as a superior law, use the legal personality denial standard of Company Law instead of other standards, and the comprehensive standard lacks content construction and has ambiguity, making it difficult to apply.

1. Single Standard: Highly Confusing Standard of Legal Personality

In the system of denial of legal personality, both the Bankruptcy Minute and the guiding cases have given the standard of recognizing the high degree of legal personality mixing, and in the judicial practice, the high degree of personality mixing is the main reason for the court to apply the rule of substantive consolidation of bankruptcy. [19] However, it is not useful to define the scope of substantive consolidation by simply replacing the high degree of personality mixing in the substantive consolidation regime with the standard in Company Law, which may lead to the same group of corporates manifesting different personality mixing in different cases in judicial practice, which relies on the discretion of the judge.

Under the substantive consolidation rule, without a criterion for personality confusion, the discretion of the judge is too rough. High-degree personality commingling exists in various aspects like personnel, business, and financial commingling, with different levels. The rule emphasizes the unity of assets and liabilities, especially the special status of financial commingling in corporate group bankruptcy. When a judge decides to deny the personality of a corporate group, the corresponding decision document should detail the special nature of property commingling.[20] But that doesn't solve the whole problem. In Chinese culture, family-owned corporations often operate like this, and it doesn't mean they're non-independent individuals; otherwise, it risks harming other corporations to protect creditors.

Current judicial practice attempts to transpose the highly hybrid legal personality in the sense of Company Law directly into the sense of the substantive consolidation rules of Enterprise Bankruptcy Law, but the latter lacks an effective adjudicative logic.

[19] He Linfeng & Li Nan (何林峰, 李楠), *Lun Guanlian Qiye Shizhi Hebing Pochan de Shiyong Tiaojian yu Chengxu* (论关联企业实质合并破产的适用条件与程序) [*On the Application Conditions and Procedures of Substantive Consolidated Bankruptcy of Affiliated Corporates*], 2 NINGDE SHIFAN XUEYUAN XUEBAO (SHEHUI KEXUE BAN) (宁德师范学院学报(哲学社会科学版)) [JOURNAL OF NINGDE NORMAL UNIVERSITY (PHILOSOPHY AND SOCIAL SCIENCES EDITION)] 29, 36 (2022).

[20] WANG JING (王静), SHIZHI HEBING POCHAN FALÜ ZHIDU GOUZAO YANJIU (实质合并破产法律制度构造研究) [RESEARCH ON THE LEGAL SYSTEM STRUCTURE OF SUBSTANTIVE CONSOLIDATED BANKRUPTCY] 164 (2021).

2. Beyond the Single Standard: The Creditor Standard of Equitable Satisfaction

Another more commonly applied standard is the creditor fair satisfaction standard, which also implements the creditor-centered principle of equitable satisfaction.[21] It is an important part of the comprehensive standard of article 32 of the Bankruptcy Minute. The creditor fair satisfaction standard is very similar in name to the creditor fair satisfaction principle due to its inability to crystallize into a particular standard designation and has to be referred to in general terms. The important problem with this type of standard is that it is vague and undefined in its application in China, making it less commonly used and always inferior to the highly confusing legal personality standard in its application in adjudication.

The fair payment standard of creditors originated in the U.S. case of Augie/Restivo, decided by the U.S. Second Circuit. The case involved Union Savings Bank as a creditor of Augie and Manufacture Hanover Trust Corporate (MHTC) as a creditor of Restivo. After a share exchange agreement, Restivo became a 100% controlling owner of Augie, and their asset management, books, and payroll were virtually identical. Augie guaranteed the debt of Restivo, and they became insolvent.[22] The Second Circuit made fair payment of creditors the central objective, leading to the creditors' reliance on interest standards and the all-creditors benefit standard. The creditors' reliance standard examines the state of reliance of the insolvent corporation's creditors in its external debt relationship to determine if the creditors' expected benefit based on reliance can be satisfied. The all-creditors benefit standard requires all creditors to obtain benefits in the bankruptcy case to open the substantive consolidated bankruptcy.

In the current law application, article 32 of the Bankruptcy Minute sets the substantive criteria for the substantive consolidation rule. It requires considering a high-degree of personality confusion and high cost of property distinction among corporate group members that seriously jeopardizes creditor interests, forming a comprehensive application criterion similar to the US. All three factors must be established simultaneously, not in a selective relationship. However, there are constraints and obstacles in applying the creditor interest standard, especially the tension between the factors. First, whether the excessive cost of property distinction should be a separate criterion or part of the high-degree personality confusion criterion. Second, if the commencement of the substantive consolidation rule benefits all creditors and overall creditor interest, but if it doesn't benefit all creditors

[21] *See* Li & Li, *supra* note 6.

[22] *See* Union Sav. Bank v. Augie/Restivo Baking Co. (*In re* Augie/Restivo Baking Co.), 860 F.2d 515, 518–20 (2d Cir. 1988);

yet, overall creditor benefit exceeds costs, should the rule be commenced? Third, the relevance of the creditor equitable satisfaction criterion to the personality confusion criterion in triggering the rule. Existing judicial decisions seem to be a comprehensive standard but are a single standard, lacking the argument of creditor fair settlement.

3. Normative Deficiencies: Revisiting the Choice and Application of Standards

The establishment of a comprehensive standard is a more realistic weighing of interests based on a determination of the substantive consolidation rule from the perspective of the interests of the creditors as a whole. This requires the court to have access to that measure of interest, which presupposes that the court needs to weigh up and account for the assets and liabilities in a comprehensive manner. If the interests of some creditors are damaged, whether or not to insist on the activation of the substantive consolidation rule is also a considerable test for the court. In bankruptcy cases, the courts, in weighing the interests of creditors, often considered the creditor-debt relationship within the corporate group, the degree of commingling, the duration, and the effect of assets expected to be saved by the merger in determining whether or not to commence. From this point of view, from the perspective of safeguarding the fair payment of creditors, how to appropriately and precisely activate the substantive consolidation rule, rather than just adding several auxiliary criteria on top of a single criterion to form the so-called formalized comprehensive criterion, is an obstacle to the rule that needs to be removed by the legislation.

After the application of the standard, China has not yet established the rules of compensation for benefits as in the German legal system, which makes the subsequent substantive remedies not yet comprehensive. In this regard, some scholars have proposed that dissenting creditors should be given the right to demand compensation for their interests and that the compensation should be reasonable and moderate.[23] However, some scholars objected to this, arguing that it is too ideal to distribute interests based on substantive consolidation to seek a new balance of interests. The rule of compensation of interests has its special characteristics of Enterprise Bankruptcy Law, especially the division of non-dominant contract and dominant contract, which has strong reference significance and is also the crystallization of mutual integration of contract law system and bankruptcy law system.

[23] *See* Xu *supra* note 8.

C. *Procedural Issues: Lack of Systematization of Substantive Consolidation Rules*

1. Subject of Initiation

About the application for commencement of substantively consolidated bankruptcy proceedings, the most active and common is the application for commencement by the administrator, in addition to which there are differences in practice as to whether creditors, debtors, and the court can serve as the commencement subjects for the commencement of a certain number of corporate groups, which is worth analyzing.[24]

Firstly, in current bankruptcy legal practice, the administrator is the subject of the commencement of proceedings.[25] Article 27 of the Enterprise Bankruptcy Law gives the administrator a fiduciary obligation similar to that of directors, supervisors, etc. The administrator has a duty of diligence, conducting comprehensive liquidation before substantive consolidation and applying for its commencement if beneficial. It also has a duty of loyalty, not colluding with external creditors. In judicial practice, courts can directly apply the administrator for substantive consolidation. For example, in the case of bankruptcy liquidation of Shenyang Eurasian Group, the court held that the circumstances controlled by the same controller included, but were not limited to, centralized management of the seal of corporate, high overlap of directors, supervisors, and senior management personnel within the corporate group, and unified payment of wages to employees within the corporate group, therefore, based on the application of the administrator, the court ruled that the corporate group was insolvent.

Therefore, when the administrator takes over the property of the corporation, he naturally has the obligation to investigate and be responsible for the financial status of the corporation at the same time, and when applying to the court, the administrator is often able to clearly argue that the substantive consolidation system is the most suitable subject to maximize the protection of the interests of the creditors.

Secondly, creditors, as claimants for the residual value of the insolvent corporation, have a direct interest in the estate of the group of insolvent corporations. It has been argued that creditors have an interest in the commencement of the substantive consolidation regime

[24] *See* Wang *supra* note 7. According to the scholar Xinxin Wang, there are few cases where the liquidator actually enjoys and exercises the right to apply, and it is inappropriate for the contributors to enjoy the right to apply as the consolidated bankruptcy does not involve their direct interests.

[25] The UNCITRAL Legislative Guide on Bankruptcy Law also considers that the administrator is entitled to apply directly for consolidated bankruptcy. *See* UNCITRAL, *supra* note 1.

in a higher order than the administrator. The reason for this is that creditors, as eligible subjects for applying for commencement of substantive consolidation, have the institutional coherence of Company Law and Enterprise Bankruptcy Law. However, not all creditors have a positive incentive to initiate the rule. Some creditors may see a reduction in their personal recovery capacity as a result of the commencement of the substantive consolidation regime, while other creditors have few claims and debts and are more likely to take a "free-rider" approach. As a result, the willingness of creditors to commence an application is not as strong as that of an administrator.

Thirdly, the court, as the judicial organ of intermediate adjudication, also has an incentive to initiate the substantive consolidation regime on its initiative. In the model of partial bankruptcy and then consolidation, the court has such power, and the law is also in line with the provisions of the Civil Procedure Law on the consolidation of cases. The legislation from which it can draw is section 150 of the United States Bankruptcy Code, which expressly provides that the court may, ex officio, require the court to rule directly on the consolidation of a corporate group when it determines that the consolidated bankruptcy of the corporate group will have a greater impact on the subjects of the parties.

In China, even if creditors of a corporate group don't agree with the substantive consolidation, the court can exercise its authority to adjudicate it. However, in current judicial practice, the application doctrine remains the core commencement model. This is because the bankruptcy legal norms, dominated by the application-based legislative concept, respect the judgment of the application subject, like the administrator, on the insolvent assets of the corporation. As such, the administrator, creditor committee, and other application subjects play a crucial role and dominate the entire process of the substantive consolidation rules.

Fourthly, the debtor is an important subject for the commencement of substantive consolidation. While the debtor has a better understanding of his assets, he is a minority initiator and may be rejected by the court. In the case of *Financial Street Huizhou Huiyang Real Estate Co., Ltd. and Huizhou Huiyang District Hongyu Industrial Development Co., Ltd.* applying for bankruptcy liquidation,[26] the court held that the administrator had the right to exercise litigation rights instead of the debtor. Moreover, the debtor may expose its abuse of legal personality, making its motivation as the application body

[26] Huizhou Guoshu Yuan Dichan Youxian Gongsi Shenqing Pochan Qingsuan Ershen Pochan Minshi Caiding shu (惠州国墅园地产有限公司申请破产清算二审破产民事裁定书) [Civil Bankruptcy Ruling of the Second Instance on the Application for Bankruptcy Liquidation by Huizhou Guoshuyuan Real Estate Co., Ltd.], (2018)粤破终第 41号 (Guangdong High People's Ct. 2018).

insufficient, resulting in the lowest willingness to apply for the substantive consolidation rule among various subjects.

Additionally, when all parties to the substantive consolidation system have the willingness, motivation, and ability to initiate, there is a lack of provisions on how to prioritize the initiation right of each type of initiator. For example, it is necessary to reasonably stipulate whether the administrator, who enters the bankruptcy of a corporate group later, has priority in commencement over the creditors who first participated in the bankruptcy claim.

2. Modes of Commencement

There are three main modes of activation of the entity consolidation rules, which generate different interests and balances and which should be carefully selected and applied by the court according to the circumstances of the case while at the same time clarifying the modes to avoid procedural complications increasing the complexity of the entity consolidation rules.

Model I: Separate bankruptcy, then consolidation. This means that after a group of corporates meets the conditions for bankruptcy, it enters into bankruptcy proceedings separately and, upon application to the court by the applicant during the period of bankruptcy, the court agrees to substantively consolidate the group of corporates. Under this model, the prerequisite for commencement is that all the corporate groups have entered into bankruptcy proceedings, thus ensuring that the corporate groups meet the bankruptcy standards, and there is no possibility of forcing corporates in good operating condition into bankruptcy consolidation. It is the most common model, with independent bankruptcy administrators handling asset and liability liquidation, making responsibilities clear and showing the real state of the corporation.

Mode II: Partial bankruptcy, then merger. This model is also known as the facilitated joint and several model, which means that part of the corporate group enters into bankruptcy proceedings, while part of the corporates does not enter into bankruptcy proceedings, and if the court, in the course of examining the assets and debt-credit relationships of the corporate group, considers that the corporates that have not entered into bankruptcy proceedings should still enter into bankruptcy proceedings, it will adjudicate, ex officio, that they should be merged into bankruptcy together with the group of corporates that have entered into bankruptcy. This model places greater emphasis on the judicial initiative of the court. Here, the administrator may make a recommendation to the court as to whether or not to merge with other corporations and submit the grounds for its argument, which the court then examines and decides. However, the subjectivity of the model and the lack of strong legitimacy lead to concerns about the forced inclusion of non-insolvent companies by the

court. [27] Scholars propose getting creditor consent outside the bankruptcy proceedings, but this is too harsh and not common in practice.[28]

Model III: Consolidation followed by bankruptcy. This model involves the debtors of the corporates involved in substantive consolidation applying for substantive consolidation with the court using a unanimous joint resolution, and the court accepting proof of debt and mixing within the group of corporates provided by the debtors, determining that the group meets the criteria for consolidation and ruling on consolidated bankruptcy. This approach is efficient because of the initiative of the debtors and the preparation of adequate documentation, but it also suffers from artificial selection and non-performance by creditors.

Each model has different features like bankruptcy efficiency, application, order, and application conditions, causing court differences in application. For instance, the first model is inefficient as it requires all corporations to enter bankruptcy simultaneously; the second judicial initiative of the model goes against the current application-based bankruptcy principle; the third model may allow debtors to avoid debts. The choice of method of commencement is an important rule in current substantive consolidation procedures.

3. Jurisdictional Rules

In addition to the above, the rules on substantive consolidation have procedural gaps. Regarding hierarchical jurisdiction, the Bankruptcy Minute is silent; with regard to territorial jurisdiction, the Bankruptcy Minute provides for it but does not indicate in detail the specifics of jurisdiction. It requires the establishment of rules in terms of hierarchical jurisdiction and territorial jurisdiction to ensure that each corporate group can be heard in the same trial and to improve the efficiency of the adjudication.

First, the discussion of hierarchical jurisdiction. It has been questioned whether cases of consolidation of insolvent entities of a corporate group belong to the ordinary civil cases heard by the Basic People's Courts. The Civil Procedure Law does not directly stipulate them as special cases. As such cases are more complex, with unclear rights and obligations, the intermediate courts hearing the cases need

[27] Gao Xiaogang & Chen Ping (高小刚、陈萍), *Lun Guanlian Qiye Pochan Chengxu Zhong Shizhi Hebing Yuanze de Shiyong* (论关联企业破产程序中实质合并原则的适用) [*The Application of Substantive Consolidation in Bankruptcy Proceedings of Affiliated Enterprises*], 12 FALÜ SHIYONG (法律适用) [JOURNAL OF LAW APPLICATION] 80, 88 (2020).

[28] Wang Jing & Jiang Wei (王静、蒋伟), *Shizhi Hebing Pochan Zhidu Shiyong Shizheng Yanjiu: Yi Qiye Pochan Fa Shishi Yilai 76 Jian Anli Wei Yangben* (实质合并破产制度适用实证研究——以企业破产法实施以来 76 件案例为样本) [*Empirical Study on the Application of Substantial Consolidated Bankruptcy System: A Sample of 76 Cases since the Implementation of the Enterprise Bankruptcy Law*], 12 FALÜ SHIYONG (法律适用) [JOURNAL OF LAW APPLICATION] 3, 12 (2019).

to meet the standard of "having significant influence within the jurisdiction" as outlined in Article 19, paragraph 1 (a). If different members of the same corporate group appeared before different levels of courts in the first instance of bankruptcy, creditors at the same level in the corporate group would face inconsistencies in the starting line for trial and supervision. Differences in the trial and adjudication capacity of the basic, intermediate, and superior courts artificially create differences in trial and adjudication before a substantive judgment is rendered.

Second, territorial jurisdiction. The rules on geographical jurisdiction in substantive consolidation cases are clearly stated in the Bankruptcy Minute. The provisions of Article 35 of the Bankruptcy Minute can be broken down into the following two points: first, in substantive consolidation cases, the core controlling corporate should be identified, and the domicile of the core controlling corporate should be confirmed. Second, where the core controlling corporate cannot be identified in a corporate group, the location of the main property is to be examined and judged.

As a matter of comparative law, the EU adopts the "center of main interests" standard for cross-border proceedings of this corporate group and determines whether the "center of main interests" of the corporate group falls within the territory of the EU to decide whether the EU enjoys the jurisdiction of procedural consolidation. The jurisdiction of the EU over procedural mergers is determined by the "center of main interests" test. Based on comparative law experience, some courts have further clarified the meaning of "domicile of the core controlling corporate." Article 3 of the Guidelines on Substantive Consolidation of Corporate Groups in Corporate Bankruptcy Cases of the Xiamen Intermediate People's Court stipulates that the location of the center of main interests (COMI) is generally the location of the core controlling corporates in a corporate group. However, this is only a conceptual equivalence, and whether it can be directly applied to Chinese territorial jurisdiction rules remains in doubt.

In territorial jurisdiction, Article 35 of the Bankruptcy Minute stipulates jurisdiction designation for conflicts, with such conflicts to be reported to and designated by a common higher court. But in specific operations, there are problems: firstly, adhering to Article 35 may lead to courts deeming their jurisdiction outside the core territorial jurisdiction, causing trial delays or questions about case transfer; secondly, in the context of the domestic market, the business of a corporate group spreads nationwide, and applying substantive consolidation rules may prompt different local government responses due to factors like taxation and employment, and facilitating the smooth investigation and enforcement of court is a practical issue.

III. PLURALISTIC IMPACT OF INTERNATIONAL CORPORATE GROUP BANKRUPTCY LEGISLATION ON CHINA

Before addressing the legislative deficiencies in China Enterprise Bankruptcy Law, it is essential to understand the legal frameworks for corporate group bankruptcy in different countries, which have unique characteristics and practices and offer important inspiration and reference for Chinese bankruptcy legislation and practice.

A. Distinct Legal Frameworks of Insolvencies of Corporate Groups

1. European Union: Procedural Coordination

On June 26, 2017, The European Insolvency Regulation (Recast) ("Recast EIR") came into force. It is a regulation that provides rules on cross-border insolvencies of corporate groups. However, it does not have substantive legal rules against insolvencies of corporate groups. As the title of Chapter 5 of Recast EIR suggests, it focuses on the bankruptcy proceedings of members of a group of corporations.[29]

From article 56 to article 77 in Recast EIR, the regulation provides for bankruptcy practitioners, courts, and debtors. It does not have substantial law provisions to deal with the insolvencies of corporate groups but focuses on the cross-border characteristic of the insolvencies of corporate groups among the Member States of the European Union. In particular, cooperation, communication, and coordination among the individual entities are some of the core contents of the clauses. It precisely regulates the powers of the bankruptcy practitioner after the bankruptcy proceedings open. For example, the bankruptcy practitioner shall specify the grounds on which jurisdiction is based in the decision opening the proceedings.[30] Article 21 also regulates the powers of the bankruptcy practitioner.[31]

However, due to the special characteristics of the insolvencies of the corporate groups, the regulations still have some limited restrictions. Firstly, the application of the Recast EIR is restricted. The preamble of the regulation has given the jurisprudence.

"The rules on cooperation, communication, and coordination in the framework of the bankruptcy of members of a group of corporates provided for in this Regulation should only apply to the extent that

[29] The conceptual approach underlying this chapter was first proposed by the German government in its legislative proposal for new domestic rules on bankruptcy proceedings of members of groups of corporates. *See* Entwurf eines Gesetzes zur Erleichterung der Bewältigung von Konzerninsolvenzen [Draft Act to Facilitate the Handling of Group Insolvencies] 18/407 of 30 January 2014 (Ger.).

[30] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on bankruptcy proceedings (Recast), art. 2(4), O.J. 2015 (L 141) 1, 30.

[31] *Id.*, art. 21.

proceedings relating to different members of the same group of corporates have been opened in more than one Member State."[32]

Secondly, the rules in the regulation do not apply to the corporate groups that have a center of main interest (COMI) in non-EU countries. It limits the application of the regulation. Even if a corporate group fits the definition of the "corporate group," if their COMIs are beyond the EU, the Recast EIR would not apply.[33] However, it does not restrict the spillover impact of the Bankruptcy Regulation. In the case of Schmid v. Hertel, "Mr[.] Schmid issued proceedings in the German Courts against Ms[.] Hertel, the latter being resident in Switzerland, to set aside a transaction that had been entered into between Ms[.] Zimmermann and Ms[.] Hertel and, thereby, to recover EUR 8,015.08 (plus interest) for the insolvent estate from Ms[.] Hertel."[34] And the Court of Justice was asked to give a preliminary ruling. The Court of Justice examined both the provisions and objectives of the Regulation. If the rules and goals of the Recast EIR do restrict its reach to the EU, but also in this kind of very small field do allow the overflow influence on the scope beyond the EU, the provisions of the regulation can be regarded to have a spillover impact on the corporate groups having COMIs beyond the EU.[35] According to this case, the Recast EIR may apply to bankruptcy proceedings of a purely domestic nature.

Since the EU is a supranational organization, it cannot legislate like a national country. However, the coordination of proceedings of the insolvencies of corporate groups between the EU and third countries, as well as the linked cooperation of bankruptcy courts and administrators, have given a distinguishing example for the world.

2. United States: Substantive Consolidation Doctrine

The distinct framework in the case of the insolvencies of corporate groups in the United States legal system is the substantive consolidation doctrine. They are the foundations of the United States legal system for insolvencies of corporate groups.

The establishment of the substantive consolidation doctrine can be traced back to 1941 when there was a case called Sampsell v Imperial Paper & Color Corp.[36] The courts finally gave the judgment that Wallpaper & Paint Corporate was a tool of Downey to escape bankruptcy. To hinder and deceive creditors, such transfer of property is bankruptcy fraud. From 1935 to 1942, the substantive consolidation

[32] *Id.*, Preamble, ¶ 62.

[33] MIGUEL VIRGÓS & FRANCISCO GARCIMARTÍN, THE EUROPEAN INSOLVENCY REGULATION: LAW AND PRACTICE 21 (2004).

[34] Alexander Riddiford, *Schmid v Hertel*, 11(5) INTERNATIONAL CORPORATE RESCUE 4, 6 (2014).

[35] *See* Case C-328/12, Schmid v. Hertel, ECLI:EU:C:2014:6, ¶¶ 24–25 (Jan. 16, 2014).

[36] *See* Sampsell v. Imperial Paper & Color Corp., 313 U.S. 215, 218 (1941).

doctrine, the judgments of cases were chaotic, which means that the substantive consolidation doctrine can be either total or partial.[37]

In 1966, Chemical Bank New York Trust Co. v. Kheel helped the substantive consolidation doctrine become a basic law rule gradually. The judgment of the court showed that Manuel Kululundis Corporate, as a controlling corporation, had eight affiliated corporates in the field of ship industry.[38] Besides, affiliated corporations went into bankruptcy orderly. The courts identified the facts and said that during the management of the assets of corporates were commingled and the finances were mixed. In this case, the court made a comprehensive analysis and enriched the conditions of the identification of the affiliated corporates. Furthermore, this is the first instance in which the considerable expense associated with differentiating between affiliated entities has been identified as a significant consideration. Compared to the evolution of the substantive consolidation doctrine in China, China is still at the stage described in this US case.

However, the case of Owens Corning in 2005 finally established the applicable criteria of the substantive consolidation doctrine.[39] Before this case, there was no uniform standard for the application of the doctrine. In the case of Owens Corning, the problem emerged when Owens Corning Corporate and all of its subsidiaries filed for bankruptcy at the same time.[40] The court reached some important conclusions when judging the applicability of the substantive consolidation doctrine. Firstly, the substantive consolidation doctrine cannot be used at any time the court wants but only in emergencies. Secondly, the rights of creditors to equitable remuneration have to be impaired, and the pre-condition for compensation is that the impairment must be caused by one of the affiliates of the group. Thirdly, the substantive consolidation doctrine must be the last remedial measure, thanks to the unfair compensation among the creditors after the use of the substantive consolidation doctrine.

In brief, the evolution of the substantive consolidation doctrine experienced a long period. This is why it is also called "rough justice."[41] Finally, the courts set up a series of distinct conditions and treatments in judicial practice. And the courts give a series of factors of the case

[37] *See* Christopher K. Grierson, *Shareholder Liability, Consolidation and Pooling, in* CURRENT ISSUES IN CROSS-BORDER BANKRUPTCY AND REORGANIZATION 300 (E. Bruce Leonard & Christopherw. Basant eds, 1994).

[38] *See* Chemical Bank New York Trust Corporate v. Kheel, 369 F.2d 845 (2d Cir. 1966).

[39] *See In re* Owens Corning, 419 F.3d 195, 212 (3d Cir. 2005).

[40] *Id.*

[41] *See In re* Owens Corning, 419 F.3d 195, 212 (3d Cir. 2005) ("Indeed, because substantive consolidation is extreme (it may affect profoundly creditors' rights and recoveries) and imprecise, this 'rough justice' remedy should be rare and, in any event, one of last resort after considering and rejecting other remedies (for example, the possibility of more precise remedies conferred by the Bankruptcy Code)").

that should be discussed.[42] Many writers have also discussed these factors.[43] From now on, the substantive consolidation doctrine has become an important legal pillar in dealing with the insolvencies of corporate groups.

3. Germany: Benefit Compensation and Indemnification Rules

In Germany, to cover losses suffered by creditors, the German Stock Corporation Act gives a series of regulations asking the controlling corporation to bear the responsibility of compensation,[44] thus protecting the deserved interests of creditors. Unlike the United States law, the German Stock Corporation Act does not admit the substantive consolidation rule. Hence, the benefit compensation rules in German law are not initiatively designed for the application against substantive consolidation rule but indeed for the adjustment of insolvencies of corporate groups.

By German legislation, the controlling corporation in a group of corporations is subject to three legal obligations. It includes compensated obligations in the absence of a dominant contract, compensated obligations in the case of a dominant contract, and indemnification obligations.

The compensated obligations in the absence of a dominant contract are stipulated in section 311 of the Stock Corporation Act, called limitations restricting the exertion of influence. The following is what the Act said.

"Where no control agreement exists, a controlling corporate may not use its influence to instigate a controlled stock corporation or public partly limited partnership to enter into a legal transaction disadvantageous to it or to take or refrain from taking measures resulting in a disadvantage, unless the disadvantages are compensated."[45]

Legally, every corporation may be controlled by other corporations without a controlling contract. It can be realized by the shareholding control and management appointments. Considering this scenario, Section 311 of the Stock Corporation Act makes a difference. Similarly, the Act provides for the influence conducted by the management of the corporation in Section 117, which reads as follows:

[42] IRIT MEVORACH, BANKRUPTCY WITHIN MULTINATIONAL ENTERPRISE GROUPS 217 (2009).

[43] *See*, for example, Henry Peter, *Bankruptcy in a Group of Corporates, Substantive and Procedural Consolidation: When and How*, *in* THE CHALLENGES OF BANKRUPTCY LAW REFORM IN THE 21ST CENTURY 199, 207 (2006). See also Andrew Brasher, *Substantive Consolidation: A Critical Examination* 1, 8 (2006), http://www.law. harvard.edu/programs/corp_gov/papers/Brudney2006 Brasher.pdf.

[44] DAS DEUTSCHE AKTIENGESETZ [AKTG] (THE GERMAN STOCK CORPORATION ACT), § 311 (2021) (Ger.).

[45] *Id.*

"Anyone who intentionally compels, by exploiting their influence on the corporate, a member of the management board or the supervisory board, an officer of the corporate vested with full commercial power of attorney (Prokurist) or an authorized agent to act to the detriment of the corporate or its stockholders will be under obligation to provide compensation to the corporate for the damage it has suffered as a result. Such party also will be under obligation to compensate the stockholders for the damage they have suffered as a result, insofar as they have suffered damage above and beyond the loss resulting for them by the damage caused to the corporate."[46]

The above duties stipulated in the Act are mandatory and statutory, the compensated obligations in the absence of a dominant contract cannot be exempted by mediation or negotiation. Meanwhile, the responsibility cannot be exempted by the decision of the shareholding meeting as well. During the bankruptcy proceeding, the bankruptcy administrator or administrator of affairs can help the creditors exercise and propose their rights.

Another duty is the compensated obligation in the case of a dominant contract. In this case, the controlling corporation gains the control of subsidiary corporations. Sections 302 and 304 of the Stock Corporation Act give the specific content. In Section 302, the rule stipulates the absorption of losses. A party shall be liable to compensate for losses incurred during the year in which the contract is in effect that cannot be compensated from the special surplus reserves drawn down during that period. If the controlling corporation has leased or given the right to operate its business to the controlling corporation, the controlling corporation shall absorb any deficit that would have arisen in that year, provided that the agreed remuneration does not amount to adequate compensation. Section 304 is about the appropriate compensation, emphasizing the external shareholders, distribution of profits, and determination of compensation payments.

The scope of the compensated obligations is more extensive and detailed than that of a contract that is not dominant. For example, the time of payment is annual, and external shareholders can terminate the contract within 2 months of the final decision of the courts.

The third is the indemnification obligation. In addition to the compensated obligations in the absence of a dominant contract and compensated obligation in the case of a dominant contract, Section 305 of the Act also emphasizes that "a control agreement or a profit and loss absorption agreement must include the duty of the other contracting party, upon a corresponding demand being made by an external stockholder, to purchase shares of stock of the latter in return for an appropriate settlement payment determined in the

[46] *Id*, § 117.

agreement."[47] The Act also regulates the settlement payment of the agreement. To summarize, there are two occasions. If the other party to the contract is a non-subordinate joint-stock corporation and does not own a majority of the assets or is located in an EU member state, compensation is provided for its shares in this corporation. If the other party to the contract is a subordinate joint-stock corporate, owns a majority of the assets, or is located in an EU member state, the compensation is provided for either the allotment of shares of stock in the controlling corporate or in the corporate holding a majority of the ownership interest, or a cash settlement.

To conclude, the German Stock Corporation Act sets up a series of compensation and indemnification rules. Compensated obligations in the absence of a dominant contract, compensated obligations in the case of a dominant contract, and indemnification obligations are the three pillars of compensation for the insolvencies of corporate groups. If the majority shareholder of the corporation has a dominant influence, the Management Board must prepare a "dependency report" (Abhängigkeitsbericht). The dependency report must state whether the corporation has been adequately compensated in such transactions or whether the corporation has been adversely affected in any way in its transactions with the majority shareholder.[48] It is a legal and stable framework for the protection of creditors in the insolvencies of corporate groups.

B. The Need for Comparative Law: Learning from Advanced Legislative Experience

1. Drawing on Experience in Principles

In the United States, the application of substantive consolidation even more demonstrates the courts' implementation of the concept of weighing. China should fully draw on the practices of the United States on this issue to solve the problems in judicial practice. Firstly, many rules established by the U.S. bankruptcy courts have played a good exemplary role worldwide. In the United States, the federal court system is divided from bottom to top into district courts, circuit courts, and the Supreme Court. District courts set up bankruptcy courts to specifically hear bankruptcy cases, and the jurisdiction of bankruptcy courts over bankruptcy cases comes from the authorization of district courts.[49]

[47] *Id*, § 305.

[48] *German Stock Corporation Law and Corporate Governance*, Cameron McKenna Nabarro Olswang LLP 1, 9 (2018), https://cms.law/en/media/local/cms-hs/files/publications/publications/german-stock-corporation-law-and-corporate-governance-2018.

[49] Li Shuguang (李曙光), *Meiguo Pochan Fayuan Zongshu* ("美国破产法院综述) [*An Overview of the Bankruptcy Courts in the United States*], 10 FAZHI ZIXUN (法制资讯) [LEGAL INFORMATION] 59, 60 (2013).

Secondly, the provisions and development of the U.S. bankruptcy law system are relatively complete. The establishment and amendments of the U.S. bankruptcy law reflect the process and results of the game between creditors and debtors[50], and the U.S. bankruptcy system has become a substitute part of its national social security.[51]

When the court rules on whether to apply substantive consolidation, it usually needs to weigh and compare various interests and make a more appropriate ruling. On the one hand, it should pay attention to the conflict between protecting the overall interests of creditors and the impairment of the interests of some creditors. On the other hand, it should consider the adverse impact of the merger and reorganization on the realization of the interests of creditors while improving the success rate of enterprise reorganization. Generally speaking, the application of the substantive consolidation system requires a comprehensive measurement of the realization of the values of substantive fairness and efficiency. Since substantive consolidation involves multiple interest subjects and the court needs to apply it prudently after comprehensively weighing various interests, it is necessary to incorporate the principle of "interest balance" into the application principles of substantive consolidation to resolve the potential interest conflicts that may exist in the application of substantive consolidation and maintain the stability of social order.

Therefore, the concept of bankruptcy law should be changed, that is, it should gradually shift from the previous "creditor-oriented doctrine" to the "interest balance among the subjects related to bankruptcy." It should not only focus on the repayment interests of creditors but also pay attention to the rebirth of debtor corporates, the interests of different creditors, and the interest balance of all parties, such as employees.[52]

2. Drawing on Experience in Substantive Rules

In China, the current judicial determination standards for the substantive consolidation of enterprise groups are relatively single. In particular, too much emphasis has been placed on the confusion of corporate personality, which has caused disputes in judicial practice. Some scholars have suggested that more attention should be paid to

[50] Todd J Zywicki, *Cramdown and the Code: Calculating Cramdown Interest Rates under the Bankruptcy Code*, 19 MARSHALL L. REV. 251 (1994).

[51] XU DEFENG (许德风), POCHAN FALUN: JIESHI YU GONGNENG BIJIAO DE SHIJIAO (破产法论——解释与功能比较的视角) [THE LAW OF BANKRUPTCY: A FUNCTIONAL COMPARATIVE STUDY] 64–65 (2015).

[52] Song Qiaochu (宋翘楚), *Shizhi Hebing Pochan Biaozhun de Leixing yu Shiyong Yanjiu* (实质合并破产标准的类型与适用研究) [*Study on the Type and Application of Substantive Consolidation Bankruptcy Standard*] 4 TAIYUAN XUEYUAN XUEBAO (SHEHUI KEXUE BAN) (太原学院学报(社会科学版)) [JOURNAL OF TAIYUAN UNIVERSITY (SOCIAL SCIENCE EDITION)] 64, 75 (2023).

the aspect of bankruptcy administration benefits, that is, whether the merger and reorganization can expand the property of the debtor and increase the repayment to creditors to achieve the protection of creditors.[53] Some scholars have also proposed whether to include the fraud standard in the scope of consideration.

In the practice of the United States, various courts have attempted to establish their substantive consolidation standards, but so far, a relatively comprehensive and appropriate set of substantive consolidation standards has not been summarized. Combining the content of diversified standards in both domestic and foreign theories and practices within the framework of the current Chinese legal system, inclusive, diversified standard rules should be adopted.[54]

Article 33 of the Bankruptcy Minute has supplemented the relevant examination standards in the trial process of the court. That is, under the circumstances meeting Article 32, in individual cases, other relevant factors of the case can be comprehensively considered to decide whether to finally apply the substantive consolidation bankruptcy system for affiliated corporates. This also reflects, to some extent, the prudent attitude of the court towards applying the substantive consolidation bankruptcy system for affiliated corporates. In the process of examining the application of substantive consolidation, attention should be paid to whether the application of the system can better realize the values of the bankruptcy law, safeguard the rights and interests of creditors, and improve the efficiency of the procedures.[55]

In addition, German compensation for the interests of creditors has also provided Chinese scholars with new legislative ideas. Some scholars divide the judgment conditions for the benefits of creditors into two situations: First, substantive consolidation will benefit all creditors, that is, all creditors will benefit from substantive consolidation. Second, substantive consolidation is beneficial to most creditors. Although the interests of some creditors may be damaged, these losses are not as much as the benefits obtained by some other creditors, that is, the creditors as a whole will benefit.[56] Regarding the benefits of substantive consolidation bankruptcy, first of all, from the perspective of bankruptcy administration, consolidated bankruptcy requires lower bankruptcy administration costs than separate

[53] *See* He, *supra* note 14.

[54] Ding Yan (丁燕), *Woguo Guanlian Qiye Shizhi Hebing Chongzheng Shiyong Biaozhun Yanjiu* (我国关联企业实质合并重整适用标准研究) [*Research on the Application Standards of Substantive Consolidated Reorganization of Affiliated Corporates in China*], 6 SHANDONG FAGUAN PEIXUN XUEYUAN XUEAO (山东法官培训学院学) [JOURNAL OF SHANDONG JUDGES TRAINING INSTITUTE] 60, 69 (2021).

[55] *See* Xu *supra* note 8.

[56] WANG XINXIN (王欣新), POCHAN FA QIANYAN WENTI SIBIAN (破产法前沿问题思辨) [A REFLECTION ON THE FRONTIER QUESTIONS IN BANKRUPTCY LAW] 350 (2017).

bankruptcies, and there is no need to spend costs to distinguish the commingled property, thus bringing benefits to creditors. Secondly, substantive consolidation bankruptcy itself can optimize asset disposal, preserve the overall value of affiliated corporates, and make the disposal more convenient and efficient, thereby enabling creditors to obtain more benefits.

3. Drawing on Experience in Procedural Rules

From the perspective of procedural rules, courts dealing with the substantive consolidation bankruptcy of enterprise groups tend to show the characteristic of making commercial judgments on whether to conduct substantive consolidation bankruptcy, breaking through the original role of being an impartial referee in disputes.[57] Additionally, the substantive consolidation and reorganization of enterprise groups involve numerous legal relationships, which pose higher requirements for the work of the courts in terms of protecting the rights and interests of creditors, clarifying various creditor-debtor relationships, maintaining social stability, as well as resettling and appeasing employees. Therefore, caution should be exercised in aspects such as the jurisdiction of enterprise groups and the appointment of administrators.[58]

Taking the determination of jurisdiction as an example, the Recast EIR of the European Council in 2000 has had a profound impact on Chinese legislation. This regulation strictly adheres to the basic principle of the independence of the corporate legal personality on this issue. It first assumes that each independent legal person should separately determine their center of main interests to identify the appropriate court to start the main bankruptcy proceedings. For each legal person, its center of main interests must be analyzed separately. That is to say, even if the parent corporation or other subsidiaries have already started the main bankruptcy proceedings in a certain country, it does not mean that the subsidiary has started the main bankruptcy proceedings in that country.[59] The dispute over the jurisdiction between the courts of Italy and Ireland in the bankruptcy case of Eurofood deeply reflects this problem.[60] The view applied by the European Court of Justice in the Eurofood bankruptcy case is that debtors constituting independent legal persons are under the jurisdiction of the court of their registered office. As a result, the centers of main interests of the subsidiaries of the parent corporation need to be determined separately, and then the main

[57] *See* He, *supra* note 14.

[58] *See supra* note 56.

[59] Samuel Bufford, *Center of Main Interests, International Bankruptcy Case Venue, and Equality of Arms: The Eurofood Decision of the European Court of Justice*, 24 NW. J. INT'L L. & BUS. 351, 359 (2007).

[60] *See* Case C-341/04, Eurofood IFSC Ltd., ECLI:EU:C:2006:281, EUROFOOD I-3854, I-3868 (May 2, 2006).

bankruptcy proceedings of each subsidiary can only be carried out in their respective registered offices.

Influenced by this, although Article 35 of the Bankruptcy Minute has made corresponding provisions on the judicial jurisdiction court, it does not have a mandatory effect. Moreover, this model is conducive to the investigation of court and evidence collection, helps to find out the truth, and enables the court to make rulings in line with the development trend of affiliated corporates.[61] However, in practice, there are also situations where multiple local courts jointly hear cases. Therefore, it is still necessary to draw on the experience of the EU to further improve procedural rules such as those regarding the jurisdiction court.

IV. CONSTRUCTION OF SUBSTANTIVE CONSOLIDATION RULES IN THE BANKRUPTCY OF CHINESE CORPORATE GROUPS

A. Establishing Theoretical Guidance for Substantive Consolidation Rules

In improving Chinese corporate group substantive consolidation rules, first, determine the fundamental principles to guide the legislative construction of Chinese substantive consolidation rules. This approach could absorb the legislative experience of various countries and make adaptive adjustments in Chinese current judicial practice.

1. Distribution of Benefits under the Principle of Fairness

The principle of equity is an important legal principle in the bankruptcy of corporate groups due to the need to balance and deal fairly with the interests of all parties in the bankruptcy of a corporate group,[62] to deal effectively with the whole process in a manner that distributes the proceeds equitably, with particular emphasis on the equal protection of creditors.

First, the basic content of the equity principle is that the assets of a corporate group and liabilities should be fairly and equitably distributed among creditors and shareholders, with claims within the group reasonably ranked. For instance, in the internal relief of insolvent corporates in a corporate group, other affiliated corporates and the holding corporate will supervise fund transfer activities to maintain normal management, maximizing the interests of creditors and shareholders. If the operating conditions of the insolvent company

[61] HE XIAODIAN (贺小电), POCHAN FA YUANLI YU SHIYONG (破产法原理与适用) PRINCIPLE AND APPLICATION OF BANKRUPTCY LAW] 1273 (2020).

[62] Irit Mevorach, *Appropriate Treatment of Corporate Groups in Bankruptcy: A Universal View*, 8 EUR. BUS. ORGAN. LAW REV. 180, 186 (2007).

are unsalvageable, its reasonable assets are retained and distributed to creditors by the administrator.

Second, the basic requirements of the equity principle are that each creditor should be treated fairly, regardless of which corporate in the corporate group is responsible for the debt.[63] In substance, the parent company cannot interfere with the interests of the subsidiary's creditors, and the bankruptcy estate of the corporate group is fairly determined. Procedurally, the asset and liability distribution between groups of corporations demands more from the bankruptcy implementation procedure.

Third, the balancing approach of the principle of equity. The principle of fairness also emphasizes the coordination of all parties in interest after the corporate group enters into bankruptcy to achieve a balance of interests through the system, mainly including intra-corporate coordination and coordination of bankruptcy proceedings.

Intra-corporate coordination focuses on changes in resources and information within the corporate group. For example, affiliated corporates may not have access to the latest information on the overall management of the corporate group, which requires the holding corporation to share information with other affiliated corporates. By coordinating entities within the corporate group, the administrator will also gain an understanding of the corporate group, which will lead to a more effective bankruptcy management strategy that takes all parties into account.

Bankruptcy proceedings coordination involves communication and collaboration among entities like the judge, administrator, and creditor's meeting to ensure smooth proceedings and consider stakeholders' interests. Guided by fairness, in corporate group bankruptcy, the law should clarify the responsibility of those at fault, and bankruptcy practitioners must cooperate and communicate. The responsible parties should be held accountable, and the liquidation priority order should be established to balance interests and be reflected in the bankruptcy reorganization plan.

In short, coordination enables smoother communication within a corporate group under crisis, enhances mutual understanding among entities, and leads to an effective, fair, and comprehensive bankruptcy reorganization plan.[64] By coordinating the rights and obligations between entities, the likelihood of sacrificing some interests in bankruptcy proceedings is reduced.

[63] LOOK CHAN HO, EQUITY AND ADMINISTRATION, 105 (P. G. Turner ed., 2016).

[64] Oriana Casasola & Stephan Madaus, *Cross-border Bankruptcy Protocols: A Mean of Implementation of Cooperation, Coordination, and Communication Duties under the European Insolvency Regulation Recast,* 33 EUR. BUS. LAW REV., 839, 846 (2022).

2. Principle of Maximizing Creditors' Interests

The principle of maximizing interests of creditors is an important legislative spirit of bankruptcy law. It requires that creditors' interests remain undiminished post-bankruptcy, respect their wishes, and enhance them when possible.[65] The goal of bankruptcy is to return the corporation to health and protect the interests of the creditor. In the substantive consolidation regime, the liquidation of the debt of corporate group relations after consolidation helps achieve greater asset freedom and gives the bankruptcy administrator more room for maneuver. In the legislative construction of substantive consolidation rules and judicial decisions, the absolute and relative benefit standards can be used to evaluate and measure to materialize the principle of maximizing the interests of creditors.

First, the absolute benefit standard. It refers to the fact that, after the implementation of substantive consolidation, every creditor can obtain substantial benefits. The absolute benefit standard requires ensuring that every creditor can obtain a substantial benefit following substantive consolidation. Such a standard is adopted to safeguard the rights and interests of individual creditors and to prevent individual creditors from being unfairly treated in consolidation. The ultimate goal of entity consolidation is to improve the ability of the debtor to repay its debts by combining resources, thereby enabling each creditor to obtain greater satisfaction. This is distinguished from the relative benefit criterion, which is more concerned with the relative level of benefit to the creditors as a whole.

Second, the relative benefit standard. It focuses on the creditor as a whole, treating the creditor as a single subject and discussing whether it benefits or not so that there is a problem of comparing benefit with loss, and as long as the benefit exceeds the loss, the criterion is considered to be met. Since substantive consolidation is only considered reasonable in this case if the benefits exceed the losses, the standard takes into account the balance of the overall interests of the creditors in the bankruptcy proceedings, usually focusing on the improvement of the overall financial position and repayment ability of debtor, emphasizing the maximization of the overall interests of the joint creditors, and thus increasing the chances of liquidation for the creditors as a whole.

Thirdly, the standards should be applied simultaneously. The unilateral application of either criterion is one-sided. The absolute benefit standard alone can lead to no insolvent corporate group and harm to creditors,[66] while the relative-benefit standard alone may result

[65] XING DAN (邢丹), GUANLIAN GONGSI POCHAN DE FALÜ GUIZHI (关联公司破产的法律规制) [LEGAL REGULATION OF THE BANKRUPTCY OF AFFILIATED CORPORATES] 228 (2022).

[66] Zhu Li (朱黎), *Lun Shizhi Hebing Pochan Guize de Tongyi Shiyong: Jiandui Zuigao Renmin Fayuan Sifa Jieshi Zhengqiu Yijian Gao de Sikao* (论实质合并破产规则的统一适用——兼对最高人民法院司法解释征求意见稿的思考) [*On the uniform application of the substantive*

in the "tyranny of the majority." Thus, the court should use the absolute benefit criterion as the main standard, supplemented by the relative benefit criterion, when approving bankruptcy plans to balance efficiency and creditor-interest maximization.

B. Improvement of the Substantive Rules of the Substantive Consolidation Regime

1. Convergence of the Legal Personality Denial System

Before applying the system of denial of legal personality, the system should be repositioned from the perspective of bankruptcy law to clarify the relationship between the system of denial of legal personality under bankruptcy law, the system of substantive consolidation, and the system of denial of legal personality in the sense of Company Law.

On the one hand, the legal personality denial regime is closely linked to the substantive consolidation regime. There is a theoretical connection between them, and in current judicial practice, the overlap is significant. After applying the substantive consolidation rules, the independent personalities of corporates are unified. Although the substantive consolidation system mainly focuses on asset unity, the unity of corporate personality is a subsidiary effect. The legal personality denial system cannot be separated from the substantive consolidation system, and the latter should emphasize judicial efficiency and fair compensation for creditors based on the former.

On the other hand, there is an essential difference between the Company Law and Enterprise Bankruptcy Law legal personality denial regimes. The application of the legal personality denial system under a single standard has discrepancies in aspects like personality mixing and legal effects. The legal personality denial system in the sense of Company Law, refined through judicial practice, has become a special system in the bankruptcy law field, and it is fundamentally designed to address controlling shareholders' abuse of rights, infringement on corporate interests, and disregard for creditor rights.

Chinese scholars discuss the substantive merger rule in the legal personality denial system.[67] The legal personality denial system in Chinese Company Law amends the limited liability system and evolves for application in corporate group bankruptcy. The substantive consolidation system directly stems from bankruptcy law, adjusting external creditor-corporate entity relationships. They don't completely overlap or replace each other, so the substantive consolidation system

consolidation rule: concurrent reflections on the draft of the Supreme People's Court's judicial interpretation for soliciting opinions], 3 ZHENGZHI YU FALÜ (政治与法律) [POLITICAL SCIENCE AND LAW] 153, 161 (2014).

[67] *See supra* note 18.

should be further established based on the personality mixing conditions of the legal personality denial system to control the judge's discretion.

2. Bankruptization of the Connotation of Applicable Standards

Since the legal personality denial system has completed its metamorphosis in the sense of bankruptcy law, it is accompanied by the bankruptcy of the connotation of the applicable standards of the legal personality denial system, that is, Article 32 of the Bankruptcy Minute, "Excessive Costs of Distinguishing the Property of Members of Groups of Corporates" and "High Degree of Confusion of Legal Personality."

First, the meaning of "excessive cost of distinguishing the property of members of a corporate group" is described below. In U.S. case law like the Chemical and Vecco cases,[68] when the parent corporate's control over a subsidiary's important business affairs and personnel makes the subsidiary lose its independent status and assets hard to differentiate, it is a criterion for recognizing asset separation difficulty, which is important for the legal personality denial system and corporate group connection determination. In China, the criterion for determining asset separation difficulty also has practical significance. Guided by the principle of maximizing creditors' interests, property separation isn't necessary to preserve corporate assets, as the costs would be reflected in administrators' fees.

Second, the meaning of 'high degree of commingling of legal personalities' is described below. A "high degree of legal personality commingling" is the core element of the bankruptcy law regime for the commencement of a legal personality denial. "Excessive cost of distinguishing between the property of members of each corporate group" serves to determine a "high degree of legal personality commingling" and is not directly a criterion. The Bankruptcy Memorandum doesn't elaborate on "highly." In bankruptcy cases, financial commingling is the core, and the "high cost of distinguishing the property of members of each corporate group" should be included in the scope of the "high degree of commingling of legal personality." In applying the legal personality denial system rules, "excessive cost of distinguishing the property of members of each corporate group" is the core determining factor, and although excessive control and significant undercapitalization constitute "personality commingling," they need to be combined with other auxiliary elements like business and personnel commingling to reach a "high degree" and be advanced to "high degree of personality mixing of the legal person" to determine the fulfillment of the elements.

It should be noted that the bankruptcy of the above two connotations is, in essence, the adaptive adjustment of the legal

[68] *See supra* note 2.

personality denial system of the Company Law in the field of Enterprise Bankruptcy Law in the single standard, but in the application problems faced by the single standard mentioned above, it is also necessary to further construct a comprehensive application in conjunction with the "serious damage to the interests of the creditors in fair liquidation" in the Bankruptcy Minute.

3. Establishment of Comprehensive Standards for Application in Bankruptcy

To resolve the tension between the standards in the Bankruptcy Minute, in addition to clarifying the "high degree of legal personality confusion" standard, it is necessary to further clarify the specific content of the fair satisfaction of creditors standard as one of the comprehensive application standards in bankruptcy. This means elaborating on what "seriously jeopardizing the fair satisfaction interests of creditors" in Article 32 of the Bankruptcy Minute means, starting from the "creditor benefit standard" and the "creditor reliance interest standard."[69]

First, in the creditor benefit standard, it is not required that all creditors can obtain a benefit in the bankruptcy case to open a substantively consolidated bankruptcy. The court decides whether to commence the proceedings based on a judgment taking the absolute benefit standard as the main criterion and the relative benefit standard as a supplement after determining that the corporate group's assets have improved following the commencement of substantive consolidated bankruptcy proceedings, reducing the cost of separate insolvable proceedings. The standard for creditor benefit abandons the U.S. case law, which used the benefit of all creditors as a judgment criterion, and provides a practical operation method for the principle of maximizing creditor's interests: first, use the "benefit" of the asset division theory to calculate administrative costs and statistical expenses before and after the merger; second, calculate the overall creditor satisfaction rate by virtually distributing the recognized assets available for liquidation.[70]

Second, the creditor reliance interest standard examines the subjective state of creditor reliance when forming a creditor-debt relationship with the insolvent corporation. It implements the principle of fairness and commercial appearance doctrine, going back to the time when rights and obligations arose to fairly protect the creditor's reliance interest. The court examines the subjective state of reliance from the creditor's perspective by first checking whether the creditor

[69] *See* Xu *supra* note 8.

[70] Wang Xinxin (王欣新), *'Quanguo Fayuan Pochan Shenpan Gongzuo Huiyi Jiyao' Yaodian Jiedu* (<全国法院破产审判工作会议纪要>要点解读) [*Interpretation of the Main Points of the Summary of the National Conference on Bankruptcy Trial*], 5 FAZHI YANJIU (法治研究) [RESEARCH ON RULE OF LAW] 122, 134 (2019).

has signed a contract with a separate group of corporates or used all the group's assets as a transaction object and whether the group's assets are used as a performance guarantee; second, examining the insolvent corporate's situation through corporate information publicity and judging whether the insolvent corporate has an independent personality and enters the creditor - debt relationship independently from the general public's perspective.

Thus, a comprehensive application standard with the connotation of the highly mixed legal personality standard and the coexistence of the creditor's fair compensation standard has been formed, respectively constructing the three basic requirements centered on Article 32 of the Bankruptcy Minute and providing the court with practical standard judgments for the exceptional application of the substantively consolidated bankruptcy of a corporate group.

C. Constructing Procedural Rules for the Substantive Consolidation System

To ensure that the court reasonably exercises the right to adjudicate, in the case of entity applicable standards, it still needs to have a legal rules system as a prerequisite guarantee. Through effective procedural design, specific boundaries are provided for the initiation of the jurisdiction of substantive consolidation rules and other aspects of the system.

1. Clarifying the Rules for the Initiation of Substantive Consolidation

First, basic principles: In accepting bankruptcy cases of substantively consolidated corporate groups, the principle of application as the norm and ex officio as the exception should be established. Although the case of a corporate group substantive merger is complex, it is essentially a civil and commercial dispute where corporates as market entities face credit and debt issues. The parties' self-governance and respect for the corporation's organizational structure and decision-making autonomy should be respected. While the court has a special responsibility to maintain social stability, fairness, and employment under China's special conditions, it should not arbitrarily incorporate non-insolvent corporate groups into the bankruptcy process. The court should always respect the principle of juridical personality independence and the limited liability of the Company Law, which is the normative consideration for the application of the substantive consolidation rule in Article 32 of the Bankruptcy Minute as an "exception."

In normal commencement modes, the court should not ex officio control the bankruptcy proceedings of a corporate group. It should remain neutral and not participate in the bankruptcy process or the presentation of bankruptcy claims. When there are unclaimed claims, and the corporate group is unaware and unable to move forward with the substantive consolidation proceedings, the court should guide by

explaining to the corporate group during the proceedings, informing them of the legal consequences, and letting the corporate group decide on its own to respect the corporate's free will, independent personality, and litigation rights.

Secondly, the status of creditors should be clarified. The Bankruptcy Minute doesn't specify the subject of commencement of substantive consolidation proceedings on application, and creditor requests for commencement are not common and easily rejected by the court. Some creditors claim that the Company Law's legal personality denial and the substantive consolidation of bankruptcy law should be initiated by creditors, but they can't point out the fundamental reason for the creditor's application status.[71]

The principle of maximizing the interests of creditors is crucial. Compared with the Company Law, the bankruptcy law emphasizes maximizing creditor interests. Only with creditor participation can the absolute benefit standard in the principle of maximizing creditor interests be realized and the relative benefit standard be reasonably calculated. Also, creditors are the ultimate beneficiaries. As the final beneficiaries of the distribution of the assets of a corporate group in bankruptcy, creditors have a strong subjective willingness to participate in bankruptcy and a strong incentive to be involved in the proceedings and to strive for more benefits.[72]

The view that including creditors as legitimate applicants for the commencement of substantive consolidation proceedings of corporate groups might be confused. In practice, however, the group of creditors most interested in whether and when substantive consolidation proceedings should be commenced should be the group of creditors with high-value claims against the corporate group, who are most in need of an effective discharge of their assets. Smaller groups of creditors should be more likely to participate in the claims filing process on a "free-rider" basis. Coordination of the interests of large creditors should also be accomplished at the creditors' meeting, which is the key pivot for establishing an effective link between the court and the creditors of the corporate group through the preparation of application and distribution plans.

Accordingly, creditors, as the ultimate beneficiaries, should be listed as the primary applicants, although they have less information

[71] Hu Qingdong & Hu Yongrui (胡庆东、胡永睿), *Guanlian Qiye Shizhi Hebing Pochan Caiding Biaozhun Yanjiu* (关联企业实质合并破产裁定标准研究) [*Research on the Adjudication Standards of Substantive Consolidated Bankruptcy of Affiliated Corporates*], 9 SHANGHAI FAXUE YANJIU (上海法学研究) [SHANGHAI LEGAL STUDIES] 160 (2021).

[72] Meng Fanxin (孟繁鑫), *Guanlian Qiye Shizhi Hebing Pochan Biaozhun de Shiyong ji Goujian* (关联企业实质合并破产标准的适用及构建) [*Application and Construction of Substantial Merger and Bankruptcy Standards of Affiliated Enterprises*], 4 CHENGDU LIGONG DAXUE XUEBAO (SHEHUI KEXUE BAN) (成都理工大学学报(社会科学版)) [JOURNAL OF CHENGDU UNIVERSITY OF TECHNOLOGY (SOCIAL SCIENCES EDITION)] 1, 7 (2019).

than other subjects, an arrangement that reflects the underlying legislative purpose of substantive consolidation proceedings.

Thirdly, the debtor can be allowed to apply as it has the best understanding of its production, operation, business liabilities, assets, and other core elements. It can increase assets through consolidation with other corporate groups, has favorable conditions compared to creditors or the court, and takes the lead in understanding the situation. However, debtor application has disadvantages such as fewer cases of application, and in cases of bankruptcy fraud, the debtor may delay and refuse to apply to prevent exposure of improper purposes, which is more subjective and serves the corporate group's interests at the expense of creditors.

Although the debtor is given the status of the main body of the application, there are many inconveniences and conflicts of interest in its exercise of rights. In the absence of the administrator, the debtor may apply alone, but when both the administrator and the debtor are present, the application should be made by the administrator. This is because the administrator is objectively neutral, responsible for managing and analyzing the insolvent corporation's operations and assets, and has specialized knowledge and the ability to provide accurate and effective asset management services. The administrator has the obligation and incentive to open the substantive consolidation procedure as it reduces the obligation of sorting out the debt relationship by consolidating each corporate and only needs to ensure that the accounting books and documents between corporates can reflect the transactions and clarify the debt relationship without tracing the root of the actual asset situation.

In short, the debtor application has its natural convenience. However, in the presence of an administrator, it should be clear that the two applications-namely, the objective and neutral administrator-have the obligation, as well as the ability and motivation to apply, as opposed to the creditor, who is more trustworthy.

Fourthly, strengthen the application of the administrator. When the corporate group enters substantive consolidated bankruptcy proceedings, although regulated by Enterprise Bankruptcy Law, before entering into bankruptcy, it should further use the corporation's legal norms to urge the corporate group to follow the principles of honesty and trustworthiness. Since the administrator controls the corporation, it is necessary to strengthen the administrator's obligation to urge the insolvent corporation to apply for the commencement of substantive consolidation proceedings. The Enterprise Bankruptcy Law in Article 130 sets up the administrator's obligation of trust and justice to the bankrupt corporation, mainly from the obligation of diligence and the obligation of fidelity.

Duty of diligence. By accepting remuneration and using an experienced ability, the administrator should act prudently to handle the insolvent corporation's bankruptcy.[73] In the commencement of substantive consolidation proceedings, the administrator should use its asset management ability to act diligently for the management of the corporate group's assets and conduct a reasonable examination and calculation of the benefits of confirming the commencement of substantive consolidation proceedings.

Duty of loyalty. Although Article 130 of Enterprise Bankruptcy Law doesn't explicitly state the administrator's "duty of fidelity," it implies the content of "faithful performance of duties."[74] The administrator should abide by professional ethics, not seek private gain when dealing with the corporate group's business, and prioritize the corporate's interests in case of conflict. The administrator, as the core subject dealing with the corporate's property, should not be interfered with by other subjects, balance the interests between creditors and debtors, and maintain a neutral legal status. In view of misalignment and conflict of interests, the administrator should have a heavier burden of proof.[75]

2. Rationalization of the Mode of Commencement

The choice of commencement mode also affects the exercise of the rights of the parties and puts forward different requirements for the court's examination and adjudication, so choosing a reasonable mode of commencement and constructing a unified procedural rule is an aspect that needs to be discussed urgently.

Mode I, "separate bankruptcy, then consolidation," should be recognized. Under the "separate bankruptcy, then consolidation" model, the judicial logic is to first examine the creditor-debt relationship and asset operation of corporate groups, rule each corporate group into bankruptcy, then when a factor for substantive consolidation rules is found, check if administrators have filed for bankruptcy consolidation, determine the number of corporates and assets to be consolidated. If the court finds it more effective to apply

[73] Liang Shuang (梁爽), *Dongshi Xinyi Yiwu Jiegou Chongzu ji Dui Zhongguo Moshi de Fansi* (董事信义义务结构重组及对中国模式的反思——以美、日商业判断规则的运用为借镜) [*Restructuring of the Structure of Directors' Fiduciary Duties and Reflection on the Chinese Model: Reference to American and Japanese Theory and Practice of BJR*], 1 ZHONGWAI FAXUE (中外法学) [PEKING UNIVERSITY LAW JOURNAL] 198, 215 (2016). (2016).

[74] Xu Defeng (许德风), *Daode yu Hetong Zhijian de Xinyi Yiwu: Jiyu Fajiao Yixue yu Sheke Faxue de Guancha* (道德与合同之间的信义义务———基于法教义学与社科法学的观察) [*Fiduciary Duties between Morality and Contracts: An Observation Based on Legal Dogmatics and Law and Social Sciences*], 5 ZHONGGUO FALÜ PINGLUN (中国法律评论) [CHINA LAW REVIEW] 140, 148–49 (2021).

[75] LI YONGJUN (李永军), POCHAN FA: LILUN YU GUIFAN YANJIU (破产法——理论与规范研究) [BANKRUPTCY LAW—THEORETICAL AND NORMATIVE RESEARCH] 33 (2013).

the rule when no administrator has applied, the court should explain the reasons and guide the administrator to submit a consolidated bankruptcy application. If the administrator still fails to submit, it is not appropriate to commence ex officio.

Model II, "Partial bankruptcy, then consolidation," should be restricted. In the "partial bankruptcy, then consolidation" model, when part of a corporate group is insolvent, examination of this corporation may trigger other corporates' bankruptcy through association. This model is inconsistent with the court's application-based adjudication principle and exceeds the reasonable discretion boundary. Given the overall Enterprise Bankruptcy Law's application of the application doctrine, the model's reliance on the court's ex-officio powers is considered. There is disagreement on how the court sets the ex-officio inclusion standard. Doubts exist regarding obtaining a property report of the corporation being applied for, its examination and publicity, and whether it maximizes creditors' interests after inclusion, making this model limited and the reason for its infrequent use in judicial practice.[76]

Model III, "consolidation followed by bankruptcy," should be limited. There is a theoretical contradiction in the merger's first commencement mode. The court needs to assess if the corporation meets bankruptcy standards before bankruptcy proceedings to use the Company Law's legal personality denial system for corporate group personality denial and merger, yet the substantive consolidation rule can't be applied as the corporation isn't insolvent then. Also, personality denial and corporate consolidation assume group corporate consolidation is possible to enhance asset value, relying on the bankruptcy application content and asset assessment. Though the "consolidation before bankruptcy" approach is efficient and closely linked to the Company Law's legal personality denial system, there is a contradiction between the two aspects, with logic not closing, a disconnect between legal norms and procedure conduct, and a fundamental disagreement with substantive consolidation rules, making it impossible to construct reasonable procedural hearings and relief rules, so this type of bankruptcy proceedings should be restricted.[77]

In short, a unified substantive consolidation commencement procedure centered on the model of "separate bankruptcy and then consolidation" should be established to reasonably protect the rights and interests of all parties in the commencement procedure.

[76] CHENG XIANGWEN (程向文), GUANLIAN QIYE POCHAN ZHONGDE SHIZHI HEBING GUIZE YANJIU (关联企业破产中的实质合并规则研究) [RESEARCH ON THE SUBSTANTIVE CONSOLIDATION RULE IN THE BANKRUPTCY OF AFFILIATED CORPORATES] 536–37 (2018).

[77] The scholar Xinxin Wang argued that the court would need to issue a judgement on substantive consolidation of associated corporates 'lifting the corporate veil' before the effects of substantive consolidation could be carried over to the bankruptcy proceedings.

3. Centralization of Competent Courts

First, in terms of hierarchical jurisdiction, the lack of provisions on the jurisdiction level of corporate groups leads to a differentiated arrangement where the first instance is heard by the basic people's court or the intermediate people's court. Different courts have provided corresponding norms to address this. For example, the Guangdong Higher People's Court has specified that the first-instance substantive consolidation rules of a corporate group are to be heard by an intermediate people's court, and only difficult, complex, and new cases of great significance are heard by the higher people's court. Given the complexity of corporate group substantive consolidation rules, it is normal for them to be referred to the intermediate people's court for adjudication rather than directly to the basic people's court. Additionally, when applying these rules, the corporates within a corporate group may be located in different geographical areas, which can confuse territorial jurisdiction and cause cases-related corporates to be tried at different court levels.

In handling cases under the substantive consolidation rules, the principle of centralization should be established, with the group of corporates tried in a single court to reduce judgment disagreement potential. The complexity of corporate group cases requires unified and centralized trials, which the intermediate people's court is better equipped to handle. Thus, the intermediate people's court should try corporate group substantive consolidation cases as a principle, with the higher people's court as an exception.

Secondly, in terms of territorial jurisdiction. The Bankruptcy Minute specifies a two-tiered system of territorial jurisdiction, i.e., the first adopts the standard of "location of the core-controlled corporate," and if there is no "location of the core-controlled corporate," then the standard of "location of the main property" is adopted. The "location of the core controlled corporate" criterion is adopted first. Among them, some courts have equated the "center of main interests" with the "location of the core controlling corporate," thus confirming jurisdiction. The above criteria, as well as the issue of conflict of jurisdiction, should be further refined and resolved concretely.

Determining the meaning of the "center of main interests" criterion. Article 13 of the Explanatory Provisions of the EU Bankruptcy Regulation (Recital 13) states that "the center of the main interests of the debtor shall be, in the ordinary sense of the word, consistent with the place where the debtor carries out the management of its business interests and is therefore recognized by third parties." Therefore, two characteristics of the "center of main interests" are set out. The center of main interest must be the place where the business interests of the debtor are managed, including actual business, production, and sales activities. And this place must be recognized by

third parties.[78] However, many corporations with factory-based production and distribution to multiple corporates, like chain brand stores, may not meet the "recognized by third party" condition as third parties generally don't know about their operations.

Determining the content of the "location of the main property" criterion. The concept of "main property" is often subjective as it is unclear whether it refers to the property with the largest assets or strongest liquidity. In a corporate group's substantively consolidated bankruptcy case aiming for fair property distribution and maximizing the interests of creditors, the "main property" should mean the location of the property that can maximize creditors' compensation.[79] For example, if after a corporate group's bankruptcy application, there is a high-value property that can't be realized since the establishment of corporate while a factory with a similar but not the highest value can be realized quickly or even at a higher price due to supply and demand, the "location of the main property" is the latter. So, the main property can be interpreted in different ways, like real estate or a collection of high-value assets, yet determining its "location" must be done considering whether it can successfully maximize creditors' payments.

Thirdly, coordination of jurisdictional conflicts. In the bankruptcy process of a corporate group, jurisdictional conflicts may occur when corporates become insolvent one after another. If part of the subsidiary group enters bankruptcy while the real core controlling corporate has not yet entered bankruptcy, the court of the former may have already started the trial of the substantive consolidation bankruptcy case, and the latter is waiting for the administrator to submit a plan. According to the territorial jurisdiction standard, the first court should not suspend the trial and transfer jurisdiction. Instead, following the principle of constancy of jurisdiction in the Civil Procedure law, the first court has the right to continue its jurisdiction. However, this may lead to the problem that the government of the location of the controlled corporation may oppose the enforcement of court due to its desire to prevent the corporation from going bankrupt. To address this, a mechanism should be established to coordinate the court's jurisdiction, and if the matter cannot be resolved through consultation with the court of the core-controlled corporate's location, a common higher court should determine the jurisdiction.[80]

[78] *See* The European Parliament & The Council, Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on bankruptcy proceedings (Recast), article 21.

[79] *See In re* Fairfield Sentry Ltd., 714 F.3d 129, 131 (2d Cir. 2013).

[80] Ge Pingliang (葛平亮), *Deguo Guanlian Qiye Pochan Guize de Zuixin Faxian Jiqi Qishi* (德国关联企业破产规制的最新发现及其启示) [*The Latest Findings and Implications of German: regulated Bankruptcy of Affiliated Corporates*], 1 YUEDAN CAIJING FA ZAZHI (月旦财经法杂志) [FINANCIAL AND ECONOMIC LAW REVIEW] (2016).

V. CONCLUSION: INNOVATION OF RULES

Chinese Enterprise Bankruptcy Law legislation started late compared to international jurisdictions. International bankruptcy law, especially the substantive consolidation theory, has provided a positive influence and diversified references for China. Despite progress, China faces challenges in enterprise group bankruptcy, including unclear applicable standards, ambiguous fair compensation of creditors, and a lack of a clear consolidation standard in the substantive area, as well as unclear subject of commencement, non-uniform modes, and loopholes in jurisdiction rules in the procedural area. To improve the substantive consolidation rules for Chinese corporate group bankruptcy, China should refer to international enterprise group bankruptcy law rules, establish principles of fair benefit distribution and creditor-interest maximization, improve substantive rules, connect with the legal personality denial system, clarify applicable standards, and establish a consolidation standard. It should also construct procedural rules, clarify commencement rules, rationalize the commencement mode, and centralize the competent court. These measures will enhance the ability of China to handle international corporate group bankruptcy, safeguard economic order and creditor rights, and promote the development of the transnational bankruptcy legal system to better adapt to the changing economic globalization business environment.