# The Regulatory Framework and Reform Direction of China's Listed Company Reorganization: Moving towards an Era with Strict Regulation

By Amy Ren | Lawrence Liu

## Introduction

The reorganization of listed companies combines the bankruptcy system and capital market system, and is subject to dual supervision by judicial authorities and securities regulatory bodies. For China, both systems are essentially "imported" and have a relatively short history. This has led to a long-term situation where the practice of bankruptcy reorganization of listed companies in China faces a lack of legal and normative supply, a lack of regulatory rules, and abuse of the system.

Considering the public nature and special economic status of listed companies, as well as the wide-ranging impact that their bankruptcy reorganization may cause, China's policymakers and regulatory authorities have always sought a balance between responding to market needs and effective regulation. However, the balance may tip this year. We believe that China's listed company reorganization is about to enter an era of strong regulation, where the Supreme People's Court of China will work with the China Securities Regulatory Commission to revise a series of rules and measures to further tighten the approval process for listed company reorganization. This view can be initially confirmed by the frequent advocacy by regulatory authorities in recent times to improve the listed company bankruptcy reorganization system. On the other hand, considering the broader context, the "New Nine Policies of State Department" was issued after which China will strictly tighten IPO approvals and implement a "exit at all costs" delisting system, which will further discourage the so-called "shell-preserving restructuring" phenomenon.

Based on the above background, on the one hand, by tracing the development trajectory of judicial practice, this article will attempt to divide China's listed company reorganization into different historical periods and summarize its regulatory features and main problems; on the other hand, based on an understanding of legislative policies and a dynamic grasp of the market, we will make certain predictions about the regulatory direction of future China's listed company reorganization, with the aim of providing reference for relevant institutional reform and judicial practice activities.

## Reviewing the History

So far, the judicial practice of corporate restructuring for listed companies in China has lasted nearly 17 years. During this period, a total of 118 listed company restructuring cases have been formally accepted by the people's court, and all of their restructuring plans have been approved by the people's court. There has been no case of restructuring failure turning into liquidation. By reviewing these cases and examining the evolution of legislative and regulatory policies, we divide the historical development of corporate restructuring for listed companies in China into the following three stages:

**Phase I (2007-2011): Trial and error**

In 2007, the "People's Republic of China Enterprise Bankruptcy Law" was officially implemented, marking the beginning of China's exploration of using modern bankruptcy law system to handle the exit and rescue of distressed enterprises, and providing the initial institutional supply and legal basis for corporate restructuring of listed companies. However, the legislators did not fully consider the complex issues that may arise in the process of listed company restructuring in terms of the linkage between judicial procedures and administrative procedures, information disclosure, protection of interests of minority investors, and the application of the absolute priority principle. Before 2012, the regulatory authorities had not formulated relevant rules for listed company restructuring. In other words, in the historical period mentioned above, both judicial authorities and regulatory authorities adopted a strategy of "trial and error" in relation to listed company restructuring, and listed company restructuring was actually in an unregulated state. Between 2007 and 2011, a total of 35 listed companies in mainland China went through reorganization procedures in the courts, and all of their reorganization plans were approved. During this period, the practice of listed company reorganization had the following characteristics: Firstly, there was a lack of administrative supervision, with more emphasis on judicial procedures led by the courts. Secondly, the responsibility of the controlling shareholder and minority investors in the listed company's debt crisis was not strictly distinguished, and most reorganization plans adopted a common approach of all shareholders surrendering a portion of their existing shares to deal with the company's debt problems. Thirdly, the value of reorganization mainly concentrated on the listing qualification ("shell resources"), i.e., not paying attention to the restoration and improvement of the original main business and instead arranging for the separation of the original main business in the reorganization process and seeking new asset injection after the reorganization was completed.

**Phase II (2012-2018): Being Cautious**

After five years of practical development, on March 22, 2012, the Supreme People's Court of China and the China Securities Regulatory Commission jointly held the symposium on the trial of listed companies' reorganization in Wanning City, Hainan Province, and consensus was reached on a series of issues related to the trial principles, jurisdiction, application and review, information disclosure, drafting of restructuring plans, and consultation mechanism for approving restructuring plans of listed companies. Based upon that, The Supreme People's Court of China officially issued the "Opinions on the Reorganization of Listed Companies" (the "Opinions"), which set forth the basic principles and procedures for listed company reorganization. The "Opinions" aimed to balance the interests of creditors, shareholders, and other stakeholders, and to prevent abuse of reorganization procedures by controlling shareholders. The "Opinions" also clarified that the reorganization plan should be approved by both the court and the shareholders with more than half of the voting rights.

Although the above meeting minutes are not formal laws and regulations, they play a strong guiding role in practice, and giving the local government of listed companies and the China Securities Regulatory Commission the authority to govern and approve the reorganization of listed companies. From 2012 to 2018, the number of cases of reorganization of listed companies accepted was significantly tightened compared with the previous historical period,
In eight years, only 19 cases were accepted, and most of them were cases of restructuring of state-owned listed companies. We understand that there are two main reasons for the above phenomenon: On the one hand, during this period, the balance sheet of Chinese enterprises showed an expanding trend, the market liquidity was relatively abundant, the financing channel was relatively loose, and the liquidity risk of listed companies was gradually accumulating but not breaking out. On the other hand, with the intervention of local governments and administrative regulatory forces, the dominance of judicial organs in the reorganization cases of listed companies has been weakened to a certain extent, and the regulatory level still lacks specific rules and guidelines, thus, the regulatory policy is conservative.

Examining the judicial practice of the reorganization of listed companies at this stage, we spotted that with the intervention of the regulatory authorities, in the protection of the rights and interests of small and medium-sized investors in the reorganization process of listed companies has been paid attention to. Specifically, in the design of the reorganization plan, the incremental shares transferred by the capital provident fund and the stock shares of the controlling shareholders are gradually used as references. As a major resource to bring in restructuring investors and deal with debts, the method of transferring stock shares jointly by small and medium-sized investors in the past has been abolished.

**Phase III (2019 to 2023): Great strides forward**

Under the combined influence of factors such as the China-US trade war, the downward macroeconomic environment, and the continuous advancement of supply-side structural reform, the economic growth driven by debt expansion and balance sheet expansion in the past has gradually become unsustainable, and the risk of stock pledge of listed companies has become prominent, and the liquidity crisis has begun to expose. In 2019, in order to resolve the stock risks of listed companies, the China Securities Regulatory Commission proposed a diversified strategy of "exiting a batch, reorganizing a batch, and reorganizing a batch" to encourage listed companies to solve their financial difficulties through bankruptcy reorganization. In 2020, The State Council of China issued ‘the Opinions on Further Improving the Quality of Listed Companies’, proposing to improve the bankruptcy reorganization system of listed companies and support listed companies to clear risks through bankruptcy reorganization and other means.

Affected by the above factors, from 2019 to 2023, the number of reorganization cases of listed companies in China showed explosive growth, with a total of 64 reorganization cases accepted, and the reorganization of private listed companies began to occupy the majority. At the same time, regulators have drawn up rules specifically for the reorganization of listed companies. In 2022, the Shanghai Stock Exchange and the Shenzhen Stock Exchange respectively issued relevant self-regulatory guidelines, clarifying the information disclosure matters involved in the reorganization of listed companies, the relevant requirements for the adjustment of investors' rights and interests and the introduction of investors in the reorganization, and the responsibilities and roles of intermediaries.

The above rules have enhanced the protection of the rights and interests of small and medium-sized investors in the reorganization process of listed companies to a certain extent, and improved the openness and transparency of the reorganization process of listed companies and the compliance, but there are still many chaos in the reorganization of listed companies at this stage: Firstly, the problem of institutional arbitrage is prominent. It is mainly reflected in the wanton ratio of capital accumulation fund to additional shares and subscription pricing in the reorganization of listed companies, and the upper limit of the proportion of transferred shares and the lower limit of the subscription price are not clearly stipulated. In some cases of reorganization of listed companies, a large number of new shares are issued at a ratio of more than 1.5 times or even 2 times, greatly diluted earnings per share of listed companies; Some industrial investors or financial investors subscribe for the shares at a price significantly lower than the market price, and there is no reasonable basis; Secondly, the linkage mechanism between the government and the courts is unbalanced. In order to maintain the number of listed companies in the territory, some local governments have excessively controlled the reorganization process through the "linkage mechanism between the government and the court", led the establishment of liquidation groups and became managers, and so on, resulting in the dominance and independence of judicial organs in the reorganization process of listed companies is constantly diminished; Thirdly, the phenomenon of "shell reforming" and "flicker reforming" occurs frequently. There is a lack of recognition mechanism for the value of listed companies, the credit background of investors and the source of funds, and the operation of listed companies is generally ignored. The feasibility of the program and the restoration of sustainable business ability began to appear in a number of listed companies after successful restructuring and delisting cases, which damaged the rights and interests of small and medium-sized investors and creditors, and wasted huge social and judicial resources.

**Trend outlook: Trace back to the source**

In August 2023, Mr. Zhao ShanXue, the deputy director of the listed company Supervision Department of the China Securities Regulatory Commission, publicly said that the bankruptcy reorganization of listed companies should really focus on the improvement of the quality of listed companies, pay attention to the protection of the rights and interests of small and medium-sized investors, and return to the source of the reorganization system, and stressed that it should adhere to the active rescue and timely liquidation. For the listed companies that do not have the value of restructuring, orderly liquidation by delisting and other means; In April 2024, the China Securities Regulatory Commission issued the Opinions on the Strict Implementation of the Delisting System, which once again emphasized the resolute liquidation of listed companies that do not have the value of restructuring, in order to cooperate with the top level of China's demand for active capital markets and the implementation of the policy spirit of "should be withdrawn".

Based on our understanding of the above regulatory trends, we believe that the restructuring system and practical activities of China's listed companies are about to undergo major changes, mainly reflected in the following four aspects:

Firstly, the phenomenon of zero failure in the restructuring of listed companies in China is likely to be broken. For those listed companies that do not have real restructuring value, both the judicial authorities and regulatory authorities have increasingly realized that bankruptcy liquidation is also an effective way to optimize the allocation of resources and avoid its "dead-end". It cannot be ruled out that listed companies will be allowed to exit the market through bankruptcy liquidation.

Secondly, listed companies with significant delisting risks that cannot be thoroughly resolved through restructuring procedures will receive key regulatory attention. In order to avoid the phenomenon of delisting again after reorganization, we expect that the regulatory authorities will be combined with the latest delisting rules, focusing on whether the listed company can completely resolve its delisting risk through the reorganization process, for the revenue cannot meet the standards or there are major financial fraud and other circumstances of the listed company reorganization, it may be more difficult to obtain regulatory approval.

Thirdly, strengthen the identification of the reorganization value of listed companies' and strictly crack down on the reorganization of so-called "shell" listed companies. Judicial organs and regulatory authorities will strictly examine whether the sustainable operation ability and profitability of listed companies can be significantly improved through the reorganization process, focusing on the credit background of industrial investors and the ability to enable the business of listed companies, so as to truly play the rescue function of the reorganization system.

Fourthly, take more favorable measures to protect the rights and interests of small and medium-sized investors. On the one hand, the regulatory authorities will tighten the approval of the reorganization of listed companies with non-operating capital occupation by controlling shareholders, illegal guarantees and major financial fraud, and may prohibit the resolution of the above major violations in the reorganization process; On the other hand, to further strengthen the management of the capital reserve fund for the conversion of shares, it is not excluded that the upper limit of the proportion of the conversion of shares and the lower limit of the price of the conversion of shares subscribed by the reorganization investors are limited, so as to avoid the dilution of earnings per share and excessive arbitrage of the reorganization investors after the success of the total share capital of the listed company is too large.

**If you would like to know more information about the subjects covered in this publication, please contact:**

**Amy Ren**
+86 21 6043 3788
+86 755 3391 7658
amy.ren@llinkslaw.com

**Lawrence Liu**
+86 21 3135 8792
lawrence.liu@llinkslaw.com

| **SHANGHAI** | **BEIJING** | **SHENZHEN** |
|---|---|---|
| 19F, ONE LUJIAZUI<br>68 Yin Cheng Road Middle<br>Shanghai 200120 P.R.China<br>T: +86 21 3135 8666<br>F: +86 21 3135 8600 | 30F, Central Tower, China Overseas Plaza, 8 Guanghuadongli,<br>Chaoyang District<br>Beijing 100020 P.R.China<br>T: +86 10 5081 3888<br>F: +86 10 5081 3866 | 18F, China Resources Tower<br>2666 Keyuan South Road,<br>Nanshan District<br>Shenzhen 518063 P.R.China<br>T: +86 755 3391 7666<br>F: +86 755 3391 7668 |
| **HONG KONG** | **LONDON** | |
| Room 3201, 32/F, Alexandra House<br>18 Chater Road<br>Central, Hong Kong<br>T: +852 2592 1978<br>F: +852 2868 0883 | 1/F, 3 More London Riverside<br>London SE1 2RE<br>United Kingdom<br>T: +44 (0)20 3283 4337<br>D: +44 (0)20 3283 4323 | |

**www.llinkslaw.com**

**Wechat: LlinksLaw**

## WE LINK LOCAL LEGAL INTELLIGENCE WITH THE WORLD