

# Research on Creditor Protection Situation and Its Necessity of Corporate Division

Nannan Chen

The Oriental Institute of Shandong University of Finance and Economics, Shandong, China

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**Abstract:** This paper analyzes the current situation of corporate division and summarizes the shortage and reasons of the creditor protection. On this basis, it further discusses the necessity of creditor benefit protection.

## 1. Introduction

The Corporation Law of our country gives more comprehensive protection to the creditors. From the time the company is established, the protection runs through the whole process of the company's operation. According to the different operation stages and time, the creditor protection can be summarized in three stages: (1) Creditor protection system of establishment stage. (2) Creditor protection system of operation stage. (3) Creditor protection system of bankruptcy liquidation, dissolution, corporate division and merger stage [23].

After the revision of the Corporation Law in 2005, the Supreme People's Court has issued four judicial interpretations on the specific application of the Corporation Law. These judicial interpretations further refine the relevant provisions of creditor's interest protection on the above basis, and have certain operability. However, there are still some deficiencies in the protection of the creditor benefit, especially the lack of benefit protection during the corporate division.

## 2. The Cause of Insufficient Creditor Protection on Corporate Division

The reasons are various, which can be summarized as the following aspects: creditors have asymmetric information about the division of the company, there is lack of necessary supervision of the creditors benefit, and the company's personality denial system is incomplete.

### 2.1 Incomplete information about corporate division.

The open principle of the company operation is regarded as a very important principle of protecting creditor benefit of modern countries. Information public is to make realistic or potential creditors and the social public to better understand the company's credit, debt paying ability, operating conditions, the nature of the liability, and its development prospect. Creditors have a good understanding of the company before the transaction, which will reduce the risk, avoid the blindness and guarantee the transaction security. In China, there are two main aspects of disclosure system of the Corporation Law. Firstly, Public company registration and registration matters system. In the Corporation Law, the company must apply to the registration authority for major matters which are recorded of in the document and the information that should be registered. Secondly, disclose the financial status of the company. In the Corporation Law, the company that issues shares and corporate bonds in public shall have the balance sheet, profit and loss statement, earnings distribution and losses to make up for the accounting statements. However, if the creditor wishes to inquire the above information, he or she must inquire the registration management department of the company. This not only increases transaction costs, but also reduces the transactions efficiency. At the same time, the creditors have no way to verify the accuracy and authenticity of the financial statements, there is also a lack of effective sanctions against the agencies involved in providing false information about the trust obligations breach [1]. The notice and notice on the separation of the company in article 176 of the Corporation Law is also extremely vague, only "the company

shall notify the relevant creditors within 10 days from the date of the division decision, and shall announce the division in the newspaper within 30 days. Moreover, it cancelled the right of creditors to dissent when the company was divided in the Corporate Law of 1993. Therefore, the law only regulate notice to creditors or announcement on the corporate division. It only urge the creditors of the divided company to negotiate and negotiate with the company as soon as possible. At present, the biggest problem of our country is the problems that enterprises evade debt. The fundamental reason is that the division information provided by the division corporate is not real. For this reason, compared with the shareholders and executives of the company, the creditors want the accurate and detailed information of the corporate division to be extremely asymmetric.

## **2.2 Lack of civil liability for executives to harm the creditors benefit.**

The company is a profit-making business entity that established in accordance with the relevant laws and has the assets of independent legal persons. As a business entity under the market economy, it lacks the same behavioral ability as the natural person. All production and operation activities of the company need to be realized by people. However, in the actual production and operation activities of the company, the behavior of the creditors' interests is basically made by the company executives who are mainly engaged in the operation of the company. Although corporate legislation in many countries (including China's Corporation Law) has established the corporate personality denial system. But the company's personality denial system is to the abuse of power of the controlling shareholders of the responsibility [1]. There is no relevant regulation to restrict the company's executives to take the corresponding responsibilities and obligations when implementing the interests of the creditors. There are some legislative loopholes in China's current business and bankruptcy provisions. Take the provisions of article 125 of the Enterprise Bankruptcy Law enacted in 2007: The directors shall bear civil liabilities in violation on their duty of loyalty, diligence and the bankruptcy of their enterprises. The civil liability assumed here is limited to the directors of the company. The company's legislation is too narrow from the point of view of shareholders and directors. Therefore, it is better to protect the interests of the creditors when the executives who are the main participants in the company operation should bear the responsibility of harming the creditors benefit.

## **3. The Necessity of Corporate Division**

### **3.1 The company's assets loss.**

On the one hand, there is lack of necessary supervision in the process of corporate division, it is easy to appear the company's shareholders or executives' subjective intent or negligence, violate laws and regulations, which lead assets loss of the divided company. Take the assets loss of state-owned enterprises as the example. In the reform of state-owned enterprises, some executives pursue short-term personal interests and intention to embezzle state-owned assets. The use the position to maliciously depress the sale price, raise maintenance price, hire irrelevant employee and "Predatory" development and production management of state-owned assets. Some state-owned enterprise executives covet small profits in corporate governance. They maliciously caused the plant and equipment to be idle for a long time, the product and raw materials of large backlog, and finally lower than the market normal price of the transfer. Then, give up the creditor's rights of state-owned enterprises or depleting state-owned assets because they are not fully utilized. Therefore, a large number of state-owned assets unnecessary loss. According to the statistics of relevant departments, China has failed to fully exploit its potential due to the mechanical equipment of state-owned enterprises, the state-owned enterprise's plant equipment is idle for a long time. Every year, the waste of state assets is high to billions of Yuan. According to the relevant data of China national information center. The total price of idle equipment and raw materials produced by the state-owned enterprises in the whole country only through the production equipment renewal and production technology transformation each year has reached hundreds of billions of Yuan [3]. These are just the statistics of the state assets loss in various companies. Combine with the actual

production and operation activities, a considerable number of companies are privately owned and the number of shareholders is limited. In the absence of necessary supervision, the corporate division in the process of asset loss is unavoidable. On the other hand, corporate division is a major decision-making behavior related to the interests of shareholders. Our current laws and regulations permit dissenting shareholders to challenge the corporate division in the company's business activities. They can withdraw from the company by exercising shareholder's right of buying claims. But in this case, the company pays a dissenting shareholder share price without necessary supervision and measurement. The company's assets are likely to be actually reduced. The effect is the same as the loss of assets. At this time, the assets of corporate division will have a direct adverse effect on the creditors, so it is necessary to protect the interests of the creditors [4].

### **3.2 The company's debt.**

The most important part of corporate division is how to distribute the assets of the corporate division. During the vision process, if there is no special agreement with the creditor, the divided company only provides a general guarantee for its debts with all the assets. When the company's assets change, the solvency of the company as the main body of debt will also change. The divided companies divest good assets, but they continue to keep all their debts. The new company does not bear any debts. Although the original company and the new company are divided into the assets and liabilities of the divided company, they are separated by the proportion of the non-corresponding debt and the transfer of assets. The unilateral reduction of the two companies and even the exemption of the liability of the newly established companies is a serious damage to the legitimate rights and interests of the creditors. Therefore, it must be clearly defined in terms of legal provisions: the agreement has been reached with the company's creditors in advance unless the separate participating companies have negotiated their debts during the separation of the original company, otherwise, the existing or newly established company shall bear the debts of the discrete company in the form of all the assets accepted by the original company. It will avoid the damage caused by the division of assets, assets and liabilities to creditors. When the company is merged, the corporate personality of the company should be merged into one [4]. Therefore, after the company merge, the existing company or the new company will have the assets of the original company. The debts of the original company are also inherited by the existing company or the new company. The succession of assets in the company's merger process does not actually affect the creditor, and the debtor who needs to repay it essentially has not changed. The court shall not approve any request by a company or a newly established company to request the creditor to perform its obligations in the event of a change in the principal of the debtor. Corporate division is different from the corporate merger. During the corporate division, whether the new company established by the division of the original company or the separation of the company absorbed by the separation of the company or the original separation company is to take the means of existence, division, merger or elimination of division, this is the complete change of corporate personality and there is no inheritance of corporate personality. This is true even when discrete companies are disbanded. The corporate personality before and after the corporate division is not the same. For the creditors of the company, the corporate division has made a profound change in the debt burden of the original debt company that bears its debt and the new debt company that has been saddled with its debt. The corporate personality of the company has also undergone profound changes. Therefore, it is necessary to take various measures to guard against risks and protect the legitimate interests of creditors.

### **3.3 Safeguard transaction security.**

Market economy is not only the commodity economy under socialization, but also the rule of law economy in modern society. The fundamental characteristic of market economy is that both parties are guided by a free price mechanism. People trade on the basis of openness, equality, voluntarism and fairness. The safeguard mechanism established by the rule of law can provide the most powerful institutional standard and legal guarantee for the trading behavior of the market trading subject. Then it will promote economic prosperity and social progress. Freedom, safety and efficiency have always been the values of the whole company law. Market economy is the free

economy, rule of law economy, fair economy, property right clear civilized economy. In the trading of market economy, the transaction security is inestimable to the legal person and natural person who conduct business transaction with the company [5]. It is an important task of the Corporation Law to confirm the reliability, safety and efficiency of the market transaction process. Only by ensuring the efficiency of transaction security can the interests of the company and its shareholders and creditors be balanced. The purpose of a company is to maximize profits through limited investment. Creditors need funds for the production and operation of the company as the premise of mutual trust. Strengthen the protection of creditors in the whole process of corporate division, is beneficial to bring rich investment returns to shareholders and reduce the operation risk and loss of the company. Moreover, it is more conducive to effectively maintaining the legal creditor's rights of the company's creditors and realizing the win-win situation of the company's operation participants. In contrast, if we ignore the creditor benefit protection during the corporate division, the creditors will lose faith in the company's cooperation. This will seriously affect its credibility and limit its financing channels. If it is allowed to do so, there will be serious damage to the stable operation of the market economy and the stability of the whole social credit system [6]. Therefore, protect the creditor benefit is a great importance to safeguard the normal production and operation order of the transaction security of market economy and maintain the prosperity and development of the whole society.

#### **4. Conclusion**

From the above analysis and discussion we can find out, no matter in law or practice, there are some deficiencies in the creditor benefit protection in our country. However, these deficiencies will hinder the long-term development of our market economy and hinder the effective realization of the creditors benefit. Therefore, it is necessary to further discuss the protection of creditor's. In the following chapters, the author will discuss how to adopt various effective systems to against risks and protect the legitimate interests of creditors in the whole process of division of the company.

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