DOI: 10.54254/2754-1169/135/2024.18591

Trust Application Advantages in Corporate Bankruptcy Reorganization: A Case Study of HNA's Bankruptcy Reorganization

Zilong He[1,a,*]

[1]*School of Humanities and Social Sciences, Beihang University, No. 37 Xueyuan Road, Haidian District, Beijing, China*
a. 23379232@buaa.edu.cn
**corresponding author*

Abstract: Bankruptcy reorganization is a systematic approach that helps enterprises escape financial distress, mitigate bankruptcy crises, and restore independent management capabilities. Traditionally, the "debt-to-equity swap" model is employed to dilute shares in order to achieve debt repayment. However, this method does not fully protect the interests of creditors. By analyzing the trust scheme used in the HNA bankruptcy reorganization case, this article summarizes the process and advantages of using trust in corporate bankruptcy reorganization. Based on theoretical and practical conditions, and in conjunction with the current state of the economy and the bankruptcy reorganization market, the article discusses the various models of trust in corporate bankruptcy reorganization, as well as the conditions under which different models apply. The analysis indicates that trust has advantages when applied to corporate bankruptcy reorganization and shows promising prospects for the future.

Keywords: Bankruptcy Reorganization, Trust, HNA Group.

1. Introduction

In recent years, with the macroeconomic downturn, unfavorable conditions for microeconomic entities, and the rapid increase in bankruptcy reorganizations, it has become particularly important to formulate a specific and effective bankruptcy reorganization plan. As a financial innovation tool, trust can be effectively applied to the design and implementation of bankruptcy reorganization plans. Therefore, this article will analyze the advantages of trust in corporate bankruptcy reorganization from the perspectives of relevant theories on bankruptcy reorganization and trust, combined with the bankruptcy reorganization case of HNA Group. Finally, based on the case analysis, the article will discuss the future prospects and developments of trust in this field.

2. Relevant Theories on Corporate Bankruptcy Reorganization

2.1. Conditions for Bankruptcy Reorganization

The conditions for bankruptcy reorganization can be summarized into three key elements[1]:

(1) The enterprise is unable to resolve its financial issues independently, meaning it cannot repay its debts and evidently lacks repayment ability.

DOI: 10.54254/2754-1169/135/2024.18591

(2) The going-concern value of the enterprise exceeds its liquidation value, indicating that the enterprise possesses high-quality assets, competitive businesses, or market-scarce resources.

(3) The debtor, creditor, or investor eligible to initiate bankruptcy reorganization must meet certain legal requirements.

In summary, condition (1) is the prerequisite for corporate bankruptcy reorganization; condition (2) serves as the assurance that the enterprise can successfully complete the reorganization; and condition (3) is the most crucial legal condition, ensuring the legality and legitimacy of the bankruptcy reorganization. It also guarantees that every stage of the reorganization process and all participants are protected and regulated under the law.

2.2. Types and Methods of Bankruptcy Reorganization

According to the “Enterprise Bankruptcy Law of the People's Republic of China”, there are three main models of bankruptcy reorganization in China[2]:

(1)Sale-based Reorganization: This involves selling the enterprise's high-quality assets to other companies or individuals, using the proceeds to repay debts, and resulting in the exit of the original shareholders.

(2)Liquidation-based Reorganization: The enterprise evaluates and liquidates its assets while retaining its legal entity status, sells the assets to obtain funds for debt repayment, recruits investors, and formulates a detailed subsequent reorganization plan.

(3)Going-concern Reorganization: This model aims to maintain the continuity of the debtor’s operations by restructuring debt through adjustments in repayment terms and amounts or by negotiating debt reduction agreements with creditors. The goal is to restructure debt and equity while preserving the interests of the original shareholders as much as possible.

The specific implementation methods primarily include debt adjustments (such as debt-to-equity swaps), introducing strategic investors, and asset restructuring.

These methods generally rely on diluting equity to repay debts, which can result in a reduction of the original shareholders' assets. In most cases, limited assets are often prioritized for distribution to major shareholders, severely harming the interests of minor shareholders, who may suffer significant losses or even complete loss of their investment[3].

In contrast, this paper focuses on a different approach to debt repayment: the trust scheme. As an asset management tool, a trust scheme generates actual revenue through asset operations to gradually reduce the number of debts and creditors, thereby preserving the enterprise's assets and the interests of the original creditors as much as possible. Moreover, the trust scheme avoids the straightforward and drastic discount sale of the enterprise's assets, providing a foundation for the debtor's subsequent reorganization and operation. In this way, it protects the debtor’s interests to some extent, achieving a dynamic balance of multiple interests.

3. Case Analysis of the Trust Scheme in HNA's Bankruptcy Reorganization

3.1. Background of HNA's Bankruptcy Reorganization

HNA Group was founded in 2000, originating from Hainan Airlines. Established by Chen Feng, it is one of China's leading private enterprises. As a multinational corporation, HNA Group operates across 22 industries, showcasing its extensive and diverse business activities. As of 2017, the group ranked 173rd on the *Fortune* Global 500 list, marking its significant presence in the international business arena.

Before 2017, HNA Group acquired numerous domestic and international assets through high-leverage strategies, aiming to achieve rapid business growth through expansion. However, this high-leverage approach also brought immense financial pressure. After 2017, China’s tightened regulations

DOI: 10.54254/2754-1169/135/2024.18591

on outbound investments exacerbated HNA's financial difficulties. The debt burden gradually became evident, leading to a liquidity crisis. Although HNA attempted to improve its financial condition by selling high-quality assets and underperforming subsidiaries, these measures failed to significantly alleviate its financial distress.

In terms of specific debt defaults, HNA Group experienced multiple severe financial crises. For instance, in January 2018, several of HNA's subsidiaries failed to make timely payments on aircraft leases, resulting in trading suspensions of multiple listed company stocks. In February of the same year, HNA defaulted on a payment of 3 billion RMB owed to China National Aviation Fuel Group. By 2019, HNA not only halted employee subsidies and bonuses but also faced investigations due to regulatory violations by some of its subsidiaries[4].

Despite the severe debt defaults and financial crises faced by HNA Group, its market position and scarce resources presented a high rescue value. HNA's influence on Hainan Province's economy was particularly significant, drawing extensive attention to the interests of creditors and employees. Given the economic impact and resource value of HNA Group, the government established a joint working group in February 2020 to assist HNA in managing risks and seeking effective solutions.

3.2. Application of the Trust Scheme in HNA's Bankruptcy Reorganization

3.2.1. Challenges in Bankruptcy Reorganization

As of October 7, 2021, HNA Group and its 321 affiliated companies had confirmed total liabilities of approximately 746.702 billion RMB, with an additional 89.566 billion RMB in temporarily deferred claims. HNA Group's bankruptcy reorganization involves numerous companies and complex creditor relationships, and its complexity is evident in the vast number of creditors and the large number of corporate entities involved. Specifically, HNA Group's assets and businesses span multiple industries, including air transportation, airport operations, shipbuilding, financial services, and the hospitality sector, involving a total of 60 aviation enterprises, 45 airport operation entities, among others[5].

This complexity makes HNA Group's bankruptcy reorganization a highly challenging task. During the reorganization process, it is necessary to treat these 321 companies as a unified entity for planning purposes. The reorganization plan must thoroughly integrate and clear internal equity and debt relationships, handling all property and debt issues related to the associated companies uniformly. This approach aims to ensure that all creditors' rights are fairly compensated and to effectively resolve internal financial conflicts and resource allocation issues.

Therefore, HNA Group's bankruptcy reorganization is not merely a legal procedure involving a vast number of creditors and corporate entities; it is also a complex task requiring a systematic and comprehensive solution. Treating all related companies as a unified whole for coordinated planning and processing is a key step in ensuring that creditors receive fair compensation. This method not only helps optimize resource allocation but also improves the efficiency and effectiveness of the reorganization process, ensuring that the legitimate rights and interests of all creditors are reasonably protected during the reorganization.

3.2.2. Application of the Trust Scheme in This Case

According to the *Reorganization Plan (Draft) for Hainan Airlines Holding Co., Ltd. and its Ten Subsidiaries* (hereafter referred to as the "Reorganization Plan"), the reorganization is implemented through the establishment of a trust scheme to manage assets and settle debts[6].

The specific plan is as follows:

(1) Structural Design: In the bankruptcy reorganization of HNA Group, the group adopted a systematic structural adjustment strategy to effectively manage its complex debt issues and inter-

DOI: 10.54254/2754-1169/135/2024.18591

company equity relationships. Specifically, HNA Group established a sponsor company responsible for handling debts other than cash settlements and retained debt settlements. The primary duty of the sponsor company is to manage and resolve the group’s internal complex debt relationships, ensuring efficient handling of various debt issues throughout the reorganization process.

To optimize management and enhance debt processing efficiency, the sponsor company set up a central holding platform company. The purpose of this platform company is to centrally manage HNA Group’s overall equity structure and to provide a foundation for further segmented management.

Under the framework of the central holding platform company, six business management platform companies were established. These platform companies hold the equity of the relevant companies according to business type, covering areas such as air transportation, airport operations, and shipbuilding, among others. This classification allows companies of different business types to operate under more targeted management platforms, thereby improving management efficiency and financial transparency.

Adjusting the equity structure is a crucial aspect of the reorganization process. HNA Group resolved the equity interconnections among different types of businesses by severing cross-holdings between companies in various sectors. This measure helps to simplify the equity structure, reduce internal financial conflicts, and provide a clearer framework for debt restructuring and asset disposal. Refer to Figure 1 for the Business Management Structure in HNA's Reorganization Plan.

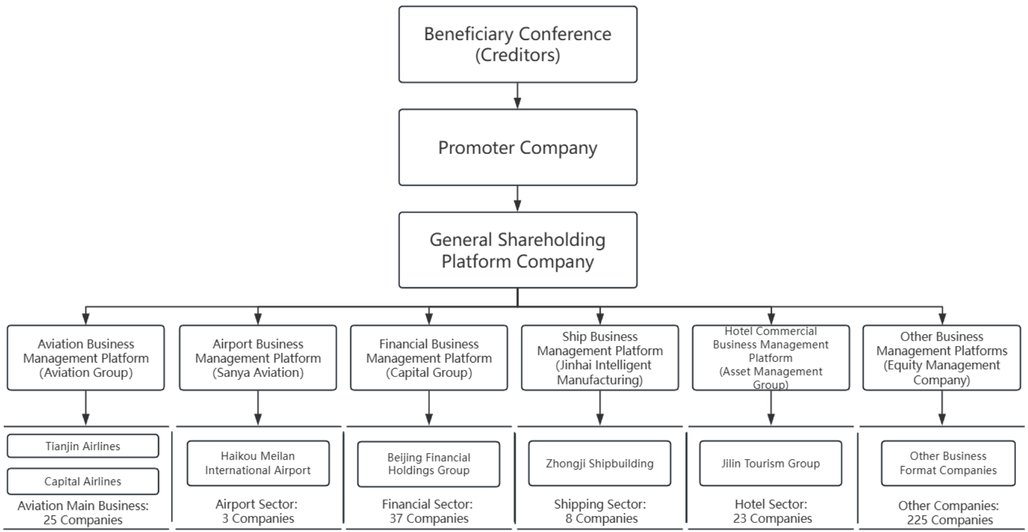

Figure 1: Business Management Structure in HNA's Reorganization Plan

(2) Trust Scheme Design: In HNA Group’s bankruptcy reorganization, the sponsor company, acting as the trustee, established a trust scheme. This trust scheme incorporated the equity of the central holding platform company and the accounts receivable claims into the trust, aiming to optimize asset management and debt settlement.

The trust scheme manages and controls the operations of HNA Group’s various business units. Through this scheme, any recovered receivables and asset revenues are automatically included in the trust assets, ensuring the centralized management and efficient utilization of financial resources. The beneficiaries of the trust include all creditors, who receive benefits according to their proportion of claims. Secured creditors have priority shares, while ordinary creditors have general shares. This arrangement ensures a fair distribution of benefits to different types of creditors within the trust scheme.

DOI: 10.54254/2754-1169/135/2024.18591

To manage and oversee the execution of the trust scheme, a Beneficiaries' Assembly and a Management Committee were established. The Beneficiaries' Assembly serves as the highest authority and supervisory body of the trust scheme, responsible for making major decisions and overseeing the overall operation of the trust management. The Management Committee, on the other hand, is specifically responsible for the daily management of the trust affairs and acts as the external representative.

In summary, HNA Group set up a trust scheme by incorporating the company's equity and accounts receivable claims into the trust, ensuring that creditors receive benefits according to their shares. The trust scheme is managed and supervised through the Beneficiaries' Assembly and the Management Committee, facilitating the efficient resolution of debt issues and fair distribution of creditor interests. Refer to Figure 2 for the Trust Relationship Diagram in the Reorganization Plan. The trustee role is ultimately undertaken by a consortium formed by CITIC Group and Everbright Group.

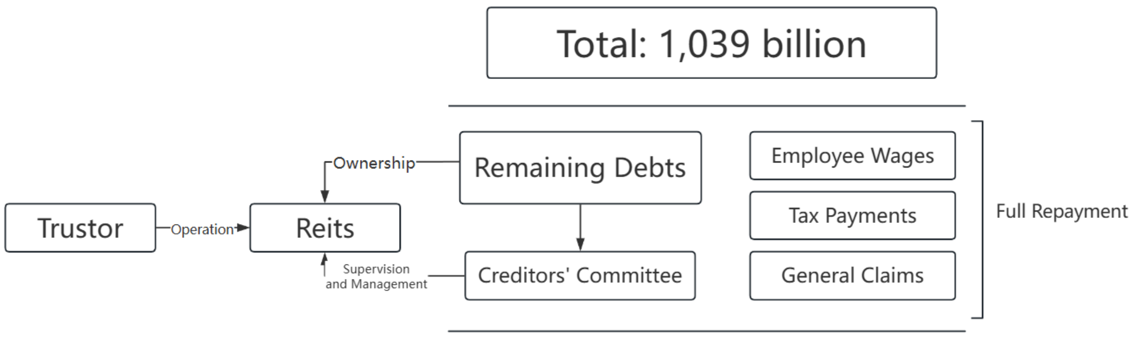

Figure 2: Trust Relationship Diagram in the Reorganization Plan

This structure achieves efficient debt management and streamlines the reorganization process through unified debt resolution. Specifically, the new management framework centralizes HNA Group's resources and organizes them into separate business units for individual operations. This approach not only reduces internal resource waste and inefficiencies but also enhances operational efficiency through synergies between business units. In terms of creditor protection, all creditors are included as ultimate beneficiaries of the trust scheme. This arrangement maximizes the protection of the interests of creditors and minority shareholders of listed companies, ensuring that they receive their rightful entitlements fairly during the reorganization process.

4. Specific Application and Advantages of Service Trusts in Future Bankruptcy Reorganizations

4.1. Beneficiary Property Trust + Sale-Based Reorganization

When addressing the challenges of bankruptcy reorganization for large, diversified enterprises, the complexity of managing corporate assets is a critical issue. Such enterprises often possess a broad and intricate asset structure that includes not only core business assets but also a large amount of non-core assets. Due to the sheer scale and diversity of these assets, it is difficult for a single investor to acquire the entire enterprise, making asset disposal a complicated task.

Although non-core assets hold economic value, they are often difficult to quickly liquidate in the short term. For reorganization managers, effectively handling these assets, especially those non-core assets that investors may not be interested in acquiring, becomes a significant challenge. As a result,

DOI: 10.54254/2754-1169/135/2024.18591

reorganization investors typically show interest only in core assets, and for the non-core or undesired assets, managers must take measures to separate and manage them.

This model allows for the packaging of non-core assets and the management of the cash flow generated from these assets. The costs incurred during the process are deducted from the cash flow, with the remaining amount distributed to creditors. This method not only reduces the investment burden on reorganization investors but also provides additional distribution opportunities, enhancing the feasibility and acceptability of the reorganization plan. In practice, non-performing or inefficient assets that strategic investors do not wish to acquire are bundled into a trust scheme, and these assets are gradually disposed of through trust beneficiary rights. This strategy effectively manages and disposes of non-core assets while offering creditors a fair opportunity for supplementary distribution[7].

In summary, for large, diversified enterprises undergoing bankruptcy reorganization, establishing a "Beneficiary Property Trust + Sale-Based Reorganization" as a strategy for managing non-core assets not only reduces the burden on reorganization investors but also offers creditors opportunities for supplementary distributions. This approach helps facilitate the smooth implementation of the reorganization plan, enhancing the efficiency and effectiveness of the overall process. Refer to Figure 3 for the Beneficiary Property Trust + Sale-Based Reorganization.

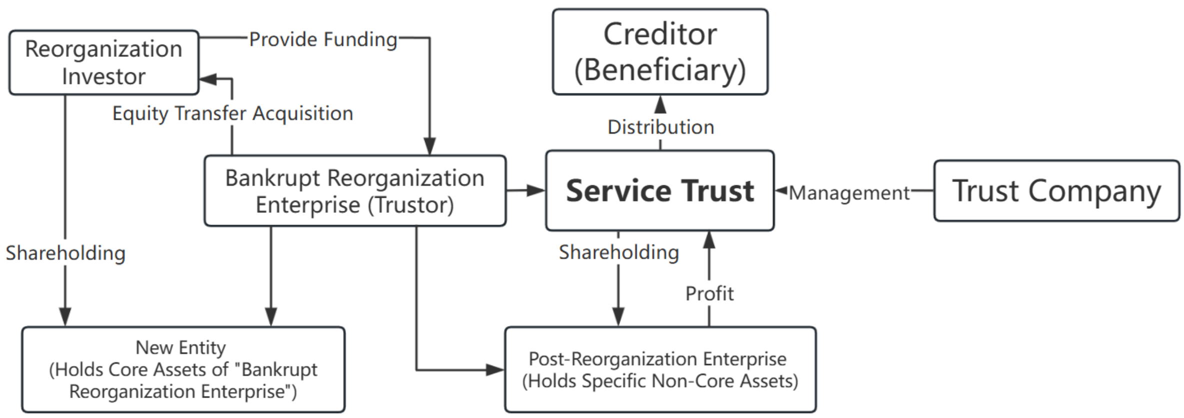

Figure 3: Beneficiary Property Trust + Sale-Based Reorganization

4.2. Going-Concern Reorganization + Equity Trustee Disposal

This service trust model is suitable for bankrupt enterprises facing liquidity crises but possessing stable cash flows. The original shareholders transfer the company’s equity into the trust scheme, establishing a service trust where creditors act as beneficiaries. This model ensures that the enterprise's assets are independent of the direct control of both creditors and original shareholders, preventing the assets from being frozen or pledged. Within the trust scheme, the assets of the bankrupt enterprise are distributed after debt repayment, and the original shareholders continue to retain their equity rights. Taking HNA as an example, its 321 companies were incorporated into the trust scheme, with all equity and accounts receivable claims managed by the trust plan established by the sponsor company. After successful reorganization, the trust plan continues to manage the enterprise’s assets, ensuring that the original shareholders retain their equity rights. This model effectively resolves liquidity crises while protecting the interests of creditors. Refer to Figure 4 for the Going-Concern Reorganization + Equity Trustee Disposal.

DOI: 10.54254/2754-1169/135/2024.18591

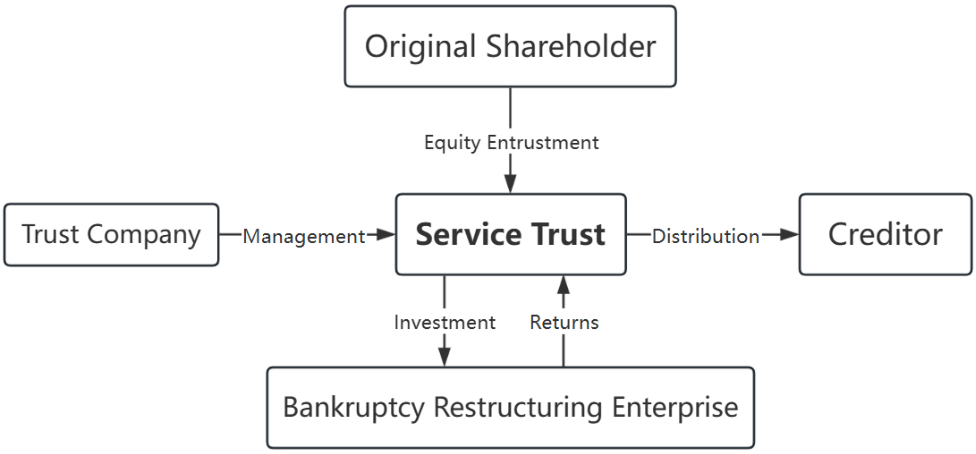

Figure 4: Going-Concern Reorganization + Equity Trustee Disposal

This trust scheme offers several advantages: it possesses actual debt repayment capabilities, maximally protects creditors' interests, uses time as leverage to improve operational efficiency, and increases the debt recovery ratio.

4.3. Retained Debt Platform

In the process of sale-based reorganization, when an investor consortium needs to establish a new entity to acquire the assets of the bankrupt entity, this model is particularly suitable for scenarios that require handling complex debt structures. For instance, in the management of debts, all creditors retain their respective debts proportionally according to the asset volume and debt amount of each new entity. These retained debts are then transferred to a trust scheme.

The main advantage of this model is its ability to avoid complicated retained debt transaction structures, thereby reducing the timeframe and difficulty of execution. By transferring the debts to the trust scheme, the transaction structure is optimized, increasing efficiency and simplifying the handling of financial debts. This approach not only improves the fluidity of transactions but also reduces the complexity of operations. Refer to Figure 5 for the Retained Debt Platform.

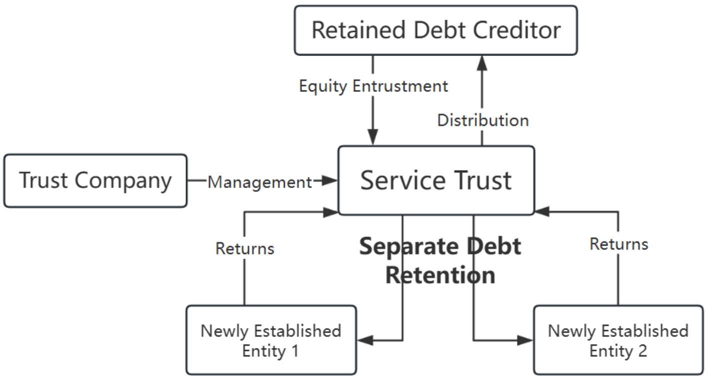

Figure 5: Retained Debt Platform

DOI: 10.54254/2754-1169/135/2024.18591

4.4. Equity Conversion Platform

When the reorganization plan includes a debt-to-equity conversion arrangement, especially in cases where creditors are restricted by policies or when the number of creditors exceeds the shareholder limit stipulated by corporate law, making direct shareholding impossible, this model effectively addresses such situations. In the operation of the trust scheme, the debt-to-equity creditors, as the grantors, transfer the equity to the trust scheme, with all debt-to-equity creditors becoming the beneficiaries of the trust. This arrangement ensures that all debt-to-equity creditors can indirectly enjoy equity rights through the trust scheme without the need for direct shareholding.

Using the trust as a platform for equity conversion efficiently manages situations involving a large number of creditors. By establishing a service trust, the execution of the equity conversion process becomes simpler and faster, optimizing the entire conversion procedure and reducing both the operational complexity and execution time. Refer to Figure 6 for the Equity Conversion Platform.

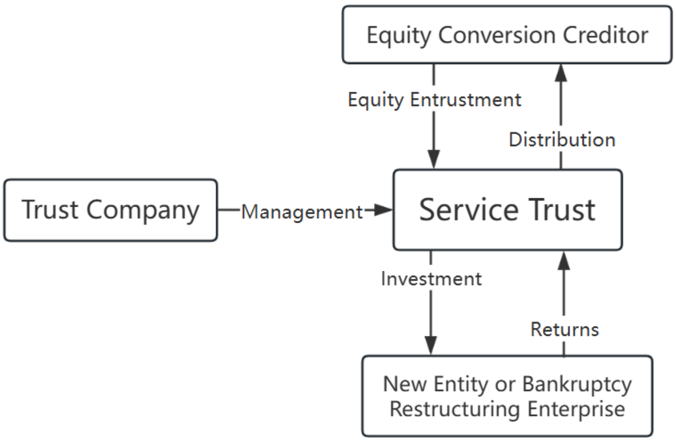

Figure 6: Equity Conversion Platform

5. Conclusion

This paper, using the HNA bankruptcy reorganization case as an example, illustrates the role of trust tools in corporate bankruptcy reorganization. Trust schemes leverage their natural advantages in risk isolation, property rights distribution, and contractually executed transactions, integrating different tools to maximize creditor protection and the debtor's interests, thereby achieving the maximization of multi-party interests during the reorganization process.

The limitation of this paper is the lack of research and discussion on risk management within the service trust itself. Issues such as the potential weakening of the grantor's rights, the virtualization of trust property value, and the dominant role of judicial authorities in determining trust parties may affect the implementation of trusts in bankruptcy reorganizations. Therefore, in future cases where trust tools are used in bankruptcy reorganization, it will be necessary to focus on these inherent risks and take targeted measures to mitigate them.

References

[1] *Li, G., Wan, W., & Zeng, Y. (2010). Efficiency characteristics of bankruptcy proceedings, reorganization conditions, and the bankruptcy of Delong companies. Management World, (06), 143-152.*

[2] *He, X., & Zhou, Y. (2006). The selection mechanism, economic efficiency, and legal basis of bankruptcy and reorganization of listed companies. Management World, (07), 125-131.*

[3] *Liu, R. (2019). Analysis and interpretation of pathways for corporate bankruptcy reorganization. Modern Business, (07), 55-56.*

[4] *Tao, J. (2021). A case study of the bankruptcy reorganization of HNA Group (Master's thesis). Huazhong University of Science and Technology, Wuhan.*
[5] *Guo, F., & Sun, T. (2021). HNA's trillion-yuan bankruptcy reorganization involves 63 companies and over 100 billion yuan of misused funds. China Economic Weekly, (Z1), 48-51.*
[6] *Chen, S. (2021, October 18). Gu Gang of HNA explains how the "Trust Plan" repays debts. China Business Daily, A04.*
[7] *Li, W. (2022). Opportunities for trust companies in the practice of bankruptcy reorganization. The Banker, (05), 100-103.*