Shanghai Chaori:
The Restructuring of China's First Domestic Bond Default

On 23 October 2014, creditors of Shanghai Chaori Solar Energy Science & Technology Co., Limited ("Chaori") approved its restructuring plan. This was only four months after the reorganisation proceedings of Chaori had been accepted by the Court and the appointment of KPMG China and King & Wood Mallesons Shanghai Office as the Co-Administrators. A few days after the creditors' meeting, the First Intermediate Court of Shanghai also gave its blessing to the restructuring plan.

Before its failure, Chaori was a major player in the solar energy industry in China. In November 2010, its shares were listed on the main board of the Shenzhen Stock Exchange on the back of annual revenues which had by then reached RMB2.7 billion. Further capital was raised through a RMB 1 billion retail bond issued in 2012. But problems began to surface and, in March 2014, Chaori defaulted on the interest payment obligations of its bond. In a period of less than four years, Chaori had experienced first the highs of a public listing and then the lows of a bond default and reorganisation.

Chaori's bond default also has the unwanted distinction of being the first such domestic bond default in China and the mere fact of the default being allowed to happen is being viewed in some quarters as perhaps signalling the emergence of a more market-oriented bond market in China. Given this context, it is not surprising that the case has attracted significant attention, both domestically and internationally. Since our appointment as the Co-Administrators, we have been working together with King & Wood Mallesons to investigate the affairs and assets of Chaori, to pursue recovery actions against the major overseas debtors, to conduct an investor search and to negotiate with potential investors to formulate a pragmatic restructuring plan for Chaori.

Challenges

Managing creditor expectations in a distressed environment is always problematic for those charged with driving the restructuring. In this case, that familiar challenge was exacerbated by the fact that domestic bondholders had never before been faced with a scenario in which a domestic issuer had not only been allowed to fall into default, but had been accepted into bankruptcy organisation to boot. And that dynamic was compounded further by the retail nature of the bond issue; this was very much a 'moms and pops' issue, rather than institutional, which meant for more than typically enthusiastic participation in the process by creditors.

Apart from expecting a high (or even full) return on their claims, creditors were also eager to understand what had led to the failure of Chaori and where their monies had gone. This type of enquiry is always undertaken to some degree or other in the context of a distressed business, of course, but in a rescue scenario consideration always needs to be given to the utility of expending resources on such investigation against the need to recognise that we are where we are and getting on with the rescue. In many restructuring cases, the decision is taken to leave a fuller historic enquiry in the hands of the post-restructuring owners or succeeding management. In this case, because of the anger of the creditors, the investigation into the affairs of Chaori pre-filing assumed more than typical importance for the Co-Administrators. The investigation was not without logistical complexity for the Co-Administrators either, as a significant portion of the assets and investments that fell to be investigated was scattered across various European countries and the USA, which made the investigation and possible pursuit of recovery actions much more difficult. To overcome those geographical barriers and differences in laws and jurisdictions, we have been able to leverage to good effect KPMG's international network, finding local specialists who could move quickly to help us build a picture of what those far-flung assets and operations looked like.

Whilst the analysis into the current condition of Chaori's assets and investments could not recoup the losses incurred by Chaori, it certainly provided useful information to the creditors to facilitate their consideration of the restructuring plan and to make an informed decision.

The suspension of the listing status of Chaori further intensified the time constraint of the reorganisation. In May 2014, trading in Chaori's shares was suspended after it recorded three consecutive years of losses. In order to resume listing, Chaori would have to generate revenue of more than RMB10 million and a net profit after deducting any non-ordinary profits or losses in 2014. Otherwise, Chaori would almost certainly be permanently delisted. In order to preserve the value of Chaori's listing status, the Co-Administrators swiftly sourced working capital – or 'DIP' - funding and sales orders to enable the gradual resumption of Chaori's production in late July, 2014.

The restructuring plan

At the time of its default, Chaori had total liabilities in the order of RMB6 billion, which included significant debts to banks and suppliers in addition to the RMB 1 billion owed to the more than 6,300 bondholders.

Of the several rescue proposals received by the Co-Administrators, it was that submitted by a nine-strong consortium led by Jiangsu Golden Concord Energy Co., Ltd which, in the view of the Co-Administrators, was the most attractive. In summary, this consortium proposed to invest RMB1.46 billion into Chaori in exchange for 1.68 billion new shares arising from capitalisation of the equity reserve. The RMB1.46 billion capital injection, together with at least RMB0.5 billion to be raised from the sale of overseas assets or debt financing, would be used to repay creditors of the Company and provide working capital to the Company's operation. This "DIP" financing – crucially – also enabled the Joint Administrators to preserve the jobs of the more than 400 employees whose salaries had fallen overdue.

Under the approved restructuring plan, creditors will receive distributions based on the nature of their claims and following the waterfall set out in the Enterprise Bankruptcy Law:-

- Preferential creditors, including government debts and employee claims, will receive full compensation on their admitted claims.
- Ordinary unsecured creditors will receive full compensation for the first RMB200,000 of their admitted claim and 20 cents in the dollar of the balance.
- Secured creditors will first receive a distribution equivalent to the value of pledged assets based on an independent valuation. The remaining portion will be classified as ordinary unsecured claim and attract the same distribution as the ordinary unsecured creditors.

Outside of the reorganisation process and in order to ensure a successful outcome, China Great Wall Asset Management Corp and Shanghai Eternal Sunshine Investment Management Centre, investors in the Consortium, provided a guarantee to the bondholders, simply viewing the cost of doing so as part of the overall deal value. It is also worth noting that, although efforts were made at a bondholders' meeting to get them to vote as a block, bondholders preferred to exercise their individual rights as provided for in the bond document. As there were more than 6,300 of them, this added a touch of excitement to the headcount voting test – the Enterprise Bankruptcy Law requiring that, of those voting, more than 50% in number and more than two-thirds by value need to vote in favour for a reorganisation plan to be approved. In the event, some 2,115 individual creditors attended the meeting.

Of those present and voting, almost 99% by number, representing 70% by value, voted in favour of the plan, indicating that a small number of larger creditors were not entirely enamoured with the outcome.

Steps ahead

The approval of the restructuring plan of Chaori is a major milestone in the reorganisation of Chaori but this is not the end yet. The upcoming challenge for Chaori is to preserve and resume its listing status. In the meantime, the Co-Administrators are working hand in hand with Chaori and the Investor Consortium to execute the restructuring plan and pursue the resumption of listing. Under its new ownership, leadership and capital structure, Shanghai Chaori now has a stable platform from which to launch an effort to regain its leading place in this sector.

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