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**SUMMATIVE (FORMAL) ASSESSMENT: MODULE 8B**

**CHINA (PRC)**

This is the **summative (formal) assessment** for **Module 8B** of this course and must be submitted by all candidates who **selected this module as one of their elective modules**.

**The mark awarded for this assessment will determine your final mark for Module 8B**.In order to pass this module, you need to obtain a mark of 50% or more for this assessment.

**INSTRUCTIONS FOR COMPLETION AND SUBMISSION OF ASSESSMENT**

**Please read the following instructions very carefully before submitting / uploading your assessment on the Foundation Certificate web pages.**

1. You must use this document for the answering of the assessment for this module. The answers to each question must be completed using this document with the answers populated under each question.

2. All assessments must be submitted electronically in **Microsoft Word format**, using a standard A4 size page and an 11-point Arial font. This document has been set up with these parameters – **please do not change the document settings in any way**. **DO NOT** submit your assessment in PDF format as it will be returned to you unmarked.

3. No limit has been set for the length of your answers to the questions. However, please be guided by the mark allocation for each question. More often than not, one fact / statement will earn one mark (unless it is obvious from the question that this is not the case).

4. You must save this document using the following format: **[studentID.assessment8B]**. An example would be something along the following lines: 202223-336.assessment8B. **Please also include the filename as a footer to each page of the assessment** (this has been pre-populated for you, merely replace the words “studentID” with the student number allocated to you). Do not include your name or any other identifying words in your file name. **Assessments that do not comply with this instruction will be returned to candidates unmarked**.

5. Before you will be allowed to upload / submit your assessment via the portal on the Foundation Certificate web pages, you will be required to confirm / certify that you are the person who completed the assessment and that the work submitted is your own, original work. Please see the part of the Course Handbook that deals with plagiarism and dishonesty in the submission of assessments. **Please note that copying and pasting from the Guidance Text into your answer is prohibited and constitutes plagiarism. You must write the answers to the questions in your own words**.

6.The final submission date for this assessment is **31 July 2023**. The assessment submission portal will close at **23:00 (11 pm) BST (GMT +1) on 31 July 2023**. No submissions can be made after the portal has closed and no further uploading of documents will be allowed, no matter the circumstances.

7. Prior to being populated with your answers, this assessment consists of **9 pages**.

**ANSWER ALL THE QUESTIONS**

**QUESTION 1 (multiple-choice questions) [10 marks in total]**

Questions 1.1. – 1.10. are multiple-choice questions designed to assess your ability to think critically about the subject. Please read each question carefully before reading the answer options. Be aware that some questions may seem to have more than one right answer, but you are to look for the one that makes the most sense and is the most correct. When you have a clear idea of the question, find your answer and mark your selection on the answer sheet by highlighting the relevant paragraph **in yellow**. Select only **ONE** answer. Candidates who select more than one answer will receive no mark for that specific question.

**Question 1.1**

**Select the correct answer:**

Which of the following are eligible to use the China Enterprise Bankruptcy Law of 2006 to enter into a court-involved bankruptcy procedure in China?

1. Consumers, when in financial difficulty.
2. Enterprises having an independent legal status.
3. Partnerships and sole traders.
4. Individuals or sole traders.

**Question 1.2**

**Select the correct answer:**

Which three bankruptcy options are provided by the China Enterprise Bankruptcy Law of 2006?

1. Reorganisation, scheme of arrangement and liquidation.
2. Receivership, settlement and liquidation.
3. Liquidation, settlement and company voluntary arrangement.
4. Reorganisation, settlement and liquidation.

**Question 1.3**

**Select the correct answer:**

How is a bankruptcy administrator appointed under the China Enterprise Bankruptcy Law of 2006?

1. The bankruptcy administrator can only be appointed by the debtor when the company files for bankruptcy in court.
2. Only the court can appoint a bankruptcy administrator. Creditors may request a replacement bankruptcy administrator to be appointed if the court-appointed administrator is proven to be incompetent or biased at a later stage of the proceedings.
3. Both the debtor and creditors can appoint provisional bankruptcy administrators when filing.
4. The court can only appoint a bankruptcy administrator after getting consent from both the debtor and the creditors.

**Question 1.4**

**Select the correct answer:**

Which parties may file for bankruptcy in court under the China Enterprise Bankruptcy Law of 2006?

1. Directors can file for company bankruptcy in a court.
2. Both the debtor and the creditors may file for bankruptcy.
3. Only the debtor is allowed to file.
4. Both creditors and shareholders of the company may file for bankruptcy.

**Question 1.5**

Regarding the “control” model in corporate reorganisation under the China Enterprise Bankruptcy Law of 2006, which of the following statements **is correct**?

1. The debtor-in-possession model is not available under the Chinese corporate reorganisation provisions.
2. Both debtor-in-possession and administrator-in-possession models are available under the Chinese corporate reorganisation provisions.
3. Once the administrator-in-possession model is chosen, it cannot be converted into the debtor-in-possession model.
4. The debtor-in-possession model is automatically selected once a reorganisation procedure is commenced.

**Question 1.6**

Regarding preferential creditors in China, which of the following statements **is correct**?

1. Both the tax authorities and employees are treated as preferential creditors in China.
2. The preference of tax authorities has been abolished by the China Enterprise Bankruptcy Law of 2006.
3. Tax authorities are ranked higher than employees in the priority hierarchy.
4. Tax authorities are treated as unsecured creditors in China and are not given preferential treatment.

**Question 1.7**

A corporate reorganisation plan that has been voted on must be approved by the court before it takes effect. Indicate which one of the following statements **is correct**:

1. If the reorganisation plan was voted down (rejected) by one or more class of creditors, the court may still approve the plan if certain statutory conditions are met; a cram-down is therefore available under Chinese law.
2. A cram-down cannot be exercised by the Chinese courts.
3. If shareholders do not support / approve the reorganisation plan, the plan cannot be crammed-down by the courts.
4. Only a reorganisation plan that has been fully supported by all classes of stakeholders entitled to vote can be sent to the court for approval.

**Question 1.8**

As regards the recognition of foreign bankruptcy proceedings in China, select the **correct answer**:

1. A foreign bankruptcy proceeding can be recognised in China, provided there is a judicial assistance treaty with China or reciprocity with China has been established.
2. China strictly applies the principle of territorialism and consequently no foreign bankruptcy proceeding or ruling can be recognised in China.
3. China has adopted the UNCITRAL Model Law on Cross-Border Insolvency and all foreign bankruptcy proceedings can be automatically recognised in China.
4. China only recognises foreign bankruptcy orders from countries which have adopted socialism.

**Question 1.9**

**Select the correct answer:**

In terms of the stated universal effect of a Chinese bankruptcy proceeding, the practical approach is that:

1. The Chinese bankruptcy administrator can use the court bankruptcy ruling to bar foreign creditors from taking legal action against the company’s assets in all foreign courts.
2. The Chinese bankruptcy administrator must seek recognition of the Chinese bankruptcy ruling abroad, otherwise the Chinese bankruptcy ruling will not be effective in other jurisdictions.
3. The Chinese bankruptcy ruling can only be recognised in countries that have adopted the UNCITRAL Model Law on Cross-Border Insolvency.
4. The Chinese bankruptcy ruling will never be recognised in other jurisdictions since China has not adopted the UNCITRAL Model Law on Cross-Border Insolvency.

**Question 1.10**

**Select the correct answer:**

When drafting the corporate reorganisation chapter of the China Enterprise Bankruptcy Law of 2006, which country’s corporate rescue laws influenced Chinese lawmakers most?

1. The United States of America.
2. Russia.
3. Poland.
4. The United Kingdom.

**QUESTION 2 (direct questions) [10 marks]**

**Question 2.1 [2 marks]**

What bankruptcy test(s) should be met if a bankruptcy petition is filed **by a creditor** in China?

If a bankruptcy petition is filed by a creditor, the test to be met is that of cash-flow insolvency pursuant to Article 7 of the China Enterprise Bankruptcy Law. The creditor must be able to demonstrate to the court that the debtor is unable to pay a debt that is due. However, in practical terms, the creditor must also have the support of local government in order to ensure that the petition is neither ignored nor dismissed.

The test applicable to a creditor filing is different to that where the debtor files voluntarily. Where the debtor files, it must show either cash-flow insolvency, or that it is insolvent on a balance-sheet basis, meaning its liabilities exceed its assets.

**Question 2.2 [maximum 4 marks]**

Name the two professions in China that dominate Chinese regional bankruptcy administrator lists **and** briefly explain how they are appointed in practice.

The two professions in China which dominate Chinese regional bankruptcy administrator lists are lawyers and accountants. In 2007, the China Supreme People's Court instructed most Chinese provinces to begin to produce their own regional bankruptcy administrator lists. The list is generally drawn up by the provincial supreme people's courts in China, which in turn seek assistance from the local associations of lawyers and accountants, who themselves are controlled by local government justice and finance departments. Those who are qualified to be insolvency practitioners include both individuals and firms, though many of the provincial supreme courts include large accountancy and law firms in the lists without requiring any specific training or qualifications to be taken.

At the point when the petition for liquidation is accepted by the court, the bankruptcy administrator is appointed at the same time, pursuant to Article 13 of the China Enterprise Bankruptcy Law of 2006. The appointment is by the court. Usually the court will use the local bankruptcy administrator list to choose the particular firm, but sometimes a bid is held in larger, more complex matters. In some Chinese provinces such as Beijing, the power to appoint has been promoted to the local provincial Supreme People's Court, whereas in others such as Zhejiang, only a local Intermediate People's Court can make the appointment.

While the first appointment is made by the court and not according to the creditors' choice, Article 22 provides that creditors may request a replacement of the bankruptcy administrator in circumstances where there is evidence of the bankruptcy administrator's lack of competence and impartiality. In practice, it is seldom that such challenges are made successfully.

**Question 2.3 [maximum 4 marks]**

Name the most used type of securities available under Chinese law **and** explain how and where they are registered.

The China Property Law of 2007 provides for three forms of security:

1. fixed charges;
2. pledges; and
3. liens.

Fixed Charges

Fixed charges are the most common form of security. Chinese law recognises floating charges as well, but they are rarely used because of the absence of supporting measures. A charge can secure both movable and immovable property of the debtor, but also of a third party if the third party's consent is obtained. The China Civil Code of 2020 provides that a charge must be registered and is not valid until it is registered. Charges over immovable property are registered at the local office of the China Housing Management Authority. The secured creditor usually also registers the charge at the local office of the China Land Management Authority, given that the use right of the land is part of the property. A small fee may apply for registration, and a security certificate is issued to the holder of the charge once registered.

Under Article 218 of the China Civil Code of 2020, all registered charges on both buildings and use rights over land should be available for interested parties to inspect. Despite this, there is no specific sanction imposed by Article 45 for failure to make such records available for inspection, and in practice it is very difficult to access records at the China Land Management Authority.

Pledges

Pledges are less frequently created than fixed charges, but are valid security under Chinese law. The pledge becomes effective once possession of the pledged movable asset is given to the secured creditor.

Registration of a pledge over movable property is not required, given there is a change in the physical possession of the property, which is sufficient. However, pledges over intangible assets including patents, trademarks, shares, cheques and bonds must be registered in order to be valid. Pledges over trademarks are registered at the China Industries and Commerce Regulation Bureau Central Office in Beijing. Pledges over patents are registered at the China Intellectual Property Authority Central Office in Beijing. Pledges over shares of listed companies are registered at the China Securities Depository and Clearing Corporation Limited, which has offices in Beijing, Shanghai, Shenzhen and Hong Kong. Pledges over shares of non-listed companies are registered at the local office of the China Industries and Commerce Regulation Bureau where the company is incorporated.

Liens

Liens fall under Chapter 19 of the China Civil Code of 2020, but are rarely used as a form of security in China.

**QUESTION 3 (essay-type questions) [15 marks in total]**

**Question 3.1 [maximum 8 marks]**

“The China Enterprise Bankruptcy Law of 2006 is a rescue-oriented piece of insolvency legislation, emphasising rescue over liquidation.”

**Discuss** what legal machanisms in this statute can support this statement.

The China Enterprise Bankruptcy Law of 2006 (the "**2006 Law**") provides for three bankruptcy-related procedures:

1. reorganisation;
2. composition/settlement; and
3. liquidation.

The first two of the three procedures are rescue-orientated. Reorganisation is provided for in Article 2 of the 2006 Law, composition is set out in Chapter 9 of the 2006 Law, and liquidation is contained in Chapter 10 of the 2006 Law. On the basis that the two rescue-orientated procedures come first in the 2006 Law, it is arguable that the legislators intended for rescue to be attempted first, which supports the statement above.

However, the 2006 Law only applies to enterprises and does not apply to sole traders and partnerships. This means that these entities are unable to make use of the rescue procedures and must seek to agree settlement under contractual principles.

Reorganisation

The reorganisation procedure in the 2006 Law is based on the US Chapter 11 procedure. Either the debtor company can file for reorganisation, or a creditor may file.

Under Article 2 of the 2006 Law, a company can voluntarily file for reorganisation in court when the company is likely to become bankrupt in the near future. This means that there is no requirement to satisfy a bankrupty test to file for reorganisation. This clearly encourages efforts to rescue a company to be made as early as possible, which supports the contention that the 2006 Law is rescue-orientated. This provision does not apply when a creditor applies, as the creditor must be able to show cash flow or balance sheet insolvency.

It is also possible, in accordance with Article 70 of the 2006 Law, for an application to be made by the debtor or shareholders with more than 10% of the company's equity to the court to convert a liquidation procedure filed by a creditor to a reorganisation. This again supports the contention that the 2006 Law is rescue-orientated, as it means that even when a filing for liquidation is made, there is still the prospect that a company can be put into the reorganisation procedure and rescued.

When a petition for reorganisation is filed and accepted by the Chinese court, a court-appointed administrator takes control of the company's business and property. However, the company's management can request the court to grant a debtor-in-possession order, permitting it to regain control of the company's assets and business affairs. The administrator's role then becomes one of supervision.

The reorganisation plan is to be voted on by creditors in four different classes: i) secured creditors; ii) employees; iii) tax/revenue authorities; and iv) ordinary unsecured creditors. If 50% or more of creditors attending, who represent two-thirds or more of attending creditors in value of each class, vote in favour, the reorganisation plan is passed. However, the court has the power to "cram-down" (force the approval of) a reorganisation plan that is not passed by crediotrs, but which satisfies particular conditions set out in the legislation under Article 87 of the 2006 Law, including that the plan is feasible. The fact that a cram-down is possible is again an argument in favour of the statement that the legislation is rescue-orientated.

Composition/Settlement

The second rescue procedure in the 2006 Law is composition, which can only be filed voluntarily by a debtor company. A creditor cannot file for composition.

Pursuant to Article 95 of the 2006 Law, the company must present a composition/settlement plan to the court when it makes its filing. If the court approves of the plan, a meeting of creditors is set to vote on the plan. Article 97 states that the plan is passed if it is voted in favour of by at least half of creditors in number attending holding two-thirds or more of total claims. If approved by creditors, the plan is then sent to the court for approval.

However, pursuant to Article 96 of the 2006 Law, secured creditors are not bound by a composition procedure, and so they are not subject to the stay on legal enforcement against the company's assets. This means that if secured creditors do not support the plan, composition is unlikely to be successful. This provision goes against the idea that the legislation is rescue-orientated, as if secured creditors do not accept the plan and the attempt at composition fails, it is likely that the company will end up in liquidation rather than being rescued.

Conclusion

In summary, the following factors relating to the drafting of the 2006 Law suggest that the 2006 Law is rescue-orientated:

* On the basis that the two rescue-orientated procedures are set out before liquidation in the 2006 Law, it is arguable that the legislators intended for rescue to be attempted first.
* Article 2 of the 2006 Law permits a company to file voluntarily for reorganisation before it meets the insolvency tests, which clearly encourages efforts to rescue a company to be made as early as possible.
* Article 70 makes it possible for a liquidation to be converted to a reorganisation.
* It is possible for the court to force the approval of a reorganisation plan even where creditors do not approve of the plan.

However, in practice it is essential that a company has the support of local government before any reorganisation petition is considered properly by the courts. Furthermore, the courts are extremely cautious in accepting petitions for reorganisation, which means it is rather rare for reorganisations to be used. Many reorganisations end up in liquidation because no buyer is found to rescue the company, or the court considers that the reorganisation is politically-motivated but not actually possible. Further, despite the provision of Article 2, in practice the courts require a debtor company to provide evidence of balance-sheet insolvency before the court will accept the petition for reorganisation. There are also courts that demand the applicant to file proof that the reorganisation proposal is very likely to be successful, sometimes even requirements that the plan is approved in advance by key creditors.

This means that while the 2006 Law certainly does promote rescue, in practice reorganisations are rare.

**Question 3.2 [maximum 7 marks]**

Briefly explain the process for the proof of claims in a corporate liquidation procedure and the procedure that is followed should the value or existence of a creditor’s claim be disputed.

At the point that a liquidation petition is accepted by the court, the liquidator (known as a bankruptcy administrator in China) will be appointed by the court in accordance with Article 13 of the China Enterprise Bankrupty Law of 2006. Upon the appointment, the bankruptcy administrator will advertise the liquidation in both local and national newspapers, which will inform all the company's creditors that they should submit their claims. In accordance with Article 45, the court will specify the time limit for a creditor to submit its claim, which will be at least 30 days but no more than 3 months.

Creditors will then need to contact the bankruptcy administrator and are usually required to complete a claim form provided by the bankruptcy administrator. In the form, the creditor must specify whether it holds any security.

In submitting their claims, Article 40 provides that a creditor that is also a debtor of the company can claim set-off, with only the balance that is still owing to the creditor being treated as a claim. This is subject to certain restrictions, including that the debt that is to be set-off cannot be purchased from a third party.

Following receipt of claims, the bankruptcy administrator will examine the company's books and records and speak to the company's employees, particularly staff who dealt with the company's finances, to establish whether the claims can be verified. This is a large part of the bankruptcy administrator's work because it is necessary in order to ascertain all of the company's liabilities. According to Article 58, if there is no objection to the claim, the court will confirm it.

If the bankruptcy administrator does not agree the existence or value of a creditor's claim, the creditor or the administrator may refer the case back to the same court which appointed the bankruptcy administrator to determine the dispute and issue a judgment. The court's adjudication is treated as the final amount of the creditor's claim. In order to process such disputes efficiently, many of the courts follow an accelerated process to resolve creditors' claims.

**QUESTION 4 (fact-based application-type question) [15 marks in total]**

**Question 4.1 [maximum 8 marks]**

The bankruptcy liquidator of a Singaporean company finds that some of the company’s assets are located in Shanghai, China. A Chinese creditor has taken legal action in a local (Chinese) court, which has issued an injunction freezing the assets of the Singaporean company in China. The liquidator has approached you for advice on how the Singaporean bankruptcy proceeding can be recognised in China. Advise the liquidator.

China has not adopted the UNCITRAL Model Law on Cross-Border Insolvency, and so the Singaporean bankruptcy proceeding cannot be recognised pursuant to the Model Law in China.

However, Article 5 of the China Enterprise Bankruptcy Law of 2006 (the "**2006 Law**") provides that a foreign court's ruling on bankruptcy binds any assets of a company that are located in China. This is subject to the conditions that the foreign bankruptcy court ruling must be recognised by a Chinese court before it takes effect in China, and that recognition of the ruling must either be based on a judicial assistance treaty signed and ratified between China and, in this case, Singapore, or, if there is no such treaty, on the principle of reciprocity. Article 5 also includes some restrictions where recognition might infringe the fundamental principles of Chinese law, China's sovereignty, security, or public interests. There is also a restriction that China's domestic creditors must not be disadvantaged.

There is a judicial assistance treaty between China and Singapore, which means that the liquidator can seek recognition of the Singaporean bankrupty proceeding before a Chinese court. In accordance with Chinese civil procedure law, the liquidator will need to seek recognition in the Chinese local intermediate people's court in Shanghai, being the place where the company's assets are located.

There is an example of a Singaporean bankruptcy order over a company having been recognised by a maritime court in Xiamen, Fujian Province, in 2020, which enabled the Singaporean liquidator to collect in the assets of the company that were located in China.

Pursuant to the 2006 Law, foreign creditors and shareholders are to be given the same treatment as domestic creditors and shareholders. This means that in theory the Chinese creditor who has taken action in a Chinese court to freeze the company's assets in China should not be preferred over foreign creditors and upon recognition of the Singaporean bankruptcy proceeding, the assets that are frozen by the injunction should be bound by the recognition. However, in practice most Chinese courts are very cautious about foreign bankruptcy recognition applications and if it is considered that the domestic creditor in China will be disadvantaged by the recognition of the Singaporean bankruptcy, the Chinese court may refuse to recognise it.

There is no indication of any provisions in the 2006 Law dealing with concurrent proceedings. Given the attitude of the Chinese courts towards foreign bankruptcy proceedings, it is likely that the ruling of the local court granting an injunction in favour of the domestic creditor will be preferred over the recognition of the Singaporean bankruptcy, unless the liquidator is able to show that the Chinese creditor is somehow likely to obtain a larger recovery from the liquidation if the Chinese assets are included in the pool of assets available to all creditors, than if the Chinese creditor simply enforces against the Chinese assets.

**Question 4.2 [maximum 7 marks]**

HuangPu Food Limited is a large beverage company based in Shanghai. In 2010, the company was unable to repay a RMB 23 million loan to the Bank of China (Shanghai Branch) and was petitioned for bankruptcy liquidation by the Bank at the Shanghai Second Intermediate People’s Court. Three days after submitting the petition, the Court accepted the liquidation filing and appointed Fenda Partners, a local law firm included in the local bankruptcy administrator list, as the liquidation administrator.

Shortly after the commencement of the bankruptcy of HuangPu Food Limited, the CEO of Naking Limited, a controlling shareholder holding 32% of the equity of HuangPu Food Limited, approaches you for advice.

**Using the facts above, answer the questions that follow.**

**Question 4.2.1 [maximum 4 marks]**

The CEO of Naking Limited tells you that the various businesses of HuangPu Food Limited are still viable and that a piecemeal liquidation of the company will not be in the interests of any of the stakeholders. Since HuangPu Food Limited appears to have a bright future if the current debt crisis can be resolved, you are asked to explain whether (and if so, how) the current liquidation procedure can be converted to a reorganisation procedure.

It is possible to convert a liquidation into a reorganisation procedure, pursuant to Article 70 of the China Enterprise Bankruptcy Law of 2006 (the "**2006 Law**"). The conditions to be satisfied under Article 70 of the 2006 Law are:

1. The liquidation must have been filed by a creditor and therefore be an involuntary rather than voluntary procedure.
2. Either the debtor company or shareholders with more than 10% of the debtor company's shares have the standing to apply.

In this case, the liquidation application was made involuntarily, as it was filed by a creditor, the Bank of China (Shanghai Branch). Naking Limited holds 32% of the equity of HuangPu Food Limited and therefore satisfies the criterion for standing to make the application.

Naking Limited may make an application to the Shanghai Second Intermediate People's Court to convert the liquidation into a reorganisation. If the application is granted, the reorganisation procedure commences immediately.

While in theory it is possible to convert the liquidation to a reorganisation, in reality Naking Limited will need local government support before the application to convert will be considered seriously by the court. It is for this reason that only a low number of liquidation procedures are converted to reorganisation procedures.

There are also certain requirements of particular courts that must be met when filing for a reorganisation that are likely to also be required to be met when seeking to convert the liquidation procedure into a reorganisation. For example, some courts require evidence that the reorganisation proposal is likely to be successful, and others require the agreement of the proposal in advance by certain key stakeholders, such as secured creditors and potential buyers.

**Question 4.2.2 [maximum 3 marks]**

Assuming that the bankruptcy liquidation of HuangPu Food Limited is successfully converted to a reorganisation procedure, a reorganisation plan for HuangPu Food Limited is eventually voted on by the various stakeholders. Due to the fact that HuangPu Food Limited is insolvent, the reorganisation plan *inter alia* proposes that the shares of all previous shareholders be cancelled. Unhappy that its equity in HuangPu Food Limited will be wiped out by the reorganisation plan, Naking Limited understandably votes against the plan. However, since the plan has only been voted down by the shareholders and approved by all the classes of creditors, the reorganisation administrator submits the reorganisation plan to the Shanghai Second Intermediate Court for approval.

Advise the CEO of Naking Limited as to whether the Court can approve such a plan under the current law in China.

Article 87 of the China Enterprise Bankruptcy Law of 2006 provides that the court may approve (or "cram-down") a reorganisation plan which has been voted down by one or more classes of creditors, or by the company's shareholders. Article 87 provides a list of six requirements that must be met for the court to be able to take this step. These conditions are that the reorganisation plan must:

1. be voted in favour of by the secured creditor class and, if not, secured creditors must be fully paid out of the secured assets (in addition to receiving fair compensation for the delay in foreclosing);
2. be voted in favour of by the employee and tax authority classes and, if not, these two classes must be paid in full;
3. be voted in favour of by the ordinary unsecured creditor class and, if not, this class of creditors must not be paid less than they would have received under a liquidation;
4. be voted in favour of by the shareholders where their equity is affected by the plan and, if not, the treatment of equity holders is fair and equitable;
5. pay the stakeholders in the same class fairly, with the priority between shareholders and creditors upheld; and
6. be feasible.

The six conditions are summarised as three tests, being:

1. the fair and equitable test, which requires that the *pari passu* principle be applied between creditors in the same class ie that creditors in the same class are treated equally;
2. the absolute priority test, where shareholders are not paid anything unless and until creditors are paid in full; and
3. the feasibility test, which means that the reorganisation plan should be realistic and able to be achieved.

In this case, conditions a), b) and c) above are satisfied because all classes of creditors voted in favour of the plan. Condition e) is satisfied because the company is insolvent, which means that creditors will not be paid in full, but the shareholders are not being paid anything. Condition d) is satisfied because while the shareholders voted down the plan, all equity holders are being treated equally. It is not known from the information above whether condition f), that the plan is feasible, is satisfied. Assuming it is, the court has the power to cram-down the plan and approve it despite the shareholders voting it down. If the court does this, the plan will be legally binding on all the stakeholders, including the shareholders who voted it down.

**\* End of Assessment \***