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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 2024**. The assessment submission portal will close at **23:00 (11 pm) BST (GMT +1) on 31 July 2024**. 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:

The **China Enterprise Bankruptcy Law 2006** applies to:

1. Natual persons in financial difficulty.
2. Enterprises having an independent legal status.
3. Partnerships.
4. Sole traders.

**Question 1.2**

Select the correct answer:

The China Enterprise Bankruptcy Law 2006 provides three major **insolvency procedures**, namely:

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 in relation to the **appointment of the bankruptcy administrator**:

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 party is **eligible to file** a company bankruptcy petition to the court?

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 approval is not available under the China Enterprise Bankrupty Law 2006.
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 joined the Belt & Road Initiative.

**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:

The introduction of the corporate rescue procedure under the China Enterprise Bankruptcy Law 2006 was most **influenced** by the jurisdiction of:

1. The United States of America.
2. Japan.
3. Singapore.
4. The United Kingdom.

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

**Question 2.1 [2 marks]**

If a creditor wants to bring a defaulting debtor company into a bankruptcy liquidation procedure in China, which bankruptcy test should be fulfilled before the court can accept the filing?

In order for a creditor to bring a bankruptcy liquidation in China it needs to prove that the Detor is an enterprise with independent legal status and that it is cash-flow insolvent and cannot pay its debts as the same become due.

**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 professionals that dominate Chinese regional bankruptcy administrator lists are qualified legal firms and accounting firms. Both are appointed exclusively by the Court when the reorganization filing is accepted. There is an exception when creditors may request the removal of the court appointed administrator, but they need to prove that such administrator is incompetent or biased. This exception is not very frequent.

**Question 2.3 [maximum 4 marks]**

Please briefly describe the major features of fixed charges and pledges as the major forms of security in China.

The major features of fixed charges in China are that they are the first and most widely used for of security. The charge can be over movable and inmovable property of the debtor or a third party (with its consent). The fixed charge has to be registered at the corresponding governmental agency pursuant to the Civil Code of 2020. They are predominantly given to banks and are held over buildings and right of use of land.

The pledge is another form of security used in China, although not as common as the fixed charge. It encumbers movable property and becomes valid when the asset changes possession to the secured creditor. It does not require registration since the change of possession is sufficient to validate the same. Nevertheless, if an intangible asset like intellectual property is pledged, then registration is required in the corresponding governmental authority.

**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 why, at least in theory, this statement is true.

The China Enterprise Bankruptcy Law of 2006 is considered a rescue-oriented piece of insolvency legislation since it is moulded and influenced a lot by Chapter 11 of the Bankruptcy Code of the United States. The Law of 2006 has three bankruptcy alternatives available to corporate debtors. Two of them are geared towards restructuring (reorganization and settlement) and the third is liquidation. The reorganization options is available to insolvent debtors but also to debtors that can prove that they are likely to become insolvent. This ability to have access to bankruptcy at an early stage promotes restructuring and viable reorganization of a company.

The settlement or composition bankruptcy option is a voluntary procedure that can be filed only by Debtors that seek reorganization and file their plan along with the bankruptcy petition. The meeting of creditors is turned into a meeting to vote for the proposed plan. If approved by the creditors, then it is submitted to the Court for its sanction.

The use of these two chapters (8 and 9) as rescue alternatives for Debtors versus the use of only one chapter for liquidation denotes the desire of the legislator to promote a more recue oriented insolvency law.

**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.

In corporate liquidation creditors need to submit their proofs of claims in order to receive distribution. After being appointed the liquidator notifies in national and local newspaper and other outlets of the filing of the bankruptcy and that creditors need to file proofs of claims. The administrator verifies the filed claims and reconciles them with the books and records of the Debtor. If there is a dispute as to the validity or the amount of the claim, then such dispute is submitted to the Court for litigation and final adjudication. The amount determined by the Court as valid and due will be the amount subject to distribution and payment by the liquidator. All allowed and reconciled claims will be paid using the distribution scheme provided by the law.

In the event the Debtor has in its books and records debts that are not yet due at the time of the filing of the petition, the liquidator can deem those debts as due and order the debtor to pay the same. If the Debtor does not pay, the liquidator can seek litigation to have the claim paid directly by the debtor.

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

**Question 4.1 [maximum 8 marks]**

The bankruptcy liquidator of an Australian company finds that some of the company’s assets are located in Beijing, China. A Chinese creditor has taken legal action in the Beijing Second Intermediate People’s Court, which has issued an injunction freezing the assets of the Australian company in China. The liquidator has approached you for advice on how the Australian bankruptcy proceeding can be recognised in China. Advise the liquidator.

The Australian liquidator needs to move the Chinese Court for recognition of the Australian insolvency judgment and the order of appointment of the Australian liquidator. Recognition of a foreign judgment in China is governed by Art. 5 of the China Enterprise Bankruptcy law of 2006 and Articles 281 and 282 of the China Civil Procedure Law of 2007. The same provide that a foreign judgment must be recognized by a Chinese court before taking affect in China. Recognition requires either the prior existence of a judicial assistance treaty between China and the foreign State (this case Australia) or on the principle of reciprocity, if there is no treaty. Recognition of the foreign judgment needs to be requested in the Court here the assets of the Debtor are located. In this case it is the Beijing Second Intermediate People’s Court (the Beijing Court).

Therefore, the first step is determining if there is a judicial assistance treaty executed and ratified between China and Australia. If there is such treaty, then according to Chinese law the Court must recognize the Australian bankruptcy judgment and the Australian liquidator can seek for relief. If such treaty does not exist, then we must identify if there is reciprocity or a prior recognition of a Chinese judgment in favor of a Chinese party by the Australian courts. If there is no prior precedent of reciprocity, the Australian bankruptcy judgment will most likely not be recognized by the Beijing Court. Unfortunately, upon a lack of a judicial assistance treaty or prior reciprocity Chinese Courts do not favor recognition of a foreign judgment and are fairly strict in the application of this matter.

Australia does not have an executed and ratified treaty with China for judicial assistance. Assuming there is prior reciprocity between the countries, the Australian liquidator needs to prove to the Beijing Court that the Australian judgment is final and conclusive, that it does not violate the fundamental principles of Chines law, sovereignty, security or the public interest. If these conditions are met, the Beijing Court may recognize the Australian bankruptcy judgment. Nevertheless, we must advise the Australian liquidator that this is extremely discretional since the concepts of fundamental principles of Chines law, sovereignty, security or the public interest are not defined and very vague. Furthermore, there is no friendly environment in China for the acceptance of foreign bankruptcy judgments. This makes the recognition process more difficult.

**Question 4.2 [maximum 7 marks]**

Huaxing Microchip Limited is a large high-tech manufacturing company based in Shanghai. In 2019, the company was unable to repay a RMB 23 million loan to the Construction Bank of China (Shanghai Branch) and was petitioned for bankruptcy liquidation by the Bank at the Shanghai First Intermediate People’s Court. Three days after submitting the petition, the Court accepted the liquidation filing and appointed Granter Partners, a local law firm included in the local bankruptcy administrator list, as the liquidation administrator.

Shortly after the commencement of the bankruptcy of Huaxing Microchip Limited, the CEO of Naking Limited, a controlling shareholder holding 32% of the equity of Huaxing Microchip 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 Huaxing Microchip Limited are still viable and that a piecemeal liquidation of the company will not be in the interests of any of the stakeholders. Since Huaxing Microchip 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.

Article 70 of the China Enterprise Bankruptcy Law of 2006 provides that a shareholder that has more than 10% of the company’s equity can move for the conversion of a liquidation to a reorganization process. In this case Naking Limited holds 32% of the Debtor’s equity, so it complies with the condition for standing to request conversion of the liquidation to a reorganization. It must be advised to the CEO of Naking Limited that this process is exceptional and not fairly granted due to the risks and exposures faced by creditors.

Due to the fact that this case was commenced by the Bank, it would be advisable that Naking Limited approach the Bank, prior to making a conversion request in order to see if there is the possibility that the Bank favour the conversion request. This would most probably require some sort of compromise for restructuring of the Debt and a showing to the Bank of the profitability of operations vis a vis liquidation of the company. The Bank’s support is crucial in order to be able to demonstrate to the Court that reorganization, in this specific case is in the best interest of all stakeholders and would allow the continuance of the enterprise as a profitable entity.

**Question 4.2.2 [maximum 3 marks]**

Assuming that the bankruptcy liquidation of Huaxing Microchip Limited is successfully converted to a reorganisation procedure, a reorganisation plan for Huaxing Microchip Limited is eventually voted on by the various stakeholders. Due to the fact that Huaxing Microchip Limited is insolvent, the reorganisation plan *inter alia* proposes that the shares of all previous shareholders be entirely cancelled. Unhappy that its equity in Huaxing Microchip 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 First Intermediate Court for approval.

Advise the CEO of Naking Limited as to whether a cram-down approval by the court is possible, and if applicable, what conditions should be met before the court could hand down a cram-down approval.

Pursuant to Art. 85 of the China Enterprise Bankruptcy Law of 2006, if the plan affects the existing equity of the Debtor, then shareholders need to be classified and given the ability to vote. Let’s assume that in this case the Naking Limited was the only voting creditor under this class and it rejected the Plan. Therefore, for confirmation purposes the Class rejected the plan and it would not be a consensual plan (which requires acceptance by all classes).

If the bankruptcy administrator wishes to have the Court sanction the Plan notwithstanding the rejection of the Equity Class, it would have to request that the Court cramdown the same. Art. 87 allows the cramdown of the plan upon the vote of a rejecting or dissenting class. In order to prevail in a cramdown and have the Court confirm the Plan, the bankruptcy administrator needs to prove the following:

1. That the Plan was voted in favor by the secured class or that the secured class is going to be paid in full.

2. That the employees and tax authority classes have accepted the plan or are going to be paid in full.

3. That unsecured creditors have voted in favor of the Plan or that in the alternative they are to be paid more than what they will receive in a liquidation.

4. That the treatment to the equity holders is fair and equitable, since in this case the Equity class rejected the Plan.

5. That the Plan pays the stakeholders in the same class fairly, with the priority between creditors and shareholders upheld.

6. That the Plan is feasible.

If the bankruptcy administrator is able to prove all of these points and comply with the cramdown provisions of the law, the plan will be confirmed notwithstanding the rejection by the equity holders. According to the facts, all classes voted in favor of the plan except the equity class. Therefore, conditions 1-3 listed above are met. We can also assume that condition 5 is met, since the Plan does not provide for payment of the shareholders and provides payment to all other classes. This leaves only conditions 4 and 6 to be proven.

One way that the plan will not be confirmed is if Naking Limited can prove that the Debtor can pay all creditors in full under the plan and there is no reason for the dilution or wiping of its shares. Naking Limited would also need to agree that it will not receive payment or treatment until all creditors have been paid, so that the absolute priority rule is followed. If these two conditions are met, then this would prove that the treatment provided to the Equity Class is not fair and equitable and frustrate the cramdown of the Plan. Alternatively, Naking Limited can try to prove that the Plan is not feasible as another way of frustrating the cramdown, but these two arguments run contrary and there is insufficient information from the presented facts to support any of them. Therefore, with the setoff facts that have been provided it is likely that the Court confirm the plan through a cramdown under Art. 87.

**\* End of Assessment \***