**Text, logo, company name

Description automatically generated**

**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. Natural 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 Bankruptcy 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?

*Pursuant to Article 7 of the China Enterprise Bankruptcy Law of 2006, if a company is unable to pay its debts as they fall due, a creditor can file for liquidation, in other words, the test for a creditor to petition is the cash-flow test. This is in contrast to the debtor company who may use either a cash-flow or balance sheet test to file a bankruptcy petition.*

**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.

*Law firms and accountancy firms dominate the regional qualified insolvency practitioner lists. Either a firm or an individual can be appointed.*

*Most if not all provincial supreme courts select some large local law or accounting firms in practice to be added to the list without going through any qualificiation exams or training.*

*The power of including a law or accounting firm in the official insolvency practitioner list is generally exercised by the provincial supreme people's courts will always seek collaboration from local law and accountancy associations. These associations are controlled local government justice and finance departments, respectively. Law firms and accountancy firms are usually included on the list due to their size because there is a perception that larger firms will be more competent to take on the matters.*

*The court will appoint someone from the qualified insolvency practitioner list to take over the affairs of the company such that the creditors do not have a say in who should be appointed. However, in theory, creditors may ask the court to replace the administrator where he/she is proven to be incompetent or biased but one would struggle to find examples of this in practice.*

**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.

Fixed charges are *the most widely used form of security in China and can be granted over moveable or immoveable property and can be granted over a debtor's assets or the assets of a third party, provided that party has given its consent.*

*A fixed charge must be registered under the China Civil Code of 2020 to be perfected (in other words, it is not valid until it is registered).*

*Fixed charges are mostly used in relation to immoveable property (buildings, houses and associated land uses), though given land in China is generally owned by the state, the fixed charge would be taken over the right to use the land (essentially a lease) which can be purchased by a private individual. Occasionally, fixed charges will be taken over moveable property such as vehicles or machinery but this is not a regular occurrence. There are different government agencies with which the security has to be registered.*

*The only threat to fixed charges are employee claims as where a debtor company goes into bankruptcy and if its valuable assets are encumbered, secured creditors are usually required to give up some of their security to allow employees to be paid first.*

*Whilst a fixed charge in theory confers a right of sale without the need for court intervention, in reality, a secured creditor would need to initiate litigation proceedings to ask the court to sell the property. Where the debtor company is in a bankruptcy process, the chargee can rely on the appointment holder to honour the security.*

*Pledges are also used in China but much more infrequently than fixed charges. As a matter of principle, the pledge will become valid after the moveable asset changes hands to the secured creditor. For moveable assets, no registration of a pledge is required as the change of physical possession is sufficient. Intangible assets can also be pledged however they must be registered to be valid. Where the pledge has to be registered depends upon the type of asset but suffice to say that they need to be registered with the relevant government agency to be valid.*

**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 (the "CEBL") is, on its face, a rescue-oriented piece of legislation. However, there are practical difficulties with the way the legislation works in practice. For example, the legislation is very court-focussed but often to the detriment of creditors and debtors who are marginalised in the process.*

*When a formal bankruptcy procedure is entered into under the CEBL, it is the court that has the exclusive power to appoint a bankruptcy administrator, in most cases an insolvency practitioner firm. At the time the legislation was drafted, certain scholars suggested that the administrator should be appointed by creditors instead. However, the China People's Congress believed that giving the courts exclusive power to appoint the administrator would promote neutrality. Accordingly, creditors often have little input in who gets appointed as administrator. There is a provision in the CEBL (Article 22) which permits creditors to request the replacement of the court-appointed administrator by way of a resolution passed at a creditors' meeting if the administrator has behaved unlawfully or in a biased manner, this rarely happens in practice. This is largely because the courts control the creditors' meeting and motions for replacing the administrator are not often passed.*

*Pursuant to the CEBL, control of the company's assets and business affairs generally falls to the court-appointed administrator who will realise the assets and distribute the proceeds to creditors. Article 61 provides that the final distribution plan prepared by the administrator needs to be approved by a vote of the creditors at a creditors' meeting. However, Article 65 provides the court with special powers, stating that if the plan was voted down at the creditors' meeting, the court retains final say as to whether it will be implemented. This has caused some commentators to argue that the fact that holding the creditors' meeting appears to be a largely a formality means that creditor protection is undermined by the process.*

*Bankruptcy administrators are selected from a local list of insolvency practitioners and while under the law, on its face, it appears that the administrator is in full control of the process. However, in reality, it is very much a court driven process, with the administrator acting under the authority of the courts and the court making many of the key decisions in the bankruptcy process.*

*These are some of the reasons that the CEBL looks more creditor-friendly than it works in practice.*

**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.

*For creditors to prove their claims, they must contact the reorganisation administrator and are usually required to fill in a claim form provided by the administrator. In many cases, the reorganisation administrator will review the company's books and records and consult with the company's financing staff for verification. In the event of a dispute over the legality or accuracy of the claim, the creditor can litigate before the same court for a judgment, which occurs fairly regularly. For the sake of efficiency, many courts will arrange for an expedited process to resolve these claims.*

**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.

*Article 5 of the China Enterprise Bankruptcy Law of 2006 (the "CEBL") provides that a foreign bankruptcy ruling can be recognised in China if there are assets located in the jurisdiction. The first steps is to determine whether a treaty is in place between China and Australia to determine if the liquidation order can be recognised under that treaty. At the time of writing there is no treaty between Australia and China therefore the Australia liquidation order would need to be recognised on the basis of reciprocity.*

*Recognition of the Australian order would also need to meet some fundamental public policy criteria e.g. that it must not infringe fundamental principles of Chinese law or China's sovereignty, security and public interests and must not disadvantage PRC creditors.*

*The liquidator should apply to the Beijing Second Intermediate People’s Court given the Company's assets are located there and the injunction has been sought in that court.*

*There are some examples of foreign liquidators being recognised in the absence of a treaty – e.g. Germany – but most of the recognition cases have been where there is a treaty in place between China and the requesting country (Italy, France, and Singapore). Where there is no treaty in place, typically the Chinese courts would want to see evidence that the Australian courts have previously granted recognition to a Chinese party.*

*Most Chinese courts are cautious in accepting or entertaining the recognition of foreign bankruptcy proceedings and China does not present a friendly environment for recognition.*

**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.

Given the insolvency procedure was initiated by the bank, the CEO (given that he holds 32% of the equity) may petition the Shanghai First Intermediate People’s Court that the bankruptcy be changed to a reorganisation under Article 70 of China Enterprise Bankruptcy Law of 2006 (the "CEBL"). It is unlikely that Huaxing Microchip Limited would be able to file the petition itself given that Granter Partners has already been appointed as the liquidation administrator and so will likely have reconstituted the board by this stage, such that the outgoing board would have no authority to direct Huaxing Microchip Limited to file the conversion petition.

It should be noted that whilst it is possible under the legislation to convert a liquidation into a reorganisation, it comes with certain difficulties and is rarely used in practice.

**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 Article 87 of the CEBL, the court has the jurisdiction to cram-down a reorganisation plan that has been voted down by one or more class of creditors or shareholders, as has happened here, provided certain criteria are met.

In particular, 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 fair compensation for delayed foreclosure);

1. be voted in favour of by the employees and tax authority classes and, if not, these classes must be paid in full;
2. be voted in favour of by the unsecured creditor class and, if not, the unsecured creditors must not be paid less than they would have received under a hypothetical liquidation procedure;
3. be voted in favour of the shareholders where their equity is effected by the plan and if not, the treatment of the equity holders must be fair and reasonable;
4. pay the stakeholders in the same class fairly, with priority between shareholders and creditors being upheld;
5. be feasible.

In other words, the plan must adhere to the *pari passu* rule between shareholders and creditors in the same class, it must ensure that creditors are paid out in full before any surplus is shared with the shareholders and it feasible / achievable.

**\* End of Assessment \***