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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: **[studentnumber.assessment8B]**. An example would be something along the following lines: 202021IFU-314.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 “studentnumber” 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 2021**. The assessment submission portal will close at **23:00 (11 pm) GMT on 31 July 2021**. 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 **8 pages**.

ANSWER ALL THE QUESTIONS

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

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 (correct)

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?

- (a) Individuals, when in financial difficulty.
- (b) Enterprises having an independent legal status.**
- (c) Enterprises or partnerships.
- (d) State-owned enterprises only.

Question 1.2 (correct)

Select the correct answer:

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

- (a) Reorganisation, scheme of arrangement and liquidation.
- (b) Receivership, settlement and liquidation.
- (c) Liquidation, settlement and company voluntary arrangement.
- (d) Reorganisation, settlement and liquidation.**

Question 1.3 (correct)

Select the correct answer:

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

- (a) The bankruptcy administrator is appointed by the debtor when the company files for bankruptcy in court.
- (b) 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.**

- (c) Both the debtor and creditors may appoint provisional bankruptcy administrators.
- (d) The court can only appoint a bankruptcy administrator after consulting with both the shareholders and the creditors.

Question 1.4 (correct)

Select the correct answer:

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

- (a) Only the debtor may file for bankruptcy.
- (b) Both the debtor and the creditors may file for bankruptcy.**
- (c) Only the shareholders of the debtor company may file for bankruptcy.
- (d) Both creditors and shareholders of the company may file for bankruptcy.

Question 1.5 (correct)

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

- (a) The debtor-in-possession model is categorically not available under the Chinese corporate reorganisation provisions.
- (b) Both debtor-in-possession and administrator-in-possession models are available under the Chinese corporate reorganisation provisions.**
- (c) Once the administrator-in-possession model is chosen, it cannot be converted into the debtor-in-possession model.
- (d) The debtor-in-possession model automatically applies once a reorganisation procedure is commenced.

Question 1.6 (correct)

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

- (a) Both the tax authorities and employees are treated as preferential creditors in China.**
- (b) The preference of tax authorities has been abolished by the China Enterprise Bankruptcy Law of 2006.
- (c) Tax authorities are ranked higher than employees in the priority hierarchy.
- (d) Tax authorities are paid before fixed charge holders.

Question 1.7 (correct)

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**:

- (a) 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.
- (b) A cram-down cannot be exercised by Chinese courts.
- (c) If the shareholders do not support / approve the reorganisation plan, the plan cannot be crammed-down by the court.
- (d) 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 (correct)

Select the correct answer:

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

- (a) 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.
- (b) China strictly applies the principle of territorialism and consequently no foreign bankruptcy proceeding or ruling can be recognised in China.
- (c) China has adopted the UNCITRAL Model Law on Cross-Border Insolvency and all foreign bankruptcy proceedings can be automatically recognised in China.
- (d) China only recognises foreign bankruptcy orders of its largest trading partners, such as the USA and the EU.

Question 1.9 (correct)

Select the correct answer:

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

- (a) 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.
- (b) 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.
- (c) The Chinese bankruptcy ruling can only be recognised in countries that have adopted the UNCITRAL Model Law on Cross-Border Insolvency.
- (d) 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 (correct)

Select the correct answer:

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

(a) The United States of America.

(b) Singapore.

(c) Australia.

(d) The United Kingdom.

QUESTION 2 (direct questions) [10 marks]

Question 2.1 [2 marks] (2 points rewarded)

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 in China, the bankruptcy test that should be met is the cash-flow bankruptcy test. This is provided for under Article 7 of the China Enterprise Bankruptcy Law of 2007 which states that a creditor can file for liquidation in court if a company is unable to pay a debt that is due.

Question 2.2 [maximum 4 marks] (4 points rewarded)

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 Chinese regional bankruptcy administrator lists. It is said that, despite the China Supreme People's Court's instruction that provinces develop their own regional qualified insolvency practitioner lists, in practice the provincial supreme courts create their lists by selecting large law and accounting firms without any qualification process. It is believed that the larger the firm, the more trustworthy it is – but there is no supervision of these insolvency practitioners.

Question 2.3 [maximum 4 marks] (4 points rewarded)

Name the two main types of security available under Chinese law **and** explain how and where they are registered.

The two main types of security available under Chinese law are fixed charges and pledges.

In order to be valid, a fixed charge must be registered under the China Property Law of 2007 with the relevant government agency (which agency will depend on the type of property secured). Once registered, the charge holder is issued a security certificate.

In the case of moveable property, a pledge will become valid upon change of possession into the secured creditor's hands. In the case of intangible property, valid registration is required. For example, pledges over shares in a listed company must be registered with the

China Securities Depository and Clearing Corporation Limited, and pledges over shares in a non-listed company must be registered with the local office of the China Companies House where the company is incorporated.

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

Question 3.1 [maximum 8 marks] (5 points rewarded)

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

Discuss this statement and indicate whether you agree or disagree with it, providing reasons for your answer.

It is said that the China Enterprise Bankruptcy Law of 2006 is a rescue-oriented piece of insolvency legislation, emphasising rescue over liquidation. The writer agrees with the above statement. There are several reasons that support the above statement.

First, the history leading up to the Law supports the claim. Between the triumph of the Communists in the late 1940s and the inception of the China Enterprise Bankruptcy Law of 1986, there was no bankruptcy law in China. As a civil law system, and given that the previous China Bankruptcy Law of 1935 had been abolished, China had no statutory authority relating to the bankruptcy of individuals or businesses. Even in 1986, the then China Enterprise Bankruptcy Law applied only to SOEs, and was implemented to deal with inefficiently run SOEs. That law was seldom used, rather acting as a warning to underperforming SOEs to perform better. The writer submits that the early lack of legal authority in bankruptcy, followed by the lack of enforcement of it when available, fostered a rescue-oriented bankruptcy system that continues today. Where liquidation is unavailable, pragmatism and compromise must prevail.

Secondly, when drafting the China Enterprise Bankruptcy Law of 2006, the Chinese draftsmen were influenced most by the bankruptcy laws of the USA and, in particular, Chapter 11 of the Bankruptcy Code 1978 which deals with reorganisation of a debtor's affairs.

Thirdly, two of the three substantial bankruptcy options available under the China Enterprise Bankruptcy Law of 2006 are rescue options rather than salvage options. Both reorganisation and settlement are aimed at preserving the debtor as an ongoing enterprise.

Fourthly, reorganisation and settlement occupy chapters 8 and 9 of the China Enterprise Bankruptcy Law of 2006, whereas liquidation is dealt with in chapter 10. It is said that this **order** reflects the lawmakers' intention that rescue be attempted before liquidation.

Fifthly, Article 70 of the China Enterprise Bankruptcy Law of 2006 promotes rescue over liquidation by providing that in the event of a creditor petitioned liquidation, the debtor or its shareholders (holding 10% or more of the equity) may apply to the court for a **conversion** from liquidation (chapter 10) to a reorganisation (chapter 8).

Sixthly, a debtor need not prove that it is bankrupt in order to file for voluntary reorganisation, incentivising rescue at an **early** stage.

To the contrary, there is no provision for informal creditor workouts in China. This does not mean that a creditor workout cannot be achieved by contract, but unanimous consent would be required.

Overall then, the China Enterprise Bankruptcy Law of 2006 is very clearly a rescue-oriented piece of insolvency legislation.

(DIP, cramdown could be mentioned)

Question 3.2 [maximum 7 marks] (7 points rewarded)

Briefly explain the process for the proof of claims in a reorganisation procedure and the procedure that is followed should the value or legality of a creditor's claim be disputed.

In a reorganisation procedure, a creditor must prove their claim to the reorganisation administrator. The administrator will usually provide the creditor a claim form for the creditor to complete. The administrator will then reconcile the completed claim form against the company's records and consult with the company's financial staff in order to verify the validity of the creditor's claim. Where a creditor is unhappy with the outcome of the reorganisation administrator's review, they may seek a judgment in relation to their claim from the same court that opened the reorganisation proceeding. For this purpose, many courts arrange a fast-track system to resolve such disputes.

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

Question 4.1 [maximum 8 marks] (8 points rewarded)

The bankruptcy liquidator of an Australian 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 Australian company in Shanghai. The liquidator has approached you for advice on how the Australian bankruptcy proceeding can be recognised in China. Advise the liquidator.

China has not implemented the UNCITRAL Model Law on Cross-Border Insolvency and is unlikely to do so in the foreseeable future. However, it is clear that the draftsmen of the China Enterprise Bankruptcy Law 2006 were influenced by the Model Law because the CEBL adopts some of the Model Law principles. For example, Article 5, provides that a foreign court bankruptcy ruling (such as the Australian liquidation proceeding) also binds the company's assets located in China. This is a promising start for the liquidator.

However, Article 5 also states that the foreign ruling must be recognised by a Chinese court before taking effect. In practice, 'recognition' requires either that the foreign country have a judicial assistance treaty with China, or that the foreign country previously have a recognition precedent in favour of a Chinese party. Australia does not have a judicial assistance treaty with China. Of the countries that do, only a handful have had success in having proceedings recognised in China.

Nevertheless, the liquidator may apply to a Chinese local intermediate people's court where the company's assets are located under Article 281 of the China Civil Procedure Law of 2007. Article 282 then requires either the judicial assistance treaty or that reciprocity between the two jurisdictions has been established.

Moreover, Article 82 stipulates that the Court may reject the recognition application if the foreign judgment violates the fundamental principles of Chinese law, sovereignty, security or the public interest. Given that these matters are not defined, it is not clear what they might mean. Accordingly, it is possible that the court will consider that recognising the Australian liquidation proceeding would be a violation of China's sovereignty, particularly given that a domestic creditor has already obtained a freezing order against the assets which the liquidator seeks to realise.

The liquidator should be advised that their claim against the company's assets located in Shanghai faces significant challenges and is unlikely to succeed.

Question 4.2 [maximum 7 marks]

Yangtze Steel Limited is a large steel manufacturing 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 Jingchen Partners, a local law firm included in the local bankruptcy administrator list, as the liquidation administrator.

Shortly after the commencement of the bankruptcy of Yangtze Steel Limited, the CEO of SanLong Limited, a controlling shareholder holding 32% of the equity of Yangtze Steel Limited, approaches you for advice.

Using the facts above, answer the questions that follow.

Question 4.2.1 [maximum 4 marks] (4 points rewarded)

The CEO of SanLong Limited tells you that the various businesses of Yangtze Steel Limited are still viable and that a piecemeal liquidation of the company will not be in the interests of any of the stakeholders. Since Yangtze Steel 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 that SanLong Limited is a shareholder holding more than 10% of Yangtze Steel Limited's equity, SanLong Limited has standing under Article 70 of the China Enterprise Bankruptcy Law of 2006 to apply to the court for a conversion of the liquidation into a reorganisation.

However, the court's power to convert liquidations into reorganisations is rarely used in China. It will be difficult to show that conversion is justified particularly in the case of a shareholder seeking that relief against the wishes of creditors. It is said that the court should consider the interests of creditors over those of shareholders in such situations. It is also said that local government support is necessary for such applications to succeed.

SanLong Limited can apply for a conversion. Its chances of success would be improved if it can gain creditor support by showing that reorganisation will result in an improvement of their position in relation to Yangtze.

Question 4.2.2 [maximum 3 marks] (2 points rewarded)

Assuming that the bankruptcy liquidation of Yangtze Steel Limited is successfully converted to a reorganisation procedure, a reorganisation plan for Yangtze Steel Limited is eventually voted on by the various stakeholders. Due to the fact that Yangtze Steel Limited is insolvent, the reorganisation plan *inter alia* proposes that the shares of all previous shareholders be cancelled. Unhappy that its equity in Yangtze Steel Limited will be wiped out by the reorganisation plan, SanLong 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 SanLong 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 cram-down a reorganisation that has been voted down by one or more classes or creditor (or by the shareholders). In this way, it is possible for the reorganisation administrator to seek the court's approval to the reorganisation plan being implemented in spite of SanLong voting against it.

However, such an application would need to comply with Article 87 which provides *inter alia* that the reorganisation plan must 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.

SanLong voted against the plan because their equity position would be significantly adversely affected by it. Given that SanLong's interest in the company would be reduced to zero if the plan were implemented, it is difficult to see how the court would consider cramming them down to be 'fair and equitable'.

The CEO of SanLong Limited should be advised that the court is unlikely to approve a cram-down.

(It is equitable for the court to do so because of the company's insolvency)

46 out of 50 points rewarded

*** End of Assessment ***