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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?

Answer

In cases in which a bankruptcy petition is filed by a creditor in China the test that should be met is that the creditor is unable to pay its debt. A cash flow bankruptcy test is therefore applicable when the petition is filed by the creditor. The company is given seven days in such cases to raise an objection. Whether or not the liquidation procedure is formally open is at the discretion of the court which in practice is difficult to achieve.

**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.

Answer

The two professions that dominate Chinese regional bankruptcy administrator's list in China are (i) Law and (ii) Accountancy.

Most of the provinces in China have their own regional qualified insolvency practitioner list. In practice, regional qualified insolvency practitioners are appointed mainly from law and accountancy firms by the provincial supreme courts with collaboration from the legal and accountancy associations without the requirement of going through any qualification exams or training courses. Such an appointment is very sought after and it is the large firms that are selected as the provincial courts assume that the larger firms are more trustworthy in terms of competency and financial strength. Insolvency practice is largely dominated by law firms in China. In practice this system is hardly regulated and complainants usually have to resort to making complaints to the professional body concerned. Liquidation firms do not currently have such a professional body that complaints can be lodged with.

**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.

Answer

The two main types of security in China are:

(a) Charges – Mainly fixed charges are used, although floating charges are also recognised they are hardly ever used.

The registration process for fixed charges is by the recording of the charge at the government agency upon the payment of a fee. Following this, a security certificate is issued to the charge holder. For immovable property, such registration should be done at the China Housing Management Authority. In practice, most such security holders also register the charge at the local office of the China Land Management Authority for safety reasons as the right to use the land upon which the building stands is part of the property.

(b) Pledges – Registration is not required when pledges are taken over moveable assets.

Such pledges become valid once they are in the possession of the secured creditor. Intangible assets over which pledges are taken, have to be registered. The registration authority varies and the process can be complex. In the case of trademark, the registration authority is the China Industries and Commerce Regulation Bureau's Central Office in Beijing. For patents, it is the China Intellectual Property Authority Central Office in Beijing. Shares in listed companies are registered at the China Securities Depository and Clearing Corporation Limited. This entity has offices in Beijing, Shanghai, Shenzhen and Hong Kong. For non-listed shares the registration is done at 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.

Answer

The China Enterprise Bankruptcy Law of 2006 (the “Act”) is the main legislation governing bankruptcy in China. Some have hailed it to be a “rescue-orientated piece of insolvency legislation, emphasising rescue over liquidation”. There are a number of reasons that support the above statement and for this reason I am inclined to agree with the above statement.

Firstly, under the Laws of China liquidation is not the only option available to failing companies. In fact, there are three types of bankruptcy options available under the Act. The first is reorganisation which a company can use if bankrupt. The company can file for voluntary reorganisation without the need to show evidence of bankruptcy. Under Article 2 of the Act, a company that is likely to become bankrupt in the near future can apply for voluntary reorganisation to the court. There is no need for such voluntary reorganisation to pass any bankruptcy test. The exclusion of the need to pass any such test supports the view that the Act is a rescue-oriented legislation seeking rescue over liquidation.

The second option is that of composition/settlement. This is also a rescue procedure. This procedure is only available for voluntary filing by the debtor and is covered by Article 95 of the Act. Under this Article the company filing for composition must present composition plan to

the court. This is followed by a voting of all creditors on the plan if the court is satisfied with the plan. For the plan to get passed if voted for by half or more of the creditors present at the meeting holding two-thirds or more of the total claim. It should be noted that the Act devotes two chapters to corporate rescue this shows that the system places considerable emphasis on corporate rescue as opposed to liquidation.

The third option is that of liquidation, which is covered in chapter 10, it should be noted that this follows chapter 8 and 9 that deals with reorganisation and composition. In my opinion the fact that two chapters as opposed to one is dedicated to reorganisation supports the statement that is the focus of this essay and the view that reorganisation should be attempted first and liquidation is must be used as a measure of last resort. Even where liquidation is used in the case of involuntary liquidation the debtor/company is given the opportunity to raise an objection within 7 days. It should be noted that the ultimate decision as to whether the liquidator proceedings should be open lies with the court.

For the above reasons I take the view that rescue is more favoured to liquidation in China. I would however also like to stress that the system is far from perfect and has its defects such as the considerable power that is given to the courts. Under the composition procedure, the final approval of any such scheme lies with the court. I would like to suggest that once a composition has been voted by the creditors then it should be final and the need for the court's approval should be removed. Equally is the case of whether to open liquidation formally. In practice the courts can choose to ignore any of the above applications by choosing to ignore such petitions without giving any reason. The fact that debtor in possession proceedings are not automatic but have to be applied for is another setback to the effectiveness of the system.

In conclusion, the Act at least for its intent and purposes favours rescue to liquidation. It would be great if it is reformed to ensure to provide more clarity in this area of law to ensure that all the benefits of a rescue orientated insolvency system is experienced in China.

(Conversion to rescue, DIP and 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.

Answer

The process for the proof of claims in a reorganisation procedure is as follows:

The creditors have an obligation to prove their claims and they must approach the reorganisation administrator. They are then required to complete the claims application form that is provided by the administrator.

It is then common practice for the reorganisation administrator to check the company's books, consult with members of the company's financial division staff to verify any such creditors claim.

In cases in which the legality or value of the creditor's claim is disputed, there is a system in place for such matter to be litigated in the same court that the reorganisation is dealt with and possible obtain a judgement. This is very common. Most courts have an expedited system in place for dealing with such litigation by creditors in the interest of efficiency.

**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.

Answer

The Chinese Enterprise Bankruptcy Law of 2006 deals with how a foreign bankruptcy proceeding such as the one in this case in Australia can be recognised in China (Shanghai) where we have been advised the Australia company owns assets. Article 5 of the China Enterprise Bankruptcy Law provides for the recognition of a foreign bankruptcy order in China if some of the assets are located in China.

There are two grounds on which the liquidator can possibly seek recognition of the Australia bankruptcy proceedings. One of the above grounds is in cases in which there is a judicial assistance treaty between China and the other country in which bankruptcy proceedings are taking place. Such a judicial assistance treaty should be over civil and commercial matters. From the facts we have been given the case in question is a commercial matter. Such a treaty being in place is crucial for the recognition of such proceedings. Unfortunately, Australia is not amongst the countries that have a judicial assistance treaty with China. The liquidator will therefore not be able to successfully have the Australian bankruptcy proceedings recognised in China under this first ground.

The second ground under which the liquidator can seek to have the bankruptcy proceedings recognised in China is if the liquidator is able to prove that there is judicial reciprocity between China and Australia. To succeed on this ground Australia must already had a successful recognition precedent in favour of a Chinese party. It is very important that Australia should have taken the first step in recognising the interest of a Chinese party. Commentators have suggested that it would be in China's interest for it to unilaterally implement the establishment of reciprocity to facilitate judicial co-operation in this area. However this is not the current position.

There are a number of precedents in which foreign bankruptcy proceedings have been recognised under the second heading such as the recognition of a bankruptcy ruling by the Italian court in Milan by the Foshan Intermediate People's Court I Guangdong Province. This decision has been seen to have been motivated by China's eagerness to demonstrate its open mindedness to its WTO partners prior to its accession to the WTO. There are similar precedents in relation to France and Germany. There isn't one in favour of Australia. The liquidator is unlikely to succeed on any of the above grounds. China does not have a friendly environment that readily accepts foreign bankruptcy rulings/proceedings.

#### **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.

Answer

It is possible to convert a liquidation procedure to that of a reorganisation procedure under the China Enterprise bankruptcy Law of 2006. Yangtze Steel Limited can apply can file for reorganisation in the court, it does not have to pass the bankruptcy test to successfully do so. We have been advised that the Bank of China has already petitioned for bankruptcy liquidation at the Shanghai Second Intermediate People's Court. As a shareholder holding more than 10% of Yangtze Steel Limited's equity, SanLong, a 32% equity holder, can petition the court to have the liquidation procedure changed to that of reorganisation. If approved by the court then the liquidation will be changed to reorganisation.

In short, SanLong as a shareholder with more than 10% equity in Yangtze Steel Limited should apply by petition to the court for a conversion from liquidation to reorganisation.

**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.

Answer

In the above case, the question is whether the reorganisation plan that has been voted down by the shareholders but approved by the creditors be approved by the Shanghai Second Intermediate Court upon submission by the reorganisation administrator. The approval of such a plan by the creditors is necessary for the plan to be implemented. Article 85 of the China Enterprise Bankruptcy Law 2006 gives shareholders the right to vote in cases as is the case in this scenario in which the reorganisation plan seeks to adjust the company's equity by cancellation of shares.

The approval by the court of the reorganisation plan is very important even though the creditors vote and if applicable the shareholders vote have been obtained. For the reorganisation plan to have any effect it must be confirmed by the court. Article 87 empowers the court to cram-down any such plan that has been voted down by the creditors or shareholders as is the case here i.e. the plan has been voted down by the shareholder.

**(cramdown conditions should have been mentioned)**

46 out of 50 points rewarded

**\* End of Assessment \***