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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] (1 point rewarded)

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

The creditor need only rely on a "cash-flow bankruptcy test" which means that the debtor must be proven commercially insolvency (thus "unable to pay a debt that is due") [Guidance Text par 4.1.3.3. page 7]. This differs from the tests available to debtors as an additional option is available to debtors – not only the "cash-flow" test but also the "balance-sheet" test (the latter is in effect actual insolvency where assets no longer exceed liabilities) [Ibid]. Creditors need not prove actual insolvency as proof of commercial insolvency is sufficient where a creditor seeks to liquidate a debtor [Ibid]. **Cash flow means that the debtor is unable to pay the 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.

The legal and accounting professions dominate the lists [Guidance Text par 4.3. pages 11 – 12]. Eligibility for appointment as administrator is dependent on being listed [Ibid]. In practice, the approach followed by the provincial supreme courts is to defer to sizable businesses located within its area, thus to "simply select some local large law and accounting firms" without having recourse to vocational training requirements [Guidance Text par 4.3. page 11]. The determining factors for inclusion are locality, size, the field of speciality (law, accounting or so-called "liquidating firms"), and the input/assistance received from "local lawyer and accounting associations" [Guidance Text par 4.3. page 12]. Administrators are appointed by the courts – who have "the exclusive power to appoint a bankruptcy administrator" [Guidance Text par 6.1. page 16] – and elected for appointment from these lists [Guidance Text par 4.3. page 12].

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.

Security interests are available in respect of movable and immovable property [Guidance Text par 5 pages 13 – 15]. The types of security available are fixed charges, pledges and liens

although the latter is not a popular form of security (even less than pledges), hence the balance of the discussion will deal with the fixed charge and pledge [Guidance Text par 5 page 13 – 15 (specifically paras 5.2 and 5.3 page 15). See also page 44: “Liens are more or less commercially irrelevant in China”].

The legitimacy of a fixed charge over immovable property is dependent on registration as per the China Property Law of 2007 [Guidance Text par 5.1. page 13]. Provision is made for two registration authorities: the one dealing with the building and the second for rights pertaining to the utilisation of the land and non-state owned property do not feature in China [Ibid; Guidance Text par 5.1. page 14]. Registration of the former is the responsibility of the “China Housing Management Authority” and, in respect of the latter, the responsibility lies with the “China Land Management Authority” [Ibid]. Registration is also a requirement for fixed charges over movable property, and the registration authority depends on the nature of the movable asset that is the object of the security [Ibid]. The process of registration entails 1) payment of the prescribed fee (if applicable); 2) documenting (“recording”) the charge at the local office of the responsible authority; and 3) receipt of a “security certificate” [Guidance Text par 5.1. page 13]. The person responsible for taking the steps to register the charge is the charge holder (the creditor) [Ibid].

The second form of security is the pledge (not popular in practice) and I will only focus on pledges related to intangible movable property (as pledges are only applicable to movable assets and pledges related to tangible property do not require formal registration in order to be recognised as such) [Guidance Text par 5.2. page 15]. Security over incorporeal movable property in the form of a pledge should also be registered with the relevant responsible authority and the jurisdiction of the authority is dependent on the nature of the asset – for example, pledges over trademarks should be registered with the “China Intellectual Property Authority” [Ibid].

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

Question 3.1 [maximum 8 marks] (6 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.

The China Enterprise Bankruptcy Law is deemed to be “rescue-oriented” [Guidance Text par 4.1.2 page 6]. The main rationale seems to be the options offered to debtors to enable rescue. It provides for a restructuring process that is closely aligned with chapter 11 of the US Bankruptcy Code, and facilitates access to the procedure by not requiring proof of insolvency [Guidance Text par 4.1.3.1 page 6]. The value of this process lies in its application to debtors who are “likely to become bankrupt in the near future” [Ibid]. In this manner, the aim is “to encourage rescue efforts to be made at as early a stage as possible” [Guidance Text par 6.5.2 page 27]. In addition, the scope of applicants with locus standi to approach the court for a restructuring order is extended to include creditors, as well as the debtor [Guidance Text par 4.1.3.2 page 7]. It does seem as if the legislation prefers that debtors initiate rescue proceedings because the standard of proof for debtors wanting to enter restructuring is lower (the debtor does not have to show that it is already insolvent whereas a creditor as applicant will have to provide evidence of actual or commercial insolvency [Guidance Text par 6.5.2 page 27]. In addition, the Law allows the transfer from liquidation to restructuring on application of the debtor or its shareholders [Guidance Text par 6.5.2 page 27].

The Law also provides for a process of “composition or settlement” initiated by the debtor and where a plan to this effect must be drafted and approved by the court [Guidance Text par 4.1.3.2 page 7]. Unfortunately, the facts that only unsecured creditors are affected by a composition detracts from its potential for success [Guidance Text par 4.1.3.2 page 7].

The involvement of the court – particularly insofar as the court is able to compel the implementation of a rescue plan under section 87 (which functions in the context of the restructuring process referred to as option 1 above) [Guidance Text par 4.1.3.1 page 7] seems like a confirmation of the rescue-orientated nature of the legislation. In fact, it allows the courts to “force” rescue on stakeholders: for example, in respect of the compromise/settlement, the appropriateness of the proposal is first decided upon by the court – where after the creditors decide on its suitability [Guidance Text par 4.1.3.2 page 7]. In reality though, this is only indicative of “the intent of Chinese lawmakers to promote the use of corporate rescue” [Guidance Text par 4.1.3.2 page 7].

The discretion awarded to the courts counteracts this aim [Guidance Text par 4.1.3.1 page 6]. It has been noted that courts demand evidence that counters the provisions of the Act, such as demanding proof of insolvency of the debtor from applicants prior to allowing an order for restructuring of the entity [Guidance Text par 6.5.2 page 27]. In this manner, some courts have created a “threshold for entering the corporate reorganisation procedure” for the debtor, that does not exist in the legislation [Ibid]. On the other hand, I am of the opinion that the approach by some courts to “demand that the filing party must convince that the reorganisation proposal is very likely to be achieved” correlates with the aim to encourage viable restructurings [Ibid]. In addition, “[i]t is worth emphasising that local government support is critical before any bankruptcy reorganisation filings will be seriously considered by courts” [Ibid]. Lastly, the limited scope of application of the China Enterprise Bankruptcy Act weakens its rescue effect – it does not apply to one man businesses and partnerships [Guidance Text par 6.5.1 page 26].

In conclusion, although the objective of the Act is to encourage and facilitate the rescue of companies in financial distress, the reality is that the implementation of the law does not achieve the same outcomes.

(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.

The insolvency practitioner involved in administering the insolvent estate is appraised of the claims of various creditors when the latter prove their claims in accordance with the provisions of the China Enterprise Bankruptcy Act [Guidance Text par 6.5.7. page 30]. The first step is for the creditor to obtain the “claim form” from the practitioner upon request [Ibid]. The second step is to complete the form (logically setting out the claim and providing evidence to this effect) and submit it to the practitioner [Ibid]. The third step is where the creditor’s claim is then authenticated and confirmed (or not) by the practitioner, who reviews the corporation’s financial records and confers with the accounting department to effect same [Ibid]. This is one of the primary functions of the insolvency practitioner – the “verif[ication] of claims” [Guidance Text par 6.5.5. page 29]

As indicated above, during the investigations conducted by the practitioner, he may find that the claim itself is not legitimate or that the amount claimed is incorrect [Ibid]. The onus then falls on the creditor to obtain a judgment establishing the claim and amount [Ibid]. The court with jurisdiction over the bankruptcy proceedings will have jurisdiction to hear the creditor’s case regarding its claim against the corporation [Guidance Text par 6.5.7. page 30]. As the matter is related to an insolvent administration in progress, concerns of efficacy may dictate that measures be implemented “for an expedited process to resolve these law suits” [Ibid].

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.

The recognition of the Australian order by a Chinese court is necessary for article 5 of the China Enterprise Bankruptcy Act to become applicable [Guidance Text par 7 page 35]. If this article becomes applicable, it would mean that the assets in Shanghai would be subjected to the Australian procedure (via the Australian order) [Ibid]. In addition, there is precedent in China that the recognition is needed in order to legitimise a foreign liquidator's actions in disposing of the property of a debtor located in China [Ibid]. In order to recognise foreign proceedings in China, the following requirements are needed:

1. A ground for recognition: "[A] judicial assistance treaty" needs to have been signed between Australia and China; or "the principle of reciprocity" in the absence of a treaty [Ibid]. The treaty needs to relate to "civil" or "commercial" affairs [Guidance Text page 48]. It does not seem as if the former exists [Guidance Text par 7 page 35], and thus reciprocity becomes applicable. The requirement is thus that Australia must have recognised a Chinese order that assisted a Chinese delegate (more specifically: "a prior favourable recognition in the interest of a Chinese party) [Ibid]. It does not seem as if an order to this effect has been granted by an Australian court [Ibid]. On this basis alone, the prospects of successful recognition is slim, unless such a recognition is politically motivated (as was the case with the WTO and Milan – see Guidance Text par 7 page 35).
2. Approaching the correct court: The Chinese local intermediate people's court in the jurisdiction where the assets are located (thus the court for the relevant area of Shanghai) [Ibid].
3. No restrictions: "[T]he recognition of a foreign court bankruptcy ruling should not infringe upon the fundamental principles of Chinese law, China's sovereignty, security and public interests and does not disadvantage China's domestic creditors" [Ibid]. In this regard, the fact that a Chinese creditor has taken steps to enforce a debt, must be taken into account and may negatively affect the success of an application for recognition in a Chinese court. In addition, it seems as if Chinese courts are of the opinion that the recognition of a foreign court's ruling will "weaken Chinese judicial sovereignty" [Ibid]. In addition, "most Chinese courts are considerably cautious in accepting or entertaining foreign bankruptcy recognition applications and China has not yet created a friendly environment for foreign bankruptcy rulings to be accepted" [Guidance Text par 7 page 36].

Overall, recognition is challenging in the absence of either a treaty or a past show of reciprocity initiated by the foreign jurisdiction whose proceedings are sought to be recognised in China [Guidance Text par 7 page 35 and page 48].

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.

As Yangtze Steel Limited (“YSL”) was subjected to the liquidation process because its creditor (the Bank of China) successfully applied to the court for its liquidation [Guidance Text par 4.1.3.3 page 7]. This would constitute a so-called “involuntary liquidation procedure” and the provisions of section 70 of the China Enterprise Bankruptcy Law would become applicable [Guidance Text paras 6.3.2 and 6.5.2 pages 20 and 27]. This provision allows “the debtor or its shareholders holding 10% or more of the company’s equity [to] apply to court for a conversion from liquidation to reorganisation” [Ibid]. There are thus two options available in respect of which locus standi for a conversion order could be obtained (the second option seems more viable in light of the facts): first, the debtor could be convinced to put the request to the court (although the displacement of the management team by the practitioner would probably require the involvement of the latter – see Guidance Text 6.3.2 page 20); second, SanLong (as a shareholder holding in excess of 10% of the shares in the debtor company YSL) has the authority, in terms of section 70, to petition the court for a conversion. If the application to court is successful, the order would transform the liquidation proceedings into restructuring proceedings (meaning that “the reorganisation procedure will commence immediately thereafter” [Guidance Text par 6.5.2 pages 27 and 46]. As such, a transition is possible but court approval is needed [Guidance Text par 6.3.2 page 20]. In addition, one would assume that the applicant(s) would need to make out a case for reorganisation and it has been observed (albeit in the context of direct applications for restructuring) that “[i]n practice, there are courts that demand that the filing party must convince that the reorganisation proposal is very likely to be achieved” together with a number of other requirements such as creditor approval [Guidance Text par 6.5.2 pages 27]. In addition, the real occurrence of conversions are low in China [Ibid].

Question 4.2.2 [maximum 3 marks] (3 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.

Shareholders must be given the opportunity to vote on a plan that impacts their shareholding in any manner [Guidance Text par 6.5.8 page 30]. However, irrespective of the outcome of their vote (whether in favour or not), once the plan is deemed approved (as is the case here where the classes of creditors eligible to vote) by 50% of creditors partaking in the vote and in respect of all of the classes of creditors, it is referred to court [Ibid]. The court has the authority under section 87 to force the acceptance of the plan onto the shareholders via a so-called

“cram-down” [Ibid]. On face value, it thus seems as if the court may approve the plan under current law and notwithstanding that the plan has been voted down by the shareholders as per the facts stated above. However, for section 87 to apply and for the court to have this cram-down authority, the plan must comply with a number of requirements (I am only going to deal with the requirements pertaining to the shareholders as the creditors approved the plan) [Guidance Text par 6.5.8 page 31]. If shareholders did not approve a plan that concerns their equity, “the treatment of equity holders [must be] fair and equitable” and the “priority between shareholders and creditors” must be recognised [Ibid]. As shareholders have no right to benefit prior to the consideration of the interests of creditors (the “absolute priority principle”), it is difficult to argue that shareholders should not be forced to accept a plan that the creditors find acceptable [Ibid]. If the court is of the opinion that the plan is viable, and all creditor classes accepted it [Ibid], I would argue that the court should be able to approve the plan.

Bibliography: INSOL International *Module 8B Guidance Text China (PRC) 2020/2021* INSOL International: London (“Guidance Text”)

47 out of 50 points rewarded

*** End of Assessment ***