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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] (9 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

Select the correct answer: (incorrect)

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?

'Under Article 7 of the China Enterprise Bankruptcy Law of 2006, if a company is unable to pay a debt that is due, the creditor can file for liquidation in court. based on this, for creditors a cash flow bankruptcy test is used before the court will accept a liquidation petition.

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.

Two professions that dominate as regional bankruptcy administrators or insolvency professionals are qualified law firms and qualified accounting firms. In 2017 to facilitate the implementation of the China Bankruptcy Law of 2006, the China Supreme People's Court instructed the establishment of regional qualified insolvency practitioner lists. Local / provincial courts seek the collaborations of local lawyer or accounting firms which are controlled by the local government justice and finance departments to create these lists or dominant firms in the region form part of the lists. Courts simply select some large law and accounting firms to be included in lists without any qualification exams. The absence of any qualifying criteria has also led parties to seek remedies for holding insolvency practitioners accountable for any alleged breaches. Amongst the two professions, law firms dominate insolvency practitioner lists. Currently there are no government agencies regulating insolvency practitioners in China.

Question 2.3 [maximum 4 marks] (3 points rewarded)

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

China Property Law of 2007 recognises three forms of security: fixed charges, pledges and liens.

A fixed charge is the most widely used form of security. Floating charges are used infrequently. In most cases a charge can be created over both movable and immovable property in favour of a secured creditor (usually a bank). A charge can be created over the debtors assets or even over the assets of a third party with advance consent.

A charge must be registered under the China Property Law of 2007 and is not valid until it has been registered. A security certificate is issued to the charge holder once the charge has been recorded by the relevant government agency. A small fee may apply for the registration of a charge. For immovable property the registration authority is the China Housing Management Authority and secured creditors simultaneously register the charge at the local office of the China Land Management Authority. While most fixed charges are created over immovable property, some movable property charges may also be created such as for vehicles with the China Industries and Commerce Regulation Bureau relevant office.

The second type of security are pledges which are valid only after the movable asset changes possession into the hands of the secured creditor. For movable assets, no registration of a pledge is required as the change of physical possession itself (delivery) is sufficient. Pledges can be created on intangible assets such as trademarks, patents, shares, cheques and bonds. Registration of pledges is complex and is based on the type – the relevant authority is accordingly different. For instance, for shares of listed companies, the China Securities Depositor and Clearing Corporate Limited is the relevant authority. For non listed companies it would be the local office of the China Companies House,

(lien is not the major type of securities in China)

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 of 2006 (CEBL) is structured as reorganisation, settlement and liquidation. The law maker intent based on the drafting of the legislation is to promote rescue with liquidation as the last option. With elements borrowed largely from the US Chapter 11 procedure, when a company is bankrupt, it can trigger a corporate reorganisation procedure where a voluntary filing can be made which does not need to pass any bankruptcy tests of balance sheet or cash flow. The debtor-in-possession structure is a part of this process, however, it is not automatic. The court appointment administrator will take control of the companies assets and business affairs and court sanction is needed to switch to debtor manager. The reorganisation plan is to be voted in favour by 50% or more attending creditors in number, representing two-thirds or more of attending creditors in value of each class. These classes include secured creditors, employees, tax/ revenue authorities

and ordinary unsecured creditors. The reorganisation process also includes a cramdown provision where the court may forcibly approve a plan which has failed to win the vote of all four classes of creditors but meets certain statutory conditions.

The second option of composition or settlement can be filed by both the company and the creditor on a voluntary basis only. However, the statute is very vague on the aspects of what a composition / settlement plan contains. The only specificity is that it must be passed by the court and voted in favour by a certain threshold of creditors. Moreover, secured creditors are not bound by this plan, thus the efforts of a composition are unlikely to succeed.

CEBL has had implementation hurdles and a vast majority of bankruptcy companies continues to exist in the market in an unlawful manner that jeopardises the interests of creditors. Despite the corporate rescue idea first, liquidation with formal government intervention is comparatively the most used option. Under the previous regime implemented in 1986, the law did not provide fair protection of creditors and formal bankruptcy was the process that was prevalent. The new regime applies to state owned enterprises and private companies. The new law is creditor friendly drafting and rescue oriented but has allowed for excessive judicial authority to courts with no specific limits on adjudication.

(early rescue, rescue conversion from liquidation should also 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.

For creditors to prove their claims, they must approach the reorganisation administrator and will usually be required to fill in a claim form provided by the administrator. In many cases the reorganisation administrator will check the company's books and consult with the staff from the company's financing unit for verification. In the event of a dispute over the legality or the accuracy of the claim, the creditor can litigate before the same court for a judgment, something that occurs regularly in practice. For the sake of efficiency, many courts arrange for an expedited process to resolve these law suits. (refer to guidance text p. 30)

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

Question 4.1 [maximum 8 marks] (7 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.

Under Article 5 of the China Enterprise Bankruptcy Law of 2006, a foreign bankruptcy ruling can be recognised in China if some assets are located there. To seek recognition, the foreign bankruptcy representative must check whether there is a judicial assistance treaty between China and that foreign country over civil and commercial matters. Having a treaty is essential for a foreign bankruptcy ruling to be recognised in China. At present, there are around thirty countries having such treaties with China. If there is no treaty, it is still possible to seek recognition and the foreign bankruptcy representative needs to prove that there is judicial reciprocity between China and that foreign country. At present, there are only around thirty countries having such treaties with China and unfortunately China does not have such treaty with its two biggest trading partners – USA and Japan. The liquidator will have to take stock of whether the judicial treaty exists in the present case. If there is no treaty, then the local liquidator with the foreign bankruptcy representative must convince the Chinese court

that there is judicial reciprocity established between China and the foreign country. The Chinese understanding of reciprocity is very restrictive, reciprocity is not established until and unless there is already a Chinese judgment recognised by that foreign country before. In other words, reciprocity is very narrowly interpreted in China, which makes the recognition of foreign bankruptcy rulings more difficult. Without the existence of a treaty or reciprocity, it is very unlikely that a foreign judgment will be recognised in China and the applicant will have no option but to imitate new litigation in China.

(Reciprocity exists between these two jurisdictions)

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.

In this case of an involuntary liquidation procedure filed by the Bank of China against Yangtze Steel Limited, the CEO holding 32% equity can petition the court for reorganisation. Upon the approval by the court, liquidation will be changed to reorganisation which is permitted by the law. In the present instance, the focus on revival and rescue can be made and the CEO must all take stock of other stakeholders and their preference towards liquidation vs rescue. The CEO must be mindful that conversions rarely happen.

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.

Under Article 87 the court may cram down a reorganisation plan that has been voted down by one or more class of creditors or by shareholders. Unlike a reorganisation plan that has been successfully voted on all classes of stakeholders and is generally assessed by a court on procedural legality, a reorganisation plan seeking a cramdown must:

- (i) Be voted in favour of by the secured creditor class and if not secured creditors must be fully paid out of the secured assets
- (ii) Be voted in favour of by the employee and tax authority classes and if not then these two classes must be paid in full
- (iii) 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
- (iv) pays the stakeholder in the same class fairly with the priority between shareholders and creditors upheld and
- (v) be feasible

the feasibility test requires the plan to be achievable and the court may confirm such a plan making it legally point on all consenting dissenting shareholders. Statistically, the courts have used cramdown in a relative number cases over the objections of creditors and in some cases shareholders.

45 out of 50 points rewarded

*** End of Assessment ***