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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 (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 (it is d)**

**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] (0 points rewarded)**

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

Legally speaking, pursuant to Article 7 of the China Enterprise Bankruptcy Law of 2006 ("the Law"), the creditor who files for bankruptcy against the debtor has to satisfy the cash-flow or balance sheet test to the Court that the debtor is unable to pay a debt that is due.

With the support from the local government, the bankruptcy application would have higher chance to be initiated under Article 7 of the Law. **(cash flow test only)**

**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 and accounting firms dominate Chinese regional bankruptcy administrator lists ("the Lists") in China.

To facilitate the implementation of the China Enterprise Bankruptcy Law of 2006, the China Supreme People's Court instructed provinces to establish regional qualified insolvency practitioner lists.

In general, it is the provincial supreme people's courts to exercise power to include law and accounting firms into the Lists without going through any qualification exams or training courses. If a firm is included in the Lists, it can be appointed as liquidator in the bankruptcy of a company. Local lawyers and accounting associations are controlled by local government justice and finance departments. The provincial supreme people's court often has collaboration with these associations.

Regarding the selection criteria to be included in the Lists, size of the law and accounting firms is critical. Most provincial supreme people's courts assume that a large law and accounting firm is more trustworthy with more competence and stronger finance. Having a small number of company bankruptcy cases annually, privileged law and accounting firms

have the chance for appointment. In particular, law firms dominate the insolvency practitioner lists across the Country.

However, with no executive nature of the provincial supreme people's courts, complaints against the appointed insolvency practitioners can only be lodged to the professional organisations that the insolvency practitioners belong, namely the local lawyer and accounting associations. The provincial supreme people's courts have no supervision obligation towards the appointed 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.

Two main types of security available under Chinese law are fixed charge and pledge.

Fixed Charge

Fixed charge is commonly used for immovable properties, for instances, buildings and the use of land, occasionally can also be used for movable properties like vehicles and machinery. Upon realization of the charged assets, the charge will be paid in priority. But in the circumstance with employees' claims, court might ask chargee to make concession and surrender part of their security for paying the employees so as to alleviate social instability.

Under the China Property Law of 2007, a charge must be registered with a small amount of registration fee so as to become valid and a security certificate is to be issued to the charge holder upon recording the charge at the government agency. The registration for immovable property is the local office of the China Housing Management Authority. For the sake of safety, secured creditors will simultaneously register the charge at the local office of the China Land Management Authority as the land use right comprise part of the property.

For the fixed charge over the vehicles, registration is to be done at the local police vehicle management office. For registering the fixed charge over machinery and other equipment, it shall be done at the local office of the China industries and Commerce Regulation Bureau.

Pledge

Under Chapter 17 of the China Property Law of 2007, pledge is another type of security other than the fixed charge. In general, a pledge become valid when the possession of the property is given into the hands of the secured creditor. Especially for movable assets, possession of physical delivery is sufficient to make a pledge becoming valid.

Pledge can also be used for intangible assets, for instances, intellectual property like trademarks and patents, shares, cheques and bonds. For securing with this type of intangible property, registration to the respective government bodies or state-company is required and several examples are listed as per the followings:-

- (a) Registration of trademarks shall be done at the China Industries and Commerce Regulation Bureau Central Office which located in Beijing;
- (b) Registration of patents shall be done at the China Intellectual Property Authority Central Office which located in Beijing;
- (c) Registration of shares of listed companies shall be done at the stated-owned company, the China Securities Depository and Clearing Corporation Limited, which has office in Beijing, Shanghai, Shenzhen and Hong Kong; and
- (d) Registration of shares of non-listed companies shall be 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] (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.

I agree with this statement. The China Enterprise Bankruptcy Law of 2006 (“the Law”) furnishes an initiation of formal bankruptcy reorganisation procedure. Under the Law, there are Articles stipulates rescue-oriented provisions for the company:-

Pursuant to Article 2 of the Law, voluntary reorganisation petition is allowed. It enables the company which “is not yet bankrupt but is **likely** to be bankrupt in the near future” to file a voluntary reorganisation petition without the need to pass any bankruptcy test or to provide evidence in the aim to rescue the company as early as possible.

Moreover, even in the involuntary bankruptcy petition, under Article 70 of the Law, the debtor or the shareholders with more than 10% of the company’s share can make application **converting** the liquidation of the company to reorganisation.

Apart from that, another rescue procedure namely composition or settlement is introduced. Under Article 95 of the Law, the company can voluntarily filed a composition or settlement plan to the court. If the court is satisfied with the plan, there will be a meeting of creditors to vote on the plan. As stipulates under Article 97 of the Law, the plan will be passed if it was voted in favour of more than half of the attending creditors representing two-thirds or more of the total claims. Finally, court final approval should be obtained. Despite this plan does not stay or suspend the legal actions of the secured creditors as stipulated under Article 96 of the Law, it does formulate another voluntary rescue procedure for company.

Furthermore, even involuntary liquidation petition is filed to the court, the company is given seven days to raise objection against the petition under Article 10 of the Law, subject to the discretion the court.

Above illustrate the rescue-oriented purpose of the Law. It formulates different ways for the company to seek reorganisation instead of liquidation. Nevertheless, the success to adopt the Law critically influences by the implementation practice of the relevant parties. Court might be reluctant to apply reorganisation to those government-backed companies due to commercially and legally unfeasible for a politically motivated rescue plan. In reality, cash-flow or balance-sheet test still exists cause debtor’s presentation of evidence before commencing the insolvency proceedings. Some court might also required agreement in advanced by the relevant stakeholders like the secured creditors and potential buyers for opening the reorganisation procedure. These practical issues raise the threshold for reorganisation procedure to a high standard.

From the above, it appears that the implementation of the Law cannot truly reflect its objective. However, the Law is built for the purpose of rescue-oriented insolvency legislation, it tries to save the company before liquidation. Therefore, I agree with the statement.

**(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.

To prove the claims of a creditor, they have to approach the reorganisation administrator ("the Administrator") and complete the claim form provided by the Administrator. As stipulates in Articles 49 and 50 of the China Enterprise Bankruptcy Law of 2006, the creditors have to explain the amount and security provision of the claim in writing format and submitted with evidence. If it is a joint and several claims, the creditors have to indicate and declared jointly or by one on behalf of all creditors.

Pursuant to Articles 45 and 48 of the China Enterprise Bankruptcy Law of 2006, creditors are required to file their claims within the specific time period as confirmed by the People's Court to the Administrator. This period should be starts from the date of publication of the announcement to accept the bankruptcy petition by the People's Court and should be run for no less than 30 days and no more than 3 months.

Under Article 92 of the China Enterprise Bankruptcy Law of 2006, if the creditor fails to declare their claims within the stipulated time, they will then be prohibited to realize their claims during the implementation of the Reorganization plan. The creditor may need to wait until the finalizing implementing the reorganization plan, to realize the claims on the same repayment terms for the particular creditor group in accordance to the reorganization plan.

The submitted claim would be subject to verification by the Administrator through checking the books of the company and consulting with the company's financing unit staff.

In regular practice, when the creditor's claim is in dispute of its value or legality, the creditor can litigate for a judgment before the same court and the Courts may arrange an expedited process to resolve the matter for 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.

Pursuant to Article 5 of the China Enterprise Bankruptcy Law of 2006 ("the 2006 Law"), a ruling of foreign court has binding effect on the assets of the liquidated company located in China. This provision is subject to some constrains, namely judicial assistance or reciprocity and public interest.

To be recognised a foreign judgment in China such a civil law country, legislative procedure under the relevant legislations, namely Chapter 27 of the China Civil Procedure Law of 1991 and the China Civil Procedure Law of 2007 ("the 2007 Law") shall be relied on. Pursuant to Article 281 of the 2007 Law, the liquidator can raise its recognition application directly raised to a Chinese local intermediate people's court in Shanghai where the disputed assets are located.

But the Liquidator should bear in mind to those constrains stipulate under Article 281, 282 and 82 of the 2007 Law.

Firstly, the foreign judgment must be final and conclusive under Article 281 of the 2007 Law. In other words, the judgment of the Australian bankruptcy proceeding should be a final and conclusive one in order to be recognised in the court of China.

Secondly, there has to be judicial assistance treaty between China and the country of the foreign judgment or otherwise, reciprocity has to be established under Article 282 of the 2007 Law. It appears that Australia yet to be one of the countries which had signed the judicial assistance treaty with China. So, reciprocity is required. The foreign country shall be the one who initiates the reciprocity and gives a prior favourable recognition to Chinese party. If there is no such establishment, the Chinese court might not unilaterally recognise the Australian bankruptcy proceeding.

Last but not least, the foreign judgment must not violate the fundamental principles of the Chinese legislation on sovereignty, security or public interest under Article 82 of the 2007 Law. Yet, there is no unequivocally definition of the concepts of sovereignty, security and public interest in the Chinese Law, the liquidator has to be attention that its application might be subject to these said challenges.

Even though the judgment or ruling of the Australian bankruptcy proceeding can overcome the above constrains, the liquidator should also be understood that practically speaking, most foreign recognition applications were still rejected by the Chinese courts due to procedural defects like the judicial notices in foreign countries are not delivered in person and are not returned with the receiving party's signature. Therefore, the liquidator should also pay attention to the Chinese domestic judicial practice so as to satisfy the requirements.

#### **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.

The Yangtze Steel Limited is subject to an involuntary liquidation procedure filed by its creditor. Having over 10% of the company's equity of Yangtze Steel Limited, the CEO of

SanLong Limited can file a petition to the Shanghai Second Intermediate People's Court for converting the liquidation into reorganisation pursuant to Article 70 of the China Enterprise Bankruptcy Law of 2006. Upon the approval from the court, reorganisation procedure of Yangtze Steel Limited will be commenced immediately.

The CEO of SanLong Limited is advised to seek the support from the local government before the filing of the reorganisation petition. With the support of the local government, the courts will be seriously considered the petition.

The CEO of SanLong Limited is advised to be attention that such conversion application only be successful in a very small number of cases because of the following three reasons:-

- (1) Firstly, upon the liquidation order was granted, Jingchen Partners was appointed as the liquidation administrator of Yangtze Steel Limited. Its management is dissolved and replaced by Jingchen Partners. It is not clear that how the CEO of SanLong Limited can exercise its right raising the conversion application to court.
- (2) Secondly, it appears to be unjustifiable to allow the conversion since the liquidation was ordered based on the satisfaction of bankruptcy test.
- (3) Thirdly, the creditors' interests under this conversion exercise are at risk.

In view of the above, unless with substantial justification on the conversion to reorganisation plan, the court might not be allowed the application raised by the CEO of SanLong Limited.

**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.

The reorganisation plan will be effectively upon ultimately confirmed by the court. Under Article 87 of the China Enterprise Bankruptcy Law of 2006 ("the Law"), the court has a duty to cram-down a reorganisation plan even it has been voted down by one or more class of creditors or shareholders. Under Article 87 of the Law, six conditions must be satisfied before the court to exercise cram-down approval on a reorganisation plan.

The six conditions can be summarised into the following three tests:-

- (a) Fair and equitable test, i.e. to apply the *pari passu* principle between creditors;
- (b) Absolute priority test, i.e. to pay the creditors in full prior to the shareholders; and
- (c) Feasibility test, i.e. to have an achievable reorganisation plan.

In general, shareholders like the CEO of SanLong Limited are in weaker position due to strict application of the above absolute priority test, unless it is a listed company.

In these circumstances, unless Yangtse Steel Limited is a listed company or the CEO of SanLong Limited can prove that the reorganisation plan is not a feasible plan, it appears that the court might, with high possibility, to approve the reorganisation plan which is approved by all the classes of creditors. This forcibly approval by court will make the CEO of SanLing Limited be binding on the approved reorganisation plan.

45 out of 50 points rewarded

**\* End of Assessment \***