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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?

The cashflow test should be met if a bankruptcy petition is filed by a creditor in China. If the company is unable to pay a debt that is due, the creditor can file for liquidation in Court.

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 law and accounting firms dominate the list of bankruptcy administrators in China. The power of including a law firm or accounting firm in the official insolvency practitioner list is generally exercised by provincial supreme people's courts, which always seek collaboration from local lawyer and accounting associations. For lawyers and accountants, the competition to be listed is fierce but whether or not they are included mostly depends on the size of the law or accounting firm concerned. In these cases, size matters, since most provincial courts assume that a large law or accounting firm is more trustworthy both in terms of financial strength and in respect of competence.

Given that annually there are only a small number of company bankruptcy cases, only a handful of privileged law and accounting firms are given the chance to take appointments.

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

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

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

The fixed charge is the first and most widely used form of security. 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 debtor's assets or even over the assets of a third party, provided the third party's consent is obtained in advance.

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 properly recorded at the government agency. A small fee may apply for the registration of a charge. For immovable property the registration authority is the local office of the China Housing Management Authority and, for safety, most secure creditors tend to simultaneously register the charge at the local office of the China Land Management Authority, since the use right of the land upon which the building stands is part of the property.

Fixed charges are mostly used in relation to immovable property such as buildings, houses and the associated land use rights.

Occasionally, a fixed charge will also be registered over movable property, such as vehicles and machinery. For vehicles, the registration authority is the local police vehicle management office; for machinery and other equipment, the local office of the China Industries and Commerce Regulation Bureau is responsible for registering charges.

Generally speaking, charges are well respected by Chinese courts, especially in bankruptcy procedures where charge holders are paid first once charged assets have been realised. Firstly, it should be noted that most fixed charge holders are powerful state-owned banks in China and have their own political means to pressure courts into doing the right thing. Secondly, there is an increasing number of judges being university educated, creating an awareness of the issues at play and contributing to an understanding of the law.

To realize fixed charges, in principle with the consent of the charger under the China Property Law of 2007, Article 195, the charge can directly sell the charged assets to meet the secured debt without having to approach the court. However, in reality this provision is largely a dead letter on the statute book, as secured creditors must initiate a litigation procedure and ask the court to sell the charged property in the subsequent execution procedure. If a bankruptcy procedure is opened, the charge can simply rely on the court-controlled liquidator to honour the security.

Pledge

Pledges are less frequently used compared to fixed charges. A pledge becomes valid after the pledged 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, delivery, is sufficient. Apart from movable. Besides movable tangible assets, many intangible assets, such as trademarks, patents, shares, cheques and even bonds, can also be pledged. However, for these pledges to be valid they must be registered.

The pledge registration authorities vary considerably and can be quite complex. For trademarks, the registration authority is the China Industries and Commerce Regulation Bureau Central Office located in Beijing. A pledge on patents should be registered at the China Intellectual Property Authority Central Office, also located in Beijing. For shares of listed companies, the registration authority is the China Securities Depository and Clearing Corporation Limited, a state-owned company that has offices in Beijing, Shanghai, Shenzhen and Hong Kong. In the case of shares of a non-listed company, the registration of a pledge takes place 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] (4 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 the statement “The China Enterprise Bankruptcy Law of 2006 is a rescue-oriented piece of insolvency legislation, emphasising rescue over liquidation.”

Here are my reasons for agreeing with the statement:

The China Enterprise Bankruptcy Law 2006 avails three options to choose from when applying for bankruptcy, namely:

- Reorganisation
 - Reorganisation is the first corporate bankruptcy option with most of its elements borrowed from the US Chapter 11 procedure. When a company is bankrupt, it can trigger a corporate reorganisation procedure under the 2006 law. Article 2 of the China Enterprise Bankruptcy Law of 2006 states that when a company is likely to become bankrupt in the near future, the company can voluntarily file for reorganisation in court, which means that a voluntary reorganisation filing does **not need to pass any bankruptcy** tests.
- Composition/settlement
 - This is the second substantial bankruptcy option which is a rescue procedure called composition or settlement. The composition procedure is reserved for a voluntary filling only, unlike the reorganisation procedure, which can be filed by both the company and its creditor(s).
 - Under Article 95 of the China Enterprise Bankruptcy Law of 2006, when the company files for composition it must also present a composition/settlement plan to the court. If the court is satisfied with the composition plan, a meeting of the creditors will be convened to vote on the plan. According to Article 97 the composition plan is passed if voted in favour of by half or more of attending creditors in number holding two-thirds or more of the total claims.
 - The 2006 Law uses two chapters, Chapter 8 and 9, to highlight corporate rescue elements of the option. The fact that the Chinese Lawmakers use two chapters, Chapter 8 and 9 highlights the intent of the Chinese lawmakers to promote the use of corporate rescue.
- Liquidation
 - The third and final bankruptcy option is liquidation, which is found in Chapter 10 of the 2006 law. The order of these three substantial chapters reflects that the lawmakers expect rescue to be attempted first.

(DIP, conversion to rescue, 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.

For the 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. Then the reorganisation administrator will check the company's books and consult with 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 judgement, something that occurs regularly in practice. For the sake of efficiency, many courts arrange for an expedited process to resolve these law suits.

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

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

The bankruptcy liquidator of an Australian company finds that some of the company's assets are located in Shanghai, China. A Chinese creditor has taken legal action in a local (Chinese) court, which has issued an injunction freezing the assets of the Australian company in Shanghai. The liquidator has approached you for advice on how the Australian bankruptcy proceeding can be recognised in China. Advise the liquidator.

China has not adopted the UNCITRAL Model Law on Cross-Border insolvency and it seems there is little political will to do so in the foreseeable future, considering that China is strongly promoting nationalism under its current leadership.

Article 5 of the China Enterprise Bankruptcy Law of 2006 states that a Chinese court bankruptcy ruling binds the company's assets located anywhere in the world, which implies that any assets outside China are also subject to the bankruptcy procedure in China.

Equally, Article 5 also provides that a foreign court bankruptcy ruling also binds the company's assets located in China. Article 5 adds some restrictions on a foreign court bankruptcy ruling, it states that the foreign bankruptcy court ruling must be recognised by a Chinese court before taking effect in China and that the recognition should be based either on a judicial assistance treaty signed and ratified between China and the requesting country, or on the principle of reciprocity if there is no treaty. Furthermore, Article 5 includes some routine public interest reservations, which provides that the 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.

It is worth highlighting that for a foreign court bankruptcy ruling to be recognised in China, a judicial assistance treaty with China is essential. As of 2015, around 30 countries have concluded the required treaty with China, but Australia is not amongst the countries who signed the treaty.

The party seeking recognition of a foreign bankruptcy judgement would have to do so in a Chinese local intermediate people's court, where the company assets are located in terms of the Chinese civil procedure law.

Chinese courts may not recognise a foreign bankruptcy judgement in the absence of a prior favourable recognition in the interest of Chinese party. In other words, from the point of view of the Chinese court system, establishing reciprocity must be initiated by the foreign country. The Chinese judicial system will never extend judicial hospitality if the foreign country does not take the first step.

It is worth noting that foreign creditors/shareholders are treated in the same way Chinese domestic creditors/shareholders are treated.

The recognition of foreign judgements in China is governed by Chinese civil procedural law. Chapter 27 of the China Civil Procedure Law of 1991 is devoted to international judicial co-operation. Considering that China is not a common law jurisdiction, these issues largely rely on legislative provisions rather than on precedents. Evidence of previously successful cases may assist to persuade judges to issue a favourable recognition ruling, even though these cases are not legally binding.

In terms of Article 281 of the China Civil Procedure Law of 2007, a foreign judgement that is sought to be recognised in China must be final and conclusive. The recognition application can be made directly to a Chinese local intermediate people's court where

the disputed assets are located, or where the defendant is domiciled, or by a foreign court on behalf of the parties in dispute if applicable.

In terms of Article 282 of the China Civil Procedure Law of 2007, recognising a foreign judgement is conditional upon that foreign country has a judicial assistance treaty with China and, if not, reciprocity must already have been established between the 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 terms of Article 70 of the China Enterprise Bankruptcy Law of 2006, if there is an involuntary liquidation procedure filed by a creditor, the debtor or its shareholders holding 10% or more of the company's equity can petition the court for the conversion into reorganisation. Upon approval by the court, the liquidation will be changed to reorganisation. Although the law allows for such a conversion, it is not frequently used in China.

It is the creditors rather than the court who should decide whether or not to convert the current liquidation into reorganisation procedure since it is the creditors' whose interests are at risk.

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.

Article 87 of the Bankruptcy Law 2206 provides that the court may cram-down a reorganisation plan that has been voted down by one or more class of creditors or by shareholders.

A reorganisation plan seeking cram-down approval by the court, reorganisation plan must:

- Be voted in favour of by the secured creditor class and, if not, secured creditors must be fully paid out of the secure assets in addition to fair compensation for delayed foreclosure.
- Be voted in favour of by the employee and tax authority classes and, if not, these classes must be paid in full.
- Be voted in favour of by the ordinary unsecured creditor class and, if not, this class of creditors must not be paid less than they would have received under a liquidation procedure.
- 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.
- Pay the stakeholders in the same class class fairly, with the priority between shareholders and creditors upheld; and
- Be feasible.

The aforementioned conditions can be summarised as three tests. The first is the fair and equitable test, which requires the application of the pari passu principle between creditors in the same class. The second is the absolute priority test, requiring shareholders to be paid nothing unless until creditors are paid in full. The third is the feasibility test, stating that the reorganisation plan should be achievable. Even if a organisation plan failed in the vote of any class of stakeholders, the court may still confirm it and forcibly approve the plan, making it legally binding on all consenting and dissenting stakeholders.

The shareholder position is weak in the context of a reorganisation procedure. The company's management surrenders control of the company, once the bankruptcy administrator is appointed. Even though Article 85 of the China Enterprise Bankruptcy Law 2006 allows the representatives of the shareholders to participate in the creditors' meetings when a reorganisation plan is deliberate, in practice most shareholders tend to remain absent due to the fact that it is almost certain that they will gain nothing due to the strict application of the absolute priority principle, especially in private company reorganisations. However, when the reorganisation of the listed company takes place the story is different, as the absolute priority principle is likely to be relaxed in the interest of shareholders, which will normally be a massive number of individual investors.

46 out 50 points rewarded

*** End of Assessment ***