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.

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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?

[Type your answer here]

ANSWER: -

Article 2 of The China Enterprise Bankruptcy Law of 2006 states that "Where an enterprise legal person cannot pay off his debts due and his assets are not enough for paying of all the debts, or he apparently lacks the ability to pay off his debts, the debts shall be liquidated according to the provisions of this Law. ….".

So, the bankruptcy tests to be met are cash flow insolvency in which case the enterprise legal person is unable to pay off his debts on the ground of present inadequate cash flow and balanced sheet insolvency in which case the balance Sheet of the Enterprise legal person shows that his assets are not enough for paying off his debt dues. The bankruptcy test will consist of both cash flow insolvency and balance sheet insolvency which is evident from the use of conjunction "and" to join "cannot pay off his debts" and "his assets are not enough for paying off all the debts".

Question 2.2 [maximum 4 marks] **(3 points rewarded)**

Name the two professions in China that dominate Chinese regional bankruptcy administrator lists **and** briefly explain how they are appointed in practice.

[Type your answer here]

ANSWER: -

In 2017 the China Supreme People's Court instructed most of the provinces to gradually establish their own regional qualified insolvency practitioner lists for facilitating the

implementation of the China Enterprise Law of 2006. But the provincial supreme courts simply select some local large law and accounting firms and include them in the list without conducting qualifying examinations or training courses. The claim of listing the qualified insolvency practitioner is misleading in the absence of qualifying examinations and training. The insolvency practitioners work as bankruptcy administrators in the region they are listed in.

The law and accounting firms are listed mainly on the basis of their size. Most provincial courts assume that a large law and accounting firm is trustworthy both in terms of financial strength and in respect of competence. Thus, the practice of appointment of bankruptcy administrator does not appear to be done in a fair and transparent manner.
From the above facts, it is clear that lawyers and accountants are two professions that dominate the Chinese regional bankruptcy administrators list. Though liquidating firms are also listed as insolvency practitioners, there is no association or body with which complaints can be raised, should the liquidating firm not be a law or accounting firm. Currently there are no government agencies regulating insolvency practitioners in China.

(Appointment issues could be included)

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.

[Type your answer here]

ANSWER: -

There are three forms of security available, namely fixed charges, pledges and liens under the China Property Law of 2007. Though floating charges are recognised in China, those are infrequently used due to lack of supporting mechanism. It is permissible to create a charge over debtor's assets or even third-party assets by obtaining consent of third-party in advance. A charge is not valid until it is registered under the China Property Law 2007 and a security certificate is issued to the charge holder after proper recording by the government agency. Generally, Chinese courts allow charge holders to be paid first after realisation of the charged assets under the bankruptcy procedures. Only claim of employees are permitted to be carved out of the realisations from charged assets.

Two main types of securities available under Chinese law are fixed charge and pledge. Fixed charges are most widely used, but pledges are less frequently used.

Fixed Charge:
Creation of fixed charges are mostly made in relation to immovable property (buildings, houses and the associated land use rights). Fixed charges ore also allowed to be created over movable property, such as vehicles and machineries, this is not a regular occurrence. It is regulated by Chapter XVI of China Property Law of 2007.

In China, all land is generally owned by State and the right to use land is allowed by grant of lease. The right to use land can be purchased by private parties including individuals. The right to use a piece of vacant land without any building can bear a charge with proper registration. Though the charge-holder of the fixed charge is allowed to sell the charged assets with the consent of the charge-giver under Article 195 of China Property Law of 2007, in reality this provision remains a dead letter on the statute book, as secured creditors simply rely on the court- controlled liquidator to realise the security in a bankruptcy procedure.

The security of immovable property having land and building can be simultaneously got registered in the local office of the China Housing Management Authority and China Land Management Authority by the secured creditor to ensure safety and for the reason that the right of use of the land on which the building stands is part of the property. If there is no building on the land, it can be got registered in the local office of the China Land Management Authority.

The movable asset like vehicle is got registered in the local office of police vehicle management office. For machineries and equipment, the office of the China Industries and Commerce Regulation Bureau is responsible for registering the charges.

Despite the provisions of Article 45 of China Guarantee Law of 1995 requiring the opening up of all registered charges to public inspection, in practice it is very difficult for most lawyers to access the records at the China Land Management Authority.

Pledge

Pledge is used less frequently than fixed charges. It is given as a security for payment of a debt and is liable for forfeiture in the event of failure. It is regulated by the China Property Law of 2007 (chapter XVII). A pledge of tangible movable asset becomes valid after the pledged asset changes possession into the hands of the secured creditor. No registration of pledge of tangible movable asset is necessary as the change of possession or delivery is sufficient.

Pledges of intangible assets such as trademarks, patents, shares, cheques and bonds must be registered in order to be valid. The registering authority for trademarks is the China Industries and Commerce Regulation Bureau central office located in Beijing. A pledge of patents should be registered at the China Intellectual Property Authority Central office also located in Beijing. The registering authority for registration of shares of the listed companies, is the China Securities Depository and Clearing Corporation Limited, a state-owned company that has office in Beijing, Shanghai, Shenzhen, and Hong Kong. The registration of pledges of the shares of a non-listed company takes place at the local office of the China Companies House where the company is registered.

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

Question 3.1 [maximum 8 marks] (8 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.

[Type your answer here]

ANSWER: -

The China Enterprise Bankruptcy Law of 2006(ELB 2006) came into force with effect from 1 June 2007. Though the Chinese lawmakers studied the bankruptcy law from a number of jurisdictions, they were particularly influenced by the American Chapter 11 procedure in course of drafting of the ELB 2006. There are reasons to agree that the ELB 2006 is a rescue -oriented piece of insolvency legislation, emphasizing rescue over liquidations.

ELB 2006 is the first rescue -oriented bankruptcy law in China. It comprises three substantial chapters, Chapter VIII on reorganisation, IX on Compromise and X on liquidation; out of the three, the objective of two, Chapter VIII and Chapter IX are rescue of the bankrupt company. The order of the three substantial chapters, arguably, reflects the intention of the legislature to prioritise the use of reorganisation and next compromise both of which are rescue-oriented followed by liquidation. The primary goal of bankruptcy being liquidation of inefficient and bankrupt business appears to have been made the secondary goal by the lawmakers.

Under Article 2 of EBL 2006, a company on the verge of bankruptcy rather than being already bankrupt can enter into voluntary reorganisation. Both the debtor and creditors can file for the reorganisation of the company before the local court under the Article 7 of EBL 2006. This is clearly an attempt at promoting corporate rescue.

The provisions of Article 70 of EBL 2006 permit the debtor or its shareholders holding more than ten percent of the company's equity to apply to the court to covert involuntary liquidation procedure into reorganisation. The message is clear that the EBL 2006 advocates the entry of reorganisation.

To improve feasibility of a corporate rescue Article 73 of EBL 2006 allows the board of directors of the debtor company to manage the company's assets and business affairs during the reorganisation procedure. This means the debtor-in-possession model of American Chapter 11 has been transplanted into the Chinese bankruptcy law with slight modification. In the Chinese debtor-in-possession model, the debtor manages its property and business under the supervision of the court-appointed administrator.

To facilitate more corporate- rescue outcomes the Article 87 of EBL 2006 provides that in the event that a reorganisation plan has been voted down by either the meeting of the creditors or of shareholders or both, it may still be forcibly approved by the court if certain statutory conditions are satisfied. It implies that American style Chapter 11 cram down is also adopted by the EBL 2006.

Overall, reorganisation is intended to be the primary rescue procedure in China. An alternative rescue procedure is compromise or composition under the EBL 2006.

Compromise under Chapter IX of the EBL2006 is also a rescue procedure like the reorganisation procedure. Under Article 95 of EBL 2006 a debtor may directly apply to the court to enter a compromise or submit an application for conversion of an existing liquidation, either voluntary or involuntary, to a compromise and present the draft of a compromise agreement. Except debtors, no other stakeholders, including creditors or shareholders, can initiate a corporate compromise procedure.

But it is left to the discretion of the court under Article 96 to allow commencement of the compromise procedure. The moratorium on commencement of the compromise procedure does not bind a secured creditor who may exercise his right of realising the security when court rules in favour of the compromise.

Unlike the debtor- in -possession in reorganisation, the control of the company's assets and business affairs remains in the hands of the court- appointed administrators under the compromise procedures. If the compromise has been transformed from liquidation, the administrator previously appointed to manage the estate in liquidation previously remains in office.

Under Article 97 of the EBL 2006, the compromise plan must be voted in favour by over half of the attending unsecured creditors holding two-thirds of the entire unsecured claims failing

which the compromise effort gets converted to liquidation under Article 99. If the compromise plan is voted in favour, it must be ultimately approved by the court under Article 98 of EBL 2006.

An approved compromise plan must be executed by the debtor under Article 102 which essentially means the debtor shall pay the unsecured creditors as promised under the approved compromise plan. In the event that the debtor is unable to fulfil its obligations, the court may at the request of the creditors terminate the execution of compromise plan under Article 104 of EBL 2006 and direct it into liquidation.
Compromise is scarcely used in practice. Most compromise plans are converted from liquidations. if a serious buyer emerges, converting liquidation into compromise becomes an effective method to sustain the company as a legal entity, since liquidation exclusively leads to the dissolution of the company. Maintaining the debtor company as a legal entity makes sense in China, as most business licenses would be revoked by the regulators if the company as a legal person is dissolved.

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.

[Type your answer here]

ANSWER: -

Article 14 of EBL 2006 provides that the people's court within 25 days of acceptance of the application of bankruptcy including liquidation and reorganisation shall notify announce its decision to the creditors already known stating the "period, place and points of attention with respect to declaration of claims" and the "title or name of the name of the administrator and the office address". The Chapter VI of EBL 2006(Article 44 to 58) contains the provisions of the process of declaration of such claims and registration and examination of such claims and filling out a form of claims before submission of the claims to the first creditor's meeting for checking. The creditor's meeting exercises the powers of checking the claims as provided under Article61(1).

The relevant provisions prescribing the process of the proof of claims in the Chapter VI of EBL 2006 are as follows. As provided under Article 48 a creditor shall declare his claims to the administrator within the time limit specified by the people's court under Article 45.

But the administrator is authorised under the same Article 48 to compile a list of claims of employees after investigation and have it published. Where an employee has objections to what is recorded in the list, he may request administrator for correction; on refusal of the request by the administrator, the employee may file an action with the people's court. Article 49 states that the creditor shall declare his claim by submitting a written statement on the amount of his claims and whether there is any property guaranty, and present the relevant evidence.

The categories of claims of employees and secured claims on the debtor's specific property is very important in the context of reorganisation as the creditors of such claims are allowed to attend the creditor's meeting and vote on the draft plan of reorganisation under Article 82 and 84 of EBL 2006.

The administrator is authorised under Article 57 to register the claims after receipt of the materials for declaration of claims, examine the claims declared and fill out a form of claims. The form of claims so filled out and the materials for declaration of claims shall be preserved by the administrator for reference by the interested parties.

The reorganisation administrator usually requires the creditor to fill in a claim form which is verified by the administrator with reference to company's book and consultation with staff of the financial unit of the company.

When a dispute arises over the value and the legality of the claim, the creditor can litigate the same before the people's court i.e., the same court in which the application for reorganisation was filed. The courts arrange for expedited process of hearing to resolve such law suits for the sake of efficiency.

But where there is no dispute, Article 58 requires the administrator to submit the form of claim to the first creditor's meeting for checking and further provides that the if the debtor or the creditor have no objections to what is recorded in the form of claims, the people's court shall make a ruling on its confirmation. Article 58 also entitles a debtor or creditor having objections to what is recorded in the form of claims to file an action with the people's court that has accepted the application of bankruptcy including the liquidation and reorganisation.

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.

[Type your answer here]

ANSWER: -

Though China has not adopted the UNCITRAL Model Law on Cross-border Insolvency, the China Enterprise Bankruptcy Law of 2006 (EBL 2006) Article 5 contains some provisions embracing the principle of universality in dealing with cross-border insolvencies. Article 281 and 282 of the China Civil Procedure Law of 2007 are also relevant legislations for recognition of foreign judgements in China.

Under Article 281, the party concerned can directly apply to the intermediate people's court within the jurisdiction of the People's Republic of China (PRC) for recognition and execution, if a foreign court requires such recognition and execution through a legally effective judgement or ruling. What is implied by "a legally effective judgement or ruling" is that the foreign judgement sought to be recognised must be final and conclusive. Alternatively, if a request is made by the foreign court itself pursuant to an international treaty between the foreign state and PRC or in accordance with the principle of reciprocity the people's court may recognise or execute the judgement or ruling.

Under Article 282 the people court, having received the application or request under Article 281, shall review such judgement or ruling with reference to the international treaties acceded to by PRC or in accordance with the principles of reciprocity. The people's court

shall either rule to recognise and execute the foreign judgement or refuse to do so, after having reviewed and considered whether or not such judgement contradicts the basic principles of the law of PRC or violates State sovereignty, security and the public interest. The concepts of Chinese sovereignty, security and public interest are not yet unequivocally defined.

Article 5 of the EBL 2006 states that the people's court shall decide to recognise and enforce a legally effective judgement and ruling on a bankruptcy case by a foreign court subject to the following conditions:

(a) The bankruptcy judgement of the foreign court involves a debtor's property within the territory of PRC;

(b) The said foreign court applies or requests the people's court to recognise and enforce the bankruptcy judgement;

(c) The people's court is satisfied after examination and concludes that the judgement does not contradict the relevant international treaties acceded to by PRC or the principles of reciprocity;

(d) The foreign judgement does not violate the basic principles of laws of PRC and does not jeopardize the sovereignty and security of the State or public interest;

(e) The judgement does not undermine the legitimate rights and interests of the creditors within the territory of PRC.

The general principles of recognising foreign judgements in Chinese Civil Procedure law are reiterated in Article 5 EBL 2006 with some more additions. The bankruptcy liquidator of the Australian company will be advised on obtaining recognition Australian bankruptcy proceedings in China following the afore-mentioned principle of law.

The assets of the Australian company are available in Shanghai, China which complies with one of the requirements of the provisions of Article 5 of EBL 2006. But the assets of the Australian company, having been frozen by issue of an injunction by the Chinese court because of a Chinese creditor taking legal action in a local court, may invite problems in recognition of the Australian proceedings on the ground of undermining the interests of the Chinese creditors.

Since recognition of the foreign judgement is conditional upon the foreign country having an international judicial assistance treaty with China and Australia not being one of 30 odd countries having such treaty with China, it is unlikely that recognition of the Australian bankruptcy proceedings, would be granted. The advice offered is based on the Article 282 of China Civil procedure code and the Article 5 of EBL 2006.

As per reciprocity, the Chinese courts may not recognise a foreign bankruptcy judgement in the absence of a prior favourable recognition of the Chinese bankruptcy judgement in the interest a Chinese party. From the point of view of the Chinese court system, establishing reciprocity must be initiated by the foreign country. Australian courts having no such history of granting recognition in favour of the Chinese party, it is unlikely that recognition to the Australian bankruptcy judgement will be granted by the Chinese courts.

As most of the applications for recognition of foreign judgement have been rejected by the Chinese courts, the Australian liquidator shall be advised not to expect recognition of recognition of the Australian bankruptcy proceedings. Chinese courts simply reject an application, if filed, on the grounds of absence of judicial assistance treaty and failure to establish reciprocity. Even if the Australian liquidator proves that there is a treaty and or reciprocity, the Chinese courts may seek some procedural defects like lack of service of judicial notice with evidence of signature of the receiving party in the foreign country to reject the recognition request. Many of the Chinese courts are reluctant to recognise foreign court bankruptcy ruling with the belief that doing so may weaken Chinese judicial sovereignty.

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.

[Type your answer here]

ANSWER: -

As per the facts of the case study, the petition of the creditor Bank of China (Shanghai Branch) for bankruptcy liquidation of Yangtze Steel Limited has been accepted and the liquidation administrator has been appointed. The debtor has not yet been declared bankrupt by the people's court. The CEO of SanLong Limited, being a controlling shareholder holding 32% of the equity of the Yangtze Steel Limited, is competent to apply to the people's court for conversion of the liquidation proceedings to reorganisation under Article 70 of the EBL 2006.

Article 70 states that where the creditor applies for putting his debtor into bankruptcy liquidation, his capital contributors whose capital contribution makes up one-tenth or more of the debtor's registered capital, may after the people's court accepts the application for bankruptcy and before it declares the debtor bankrupt, apply to the people's court for reorganisation. The capital contributor, SanLong Limited holding 32% equity (more than one-tenth) of Yangtze Steel Limited is eligible to apply. The timing for filing the application for conversion is also appropriate as it is after the acceptance of the petition of the creditor and before the declaration of the debtor as bankrupt. In view of the above, it will be explained to the CEO of SanLong Limited that they can apply to the people's court to get the liquidation procedure converted to reorganisation procedure.

Under Article 71, if the people's court deems that the application for conversion of liquidation procedure to reorganisation procedure conforms to the provisions of law prescribed in EBL 2006, it shall rule that the debtor Yangtze Limited should undergo reorganisation. The court shall also make the matter known to the public. It may be made through a public

announcement. The application of the provisions of Article 71 explains how the liquidation procedure can be converted to a reorganisation procedure.

The reorganisation applications are filed by either the debtor or creditors in vast majority of cases. In practice only a small number of cases get converted from liquidation procedure to reorganisation procedure under the provisions of Article 70 of EBL 2006. Even after conversion from liquidation procedure to reorganisation procedure, in order to be implemented, the reorganisation plan mostly comprising of either debt forgiveness, must pass a vote by four classes of creditors under Article 82. In such case the shareholders who get the liquidation procedure filed by the creditors converted to reorganisation procedure, are required to persuade all classes of creditors to vote in favour of the reorganisation plan which follows the conversion.

The other difficulty facing the converted reorganisation procedure is the voting by the capital contributors or shareholders Under Article 85, where the reorganisation plan has an equity adjustment arrangement. For conversion of the liquidation procedure, there is the requirement of filing of application by Shareholders holding minimum 10% of equity, but for successful voting in favour of the reorganisation plan, such percentage of shareholding may not suffice. Finally, the court will have to confirm the reorganisation plan in accordance with the Article 87 of EBL 2006.

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.

[Type your answer here]

ANSWER: -

The CEO of SanLong, the shareholder of Yangtze Steel Limited is to be advised as to whether or not the Shanghai Second Intermediate Court can approve the reorganisation plan voted down by the shareholders, but approved by all the classes of creditors under the current law in China. Article 87 of EBL 2006 states that the reorganisation administrator in the present case shall consult the shareholder group for taking another vote on adopting the plan. If the shareholder group refuses to take another vote or the draft plan is not adopted even by a second vote, the administrator may apply to the court for approval of the draft plan.

Article 87 also provides that the court may cram- down a reorganisation plan that has been voted down by one or more classes of creditors or by the shareholders. But the court will generally assess the procedural legality of a reorganisation plan that has been successfully passed by vote of all classes of creditors and the shareholders where ever necessary. The

present reorganisation plan of the case study, being voted down by the shareholders must meet the following statutory provisions of Article 87 for confirmation by the court:

(a) The secured creditors must be fully paid out of the secured assets (in addition to delayed foreclosure) or the plan must be voted in favour of by the secured creditors. In the instant case resolution plan has been voted in favour by all classes of creditors including the secured creditors.

(b) The two classes of creditors comprising of employees and tax authorities must be paid in full or the plan must have been voted in favour of by both the classes of creditors. Here, in the present case the plan has been voted in favour of by all classes of creditors including the employees and the tax authorities;

(c) The ordinary unsecured creditors having common claims must not be paid less than that they would have received under the liquidation procedure or the plan must have been voted in favour by such class of creditor. As per the facts in the present case study, the plan has been voted in favour by all classes of creditors including the ordinary unsecured creditors;

(d) The rights and interests of capital contributors or shareholders are adjusted in a fair and impartial manner or the group has voted in favour of the plan. In the given case study, the shareholders have voted down the reorganisation plan, hence their rights are required to be adjusted in a fair and equitable manner by the court;

(e) The stakeholders in the same class or the voting group are treated fairly and the order arranged in the plan for payment of claims does not contravene the priority between creditors and shareholders as provided under Article 113 of EBL 2006;

(f) The reorganisation plan must be feasible.

The conditions required to be met for cram-down of the reorganisation plan not voted in favour by one more class of stakeholders can be summarised under three tests which are quite similar to the US practice under Chapter 11 of the US Bankruptcy Code. The first is the fair and equitable test, which requires the application of *Pari passu* principle between creditor of the same class. The second is the absolute priority test, requiring the shareholders to be paid nothing until and unless creditors are paid in full. The priority order between the two group of stakeholders must be respected, unless the creditors as a whole agree to any deviation from the order of priority. The third is the feasibility test, stating the reorganisation plan should be achievable.

Therefore, in the present case the court may still confirm and approve the plan, making it legally binding on the creditors and the shareholders despite the fact that the plan has been voted down by the shareholders. The CEO of SanLong, the shareholder of Yangtze Steel Limited will be accordingly advised.

49 out of 50 points rewarded

*** End of Assessment ***