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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] (0 points rewarded)**

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

Cash-flow bankruptcy test and balance sheet insolvency test. (cash flow test only)

**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.

Law firms and accounting firms – The local lawyer and accounting associations are controlled by local government justice and finance departments. Therefore, the law firm or accounting firm selected are generally chosen in collaboration with the local law and accounting associations. As the firm(s) are selected by the Provincial Supreme People's Courts, who assume that a large law or accounting firm is more trustworthy both in terms of financials strength and in respect of competence, size of the firm is also a factor in determining its appointment.

(appointment issues should be discussed)

**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.

1. Fixed charge – Mostly used in relation to immovable property. As land is generally owned by the State and no private party is allowed to take ownership of land, a charge can also be granted by the debtor over the right to use land as well as the immovable property that sits on top of the land. The charge must be registered under the China Property Law of 2007 and is not valid until it has been registered. For immovable property the registration authority is the local office of the China Housing Management Authority. Most secured creditors tend to simultaneously register the charge at the local office of the China Land Management authority as well.
2. Pledge – No registration of a pledge is required for moveable assets however in terms of pledged intangible assets such as trademarks, patents, shares, cheques

and bonds, which can be pledged, in order for the pledge to be valid, it needs to be registered. For trademarks, the registration authority is the China Industries and Commerce Regulation Bureau Central Office; Patents will be registered at the China Intellectual Property Authority Central Office; Shares of listed companies, registration is the China Securities Depository and Clearing Corporation Limited; Shares of private companies, registration will be 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] (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.

The following are taken into consideration in contemplating a response to this question:

- Article 2 of the China Enterprise Bankruptcy Law of 2006 states that a voluntary reorganisation petition can be made when the company is **not** yet bankrupt however in practice, the debtor must present evidence to prove that the company is balance-sheet bankrupt before the court opens the procedure.
- Article 70 of the China Enterprise Bankruptcy Law of 2006 stipulates that in the event of an involuntary liquidation procedure, the debtor or its shareholders holding 10% or more of the company's equity can apply to the court for a **conversion** from liquidation to reorganisation however there are several problems with actually implementing this.
- Where a company successfully manage to have a reorganisation petition accepted by the court, it is usually only done with the support by the local government.
- Courts are cautious when allowing the commencement of corporate reorganisations.
- There are courts that demand that the filing party must have a convincing reason that the reorganisation proposal is very likely to succeed.
- In terms of control over the company's assets and business affairs, it is generally in the hands of the court-appointed administrator who will seize this control from previous management.
- Neither debtor nor creditors have a say regarding the appointment of the administrator as this is in the discretion of the court.
- The debtor can also subsequently apply to the court for the **debtor-in-possession** model to be applied, which creditors have no say over.
- While there exists a reorganisation plan which must include a business restructuring sub-plan, the reality is that the reorganisation relies on a sale rescue and therefore said restructuring plan do not deal with the core issues of the company.
- Once the reorganisation plan is completed and presented to be voted on, the court is ultimately still able to **crum down** the reorganisation plan even if the plan failed in the vote of any class of stakeholders, making it legally binding on all consenting and dissenting stakeholders, so long as it meets the statutory provisions of Article 87.

Therefore, based on the above,

1. the difficulty in commencing a reorganisation due to the debtor most likely having to first seek out a willing buyer before petitioning the reorganisation to the court for its approval,
2. The reorganisation being carried out by a court appointed administrator over the debtor at first instance,

3. The debtor having to seek leave of the court to convert the reorganisation to a debtor-in-possession reorganisation,
4. The Court playing such an active role in the reorganisation procedure with its ability to cram down the reorganisation plan notwithstanding the plan failing in vote,
5. The Creditor taking a back seat throughout the entire process, and
6. Most notably, directors are not under any obligation to file for reorganisation in court when insolvency is imminent, under the current insolvency and company law in China

It is difficult to argue that The China Enterprise Bankruptcy Law of 2006 is a rescue-oriented piece of insolvency legislation, emphasising rescue over liquidation as it appears incredibly challenging for a reorganisation plan to be successful. Not to mention the following:

1. the issue that many commercial buildings in China do not have proper legal document which may deter buyers due to the difficulty in legally transferring ownership. Therefore, even if a buyer was lined up when the reorganisation was petitioned to the court, the actual mechanics of the reorganisation is difficult and complicated; and
2. Directors are not under any obligation to file for insolvency reorganisation in court despite the company's financial status. Thus, the company will continue to trade until the company's operations collapses.

Therefore, I do not agree that the China Enterprise Bankruptcy Law of 2006 is a rescue-oriented piece of insolvency legislation as the current statutes makes it extremely difficult and complex to carry out a successful reorganisation in China.

**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.

Creditors will need to approach the reorganisation administrator and will be required to fill in a claim form provided by the administrator.  
 The reorganisation administrator will examine the debtor's books and consult the company's staff members for verification of claim.  
 If there is a dispute (legality or accuracy of the value of the claim), the creditor can litigate before the same court for a judgment.  
 These law suits are usually resolved by the court in an expeditious manner for the sake of 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.

In China, a 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.



At the time of writing, China and Australia have not entered into a judicial assistance treaty and therefore the recognition of the Australian bankruptcy proceeding would have to be recognised on the principle of reciprocity. This presents challenges to the Australian bankruptcy liquidator as for judicial reciprocity, the Chinese judicial system takes the view that the foreign country must already have had a recognition precedent in favour of a Chinese party in the first place and that the Chinese courts may not recognise a foreign bankruptcy judgment in the absence of a prior favourable recognition in the interest of a Chinese party.

On the basis that there is yet to be a prior favourable recognition granted by the Australian court in the interest of a Chinese party, it would be very unlikely that the Australian bankruptcy proceeding will be recognised in China. Moreover, the fact remains that many of the Chinese courts are reluctant to accept a foreign court bankruptcy ruling.

Furthermore, consideration should also be given by the Australian liquidator to the fact that there is currently already a Chinese creditor who has taken legal action in a local court in China (who has issued an injunction freezing the assets of the Australian company in Shanghai). This further complicates the Australian liquidator's efforts in pursuing a debt recovery through the realisation of the company's assets in China because in the absence of any principle of universalism or recognition of foreign (cross-border) insolvency proceedings in China, the success of a debt recovery in China is highly contingent on the first in line, first in right rule. Thus, if (even if extremely unlikely) the Australian liquidator eventually manages to obtain recognition from the Chinese court of the Australian bankruptcy proceedings, the assets of the company may very well have already been realised by the local creditor.

**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.

Article 70 of the China Enterprise Bankruptcy Law of 2006 stipulates that where an involuntary bankruptcy liquidation procedure is filed by a creditor, shareholders holding a stake of more than 10% of the company's equity can apply to court for a conversion from liquidation to reorganisation.

Therefore, as the liquidation bankruptcy procedure was petitioned by Yangtze Steel Limited's creditor, Bank of China (Shanghai Branch), the CEO of SanLong Limited (holding a

32% equity of Yangtze Steel Limited) may apply to the Shanghai Second Intermediate People's Court to convert the liquidation of Yangtze Steel Limited to a reorganization procedure under Article 70 of the China Enterprise Bankruptcy Law of 2006. If agreed, the reorganization procedure will commence immediately after.

As the courts are considerably cautious when allowing the commencement of corporate reorganisations, it is noted that CEO of SanLong Limited advised that various businesses of Yangtze Steel Limited are still viable and that the company appears to have a bright future if the current debt crisis can be resolved, thus, the CEO may have a "convincing" argument which demonstrates why a reorganization proposal is very likely to be achieved and should be approved by the Court.

Separate to the CEO of SanLong Limited's efforts of seeking to convert the current liquidation procedure to a reorganisation procedure, it is noted that while the CEO of SanLong Limited advises that a piecemeal liquidation is not in the interests of stakeholders, it is to be noted that there are two approaches in dealing with the bankruptcy of company groups in China and therefore it would be a remiss to not give any consideration to the fact that Jingchen Partners may consolidate all companies in the liquidation of Yangtze Steel Limited as one case especially noting that this approach is widely practised in China.

**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.

In terms of the passing of the reorganisation plans, it is noted that Article 84 states that the reorganisation plan must be accepted by each class of creditors and should be voted in favour of by 50% or more of attending creditors in numbers whose claims represents two-thirds or more of the entire claims in each class.

Further to the above, Article 85 suggests that all reorganisation plans must also pass the vote of shareholders where the company's equity is affected, adjusted or cancelled by the reorganisation plan.

The approval of the reorganisation plan does not end after being voted on by the creditors (and shareholders, where required), as it must ultimately be confirmed by the court and Article 87 provides that the court may cram-down a reorganisation plan that has been voted down by one or more class of creditors (or by the shareholders).

Therefore, in this instance, based on the facts of the case, despite the creditors of Yangtze Steel Limited approving the reorganisation plan, the plan has not been approved by shareholders (e.g. SanLong Limited) who are entitled to vote on the reorganisation plan under Article 85 as noted above.

Article 87 allows for a cram-down of the reorganisation plan despite the plan being voted down by SanLong Limited & other shareholders of Yangtze Steel Limited as long as the reorganisation plan fulfils the following requirements (amongst other requirements):

1. 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;
2. Pay the stakeholders in the same class fairly, with the priority between shareholders and creditors upheld

Thus, under Article 87, in order for the non-consensual reorganisation plan to be forcibly confirmed by the court, both the pari passu and absolute priority principles must be followed.

Therefore, so long as the reorganisation plan fulfils the fair and equitable test (pari passu principle) and absolute priority test (requiring shareholders to be paid nothing unless and until creditors are paid in full), the reorganization plan will ultimately be approved by the Shanghai Second Intermediate People's Court, despite the shareholders' of Yangtze Steel Limited's dissent.

47 out of 50 points rewarded

**\* End of Assessment \***