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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] (8 points rewarded)

Questions 1.1. – 1.10. are multiple-choice questions designed to assess your ability to think critically about the subject. Please read each question carefully before reading the answer options. Be aware that some questions may seem to have more than one right answer, but you are to look for the one that makes the most sense and is the most correct. When you have a clear idea of the question, find your answer and **mark your selection on the answer sheet by highlighting the relevant paragraph in yellow**. Select only **ONE** answer. Candidates who select more than one answer will receive no mark for that specific question.

Question 1.1 (correct)

Select the correct answer:

Which of the following are eligible to use the China Enterprise Bankruptcy Law of 2006 to enter into a court-involved bankruptcy procedure in China?

- (a) Individuals, when in financial difficulty.
- (b) Enterprises having an independent legal status.**
- (c) Enterprises or partnerships.
- (d) State-owned enterprises only.

Question 1.2 (it is d)

Select the correct answer:

Which three bankruptcy options are provided by the China Enterprise Bankruptcy Law of 2006?

- (a) Reorganisation, scheme of arrangement and liquidation.
- (b) Receivership, settlement and liquidation.**
- (c) Liquidation, settlement and company voluntary arrangement.
- (d) Reorganisation, settlement and liquidation.

Question 1.3 (correct)

Select the correct answer:

How is a bankruptcy administrator appointed under the China Enterprise Bankruptcy Law of 2006?

- (a) The bankruptcy administrator is appointed by the debtor when the company files for bankruptcy in court.
- (b) Only the court can appoint a bankruptcy administrator. Creditors may request a replacement bankruptcy administrator to be appointed if the court-appointed administrator is proven to be incompetent or biased at a later stage of the proceedings.**

- (c) Both the debtor and creditors may appoint provisional bankruptcy administrators.
- (d) The court can only appoint a bankruptcy administrator after consulting with both the shareholders and the creditors.

Question 1.4 (correct)

Select the correct answer:

Which parties may file for bankruptcy in court under the China Enterprise Bankruptcy Law of 2006?

- (a) Only the debtor may file for bankruptcy.
- (b) Both the debtor and the creditors may file for bankruptcy.**
- (c) Only the shareholders of the debtor company may file for bankruptcy.
- (d) Both creditors and shareholders of the company may file for bankruptcy.

Question 1.5 (correct)

Regarding the “control” model in corporate reorganisation under the China Enterprise Bankruptcy Law of 2006, which of the following statements is correct?

- (a) The debtor-in-possession model is categorically not available under the Chinese corporate reorganisation provisions.
- (b) Both debtor-in-possession and administrator-in-possession models are available under the Chinese corporate reorganisation provisions.**
- (c) Once the administrator-in-possession model is chosen, it cannot be converted into the debtor-in-possession model.
- (d) The debtor-in-possession model automatically applies once a reorganisation procedure is commenced.

Question 1.6 (it is a)

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?

When a bankruptcy petition is filed by a creditor, the court uses a cash-flow bankruptcy test before admitting the petition for liquidation of a corporate debtor.

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.

Upon acceptance of a bankruptcy application, a bankruptcy administrator is appointed by the court. As there is no systemic supervision of qualified insolvency practitioners and following China Supreme People's Court's instruction to each province to appoint its own regional qualified insolvency practitioner lists. Most provincial supreme courts just select the local large law firm and accounting firms. The power of including a local law firm in the list is usually controlled in a collusive manner by the court and the accounting and law associations. Although, Article 22 of the China Enterprise Bankruptcy Law of 2006 authorises creditors to request for a replacement for the administrator due to any illegal or biased conduct of the administrator. The creditors cannot question the court appointed administrator's appointment without presenting evidence as to lack of competence and impartiality.

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 charges and pledges. Fixed charges are the most frequently used form of security and it can be created over both moveable and immoveable property. A fixed charge can be created over the debtor's property and even a third party's property subject to procuring their consent. A charge must be registered under the China Property Law, 2007 and is not valid until it is registered. A

security certificate is issued to the charge holder once the registration process is complete with the government agency. In case of immovable property the registration authority is the local office of the China Housing Management Authority and most creditors tend to simultaneously register the charge with the China Land Management Authority.

A pledge is the second most favoured mode of security creation. It is created when the moveable property changes hands into the secured creditor's possession. Pledge over moveable property does not need to be registered and as aforesaid only a change of possession makes it valid. However, pledge of intangible assets have to be registered. Each type of intangible asset has to be registered with different authorities, like the registration authority for trademark is China Industries and Commerce Regulation Bureau Central Office, whereas patents have to be registered with China Intellectual Property Authority Central Office. Pledge of shares of listed companies have to be registered with the China Securities Depository and Clearing Corporation Limited and in case of shares of listed companies the registration can happen with China Companies House.

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

Question 3.1 [maximum 8 marks] (6 points rewarded)

"The China Enterprise Bankruptcy Law of 2006 is a rescue-oriented piece of insolvency legislation, emphasising rescue over liquidation."

Discuss this statement and indicate whether you agree or disagree with it, providing reasons for your answer.

The China Enterprise Bankruptcy Law, 2006 appears to be rescue-oriented on the face of it, however the practical enforcement of the law faces many challenges. The biggest obstacle in the face of the bankruptcy infrastructure is the lack of judicial accountability and as it is very difficult for a bankruptcy application to be accepted by the court. Majority of the bankrupt companies in China simply continue to exist illegally in the market in an unlawful manner which jeopardises the interest of the creditors.

The modes of rescue oriented bankruptcy proceeding is settlement and reorganisation. Where reorganisation is a framework where the debtor or the creditors can file an application and upon acceptance by the court an administrator would be appointed. However, the reorganisation could be converted into a **debtor-in possession** model if an application to this effect is filed by the debtor. However, even in this model the court has the power to **cram down a plan** that is not accepted by the all four creditor classes but meets certain statutory conditions. The settlement framework is reserved only for voluntary filing and the application has to be approved by court. The law is vague as to whether all creditors would be lumped together upon acceptance or whether separate classes would be formed. But I do unequivocally say that the secured creditors are not bound the automatic stay that operates to protect the debtor's estate. Moreover, without the support of the secured creditors a composition effort is unlikely to succeed.

Finally, for an application of liquidation, the court would apply the balance-sheet or cash flow test for gauging whether the application is to be accepted. The discretion of the court in the matter of acceptance of the liquidation application is a bottleneck in Chinese insolvency framework. In reality opening a bankruptcy in China is very difficult, because in most cases courts just ignore the liquidation or reorganisation and settlement petitions without so much as an explanation. Even after the rare occurrence of an acceptance of the petition, the court has complete discretion in the appointment of the administrator who yields important powers in every step of the insolvency process. Considering the lucrative nature of the business of

corporate bankruptcy there is a big concern over corruption and non-independence of the judges in the matter of appointment of administrators.

Although on the face of it the bankruptcy may appear to be rescue-oriented but the reality it is run by the whims and fancies of courts as it wields unlimited power in all aspects of the corporate insolvency process.

(early rescue, conversion to rescue, could be discussed)

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.

The commencement of a formal reorganisation procedure is upon acceptance of a petition for the same filed either by the company or its creditors, by the court. Upon acceptance of the reorganisation petition, the court appoints a bankruptcy administrator who takes control of the company's assets and business affairs. The main task of the bankruptcy administrator is to verify claims and to investigate the company's assets.

The creditors for submission of their claims are required to submit a claim form provided by the reorganisation administrator. The reorganisation administrator shall verify the claims by relying on the company's books and consulting with the staff from the company's financing unit. In the event of a dispute with respect to the legality or accuracy of the claim, the creditor can litigate before the same court for a judgment. The litigation pertaining to the disputed claims is a common occurrence before the courts. Many courts also employ expedited processes to fast-track such claims. The final result of the litigations serves as the finalised amount of the disputed claims.

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 as adopted the UNCITRAL Model Law on Cross-border Insolvency. Article 5 of the China Enterprise Bankruptcy Law of 2006 states that a ruling by a Chinese Court shall be binding on the company's assets located anywhere in the world, which implies that assets lying outside China shall also be bound by Chinese rulings. Further, Article 5 provides that a foreign court bankruptcy ruling also binds the company's assets in China once it is recognised by a Chinese court. Recognition of foreign judgments is based either on a judicial assistance treaty signed between the requesting country and China or on the principle of reciprocity. Currently, Australia does not have a judicial assistance treaty in place with China.

The only alternative that remains is the principle of judicial reciprocity. For judicial reciprocity, the Chinese judicial system takes the view that the requesting country in this case Australia must already have had a recognition precedent in favour of the Chinese party in the first place and that Chinese courts may not recognise a foreign bankruptcy judgement in the absence of a prior favourable recognition in the interest of Chinese party. Therefore, establishing of reciprocity must be initiated by the foreign country.

However, practically there are only a handful of foreign bankruptcy proceedings that have been recognised in China. Chinese courts are reluctant to grant recognition to foreign proceedings due to their misplaced belief that doing so might dilute Chinese 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.

The CEO of SanLong Limited who holds 32% of the shareholding in Yangtze Steel Limited could single-handedly apply for conversion of the liquidation process to reorganisation process. Article 70 of the China Enterprise Bankruptcy For a company undergoing involuntary liquidation, the procedure can be converted into reorganisation if a petition to this effect is submitted by the debtor themselves or shareholders of the company who either by themselves or together with other shareholders who hold at least 10% or more of the company's equity. The petition if accepted by the court the process of liquidation would stand converted into reorganisation. However, conversion is not frequently allowed in China.

Moreover a conversion would lead to several problems such as upon commencement of a liquidation process the company is fully controlled by the court appointed administrator and the company's management would be dissolved and the procedure to raise a reasonable conversion request is not clear in the law. Striking a balance between the creditors and the shareholders would be a problem in this situation as the creditors are the stakeholders who would have to undergo a haircut in the event that the assets and performance is not sustainable in the long run.

However it is unclear from the facts whether Yangtze Steel Limited submitted for a voluntary liquidation or the same was petitioned by its creditors, as the option to convert the process is only available to a company that was brought into liquidation involuntarily.

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 85 of the China Enterprise Bankruptcy Law of 2006 states that where the company's equity is affected, adjusted or cancelled by the reorganisation plan, it must be voted by the shareholders. Therefore, over and above the approval of all four classes of creditors, the plan must also be approved by the shareholders. However, as the law is designed in the way that the final say in the matter of approval of the plan lies with the court and the court being armed with the cram-down provision. The court can force approve a plan that has been voted down by the creditors or the shareholders if it meets the statutory provisions of Article 87. Specifically, with regard to shareholders Article 87 lays down that if the plan cancels or alters the equity it must be approved by the shareholders and if such approval is not received then the shareholders must be dealt with in a fair and equitable manner.

Although the position of the shareholders is generally weak as creditors are given priority over the shareholders. The rule of absolute priority is in effect during the reorganisation process wherein, the shareholders shall be paid nothing unless and until creditors are paid in full. The management loses its position once the reorganisation process is started and although they have the right to attend the creditors' meeting, practically they seldom attend these meetings.

However, in the case of reorganisation of a listed company the absolute priority rule takes a backseat and it is relaxed in the interest of a large number of public shareholders. Assuming in the present case as the shareholders have not agreed to the plan, it is up to the court to decide based on the principles laid down in Article 87 if a cram-down approval could be allowed by the court. Further assuming that Yangtze Steel Limited is a public company the rule of absolute priority may be relaxed in this case by the court.

46 out of 50 points rewarded

*** End of Assessment ***