INSOL INTERNATIONAL
FOUNDATION CERTIFICATE
IN INTERNATIONAL INSOLVENCY LAW

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).

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6. The final submission date for this assessment is **31 July 2022**. The assessment submission portal will close at **23:00 (11 pm) BST (GMT +1) on 31 July 2022**. No submissions can be made after the portal has closed and no further uploading of documents will be allowed, no matter the circumstances.

7. Prior to being populated with your answers, this assessment consists of **8 pages**.

ANSWER ALL THE QUESTIONS

QUESTION 1 (multiple-choice questions) [10 marks in total] (9 points awarded)

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

Select the correct answer: (1 point)

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) Consumers, when in financial difficulty.

(b) Enterprises having an independent legal status.

(c) Enterprises or partnerships.

(d) State-owned enterprises only.

Question 1.2 (1 point)

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 (1 point)

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 (1 point)

Select the correct answer:

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

(a) Directors can file for company bankruptcy in a court.

(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 (1 point)

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 (1 point)

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 (1 point)

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 (1 point)

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 (0 point)

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 (1 point)

Select the <u>correct answer</u>:

When drafting the corporate reorganisation chapter of 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) Russia.

(c) Australia.

(d) The United Kingdom.

QUESTION 2 (direct questions) [10 marks] (9 points)

Question 2.1 [2 marks] (2 points)

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

In terms of Article 7 of the China Enterprise Bankruptcy Law of 2006, where a company is unable to pay a debt that is due, the creditor will file for liquidation. This means that a cash-flow bankruptcy test is used before a court can order liquidation.

Under Article 2 of the China Enterprise Bankruptcy Law of 2006, when a creditor petitions the court for reorganization, both the cash-flow and balance sheet tests apply.[1]

Question 2.2 [maximum 4 marks] (4 points)

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

Law and accounting firms dominate Chinese regional bankruptcy administrator lists.

The genesis of these lists emanated in response to the enactment of the Bankruptcy Law, by which the China Supreme People's Court instructed each province to compile their regional lists of potential bankruptcy administrators/insolvency liquidators.

By 2007, the Shanghai Municipal Supreme People's Court had created a list involving 12 legal firms, 4 accounting firms, and 4 liquidation firms!

In order to be included in such a list, the provincial supreme courts before appointing the firm of either lawyers or accountants, will collaborate with the local firms to get a sense of whether such firm should be added. Collaboration discussion will entail a consideration of the size of the law firm as the presumption is that larger law firms are more competent and financially stable than smaller ones.

Once making it onto the said list, and during for example, reorganization filing, the court retains exclusive jurisdiction to appoint the insolvency practitioner.

[1] Voluntary reorganization does not need to invoke any bankruptcy tests – Article 2 of the China Enterprise Bankruptcy Law of 2006.

However, under Article 22 of the China Enterprise Bankruptcy Law of 2006, creditors can ask the Court for a replacement administrator in the event that the court-appointed administrator is incompetent or biased.

Question 2.3 [maximum 4 marks] **(3 points awarded)**

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

The two main forms of security available are fixed charges, and pledges and liens.

Fixed charges are widely used over both immovable and to some extent, movable property such as vehicles and machinery.

In order to be valid, the fixed charge is registered under the China Civil Code of 2020. Prior to registration a fee must be paid, and thereafter the charge holder receives a security certificate as proof of its registration.
For immovable property, the registration authority used is the local office of the China Housing Management Authority. Because the building is also situated on land, and because all land in China is owned by the State, charge holders also register the charge at the local office of the China Land Management Authority.

The second type of main security used is a pledge. Pledges are used for both movable tangible and intangible assets.

In the case of a movable tangible asset, the pledge becomes valid the moment the asset is in the possession of the secured creditor. Thus, no registration is required.
On the other hand, for intangible assets such as trademarks, patents, shares, cheques and bonds, the validity of the pledge is dependent upon its registration.

The place of registration differs from one intangible asset to another:
Trademarks are registered with the China Industries and Commerce Regulation Bureau Central Office.
Patent pledges are registered at the China Intellectual Property Authority Central Office. Both the trademark and patent pledges registration offices above are located in Beijing.
Shares of listed companies are registered with the China Securities Depository and Clearing Corporation Limited which has decentralized offices in Beijing, Shanghai, Shenzhen and Hong Kong.
Shares of non-listed companies are registered at the local office of the China Companies House at the place where the company is incorporated.

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

Question 3.1 [maximum 8 marks] **(8 points)**

"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.

INTRODUCTION

The China Enterprise Bankruptcy Law of 2006 ("EBL") was a significant legal step in the development of Chinese Bankruptcy laws. The Act represents a careful grafting of a mosaic of laws lifted from other foreign jurisdictions and blended into the Chinese system.[2]

The EBL IS China's attempt at establishing a corporate rescue culture and Zinian points out that the fact that bankruptcy reorganization come before chapters on liquidation signals that corporate reorganization is foremost at the helm when corporate bankruptcy procedures are considered.[3]

Thus, although the EBL comprises only 136 Articles, reorganization and composition are the preferred direct and exit strategy clauses as methods to avoid liquidation.

ARTICLES WHICH SIGNAL RESCUE

Voluntary Bankruptcy

At the outset, Article 2 of the EBL encourages early rescue efforts by allowing a company to petition for voluntary bankruptcyy "at a time when the company is on the verge of bankruptcy rather than is already in a bankruptcy trouble."[4]

Article 2 states:

Where an enterprise legal person cannot pay off his debts and his assets are not enough for paying off 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.

Its wording indicates that the gateway to file for bankruptcy is either the cash-flow test, or the balance sheet test. In practice, the company must prove balance sheet insolvency but the efforts to curb insolvency, at least on paper, are instantly recognizable compared to Article 7 for which the creditor must convince the court that the debtor is cash-flow insolvent, and which in practice, usually requires government support.

Reorganization

Reorganization is the fountainhead of corporate rescue. It is a hybrid legal procedure encompassing both the voluntary debtor-in-possession model from the USA, and the bankruptcy procedure from UK liquidations found in the UL Insolvency Act, 1986.

Articles 70 and 73 represent the antithesis of the very nature of insolvencies which are essentially, a creditor driven process. In essence, it is distinctively beneficial for aiding the revival of a company in financial difficulty by inducing a moratorium on all creditor action so that the business may be operated continually as a going concern during reorganization proceedings.[5]

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[2] Z Zhang, "Resolving Corporate Insolvencies in China: the Gap Between Law and Reality" (2020) 27:2 *University of Miami International and Comparative Law* at 375. Available online at https://repository.law.miami.edu/cgi/viewcontent.cgi?article=1348&context=umiclr. Accessed 26th June 2022.

[3] Z Zhang, "Corporate Reorganization under the Enterprise Bankruptcy law of the People's Republic of China - the Relevance of Anglo-American Models for China" (2014) *Durham University* p 40. Available online at http://etheses.dur.ac.uk/10556/1/Zinian_Zhang_PhD_Thesis.pdf?DDD19. Accessed 5th June 2022.

[4] Ziang note 4 above.

[5] E Lee, "The Reorganization Process under China's Corporate Bankruptcy System" (2011) *The International Lawyer*. 45:4 at 939- 974

Thus it appears as the premium option over liquidations detecting with an aim to solve bankruptcy at an early stage. In successful cases, the added advantage is that employees are able to retain their jobs.

The most striking element of the EBL is found in Articles 70 and 73 which drew heavily upon the Chapter 11 Bankruptcy proceedings of the USA and imported the "debtor-in-possession" model.

The EBL set a relatively low threshold in allowing a company or shareholder holding more than 10% of the debtor company's equity to apply for conversion of the liquidation to reorganization. It is also vague for specifying any criteria that will muster the test in granting such an application.

Courts have thus developed their own practice guidelines such as requiring that the company prove that the reorganization plan have been put through a prior screening process with creditors, and that the goals of the plan are likely to be achieved.

Upon a successful application, control of the business reverted to the board of directors, and the bankruptcy administrator, previously in a prime position, was relegated to the role of a supervisor.

Article 73 therefore returned decision-making powers relating to the business affairs of the company and the management of its assets back to the debtor-company. In the absence of specified time constraints, the company is at liberty to draft a reorganization plan to the exclusion of creditors.[6]

Cram-down

Meanwhile, to facilitate more rescue outcomes, under the EBL 2006 Article 87, in the event that a reorganization plan has been voted down by either the meeting of creditors or of shareholders or both, it may still be forcibly approved by the court if certain statutory conditions are satisfied, which means a Chapter 11-style cram down is also adopted by the EBL 2006

Where a reorganization plan has been voted down at a meeting of creditors and/or shareholders, Article 87 empowers the courts in certain conditions to cram-down on the dissenting creditors in order to approve the plan thereby facilitating corporate rescue. The Court is also authorized to choose the bankruptcy administrator and convene the first creditors' meeting.[7]

Directors Accountability

It is a universal principle of all insolvency systems that delinquent directors be brought to book.

However, Article 125 of the EBL provides no more than the superficial clause that the directors be held accountable. Actions for claims against directors are conspicuously absent in the EBL; thus claims in relation to the misfeasance or breach of the director's fiduciary duties, or claw-back or avoidance provisions may present a challenge for creditor-action.

It may be that the EBL hangs its hat so firmly on a company's adoption of reorganization that it has disregarded the need to create provisions regarding fiduciary duties of a director as nowhere in the EBL is there any provision requiring directors to file for bankruptcy.

In any event, even if the director indeed filed for bankruptcy, in practice the petition is unlikely to be entertained by the courts.

[6] Article 73 of the China Enterprise Business Law of 2006.
[7] Article 62.

CONCLUSION

In conclusion, the EBL claims wonders on paper but for all its efforts, the collective reorganization of these companies have been labelled as nothing more than "lame-ducks." Parry notes that "there were significant numbers of companies leaving the market without going through the formal, collective bankruptcy procedure, about 7-800,000 each year."[8]

This is because in practice, the reorganization plan "is used merely to achieve higher returns in a sale of the company's underlying business, or dispersal sale of assets in a break-up sale."[9]

Question 3.2 [maximum 7 marks] **(7 points)**

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 wishing to prove their claims will complete a claim form and provide same to the reorganization administrator.

The claim will be verified by the administrator against the company's books as well as company personnel in the financing department.

Where a dispute occurs either as to the legality or accuracy of the claim, the matter will proceed to litigation. As this is fairly common, courts adopt an expedited procedure to achieve quick resolution.

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

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

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.

ISSUE

Whether the Australian foreign judgment can be recognized in China for purposes of its enforceability?

LAW

The China Civil Procedure Law of 1991 governs the technical requirements for the recognition of foreign judgments in China and Chapter 27 deals with international judicial cooperation.

Article 5 of the China Enterprise Bankruptcy Law of 2006 also deals with recognition of foreign judgments.

[8] R Parry, "China's Enterprise Bankruptcy Law, Building an Infrastructure Towards a Market-Based Approach" available online at http://irep.ntu.ac.uk/id/eprint/37117/1/14290_Parry.pdf. Accessed 5th June 2022.

[9] Parry note 6 above.

Judgment requirements:

In as far as the requirements for the judgment are concerned, the application for recognition must be made in a Chinese local intermediate people's court.

The court of jurisdiction must be one where the (disputed) assets are located, or where the defendant is domiciled, or by the foreign court on behalf of the parties.

The judgment sought to be recognized must be final and conclusive.[10]

Article 82 of the China Civil Procedure Law of 1991 allows a Chinese Court to reject a recognition application if the foreign judgment violates principles of Chinese Sovereignty, or its laws, security or out of public interest.

Recognition:

Recognition of a foreign judgment is governed by Article 282 of the China Civil Procedure Law of 2007.

Recognition occurs in one of two defined instances:

(a) Where there is a treaty[11] in existence between China and the requesting country based on judicial assistance or,

(b) On the principle of reciprocity.

In as far as reciprocity is concerned, Chinese law will not unilaterally recognize a foreign judgment. It will require the requesting country to affirm reciprocity by recognizing a Chinese bankruptcy order before the Chinese courts will entertain any foreign bankruptcy application.

It is important to point out that Article 5[12] of the China Enterprise Bankruptcy Law authorizes a Chinese Court to freeze a company's assets both in in China and where located elsewhere in the world.

So, for a requesting country to be able to freeze the company's assets in China through recognition of the foreign order, Article 5 and requires that the Chinese order be first recognized by a foreign court, else it will lack enforceability.

Case Law:

As at current date, only three cases have achieved judicial recognition of the foreign bankruptcy orders, and then too, the decisions have been politically motivated.

The 2001 decision issued out of the Foshan Intermediate People's Court, Guangdong Province, recognizing a bankruptcy ruling issued by the court of Milan in Italy;

The 2005 decision of the Guangzhou Intermediate People's Court recognizing a French Bankruptcy order and the status of the liquidator which then authorized him/her to sell the Chinese assets;

The 2012 decision from the Wuhan Intermediate People's Court recognizing a German bankruptcy order which was based on reciprocity; and

A 2016 matter involving the bankruptcy of Hanjin Shipping Limited, which foreign bankruptcy orders were recognized in the USA, UK, Australia and Singapore. An application for recognition in a Chinese court however, failed, meaning that assets that could have

[10] Article 281 of the China Civil Procedure Law of 2007.

[11] Currently, 30 countries have signed the said treaty.

[12] In borrowing from the UNCITRAL principles, Article 5 contains the usual reservation clauses such that the order must not infringe upon Chinese law or the sovereignty of China or its security and public interests, and obviously that the order must not disadvantage domestic creditors.

formed part of the collection for distribution were frustrated by a Chinese court order freezing the assets of Hanjin in China.

APPLICATION of the LAW to the FACTS
In application, the following should be noted:

1. The Australian proceeding is a main proceeding.

2. The proceeding in China, if and when, recognized should then be a foreign proceeding.

3. Applying Article 5, the Australian liquidator who wishes to obtain an injunction freezing the Chinese assets must apply for recognition of the foreign order.

4. In applying for recognition, the Australian liquidator should take care to establish if any judicial assistance treaty is in force as between China and Australia, as the requesting party.

5. If indeed it is, then the Australian judgment can be recognized for purposes of enforceability. Whilst the assets of the Australian company are already frozen under Chinese law, a collaborative effort should thereafter ensue so as to coordinate the winding-up and distribution.

6. Even if the foreign judgment is recognized in China, it may still be rejected on the basis of procedural defects such as notices not being delivered in person, or a lack of signature confirming receipt by the receiving party.

7. However, assuming there is no treaty in force, then the Australian liquidator will rely on the principle of reciprocity. The Australian liquidator must bear the caveat that its own jurisdiction (*viz.* Australia) must *first* recognize the Chinese bankruptcy order before it can apply to the Chinese local intermediate people's court where the company's assets are located.

It is noteworthy to further point out to the Australian liquidator his chances of success are slim to none. This is because case law would suggest that Chinese courts are reluctant to recognize a foreign bankruptcy ruling for fear of weakening its own Sovereignty; and, it would appear Judges in that division are nervous of dealing in such foreign cases.

In sum, the Australian liquidator would have to have the Chinese bankruptcy decision recognized in Australia so as to apply for recognition of the Australian decision in China.

A treaty based on judicial assistance would be the liquidator's only option. This is because, on application of the above case law, recognition of the Australian judgment based on reciprocity is unlikely to succeed.

If the Australian liquidator were to proceed to foreign arbitration however, the results would certainly be more positive.

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)

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.

LAW

Articles 70 and 73 represent the pinnacle of reorganization in the China Enterprise Business Law of 2006 ("EBL"). These novel features of the EBL can be effected during an involuntary or creditor-petitioned insolvency.

Together, the effect of these sections is to graft a debtor in possession model which is based on the Chapter 11 Bankruptcy proceedings of the USA within the nebulous of liquidation proceeding, thus changing its status to a reorganization proceeding.

Article 70 allows a conversion from liquidation to reorganization proceedings to be brought by the debtor, or its shareholders holding 10% or more of the company's equity.

Once sanctioned by the Court, Article 73 governs the procedure for the debtor who regains control of the company to draft the reorganization plan of the company, to the exclusion of creditors.

APPLICATION of the LAW to the FACTS

Procedurally speaking, the obvious challenge within this procedure is one of standing. Whilst the debtor company is under liquidation, the operational functions of management are subverted in favour of the bankruptcy administrator. Therefore, in principle the debtor company lacks *locus standi* to make any such application.

In the same vein, the application for conversion by shareholders is inhibited by the very notion of the balance-sheet insolvency of the company which cannot be said to be justifiable.

Substantively speaking, the CEO of Sanlong Limited is a controlling shareholder of Yangtzee with a 32% stake in the company. Sanlong therefore fits the definition under Article 70 of a shareholder holding 10% or more shares in the company and is empowered to bring an application for conversion.

In bringing the application, Sanlong is signalling that Yangtzee is not bankrupt. This is contrary to the fact that an involuntary creditor petition has been accepted by the court and which in itself confirms the insolvency of Yangtzee. It will be upon the application of Articles 70 and 73 for the court to decide whether to convert the proceedings to a reorganization.

Question 4.2.2 [maximum 3 marks] **(3 points)**

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 Article 85 of the China Enterprise Business Law of 2006, a reorganization plan must pass the vote of shareholders in cases where their equity is affected, or adjusted, or cancelled.

However, in terms of Article 87, a court override the provisions of Article 85. It will do this by cramming-down on a reorganization plan that has been voted down by shareholders whose equity is affected or adjusted or cancelled.

In this case, and despite being a controlling shareholder, the shares of SanLong Limited stand to be cancelled once the reorganization plan is sanctioned by the Court, therefore they are for purposes of Article 87, affected.

The Court cannot lightly cram-down a reorganization plan and must adhere to the statutory requirements laid out in Article 87.

These requirements are:

(a) That the secured creditors voted in favour of the plan, or where no favourable vote was achieved, that the secured creditors are paid out in full, from the assets of the company including compensation for the delayed foreclosure;

(b) That the employees or Tax authorities voted in favour of the plan, or in the alternative that they are paid in full;

(c) That ordinary creditors voted in favour of the plan, or where no favourable vote from this class was achieved, that these creditors would not receive less than in an ordinary liquidation;

(d) That in the case of shareholders whose equity is affected, voted in favour of the plan, or in the alternative that their treatment is fair and equitable;

(e) The stakeholders of each class must be paid fairly, in accordance with their respective class priority; and,

(f) The plan must be feasible.

In application of the law to the facts at hand, Sanlong will also be aware of the three tests embedded in Article 87 *viz.*

(i) The fair and equitable test, which adopts the principle of *pari passu* and the equal distribution amongst creditors of the same class;

(ii) The absolute priority test, calling for creditors to be paid before shareholders; and

(iii) The feasibility test, which calls for the reasonableness of achieving the goals of the plan.

Thus, as all classes of creditors have approved the plan, the tests adumbrated above have been achieved in that the creditors will receive their payments in order of priority, making the liquidation feasible.
Although Sanlong is a controlling shareholder, there is nothing to indicate that Yangtzee is a listed company, which would ultimately affect its liquidation by virtue of the amount of shareholders.
The conclusion drawn herein is that Sanlong has no footing upon which to object to the approval of the plan and it will be sanctioned by the court.

48 out of 50 points awarded

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*** End of Assessment ***