



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: **[studentID.assessment8B]**. An example would be something along the following lines: 202122-336.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 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] (10 points)

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 (1 point)

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) 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 (1 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 **correct answer**:

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] (10 points)

Question 2.1 [2 marks] (2 points)

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

For a liquidation petition: For a corporate liquidation, a bankruptcy petition filed by a creditor needs to meet the 'cash flow' bankruptcy test, according to Article 7 of the China Enterprise Bankruptcy Law of 2006. In other words, the creditor needs to show that the debtor is unable to pay a debt that has become due, to get the court to admit the liquidation petition.

For a reorganisation petition: For a reorganisation, a petition filed by a creditor will need to meet either the cash flow or balance sheet bankruptcy test at the time when the reorganization petition is presented.

Question 2.2 [maximum 4 marks] (4 points)

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

Two professions in China that dominate Chinese regional bankruptcy administrator lists are:

- Lawyers from large law firms
- Accountants from large accounting firms

Process of appointment

In 2007, the China Supreme People's Court directed provinces to have their own regional qualified insolvency practitioner lists. The power to include law or accounting firms in the list is usually exercised by the provincial supreme people's courts, which seek collaboration from local accounting and lawyer associations.

Despite usage of the term "qualified", law and accounting firms are usually included in these lists without undergoing any qualification exams or training. There is high competition amongst the lawyers and accountants to be listed, but the provincial supreme people's courts usually include firms based on their size on the assumption that a large law or accounting firm is more trustworthy in terms of competence and financial strength.

Question 2.3 [maximum 4 marks] (4 points)

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:

- 1) **Fixed charge:** Fixed charge is the most used form of security in China. A charge can be created on both immovable and movable property. China Civil Code of 2020 requires all charges to be mandatorily registered.

Process of registration: The charge holder is issued a security certificate once the charge has been properly recorded and registered with the relevant government body. A small fee may also need to be paid for the registration and such charge is not valid until properly registered.

Place of registration: The place of registration depends on the nature of the charged property and registration authorities for different types of property are as follows:

- A charge over immovable property (like building, houses and related land-use rights) needs to be registered with the local office of the China Housing Management Authority and most secured creditors also simultaneously register the charge at the local office of the China Land Management Authority (for the land-use right).
- A charge over vehicles needs to be registered with the local police vehicle management office.
- A charge over machinery and other equipment needs to be registered with the local office of the China Industries and Commerce Regulation Bureau.

- 2) **Pledge:** A pledge may be created over moveable assets and becomes valid once the pledged movable asset is delivered to the possession of the secured creditor.

Process of registration: Pledge over movable assets need not be registered, as change in possession and delivery of the asset to the secured creditor is enough. However, pledges over intangible assets such as patents, trademarks, shares, cheques and bonds can only be valid if it is registered.

Place of registration: The place of registration depends on the nature of the pledged intangible property and registration authorities for different types of intangible property are as follows:

- A pledge over trademarks needs to be registered at the China Industries and Commerce Regulation Bureau Central Office in Beijing.
- A pledge over patents needs to be registered at the China Intellectual Property Authority Central Office in Beijing.
- A pledge over shares of a listed company needs to be registered at the China Securities Depository and Clearing Corporation Limited (with offices in Beijing, Shanghai, Shenzhen and Hong Kong).
- A pledge over shares of an unlisted company needs to be registered 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)

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

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

I agree with the statement that China Enterprise Bankruptcy Law of 2006 (EBL) is a rescue-oriented piece of insolvency legislation that emphasises rescue over liquidation. The reasons for agreement with this statement are:

- EBL's focus on rescue procedures: The China Enterprise Bankruptcy Law contains two full chapters dedicated to corporate rescue procedures – Chapter 8 which deals with 'reorganisation' and Chapter 9 which deals with 'compromise or composition or settlement'. After a reorganisation process commences, debtor's management can also request the court to allow a debtor-in-possession model in the reorganisation. Only one chapter which is chapter 10 is dedicated to 'liquidation'. Moreover, the order of these chapters (i.e., rescue related chapters and provisions precede liquidation related chapter and provisions) indicates that rescue is to be attempted first.
- Ability to convert involuntary liquidation procedure into reorganisation: Debtor or shareholder holding more than 10% of the debtor's equity shareholding can apply to the court to convert a liquidation process to a reorganisation. This provision again highlights EBL's focus on corporate rescue as opposed to liquidation.
- Ability to make a voluntary reorganisation application: Article 2 of EBL allows a company to voluntarily file for reorganisation in court without having to pass any bankruptcy tests. This provision encourages companies to undertake rescue efforts as early as possible, which again shows EBL's focus on rescue over liquidation.
- Ability to cram down even when plan has not received approval from all classes of creditors: Article 87 of EBL allows the court to approve a reorganisation plan which did not receive approval from all the necessary creditor classes, effectively allowing cramming-down dissenting creditors. Article 87 applies provided that certain statutory conditions such as plan being feasible, employee and tax authority classes should have voted in favour of the reorganisation plan, and if not, then they must be paid out in full, among other conditions. Ability to cram-down dissenting creditors will allow more corporate rescues of debtors even when they did not get approval from all classes of creditors. This provision shows EBL's rescue-oriented focus.

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 will usually be required by the reorganisation administrator to fill in and submit a claim form to the reorganisation administrator in order to prove their claim. The reorganisation administrator will verify the claim against the company's books and also consult with the staff belonging to the company's financing unit to verify the claim.

In case of any dispute in relation to the value or legality of a creditor's claim, the creditor whose claim is being disputed can file a litigation before the same court which is hearing the reorganisation case. This is common and courts often hear these litigations in an expedited manner to resolve the dispute efficiently.

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

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.

Recognition of foreign bankruptcy proceedings in China is dealt with under Article 5 of the China Enterprise Bankruptcy Law of 2006. Article 5 provides that a foreign bankruptcy ruling may bind assets in China, provided that:

- The foreign bankruptcy ruling is recognised by a Chinese court;
- The recognition is based on either a judicial assistance treaty signed between the foreign country over civil and commercial matters and China or on the principle of reciprocity in case there is no such treaty; and
- Recognition of the foreign ruling does not infringe upon fundamental principles of Chinese law, China's sovereignty, security, public interests and does not disadvantage domestic creditors.

Therefore, in order to get the Australian bankruptcy proceedings recognised in China, the liquidator will need to:

- Approach the Chinese local intermediate people's court in Shanghai (i.e., the place where the Australian company's assets are located);
- Subsequently, the liquidator will need to check whether a judicial assistance treaty has been signed between China and Australia over civil and commercial matters. Currently, very few countries have entered into such treaties with China. Therefore, in the absence of such a treaty, the liquidator will need to rely on principle of reciprocity as a basis for recognition of the Australian bankruptcy proceedings. This means that the liquidator will need to check if there are any past precedents where an Australian court has granted recognition in favour of a Chinese party. The principle of reciprocity is interpreted very narrowly by Chinese courts which require the foreign country to take the first step by extending recognition in the interest of a Chinese party to establish reciprocity.
- If the liquidator is able to identify such a precedent, then it may rely on the principle of reciprocity to seek recognition of the Australian bankruptcy proceedings before the Chinese court. Importantly, the liquidator will also need to show that foreign ruling does not infringe upon fundamental principles of Chinese law, China's sovereignty, security, public interests and does not disadvantage domestic creditors.
- However, in the absence of such a treaty between Australia and China, and without a past precedent of Australian courts granting recognition to a Chinese judgment, recognition of the Australian bankruptcy proceedings in China may not be possible.
- It is usually quite difficult to get recognition of a foreign bankruptcy rulings in China and there are not more than three past instances involving bankruptcy procedures in France Italy and Germany to which recognition has been extended.
- Interestingly, in the case involving recognition of the Germany bankruptcy procedure, the Wuhan Intermediate People's Court relied on Article 282 of the China Civil Procedural Law of 1991 to grant the liquidator's request for asset disposal efforts in China. Article 282 deals with recognition of general foreign judgments and lays down similar requirements as Article 5 (i.e., existence of a judicial assistance treaty or principle of reciprocity) for granting recognition.

Conclusion: The Australian liquidator will need to meet the requirements set out under Article 5 as discussed above in order to seek recognition in China. However, in the absence of a

treaty between Australian and China and even generally seeking recognition of foreign bankruptcy procedures in China may be a challenge.

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.

Yes, the liquidation procedure against Yangtze Steel Limited can be converted to a reorganisation procedure.

Process for conversion of liquidation procedure into a reorganisation procedure:

According to Article 70 of the China Enterprise Bankruptcy Law of 2006, in case of an involuntary liquidation procedure (i.e., liquidation initiated by a creditor), the debtor or shareholders holding at least 10% or more of the debtor's equity can petition the court to convert the liquidation procedure into a reorganisation procedure. If approved by the court, then the liquidation procedure is converted into a reorganisation procedure.

In the given facts, Bank of China (a creditor) had filed a petition before the Shanghai Second Intermediate People's Court to initiate bankruptcy liquidation procedure against Yangtze Steel Limited. Therefore, since this was an involuntary liquidation procedure, either the debtor (i.e., Yangtze Steel Limited) or SanLong Limited (which holds more than 10% of Yangtze's equity) can petition the Shanghai Second Intermediate People's Court to convert the liquidation procedure to a reorganisation. If approved by the court, then the liquidation procedure can be converted into a reorganisation procedure.

One potential hurdle to be kept in mind if the conversion request is being raised by the debtor is that it is not clear how a debtor's board can exercise its right to raise the conversion request because as soon as liquidation is commenced against the debtor, the court appointed administrator takes over the control of the company and the company's erstwhile management is dissolved.

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.

According to Article 87 of the China Enterprise Bankruptcy Law of 2006, the Shanghai Second Intermediate Court can approve such a plan, even though it was voted down by the shareholders as long as it met certain statutory conditions.

Under Article 87, a court can cram-down approval of a reorganisation plan provided the following conditions are met:

- Secured creditor class should have voted in favour of the reorganisation plan, and if not, then they must be fully paid out from the secured assets (additionally fair compensation for delayed foreclosure should be paid);
- Employee and tax authority classes should have voted in favour of the reorganisation plan, and if not, then they must be paid out in full;
- Ordinary unsecured creditor class should have voted in favour of the reorganisation plan, and if not, then this class of creditors must not be paid lesser than what they would have received in liquidation;
- Shareholders should have approved the reorganisation plan if their equity is affected by the plan and if not, then they should be treated in a fair and equitable manner;
- Reorganisation plan must pay stakeholders belonging to the same class fairly, and the priority between creditors and shareholders should be upheld; and
- Reorganisation plan should be feasible.

Therefore, as long as the reorganisation plan meets (1) the fair and equitable test (i.e., *pari passu* treatment of creditors in the same class (2) absolute priority test (i.e., shareholders to be paid out only after all creditors have been paid in full (3) feasibility test (i.e., reorganisation plan must be achievable), the court can cram-down approval of the plan.

Therefore, since the reorganisation plan has only been downvoted by the shareholders but approved by all creditor classes, then as long as the plan is feasible, the Shanghai Second Intermediate Court may cram-down and approve the reorganisation plan in accordance with Article 87 of the China Enterprise Bankruptcy Law of 2006.

50 out of 50 points awarded

*** End of Assessment ***

Commented [ZZ1]: 50 out of 50 points awarded.

This might be the only paper fully meeting the required answers. Excellent.