



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] (9 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?

If a bankruptcy petition for liquidation is filed by a creditor in China, the bankruptcy test is to show cash flow insolvency of the debtor i.e. the debtor is unable to pay its debts as they fall due.

For a bankruptcy petition for reorganisation filed by a creditor, the test is to show either (a) cash flow insolvency, or (b) balance sheet insolvency (i.e. total liabilities more than total assets), when the petition is filed.

In practice, the creditor will need to garner support of the local government for the petition in order for the court to accept the same.

Question 2.2 [maximum 4 marks] (3 points)

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

The two professions in China that dominate Chinese regional qualified bankruptcy administrator lists are lawyers and accountants. Generally, it is the provincial supreme people's court that establish their own regional lists and determines the firms that are included in the lists. The court will consult with local lawyer and accounting associations, which are controlled by local government justice and finance departments. There are no specific qualifications for inclusion on the list but the courts will generally take into account the size of the firms on the assumption that a large law firm or accounting firm will have better financial strength and competence.¹

When a bankruptcy petition is accepted by the court, the court will appoint a bankruptcy administrator from the roster of the local qualified bankruptcy administrator list. At times, where the matter is large and complex, there will be a bid held to determine the bankruptcy administrator. In many provinces, the power to appoint the bankruptcy administrator is undertaken by the local provincial Supreme People's Court (e.g. in Beijing), while the local

¹ Guidance text for Module 8B China (PRC), page 13, paragraph 4.3.

Intermediate People's Court is empowered to do so for some other provinces (e.g. in Zhejiang).²

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 fixed charge and pledges.

Fixed Charge

The China Civil Code of 2020 requires a charge to be registered in order to be valid. A security certificate will be issued to the charge holder upon registration at the relevant government agency. A fee may be imposed by the authority for registration of the charge.³

Fixed charges are mainly on buildings and the use rights of the land on which the building is situated. For charge over immovable property, the charge is to be registered at the local office of the China Housing Management Authority. Most secured creditors also register the charge at the local office of the China Land Management Authority as property includes right to use the land.

Fixed charge can also be created over movable property such as vehicles and machinery. For vehicles, the charge is registered with the local police vehicle management office. For machinery, the registration authority is the local office of the China Industries and Commerce Regulation Bureau.

Pledge

A pledge becomes valid security when the pledged movable asset is in the possession of the secured creditor. For pledge of movable assets, the physical possession of the asset by the creditor is sufficient and no registration is necessary.

For pledge of intangible assets such as intellectual property rights and shares, registration is required for the pledge to be valid. If not registered, the pledge is invalid. The registration authority for such intangible assets depends on what type of asset it is.

For pledge on trademarks, registration is with the China Industries and Commerce Regulation Bureau Central Office in Beijing. For pledge on patents, registration is with the China Intellectual Property Authority Central Office in Beijing. For shares of listed companies, registration is with the China Securities Depository and Clearing Corporation Limited (which has offices in Beijing, Shanghai, Shenzhen and Hong Kong). For shares of unlisted companies, registration is with the local office of the China Companies House where the company is incorporated.⁴

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

Question 3.1 [maximum 8 marks] (8 points)

² Guidance text for Module 8B China (PRC), page 23, paragraph 6.3.4.

³ Guidance text for Module 8B China (PRC), page 15.

⁴ Guidance text for Module 8B China (PRC), page 16.

"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 of 2006 ("CEBL 2006") sets out three (3) options for bankruptcy, starting with reorganisation, followed by composition / settlement and ending finally with liquidation. Taking into consideration that there are two substantial procedures focussed on rescue, it can be seen that the CEBL 2006 is meant to be rescue-oriented.

Further, with the order of the three options starting with the rescue options, this would indicate that the intention of lawmakers was for rescue to be attempted **first** when a company is financially distressed before resorting to liquidation.

The rescue-oriented intention of the CEBL 2006 can be seen from the commencement procedures for reorganisation where a voluntary reorganisation petition can be filed by the debtor where the company is **not yet** bankrupt but is only likely to be bankrupt in the near future (Article 2 of CEBL 2006). There is no requirement for the company to be insolvent and debtors can therefore avail of such rescue option early on. In addition, where liquidation procedure has been filed by a creditor, there is also an option to **convert** the liquidation proceedings to reorganisation by application of the debtor or its shareholders holding more than 10% equity. The conversion need only to be sanctioned by the court and creditors have no say in this. The ease for a debtor to undertake reorganisation under the CEBL 2006 shows the rescue-oriented intention of the statute.

The reorganisation procedures also have features which are clearly intended to make rescue more feasible. Aside from administrator-in-possession, the CEBL 2006 provides for a **debtor-in-possession** model (subject to court's approval) after reorganisation has commenced which would allow the debtor to regain control of the company. This is clearly to encourage debtors to make use of the reorganisation process to rescue the company.

Further, under reorganisation, there is the option of **cram-down** where the court may force through the reorganisation plan despite the plan not having the votes of the four requisite creditor classes, provided that the statutory conditions are met (Article 87 of CEBL 2006). Again, this is clearly to make reorganisation more feasible to rescue the company.

Based on the above, I agree with the statement that the CEBL 2006 is a rescue-oriented legislation that emphasises rescue over liquidation. However, while the intention and spirit of the CEBL is rescue-oriented, implementation of it falls short. Also, while reorganisation have features which encourage its use and feasibility, the procedures for composition/settlement is less practical. For example, secured creditors are not bound by the composition procedure and consequently would also not be subject to the stay on proceedings against the debtor's assets. Practically speaking, a rescue is unlikely to succeed if the secured creditors are not parties to it. As such, while there are two options for rescue under the CEBL 2006, it would seem only the reorganisation procedure is more feasible to undertake a rescue.

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.

Once the reorganisation procedure has commenced and the reorganisation administrator appointed, the proof of claims process is for creditors to approach the reorganisation

administrator to file their claims, usually by filling in a claim form provided by the reorganisation administrator. The reorganisation administrator will then verify the claims by checking the debtor's books and records and check with staff from the debtor's financing unit. Where the creditor owes the debtor as well, the creditor can request for the reorganisation administrator to set-off the debt owed by the creditor against the creditor's claim.

The reorganisation administrator has two months to assume or reject executory contracts. Where the counterparty of an executory contract requests for the decision of whether the contract will be assumed or rejected, the reorganisation administrator must decide within 30 days from the request. Where the reorganisation administrator does not decide for over two months or 30 days from request of the counterparty, the executory contract will be deemed rejected. If the executory contract is assumed, security must be provided to the counterparty and the debt arising from performing the contract will be a reorganisation expense which has priority over pre-bankruptcy claims.

If there is a dispute as to the value or legality of a creditor's claim, the creditor can litigate the issue before the same bankruptcy court to obtain a judgment for the debt. The court can expedite the process to resolve the lawsuit.

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.

In principle, the Australian court bankruptcy ruling will bind the Australian company's assets in Shanghai (Article 5 of the China Enterprise Bankruptcy Law of 2006 ("CEBL 2006")). However, the Australian liquidator will need to apply to the court in Shanghai (where the assets are located) to seek recognition for the Australian bankruptcy proceedings. For the Australian bankruptcy proceeding to be recognised in China, there must either be a judicial assistance treaty signed and ratified between China and Australia or there must be judicial reciprocity between China and Australia.

There is presently no judicial assistance treaty signed and ratified between China and Australia. Therefore, the Australian liquidator cannot rely on this limb and must instead show there is judicial reciprocity between China and Australia.

To satisfy judicial reciprocity, there must already be a recognition precedent by Australian courts in favour of a Chinese party when the Australian liquidator seeks recognition for the Australian bankruptcy proceeding. If there is no prior favourable recognition by Australia to a Chinese party, then judicial reciprocity will not be satisfied.

Further, even if the Australian liquidator is able to show there is judicial reciprocity, the Chinese court can still decline to recognise the Australian bankruptcy proceeding if the recognition will infringe upon fundamental principles of Chinese law or China's sovereignty, security and public interests or disadvantage China's domestic creditors.

On the facts, as a Chinese creditor has already taken action and there is an injunction over the Australian company's assets in Shanghai, it is likely that the Chinese court will refuse to recognise the Australian bankruptcy proceedings on the basis that recognition will violate

Chinese law and disadvantage the Chinese creditor. This is likely so as there are barely any foreign bankruptcy proceedings recognised by Chinese courts and it appears Chinese courts are reluctant to recognise such foreign proceedings.

As such, it will be an uphill battle for the Australian liquidator to have the Australian bankruptcy proceedings recognised by the Chinese court.

Question 4.2 [maximum 7 marks] (7 points)

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.

In an involuntary bankruptcy liquidation procedure, Article 70 of CEBL 2006 provides that the debtor or its shareholder holding more than 10% of the company's equity may apply to court to convert the liquidation to reorganisation. As SanLong Limited holds 32% of the equity of Yangtze Steel Limited, it can apply to the bankruptcy court to convert the liquidation of Yangtze Steel Limited to reorganisation.

The application for conversion by SanLong Limited requires the sanction of the bankruptcy court. The creditors of Yangtze Steel Limited have no say in the application for conversion. Nevertheless, to support the application for conversion, SanLong Limited should have ready its reorganisation proposal and preferably have the support of key stakeholders and the local government when applying for the conversion.

If the court sanctions the application for conversion, the reorganisation procedure for Yangtze Steel Limited will then commence.

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.

Article 87 of CEBL 2006 provides that the court may cram-down and forcibly approve a reorganisation plan even if it has been voted down by one or more class of creditors or shareholders, provided the plan meets the statutory conditions thereunder. In this regard, the reorganisation plan must, among others, be fair and equitable in its treatment of its shareholders, maintain the distribution priority between creditors and shareholders and is feasible.

In this case, assuming Yangtze Steel Limited is insolvent and its shareholders would not have received anything in liquidation, then the aforesaid statutory conditions for cram-down can be met. The plan will likely be deemed fair and equitable as the shareholders are not better off in liquidation and the distribution priority is maintained. Therefore, the court can forcibly approve the reorganisation plan under the CEBL 2006 despite the shareholders down-voting the plan.

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*** End of Assessment ***