



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] (9 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 (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 **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] (6 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 procedure, as per Article 7 of the China Enterprise Bankruptcy Law of 2006, if the company is unable to pay a debt that is due, the creditor can file for liquidation procedure in court. However, a cash-flow bankruptcy test should be met if a bankruptcy petition is filed by a creditor. As the common reason for insolvency is the failure to manage cash flows.

For initiation of the formal bankruptcy reorganisation procedure by the creditor under Article 2 of the China Enterprise Bankruptcy Law of 2006, either cash-flow or balance sheet bankruptcy test will apply when the petition is presented to the court.

Question 2.2 [maximum 4 marks] (2 points)

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

The law and accounting firms are mainly the two professional firms in China that dominate Chinese regional bankruptcy administrator lists. The China Supreme People's Court to facilitate the implementation of the China Enterprise Bankruptcy Law of 2006 instructed most provinces in 2007 to establish their own regional qualified insolvency practitioner lists. Most of this provincial supreme courts have selected local law and accounting firms in the list without any qualification exams or training courses. As mentioned above, the power of selecting the official insolvency practitioner list is generally exercised by the provincial supreme people's courts which always seek collaboration from local lawyer and accounting associates. These two associations are controlled by local government, justice, and finance departments respectively. It has been observed that provincial courts mostly select the large law or accounting firm as they are more trustworthy in terms of financial strength as well as in competence. Further, given provincial supreme people's courts are not executive branches of the local government it is unreasonable for them to monitor and regulate the work of insolvency practitioners.

Other than law and accounting firms, the liquidating firms also can be appointed as insolvency practitioner, however there is no association or a body where complaint can be made against this liquidating firm while for law and accounting firm the complaint can be lodge with their professional organisations to which these professionals belong to.

However, one should note that currently there are no government agencies regulating insolvency practitioners in China.

Question 2.3 [maximum 4 marks] (2 points)

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

There are three form of security available under the China Property Law of 2007 namely fixed charge, pledge and liens.

The fixed charge is most widely used form of security and can be created over both movable and immovable property in favour of secured creditor. A charge can also be created over the debtor's assets or even over the assets of third party, however third party's consent must be obtained in advance for this. A charge must be registered under the China Civil code of 2020, if not registered it is not valid. Once charge is registered and is properly recorded at the government agency a security certificate is issued to the charge holder. A small fee applies for the registration of a charge. For immovable property the registration authority is the local office of the China Housing Management Authority and for more safety the secured creditors also tend to register the security at the local office of the China Land Management Authority. Under article 218 of the China Code of 2020 all the registered charges on buildings and use rights over land should be open to interested parties for inspection. However, it is observed that it very difficult to access the records at the China Land Management Authority even for most lawyers. The charge can also be registered over movable property such as vehicles and machinery. For vehicles, the registration authority is the local police vehicle management office while of machinery and other equipment the local office of the China Industries and Commerce Regulation Bureau is responsible for registering charges.

The second form of security, under Chapter 17 of the China Civil Code of 2020 which used is pledge, however it is less frequently used than fixed charge. A pledge becomes valid only after the pledged movable asset changes possession into the hands of the secured creditor. For moveable assets, no registration of a pledge is required as the change of physical possession itself is sufficient. Movable tangible assets such as intangible assets such as trademarks, patents, shares, cheques and even bonds can also be pledged. However, for these pledges to be valid they must be registered. For trademarks, the registration authority is the China Industries and Commerce Regulation Bureau Central Office located in Beijing. A pledge should be registered at the China Intellectual Property Authority Central Office, also located in Beijing. For shares of listed companies, the registration authority is the China Securities Depository ad Clearing Corporation Limited, a state-owned company that has offices in Beijing, Shanghai, Shenzhen and Hongkong while for unlisted companies shares, the registration of pledge takes place at the local office of the China Companies House where the company is incorporated.

QUESTION 3 (essay-type questions) [15 marks in total] (11 points)

Question 3.1 [maximum 8 marks] (4 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.

The China Enterprise Bankruptcy Law of 2006 is largely influenced from the US and Germany's bankruptcy laws. The law comprises of three bankruptcy options i.e., reorganisation, settlement, and liquidation. However, in all three options, the court must approve/ accept the petition for company to get admitted into the process. The China Enterprise Bankruptcy Law of 2006 appears to be creditor -friendly, however in reality it is court-friendly as it gives unlimited powers to court to run the process. Thus, implementing this law in the real world is difficult as well as challenging. Till 2014, the number of cases under the corporate bankruptcy were at a declining trend, though it peaked in 2018 wherein we saw only 11,264 corporate bankruptcy cases handled by the Chinese courts in such a large economy. The major problem faced by the creditors is to open a court involved corporate bankruptcy procedure in China and second being if a creditor wants to appeal a judgement the law allows them to do it only once. Thus, the first appeal is said to be final.

The first two options i.e., reorganisation, settlement are preferred options for the Chinese lawmakers. The Chapter 8 and 9 in the 2006 law highlights corporate rescue. However, article 2 of the China Enterprise Bankruptcy Law of 2006 mentions that the reorganisation or liquidation can be initiated only towards the enterprises having independent legal status i.e., partnership firms and sole traders cannot make use of this procedure, because of this there are huge number of companies in China still existing which are bankrupt. Other than this, to promote more corporate rescues the debtor or the shareholder of the company holding **more than 10%** or more in the company's equity can apply to court for conversion from liquidation to reorganisation if an involuntary liquidation procedure is commenced against the company, this is as per Article 70 of the China Enterprise Bankruptcy Law of 2006. However, doing this can led to several problems. If the local government is in support of the reorganisation the court, consider it seriously.

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

- The court has unlimited powers to run the process. It also has the exclusive powers to appoint a bankruptcy administrator.
- The Article 22 of the China Enterprise Bankruptcy Law of 2006 authorises creditor to request the replacement of the court appointed administrator by way of resolution, however it do not happen in practice, as the court has control over the creditor's meeting and the motion for replacement of the administrator are rarely heard.
- Even simple administrative functions such as convening the first creditors meeting under Article 62 of the China Enterprise Bankruptcy Law of 2006 are performed by court and not by the administrator.
- Under Article 65 the court has special powers wherein if the plan proposed is voted down by creditors in the meeting, the court has final say in as to whether it will be implemented or no.
- In case of the reorganisation plan also if it does not pass the voting threshold of the creditors, a cram-down clause is available under the China Enterprise Bankruptcy Law of 2006, i.e., Article 87 wherein court may **forcibly** approve the reorganisation plan.

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.

The process for proof of claims in a reorganisation procedure is that creditors must approach the reorganisation administrator and is usually required to fill the claim form provided by the administrator. In most of the cases, the reorganisation administrator will check the company's books and consult the company's financing unit staff for verification, post which the claim either get accepted or rejected. The creditor can litigate before the court in which the application has been filed if there is any dispute over legality or

accuracy of the claim. In many cases, court will expedite the process to resolve these lawsuits. Sometimes administrator do not agree on the amount of the claim with the creditor, if creditor files for litigation in court, the result of the litigation will serve as the final amount of the disputed claim.

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.

The Article 5 of the China Enterprise Bankruptcy Law of 2006, states that a Chinese court bankruptcy ruling binds the company's assets located anywhere in the world likewise Article 5 also provides that a foreign court ruling also binds the company's assets located in China. However, for foreign court bankruptcy ruling Article 5 adds some restrictions i.e., for a foreign judgment to be recognised in China, the applicant must prove that there is a judicial assistance treaty over civil and commercial matters between China and the foreign country in which the judgement is produced. There are around 30 countries who have signed such treaties with China at present. In this case, Australia is not part of these 30 countries which have sign judicial assistance treaty with China, so it will be difficult for Australian bankruptcy liquidator to takeover assets located in China. However, if there is no treaty, the foreign judgment can still be recognised in China if the applicant can prove that there is judicial reciprocity established between China and the foreign country. However, the Chinese way of understanding and practicing reciprocity is unique. Reciprocity is non-existent unless and until there is a Chinese judgement recognised in that foreign country and Chinese courts rarely take the first step to exercise comity or reciprocity. Up to now, only handful of foreign bankruptcy proceeding have been recognised in China. There is also no history of the reciprocity proceeding between Australia and China. Thus, without the existence of treaty or reciprocity it is very unlikely that a foreign judgment will be recognised in China in this case.

Article 281, of the China Civil Procedure of 2007, also mentions that a foreign judgement that is sought to be recognised in China must be final and conclusive. The recognition application should be made directly by the interest party to the Chinese local intermediate people's court where the disputed assets are located, but Article 282 of this law makes clear that recognition of foreign judgement is conditional upon that the foreign country having a judicial assistance treaty with China and if not, reciprocity must already be established between the two jurisdictions. If also a judicial treaty or reciprocity is available than also the court may reject the recognition application if the foreign judgement violates the fundamental principles of Chinese law (Article 82) i.e., sovereignty, security or public interest. However, China Civil procedure law of 1991 has not elaborated on what these fundamental legal principles of Chinese law really are.

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.

Given the involuntary liquidation procedure is filed by Bank of China (a creditor), its shareholder i.e., the CEO of SanLong Limited (holding 32% of the company's equity) can file a petition to the court for **conversion** of the current liquidation procedure to a reorganisation procedure. If the court grants the approval then liquidation will be changed to reorganisation.

The Article 70 of the China Enterprise Bankruptcy Law of 2006 allows the debtor or shareholder holding more than 10% of the company's equity to file a petition to the court for conversion of the liquidation procedure to a reorganisation procedure. If approved by court then liquidation will be changed to reorganisation. However, this can give rise to several problems. First, being post commencement of the liquidation procedure the company is fully in controlled by the court appointed administrator and the company's management is dissolved, so it is not clear how debtor's board can exercise its right to raise the conversion request. Second, company is into liquidation means that company has meet the bankruptcy test, thus allowing the shareholder to substantially altering the course of bankruptcy in this way is unjustifiable and lastly conversion request must also be submitted to the court that than makes decision in that regards, which can be controversial. Ideally, it is said that creditors should be given power to decide whether to convert the liquidation into reorganisation or no.

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.

The Article 87 of China Enterprise Bankruptcy Law of 2006 provides that the court may cram-down the reorganisation plan that has been voted down by one or more class of

creditor or shareholder. However, a reorganisation plan seeking the cram-down approval by the court must meet the statutory provisions of Article 87 i.e.

- i) The reorganisation plan must be voted in favour of by the secured creditor class and if not, secured creditors must be fully paid out of the secured assets.
- ii) The reorganisation plan must be voted in favour of by the employee and tax authority classes and if not, these two classes must be paid in full.
- iii) The reorganisation plan must be voted in favour of by the ordinary unsecured creditor class and if not, this class of creditors must not be paid less than they would have received under the liquidation procedure.
- iv) The reorganisation plan must be voted in favour of by the shareholders where their equity is affected by the plan and if not treatment of equity holder is fair and equitable.
- v) The reorganisation plan must pay the stakeholders in the class fairly with the priority between shareholders and creditors upheld.
- vi) The reorganisation plan must be feasible.

In this case, the court can approve the reorganisation plan under the cram-down principal even if the plan is not approved by its largest shareholder as the plan is approved by all the classes of creditors. However, the court will make sure that all the statutory provisions are met i.e., only if the creditors are paid in full and shareholder group is receive its share, else the shareholders are paid nothing.

41 out of 50 points awarded |

*** End of Assessment ***

Commented [ZZ1]: 41 out of 50 points awarded