



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] (8 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?

Liquidation is dealt with in Ch 10 of the Chinese Enterprise Bankruptcy Law 2006 (the 'CEBL'). Article 7 provides that if a company is unable to pay a debt that is due a creditor may file for liquidation. This is a cash flow test of inability to pay. Its worth noting that the test for a filing by the company itself is either a cash flow insufficiency or a failure of a balance sheet test of its assets exceeding its liabilities.

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 two that dominate are the legal and accountancy professions.

The persons eligible to be appointed as IPs are set at a provincial level and by the provincial supreme people's court. Generally the provincial courts refer to the local legal and accountancy professional associations for advice on who to appoint. These associations are controlled by the provincial justice department and finance department who will look to the larger and more established firm's in each profession to appoint. The logic applying to why these large and established firm's are used is that they are considered to be more experienced and have sufficient financial turn over to be able to support the role. There is no requirement that any firm or individual have to pass any exam or undergo any form of specific insolvency training.

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 types of security used in China are the fixed charge and the pledge. There is a third type, the lien, that exists but it is not often used.

Charge

The fixed charge is the most frequently used form of security in China. A fixed charge can be taken over moveable or immoveable property belonging to the debtor or a third party who has consented to the charge.

It must be registered, for immovable property at the relevant office at the China Housing Management Authority and, out of caution, at the relevant office of the China Land Management Authority. Article 218 of the China Civil Code 202 provides that parties should be able to inspect the charges registered against buildings and land use rights. However the China Land Management Authority doesn't generally allow access and so connections need to be used in order to verify the records.

Moveable assets are also capable of being charged. A charge over a vehicle must be registered at the local police vehicle management office. If it is machinery or other forms of equipment then registration should take place at the local office of the China Industries and Commerce Regulation Bureau.

Pledge

Pledges are also used in China for moveable property. Pledges require the delivery of a moveable asset to the secured creditor who keeps it in their possession until the secured liability is discharged. There is no need to register the pledge of a moveable asset as possession has changed.

It is also possible to pledge certain intangible assets such as trademarks, patents, shares, cheques, and bonds. These type of assets need registration for the pledge to be effective. They are registered as follows:

- Trademarks at the China Industries and Commerce Regulation Bureau in Beijing;
- Patents at the China Intellectual Property Authority Central Office in Beijing;
- Share in listed companies at the China Securities Depository and Clearing Corporation Limited at its offices which are located in Beijing, Shanghai, Shenzhen and Hong Kong; and
- Shares in non-listed company at the local office of the China Companies House at the place
- of incorporation of the pledged shares issuing company.

QUESTION 3 (essay-type questions) [15 marks in total] (13 points)

Question 3.1 [maximum 8 marks] (6 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.

On the surface the CEBL does seem to be a rescue orientated piece of legislation as it contains two rescue mechanisms (reorganisation and composition) and one insolvency process (liquidation). We know that the draftsmen of the CEBL, led by Wang Weiguo, were heavily influenced by the rescue style procedures contained in Ch 11 of the US Bankruptcy Code.

There are a number of other features within CEBL that are designed to facilitate rescue and are seen in other parts of the world. Examples of this are a moratorium, the ability for **DIP** management, the ability to raise DIP financing, the use of class based voting and the ability for a class **cram down**. These are all features that are incorporated into rescue type systems

to facilitate a better opportunity for a successful rescue. All these features point to the intention of the drafters for CEBL to promote a rescue culture.

However there are some features within the CEBL legal systems that distinguish it from systems seen elsewhere:

- Entry into any insolvency procedure in China involves the court and results in a the appointment of an administrator who is court appointed. The administrator acts under the direction of the relevant appointing judge so in practice it is the judge who makes most of the decisions in a procedure and China generally doesn't have specialist insolvency judges. In addition it is generally considered in the international markets that, if an external appointment is made, it is best made to appoint a specialist in the type of insolvency procure and sector to allow for a successful running of the underlying business, even in the case of a liquidation. Clearly the Chinese system in practice does not lend itself to a successful rescue outcome if a judge is in effect running the restructuring.
- Connected to the above, the final sign off on any restructuring is not the creditors (as is generally the case in most systems) but the court. This gives the court an ability to approve a plan which has been voted down in a creditors vote and thereby impose an outcome on the creditors.
- China lacks any mechanism to hold directors to account for trading whilst insolvent. Without the There is no obligation in the CEBL requiring the directors to file for any form of insolvency process when they are aware that the company is insolvent. Without a pressure on them there is no likelihood of directors pursuing insolvency and so companies are more likely to become dormant or zombie companies than go through the formal insolvency route.

Lastly there is the defacto factor of Chinese business culture and Chinese government roles in the economy. China is a centrally planned state where government plays a very significant factual role and soft power role in day to day business. Central government delegates to the provincial government the obligation to try to maintain high employment in their provinces. Therefore provincial government plays an outsized role in insolvency in China because it does not want to be perceived to be a location for business failure nor for there to be a decline in employment. For these reasons provincial government will try to avoid insolvency proceeding of any nature and, if there is an unavoidable trigger to a proceeding, push for a restructuring to avoid redundancies. Given that there is no clear separation between the executive branch of government and the court system this gives the provincial government considerable sway over the judges to implement its decision.

So in the sense of a literal interpretation of the law it is fair to say that the drafting prioritises rescue over insolvency. In practice the overall economic governance system does not favour any form of insolvency process so there is no real prioritisation.

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.

A creditor is required to file its claim with respect to a restructuring estate within the time period laid down by the relevant People's court at the opening of the proceedings. Generally such time frames run between 30 days and three months from the date of the commencement of the petition.

Eligible claims include the following:

- Unpaid sums that are unpaid at the time of the petition application;

- Debts that are yet to mature;
- Contingent debts;
- Debts that are subject to a disputes process;
- Any obligation to indemnify a third party who has acted as surety or otherwise discharge a liability for the debtor; and
- Any damages due to termination of any contract by the debtor or administrator.

Proof is made by approaching the reorganisation administrator for the necessary form that the proof should be filed in. The creditor should fill in the specified form required by the administrator detailing the particulars of the claim and amount.

The reorganisation administrator will verify the claim submitted. It will usually do this by reference to the debtor's books and may also consult with the debtors staff as to the veracity of the claim.

In the event that the reorganisation administrator denies the validity of a claim the creditor can apply to the court supervising he restructuring. The assigned supervising insolvency judge will adjudicate between the creditor and the reorganisation administrator as to the validity of the claim and order its admission or not.

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 issue here is recognition of a foreign insolvency practitioner in China.

China has not adopted the UNCITRAL Model Law on Cross-Border Insolvency so there is no recognition under an implementation of that model.

Article 5 of CEBL does provide that the China should recognise a foreign court's bankruptcy ruling in relation to any assets of the bankrupt located in China. However the obligation to recognise a foreign bankruptcy ruling is no unqualified. Most importantly the foreign court ruling must be recognised by a Chinese court on the basis of either a judicial assistance treaty signed and ratified between China and that foreign court's country or on the principal that that country has already recognised a Chinese judgement and therefore reciprocity of recognition exists. In addition there are some more general public policy type restrictions on recognition: the foreign court's ruling must not trespass upon the fundamental principles of China's laws, sovereignty, security or public interest; and, it must not put any Chinese domestic creditor to the foreign entity at a disadvantage.

Australia is not a party to a treaty of judicial assistance with China and therefore the Australian bankruptcy liquidator will not be able use that avenue to seek recognition.

In order to establish recognition by reciprocity China insists that the foreign jurisdiction must have recognised a Chinese court judgment prior to any recognition by China. This means that there has to have been recognition in Australia of a Chinese party's favourable judgement.

There have been few recognitions of foreign bankruptcy rulings in China. Recognition has been granted to foreign representatives from Italy, France and Germany. There has been recognition of a Chinese court judgement in Australia in the case of Liu v Ma 2017 VSC 810. On the basis that that was recognition of a Chinese judgement the first step for recognition in China of an Australian foreign bankruptcy judgement is in place. It would be up to the people's court in Shanghai (being the place of location of the freezing injunction) as to whether recognition could be granted.

I note that the legal action in China is a freezing order over the Australian company's assets. One of the principals of recognition is that the recognition would not disadvantage Chinese creditors. Recognition itself should not do that however it is likely that the Chinese creditor will challenge any recognition of the Australian IP and Chinese courts can have nationalistic leanings which may not help a recognition.

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.

It is possible to **convert** a liquidation process to a reorganisation if certain conditions are met:

- The liquidation must have been an involuntary one filed by a creditor; and
- A person who is either the debtor itself or a shareholder who holds more than 10% of the equity must apply to court for conversion into a reorganisation.

In this case both of these tests are met. In theory YSL should therefore be able to convert from a liquidation to a reorganisation. In practice the court is not going to sanction a switch from one to the other unless SLL can show a fully implementable reorganisation plan that has the buy in of the creditors. In this case the court is also likely to ask Jingchen Partners' view on the proposal and conversion to reorganisation may not be in their interests so they may not be aligned to help the process. It would also be key to get Bank of China's agreement to the reorganisation plan as they are a powerful state owned bank with ability to guide things behind the scenes.

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.

Under the CEBL the court has the power to approve a plan that does not have unanimous consent.

Under Article 85 of CEBL any reorganisation plan that affects the shareholders must be voted upon by the shareholders.

Having passed or failed to pass the creditor and shareholder vote the court must confirm the plan or not. Under 87 the court has the power to cram down any class (including the shareholders) who vote against a plan. Article 87 sets out the parameters for a cram down by the court. Any plan it approves must:

- Have been approved by the secured creditors, or if not so approved, provide that they will be fully repaid from the security;
- Be approved by the employees and the tax authorities and, if not approved, provide for them to be fully paid;
- Be approved by the unsecured creditor class and, if not approved, have them paid out not less than they would have received on a liquidation pay out;
- Be approved by the shareholders and, if not so approved, ensure that the plan is fair and equitable to those shareholders;
- Pay classes as between themselves fairly and ensure that the ranking of creditors and shareholders is respected; and
- Be implementable.

From the application of these tests we can see that the court can approve the plan notwithstanding SanLong's vote against it provided that the court believes the plan is fair and equitable to SanLong, generally preserves the credit distinction between creditor and equity holder and the plan is feasibly implementable.

Generally dissenting shareholders will get crammed down if a reasonable implementable plan is produced. The only case where this may not be the case is where the bankrupt entity is publicly listed with significant public float. In that case the court may be swayed by a desire to protect the individual shareholders and look for a plan that offers the shareholders something. From the fact pattern it is not possible to say whether Yangtze Steel is listed.

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*** End of Assessment ***