



**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**.

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## **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?

Under Article 7 of the China Enterprise Bankruptcy Law, a creditor can file for a bankruptcy petition before the relevant court if it can prove that the debtor is insolvent on a cash flow basis. However, in practice, a bankruptcy petition should be supported by local government before it is accepted by 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.

Bankruptcy administrators are appointed solely by the courts from regional insolvency practitioner lists. The two professions that dominate regional bankruptcy administrator lists are the legal and accountancy professions.

In practice, most if not all provincial supreme courts select lawyers from large local law firms and accountants from large accounting firms for their lists without requiring any formal training or qualifications, as the size of the firm is considered to be indicative of its competence and financial strength. These courts collaborate with local lawyer and accounting associations for the selection process.

**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 are fixed charges and pledges.

Fixed charges are the most widely used form of security and they can be created over moveable and immoveable property belonging to the debtor or even to a third party. Fixed charges are mostly used in relation to immoveable property such as buildings, houses and

associated use rights. Fixed charges can also be created over moveable property such as vehicles and machinery but this is less commonly used.

Chapter 17 of the 2020 China Civil Code provides that a fixed charge is only valid when it is registered with the relevant government agency. A small registration fee may be payable and a security certificate is issued to the charge holder. A charge over immovable property must be registered at the local office of the China Housing Management Authority. For added security, charge holders will also register the charge with the China Land Management Authority, as the land use right corresponding to the land where the building stands forms part of the property.

Pledges are less frequently used than fixed charges over moveable property, including tangible (e.g. vehicles and machinery) and intangible assets (e.g. trademarks, patents, shares, bonds). For moveable property, a pledge is created after the property is in the secured creditor's possession and is not required to be registered. By contrast, intangible assets must be registered in order to be valid.

Pledge registration authorities vary depending on the asset:

- trademarks must be registered at the China Industries and Commerce Regulation Bureau Central Office in Beijing;
- patents must be registered at the China Intellectual Property Authority Central Office in Beijing;
- shares in listed companies must be registered at offices of the China Securities Depository and Clearing Corporation Limited;
- shares in unlisted companies must 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] (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.

The 2006 China Enterprise Bankruptcy Law (**Bankruptcy Law**) is described as rescue oriented but in practice, successful corporate rescues appear limited in number. There are only a small number of court-involved bankruptcies each year (peaking at only 11,261 in 2018) given the practical difficulties in opening bankruptcy procedures via the courts. The vast majority of bankrupt companies simply continue to exist and jeopardise the interests of creditors. There are a number of reasons for this.

Firstly, Article 2 of the Bankruptcy Law states that the Bankruptcy Law only applies to enterprises having a separate legal identity, so that it does not apply to sole traders or partnerships. There is no rescue mechanism under Chinese law for entities who do not have a separate legal identity, even though around 70% of registered businesses in China are sole traders.

Secondly, despite there being three options available to debtors in distress under the Bankruptcy Law, the options relating to rehabilitation or rescue appear limited for the reasons stated below.

1. One option is reorganisation, which is largely borrowed from the US Chapter 11 procedure. A company can voluntarily file for bankruptcy when it is likely to become bankrupt in the near future, **without** having to provide evidence of bankruptcy. When a petition for reorganisation has been accepted by the court, that court appoints a bankruptcy administrator (from its list of qualified insolvency practitioners) to take control over the company's affairs and assets. Thereafter, the company management can seek a **debtor-in-possession** style order from the court and if granted, the debtor's management regains control of the company and the court-appointed administrator adopts the role of a supervisor. However, it is practically impossible for the board of directors, who have lost control of the company, to pass the requisite board resolution and obtain shareholder approval to seek a debtor-in-possession order.

A creditor can also file for the reorganisation of the debtor.

One good point is that even if a reorganisation plan fails to receive approval from a certain class of creditors, Article 87 of the Bankruptcy Law stipulates that the court can exercise a **cram-down** and forcibly approve the reorganisation plan.

2. Another option is a settlement or composition procedure, which can only be done voluntarily. Pursuant to Article 95 of the Bankruptcy Law, the debtor presents a composition or settlement plan to the court for approval. Once approved, a creditors' meeting must be convened to vote on the plan. Article 97 of the Bankruptcy Law lacks the necessary detail to ensure that this process can be carried out in practice – it only provides that the composition plan is passed if voted in favour by 50% or more of the attending creditors in number holding at least two-thirds of the total claims. However, given that secured creditors such as banks, who are the largest debt holders, are not bound by the composition procedure under Article 96 of the Bankruptcy Law, they are not subject to the mandatory stay suspending all legal enforcement against the debtor's assets and are not incentivised to participate in the composition plan. In practice, without the participation of secured creditors, composition plans are unlikely to succeed.
3. The third option is liquidation under Chapter 10 of the Bankruptcy Law. This is not a rescue option and instead focusses on winding up the company and maximising returns to creditors in the order of priority as stipulated by statute.

### **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 must submit proof of its claim to the bankruptcy administrator, usually by completing a claim form, which will then be verified by the administrator in consultation with the company's books and the company's finance department.

In the event of a dispute over the value or legality of a creditor's claim, the creditor can commence a claim in litigation before the same court. Some courts arrange for such lawsuits to be resolved on an expedited basis. The outcome of the litigation determines the final amount of the disputed claim.

### **QUESTION 4 (fact-based application-type question) [15 marks in total] (11 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.

Article 5 of the Bankruptcy Law provides that a foreign court bankruptcy ruling is binding on the company's assets in China, with certain important restrictions, namely that the foreign ruling must first be recognised by a Chinese court before taking effect in China. Such recognition is based on either (a) a judicial assistance treaty signed and ratified by China and the country where the bankruptcy ruling originated; or (b) in the absence of such a treaty, the principle of reciprocity. As at 2020, China has signed 39 bilateral treaties on judicial assistance on civil and commercial matters including recognition and enforcement of foreign judgments<sup>1</sup>.

As there is no such treaty between China and Australia, the liquidator would need to rely on the principle of reciprocity. However, China recognises a restricted form of reciprocity such that reciprocity must first be established by the foreign country. The liquidator therefore should provide at least one instance of an Australian court enforcing a Chinese judgment. It appears that the first instances of judicial recognition of Chinese judgments by Australian courts occurred in 2017 and 2019 by the Victoria Supreme Court in *Liu v Ma & anor* [2017] VSC 810, and *Suzhou Haishun Investment Management Co Ltd v Zhao & Ors* [2019] VSC 110. More recently, in May 2020, when the New South Wales Supreme Court enforced a Qingdao Intermediate People's Court judgment in *Bao v Qu; Tian (No 2)* [2020] NSWSC 588. Hopefully this growing practice of Australian courts enforcing Chinese judgments will also encourage the relevant Shanghai court to recognise and enforce the Australian court's bankruptcy ruling.

**Question 4.2 [maximum 7 marks] (3 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] (0 point)**

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.

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<sup>1</sup> See <https://www.chinajusticeobserver.com/a/list-of-chinas-bilateral-treaties-on-judicial-assistance-in-civil-and-commercial-matters>.

Under Article 10 of the Bankruptcy Law, following an involuntary liquidation filing, Yangtze Steel Limited has 7 days in which to object to the liquidation procedure. As such, in theory, if the 7-day time period is still running, SanLong Limited can try to organise the board to pass the special resolution to seek a reorganisation which would then need to be passed by a shareholders' meeting, and file its objection to the Court and petition the Court to convert the liquidation procedure to a reorganisation procedure. In practice, this is very difficult to achieve given that the company is now in the hands of Jingchen Partners, who were appointed by the Court as the bankruptcy administrator.

Further, SanLong Limited would need to secure local government support in order to incentivise the court to accept such an application as it is understood that in most cases, courts simply ignore petitions without providing any explanation. Given that the Court has already accepted the liquidation procedure, which would have necessitated local government support in the first place, this may be difficult. The fact that SanLong Limited is a controlling shareholder holding 32% of the equity in Yangtze Steel Limited and that there is still value in some of the company's businesses would be insufficient to sway the court. If SanLong Limited can exercise influence in local government, now would be the time to do it. Securing the support of the bankruptcy administrator for the reorganisation procedure, may also assist as the administrator was appointed by the Court and may have the ear of the relevant judge(s).

**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.

Approval of the reorganisation plan does not end with the approval of all classes of creditors, under Article 87 of the Bankruptcy Law, the Court can still cram-down the reorganisation plan despite SanLong's vote against it subject to the following conditions:

1. The secured creditor class voted in favour of the reorganisation plan, failing which the secured creditors are repaid in full out of the secured assets (with interest to compensate for the delayed foreclosure);
2. The employee and tax authority classes of creditors voted in favour of the reorganisation plan, failing which they are repaid in full;
3. The ordinary unsecured creditors voted in favour of the reorganisation plan, failing which they are not paid less than they would have been paid under the liquidation procedure;
4. The shareholders voted in favour of the reorganisation plan where their equity is affected by the plan, failing which they are treated in a fair and equitable manner;
5. The plan pays the stakeholders in the same class fairly, with priority between creditors and shareholders upheld; and
6. The plan must be feasible.

From the above conditions, given that all classes of creditors approved the plan, it would appear that the key condition as far as SanLong is concerned is whether SanLong and the other shareholders have been treated in a "fair and equitable manner". As the plan proposes that the shares of all previous shareholders be wiped out, it would appear that this condition is fulfilled, albeit to SanLong Limited's (and the other shareholders) detriment. As long as conditions 5 and 6 above are respected, even where SanLong Limited voted against the reorganisation plan, the Court can still confirm it and forcibly approve the plan, making it legally binding on all consenting and dissenting stakeholders.

42 out of 50 points awarded

**\* End of Assessment \***

Commented [ZZ2]: 42 out of 50 points awarded