



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: 202223-336.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 "studentID" 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 2023. The assessment submission portal will close at 23:00 (11 pm) BST (GMT +1) on 31 July 2023. 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 9 pages.**

ANSWER ALL THE QUESTIONS

QUESTION 1 (multiple-choice questions) [10 marks in total] (10)

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)

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) *Partnerships and sole traders.*
- (d) *Individuals or sole traders.*

Question 1.2 (1)

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)

Select the correct answer:

How is a bankruptcy administrator appointed under the China Enterprise Bankruptcy Law of 2006?

- (a) *The bankruptcy administrator can only be 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 can appoint provisional bankruptcy administrators when filing.*
- (d) *The court can only appoint a bankruptcy administrator after getting consent from both the debtor and the creditors.*

Question 1.4 (1)

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 debtor is allowed to file.*
- (d) *Both creditors and shareholders of the company may file for bankruptcy.*

Question 1.5 (1)

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 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 is automatically selected once a reorganisation procedure is commenced.**

Question 1.6 (1)

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 treated as unsecured creditors in China and are not given preferential treatment.**

Question 1.7 (1)

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 the Chinese courts.**
- (c) **If shareholders do not support / approve the reorganisation plan, the plan cannot be crammed-down by the courts.**
- (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)

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 from countries which have adopted socialism.**

Question 1.9 (1)

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)

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 most?

- (a) **The United States of America.**
- (b) **Russia.**

(c) Poland.

(d) The United Kingdom.

QUESTION 2 (direct questions) [10 marks] (8)

Question 2.1 [2 marks] (2)

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

Pursuant to article 7 of the China Enterprise Bankruptcy Law of 2006, a creditor must prove that the debtor company is unable to pay a debt that is due. This means that the cash flow test is used for creditor-filed petitions.

Where the petition is by the company, either a cash flow or balance sheet test is permissible.

Question 2.2 [maximum 4 marks] (2)

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 dominating the administrator lists are law firms and accounting firms. In practice, many provinces such as Beijing have reserved the power of appointment to the local provincial Supreme People's Court (apparently in an attempt to limit corruption). However, some provinces like Zhejiang have reserved the power to the Intermediate People's Court.

Question 2.3 [maximum 4 marks] (4)

Name the most used type of securities available under Chinese law and explain how and where they are registered.

The most common type of security under Chinese law is the fixed charge. Fixed charges are typically granted in relation to buildings and use rights on land (private land ownership being impermissible in the PRC), so are registered at the office of the China Housing Management Authority local to the relevant immovable property. Whilst not strictly required, most creditors taking a fixed charge over immovable property also have it registered at the local office of the China Land Management Authority, because the use right of the land is included in the immovable property.

Fixed charges over vehicles (although less common than those over immovable property) are registered at the local police vehicle management office. Similarly, fixed charges over machinery are also uncommon but are registered at the China Industries and Commerce Regulation Bureau.

A fixed charge only becomes valid under the China Civil Code after registration (for which a fee may be payable) and a security certificate is issued to the secured creditor post-registration to evidence this.

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

Question 3.1 [maximum 8 marks] (6)

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

Discuss what legal mechanisms in this statute can support this statement.

The China Enterprise Bankruptcy Law of 2006 (CEBL) contains three key mechanisms for dealing with insolvent or near-insolvent companies. The first two (dealt with at chapters 8 and 9 respectively) are reorganisation and composition (also known as settlement), both of which are aimed at the rescue of the relevant entity rather than its winding-up. It is only the third option (dealt with at chapter 10) of liquidation that contemplates the eventual dissolution of the company. Even the order of the relevant chapters shows the rescue-focussed approach that was intended to be adopted.

Reorganisation

Reorganisation under chapter 8 of the CEBL is similar to a US Chapter 11 procedure. Under this mechanism, a company that is bankrupt or approaching bankruptcy may petition the Court for the commencement of a reorganisation procedure. The fact that no bankruptcy test is required for company-led petitions shows the pro-rescue nature of this remedy: the idea is to reorganise the company's debt, equity or business (as may be appropriate) before insolvency is reached, to enhance the prospects of the company being successfully rescued and returning to trading as a financially viable enterprise.

Once the Court has been petitioned for the commencement of a reorganisation procedure, a bankruptcy administrator will be appointed and will take control of the company. A moratorium on claims will also commence to allow the company "breathing room" to effect the reorganisation. Typically, the administrator will create a reorganisation plan and see it through, but it is possible (although rare) to convert the reorganisation into a debtor-in-possession (DIP) reorganisation in which instance the company's former management will again assume control and the administrator will take on a supervisory role only.

Most reorganisations take the form of a business sale, but the plan will ultimately depend on the nature of the entity's business and debt. The reorganisation plan must be voted on at a creditor's meeting, and votes are tallied in 4 classes (employees, tax creditors, secured creditors and ordinary (unsecured) creditors).

In addition to the creditor vote, a shareholder vote is also required where the company's equity will be impacted by the reorganisation plan. Cramdown mechanisms are available to prevent one dissentient class from jeopardising the entire reorganisation.

Assuming that the plan is passed by the above votes, it will be remitted to the Court for consideration and further approval. If the plan was not passed by all classes, the court can cram down dissident creditors (or shareholders) by using the mechanisms set out in article 87 of the CEBL.

Composition

Composition under the CEBL is a voluntary process (i.e. can only be commenced by the company itself, not by creditors). To utilise the composition route, a company will present a petition to the Court under article 95 of the CEBL, along with a composition (settlement) plan. A moratorium is commenced (although has limited effect, because secured creditors are expressly excluded from its application).

If the Court approves the plan, it will convene a meeting of creditors to vote on it. The composition plan will pass if voted for by at least half of the creditors in attendance representing two-thirds of the total creditor claims (albeit it is not clear from the language of the CEBL whether that will be in classes like a reorganisation, or simply across the entire creditor body).

If the composition/settlement plan is approved by the creditors, it is remitted to Court for further approval. However, as mentioned above secured creditors are excluded from the stay, and are generally not subject to the composition mechanism. In practice this means that a company with a significant secured debt burden is unlikely to be able to successfully apply a composition mechanism by way of rescue.

Practical effect

Unfortunately, despite the pro-rescue options set out in the CEBL, it is often the case that the Courts in China refuse to grant any petitions under the CEBL, including reorganisation and composition/settlement petitions, due to a lack of judicial accountability. This means that in practice many entities that should have been dealt with under the relevant mechanisms simply continue to trade into insolvency, which jeopardises the economy and the interests of creditors.

Question 3.2 [maximum 7 marks] (7)

Briefly explain the process for the proof of claims in a corporate liquidation procedure and the procedure that is followed should the value or existence of a creditor's claim be disputed.

In a corporate liquidation scenario, one of the liquidation administrator's key functions is to call for and adjudicate proofs of claim. Post-appointment, the administrator will advertise its appointment and call for proofs to be submitted to it.

*Proofs of debt submitted are checked with reference to the company's financial books and records, and potentially by questioning the employees of the company's financial department where required. In the event that a claim is accepted as valid by the administrator, that claim will be paid out of the administrator's realisations at the conclusion of the liquidation process in accordance with the relevant priority (if any) of that particular claim and *pari passu* with any other claims of the same class.*

In the event that the claim is disputed, whether that be because the entire existence of the claim is denied or because the claim is admitted but its quantum is not agreed, the creditor will litigate to secure an adjudication of that claim. Many courts have expedited procedures to efficiently deal with claims of this nature. The creditor and the administrator will respectively argue for and against the claim (or its quantum if only that is disputed), and the Court will determine the existence and extent of the creditor's claim. Assuming the Court finds that there is a valid claim, that claim will be paid out of the realisations in the same way as other claims, at whatever quantum has been fixed by the Court.

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

Question 4.1 [maximum 8 marks] (8)

The bankruptcy liquidator of a Singaporean 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 Singaporean company in China. The liquidator has approached you for advice on how the Singaporean bankruptcy proceeding can be recognised in China. Advise the liquidator.

Pursuant to article 5 of the China Enterprise Bankruptcy Law, a foreign bankruptcy order binds assets situated in China, but must be recognised in China before taking effect. Foreign bankruptcy proceedings are only recognised in China where (i) there is a judicial assistance treaty concluded between the relevant country of origin and China, or (ii) there is judicial reciprocity established between China and the country concerned. In addition, the recognition of the foreign order must not infringe on fundamental Chinese law, the sovereignty of the Chinese state, Chinese security or public interest. In addition, it must not disadvantage any domestic creditors.

Recognition is achieved by way of an application to the intermediate people's court with jurisdiction over the place where the assets are situated - in this instance, Shanghai.

Because the Singaporean company has assets in Shanghai, and the Singaporean government has concluded a judicial assistance treaty with the Chinese government, the Singaporean bankruptcy order can, in theory, be recognised in China under article 5. The liquidator could rely on that recognition to seek to have the injunction overturned so that he can gather in the assets situated in China to bring them within the envelope of the liquidation and deal with the creditor's claim in that manner.

Despite having the mechanism available as set out above, Chinese courts tend to take a very conservative approach and there has only been one instance in the history of Chinese bankruptcy law of a Singaporean bankruptcy being recognised. This is said to be based on a perception that recognising foreign proceedings may give the appearance of weakening China's judicial system, or possibly because Chinese judges are hesitant to deal with cases where foreign law is involved.

As such, it is very likely that if an application were made by the Singaporean liquidator, it would ultimately be unsuccessful. This is likely to be because granting the recognition would, as indicated above, result in the assets which are currently subject to an injunction in favour of a Chinese creditor being brought within the Singaporean liquidation. The Court may well conclude that this falls foul of the requirements of article 5, inasmuch as granting recognition in these circumstances is likely to be to the disadvantage of that creditor (because it will now be required to share in the realisations of those assets with other creditors in the liquidation in accordance with Singaporean law, rather than enjoying sole rights to deal with those assets in satisfaction of its claim as it presently does).

Question 4.2 [maximum 7 marks] (7)

HuangPu Food Limited is a large beverage 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 Fenda Partners, a local law firm included in the local bankruptcy administrator list, as the liquidation administrator.

Shortly after the commencement of the bankruptcy of HuangPu Food Limited, the CEO of Naking Limited, a controlling shareholder holding 32% of the equity of HuangPu Food Limited, approaches you for advice.

Using the facts above, answer the questions that follow.

Question 4.2.1 [maximum 4 marks] (4)

The CEO of Naking Limited tells you that the various businesses of HuangPu Food Limited are still viable and that a piecemeal liquidation of the company will not be in the interests of any of the stakeholders. Since HuangPu Food 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.

*Pursuant to article 70 of the China Enterprise Bankruptcy Law, it is possible to convert an involuntary liquidation to a reorganisation where *inter alia* the holder of a 10% or higher equity stake in the Company applies to the Court for it to be so converted. Given that the HuangPu liquidation was commenced on the petition of the Bank, it is classed as an involuntary liquidation. Similarly, given that Naking holds a 32% stake in the HuangPu, it is eligible to apply for the liquidation to be converted to a reorganisation.*

This can be achieved by Naking applying to the Shanghai Second Intermediate People's Court for an order converting the HuangPu liquidation to a reorganisation.

*However, it must be borne in mind that practically speaking, very few such orders are actually granted. This procedure is also heavily criticised for being potentially detrimental to the creditors, since they (i) do not have the ability to seek such a conversion, and (ii) do not have a say in whether or not the conversion is granted, despite that conversion having an impact on their rights *qua* creditors.*

Question 4.2.2 [maximum 3 marks] (3)

Assuming that the bankruptcy liquidation of HuangPu Food Limited is successfully converted to a reorganisation procedure, a reorganisation plan for HuangPu Food Limited is eventually voted on by the various stakeholders. Due to the fact that HuangPu Food Limited is insolvent, the reorganisation plan *inter alia* proposes that the shares of all previous shareholders be cancelled. Unhappy that its equity in HuangPu Food Limited will be wiped out by the reorganisation plan, Naking 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 Naking Limited as to whether the Court can approve such a plan under the current law in China.

Under article 87 of the China Enterprise Bankruptcy Law, it is permissible for the administrator to submit the plan for Court approval despite the lack of approval by the shareholder class. If the Court approves the plan despite objection from the

shareholder class (or a creditor class, albeit that is not relevant here), it is known as cram-down. The requirements for a cram-down are set out in article 87, and broadly fall into three distinct categories: first, the plan must be fair and equitable, ensuring equality (pari passu distribution) between creditors in the same class. Second, the plan must respect the absolute priority of creditors, meaning that all creditors must be paid in full before any shareholder receives anything (unless the contrary is unanimously agreed by the creditors). Finally, the plan must be feasible, meaning that it is achievable in the circumstances of that particular company.

If all of these tests are met, the Court is empowered under article 87 to approve the plan regardless of the dissent of the shareholder class, i.e. to cram down the shareholders including Naking.

Final mark: 46/50

* End of Assessment *