



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).**
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- 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] (10)

Question 2.1 [2 marks] (2)

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

The cash-flow test (per Art 7 of the CEBL); namely that the debtor is unable to pay a debt that is due. Notwithstanding this, without the support of the local government, there may be a good chance that the application would be ignored (Guidance Text at p 21).

Question 2.2 [maximum 4 marks] (4)

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

Generally, large law or accounting firms tend to dominate the Chinese regional bankruptcy administrator lists. These firms are drawn from a list of qualified insolvency practitioners. Generally, the provincial supreme people's courts exercise the power to include and appoint a law or accounting firm into this list. In some other provinces (such as in Zhejiang), it is the local Intermediate People's Court that may exercise the power of appointment. The provincial courts tend to seek collaboration from local lawyer and accounting associations in this regard, with said associations actually controlled by the local government justice and finance departments (Guidance Text at p 13). These firms tend to be large as the provincial courts assume that a large firms are more trustworthy (Guidance Text at p 13). It has been noted, however, that the moniker of "qualified" insolvency practitioner may be misleading since there appear to be no qualification requirements (such as taking exams or training courses) that said practitioners are held to.

Insofar as the actual appointment of the bankruptcy administrators in the context of a formal insolvency procedure is concerned, these administrators are appointed exclusively by the courts, with the creditor and debtor having no say regarding the appointment. While the creditor may ask the court to replace the incumbent administrator pursuant to Art 22 of the CEBL, it is noteworthy that this can only be done upon proving that the administrator is incompetent or biased, and further that there appear to be little to no examples of this happening in practice (Guidance Text at p 31).

The debtor, on the other hand, may be in a position to weaken the control which the bankruptcy administrator may influence over the company. The debtor could apply for the debtor-in-possession model (Art 73 of the CEBL), which, if approved, means that the administrator recedes into a supervisory role and must return control over the company to the debtor. In practice, however, most reorganisations remain under the control of the administrator as only a small percentage of cases apply for the DIP regime (Guidance Text at p 32).

The Court may then organise a bid amongst the firms listed on the locally qualified bankruptcy practitioner list should the case be complex and large.

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.

(1) Fixed Charge

The fixed charge is the most widely used form of security. These must be registered under the China Civil Code of 2020 and are not valid until so registered. For charges over immovable property, the registration authority is the local office of the China Housing Management Authority, though for safety, most secured creditors tend to simultaneously register the charge at the local office of the China Land Management Authority. Once the charge is recorded at the relevant government agency and upon the payment of a small fee (if necessary), a security certificate is issued to the charge holder.

If a fixed charge is created over movable property, these should be registered as follows: for vehicles, the local police vehicle management office; for machinery and other equipment, the local office of the China Industries and Commerce Regulation Bureau.

(2) Pledge

Pledges are also a form of security used in China. For movable assets, no registration is required as the change of physical possession itself is sufficient. However, intangible movable assets such as trademarks, patents, cheques and bonds must be registered to be valid.

For trademarks, the registration authority is the China Industries and Commerce Regulation Bureau Central Office in Beijing; for patents, the registration authority is the China Intellectual Property Authority Central Office; for shares of listed companies, registration should be made at the China Securities Depository and Clearing Corporation Limited; for shares of non-listed companies, registration may take place at the local office of the China Industries and Commerce Regulation Bureau where the company is incorporated.

QUESTION 3 (essay-type questions) [15 marks in total] (14)

Question 3.1 [maximum 8 marks] (7)

“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.

Art 70 of the CEBL stipulates that in the vent of an involuntary liquidation procedure, the debtor or its shareholders holding 10% or more of the company’s equity can apply to the court for conversion from liquidation to reorganisation. (see p22). This mechanism allows for an ‘out’ for the debtor or the shareholders such that the insolvency proceedings may be steered toward the object of rescuing the company rather than liquidating it.

*Art 2 of the CEBL also envisages that the debtor may lodge a *voluntary* reorganisation petition when the company is not yet bankrupt but is likely to be bankrupt in the near future. This encourages rescue efforts to be made at as early a stage as possible, and allows the debtor some manner of autonomy over when insolvency proceedings are commenced.*

Art 19 of the CEBL also imposes a moratorium on all executions against the company and its assets once the court accepts the reorganisation filing. Helpfully, this also binds secured creditors, though secured creditors may apply under Art 75 of the CEBL for the moratorium to be lifted if the encumbered assets are likely to be substantially damaged or if the value of the assets is likely to decline sharply over a short period of time. The broad ambit of the moratorium aids in creating breathing room for the reorganisation plan to be implemented. It is acknowledged, however, that this moratorium applies equally to reorganisations as it does to liquidations, and thus may be an equivocal point in relation to the question at hand.

*Even though the CEBL does not contain any provisions allowing the bankruptcy administrator to borrow new money and take the illiquidity of the company, Art 42 of the CEBL provides that if a company in a bankruptcy procedure continues to trade, the newly-generated employee wages, pension contributions and other post-bankruptcy debts are treated as bankruptcy expenses to be paid before all pre-bankruptcy creditors. It is thus posited that, in theory, the bankruptcy administrator may borrow new money and include this new debt as a category of post-bankruptcy debts to aid the reorganisation effort (Guidance Txt at p 32). This may be a form of *de facto* priority financing. Notably, however, attaining loans on this basis is still uncertain, as the courts are not in unison as to whether this post-bankruptcy borrowing constitutes bankruptcy expenses. To that extent, the extent to which Art 42 is emblematic of a pro-rescue approach is arguable.*

In terms of the voting process to affirm a reorganisation plan, it is also noteworthy that the CEBL allows for a cram-down of dissenting classes similar to that in Chapter 11 of the US Bankruptcy Code. In terms of the voting process, Art 82 of the CEBL separates the classes of creditors into the secured creditors, the employees, tax authorities and ordinary unsecured creditors. Under Art 84 of the CEBL, the plan must be accepted by each class of creditors and should be voted in favour of by 50% or more of attending creditors in number whose claims represent two-thirds or more of the entire claims in each class. Following this, Art 87 provides that the court may cram-down a reorganisation plan that has been voted down by one or more classes of creditors (or even the shareholders under Art 85). Art 87 provides that for the cram-down approval to be granted, "the debtor or administrator may apply with the people's court for approval of the draft plan:

- (1) according to the draft plan for reorganization, the claims as specified in Subparagraph (1) under the first paragraph of Article 82 of this Law will be paid in full as far as the specific property is concerned, the losses caused by postponed payment will be compensated for in a fair manner, and the secured interests will not be substantially impaired, or the voting groups concerned have adopted the draft plan for reorganization;*
- (2) according to the draft plan for reorganization, the claims as specified in Subparagraphs (2) and (3) under the first paragraph of Article 82 of this Law will be paid in full, or the voting groups concerned have adopted the draft plan for reorganization;*
- (3) according to the draft plan for reorganization, the proportion for repayment of the common claims will not be lower than that as allotted under the procedures for bankruptcy liquidation at the time when the draft plan is submitted for approval, or the voting groups concerned have adopted the draft plan;*
- (4) in the draft plan for reorganization, the rights and interests of capital contributors are adjusted in a fair and impartial manner, or the group of capital contributors has adopted the draft plan;*
- (5) in the draft plan for reorganization, members of the same voting group are treated fairly, and the order arranged therein for payment of the claims does not contravene the provisions of Article 113 of this Law; and*
- (6) the debtor's plan for business operations is feasible.*

The CEBL also provides a second substantial bankruptcy option other than reorganization, that is, composition/settlement. Under Art 95 of the CEBL, when the company files for composition it must also present a composition/settlement plan to the court, which will then be approved/rejected by a meeting of creditors. Art 97, in turn, provides that the composition plan is passed if voted in favour of by half or more of attending creditors in number holding two-thirds or more of the total claims.

As a more general point, it is also arguable that the order in which the rescue provisions appear (ie, earlier in the CEBL than the liquidation provisions) suggests

that the statute as a whole is rescue-oriented, though this is not a legal mechanism in itself. As the CEBL uses two Chapters (Cap 8 and 9) to highlight corporate rescue, it may be argued that the statute as a whole leans in favour of corporate rescue as well.

As a final caveat, it is noted that despite these statutory initiatives, it has been opined that these corporate rescue efforts may ultimately depend on a wide array of strictly non-legal factors such as political or judicial will (per Guidance Text generally). For instance, while no evidence of bankruptcy is technically required where the debtor itself files for reorganisation, it is noted that this may be different in practice as “almost all existing cases the debtor must present evidence to prove that the company is balance-sheet bankrupt before the court opens the procedure” (Guidance Text at p 30). Practically, courts may also demand a high level of certainty of the reorganisation proposal’s success before accepting the reorganisation petition (Guidance Text at p 30).

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.

The first step of the proof of claims process, following the appointment of the liquidation administrator, is that the administrator advertises the bankruptcy procedure in both local and national newspapers in order to inform all creditors that they should submit claims.

Creditors must then approach the administrator and will be required to fill a claim form provided by the administrator. The administrator is also to examine the company’s books in order to trace the company’s debtors and the amount of receivables, in addition to the existing assets already listed in the company’s balance sheet. He is then empowered under Art 46 of the CEBL to instruct debtors to pay immediately since that article provides that the company’s debt that is not due at the point of entering into the liquidation procedure is deemed to be due.

In terms of determining the existence or quantum of claims, where the administrator is unable to agree on the amount of the claim with an individual creditor, the dispute will be litigated in the same court, with the final result of litigation being the finalised amount of the disputed claim. Courts may arrange for an expedited process to resolve these lawsuits (Guidance Text at p 33).

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.

*The liquidator should note that China has not adopted the UNCITRAL Model Law, and consequently that there are two main approaches to recognition of foreign proceedings in China. First, through a judicial assistance treaty, and second, where there is no judicial assistance treaty, through the principle of reciprocity. Recognition by a Chinese court is essential in this regard, as Art 5 of the CEBL provides that a foreign court bankruptcy ruling binds the company's assets located in China, however said foreign ruling must be recognised by a Chinese court before it can take effect in China and that the recognition should be based on either of the two methods mentioned above. It is also noteworthy that foreign creditors are treated in the same way Chinese domestic creditors are treated, *ie*, there is no preference given to domestic creditors over foreign ones (legally speaking) (Guidance Text at p 40). In practice, however, the Singaporean-bankruptcy liquidator should note that there have only been a handful of foreign bankruptcy that has been successfully recognised (Guidance Text at p 39 - 40).*

*In terms of the judicial assistance treaty, Singapore does have one with China: The Treaty on Judicial Assistance in Civil and Commercial Matters between the People's Republic of China and the Republic of Singapore 1997 (referred to as the "Treaty"; accessed at <https://cicc.court.gov.cn/html/1/219/199/202/643.html>). Under the Art 3(1) of the Treaty, judicial assistance is to be rendered by the 'Central Authority' set up by each contracting party, with China's being the Ministry of Justice and Singapore's being the Supreme Court of Singapore. The liquidator should bear in mind Cap 2 of the Treaty, which stipulates the manner in which judicial documents must be served (Art 5 and 7), the form and language of the request (Art 6), and the receipt of a certificate of service (Art 9). While it is the respective Central Authorities that execute and serve these documents, the Liquidator may be in a position to aid the courts in Singapore in drafting and furnishing the court with the necessary details for service (in particular with Art 7, lest the Chinese courts reject the request on the account of these procedural rules/technical grounds as has been the case before - see Guidance Text at p 42). The Singapore-bankruptcy liquidator should note also that in 2020, a maritime court in Xiamen, Fujian Province recognised a corporate bankruptcy order from Singapore, which facilitated the Singapore liquidator's efforts in collecting the company's assets located in China (see: *In re Xihe Holdings Pte. Ltd. et al.* (2020) Min 72 Min Chu No. 334 ((2020)闽 72 民初 334 号); <https://www.chinajusticeobserver.com/a/the-first-time-chinese-court-recognizes-singapore-bankruptcy-judgment>).*

Such requests for judicial assistance are also subject to the requested party's (China's) right of refusal on the ground that the request is "contrary to its

sovereignty, security or national interest and shall promptly give the requesting party the reasons for the refusal” (Art 11(1)). Similarly, Art 5 of the CEBL also contains public interest reservations, such as that the recognition of the foreign court bankruptcy ruling should not infringe upon the fundamental principles of Chinese law, China’s sovereignty, security and public interests and does not disadvantage China’s domestic creditors.

It may be possible for the liquidator to seek assistance under Art 281 of the China Civil Procedure Law of 1991 (most recently amended in ; accessed at: <https://cicc.court.gov.cn/html/1/219/199/200/644.html>). Art 281 provides that:

“If a legally effective judgment or ruling made by a foreign court requires recognition and execution by a people's court of the People's Republic of China, the party concerned may directly apply for recognition and execution to the intermediate people's court with jurisdiction of the People's Republic of China. Alternatively, the foreign court may, pursuant to the provisions of an international treaty concluded between or acceded to by the foreign state and the People's Republic of China, or in accordance with the principle of reciprocity, request the people's court to recognize and execute the judgment or ruling.”

What is notable from Art 281 is that (a) the court ruling must be “legally effective” or in other words final (Guidance Text at p 41); and (b) that the party seeking recognition of a foreign bankruptcy judgment would have to do so in the Chinese local intermediate people’s court where the company’s assets are located; and (c) that Art 281 envisages three alternate routes to recognition: (i) direct application to the intermediate people’s court with jurisdiction; (ii) the provisions of an international treaty (as enumerated above); or the principle of reciprocity. Great care should be taken to comply with the procedural requirements of domestic service, given that “some courts in China frequently quote the fact that judicial notices in foreign countries are not delivered in person and are not returned with a signature from the receiving party, which is contrary to Chinese domestic judicial practice” (Guidance Text at p 42).

Unsurprisingly, this request is also subject to public interests reservations. Art 282 provides in this regard that: “Having received an application or a request for recognition and execution of a legally effective judgment or ruling of a foreign court, a people's court shall review such judgment or ruling pursuant to international treaties concluded or acceded to by the People's Republic of China or in accordance with the principle of reciprocity. If, upon such review, the people's court considers that such judgment or ruling neither contradicts the basic principles of the law of the People's Republic of China nor violates State sovereignty, security and the public interest, it shall rule to recognize its effectiveness. If execution is necessary, it shall issue an order of execution, which shall be implemented in accordance with the relevant provisions of the Law. If such judgment or ruling contradicts the basic principles of the law of the People's Republic of China or violates State sovereignty, security or the public interest,

the people's court shall refuse to recognize and execute the judgment or ruling". It is notable, however, that the China Civil Procedure Law does not elaborate on what these fundamental legal principles of Chinese law really are (Guidance Text at p 41).

There have been instances of this approach being successful in the past (even amidst the smattering of cases in which foreign bankruptcies have been successfully recognised). In 2012, the Wuhan Intermediate People's Court recognised a bankruptcy procedure from Germany on the basis of reciprocity, which facilitated the German liquidator's efforts to deal with the company's assets in Wuhan. While China, being a civil law jurisdiction, has no doctrine of precedent (and is thus not bound to follow this course), it would at least be of some comfort to the Singapore-bankruptcy liquidator that there have been successful examples of recognition. Any expectations of success, however, should be tempered by the broader reality that "most foreign judgment recognition applications are rejected by the Chinese courts" (Guidance Text at p 42).

*Finally, while the avenue of judicial reciprocity need not necessarily be discussed given that there is a judicial assistance treaty between the two states, it should be noted that the Chinese understanding of reciprocity is unique - reciprocity is non-existent unless and until there is a Chinese judgment recognised in that foreign country, and Chinese courts rarely take the first step to exercise reciprocity. In the context of Sino-Singapore relations, however, it would appear that reciprocity has been established. According to commentators at Bird&Bird ATMD, "in the *Kolmar Group* case, ... the Nanjing Court cited a 2014 judgment of the High Court of Singapore, in which the Singapore Court recognised a Chinese judgment (incidentally, also from Jiangsu Province), and held that such a decision had established the ground of reciprocity such that the Nanjing Court was willing to grant the application on this basis" (see: <https://www.twobirds.com/en/insights/2017/singapore/nanjing-court-enforces-singapore-judgment-based-on-the-principle-of-reciprocity>). Even if, therefore, the Chinese courts do not take into account the Treaty in considering the application, it is conceivable that such history of reciprocity will be favourable to the Singapore-bankruptcy liquidator's hopes of having the Singapore proceedings recognized.*

Question 4.2 [maximum 7 marks]

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.

The liquidation can, in principle, be converted into a reorganisation procedure. Under Art 70 of the CEBL, in the event of an involuntary liquidation procedure, the debtor or its shareholders holding 10% or more of the company's equity (which Naking is) can apply to the court for a conversion from liquidation to reorganisation

The Naking CEO should note, however, that conversions only take place in a very small number of cases in practice (Guidance Text at p 22).

The Naking CEO should note, however, that there are at least three issues with this approach. First, given that following the commencement of the liquidation procedure the company is fully controlled by the court-appointed administrator and the company's own management is routinely dissolved, the board may thus not be able to exercise its right to raise a legitimate conversion request (since it no longer exists). Of course, Naking as >10% shareholder can make the request as a shareholder, rather than causing HuangPu to make it in its capacity as debtor.

The Naking CEO should note, however, that there are at least three issues with this approach. First, given that following the commencement of the liquidation procedure the company is fully controlled by the court-appointed administrator and the company's own management is routinely dissolved, the board may thus not be able to exercise its right to raise a legitimate conversion request (since it no longer exists). Of course, Naking as >10% shareholder can make the request as a shareholder, rather than causing HuangPu to make it in its capacity as debtor.

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.

Upon submission of the reorganisation plan to the court, the court must confirm the plan before it can take effect. Under Art 87 of the CEBL, the court may cram-down a Reorganisation plan that has been voted down by the shareholders. To this, a reorganisation plan seeking cram-down approval by the court must meet the following conditions under Art 87:

- (1) that “the losses caused by postponed payment will be compensated for in a fair manner, and the secured interests will not be substantially impaired, or the voting groups concerned have adopted the draft plan for reorganization”;*
- (2) that “according to the draft plan for reorganization, the claims as specified in Subparagraphs (2) and (3) under the first paragraph of Article 82 of [the CEBL] will be paid in full, or the voting groups concerned have adopted the draft plan for reorganization”;*
- (3) that “according to the draft plan for reorganization, the proportion for repayment of the common claims will not be lower than that as allotted under the procedures for bankruptcy liquidation at the time when the draft plan is submitted for approval, or the voting groups concerned have adopted the draft plan”;*
- (4) that “in the draft plan for reorganization, the rights and interests of capital contributors are adjusted in a fair and impartial manner, or the group of capital contributors has adopted the draft plan”;*
- (5) that “in the draft plan for reorganization, members of the same voting group are treated fairly, and the order arranged therein for payment of the claims does not contravene the provisions of Article 113 of [the CEBL]”; and*
- (6) the debtor’s plan for business operations is feasible.*

Of note is the obligation that the plan must be voted in favour of by the shareholders where their equity is affected, and if not, that the treatment of equity holders is “fair and impartial”. This is a potential ground of opposition against the cram-down.

Final mark: 49/50

* End of Assessment *