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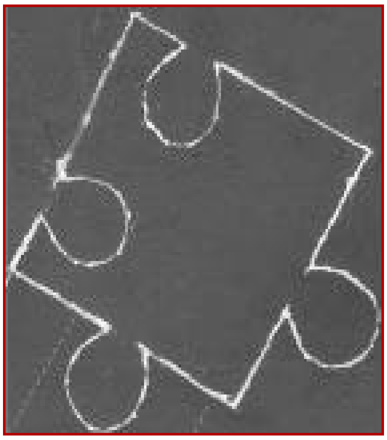

Guide to Restructuring in Asia 2001

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Guide to Restructuring in Asia 2001

White Page wishes to thank each of the law firms contributing chapters to this *Guide to Restructuring in Asia 2001*.

This publication is intended to provide a general guide to the main legal implications of restructuring and insolvency regulation in the individual jurisdictions described. The information and opinions which it contains are not intended to be a comprehensive study, nor to provide legal advice, and should not be treated as a substitute for specific advice concerning particular situations (where appropriate, from local advisers). This publication is written on the basis of law and practice as at 1 February 2001.

The views presented in this publication do not necessarily reflect the views or position of the Asian Development Bank (ADB), or its Board of Directors, or the governments they represent. The ADB does not guarantee the accuracy of the data included in this publication and accepts no responsibility for consequences arising from its use. The term "country" does not imply any judgment by ADB as to the legal or other status of any territorial entity.

Foreword

Gerald A. Sumida, General Counsel
Asian Development Bank

Asia is recovering from the financial crisis of 1997–1998. Still, Asian economies must continue to strengthen their legal and regulatory frameworks if they are to avoid a recurrence of such a crisis. In the face of continuing political uncertainties, predictable and transparent legal frameworks are needed now more than ever to encourage credit expansion and private sector investment – factors that are so necessary for economic growth. The establishment and strengthening of legal frameworks and the restructuring of ailing corporations and banks are vital for sustained development in Asia.

The Asian Development Bank (ADB) is actively promoting the development of sound legal frameworks to underpin insolvency and restructuring activities. In 1998, the ADB provided support for a comprehensive review of the insolvency regimes in 11 Asian economies. This has helped to identify and stimulate the development of best practice for insolvency law. Economies that are seeking to assess, revise and amend their insolvency legal regimes can use these standards as operational benchmarks.

Sound laws, however, have little impact without transparent, predictable and effective judicial and extra-judicial processes, as well as additional enforcement mechanisms. For this reason, the ADB has assisted, and will continue to assist, its developing member countries in legal and judicial reform. Such reforms include alleviating court congestion, increasing access to justice, strengthening legal information systems and developing other related institutional capacities. As recently as December 2000, the ADB approved a technical assistance project that provides training for officials at Thailand's Business Reorganization Office.

Building on its previous innovative work in insolvency law reform, the ADB will launch a regional technical assistance project this year that will include Indonesia, Korea, the Philippines and Thailand. The project aims to strengthen regional cooperation in insolvency law reforms and will look at cross-border issues, informal workouts and judicial cooperation. As

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intra-Asian trade and commerce increase, the absence of cross-border legal regimes to deal with insolvency will become a pronounced problem. Top priorities for the project are enhancing cross-border judicial cooperation and increasing understanding throughout the region of case management procedures.

Equally important is the development of a "restructuring friendly" culture. The challenge for Asia is to foster, within the cultural context of each economy, an understanding and acceptance of restructuring's benefits among practitioners, business communities, government regulators and legislators. This will require the comprehension of restructuring and related laws as they are actually applied by these parties and additional stakeholders.

This is why I am very pleased to introduce this Guide to Restructuring in Asia 2001. In association with White Page and the participating law and accounting firms in the region, we have jointly developed a guide to the implementation of restructuring and insolvency laws in 11 Asian jurisdictions, as well as a comparative study of their application. The legal and accounting analyses are accompanied, in most cases, by an evaluation of implementation experience. We hope that the Guide will serve as a good basic reference, and that it will contribute in a practical way to Asia's economic development.

Gerald A. Sumida

Introduction

Ronald Harmer, Staff Consultant
Asian Development Bank

This publication presents a guide to corporate restructuring in 11 Asian jurisdictions. They are Pakistan, Indonesia, Singapore, Malaysia, Thailand, Philippines, Japan, Korea, the People's Republic of China, Hong Kong, China, and Taipei,China. They are collectively referred to as the "11 jurisdictions".

Each jurisdiction is separately covered in the chapters that follow. The aim of the guide is to present, for the benefit of investors and lenders, the major restructuring and insolvency processes in each jurisdiction (this largely presents the legal position through the contributions of the various law firms) and to focus upon important issues that might affect or impede the application of those processes (this, in the main, will be found in the "Financial issues" supplements prepared by PricewaterhouseCoopers that accompany each legal chapter). Although the guide is centered upon reconstruction and insolvency processes, these cannot be presented in isolation from other important related considerations. Thus, the guide also briefly reviews debt recovery and security enforcement processes and the judicial and administrative application of the processes.

The main emphasis in the guide is upon the more positive and creative area of corporate restructuring processes and techniques. Accordingly, this introduction contains a presentation of restructuring processes, the forms they may take and their importance to the development and stability of the commercial law systems of the 11 Asian jurisdictions.

The art form of restructuring

Restructuring is variously labeled or titled as "rescue", "reorganization", "reconstruction", "arrangement" and so forth. Whichever of those descriptions might be used, the restructuring of a corporation that is insolvent or in financial difficulty involves the employment of a relatively basic theory of modern microeconomics. This theory, simply stated, is that greater value may be obtained from maintaining the essential components of a business organization together, rather than breaking them up and endeavoring to dispose of them in fragments.

Obtaining more value means that the variety of stakeholder interests that are likely to be involved in or adversely affected by the insolvency of a corporation may obtain greater benefit. These stakeholders include creditors, both secured and unsecured; employees; suppliers of goods or services to the corporation; managers; and shareholders. Restructuring does not imply that all of those interests must be wholly protected or that they should be restored to a financial or commercial position that would be consistent if the event of insolvency had not occurred. Not all of them will benefit from a successful reconstruction. Creditors may not be paid in full (some may not be paid at all); management may be terminated and changed; the equity of shareholders may be reduced to nothing (if it is not already completely lost); employees may be retrenched; and the source of a market for suppliers may disappear.

There are a variety of techniques that may be employed in a corporate restructuring. A restructuring may result, for example, in a sale of the business interests of a corporation and the eventual liquidation and extinguishment of the corporation. It may involve the injection of new capital or the conversion of debt to equity (and a consequent reduction or extinguishment of existing shareholder equity). It may necessitate the recycling or rescheduling of existing debt, to be recovered, in part or in full, over a period of time. But, whatever the form and whatever the label or title of the process, the aim is to provide more value than if the corporation was liquidated or bankrupted.

Over the last two decades restructuring has become the art form of insolvency practice. It involves taking a much more creative, commercial and robust approach to financially troubled corporations than that typified by the employment of the traditional and highly conservative approach of liquidation or bankruptcy. Simple though the concept of restructuring may appear, it may be questioned why it is that the apparent benefit of restructuring took so long to be recognized and established as a major insolvency process. The validity of the economic theory that supports it is incontestable. Yet for almost a century following the creation and legal recognition of the corporate or juristic form, liquidation dominated the arena of corporate insolvency. That was probably because it took that long to overcome a prevailing economic theory that in a market economy uncompetitive and unproductive businesses should not be entitled to survive and should be immediately removed from the competitive market place. It was also no doubt prolonged by a somewhat moralistic legal theory that suggested that business failure should be greeted with curtailment, censure and, in some cases, penal sanction. However, both theories have now given way to more contemporary models.

Restructuring processes

There are two forms of process that restructuring may take. One is “formal”, the other is “informal”. A formal restructuring process will be provided for as part of an insolvency law regime. An informal restructuring process will be developed through the initiative of the banking and commercial sectors and will not be dependent upon a law for its employment. However, as will be seen, both forms of restructuring process require a law to underpin and support them. It may be fairly claimed that restructuring processes would be unlikely to succeed in the absence of an insolvency law that provided some indirect incentive or persuasive force to encourage a restructuring.

Formal restructuring processes

Modern restructuring laws have a number of identifiable and essential features. These may be broadly identified as follows:

- Ease of entry into the process, particularly for a debtor corporation that seeks to volunteer to the process.
- A form of judicial supervision of the process.
- An automatic and mandatory stay or suspension of actions and proceedings against the property and business activities of the corporation affecting most, if not all, creditors and persons having other interests in the property of a corporation (such as lessors of property and suppliers with a claim of retention of title) for a limited period of time.
- The continuation of the business of the corporation either by existing management, an independent manager or a combination of both.
- The formulation of a plan which proposes the manner in which creditors, equity holders and the corporation itself (including its business and assets) will be treated.
- The consideration of, voting on and acceptance of the plan by creditors.
- The judicial sanction of a plan.
- The implementation of the plan.

All of these elements are important. But restructuring laws vary considerably. As this guide shows, this is particularly so in the Asian region.

Informal restructuring

As mentioned earlier, a corporate restructuring may be conducted under an informal process, sometimes referred to as an informal “work out”. The informal process was developed some ten years or so ago by the banking sector, as an alternative to formal restructuring processes. Led and influenced by internationally active banks and financiers, the informal process has gradually spread to a considerable number of jurisdictions.

The application of the informal process is generally restricted to cases of corporate financial difficulty or insolvency in which there is a significant amount of debt owed to banks and financiers. The process is aimed at securing an agreement both between the lenders themselves and the lenders and the debtor corporation for the restructuring of the corporation and / or rearrangement of the financing. An informal restructuring, it is claimed, provides scope for greater flexibility; it enables a more immediate pro-active response to a corporation in financial difficulty and, because of its essentially private nature, results in less adverse publicity and less commercial damage for the debtor.

The informal process is an entirely voluntary co-operative process. However, there will be many cases when the driving force toward any such co-operation will come from the real possibility of a sanction being imposed upon the prospective participants. The sanction is that unless the debtor corporation and its bank and finance creditors take the opportunity, if one is offered, to join together and commence the informal process, it is somewhat inevitable that either the debtor or a creditor will invoke the formal insolvency law. That could result in liquidation, to the detriment of both debtor and creditors.

An efficient insolvency law is sometimes also required, in the context of informal restructuring, to enable an informally agreed restructuring plan to become the basis for a court-approved restructure under the formal law (sometimes referred to as a "fast-track" or "pre-packaged" restructuring). This may be necessary in cases where, despite the bulk of the debt of a corporation being owed to the banking and finance sector, there are other non-bank and finance creditors whose participation in the restructure is necessary. It is thus necessary to use the formal process to produce a legally binding restructuring involving all creditors.

An informal restructuring requires the employment of a number of skills and processes. The main elements in the process are as follows:

- The creation of a forum for negotiation. Although it may seem a somewhat abstract notion, this involves the development of a commercial environment in which a debtor and its creditors may come together for the purpose of negotiation. This "forum" is not only for the benefit of the debtor, but also for the creditors between themselves. The development of this commercial environment is largely dependent upon the initiative of the banking and finance sector and the presence of an efficient insolvency law regime.
- The appointment or selection of a "lead creditor" to provide motivation, leadership, organization and administration to enable negotiations to be commenced and advanced.
- The selection of a "steering committee" that is representative of creditors and the debtor to assist the lead creditor and to act as a provisional sounding board for proposals in respect of the affairs of the debtor.
- A "standstill" that takes the form of an agreement for the suspension of adverse actions by both creditors and the debtor during a defined time period to enable negotiation to occur.
- The engagement of professional expert advisors from a variety of possible disciplines.
- The provision of information regarding the debtor, its business activities, and its current financial and trading position.

One purpose of this guide is to identify the jurisdictions in which informal processes have commenced to develop and to assess their acceptance and relative success.

The relevance of efficient liquidation and secured transaction enforcement processes to restructuring

As mentioned above, the availability of an effective liquidation remedy as part of the formal insolvency law often provides the catalyst for the commencement of an attempt at restructuring, whether formal or informal. Without an effective liquidation process there is no really compelling reason why a financially distressed corporation would be prepared to put itself largely in the hands of its creditors to fashion a restructure. It also needs reiterating that liquidation is also the ultimate remedy for unsecured creditors.

Without such a remedy, an unsecured creditor could never enforce or attempt to enforce a right to payment. The real threat of liquidation can be avoided if a corporation commences a formal reorganization, because the law will generally provide for a stay and suspension of liquidation proceedings during the time that it might take to determine if a formal restructuring is possible. This guide therefore also covers the possible use of the remedy of liquidation in the 11 jurisdictions.

The remedy of enforcement of secured property claims must also not be overlooked. It is also relevant to the reorganization process. If a secured creditor can effectively invoke secured property enforcement processes against a corporate debtor, it is likely that the corporation will seek protection from that enforcement. A modern restructuring law will generally provide for a stay or suspension of enforcement action by secured creditors upon the commencement of the formal rescue process, again in order to give creditors and the debtor the opportunity to determine if a formal restructuring is possible. This guide therefore also surveys the availability of effective secured transaction enforcement processes in the 11 jurisdictions.

The relevance of restructuring to the Asian region

The modern process of restructuring has been a late arrival in the Asian region. The insolvency law regimes of most Asian jurisdictions were derived from overseas conservative models that concentrated considerably on liquidation and bankruptcy processes. Although some provided for a form of restructuring, this was generally a very conservative process, expensive, inefficient and limited in its application. Many of these regimes are old, out-of-date and inadequate for the employment of modern restructuring techniques. Examples may be found in those Asian jurisdictions whose insolvency law regimes were derived from English law models (such as Pakistan, India, Malaysia, Thailand and Hong Kong, China); in countries such as Japan, the Republic of Korea and Taipei,China, in which the restructuring laws were derived from immediate post-Second World War USA models; and in Indonesia where the insolvency law regime was based on a 19th century Dutch insolvency law.

However, modern restructuring laws are now being adopted and employed in many Asian jurisdictions. This development has, undoubtedly, been one of the positive effects of the Asian financial crisis.

The Asian financial crisis

The Asian financial crisis is generally considered to have commenced in July 1997. It precipitated a scramble in the commercial sector as investors and lenders endeavored to retrieve investments and recover loans. These endeavors included attempts to employ debt recovery, security enforcement and insolvency law processes.

In many of the crisis-affected jurisdictions, the employment of these processes proved to be difficult and, in some cases, totally ineffective. As a result, the commercial law systems of many of these jurisdictions were subjected to critical analysis and judgement. In many cases the system was found to be fragile and inadequate.

The gravest of the criticisms came from foreign investor and lending institutions, particularly those that were endeavoring to retrieve investments and recover loans. These criticisms, though understandable, could hardly be claimed to be a surprising revelation. The investment and lending institutions involved were or should have been aware of the very inadequacies of which they subsequently chose to be critical. It would or should have been known, long prior to the crisis, that the insolvency law regimes of some Asian jurisdictions were commercially inadequate and that they were ill-equipped to deal with anything like the devastating effect that the crisis had on domestic private corporate sectors.

In any event, a practical and beneficial consequence of the focus upon the commercial law systems of crisis-affected jurisdictions was projects to develop and reform these systems and, in particular, the insolvency law system.

One major result of this was a regional technical assistance project that the Asian Development Bank initiated in July 1998. It took the form of a comparative study of insolvency law regimes in the Asian region. The aim of that study was to produce a comparative analysis of the insolvency law regimes and associated practices and to develop and present a set of good practice standards to encourage sustained and long-term reform.

That work is now complete. A report entitled "Insolvency Law Reforms in the Asian and Pacific Region" was published in Law and Policy Reform at the Asian Development Bank, 2000 Edition, Vol.I ("the ADB Report"). Of relevance to this guide, the report of the work of the ADB covers 10 of the 11 jurisdictions and covers both formal and informal insolvency practices.

The ADB Report identified a number of economic expectations and commercial needs to which a restructuring law should respond, as follows:

- The economic need to maximize the value of the enterprise and to lessen the effects of a possible liquidation.
- Affording corporate debtors the opportunity of determining upon a form of administration that may provide greater value for them.
- Certainty, predictability, commercial stability, commercial efficiency, and transparency.

The appropriate role of a restructuring law is to provide the means to enable the above expectations and needs to be reached and to provide mechanisms to enable the means to be employed.

To meet those commercial and economic expectations and needs, the ADB Report emphasized a number of "good practice standards" that should be applied in a restructuring law. A survey was then made of the insolvency laws of the 10 jurisdictions to determine the extent to which the standards were applied in the legislation. The report presents the results of the survey. The ADB Report may be obtained from www.adb.org/law.

Formal restructuring and insolvency laws in the 11 Asian jurisdictions

The existing laws relating to restructuring and liquidation in the 11 Asian jurisdictions that are the subject of this guide may be summarized as follows:

Pakistan, Malaysia, Singapore and Hong Kong, China

In these four jurisdictions, both the liquidation and the restructuring processes form part of the general company law. That law was largely inherited from English law. The restructuring provisions are known as "schemes of arrangement". Pakistan also commenced the development of a quasi-administrative restructuring process under somewhat aptly named "sick company" legislation.

Sadly, with the exception of Singapore, the restructuring laws in the "English"law-based jurisdictions are out of date, inefficient, expensive and little used. In Pakistan that problem is compounded because the liquidation process is largely ineffective. This is caused by delays and inefficiencies in the court system and political and other interference in economic and commercial affairs generally.

Singapore, however, has a modern and effective restructuring process known as "judicial management". As the report on Singapore states, its formal insolvency law system "balances the need to protect creditors and to hold management accountable with the practical need to try to preserve businesses that are inherently sound but are suffering unanticipated financial crisis".

Thailand

The restructuring and liquidation processes are contained in the Bankruptcy Law of 1940. The restructuring process, known as "business reorganization", is the result of a new chapter introduced into the

Bankruptcy Law in April 1998. It commenced operation in August 1998 and is a good example of the response of a crisis-affected economy to the need to modernize insolvency law processes, as observed in the report on Thailand. Thailand has also benefited from the establishment, in April 1999, of a specialized Bankruptcy Court.

Some questions about these formal processes still, however, exist. One of the problems is that the issue of "insolvency" under the Thailand law requires the application of a balance sheet test (liabilities exceeding assets). The report on Thailand states that this "can often be hotly contested when an aggressive petition is filed by creditors without the debtor's consent".

Indonesia

The restructuring and liquidation processes are contained in the Bankruptcy Ordinance 1905. The restructuring process is known as "suspension of payments". This restructuring process was substantially amended by a Government Regulation In Lieu of Law, April 1998. It is another example of a positive response to the financial crisis. The report on Indonesia states that prior to the crisis "here was an almost complete absence of formal insolvencies in Indonesia".

Indonesia also stood to benefit from the establishment of a Commercial Court. Unfortunately, as the Financial Aspects of the Indonesian report observes: "Several decisions to date demonstrate that the Commercial Court…appears not to fully understand the law or the principles underlying it. Most decisions of the court have tended to favor the local applicant over the foreign creditor and the government as a creditor".

Further reforms are, however, proposed in Indonesia. In part, these are intended to redress the inadequate language and interpretation problems of the present law, many of which appear to have contributed to some of the decisions of the Commercial Court.

Philippines

The basic liquidation law is contained in the Insolvency Law. This was also, originally, the source for a form of restructuring known as "suspension of payments". However, in 1976 a presidential decree was declared, known as PD902A. This decree removed jurisdiction in respect of suspension of payments process from the courts and vested the jurisdiction in the corporate regulatory authority, the Securities and Exchange Commission ("SEC"). In addition, the decree provided for a new form of restructuring process that has become known as "rehabilitation" process.

For a time this rehabilitation process appeared to work reasonably well under the jurisdiction of the SEC (the Philippines Airline rehabilitation case was probably the high-water mark), but all that has now been changed. The report from the Philippines states that jurisdiction in corporate insolvency matters has now been transferred to the regular courts and "a proposed bill on Corporate Recovery, encompassing provisions on corporate insolvency, rehabilitation and suspension of payments" is now pending in the Congress. If enacted, it is "expected to change the landscape of Philippine corporate law on insolvency and rehabilitation".

Japan, Korea and Taipei,China

In these three jurisdictions, the sources from which the formal insolvency law has been derived are the same and it is, therefore, convenient to consider them together.

In Japan the liquidation process is contained in the Bankruptcy Law 1922. Japan has three potential rescue processes contained in separate legislation. The most commonly used are a composition process under the Composition Law and a corporate reorganization process under the Corporate Reorganization Law. Both of these processes originated in the 1950's. Recently, however, Japan enacted the Civil Rehabilitation Law. The Japan report states that: "It is designed to rehabilitate middle and small-sized companies under a more simplified process than corporate reorganization. It is effected by a debtor-in-possession type process". Somewhat unusually, however, this process does not restrain a secured creditor from enforcing secured property rights separately from the procedure.

The insolvency law regime of the Republic of Korea is very similar to that of Japan. The law relating to corporate liquidation is contained in the Bankruptcy Act 1962. The Republic of Korea has two potential rescue processes contained in separate legislation. One is a composition process under the Composition Act 1962. The other main process is known as "company reorganization" and is contained in the Company Reorganization Act 1962. Prior to the financial crisis the area of insolvency law "was largely under-utilized and somewhat overlooked" according to the Korean report. The report also comments that the shortcomings of legal structures such as the insolvency laws became "all too apparent with the onset of a serious economic crisis". "Since then a massive revision to insolvency laws has been undertaken…with emphasis…on three specific areas. First, setting out with some clarity and certainty specific procedures to be undertaken in the event of corporate fiscal ill-health…. Second, an improvement of the speed with which such procedures were to be undertaken…Third, a trend toward specialization of the judiciary".

In Taipei,China the Bankruptcy Law 1935 provides for liquidation and composition processes. However, the restructuring process forms part of the Companies Act. It is known as "reorganization". The report clearly identifies some serious problems with the application of these laws – mentioned are "the inability / unwillingness of the courts…to enforce compliance with insolvency procedures" and "a mindset among local… banks which is inclined not to recognize the depth of problems". The report recommends "that creditors involved in Taipei,China insolvencies pursue an aggressive 'hands on' role in the restructuring".

The People's Republic of China

Insolvency law is relatively new in the People's Republic of China. The relevant law is the Law on Enterprise Bankruptcy, approved in 1986 and first applied in 1988. Prior to this law, insolvency was virtually unknown in the People's Republic of China. This law provides for liquidation and a form of restructuring process, but it applies only to state-owned enterprises. It is thus not surprising that the law and practice is not sophisticated and not well developed. As the "Financial issues" commentary states: "The current legislation was not designed to protect creditors and offer restructuring opportunities to debtors, rather it simply provides a set of legalized procedures to terminate certain state-owned enterprises". However, there are signs that, as a result of the growth of the private sector, the development of commercial education and knowledge and the general expansion of international trade, a massive reform to the insolvency law regime and its application is likely to occur in the People's Republic of China within the next two years.

Informal restructuring processes in the Asian region

Prior to the Asian financial crisis, there was little evidence of the employment of informal restructuring processes in Asia. One exception was in Hong Kong, China where, because of the long presence and influence of both local and foreign banks, an informal process, similar to that practiced in the UK and the USA, had been developed. The banking sector in Singapore has since also promoted an informal process, similar to that of Hong Kong, China.

The effects of the Asian crisis resulted in the development of a number of informal processes in the crisis-affected jurisdictions – Korea, Thailand, Malaysia and Indonesia. In each of these jurisdictions, a semi-official "structured" form of informal restructure has been developed. These are largely government or central bank-inspired processes and were developed for the purpose of dealing with systemic financial problems within the banking sector. They follow a relatively common pattern as follows:

- First, each has a facilitating agency to encourage and, in part, co-ordinate and administer informal restructuring. These agencies were established because it was considered that without such an agency there would be little incentive or motivation for the informal process to develop. In Indonesia the facilitator is the "Jakarta Initiative Task Force". In Korea there is a "Company Restructuring Committee". In Thailand the agency is known as the "Corporate Debt Restructuring and Advisory Committee", similar to the "Corporate Debt Restructuring Committee" in Malaysia.
- Second, each process is underpinned by an agreement between commercial banks in which the participants agree to follow a set of "rules" in respect of corporate debtors who are indebted to one or more of the banks and which may participate in the process. These rules basically provide the procedures to be followed and the conditions to be imposed in cases of attempts at corporate restructure. In some of the jurisdictions a debtor corporation that seeks to negotiate an informal restructure is required to agree to the application of these "rules".
- Third, the processes generally provide for time limits for various parts of the procedures and, in some cases, for agreements in principle to be referred to the relevant court for a formal restructuring to occur under the law.

In Malaysia, a further development was the establishment of a statutory body known as "Danaharta". This statutory body has extremely wide powers to acquire non-performing loans from the banking and finance sector and then to impose extra-judicial processes upon a defaulting corporate debtor, including a forced or imposed restructuring.

In the People's Republic of China asset management companies ("AMCs") were established in 1999. These were created to handle non-performing loans transferred from the four state banks. The AMCs are assigned the task of resolving these bad debts, the great majority of which are owed by state-owned enterprises. Although they have made some progress, the People's Republic of China report observes that "they are constrained by the current non-commercial insolvency legislation, government approval of most commercial decisions, and an economy that is not large enough or healthy enough to absorb these problem assets" (in total they amount to some US$1.2 trillion).

In Taipei,China there has been very little development of informal processes.

These processes are all addressed in the chapters that follow. Their importance in corporate restructuring may be best appreciated by reference to the number of corporate restructuring that have occurred through these processes when compared to formal restructuring under the formal court processes. The number of informal restructurings is far greater than formal.

Although the more "structured" informal restructuring mechanisms may be considered as somewhat temporary, stopgap measures (they were all necessitated by the financial crisis), it is likely that they will leave an important legacy for the commercial sector. They have each greatly contributed to the appreciation, understanding and knowledge of the informal restructuring process which, hopefully, will be continued and further developed by the banking and finance sector after the dismantling of the structures that were necessary to initiate them.

The commercial culture of many of the 11 jurisdictions appears to be more conditioned toward non-confrontational dispute resolution, through negotiation and mediation, than by the employment of strict confrontational legal processes. In the context of corporate financial difficulty or insolvency, this suggests that there may be an opportunity for the informal restructuring process to flourish in the Asian region.

Impediments to the employment of restructuring processes in the Asian region

Despite the many advances that have been made in recent years toward the establishment and acceptance of restructuring processes in Asia, there are a number of factors that, individually or in concert, hamper and restrict that development. The reports in this guide underline the problems. The impediments may be most conveniently presented under the following labels:

Corporate governance

In some of the jurisdictions, commercial attitudes and laws directed at proper corporate management either do not exist or, if they do, they are weak and not enforced. Although this is not the task of an insolvency law regime to address, it cannot be ignored because such a regime cannot be expected to operate and to produce positive results in an environment of inadequate corporate governance and financial irresponsibility. Weaknesses in this area result in considerable havoc to any form of insolvency law endeavor. It may be noted from a number of the reports in this guide (see, for example, those of Malaysia, Korea and Thailand) that it is an area in which the development and enforcement of appropriate regulation is required.

Accounts and accounting standards

There are also many fundamental weaknesses in some of the jurisdictions in relation to accounting standards and their application. This includes proper internal financial management and financial control and, also, external auditing standards and their application. Objectively assessed internal financial information in relation to a corporation is vital because it provides an early warning of the onset or possible onset of financial difficulty and can greatly contribute to early restructuring action before it is too late. Proper external audits provide an information system for financiers and suppliers and can be crucial to the prospect of a successful restructure. Singapore and Hong Kong, China provide good examples of the proper application of such standards.

Attitudes to legal processes

In a number of the jurisdictions there appears to be a cultural attitude, particularly evident in the commercial community, that views dispute resolution and problem solving as best-suited to non-confrontational negotiation and mediation. Insolvency law and related practices are primarily a collective form of remedial process, involving a variety of different interests that are often in conflict with one another. There is some difficulty in applying negotiation and mediation techniques to address those differences, particularly when a restructuring process requires a collective agreement or solution. So in some jurisdictions, these cultural attitudes pose a problem for the application of insolvency laws. However, the future development and application of informal restructuring processes may be able to better take account of these cultural attitudes and turn them to advantage.

Court systems and judicial administration

Much of the formal insolvency law system requires the involvement of courts and judges. Corporate insolvency law, particularly restructuring, requires considerable wide commercial knowledge and appreciation of commercial practices. It is a difficult and complex area of commercial law. In some of the Asian jurisdictions there is a negative reaction to the use of the insolvency law because of problems with the court and judicial system (see, for example, Pakistan). The processes are slow (see, in particular Korea and Japan), judges are not suitably qualified nor experienced and the judicial process is unpredictable and unreliable (for example, Taipei,China). Many of the jurisdictions require the establishment of dedicated commercial courts or, even, a specialist bankruptcy court (as, for example, in Thailand). Too often, there is a failure to properly apply the insolvency laws, often as a result of a lack of commercial knowledge and appreciation on the part of the judges. Indonesia is an example.

Professional knowledge and expertise

The handling and administration of insolvency cases requires trained and experienced people. Cases of complex corporate restructuring require professional expertise. A number of the jurisdictions lack this resource. Professionally based organizations are required in these jurisdictions to advance knowledge and expertise. Another area of difficulty is found in attitudes toward the employment of outside experts. Family and dynastic control of corporations often does not allow for the engagement of outsiders. This, coupled with a reluctance to permit control or, even, permit close scrutiny of the affairs of a corporate debtor, often results in a difficulty to advance restructuring proposals. The reports of Japan, Philippines, Indonesia, Korea and Taipei,China are all instructive in this regard.

The effectiveness of the remedy of liquidation in the 11 jurisdictions

The reforms that have occurred in relation to insolvency law and practices appear to have been largely centered upon restructuring. The remedy of liquidation has received little attention.

Liquidation is an effective remedy in Singapore, Malaysia and Hong Kong, China. It is not as effective in Pakistan because of delays in, and interference with, court proceedings in that jurisdiction.

Although liquidation should be effective in Indonesia, Thailand and the Philippines, for a variety of reasons it is not.

In Thailand, for example, a creditor who seeks the liquidation or bankruptcy of a corporation faces a problem of having to establish that the corporation is insolvent on a balance-sheet test. That can cause a creditor significant problems of proof and procedure.

In the Philippines, under the existing law, at least three creditors must join together to bring a liquidation proceeding against an insolvent debtor. Whether or not that presents an obstacle, the fact is that there have been very few cases of liquidation in the Philippines over many years.

In Indonesia the position has improved, although there have been some decisions of the newly established commercial court that have caused considerable doubt and uncertainty.

In Japan, liquidation or bankruptcy proceedings are reasonably certain and predictable. In Korea less so and in Taipei,China liquidation would appear to be quite ineffective.

Although that general survey may not give rise to much hope or expectancy for creditors, there are many signs that this position is changing and the next few years should see some improvement as many of the jurisdictions continue to overhaul and reform their formal regimes.

The position of secured creditors in Asian restructuring processes

It will often be the case that the success or otherwise of a restructuring will depend upon the manner in which creditors who hold security (or collateral) over the assets of a corporation may be involved in, accommodated, or restrained by, the process. The contributions to the guide clearly identify some major differences to the approach to this issue amongst the 11 jurisdictions. In summary, they appear as follows:

- In Singapore, a creditor who has security over all, or substantially all, of the property of a corporation (often referred to as a floating charge holder) may elect not to be party to, or to be bound by, the judicial management process. However, other secured creditors will be bound, unless they can successfully apply for relief from the stay.

- In Hong Kong, China and Pakistan secured creditors are not bound by the scheme of arrangement process.
- In Malaysia secured creditors may, according to some recent judicial decisions, be effectively restrained from enforcement action under the scheme of arrangement process.
- In Japan, under the new Civil Rehabilitation Law, a secured creditor is not bound by the process and may exercise rights of enforcement.
- In Korea and Taipei,China the enforcement powers of secured creditors will normally be stayed by an interim order.
- In Philippines the appointment of a receiver or management committee under the existing rehabilitation procedure has the effect of staying the enforcement rights of secured creditors.
- In the People's Republic of China secured property enforcement is stayed once the court has accepted the case.
- In Indonesia the position is a little ambivalent, but it is generally reckoned that a secured creditor can be stayed by a court order.
- In Thailand a secured creditor cannot enforce a security, without leave of the court, once the reorganization process has commenced.

Measuring the actual results of restructuring in the 11 jurisdictions

The "Financial issues" segments of the reports deserve close attention. They supplement the legal chapters on each jurisdiction by providing objective practical observations on the application and results of the restructuring processes and, in particular, point out the impediments that must be borne in mind and overcome in many of the jurisdictions.

They contain a valuable evaluation of the different restructuring processes. These make it clear that investors and lenders should be wary of judging the effectiveness of corporate restructurings based on sheer numbers of corporations that are subject to a restructuring process. A number of the "Financial issues" segments (for example, those dealing with Indonesia, Thailand, Malaysia and Taipei,China) are critical of some of the so-called "restructurings" in those jurisdictions and assert that many of them are really not much more than a debt rescheduling exercise, which, of course, merely postpones the day of reckoning. Debt rescheduling exercises underscore the unwillingness or inability of the banking and finance sector to take the inevitable "haircut". The supplements also suggest that very little attention is paid to addressing important and fundamental issues that would normally arise in a genuine restructuring – such as overall corporate structure, organizational structure, management, business evaluation, non-core asset shedding and so forth.

Some conclusions from the contributions to the guide

Significant recent advances have been made in the Asian region in relation to corporate restructuring and insolvency. Moreover, it is apparent that the wave of development and reform will continue, because it is now clearly recognized that insolvency laws and practices are important for economic development and commercial stability.

The benefits that have been achieved are considerable. But there is a risk that some of these may be dimmed or lost. There is some suggestion that economic and commercial conditions have commenced to improve in the region. But it is an unfortunate fact of life that the onset of economic improvement quickly erases memories of economic recession. Moreover, it is by no means clear that the signs of improvement are consistent with recovery. It is therefore important that investors and lenders are fully aware of the state of restructuring and insolvency laws and related processes in the region. It is suggested that a careful reading of the contributions that follow will greatly assist that knowledge and awareness.

Legal Issues: China, People's Republic

CMS Cameron McKenna

The People's Republic of China is a civil law jurisdiction. Creditors' rights are governed by the Bankruptcy Law and ancillary "legislation" / opinions (in the case of the state-owned enterprises), and the Civil Procedure Law (in the case of non-state owned enterprises), as well as disparate insolvency laws relating to foreign invested enterprises.

The People's Republic of China law recognizes the creation and enforcement of certain security interests over immovable / fixed assets. However, it has no concept of a floating charge. Creditors' rights are, in theory, enforced through a court system that is not considered mature or independent, and is marred by local protectionism (see Working Report of the Supreme People's Courts of China delivered on 10 March 1999).

While the bankruptcy and formal rescue of a state-owned enterprise or other financial institution is possible under existing legislation, there is only one known case of the liquidation of a large state-owned enterprise. There are no known cases of any formal corporate rescue proceedings under any relevant legislation. Accordingly, in the case of restructurings involving People's Republic of China assets, it has been common for them to proceed, informally, in accordance with the rules and structures that are applied in informal restructurings conducted in Hong Kong, China.

The main difficulties of restructuring in the People's Republic of China arise as a result of the following:

- The lack of experience in some provinces of government officials in restructuring.
- A lack of knowledge on the part of non-People's Republic of China creditors of the way in which proposals made by creditors for restructuring will be received by the relevant government officials and which government officials should receive them.
- A lack of understanding on the part of People's Republic of China debtors and non-People's Republic of China creditors of each other's legal systems, and what is expected of each party in the restructuring process.

Finally, if a restructuring involves leaving the People's Republic of China debtor in possession and a debt / equity swap with repayment being made in the form of dividends, non-People's Republic of China creditors may require substantial input in the management of the asset management company holding the shares of the insolvent People's Republic of China enterprise. However such an approach may not be welcomed or, in some cases, not permitted. Despite proposed reforms to the Bankruptcy Law, at present, creditors, who wish to insulate themselves from the uncertainties of the legal system and the lack of experience in restructurings, need to be extremely careful when investing in the People's Republic of China. If possible, creditors should secure their exposures in other countries due to the difficulty in obtaining access to and fair treatment in the People's Republic of China legal system.

1 Describe the nature and the effectiveness of the following processes:

a) Civil unsecured debt collection remedies.

Creditors obtain repayment by application to the court on a first-come, first-served basis. Enforcement Divisions ("EDs") established under various levels of People's Courts, are responsible for compelling debtors to pay their overdue debts evidenced by enforceable legal documents.

In order to have the aid of an ED, a creditor must first obtain enforceable legal documents recognized by an ED. These include:

- A payment order issued by the court.
- A court judgment or arbitration award.
- A debt document notarized by a notary public as directly enforceable.

A creditor may ask a competent court for a payment order to be issued against the debtor, if three conditions are met:

- The creditor's claim involves only the repayment of money or securities.
- The creditor is not involved in any other debt disputes with the debtor.
- Service of the payment order on the debtor is possible.

With such a payment order, the competent ED will take all necessary steps to ensure that the order is complied with, i.e. repayment is made, by the debtor.

In most cases, creditors have to litigate or arbitrate before they can use the EDs to enforce their debts. The law has clear provisions as to the kinds of measures an ED may use to ensure enforcement of legally enforceable documents. However, it is widely admitted among People's Republic of China officials and the legal profession that successful enforcement has been very hard to achieve, due in part to local protectionism. It has been observed that courts of the same level in different municipalities or provinces produce dramatically different results. It has also been noted that People's Republic of China Courts at any level are reluctant to enforce debts owed to foreign creditors. Such courts will generally refuse to recognize judgments of foreign creditors on the basis that it would be contrary to People's Republic of China public policy or the foreign jurisdiction does not reciprocate by recognizing People's Republic of China judgments. However, there are two or three known cases where foreign creditors have succeeded under the People's Republic of China legal system.

b) Secured property enforcement remedies.

An application to the court needs to be made by the secured creditor before any enforcement measures can be taken against the debtor's property. Secured creditors cannot legally enforce security without applying to court.

c) Any special debt collection or secured property remedies that are available to banking sector creditors.

No special treatment is afforded to creditors in the banking sector.

d) Corporate bankruptcy/liquidation processes that are available to corporate debtors and creditors.

In 1986, the Bankruptcy Law (for a trial run) ("the Law") was set up to deal with cases where insolvent enterprises "owned by the whole people" (state-owned enterprises), were unable to pay their debts. The Law applies to state-owned enterprises such as the international trust and investment corporations, known as "itics". Guangdong itic, or "Gitic", is the most famous. Gitic is the first time that the Law had been applied to a state-owned enterprise that was a large financial institution. Prior to Gitic, the Law had been used for small state-owned enterprises only. Also prior to Gitic, financial institutions were simply "closed" by the relevant authorities, such as the People's Bank of China ("PBOC") under central banking regulations promulgated by the PBOC in 1994.

The PBOC has authority to close down a financial institution if, for example, losses reach 10 percent of capital or if the financial institution fails its annual examination two years in a row, or fails to improve after failing the examination, or any other circumstance deemed appropriate by the PBOC. Closure is announced without prior notice to creditors and the relevant government authorities make arrangements for the re-employment of the employees and the disposal of the assets. Little is known about how domestic creditors are handled. Closure under the central banking regulations typically involved full repayment of foreign creditors. However, in the formal bankruptcy of Gitic, its creditors will not be paid in full.

The debtor or any creditor may apply to the court for the bankruptcy of a state-owned enterprise. Where the debtor applies, the prior approval of the government is required (Article 8 of the Law). Article 3 of the Law provides that enterprises which are unable to repay debts that are due shall be declared bankrupt under the Law. Article 8 of the "Opinion of the Supreme People's Court on Several Issues in the Implementation of the Law of the People's Republic of China on Enterprise Bankruptcy", attempts to clarify inability to pay debts. It provides that "insolvency" in article 3 of the Law indicates :

"1) the expiration of the repayment term of the debt;
2) that creditors have demanded repayment; and
3) clear evidence that the debtor is unable to pay its debts...."

The Law provides that the application must be made to the People's Courts where the debtor is located. Hence, regional differences in the application of the Law arise.

The Law attempts to impose a regime for the adjudication of creditors' proofs and the getting in of assets and their distribution. The meeting of creditors (all creditors except secured creditors) is entrusted with the power to determine the existence or amount of debts owed to each creditor, discuss and approve proposals of reconciliation, or the disposal and distribution of the enterprise's assets. In practice, these responsibilities are performed by the liquidation "committee" or "team". The Law imposes *pari passu* distribution of the bankrupt enterprise's assets after payment of certain preferential creditors. However, detailed mechanisms for carrying out the sale and distribution of assets and adjudication of proofs of debt are absent in the People's Republic of China legislation.

The bankruptcy of a non-state-owned corporate enterprise is governed by the rules set out in Chapter 19 of the People's Republic of China Civil Procedure Law. Under these rules, a bankruptcy proceeding may be initiated either by the creditor or by the debtor, when the debtor fails to meet its liabilities when they become due. The process is similar to the liquidation process for state-owned enterprises, with a liquidation committee responsible for the custody, disposal and distribution of assets. The liquidation committee is subject to the supervision of the court and must report its work to it.

There is also in existence disparate legislation dealing with the liquidation of foreign invested enterprises ("FIEs") – (Measures on Liquidation of Foreign Invested Enterprises – issued, upon the approval of the State Council, by Ministry of Foreign Trade and Economic Cooperation ("MOFTEC") on 9th July 1996). The liquidation of solvent FIEs occurs at their termination and follows the bankruptcy rules under the Civil Procedure Law. Each FIE must go through the liquidation process at its termination. Where the FIE forms a liquidation committee by itself, the FIE goes into ordinary liquidation. However, in some cases the FIE cannot form a liquidation committee on its own, and the rules governing ordinary liquidation cannot be followed in those circumstances. The highest authority of the FIE (for example the board of directors, the shareholders or the creditors of the FIE) may apply to the FIE approval authority for special liquidation. Where special liquidation is applied for, the approval authority appoints the liquidation committee. The main rules of the liquidation are similar to those of a bankruptcy of a state-owned enterprise.

There is no provision in the liquidation process of an FIE that imposes a moratorium on debt enforcement, whether secured or unsecured. However, it is provided that the shareholders of an FIE are prohibited from disposing of the FIE's assets from the commencement of a liquidation. The liquidation starts from the date on which one of the following occurs:

- The operation or duration of the FIE expires.
- The approval authority approves dissolution of the FIE.
- The joint-venture contract of the FIE is terminated by court judgment or arbitration award.

The effect of liquidation on the management of a FIE is that it is prohibited from engaging in any new business activity. The liquidation committee is responsible for handling any unfinished business.

The liquidation committee, whether formed by the FIE in an ordinary liquidation or appointed by the approval authority in a special liquidation, controls the process of case management control and administration.

Regarding antecedent and fraudulent transactions of an FIE, activities, similar to impeachable transactions defined in the Law conducted by the FIE within 180 days prior to the date on which the liquidation starts the "review period", are void. Security provided by the FIE during the review period is also void.

e) Formal corporate rescue processes that are available to corporate debtors and creditors.

A restructuring procedure is provided as part of the bankruptcy law for state-owned enterprises. For non-state-owned enterprises, the Civil Procedure Law provides that where a "conciliatory" agreement has been reached with the creditors, the People's Court may, after approving the agreement, terminate the bankruptcy. Nothing more is said in the Civil Procedure Law about formal restructuring.

For state-owned enterprises, the government authority in charge of the bankrupt enterprise may apply to the court for the restructuring of the bankrupt enterprise within three months of the court accepting the case. The reaching of a conciliation or compromise agreement between the debtor enterprise and its creditors is a precondition for starting a restructuring. The term of restructuring cannot exceed two years. The government authority is responsible for the restructuring and is required to report regularly to the court on the progress.

The court will terminate a restructuring and declare bankruptcy of the enterprise if certain activities took place during the course of restructuring, such as breach of the conciliation agreement, the continual deterioration of the bankrupt's financial situation or activities that seriously damage the interests of creditors. There are no known cases of the procedure ever having been used in the People's Republic of China.

In the past, there were cases where a solvent state-owned enterprise was required, by administrative order, to merge with an insolvent one. This, in some cases, adversely affected the solvent state-owned enterprise. With the People's Republic of China state-owned enterprise reform, state-owned enterprises have started to sever their links with governmental authorities and have become more autonomous in making commercial decisions. The practice of merger as a result of governmental order is less and less used.

f) Informal corporate rescue processes.

There are no reported or anecdotal cases of informal corporate rescue initiated from within the People's Republic of China. While People's Republic of China assets are being used in a number of high profile restructurings, such as Guangdong Enterprises (Holdings) Ltd ("GDE"), Guangzhou itic ("Gzitic") and Fujian Enterprises (Holdings) Ltd ("FJE"), all involve a Hong Kong, China connection. The explanation for this may lie in the way in which money is lent to People's Republic of China projects. Typically, bank creditors (foreign) advance funds to a Hong Kong, China window company that on-lends to various People's Republic of China entities, usually state-owned enterprises. The shares of the window companies in Hong Kong, China are usually owned by the state-owned enterprise (the People's Republic of China parent of the Hong Kong, China window company).

In those circumstances, the Hong Kong, China window company's largest asset is often its inter-company debt to its People's Republic of China parent. Although many state-owned enterprises are insolvent in the People's Republic of China, their restructuring is carried out in accordance with Hong Kong, China "rules". The principles applicable to informal corporate restructurings in Hong Kong, China seem to apply, indirectly, to the restructuring of state-owned enterprises in the People's Republic of China.

Accordingly, People's Republic of China restructurings can take many different forms. The nature of the restructuring is limited only by the collective imagination of the legal and financial advisers involved and the level of experience of the relevant municipal government in restructurings. Municipal governments that are involved in a number of restructurings may be more open to different forms of restructurings. Their prior experience with restructurings may mean, for the foreign creditor, that they are relatively easier to deal with when compared to a municipal government with no experience in restructuring. However, as restructuring practices deepen and broaden throughout municipalities, it is expected that municipalities with little or no experience may be prepared to follow the example of other more experienced municipalities.

g) Any other corporate insolvency, or insolvency-related, processes that are available under special legislation.

There is no such special legislation applicable under these circumstances.

2 What is the effect upon debt enforcement and secured property enforcement processes of:

a) An adjudication of corporate bankruptcy/liquidation?

Upon a court's acceptance of a bankruptcy application, all enforcement proceedings upon the property of the bankrupt are stayed. The Law does not purport to have any extraterritorial effect. Academic opinion is divided on whether the moratorium on creditor action is extraterritorial. On balance, it is the author's view that there is no extraterritorial application of People's Republic of China bankruptcy law.

b) The commencement of a formal corporate rescue process?

All enforcement proceedings upon the relevant bankrupt remain stayed (formal corporate rescue process only commences after a court accepts the bankruptcy case).

c) The initiation of an informal corporate rescue process?

As in Hong Kong, China, there is usually an informal standstill of creditors. Formal standstill agreements are rare. The informal standstills are usually only relevant to non-People's Republic of China creditors ("foreign creditors"). It is not known how domestic People's Republic of China creditors are dealt with, as the People's Republic of China government at local, municipal and state levels is not forthcoming with such information.

d) The initiation of an insolvency, or insolvency-related, process under any special legislation?

There is no such special legislation applicable under these circumstances.

3 What is the effect on the management of a corporation of:

a) An adjudication of corporate bankruptcy/liquidation?

The management of the bankrupt enterprise is deprived of the power to deal with the assets, books, documents, materials, etc. of the bankrupt enterprise. Property of the enterprise does not, however, vest in the liquidation committee. The liquidation committee is not necessarily made up of creditors. In practice, it is common that a large number of government officials who have little or no experience in liquidations are on the committee. In the case of Gitic, an experienced liquidator from a well-known international accounting firm works behind the scenes and assists the liquidation committee in performing their duties.

The registered "legal representative" of the bankrupt – the chairman of the board of directors in a limited liability company or the general manager of a state-owned enterprise – is required to be responsible for the safekeeping of the above-mentioned property before a liquidation committee takes over.

b) The commencement of a formal corporate rescue process?

The government authority in charge of the debtor takes over the debtor enterprise and reports regularly to the creditors. However, as already stated, there are no known instances of formal rescue in the People's Republic of China.

c) The initiation of an informal corporate rescue process?

Effectively, the municipal government of the province in which the insolvent enterprise is located takes over. The former management remains involved at a cosmetic level, but no decisions are made without the approval of the local or provincial government. For some issues, (i.e. that may involve exchange control regulations or debt registration), the state government (Beijing) must get involved, usually through the PBOC.

d) The initiation of an insolvency, or insolvency-related, process under any special legislation?

There is no such special legislation applicable under these circumstances.

4 Who is responsible for "case management" control and administration:

a) A corporate bankruptcy/liquidation?

The liquidation committee appointed by the court takes over the bankrupt enterprise and is responsible for the safekeeping, putting into order, valuation, disposal and distribution of the bankrupt's assets. The liquidation committee may conduct necessary business activities and is accountable to the court, reporting regularly to it.

b) A formal corporate rescue?

The government authority in charge of the enterprise takes control of the enterprise during the restructuring and reports regularly to the creditors' meeting.

c) An informal corporate rescue?

The municipal government where the enterprise is located indirectly controls the process. Depending on the issues involved, the state government will control certain aspects of the process. The level of involvement of the government and the level of government that should be consulted is not known and may vary from work out to work out. This is one of the difficulties faced by foreign creditors in People's Republic of China restructurings. What is clear is that without the involvement of the relevant governments, there would be no restructuring and the return to foreign creditors would be minimal.

d) A case of corporate insolvency under any special legislation?

There is no such special legislation in the People's Republic of China.

5 Who has the responsibility for the preparation of the plan of rescue under:

a) A formal corporate rescue?

The Law deals with restructuring by dividing it into two categories: the restructuring of the bankrupt and the compromise of its debts.

The government authority in charge of the bankrupt enterprise may apply to the court for the restructuring of the bankrupt enterprise.

In such a case, the enterprise prepares a restructuring proposal, which, after discussion at the employees' representatives' meeting, is submitted to the People's Court and the creditors' meeting. Under the Law, a restructuring proposal must include:

- An analysis of the reasons leading to the enterprise's insolvency.
- A plan of change of management.
- Measures for improving the management and operation of the enterprise, and the feasibility of measures of amending or changing production scopes.
- Proposals for reducing losses and increasing profits.
- The time limit and target of restructuring.

In the meantime, the enterprise prepares a draft conciliation or compromise agreement and submits it to the creditors' meeting. Under the Law, a conciliation or compromise agreement provides for (i) the sources of assets proposed to be used to repay debts, (ii) the means and time of repayment and (iii) the extent of any haircut, if applicable. After an agreement is reached between the debtor enterprise and the creditors, the conciliation or compromise agreement needs to be submitted to the People's Court for confirmation. The agreement becomes effective only when confirmation is given and publication is made by the People's Court.

The conclusion of a conciliation or compromise agreement, is a precondition of the formal restructuring of the enterprise.

In practice, there is no evidence that the procedure has been used.

b) An informal corporate rescue?

Responsibility for the plan usually resides with the lawyers (typically in Hong Kong, China) acting for the steering committee of the foreign creditors, in conjunction with the financial advisers (usually accountants or merchant bankers or both), acting for the debtor / municipal government. While the debtor has the contractual relationship with its financial advisers, it is common for the relevant municipal government to act independently of the debtor's financial and legal advisers. Indirectly, the municipal government makes many of the decisions about the restructuring, as without it, there would be few, if any, assets available to foreign creditors.

c) A case of corporate insolvency under any special legislation?

There is no such special legislation in the People's Republic of China.

6 How are the different classes of creditors treated in relation to:

a) A formal corporate rescue?

A precondition for the start of a corporate restructuring is the conclusion of a conciliation agreement between the debtor and the creditors. Such agreement needs to be approved by a majority of creditors in number representing more than two thirds in value of the unsecured debts. Secured creditors are not allowed to vote at the meeting of creditors, as only unsecured creditors are entitled to vote.

The resolution of the meeting of creditors is binding on all creditors, including secured creditors. The legislation does not specify how different classes of creditors should be treated. However, in a formal bankruptcy, it is clear from a State Council directive of 25 October 1994 – "Proposal for Carrying out State-Enterprise Bankruptcy Law in Some Cities (Document 59)" that where this directive applies the first priority is to re-settle employees. Article 4 of the Law provides that the State shall arrange for appropriate re-employment of staff and workers of bankrupt enterprises and shall guarantee the basic living needs prior to re-employment. The specific measures are separately stipulated by the State Council in Document 59. In summary, they involve the resettlement of the employees in order to maintain order and stability in the society, the priority payment of employees' resettlement claims and wages, etc. Such things as staff quarters, schools, nurseries and hospitals and other welfare facilities of the bankrupt enterprise do not form part of the bankruptcy property available for distribution and are confiscated by the government of the province or region. Further, there is provision for the government of the province or region to take appropriate measures to re-train employees, refer employees to other enterprises or export the employees' skills with a view to resettling the employees and insuring them of a basic living before they find a new job.

As already stated, there are no known instances of formal corporate rescue in the People's Republic of China. However, in view of the emphasis placed upon the handling of employees in the formal bankruptcy of a state-owned enterprise, it is assumed that a similar emphasis would be placed upon a formal corporate rescue under the Law. However, there is nothing in the legislation for formal corporate rescue, according any particular treatment of different classes of creditors.

b) An informal corporate rescue?

The starting point, in theory, is to treat creditors in the same way as they would be treated under the liquidation laws of Hong Kong, China. However, it is common for all creditors, other than secured creditors, to be treated identically, irrespective of class. It is common for the municipal government to supply the assets / funds to support the restructuring. Usually, the municipal government will make only one pool of assets available against which all creditors "prove". It is common for creditors holding guarantees to be treated no differently to those that have no guarantees.

The treatment of employees in an informal restructuring depends on the municipal government's plan for the region. Not a lot is known about how any level of the government in the People's Republic of China deals with domestic employees. It is surmised that the government provides for the "the well-being of employees by ensuring, for example, that they are adequately housed and fed."

c) A case of corporate insolvency under any special legislation?

See comments (above) regarding Document 59 in the case of bankruptcy of a state-owned enterprise under the Law.

7 What is the position of both unsecured and secured creditors who vote against, do not agree with, or do not consent to, a plan of rescue in relation to:

a) A formal corporate rescue?

If a creditor considers the resolution contrary to the provisions of law, opposing creditors (including unsecured and secured creditors) may apply for a ruling to the People's Court that accepted the case within seven days of a resolution being made at a creditors' meeting. Such ruling of the court is final. It seems that it is still open for creditors to take action in other jurisdictions where assets are located, subject to the intervention of the liquidation committee in those jurisdictions.

b) An informal corporate rescue?

This will depend on the terms of rescue and whether there is a standstill agreement whose terms have been breached. In the absence of any formal standstill agreement (which is common) and assuming creditors have reserved their rights throughout the negotiation process, creditors will be free to exercise their legal rights as best advised. This, of course, may result in the end of the restructuring process, so dissenting creditors have to be placated in some way if the process is to continue.

c) A case of corporate insolvency under any special legislation?

There is no such special legislation applicable under these circumstances.

8 In relation to the need for an insolvent corporation to have urgent working capital funding, what difficulties are encountered in the provision of such funding in relation to:

a) A formal corporate rescue?

The relevant law does not touch on such issues directly. There are no known cases of formal rescue in the People's Republic of China. It is suspected that the government would support working capital requirements as it has done in the case of informal corporate rescues.

b) An informal corporate rescue?

Generally, the enterprise will effectively cease operations or the provincial government will support the debtor's business operations – usually on a scaled-down basis – until the rescue is implemented. Where new money is required, it is open to the enterprise to request the banks to advance funds with appropriate security and assurances. In practice, this is rare, as security in the People's Republic of China is difficult to enforce and guarantees from the government are no longer given. It has been observed that foreign creditors now treat arrangements such as guarantees or letters of comfort from municipal governments with skepticism, as they have not always been honored in the past.

c) A case of corporate insolvency under any special legislation?

There is no such special legislation applicable under these circumstances.

9 Briefly describe the relevant provisions relating to the setting aside of antecedent and fraudulent transactions in relation to:

a) A corporate bankruptcy/liquidation.

The transactions conducted by an insolvent enterprise during the period starting from six months prior to the date on which the court accepted the bankruptcy case and ending on the date on which a bankruptcy declaration was made by the court (the review period) are subject to court review. Impeachable transactions include:

- Concealing, private distribution or gratuitous transfers of assets.
- Transfers of assets at unreasonable prices.
- Provision of security to originally unsecured creditors.
- Repayment of debts before they become due.
- The waiver of debts owed to the insolvent enterprise.

The liquidation committee may apply to the court to recover property so transferred.

b) A formal corporate rescue.

Under the relevant People's Republic of China law, restructuring occurs only after the court has taken the bankruptcy case and, in the case of an unsuccessful restructuring, before the declaration of bankruptcy. Therefore, the above provisions appear to apply, as in a formal bankruptcy, only where the restructuring fails.

c) A case of corporate insolvency under any special legislation.

There is no such special legislation applicable under these circumstances.

10 Are there any provisions of law that might operate to invalidate a secured property transaction in relation to:

a) A corporate bankruptcy/liquidation?

As mentioned above, security given during the review period will be invalidated if it was given to secure a previously unsecured debt.

b) A formal corporate rescue?

Please refer to Section 9 above.

c) A case of corporate insolvency under any special legislation?

There is no such special legislation applicable under these circumstances.

11 Describe the difficulties that are encountered in endeavoring to administer cases of corporate bankruptcy/liquidation and formal corporate rescue that involve property and business interests located in more than one jurisdiction.

The closed legal system in the People's Republic of China makes it difficult for foreign creditors to comprehend the laws and processes that govern corporate bankruptcy or rescue. The lack of restructuring experience according to open market principles increases the burden for foreign creditors. The practice of dealing with the financial difficulties of state-owned enterprises "in house" adds to the difficulties.

Many of the state-owned enterprises have assets located all over the world, particularly in Hong Kong, China. However, the People's Republic of China has yet to apply for recognition or ancillary liquidation of Gitic in any jurisdiction other than the People's Republic of China. Accordingly, it is open to creditors to take such action as they are advised in other jurisdictions. The Gitic bankruptcy is, to date, confined to the People's Republic of China in its administration, despite the wide-ranging location of assets and business interests in other jurisdictions.

It remains to be seen how the Gitic bankruptcy will evolve and whether Gitic will be placed under any formal insolvency regime in other jurisdictions and if so, what effect this will have on the People's Republic of China administration of the bankruptcy. These questions are yet to be answered.

Additional comments on the "debt-to-equity-swap policy"

The policy of debt-to-equity-swap adopted in the People's Republic of China reform of its financially deeply-troubled state-owned enterprises has been widely viewed as a means of achieving a win-win result for both the state-owned enterprise debtors and bank creditors.

Under the policy, debts owed to banks are swapped for a shareholding in the debtor, which is held by an asset management company owned by the banks. The theory is that interest payments are reduced (if not waived), management is improved, and creditors have a new chance to recover their debt by way of receiving dividends from the asset management company. Usually, there is a mix of debt/equity swap and payment of a certain amount directly to bank creditors in return for a release of debt. In some cases, creditors are given an alternative to swap debt for equity or they can take a "cash out" option, instead.

Currently, the policy applies only to large- or medium-sized state-owned enterprises and state-owned commercial banks. The State Economic and Trade Commission ("SETC") is responsible for recommending state-owned enterprises to enter into these types of arrangements. Debt-to-equity-swap agreements are negotiated and concluded between state-owned enterprises and asset management companies representing the banks. Such agreements are required to be approved by SETC, before they can be implemented.

By the end of 1999, the SETC recommended 601 state-owned enterprises for this type of restructuring, which involved debts valuing RMB495.6 billion. By the end of July 2000, 485 state-owned enterprises had negotiated debt-to-equity swap agreements with asset management companies and 62 of these agreements were approved by the SETC.

There have been reports that some state-owned enterprises will make profits this year, as a direct result of the implementation of the debt-to-equity-swap.

It has yet to be explored as to whether and how this policy will apply to cases in which creditors are foreigners.

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Financial issues: China, People's Republic

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1 Is the insolvency legislation generally:

a) Understood?
b) Being followed and/or available opportunities being taken up?
c) Being enforced by relevant authorities?

Insolvency was not a known legal concept in the People's Republic of China planned economy until 1986 when the People's Congress passed the first Bankruptcy Law (the "Old Law"). The economy at the time was comprised entirely of state-owned enterprises and the legislation reflects this. In more recent years, market economy concepts have been introduced, yet due to the continued existence of strong government controls, the economic and legal systems have been slow to adjust to take full advantage of these ideas.

The Old Law addresses all basic aspects related to bankruptcy and sets clear guidance on its handling, such as the application process, obligation of the creditors' committee, restructuring and liquidation.

During the on-going transformation process, called "economic reform", the existing insolvency legislation proved to be insufficient in respect to the growing number of privately-owned businesses arising under the market economy. Proportionally, loans to privately-owned businesses are still extremely limited when compared with lending volume to state-owned enterprises.

In 1991 the People's Congress passed a bankruptcy guide for privately-owned enterprises as part of the civil legislation. This guide is extremely simple and short in length.

In 1994, the first set of Corporate Law was enacted. Although the chronological order of the series of commercial laws is somewhat awkward, the significance of the Corporate Law cannot be under-estimated. Prior to the enactment of the Corporate Law, all state-owned entities were given the status of "enterprise". Since the State is the sole owner, the legal and ownership structure for enterprises do not provide a foundation for more complicated commercial transactions, such as change of ownership. The new Corporate Law introduced the concept of shareholders and legalized the rights of a shareholder for the first time. This Corporate Law laid down the fundamental basis upon which other commercial legislation, such as the insolvency or restructuring law, can be built.

The current legislation simply provides a set of legalized procedures to terminate certain state-owned enterprises and relieve the government of its burdens. Therefore, it is badly in need of updating since the Corporate Law has taken effect. As such, the legislation is understood, being followed and being enforced. However, this is clearly not effective, as the legislation being followed is inadequate.

2 Broadly speaking, in practice, does the insolvency/restructuring legislation tend to lead to:

a) Early recognition and action?
b) Restructuring alternatives and action?

Under the Old Law, profitability was not the sole factor considered by the State when determining which entities to close. Likewise, creditors' rights were not a top priority. Typically, these organizations have been unprofitable and operating under government subsidy for many years prior to their bankruptcy proceedings.

Because of social stability factors, all bankruptcies are carefully selected by the central government, hence the limited number of bankruptcy cases per year. Conversely, given the importance of social stability, both components of the Bankruptcy Law failed to provide guidance on the disposition of the employees. As a result, the current legislation was simply not designed to protect creditors and offer restructuring opportunities to debtors. The legislation is therefore ineffective in meeting the above objectives.

3 What are the main practical difficulties being encountered in:

a) The preparation of restructuring plans?
b) The implementation of restructuring plans?

Burdened by the heavy load of non-performing loans resulted from government policy lending in the past, the four largest state-owned banks have struggled to regain strong financial performance and growth. Further more, the problem assets often become roadblocks in the commercialization for People's Republic of China banks.
To demonstrate its determination to build a sound financial system and ease the burden of the state banks, the People's Republic of China government established four

asset management companies ("AMC") in 1999. The AMCs were created to handle the problem assets transferred from the four state banks. To date, the estimated total of problem assets transferred to the AMCs is US$1.2 trillion, with the majority of these assets belonging to state-owned enterprises.

Although the four asset management companies are assigned with the task of resolving bad debts, they are constrained by the current non-commercial insolvency legislation, government approvals of most commercial decisions, and an economy that is not large enough or healthy enough to absorb these problem assets.

All restructuring plans are standardized. Because they are currently directed by the government and welcomed by most borrowers, all deals can be closed without much effort. However, execution of additional agreement terms, such as the debt repurchase at the end of the equity term, remain untested and the effectiveness and feasibility of these terms remain unknown.

The ability to create effective restructuring plans is particularly hampered by the significant further problem that even though the AMC has become the controlling shareholder, it is not able to participate in the management of the company. This creates further problems in finding proper commercial solutions to the corporation's problems.

Furthermore, the existing legislation does not grant the creditors or the converted shareholders with appropriate rights, even though the creditors have taken all related risks. This is a further hindrance to effective restructuring plans.

As a whole, the deeply troubled state sector is facing restructuring on all levels. But figuring out how to restructure the massive and problematic state sector for the world's most populous developing country is not an easy task.

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4 To what extent are companies that are going through any formal or informal restructuring merely adjusting their debt/equity structure, rather than genuinely restructuring their business operations?

Debt-to-equity swaps have helped the borrowers only in reducing or eliminating the current and future interest liabilities accrued. This relieves the company of some cash flow pressure, but does not necessarily improve their operations. The debt-to-equity swaps, therefore, are merely changes in the structure of the debt rather than a true restructuring of the business operations of the borrowers.

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5 What are the main areas from which funding is generally being utilized by companies which undertake either formal or informal restructuring?

Due to the way in which restructuring occurs, there is little external funding applied to these restructures. Clearly, a wide-range of changes is necessary to make the Bankruptcy Law relevant to the current commercial environment in the People's Republic of China. The government is aware of the unfairness in the existing legislation and the need for an update. New legislation will have to be passed before AMCs can function as they were designed. Insolvency and restructuring are still in their infancy in the People's Republic of China and there will be changes to both the legal framework and practical implementation of insolvency.

The most important next step for the AMCs appears to be further participation in borrowers' management. Once legal protections are provided through new legislation, the AMCs will be able to seek out more effective long-term solutions, including seeking other equity investments in insolvent companies.

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Legal issues: Hong Kong, China

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Insolvency law in Hong Kong, China is based on the law of the United Kingdom prior to the implementation of the recommendations of the Cork Report. It is what may be described as a creditor-friendly regime and has this in common with other UK-based jurisdictions, such as Australia and New Zealand.

Corporate insolvency procedures available in Hong Kong, China include contractual restructuring, schemes of arrangement, compulsory liquidations, creditors' voluntary liquidations and receiverships. The legislation dealing with corporate insolvency procedures is contained in the Companies Ordinance, the Bankruptcy Ordinance and the Companies (Winding-up) Rules.

The legislation is now outdated and in need of reform. The most obvious deficiency is the absence of a modern corporate rescue procedure which incorporates a moratorium. Perhaps this is why out-of-court restructuring has been widely used in Hong Kong, China. The general attitude to workouts in Hong Kong, China is reflected by "the Hong Kong Approach to Corporate Difficulties", a joint publication of the Hong Kong Monetary Authority and the Hong Kong Association of Banks. This paper consists of formal, but non-statutory, guidelines covering how institutions should deal with customers in difficulties when the borrower is dealing with multiple banks. The paper supports the survival of businesses which would otherwise fail, and it does so by suggesting throughout that the banks' initial attitude towards borrowers with financial problems should be one of support, with decisions based only on reliable information that is shared fully with all banks.

Statutory reform has made slow progress during the last decade. The future should see the introduction of statutory provisions dealing with insolvent trading and corporate rescue. In January 2000, a bill was gazetted by the Hong Kong, China government with a view to enacting legislation relating to insolvent trading and provisional supervision and voluntary arrangements for companies. However, as a result of extensive criticism of the bill, plans to introduce the legislation have been delayed. Although overdue, it is currently uncertain when this proposed legislation will become effective.

1 Describe the nature and the effectiveness of the following processes:

a) Civil unsecured debt collection remedies.

There are five principal remedies available to judgment creditors:

- In garnishee proceedings a judgment creditor seeks to recover the sum owed to it by a judgment debtor from a third party (the garnishee) who is indebted to the judgment debtor. This remedy is especially effective to "garnish" monies in the judgment debtor's bank account.
- A writ of execution issued over the judgment debtor's goods and chattels (moveable property) which orders a court officer to seize and sell as much of the debtor's goods and chattels as may be sufficient to realize the judgment debt and expenses.
- A charging order can be taken over immovable property which puts the judgment creditor in the position of a secured creditor, subject to any prior mortgages and charges affecting that property. By similar procedures, a judgment creditor can also obtain a charging order on a judgment debtor's beneficial interest in securities, as well as over chattels such as ships or aircraft.
- Winding-up proceedings are commonly used because of their potentially serious impact on a debtors' business or affairs. Winding-up proceedings are available to both judgment and non-judgment creditors who nevertheless have a debt which is not *bona fide* disputed. Bankruptcy proceedings in Hong Kong, China are analogous to winding up proceedings except that they apply to individuals. Winding-up proceedings are an effective alternative to pursuing judgment remedies or remedies enforcing debts. The effect of a winding up petition is to prohibit all dispositions of a debtor's assets without leave of the court.
- Examination of judgment debtors to obtain information about property and income may help to supplement existing information known to the judgment creditor.

b) Secured property enforcement remedies.

Security documents usually confer four principal remedies: (i) right to take possession of assets, (ii) power of sale of assets, (iii) power to appoint a receiver over assets charged, and (iv) right of foreclosure.

A mortgagee or chargee can take possession of the secured assets and exercise its power of sale or appoint a receiver without a court order if, as is always the case, the documentation confers this power on a mortgagee or chargee.

c) Any special debt collection or secured property remedies that are available to banking sector creditors.

Hong Kong, China has no special legislation regarding banking sector creditors.

d) Corporate bankruptcy/liquidation processes that are available to corporate debtors and creditors.

There are two types of voluntary liquidation:

- Members' voluntary winding-up which occurs when the members, by special resolution (75 percent), resolve to wind-up the company and when the directors make a declaration of solvency in accordance with the Companies Ordinance. The Liquidator is appointed by the company in general meeting.
- Creditors’ voluntary winding-up occurs if the company arranges for a meeting of creditors to be summoned immediately after the general meeting sanctioning the winding-up of the company. Creditors have the right to appoint their own liquidator in preference to the company’s nominated liquidator. In the event of a conflict, the creditors' choice prevails.

In addition, or alternatively, the creditors can petition the court for the winding-up of a company on the grounds, among other things, of the corporate debtor’s inability to pay its debts. Presentation of a winding-up petition freezes the business of the company without orders from the court.

e) Formal corporate rescue processes that are available to corporate debtors and creditors.

The scheme of arrangement is the only formal corporate rescue process available in Hong Kong, China. A scheme of arrangement may be initiated by the company or any of its creditors by filing an application with the High Court together with an explanatory statement, the prescribed notices summoning meetings and forms of proxy for those meetings. The court will provide directions as to the timing and location of the meetings of creditors. Notices, together with the explanatory statement, must be sent to all known creditors or given by advertisement. The explanatory statement must give sufficient information to creditors to enable them to decide whether or not to approve the scheme. It is not necessary for a scheme to deal with all classes of creditors. However, if any creditors' claims are not addressed in the scheme, those creditors retain their full original rights against the company, following implementation of the scheme.

Meetings of creditors or classes of creditors are then held to approve the scheme. A resolution approving the scheme must be passed at each meeting (including meetings of any separate classes) by a majority in number representing at least 75 percent in value of those present and voting (including by proxy). If the scheme is approved, there should also be a general meeting of the shareholders of the company and, if deemed necessary, a board meeting of the company to approve the company entering into the scheme of arrangement.

Once all appropriate meetings have approved the scheme, a petition must be presented to the court for approval. The scheme does not take effect until the filing of the order of the court sanctioning the scheme with the Registrar of Companies.

Formulation and implementation of even a very basic scheme is likely to take at least two months. A more complicated scheme may take in excess of six months to take effect.

The term "creditor" for the purposes of the legislation relating to schemes of arrangement includes parties holding any claim whether liquidated or unliquidated, prospective or contingent.

Once the scheme is approved by the court, it will take effect so as to bind all creditors in each class approving the scheme, not just those creditors who voted or were entitled to vote at the relevant meetings.

The primary advantage of a scheme of arrangement is that it does not require unanimity.

The perceived problems with schemes of arrangement include delay, cost, uncertainty, the lack of a moratorium or stay of proceedings and the lack of implied powers for scheme administrators.

f) Informal corporate rescue processes.

Informal corporate rescue processes in Hong Kong, China are undertaken by contract. The Hong Kong Monetary Authority and the Hong Kong Association of Banks have jointly published non-binding, recommended guidelines for the Hong Kong Approach to corporate difficulties. In summary, the guidelines provide that the attitude of banks should be one of support, with decisions only being made based on information that is reliable and shared fully with all banks. The guidelines encourage collective decisions and equal treatment of banks tempered by certain restrictions on the borrower's activities.

g) Any other corporate insolvency, or insolvency-related, processes that are available under special legislation.

Hong Kong, China does not currently have any other rescue-related legislation. Legislation to implement a court-based rescue procedure has been postponed.

2 What is the effect upon debt enforcement and secured property enforcement processes of:

a) An adjudication of corporate bankruptcy/liquidation?

After the commencement of a winding-up (which in the case of a winding-up by the court is the date the winding-up petition is presented, or in the case of a voluntary winding-up is the date the resolution is passed), many significant enforcement proceedings against a company are void. Generally, a winding-up order stays all actions against the company. Where a winding-up order has been made, no action or proceeding shall be proceeded with or commenced against the company except by leave of the court, and subject to such terms as the court may impose.

The power of a secured creditor to appoint a receiver is not restrained by liquidation, although upon liquidation of the company the receiver ceases to act as agent of the company. Secured creditors may also realize their security and obtain full satisfaction without proving their claim in the corporate liquidation, although they may prove for what they consider to be the amount of their shortfall (i.e. the difference between the value of the assets over which they hold security and their outstanding claim) in the liquidation.

b) The commencement of a formal corporate rescue process?

There is no legal mechanism to prevent individual creditors from enforcing their debts before a scheme of arrangement is approved, or preventing a creditor from filing a winding-up petition, or preventing a secured creditor from enforcing its security.

c) The initiation of an informal corporate rescue process?

The effect of an informal corporate rescue on debt and security enforcement processes against a company are a matter of contract between the company and its creditors. It is unusual for there to be a formal pre-existing agreement (a formal standstill agreement) to defer enforcement in the event of a restructuring. In the absence of such agreement, creditors are free to pursue their remedies at will although informal standstill arrangements between financial creditors are common.

d) The initiation of an insolvency, or insolvency-related, process under any special legislation?
As mentioned earlier, Hong Kong, China has no special legislation.

3 What is the effect on the management of a corporation of:

a) An adjudication of corporate bankruptcy/liquidation?
The powers of the board of directors effectively cease in a winding-up.

b) The commencement of a formal corporate rescue process?
Application to court to convene meetings to consider a scheme of arrangement does not restrict the power of the management of the company. The scheme, when implemented, is likely to give the powers to a scheme manager who is generally an insolvency practitioner.

c) The initiation of an informal corporate rescue process?
Management retain their powers, although if a standstill agreement is put in place these powers will be curtailed by contract.

d) The initiation of an insolvency, or insolvency-related, process under special legislation?
As mentioned earlier, Hong Kong, China has no special legislation.

4 Who is responsible for "case management" control and administration in:

a) A corporate bankruptcy/liquidation?
Administration of a liquidation, whether voluntary or compulsory, is undertaken by the liquidator. The liquidator may seek directions from the court on any matter and, where creditors are involved, appoint a committee of inspection to assist him in his functions.

b) A formal rescue?
The responsibility for managing a formal rescue by way of a scheme of arrangement is on the company. It also often involves the input of a steering committee of financial creditors. A scheme manager generally manages the administration of the scheme of arrangement itself.

c) An informal rescue?
Management remains in control of the company. Its major creditors exercise control over management through a standstill arrangement and by obtaining security (if this is available).

d) A case of corporate insolvency under any special legislation?
As mentioned earlier, Hong Kong, China has no special legislation.

5 Who has the responsibility for the preparation of the plan of rescue under:

a) A formal rescue?
In a scheme of arrangement, the scheme documents incorporating the rescue plan are prepared by the company and its legal and financial advisers.

b) An informal rescue?
Generally, an informal rescue plan is prepared by the company in conjunction with the steering committee of its creditors and relevant legal and financial advisers.

c) A case of corporate insolvency under any special legislation?

As mentioned earlier, Hong Kong, China has no special legislation.

6 How are the different classes of creditors treated in relation to:

a) A corporate bankruptcy/liquidation?

In a winding-up, the following claims (in order of priority) will be paid in priority to all debts (other than secured debts):

- Costs and expenses of the winding-up (including the liquidator's remuneration and legal fees).
- Wages and salaries of employees, severance payments to employees, long services payments to employees, workmen's compensation, wages in lieu of notice, accrued holiday remuneration and unpaid pension contributions (including all amounts which the Protection of Wages on Insolvency Fund is entitled to receive).
- All statutory debts due to the Government within the 12 months before the appointment of a provisional liquidator or the date of the winding-up order in the case of a compulsory liquidation or the date of commencement of a voluntary winding-up.

The debts in the second point above rank equally among themselves and are paid *pro rata* if the company has insufficient assets to meet them all. Some of those debts are subject to statutory limits that vary from time to time.

The creditors owed debts described in the first and third points are termed preferential creditors. Unsecured creditors rank *pari passu* amongst themselves.

b) A formal rescue?

There is no legislation setting out the priorities of different classes of creditors in relation to a scheme of arrangement, however, creditors of different classes must separately approve the scheme. Note that the court in Hong Kong, China has shown an unwillingness to approve a scheme where shareholders will receive in excess of 5 percent of the funds put into the scheme.

c) An informal rescue?

This is a matter of negotiation between the company and its creditors.

d) A case of corporate insolvency under any special legislation?

As mentioned earlier, Hong Kong, China has no special legislation.

7 What is the position of both unsecured and secured creditors who vote against, do not agree with, or do not consent to, a plan of rescue in relation to:

a) A formal rescue?

Creditors (or a class of creditors) that disagree with a proposed scheme of arrangement may vote against it at the court-convened meeting. If the scheme obtains the necessary majority from a claim however, dissenting creditors in that claim are bound by it regardless. The scheme also binds creditors even if they did not receive notice of or did not know of the scheme, but such a creditor can challenge a scheme on the grounds that the company took inadequate steps to bring the scheme to its attention.

b) An informal rescue?

Creditors who disagree with an informal plan of rescue are still entitled to actively pursue all rights and remedies against the company until the scheme is implemented.

c) A case of corporate insolvency under any special legislation?

As mentioned earlier, Hong Kong, China has no special legislation.

8 In relation to the need for an insolvent corporation to have urgent working capital funding, what difficulties are encountered in the provision of such funding in relation to:

a) A formal rescue?
There is no legal impediment to allowing overdraft and other short-term facilities to revolve within existing limits, although the standstill agreement should provide for equalization. Likewise, there is no legal impediment to lenders taking security for fresh advances.

b) An informal rescue?
Please refer to Section 8a above.

c) A case of corporate insolvency under any special legislation?
As mentioned earlier, Hong Kong, China has no special legislation.

9 Briefly describe the relevant provisions relating to the setting aside of antecedent and fraudulent transactions in relation to:

a) A corporate bankruptcy/liquidation?
Some of the methods by which a transaction may be avoided by a liquidator include:

- Vulnerable under the general law, for example by reason of the abuse of powers doctrine, absence of corporate benefit if the recipient of the consideration knew or ought to have known of such absence, or for misrepresentation, undue influence or some other ground.
- An unfair preference pursuant to s.266 and s.266B of the Companies Ordinance.
- A floating charge given by an insolvent company within 12 months of commencement of the winding-up pursuant to s.267 of the Companies Ordinance.
- A registerable but unregistered charge pursuant to s.80 and s.267 of the Companies Ordinance.
- A disposition of the company's property made without the leave of the court after the commencement of winding-up pursuant to: s.182 (compulsory liquidation only) and pursuant to s.232 of the Companies Ordinance (relates to the transfer of shares, involuntary liquidation only).
- Any attachment, sequestration, distress or execution put in force after commencement of the winding-up pursuant to s.183 of the Companies Ordinance (compulsory liquidation only) and s.269 of the Companies Ordinance.
- An extortionate credit transaction pursuant to s.264B of the Companies Ordinance.

There is no concept of transactions at an undervalue in the context of corporate insolvency in Hong Kong, China. Legislation to this effect has been postponed.

b) A formal rescue?
No similar provisions apply to companies bound by a scheme of arrangement.

c) A case of corporate insolvency under any special legislation?
As mentioned earlier, Hong Kong, China has no special legislation.

10 Are there any provisions of law that might operate to invalidate a secured property transaction in relation to:

a) A corporate bankruptcy/liquidation?
Provisions of general law apply as set out in Section 9a above. There are no specific legal provisions invalidating the realization of a secured property under insolvency law.

b) A formal rescue?
The law on unfair preferences does not apply to secured property transactions of companies bound by a scheme of arrangement.

c) A case of corporate insolvency under any special legislation?
As mentioned earlier, Hong Kong, China has no special legislation.

11 Describe the difficulties that are encountered in endeavoring to administer cases of corporate bankruptcy/liquidation and formal corporate rescue that involve property and business interests located in more than one jurisdiction.

Legislation in Hong Kong, China does not make specific provision for the extra-territorial effect of Hong Kong, China insolvency orders, although a liquidator will obviously seek to secure and realize assets located outside Hong Kong, China. The effect of insolvency orders in other jurisdictions will depend upon the extent to which the courts in those jurisdictions are prepared to recognize Hong Kong, China orders.

In relation to foreign insolvency orders, Hong Kong, China legislation does not expressly provide for recognition of foreign orders. However, the courts will generally recognize foreign proceedings in accordance with the principle that matters as to a company's status are to be determined in accordance with the law in its place of jurisdiction.

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Financial issues: Hong Kong, China

PricewaterhouseCoopers

1 Is the restructuring/insolvency legislation generally:

a) Understood?

b) Being followed and/or available opportunities being taken up?

c) Being enforced by relevant authorities?

As is the case in many countries, the Hong Kong, China insolvency legislation is generally understood by professional persons, and less so by the rest of the community. It would be fair to say that the Hong Kong, China business community has experienced a steep learning curve since late 1997, when the Asian financial crisis first hit the region.

The average person's lack of understanding of Hong Kong, China's insolvency legislation / process is exemplified by the protests that arose when the brokerage firm CA Pacific collapsed. In this case, clients demanded the full return of shares from an insolvent brokerage that did not have sufficient shares to repay its clients.

As a general rule, Hong Kong, China insolvency legislation is being followed, but there is always room for improvement – an example is the issue of the licensing of insolvency practitioners. Licensing is *de rigueur* in most other common law jurisdictions and the Hong Kong Law Reform Commission on Insolvency recommended its implementation just over five years ago. However, at present, liscensing is still in the cards and anyone can be appointed liquidator of a Hong Kong, China company. Court-appointed liquidators, however, are chosen from a panel of suitably qualified practitioners.

Insolvency legislation in Hong Kong, China is effectively policed by the court and the Official Receiver. Statutory powers are available in certain industries and are affected by such government or quasi-government authorities as the Securities and Futures Commission ("SFC"), the Office of the Insurance Commissioner and the Hong Kong Monetary Authority. For example, the SFC petitioned to place a number of share brokerages in Hong Kong, China (the largest of which was CA Pacific) in liquidation after they detected discrepancies.

Where funding and manpower constraints permit, the office of the Official Receiver will investigate the issues raised by liquidators' reports lodged in Directors' conduct returns. Where there is sufficient public interest, an inspector may be appointed to examine reasons for a particular collapse. When the Peregrine Group (the largest investment bank in Asia outside of Japan) collapsed and went into liquidation, the court appointed an inspector for this purpose on the application of the Hong Kong Financial Secretary. The costs of the inspector were paid from public funds. Controversy surrounds this particular appointment because the findings of the inspector's report have not been made public.

2 Broadly speaking, in practice, does the restructuring/insolvency legislation tend to lead to:

a) Early recognition and action on financial difficulties experienced by a corporation?

b) Restructuring alternatives as opposed to liquidation, and if not, why not?

Insolvency legislation in Hong Kong, China is very much focused on formal procedures, leaving little opportunity for restructuring under the legislation. Other than schemes of arrangement, which are particularly difficult, costly, and time consuming to implement, there are no formal restructuring processes such as administrations. Thus, companies are either successful in working out their financial difficulties in an out-of-court environment or move straight into liquidation or receivership.

In what originally was thought to be good news, a formal, court-driven workout process, called Provisional Supervision, was put before the Legislative Council for consideration last year. This legislation has been many years in coming and is conceptually supported by the business community. However, when the actual draft legislation was proposed, there were many submissions from insolvency practitioners, bankers, academics and professional bodies that suggested that the proposed legislation was unworkable for practical purposes. The Legislative Council is currently considering a further draft bill, but it appears to be substantially unchanged from the first.

In some countries, insolvency legislation works to make directors focus on a company's financial difficulties in the early stages by making them personally liable for debts incurred in certain situations (such as when the company is insolvent). The legislation of Hong Kong, China does not work in this way. Directors of Hong Kong, China companies are only liable under fraudulent trading provisions, wherein it must be proved that they had the intent to defraud creditors. This very high threshold of proof is rarely met in cases against directors, and thus few cases are brought before the court. The recently completed case of *Wheelock Marden*, which ran through various appeals for over 15 years, is an example of how costly and complex fraudulent trading cases can be. The Final Appeal Hearing in *Wheelock* ran before the Court of Final Appeal for 189 days. The costs of both sides are estimated to well exceed the initial claim and at the end the plaintiff, who sued the former directors, was unsuccessful.

The Hong Kong Association of Banks, with the full endorsement of the Hong Kong Monetary Authority, has issued "The Hong Kong Approach to Corporate Difficulties" to workouts in Hong Kong, China. The guide focuses primarily on how lenders should act when faced with problem loans situations, particularly in multi-bank problem loan situations. The guide encourages workouts and a code of conduct, but discourages formal intervention by banks except in cases of fraud or serious mismanagement. The guide also encourages banks to work together as a unified group, rather than as separate competing interests.

3 What are the main practical difficulties being encountered in:

a) The preparation of restructuring plans?
b) The implementation of restructuring plans?

The main difficulties encountered in the preparation of restructuring plans are the nature of banking relationships in Hong Kong, China, as it is rare for a medium or large company to be financed by only one bank. Bank groups of 10 to 20 are considered normal and on some of the large workouts, bank groups exceeding 100 are not uncommon. Bank groups typically comprise of Hong Kong, China banks, non-Hong Kong, China (foreign banks) and the People's Republic of China banks.

The prevalent use of multi-bank lending leads to workouts involving a liaison or lead bank, steering committees and even working groups within steering committees to ensure a successful restructuring. Nearly every major restructuring in Hong Kong, China involves foreign banks. Foreign banks with Hong Kong, China offices often require head office guidance and / or approval for action on problem loans. The relevant head office may not have sufficient knowledge or understanding of local problems or legal requirements to implement an appropriate strategy. However, local office expertise and head office understanding has improved greatly since the start of the financial crisis in 1997. "The Hong Kong Approach to Corporate Difficulties" advocates that banks set up in-house problem credit management teams in Hong Kong, China.

Differing philosophical, cultural, legal, economic and corporate ideas can complicate a restructuring in Hong Kong, China. A diversified group of banks have diversified and competing interests: different banks have different attitudes towards and requirements from a restructuring; banks from different jurisdictions have different philosophies; different foreign banks may have different cash flow requirements, depending on the state of their home economy; and different banking jurisdictions also have different legal requirements. For example, Japanese and Italian banks have difficulty converting debt to equity if it requires them to hold onto such securities.

Hong Kong, China companies often have assets and / or operations in the People's Republic of China, and to further complicate matters, the laws, and consequently the enforceability of charges, loans, etc., are different between the two jurisdictions.

In most jurisdictions, banks can use the threat of enforcement, receivership or liquidation as a negotiating tool. The People's Republic of China does not generally recognize Hong Kong, China security or liquidators over assets. Creditors in the People's

Republic of China can enforce their debts against assets in priority to foreign creditors. While there is one country, there are two systems for debt recovery purposes and Hong Kong, China creditors are considered foreign creditors in the People's Republic of China. This again makes restructuring difficult in many cases.

4 To what extent are companies that are going through any formal or informal restructuring merely adjusting their debt/equity structure, rather than genuinely restructuring their business operations?

The goal of most companies undergoing a restructuring process in Hong Kong, China is simply to reduce debt to an acceptable level and carry on with business. It is rare that fundamental changes are made to the existing business operations. The reasons for this appear to be that companies have little ability to access to capital (due to their poor balance sheets) and have no rights to a standstill period that allows them to reorganize their business properly.

There are many instances where listed shells of insolvent companies are used as a means of "backdoor listings" onto the Hong Kong Stock Exchange. A current example is the Yaohan situation in which a listed department store went into liquidation. The company has entered into a scheme of arrangement whereby an investor will effectively buy a clean company shell – the listing – for a fraction of the amount the company owes its creditors – effectively becoming a listed company through the "back door".

An example of a more comprehensive restructuring of business operations is that of QPL International Holdings Limited ("QPL"). QPL sold a minority share in its most profitable business to pay creditors and fund working capital. By realizing the value in their organization, they were able to expand and move forward.

Measured in terms of debt, the US$4.6bn restructuring of Guangdong Enterprises Limited ("GDE") is the largest ever insolvency to date in People's Republic of China. GDE was the largest so-called "window company" (government-owned entity established primarily to make investments in the People's Republic of China using foreign debt financing) of the Guangdong Province of the People's Republic of China, and one of the largest in the country as a whole. In addition to the large debt burden, it boasted approximately 300 operating subsidiaries, including five corporates listed in Hong Kong, China.

GDE was restructured by way of an out-of-court negotiated workout involving some 170 foreign and People's Republic of China banks and a series of bond issues largely held by US investors. GDE engaged Goldman Sachs as its financial advisor in the restructuring, and PricewaterhouseCoopers advised the banks.

The negotiations took place over a period of two years culminating in legal completion of the deal – including obtaining all necessary approvals from the People's Republic of China – in December 2000. The Guangdong Provincial Government ("GPG") participated in the negotiation process on behalf of GDE and it was understood that key aspects of the restructuring proposal passed across the desk of the Premier in Beijing. The restructuring was regarded as a test-case for the People's Republic of China, and the government saw it as key to establishing their *bona-fides* with the international investment community.

As a measure of government commitment, the key plank of the restructuring was the privatization and injection of the GPG owned Dongshen water project (WaterCo) – the provider of approximately 70 percent of the water needs of Hong Kong, China. Financial creditors exchanged their existing debts for a package of assets including a US$1.8bn 10 year loan note issued by WaterCo, together with equity in WaterCo, debt and equity assets arising from the restructuring of GDE itself, and some cash. The corporate restructuring of the existing GDE involved segregating its assets into three broad categories (saleable property in Hong Kong, China; performing assets; and distressed assets) each of which was injected into newly-formed corporate entities with appropriate strategies to realize value from each category. Each of the three newly-formed corporate entities issued debt and equity instruments which were part of the package offered to the financial creditors. It was agreed that PricewaterhouseCoopers would monitor the progress and performance of the newly-formed corporate entities and of WaterCo on behalf of the financial creditors going forward.

The GDE deal had a number of unique and interesting features which are beyond the scope of this guide. It appears, however, that the restructuring was regarded as a success story by the majority of foreign banks and bondholders involved, and by the reform minded politicians within the People's Republic of China. As other large restructurings in the People's Republic of China come to a close in its wake (including the large Guangzhou ITIC restructuring), it remains to be seen what the precedents are, and to what extent providers of foreign capital into the People's Republic of China are encouraged to resume lending into the jurisdiction.

5 What are the main areas from which funding is generally being utilized by companies which undertake either formal or informal restructuring?

The most common forms of funding for Hong Kong, China companies undergoing restructuring are as follows:

- Through a "white knight" or associates of shareholders – i.e. friendly investors usually interested in a long-term stake.
- Genuine third party investors (e.g. QPL as discussed above).
- "Creditor refinancing" – where creditors either write off debt or convert to equity to release cash flow.
- Through a "black knight" – investors who squeeze shareholders and creditors.

Debtor-in-possession ("DIP") financing, where a lender loans money to a company in restructuring on a super-priority basis, is not particularly common in Hong Kong, China. In PricewaterhouseCoopers' experience, this is due to a lack of early recognition of financial difficulties and acceptable sources of repayment.

There appears to be some scope for bank financing when a company first owns up to its financial difficulties. At that stage banks may choose to fund working capital for a short period while they explore their options.

In large-scale insolvencies there has been an increase in the purchase of debt by venture capitalists and specialist distressed debt sectors of banks. Usually these traders enter the market after winding-up. There does not appear to be much interest at the restructuring phase, although this may change.

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Legal issues: Indonesia

White & Case LLP and Ali Budiardjo, Nugroho, Reksodiputro

Formal insolvency proceedings and restructurings are recent developments in the legal landscape of Indonesia. As part of the general continuation in force of Netherlands-Indies legislation in existence at Indonesia's independence, Indonesia inherited the Bankruptcy Ordinance, first enacted by the Netherlands-Indies government in 1906. In 1998, the Indonesian government amended the Bankruptcy Ordinance for the first time through Government Regulation In Lieu of Law No. 1, which was enacted by Law No. 4 of 1998 (the "Bankruptcy Law"). When the economic crisis abruptly occurred in 1997, there was an almost complete absence of formal insolvencies in Indonesia for reasons that include:

- The non-confrontational nature of Indonesian business mores.
- Perceived difficulties in the administration of justice in Indonesia which ranged from inadequate training of judges to inexperienced litigation lawyers and to more fundamental impediments such as corrupt practices.

In this context, we now examine the collection and restructuring of Indonesian debt.

1 Describe the nature and the effectiveness of the following processes:

a) Civil unsecured debt collection remedies.

The enforcement of unsecured debt commences by filing a claim with the District Court situated at the place where the debtor has its usual place of abode, unless agreed otherwise. However, any District Court judgment is subject to appeal through the Court of Appeals and cassation procedures before the Supreme Court. Thereafter, there is a possibility of civil review before a different chamber of the Supreme Court. This tiered system of appeals can result in a lengthy and expensive judicial process. Pending appeal, no order can be enforced. Therefore, an appeal represents an instrument for debtors to delay the enforcement of a creditor's debt.

An unsecured creditor can also petition for the debtor's bankruptcy in the Commercial Court, the procedure and consequences of which are considered in Section 1d.

b) Secured property enforcement remedies.

Security over assets in Indonesia is generally taken by the following means:

- A mortgage (known as *hak tanggungan*) over immovable property.
- A fiduciary transfer of ownership for security purposes on movable property.
- A pledge over movable property.
- A fiduciary assignment for security purposes over intangible property.

While in principle enforcement of a creditor's security may be undertaken without recourse to the courts, practice is different:

- A mortgage holder enjoys the right of direct execution without writ of execution. However, unless the debtor agrees to the auction, the Auction Office, which conducts and supervises the public auction, inevitably requires a court order for the auction.
- In the absence of cooperation from the debtor, the creditor has to institute legal proceedings to reclaim possession of the goods subject to a fiduciary transfer, after which the goods must also be sold in a public auction.
- As a pledge requires the pledged property to be brought outside of the possession of the pledgor, re-possession of pledged property is normally less problematic, although pledged goods must also be auctioned after repossession.
- In order to enforce a fiduciary assignment of receivables, each debtor of a receivable must be notified to pay the assignee, and the creditor's only recourse against a debtor who disregards such notification is to institute legal proceedings against it.

The court proceedings to foreclose on secured assets are substantially the same as for the enforcement of unsecured debt detailed in the first paragraph of Section 1a with the attendant disadvantages.

c) Any special debt collection or secured property remedies that are available to banking sector creditors?

There is no effective system of summary judgment proceedings in cases involving a legitimate dispute as to the validity and amount of the debt. The Indonesian Bank Restructuring Agency has widespread powers to recover assets of the banks under its supervision.

d) Corporate bankruptcy/liquidation processes that are available to corporate debtors and creditors?

Under the Bankruptcy Law, one or more creditors may file for the debtor's bankruptcy once the following test for bankruptcy is satisfied:

- The debtor must have at least two creditors.
- The debtor must have failed to pay at least one of its debts which has become due and payable.

If the debtor is a bank, only Bank Indonesia (the central bank) may petition for its bankruptcy and if the debtor is a securities company, only BAPEPAM (the Capital Markets Supervisory Board) may so petition. A bankruptcy petition may also be filed by the debtor itself or, if the public interest so requires, the Public Prosecutor.

In reality, the Commercial Court has so far not consistently interpreted this bankruptcy test. Some examples to date include:

- Not recognizing that the debt was due and payable even when the loan had been accelerated because the final repayment date had not occurred.
- Not recognizing debt under a swap transaction as valid debt for these purposes.
- Disallowing an unpaid claim for damages to be the basis of a bankruptcy filing.

e) Formal corporate rescue processes that are available to corporate debtors and creditors.

Only one formal corporate rescue process is available, namely the suspension of payments (moratorium) under Chapter II of the Bankruptcy Law. The Commercial Court is required under law to grant a petitioning debtor provisional moratorium and to appoint a Supervisory Judge and an administrator to assist the debtor in managing its estate. The debtor will still be entitled to manage and dispose of its assets jointly with the administrator.

The Commercial Court is required to call a meeting of the unsecured creditors within 45 days of the grant of a provisional moratorium. At this meeting, the unsecured creditors must either approve the composition plan (or rescue package), assuming that such a plan is submitted to the Commercial Court by the debtor, or agree to convert the provisional moratorium into a permanent moratorium for a period of up to 270 days from the date of grant of the provisional moratorium. The decision requires the affirmative votes of more than half in number of the unsecured creditors who are present in the meeting, who represent at least two thirds of the amount of the unsecured claims of the unsecured creditors present at the meeting. If no plan is submitted and the unsecured creditors fail to extend the moratorium, the bankruptcy will be pronounced.

No later than 14 days after acceptance of the plan by the unsecured creditors, the Commercial Court must decide whether or not to ratify the plan. Dissenting creditors may express their views against the plan. The Commercial Court may refuse to ratify the plan only on limited grounds, which include:

- If the implementation of the plan is not adequately assured (e.g. the debtor's assets are clearly inadequate to support the distribution to the creditors).
- If the plan was concluded fraudulently or under undue influence of certain creditors.

A composition plan, once ratified, becomes final and binding on the unsecured creditors. A plan can be submitted only once, and if rejected by the unsecured creditors, or not ratified by the Commercial Court, bankruptcy will immediately be pronounced and all the debtor's assets will be liquidated thereafter.

During a suspension of payments, the debtor is only excused from making payments to its unsecured creditors. However, if the debtor fails to pay the secured creditors during this period, secured creditors are unable to enforce security rights, as they will inevitably be subject to a stay of proceedings for the same period as the moratorium.

f) Informal corporate rescue processes.

Given the enforcement difficulties highlighted above, the preferred route of creditors tends to be negotiation on a private basis with co-operative Indonesian debtors.

In order to facilitate such restructuring negotiations, the Jakarta Initiative Task Force ("JITF") and the Financial Section Policy Committee ("FSPC") were established. The JITF mediates in debt-restructuring negotiations among Indonesian debtors and their creditors, and has drawn up mediation rules for that purpose. It has the authority to require Indonesian debtors to participate in the mediation and to report unco-operative debtors to the FSPC, who may in turn request the Attorney General to file for the debtor's bankruptcy. In practice, the JITF has considerable leeway to conduct the restructuring negotiations in a manner it deems appropriate.

g) Any other corporate insolvency, or insolvency-related, processes that are available under special legislation.

There are no other corporate insolvency related processes available under special legislation.

2 What is the effect upon debt enforcement and secured property enforcement processes of:

a) An adjudication of corporate bankruptcy/liquidation?

The general rule on distributing the proceeds of a bankrupt's estate is one of equality of creditors, subject to statutory priority rights of certain categories of creditors.

First in priority are specific statutorily preferred creditors whose preference relates only to specific assets. After such creditors have been paid, general statutorily preferred creditors (e.g. employees, inland revenue, etc.) are paid from the proceeds of the bankrupt's estate. Finally, the unsecured creditors receive their *pro rata* share of the remaining proceeds, if any. Note that the cost of the bankruptcy is shared *pro rata* among the statutorily preferred creditors and the unsecured creditors.

The general rule is that secured creditors may enforce their security rights as if there were no bankruptcy, subject to any applicable stay of enforcement. If a secured creditor fails to enforce its security within two months after the date on which the bankruptcy enters the liquidation phase, the secured creditor will be liable to share in the bankruptcy costs.

b) The commencement of a formal corporate rescue process?

The requirements on the debtor, the processes involved during this period and the effects of the moratorium on unsecured and secured creditors are described in Section 1e.

c) The initiation of an informal corporate rescue process?

In theory, creditors are entitled to exercise their legal remedies (including taking court action) against a debtor during restructuring / rescheduling negotiations. However, in practice, a "cooling-off" period of at least a few weeks after negotiations have irretrievably broken down is recommended. This is to alleviate the risk that the courts may refuse enforcement action on the grounds that the creditor is still engaged in negotiations with the debtor.

If the JITF is involved in mediating the negotiations, the end result will be one of the following: i) the parties will reach a negotiated solution, or ii) the mediator will determine that no mutual agreement can be reached. If the latter is the case, a final mediation meeting is then held, at which the parties may attempt to resolve outstanding disputes. If the parties cannot come to an agreement within 30 days of the final mediation meeting, the JITF will circulate its final mediation report to the parties, and may also file that report with the FSPC. The parties may introduce the final report in any legal proceedings. The FSPC may refer the final report to the Attorney General to institute bankruptcy proceedings where the debtor has acted in bad faith during the mediation. Parties involved in a JITF mediation can only terminate the JITF mediation by mutual agreement.

d) The initiation of an insolvency, or insolvency-related, process under any special legislation.

The debtor may apply for a provisional moratorium. The Commercial Court is required by law to grant this provisional moratorium, and is further required to call a meeting among the debtor's unsecured creditors within 45 days (see Section 1e).

If the debtor does not apply for a provisional moratorium following a petition by a creditor for its bankruptcy, it will be declared bankrupt if it fails to successfully contest the petition.

Secured creditors can enforce their rights as if there were no bankruptcy. However, many secured creditors will tend not to embark on enforcement proceedings before the general courts that will inevitably be stayed upon the imposition of a suspension of payments, or the declaration of bankruptcy. In fact, the initiation of bankruptcy proceedings can be advantageous to the secured creditor, as it should entitle a secured creditor to enforce security in the Commercial Court, thus avoiding the time delays associated with appeals in the general courts.

3 What is the effect on the management of a corporation of:

a) An adjudication of corporate bankruptcy/liquidation?

The debtor company and its directors lose the right to manage and dispose of its assets (see Section 4a for more details).

b) The commencement of a formal corporate rescue process?

Upon the grant of a suspension of payments, the debtor's directors retain their powers to manage and dispose of its assets, provided that such powers are exercised jointly with the appointed administrator.

c) The initiation of an informal corporate rescue process?

During rescheduling / restructuring negotiations, the board of directors retains full management control of the debtor. However, creditors will often require, in consideration of temporarily suspending their enforcement rights, the establishment of monitoring arrangements, cash-flow escrow arrangements, creditor approval for material expenditure, new indebtedness, payment of dividends and / or the creation of security over assets.

d) The initiation of an insolvency, or insolvency-related, process under special legislation?

The transfer of management duties and powers to a receiver may be granted by an interim order of the Commercial Court immediately after a bankruptcy petition has been filed, if the danger of embezzlement can be shown to exist.

4 Who is responsible for "case management" control and administration:

a) A corporate bankruptcy/liquidation?

The receiver is responsible for the full administration and control of the bankruptcy. The Supervisory Judge generally oversees the performance of the receiver's duties and must grant approval with respect to certain material transactions, such as termination of contracts and sale of assets. The Supervisory Judge will also hear petitions from the creditors and the debtor relating to the actions of the receiver.

The Commercial Court may appoint a creditors' committee to advise the receiver. If the receiver does not follow the committee's recommendation, the committee may appeal to the Supervisory Judge for a ruling on the matter.

In addition, a creditors' meeting must be convened when so requested by at least five unsecured creditors representing at least 20 percent of the aggregate admitted unsecured claims. Generally, proposals at a creditors' meeting will be adopted if approved by more than one half of the votes cast, with a creditor having one vote for every Rp10 million of debt.

b) A formal rescue?

Please refer to Section 3b above.

c) An informal rescue?

If negotiations are conducted within the JITF framework, a Senior Case Manager will be assigned to the matter. This person will conduct preliminary meetings to report on the suitability of the case being submitted to mediation and the issues to be mediated. The JITF will then appoint a permanent mediator to oversee the mediation process.

The permanent mediator is in charge of the negotiation, decides when accelerated dispute resolution would be appropriate, and has ultimate responsibility for producing the final mediation report referred to in Section 2c above and calling the mediation process to a close in the absence of timely agreement.

d) A case of corporate insolvency under any special legislation?

There is no other special legislation that applies in these circumstances.

5 Who has the responsibility for the preparation of the plan of rescue under:

a) A formal rescue?

The debtor must submit a rescue plan during the moratorium period, failing which it will be declared bankrupt. The plan may be pre-negotiated with creditors holding the majority of its unsecured debt required to approve the plan (see Section 1e). Once negotiations are concluded with an undertaking from such unsecured creditors that they will approve the plan, the debtor can proceed to file for a suspension of payments and present the pre-negotiated plan for approval by the unsecured creditors.

There are no specific regulations governing the content of a composition plan, which may include elements of debt cancellation, debt rescheduling, "cash-sweeps", convertible debt and / or conversion of debt into equity. The precise contents will be determined by negotiation.

The Bankruptcy Law provides that only the unsecured creditors are entitled to vote on the composition plan. However, if the secured assets are valuable to the continuing business of the debtor and / or the plan will depend on the revenue generated by the secured assets, then in a pre-negotiated composition plan, the secured creditors are likely to be involved in the negotiations and, if it is to be successful, in practice, would have to be in agreement with the plan.

b) An informal rescue?

Outside the suspension of payments process, restructuring plans will require the approval of all creditors whose debts are involved in the restructuring, unless the documentation which evidences the debt provides otherwise.

c) A case of corporate insolvency under any special legislation?

There is no other special legislation that applies under these circumstances.

6 How are the different classes of creditors treated in relation to:

a) A corporate bankruptcy/liquidation?

Unsecured creditors rank behind statutorily preferred creditors. Secured creditors can continue to enforce their rights as if there is no bankruptcy, subject to an automatic 90 days' stay commencing from the date of the bankruptcy declaration. Once the stay is lifted, the secured creditor is free to enforce its security, and must do so within two months after the commencement of the liquidation phase of the bankruptcy. Otherwise, it will be liable to contribute to the bankruptcy costs.

b) A formal rescue?

Section 5a sets out the respective rights of unsecured and secured creditors to approve a composition plan presented in a suspension of payments.

c) An informal rescue?

During restructuring / rescheduling negotiations, the secured and unsecured creditors are entitled to enforce their rights unless they have entered into a standstill or similar agreement with the debtor. Each creditor is also entitled to demand payment from the debtor of its debts. However, this may result in the payment to only some of a debtor's creditors, which may jeopardize restructuring discussions and can in specific circumstances be invalidated if bankruptcy ensues.

d) A case of corporate insolvency under any special legislation?

No such special legislation applies under these circumstances.

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7 What is the position of both unsecured and secured creditors who vote against, do not agree with, or do not consent to, a plan of rescue in relation to:

a) A formal rescue?

Unsecured creditors who voted against an approved composition plan are, subject to ratification by the Commercial Court, bound by the terms of the plan. Legally, the original terms of the debt are amended to reflect the terms of the composition plan.

A secured creditor is entitled to enforce its rights as if there is no bankruptcy, and will theoretically have no say in the composition plan. However, a debtor may ensure that its secured creditors agree to the plan in circumstances discussed in Section 5a.

b) An informal rescue?

The restructuring plan must be approved by all creditors whose debts are involved in the restructuring (unless relevant credit documentation provides otherwise). Any dissenting creditor is not bound by the restructuring and can file for the debtor's bankruptcy.

c) A case of corporate insolvency under any special legislation?

There is no other special legislation that applies under these circumstances.

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8 In relation to the need for an insolvent corporation to have urgent working capital funding, what difficulties are encountered in the provision of such funding in relation to:

a) A formal rescue?

When a company is in financial difficulties, the cost of working capital funding inevitably increases and will likely require the giving of security by the company. When a company is in suspension of payments, it is entitled to borrow new funds and can provide security for such financing with the approval of the administrator. Such security would rank behind existing security on the same assets only. These new lenders enjoy a position of advantage in that they are not subject to the moratorium and must be paid in full when the debts fall due.

b) An informal rescue?

Outside of the suspension of payments regime, there is no rule that new financing will be treated with any priority if the company later applies for suspension of payments.

c) A case of corporate insolvency under any special legislation?

There is no other special legislation that applies under these circumstances.

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9 Briefly describe the relevant provisions relating to the setting aside of antecedent and fraudulent transactions in relation to:

a) A corporate bankruptcy/liquidation?

Certain transactions favoring one creditor over other creditors can be annulled by an "*actio Pauliana*". The test for whether a pre-bankruptcy transaction can be annulled is as follows:

- The transaction qualifies as a legal act, was voluntarily undertaken, i.e. without contractual obligation to do so and has had a detrimental effect to the creditors.

- The parties to the transaction knew or should have known that the transaction was prejudicial to the creditors.

There is a rebuttable statutory presumption that such knowledge exists if the transaction was performed within one year prior to declaration of bankruptcy and was:
- At an undervalue.
- For the granting of security for debts which are not yet due.
- Entered into between the debtor and certain related parties.

The payment of a debt due and payable may be annulled if it is shown either that the creditor knew that a bankruptcy petition was pending, or that the payment was the result of collusion between the debtor and the creditor.

b) A formal rescue?

The test for invalidating an antecedent transaction by an *"actio Pauliana"* is the same as in Section 9a above. However, there is no rebuttable presumption of knowledge of prejudice otherwise available in a formal bankruptcy.

c) A case of corporate insolvency under any special legislation?

There is no other special legislation that applies under these circumstances.

10 Are there any provisions of law that might operate to invalidate a secured property transaction in relation to:

a) A corporate bankruptcy/liquidation?
b) A formal rescue?
c) An case of corporate insolvency under any special legislation?

A secured property transaction can be invalidated by an *"actio Pauliana"* if it is preferential. The test for whether a secured property transaction can be invalidated following a corporate bankruptcy and in a formal rescue is set out in detail in Section 9 above.

11 Describe the difficulties that are encountered in endeavoring to administer cases of corporate bankruptcy/liquidation and formal corporate rescue that involve property and business interests located in more than one jurisdiction.

Indonesia is not a party to any treaty relating to international insolvency issues and the Bankruptcy Law addresses international aspects summarily. It adopts the universality principle, under which an Indonesian bankruptcy encompasses all of the debtor's assets wherever they are located. The universality principle is obviously limited to the extent that such principle is or is not accepted by the jurisdiction in which the assets are located.

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Financial issues: Indonesia

PricewaterhouseCoopers

1 Is the restructuring/insolvency legislation generally:

a) Understood?

Prior to the economic crisis that hit Indonesia in the second half of 1997, the insolvency legislative framework was based on laws implemented by the Dutch in 1905. This legislation had seen virtually no large-scale commercial liquidation or insolvency since that time. The law was mainly used for voluntary procedures instigated by the debtors themselves.

As a result of the Asian financial crisis, Indonesia overhauled it bankruptcy legislation. A new law was enacted in September 1998. The law was purposely constructed as a framework and was intended to be read in accordance with the principles of the Civil Code and Commercial Code, leaving it open to interpretation. This approach depends upon the capability of the judiciary to uphold the principles within the law. Several decisions to date demonstrate that the Commercial Court, set up to administer the bankruptcy code, appears not to fully understand the law or the principles underlying it. Most decisions of the court have tended to favor the local applicant over the foreign creditor and the government as a creditor.

Those applications that do succeed are placed in the hands of a licensed curator, the western equivalent of a liquidator or receiver, who is selected by the court. A supervisory judge is appointed by the court to supervise the conduct of the administration. Both curators and supervisory judges are generally inexperienced in this sort of law and its application, particularly in asset recovery and business reorganization. While these parties may understand the mechanics of the law, they do not generally understand the principles behind it and therefore do not apply it consistently. As a result, debtors and creditors generally lack confidence in using the law as an avenue of defense or collection.

Debtors largely view the threat of bankruptcy as a tactic used by bank creditors in debt negotiations, yet it is not seen as a serious threat. Debtors generally would not use the legislation as a chance to create “breathing space” from their creditors. If a judgment is made against a debtor, enforcement depends largely on the debtor’s cooperation. As a result, debtors do not need to understand the law if there is no effective way to enforce it.

Different types of creditors view the process differently. Foreign bank creditors who have experience in similar laws from other territories in which they operate have a better understanding of the concepts behind Indonesian law and are better prepared to consider the bankruptcy option. However, the poor application of the bankruptcy law has diminished its viability. Local bank creditors and some foreign bank creditors (particularly other Asian-based banks) have no experience with the law and generally do not consider bankruptcy as an option, unless they are with a syndicate of a foreign bank or with the Indonesian Bank Restructuring Agency (“IBRA”).

The Supreme Court interpretation of the law would appear to exclude trade creditors from making application under the law. This conflicts with both the definition of debt under the law and the interpretation made by the Commercial Court. Trade creditors are generally more comfortable with using traditional means of debt collection via their personal relationship with the debtor. If a debtor goes into bankruptcy, most trade creditors have little or no understanding of their rights and obligations.

b) Being followed and/or available opportunities being taken up?

For reasons explained above, the opportunities the law provides for creditors and debtors are generally overlooked. The principles underlying the law provide for the equitable treatment of creditors, a framework for investor protection, opportunities for corporate reorganization and minimizing the deterioration of assets. There is not enough consideration given to the commercial aspects of the task, even though the letter of the law is followed and a supervisory judge guides each curator. More value can be salvaged from assets and closed businesses.

As noted earlier, both debtors and creditors use the legislation as a tool in negotiations for restructuring debts. The process and appointment is not an end in itself, as enforcement of the law where understanding is so low is difficult and depends on the co-operation of debtors.

c) Being enforced by relevant authorities?

Enforcement of the Bankruptcy Act occurs through the Commercial Court, which has had little experience in such matters. Consequently, rulings have been inconsistent and some even illogical. Enforcement of the rulings has been problematic. Uncooperative debtors and creditors have little to stop them from taking property or assets, and debtors particularly have many avenues with which to disrupt businesses. Securing police assistance is difficult because they too have little understanding of the law and the powers conferred by the court on the curator.

Those debtors with knowledge of the law and the system of law enforcement here have an advantage in manipulating outcomes to their advantage. Creditors' claims of fraud and embezzlement are being overlooked by authorities and the court. An interesting example is of the Canadian life insurer, Manulife Finance Corporation, who attempted to buy out the share of its Indonesian business owned by its bankrupt local partner through an open auction run by the court-appointed curator. Near the end of proceedings a lawyer claiming to represent the true owner of the shares, a British Virgin Islands company called Roman Gold, stepped forward. Since then the sale has been in limbo, with the proceeds unusually being awarded to the custody of the police. Manulife claims its partner had illegally sold its 40 percent stake in the venture, whereas the partner claims to have sold its stake to a company called Harvest Hero International Ltd in 1996. Roman Gold claims to have purchased its stake from a Western Samoan registered company called Highmead Ltd days before Manulife made its own purchase from the curator. In an unusual twist, Manulife's vice-president in Indonesia spent some time in jail for his troubles, only being released supposedly on the intervention by the Indonesian president acting on a plea from the Canadian president.

Co-incidentally, Highmead Ltd was a member of a loan syndicate arranged by Harvest Hero, a Hong Kong, China registered company that is meant to have lent US$160m to PT Panca Overseas Finance in the second half of 2000. This unsecured loan came in the midst of protracted negotiations between Panca and its creditors, including several foreign banks and the International Finance Corporation ("IFC") (a member of the World Bank Group) who are owed around US$68m. The IFC claims in its petition to the court that Panca created these fictitious creditors in order to block their petition to bankrupt the company and accept Panca's restructuring proposal that offered all creditors, including the recent ones, a payment of 17 cents in the dollar on their debts. The other members of the syndicate are all registered in either Western Samoa or the Bahamas. Harvest Hero, according to the IFC submission, has paid up capital of HK$2, no telephone listing in Hong Kong, China, nor any permit to lend money there. Harvest Hero's registration papers lists the address of one of its directors, the one who signed the loan agreement with Panca, as a restaurant selling chicken and noodles in North Jakarta. The restaurant's proprietor has never heard of the director or Harvest Hero.

2 Broadly speaking, in practice, does the restructuring/ insolvency legislation tend to lead to:

a) Early recognition and action on financial difficulties experienced by a corporation?

The legislation is not generally applied within the early stages of financial difficulties. It is commonly used as a "last resort" within the final stages of a restructuring to bully uncooperative debtors, or to force dissenting creditors into compliance. It is sometimes used as a compromise outcome whereby creditors takeover a debtor's business via liquidation. In return, the debtor is released from other obligations, such as personal guarantees.

As a result of the economic collapse, the majority of businesses have been unable to pay their debts. Most businesses would be technically classified as insolvent, but due to the lack of enforceability of not only this legislation, but of normal repayment terms, financial difficulties can be delayed almost indefinitely, unless creditors have the ability to impact the debtor's day-to-day business.

b) Restructuring alternatives as opposed to liquidation, and if not, why not?

In the absence of an enforceable legal framework with which to collect debts, most restructuring tends to be a negotiated settlement between debtor and creditor. The legislation does not tend to lead to any action, but is used as a tool in the negotiation process.

A negotiated settlement is viewed as a better outcome to liquidation for all stakeholders, even in cases where businesses were not viable and liquidation may have been more appropriate. Other factors that can make liquidation an unattractive option are as follows:

- When there is no real break-up value for a business, or a prospect of sale and continued operation by existing stakeholders is seen as the only option.
- When liquidation requires creditors to write-off rather than provide for a bad debt.
- When potential social problems could arise from placing large numbers of people, often from the same community, out of work without alternative means of support (i.e. no other work or social safety net).

3 What are the main practical difficulties being encountered in:

a) The preparation of restructuring plans?
b) The implementation of restructuring plans?

Based on PricewaterhouseCoopers' experience, in Indonesia there are many practical difficulties faced by debtors and creditors in negotiating a restructuring plan.

The expectation gap between debtor and creditor often leads to initial negotiations being slow and unproductive. This is accentuated when the debtor and creditor have a history of not trusting or co-operating with each other. In this situation both parties will often make unrealistic demands that impede useful commercial negotiations.

Generally, creditors are not in a strong position to force negotiations, due to the ineffectiveness of the legal system. At the same time, debtors will often use this to their advantage in negotiations.

The Jakarta Initiative Taskforce ("JITF"), a body set up by the government to facilitate restructurings, was seen as a positive move to accelerate corporate restructuring. However, the implementation of the JITF was delayed, and only in the second half of 2000 had it gained influence and begun assisting with restructurings.

The IBRA is a creditor in many of Indonesia's restructurings. Numerous changes to IBRA's management since its inception have led to delays in restructuring negotiations. Changes within the Indonesian government and the unstable political environment have also impeded significant progress.

In addition, IBRA often has sets of "rules", with which it must comply in approving any restructuring proposal, that bear no relation to the commercial aspects of the situation. For example, it is difficult to get them to agree to any debt write-off, even if they agree that the company can only sustain a much lower debt burden.

The unstable economic environment, particularly the value of the Rupiah, has also resulted in companies changing their financial projections, resulting in the renegotiation of restructuring deals.

Companies with syndicated loans involving large lender groups can sometimes find it difficult to get agreement from all participants. This is particularly difficult where the restructuring is complex and the terms of the deal are difficult to communicate to such a large group.

Once a restructuring is agreed, implementation of the plan can also face practical difficulties. Legal documentation, particularly on the more complex transactions, can be very extensive. This is time-consuming and can lead to the re-negotiation of parts of the plan as unforeseen legal issues arise.

Regulatory issues can also impede the implementation, such as limitations on the terms for issue of warrants to lenders and debt for equity conversions. There are other cases where shareholders have acquired their shareholding through debt settlements but legal documentation has not been properly agreed. This leaves shareholders in such a position that they do not have the legal authority to implement the restructuring plan they have agreed. Also, tax and capital market regulations have not been set up to contemplate such an environment as the current one. Consequently, there has been, and will continue to be, a need to review these regulations. Tax treatments of debt write-offs or foreign exchange losses have come under scrutiny and continue to be fine-tuned.

4 To what extent are companies that are going through any formal or informal restructuring merely adjusting their debt/equity structure, rather than genuinely restructuring their business operations?

In our experience in Indonesia, the vast majority of corporates restructure their debt / equity structure rather than their business operations. The focus has been on rescheduling and debt write-offs without consideration to the underlying business that supports the repayment of any new arrangements. It appears that as the economic recovery continues in Indonesia, the corporate sector will concentrate on restructuring business operations and creating shareholder value after debt restructuring is complete.

Restructuring of only the debt / equity structure is common practice in Indonesia. The general approach is for a company to reschedule debt that it can service, for example in tranches with a grace period on principal repayment and concessional interest rates. The portion of debt that is not serviceable is normally dealt with in a number of ways, such as subordination, convertible bonds, straight equity conversion, warrants, and / or debt forgiveness.

The restructuring of business operations could be a key factor in driving future growth in Indonesia. Businesses expanded very quickly in the pre-crisis period, often without adequate research and planning. This has resulted in substantial inefficiencies from an operational and financial perspective. Those companies that become efficient will be best placed to handle any further shocks to the economy.

Often the independent accountant appointed by creditors identifies operational issues that could be improved. However, these issues are very rarely investigated further for the following reasons:

- There is no incentive for debtors to restructure their business operations during debt restructuring negotiations with creditors. Improved financial performance through operational restructuring will result in creditors negotiating for a higher level of debt. This is not in the interest of the debtor.
- Management's time is normally consumed by debt restructuring negotiations leaving insufficient time to consider restructuring of business operations.
- Restructuring of business operations usually involves capital expenditure that may not be agreeable to creditors during times of debt restructuring. Unless there is a very compelling business case, creditors would prefer the company to use excess cash to repay debt.
- Restructuring can often cause disruptions to business operations and impact cash flow. Default risk is high during the early years of a restructuring agreement and companies cannot afford such interruptions to their operations.
- Lenders are reluctant to negotiate a debt restructuring based on financial forecasts that are predicated on significant changes to the business. This only increases the risk, as it is already difficult to have agreement from all parties on financial forecasts predicated on the existing business structure.

While business restructuring activity in Indonesia has been minimal, we are aware of one significant case where operational restructuring has been negotiated between debtor and creditors. The debt restructuring incorporated significant changes to the group ownership structure so that different business lines would be more attractive to investors. This created additional shareholder value and was crucial in persuading creditors to convert debt to equity.

The restructure also involved significant capital expenditure that was approved by creditors and was funded from cash flow that would have otherwise repaid debt. This was negotiated as part of the restructuring, but only after vigorous analysis convinced creditors that it was financially viable given the level of risk.

This is a rare case, as most restructurings are of the debt / equity structure and not of business operations.

5 What are the main areas from which funding is generally being utilized by companies which undertake either formal or informal restructuring?

As noted above, the majority of restructuring in Indonesia to date has involved debt / equity swaps and debt haircuts. Some restructuring includes asset sales where the proceeds are applied to debt, but those completed to date have not included, to any significant extent, new funding either by way of equity or debt.

A number of restructurings have been undertaken on a "cashless basis", involving the rescheduling of debt repayment obligations to match forecast future cash flows. A number of these have been based on projections that assume an early return to pre-crisis economic conditions.

The instability of the political situation, as well as the volatility of the currency, has deterred most foreign investors from investing in Indonesian corporations. This is particularly the case as other countries in Asia, such as the Republic of Korea and to a lesser extent Thailand, show improving economies and a commitment to political and economic reform. The long-term "patient" capital required continues to show interest in the country, but these equity investors generally get frustrated with unrealistic price expectations and long protracted due diligence and negotiation periods.

Since the recapitalization program started, there have been an increasing number of banks with sufficient capital to lend, yet no significant new lending is occurring. This is possibly a result of banks adhering to stricter credit policies, or merely the inability of a significant number of restructurings to be completed. Also, recapitalization bonds held by banks are returning 13 percent relatively risk-free (i.e. Indonesian Government) and thereby stifling the incentive to risk capital in the corporate sector.

The following factors will contribute to new capital being employed in this country for restructuring:

- Political and exchange rate stability.
- Preparedness of owners to cede management control.
- More realistic valuation expectations for both companies and their existing creditors.
- Business restructuring strategies along with debt restructuring.
- Restructuring government support for the banking and finance sector to encourage lending / investment.

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Legal issues: Japan

Nagashima Ohno & Tsunematsu

Until recently, there were five statutory insolvency procedures available in Japan. Two of these procedures address cases of corporate liquidation – bankruptcy (enacted in 1921) and special liquidation (enacted in 1938). The other three procedures address cases of corporate rehabilitation – composition (enacted in 1921), corporate arrangement (enacted in 1938) and corporate reorganization (enacted in 1952). The law regarding composition proceedings has been repealed, and the law regarding corporate arrangement proceedings, while still in effect, is rarely utilized. Since the collapse of the so-called "bubble economy" in Japan, insolvency cases have increased dramatically, and new laws were enacted to address the changed circumstances facing Japan. Two new procedures for addressing cases of corporate rehabilitation were enacted – the special arrangement procedure and the civil rehabilitation procedure. These procedures are available to companies of any size, but are predominantly used by small to mid-sized companies. Finally, a new law was enacted in November 2000 (to take effect by June 2001) to accommodate the growing number of international insolvency cases by abolishing the so-called "territorial policy" now in place for bankruptcy and corporate reorganization cases. Other than the statutory insolvency procedures mentioned above, some insolvency cases in Japan are resolved by way of a court-supervised conciliation procedure.

1 Describe the nature and the effectiveness of the following processes:

a) Civil unsecured debt collection remedies.

If a debtor has defaulted in payment of its debt, a creditor may file a motion against the debtor with a competent local court to obtain a judgment ordering the payment. If the debtor has failed to pay the debt when a final and conclusive judgment has been obtained by the creditor, the creditor may execute the judgment against property of the debtor. The distribution of the proceeds of the public sale of such property will be made equally among such creditors and all other unsecured creditors that have filed their claims with the execution court.

If it is likely that a debtor will dispose of its property before a judgment is made, a creditor may seek provisional remedies to attach the property, or to prevent the debtor from disposing of the property by obtaining an appropriate order from a competent local court.

b) Secured property enforcement remedies.

A secured creditor may execute a public sale or a private foreclosure, depending on the type of security interest. In the case of real property, a creditor who has a registered mortgage over property may take a civil execution procedure for a public sale. A creditor who has a registered mortgage by assignment over property may sell the property through private sale. In the case of receivables and deposits, a creditor who has a perfected security interest over property, through either pledge or mortgage by assignment, will usually take title to the receivables and then collect the proceeds from the original payees of the receivables. With other movable property, including debentures and stock, a creditor who has a perfected security interest over the property may sell it by public sale under pledge and take title, or foreclose the property by private sale under mortgage by assignment.

c) Any special debt collection or secured property remedies that are available to banking sector creditors.

If a bank has received a promissory note from its customer for collection, the bank will be granted a possessory statutory lien against the note under certain circumstances.

d) Corporate bankruptcy/liquidation processes that are available to corporate debtors and creditors.

Bankruptcy procedure and special liquidation are available. Special liquidation is initiated by a creditor, liquidator, statutory auditor or shareholder if it is found that a debtor is likely to be insolvent after it is wound-up by resolution at shareholders' meetings. The process is implemented by a special liquidator under the court's supervision. The special liquidator may prepare an arrangement for debt repayment for consideration at a meeting of creditors. The arrangement is required to be passed by a majority of the creditors attending the meeting and who have three fourths of the total debts. The arrangement must also be approved by the court. Typically, such an arrangement includes provisions which favor the creditors and provisions which do not. Bankruptcy procedure is initiated by a creditor or a debtor if a debtor becomes insolvent. A bankruptcy trustee appointed by a court has the power to dispose of all the estate of a debtor and distribute the proceeds to creditors equally. Collateral covered by security interests is not included in the estate for liquidation or bankruptcy purposes.

e) Formal corporate rescue processes that are available to corporate debtors and creditors.

Corporate reorganization and civil rehabilitation procedures are available. Corporate reorganization is designed to reorganize large-sized limited liability companies with the aid of strong powers given to reorganization trustees. The collateral covered by secured creditors is incorporated into the estate and the payment of secured debts will be paid out under the reorganization plan. The civil rehabilitation procedure, which became effective in April 2000, is designed to rehabilitate middle- and small-sized companies under a more simplified process. It is effected by a debtor-in-possession process. A secured creditor may enforce its security interest in collateral separately.

f) Informal corporate rescue processes.

There are a number of cases where corporate creditors have agreed on the reorganization of a debtor and provision of financial aid to the debtor while reducing outstanding debts and releasing security interests. However, in order to successfully make this arrangement, it is necessary for the main banks to fully co-operate with the reorganization under a sponsor's commitment.

g) Any other corporate insolvency, or insolvency-related, processes that are available under special legislation.

There is a process known as a debt adjustment arrangement (the Debt Adjustment Process), which became effective in February 2000. The Debt Adjustment Process requires agreement between a debtor and each creditor, under the involvement of a conciliation committee which consists of court-appointed conciliation members.

2 What is the effect upon debt enforcement and secured property enforcement processes of:

a) An adjudication of corporate bankruptcy/liquidation?

A request for debt enforcement against a debtor's property is not permissible, and a pending enforcement procedure ceases to be effective in case of bankruptcy and is suspended in the case of a special liquidation. There is no effect on the enforcement of secured property rights.

b) The commencement of a formal corporate rescue process?

A request for debt enforcement against the debtor's property is not permissible, and a pending enforcement procedure is suspended. A pending enforcement procedure of secured property rights is also suspended in the case of corporate reorganization, and may be suspended in the case of civil rehabilitation.

c) The initiation of an informal corporate rescue process?

The informal process does not affect enforcement of debt or secured property rights unless agreed to by the creditors concerned.

d) The initiation of an insolvency, or insolvency-related, process under any special legislation?

In the case of the Debt Adjustment Process, the court may order that debt and secured property enforcement procedures be suspended.

3 What is the effect on the management of a corporation of:

a) An adjudication of corporate bankruptcy/liquidation?
The management is replaced by the trustee in case of bankruptcy, and by the liquidator in the case of special liquidation.

b) The commencement of a formal corporate rescue process?
The management is replaced by the trustee in case of corporate reorganization. In the case of civil rehabilitation, management may be retained unless a trustee is appointed by the court.

c) The initiation of an informal corporate rescue process?
Unless it is otherwise agreed between the creditors and the debtor, the existing management of a debtor corporation continues.

d) The initiation of an insolvency, or insolvency-related, process under any special legislation?
The commencement of the Debt Adjustment Process has no effect on management.

4 Who is responsible for "case management" control and administration:

a) A corporate bankruptcy/liquidation?
The trustee is responsible for administration in the case of bankruptcy. The liquidator is responsible for administration in the case of special liquidation.

b) A formal rescue?
The trustee is responsible in the case of corporate reorganization. The management of the debtor is responsible in case of civil rehabilitation, unless a trustee is appointed.

c) An informal rescue?
There is no trustee or liquidator in such cases.

d) A case of corporate insolvency under any special legislation?
There is no trustee or liquidator in the case of the Debt Adjustment Process.

5 Who has the responsibility for the preparation of the plan of rescue under:

a) A formal rescue?
In the case of corporate reorganization, the trustee must prepare a reorganization plan and submit the plan to the court. The debtor, creditors or shareholders also have the right to produce a plan. In the case of civil rehabilitation, the trustee (if one is appointed, or the debtor in the absence of a trustee) must prepare a rehabilitation plan and submit the plan to the court. Where a trustee is appointed, it is also possible for the debtor itself, or a trustee in foreign jurisdiction, or creditors who have filed claims, to submit a plan to the court.

b) An informal rescue?
The plan is the result of the negotiation process between the creditors and the debtor.

c) A case of corporate insolvency under any special legislation?
A debtor, creditor or the conciliation committee may produce the proposed debt arrangement.

6 How are the different classes of creditors treated in relation to:

a) A corporate bankruptcy/liquidation?
Secured creditors may enforce their security interest in collateral outside the procedure. In the case of bankruptcy, the remaining classes are composed of (i) creditors having claims attributable to common benefits, such as trustee fees, (ii) senior unsecured creditors, such as employees, (iii) subordinate creditors and (iv) others. Each of these classes is treated differently in distribution. In the case of special liquidation,

debt repayments are made in accordance with a court-approved arrangement. The terms and conditions of the arrangement must be equal as among the creditors, except that a court may approve an arrangement that treats creditors differently if it is not inequitable.

b) A formal rescue?

In the case of a corporate reorganization, creditors are classified into (i) secured creditors and (ii) unsecured creditors. Unsecured creditors are further classified into (a) creditors having claims attributable to common benefits, (b) senior unsecured creditors, (c) subordinate creditors and (d) others. Creditors (other than those having claims attributable to common benefits) will be paid through the plan. In the case of a civil rehabilitation, creditors have the same classification as described in the case of bankruptcy above, and creditors (other than those having claims attributable to common benefits and senior unsecured creditors) will be paid through the plan.

c) An informal rescue?

This will depend on the outcome of the negotiations between the creditors and the debtor.

d) A case of corporate insolvency under any special legislation?

There is no provision for different classes of creditors under the Debt Adjustment Process.

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7 What is the position of both unsecured and secured creditors who vote against, do not agree with, or do not consent to, a plan of rescue in relation to:

a) A formal rescue?

In the case of corporate reorganization, the plan must be passed by unsecured creditors holding at least two thirds of the total unsecured debts and by secured creditors holding at least three fourths, (or four fifths if the plan proposes to cut off the secured debt), of the total secured debts. In the case of civil rehabilitation, the plan must be passed by a majority of creditors having claims of not less than one half of the total debts.

b) An informal rescue?

The proposed plan must be unanimously agreed.

c) A case of corporate insolvency under any special legislation?

The proposed debt adjustment arrangement must be agreed with each creditor.

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8 In relation to the need for an insolvent corporation to have urgent working capital funding, what difficulties are encountered in the provision of such funding in relation to:

a) A formal rescue?

In the case of corporate reorganization, a loan which has been funded between the filing and commencement of the procedure is not always granted a preferable position over other unsecured debts. If a loan has been granted a preferable position it will cease to keep that position if the procedure turns into bankruptcy before the commencement of corporate reorganization.

b) An informal rescue?

No preferable position will be given to a person who has provided a debtor with funding, unless all other creditors accept.

c) A case of corporate insolvency under any special legislation?

There is no provision under the Debt Adjustment Process legislation for such finance.

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9 Briefly describe the relevant provisions relating to the setting aside of antecedent and fraudulent transactions in relation to:

a) A corporate bankruptcy/liquidation.

A trustee of bankruptcy has the power to void certain fraudulent transactions, while a liquidator does not.

b) A formal rescue.

A trustee in the case of corporate reorganization and a trustee in the case of civil rehabilitation procedure has the power to void certain antecedent and fraudulent transactions.

c) A case of corporate insolvency under any special legislation.

A creditor is allowed to request a court to declare the invalidity of a fraudulent transaction between the debtor and another creditor.

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10 Are there any provisions of law that might operate to invalidate a secured property transaction in relation to:

a) A corporate bankruptcy/liquidation?

In the event that a secured creditor has failed to enforce its security interest in collateral after the commencement of bankruptcy or special liquidation, the bankruptcy trustee or liquidator will be authorized to enforce its security interest in collateral under the rules of formal civil execution procedure.

b) A formal rescue?

Under corporate reorganization, secured creditors are subject to the reorganization process through which they will be given priority positions in a reorganization plan in relation to the repayment of debts. In the case of civil rehabilitation, (i) the court may, upon application of an interested person or its own motion, order the suspension of the execution of a security interest on the collateral if it deems that such order meets the general interest of creditors and there is no risk of inflicting undue loss or damages on the applicant for public auction, or (ii) a trustee or a debtor in possession may request the court to eliminate the security interest from the collateral by payment of the fair market price of the collateral, where it is dispensable to take such orders for the rehabilitation of business.

c) A case of corporate insolvency under any special legislation?

Under the Debt Adjustment Process, a creditor may request a court to suspend the execution of a security interest on the collateral if the court considers the suspension to be necessary for debt adjustment.

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11 Describe the difficulties that are encountered in endeavoring to administer cases of corporate bankruptcy/liquidation and formal corporate rescue that involve property and business interests located in more than one jurisdiction.

The insolvency laws of Japan, except for civil rehabilitation, follow a “territorial” policy – there is no recognition of insolvency proceedings commenced in another jurisdiction and there is no effect upon property of the debtor located in Japan. Likewise, insolvency proceedings (except for civil rehabilitation) in Japan will have no effect in foreign jurisdictions. Thus, for example, even where there is a need to integrate the property and business assets among group companies which are located in more than one jurisdiction, separate proceedings (except in the case of civil rehabilitation) must be initiated in separate jurisdictions for each group company. However, a new law, which was promulgated on November 29, 2000 and will come into force within six months from such date, abolishes the territorial policy both in the bankruptcy procedure and the corporate reorganization procedure.

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Financial issues: Japan

PricewaterhouseCoopers

1 Is the restructuring/insolvency legislation generally:

a) Understood?

Japan does not have a uniform insolvency code. Insolvency law consists of liquidation and reorganization laws. Under liquidation, the Bankruptcy Law and Special Liquidation (in Commercial Code) apply. Under reorganization, the Corporate Reorganization Act, the Company Resolution (in Commercial Code) and the Civil Rehabilitation Law (which replaces the Composition Law ("Waghi") as of April 1, 2000) apply. These laws generally are in need of complete overhaul, but due to time constraints, only the Waghi has been amended. Company Resolution is expected to be abolished in the near future.

In addition, a new law for the rehabilitation of consumer debtors will be legislated soon. Provisions for international bankruptcy will be arranged as well so that a current strict territorial system (i.e. Japanese insolvency proceedings applicable to assets in Japan only) will be changed to a universal system (i.e. acceptance of foreign insolvency proceedings with possible parallel filings).

The insolvency / restructuring legislation is complicated and understood only by a limited number of insolvency lawyers. Some financial advisors, consultants, accountants, bankers and other professionals also have a good understanding of the legislation, but the legislation is not fully utilized. Rather, most of the restructurings have been done as out-of-court workouts under the initiative of banks, finance companies, lawyers and sometimes of "unlicensed" special fixers without any disclosure of information.

b) Being followed and/or available opportunities being taken up?

The situation has been changing since April 1, 2000 – the effective date of the Civil Rehabilitation Law. This new law allows a debtor to keep its operation as a debtor-in-possession ("DIP") and promotes quicker solutions to problems and the regeneration of businesses. Indeed, in Fiscal Year 1999 (April 1999 to March 2000), 225 petitions under legal reorganization procedures were filed (excluding liquidation and winding-up), while more than 100 petitions were filed under the procedures of Civil Rehabilitation Law within the first two months (April and May 2000) of its effective commencement date.

c) Being enforced by relevant authorities?

Enforcement by the authorities has also improved thanks to the Civil Rehabilitation Law. The Waghi, which was a kind of composition or voluntary arrangement, was a notorious law because under its procedures many debtors did not abide by the agreed terms once supervision of the court was finished. Under the Civil Rehabilitation Law a court's supervision will be maintained in most cases for three years, even after the confirmation of the rehabilitation plan. If the debtor does not follow the terms under the plan, it may be forced into liquidation proceedings by the initiative of the court. Though liquidation value may not be high in such cases, this enforcement mechanism is considered to be a necessary discipline.

2 Broadly speaking, in practice, does the restructuring/insolvency legislation tend to lead to:

a) Early recognition and action on financial difficulties experienced by a corporation?

In the past, the legislation did not lead to early recognition and action on financial difficulties because, as explained above, most of the restructuring used to be settled as out-of-court workouts under the initiative of the so-called "main banks" and other related parties. Main banks used to control their borrowers by holding their shares, seconding executives and taking care of various financial problems. The main bank system used to be well maintained thanks to hidden reserves (unrealized capital gains of shares held by the banks) and less stringent disclosure rules (which allowed banks to carry bad loans without providing them appropriately and to write them off little by little, utilizing hidden reserves). These hidden reserves have substantially decreased due to the economic recession of the 1990s and the recent strict tightening of disclosure requirements. Thus, the so-called main bank system has almost collapsed. Partly because of this collapse and partly because of the new Civil Rehabilitation Law, early recognition and action on financial difficulties will be enhanced.

b) Restructuring alternatives as opposed to liquidation, and if not, why not?

Banks have come to prefer solving their problems via transparent legal procedures to save time, costs and expenses.

According to the Civil Rehabilitation Law, a petition is allowed when a debtor is under the "apprehension" that it would be insolvent. This provision, when combined with the provision of the DIP, tends to lead to earlier recognition and action on financial difficulties.

Corporate Reorganization Law also has the same provision, but it has not been effective since the DIP concept is not allowed under this Law. In other words, once a petition is filed, the management of the debtor is replaced by the trustee (administrator).

Restructuring alternatives are usually preferred to liquidation, not because of the legislation but because of banks' willingness to avoid write-offs. Most of the banks do not like to see realized losses after writing off deficiency claims in case of liquidation, they would rather restructure the loans by lowering interest rates and / or extending maturity dates.

Again, the Civil Rehabilitation Law will tend to lead to restructuring alternatives since it promotes the regeneration of businesses through asset sales and business sales at earlier timings, rather than waiting for confirmation of the plan.

3 What are the main practical difficulties being encountered in:

a) The preparation of restructuring plans?

Forgiving indebtedness is common in Japan because the simple conversion from debt to equity at par is legally prohibited. After the forgiveness, the remaining debts, which are marked down to their market values, may be swapped into equity, but banks usually do not like such equity. From their viewpoint forgiveness is enough, as the additional swap to equity is a double penalty to them. Thus, in the preparation of restructuring plans, the main practical difficulties are how to determine the degree of forgiveness and how to convince the related parties, particularly banks.

Though the so-called main bank system is collapsing as explained above, it is still a market practice for the main bank to forgive more and for small lenders to forgive less.

In out-of-court workouts, the level of remaining debts is usually higher since banks want to minimize their losses from forgiveness. However, if the level is higher, the debtor will face financial difficulties again sooner or later. Ultimately, the cases may have to be settled pursuant to legal procedures under the Corporate Reorganization Law or Civil Rehabilitation Law.

In cases under the Corporate Reorganization Law, it is not rare for unsecured creditors to accept more than a 90 percent haircut, leaving the remaining claims to be paid in installments for 15 to 20 years. The preparation of such restructuring plans assumes that the debtors may not be regarded as restructured until they become debt-free companies in 15 to 20 years time. In addition, since a DIP is not allowed under this Law, a trustee (administrator) is appointed to manage the company's operations. This is why utilization of this Law has been low. In Fiscal Year 1999 (April 1999 to March 2000), only 45 petitions were filed under this Law.

On the contrary, under the procedures of the Civil Rehabilitation Law the payments of claims should be finished within 10 years after confirmation of the plan. The 20-year maximum payment period allowed under the Corporate Reorganization Law is considered to be too long. The Civil Rehabilitation Law assumes that payments come in a shorter period of time when they are derived from the proceeds of a sale of the assets or a sale of the business.

b) The implementation of restructuring plans?

In the case of out-of-court workouts, the implementation of restructuring plans is difficult because, as mentioned above, such plans are usually not stringent enough to have the debtor regenerate its businesses. However, in the case of legal procedures under Corporate Reorganization Law or Civil Rehabilitation Law, implementation is not difficult since plans are enforceable.

4 To what extent are companies that are going through any formal or informal restructuring merely adjusting their debt/equity structure, rather than genuinely restructuring their business operations?

In most of the cases, restructuring in Japan results in a mere adjustment of the debt / equity structure of the debtor. Forgiving indebtedness is common in Japan, and the debtor may not be regarded as restructured until they become debt-free companies, which can take 15 to 20 years. Since this concept underpins restructuring in Japan, a mere adjustment of the debt / equity structure is common and a genuine restructuring of business operations is rare.

If a genuine restructuring of business operations is done in Japan, it is in the context of Mergers and Acquisitions (“M&A”). When a debtor faces financial difficulties, it has the option to sell its businesses to investors who are either strategic buyers or financial buyers. Once the M&A is completed, the buyer usually restructures the acquired business to coincide with the existing businesses.

However, if the debtor files a petition for legal procedures after a M&A, the sale may be avoided as a preference or a fraudulent conveyance. Therefore, many buyers like to close the deal in the course of legal procedures. The Corporate Reorganization Law is not a suitable law for M&As because it is interpreted that a M&A can be done only in the reorganization plan.

It generally takes a few years before the plan is confirmed and by then, the businesses deteriorate and their value decreases. The *Japan Leasing case (1999)* is an exceptional example because the court approved the business sale before the confirmation of the reorganization plan with the intention that the business should not deteriorate before sale. It is not known, however, whether the scope of this precedent is wide enough to cover future business sales under the Corporate Reorganization Law. However, now that the Civil Rehabilitation Law has come into effect, this is no longer an important consideration.

Subject to the court’s approval under the assumption that a debtor’s equity value is zero or negative, this new law allows the debtor to sell its businesses, partially or entirely, to a buyer without waiting for the plan to be confirmed. Thus, if a debtor wants to restructure its business operations genuinely through a M&A, it is better to do it through procedures under the Civil Regeneration Law.

5 What are the main areas from which funding is generally being utilized by companies which undertake either formal or informal restructuring?

Although the main bank system has been transfigured substantially, it is still common for a main bank to fund a debtor that undertakes restructuring, either in out-of-court workouts or in legal procedures. For example, a general merchandising store, Nagasakiya, filed a petition under the Corporate Reorganization Law in February 2000 and its main bank is still providing working capital as a result of its responsibility of being the “main bank”. Subject to the court’s approval, such credit extensions after the petition are protected as “claims for common benefits” (equivalent to “administrative expenses” under the U.S. Bankruptcy Code). Higher priority is given to general unsecured claims under the condition that the court decides to commence the procedures of the Corporate Reorganization at a later date.

Under the Japanese insolvency system there is a gap period between the filing of the petition and the court’s decision to commence the case (equivalent to “order for relief” under the U.S. Bankruptcy Code). In the case of Nagasakiya, the court decided to commence the case under the Corporate Reorganization Law in May 2000, therefore the main bank’s post-petition claims have been protected as “claims for common benefits”.

If the decision of commencement of the case is not made by the court and the case is converted into a liquidation under the Bankruptcy Law, then such post-petition claims under the Corporate Reorganization Law are regarded as general unsecured claims under the Bankruptcy Law. Though the court usually gives guidance to the debtor so that such claims are paid in advance, this has been a problem of post-petition finance under the Corporate Reorganization Law.

Again, the Civil Rehabilitation Law has rectified this problem by stating that even in the case of conversion to liquidation, such claims are protected with priority to other general unsecured claims under the Bankruptcy Law. Since "super-priority" (which is admitted in Section364(c)(d) of the U.S. Bankruptcy Code) is not granted to post-petition creditors even under this new law, their claims are *pari passu* with other "claims for common benefits" unless security interests are attached to unencumbered assets.

This is a remarkable difference from a DIP finance mechanism under the U.S. Bankruptcy Code. Thus, only main banks are still reluctantly providing post-petition finance to debtors, and DIP finance by a third party is rare. The majority of creditors are of the opinion that granting super-priority and / or security interests to a DIP finance provider is unfair and that such finance is a responsibility of the main bank.

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Legal issues: Korea, Republic of

Bae, Kim & Lee

The introduction of a formalized system of laws in the Republic of Korea was largely a result of Japanese influence, notably accelerated by Japan's colonization of the Republic of Korea in the first half of the 20th century. Since Japan itself had been heavily influenced by German law, the legal system in the Republic of Korea is a "Civil Law" system, with strong influences discernible from principles of Franco-German law in areas such as the Civil Code. However, the Republic of Korea has also borrowed from other jurisdictions, and in many other areas has adopted the structures of Anglo-American law, notably since the end of the Korean War.

Insolvency laws in the Republic of Korea consist of (i) the Bankruptcy Act, (ii) the Composition Act and (iii) the Corporate Reorganization Act, which are discussed below in more detail. The Composition Act has its origins in Austrian Law and the Bankruptcy Act's principles were founded in the German system. Both were introduced to the Republic of Korea via Japan. The Corporate Reorganization Act is largely modeled along the lines of US federal law, such as the "Chapter 11" protections.

Historically, the area loosely described as insolvency law was a largely under-utilized and somewhat overlooked section on the nation's legal bookshelves, particularly from the 1960s to the late 1980s, a period which saw a dramatic surge in industrial output and economic prosperity. The shortcomings of what legal structures did exist became all too apparent with the onset of a serious economic crisis from late-1996. The ensuing market instability coincided with a general collapse in economic confidence, which was then further exacerbated by the upheaval caused by the Asian currency crisis that reached the Republic of Korea by September of 1997, leading to a bailout by the International Monetary Fund.

Since then, a massive revision to insolvency laws has been undertaken, with emphasis being placed, among other things, on three specific areas. First, setting out with some clarity and certainty specific procedures to be undertaken in the event of corporate fiscal ill-health, and distinguishing between procedures for recovery (or attempted recovery) and procedures for dissolution. Second, an improvement of the speed with which such procedures were to be undertaken, the emphasis being on setting increasingly tighter deadlines. Third, a trend towards specialization of the judiciary, who until a few years ago, were largely unschooled in the practicalities of insolvency laws, only to find themselves submerged under heavy caseloads in that area of law, being further hampered by the fact that the legislative implements at their disposal were somewhat lacking in effectiveness and sophistication. The various revisions to the insolvency laws which have occurred have generally all followed the above themes.

1 Describe the nature and the effectiveness of the following processes:

a) Civil unsecured debt collection remedies.

A creditor first obtains a judgment from a court against the debtor in connection with the pertinent unsecured debt. Upon the creditor's petition for enforcement of the judgment, the court orders attachment on the debtor's assets and has the attached assets disposed of, normally through a public auction sale. Sale proceeds, net of expenses, will be distributed to the creditor. The creditor may file a petition for preliminary attachment with a competent court prior to the filing of a formal lawsuit, if necessary.

b) Secured property enforcement remedies.

In this case, the creditor need not obtain a judgment from a court. Depending on the nature of the security rights and terms and conditions of the security agreement, the creditor either directly enforces its security rights or petitions the court to proceed with the enforcement process.

c) Any special debt collection or secured property remedies that are available to banking sector creditors.

There was, previously, a special law which contained certain provisions for simplifying and speeding up the procedures in connection with the debt collection or secured property remedies available to banking sector creditors. This special law was repealed in April 1999.

d) Corporate bankruptcy/liquidation processes that are available to corporate debtors and creditors.

Under the Bankruptcy Act ("the BA"), an insolvent debtor company or its creditors may file an application for bankruptcy proceedings. Upon the adjudication of bankruptcy, the court appoints a trustee who will conduct the liquidation process.

e) Formal corporate rescue processes that are available to corporate debtors and creditors.

Formal corporate rescue is conducted through the mechanism of either corporate reorganization, under the Corporate Reorganization Act ("the CRA"), or a composition proceeding, under the Composition Act ("the CA"). Both processes attempt to rehabilitate insolvent companies, and are carried out under court supervision.

Corporate reorganization

Corporate reorganization proceedings are available only to stock corporations. An application for corporate reorganization can be filed in the following circumstances:

- If a company cannot pay its debts when they are due without a significant impact on the continuity of business.
- If there exists the fear that a company will go into bankruptcy. Companies typically file for corporate reorganization on a voluntary basis.

However, the CRA also permits a company's creditors holding claims amounting to at least 10 percent of the company's paid-in capital, or shareholders owning at least 10 percent of the company's total issued and outstanding shares to apply for corporate reorganization of the company.

Existing management and controlling shareholders of the debtor company are excluded from the management of the company. The court appoints a receiver to manage the debtor company under the supervision of the court. Further, a creditors' council, consisting of major creditors of the company, is formed unless the debtor company is a small or medium-sized company. The creditors' council will adjust the interests among the creditors and convey to the court opinions of the creditors relating to the reorganization proceedings. The company's debts are restructured or rescheduled in accordance with the reorganization plan. Further, the debtor company will be managed by the receiver under the supervision of the court in accordance with the reorganization plan.

Composition

An application for composition can be filed in the following circumstances:

- If a company cannot pay its debts when they are due without a significant impact on the continuity of the business.
- If there exists the fear that a company is in danger of bankruptcy.

Unlike corporate reorganization, only debtor companies are entitled to apply for composition. Composition proceedings are available to all forms of companies.

At the time of the filing, the draft composition plan must be reported to the court. If the composition plan is adopted by the creditors' meeting and approved by the court, the debt restructuring of the company will be made in accordance with the composition plan. The debtor company will be managed by the company's own management or the controlling shareholder.

Bankruptcy stemming from corporate reorganization or composition

Under the CRA, reorganization proceedings will be converted to bankruptcy proceedings by the court's adjudication in the following events:

- Where the court refuses to grant the commencement of the reorganization proceedings.
- Where the court discontinues the reorganization proceedings.
- Where the court dismisses the reorganization plan which was adopted by the interested parties' meetings.

Likewise, under the CA, composition proceedings will be converted by the court's adjudication to bankruptcy proceedings in the following events:

- Where the court discontinues the composition proceedings, before the court has authorized a composition plan.
- Where the court dismisses the composition plan which the creditors meeting has approved.
- Where the court cancels the composition proceedings upon application of the creditors, after the court has authorized the composition plan.

f) Informal corporate rescue processes.

So-called "workout" programs are conducted by financial institutions in accordance with a master workout agreement executed among financial institutions. In addition, a debtor company may seek so-called "private composition" – that is, out-of-court debt rescheduling in accordance with one or more private and individual agreements with the creditors.

g) Any other corporate insolvency, or insolvency-related, processes that are available under special legislation.

The Republic of Korea has no special legislation applicable under such circumstances.

2 What is the effect upon debt enforcement and secured property enforcement processes of:

a) An adjudication of corporate bankruptcy/liquidation?

Upon adjudication of bankruptcy by the court, all assets of the debtor are transferred into a bankruptcy estate. Liquidation of the bankruptcy estate is conducted by the trustee, subject to security rights. No unsecured creditor may individually enforce its claims. However, security rights are not affected and secured creditors may individually enforce their security rights.

b) The commencement of a formal corporate rescue process?

Corporate reorganization

The CRA provides for an interim period between the filing of the application and the commencement of the proceedings, whereby the company's assets will be "preserved" for rehabilitation and distribution under the reorganization plan. The court is required to render a decision whether to grant the provisional preservation order within two weeks of the filing date. The court is required to render a decision whether to commence the reorganization proceedings within one month of the filing date. Upon the commencement, both secured and unsecured creditors are prevented from individually enforcing their claims arising prior to the date of commencement by the operation of law. Claims arising after the commencement are not stayed.

Composition

Under the CA the court is required to render a decision whether to commence the composition proceedings within one month of the filing date. The court can issue a preservation order even before the commencement of the composition proceedings, whereby the company's assets will be "preserved" to prevent dissipation, waste, or concealment by the debtor company. Upon the commencement, unsecured creditors are prevented from individually enforcing their claims by the operation of law, except for the claims arising after the commencement. However, security rights are not affected and secured creditors may individually enforce their security rights, unless the secured creditors have agreed otherwise.

c) The initiation of an informal corporate rescue process?

In the case of workouts, participating financial institutions are contractually prevented from individually enforcing their secured or unsecured claims, under the master workout agreement. In the case of private compositions, debt collection and secured property enforcement processes are subject to individual agreements between the debtor and the creditors.

d) The initiation of an insolvency, or insolvency-related, process under any special legislation?
The Republic of Korea has no special legislation applicable under such circumstances.

3 What is the effect on the management of a corporation of:

a) An adjudication of corporate bankruptcy/liquidation?
Upon adjudication of bankruptcy by the court, the debtor company continues to exist only for the purpose of liquidation. Normal business operations are wound up. Existing management and controlling shareholders are excluded from the management of the debtor company and the appointed trustee conducts the liquidation process.

b) The commencement of a formal corporate rescue process?
In the case of corporate reorganization proceedings, existing management and controlling shareholders are excluded from the management of the debtor company. Shares owned by controlling shareholders are in principle extinguished without consideration. Upon a preservation order, the court appoints one or more “interim” receivers to manage the affairs of the company. The interim receiver is replaced by one or more “permanent” receivers at the time of the official commencement of the reorganization proceedings.

In the case of composition proceedings, in general, existing management and controlling shareholders are not excluded from the management of the debtor company. They continue to manage the company. In limited exceptional cases, upon a preservation order, the court appoints one or more interim receivers to manage the affairs of the company.

c) The initiation of an informal corporate rescue process?
In the case of an informal corporate rescue process, in general, existing management and controlling shareholders are not excluded from the management of the debtor company. They continue to manage the company. However, representatives of the creditors generally conduct supervisory roles, particularly in connection with the company’s financial affairs. Sometimes, representatives of creditors are dispatched and appointed as the debtor company’s officers.

d) The initiation of an insolvency, or insolvency-related, process under any special legislation?
The Republic of Korea has no special legislation applicable under such circumstances.

4 Who is responsible for “case management” control and administration of:

a) A corporate bankruptcy/liquidation?
Please refer to Section 3a above.

b) A formal rescue?
Please refer to Section 3b above.

c) An informal rescue?
Please refer to Section 3c above.

d) A case of corporate insolvency under any special legislation?
The Republic of Korea has no special legislation applicable under such circumstances.

5 Who has the responsibility for the preparation of the plan of rescue under:

a) A formal rescue?
Corporate reorganization
In the case of corporate reorganization proceedings, the court-appointed receiver is responsible for the preparation of the draft reorganization plan.

Under the CRA, the reorganization plan should be adopted within two months from the date of the first interested parties’ meeting; provided that if the court deems necessary, it may, upon application from the person who submitted the draft reorganization plan, or *ex officio*, extend such deadline up to an additional one month. The reorganization plan should be adopted within one year from the date of commencement of reorganization proceedings; provided that if there are unavoidable reasons, the court may extend the deadline up to an additional six months.

The plan is formally adopted over the course of three or more statutory meetings of "interested parties." The final meeting is convened to vote on a resolution approving the draft reorganization plan that was deliberated at the previous meeting. In order for the resolution to pass, it must be affirmed by the following:

- Unsecured creditors holding reorganization claims totaling not less than two thirds of the total amount of such claims having voting rights.
- Secured creditors holding reorganization claims totaling not less than three fourths of the total amount of such claims having voting rights (if the draft plan is to rehabilitate the debtor company), or all of the total amount of such claims having voting rights (if the draft plan is to liquidate the debtor company).

Shareholders may also vote in the draft reorganization plan in proportion to their shareholdings. In this connection, the draft reorganization plan must be affirmed by a majority of shareholders, regardless of whether a certain super-majority voting requirement would be required under the Commercial Code. However, if the total liabilities exceed the total assets of the debtor company at the time of commencement of the corporate reorganization proceedings, then the shareholders are not entitled to vote.

Once the interested parties have approved a draft reorganization plan, the court will determine whether or not to authorize the plan. In making its determination, the court will analyze whether the draft reorganization plan meets all of the legal requirements under the CRA and whether it is fair to the interested parties.

Composition

In the case of composition proceedings, the company is required to prepare the draft composition plan in advance and submit the draft plan at the time of filing the petition for composition proceedings with the court. Generally, the draft plan is later modified by consultation with the creditors.

The creditors' meeting is convened to vote on a resolution approving the draft composition plan. In order for the resolution to pass, it must be affirmed by the majority of attending creditors and not less than three fourths of the total amount of such claims having voting rights. If the creditors' meeting fails to approve the draft composition plan, it will be automatically converted to bankruptcy proceedings.

Once a draft composition plan has been approved by the creditors' meeting, the court will determine whether or not to authorize the plan. The court authorization procedure will take approximately one week after resolution of the creditors' meeting. If the court issues a final decision approving the plan, it will become effective immediately.

b) An informal rescue?

In general, the management of the debtor company and the representatives of creditors consult with each other and jointly prepare the draft plan. Relatively speaking, creditors have the opportunity to exert more influence on the preparation of the plan.

c) A case of corporate insolvency under any special legislation?

The Republic of Korea has no special legislation applicable under such circumstances.

6 How are the different classes of creditors treated in relation to:

a) A corporate bankruptcy/liquidation?

The BA classifies creditors into three basic categories:

- Creditors with bankruptcy (unsecured) claims.
- Creditors with separate security right (secured) claims.
- Creditors with claims for the bankruptcy estate.

Bankruptcy (unsecured) claims are defined as claims arising prior to the commencement of bankruptcy proceedings. Secured claims are defined as claims with security such as a lien, right of pledge, mortgage, or lease on a deposit basis on the debtor company's property. Claims for bankruptcy estate are similar to the claims for common benefits in reorganization proceedings. (See below.)

Whenever the court recognizes that there are proceeds appropriate for distribution, it must distribute the proceeds to creditors in accordance with the priority of claims as listed in the distribution list (which was fixed by the procedure of filing and examination of the claims). Thus, distribution may happen more than once.

b) A formal rescue?

Corporate reorganization

The CRA classifies creditors into three basic categories:

- Creditors with general (unsecured) reorganization claims.
- Creditors with secured reorganization claims.
- Creditors with claims for the common benefit.

The claims held by the unsecured and secured creditors may be repaid only pursuant to the terms and conditions provided in the reorganization plan. In contrast, claims held by creditors with claims for the common benefit may be paid or repaid outside the scope of the corporate reorganization plan. This category of creditors primarily includes those creditors whose claims either arose after the commencement of the corporate reorganization proceedings or those creditors whose claims were approved by the court during the preservation period. These claims also include, *inter alia*, employee salaries, severance payments, certain legal expenses, taxes and costs of managing the company incurred by the receiver during the preservation period.

Any reorganization creditor, whether unsecured or secured, which seeks repayment of its claim must file a report of its claim and proof thereof with the court within the fixed time period set by the court. Failure to report claims against the debtor company within the specified period will generally discharge the company from the obligations thereof.

Composition

The CA classifies creditors into three basic categories:

- Creditors with composition (unsecured) claims.
- Creditors with separate security right (secured) claims.
- Creditors with claims for general priority.

Composition (unsecured) claims are defined as claims arising prior to the commencement of composition proceedings. Secured claims are defined as claims with security such as lien, right of pledge, mortgage or lease on a deposit basis on the debtor company's property. Claims with general priority are defined as employees' salary, taxes, and claims approved by the court during the period from the preservation order to the commencement of the composition proceedings. Claims for general priority will be outside of the composition plan.

The reporting of claims is required to establish voting rights at the creditors' meeting. Failure to report the claims within the prescribed period would not discharge the debtor company from the obligations thereof.

c) An informal rescue?

In the case of an informal rescue process, creditors are generally classified into two categories:

- Secured creditors.
- Unsecured creditors.

In principle, secured creditors are treated more favorably than unsecured creditors in preparing the debt rescheduling plan.

d) A case of corporate insolvency under any special legislation?

The Republic of Korea has no special legislation applicable under such circumstances.

7 What is the position of both unsecured and secured creditors who vote against, do not agree with, or do not consent to, a plan of rescue in relation to:

a) A formal rescue?

If a reorganization plan is duly adopted by the interested parties' meetings and approved by the court, such plan has binding force against all secured and unsecured creditors, including dissenting creditors.

If a composition plan is duly adopted by the creditors' meeting and approved by the court, such plan has binding force against all unsecured creditors (whether or not dissenting) as well as participating and consenting secured creditors. Non-participating or dissenting secured creditors are not bound by the composition plan.

b) An informal rescue?

If a workout plan is duly adopted by the representatives of creditors in accordance with the master workout agreement, such plan has binding force against all creditors that are parties to the master workout agreement, whether or not dissenting. Non-participating creditors are not bound by the workout plan. In case of a private composition, a debt rescheduling plan has binding force against only those creditors that have individually agreed to the plan.

c) A case of corporate insolvency under special legislation?

The Republic of Korea has no special legislation applicable under such circumstances.

8 In relation to the need for an insolvent corporation to have urgent working capital funding, what difficulties are encountered in the provision of such funding in relation to:

a) A formal rescue?

The financial credibility of the debtor company that becomes subject to formal or informal corporate rescue process is necessarily decreased. Further, if the court issues a preservation order, such actions as disposing of property and obtaining new loans are only allowed with the approval of the court.

b) An informal rescue?

Please refer to Section 8a above.

c) A case of corporate insolvency under any special legislation?

The Republic of Korea has no special legislation applicable under such circumstances.

9 Briefly describe the relevant provisions relating to the setting aside of antecedent and fraudulent transactions in relation to:

a) A corporate bankruptcy/liquidation?

The Civil Code contains a general provision invalidating fraudulent conveyance transactions (dispositions of property for no or unfairly low consideration). The BA, CRA and CA similarly contain largely parallel provisions.

The scope of "fraudulent conveyance transactions", subject to invalidation under the BA and CRA, is enlarged compared to that under the Civil Code. For example, debt repayment to one or more specific unsecured creditors or disposal of property for that purpose, in and of itself, does not qualify as "fraudulent conveyance transactions" to be invalidated under the Civil Code. However, such activities in violation of the principle of equal distribution among the unsecured creditors which have been taken within a certain period of time prior to the bankruptcy adjudication or after the filing of the bankruptcy or corporate reorganization petition may be invalidated under the BA and CRA.

Under the CA, fraudulence conveyance transactions taken after the filing of the composition petition may be invalidated in the same manner as the BA and CRA. Fraudulent conveyance transactions taken prior to the filing of the composition petition are subject to general provisions under the Civil Code.

b) A formal rescue?
Please refer to Section 9a above.

c) A case of corporate insolvency under any special legislation?
The Republic of Korea has no special legislation applicable under such circumstances.

10 Are there any provisions of law that might operate to invalidate a secured property transaction in relation to:

a) A corporate bankruptcy/liquidation?
Subject to restrictions on security right enforcement explained above, secured creditors are allowed to assign, transfer or otherwise dispose of their security interests to third parties while the debtor company undergoes bankruptcy, corporate reorganization or composition proceedings.

Creation of new security rights over assets by the debtor company is restricted by the preservation order or the statutory provision of invalidating fraudulence conveyance transactions as aforesaid.

b) A formal rescue?
Please refer to Section10a above.

c) A case of corporate insolvency under any special legislation?
The Republic of Korea has no special legislation applicable under such circumstances.

11 Describe the difficulties that are encountered in endeavoring to administer cases of corporate bankruptcy/liquidation and formal corporate rescue that involve property and business interests located in more than one jurisdiction.

The BA, CRA and CA do not apply to the debtor company's assets located overseas. Consequently, where the debtor company has property and business interests located overseas, the effective and fair administering of cases of corporate bankruptcy / liquidation and formal corporate rescue is sometimes very difficult.

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Financial issues: Korea, Republic of

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In the Republic of Korea there is an unusual divide between the insolvency legislation and the arrangements for corporate restructuring.

The insolvency legislation is embodied in statute – specifically the Bankruptcy Act of 1962 (amended 1998), the Company Re-organization Act and the Composition Act. However, early in the financial crisis of 1997 to 1998 it was recognized that the insolvency legislation could not deal effectively and in a socially acceptable manner with the massive number and scale of distressed corporates.

In 1998 the then-new government of President Kim Dae-Jung facilitated the Agreement for the Promotion of Corporate Workout ("the Agreement"), between all significant Korean financial institutions not then subject to formal insolvency proceedings and the Corporate Restructuring Creditors Committee ("CRCC"). The CRCC is a subsidiary body of the Financial Supervisory Commission ("FSC"), a government body ultimately reporting to the President's office through the Financial Supervisory Service ("FSS").

The Agreement sets out a contractual arrangement for major Korean corporates to apply for "workout" and for their debts to Korean financial institution creditors to be stayed and for a due diligence process to be carried out. If prescribed conditions are satisfied regarding the viability of the company and of the proposed workout agreement, a Memorandum of Agreement ("MoA") is entered into by the company and the Korean Creditor Financial Institutions ("KCFIs"). The MoA would normally provide for a range of restructuring measures including asset reduction, repayment holidays, interest holidays and / or reduced interest rates and commitments to restructure businesses and operations.

The Agreement is essentially a contractually binding arrangement based upon the so-called "London Approach" and Chapter 7 of the US Bankruptcy Code.

The Agreement is a contractual arrangement and is not binding on any creditors who have not signed – including foreign creditor financial institutions ("FCFIs"). Usually, the KCFIs have bought out the claims of the FCFIs, either at 100 percent or, if they are material, at a discount. The Daewoo companies are an example in that a protracted and difficult negotiation has led to terms being agreed between the steering committee for the FCFIs and the relevant Korean entities for debt due to the FCFIs to be purchases at prices reflecting the circumstances of the relevant companies.

Notwithstanding that the Agreement does not bind FCFIs of companies entering workout, its operation is relevant to FCFIs in relation to the following:

- How the debtor company's future will be determined.
- The treatment of debt due to FCFIs.
- FCFIs purchasing debt of companies in workout pursuant to the Agreement originally due to KCFIs.
- The provision of additional funding to companies in workout.

1 Is the restructuring/ insolvency legislation generally:

Understood?
Being followed, and/or available opportunities being taken up?
Being enforced by relevant authorities?

The KCFIs, and especially the major banks that act as lead creditor banks or on steering committees for most workouts, generally understand the operation of the Agreement.

The fundamental structural difficulty affecting the implementation of restructuring in Republic of Korea, whether within the Agreement, under the insolvency legislation or informally, is the difficulty of exerting pressure upon, and, where necessary, changing or strengthening the management of corporates.

Most corporates and chaebol in Republic of Korea are family controlled through a web of interlocking shareholdings and directorships. Although many of the larger companies are listed, the founding families retain either a majority or a large minority of shares.

Further, the historic practice of the commercial banks, prior to the crisis of 1997 to 1998, was to act as conduits of funds to corporates operating, or selected by the government of the day to operate, in selected industries identified as being in the national interest. In general terms, corporates were not expected to repay bank finance other than by means of fresh bank lending. This led to very high debt / equity ratios.

Although bank lending was often secured, with property being the preferred collateral, banks very infrequently relied upon the collateral taken. Further, the property market in Republic of Korea did not operate as a market in the usual sense. Valuations were based on the expectations of the property owner and turnover in the commercial property market was low.

In short, bank finance was generally regarded in practice as long term funding and not ultimately repayable – i.e. more as equity than traditional bank finance. Banks generally did not act in the traditional function of a bank, providing lending to be repaid from future cash flows.

Further, corporate governance, accounting and auditing practices were weak, with very few external (non-executive) directors. Groups of companies were not required to produce consolidated accounts, leaving significant weaknesses in the accounting standards and audit fees fixed by reference to asset size (the first disclosed consolidated financial statements (for Financial Year 1999) were published for the 30 largest chaebol groupings from August 2000). The result has been that corporates have not had the discipline of reporting to stakeholders (whether banks, external shareholders or others) in a coherent, comprehensive, comprehensible, timely and prudent manner. They therefore lacked both the systems and controls, and the culture and will, to do so. Such reporting as existed focused upon size of turnover and of assets, not profitability or cash flow.

For the same reasons, the banks lacked the skills and systems to effectively assess lending opportunities and to monitor and control lending after it had been made.

A more subtle but more pervasive issue is that the banks have lacked the will, the organizational culture and the political connections to take a strong line with management of corporates – particularly the major corporates and chaebol. A policy statement made by the Chairman of the FSC in July 2000 reads in part:

> Management transparency and responsible management of banks will be guaranteed through the prohibition of outside interference, special favors and undue pressure, while the board of directors at banks in which the government is the majority shareholder will assume responsibility for all major managerial decisions.

(Quoted from the FSC Chairman and special member of the Tripartite Commission, Yong Keun Lee, in a report entitled Policy for the Development and Reform in the Financial Industry presented to the meeting of the Tripartite Commission held on 12 July 2000.)

It is unusual for KCFIs to force a major corporate into Court Receivership or bankruptcy unless there is evidence of fraud or the business is very obviously not viable. More often, the corporate will apply for a workout under the Agreement. The KCFIs have in the past almost always approved workout agreements, usually with the same management team in place but sometimes without (e.g. Dongah, various Daewoo companies).

In the early days of the Asian crisis, when the Agreement was made, this was probably the correct balance. The overriding priority was the preservation of economic and social stability. However, once that had been achieved, the priority changed to the more traditional function of insolvency and restructuring laws. This is to give viable corporates encountering temporary difficulties the time and opportunity to make the necessary financial, management and business changes to restore profitability, to ensure that the necessary changes are implemented quickly and effectively, and to identify and weed out corporates that are not or cannot be made viable.

For major corporates in the Republic of Korea, management teams will not usually be changed and / or the corporate not usually forced into formal insolvency unless either (i) major malpractice or misfeasance is alleged or proved; or (ii) an MoA has been approved but breached by the corporate, with the result that a major refinancing is required (e.g. Jindo).

This has meant that corporates in workouts have not been obliged to make the changes necessary to restore viability and many that should have been quietly dismantled have been allowed to continue.

Progress is being made on many of these issues and the government has been energetic and generally effective in encouraging and bringing about reforms. The government has sought to do this in several ways, including the following:

- The introduction of legislation and regulations reforming corporate governance, accounting and reporting practices. A Code of Best Practice of Corporate Governance has been issued and from 2000 all listed companies are required to issues a statement declaring their compliance with the Code. It may be expected that the government will take punitive action if it should be found that a company has issued a false or misleading statement.
- Encouraging banks to identify and properly provide for loans to under-performing corporates, by changing the method by which banks are required to establish reserves.
- Encouraging banks to objectively assess proposed workouts, through the CRCC.
- Changing the political climate to reduce the political influence wielded by chaebol management – the dismantling of Daewoo and the removal of its management has been a key example.

Further progress is required. The problems are deep rooted and will not be solved overnight.

In summary the insolvency and restructuring legislation and provisions are generally understood. Cultural and political systems and skills issues combine to delay identification and action to resolve developing problems of under-performance, with the result that available opportunities are not identified, and / or not taken up as early as is desirable. When the need for a restructuring becomes clear, the banks (strongly encouraged by the government) do enforce the insolvency legislation and the Agreement. Unless the government ensures that the banks do focus on ensuring that the legislation and the Agreement are properly enforced as intended, too often the banks lack the necessary skills, resources and political confidence to ensure that restructuring is effective.

It is noteworthy that in Republic of Korea, almost all reforms are initiated and driven forward by the government. This is particularly true in the corporate and financial sectors of the economy. Not only is the government the principal source of authority and direction in what remains a very disciplined society, but also the political and economic power of the chaebol has often proved greater than that of the financial sector. It has not helped that the chaebol and their controlling families – although forbidden from controlling banks – have major stakes in financial institutions: the old saying “if you owe the bank $1,000, you have a problem; if you owe the Bank $1 million, the Bank has a problem” remains true. The principal difference is scale – the total liabilities of the failed Daewoo chaebol are now estimated to be in the region of US$65 billion.

2 Broadly speaking, in practice, does the restructuring/insolvency legislation tend to lead to:

Early recognition and action on financial difficulties experienced by a corporation? Restructuring alternatives as opposed to liquidation, and if not, why not?

These issues have been touched upon in Section 1 above. Although the commercial atmosphere is slowly changing, in general terms the following is true:

- The financial difficulties experienced by corporates are not generally recognized and acted upon early enough.
- Restructuring alternatives are generally chosen when, in some instances, liquidation would be preferable.
- Restructuring alternatives are often not implemented effectively, allowing businesses to continue to under perform.

As discussed above, the problems are not generally with the insolvency and restructuring legislation, although this is not perfect and some reforms would be beneficial. The problems mostly lie in the social, political and historical context in which businesses operate.

In the typical western economic model, financial difficulties are generally identified as follows:

- By non-executive directors, monitoring in detail performance of the company and its executive directors.
- By shareholders, through the medium of periodic reports and accounts prepared to rigorous standards and subject to independent audit.
- By banks and other finance providers, through the medium of periodic reports and accounts, through monitoring of exposures and through information provided by the company in accordance with banking / finance agreements.

Non-executive directors

There are at present relatively few non-executive directors of corporates in the Republic of Korea. Although there is a statutory requirement for companies listed on the KOSDAQ stock exchange to have a majority of non-executive directors, the legislation came into force as recently as 1 January 2000. Most corporates are still in the process of identifying and appointing non-executive directors and the boardroom culture has yet to adapt to the concept of non-executive directors having an independent role.

The result is that non-executive directors do not yet provide an effective control to identify and take action to remedy the early signs of financial difficulties. The recent reforms are to be greatly welcomed. If the non-executive directors appointed are appropriately trained and their role as protectors of the interests of "external" stakeholders is accepted, both socially and within board rooms, it is reasonable to expect that in the future financial difficulties will be identified and acted upon significantly earlier than has been the case.

Shareholders

Although large numbers of corporates are listed on KOSDAQ, for most listed corporates only a minority of their shares are publicly held. Most are held within the founding family or by other companies within the chaebol grouping. Complex nets of cross-shareholdings are frequently encountered and have their roots in two principal issues, as follows:

- Until 2000, pure holding companies were illegal.
- Corporations were taxed as single enterprises and group tax arrangements were not recognized, so it was difficult to move profits between linked companies without suffering tax.

The result is that hostile take-overs are virtually unknown and it is very unusual for external shareholders to have sufficient voting power to force management change. The position of external shareholders has been further weakened by the lack of reliable accounting information, not least by reason of the historic weakness of Korean accounting standards.

The net effect was to reduce pressures from shareholders for early problem recognition.

The government has taken steps to address these issues. Holding companies are now permitted and tax reforms are being introduced. As noted above, Korean accounting standards have been changed and are now based on the Generally Accepted Accounting Principles of the United States of America. These changes may be expected to lead to more "normal" holding company / subsidiary group structures and to external shareholders exercising greater influence.

The banks

Discussed in Section 1 above are the weaknesses of the major banks, in particular, (i) lack of appropriate skills, (ii) lack of political connections and will to force management to provide meaningful information and properly restructure businesses, and (iii) regulations concerning provisioning against loans favoring the agreement of workouts, even when these will not lead to greater recoveries.

Also described above are some of the changes encouraged or implemented by the government, which have already brought about some improvement. With greater experience of using the legislation and confidence in the role of banks in the economy generally, further improvements may reasonably be expected.

Overall, the management of corporates is generally in a very strong position in relation to banks and external shareholders. Management usually has a vested interest in the maintenance of the status quo – both to preserve the source of their income and to avoid the loss of face consequent upon the implicit or explicit recognition of past mistakes which is a necessary first step in a restructuring.

This has led to management being able to secure the approval of KCFIs to workouts on generally favorable terms. Further, following approval of workouts, management have rarely taken the radical and hard decisions necessary to reshape the businesses carried on by the corporate and restore profitability. Almost invariably, corporates have failed to meet the projections upon which workouts are based and have succeeded in gaining the acceptance of the KCFIs to a further round of debt-for equity swaps, interest holidays and interest rate holidays and, most damaging, the provision of further loans to meet working capital needs. Finally, for reasons set out in Section 1 above, the banks have been slow to put pressure on borrowing corporations.

All of the above have tended to work against early recognition of problems.

Current developments

There are signs that the government's continuing pressure, designed to strengthen external shareholders and the KCFIs (and the commercial banks in particular) and to weaken the chaebol, is bearing fruit. A few workout plans have been rejected and management of some corporates have been changed. However, the balance remains skewed towards the survival of existing businesses under existing management and against the recognition of the following:

- It is often necessary to change the management of businesses that are under performing.
- Addressing the underlying under performance of a business will often require a fundamental change to the way in which the business is carried on.
- Some businesses fail and in normal times it is in the wider economic interest for such businesses to be liquidated.

3 What are the main practical difficulties being encountered in:

The preparation of restructuring plans?
The implementation of restructuring plans?

The principal practical issues are summarized below.

Difficulties in the preparation of restructuring plans	Difficulties in the implementation of restructuring plans
Extreme time pressures imposed by the Agreement (stay of three months, extendable to four).	Poor quality of many of the plans including the lack of credible trading projections.
Entire plan must be developed and agreed within the stay period.	Plans are often limited and unrealistic as a result of their hasty development and are difficult or impossible to implement.
Lack of coherent and credible financial information, including properly developed and validated business plans and forecasts.	Lack of coherent and credible information upon the activities and performance of the corporates in restructuring.
Retention of shareholder management in many companies.	Lack of a pool of management talent to introduce into a corporate undergoing restructuring – include "crisis" and "turnaround" management specialists – and arbitrary selection of new management by KCFIs.
The lack of experience of both KCFIs and professional advisors in dealing with restructuring.	Lack of experience of KCFIs in monitoring corporates, and in the management of their stakes in corporates undergoing restructuring.
The "blame culture" and sacred cows – existing management are often very reluctant to acknowledge the causes of under-performance.	The "blame culture" and sacred cows – it is often necessary to make quick and hard decisions, which existing management often find very hard to do.
"Rampant moral hazard" – failure of owners/management to properly disclose assets, liabilities and trading prospects in the course of the development of the workout plan.	"Rampant moral hazard" – shareholders/managers (i) using cash injections from KCFIs for private purposes, (ii) failing to deliver up assets and cash injections promised under the MoA, (iii) neglecting their management responsibilities, and (iv) starting new businesses and funding such businesses from the workout without the consent of the KCFIs (FSS report, 23 August 2000).

KCFIs have not, prior to the Asian crisis in mid-1998, had to deal with the restructuring of corporate entities. The Korean economy enjoyed strong and uninterrupted growth for many years – enabling even poorly managed companies to survive. Also, as noted in Section 1 above, the role of the KCFIs and of the major banks in particular was to provide long term funding to corporates as directed by the government, not to monitor and manage for profit in the usual way a loan portfolio.

The result is that the KCFIs and their staff were not equipped to handle the restructuring of major corporates that became necessary in the sharp recession of late-1997 to early-1998. As part of the World Bank program of aid and support to the economy of the Republic of Korea, all major banks were required to establish workout teams. Foreign advisers were introduced to support and assist the workout teams from September 1998. This has provided the basis for a core of expertise in restructuring.

Similarly some incumbent management teams have good knowledge, skills and attributes, and many are very competent at dealing with the technical aspects of their roles. However, the qualities required of management in a workout are very different from the qualities required during the normal operation of a business.

One of the most critical difficulties in the practical operation of the Agreement has been that the stay on debt repayments and time permitted for negotiation and approval of the MoA is limited to a maximum of four months. The MoA agreed at the end of the process is expected to be complete and capable of performance in every respect.

If the corporates were in possession of credible business plans, budgets and financial forecasts at the commencement of the stay period, and their accounting information was credible, this might be achievable. However, most corporates requiring restructuring do not possess such things, for the reasons discussed above (indeed, the lack of such information has usually been a root cause of difficulties encountered).

It is probably not surprising therefore that most MoAs have been found to be significantly flawed and in need of extensive revision after the first year of the workout.

Perhaps the greatest single difficulty in the implementation of workout plans has been that the retention of shareholder management is a continuing problem in many businesses. In a workout, it is usually necessary to do the following:

- Make and quickly implement tough decisions, to cut costs, terminate unprofitable activities and release cash.
- Recognize that the underlying reason for the under performance of the business is that at some point a wrong strategic direction has been chosen.

A thoroughgoing strategic review is required. Businesses leaving workout are very often radically different in shape and strategic direction from the businesses that entered workout.

It is naturally painful and difficult for management to recognize that it's previous decisions were faulty, and / or that it's strategic vision is lacking, and / or that the knowledge, skills and attributes of the management team are inadequate for the task at hand.

As noted in the table above, moral hazard is an issue. The FSS has said that non-compliant companies and managers will be brought to the attention of the National Tax Service, for tax investigations to be conducted. While this is a welcome step forward, it addresses the symptom but does not resolve the underlying ailment.

One of the issues restricting the extent of management change in workouts is a lack of a pool of available talent.

The FSS report also identified neglect of supervisory responsibilities by KCFIs as a contributory factor. The KCFIs' lack of experience of workouts and restructuring and the political concerns of their management are the principal reasons for such neglect.

4 To what extent are companies that are going through any formal or informal restructuring merely adjusting their debt/equity structure, rather than genuinely restructuring their business operations?

In general terms, workouts have not led to genuine and far-reaching restructuring of the business operations of the corporate entity. A relatively crude but useful measure is the extent to which companies in workout have met the terms of the MoA setting out the terms of the restructuring, including the required asset reductions and the expected performance of business units.

In September 1999, it was reported that 78 out of 82 chaebol and major corporates that had entered into workout agreements with KCFIs were in significant default of the terms of the MoA. Some of the deficits were very large indeed. Most would require another round of refinancing and debt restructuring. A fresh round of workouts were negotiated in the latter part of 1999 and the early months of 2000. In the latter part of 2000, a number of high profile workouts failed and companies placed in Court Receivership.

Workout plans vary considerably. They will usually include the following components, in varying proportions according to the circumstances of the company and the negotiating strengths of the various parties:

- Debt restructuring, including interest forgiveness / rate reductions, medium and long-term loans, additional working capital finance from lenders and debts for equity swaps, but not debt forgiveness.
- Asset reductions including the sale of properties and of operating divisions or subsidiaries.
- Improvements in the operating performance of businesses to be retained in the company.

PricewaterhouseCoopers' experience is as follows:

- The debt restructuring is usually implemented quickly.
- There are commonly extended delays to the asset reduction programs.
- Operating performance may improve, but improvements are usually slower and lower than envisaged in the workout plan.

Debt restructuring is controlled by the KCFIs, which are efficient in pushing through the required measures.

Asset reduction takes place more slowly and it has been usual to see realizations falling behind schedule. One of the principal issues has been price expectation. The hasty preparation of the MoA and the limited market information available has often precluded, or limited, challenges made to the management's assumptions or assertions regarding the value of properties or business entities. In other jurisdictions, management often seize the opportunity offered when a restructuring is being negotiated to write down assets as far as possible. This enables them to claim in due course, when the asset is sold, that they have either met, or, better, exceeded expectations.

In Republic of Korea, however, this is rarely seen. Incumbent management is usually retained, creating barriers to an acknowledgement that assets are worth significantly less than what was paid. Management will often insist that an unrealistic value is placed on assets for the purpose of the MoA. The asset is then marketed at that price and, unsurprisingly, frequently fails to sell.

Operating performance of the retained businesses is also frequently lower than forecast in the business plans upon which the MoA is based. This is partly a function of the quality of the workout agreements. Most corporates entering workout do not have properly prepared business plans and financial projections, or the skills to prepare such documents. When workouts were being negotiated, business plans and financial forecasts were necessarily prepared, but sometimes hurriedly and / or by inexperienced personnel. The net result was that many of the workout agreements were unrealistic and the performance targets set unlikely to be achieved.

Another significant factor has been the reluctance of incumbent management to make significant changes to the businesses carried on or the corporate structure – the "sacred cows" problem.

The net result is that most corporates in workout have not genuinely restructured their operations.

However, many of the corporates in workout are heavily loss making. The government has given clear signals that it will require the KCFIs to take a stronger line with corporates in workout that fail to meet their MoA targets. The strong growth of the Korean economy in 2000 and the reduction in unemployment has given the government leeway to require KCFIs to impose stricter terms and to enforce existing terms more rigorously, although growth is slowing in early 2001. Initial signs were good with three seriously under-performing companies – Dongah Construction, Daewoo Motor and Woobang Construction – being forced out of workout and into Court Receivership. There are other, smaller examples but it remains to be seen whether the KCFIs will deal effectively with the many corporates that fail to meet the terms of their workout agreements.

A useful illustration is Dongah Construction. Its workout was the first to be approved, in mid-1998. By early 2000, the deficit in the workout was in excess of US$1 billion – attributable in part to delays in selling the Korea Express business, but mostly to trading losses and realized or expected shortfalls in the asset reduction program. Although the president of Dongah was replaced as part of the workout package, many of the previous management team remained. It would appear that the management changes had not been sufficiently deep or far-reaching. A revised MoA was agreed in early 2000 and further management changes imposed, but these were evidently too little too late and Dongah was placed in Court Receivership in October 2000.

There are signs that the balance is shifting away from workout being (in practice) largely focused on debt / equity adjustments and towards a focussed business restructuring process, but it remains to be seen how far and how quickly the balance will shift.

5 What are the main areas from which funding is generally being utilized by companies which undertake either formal or informal restructuring?

Existing finance providers – principally the Korean banks – are the usual sources of finance for companies undergoing restructuring.

In practice, there are often few choices available. The financial information and business performance of companies undergoing restructuring are often such that only lenders or investors willing to accept a higher level of risk would wish to become involved. The KCFIs, therefore, often find that they have few options other than to either see the company proceed into formal insolvency, with the prospect of very heavy losses, or to provide DIP financing in a workout.

Under the Agreement, if a workout is approved by a majority of the KCFIs then all KCFIs with unsecured claims may be required to make fresh loans to the company to be used as working capital as specified in the MoA, *pro rata* to their respective unsecured claims and without regard for whether they have voted for, or against approval of the proposed workout.

After a restructuring has been approved, it is sometimes possible for a company to raise finance outside the KCFIs. Dongah Construction is an example, as it issued interest-bearing bonds to international investors.

However, even less-risk averse investors require some evidence of a satisfactory performance. Many companies in workout find it very difficult to provide that evidence, and in consequence, it is unusual for new investors to provide additional finance.

In many workouts, the claims of FCFIs are bought out. As a result, the burden of providing DIP financing falls almost entirely on KCFIs.

Debt owed by companies subject to insolvency proceedings, such as Court Receivership, is frequently sold by the KCFIs to the Korea Asset Management Company, a government funded body. The debt is repackaged by the Korea Asset Management Company and sold by tender to international investors.

The amount of debt sold may be sufficient to give one, or a group of international investors effective control over the company (e.g. Hanbo Steel). It has yet to be seen whether international investors can resolve the cultural and management problems; but while they grapple with the problems, many will need to provide additional finance.

It has been suggested that debts due by companies in workout will also be sold, as part of the process of cleaning up the non-performing loans books of KCFIs.

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Legal issues: Malaysia

Shearn Delamore & Co

Malaysia has a legal system based on the common law, and common law and equitable concepts have long been received and applied. English and other Commonwealth precedents are still persuasive in the Malaysian courts, and are consequently cited and relied upon frequently. The core of Malaysia's current company and corporate insolvency law is contained in the Companies Act 1965, which was derived from Australian state legislation of the 1960s. A new formal insolvency process, namely Special Administration under the Danaharta legislation of 1998 (Pengurusan Danaharta Nasional-Berhad Act - "the Danaharta Act"), was introduced to supplement the older insolvency and restructuring laws, in response to problems in the Malaysian banking sector in the wake of the Asian Financial Crisis of 1997. The creation of the Corporate Debt Restructuring Committee under the auspices of Malaysia's central bank provided a much need informal restructuring process. Recent amendments to the Companies Act enabled some of the older insolvency processes, such as schemes of arrangements, to keep pace with developments elsewhere in the Commonwealth. However, notwithstanding the amendments, as the bulk of the formal insolvency processes operate through the Malaysian courts, judicial officers inexperienced in insolvency processes and delays have combined to affect the speedy application of insolvency processes. The scheme of arrangement process in particular has been slow and costly. Special Administration under the Danaharta legislation is not court based, and it has been largely successful, given that the Danaharta legislation provided special administrators with wide powers and prescribed procedures for expeditiously securing the passage of an approved restructuring plan without being subject to delays in the court system.

1 Describe the nature and the effectiveness of the following processes:

a) Civil unsecured debt collection remedies.

Actions to collect unsecured debt are commenced in the Magistrates Court, the Sessions Court or the High Court, depending on the amount of the debt. Debtors must enter an appearance to such proceedings; failure to do so results in a judgment in default being entered. Debtors could face a summary procedure to dispose of claims where there is no credible defense fit to go to trial. If the debtor defends the summary proceedings, the claim goes for a full trial. Winding-up, seizure and sale of assets, garnishment of bank balances or charging order over land and shares are different methods of enforcing judgments. The process leading to judgment can be time consuming, and bad decisions by inexperienced judicial officers are not unusual. The enforcement procedure generally produces results, but it is slow.

b) Secured property enforcement remedies.

Land ownership in West Malaysia is based on a system of land registration backed by a central register administered under the National Land Code 1965 ("NLC"). Land can be charged under the NLC or be subject to a fixed or floating charge under a debenture. Where land is concurrently charged under the NLC and secured by a debenture, a receiver appointed by the debenture holder may not sell the land by private sale. Instead, the debenture holder must take judicial enforcement proceedings under the NLC. However, a receiver can sell land that is subject to a debenture but not to an NLC charge. Rights over land, pending issuance of title, can be assigned to the creditor, leaving the land to be sold by judicial sale. The whole process is subject to delays within the court system, and challenges to the right to sell, or to the mode of sale, can take a long time to resolve, reducing the efficacy of the process.

The holder of a debenture over the assets of a corporation can appoint a receiver and manager with minimal formality. The receiver and manager is normally empowered to run the business of the debtor, and to realize its assets. Again, challenges to the appointment and the conduct of receivers can hold up and impede the receivership because of delays within the court system.

Security can be obtained over shares by way of a legal or equitable charge, which can be privately force-sold. Where the shares deposited are shares in a licensed insurance company or a licensed bank, regulatory body approval is required prior to creation and enforcement.

c) Any special debt collection or secured property remedies that are available to banking sector creditors.

There are no special remedies available to banking sector creditors.

d) Corporate bankruptcy/liquidation processes that are available to corporate debtors and creditors.

Creditors of corporations can initiate winding-up proceedings by filing a winding-up petition under sections 217 and 218 of the Companies Act for inability to pay debts as and when they fall due. If the winding-up order is made, the court will appoint a liquidator, who will oversee the liquidation process to ensure an orderly realization of assets and repayment of creditors and members.

Corporate debtors can initiate voluntary liquidation proceedings by passing a resolution by the statutorily prescribed majority of 75 percent at a general meeting, provided the directors are in a position to declare that the company is solvent, known as members' voluntary winding-up. If the directors are unable to declare that the company is solvent, the creditors can resolve to carry on with the voluntary winding-up in a creditors' voluntary winding-up.

e) Formal corporate rescue processes that are available to corporate debtors and creditors.

The only formal rescue process is the scheme of arrangement pursuant to section 176 of the Companies Act, which can be initiated by the members of a corporation or its creditors. The scheme requires the approval of 75 percent in value and a simple majority in number of each class of creditors present and voting, creditors being divided into classes according to their communality of interests. The debtor decides on how creditors are to be classified, and though creditors can challenge the classification, few do because of the delays in getting a court decision. The scheme must then be sanctioned by the High Court. Pending such sanction, the applicant can apply to the High Court to grant an order staying all proceedings against the company. The procedure is cumbersome and is subject to delays within the court system. Creditors are kept from enforcing security for unduly long periods by the use of temporary restraining orders, which do not rest on sound conceptual ground or precedent.

f) Informal corporate rescue processes.

Informal corporate rescue processes comprise workouts under the Corporate Debt Restructuring Committee ("CDRC") framework, and other private workouts. CDRC only accepts applicants that meet certain eligibility criteria, such as having a potentially viable business and having more than RM50 million worth of debt. CDRC has a secretariat at Bank Negara Malaysia, the Central Bank, which facilitates negotiations between the creditor banks and the debtor, formation of creditors' committees, selection of a lead creditor and the terms of a standstill. During the standstill, consultants may be appointed to study and propose workout proposals.

g) Any other corporate insolvency, or insolvency-related, processes that are available under special legislation.

In 1998, the Malaysian Parliament passed the Danaharta Act. This Act provided for the formation of an asset management company known as the Danaharta Corporation, which would acquire non-performing loans and the underlying security rights from financial institutions. A "Special Administrator" may be appointed by Danaharta, either at its discretion or at the request of the corporate debtor, which becomes known as an "affected person" for the purposes of the Act. The appointment of a Special Administrator must serve the public interest, and one or both of the following purposes: i) the survival of the corporate debtor as a going concern, and ii) a more advantageous realization of its assets than on a winding-up. The breadth of the powers conferred on Special Administrators, and the Parliament's choice of allowing only secured creditors to approve the Special Administrators' plan (to the exclusion of all classes of creditors) has enabled a relatively high number of rescues to be implemented quicker than in a court based rescue. A solitary challenge in the Malaysian courts to the appointment of a special administrator did not succeed, and in any event, an amendment to the legislation, to all intents and purposes, put an end to such challenges.

2 What is the effect upon debt enforcement and secured property enforcement processes of:

a) An adjudication of corporate bankruptcy/liquidation?

Once a resolution for creditors' or members' voluntary liquidation is passed, or an order of court for the winding-up of a debtor is granted, all legal proceedings against a corporate debtor will be stayed, unless leave of court to continue is granted. All dispositions of property of the company are void. However, secured creditors stand outside the liquidation, and may enforce their securities. Leave of court is required if a secured creditor wishes to enforce a National Land Code charge, because under such a charge the beneficial ownership of the land remains with the debtor. Leave is normally granted.

b) The commencement of a formal rescue process?

The scheme of arrangement procedure under section 176 of the Companies Act 1965 does not have any legal effect on debt or secured property enforcement. However, debtor companies usually seek a restraining order for three months against the continuation or commencement of all forms of enforcement proceedings. These orders can be renewed every three months thereafter until the scheme has been sanctioned by the High Court. Extensions of restraining orders are frequently given, though not normally more than once or twice. There have been exceptional situations where orders have been extended many times.

c) The initiation of an informal rescue process?

The CDRC -based informal rescue process only involves bank creditors, and does not result in the interruption of debt or secured property enforcement, unless a standstill has been agreed to.

d) The initiation of an insolvency, or insolvency-related, process under any special legislation?

The appointment of a special administrator gives rise to a moratorium of 12 months duration (subject to extension), during which *inter alia* all proceedings against the company are effectively stayed, winding-up proceedings are dismissed, and no set-off of debts is permitted.

3 What is the effect on the management of a corporation of:

a) An adjudication of corporate bankruptcy/liquidation?

Directors cease to have any powers once a liquidator is appointed by the High Court upon the making of a winding-up order by court or once a liquidator is appointed in a voluntary liquidation.

b) The commencement of a formal corporate rescue process?

The commencement of a formal rescue process has no effect on the management of a corporation.

c) The initiation of an informal corporate rescue process?

The commencement of an informal rescue process has no effect on the management of a corporation.

d) The initiation of an insolvency, or insolvency-related, process under any special legislation?

As long as the appointment of Special Administrators subsists, all powers of directors of the "affected person" are suspended.

4 Who is responsible for "case management" control and administration:

a) A corporate bankruptcy/liquidation?

In a court-ordered winding-up, the court appointed liquidator conducts the liquidation, subject to the supervision of the High Court and the committee of inspection. Creditors and contributories are entitled to give the liquidator directions by way of resolutions passed at the general meetings.

In a voluntary winding-up, the conduct of the liquidation is in the hands of the liquidator, subject to supervision by the committee of inspection, or the creditors (in the absence of a committee).

b) A formal rescue?

From the inception through to implementation of a scheme of arrangement, management would have primary conduct of the process, subject to supervision by the High Court. Occasionally, a "scheme administrator" is appointed under the terms of an approved scheme to oversee it.

c) An informal rescue?

The "Creditors' Committee" formed under the auspices of CDRC would have general control and administration of an informal rescue.

d) A case of corporate insolvency under any special legislation?

In a "Special Administration" under the Danaharta Act, the Special Administrator appointed by the Danaharta Corporation would have control and administration of the process.

5 Who has the responsibility for the preparation of the plan of rescue under:

a) A formal rescue?

It will usually be the management, aided by financial and legal advisers, that formulates a scheme of arrangement in the case of a formal rescue under section 176 of the Companies Act 1965.

b) An informal rescue?

In the case of an informal rescue under the auspices of the CDRC, the creditors' committee will usually appoint consultants to formulate a plan of rescue.

c) A case of corporate insolvency under any special legislation?

It is the duty of a Special Administrator appointed over an "affected person" to prepare and submit to the Danaharta Corporation, as soon as reasonably practicable from the date of his appointment, a proposal setting out a plan for the "affected person". The Danaharta Corporation and an "Independent Advisor" will usually review the plan.

6 How are the different classes of creditors treated in relation to:

a) A corporate bankruptcy/liquidation?

Secured creditors stand outside the winding-up, and may resort to the assets that form part of their security. Holders of rights over property (such as suppliers with the benefit of a reservation of title clause, leasing companies, etc.) may also exercise their rights. The Companies Act 1965 prescribes the order of preferential debts.

b) A formal rescue?

The terms of schemes of arrangements generally provide that secured creditors will receive the highest consideration (whether in the form of cash, or equity as a result of debt to equity conversions, or financial instruments), while other creditors receive much lower levels.

c) An informal rescue?

Informal rescues under the auspices of CDRC mainly deal with restructuring of the bank debt, as opposed to other categories of debt.

d) A case of corporate insolvency under any special legislation?

Proposals in the course of Special Administration are only voted on by secured creditors, who receive first priority. The Act does not take cognizance of claims by unsecured creditors or preferential creditors, who are bound by the decision of secured creditors on the proposal.

7 What is the position of both unsecured and secured creditors who vote against, do not agree with, or do not consent to a plan of rescue in relation to:

a) A formal rescue?

In the case of a scheme of arrangement, if 75 percent of the various classes of creditors have approved the scheme, then once the High Court sanctions or confirms the scheme, it binds all creditors.

b) An informal rescue?

Under the CDRC framework, at the standstill stage, the majority of the creditors must agree on whether or not to accept the workout proposal. The institutions in the minority would be bound by contract to go along with the proposal.

c) A case of corporate insolvency under any special legislation?

Once the proposal is approved with the requisite majority in value of debt by a meeting of secured creditors specially convened for that purpose, it becomes binding on all other creditors, and on the “affected person” and its members.

8 In relation to the need for an insolvent corporation to have urgent working capital funding, what difficulties are encountered in the provision of such funding in relation to:

a) A formal rescue?

While the scheme is pending creditor approval, it is difficult to get urgent capital funding because creditors are reluctant to advance monies when acceptance of the scheme is uncertain. If the scheme was rejected, and the company wound-up, any security for interim new money funding would be vulnerable to being set aside under the Companies Act 1965.

b) An informal rescue?

Reluctance of existing lenders to allow a new lender to inject new monies on an elevated priority are among the difficulties faced by debtors that have opted for the CDRC framework.

c) A case of corporate insolvency under any special legislation?

A Special Administrator has an express power to borrow money and give security over assets of an “affected person”. Any security taken would have the benefit of exemption from the general application of the laws on undue preference under the Danaharta Act.

9 Briefly describe the relevant provisions relating to the setting aside of antecedent and fraudulent transactions in relation to:

a) A corporate bankruptcy/liquidation?

Any payment or conveyance of property by an insolvency debtor within six months of commencement of winding-up (i.e. the date of presentation of the winding-up petition or the date the resolution for voluntary winding-up was passed) would be deemed fraudulent and void. There is protection of *bona fide* transactions without notice of commencement of winding-up. Floating charges created within the same period are also invalid unless it can be shown that the debtor was solvent at the time the charge was created.

b) A formal rescue?

This issue does not generally arise in the context of a scheme of arrangement, where a rescue has been facilitated and a winding-up staved off.

c) A case of corporate insolvency under any special legislation?

The Danaharta Act empowers the Special Administrator to avoid any transfer, mortgage, delivery of goods, payment made or done by or against an "affected person" which would have been void in the liquidation of a company.

10 Are there any provisions of law that might operate to invalidate a secured property transaction in relation to:

a) A corporate bankruptcy/liquidation?

Section 293 of the Companies Act avoids transactions within six months of the commencement of winding-up, and section 294 invalidates floating charges created within six months of commencement of winding-up, unless the company was solvent at creation.

b) A formal rescue?

This issue does not generally arise in the context of a scheme of arrangement, where a rescue has been facilitated and a winding-up staved off.

c) A case of corporate insolvency under any special legislation?

Section 42 of the Danaharta Act empowers the Special Administrator to avoid any transfer, mortgage, delivery of goods, payment or other act relating to any asset made or done by or against an "affected person" which would have been void in the liquidation of a company.

11 Describe the difficulties that are encountered in endeavoring to administer cases of corporate bankruptcy/liquidation and formal corporate rescue that involve property and business interests located in more than one jurisdiction.

Singapore is the only country with which Malaysia currently has reciprocal recognition arrangements, but those arrangements only pertain to personal bankruptcy and not corporate insolvency. Administering corporate liquidations and rescues where assets of a Malaysian company are located in other jurisdictions (or the reverse) will, in either case, pose significant legal and practical difficulties, both to Malaysian insolvency administrators in other jurisdictions and foreign administrators in Malaysia. How Malaysian creditors stand to be treated in relation to assets of a debtor in another jurisdiction *vis-à-vis* creditors in that jurisdiction (and the reverse) has yet to be examined or resolved. This and the absence of significant corporate failures with cross-border implications in Malaysia have meant that, to date, little consideration has been given to cross-border arrangements on recognition and enforcement.

Shearn Delamore & Co

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Financial Issues: Malaysia

PricewaterhouseCoopers

1 Is the restructuring/insolvency legislation generally:

a) Understood?
b) Being followed and/or available opportunities being taken up?
c) Being enforced by relevant authorities?

The Malaysian insolvency and restructuring framework pre-1998 is contained in the following statutes and supplemented by common laws:

- Companies Act 1965.
- Companies (Winding Up) Rules 1972.

Recognizing the severity of the crisis that started in mid-1997, the Malaysian Government swiftly implemented several new measures to address the challenges. Selective capital controls, which included an exchange rate peg to the US Dollar, were introduced to shield Malaysian companies from the destabilizing effects of exchange rate fluctuations.

In mid-1998 the government initiated the establishment of a new restructuring infrastructure comprising three agencies, namely Pengurusan Danaharta Nasional Berhad ("Danaharta") (an asset management company), Danamodal Berhad ("Danamodal") (a bank recapitalization agency) and the Corporate Debt Restructuring Committee ("CDRC") to accelerate restructuring of the banking and corporate sectors.

Danaharta was set up by way of legislation to remove non-performing loans ("NPL") from the banking sector. CDRC was established to restructure, in a less formal environment, the debts of corporate borrowers in excess of RM50 million. Danamodal, a special purpose company, was set up to recapitalize the banks. The establishment of these three agencies expanded the avenues for debt resolution for distressed companies: restructuring could now be carried out with or without formal legal sanctions.

Formal restructuring is effected through the following:

- The company under Part VII of the Companies Act 1965 (commonly referred to as Section 176).
- The Special Administrators under Part VI of the Pengurusan Danaharta Nasional Berhad Act 1998 ("Danaharta Act").
- Receivers and managers under common law.
- Liquidators under Part VII and / or Part X of the Companies Act 1965.

The restructuring without formal legal sanctions is effected through (i) the company voluntarily undertaking private negotiations, and (ii) the company voluntarily seeking CDRC's assistance.

Section 176 of the Companies Act 1965

Section 176 allows a restructuring to proceed under the court's supervision, where the decisions of the majority creditors are binding on the minority creditors. It also gives some assurances against the destruction of viable businesses by unreasonable creditors. In instances where restructuring is not the desired objective, creditors can choose to wind-up distressed companies under Part X of the Companies Act 1965.

Some 40 companies applied for Section 176 in the period up to December 1998. As the court protection under Section 176 allowed the company a moratorium period, many criticisms of the process surfaced, mostly surrounding the ease with which a restraining order ("RO") can be secured by the company against its creditors. The main weaknesses were as follows:

- Lack of transparency.
- Loss of confidence / distrust of current management.
- Doubts as to the credibility and / or viability of any scheme put forward by the company.
- Only a conceptual scheme was in place before RO was granted.
- Creditors were not consulted on the scheme before they were served with the RO.
- Secured creditors' rights and security were prejudiced, as companies could dispose of assets during the period of RO.

These weaknesses, and the government's subsequent decision to amend certain provisions, show that the previous Section 176 process was open to wide interpretation and not well understood. Section 176 was amended in November 1998 and the process to secure a RO is now more transparent. It now requires that the following be put in place:

- The proposal be supported by at least 50 percent of creditors.
- A Statement of Affairs made up to a date not more than three days before application for RO.
- The appointment of a director nominated by a majority of the creditors.

Since the amendments, the popularity of the Section 176 route decreased considerably.

Danaharta

The main objectives of Danaharta are to assist the financial institutions in the asset management and disposition of NPLs, including loan and asset management and restructuring. Danaharta was equipped with a host of legislative powers to expedite its restructuring process – including the power to buy assets through statutory vesting and to appoint special administrators under Part VI of the Danaharta Act .

The Danaharta Act was amended in July 2000 and as at 30 June 2000, Danaharta's results were impressive, having acquired and managed NPLs with loan rights amounting to RM46.7 billion at gross value – RM38.2 billion from the banking system. RM11.1 billion nominal value zero-coupon bonds have been issued up to March 2000 as consideration for the loan acquisitions. To date, Danaharta has appointed Special Administrators to manage some 75 companies, with five of these culminating in successful restructurings so far. To date, Danaharta has appointed Special Administrators to manage some 75 companies. So far, the services of the Special Administrator to five of these companies have been terminated upon the companies' successful restructuring.

Danaharta is well into the asset management and disposal phase of its operations. As at 30 June 2000, Danaharta had restructured and disposed NPLs with a total gross value of RM32.15 billion, surpassing the initial target of RM30 billion. On the asset management front, Danaharta has conducted its third open tender exercise involving foreclosed properties. As at 30 June 2000, the recovery rate for the foreclosure was 48 percent. Danaharta's second year results indicate that there has been widespread acceptance by financial institutions and borrowers alike of its mode of restructuring.

Receivership and liquidation

The possibility of restructuring companies that are in receivership or liquidation is under-recognized. The common perception is that a company in receivership or in liquidation is beyond salvation. There are, however, exceptions where prompt action was taken on companies that had core viable businesses (Socoil Corporation Berhad and Radio & General Sdn Bhd).

Private workouts

A private workout refers to a negotiated agreement between the debtors and its creditors outside of the formal restructuring process. Only a few large companies have embarked on restructuring voluntarily without formal legal sanction. Without a formal process, the schemes may not be collectively binding on creditors.

CDRC

The CDRC, a steering committee established to assist in the restructuring of large corporate debts in excess of RM50 million, emulates the "London Approach" model used in the United Kingdom. All applications to the CDRC are made on a voluntary basis. This approach relies on the use of moral suasion to encourage creditors and borrowers to reach mutual agreement. CDRC works within the auspices of Bank Negara Malaysia.

Restructuring efforts under CDRC have succeeded where creditors were willing to abstain from exercising their legal rights to enforce securities over troubled loans. This allowed all parties concerned to work out mutually beneficial solutions. Apart from corporate restructuring, CDRC is also actively looking into the restructuring of transportation, telecommunications and steel industries to ensure that the restructured companies remain viable. With improved conditions in the corporate sector, there has been a reduction in new applications submitted to CDRC since late 1999.

Conclusion

In the application and enforcement of insolvency / restructuring legislation, the key factors are as follows:

- Trust between the company and its creditors.
- Understanding of the impact of the legislation on the proposed restructuring plans.
- A moratorium period pending the approval of a scheme (to ensure no affected party is preferred over another).
- A mechanism to bind affected parties to the restructuring plan.

Based on the results thus far, it would appear that Malaysia's restructuring framework and legislation (old and new) is generally understood and enjoys wide application.

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2 Broadly speaking, in practice, does the restructuring/ insolvency legislation tend to lead to:

a) Early recognition and action on financial difficulties experienced by a corporation?

b) Restructuring alternatives as opposed to liquidation, and if not, why not?

The current insolvency / restructuring framework, except for restructuring under the Danaharta Act, requires the debtor company to initiate the process. However, it is apparent that most debtor companies would attempt to solve the problem first. When they eventually seek professional advice, the financial situation will typically have deteriorated, reducing viable restructuring opportunities. The secured creditors (generally the financial institutions) may be able to pressure the debtor company to recognize its financial difficulties.

The longer-term solution to early recognition does not lie in existing insolvency / restructuring legislation, but in measures initiated to prevent the financial distress from happening or to provide early warning signals. The new Malaysian Code on Corporate Governance promotes the need for more disclosure concerning the financial health of public listed companies.

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3 What are the main practical difficulties being encountered in:

a) The preparation of restructuring plans?

b) The implementation of restructuring plans?

Some of the more common difficulties encountered in the formulation and implementation of restructuring plans are as follows:

Underlying business of the company not viable

In Malaysia, corporate distress did not become systemic. The sectors that were severely hit were finance, property and infrastructure. Therefore, establishing the underlying viability of the businesses in these sectors presented the most immediate challenges.

Owner-managers in denial

From the outset, the owner-managers of a number of troubled companies appeared to be in denial. Only the more acute cases initiated action by seeking a RO under Section 176 of the Companies Act 1965. While under court protection, some companies continued to fund cash flow shortages with inter-company advances, or by extending their working capital cycle.

Difficulties in obtaining funding and support for the company in the short and medium-term

Companies under restructuring found it difficult to obtain funding and support in the short and medium-term. This is because existing creditors, whose earlier debts had not been settled, were unwilling to extend "new money". New creditors were similarly unwilling to extend fresh credit.

The lenders sometimes extended a mix of cash and non-cash facilities to the company debtor. This allowed the debtor company to enjoy uninterrupted operations while it restructured.

Lenders acting too fast or too slow

The lenders' interpretation of the continued value of the loan dictated the speed of their reaction and the options available. The practical difficulties in initiating and formulating restructuring plans arose because of a gap between estimations of the recoverability of the loan values between the lenders and debtors.

Diverse and conflicting agendas

Conflicts arose from the need to balance the requirement for funds / financial trading instruments from financial institutions and continued supplies of raw materials / goods from operational trade creditors.

The number of creditors involved in some restructuring plans also contributed to the protracted time line for completion of negotiations. Occasional diverse and conflicting agendas sent confusing signals during negotiations. This problem was addressed in a number of cases by the setting up of creditors' committees with representation from relevant creditor parties / groups.

Debtors and creditors could also have conflicting agendas. While both sides are interested in preserving the underlying business value and agree that restructuring is the option, expectation gaps occur in negotiating the terms of final settlement.

The appointment of independent professional business advisors facilitates the development of restructuring solutions that recognize all the relevant stakeholders' interests.

No perception of "haircut"

Prior to the recovery, creditors were more prepared to accept a "haircut", since liquidation would be the worse of two options in terms of debt recovery. With rising asset prices and improved business prospects, however, creditors are expecting full repayment, alongside an opportunity to participate in the company's upside potential.

There is a perception that large corporations, particularly public listed companies, have not suffered equitable "haircuts". In reality, there have been a lot of capital reduction exercises that adversely impact shareholders.

Insufficient appreciation of what works on the ground

Given the magnitude of the debt problems, there was sometimes an insufficient appreciation of what works on the ground. This was partly because the newly-established restructuring framework was untested in 1998.

4 To what extent are companies that are going through any formal or informal restructuring merely adjusting their debt/equity structure, rather than genuinely restructuring their business operations?

There are mixed views over the effectiveness of corporate Malaysia's restructuring program, now into its third year. Although the Bank Negara Malaysia has forecasted a growth of 7 percent for 2001, certain areas still require attention before corporate Malaysia can become more resilient. To enhance the values of restructured Malaysian companies, there must be a real focus on corporate governance and sound management.

5 What are the main areas from which funding is generally being utilized by companies which undertake either formal or informal restructuring?

Restructuring requires funding over the immediate, medium and longer term. In Malaysia, the source of funding is independent of whether the restructuring is formal or informal.

Immediate and short-term funding
In order to ensure business operations continue, distressed companies often maximize their operational working capital cycle. Trade creditors and friendly third parties are requested to extend further credit or accept deferred payment. Trade debt collection is more closely monitored. Such actions are often constrained as the distressed companies' trade creditors and debtors are in similar financial difficulties.

Medium and longer-term funding
A number of corporations refinanced their bank borrowings by raising funds in the private debt securities ("PDS") market, taking advantage of the more competitive interest rates, as well as the ability to borrow long-term on a fixed-rate basis. In 1999, the size of the Ringgit bond market grew by 28.1 percent, driven mainly by the higher issuance of PDS for corporate debt restructuring schemes. Post crisis, the Malaysian Government implemented various initiatives to further deepen the bond market. The recent guidelines issued by the Securities Commission ("SC") to liberalize the PDS market include:

- The merit-based approval process was abolished in favor of a disclosure-based regime, providing issuers with greater flexibility and speed, while allowing investors greater access to a diversified range of securities.
- Limited companies can now issue PDS regardless of their credit rating.
- Anyone may enter into repurchase agreement ("repos") transactions in PDS instruments, whether or not the person is a licensed institution under the Banking and Financial Institutions Act.
- Shelf registration of PDS will be permitted. Once companies have obtained shelf registration approval from the SC they are given two years to issue PDS into the market.

The development of the PDS market should reduce over-dependence on the Malaysian banking system (particularly for long-term financing).

The other main means of funding was by equity. Shortage of cash and the need to bring gearing down to manageable levels meant that some creditors were faced with converting their debt into equity. The creditors were offered equity in the restructured NewCo, or direct equity in the distressed company's cash generating operations. With the recovery of the equity markets in early 2000, more creditors were willing to accept equity as a credible means of repayment.

PricewaterhouseCoopers

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Legal issues: Pakistan

Rizvi, Isa & Co

Pakistan has a comprehensive debt recovery and corporate restructuring and insolvency legislative framework. Debt recovery is governed largely by the Code of Civil Procedure 1908. Banking companies are covered by special legislation, the Banking Companies (Recovery of Loans, Advances, Credits and Finances) Act 1997. Corporate restructuring and insolvency laws are based almost entirely on the equivalent English laws and are found in the Companies Ordinance 1984. In an attempt to keep pace with developments in other jurisdictions, the legislature has promulgated other new laws including the Corporate and Industrial Restructuring Ordinance 2000 (concerning the restructuring and management of the non-performing assets of certain banks and financial institutions) and the Companies (Rehabilitation of Sick Industrial Units) Rules 1999.

The issue in Pakistan is not the lack of an adequate and comprehensive legislative framework, but rather the lack of a speedy and efficient implementation process. Legal proceedings are generally protracted, partly due to the caseload.

1 Describe the nature and the effectiveness of the following processes:

a) Civil unsecured debt collection remedies.

Legal proceedings may be instituted against the debtor by the creditor. These will be governed by the provisions of the Code of Civil Procedure 1908 (“the Code”). After hearing the suit in accordance with the Code, the court passes judgment. The creditor must then commence execution proceedings to obtain enforcement. Legal proceedings, however, are generally slow. There is a backlog of approximately 20 years on the original jurisdiction side of the High Court of Sindh and the appeal process can take up to five years.

b) Secured property enforcement remedies.

A secured debt may also be recovered by initiating a suit for damages against the debtor as discussed in Section 1a. In addition, legal proceedings may be commenced against the person providing the security. The nature of the enforcement proceedings will differ according to the nature of the security.

If the debt is secured by a mortgage, then the mortgagee may (at any time after the debt becomes due) institute a suit for foreclosure or sale of the mortgaged property against the mortgagor. Both suits give the mortgagor an opportunity to pay the creditor the amount due to him. If payment is not made within the prescribed time period, then, in the case of a suit for foreclosure, the mortgagor is debarred from redeeming the mortgaged property and is required to give possession of the mortgaged property to the creditor (where necessary). In the case of a suit for sale, if payment is not made within the prescribed time period then the mortgaged property may be sold and the proceeds applied for the repayment of the debt. If the proceeds of sale are insufficient, then the court may pass a decree for the recovery of the balance amount from the mortgagor. The creditor may also institute a suit for the recovery of the amount secured by the mortgage against the mortgagor in a number of different circumstances.

If the debt is secured by a pledge or hypothecation of goods and the debtor makes a default in the payment of the debt, or in the performance of the promise for which the goods were pledged, then the creditor may either initiate a suit against the debtor upon the debt or promise and retain the goods pledged as collateral security, or sell the pledged goods (having given the debtor reasonable notice of the sale). If the proceeds of the sale are insufficient, the debtor is liable to pay the balance amount due and any proceeds in excess of the amount due must be paid by the creditor to the debtor.

The comments in Section 1a above on the protracted nature of legal proceedings are equally applicable here.

c) Any special debt collection or secured property remedies that are available to banking sector creditors.

Banks seeking to recover debts benefit from special legislation in Pakistan. The banking company may institute an action in a banking court if a borrower or customer (including a surety or indemnifier) defaults on a loan or finance provided by a banking company. The advantage of proceedings before banking courts (as opposed to the ordinary courts) is that the banking courts are specialized and follow procedures geared to the expeditious disposal of debt recovery suits. If the debt is secured by a mortgage and the suit filed before the banking court is for its enforcement, the mortgagor is not given the opportunity to pay the creditor the amount due to him – rather, the court will pass a decree for foreclosure or sale at the first instance. If the banking company is seeking to recover the debt through the sale of any property pledged, mortgaged, hypothecated, assigned or otherwise charged as security for the debt, the banking court may at any stage of the proceedings do one of the following:

- Restrain or injunct the sale, creation or transfer of an interest or charge or lease or disposal of the property.
- Attach the property or appoint a receiver for the property.

Also, a banking company may, having obtained a decree in its favor, sell pledged or mortgaged property with or without the intervention of the banking court, either by public auction or by inviting sealed tenders. The proceeds can then be appropriated towards satisfaction of the decree. If the banking company sells or seeks to sell such property, but is unable to obtain voluntary possession for this purpose, the banking court will give possession of such property to the purchaser, or to the banking company, as the case may be.

The Corporate and Industrial Restructuring Corporation has been entrusted with the acquisition, restructuring, rehabilitation, management, disposition and realization of the "non-performing asset(s)" of certain banks and financial institutions in which the Federal Government holds 85 percent or more of the shares. Any financial asset (such as a loan) which is held as an asset in the books of the relevant bank or financial institution and with respect to which the obligor has been in arrears on any payment obligation for a period of more than 365 days, and with respect to which the obligor's outstanding payment obligation exceeds PRs10 million, is a "non-performing asset". The corporation may proceed in respect of the non-performing assets of certain banks and financial institutions in which the federal government holds 85 percent or more of the shares. The corporation is empowered, amongst other things, to acquire, manage, restructure, rehabilitate, sell and dispose of non-performing assets and to initiate actions for the recovery of non-performing assets including filing suits and appeals, entering into settlements through the courts or outside.

The corporation also has, for the purposes of the rehabilitation, management and restructuring of the obligor in respect of whom any non-performing assets and collateral are held by it or on its behalf, been empowered to do the following:

- Request the relevant regulatory body to appoint an administrator to manage the obligor's affairs.
- Apply to the relevant regulatory body to initiate the sick industrial companies process.

d) Corporate bankruptcy/liquidation processes that are available to corporate debtors and creditors.

Where a company is unable to pay its debts, any creditor or creditors of the company may apply to the court for its winding-up by submitting a winding-up petition. A company is deemed to be unable to pay its debts when, for instance, a creditor to whom the company is indebted for an amount exceeding 1 percent of its paid up capital, or PRs50,000, whichever is less, has made a written demand for its payment and the company has not paid or secured or compounded it to the creditors' satisfaction within 30 days. If the court makes a winding-up order, it will appoint an official liquidator to effect the liquidation.

In addition, if a company is being voluntarily wound-up by its shareholders, its directors are required to make a declaration to the effect that, in their opinion, the company has no debts or that it will be able to pay all its debts within a specified period. If, at any time, the liquidator responsible for the voluntarily winding-up of a company by its shareholders is of the opinion that the company will be unable to pay its debts within the period specified in the declaration, or if that period has expired and the debts have not been paid, then the liquidator is required to summon a meeting of the company's creditors. The creditors may appoint a different liquidator at that meeting. Further, a company that is insolvent and is proposed to be voluntarily wound-up by its shareholders is required to summon a meeting of its creditors. At that meeting, if the creditors nominate a different person from the person nominated by the company as liquidator, then the person nominated by the creditors will be the liquidator responsible for the winding-up.

e) Formal corporate rescue processes that are available to corporate debtors and creditors.

If a compromise or arrangement is proposed between a company and its creditors, or any class of them, the court may, on an application by the company or any creditor or (in the case of a company which is being wound-up) the liquidator, order a meeting of the creditors or a class of creditors to be called and conducted in such a manner as the court directs. If at least 75 percent of the creditors or class of creditors present and voting at such meeting agree to a compromise or arrangement and such compromise or arrangement is sanctioned by the court, then it will be binding on the creditors or class of creditors and the company, or in the case of a company which is being wound-up, the liquidator and the shareholders of the company. If the court is satisfied that a sanctioned compromise or arrangement cannot be worked satisfactorily with or without modifications it may, either on its own motion or upon an application being made by the registrar or any person interested in the affairs of the company, order the winding-up of the company.

A creditor(s) having an interest equivalent in amount to at least 60 percent of the paid up capital of a company may in certain circumstances request the relevant regulatory body to appoint an administrator to manage the affairs of the company. These circumstances can include, for instance, when the affairs of the company are being conducted with an intent to defraud its creditors, or when the accumulated losses of the company exceed 60 percent of its paid-up capital, or when the company has defaulted on the repayment of a debt of PRs1 million or more, as adjudicated by a court.

f) Informal corporate rescue processes.

There is no developed practice regarding such processes in Pakistan.

g) Any other corporate insolvency, or insolvency-related, processes that are available under special legislation.

The Federal Government of Pakistan has set up a Task Force for Revival of Sick Industrial Units which is required to identify sick industrial companies. If the Bankers' Committee is of the opinion that a company owning an industrial unit is facing financial or operational problems, it must report this to the Task Force. If, after considering the Bankers' Committee's report and other evidence, the Task Force is of the opinion that the company is a sick company, it is required to make a reference to the Federal Government. The Federal Government may declare it to be a sick company having considered the Bankers' Committee's report and the Task Force's reference. If the Federal Government declares a company to be a sick company it will ask the Task Force to prepare a plan for its rehabilitation. This must be submitted to the Federal Government for approval. The Federal Government will cause the plan to be published in the official Gazette to ascertain the views of the shareholders, creditors and other concerned persons within a specified period of time. Having considered these views, the Federal Government may approve the rehabilitation plan. Once a rehabilitation plan is approved by the Federal Government it becomes valid, binding and enforceable in all respects notwithstanding anything to the contrary contained elsewhere. The Federal Government may vary or rescind a rehabilitation plan from time to time and may issue directions for its implementation. Implementation will be supervised by the Federal Government or any authority or person authorized by the Federal Government in this regard.

2 What is the effect upon debt enforcement and secured property enforcement processes of:

a) An adjudication of corporate bankruptcy/liquidation?

Once a winding-up order for a company has been passed, no suit or other legal proceedings may be proceeded with or commenced by or against that company except with the leave of, and subject to any terms imposed by, the court responsible for the winding-up. The court may entertain or dispose of any suit or proceeding by or against the company.

b) The commencement of formal corporate rescue process?

The court may, at any time after application for a compromise or arrangement between a company and its creditors or any class of them is made to it, stay the commencement or continuation of any suit or proceeding against the company on such terms as it sees fit until the application is finally disposed.

c) The initiation of an informal corporate rescue process?
There is no experience of such processes in Pakistan.

d) The initiation of an insolvency, or insolvency-related, process under any special legislation?
There is no specific effect under the Sick Industrial legislation mentioned earlier.

3 What is the effect on the management of a corporation of:

a) An adjudication of corporate bankruptcy/litigation?
The court will appoint an official liquidator and the management of such company will, in effect, vest in the official liquidator. In any voluntary winding-up, upon the appointment of a liquidator, all the powers of the directors, chief executive and other officers cease and management, in effect, vests in the liquidator.

b) The commencement of a formal corporate rescue process?
Where an application is made to the court for sanctioning a compromise or arrangement between a company and its creditors (or any class of them) and the compromise or agreement is for the purposes of a scheme of reconstruction or amalgamation of a company, then the court may make orders to facilitate the transfer of the whole or any part of the undertaking of a company, which may effect the management of the company.

c) The initiation of an informal corporate rescue process?
There is no experience of such processes in Pakistan.

d) The initiation of an insolvency, or insolvency-related, process under any special legislation?
The rehabilitation plan prepared by the Task Force and approved by the Federal Government in respect of a sick industrial company may contain such provisions as are deemed appropriate by the Task Force / Federal Government for the rehabilitation, reconstruction and re-organization of the company, including the removal and appointment of directors and other officers of the company. Essentially, a sick industrial company must be managed in accordance with the provisions of its rehabilitation plan.

4 Who is responsible for “case management” control and administration:

a) A corporate bankruptcy/liquidation?
The “case management” control and administration for a compromise or arrangement for the winding-up of a company by the court vests in the court and the official liquidator, and in the event of a voluntary winding-up, it vests in the company, the creditors and the liquidator.

b) A formal rescue?
The “case management” control and administration for a compromise or arrangement between a company and its creditors or any class of them vests in the court and any person appointed by the court to effect the compromise or arrangement.

c) An informal rescue?
There is no experience of this process in Pakistan.

d) A case of corporate insolvency under special legislation?
The “case management” control and administration in respect of a sick industrial company vests in the Task Force and the Federal Government.

5 Who has the responsibility for the preparation of the plan of rescue under:

a) A formal rescue?
In the event of an application for a compromise or arrangement between a company and its creditors or a class of them the court will, most likely, require the applicant to prepare the plan of rescue.
b) An informal rescue?
There is no experience of this process in Pakistan.

c) A case of corporate insolvency under any special legislation?
Where a sick industrial company is concerned, the rescue plan will be prepared by the Task Force and may be amended prior to approval and thereafter by the Federal Government.

6 How are the different classes of creditors treated in relation to:

a) A corporate bankruptcy/liquidation?
Upon the winding-up of a company, certain debts such as all revenues, taxes, cesses (assessments) and rates payable to the Federal or a Provincial Government and the wages and salaries of, and other payments to, employees are paid in priority to other debts.

b) A formal rescue?
Where an application is made to the court for the sanctioning of a compromise or arrangement between a company and its creditors, or any class of them, and the compromise or arrangement is for the purposes of a scheme of reconstruction of a company, the court may make orders for the purposes of facilitating and effecting the same, which orders may affect the priority of debts.

c) An informal rescue?
There is no experience of this process in Pakistan.

d) A case of corporate insolvency under special legislation?
The rehabilitation plan prepared by the Task Force may reschedule the debts of the company, modify the terms and conditions of any of its outstanding debts and liabilities and vary the rights of any creditors (or class of them), including any relevant security.

7 What is the position of both unsecured and secured creditors who vote against, do not agree with, or do not consent to, a plan of rescue in relation to:

a) A formal rescue?
If a compromise or arrangement is approved by the required majority vote of the creditors (or a class or classes of creditors) and sanctioned by the court, it is binding on all creditors.

b) An informal rescue?
There is no experience of this process in Pakistan.

c) A case of corporate insolvency under any special legislation?
Every rehabilitation plan formulated by the Task Force must be submitted to the Federal Government for approval and the Federal Government will, unless it otherwise decides for reasons to be recorded, publish the plan in the official Gazette to ascertain the views of the shareholders, creditors and other concerned persons before its approval. Creditors should communicate any reservations they might have within the time period specified by the Federal Government. An approved rehabilitation plan is, however, binding on all creditors and the company.

8 In relation to the need for an insolvent corporation to have urgent working capital funding, what difficulties are encountered in the provision of such funding in relation to:

a) A formal rescue?
An insolvent company that wishes to raise working capital urgently by issuing shares at a discount would require approval from its shareholders and the relevant regulatory body.
An insolvent company may face difficulties if it wishes to raise working capital through debt financing. For instance, when providing a financial facility, a bank or other financial institution must ensure, amongst other things, that a certain debt to equity ratio is maintained.

b) An informal rescue?
There is no experience of this process in Pakistan.

c) A case of corporate insolvency under special legislation?
There are no provisions regarding this subject under the Sick Industrial Companies legislation mentioned earlier.

9 Briefly describe the relevant provisions relating to the setting aside of antecedent and fraudulent transactions in relation to:

a) A corporate bankruptcy/liquidation.
A conveyance, mortgage, delivery of goods, payment, execution or other act relating to property made or done by or against a company within six months before the commencement of its winding-up may be deemed a fraudulent preference of its creditors and may, therefore, be invalid. Where a company is being wound-up by the court, any attachment, distress or execution against the estate or effects without the leave of the court or any sale of any of the properties of the company without the leave of the court will be void. A floating charge on the property of the company created within 12 months of its winding-up will, unless the company was solvent immediately after the creation of the charge, be invalid except to the extent of any cash paid at the time of, or subsequent to, the creation of, and in consideration for, the charge.

b) A formal rescue.
The provisions covering attachment, distress or execution against the estate or effects or any sale of any of the properties of the company and with regard to a floating charge are applicable in the case of an application to the court by the creditor(s) for the prevention of mismanagement or oppression as well.

c) A case of corporate insolvency under special legislation.
There are no provisions relating to this subject under the Sick Industrial Companies legislation mentioned earlier.

10 Are there any provisions of a law that might operate to invalidate a secured property transaction in relation to:

a) A corporate bankruptcy/liquidation?
b) A formal rescue?
c) A case of corporate insolvency under special legislation?
Please refer to Section 9 above.

11 Describe the difficulties that are encountered in endeavoring to administer cases of corporate bankruptcy/liquidation and formal corporate rescue that involve property and business interests located in more than one jurisdiction.

If the property of an insolvent company is outside Pakistan, it would need to be dealt with by instituting appropriate proceedings in that jurisdiction. However, if such assets are situated in the United Kingdom, then a decree by a Pakistani court may be able to be executed in the United Kingdom. Under Pakistani law, a decree of any of the superior courts of the United Kingdom can be filed in a Pakistani court and executed in Pakistan as if the decree had in fact been passed there. Reciprocal arrangements in respect of the execution in the United Kingdom of decrees passed by Pakistani courts exist in the United Kingdom.

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Legal issues: Philippines

Abello Concepcion Regala & Cruz

Insolvency proceedings in the Philippines are governed by Act No. 1956, otherwise known as the Insolvency Law, passed in 1909. It vested the courts with jurisdiction over petitions for insolvency and suspension of payments. Presidential Decree No 902-A ("PD 902-A"), passed in 1976 and amended in 1981, vested the Securities and Exchange Commission ("SEC") with jurisdiction over petitions for suspension of payments and rehabilitation filed by corporations, partnerships, and associations. The view has been expressed that the Insolvency Law is "sorely out-dated", that PD 902-A is "skeletal and confusingly written", and both are inadequate and unresponsive to modern business trends, including the need for quick resolution of financial dilemmas. Through the years, rather few entities have resorted to insolvency, suspension of payments and rehabilitation proceedings.

Recent events have heralded important changes in Philippine law on corporate rehabilitation and suspension of payments. The Securities Regulation Code, which took effect on 8 August 2000, transferred jurisdiction over petitions for suspension of payments and rehabilitation for corporations and partnerships from the SEC to the regular courts, except those filed with the SEC as of 30 June 2000, over which the SEC retains jurisdiction until finally disposed. The Supreme Court has recently released the rules of procedure for rehabilitation proceedings.

Even so, the situation remains uncertain. There is now pending in Congress a proposed bill on Corporate Recovery, encompassing provisions on corporate insolvency, rehabilitation, and suspension of payments. The bill, if passed, is expected to change the landscape of Philippine corporate law on insolvency and rehabilitation. It is currently uncertain whether the bill, as presented, will ever be addressed by Congress. In any event, it is anticipated that the bill will not be addressed by Congress any sooner than mid-year 2001.

1 Describe the nature and the effectiveness of the following processes:

a) Civil unsecured debt collection remedies.

An unsecured creditor may file an action for collection against a debtor. In the same suit, the creditor may ask for a writ of preliminary attachment, a provisional remedy whereby property of the defendant is levied upon as security to satisfy whatever judgment might be obtained by the creditor. An attachment is granted only under specific circumstances, usually when there is fraud in contracting or performing the obligation, or when the debtor is about to abscond, or has concealed its property (Section 1, Rule 57, Rules of Court).

Proceedings in the trial court may last up to four years. Where the judgment is appealed all the way to the Supreme Court, the entire proceedings may take from 8 to 10 years. In this sense, the judicial system may not be an effective debt collection remedy.

b) Secured property enforcement remedies.

There are three principal types of security over property – real estate mortgage ("REM"), chattel mortgage, and pledge.

In case of default, the REM may be foreclosed either judicially or extrajudicially. A mortgage is foreclosed judicially if the mortgagee files a complaint in court for foreclosure of the mortgage. It is foreclosed extrajudicially if the mortgagee causes the sale of the property in a public auction in accordance with Act No. 3135, through a sheriff or notary public. Almost all mortgage deeds contain a clause authorizing extrajudicial foreclosure of the mortgage. After foreclosure, the proceeds of the sale are used to settle the obligations secured by the mortgage.

As with REM, in case of default, a chattel mortgage may also be foreclosed judicially or extrajudicially. It is usually foreclosed extrajudicially because of the inconvenience, time and expense that a judicial proceeding would require.

In a pledge, personal property (or the document evidencing the incorporeal right) is delivered to the creditor or to a third person by common agreement of the parties. In case of default, the creditor may foreclose the pledge by having the thing sold at a public auction through a notary public.

Upon foreclosure of a REM or chattel mortgage, the creditor may bring an action against the debtor for any deficiency in case the proceeds of the foreclosure sale are not sufficient to cover the secured obligations. In the case of a pledge, the sale of the thing pledged at a foreclosure extinguishes the principal obligation. If the price of the sale is less than the amount of the principal obligation, the creditor is not entitled to recover the deficiency, notwithstanding any stipulation to the contrary. The creditor, however, is not obliged to foreclose a pledge. It may choose instead to sue in court on the principal obligation.

c) Any special debt collection or secured property remedies that are available to banking sector creditors.

There are no special debt collection or secured property remedies available to banking sector creditors.

d) Corporate bankruptcy/liquidation processes that are available to corporate debtors and creditors.

Please refer to Section 1e below.

e) Formal corporate rescue processes that are available to corporate debtors and creditors.

"Bankruptcy" is referred to in the Philippines as "insolvency". It denotes the state of an entity (or person) that has liabilities greater than its assets. "Corporate rescue" is more commonly known as "rehabilitation".

There are four scenarios for a financially distressed corporation:

Suspension of payments

The proceeding involves a petition by a debtor for the postponement of the payment of its debts pending the approval of an agreement with its creditors. The basis is the debtor's inability to meet its obligations when they respectively fall due, despite the fact that it has sufficient assets to cover all its liabilities. Two thirds of the creditors voting must approve the debtor's proposal, and the claims represented by said creditors must amount to at least three fifths of the total liabilities of the debtor mentioned in the petition.

Petition for suspension of payments with the appointment of a Management Committee or Rehabilitation Receiver

Section 5 of PD 902-A vested the SEC with jurisdiction over petitions of corporations, partnerships, or associations to be declared in a state of suspension of payments in cases where the corporation, partnership or association possesses sufficient property to cover all its debts but foresees the impossibility of meeting them when they respectively fall due, or in cases where the corporation, partnership or association has no sufficient assets to cover its liabilities, but is under the management of a Rehabilitation Receiver or Management Committee created pursuant to PD 902-A. In order to effectively exercise its jurisdiction (as enumerated in Section 5), Section 6 of PD 902-A granted the SEC the power to appoint a Rehabilitation Receiver and to create and appoint a Management Committee to undertake the management of corporations, partnerships or associations in appropriate cases when there is imminent danger of dissipation, loss, wastage or destruction of assets or other properties or paralyzation of business operations of such corporations or entities. Thus, in addition to simple suspension of payments, PD 902-A introduced a variation thereof, or suspension of payments coupled with an application for or the appointment of a Rehabilitation Receiver or Management Committee. This form is what is generally referred to as rehabilitation proceedings in the Philippines.

However, Article 5.2 of the Securities Regulation Code, which took effect on 8 August 2000, transferred from the SEC to the regular courts jurisdiction over petitions of corporations, partnerships and associations for suspension of payments and rehabilitation. The Supreme Court has very recently formed a committee to draft the Rules of Procedure to govern the proceedings for rehabilitation and suspension of payments.

Voluntary and involuntary insolvency

An insolvent debtor who owes debts exceeding 1,000 pesos, may file a petition for involuntary insolvency to be discharged from its debts and liabilities (Section 14, Insolvency Law). An adjudication of insolvency may also be made on the petition of three or more creditors, residents of the Philippines, whose credits accrued in the Philippines, totaling not less than 1,000 pesos (Section 20, The Insolvency Law). Corporations, however, are not entitled to a discharge – both present and future properties are answerable for its past obligations.

Tedious and protracted court proceedings are the major deterrents to effective rehabilitation and insolvency proceedings. Additionally, many debtors, before these proceedings are initiated, may have already disposed of or concealed at least some of their assets.

f) Informal corporate rescue processes.

It is now common in the Philippines for a financially distressed corporation to enter into rehabilitation, debt rescheduling or similar agreements with its creditors. It is believed that this will become more prevalent as creditors generally seek to avoid lengthy court processes where there is even no guaranty of recovery. The agreements may include controls on the finances of the corporation and the disposition of its assets. A creditors' committee may be formed to oversee the implementation of the agreement and even the management of the corporation.

g) Any other corporate insolvency, or insolvency-related, processes that are available under special legislation.

Under Article 1177 of the Civil Code, if the properties of the debtor are not sufficient to satisfy their claims, the creditors may proceed against third persons against which the debtor may have a claim or credit. The same provision allows creditors to bring actions to annul the acts that the debtor may have done to defraud them. This is complemented by Article 1380, which allows creditors, when they cannot collect their claims from the debtor, to bring an action to rescind contracts entered into by the debtor to defraud them. Under Article 1382 of the Civil Code, payments made by the debtor at a time that it was already insolvent, for obligations which are not yet due at the time of payment, may be rescinded.

2 What is the effect upon debt enforcement and secured property enforcement processes of:

a) An adjudication of corporate bankruptcy/ liquidation?

In both voluntary and involuntary insolvency, once the court issues an order declaring the debtor insolvent, all civil proceedings pending against the insolvent debtor are suspended or stayed (Sections 18 and 20, The Insolvency Law). However, mortgages, pledges, attachments, or executions on the property of the debtor duly recorded in the Register of Deeds are not affected (Section 59, The Insolvency Law).

Secured creditors have the following options:

- They may maintain their rights under their security and ignore the insolvency proceedings, in which case, the assignee in the insolvency proceedings will surrender to them the property encumbered.
- They may waive their rights under the security and share in the distribution of the assets of the insolvent debtor.
- They may have the value of the encumbered property appraised and then share in the distribution of the assets of the debtor with respect to the balance of their credit.

b) The commencement of a formal rescue process?

Rehabilitation

All actions for claims (secured and unsecured) against the debtor corporation are suspended upon the appointment of the rehabilitation receiver or management committee (Section 6(c), PD 902-A; *Barotac Sugar Mills, Inc. vs. Court of Appeals, G.R. No. 123379, 15 July 1997*).

Simple Suspension of Payments

No creditor may sue or institute proceedings to collect its claim from the time the petition is filed by the debtor and while the proceedings are pending. This prohibition does not apply to creditors having contractual or legal mortgages (Sections 6 and 9, Insolvency Law).

c) The initiation of an informal corporate rescue process?

Creditors who are parties to a rehabilitation or debt restructuring agreement are bound by the terms thereof, which may include provisions on the suspension of collection or enforcement actions against the debtor. Even before the signing of any agreement, the creditors may have already agreed, in principle, to a debt moratorium for a limited period of time.

d) The initiation of an insolvency, or insolvency-related, process under any special legislation?

In the case of banks or quasi-banks under receivership or liquidation, their assets are deemed in *custodia legis* in the hands of the receiver and are exempt from garnishment, levy, attachment, or execution (Section 30, New Central Bank Act).

In case of insurance companies, the liquidator appointed by the Insurance Commissioner is authorized to convert assets of the insurance company to cash, or sell, or otherwise dispose of the same to settle the liabilities of the company (Section 29, Insurance Code).

3 What is the effect on the management of a corporation of:

a) An adjudication of corporate bankruptcy/liquidation?

In the same order declaring the corporation insolvent, the court will direct the sheriff to take possession of all the corporation's properties until the appointment of a receiver or assignee, to whom the sheriff will convey the assets. The order will effectively displace existing management (Sections 18, 24, and 32, Insolvency Law).

b) The commencement of a formal rescue process?

Rehabilitation

The Rehabilitation Receiver will closely oversee and monitor the operations of the debtor for any sign of mismanagement or dissipation of corporate assets and may recommend the appointment of a Management Committee.

Simple Suspension of Payments

Upon the filing of the petition, the court will prohibit the debtor, during the proceedings (i) from disposing of its property, except in the ordinary operation of business; and (ii) from making any payments other than the necessary or legitimate expenses of its business. The management of the corporation remains with the board of directors and officers.

c) The initiation of an informal corporate rescue process?

The management remains with the debtor corporation unless otherwise provided in the terms of the debt rescheduling or restructuring agreement.

d) The initiation of an insolvency, or insolvency-related, process under any special legislation?

The Monetary Board of the Bangko Sentral ng Pilipinas (“Monetary Board”), under certain circumstances, may appoint a conservator to take charge of the assets, liabilities, and management of a bank having liquidity problems, reorganize its management, collect all debts and exercise all powers necessary to restore its viability. The conservator reports to the Monetary Board and may overrule the actions of the previous management (Section 29, New Central Bank Act).

With the designation of the Philippine Deposit Insurance Company (“PDIC”) as receiver of an insolvent bank, the management passes on to the receiver. The same is true with respect to insurance companies under a receiver or liquidator appointed by the Insurance Commissioner.

4 Who is responsible for “case management” control and administration:

a) A corporate bankruptcy/liquidation?

The insolvency court / receiver has general control over insolvency proceedings. The assignee elected by the creditors has the duty to recover and take possession of all assets of the insolvent, to convert assets into cash, and to settle all accounts between the debtor and its creditors (Section 36, Insolvency Law). The assignee is subject to the control of the court.

b) A formal rescue?

Rehabilitation

The court has general control over rehabilitation proceedings. The Rehabilitation Receiver has the duty to evaluate the feasibility of continuing operations and to restructure and rehabilitate the debtor corporation. However, the court will determine whether or not the continuance of the business of the insolvent is feasible or will work to the best interest of all the affected parties (Section 6(d), Insolvency Law).

Simple Suspension of Payments

The court in which the case is pending has control over the proceedings.

c) An informal rescue?

Usually, the creditors, at times together with the debtor, agree on an administrator for the rehabilitation or restructuring agreement. In general, the administrator ensures that the terms of the agreement are implemented. The administrator is often the creditor with the biggest exposure. In other cases, a rehabilitation committee composed of several creditors oversees the implementation of the agreement.

d) A case of corporate insolvency under any special legislation?

This is discussed under Section 3d above.

Additionally, in the case of banks, if the receiver determines that the institution cannot be rehabilitated, the Monetary Board will notify the board of directors of its findings and direct the receiver to proceed with liquidation. The receiver will then institute liquidation proceedings in court.

In the case of insurance companies, the Insurance Commissioner, the receiver, the liquidator, and the courts interact to control the proceedings.

5 Who has the responsibility for the preparation of the plan of rescue under:

a) A formal rescue?

The petitioning corporation submits a proposed rehabilitation plan, which is ultimately subject to the approval of the court.

b) An informal rescue?

In most cases, the terms of the rescue plan is the result of negotiations between the debtor and its creditors (sometimes assisted by financial advisers).

c) A case of corporate insolvency under any special legislation?

Whenever the Monetary Board designates the PDIC as receiver of an insolvent bank, the receiver determines, whether the bank may resume business with safety to its depositors, creditors and the general public, which determination is subject to prior approval of the Monetary Board (Section 30, New Central Bank Act).

In the case of an insurance company, following the order for the company to cease and desist from transacting business and the designation of a receiver, the Commissioner determines whether the company may be placed in such condition as to resume business with safety to its policyholders and creditors and shall prescribe the conditions under which such resumption of business shall take place (Section 249, Insurance Code).

6 How are the different classes of creditors treated in relation to:

a) A corporate bankruptcy/liquidation?

In insolvency proceedings, credits are paid in accordance with the order of preference set forth principally in the Civil Code. In general, secured creditors enjoy preference over unsecured creditors.

Special preferred credits

Taxes and assessments on specific property enjoy absolute preference. Other liens attaching on specific property enjoy no priority among themselves, but must be paid concurrently and *pro rata*. The *pro rata* rule, however, does not apply to credits annotated in the Registry of Property in virtue of a judicial order, by attachments and executions, which are preferred as to later credits (Articles 2242, 2242, and 2249, Civil Code).

Ordinary preferred credits

With respect to credits that are not secured by any specific property, and credits that are unsecured, they are paid in accordance with an order of preference set forth in Articles 2244 and 2245 of the Civil Code.

Wages and other monetary claims of laborers

There are two interpretations of a Labor Code provision giving wages and other monetary claims of workers preference in case of bankruptcy or liquidation of an employer's business (Article 110, Labor Code). The prevailing view is that, when the creditors' claims do not attach to any specific property, it is an ordinary preferred credit, although it is now first in the list (*Development Bank of the Philippines vs. National Labor Relations Commission, 183 SCRA 328 (1990)*; *Banco Filipino vs. National Labor Relations Commission, 188 SCRA 700 (1990)*; *Hautea vs. National Labor Relations Commission, 230 SCRA 119 (1994)*). The other view is that wages and other monetary claims of workers should be paid in full even before taxes and other claims of the government (*Philippine National Bank vs. Cruz, 180 SCRA 206 (1989)*).

b) A formal rescue?

Rehabilitation

All claims against the corporation, whether secured or unsecured, are suspended upon the appointment of a Rehabilitation Receiver. Secured creditors retain their preference, but enforcement of such preference is suspended. In the event the assets of the corporation are finally liquidated, secured and preferred creditors will have preference over unsecured ones (*Rizal Commercial Banking Corporation vs. Intermediate Appellate Court, GR No. 74851, 9 December 1999*).

Simple Suspension of Payments
Persons having contractual or legal mortgages may refrain from attending the meeting of creditors and from voting therein, and enforce their liens independently of any agreement reached therein. These creditors are not bound by any agreement reached at such meeting, unless they join in the voting, in which case they will be bound in the same manner as the other creditors (Section 9, Insolvency Law).

c) An informal rescue?
The different classes of creditors will be treated in accordance with the terms of the rehabilitation, or debt restructuring or rescheduling agreement, which are binding only upon those creditors, secured and unsecured, who are parties to it.

d) A case of corporate insolvency under any special legislation?
Please refer to Section 6a above.

7 What is the position of both unsecured and secured creditors who vote against, do not agree with, or do not consent to, a plan of rescue in relation to:

a) A formal rescue?
Rehabilitation
All creditors, secured and unsecured, whether or not concurring with the rehabilitation plan approved by the court, are bound thereby. The validity of the liens of secured creditors is not affected, except that enforcement of the liens may be suspended until the rehabilitation proceedings are terminated.

Simple Suspension of Payments
Please refer to Section 6b above.

b) An informal rescue?
Please refer to Section 6c above.

c) A case of corporate insolvency under any special legislation?
In case of banks, when the Monetary Board approves a determination by the receiver that the bank may be rehabilitated, the decision of the Monetary Board is final and executory. (The decision of the Monetary Board may not be set aside by the court except on petition for *certiorari* filed by stockholders representing the majority of the capital stock on the ground that the action taken was in excess of jurisdiction or with grave abuse of discretion.)

8 In relation to the need for an insolvent corporation to have urgent working capital funding, what difficulties are encountered in the provision of such funding in relation to:

a) A formal rescue?
One perceived difficulty arises from the absence of a law enabling a court or administrative body to grant priority or superpriority to “new money” from entities willing to provide such funding after insolvency.

b) An informal rescue?
Please refer to Section 8c below.

c) A case of corporate insolvency under any special legislation?
Existing creditors, stockholders, and other investors are generally hesitant to infuse “new money” to a corporation that is already insolvent.

Where a bank is placed under receivership of the PDIC, and the ailing bank has resorted to advances from the Bangko Sentral, there are difficulties encountered in the re-allocation of security interests over assets of the insolvent bank in relation to the rescuing bank.

9 Briefly describe the relevant provisions relating to the setting aside of antecedent and fraudulent transactions in relation to:

a) A corporate bankruptcy/liquidation?

Under Section 70 of the Insolvency Law, fraudulent transfers of property made within 30 days before the filing of the petition for insolvency, with a view to giving preference to a creditor, which creditor has reasonable ground to believe the following:

- The debtor is insolvent.
- Such disposition of property is made with a view to prevent the same from coming to the assignee in insolvency or to prevent the same from being distributed ratably among the creditors, are void, and the assignee may bring an action to recover the property or its value.

Under Section 37, actions may be brought against persons who (having notice of the insolvency proceedings, or having reason to believe that such proceedings are about to be commenced) conceal, embezzle, or dispose of any property of the debtor, for the recovery of said property or for double its value.

This is also discussed under Section 1f above.

b) A formal rescue?

The SEC has rendered an opinion that Section 70 of the Insolvency Law is applicable to petitions for suspension of payments and rehabilitation filed by corporations, partnerships, and associations. The authors believe that Section 37 of the Insolvency Law, and Articles 1177 and 1380 of the Civil Code, are also applicable in rehabilitation proceedings (Please refer to Section 1f above). These provisions, in general, will allow the assignee or receiver in rehabilitation proceedings to bring actions to set aside fraudulent transactions of the debtor as well as to collect from third persons against which the debtor may have a claim or credit.

c) A case of corporate insolvency under any special legislation?

Please refer to Section 9b above.

10 Are there any provisions of law that might operate to invalidate a secured property transaction in relation to:

a) A corporate bankruptcy/liquidation?

Please refer to Section 9a above.

b) An informal rescue?

Please refer to Section 9b above.

c) A case of corporate insolvency under any special legislation?

Please refer to Section 9c above.

11 Describe the difficulties that are encountered in endeavoring to administer cases of corporate bankruptcy/liquidation and formal corporate rescue that involve property and business interests located in more than one jurisdiction.

The Philippines is not a party to any treaty addressing issues relating to cross-border insolvencies.

Under Philippine law, real property as well as personal property is subject to the law of the country where it is situated (Article 16, Civil Code). Thus, in the case of rehabilitation or liquidation proceedings in the Philippines, the court may not have jurisdiction over properties of the company outside the country.

Foreign bankruptcy or liquidation courts likewise do not have jurisdiction over properties located in the Philippines. If the claim of a creditor is based on a judgment or final order of a tribunal of a foreign country, the creditor must bring suit in the

Philippines to enforce the foreign judgment. Such judgment shall be recognized and enforced by the Philippine court only when the following conditions are met:

- There must be proof of the foreign judgment.
- The judgment must be on a commercial or civil matter.
- The judgment or final order is not repelled by evidence of want of jurisdiction, want of notice to the party, collusion, fraud, or clear mistake of law or fact (Section 50, Rule 39, Rules of Court).

In case of a judgment or final order upon a specific thing, the judgment or final order is conclusive upon the title of the thing. In case of a judgment or final order against a person, the judgment or final order is presumptive evidence of a right as between the parties and their successors in interest by a subsequent title.

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Financial issues: Philippines

PricewaterhouseCoopers

Various pieces of legislation in the Philippines cover insolvency and restructuring, such as the Civil Code, the Corporation Code, Presidential Decree 902-A (which vested certain powers to the Securities & Exchange Commission ("SEC") and the Insolvency Law of 1909.

There are also specialized laws under which insolvency and restructuring proceedings on banks, insurance companies and other financial service institutions are applied. These include Section 30 of RA 7653 (the "New Central Bank Act"), Title XV of PD 612 (the "Insurance Code Insolvency Proceedings") and RA 3591 as amended by RA 7400 (the "Philippine Deposit Insurance Corporation").

Moreover, there is also special status accorded to government-owned banks and corporations in relation to enforcement of their charters (also considered laws) particularly on their rights to unilaterally enforce their rights against debtors in recovering their loans under insolvency proceedings. Several observers have cited these various laws as a cause of confusion, disruption, conflict and / or lack of coverage on some aspects of insolvency cases.

Up to July 2000, there have been two venues for resolving insolvency cases of Philippine corporations (except for banks and insurance companies) – the regular trial courts and the SEC. The former handle petitions for insolvency proceedings while the latter covers petitions for "suspension of payments" and rehabilitation. Most cases on business failures, to date, have taken the SEC route.

The Insolvency Law contains a detailed description of procedures on simple suspension of payments and liquidation.

The SEC follows its own set of rules – "The Rules of Procedure on Corporate Recovery", issued by the SEC in January 2000 and which replaced its former guidelines issued in October 1997, due to the latter's inadequacies. The SEC Rules, to date, have been the primary basis in handling insolvency and restructuring cases of troubled companies.

On 19 July 2000, the Securities Regulation Code was signed into law by the President of the Philippines. The Code mandates that all quasi-judicial cases under the SEC, including cases of suspension of payments and rehabilitation, be transferred to the regular trial courts. Given this new development, uncertainty is expected to prevail until the Supreme Court issues a circular that would mandate how such cases should be handled. As yet the Supreme Court has not reacted publicly to the transfer provisions in the new Code. However, the Supreme Court has constituted a special committee to draft rules of procedure for the courts to follow. At time of writing, no drafts were available for review.

Partly in response to the transfer, the Corporate Recovery Act (HB 11867) ("CRA") was tended for submission to the Philippine Congress. The CRA provides for the liquidation, reorganization and restructuring of corporations other than banks and insurance companies. The Capital Market Development Council has hosted several workshops on the CRA. As a result of such workshops, the CRA may be revised, and submitted to the Philippine Congress no sooner than mid-2001.

1 Is the restructuring/ insolvency legislation generally:

a) Understood?
b) Being followed and/or available opportunities being taken up?
c) Being enforced by relevant authorities?

The insolvency / restructuring legislation is generally understood and implemented, but too many uncertainties have arisen as a result of the transfer of jurisdiction from the SEC to the regular trial courts (see the introductory section above).

At the onset of the regional crisis in 1997, the existence of various pieces of legislation concerning insolvency and restructuring (as mentioned in the introductory section) which are outmoded and lacked detail resulted in some confusion among relevant parties on how and where to take their cases.

These problems, including issues of jurisdiction, were dealt with when the SEC developed more detailed rules on these matters. The SEC initially issued its guidelines in handling suspension of payments and rehabilitation in October 1997 and subsequently replaced them with a new set of rules in January 2000, as the cases became more complex. The rulings made by the SEC in these cases during this period have boosted the SEC's arguments that provisions of the other legislations, especially the Insolvency Law, did not apply with respect to the suspension of payments cases filed with the SEC. As it has evolved over the past years, the insolvency procedure that is most often used is the petition for suspension of payments and corporate rehabilitation proceedings under the SEC. By contrast, only a few cases have been filed with the regular trial courts concerning insolvency.

With the passage of the new law, cases filed with the SEC on or before 30 June 2000 will still remain under the jurisdiction of the SEC until finally disposed. Any cases filed after that date would be subject to dismissal. Petitioning debtors will have to file a petition in a court following the applicable court rules on venue, filing fees, etc. Various parties have expressed doubts as to the capacity and capability of the regular courts to handle these cases. To address the urgent training needs created by the recent transfer of jurisdiction, the Supreme Court in association with the Philippine Judicial Academy will be convening special training courses on general insolvency principles as well as the draft rules (when completed) for judges of the Regional Trial Courts.

2 Broadly speaking, in practice, does the insolvency/ restructuring legislation tend to lead to

a) Early recognition and action on financial difficulties experienced by a corporation?

b) Restructuring alternatives as opposed to liquidation, and if not, why not?

The insolvency / restructuring legislation do tend to lead to early recognition and action on financial difficulties experienced by a corporation. Until recently, the Philippine rules on insolvency were deemed to be somewhat debtor-friendly. However, they are now evolving towards a framework where creditors have a greater say in the outcome of the proceedings.

The SEC Rules of Procedure on Corporate Recovery ("the Rules") encourage the early recognition of financial difficulties and rehabilitation as opposed to liquidation. The goal of the Rules is to give solvent, but temporarily illiquid, companies a short break from creditors in order to reestablish their financial health by the following:

- Allowing management to remain in place (with the proviso that a "receiver" act as a monitor).
- Staying the claims of all creditors.
- Giving the debtor up to six months to obtain approval of a rehabilitation plan.

While the creditors may veto the plan by majority vote, the SEC may override the veto if it finds the veto to be "manifestly unreasonable". However, the Rules are not explicitly clear on the criteria for determining what is a reasonable or feasible plan or on how the SEC will determine whether a debtor is entitled to debt relief.

The other specialized legislation on banks and insurance companies also allow for a period to determine whether a troubled company can still be rehabilitated. If yes, then a receiver, who will oversee the process of rehabilitation, is appointed. If it is determined that no restructuring is possible, then liquidation is commenced and / or the process of a take over by another party is considered.

3 What are the main practical difficulties being encountered in:

a) The preparation of restructuring plans?

b) The implementation of restructuring plans?

The main practical difficulties are listed below.

Corporate groups filing under one petition

The SEC has traditionally allowed groups of affiliated companies to file under one petition. They have done so because of the various cross guarantees among the group members and the need to reach a global solution to the operational problems of the corporate group. This approach, however, has resulted in very complex rehabilitation plans. Creditors of the healthier companies within the group complain that the assets of their debtor companies are being used to pay back the creditors of insolvent companies in the group.

The lack of certainty that the terms of a rehabilitation plan will bind minority dissenting creditors

The Rules state clearly that the claims of creditors are suspended in accordance with the plan's terms and that payments are allowed only if allowed by the plan. Nonetheless, in several high profile rehabilitation cases, the parties have insisted on getting all creditors to voluntarily agree to a plan. In at least one case, a potential white knight investor has conditioned its involvement on obtaining such consensus. This reflects the fear that provisions in the Rules that bind dissenting creditors may conflict with the Civil Code or the Constitution.

An absence of well-respected and capable individuals who are willing to serve as a rehabilitation receiver

Under the Rules, the receiver is supposed to act as a mediator amongst the creditors and between the debtor and the creditors in arriving at a workable solution for rehabilitation. As a result, the SEC favors the appointment of individuals who would command respect among all the parties to the proceedings. However, individuals who command such respect and who are willing to serve as rehabilitation receivers are difficult to find.

The lack of competence and appreciation of SEC hearing officers and regular court judges of business and financial issues/aspects of cases

This has been recognized as a problem at the SEC and will likely continue to be a problem at the regular trial courts until some sort of specialization or training program is established by the Supreme Court.

Lack of appreciation of the value of hiring independent professional consultants to assist troubled companies in crafting restructuring plans

Except in some high profile cases, debtors have tried to develop restructuring plans either in-house or with the aid of parties which may have a conflict of interest. This has led to delays in arriving at mutually acceptable plans with the creditors. The role of independent third parties has also been confined to "comptrollership" functions, i.e. monitoring the cashflows of the debtors on behalf of creditors. However, if creditors are allowed to have more say in the outcome of proceedings, they are likely to support the rehabilitation plan. Debtors should recognize the value that such consultants can add to the development of a rehabilitation plan.

4 To what extent are companies that are going through any formal or informal restructuring merely adjusting their debt/equity structure rather than genuinely restructuring their business operations?

While it is difficult to quantify activities in connection with informal restructuring (as they are usually low profile efforts), the general impression is that informal restructurings focus primarily on debt rescheduling rather than fundamental alterations of the debtor's business operations.

As the focus of most cases filed with the SEC is on "suspension of payments" – the objective of these troubled companies is primarily debt relief. Such cases contain plans for both debt rescheduling and projections on cashflows from restructured operations, including divestments or liquidation of non-core businesses and certain assets.

Some debtors and creditors have also agreed on certain "payment-in-kind" arrangements such as debt-for-property (or asset) and debt-for-equity swaps. Creditors resort to these extra-judicial settlements under the *dacion en pago* clauses in their mortgage contracts. Unsecured creditors, however, have fewer alternatives because of their lower priority rights to payment and their lack of collateral. In several cases, they have had to accept significant discounts on their claims.

Nonetheless, in many cases, formal insolvency proceedings with the SEC (i.e. suspension of payments or rehabilitation) have been used by debtors as an attempt to delay the inevitable (either liquidation, take-over or settlement of debts). As seen in the profile of SEC cases below, the status of almost half of the cases since 1995 have either been withdrawn or denied.

5 What are the main areas from which funding is generally being utilized by companies which undertake either formal or informal restructuring:

Some debtors, particularly conglomerates who have filed petitions as a group (rather than on an individual company basis), have been able to leverage on the cashflows (or even assets and / or shares for debt swap) of its healthy companies to service the debts of its insolvent subsidiaries or affiliates. This is, of course, to the detriment of the creditors of the healthy companies whose best course of action is to appoint comptrollers on said companies to ensure that no such payments are made. Even an appointment of a receiver or management committee by the SEC may not ensure the prohibition of such cross-financing practice or inter-company transactions.

Although the Rules theoretically could allow for post-petition financing with the entry of new creditors or white knight investors (most often in the form of bridge and convertible financing with priority in payment), few if any have taken advantage of that situation. This is more due to the obvious reluctance of Philippine banks to "take out" financing on troubled companies and the growing restrictions imposed by the Central Bank on bank exposures to certain debtors and / or industry sectors.

On the other hand, in the case of insolvent banks, the Bangko Sentral ng Pilipinas provides emergency credit lines under certain terms and conditions and charged to any proceeds should the concerned bank be subsequently liquidated. The Philippine Deposit Insurance Corporation ("PDIC") provides funds to pay depositors of said banks up to its deposit insurance limits. The PDIC, in most instances, also acts as the appointed receiver of such banks by the Central Bank.

Instead, financing comes from the following:

- The sale of non-core assets.
- The cash flow that was previously allocated to debt servicing.

In the past, there have been complaints that certain debtors financed their operations from the sale of goods they were holding in trust for their customers. No such complaints have arisen recently.

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Legal issues: Singapore

Wong Partnership *in collaboration with* **Clifford Chance (Singapore) LLP**

Singapore has a well-established, comprehensive corporate bankruptcy and insolvency statutory framework. Largely set forth in the Singapore Companies Act, its corporate bankruptcy and insolvency laws primarily stem from English and Australian sources and remain similar in many respects to the laws of those jurisdictions. These laws have been progressively developed over the years to keep pace with developments in other jurisdictions having sophisticated legal systems, such as the introduction of judicial management close to the time of the introduction of judicial administration in the United Kingdom. In practice, the Singapore courts have effectively applied these laws. In relation to insolvency situations, the legislation balances the need to protect creditors and to hold management accountable with the practical need to try to preserve businesses that are inherently sound but are suffering unanticipated financial crises.

1 Describe the nature and the effectiveness of the following processes:

a) Civil unsecured debt collection remedies.

Enforcement of a civil unsecured debt begins by filing a Writ of Summons in the Subordinate Courts or Supreme Court for amounts below S$250,000 and amounts of S$250,000 and above, respectively. Creditors may enter default judgment when a debtor fails to enter an appearance to the suit by filing a "Memorandum of Appearance", or when a debtor enters appearance to the suit but fails to file and serve a defense to the claim within the requisite time period.

Except for situations in which a default judgment is entered, the matter typically proceeds to trial in the Subordinate Courts or the High Court (as the case may be) for adjudication. In certain limited circumstances, decisions of the Subordinate Courts can be appealed to the High Court and decisions of the High Court can be appealed to the Court of Appeal.

This multi-tiered system of appeals, although speedy on account of landmark judicial reforms in the 1990s, does increase the legal costs. The costs factor combined with the general judicial policy and case law rules discouraging stays of execution on a judgment pending appeal act as a deterrent to the abuse of appeal procedures by recalcitrant debtors in attempting to delay enforcement of judgment.

Judgment creditors have five ways of enforcing a judgment:

- In garnishee proceedings a judgment creditor seeks to recover the sum owed to it by a judgment debtor from a third party (the garnishee) who is indebted to the judgment debtor. This remedy is especially effective to "garnish" monies in the judgment debtor's bank account and involves a relatively quick time frame of about one month to complete.
- A writ of seizure and sale of the judgment debtor's property (movable or immovable) is effective against unencumbered property. For suits filed in the Supreme Court, a seizure of property could take up to 10 days and the auction date fixed within a time period of about two weeks thereafter. The speed of this remedy makes it a popular choice for judgment creditors.
- Winding-up proceedings are commonly used because of their drastic effect. Some company directors negotiate a settlement with creditors in order to forestall that process. Bankruptcy proceedings in Singapore are analogous to winding-up proceedings except that they operate *vis-a-vis* individuals. Winding-up and bankruptcy petitions are conventionally heard about a month after the filing date of the petitions.
- Judgment debtors can be examined so that information as to their means can be obtained for the purpose of confirming and supplementing existing information known to the judgment creditor to help in identifying suitable modes of enforcing judgments. In the case of a corporate judgment debtor, an officer of the company can be summoned to attend court to be examined on oath by solicitors for the judgment creditors and produce documents. This process takes about two weeks in the High Court.
- Committal proceedings against directors of corporate debtors are taken out to compel compliance with a judgment. Sanctions involve fines or imprisonment.

b) Secured property enforcement remedies.

Security documents usually confer four principal remedies:

- Power of sale of assets.
- Power to appoint a receiver over assets charged.
- Right to take possession of assets.
- Right of foreclosure.

As the first two remedies generally do not involve court proceedings, the secured creditor can readily exercise such powers. In practice, the last remedy is rarely used, as it is only commercially viable if the assets increase in value.

c) Special debt collection or secured property remedies that are available to banking sector creditors.

Banking sector creditors commonly have the following remedies:

- Enforcement of covenant to pay "on demand" in bank security documents that involves a legal suit as outlined in Section 1a above.
- Claims on third-party guarantees or charges given by the corporate debtor's directors that also involve a legal suit.
- Fixed charges over company assets created by appropriate banking documents – assets charged cannot be disposed of without the consent of the debentureholder.
- Floating charges over company assets also created by appropriate banking documents (these are generally vulnerable to subsequent fixed charges, liens and execution creditors).

d) Corporate bankruptcy/liquidation processes that are available to corporate debtors and creditors.

There are two types of voluntary liquidation processes:

- Members' voluntary winding-up activated when the directors make a declaration of solvency in accordance with the Companies Act. (Under Singapore law, the members of a company are those persons that either subscribe to the company's Memorandum of Association or agree to become a member and appear on the company's register of members. A person may purchase shares without becoming their registered holder and thus would be a shareholder, but not a member, in this situation.)
- Creditors' voluntary winding-up in a situation of insolvency. Creditors may appoint their own liquidator in preference to the company's nominated liquidator.

Creditors can petition for the winding-up of a company on the grounds of the corporate debtor's inability to pay its debts as outlined in Section 1a above.

e) Formal corporate rescue processes that are available to corporate debtors and creditors.

There are two regimes available under the Companies Act: (i) a scheme of arrangement and (ii) a judicial management. Both regimes envisage scenarios in which a debt-restructuring plan is approved at a creditors' meeting.

Where a scheme of arrangement or compromise is proposed between a company and its creditors, the court may order the convening of a creditors' meeting, or any class of them, on the application of the company, a member, a creditor or a liquidator. If the court sanctions a compromise or arrangement agreed to by a majority in number representing three fourths in value of the creditors or class of creditors at the meeting, it is binding on all creditors. There are detailed statutory provisions about the information that must be circulated to creditors in the notice summoning the meeting.

Typical schemes of arrangement of insolvent companies involve debt for equity conversions, moratoriums and extended repayment schedules. Another method is procuring that the largest shareholders or trade investors subscribe for new shares in the company.

Judicial management will only be ordered in the following circumstances:

- Where a more advantageous realization of the company's assets could be effected than on a winding-up.
- To enable the company or the whole or part of the undertaking to survive as a going concern.
- To enable a scheme of compromise or arrangement to be approved.

Judicial management, though popular after it was first introduced in 1987, is not presently an automatic first choice for financially beleaguered companies. The alternative regime of schemes of arrangement presents three practical advantages as follows:

- There is less stigma attached to a company undergoing a scheme of arrangement as opposed to a judicial management.
- The directors continue to retain their powers in a scheme of arrangement unlike judicial management as elaborated in Section 3b below.
- There is no need to attempt to forecast a company's future financial health that would otherwise be required in relation to a judicial management.

For these reasons, the commercial sector is generally inclined to favor the use of schemes of arrangement.

f) Informal corporate rescue processes.

Informal corporate rescue processes such as direct negotiations, voluntary arrangements or "standstill" agreements tend to be ineffective where threats of litigation by different creditors bring pressure to bear on the negotiation. However, in cases where key creditors cooperate, consensual restructuring has proven to be effective on account of the following:

- Its privacy (whereas, in contrast, scheme documents become a matter of court and public record and companies undergoing such schemes attract media publicity).
- Its flexibility (whereas amendments to private scheme documents are a matter of contract, amending approved scheme documents to change the general principles of the scheme requires additional court approval).

g) Any other corporate insolvency, or insolvency-related, processes available under any special legislation.

Banks, as debentureholders (the holders of security over all or part of the assets of a company) or trustees for debentureholders, can apply to court to appoint receivers. A court may appoint a receiver even if the security has not yet become enforceable if there is a danger of the assets covered by a debentureholders' charge being dissipated. Such danger has been held to exist where the company ceases to carry on its business and is insolvent or where there are threats of action against the company by other creditors.

If it is necessary to realize the business as a going concern, a receiver and manager may be appointed where there is a charge over the business or undertaking (not merely a specific asset) of the company.

2 What is the effect upon debt enforcement and secured property enforcement processes of:

a) An adjudication of corporate bankruptcy/liquidation?

After the commencement of a winding-up (which is the date the winding-up petition is presented), many significant enforcement proceedings against a company are void. Generally, a winding-up order stays all actions against the company indefinitely.

The power of a secured creditor to appoint a receiver can be exercised after the company has gone into liquidation. Secured creditors may also realize their security and obtain full satisfaction without filing a proof of debt in respect of their claim in the corporate liquidation.

b) The commencement of a formal corporate rescue process?

A petition for judicial management operates as an automatic moratorium on all legal proceedings. Secured creditors may not enforce their security against the company unless the judicial manager or the court allows it.

In the case of a scheme of arrangement, court applications have to be made to stay each pending suit against the company. This is one of the inherent weaknesses of a court-sanctioned scheme of arrangement, as separate court applications that can prove costly and time-consuming are required to restrain legal proceedings against the company.

c) The initiation of an informal corporate rescue process?

The impact of informal debt and secured property enforcement processes on a company are a matter of contract between the company and its creditors. Absent such agreement, creditors are free to pursue their formal remedies with impunity.

d) The initiation of an insolvency, or insolvency-related, process under any special legislation?

An appointment of a receiver and manager neither affects assets that are the subject of a separate security nor debt enforcement.

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3 What is the effect on the management of a corporation of:

a) An adjudication of corporate bankruptcy/liquidation?

The powers of the board of directors cease in a winding-up. Instead, the power to manage the company vests in the liquidator.

b) The commencement of a formal corporate rescue process?

A scheme of arrangement does not necessarily impact on the management of the company. Usually, financial advisors are appointed to advise on the proposed scheme. The powers of a scheme manager are spelled out in scheme documents. In an insolvency restructuring, a committee of participating creditors commonly makes major decisions involving large-sum transactions or sale of assets.

When a judicial management order is issued, the powers and functions of the board of directors are transferred to the judicial manager. The directors only retain certain residual powers to call meetings. The ceding of powers and functions of the board to the judicial manager renders judicial management less attractive to the commercial sector than schemes of arrangement.

c) The initiation of an informal corporate rescue process?

The management of a company is unaffected by the initiation of informal corporate rescue processes.

d) The initiation of an insolvency, or insolvency-related, process under any special legislation?

Only the powers of the company and the directors to deal with assets subject to receivership are affected. Where substantial assets are in the receiver's hands or where a receiver and manager is appointed, the directors' powers are effectively suspended until the receiver hands back the company.

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4 Who is responsible for "case management" control and administration of:

a) A corporate bankruptcy/liquidation?

Up to the point of the liquidation order, responsibilities are as follows:

- The members of the company manage the members' voluntary liquidation process.
- Creditors' voluntary liquidation processes (although initiated by directors) involve creditors in its management process.
- The petitioning creditor manages compulsory liquidation processes.

As from the point of the liquidation order, a liquidator manages the administration processes of liquidation (both compulsory and voluntary).

b) A formal rescue?

The responsibility for managing a formal rescue by way of a scheme of arrangement is on the company and (often) a steering committee of banking creditors. A scheme manager generally manages the administration of a scheme of arrangement itself.

The responsibility for managing a formal rescue by way of a judicial management is on the company itself or a creditor. Either the directors or company may resolve that the company present a petition for judicial management. Where the judicial manager's proposals for rescue have been approved by a majority of creditors in number and value in the creditors' meeting and by the court, the judicial manager must manage the company in accordance with these proposals. The creditors may appoint a committee to supervise the judicial manager.

c) An informal rescue?

The company and its major creditors manage the process of informal rescue.

d) A case of corporate insolvency under any special legislation?

The decision to place a company, or any of its assets, under receivership is made by a debentureholder. Exceptionally, a shareholder could apply to court for the appointment of a receiver and manager in cases of serious disputes among shareholders and a deadlock in the management of the company.

5 Who has the responsibility for the preparation of the plan of rescue under:

a) A formal rescue?

In a scheme of arrangement, the scheme documents incorporating the rescue plan are prepared by financial advisors, vetted by legal advisers, and later implemented by the scheme manager.

A judicial manager must send to the Registrar of Companies, the members and the creditors of the company, a statement of proposals for the achievement of the purposes for which the judicial management order was made. This must be done within 60 days of the judicial manager's appointment (or such longer period as the court may allow).

b) An informal rescue?

The company together with its major (usually banking) creditors generally prepares an informal rescue plan.

c) A case of corporate insolvency under any special legislation?

In a receivership, the ultimate aim is not to effect a plan of rescue but to pay off the creditors on whose behalf the appointment of the receiver or receiver and manager was made.

6 How are the different classes of creditors treated in relation to:

a) A corporate bankruptcy/liquidation?

The following claims (in order of priority) will be paid in priority to all debts (other than secured debts):

- Costs and expenses of winding-up.
- Wages and salaries of employees.
- Retrenchment benefits and *ex-gratia* payments.
- Workmen's compensation.
- Contributions to provident fund.
- Remuneration in respect of vacation leave.
- Taxes.

Unsecured creditors rank *pari passu* amongst themselves.

b) A formal rescue?

There is no legislation under the Companies Act enumerating the priorities of different classes of creditors in relation to a scheme of arrangement and judicial management. However, an insolvent company is likely to be unsuccessful to the extent that it attempts to vary the priorities of classes of creditors in insolvency law as the Singapore High Court has held this to be against public policy.

c) An informal rescue?

This is a matter of contract between the company and its creditors.

d) A case of corporate insolvency under any special legislation?

When a receiver is appointed on behalf of a debentureholder secured by a floating charge, debts which would be preferred in a winding-up (excepting taxes) will receive priority to the claims of the debentureholder. However, it is only where the uncharged assets are insufficient to meet the preferred debts that assets covered by the floating charge would be taken.

7 What is the position of both unsecured and secured creditors who vote against, do not agree with, or do not consent to, a plan of rescue in relation to:

a) A formal rescue?

Creditors (or a class of creditors) that disagree with a proposed scheme of arrangement may vote against it at the court-convened meeting. If their collective votes are more than 25 percent of the valid votes cast at the meeting, the proposed scheme would not be passed. A majority in number representing 75 percent in value of the creditors is required to approve a scheme. Dissenting creditors can appear in court to object to the proposed scheme on the following grounds (among others):

- The class of creditors is not properly constituted.
- The scheme is unfair or unreasonable.
- The scheme is being put forward in bad faith.

If the objections of dissenting creditors are overridden by the High Court, the scheme of arrangement becomes valid and binding on the class of creditors concerned.

Unlike the case of a scheme of arrangement, a debentureholder may effectively veto the making of a judicial management order. However, once a judicial management order is made, a secured creditor is not allowed to vote if the security covers all the debts owed to that creditor, unless the security is surrendered. If the requisite majority of creditors approve the proposals at the creditors' meeting, they will be carried through. If the creditors do not approve the proposals, the court may order that the judicial management order be discharged. The statutory safeguards regulating judicial management are an attractive feature to banking creditors, as they provide certainty and in-built timelines for the judicial manager to accomplish the objectives.

b) An informal rescue?

Creditors who disagree with an informal plan of rescue could scupper the rescue by actively pursuing enforcement proceedings against the company.

c) A case of corporate insolvency under any special legislation?

If a receiver's appointment is valid, in practice, no objections are usually made to the receivership. However, a court-appointed receiver and manager can be discharged if it can be demonstrated that the company's assets were not in jeopardy.

8 In relation to the need for an insolvent corporation to have urgent working capital funding, what difficulties are encountered in the provision of such funding in relation to:

a) A formal rescue?

Banks lend at their own risk and should negotiate fresh security or procure a subordinated debt arrangement. Working capital funding could be built into the proposal (in judicial management or a scheme of arrangement). However, there are no statutory safeguards to assist banks in providing these new emergency lendings.

b) An informal rescue?

There is no legislation providing superpriority for working capital funding hence there are always difficult negotiations between existing creditors who are not providing working capital funding and those that are. Furthermore, there is the issue of existing banking creditors being unwilling to write off outstandings (including interest), thus continuing the company's debt load.

c) A case of corporate insolvency under any special legislation?

A company in receivership faces the practical difficulties described in Section 8a above.

9 Briefly describe the relevant provisions relating to the setting aside of antecedent and fraudulent transactions in relation to:

a) A corporate bankruptcy/liquidation?

Antecedent transactions can be set aside by virtue of Section 329 of the Companies Act read together with Sections 99 and 103 of the Bankruptcy Act. The prohibition is against the transfer of property to creditors, sureties or guarantors of an insolvent company's debts (if made within six months before the date of commencement of the winding-up) which, upon the winding-up of the transferor, puts the transferee in a better position than what would otherwise have been. In the case of unfair preferences to an "associate" (a broadly defined term), such transactions are voidable if made within two years from the date of the commencement of winding-up.

Transactions at an undervalue can be avoided if made within five years from the date of commencement of winding-up by virtue of Section 100(1)(a) of the Bankruptcy Act.

b) A formal rescue?

The catalogue of transactions voidable as unfair preferences in a judicial management includes:

- Settlements.
- Conveyances or transfers of property.
- Charges on property.
- Payments made.
- Obligations incurred.

No similar provisions apply to companies bound by a scheme of arrangement.

c) A case of corporate insolvency under any special legislation?

There are no statutory provisions in relation to a company in receivership.

10 Are there any provisions of law that might operate to invalidate a secured property transaction in relation to:

a) A corporate bankruptcy/liquidation?

Apart from unfair preferences and transactions at an undervalue, where a company has gone into liquidation within six months from the date of creation of a floating charge, Section 330 of the Companies Act invalidates the charge, except to cover the amount of the cash advanced to the company together with interest at 5 percent per annum.

There are no specific legal provisions invalidating the realization of a mortgaged property or a secured property under insolvency law.

b) A formal rescue?

The law on unfair preferences applies to secured property transactions of companies in judicial management, but not to similar transactions in relation to a company bound by a scheme of arrangement.

c) A case of corporate insolvency under any special legislation?

The company has no power to enter into contracts in relation to the business or to sell, pledge or otherwise dispose of the property in the possession of the receiver. Apart from this, there are no specific legal provisions invalidating the realization of security in a receivership.

11 Describe the difficulties that are encountered in endeavoring to administer cases of corporate bankruptcy/liquidation and formal corporate rescue that involve property and business interests located in more than one jurisdiction.

Under Singapore law, the regimes of winding-up and schemes of arrangement may extend to foreign companies, if there is a sufficient connection between the foreign company and Singapore. Dispositions of property of a company (even if situated overseas) are prohibited, subject to the laws and judgments of the courts where the property is located. There are practical difficulties in administering property and business interests located in other jurisdictions. For instance, judgments made by a Singapore court in respect of debts owing by a foreign company are enforceable only in certain Commonwealth countries by virtue of laws governing reciprocal enforcement of foreign judgments. In cases of non-compliance with such judgments, this invariably leads to additional legal proceedings in those countries with attendant costs and expenses.

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Financial issues: Singapore

PricewaterhouseCoopers

1 Is the restructuring/ insolvency legislation generally:

a) Understood?
b) Being followed and/or available opportunities being taken up?
c) Being enforced by relevant authorities?

The Singapore legislation governing the insolvency and restructuring of companies is set out in The Companies Act, Chapter 50, and The Winding-Up Rules. In addition to relatively standard provisions on voluntary and compulsory liquidation and receivership, the legislation provides two other forms of insolvency / restructuring regimes known as Judicial Management and Scheme of Arrangement.

Judicial Management

The Judicial Management provisions of The Companies Act specify that the court may grant a Judicial Management order for the purposes of achieving one or more of the following:

- The survival of a company, in whole or in part, as a going concern.
- The approval of a Scheme of Arrangement between the company and its creditors wherein a compromise is reached between the same in relation to the company's debt obligations.
- A more advantageous realization of the company's assets than would be effected in a liquidation.

Effectively, Judicial Management provides protection from creditors and a moratorium period in which the Judicial Manager explores the options available to restructure the business and / or debt obligations.

Scheme of Arrangement

Scheme of Arrangement is a voluntary arrangement whereby a financial scheme is structured and proposed to the creditors and / or members of a company for acceptance. If approved by a majority in number representing three fourths in value of the creditors or members voting at a meeting called to consider the proposed scheme, it will be binding on all the creditors or members upon endorsement by the court. There is no restriction on the scope or format of a scheme that may be proposed to creditors or members. Accordingly, there is significant flexibility within which proposals can be formulated.

The insolvency and restructuring legislation is generally well understood, applied and closely followed. For example, Vikay Industrial Ltd, a listed company that produces liquid crystals display, sought court protection from creditors and was successfully placed under Judicial Management. Successful voluntary debt workouts involving listed companies include IPC (a computer, telecommunication and electronic equipment manufacturer) and Goldtron Ltd (an electronic and telecommunication product manufacturer and distributor), both of which obtained majority creditor support and court endorsement of their debt restructuring schemes. In the process, the authorities have rendered support and gave due weight to the legislation.

Insolvency and restructuring legislation is being used widely when directors and / or creditors recognize an entity's precarious financial position. When utilized, insolvency and restructuring legislation is strictly enforced by the relevant authorities.

2 Broadly speaking, in practice, does the insolvency/ restructuring legislation tend to lead to

a) Early recognition and action on financial difficulties experienced by a corporation?
b) Restructuring alternatives as opposed to liquidation, and if not, why not?

A company generally does not need to rely on the insolvency / restructuring legislation to recognize its financial difficulties. Directors who are aware of their company's poor financial health will frequently attempt to resolve identified problems internally. Professional help is generally shunned, unless as a last resort. Frequently, professional help is only engaged after extensive pressure from creditor banks and often due to an impasse in negotiations between the company and banks. A professional is often engaged to undertake an independent assessment of the company's financial health in order to identify the options available to the company and the creditor banks.

Although the legislation imposes penalties on directors of companies for wrongful and fraudulent trading, (a situation where a liability is incurred with no reasonable expectation of it being paid), this has not been a positive catalyst for seeking immediate help and protection under the insolvency legislation. Seeking help under insolvency legislation is considered an admittance of incompetence by the directors, which can be perceived as discrediting the social standing of the directors and the company in the industry. Losing effective management control to professionals or public knowledge of such help in dealing with a company's debt obligations is often seen as a "loss of face".

For companies on the verge of insolvency due to a liquidity crisis, the restructuring legislation provides a soft landing for those companies with viable businesses. The legislation can provide assistance in enabling the restructuring of debts.

Notwithstanding the protection that can be afforded to companies in financial difficulty through the legislation, restructuring is often undertaken outside the provisions of legislation and has become a function of professional management. This was frequently the case in the recent Asian financial crisis during which companies carried out voluntary restructuring exercises with the assistance of professionals.

3 What are the main practical difficulties being encountered in:

a) The preparation of restructuring plans?

The main difficulties encountered in the preparation of restructuring plans are as follows:

Lack of viable standalone business

The lack of a viable standalone business to guarantee the survival of a company is often a main difficulty in preparing a restructuring plan that is acceptable to the creditors. It is common that a company may have several lines of business which, although generating a contribution margin, do not have sufficient earning capacity to stand alone once other poorer performing lines of business are disposed. The non-core businesses commonly lack focus and unnecessarily utilize scarce resources.

Unrealistic forecasts

Eager to portray a viable business, management is inclined to set rosy, but unrealistic, forecasts. Failure to achieve ambitious plans may undermine the objective of a restructure plan, as creditors may lose faith in the company through non-performance of plans.

Lack of support

Workable restructuring plans require support from parties both within the company (management and staff) and externally (creditors, suppliers and customers).

A perceived loss in credibility through having to undertake a restructuring can result in key staff leaving and both suppliers and customers adopting a conservative position. Suppliers may refuse to extend further credit and customers may seek alternative supply channels.

Unreasonable creditors' expectation

It is almost certain that there will be creditors who are a stumbling block in the process of obtaining support for any restructuring plan. The unreasonable expectations of such creditors sometimes make a restructuring almost impossible. To make matters worse, the company may be forced to make unrealistic revisions to forecasts in order to gain acceptance from creditors, only to be faced with not achieving these forecasts at a later date.

b) The implementation of restructuring plans?

On the implementation aspect, the main practical difficulties are as follows:

Failing to achieve key performance forecasts

Prior to the implementation of a formal restructuring plan, a company may have been operating under intensive scrutiny of its major creditors, including its bankers. If during this period forecasts have been optimistically set and not achieved, the creditability of the management is often damaged to such an extent that restructuring plan forecasts are not taken seriously.

Lack of support from creditors and banks

A financially bruised company often meets difficulties with getting financial support from its suppliers and bankers. Financiers are wary of such doubtful accounts and would limit their support thereby stifling the corporation's implementation of the restructuring plans.

Lack of internal support

A company undergoing restructuring is generally not well perceived in the eyes of staff or potential employees. Frequently, staff with low morale leave to find more stable jobs with financially sound corporations. Job-seekers would shy away from employment with a corporation that has an uncertain future. As a result, the company often faces staff shortage to help it implement its restructuring plan.

4 To what extent are companies that are going through any formal or informal restructuring merely adjusting their debt/equity structure, rather than genuinely restructuring their business operations?

In almost all instances of insolvency restructuring, the debt / equity structure will be adjusted. Even though a company may dispose of non-core assets, if any, to raise funds to repay liabilities, this is often insufficient and creditors are inevitably asked to accept a "haircut" or take equity in the company in substitution for their debts. This could be in the form of a convertible bond that converts the debt into a long-term debt with an option to convert into equity at maturity. Another possible option could be to pay a small sum up front to the creditors and to convert the balance debt to a medium-term debt with intermittent repayment over several years, or any mixture of cash, bonds and shares.

Rationalization of business operations is likely to be a function of professional management. A company with a professional management team is commonly perceived to be better able to streamline operations and businesses than previous management.

Creditors in Singapore are reasonably well informed of insolvency legislation and their rights. Creditors in Singapore are unlikely to accept the mere adjusting of a company's debt / equity structure without an attempt to genuinely restructure the business to reduce the likelihood of the previous failings being repeated.

5 What are the main areas from which funding is generally being utilized by companies which undertake either formal or informal restructuring?

The main areas of fund raising in a restructuring exercise are as follows:

Tighter working capital cycle

This internal source of funds is derived from primarily cost cutting, maximizing credit and increasing receivable realizations.

Client and creditor support

Supportive clients and creditors are another source of funds. The company's fund position is boosted when clients continue to give business and make early payments for services rendered, and when creditors continue to extend credit and / or agree to a moratorium on past debts, thereby freeing up resources to build up the financial health of a company.

Capital injection

With creditors' support in a restructuring exercise, it is not uncommon for shareholders to show commitment and confidence by injecting more capital funds to the corporation. Externally, venture capitalists are another potential source of funding since it would be timely for them to take a stake in the company when investment terms are favorable.

Banks

Banks continue to be the primary source of financing. It is common for companies to convert existing short-term loans to longer-term loans with repayment over an extended period, and to obtain a new line of facility. However, this is only when the banks are supportive, which happens if there has been a good, long banking relationship. A frequent condition associated with such an arrangement is for a professional advisor to closely monitor the cash flow.

Bonds

To raise funds to finance its restructuring exercise, a company could issue unsecured bonds with attractive coupon payments or embedded options to convert into equity on maturity.

Summary

Provided there is an underlying viable business, there is generally a favorable attitude towards supporting a company in financial difficulty, as long as the restructuring proposals are credible and within a reasonable risk profile.

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Legal issues: Taipei,China

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Taipei,China is a civil law jurisdiction. Creditors' rights are governed by the Civil Code, the Bankruptcy Law, the Company Law and specific laws governing various types of security interests such as the Chattel Secured Transactions Act, or the insolvency of specific types of entities such as the Central Deposit Insurance Act ("CDIA"), which governs the insolvency of banks.

Taipei,China law recognizes and facilitates the creation and enforcement of security interests over fixed assets (land, building and equipment) and over rights (accounts receivables, bank accounts, shares, bonds, etc.), but does not provide for floating charges.

Creditor rights are enforced through a court system which is comparatively mature and independent.

In theory, various types of insolvency proceedings are available. However, for the restructuring of corporations engaged in ongoing businesses of a size and type relevant to institutional creditors, the three proceedings that are relevant are as follows:

- Liquidation bankruptcy under the Bankruptcy Law (the "Bankruptcy Law").
- Corporate reorganization under the reorganization provisions of the Company Law ("Court Reorganization").
- Reorganizations by contract negotiated among the debtor and its creditors outside the judicial system ("Contractual Reorganization").

The primary concerns / difficulties in restructuring in Taipei,China relate to (i) the inability / unwillingness of the courts to take an active role in the selection of bankruptcy trustees / reorganization managers and / or in enforcing compliance with insolvency procedures; and (ii) a mind set among local (particularly government-owned) banks which is inclined not to recognize the depth of problems or the need, for example, to write off debt in a Contractual Reorganization.

Such concerns / difficulties often result in courts (i) permitting Court Reorganization of companies which clearly have no hope of survival; and / or (ii) allowing the debtor's management to remain in control of the process which, in turn, creates a lack of discipline and facilitates extra-legal self-help and other actions that are detrimental to both domestic and foreign institutional creditors. To combat such risks, it is critical that creditors involved in Taipei,China insolvencies pursue an aggressive "hands-on" role in the restructuring.

1 Describe the nature and the effectiveness of the following processes:

a) Civil unsecured debt collection remedies.

An unsecured creditor would normally pursue debt collection in Taipei,China through commencement of an action on the debt in the Taipei,China courts. Actions are commenced by filing a complaint and payment of a court fee of 1 percent of the claim amount. The fee is non-refundable but becomes a part of the claim against the debtor. Provisional attachment of assets prior to commencing court action is available and highly recommended as a means of preserving assets. Provisional attachments, however, do not create a priority. Thus, other attaching creditors would share in any proceeds.

Provisional attachment may be requested *ex parte* upon the following:

- Submission of nominal evidence of the debt.
- Providing the court with the identity and location of the specific assets to be provisionally attached (and evidence that such assets are owned by the debtor).
- Posting of a cash or cash-equivalent bond of from one third to 100 percent of the debt amount at the discretion of the court.
- Paying a court fee of 0.7 percent of the claim amount.

Upon the obtaining of a final judgment and exhaustion of appeals, the creditor may use that judgment to execute against provisionally attached or other locatable assets of the debtor through court seizure and auction.

Provisional attachments can generally be obtained within 1 to 2 weeks. The time required to obtain judgment on the debt (and exhaust appeals) will vary significantly case by case. However, in the absence of special circumstances or appeals, time frames of 6 to 12 months would be normal. Post-judgment execution against assets, once located and seized, normally requires 3 to 6 months. However, substantial delays are always possible in any given case.

Assuming assets can be located, debt actions in Taipei,China courts are viable.

b) Secured property enforcement remedies.

Security over land and chattels is generally created by registration. Security over rights is created by contract, delivery of the instrument evidencing the right and notice to the underlying obligor.

Realization on security in most cases requires foreclosure and auction through the courts. Auction sales are conducted by sealed bid. Foreclosure is commenced by application to the court and a showing that the debt is past due. Judgment on the underlying debt is not required. Upon foreclosure, the court will cause the asset to be appraised, use such appraisal as a “floor price”, schedule an auction date, and accept sealed bids. The highest bid over the floor price is the winning bid. If no bid exceeds the floor price, the auction will be cancelled, the floor price will be reduced (normally, by 20 percent), and the process repeated. Such repetition, with limited exceptions, will continue until a bid over the floor price is received.

There are variations for certain types of assets. For example, if the security is shares of stock listed on an exchange, the auction is replaced by a sale through the normal exchange trading mechanism handled by a court-designated broker or by the Central Depositary, and if the asset is cash (e.g. a bank deposit), auction is not required.

Private sales generally are available only if the owner of the asset agrees thereto after default (agreements permitting private sale that are entered into prior to default are null and void).

Security holders may bid at auction to the same extent as if they were not the security holder. However, foreigners may be subject to foreign ownership restrictions and / or approval requirements related to purchase of land and shares of stock of companies in certain industries (e.g. telecommunications, airlines, shipping, etc.).

Taipei,China’s security foreclosure system is mature and quite viable assuming that the assets have marketable value.

c) Any special debt collection or secured property remedies that are available to banking sector creditors.

There are no special debt collection or secured property remedies available to creditors that are banks but are not available to non-bank creditors.

d) Corporate bankruptcy/liquidation processes that are available to corporate debtors and creditors.

The primary action available for liquidation is bankruptcy. A petition for bankruptcy may be filed by the debtor or by any one or more creditors, and is filed with the court. The court must either accept or reject the petition within seven days. If accepted, the court will appoint a trustee, fix a time within which claims are to be filed and fix a date for the first creditors’ meeting.

Bankruptcy proceedings are rare and generally not viable because of the following:

- Land, building and rights tend to be the subject to security interests and holders of security interests may auction the relevant assets independent from the bankruptcy.
- Assets not subject to security interests (e.g. inventory etc.) tend to disappear through extra-legal self-help measures leaving few, if any, assets to be divided among general creditors.

Bankruptcy proceedings can be very protracted.

e) Formal corporate rescue processes that are available to corporate debtors and creditors.

The formal rescue mechanism available for entities other than banks in Taipei,China is Court Reorganization. Court Reorganization, however, is available only to so-called "public companies" (companies are considered public if, among other criteria, they have paid-in capital of NT$500 million or more).

Court Reorganization may be applied for by the following:

- The debtor's board of directors.
- Shareholders which hold 10 percent or more of the debtor's shares and have held such shares for at least six months.
- Creditors whose claims in amount equal 10 percent or more of the debtor's paid in capital.

Upon filing the petition, the court will issue interim orders which typically bar disposal of assets, payment of debts and transfer of shares. Such orders are valid for 90 days and may be extended twice.

If the court approves reorganization it will appoint a reorganization manager(s) who have powers similar to a receiver / trustee in other jurisdictions and a reorganization supervisor(s) who have certain over-sight powers / responsibilities with respect to the activities of the manager.

The reorganization manager is mandated to continue the business of the debtor, register debts, formulate a plan and obtain approval thereof.

Interested parties are divided into three groups: secured creditors, unsecured creditors and shareholders. The plan must be approved by simple majority vote within each group with the qualification that if the debtor has negative net worth, the shareholders lose their right to vote on the plan. The areas of concern are:

- The fact that reorganization manager(s) / supervisor(s) often are not sufficiently independent from pre-filing managers / owners.
- The fact that interested party groups (secured creditors, unsecured creditors and shareholders) often cannot agree to a plan.
- The lack of court enforcement to prevent extra-legal activities.
- Long delays.

Timing is uncertain at best because long delays in obtaining approval of a plan are not unusual. Based on past experience, the success rate (i.e. the number of cases which result in a company which survives and provides its creditors a reasonable pay back on debt) is very low both because the companies permitted to reorganize are, in fact, often not commercially viable and because the process is not sufficiently disciplined to facilitate fairness.

f) Informal corporate rescue processes.

Informal rescues are solely a matter of contract. To a limited extent the authorities may take steps to "encourage" participation, but to date this author is not aware of legally mandatory participation being imposed.

g) Any other corporate insolvency, or insolvency-related, processes that are available under special legislation.

To date the only special legislation which would likely be relevant is the CDIA, which governs the insolvency of banks.

2 What is the effect upon debt enforcement and secured property enforcement processes of:

a) An adjudication of corporate bankruptcy/liquidation?

If a debtor becomes subject to bankruptcy proceedings, such proceedings would supplant enforcement of general creditor claims, which would be stayed. Secured creditors generally may continue to pursue foreclosure on the assets they hold as security outside the bankruptcy proceedings.

b) The commencement of a formal corporate rescue process?

Upon application for court reorganization, as discussed above, the court will issue an interim stay order pending the court's decision on whether or not to permit the reorganization. Interim stay orders normally stay all collection actions by both secured or unsecured creditors. Although, set-offs generally are not barred.

c) The initiation of an informal corporate rescue process?

Informal rescues (i.e. Contractual Reorganizations) are governed solely by contract and, thus, do not preclude enforcement actions by parties other than those who contractually agree to be bound by the relevant agreements.

d) The initiation of an insolvency proceeding under special legislation?

Initiation of a bank bail-out under the CDIA would result in a stay of all debt enforcement actions against the bank.

3 What is the effect on the management of a corporation of:

a) An adjudication of corporate bankruptcy/liquidation?

Upon commencement of bankruptcy proceedings, the court will appoint a trustee who effectively takes over the role of the board of directors. The prior board of directors loses its authority to act upon appointment of the trustee. Shareholders also lose their powers of governance.

b) The commencement of a formal corporate rescue process?

Upon court approval of Corporate Reorganization and appointment of the reorganization manager(s) and supervisor(s), the reorganization manager(s) effectively acquire the powers of the pre-filing board of directors and the reorganization supervisor(s) effectively acquire a role similar to that of a corporate supervisor. The board of directors, the corporate supervisor(s) and the shareholders all lose their powers to govern the debtor upon such appointments.

c) The initiation of an informal corporate rescue process?

The initiation of negotiations of, or execution of an agreement for, Contractual Reorganization has no impact on the management of and corporate governance powers of the debtor except to the extent the debtor or its shareholders agree to be bound by contract.

d) the initiation of an insolvency, or insolvency-related, process under any special legislation?

In the insolvency of a bank, the Ministry of Finance ("MOF") may appoint the Central Deposit Insurance Corporation ("CDIC") to take over control of the debtor bank in which case the bank's management, board of directors and shareholders lose their power to govern.

4 Who is responsible for "case management" control and administration:

a) A corporate bankruptcy/liquidation?

The trustee has the power to administer a bankruptcy under the general oversight of the court.

b) A formal rescue?

The reorganization manager has the general management / administrative functions in a Court Reorganization. Certain specified actions, however, require approval / agreement of the reorganization supervisor(s) and / or the court.

c) An informal rescue?

Which party(ies) would be responsible is solely a matter of contract. In practice, creditors tend to include in the relevant agreements a concept of a steering committee (normally made up of the largest creditors) who are given authority to make decisions based on a majority vote among themselves. One creditor may then act as the lead bank or chairman of the steering committee.

d) A case of corporate insolvency under any special legislation?

In a bank insolvency, the CDIC takes over this responsibility under the supervision of the MOF.

5 Who has the responsibility for the preparation of the plan of rescue under:

a) A formal rescue?

The reorganization manager is obligated to prepare the plan.

b) An informal rescue?

Who is to prepare the plan is a matter of contract. Generally, the debtor's management (often with the assistance of a designated accounting firm) is required to produce a plan within general parameters outlined in the agreement and to submit such plan for steering committee or creditor approval within some specific period failing which the agreement (and the rescue) terminates.

c) A case of corporate insolvency under any special legislation?

The CDIC and the MOF would develop a plan for a bank.

6 How are the different classes of creditors treated in relation to:

a) A corporate bankruptcy/liquidation?

Secured creditors generally may remove the relevant secured assets and auction such assets outside the bankruptcy proceedings. Any residual proceeds after payment of the secured debt are then returned to the bankruptcy pool.

There are various statutory preferences depending on the nature of the debtor's business or the assets involved. The more significant of these include (the following list is not necessarily exhaustive):

- In an auction or bankruptcy sale of assets, sale related costs have a priority.
- Land value increment tax (a type of capital gains tax on sale of land), customs duties (in the case of duty-deferred, imported chattels) and various other taxes and government charges (but not general income or revenue taxes) have priorities.
- Unpaid employee wages for up to six months rank in priority to general creditors.
- Builders', mechanics' and possessory liens may have priority over general creditors.
- In the sale of a vessel, claims reorganized as maritime liens under the Maritime Law, take preference over unsecured creditors.

b) A formal rescue?

In a Court Reorganization, pre-filing debt is defined as secured debt or unsecured debt. When the plan is developed the plan must be approved by a majority (one dollar / one vote) of the secured creditors and the unsecured creditors. If the debtor has positive net worth, the plan must also be approved by a majority of the shareholders (one share / one vote). If the debtor has negative net worth, shareholders lose their right to vote. In concept, there are no priorities except for those as provided for in the plan. However, it is unlikely that secured creditors will approve a plan that deprives them of the priority provided by their security interests.

Administrative costs and permitted debts incurred in the post-filing conduct of the debtor's business take priority over pre-filing debt.

c) An informal rescue?

In a Contractual Reorganization, each creditor retains its underlying claims and priorities unless such creditor expressly waives or agrees to modify such rights by contract.

d) A case of corporate insolvency under any special legislation?

Priority in the winding-up of a bank is the same as priority in the winding-up of a non-bank. Depositors are treated (in the insolvency) as general creditors. However, because deposits are insured by CDIC, it is likely CDIC would pay out insured depositors and acquire their claims as subrogee.

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7 What is the position of both unsecured and secured creditors who vote against, do not agree with, or do not consent to, a plan of rescue in relation to:

a) A formal rescue?

As discussed above, in Court Reorganizations, each interested party group (secured creditors, unsecured creditors and, if there is positive net worth, shareholders) must approve the plan by majority vote. A creditor / shareholder that is out-voted by the majority is bound by the result.

b) An informal rescue?

A creditor which does not agree to sign the agreement is not bound thereby, and is free to pursue its legal and contractual remedies independently.

Once a creditor signs the agreement, it would be contractually bound by whatever voting mechanisms (e.g. delegation of authority to a steering committee) set out therein.

c) A case of corporate insolvency under any special legislation?

All creditors of a bank would be bound by CDIC's and / or the MOF's decisions.

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8 In relation to the need for an insolvent corporation to have urgent working capital funding, what difficulties are encountered in the provision of such funding in relation to:

a) A formal rescue?

In a Corporate Reorganization, new (post-filing) extensions of credit have priority over pre-filing debt. The primary difficulty is the willingness of banks to extend credit notwithstanding such priority.

b) An informal rescue?

In an informal rescue, unless security is provided, the new debt has no special priority over prior debt. Thus, the primary difficulty is arriving at a financing plan with which all creditors can agree.

c) A case of corporate insolvency under any special legislation?

In a bank insolvency, the supplier of emergency funding is the CDIC or the government.

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9 Briefly describe the relevant provisions relating to the setting aside of antecedent and fraudulent transactions in relation to:

a) A corporate bankruptcy/liquidation?

In a bankruptcy, the trustee may do the following:

- ▲ Apply to the court to set aside any "gratuitous or onerous" acts done by the debtor at any time prior to the adjudication of bankruptcy if such acts are prejudicial to creditors rights and which may be set aside "under general law". General law provides that if a debtor engages in a gratuitous act (e.g. issues a guarantee of third party debt without compensation) and such act jeopardizes a prior creditor, the prior creditor may petition a court to invalidate the act (e.g. invalidate the guarantee).
- ▲ Set aside any security for pre-existing debt created within six months prior to the adjudication of bankruptcy unless there was a pre-existing contractual obligation to provide such security and any prepayment of unmatured debts.

b) A formal rescue?
There are no specific set aside provisions in the Reorganization Law. However, the above gratuitous act concept would apply.

c) A case of corporate insolvency under any special legislation?
In a bank insolvency, the above gratuitous act concept would apply.

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10 Are there any provisions of law that might operate to invalidate a secured property transaction in relation to:

a) A corporate bankruptcy/liquidation?
Please refer to Section 9a above.

b) A formal rescue?
There are no provisions that would invalidate a security interest.

c) A case of corporate insolvency under any special legislation?
Because of underlying banking regulations, security interests generally do not exist over bank assets.

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11 Describe the difficulties that are encountered in endeavoring to administer cases of corporate bankruptcy/liquidation and formal corporate rescue that involve property and business interests located in more than one jurisdiction.

As a general concept, Taipei,China courts most likely do not have jurisdiction over assets located outside Taipei,China and vice versa. The Bankruptcy Law, for example, expressly states that a bankruptcy adjudication outside Taipei,China shall be ineffective as regards the debtors assets located in Taipei,China. Thus, in practice, parallel proceedings may be needed.

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1 Is the restructuring/insolvency legislation generally:

a) Understood?
b) Being followed and/or available opportunities being taken up?
c) Being enforced by relevant authorities?

Under the insolvency laws of Taipei,China a distinction is made between companies that have prospects of survival and those that do not. The Company Law provides for restructuring companies that may be salvaged, while the Bankruptcy Law regulates the winding-up or insolvency procedures for those companies with no real prospect of restructuring.

Prior to the Asian financial crisis, the restructuring legislation was not generally understood or followed and very few cases had been seen in Taipei,China. The financial crisis has, however, seen over 30 public companies face financial difficulty since the second half of 1998, leaving the total corporate bad debt estimated at nearly NT$200 billion (approximately US$6.3 billion). Most of these companies have turned to the restructuring legislation to help solve their debt problems, although many are still under the court's rule. Their final outcomes have yet to be determined. This delay illustrates a slow and unwieldy process that is generally not sufficiently responsive in today's economic circumstances.

According to Article 282 in the Company Law, the board of directors, major shareholders and major creditors of the company may apply for restructuring. The company's property is preserved and creditors cannot make claims during the period of restructuring. Consequently, most restructuring cases have been applied for by the board of directors and major shareholders as a means of obtaining immunity from creditors' claims. The use of the restructuring process for this purpose has caused concern in the banking and financial sector and, as a result, the relevant authorities plan to update the restructuring protection for all interested parties, which will likely lead to stricter conditions and requirements on restructuring applicants.

According to Article 58 in the Bankruptcy Law, the court may declare a company bankrupt on the application of the debtor or the creditors. The court can force the company into bankruptcy under certain circumstances, i.e. if the debtor and its creditors can not reach a settlement. However, cases of forced bankruptcy have been very rare in recent years.

2 Broadly speaking, in practice, does the insolvency/ restructuring legislation tend to lead to:

a) Early recognition and action on financial difficulties experienced by a corporation?
b) Restructuring alternatives as opposed to liquidation, and if not, why not?

The restructuring and insolvency laws do not generally lead to early recognition and action by corporates facing financial difficulties. Article 282 of the Company Law states that a public company can apply under the insolvency / restructuring legislation when its financial difficulties are likely to cause its business to cease or be suspended. In practice, the restructuring procedure is treated as an alternative to liquidation and most of Taipei,China's troubled corporations only apply for insolvency / restructuring protection when their financial difficulties worsen. Major shareholders of these companies generally use their shares as collateral to acquire funding from financial institutions. Shareholders typically fear that if they disclose the company's financial problems share prices would collapse, causing lenders to squeeze their credit and create a sequential impact on the company's finances.

3 What are the main practical difficulties being encountered in:

a) The preparation of restructuring plans?
b) The implementation of restructuring plans?

Article 303 of the Company Law sets out the schedule for preparation of the restructuring plan and Article 304 regulates the scope and content of the plan. Providing a practical and workable financial plan is extremely difficult because of the following reasons:

- The company will lack the resources to implement its recovery plan.
- Experienced employees will likely resign.
- Credit lines will remain restricted.

The legislation does not provide for flexible arrangements to be made with creditors nor does the process proceed quickly enough to deal with a deteriorating financial situation. Consequently, there are very few successful examples of corporate restructuring in Taipei,China.

4 To what extent are companies that are going through any formal or informal restructuring merely adjusting their debt/equity structure, rather than genuinely restructuring their business operations?

The companies that apply for restructuring are usually companies with high debt / equity ratios. The financial problems of numerous companies are derived from over-investment and over-expansion into non-core businesses. Therefore, most restructuring plans focus on the debt-payback schedule and adjusting their debt / equity structure and include the disposal of non-operating assets, organization restructuring and strategic moves into high-growth sectors.

5 What are the main areas from which funding is generally being utilized by companies which undertake either formal or informal restructuring?

In Taipei,China, companies undertaking restructuring find it extremely difficult to acquire funding from formal channels such as capital markets or financial institutions. Few financial institutions will lend money to companies in the process of recovery due to their bad credit rating. Furthermore, public companies in financial difficulty are not allowed by the Securities Exchange Committee to issue new shares to raise money from the public.

Companies facing financial difficulty must search for potential acquirers or investors. However, most of these companies conduct business in traditional sectors, such as food, textile, metal and construction. These are sectors in which few investors are interested.

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Legal issues: Thailand

Siam Premier *in association with* **Allens Arthur Robinson**

Prior to the Asian economic crisis, there had been little use of Thailand's Bankruptcy Act which was enacted in 1940 and provided only for bankruptcy (liquidation) proceedings. Following the Asian economic crisis, the level of reported non-performing loans peaked at approximately 47 percent of the total outstanding credit (according to official figures). The government determined that a rehabilitation procedure should be established to promote economic recovery. In April 1998 amendments to the Bankruptcy Act were enacted to introduce a formal rehabilitation procedure. Further amendments were introduced in 1999 to enhance the efficiency of the bankruptcy and rehabilitations procedures. A specialized Bankruptcy Court was also established in April 1999.

Despite these legislative reforms, it was perceived that the pace of restructuring remained slow. Most restructuring negotiations were taking place informally outside the court system and were often progressing slowly. To help facilitate restructuring, a committee known as the Corporate Debt Restructuring Advisory Committee ("CDRAC") was established by the Bank of Thailand and various associations. In March 1999 a number of financial institution creditors agreed to a framework devised by CDRAC to be applied in informal workouts. The pace of restructuring significantly increased as a result and the official non-performing loan figures have declined.

However, questions exist regarding the quality of some restructuring deals. A common criticism is that the so-called restructuring is no more than an unworkable rescheduling of debts without any realistic expectation that the debtor will be able to comply with the rescheduled timetable for repayment. Some restructuring deals have already failed and are being reworked.

Despite these developments, there have been some successful restructures. These have most commonly occurred where the debtor has been co-operative in the process and where an attempt has been made at operational restructuring as well as realistic financial restructuring with the assistance of independent professional advisers.

1 Describe the nature and the effectiveness of the following processes:

a) Civil unsecured debt collection remedies.

Most civil actions are commenced in the Civil Courts or the Intellectual Property and International Trade Court, which has exclusive jurisdiction, relevantly, over international trade.

Proceedings are conducted on a "installment hearing basis" whereby hearings in a case are scheduled with significant intervals between hearing dates. Even in cases where each party has only two or three witnesses, it is not uncommon for cases to run for two years or more before a judgment is received. The judgment of the court may be appealed. A further appeal to the Supreme Court is possible once a judgment has been obtained. If the debtor does not pay in response to the judgment, the next step is to seek enforcement of the judgment. The plaintiff must assist an execution officer from the Legal Execution Department of the Ministry of Justice to locate and seize assets and receivables of the debtor. The assets are then sold by public auction and the proceeds applied in payment of the debt owed to the plaintiff. However, the plaintiff will not necessarily receive the entire proceeds of asset sales or debts recovered as other judgment creditors can apply to share in the moneys.

b) Secured property enforcement remedies.

The Civil and Commercial Code ("the CCC") recognizes a number of security interests including mortgages, pledges, guarantees and avals which are each discussed below. The CCC also recognizes other forms of security interests, such as warehouse liens and preferential rights.

Mortgages

Land and machinery are the most common types of property over which mortgages may be granted. Machinery mortgages are often cumbersome, as the legislation requires each item of machinery to be registered before a mortgage can be registered over the machinery.

Ordinary civil proceedings in court must be commenced to obtain judgment ordering the enforcement of the mortgage. The mortgagee may ask the court for a judgment ordering the mortgaged property to be seized and sold by public auction or for the mortgaged property to be foreclosed (if interest has been outstanding for five years).

The most common enforcement technique for mortgages is to obtain a judgment ordering seizure and sale by public auction of the mortgaged property. This process normally takes 1-2 years. In the case of land, sales by public auction often do not proceed because the execution officer will not allow the property to be sold unless the bids at the auction are greater than the historical land valuation at the land department. Following the Asian economic crisis, the historical land valuation is often significantly higher than any bidder is prepared to offer in Thailand's presently depressed real estate market.

Pledges

A pledge is a relatively efficient form of security over movable property. Delivery of the pledged property to the pledgee is required. In the case of pledges of shares, the pledge should be noted in the share register of the company. Pledges can be enforced, without having to first obtain a court order, by public auction of the pledged property conducted by the pledgee's appointed auctioneer. Pledges, particularly over shares, are easily and quickly enforced.

Guarantees

Guarantees take the form of suretyship contracts whereby a guarantor agrees to pay a creditor or satisfy a debtor's obligations in the case of the debtor's default. If the guarantor fails to pay, an ordinary civil action must be brought against the guarantor. It is common for directors to provide guarantees of the company's debts, even for public listed companies.

Avals

Payment of a bill of exchange or promissory note may be guaranteed by an aval. The giver of the aval writes the words "Good as Aval" on the bill.

Assignments

Due in part to the inefficiencies in remedies available to creditors under the above security interests, it has become common for debtors to actually assign or transfer property to their creditors, effectively, as security for repayment of their debts. So long as the assignment becomes unconditional in all respects before the debtor is placed into rehabilitation or bankruptcy, the creditor can deal with the property as its own.

A new secured transactions law has been proposed. A draft of the law proposes a form of security over business enterprises.

c) Any special debt collection or secured property remedies available to banking sector creditors.

There are no such special rememdies available to banking sector creditors.

d) Corporate bankruptcy/liquidation processes that are available to corporate debtors and creditors.

Under the bankruptcy procedure, the assets of the bankrupt person or company are liquidated and the proceeds from such liquidation are shared between the creditors. The assets will be insufficient to cover the liabilities of the bankrupt person, and therefore, the creditors will be required to share on a *pro rata* basis.

To place a debtor into bankruptcy it is necessary to establish, among other matters, that the debtor is insolvent and that the petitioner's debt is not less than Baht 1,000,000 for individuals and Baht 2,000,000 for corporate debtors.

Where the petitioner is a secured creditor, it must satisfy the additional criteria and must state in its petition that it will either surrender or value its security.

The courts apply a balance sheet test of insolvency (i.e. whether assets exceed liabilities). A number of presumptions of insolvency are set out in the Bankruptcy Act that assist the petitioning creditor to prove insolvency. To rebut these presumptions the debtor must introduce credible evidence of solvency.

If satisfied, the court will issue a final receiving order over the assets of the debtor and will appoint the official receiver, whose duties are to administer and manage the business affairs and assets of the debtor. All creditors, including the petitioner, are then required to file a claim with the official receiver for the settlement of the debts owed to them.

e) Formal corporate rescue processes that are available to corporate debtors and creditors.

In April 1998 Thailand introduced a formal corporate rescue procedure by inserting Chapter 3/1 into the Bankruptcy Act dealing with business reorganizations. The procedure is commonly referred to as “rehabilitation”. Debtors, creditors or specific government agencies may petition the court for the rehabilitation of a corporate debtor if they can show that the debtor is insolvent, has aggregate debts exceeding Baht 10 million and that there are reasonable prospects of a successful rehabilitation.

Insolvency is considered on the same basis as in the bankruptcy proceedings and can often be hotly contested when an aggressive petition is filed by creditors without the debtor’s consent. The decision of the Central Bankruptcy Court in the rehabilitation case of Thai Petrochemicals Industry in March 2000 was widely misreported as indicating a shift to a cash flow test of insolvency. Rather, the judgment appears to be an indication that the Central Bankruptcy Court will apply the balance sheet test sensibly by valuing assets on a discounted cash flow basis if credible valuation evidence is submitted to the court. The court has indicated that each case will be considered on its own fact. Subsequent judgments in other cases have seen the court accept evidence submitted by the debtor to prove that its assets exceed its liabilities, and therefore, the court has determined that the company is not insolvent.

If the court orders rehabilitation of the debtor, a planner is appointed. The planner must prepare and submit a plan for creditor approval. This process normally takes 3-5 months. Creditors vote on the plan and then it is submitted to the court for approval. The term of the plan must not be more than five years, although the court can extend this period to a maximum of seven years.

The rehabilitation procedure has since its introduction become increasingly more popular and now represents a significant alternative remedy available to creditors and debtors.

f) Informal corporate rescue processes.

In 1998 a framework of principles known as the Bangkok Framework was formulated to provide guidelines for stakeholders in informal debt restructuring negotiations. CDRAC was then established by a number of trade, banking and finance company associations in conjunction with the Central Bank of Thailand (“the BOT”) to help facilitate corporate debt restructurings. In March 1999 CDRAC issued a Debtor-Creditor Agreement and an Inter-Creditor Agreement that were signed by a number of local and foreign financial institutions. These agreements are binding contracts that commit the signatories to follow a set framework to expedite debt restructurings. The agreements bind the creditors who signed up to the terms for all debtors that subsequently sign a Debtor Accession agreeing to be bound by the Debtor-Creditor Agreement. CDRAC targets debtors and asks them to sign a Debtor Accession. If the debtor refuses, the participating creditors are bound to seek to place the debtor into bankruptcy, rehabilitation or take legal proceedings against the debtor.

The agreements establish a process to disclose information, prepare and approve a restructuring plan, mediate debtor-creditor disputes and arbitrate inter-creditor disputes. The agreements were unconditionally binding until 31 December 2000. Now, creditors may elect not to be bound by the agreements by giving 30 days notice in writing.

Creditors who breach the agreement face penalties and fines imposed by the BOT. Few fines have, in fact, been imposed to date.

The CDRAC process begins with a first meeting of creditors to prepare a workout schedule and appoint a "Lead Institution" that helps to co-ordinate the process. A steering committee of creditors may be appointed and, if so, the Lead Institution is the chairman of the steering committee.

The process has, in practice, been very time compliance focused with often inadequate attention paid to the quality or feasibility of restructuring deals.

g) Any other corporate insolvency, or insolvency-related, processes that are available under special legislation.

There are no other insolvency related processes under special legislation.

2 What is the effect upon debt enforcement and secured property enforcement processes of:

a) An adjudication of corporate bankruptcy/liquidation?

The official receiver is joined in all proceedings relating to the debtor's property. The court may make orders as appropriate including for the termination of those proceedings. However, pending a final bankruptcy order, a creditor may bring a civil action for repayment.

The final order for control freezes further claims by creditors to the courts. From the date of the final order, claims may be made under the Bankruptcy Act only.

Orders to enforce judgments are suspended unless completed before the bankruptcy order. Enforcement of these orders is deemed to be complete once the period provided for other creditors to apply for a share of assets under the civil law has expired. These provisions do not affect the rights of secured creditors to enforce their securities.

Secured creditors need not file claims for repayment in the bankruptcy. The secured creditor can stand outside the bankruptcy and simply enforce its security. Alternatively, a secured creditor may choose to participate in the bankruptcy and may file a claim for repayment for the full amount of its debt if it surrenders its security. The secured creditor may also ask the official receiver to liquidate its security, and if so, it may claim for the difference between the sale price obtained by the receiver and its debt. Alternatively, the secured creditor may have its security valued and claim for the difference between its debt and the appraised value. The official receiver may redeem the property at such valuation.

b) The commencement of a formal corporate rescue process?

During rehabilitation, the debtor is provided with many protections intended to implement a standstill on enforcement actions. Any applications for its liquidation, dissolution or bankruptcy, civil complaints or arbitration applications that could affect its assets and enforcement actions by judgment creditors against its assets cannot proceed during this period.

No secured creditor may enforce its securities unless the court orders otherwise. The court may grant permission for such enforcement if the creditor can show that the security it holds is not necessary for a successful rehabilitation of the debtor or that the secured creditor is not sufficiently protected during the rehabilitation. Secured creditors do not forfeit their security during the rehabilitation and maintain priority rights to their security.

Owners of assets material to the business operations of the debtor (for example, leased equipment) may not repossess the assets without court permission.

The debtor cannot transfer assets or incur debts, except in the ordinary course of business, without court approval.

c) The initiation of an informal corporate rescue process?

No automatic stay is imposed on creditors by the CDRAC process. The Bangkok Framework (which is non-binding) envisages that creditors will not enforce their claims during restructuring negotiations. However, there is no binding standstill imposed under the CDRAC process. Separate standstill agreements may be agreed and often an informal standstill takes place during negotiations.

Creditors have agreed in the Debtor-Creditor Agreement to temporarily suspend the requirement for the debtor to pay default interest from the date the debtor signs the Debtor Accession.

d) The initiation of an insolvency, or insolvency-related, process under any special legislation?

There is no such special legislation that applies under these circumstances.

3 What is the effect on the management of a corporation of:

a) An adjudication of corporate bankruptcy/liquidation?

In bankruptcy the official receiver takes control of the debtor's business and assets and the existing management will not have any further powers unless the receiver instructs them to perform some work.

The debtor and its management must provide information on oath to the official receiver and explain the cause of the debtor's insolvency. The debtor and management are also publicly examined in court.

b) The commencement of a formal corporate rescue process?

Upon the appointment of a planner, the assets and business operations of the debtor are placed under the control of the planner. Similarly, once a planner has been appointed all shareholders' rights, other than the right to receive dividends, are vested in the planner. Management must provide information to the planner and can be examined before the court.

Once a plan has been approved by creditors and the court, the administration of the plan will be overseen by a plan administrator who assumes all of the management powers over the debtor's business operations and assets that were previously held by the planner.

Upon successful completion of the rehabilitation plan, the debtor will regain the authority to manage its business operations and assets and the debtor's shareholders will regain their full legal rights as shareholders.

c) The initiation of an informal corporate rescue process?

While a company is undergoing a restructuring under the CDRAC process, the existing management of the company retains control of the company and shareholder rights are not affected.

However, under the Debtor-Creditor Agreement the debtor agrees not to incur any expenses or dispose of assets outside the ordinary course of its business. A number of other restrictions are imposed under this agreement.

Management is required to provide information to creditors subject to confidentiality obligations.

d) The initiation of an insolvency, or insolvency-related, process under any special legislation?

There is no such special legislation that applies under these circumstances.

4 Who is responsible for "case management" control and administration of:

a) A corporate bankruptcy/liquidation?

The official receiver and the Bankruptcy Court administer the bankruptcy. The bankruptcy process is viewed as an inefficient process as it can often take numerous years for the official receiver to liquidate the debtor's property and make distributions to creditors.

b) A formal rescue?

In rehabilitation the planner is responsible for the preparation of the plan and the management of the company. Once creditors and the court approve a plan, a plan administrator is appointed to administer the plan.

The official receiver, via the Business Reorganisation Office, a department of the Legal Execution Department of the Ministry of Justice, undertakes a case management role in all rehabilitations. It is also responsible for assessing claims of creditors, convening meetings of creditors, holding examinations and has a number of other functions during the rehabilitation.

c) An informal rescue?

While a company is subject to the CDRAC process, the existing management remains in control of the company. The company is subject to the restrictions described in Section 3c above.

A committee of CDRAC monitors the progress of the restructuring and considers requests for extensions of deadlines and amendments to the workout schedule for the restructuring. Representatives from CDRAC attend some creditor meetings.

In practice, the Lead Institution together with financial and legal advisers case manage the restructuring.

d) A case of corporate insolvency under any special legislation?

There is no such special legislation that applies under these circumstances.

5 Who has the responsibility for the preparation of the plan of rescue under:

a) A formal rescue?

From the date that its appointment is announced in the Government Gazette, the planner has three months to prepare a plan and present copies to the official receiver and the creditors. With court approval this period may be extended twice for up to one month each time.

Once the plan has been submitted, the official receiver must call a meeting of all creditors to consider approval of the plan. Revisions to the plan may be made and a new planner appointed if the planner does not agree to amendments approved by creditors holding a majority of the debt.

If the creditors' meeting fails to approve a plan, the court may do either of the following:

- Revoke the order granting approval to the rehabilitation, in which case control of the company will be handed back to the previous management.
- If a bankruptcy petition was filed prior to the rehabilitation, place the debtor into bankruptcy.

b) An informal rescue?

Under the CDRAC process, the debtor must formulate the restructuring plan and submit the workout schedule within the specified time frame. This should be done within three months of the first meeting of creditors, extendable for up to two months with the consent of CDRAC.

In practice, the debtor often consults with the legal and financial advisers and creditors to prepare a plan acceptable to all. Often the advisers are instructed to draft the plan. Lengthy negotiations between creditors in relation to inter-creditor issues and between a steering committee of creditors and the debtor take place prior to the submission of the plan by the debtor.

Creditors may propose amendments to the plan and a meeting is held to vote on the plan. If the plan does not receive the requisite level of creditor approval, dissenting creditors may submit an alternative plan. In practice, the debtor will often revise the plan to take into consideration requests from creditors to which the debtor is prepared to agree. A second meeting is held where creditors vote on the debtor's revised plan and submit any alternative plan.

6 How are the different classes of creditors treated in relation to:

a) A corporate bankruptcy/liquidation?

The debtor may propose a composition of the debtor's debts in writing to the official receiver. A special resolution (meaning a resolution by a majority of creditors whose debts equal at least 75 percent of the total debts of creditors present and voting) is required to approve the composition together with approval of the court.

Creditors are not divided into classes for voting or other purposes. Other than in relation to compositions, creditor voting does not play a significant role in the bankruptcy process.

b) A formal rescue?

In rehabilitation creditors are divided into classes by the planner and are specified as such in the plan. The classes are as follows:

- Each secured creditor holding secured debt of not less than 15 percent of the debtor's total debts shall each be classed as a group.
- Other secured creditors.
- Unsecured creditors may be classified into several groups where their claims are similar.
- Subordinated creditors.

Creditors in the same class must be treated equally unless they consent otherwise.

A rehabilitation plan must be approved by a special resolution (see above) of all classes of creditors or at least one class of creditors, provided that creditors (in any class) holding at least 50 percent of the total debts of creditors present and voting voted to approve the plan. However, some creditors are deemed to have voted for the plan, such as creditors who are to be paid in full within 15 days and subordinated creditors.

For voting purposes, foreign currency debts are converted into Baht.

If creditors approve the plan, the court will consider whether or not the plan satisfies a number of requirements, such as whether it provides for a better return to creditors than they would receive in bankruptcy.

c) An informal rescue?

At the first and second meetings of creditors under the CDRAC process, approval of the plan requires a special resolution (75 percent in value and more than 50 percent in number of participating creditors). Once approved, the plan is binding on all participating creditors.

However, if at the second meeting a special resolution is not passed but at least 50 percent in value and in number of creditors approve of the proposed plan, the plan is submitted to the Executive Decision Panel of CDRAC for arbitration to resolve any inter-creditor issues.

If, at the second meeting less than 50 percent in number and value of creditors vote for the proposed plan, creditors are compelled to commence the bankruptcy, rehabilitation or other legal proceedings against the debtor.

There is no system for classifying creditors into classes.

d) A case of corporate insolvency under any special legislation?

No such special legislation applies under these circumstances.

7 What is the position of both unsecured and secured creditors who vote against, do not agree with, or do not consent to, a plan of rescue in relation to:

a) A formal rescue?

At the court hearing at which the court considers whether to approve the plan, creditors who did not vote to approve the plan may raise objections to the plan. If after considering the objections, the court approves the plan, it binds all creditors.

b) An informal rescue?

Any creditor whose debt is greater than Baht 1 Billion may elect not to be bound by a decision of the Executive Decision Panel to approve a plan and could then take any action available to it.

In all other cases, once a plan is approved in the CDRAC process, all participating creditors are bound by it and must implement the plan, including, if necessary, by filing a rehabilitation petition and seeking to have a plan approved under the rehabilitation procedure.

c) A case of corporate insolvency under any special legislation?

No such special legislation applies under these circumstances.

8 In relation to the need for an insolvent corporation to have urgent working capital funding, what difficulties are encountered in the provision of such funding in relation to:

Under the Bankruptcy Act, a creditor cannot file a claim for repayment if the creditor allowed the debtor to create the debt at a time when the creditor knew that the debtor was insolvent. However, an exception has been introduced to allow the creditor to claim if the creditor allowed the debt to be created so that the debtor could continue its operations. This exception was introduced in 1999 and removed a significant disincentive to creditors in providing working capital to distressed debtors.

In practice, it remains difficult for many debtors in financial difficulty to obtain working capital.

a) A formal rescue?

Once in rehabilitation, the company and the planner cannot incur debts except where it is essential to enable the debtor to carry on business as normal, unless otherwise ordered by the court. Due to the imprecise nature of the concepts involved here, a prudent planner will seek court approval before obtaining any new working capital.

The law does provide that any creditor who provides finance to the planner or plan administrator need not submit a claim for repayment in the rehabilitation to be entitled to repayment. The law also provides a priority to debts incurred by the planner and plan administrator if the debtor is placed into bankruptcy following the rehabilitation.

b) An informal rescue?

There is no priority extended to creditors who provide working capital or other facilities in a CDRAC restructuring or any other out-of-court restructuring.

c) A case of corporate insolvency under any special legislation?

There is no such special legislation that applies under these circumstances.

9 Briefly describe the relevant provisions relating to the setting aside of antecedent and fraudulent transactions in relation to:

a) A corporate banktuptcy/liquidation.

In bankruptcy, antecedent transactions, such as preferences entered into within the three months (one year for insiders of the debtor, i.e. related parties) and fraudulent transactions entered into within one year before the application for adjudication of bankruptcy can be cancelled by the official receiver. These types of actions have been rare to date.

b) A formal rescue.

In rehabilitation a planner, plan administrator or the official receiver may ask the court to set aside a fraudulent transaction as per above, including any preferences. The time periods are the same as in bankruptcy.

In an informal rescue, while the CDRAC agreements do specify that the debtor shall not make preferential payments to creditors, there is no power afforded to set aside such payments aside from the general CCC provisions under which fraudulent transactions and preferences can be attacked.

CDRAC creditors are required to act in good faith in accordance with the provisions of the agreements. In theory, sanctions from the Bank of Thailand and fines could be levied if it could be said that in receiving or procuring a preferential payment from a debtor the creditor was not acting in good faith.

c) A case of corporate insolvency under any special legislation.
No such special legislation applies under these circumstances.

10 Are there any provisions of law that might operate to invalidate a secured property transaction in relation to:

a) A corporate bankruptcy/liquidation?
b) A formal rescue?
c) A case of corporate insolvency under any special legislation?
The provisions discussed in Section 9 above apply to secured property transactions.

11 Describe the difficulties that are encountered in endeavoring to administer cases of corporate bankruptcy/liquidation and formal corporate rescue that involve property and business interests located in more than one jurisdiction.

A number of problems can be encountered in administrating bankruptcy and rehabilitation cases that involve property or business interests located outside Thailand. Foreign judgments will not be enforced by a Thai Court but may, at the discretion of the Thai Court, be admitted as evidence. However, foreign arbitration awards are recognized. Foreign law will be recognized as the governing law of an agreement only to the extent that the foreign law is proved to the satisfaction of the Thai Court and is not contrary to the public order and good morals of Thailand.

Bankruptcy proceedings apply only to assets of the debtor in Thailand whereas foreign bankruptcy proceedings have no effect on assets within Thailand. In bankruptcy proceedings, foreign creditors can only claim for repayment of their debts if they prove that Thai creditors would be similarly entitled to claim in bankruptcy actions in the foreigner's country. They must also agree to deliver any asset or distribution they have received in any foreign bankruptcy to be added to the debtor's estate in Thailand.

There has been some discussion of adoption of the UNCITRAL Model Law on cross border insolvency.

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Financial issues: Thailand

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1 Is the restructuring/insolvency legislation generally:

a) Understood?

The current insolvency / restructuring legislation in Thailand, the Bankruptcy Act B.E 2483 (AD 1940) as amended by Bankruptcy Act (No5) B.E 2542 (AD 1999), ("the Act"), has only been operative since mid-1998. The revised legislation introduced fundamental changes, including new concepts such as the "planner". Formalized insolvency proceedings were rare in the pre-crisis economic environment and the introduction of the revised restructuring legislation was not widely understood initially. Creditors now have a better understanding of the general concepts, however, the practical application of these concepts has yet to be universally understood.

Rehabilitation provisions of the Act are heavily weighted in favor of creditors, leaving shareholders technically excluded from the process. Shareholders cannot veto a rehabilitation plan that has been approved by creditors and the court.

The legislation is drafted widely and as a consequence, the initial rulings by the Bankruptcy Court Judiciary were not always consistent. This is understandable when considering the previous lack of experience with this aspect of the law. The Ministry of Justice ("MOJ") and the Business Reorganization Office ("BRO") have organized training for the judiciary in the issues facing restructuring companies. Training covers such matters as asset valuation techniques, understanding how corporate feasibility studies are performed and their purpose, learning more about the process of corporate and debt restructuring, and the economic environment that has given rise to the need for restructuring.

The legislation is still not widely understood or acknowledged by other courts (such as the Labor and Civil Courts) and governmental authorities. Experience has shown that there is a gap between the legislation provisions and the required amendment to internal procedures of these organizations.

b) Being followed and/or available opportunities being taken up?

The use of the Rehabilitation process is gaining in acceptance with a total of130 rehabiliation orders granted and a further 19 applications pending as at the end of December 2000.

As a result of the relatively few applications made to use the Rehabilitation process in the early period following the introduction of the new law and the speed of restructuring generally, the Bank of Thailand established the Corporate Debt Restructuring Advisory Committee ("CDRAC") to oversee a framework which provides a timetable and structure for informal restructuring. Under this process creditors party to the agreement (financial institutions subject to the supervision of the Bank of Thailand) are required to institute formal insolvency proceedings at the conclusion of an unsuccessful CDRAC informal process.

Creditors in enforcing their rights against a debtor have not generally applied the legislation in an adversarial context to date. Recent appointments in respect to Thai Petrochemical Industries and Thai Amarit Brewery are exceptions to this trend, which is likely to continue as creditors become more familiar and comfortable with the process.

As noted above, in the event of an unsuccessful outcome following the conclusion of the CDRAC process, the use of the bankruptcy provisions is required by the CDRAC through an obligation of creditor signatories to institute formal insolvency proceedings. However, in practice, creditors have not rigorously pursued the enforcement provisions contained within the process guidelines.

c) Being enforced by relevant authorities?

Enforcement of the Act occurs through the Bankruptcy Court, which is a public and transparent process. Applications to the court are instigated by creditors or the debtor. Increasingly this avenue is being used.

The commitment to the process is evident in the quality of judges appointed to the Bankruptcy Court and the level of training provided to them. The court held a seminar following the first year of its operations for the purpose of reviewing its performance and developing ongoing enhancement to its operations. In addition, a project to strengthen the Business Reorganization Office is planned for this year.

2 Broadly speaking, in practice, does the insolvency/restructuring legislation tend to lead to:

a) Early recognition and action on financial difficulties experienced by a corporation?

The legislation is not generally being applied within the early stages of financial difficulties. It is being applied as a “last resort” under the CDRAC process or within the final stages of a restructuring to cram down on creditors or provide certainty as to liabilities going forward. This is due to a number of factors, including the following:

- The extent of the economic crisis in Thailand, resulting in resources being prioritized to the most distressed situations.
- A lack of provisions within the legislation requiring debtors / directors to proactively take any action if they become aware of insolvency (for example no director personal liability for failure to remit employee tax deductions, as is the case under Australian law).
- The requirement for debtors to admit insolvency at the outset of the process.
- Concern at the exclusion of shareholders from the process after it has commenced, unless there is prior debtor / creditor agreement as to the role of the company / shareholders in formulating the plan.
- The application of the CDRAC process in which debtors are centrally selected for restructuring using a top down approach based on level of debt.
- The provisions of the Act dictate a balance sheet, rather than a cash flow, test of insolvency, resulting in a greater burden in proving insolvency. This may act as a deterrent to creditors in making a contested application and increases the leverage of the debtor. The outcome of the TPI case earlier this year in which a contested application was successful was widely viewed as being pivotal to the future application of the legislation.

As a result of the above issues, planner appointments have tended to occur at the conclusion of a restructuring negotiation, with either a “prepackaged” agreed plan or a high-level understanding of how the plan will be developed. Perceived benefits of using the planner process at this stage are to “lock in” dissenting minority creditors (which may not be possible in an informal restructuring) and to give protection from existing “unidentified” claims. The latter point is particularly important from the perspective of potential new investors.

A number of planner appointments have involved the debtor taking a role in the planner appointment as either sole planner or jointly with creditor / independent representatives. This has resulted in greater debtor acceptance of the process, but only after they are made aware of the scope of their ongoing involvement.

The use of the planner process in the implementation of restructuring provisions reduces practical difficulties in certain processes such as capital reductions and debt / equity conversions, as compared to seeking to implement these actions in an informal restructuring. However, the legislation is being applied at the end of the process.

b) Restructuring alternatives as opposed to liquidation, and if not, why not?

Rehabilitation through the planner process is broadly viewed across all stakeholder groups as a more positive alternative to bankruptcy within Thailand.

This is substantially due to the stigma attached to liquidation. We have seen a number of instances of non-viable companies where restructuring efforts have been pursued in circumstances where liquidation may have been more appropriate.

Other factors that make liquidation an unattractive option are as follows:

- In some instances there is no real break-up value for a business, nor a prospect of sale as a going concern, therefore continued operation by existing stakeholders is seen as the only option.
- Liquidation requires creditors to write off, rather than provide for, a bad debt.

The use of the rehabilitation process is likely to be significantly less time consuming and more straightforward than individual creditors pursuing foreclosure options over pledged assets, which is another option open to individual creditors.

3 What are the main practical difficulties being encountered in:

a) The preparation of restructuring plans?

The following practical difficulties have been encountered in preparing restructuring plans:

- Dealing with individual creditor requirements to find alternative treatments for amounts that should be written off.
- The creditors' desire for incorporating a substantial level of detail in a plan prior to acceptance, rather than agreeing to a plan that is then implemented under broad parameters. The consequence of this is a requirement for detailed work prior to knowing if the plan is accepted.
- The creditors' reluctance to accept the commercial realities of losses.
- Both creditors and other stakeholders concentrating on the financial aspects of a plan, rather than the incorporating into the plan essential non-financial areas, such as accounting systems and corporate governance.

b) The implementation of restructuring plans?

Practical difficulties have been encountered in implementing restructuring plans. Getting regulatory authorities to recognize the restructuring plan has proved difficult. This is problematic because in a number of instances these authorities do not yet have internal systems in place to deal with the provisions of the Act. Difficulty lies in the task of managing "deal creep" and a tendency towards two negotiations, i.e. in agreeing the plan and then the subsequent execution of the related formal transaction documentation.

4 To what extent are companies that are going through any formal or informal restructuring merely adjusting their debt/equity structure, rather than genuinely restructuring their business operations?

There is a widely held view within the financial community in Thailand that the majority of completed restructurings are, in fact, largely rescheduling arrangements (often with grace periods or concessional arrangements on interest / principal repayments) with little genuine financial or operational restructuring taking place. This is supported to some extent by evidence of the return to non-performing loan ("NPL") status of some restructured loans.

The following circumstances contribute to the above trend:

- The reluctance of financial creditors to accept up front principal write-offs.
- The focus of Thai financial creditors on short-term reduction in NPL numbers, due to the positive impact of this on capital adequacy requirements.
- The reluctance of shareholders for up front equity dilution (potential dilution, down the track, as a consequence of future under performance is more acceptable).
- The tendency for management / shareholders to view financial and operational issues as independent issues and a reluctance from the financial creditors to force these issues.
- The tendency for management / shareholders to view all aspects of their business as core, resulting in a reluctance towards divestment or other business restructuring alternatives.

The exception to the above trend has occurred where the restructuring involves the introduction of a new strategic investor taking a majority or substantial equity position. Leverage has existed in these situations to force business or operational changes as a condition of the new investment.

5 What are the main areas from which funding is generally being utilized by companies which undertake either formal or informal restructuring?

As noted above, the majority of restructurings completed to date have not included, to any significant extent, new funding either by way of equity or debt. An exception is the restructurings that are effectively asset sale transactions involving the near or total dilution of existing shareholder interests, for example the case of Alphatec.

A number of restructurings have been undertaken on a "cashless basis", involving the rescheduling of debt repayment obligations to match forecast future cash flows. A number of these have been based on projections that assume an early return to pre-crisis economic conditions.

In addition, a number of completed cases have included an equity element – either an obligation to obtain new capital within a specified time frame or actual / contingent debt / equity swaps. Contingent future debt / equity swap options are often based around an inability to meet financial projections incorporated within the restructuring plan.

Where new capital from new investors has been introduced, it has often involved near or total dilution of existing shareholder interests, or at a minimum, substantial reductions in control by the existing shareholder groups.

Raising funds from the capital markets has not been a viable alternative in the restructuring experience in Thailand to date. Companies in the process of restructuring are increasingly looking at the domestic bond market as an option for refinancing foreign debt.

The following factors contribute to the relative absence of new money within restructurings:

- The reluctance / inability of existing shareholders to contribute new equity.
- The focus of domestic banks on reducing NPLs – a risk adverse approach to putting new money into a restructuring case (inability to lend money to a NPL).
- Foreign ownership restrictions / desire for foreign investors to have control conflicting with existing shareholders who wish to maintain control (dilution issue per above).

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Victor P Lazatin is currently the managing partner of the firm, and is a member of the firm's litigation department. He received his education from the University of the Philippines (AB and LLB, cum laude), and University of Michigan (Cyde Alton Dewitt Fellow, LLM). He authored the "Handbook on Commercial Arbitration" and is active in arbitration, as well as in litigation involving insolvency and restructuring. His areas of practice include: litigation; alternative dispute resolution; construction; civil law; business law.

Teresita J Herbosa is a senior partner and heads the firm's litigation department. She received her education from the University of the Philippines (BA, cum laude, and LLB, cum laude), and University of Michigan (LLM). She is active in arbitration, as well as in litigation involving insolvency and restructuring. Her areas of practice include: alternative dispute resolution; telecommunications; environmental law; air transport; land law; estates; government contracts; customs law.

Francis Ederalin Lim is a senior partner and is a member of the firm's litigation department and special projects department. He received his education from the University of Santo Tomas (AB, cum laude, and PhB, magna cum laude), Ateneo de Manila University (LLB), and University of Pennsylvania (LLM). He worked as an associate at Morgan Lewis & Bockius in Washington DC. He is on the faculty of the College of Law, Ateneo de Manila University, and assisted the Securities and Exchange Commission in drafting rules on corporate recovery. His areas of practice include: commercial law; civil law; debtor and creditor; litigation; arbitration; white collar crime.

Gilberto D Gallos is a senior associate and a member of the firm's litigation department and intellectual property deparment. He received his education from University of the Philippines (AB, magna cum laude) and Ateneo de Manila University (JD). He is active in litigation involving rehabilitation and restructuring. His areas of practice include: litigation; corporate law; intellectual property law.

Ali Budiardjo, Nugroho, Reksodiputro

Emir Nurmansyah is a partner with Ali Budiardjo, Nugroho, Reksodiputro. He joined the firm in 1989 after graduating from the University of Indonesia. In 1993, he obtained an LLM degree from Bond University, Australia. Initially, his main practice areas were project and corporate financing. His current practice focuses on debt restructuring and insolvency, and he is involved in the restructuring of a number of large Indonesian conglomerates. He was also involved in the drafting of the fiduciary security law, which was recently enacted in Indonesia.

Allen & Overy

Mark Sterling, a partner based in the Hong Kong, China office, heads Allen & Overy's Asian Business Reconstruction Group (BRG). Educated at Oxford University (BA Jurisprudence 1979; BCL 1980). He is qualified as a solicitor in England and Hong Kong, China. He worked as a lecturer in law at Nottingham University for seven years, and has been with Allen & Overy since 1992. He has extensive expertise in major restructurings, workouts and insolvencies in Asia, the United Kingdom and many other jurisdictions, having acted for creditors and debtors, steering committees, financial and governmental institutions. He led the team acting for the steering committee of bank creditors on the landmark GDE restructuring, one of the largest in the world to date. His recent accolades include an individual five-star rating in the *Insider's Guide to Corporate Rescue and Insolvency 2000*. He has published widely on a range of insolvency and corporate issues.

Moira L Taylor is a partner who has worked since 1989 in the firm's Business Reconstruction Group in London, Singapore and now Hong Kong, China. She received her education at the University of Lancaster (LLB) and was admitted as a solicitor for England and Wales in 1988. She has wide-ranging experience of all types of restructuring and insolvency work both domestic and cross-border in Asia and the United Kingdom. Most recently she has taken a key role in the restructuring of Guangdong Enterprises in the People's Republic of China and the restructuring of PT Mulia Industrindo Tbk and PT Indocement Tunggal Prakarsa Tbk in Indonesia, all of which closed at the end of 2000. She has published articles relating to insolvency issues, and is member of the Law Society of England & Wales and of The Society of Practitioners of Insolvency.

John Richards is a banking partner in Allen & Overy's Singapore office. He graduated from Cambridge University (BA) and was admitted as a solicitor in 1991 in England where he began his career with Cameron Markby Hewitt (now Cameron McKenna). He has been with Allen & Overy since 1997 and in the Singapore office since 1999. He specializes in debt restructurings and workouts but also has a practice in syndicated lending, structured finance, acquisition finance and property finance.

Marcus Collins is a partner in the banking group of our Bangkok office. He received his education at Erasmus Universiteit, in the Netherlands (Doctoral degree in law 1982) and Cornell University Law School, in New York (LLM 1983). He has been practising in Thailand for the past 10 years, and is admitted to practise in New York and the Netherlands. He has extensive experience advising on restructurings in Thailand, both out-of-court and under the rehabilitation provisions of the Bankruptcy Act. He has acted for creditors and debtors alike. Most recently he has advised on Italian-Thai Development Pcl's US$900 million debt restructuring representing the bank creditors and the US$2 billion debt restructurings of TelecomAsia Corporation Pcl representing the secured creditors as well as Kreditanstalt fur Wiederaufbau, one of the secured creditors, which invested US$150 million in new preference shares as part of the debt restructuring.

John Wacker is a senior associate in the firm's Hong Kong,China office. He received his education at The University of Queensland (Bachelor of Commerce 1990; Bachelor of Laws 1993; Master of Laws 1999). He is admitted as a solicitor in the High Court and Federal Court of Australia and the Supreme Court of Queensland. He has advised on a wide variety of major restructurings, workouts and insolvencies in Asia and Australia, acting for borrowers, creditors and steering committees and insolvency practitioners, and has published a number of articles on insolvency-related topics.

Scott Bache is a senior associate in the firm's Hong Kong, China office. He received his education at Flinders University, South Australia (Bachelor of Arts 1990) and The University of the Northern Territory (Bachelor of Laws 1993). He is admitted as a barrister and solicitor in the Supreme Courts of South Australia and Victoria, and both the High Court and Federal Court of Australia. He joined A&O from National Australia Bank in 1999 where he worked on the bank's restructuring portfolio. He has worked on numerous restructurings, workouts and insolvencies in Asia and Australia.

Clifford Chance (Singapore) LLP

Sam Bonifant is a partner and head of the Finance Group of Clifford Chance in Singapore. He graduated from Canterbury University, Christchurch with an LLB (Hons) in 1973. He is admitted to practise in New Zealand (1974) and England and Wales (1981). Mr Bonifant has over 20 years' experience with all aspects of cross-border financing and project finance. He has represented many of the leading and international banks, merchant banks and other financial institutions in Europe and Asia. Particularly, he has advised on debt restructuring, project financing and development, asset based financing and other structured and tax based finance, export credit financing and all forms of corporate lending.

Kayal Sachi is a partner in the Finance Group of Clifford Chance in Singapore. She graduated from the National University of Singapore (Law Faculty) in 1983 with an LLB (Hons). She is admitted to practise in England and Wales, Western Australia and Singapore. Ms Sachi has over 13 years' experience in numerous banking and finance transactions and has represented many leading banks and corporate clients in corporate restructurings and work-outs in Europe and Asia. Particularly, Ms. Sachi has advised on matters involving debt restructuring, but also has a practice in syndicated lending, structured and asset-backed finance and trade finance, project finance, capital markets and all forms of corporate lending. She was most recently involved in the first Thai restructuring of Total Access Communications and acted for an investor in the Indocement restructuring in Indonesia.

CMS Cameron McKenna

David Kidd leads CMS Cameron McKenna's corporate recovery and restructuring team in Hong Kong, China. His range of experience includes advice to UK administrators, receiverships and liquidations, as well as advice to banks concerning the restructuring of debt outside formal insolvency. He has also been involved in contentious aspects of insolvency, including asset tracing. He is experienced in alternative forms of dispute resolution, including mediation. In Hong Kong, China, David has led his team in their role on the restructurings of People's Republic of China governmental window companies in Hong Kong, China, ITICs and of a Hong Kong, China-listed company. His UK cases include acting for the administrators of Polly Peck International Plc, the administrators of Atlantic Computers Plc, the receivers of Aveling Barford and the court-appointed receiver in *Derby v Weldon*. In Hong Kong, China his larger cases include Peregrine, Gzitic and Fujian Enterprises. He received his education from Auckland University (1982 B Com, LLB). He qualified in 1983 in New Zealand and 1988 in England and Wales.

Prudence Mitchell is a partner of the corporate recovery & restructuring team in CMS Cameron McKenna in Hong Kong, China. She has a total of 15 years' experience in both contentious and non-contentious insolvency in Australia, the United Kingdom and Hong Kong, China. In general, Prudence advises banks and financial institutions on the validity of their securities, restructuring strategies, the risks associated with proposed transactions (such as unfair preferences), uncommercial transactions, invalidity of floating charges, shadow directorship / insolvent trading and set-off. In Hong Kong, China, Prudence has focused on large-scale restructuring of ITICs resident in the People's Republic of China and advising financial institutions on and litigating the numerous conflict of law issues arising from cross-border insolvencies, occurring both within and outside Hong Kong, China. Her major cases include Spedley Securities, GPI Leisure Maxwell, GITIC and GZITIC. Prudence lectures to the international banking, legal and accounting communities and is an occasional guest lecturer at the University of Hong Kong on insolvency. She has recently commentated at the Insolvency Symposium held in November 2000 in Hong Kong, China and is a workshop facilitator for the insolvency diploma course for the Hong Kong Society of Accountants. She received her BA.LLB in 1984 from the University of Sydney and her LLM (with merit) from the London School of Economics in 1992.

Yongfu Li is chief representative and resident partner in the Beijing office of CMS Cameron McKenna. He specializes in major projects and corporate and commercial transactions. He received his education from the East China Institute of Political Science and Law, Shanghai (Bachelor in Law awarded in 1984), China University of Political Science and Law, Beijing (Master Degree in Law awarded in 1987) and Queen's University, Ontario, Canada (LLB awarded in 1993). He has advised on the People's Republic of China aspects of major debt restructuring in connection with major People's Republic of China governmental window companies in Hong Kong, China, including injections of new assets for the restructurings. He has also advised numerous foreign companies in real property development, property valuation, trade, hotel, medical, mining, various manufacturing and other businesses and has assisted in the negotiation and documentation for the establishment of their presence of the People's Republic of China, of sino-foreign joint ventures, wholly foreign-owned enterprises, branches and representative offices.

Aili Zhao is a consultant at CMS Cameron McKenna's Beijing office. She received her education from the People's University of China (LLB, LLM) and University of Toronto (LLB). She was qualified in the People's Republic of China in 1993 and worked as an associate at a firm in Halian under the Ministry of Justice. Her areas of practice include: direct investments in the People's Republic of China, transitional trade, company restructurings and IPOs.

Rizvi, Isa & Co

Ahasan Zahir Rizvi is one of the firm's founding partners. He completed his LLB (Hons) from the London School of Economics & Political Science in 1979, was called to the Bar from Lincoln's Inn in 1980, and did his LLM from the University of London in 1981. He has been practising corporate law in Pakistan since 1981. He deals with all aspects of corporate law issues and non-litigious matters including contract negotiations, strategic planning, financial restructuring, privatizations, acquisitions, mergers, divestations and project finance matters. He has drafted several regulatory frameworks which have been promulgated as laws of Pakistan. He has been named as one of the leading lawyers in Pakistan in the publication *Chambers Global The World's Leading Lawyers 2000* and in *The Asia Pacific Legal 500*.

Qazi Faez Isa is one of the firm's founding partners. He completed his BA (Hons) in 1981 and was called to the Bar from the Middle Temple in 1982. He has been practising law in Pakistan since 1983. He is enrolled as an advocate of the Supreme Court of Pakistan. He has fifteen years' experience at the High Court level. Areas of expertise include corporate litigation, joint ventures, banking law, labor law and Islamic law. He has appeared in and conducted litigation on behalf of banks, financial institutions, corporations, the Federal Government, including the Privatization Commission. He has also conducted a number of arbitrations involving questions of insurance, partnership, contract, carriage of goods and other laws. He is actively involved in the development of environmental laws in Pakistan.

Khwaja Ahmad Hosain is the resident partner in the Lahore office of the firm. He completed his Bachelor of Arts in Philosophy, Politics and Economics from Oxford University, Master of Arts from University of London, Diploma in Law from City University in London and was called to the Bar of England and Wales in 1991. He practised general common law at the Bar in England until 1993. From 1994 onwards he has practised corporate law in Pakistan. Areas of expertise include: project finance, privatization, sovereign and corporate debt issues, banking law, mark-up financing, security documentation, non-rupee advances and facilities, syndications, non-banking financial institution regulations and laws, taxation, oil and gas, joint ventures, telecommunications and all forms of general corporate advisory work.

Ayla Ahmed is an associate in the Karachi office of the firm. She completed her LLB (Hons.) from University of London in 1995, LLM from University of Cambridge in 1996, and was called to the Bar of England and Wales from Lincoln's Inn in 1997. She has been practising corporate law in Pakistan since 1997. Areas of work experience include banking, taxation, oil and gas, telecommunications, acquisitions, privatization, contract negotiations and all forms of general corporate advisory work.

Russin & Vecchi

T Y Lee is the managing partner of Russin & Vecchi, Taipei,China. He is a graduate of National Taiwan University and Southern Methodist University and has practised law in Taipei,China for over 26 years in a wide range of practice areas, including litigation.

S H Wu is Russin & Vecchi's senior litigator and securities law specialist. She is a graduate of National Taiwan University and the University of Illinois and has practised law in Taipei,China for over 18 years, including in the areas of creditors' and shareholders rights.

H Y Cho is Russin & Vecchi's senior banking specialist. She graduated from National Taiwan University in 1975 and has handled on banking and credit-related legal matters throughout her career.

Thomas H McGowan is Russin & Vecchi, Taipei,China's senior foreign legal consultant. He is a graduate of the University of Notre Dame and Georgetown University Law Center and a member of the District of Columbia Bar. He has spent virtually his entire career working in Asia (five years in Korea and 18 years in Taipei,China) specializing in financial services.

Siam Premier *in association with* Allens Arthur Robinson

Lampros Vassiliou is a partner of the firm and Head of Corporate Insolvency & Reorganization. Lampros is an insolvency and restructuring law specialist. He has been in Thailand since 1998 and is originally from the Sydney office of Allens Arthur Robinson. He has handled numerous Australian insolvencies particularly in the mining sector. He is presently handling a number of high-profile restructurings and rehabilitations in Thailand. Lampros is a regular conference speaker. He has recently participated in initiatives by the Asian Development Bank, the World Bank, the OECD and UNCITRAL in the insolvency arena. Lampros has been appointed as an Insolvency Law Expert for the World Bank and the Asian Development Bank and has been involved in insolvency law reform and judicial training projects in Thailand and the Philippines. He is an expert panelist for the *Insolvency Law Bulletin*. Lampros is also a founder of the Thai Association of Restructuring Advisors.

Thomas Miller is a partner of the firm. His areas of practice include banking and finance, restructuring, project and corporate finance, mergers and acquisitions, foreign investment and commercial law. He has acted on restructurings in Thailand and Australia. Thomas has been in Thailand since 1993 and is also from the Allens Arthur Robinson Group. He began the association between Siam Premier and the Allens Arthur Robinson Group, the largest law group in the Asia Pacific region. Thomas speaks English, Japanese and Thai.

Surapol Srangsomwong is a founding partner of Siam Premier. He is a barrister-at-law and heads the firm's litigation and dispute resolution practice. He also holds qualifications as a labor adviser and an auctioneer. He is a former editor of the Chualalongkorn University Law Journal and often speaks at legal conferences. He has acted in numerous commercial litigation cases including rehabilitation and bankruptcy cases. He is widely regarded as one of the leading litigation lawyers in Bangkok.

Phisud Dejakaisaya is a founding partner of the firm. He specializes in banking and finance together with investment law. He has acted on numerous restructuring and debt enforcement matters. He is known for his negotiation skills and ability to bring deals to fruition. He is well known to Thai financial institutions and corporates. He has an intricate understanding of how Thai government departments operate. He is the present managing partner of the firm, which has grown to over 50 lawyers, and is a leading firm in restructuring, banking and finance, corporate and litigation.

White & Case LLP

Theodoor Bakker is a partner with White & Case LLP and is seconded to Ali Budiardjo, Nugroho, Reksodiputro, Jakarta, Indonesia. A Dutch-qualified lawyer, Theodoor Bakker has been active in Indonesia since 1985. Initially focusing on project and infrastructure finance and foreign direct investment in Indonesia, Mr Bakker's current practice focuses on debt restructuring, insolvency and cross-border debt trade. In 1998, he co-advised the International Monetary Fund on Indonesia's new Bankruptcy Law. He is also an advisor to the International Finance Corporation, the Indonesian Bank Restructuring Agency (IBRA / BPPN) and a number of creditor steering committees established for the financial restructuring of publicly and privately-owned Indonesian companies. In 1999, Euromoney named him a Leading Insolvency Lawyer. In 1999, White & Case established a formal association with the leading Indonesian law firm, Ali Budiardjo, Nugroho, Reksodiputro, to facilitate the firm's clients access to Indonesian law advice.

Wong Partnership

Alvin Yeo Khirn Hai is a partner in the litigation department of Wong Partnership. He was admitted to the English Bar in 1987 and to the Singapore Bar in 1988. He was appointed Senior Counsel (Singapore's equivalent of UK Queen's Counsel) in January 2000. Mr Yeo has extensive experience in the field of restructuring work, and has acted for bank and corporate creditors as well as liquidators, judicial managers and receivers and managers in respect of major corporate failures in Singapore. He has advised local and international groups of companies and / or their independent financial advisors in structuring and co-ordinating restructuring and refinancing schemes. Mr Yeo has also been involved in restructuring and insolvency work in the region, including Thailand and Indonesia. Mr Yeo is a member of the Law Reform Committee of the Singapore Academy of Law and the Practice Structures Committee of The Law Society of Singapore.

Gregory Vijayendran is a partner in the litigation department of Wong Partnership. He graduated from the National University of Singapore in 1992 and was admitted to the Singapore Bar in 1993. His main areas of practice are commercial and civil litigation, including, in particular, restructuring and insolvency disputes. He has acted for bank and corporate creditors, as well as liquidators and judicial managers in respect of a number of corporate failures in Singapore, advising both local and international groups of companies and independent financial advisors on litigation aspects involving restructuring and insolvency disputes. Mr Vijayendran has been a member of the Publications Committee of the Law Society since 1997 and an Advocacy Teacher of the Law Society since 1999. He speaks regularly on company law matters and is an insolvency tutor in the Postgraduate Practice Law Course run by the Board of Legal Education.

PricewaterhouseCoopers

Cliff Rees is the senior partner in charge of the corporate advisory division at PricewaterhouseCoopers in Jakarta and has worked in Indonesia for over 15 years. He has had wide experience advising numerous foreign and domestic corporations on all aspects of corporate financing, and has advised both companies and their lenders on corporate restructuring.

Ted Osborn is a partner of PricewaterhouseCoopers in Hong Kong, China and is head of the PwC Hong Kong Corporate Recovery practice. He has assisted companies with financial and corporate recovery-related issues for more than 15 years in the United States and Asia. His experience includes assessing the viability of troubled companies, advising companies and banks involved in workout and turnaround situations, formulating and assessing restructuring plans, operating companies in financial difficulty and / or during liquidation or sale proceedings, and acting as, and assisting, receivers. He is also an experienced liquidator and has extensive valuation and litigation consulting experience. Prior to joining PricewaterhouseCoopers, Ted was a corporate lending officer at Bank of America NT&SA in Los Angeles.

Charles Ostick is a partner at PricewaterhouseCoopers in Bangkok, Thailand, where he has been based since 1998. In Thailand he has been involved in a number of restructuring cases including assignments under the CDRAC process of the Bank of Thailand and under the Bankruptcy Act where PwC has been involved as the "planner". Prior to working in Thailand, he spent seven years in Hong Kong, China where he was involved in a range of liquidations, receiverships and voluntary restructurings and seven years in the United Kingdom, where he qualified as a chartered accountant before moving into the field of corporate finance.

TIM REID is a partner of PricewaterhouseCoopers, Singapore specializing in business recovery and restructuring. He has specialized in this area of practice for 14 years working for PricewaterhouseCoopers in New Zealand, London and Singapore. Tim has lectured on insolvency law and published articles on various aspects of insolvency law. Prior to emigrating to Singapore, he was a member of the Joint Insolvency Committee of the New Zealand Law Society and the Institute of Chartered Accountants of New Zealand.

CHEW HOY PING is the executive director and leader in the Corporate Finance and Recovery practice in PricewaterhouseCoopers in Malaysia. He has worked on an extensive range of corporate finance and restructuring assignments in the Asia Pacific region over the past 15 years.

IAN ENGLAND is a director at PricewaterhouseCoopers based in Sydney, Australia. He has worked on an extensive range of insolvency and restructuring assignments in the Asia Pacific region and in Europe over the past 12 years. Prior to that, he held a range of senior positions in a large multinational based in Australia and trading throughout the Asia region. He has run a wide range of courses for financial institutions and government instrumentalities in Australia and throughout the Asian region. He is the author of a range of material on insolvency and restructuring.

ROBERT MUNN is an associate director at PricewaterhouseCoopers, based in the London office. He has worked extensively on a range of the largest and most complex international restructuring and insolvency assignments in Asia, Europe, the United Kingdom, Africa and the United States over the past 12 years, in a wide variety of industries from insurance and banking through manufacturing, mining and leisure. He was engaged in the Republic of Korea as a member of a World Bank program to provide advisory groups to Korean banks for the whole of 1999 and has since continued his interest in the region.

TING LIU is a senior manager at PricewaterhouseCoopers in Beijing, People's Republic of China. For over nine years, she has served a wide range of financial institution clients in both the United States and the People's Republic of China, in areas of financial statement audits, due diligence, management consulting and annual report writing. When asset management companies were first established in the People's Republic of China, she led a team of professionals and designed the first set of accounting and financial policies for this new industry. She has also conducted various professional courses for employees of the firm and for financial institutions and government entities in the People's Republic of China.

FRANK LI is a manager of PricewaterhouseCoopers in Taipei,China. He has worked on the financial advisory services and mainly focused on the fields of M&A advisory, corporate restructuring, and private placement since joining PwC in 1999. Prior to that, he worked as an equity analyst in different international securities firms during the period of 1994-1999 and covered banking, building materials, construction and steel sectors.

RAYMOND HOH SEE LEE is a managing consultant in the Corporate Finance and Recovery practice in PricewaterhouseCoopers in Malaysia. He has over 10 years' working experience in Malaysia and abroad. His areas of experience include corporate restructuring, insolvency, corporate receiverships, liquidation and investigations. He is also the technical risk management manager for CFR in Malaysia.

WONG TOON ING is a managing consultant in the Corporate Finance and Recovery practice in PricewaterhouseCoopers in Malaysia. She has over seven years' working experience in Malaysia and the United Kingdom. Her experience includes corporate and debt restructuring and strategic advisory work.

TOMOO TASAKU joined PricewaterhouseCoopers after serving at The Nippon Credit Bank Ltd for more than 20 years. The position he held during his career at the Bank includes senior manager of New York branch, joint general manager of London branch and joint general manager of Distressed Loan Sales Division in Tokyo. Among other things, Mr Tasaku worked on distressed loans and completed many workouts and business recoveries in the United States and the United Kingdom where he lived for more than 15 years (1982-1997). After coming back to Japan in late 1997, he served as an advisor to regional banks which needed to sell distressed loans in the market. He also made substantial efforts for the legislation of servicer law and the implementation of economic policies through his writings, lectures and participations in various committees. Mr Tasaku is an author of five books and various articles in professional journals. He earned a bachelors degree from the Faculty of Law at The University of Tokyo in 1979 and an MBA from Stanford University in 1984.