

Foreword

By Carolyn Boyle, Editor

The Asia-Pacific Restructuring & Insolvency Guide 2006

It is a pleasure to welcome you to this third edition of *The Asia-Pacific Restructuring & Insolvency Guide*.

The 2006 edition continues to set the pace as the only guide to explain the restructuring and insolvency frameworks of key jurisdictions in the Asia-Pacific region with such clarity and unity of purpose. Once again, the authors are leading professionals in the field with a wealth of experience in the practicalities of achieving results, often under challenging conditions.

Our intention remains the same: to publish a useful and practical tool, not an academic textbook. We are confident that we have once again succeeded in this objective. Readers will benefit from straightforward advice, based on first-hand experience. The standardised question-and-answer format of the country chapters guarantees consistency and ease of reference.

In any publication of this scope the publishers owe an enormous debt of gratitude to their consulting editors, and this Guide is no exception. Clare Wee of the Asian Development Bank was unfailingly generous with her time and expertise, and played a crucial role in shaping and refining this publication. Thanks are also due to Rebecca Banks, David Webb and Julie Hocking of PricewaterhouseCoopers, whose energy and enthusiasm helped to drive the project forward. We would also like to thank Morgan Stanley for its continued support.

As ever, we are grateful to all the other contributors to this book, each of whom has invested considerable time and effort in meeting our editorial requirements and deadlines. Their contributions have been invaluable.

The following editorial is based on law and practice as at January 1 2006. It does not purport to provide exhaustive coverage of the subject – instead, it is intended to direct readers towards the key issues of practical concern. The views expressed herein are those of the authors.

Comment

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This year's edition of the *Asia-Pacific Restructuring & Insolvency Guide* includes a wider coverage of jurisdictions and features two new countries – Cambodia and Nepal. The questions have also been expanded to include issues that may be of interest to governments, lawmakers, researchers and academics. One key global development since publication of the 2003 edition is the completion by the United Nations Commission on International Trade Law (UNCITRAL) of the *UNCITRAL Legislative Guide on Insolvency Law*, which provides lawmakers and practitioners with comprehensive guidance on the recommended approaches to structuring an effective and efficient insolvency law. It is heartening to see that this has already had an impact in the Asia-Pacific region. For example, the Taipei, China chapter notes that the Ministry of Justice is contemplating the restructuring of the insolvency system to accommodate certain key recommendations of, among others, UNCITRAL.

From a review of the country chapters, it is clear that there is a widening gap in insolvency standards throughout the Asia-Pacific region. At the one end of the spectrum is Cambodia, with no insolvency law or experience; at the other is Australia, with a relatively sound and efficient insolvency system; and there is a broad range in between the two. Notably, there has been considerable development in the level of implementation of insolvency law in countries such as Thailand, the Republic of Korea and Indonesia. There is also a growing awareness of the issues related to creditors' and debtors' rights and responsibilities in these countries. For example, the Thailand chapter observes that "a number of high-profile legal challenges and court decisions... have clarified aspects of the law or exposed deficiencies in it. These will shape the operation of the law in practice going forward."

The region also continues to ride the wave of insolvency reforms. New bankruptcy legislation has been enacted in four of the countries covered in this year's edition: Indonesia, Vietnam, the Republic of Korea and Nepal. While the effectiveness of such reforms remains to be seen, it is heartening to note that many of the reforms include best practices. For example, the Vietnamese law is encouragingly extensive in its scope and covers, among others, state-owned enterprises.

Legislation is also pending in the People's Republic of China and New Zealand. It is anyone's guess as to when the third (and hopefully final) reading of the PRC draft law will take place: as mentioned in the PRC chapter, the "third reading that many had expected to take place in late 2004 or early 2005 did not eventuate". As for New Zealand, the wide-reaching Insolvency Law Reform Bill is currently before the Parliament.

Overall, significant advances have been made in insolvency and related disciplines in the Asia-Pacific region, and the 2006 edition of the *Asia-Pacific Restructuring & Insolvency Guide* has been structured to draw the reader's attention to the most recent developments. While the 'implementation gap' remains, some progress is apparent, particularly in Thailand and the Republic of Korea. In general, however, and with few notable exceptions, the practice of insolvency law remains prolonged and unpredictable. More

detailed commentary on particular areas of insolvency law and related disciplines is set out below.

Cross-border insolvency

Disappointingly, there has been little development in the area of cross-border cooperation and assistance. As globalisation increases, the lack of greater international harmonisation of insolvency laws represents a major obstacle to the efficient liquidation and restructuring of truly global enterprises. In the 2003 edition, it was noted that Australia and New Zealand were considering the adoption of the UNCITRAL Model Law on Cross-Border Insolvency. This remains the case. The Australia chapter states that a reform package will be introduced for public comment in 2006. The reform package is expected to include the adoption of the UNCITRAL Model Law, which will operate in addition to existing recognition of foreign proceedings provisions. Similarly, the Insolvency Law Reform Bill currently before the New Zealand Parliament includes provisions for the implementation of the UNCITRAL Model Law.

Unfortunately, reforms in this area lag behind the growth of regional financial markets in Asia, and it may be up to the private sector to push for change. In this respect, it is noteworthy that the Asian Bankers' Association (ABA) recently released a position paper titled "Providing the Legal and Policy Environment to Support Effective Informal Workout Regimes in the Asia-Pacific Region". The position paper proposed five measures:

- adoption of a fast-track formal workout regime;
- enactment of legislation providing for creditors' voluntary liquidation or voluntary administration;
- promotion of a regional centre or centres for the resolution by arbitration of cross-border disputes;
- strengthening of cross-border cooperation and assistance in insolvency cases; and
- undertaking of measures to enhance institutional capacity.

The ABA has also developed a model workout agreement and is actively encouraging its membership to consider informal resolution of creditor-debtor issues. More initiatives of this kind will be required going forward.

Liquidation

In the 2003 edition of the Guide, I noted that very little notice was given to the remedy of liquidation. A survey of the insolvency regimes covered by the 2003 edition indicated that, with notable exceptions (Singapore, Malaysia and Hong Kong, China), many of the countries did not have well-functioning and effective liquidation processes. This remains the case, particularly in the Philippines. As pointed out in the Philippines chapter, "an urgent concern is the immediate liquidation of the debtor's assets". Additionally, most still do not provide for the conversion from rescue to liquidation. However, one development to watch is the Japanese special liquidation procedure (amended form in the new Company Law promulgated on July 26 2005) to come into force in 2006, referred to in the Japan chapter, which is intended to streamline the procedures for liquidation of corporations.

Governance and corporate governance

Some improvements are noted in the area of governance. The Indonesia chapter points out that the "Corruption Eradication Commission is slowly starting to gain momentum, which in turn is turning up the heat on the judiciary". However, governance remains the most divisive factor to well-functioning insolvency regimes in the region. This fundamental tenet of rule of law must exist if an insolvency law – or for that matter, any law – is to function effectively. As the Indonesia chapter observes, "other issues affecting bankruptcy and restructuring in Indonesia include the non-confrontational nature of Indonesian business customs and perceived difficulties in the administration of justice". Factors that contribute to poor administration of justice include:

- delays in court hearings;
- poor physical infrastructure;
- low status of judges, and poor terms and conditions of employment;
- weak judicial accountability mechanisms, which in some countries permit widespread buying of favourable verdicts (particularly in rural areas);
- lack of trained support staff and case management systems; and
- inadequate legal education and training.

Indeed, most of the commentators have noted that the most urgent reform required to facilitate

the systematic and efficient handling of corporate insolvency cases is reform of the judiciary and the training of judges in the handling of corporate insolvency cases. Therefore, legal reform – including of any specialised insolvency courts – must be of the highest priority. The Asian Development Bank (ADB) has provided and continues to provide considerable loan and technical assistance aimed at law reform. In promoting law and policy reform in the financial sector, the ADB also continues to contribute to the regional debate on issues of insolvency and secured transaction law reforms in the Asia-Pacific region.

Effective national anti-corruption strategies must also be at the top of governments' priorities. Consideration should be given to strengthening regional cooperation in combating corruption. Further, it is recommended that any governance reform strategy include a broad-based communications campaign to motivate new attitudes and new patterns of behaviour in the public and private sector. A similar strategy may be contemplated for fostering greater understanding and acceptance of the value of good corporate governance, as discussed below.

From the country chapters, it appears that there is similarly some improvement in corporate governance generally. Nevertheless, as is now beginning to be recognised, corporate governance standards in Asia are still far behind those in the United States and Europe. Research indicates that most emerging-market family-owned businesses – the dominant form of business practice in this region – remain unconvinced that governance reform is in their interest. It is time that governance reformers came up with a sequenced programme of incremental governance changes that may be more palatable to family businesses. A recent McKinsey survey suggests that as the benefits of specific governance changes become self-evident to the

members of family-owned businesses, they are likely to become convinced of the need for further reforms.

Driving cultural change, whether inside or outside of the boardroom, takes sustained efforts. Instilling new attitudes and behaviour takes a long time and some innovative cross-disciplinary thinking. To succeed in fundamentally changing attitudes towards market structures and corporate governance, any reforms must be coupled with an aggressive educational and awareness-raising campaign that is capable of reaching all levels of government, civil society, business and industry and the public sector. Corporate governance reforms will not be fully implemented in Asia until the relevant parties come to believe that adherence will enhance wealth creation and lead to more rapid economic development.

Although the conduct of owners and directors of a corporation is primarily a matter of corporate law policy and regulation, it may continue to fall, inappropriately, to insolvency legislation to remedy the aforementioned corporate governance defects, through the imposition of civil sanctions for fraudulent and other like conduct which causes damage or loss to creditors of an insolvent corporation.

In sum, despite considerable improvements in certain jurisdictions, in the majority of jurisdictions covered by this Guide insolvency remains a high risk factor and insolvency law judgments continue to be unpredictable.

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A regional perspective

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It has been over two years since the last edition of this Guide was published. At that time, one of the prevailing themes was the aftermath of the 1997 Asian crisis and the variety of responses and countermeasures put in place across the region, including the establishment of asset management companies. Other themes included the role and extent of foreign direct investment, as well as prospective changes to legal frameworks. So how does the regional picture look today? What have been the changes? Where has progress been made and what challenges are faced now?

The landscape

Perhaps the most obvious change has been in terms of mood. Even as recently as two years ago, the shadow of the Asian crisis loomed large. This largely reflected the fact that the suddenness and severity of the crisis meant that not just corporates, but also the region's banks, were hit. The first priority in many cases was therefore to shore up the banking system, leaving the task of corporate restructuring to later. Hence, the restructuring process took longer than many had perhaps anticipated back in 1997. Now, however, although it would be wrong to say that the effects of 1997 have completely worked their way out of the system, the prevailing mood is forward-looking and optimistic, with the 'hard yards' having been completed.

Malaysia and Japan provide contrasting examples of this mood. Malaysia responded to its non-performing loan problems early, taking an aggressive approach. Aside from changes to the currency regime (the impact of which remains controversial), Malaysia was quick off the mark in following the example of the Republic of Korea and establishing a national asset management company, Danaharta, in mid-1998. Danaharta wound up its operations, on target, on December 31 2005. This followed on from the closure in 2002 of the Corporate Debt Restructuring Committee, a mediating body for large borrowers and their creditors, and in 2003 of Danamodel, established to recapitalise banks in need of financial assistance. Danaharta estimated the total cost of restructuring the Malaysian banking sector at around three per cent of gross domestic product (GDP), well below the estimates of international agencies and other commentators. GDP growth in Malaysia was over seven per cent in 2004 and the consensus forecast is for continuing growth of around five per cent in the short to medium term.

The problems in Japan emanated from the collapse of the 'bubble economy' (the asset and land price explosion in the late 1980s) and the subsequent 'decade of lost growth', not from the 1997 Asian crisis. The non-performing loan problem was also a domestic problem, with the loans being denominated in domestic currency. Although this allowed Japan to pursue policies at its own pace, rather than at that dictated by the demands of the international capital markets, the result was a slower rate of change and reform, with the initial response focusing more on rescheduling debt than on tackling the underlying problems. However, progress in the past few years

has been substantial. The biggest banks' non-performing loans have fallen to less than three per cent of their loan portfolio, as against over eight per cent just three years ago, while loan volumes are rising for the first time in a decade. Moreover, the Industrial Revitalisation Corporation of Japan, the joint public/private sector body established primarily to assist in the revitalisation of heavily indebted companies, is over halfway through its mandate and remains on course to wind up its operations in 2008.

The other major change in the landscape since the last edition of the Guide has been the opening-up of the People's Republic of China.

The People's Republic of China was to some extent insulated from the shocks of 1997. In December 2001 it acceded to the World Trade Organisation with a transitional programme which will culminate in the full opening of its markets on a segmental basis over a number of years. Of particular note is the exposure of the financial sector to international competition on December 1 2006, after which date foreign banks will be allowed to compete on a level playing field in commercial and retail lending and services.

The government has focused on restructuring the country's banking, state-owned and securities sectors, and on other significant macro-economic issues, in preparation for the anticipated onslaught of market forces. In the banking sector, asset management companies have been established to work out the bad loans of the big four state-owned banks as part of a programme to prepare the banks for recapitalisation and eventual listing. Three of the four banks have received large capital injections from the state and have sold minority stakes to foreign investors. In October 2005 China Construction Bank listed in Hong Kong, China, raising US\$9.2 billion – the largest initial public offering (IPO) in the world in 2005. Bank of China and Industrial and Commercial Bank of China are expected to list in 2006. Elsewhere, the process of restructuring and privatising the inefficient state-owned sector has continued apace, with mega-IPOs on Hong Kong, China and overseas stock exchanges, such as China Life and PetroChina, contrasting with hundreds of behind-the-scenes domestic privatisations and management buy-outs. Meanwhile, the securities regulator has wrestled with the problems of the domestic stock markets. Reforms were pushed through in 2005 to address problems associated with the large overhang of state-owned shares in listed companies, an issue seen to be behind the enigma of the declining

equity markets despite huge growth in GDP and other economic indicators. The jury is still out on how successful these domestic stock market reforms will be, and the established Hong Kong, China bourse remains the primary destination of credible new listings, even as New York and London step up their efforts to attract PRC IPOs.

The PRC currency, the renminbi, remains non-convertible on the international currency markets, but in 2005 the first moves were made to delink it from its unofficial peg to the US dollar. Partly in response to international pressure, particularly from the United States, the People's Republic of China 're-pegged' the renminbi to an undisclosed basket of currencies and allowed a two per cent appreciation. There is speculation that further relaxation over exchange rate controls may follow, with most observers predicting a further appreciation of the renminbi in the near term.

As noted below, the People's Republic of China comprises the biggest market for foreign direct investment, which has risen from US\$45 billion in 1997 to an estimate of just under US\$60 billion in 2005.

Despite the trend of increasing foreign direct investment and the inexorable opening-up of PRC markets, the restructuring of PRC corporates and problem loans has been conducted largely behind closed doors, much to the frustration of international restructuring professionals and distressed investors. The asset management companies have confounded expectations by largely shunning would-be foreign buyers of their non-performing loan portfolios, and have even taken things one step further by seeking to convert themselves into investment banks, competing to buy non-performing loan portfolios off one another and becoming involved as 'administrators' in domestic restructuring situations. Although a draft of the long-awaited Enterprise Bankruptcy Law has been circulated, it is still unclear whether, when and in what form it will be passed into legislation. One issue of particular debate is the rights of employees over creditors, with many senior officials in the ruling communist party expressing concerns over the possible social implications of a rash of large corporate insolvencies or restructurings conducted under a new law.

Notwithstanding these difficulties, the proposed new law in its current form is all-encompassing and plainly drafted, and contains clear references to international best practices. If enacted, it could ultimately prove to be a remarkable piece of legislation for a country whose

modernisation drive began a scant 25 years ago. What makes the draft law so important is that its use should prove to be a catalyst for change in the People's Republic of China, with wide-ranging consequences. For example, while in some respects debtor friendly, the proposed new law nevertheless provides a clear endgame for stakeholders in virtually all commercial enterprises in the People's Republic of China – from state-owned enterprises to foreign investment holding companies – paving the way for true corporate and economic reform. With its implementation, investors will also have a much clearer idea of their worst-case exit options, and this may help spur yet more investment activity.

Will the draft law be used a lot? Many factors suggest not, at least initially. If what happened in Thailand and the Republic of Korea after those countries implemented new insolvency legislations in the wake of the Asian financial crisis is any indication, it may well take years before the law is widely used. Firstly, it will take some time to build up an infrastructure to accommodate anything more than a trickle of cases – as it stands, there is a lack of experienced professional advisers to help guide parties through the process, a bankruptcy bench has yet to be established and there are no real case precedents to rely upon. Secondly, as alluded to above, any change which could affect workers is normally slow to take effect – social welfare issues will likely come first. Thirdly, over 2,000 of the country's largest state-owned enterprises will be exempted from the legislation for three to five years in order to allow them some time to clean up their affairs. It could thus take several years before the proposed new bankruptcy law is widely used and consistently applied.

However, this is not to say that a significant number of potential cases are not waiting in the wings and that the new law will not be used at all. PRC banks and other financial institutions have a huge backlog of cases that need cleaning up, and this legislation will provide them with a new avenue to go about this process. Investors in non-performing loans will also recognise the legislation as a potential new source of leverage in their efforts to realise their investments. So it is not a question of whether the inventory of cases is there; the real question is when Pandora's Box will be opened.

Foreign direct investment

No discussion of the Asian economies would be complete without further mention of the scale and pace of foreign direct investment. Foreign direct

investment into Asia continues to grow. According to the United Nations Conference on Trade and Development (UNCTAD) 2005 World Investment Report, foreign direct investment into Asia (including Oceania) in 2004 reached US\$148 billion, up from US\$102 billion in 2003. Not surprisingly, the People's Republic of China was the biggest recipient of foreign direct investment, with inflows of around US\$60 billion; when combined with Hong Kong, China, it accounted for around two-thirds of the foreign direct investment into the region. Foreign direct investment growth was also strong into India, as well as Southeast Asian countries. Indeed, UNCTAD goes so far as to say that the 1997 crisis is no longer affecting foreign direct investment inflows. Other points of note include a continued increase in the volumes of foreign direct investment accounted for by cross-border mergers and acquisitions (albeit still less than greenfield investment), and certain countries becoming important destinations for foreign direct investment in research and development, most notably India and the People's Republic of China. All the indicators are that foreign direct investment inflows will continue to rise.

Legal frameworks

The legal frameworks pertaining to restructuring and insolvency vary significantly across the region, as even a cursory glance at this Guide clearly demonstrates. This is not surprising. The Asia-Pacific region is diverse, in terms of both state of development and legal tradition. Legal traditions are affected not only by the framework of law (eg, English, continental or US insolvency frameworks), but also by more intangible factors such as cultural attitudes, the speed and efficiency of the legal system, corporate governance traditions and the availability and experience of key professional staff.

Since publication of the last edition of this Guide, there have been changes to the legal frameworks in a number of countries. A detailed description can be found in the respective country chapters. For example, Indonesia enacted a new Bankruptcy Law in 2004, as did Vietnam, while Nepal introduced a new Insolvency Ordinance in 2005. However, it is too early to judge how these changes have bedded down, and in Vietnam further changes will be introduced in 2006. Perhaps the most comprehensive set of changes has occurred in the Republic of Korea, where the Act on Rehabilitation and Bankruptcy of Debtors is due to come into effect as of March 31 2006.

In other territories, however, progress has been slower. For example, in the People's Republic of China, the long-awaited enactment of amendments to the Enterprise Bankruptcy Law has been delayed by political debate over issues such as the rights of employees over creditors. In India, while the need for a comprehensive bankruptcy code is growing even stronger, there appears to be little tangible action. Given the increasing foreign direct investment inflows and contribution to the world economy of both the People's Republic of China and India, it is likely that there will be an increasing

focus not only on how these countries adjust their formal legal frameworks, but also on the actual operation of their judicial systems in implementing the law and handling the legal process.

It is this diversity of legal frameworks, coupled with cultural and economic conditions, that has evolved a variety of approaches to restructuring and insolvency across the Asian region. This Guide provides a comprehensive and detailed summary of both the legal frameworks and manner in which the legal frameworks are applied. We hope you find it both useful and informative.