

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.

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## **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).

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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.

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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.

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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).

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**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.

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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?

**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.)

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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?

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.

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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?

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.

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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) 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.

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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 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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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 sub-

sequently 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.

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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.

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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?

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.

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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?

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 controllers 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.

## PricewaterhouseCoopers

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