A REPORT ON THE PROCEEDINGS OF THE JOINT SYMPOSIUM ON INSOLVENCY AND SECURED TRANSACTIONS

26–27 October 1999
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A. Introduction

1. The Joint Symposium on Insolvency and Secured Transactions (the "Joint Symposium") brought together two teams that are currently involved in the Law and Development activities of the Asian Development Bank (the "ADB" or the "Bank"), namely, the Regional Technical Assistance for Insolvency Law Reforms (TA No. 5795-REG) ("RETA") team (the "Insolvency Team") and the RETA for Secured Transactions Law Reforms (TA No. 5773-REG) team (the "Secured Transactions Team"). The Asian financial crisis has highlighted the inadequacies in many of the developing member countries in Asia ("DMCs") in the related areas of insolvency[1] and secured transactions. These two RETAs were commissioned to study some of these economies.

2. The economies covered by the Insolvency Team initially included the following: South Korea; Japan; Taipei,China; Hong Kong, China; Singapore; Indonesia; Malaysia; Thailand; India; Pakistan; and the Philippines. Consultants for these jurisdictions prepared reports for a symposium held in Manila in January 1999. A summary of those proceedings was included in the 1999 Edition of the Report entitled Law and Development at the Asian Development Bank - Special Report: Insolvency Law Reform in the Asian and Pacific Region (April 1999). In the second stage of the Team's activities, the economies were narrowed to include South Korea, Indonesia, Malaysia, Thailand, and the Philippines.

3. The economies covered by the Secured Transactions Team include the People's Republic of China (the "PRC"), Indonesia, India, Pakistan, and Thailand.

4. The areas of investigation of the two Teams overlap and the Joint Symposium was organized to consider the points of intersection between these two important areas of the law. From 25-27 October 1999 the Insolvency Team held a Symposium on Insolvency Law Reform at the Bank's headquarters. From 25-28 October, the Secured Transactions Team held a Symposium on Secured Transactions Law Reform. On 26-27 October, the two Teams combined and held the Joint Symposium, which focussed on economic and legal issues arising from the integration of secured transactions and bankruptcy regimes. This Report presents a summary of the discussions at the Joint Symposium. The RETA economies were represented at the Joint Symposium by local experts, judges, bankruptcy practitioners, policy makers, scholars, lawyers, bankers, and accountants. Also present were delegates from various legal institutes and observers from other multilateral institutions, including the World Bank, the International Monetary Fund, and the Organisation for Economic Co-operation and Development.

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[1] Used in the general sense as including both liquidation (or winding up) and reorganization (or rehabilitation). In the discussions during the Joint Symposium distinctions at times were drawn between liquidation and reorganization. In this Report, the terms bankruptcy and insolvency are used interchangeably.

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5. Prior to the Joint Symposium, the Secured Transactions Team prepared a Report entitled Integrating the Legal Regimes for Secured Transactions and Bankruptcy: Economic Issues (the "Secured Transactions Report"). The Secured Transactions Team also prepared an Overview of Key Legal and Economic Issues in Five Asian Countries and compilations of the country consultants' interviews and commentaries. Individual commentaries focussing on Secured Transactions issues were also completed by country consultants involved in the Insolvency RETA.

B. Background to Bankruptcy and Secured Lending

6. On the morning of 25 October 1999, Mr. Ron Harmer presented an introduction to the Insolvency Law Reform RETA. Mr. Heywood Fleisig presented an introduction to the Secured Transactions Law Reform RETA, as well as a general background to bankruptcy and secured lending. He noted that debtor-creditor laws include systems for collecting debts and bankruptcy systems for terminating the collection of unpaid debts. He highlighted the following three systems for collecting debts:

- secured transactions - a system using movable property as collateral;
- mortgages - a system using fixed property as collateral; and
- unsecured lending - a system that uses no property as collateral.

7. Mr. Fleisig's emphasis was on the interaction between secured lending and bankruptcy law. His starting point was that secured lending and bankruptcy focus on different economic and legal problems, and therefore arrive at different solutions. A secured lending system seeks answers to the question, How does the lender get repaid?; in contrast, a bankruptcy system seeks answers to the question, How do we deal with the borrower who cannot pay?

8. He noted that there are important points of intersection between secured transactions and bankruptcy, and he argued that these two systems need to be integrated; one system cannot substitute for the other.

9. He highlighted one important area of intersection involving the important question - Should bankruptcy terminate a security interest? - which was the subject of extensive discussion in the Joint Symposium. Mr. Fleisig offered answers (and supporting arguments) both for and against this proposition:

A. Yes, bankruptcy should be able to terminate a security interest, because:

(1) Secured lending produces no social gain. Equity or unsecured lending could replace secured lending; and since the capacity of a firm to service debt is fixed, secured lenders crowd out unsecured lenders.

(2) Priority of secured lending imposes other social costs. It is not clear why secured loans should be treated as more important than tax claims of the government, unsecured debts of small creditors, unpaid wages, unfunded pensions of injured parties, tort claims of injured parties, or potentially viable firms that need protection

(3) Secured lending creates a moral hazard; in other words, given the possibility of gaining protection from the use of collateral, a lender might loan too much or a borrower might borrow too much and become over leveraged.

B. No, bankruptcy should not be able to terminate a security interest, because:

(1) Secured lending produces a large social gain. Direct consequences of secured lending include more credit, broader access to credit, longer repayment periods, and lower interest rates. Indirect consequences of secured lending include more equipment, higher incomes, and more broadly distributed income and wealth.
(2) Social costs arising from priority could be eliminated by using other, better techniques to address these problems without damaging the lending market.

C. Creation of Security Interests and Insolvency

1. Secured Transactions Before and After Insolvency

10. At the outset of the Joint Symposium, the participants turned to issues involving secured transactions entered into before and after insolvency. The primary area of inquiry was the issue raised by Mr. Fleisig in his introductory remarks, namely: To what extent (if any) should the pre-existing rights of secured creditors be adversely affected by insolvency?

a. Secured Transactions Position

11. The heart of the Secured Transactions position is that the implementation of an efficient system of secured lending produces important economic and social benefits for society overall. It was claimed that secured lending supports a seven-fold increase in credit with no additional risk. The increased credit from secured lending makes it more likely that distressed firms are able to get access to credit and avoid the need to resort to bankruptcy. Creditors also benefit, because a system of secured lending limits the need for creditors to initiate the bankruptcy process to get paid.

12. As the quality of collateral improves, general access to credit also improves and other benefits arise. Charts were displayed that demonstrated that as the quality of collateral increases (e.g., from personal loans to used car, boat, and RV loans; to home equity loans; to mortgages) the interest rate decreases up to a factor of 50% and the ratio of debt/income rises more than eight-fold. Similarly, as the quality of collateral improves, the loan size dramatically improves, as does the term length. (These charts are included in the Secured Transactions Report, p. 10.)

13. It was noted that these factors are especially pertinent when movable property is used as collateral. In jurisdictions where movable property is not available as security, banks are forced to loan on the basis of real property and/or personal guarantees and it is not unusual for small shop keepers to pay annual interest rates as high as 40-50%.

14. Of course, social norms limit the scope of property that may be subject to a security interest. For example, exemption laws frequently exempt homesteads, tools of the trade, and minimum amounts of personal property for debtors.

15. Another tenet of the Secured Transactions position is that "market-based mechanisms that convert lenders into shareholders are more efficient and may ultimately be no less socially progressive and equitable than judicially-administered reorganization proceedings." (Secured Transactions Report, p. 18.) In support of this position, much evidence was cited from the United States in regard to workouts and Chapter 11 reorganizations. Although it was noted that the evidence on Chapter 11 was not conclusive, it was argued that the results cannot be seen as promising. In short, it was claimed that most viable workouts of distressed firms in the United States are voluntary (and that they involve small amounts of money relative to the credit provided by the secured lenders). Overall, it was noted that most Chapter 11 cases either end in insolvency or in the eventual return of the corporate debtor to Chapter 11.

16. The primary worry of the Secured Transactions Team was that allowing reorganization or bankruptcy proceedings to void or alter the pre-existing rights of secured creditors reduces or destroys the value of collateral and leads banks to cut back on their lending. It imposes a heavy cost on society because there are no offsetting social gains from allowing the insolvency process to interfere with secured transaction rights. For example, as noted above, it was argued that there is little evidence of economic gain resulting from reorganizations in general (and from Chapter 11 proceedings in the United States, in particular). Thus, the concluding position was that the benefits from secured lending justify a policy of non-intervention by bankruptcy in pre-existing secured transactions.

b. Insolvency Position

17. The Insolvency Team wholeheartedly agreed with the Secured Transactions Team that important economic and social benefits result from secured lending, and that an effective secured transactions system acts as an engine of economic growth. However, the Insolvency Team was not convinced that these benefits inevitably lead to a policy of non-intervention by bankruptcy or reorganization law. The position of the Secured Transactions Team appeared to many in the Insolvency Group to be rather absolutist in nature. In contrast, the starting point of the Insolvency Team was that although bankruptcy should, as a rule, respect pre-existing contractual relationships that give rise to security interests (and thereby preserve the priority of secured creditors), it nevertheless is appropriate in certain circumstances for bankruptcy to interfere with - or even terminate - the rights of secured creditors. The Insolvency Team's position is based on the belief that since bankruptcy is a collective proceeding, it therefore is appropriate at times (pursuant to narrowly drawn exceptions) to interfere with the rights of secured creditors to protect the collective or public interest.

18. The Insolvency Team's aim was to identify those circumstances and, more particularly, to do the following:

- to define those instances when the collective or public interest justified allowing bankruptcy to interfere with the rights of secured creditors;
- to define the types of interference that should be permitted; and
- to propose mechanisms to protect the interests of secured creditors whose rights have been adversely affected by such interference.

19. The Insolvency Team agreed that if bankruptcy or reorganization laws pose unreasonable threats to lenders, lenders will most likely stop lending or raise interest rates. However, the Team argued that creating clear, narrowly drawn rules as to when the insolvency law will interfere with the rights of secured creditors is unlikely to cause unreasonable threats to lenders. Moreover, limited intervention would also lead to other social benefits, such as increasing the likelihood of successful reorganizations.

20. The type of insolvency law intervention that had the most support within the Insolvency Team was the use of a moratorium (or a stay) in reorganization proceedings to delay the ability of a secured creditor to enforce its security interests and rights. A moratorium would normally come into existence either upon the filing of an insolvency petition or the making of a formal court order (such as a winding-up order). Team members agreed that secured creditors should have the ability to seek the lifting of, or relief from, the stay.

21. Mr. Harmer discussed his efforts (when recommending amendments to Australian insolvency law) to convince the Australian banking community of the merits of agreeing to extend the automatic stay to secured creditors in cases where a company was in the process of being reorganized. Initially he encountered great resistance. However, slowly but surely, he persuaded the banks that they would be better off by agreeing to a stay and that interest rates need not be significantly affected by such a change to the law. In essence, he convinced them that the automatic stay may have just as important benefits for secured creditors as it does for a debtor company. For example, there arguably may be economic value to secured creditors from the imposition of an automatic stay. Secured creditors do not necessarily want to recover their collateral; they want to get repaid. However, taking steps to recover collateral takes time, costs money, and often requires judicial assistance. A stay on creditors' actions can save secured creditors this extra time and expense and might well create the conditions for a successful corporate rescue and enable secured creditors to get repaid in full without the need to resort to self-help.

22. The Insolvency Team also returned to the moral hazard argument noted by Mr. Fleisig in his introductory remarks; in short, that banks may over-lend or that debtors may over-borrow. In fact, it was noted that this has recently been the experience in many RETA economies where banks relied primarily on asset-based or name lending rather than on cash-flow analysis. This may not be a serious problem during strong economic periods. However, the consequences are dire for lenders if a market or economy collapses, as has been borne out by the recent Asian economic crisis. During such times borrowers are unable to repay their debts (as their cash flow is severely disrupted or non-existent) and the value of the banks' collateral falls in value. One member of the Insolvency Team even queried whether the law should penalize reckless lenders.

23. A recurring contention of the Insolvency Team was that the potentially dire consequences that the Secured Transactions Team suggested would result if insolvency law interferes with the rights of secured creditors might well be illusory. For example, it was noted that much of the data presented by the Secured Transactions Team is drawn from the United States, but the United States is far from being a secured creditors' paradise. For example, in a U.S. reorganization, secured creditors are bound by a stay and post-petition lenders may (under certain circumstances) prime the interests of pre-existing secured lenders. Nevertheless, the data also shows that the United States has about the lowest interest rates and that creditors continue to lend. Moreover, even though lenders realize that they can be held up for years in a corporate reorganization, 70% of the credit in the United States is nevertheless secured. There was agreement among both Teams that further investigation should be done to ascertain why there are low interest rates in the United States despite such interference by U.S. bankruptcy law with the rights of secured creditors.

(i) Should reorganization or bankruptcy proceedings annul or void secured transactions entered into before insolvency or in contemplation of bankruptcy?

24. There was general agreement among both Teams that where an asset has been charged or mortgaged during the run up to insolvency in exchange for a lender providing value to a debtor company, as a general rule, the mortgage or charge should not be voided.

25. The Insolvency Team also argued that although the rights of the secured creditor should not be annulled or voided, the ability of the secured creditor should give way to an automatic stay in cases where a reorganization has been commenced. There was less agreement within the Team as to the appropriate length of time for the stay to continue in operation and as to whether secured creditors should also be subject to a stay in a liquidation.

26. The Secured Transactions Team, in contrast, took the position that an interference with the rights of secured creditors in the form of a stay was wrong. It argued that if insolvency laws pose threats to lenders, reasonable lenders might well decide not to lend.

27. However, there was some support among both Teams as to how to mediate their disagreement. They agreed that where insolvency laws stay the collection efforts of secured creditors, it would be best to ascertain the desirable length of the stay on the basis of practical experience, rather than as a legal or moral issue. Thus, additional investigation might well reduce the extent of the disagreement between the two Teams.

(ii) Should reorganization or bankruptcy proceedings annul or void transactions that convert an unsecured debt into a secured debt?

28. There was general agreement that such transactions should be permitted where they are entered into a substantial period of time before the commencement of a bankruptcy proceeding.

29. This question, however, led to divergent views between the two Teams for those cases in which the transactions are entered into in contemplation of insolvency. Such transactions involve situations where one creditor is benefiting individually at the expense of other creditors without having given any additional value to the debtor company. The majority view of the Insolvency Team was that unlike a creditor that loans money to a company on the eve of insolvency and takes a charge in return (as in para 24 above), a creditor that improves its status from unsecured to secured without contributing any additional value to the company adversely affects the interests of existing unsecured creditors when such a transaction is made at a time that the debtor company is unable to pay its debts generally. By improving its individual status at such a time, the creditor violates the fundamental pari passu (equality of distribution) principle. Many insolvency regimes define these transactions as preferential transfers (or unfair preferences) and enable a trustee or liquidator to avoid such transactions, to recover the property in question, and to distribute the proceeds to unsecured creditors. The general Insolvency Team position was that such preferential secured transactions should be avoided, although there was some disagreement as to how to define a preference. In some jurisdictions (e.g., the United States) the focus is primarily on preventing "last minute grabs" or queue jumping by creditors at a time that the debtor company was unable to pay its debts generally. In other jurisdictions (e.g., Hong Kong, China and the United Kingdom), there is more of a focus on the voluntary nature of a debtor's (or its directors') act and therefore on the debtor's (or directors') state of mind when making a payment or transfer (e.g., was the debtor influenced by a desire to prefer a creditor). However, some members of the Insolvency Team held the view that converting an unsecured debt into a secured debt should only be avoided where fraud was involved.

30. In contrast, the Secured Transactions position opposed any interference on these grounds. Its response was that if the company refused to improve the creditor's position from unsecured to secured, the creditor might well call in its loan and thereby cause harm to the unsecured creditors. In essence, the argument is that there is new value in the form of fear that credit might be withdrawn. The Secured Transactions Team asked why the law should penalize a creditor that is the first to spot the debtor company's financial problems.

(iii) Should reorganization or bankruptcy proceedings annul or void fraudulent or commercially unfair transactions that have a security component?

31. This question led to agreement between the Teams. Most members of both Teams agreed that it was appropriate for insolvency law to interfere with the rights of secured

creditors where fraud has been involved and that it was fair to annul or avoid security transactions that result from fraud or commercially unfair practices.

(iv) Should the law support a debtor's ability to obtain financing during bankruptcy by allowing a bankrupt to continue to give security during reorganization?

32. This issue involves the granting of post-petition security interests by a debtor and goes to the heart of whether many reorganizations are likely to succeed. Both Teams supported the use of post-petition grants of security, although there were differing views as to the use of such a procedure when it infringed the rights of pre-existing secured creditors. The Secured Transactions view was that companies in bankruptcy should not be able to create post-petition security interests that impair the pre-existing rights of existing pre-petition secured creditors without first securing the consent of any pre-existing secured creditor that would be adversely affected by the post-petition grant of security.

33. The Insolvency position was that post-petition grants of security are crucial to the overall success of most reorganizations because post-petition grants of security are usually necessary to attract post-petition financing. Without post-petition financing, a typical company in reorganization would most likely not be able to pay employees (who might otherwise be forced leave the company) or creditors (who might otherwise stop trading with, or supplying supplies to, the company), and liquidation would most likely result.

34. Although there were differing views, it appeared that the majority of the Insolvency Team supported the use of super-priority grants of security. The arguments in favor of granting super-priorities were premised on the notion that it is fair to subordinate the interest of individual secured creditors to the overall interest of rescuing corporate enterprises and to the interests of creditors generally. Most Team members who favored super-priority did not believe that a post-petition grant of security should be made conditional on gaining the consent of existing secured creditors.

35. There did not appear to be a majority view within the Insolvency Team on who should be given the authority to approve post-petition grants of security. Team members put forth a variety of views including the following: requiring the consent of unsecured creditors generally; allowing an administrator to decide; requiring court approval; or allowing for a combination of these approaches (e.g., one view was that where a debtor-in-possession is in control, judicial approval should be required, but where an administrator has been appointed, then the administrator should make the decision).

36. Some Team members argued that in a reorganization finance decisions often have to be made quickly and there is no luxury of time in such situations to hold a meeting of creditors. They noted that in a crisis your solution to these problems must be pragmatic and the administrator must be given the authority to make decisions as to the post-petition granting of security interests. Super-priority is a major interference with the rights of pre-existing secured creditors, but an administrator would not use such a remedy unless he thought that creditors would generally benefit.

37. An example was given involving an administrator of a computer company who discovered that the company had a contract to deliver computers. The contract would have been a profitable contract for the company, but the company did not have sufficient working capital to pay for the supplies necessary to complete the contract. Not to have performed the contract not only would have forced the company to forgo a profit, but would also likely have forced the company to go under. The administrator sought input from creditors and got judicial approval for the granting of super-priority security interests to protect the lender that lent the additional capital.

38. Participants in the Joint Symposium received handouts that contained examples of insolvency procedures for post-petition financing from the United States Bankruptcy Code (the "USBC") and from recommendations of the Hong Kong Law Reform Commission. In the United States, section 364 of the USBC enables a trustee to obtain credit during a reorganization and provides him with a variety of options that may be pursued. The norm is for a trustee (who is authorized to operate the business of the debtor) to obtain post-petition unsecured debt in the ordinary course of business, which is to be treated as an administrative expense in the reorganization (which has a high priority ranking). Where post-petition financing is obtained by the trustee out of the ordinary course of business, the norm is for the debt to also be treated as an administrative expense, but the trustee is required to obtain court approval (after notice and a hearing). If the granting of an administrative expense is not sufficient to enable a trustee to obtain credit, the court may (after notice and a hearing) authorize the obtaining of credit or the incurring of debt on the following terms: with priority over any or all administrative expenses provided in other sections of the USBC; secured by a lien on property of the estate that is not otherwise subject to a lien; or secured by a junior lien on property of the estate that is subject to a lien. As a final resort, the court (after notice and a hearing) may authorize the granting of a senior or equal lien on property of the estates that is subject to a lien, but only if:

- the trustee is unable to obtain such credit otherwise; and
- there is adequate protection of the interest of the holder of the lien on the property of the estate on which such senior or equal lien is proposed to be granted.
- As can be seen in the United States, as it becomes more and more difficult for the trustee to obtain credit, the trustee is given stronger and stronger weapons to use, the most powerful of which is the ability to grant a post-petition lender a super-priority interest in the form of a senior lien - but only if the interests of the existing secured creditor are protected. In practice, it is relatively easy to provide a post-petition lender with a junior position, but rare to provide it with a senior lien.

39. The proposed Hong Kong, China position, which is part of the Law Reform Commission's recommendations for the enactment of a Provisional Supervision procedure is much simpler. It provides that post-petition borrowing should receive super-priority over all existing debts, with the exception of fixed charges. Because the interests of existing lenders would be adversely affected by the granting of super-priority to other creditors, existing lenders will have a right of first refusal on any super-priority lending. Only if they refuse will the provisional supervisor be able to seek post-petition financing from other lenders. Moreover, existing creditors who hold charges (either fixed or floating, or a combination of the two) on substantially all of the assets of the company, would also have had the opportunity to have elected not to participate in provisional supervision. (See The Law Reform Commission of Hong Kong, Report on Corporate Rescue and Insolvent Trading (Hong Kong: Government Printer, October 1996), at pp 73-78.)

40. Eventually a straw poll was taken and symposium participants were asked whether they favored a policy of enabling a company genuinely seeking to rehabilitate to borrow post-petition in the ordinary course of business and to continue giving security to attract such funds. There was strong support for this proposition being adopted as general policy. But there was less agreement as to how it should be implemented. Varying levels of support were expressed in favor of different mechanisms for regulating such transactions, including the following:

- requiring judicial approval;
- requiring creditor approval;
- authorizing an independent administrator to make the decision unilaterally; and
- requiring that the granting of post-petition security interests enhance the economic outcome for creditors at large.

Participants also agreed that support for these different mechanisms would depend on the type of insolvency system in place in a given jurisdiction.

2. Security Interest's Scope of Application

(i) Should security interests in after-acquired property or in generally described collateral be enforced in insolvency? In particular, should continuation in proceeds prevail in insolvency? For example, should a mortgagee or pledgee collect against accounts receivable proceeds?

a. Secured Transactions Position

41. The argument was put forward that by restricting the pre-existing rights to certain types of collateral, the result would be that the potential borrowing power would be reduced (i.e., secured lenders would lend less money to companies).

b. Insolvency Position

42. Within the Insolvency Team there was general agreement that, as a rule, pre-existing security agreements should prevail (including the continuation of pre-petition interests in post-petition proceeds), but that such pre-existing rights should not be absolute. It was argued that in practice there need not be a reduction in borrowing power where such interference with pre-petition security rights occurs. Discussion also considered whether there should be differences in treatment between tangible and intangible property.

(ii) In unreformed secured transactions systems, how should bankruptcy treat hybrid security interests, such as title-retention conditional sales and financial leasing?

43. There is great difficulty in ascertaining whether a “lease” is in fact a true lease where the lessor retains ownership of the property being leased or whether it is a disguised sales/purchase or installment sale contract, where the lessor's interest is more in the nature of a security interest. In such situations it is clear that it would be best for the lessor/seller to try to register/perfect its security interest in case a court found that the relationship was more along the lines of the latter. Participants from some jurisdictions (e.g., Indonesia) were hesitant as to how a bankruptcy court would handle this issue. Others responded that their jurisdiction (e.g., Pakistan) did not make such a distinction. IV. Publicity of Security Interests and Insolvency A. The economic costs and benefits of making public the existence of security interests

44. There was general agreement as to the importance of publicizing the granting by a debtor of security interests, for the publicity puts the commercial community on notice that:

- the debtor company has charged property to a lender that will not be available to future lenders; and

- if the company becomes insolvent, the assets of the company will be distributed in a certain order or priority to certain creditors before payments will be made to general unsecured creditors.

(i) Possession as a means of publicity: its implications in fraud and the problem of hidden creditors.

45. There was agreement among both Teams as to the deficiencies of possession as a means of publicity, in comparison to a registration or filing system. To publicize possession, the property must be transferred to the creditor. However, such a system is unworkable for most economically beneficial transactions, where the debtor is unable to part with the collateral. Nevertheless, it was noted that in some jurisdictions possession is a frequently used financing mechanism. Particular mention was made of gold and silver loans in Nepal.

46. Other serious weaknesses with possession as a means of publicity is the confusion that often results in the law. For example, the interface between the possessory pledge and the non-possessory pledge were discussed. It was asked whether it makes sense to file in regard to one type of pledge but not the other. For example, in India the non-possessory pledge is treated as a charge and must be registered (and the property remains with the borrower), but the possessory pledge does not require registration and requires that the property must be possessed by the lender.

47. In cases where a borrower has entered into warehousing or hypothecation arrangements with its creditors, it is frequently the case that prospective lenders and sellers cannot tell whether the borrower's existing goods will be available as security for future loans. Of course, in many warehousing transactions, the buyer is required to store the seller's goods separately and to label the goods as belonging to the seller. But problems frequently arise where the seller's goods become commingled with the goods of others or the buyer fails to properly identify the goods.

(ii) Registration versus filing systems as a means of publicity

48. This topic was among those covered at the lunch talk by Mr. Fleisig, rather than during the Joint Symposium. Mr. Fleisig pointed out that in some jurisdictions the registry (which is usually government run) merely serves as a filing office. In contrast, in other jurisdictions (including Thailand, Indonesia, and the PRC) the process of registration is much more involved, because the government checks the information being registered and, in essence, guarantees the legality of the underlying transaction. In such jurisdictions, the parties must also submit originals or copies of the security agreement. It was clear from Mr. Fleisig's talk that this type of system is much slower and more expensive than a pure filing system.

D. Priority of Security Interests and Insolvency

(i) The economic costs and benefits of different options for integrating claims of secured creditors and other creditors in insolvency

a. Secured Transactions Position

49. The starting point was that secured lending must retain its level of priority in insolvency. It was noted that granting concessions to other groups will not merely hurt the secured lending system, but will kill the system. Furthermore, a problem with allowing the

claims of other groups (e.g, workers or tort claimants) to supersede the rights of secured creditors is that there is no way for a bank to quantify these claims at the time the bank contemplates making a loan to a company. It was argued that rather than inserting priorities in the bankruptcy legislation that adversely affect the rights of secured creditors, countries should enact non-bankruptcy remedies that would preserve the economic gains from secured transactions, yet also enable these other groups to obtain payment of their claims.

b. Insolvency Position

50. It was noted that the modern trend in insolvency laws is to abolish statutory priorities in insolvency. Thus, there was general agreement within the Insolvency Team that insolvency priorities should not prime the interests of secured creditors. For example, there was support for the proposition that the government should not have priority in insolvency for tax claims. It was noted that priority in insolvency often leads to lax enforcement, and evidence was offered from Australia that once the tax priority in insolvency was abolished the government became more active in collecting debts.

51. However, the Insolvency Team looked at the various priorities on a case-by-case basis and considered the non-insolvency policy in favor of each specific priority. The one area in which there was general support for retaining statutory priorities in insolvencies was that involving the claims of employees and workers. Some members thought that their rights should supersede the rights of secured creditors (e.g., as often happens in the PRC), but others thought that their ranking should be after secured creditors.

E. Enforcement of Security Interests and Insolvency

(i) Unbalanced creditor/debtor environment due to ineffective enforcement regime

52. This was the topic on which both Teams were most unified. There was general agreement that the ability of being able to enforce security interests is a key component of an effective secured transactions system. Furthermore, it was argued that the efficiency of the system for enforcing security interests is a key factor for parties in determining whether to pursue informal or formal workouts. An inefficient system of security enforcement often leads to an ineffective corporate rescue mechanism. This is because in those jurisdictions where it is difficult for creditors to enforce their security interests, it is difficult to pressure debtors to come to the table to negotiate with creditors and seek a collective remedy. Ultimately, the secured creditor might well be forced to exercise its rights in a liquidation proceeding.

53. Unfortunately, it was noted that many Asian jurisdictions lack an effective enforcement regime. Overall, it was acknowledged that the enforcement processes throughout much of the region take too long, are too expensive, and are commercially inefficient. Some of the strongest criticisms were targeted at the procedures for enforcing claims against real estate. In such cases, the need for judicial assistance is the norm and the process is slow. (When the assets in question are state-owned assets, the situation is even worse.) A further problem is that even where a creditor's actions are uncontested, judicial assistance is still often required. There was agreement that it was best to minimize the need for judicial assistance; and that where judicial assistance is necessary, it is important to expedite the enforcement process.

(i) Enforcing security interests outside a reorganization or bankruptcy proceeding: Should self-help repossession and ex parte court orders for seizure be effective?

54. There was general agreement among both Teams that security interests should be capable of enforcement outside a reorganization or a bankruptcy - without the need for seeking court approval - although as noted in para 53 above, the result in practice is far different. There was strong support favoring the need to streamline enforcement processes and enable secured creditors to act ex parte. Timing can be crucial, especially when dealing with perishables and movables such as inventory, whose value diminishes quickly.

55. The more contentious issue was when it is appropriate for an insolvency system to impede the self-help and ex parte collection attempts of secured creditors. The Secured Transactions Team urged non-interference. There was a split within the Insolvency Team. Some argued that both liquidation and corporate reorganization should impede the collection attempts of secured creditors, while others argued that the interference should be limited to corporate reorganization and that once it became clear that rescue was unlikely, the moratorium should cease. (See para 25 above.)

F. Conclusions

56. It clearly emerged from the Joint Symposium that any effective reform of debtor-creditor laws must include both secured lending and bankruptcy law, as well as related reforms in other areas of the law. It is hoped that this point will be borne in mind by governments in RETA economies that are considering, or are in the process of, reforming their secured transactions and insolvency laws.

57. It is also clear that secured transactions play a fundamental role in creating economic and social benefits for society overall. Thus, there was strong agreement among both Teams that regardless of what kind of bankruptcy law is in place, RETA economies would benefit from improving the laws relating to secured lending. As the quality of collateral improves, general access to credit, the amount that can be borrowed, and the term length of a loan all increase; and the interest rate on borrowings falls. (See para 12 above.) The enactment of effective secured transactions systems that allow for movable property to be used as collateral will make it more likely that distressed firms are able to get access to credit and avoid the need to resort to bankruptcy and, concomitantly, less likely that creditors will need to initiate the bankruptcy process to get paid. (See paras 11-13 above.)

58. Both Teams agreed that security interests need to be properly publicized. An effective method of publication will put both existing and potential creditors on notice that the debtor company has less property available in which to grant interests to future lenders. (See para 44 above.) It also provides notice as to the order of priority for the distribution of the company's assets if the company becomes insolvent. (Ibid.) Both Teams acknowledged the problems with possession as a means of security. Filing or registration systems are better, and of the two, a filing system is more efficient and often more accessible. (See paras 45–48 above.)

59. The efficient enforcement of security interests is a key component of an effective secured transactions system; it also plays an important role in promoting both informal and judicially supervised workouts. (See para 52 above.) An efficient system should minimize the need for judicial assistance wherever possible and expedite the enforcement process. (See para 53 above.)

60. There was strong agreement between the two Teams on the key issue involving the interaction between secured transactions and bankruptcy - that, as a rule, insolvency law should respect the pre-existing priority rights of secured creditors should. (See, e.g., para 17 above.) If insolvency law poses unreasonable threats to secured lending, banks will most likely raise interest rates or stop lending entirely. (See para 19 above.) There was also agreement among both Teams on the following insolvency issues:

that where before insolvency or in contemplation of bankruptcy a company charges or mortgages an asset to a creditor in exchange for the company providing value to the company, as a general rule, such a charge or mortgage should not be voided by a subsequent insolvency proceeding (see para 24 above); that secured creditors should be permitted to convert an unsecured debt into a secured debt as long as such transactions are entered into a substantially long time before the commencement of a bankruptcy (see para 28 above); that fraudulent or commercially unfair transactions that have a security component may be avoided (see para 31 above); that post-petition grants of security should be permitted (see para 32 above); that, as a general rule, pre-petition interests should continue in post-petition proceeds (see para 42 above); and that, as a general rule, priorities in bankruptcy should be abolished (see para 50 above).

61. Although there was agreement as to the primacy of secured rights in insolvency, there were differences of opinion between the Teams in regard to when it is` appropriate for bankruptcy to interfere with these pre-existing rights - in other words, of what the exceptions to the rule should be. These differences of opinion result from the different starting positions, and different orientations, of the two Teams.

62. The Secured Transactions Team proposed a general policy of non-interference. The Insolvency Team cut back on the Secured Transactions position by arguing that it is appropriate to interfere with, and at times even terminate, the rights of secured creditors, subject to narrowly drawn rules. A majority of the Insolvency Team supported the following types of interference with the pre-petition rights of secured creditors:

63. the implementation of a moratorium or stay on the rights of secured creditors in a reorganization, with secured creditors retaining the right to seek the lifting, or relief, from the stay (see paras 20 & 25 above);

- the avoidance of secured transactions when such transactions would be considered preferential transfers or unfair preferences (see para 29 above);
- the granting of super-priority security interests without obtaining the consent of pre-petition secured creditors (see para 34 above); and
- at times interfering with the effect of pre-petition interests in post-petition proceeds (see para 42 above).
- The Insolvency Team, however, did not espouse a unified view on all issues. There were disagreements within the Team on the following matters:
- whether secured creditors should be subject to a moratorium or a stay in a liquidation or winding up (see para 25 above);
- what types of transactions should be considered preferences (see para 29);
- what form post-petition security interests should take, as well as who should be given the authority to approve post-petition grants of security (see para 35 above); and
- whether the priorities for workers should take precedence over the rights of secured creditors (see para 51 above).

64. In some of the areas in which there was disagreement between the two Teams (e.g., in regard to the imposition of a stay or a moratorium on the rights of a secured creditor in a reorganization), there was overall agreement of both Teams that further investigation should be made to determine on the basis of practical experience how to reduce the extent of the disagreements (see para 27 above).

65. Overall, both Teams agreed that that RETA economies would benefit from enacting insolvency laws that respect the pre-existing rights of secured creditors. However, in deciding to what extent exceptions to the rule should be permitted and of how best to structure the balance between secured transactions and bankruptcy, governments in RETA economies must first determine which Team approach is most appropriate for adoption in their jurisdiction.

66. The Joint Symposium was the first major effort by the Bank to approach secured transactions and bankruptcy law as complementary legal regimes that should be considered together. It is envisioned that the Bank will sponsor further study of the relationship between these two areas and of the role that they play in fostering economic development. Among the projects under consideration is the drafting of model provisions for post-petition financing and the granting of super priority.