

**LAW AND DEVELOPMENT AT THE
ASIAN DEVELOPMENT BANK**

April 1999

**ADB “LAW AND DEVELOPMENT” INTERNET FORUM
COMPLETES THIRD YEAR OF OPERATION**

On 15 February 1996, Asian Development Bank (ADB) launched a law and development Internet list service, LAW-DEV, to provide an international forum for interested users. LAW-DEV will soon complete its third year of operation.

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Introduction

The 1999 edition of Law and Development at the Asian Development Bank is divided into two Sections. Section A describes major developments and programs highlights in the Bank's work in law and development in 1998. Of particular mention is the completion of the six-economy study under Regional Technical Assistance No. 5665 on *The Role of Law and Legal Institutions in Asian Economic Development*. The study was discussed at various international seminars and has been co-published by the Bank and the Oxford University Press. The Bank's law and development work continues to focus on human resource development in the legal and judicial sector and it is now also beginning to address the need for systemic law reform in some of the Bank's developing member countries. The ongoing work in Pakistan under TA No. 3015-PAK: Legal and Judicial Reform Project is an example of this.

Section B is a report on insolvency law reform in the Asian and Pacific region. The report is based on initial findings of an ongoing technical assistance for Insolvency Law Reform (TA No. 5795-REG) (RETA) which was one of the Bank's response to the Asian financial crisis. Insolvency law reform is a topical issue in the Asia-Pacific region. It is hoped that presentation of the report in Section B will contribute to informed debate and discussion on this important issue. The principal consultants for the RETA are Ron Harmer and John Lees. This Section was prepared by Ms. Clare Wee, Counsel, who is the Project Officer for the RETA, and on the basis of the report of the principal consultants.

The views presented in Section B do not necessarily represent the views or position of the Asian Development Bank or any of its member governments.

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**Section A: BANK LAW AND DEVELOPMENT
ACTIVITIES IN 1998**

BANK LAW AND DEVELOPMENT ACTIVITIES IN 1998

Responding to the Financial Crisis

1. In recent years, the Bank has worked closely with its DMCs in addressing legal and regulatory reforms considered necessary to foster sustainable development. Such law and development activities took on a new dimension in 1998, as legal and regulatory reforms became a central element in DMCs' responses to the Asian financial crisis and in the Bank's assistance to those countries affected. Such crisis-related assistance complemented the Bank's ongoing law and development assistance in 23 DMCs in support of the Bank's five strategic objectives of promoting economic growth, reducing poverty, supporting human development, improving the status of women, and protecting the environment. In 1998, law and development assistance was provided through 11 program loans, two technical assistance loans, numerous project loans and 59 technical assistance projects.

2. The Bank's assistance to DMCs affected by the crisis in its earliest days focused on reforms to the legal and policy framework for regulation of financial institutions and regulation of their financial and capital markets.

3. The Financial Markets Reform Program for Thailand,¹ which provided a \$300 million loan, addressed problems arising from nonperforming loans to finance companies and rehabilitation of unliquidated finance companies by improving the legal framework for debt recovery. The program required enactment of an amended Bankruptcy Law, ensuring autonomy of the Securities and Exchange Commission, increasing accountability of the Stock Exchange of Thailand, preparing a Corporatization Law allowing conversion of existing state enterprises to privatized companies, and enacting amendments to the Alien Business Law to permit participation of foreign and majority foreign-owned domestic securities companies in securities brokerage and dealership businesses.

4. The Financial Sector Program for the Republic of Korea,² which provided a \$4,000 million loan, worked with the Government to reform significant financial sector laws and regulatory policies. The program involved amendments to the Bank of Korea Act to guarantee the operational independence and autonomy of the Bank of Korea, passage of an Act for the establishment of the Financial Supervisory Institutions to consolidate supervision of all commercial and specialized banks, and issuance of guidelines reforming the insurance industry. In August 1998, Korea's Bank Supervisory Authority, after reviewing prudential standards in accordance with the requirements of the program, announced revised core principles relating to the treatment of financial assets and the revision of loan classification criteria. Also in furtherance of the program loan's objectives, the Republic of Korea's National Assembly enacted at year-end 1998 the Mortgage-Backed Securitization Companies Act.

5. The Bank's 1998 Financial Governance Reform Program in Indonesia,³ which provided a \$1,500 million loan, addressed bankruptcy law reforms, secured transactions law reforms and reforms to Indonesia's anticorruption legislation and regulations. Pursuant to this

¹ Loan No. 1600-THA: *Financial Markets Reform Program*.

² Loan No. 1601-KOR: *Financial Sector Program*.

³ Loan No. 1618-INO: *Financial Governance Reforms: Sector Development Program*.

Financial Governance Reform Program, the Government enacted a 1998 Banking Law and approved regulations providing a framework for bank mergers and acquisitions as well as for liquidation of commercial banks. Bank Indonesia also issued new guidelines concerning information to be included in annual reports by commercial banks and approved new loan loss regulations. A 1998 Presidential Decree established the State Ministry for the Empowerment of State Enterprises, which will commence performance audits and recommend measures to improve accountability and transparency. Under a parallel technical assistance loan,⁴ the Bank is making available financing to the Government for training of bankruptcy personnel and for development of a secured transactions registration system.

6. Focusing on the importance to the crisis affected DMCs of effective bankruptcy regimes to provide structure and process for the rehabilitation and restructuring of insolvent companies and the liquidation of those companies that are incapable of rehabilitation, the Bank approved in 1998 a regional technical assistance on Insolvency Law Reform.⁵ The technical assistance will bring together government officials responsible for bankruptcy law reform and bankruptcy administration, bankers, leading insolvency practitioners from the legal and accounting professions, and academic experts to consider recent experiences with insolvency law reforms in the Asian and Pacific region. National studies have been commissioned, and the studies and the proceedings of seminars convened will be published. An Asian Insolvency Law Reform site on the Internet is also being established.

Law and Economic Development

7. The legal and regulatory elements of the Bank's response to the financial crisis were shaped in part by two Bank-sponsored studies released in 1998: *The Role of Law and Legal Institutions on Asian Economic Development, 1960-1995* and *A Review of the Law and Development Activities of the Asian Development Bank*, which was presented to the Bank's Board of Directors as a Board Information Paper (the Information Paper).

8. The first study, *The Role of Law and Legal Institutions on Asian Economic Development, 1960-1995*, reports on the results of a major Bank-commissioned⁶ examination of the role which economic laws and legal institutions played in the economic development of the PRC, India, Japan, Republic of Korea, Malaysia, and Taipei, China during a 35-year period of dynamic economic growth. Conducted under the direction of the Harvard Law School and the Harvard Institute for International Development, the study brought together an interdisciplinary research team of 12 leading Asian legal and economic scholars. It found that law played an important role in facilitating economic development, particularly when governments pursued economic policies which fostered free markets and reduced the role of government as a primary decision-maker in the economy. The study concluded that, for rule-based law to play an effective role in economic development, economic policies reducing direct state management of economic activities must be in place, and there must be an effective congruence of economic law reforms and economic policy. This is among the principal lessons of the study for DMC policymakers in the context of the current financial crisis in the region. Another is that particular attention needs to be directed to the institutional framework for the administration and enforcement of legal reforms, which have demonstrated greater resistance to change and greater path-dependency.

⁴ Loan No. 1620-INO: *Capacity Building for Financial Governance*.

⁵ RETA No. 5795: *Insolvency Law Reform*.

⁶ RETA No. 5665: *The Role of Law and Legal Institutions in Asian Economic Development, 1960-1995*.

The Role of Law and Legal Institutions in Asian Economic Development, 1960-1995

A multidisciplinary study financed under Bank regional technical assistance evaluated change in the legal systems of six Asian economies (PRC, India, Japan, Republic of Korea, Malaysia, and Taipei,China) in the period 1960-1995, and examined the causal relationships between legal change and economic and social development. Broadly, the study validated a basic premise upon which governments have acted in both transition and liberalizing economies in enacting significant law reforms: that law is important to private sector development and, in particular, to the development of financial and capital markets. The study also observed, somewhat more tentatively, increased use of the courts as economic activity increased, increased use of the courts to challenge governmental action, and an increase in the frequency with which private parties were successful in their disputes with government. These are signs of the growing importance of legal remedies as economies become more complex and impersonal, and of the growing use of the legal system to enhance the accountability of government.

The findings of the study have important implications for DMC law reform policies and for externally assisted legal technical assistance programming: Economic law reform must take into account existing laws, their actual use, and the overall economic policy and institutional framework in which they function; effective congruence is necessary between prevailing economic policies and economic law reforms if such legal reforms are to be effective; and effective law reform requires pursuit of a broadly consultative law-making process. The study points to the need for collaboration between lawyers and economists in the design of law and development programs. By demonstrating that the effectiveness of economic laws depends on the prevailing economic policy environment and upon the institutional framework for enforcement of laws, the study is likely to reinforce the growing recognition among funding agencies of the need to move beyond the narrow focus on particular laws and their content to a more systemic approach that takes into account broader economic policies and institutional frameworks and the functioning of the broader legal and judicial system in which laws must operate, be administered and enforced.

The study has been copublished by the Bank and the Oxford University Press. An Executive Summary is also available on the Bank's Internet Web site and from the Office of the General Counsel.

Supporting Systemic Reform

9. The Information Paper emphasizes the need for a systemic approach to legal reform which recognizes that the effectiveness of laws depends upon the quality of government legal personnel and the operation of legal and judicial institutions, in addition to the quality of the law enacted. In pursuing a systemic approach to legal reform, it states that the Bank will focus on capacity building and institutional strengthening, strengthening of secondary institutions such as law schools and professional associations, and supporting an institutional framework characterized by accountability and protection against abuses of discretionary power by government officials and agencies.

10. Illustrative of this more systemic approach to the effectiveness of the legal system are two Bank technical assistance grants which focus on the development of local institutions capable of retraining public sector lawyers in two transition economies: Mongolia and Viet Nam. To assist with continuing legal education in the application of market economy-based legal principles, the Bank approved in 1998 a technical assistance to Mongolia for the establishment of a Legal Retraining Center, for the development of the Legal Retraining Center's faculty and teaching program, and for development of the Center's management. About 200 Mongolian public sector lawyers (including judges, prosecutors, and legislative draftsmen) will be training in each of the first two years of the Bank's assistance. A similar program in support of the Viet Nam Legal Professional Center was approved by the Bank in 1997 for the retraining of legal personnel within the Ministry of Justice. In 1998, the faculty of

the Viet Nam Legal Professional Training Center completed its training and initial curriculum development work in Australia, and the first of its retraining courses in Viet Nam was launched. The emphasis of such programs in Mongolia and Viet Nam is on the large body of new economic laws enacted in each country in recent years and the need to ensure that government lawyers and judges responsible for implementation have the requisite training in the substantive content of such laws, the practical aspects of their implementation, and the related skills required in their application.

11. Also illustrative of the systemic approach endorsed by the Information Paper is Bank technical assistance,⁷ approved in 1998, to assist the Government of Pakistan to improve the efficiency of its legal and judicial system. The technical assistance will assist the Government in carrying out a detailed study to define an agenda and implementation schedule for legal and judicial reforms. The study and recommendations for reform will address the reduction of court congestion reorganization of government legal service, the accessibility of information on Pakistan's laws and regulations, legal education, judicial training, economic law reform, and improving access to justice. Among other subjects, the study will consider means of increasing the participation of women in the legal profession, government legal service, and the judiciary.

People's Republic of China: Assistance for (i) Drafting of the New Securities Law and (ii) Capacity Building in Drafting Land Administration Laws

Subsequent to the commencement of the financial crisis in Asia in the middle of 1997, the Bank provided technical assistance to strengthen laws governing securities laws in Bank DMCs. One such technical assistance grant financed legislative drafting support for the Securities Law approved by the PRC on 29 December 1998 after six years of preparatory work. Under this technical assistance, the Bank's Office of the General Counsel provided staff lawyers and consultants who participated in discussions during a three-day seminar in Beijing in September 1998 and an International Symposium in October 1998. The Symposium, which was covered by television and print media, provided a forum for discussion of the draft Securities Law by international and domestic experts as well as representatives of government and the general public prior to submission of the draft law to the National People's Congress. The Securities Law strengthens the legal framework for the PRC securities market, increases transparency and accountability of the China Securities Regulatory Commission, facilitates disclosure-based initial public offerings, and prohibits such practices as insider trading and brokerage firms mixing their own and clients' money to trade shares.

Pursuant to the Bank's strategic objectives of protecting the environment and supporting human development, the Bank also provided technical assistance to the PRC to train staff members of the Environmental Protection and Natural Resources Conservation Committee of the National People's Congress and to provide assistance in drafting a new Land Administration Law. Enacted in 1998 soon after a symposium supported by Bank technical assistance, the Land Administration Law deals with the ownership of and right to use land, overall planning for land utilization, protection of cultivated land, use of land for construction, as well as supervision of land administration statutes and regulations. Consistent with advice provided under this legislative capacity-building technical assistance, the new Land Administration Law increases levels of resettlement fees to be paid directly to people losing productive land. Training provided also improved the processes for adjustment of contracts and dispute resolution, including provisions permitting parties not accepting the decision of the local government under the Land Administration Law to file a lawsuit within 30 days after receiving notification of the government's decision.

Disseminating Information and Encouraging Dialogue

12. The Bank continues to play a leadership role in fostering interchanges in the field of law and development among DMCs, funding agencies, academics, and other interested parties. LAW-DEV, the Bank-sponsored Internet forum, provides a daily link for the

⁷ TA No. 3015-PAK: *Legal and Judicial Reform Project*.

communication of ideas and information among more than 600 participants in 40 countries. The Bank also encouraged dialogue on key legal and policy issues on infrastructure development at the Annual General Meeting Seminar on *"Private Interest vs. Public Good: Governance Dimensions of Regulatory Frameworks for Private Sector Infrastructure Development."* The *Informal Consultation on Legal Issues of Investment and Finance Arising from the Asian Financial Crisis* also brought together 30 leading lawyers from the region and provided a forum for a lively exchange on some very current issues.

13. After completing the pilot project on Project DIAL (Development of the Internet for Asian Law),⁸ a pioneering project which makes available to DMC law reform personnel and legal draftsmen full-text legislative materials from more than 40 countries as a "virtual reference library" larger than any legislative reference library currently in the Asian and Pacific region, the Bank approved expansion of Project DIAL to a full-fledged project with the objective of making it a long-term sustainable resource. For more information on Project DIAL, see inside cover.

⁸ RETA No. 5701: *Feasibility Study for Creation of an Electronic Development Law Resource Center*. This is also known as Project DIAL, for Development of the Internet for Asian Law.

**Section B: INSOLVENCY LAW REFORM IN THE ASIAN
 AND PACIFIC REGION**

INSOLVENCY LAW REFORM IN THE ASIAN AND PACIFIC REGION

I. INTRODUCTION

1. The Regional Technical Assistance for Insolvency Law Reform (TA No. 5795-REG) (RETA) is being carried out as a part of the Law and Development activities of the Asian Development Bank (ADB or Bank), and as one of the Bank's responses to the Asian financial crisis. The Asian financial crisis has brought to the fore many of the inadequacies of the legal regimes in the region, and in particular, the failings of the insolvency regimes in the Bank's developing member countries in Asia (DMCs). The economies covered by the RETA include Korea, Japan, Taipei, China, Hong Kong, China (hereinafter "Hong Kong"), Singapore, Indonesia, Malaysia, Thailand, India, Pakistan, and the Philippines (collectively, the "RETA economies").⁹

2. The lack of frameworks for the systematic restructuring of debt or the efficient liquidation of businesses incapable of being restructured pose impediments to economic recovery, complicate the rehabilitation of financial sector institutions, stifle foreign investment, and inhibit the growth of the region's domestic debt markets. Many of the DMCs have outdated bankruptcy codes that are no longer appropriate in today's business and corporate climates. For example, Indonesia's Bankruptcy Ordinance (1904) is based on the Dutch Bankruptcy Act of 1896. Outmoded insolvency laws, which are ill-equipped, for example, to facilitate the restructuring of distressed corporations through formal and informal processes, and to provide priority for "new money" are key constraints to economic recovery.

3. Other constraints highlighted by the Asian financial crisis are the inadequate court systems, and the weak enforcement and implementation of existing insolvency laws in the RETA economies. While these problems are obviously not new, they have been ignored or circumvented by many of the DMCs during "boom" times. However, it has now been recognized by many of these DMCs that modern insolvency laws and processes are important to restore investor confidence in their economies.

4. A study on insolvency law reform in the Asian region is, therefore, timely especially since, as a result of the Asian financial crisis, there has been a frenzy to implement insolvency law reforms. The RETA is designed to provide a regional forum for government officials and others concerned with insolvency law reform and administration to discuss common problems in insolvency law reform and administration and to explore regional and international best practice.

⁹ The corporate liquidation (winding up) laws of Hong Kong, Singapore, India, Pakistan and Malaysia are modeled on English (or in some cases Australian) law. The Indonesian bankruptcy law (which, when applied, can lead to a liquidation) has its origins from Dutch law. Some of the Japanese insolvency processes may be traced to German, then later, American influence. Elements of the insolvency law of Korea resemble those of Japan. Taipei, China has a liquidation (bankruptcy) law which, although initially applied in and then brought from mainland China, has elements of civil code origins. The Philippines insolvency law regime contains elements of American influence. And, the judicial management (rescue) law of Singapore has elements of English and Australian law.

5. In DMCs that have been worst affected by the crisis, such as, Indonesia, Thailand, Korea and Malaysia, some considerable progress toward reform of the insolvency law had occurred by the time the RETA commenced. In Hong Kong extensive reforms to the corporate insolvency law have been proposed. Others among the RETA economies have adopted short-term special legislation to deal with particular aspects of the crisis (for example, in the banking sector). In addition, six of the RETA economies have commenced the promotion of semi official informal work-out processes in relation to insolvent corporations which have large debt exposure to banks and other financial institutions.

6. However, the purpose of the RETA is not solely to address the immediate effects and consequences of the economic crisis, or the immediate or rushed solutions to the many problems presented by it. The RETA is designed with the much broader and longer term aim of encouraging the greater development of legal and commercial systems, practices and institutions, for application in all circumstances. The broad aims of the RETA are to (i) study the relationship between corporate debt and the insolvency or financial difficulty of corporate debtors in the region; (ii) make recommendations which are suitable for the region to effectively deal with a problem or corporate insolvency and recovery of debt; and (iii) make available, through the Internet, the insolvency and other related legislation of RETA economies and the studies and reports produced as a result of the project.

7. This paper presents a description of the RETA, including a summary of discussions at the Symposium on Insolvency Law Reforms held at the Bank's headquarters from 25 to 26 January 1999 (Symposium). The RETA economies were represented at the Symposium by the local experts, judges, bankruptcy practitioners, policy makers, scholars, lawyers, bankers and accountants. Also present were observers from other multilateral institutions, including the World Bank, International Monetary Fund, and United States Agency for International Development (USAID), and Organisation for Economic Co-operation and Development (OECD), as well as delegates from various legal institutes, Socialist Republic of Vietnam and People's Republic of China.

8. In preparation for the Symposium, individual studies for each of the RETA economies ("local studies") were prepared by local experts in each of the RETA economies who were required to work with representatives of the finance sector, entrepreneurs, professionals and government in the preparation of the study. In order to permit a basis of comparison, the local experts were required to prepare the local study in response to issues set out in a working guide. A preliminary comparative report ("Comparative Report") was prepared based on the local studies. The Comparative Report seeks to develop key areas for discussion and critical evaluation with the eventual prospect of framing recommendations for consideration and possible application in some of the RETA economies.

9. The subject will be revisited in October 1999 at a further symposium at the Bank's headquarters in Manila. It is anticipated that the recommendations from this RETA will eventually form the basis for further examination and follow-up actions by governments in the RETA economies and by the Bank in Bank-funded Loan and Technical Assistance projects.

II. ASSUMPTIONS, STANDARDS AND JUDGMENTS

10. As stated above, one of the goals of the RETA is to develop recommendations for dealing with the problems of corporate debt recovery and corporate insolvency. This necessarily involves the selection of a standard by which some judgment might be made when

reviewing laws and practices in the RETA economies. Under the RETA, basic standards are determined by reference to well established and accepted policies and principles, as drawn from the corporate insolvency regimes and related practices, of more fully developed countries. This proposal may possibly attract the criticism that this is tantamount to suggesting that such laws and practices be imported into a RETA economy which may be far from willing or capable of accepting and applying such laws and practices. One might also be accused of seeking excessive homogeneity or of promoting the expansion of “globalization”, unwisely and unnecessarily.

11. In responding to such possible criticisms, a number of points arise. Firstly, that the insolvency law regimes of more fully developed countries vary considerably and there are significant differences between them. Proposals or suggestions about the benefit of harmonizing insolvency laws of these countries, while attractive in theory, have never overcome substantive real and practical differences between the regimes.

12. Secondly, there are common basic policies and principles of approach in insolvency regimes of more fully developed countries even though their application in legislation and actual practice varies considerably. It is, therefore, not impossible to identify the basic policy framework of a commercially acceptable insolvency law regime that appears reasonably suited to application in a market economy. The addition of sensible pragmatism should make it possible to also set out desirable standards of practice and procedure.

13. Thirdly, it should also be observed that the backdrop or environment in which most corporate insolvency law regimes operate (or are supposed to operate) is relatively similar. For example, all corporate insolvency laws are directed at corporations; corporations compete in a market economy and engage in trade, commerce, debt funding and secured lending; there is a complex commercial structure in which corporations function; and corporations have employees, are liable for taxes and are governed by directors. Therefore, it is not difficult in principle to identify standards, by reference to principles and policies which lie behind the development of insolvency law regimes in other countries. In applying such standards to promote reform, we are mindful that effective reform to insolvency law regimes cannot take place without properly established frameworks to accommodate such laws and practices.

14. Finally, it is acknowledged that non-conformity with such standards does not necessarily mean that some form of correction is required. It is also acknowledged that apparently inadequate responses to particular problems or issues in some of the RETA economies may not be much different from that found in other more fully developed countries. For example, corporate fraud occurs in every country but the record of successful prosecution and recovery of the proceeds of corporate fraud in the context of insolvent corporations is not high, irrespective of levels of development.

III. SYMPOSIUM DISCUSSIONS

15. The Symposium was conducted through a series of discussion topics on insolvency law, processes and reforms. Symposium participants spoke of recent developments in insolvency law, and the merits and deficiencies of the insolvency law regimes in their respective economies. A summary of the major issues that emerged during these discussions is set forth below.

A. Statistics, Knowledge and Information

16. The Comparative Report observed that there is generally an absence of information about and reports of cases of insolvency in some of the RETA economies, and expressed concern about the availability and quality of reliable statistical information relating to insolvency. Statistics on insolvency cases in many of the RETA economies are either barely sufficient, or worse, non-existent. In the RETA economies where statistics do exist, the statistics rarely present any analysis of the type of information that a basic statistical recording system should show. Hong Kong, at least, appears to be a notable exception. Reference to the statistical information contained in the Hong Kong local study, gives not only the number of cases of insolvent corporations but also gives details of the industries or business activities in which those corporations were engaged. With respect to accounts and accounting information, it was observed that in most cases, accounting information would not be accurate. Even the local studies of Japan and Hong Kong opined that the accuracy of financial disclosure could not be depended upon.

17. The Comparative Report also expressed concern that when such statistical information was available, the information revealed a surprisingly low incidence of cases of formal insolvency in many of the RETA economies. These numbers remained low despite the obvious effects of the Asian financial crisis over the last 18 months. This suggests, taking into account both normal and exceptional economic circumstances, that there is very little recourse to formal insolvency procedures in the RETA economies.

18. The Symposium discussions also confirmed that there is an alarming absence of knowledge and information concerning insolvency in many of the RETA economies. This extends not only to that which might be termed "real" information, such as statistics about insolvency, causes, effects and so forth, but also to knowledge about insolvency processes generally. For example, there is very little knowledge about the informal work-out process. Some have the view that such a process can only deal with bank debts and cannot be used as a means of dealing with all the debts of an insolvent corporate debtor. There is likewise very little knowledge and understanding of the formal rescue process¹⁰.

19. In some cases the absence of such knowledge was attributed to the fact that in the past there had been very little recourse to formal insolvency procedures and that new and

¹⁰ Essential elements of "rescue" include: (i) voluntary submission by a corporation to the process (which may or may not involve judicial proceedings and thereafter judicial control or supervision); (ii) automatic and mandatory stay or suspension of actions and proceedings against the property of the corporation affecting all creditors for a limited period of time; (iii) continuation of the business of the corporation either by the existing management, an independent manager or a combination of both; (iv) formulation of a plan which proposes the manner in which creditors, equity holders and the corporation (including its businesses and assets) will be treated; (v) consideration of and voting on acceptance of the plan by creditors; (vi) possibly, the judicial sanction of an accepted plan; and (vii) implementation of the plan. Within this framework, there may be many variations and divergences.

For example, rescue may take the form of a composition, by which the debtor and the creditors agree to a simple compounding of debts. Or, rescue may take the form of a complex reorganization under which the debts of the debtor are restructured (extended length of loan, extended period to repay, deferral of payment of interest, and possible change in the identity of lenders). Restructuring may also involve the conversion of some debt to equity, sale of some non-core assets, and closure of non-profitable business activities. Rescue does not imply that the debtor, its creditors and its shareholders are or will be completely restored. Nor does rescue necessarily mean that the ownership or management of the debtor corporation will maintain and preserve their respective positions. However, in general, rescue does imply that under whatever form of plan, scheme or agreement is agreed, creditors will eventually receive more than if the debtor corporation was immediately or soon liquidated.

reformed procedures (both formal and informal) had been only recently introduced. It is still too early to gauge the effect of these reformed laws. In addition, the necessary infrastructure to enable the new laws and new procedures to be implemented and enforced are still being developed.

20. It was suggested that an explanation of the low numbers of formal insolvency cases is the negative attitude towards insolvency generally, and resort to informal insolvency process in particular. In many of the RETA economies there appears to be a cultural attitude, particularly evident in commercial society, which views dispute resolution and problem solving as best suited to non-confrontational negotiation and mediation. Consistent with that, there also appears to be a distinct aversion to the use of strict legal processes (which require a somewhat rigid adherence to legal system organization, function and methodology) for the resolution of commercial disputes and problems. It was also suggested that another explanation of the low numbers of formal insolvency cases might be due to the severe drop in asset values and poor debt recovery prospects because of the economic crisis. It was argued that as a result, creditors, particularly bank creditors, and debtors alike have adopted a general "wait and see" attitude and have postponed individual enforcement and collective remedial actions.

21. Symposium participants generally accepted that most of the RETA economies would benefit from considerable education and training in many aspects of insolvency law and practice. This should extend to a number of interest groups such as banks, entrepreneurs and government officials. It was also generally accepted that the process of gathering and recording statistical insolvency information should be commenced and encouraged in a number of the RETA economies. In the context of insolvency, the proper construction and maintenance of accounts and accounting information in relation to a corporation serves three important purposes. First, it provides a warning of the onset of financial difficulty and thus serves an important internal purpose. Second, it is important externally as an information system to financiers and suppliers (although one suspects that, in the case of the latter, this may be overstated). Third, it can be crucial to the prospect of rescue or work-out (for example, as providing some comfort to existing investors and lenders; to determine a plan of rescue; to satisfy the inquiries of potential investors, purchasers or financiers).

B. The Insolvency Laws

22. This discussion concerned the standard of formal insolvency laws in the RETA economies. Although all of the RETA economies have formal laws that deal with both liquidation¹¹ and rescue of corporate debtors, many of them are either outdated or inadequate. The participants of the Philippines, India, Pakistan and Taipei, China spoke of the considerable deficiencies in their respective formal rescue laws, and of very little endeavor to effect new or reformed laws to correct the deficiencies. It appears that at present the economies of Pakistan, the Philippines, India and Taipei, China would benefit most from a comprehensive reform of their respective insolvency law regimes.

¹¹ Also known as "winding-up" or "bankruptcy". Liquidation tends to be close to "universal" in its concept, acceptance and application. Liquidation normally follows a pattern which includes: (i) an application to a court or tribunal either by the corporation or by creditors, (ii) an order or judgment that the corporation be liquidated; (iii) appointment of an independent person to conduct and administer the liquidation; (iv) immediate closure of the business activities of the corporation; (v) termination of the powers of directors and employment of employees; (v) sale of the corporation's assets; (vi) adjudication of claims of creditors; (vii) distribution of available funds to creditors (under some form of priority); and (viii) ultimate dissolution of the corporation.

23. The participants of Japan, Hong Kong and Malaysia were hopeful that their respective governments would soon reform their respective systems. Singapore, by comparison, had effected reforms well prior to the economic crisis which, by all accounts, are working efficiently. The participants of Indonesia were concerned that, although the recently introduced reforms were overdue and necessary, they had stopped short of conducting a much-needed general overhaul of the insolvency and related laws, procedures and processes. The Thai participants reported that some of the new reforms have had some effect but that complementary reforms (for example, concerning the enforcement of security rights) were still outstanding.

C. Court System

24. The Symposium discussions confirmed that in at least some RETA economies there is an aversion to formal insolvency procedures, particularly those that involve the judicial process. In some RETA economies there is also a negative reaction toward the use of insolvency law because of problems with the court and judicial system.

25. In many of the RETA economies, processes are slow, judges are not suitably qualified or experienced, and the judicial process is unpredictable and unreliable. This may be the result of the absence of, or only recently established, infrastructure and systems to deal with formal and informal insolvency procedures. For example, the local studies and Symposium discussions showed that in Indonesia, Thailand, Pakistan and the Philippines, the court system is not sufficiently structured to deal properly with insolvency cases. Many judges are not competent to understand even the most basic of the complexities normally involved in a case of corporate insolvency. At present, a complex case of corporate reorganization and financial restructuring would appear to be beyond the knowledge and experience of most judges and officials.

26. The Symposium participants from these RETA economies identified the organization of the courts, the status and the general accountability of judges and court officials as areas requiring considerable improvement. Some of the participants pointed out that their systems also required suitably trained and qualified insolvency case management administrators. This is particularly true of government agencies whose task it might be to administer cases of both liquidation and rescue, but it is also true of the private sector where there is an absence of trained and qualified insolvency practitioners. It would appear that the highest priority should be accorded for the intensive education and training of judges, court officials and insolvency administrators in many of the RETA economies.

D. Systemic Problems and Special Insolvency Laws

27. Many of the insolvency law reform initiatives that have been recently undertaken in a number of the RETA economies have been affected in their operation and application by the fact that the banking and financial sector in those economies has been badly affected by the Asian financial crises. The systemic problem of a hugely over-extended banking and financial sector with non-performing loan portfolios, and massive unhedged foreign currency debt that was made worse by deep currency devaluations, called for emergency reform measures designed to address the systemic problems in the banking and financial sectors. While

necessary, these have distorted, and created considerable difficulty in, the normal application of insolvency law and related procedures.¹²

28. Some considerable attention and discussion was given to Malaysia's Pengurusan Danharta Nasional Berhad Act (Danharta Act) (1998).¹³ This law was specifically directed towards the systemic problem area and, at the same time, provided for the possible rehabilitation of debt burdened corporations. It is instructive that this legal process is operated through an administrative board that has been accorded significant powers. It appeared to be a good example of the type of methodology that is sometimes required to deal with systemic insolvency problems.

E. Informal Work-Outs¹⁴

29. Other sessions of the Symposium discussed the informal "work-out" initiatives recently adopted in Indonesia (known as the Jakarta Initiative), Thailand (popularly called the Bangkok Rules) and Korea (known as Financial Institution Agreement for Promotion of Company Restructuring). The text of these initiatives is presented in Appendixes 1 to 3 respectively. These contrast with similar initiatives taken in Malaysia, Hong Kong (known as Guidelines on Corporate Difficulties) and Singapore. The text of the Hong Kong Guidelines on Corporate Difficulties is presented in Appendix 4. The former are primarily directed at the banking sector and appear to be designed to facilitate the preservation of the value of debts owed to banks by the corporate sector. The latter are more generally directed at providing alternative procedures to rescue corporate debtors outside of formal "out-of-court" procedures.

30. It was generally agreed and accepted that alternative informal work-out procedures should be encouraged. Concerns were expressed by the participants from a number of the RETA economies that such procedures might only be successful if there was significant education and training among banks and financial institutions and owners and managers of corporations about the methodology and processes involved in such processes. This also extended to the absence in a number of the RETA economies of professional and other advisors who have experience in the work-out process.

31. It was also observed that the presence of a facilitating agency to bring debtors and creditors together (as, for example, under the Malaysian and Korean schemes) was most useful in those countries which had no experience of the informal process. Participants from some of the RETA economies also pointed to the absence of lending practices based on cash flow and income as a reason for difficulty in bringing lenders and corporate debtors together at a time of corporate debtor financial crisis.

32. It is hoped that once the systemic debt problem of the banking sectors in many of the RETA countries is arrested, the informal processes can be reviewed to ensure that in dealing with corporate debt problems, all creditors (and not solely the banking sector) will

¹² In market economies, the liquidation and rescue process should not be the subject of political or government influence or intervention. However, the presence of some exceptional economic, social or other such circumstance might sometimes justify a special process and the involvement or intervention of the government. Typical of such a process is one that might sometimes be applied when the banking sector of a country is itself in financial difficulty.

¹³ The Danharta Act is more fully described in Section V.

¹⁴ A discussion of the basic elements of the informal work-out process and the particular work-out practices in the RETA economies is set out in Section VI.

benefit. Observers from organizations, such as the International Law Institute and the OECD, expressed concern that, at present, the informal processes did not take proper account of important collective characteristics.

F. Individual Creditor Rights and Collective Insolvency Processes

33. The Comparative Report raised the issue of the clash of values between the enforcement of individual creditor rights and the imposition of collective creditor procedures. Specifically it pointed to the need to balance individual rights (particularly those of secured and other like creditors) with the restraint that is sometimes necessary in the context of a formal rescue process.

34. It is a common banking practice throughout the RETA economies to engage in the practice of secured lending, particularly on the security of land and shares. Probably, in the majority of cases, the reaction of a secured lender to the financial difficulty of a corporate debtor will be to take action to recover the outstanding debt and enforce the rights of a secured lender. In Hong Kong, Singapore, Malaysia, India and Pakistan, lenders have the facility of the "floating charge" (or something similar) as security over all the assets of a corporate borrower. In some of these latter jurisdictions the common method of enforcement is to appoint a receiver (which can normally be done without recourse to the courts) who is empowered to collect and otherwise sell all the assets of the corporation for the benefit of the secured creditor.

35. Except in Malaysia, the appointment of a receiver will normally rule out any possibility of a rescue process for the corporate debtor. None of the rescue processes of Hong Kong and Singapore restrict the rights of the appointment of a receiver by a secured creditor. In the case of Singapore, judicial management would be declined to a corporate debtor if a receiver has been appointed or if there is a likelihood that a receiver will be appointed. Thus in those countries, the enforcement of the security by the appointment of a receiver can forestall and prevent any type of corporate rescue.

36. During the Symposium discussions, it became apparent that some of the RETA economies need to address a number of unresolved issues concerning the enforcement of individual creditor rights, particularly those involving or related to enforcement of securities, lease property rights and guarantees. There is nothing much that an insolvency law can do about deficiencies concerning the exercise of individual creditor rights. But there is a real problem when, at the same time, there are deficiencies in both that area and in the rights of creditors to seek the application of insolvency processes against a debtor corporation. If a creditor cannot, in a practical and effective sense, seek either individual or insolvency remedies against a debtor, a considerable bias is created for the benefit of the debtor. In Indonesia for example, it could be argued that a debtor corporation, despite the fact that it is insolvent, might easily obstruct and delay enforcement of security rights. This results in a very unequal position between debtor and creditor.

37. In India, a radical initiative may soon be taken to overcome the considerable difficulties in enforcing secured property rights through court related processes. The initiative proposes that the parties to a secured lending contract would submit to a form of arbitration for the determination of such issues as the right to enforce, the method of realizing the value of the secured property and any consequent liability for the shortfall. In Thailand, legislative progress toward improved enforcement rights for secured creditors had begun but was the subject of considerable opposition because of the effect of the economic crisis.

38. On balancing individual enforcement rights and the restraints that are necessary for the practical operation of a collective rescue regime, Symposium participants agreed on the need for such restraints. It was accepted that many of the RETA economies need to revisit this aspect and carefully consider the balancing of individual rights against the application of collective insolvency processes.

G. Corporate Governance

39. Although much of this subject is beyond the competence of an insolvency law to regulate, the Symposium participants agreed that a fundamental problem of any insolvency law system is that it is often expected to operate and produce positive results in an environment of inadequate corporate governance and financial responsibility. The participants from Pakistan and the Philippines mentioned the problems caused by political favoritism, "cronyism", and forms of fraud and corruption¹⁵ that often contribute to a considerable lack of corporate responsibility among owners and management. "Crony capitalism" and corruption has been, in part, blamed for the Asian financial crisis. Consequently, there is a slow change in the attitudes towards corruption and bribery, and at least outwardly, it is no longer said that corruption and bribery are inevitable and unalterable ways of life in the RETA economies.

40. Symposium participants agreed that corruption is seriously harmful to commercial processes generally as it undermines proper and normal legal and commercial practices and processes. For example, a corrupt judiciary could easily undermine the proper commercial enforcement of a security over property of an insolvent corporate debtor; or prevent a legitimate application for the winding-up or other form of insolvency administration of an insolvent corporate debtor. Additionally, a commercially workable formal insolvency administration regime or even an informal work-out regime would be impossible since the necessary commercial conditions to bring debtor and creditors together are simply absent.

41. It was agreed that standards of corporate governance and accountability of managers and owners need to be considerably improved in a number of the RETA economies. This is particularly the case with the greater involvement of the RETA economies in both regional and world trade and commerce. It was also generally accepted in the Symposium discussions that it is of fundamental importance that the insolvency laws of the region contain adequate sanctions to penalize managers and owners of insolvent corporations for fraudulent behavior and also for behavior that falls short of proper standards. This requires that adequate resources are made available to insolvency administrators to investigate and report on corporate governance breaches. Some participants also considered that there is difficulty in determining whether such sanctions should be applied in both liquidation and rescue processes. Although there was general agreement that sanctions are appropriate in a liquidation context, opinions varied as to whether sanctions are appropriate to the rescue process since this might often involve negotiations and bargaining designed to compensate for breaches of corporate governance standards.

¹⁵ Corruption is defined as the misuse of public or private office for personal gain, and includes bribery. Fraud, in the context of this RETA is defined to cover "hard" and "soft" fraud. Hard fraud is the act of obtaining property or a benefit of whatever description that should rightfully belong or remain with a corporation. Soft fraud is the act of manipulating the accounts, financial statements or other documents of or related to a corporation that has the effect of altering the factual (and legal) position of a corporation.

H. Cultural Influences

42. The Comparative Report highlighted the impact of culture, both societal and commercial, on attitudes to insolvency generally. In particular, it was suggested that cultural influences might pose a considerable barrier toward the application of both informal and formal insolvency processes, notwithstanding that a law or a set of informal "rules" provides convenient access to those processes. Insolvency processes, particularly the formal rescue process and the informal work-out process, rely for their effectiveness on early initiation, before the financial position of a debtor corporation has so deteriorated that no attempt at rescue or a work-out might be contemplated. The majority of the local studies clearly evidence that the financial difficulty of a corporation is, more often than not, accompanied by an attitude of concealment and denial on the part of owners and managers. It was suggested in the Comparative Report that the "stigma" of insolvency is a compelling and potentially destructive cultural influence.

43. The discussion of attitudes in the RETA economies to legal processes, the "stigma" of insolvency and the fear of loss of control and the effect of such influences produced some interesting proposals. The so-called "stigma" is because insolvency represents financial failure, that few persons would care to admit. Transposed to a corporation it means that, in the minds of the owners or directors of a corporation, the failure of the corporation represents their failure, which is sometimes accompanied by "peer" judgment resulting in business and social disgrace. It was assumed in the Comparative Report that the presence of cultural factors in many of the RETA economies possibly heightens a greater sense of "stigma".

44. Another factor, which is linked to but is not quite the same as the "stigma" influence, is reluctance, based on commercial considerations, to access a formal or informal corporate insolvency regime. There is evidence that a principal factor that concerns "owners" of financially troubled corporations in many of the RETA economies is the fear of loss of control of the corporation. This produces an aversion to anything that might put the corporation in a position where others might dictate its immediate and long-term future. The result is that relief or remedy, if and when it is eventually sought or imposed, comes far too late. It was argued that the effect of the "stigma" of insolvency and fear of "loss of control" is to create a very significant barrier to the application and operation of both formal and informal corporate insolvency law regimes. It was therefore suggested that "stigma" and "loss of control" could not be ignored in the RETA economies.

45. Symposium participants suggested that these attitudes, while prevalent, were no longer acceptable. They argued that such cultural attitudes could no longer be considered a realistic barrier to the adoption and employment of laws and processes. They suggested that the tendency to regard many of these influences as negative barriers, might be overcome if, instead, their existence might be used as incentives to promote recourse to insolvency processes. Thus, for example, the so-called "stigma" of insolvency might be avoided by actual recourse to modern forms of both formal and informal rescue processes.

I. Globalization

46. The historical imposition¹⁶ of many foreign insolvency laws and processes among the RETA economies and the more contemporary process of globalization and the importation of other commercial laws and practices as a result of that process were discussed at the Symposium. It was generally accepted that globalization should be considered an advantage rather than a disadvantage, although some representatives questioned the pace of introducing new laws and commercial practices, believing that sometimes this process was too fast and afforded insufficient time for absorption.

47. The issue was posed whether it might be preferable for the insolvency law process to be completely rebuilt in some of the RETA economies and whether the process of globalization brought problems. There was general agreement that not too many difficulties had been experienced as a result of the imposition or adoption of foreign based insolvency laws, although this appeared more confined to the common law economies. In Indonesia, for example, there was a strong suggestion that the existing base of Dutch colonial insolvency law should be repealed and a completely new law should be structured and developed.

J. Essential Reforms

48. In a session that was given over to the participants from the RETA economies proposing ideas for improvements in their respective domestic insolvency law systems, a number of essential "needs" were mentioned. These are considered below:

(i) Cross-Border Considerations

49. During the discussion on this issue it became apparent that there is a lack of knowledge generally of problems of, and the different approaches to, issues of cross-border insolvency. In particular, there is a lack of knowledge on the United Nations Commission for International Trade Law (UNCITRAL) cross-border model law of May 1997.

50. As the growth of both regional and international trade and commerce increases, so too the problems associated with cross-border insolvency. The trading and business activities of a corporation in one jurisdiction may result in that corporation having businesses, assets and trading activities in another jurisdiction. If that corporation becomes insolvent and subject to an insolvency administration, it would be beneficial to both jurisdictions if the insolvency regimes in both jurisdictions provided for cooperation in the overall administration of that corporation. This is a particularly important factor in relation to a corporation that is proposing a rescue.

51. It is therefore, increasingly important that the insolvency laws of any jurisdiction permit that jurisdiction to respond to, and cooperate with another jurisdiction, in the overall administration of insolvency proceedings. Ideally, the adoption by the RETA economies of

¹⁶ Except for Thailand and Japan, each of the RETA economies has been, at some time, colonized or under the direct influence or control of another country. Hong Kong, Singapore, Malaysia, India and Pakistan were former British colonies, and Indonesia was a former Dutch colony. Taipei, China and Korea were both under Japanese control, while the Philippines was a former Spanish colony and more recently, under American control. Although Japan was not colonized, it has been influenced by French, German and American systems and practices. In many cases, these influences have produced a lasting and continuing effect in areas such as the development of the legal systems and industry and commerce. Similarly Thailand has been influenced by English and continental (mainly French) systems and practices.

uniform cross-border insolvency legislation would equip all of these economies with similar and reciprocal provisions regarding recognition, relief and co-operation between and with the courts, regulators and administrators of each of the RETA economies.

52. However, symposium discussion highlighted the absence of such cross-border provisions in the RETA economies. Additionally, it did not appear that any of the RETA economies were currently contemplating the adoption of the UNCITRAL cross-border model law.

(ii) Super Priority and New Money

53. Another essential "need" identified by Symposium participants is the availability of on-going funding for an insolvent corporation as part of a possible rescue. Where a genuine prospect of rescue exists, on going funding may be of critical importance. If a debtor has no available funds to meet its immediate cash flow needs (for example, to pay for supplies, to pay wages to employees) a rescue will fail unless those funds can be provided.

54. Most insolvency regimes can help this situation firstly by recognizing the need for and sanctioning such funding and, secondly, by creating a "super priority" for its repayment. Many of the insolvency law regimes of the RETA economies did not provide for the concept of the "super priority" in order to safeguard and protect, for example, a bank that might be prepared to advance further funding to ensure the survival of the insolvent corporation at the commencement of or during a rescue process.

(iii) Corruption and Fraud

55. Other representatives spoke of the need to have comprehensive reform of the insolvency law system; including judicial reforms to ensure that judges were independent and immune from influence. They also spoke of the need to impose stricter sanctions to enable the proceeds of fraud to be recovered under an insolvency law regime.

IV. CORPORATE, BANKING AND LENDING PRACTICES

56. The following is a brief description of the corporate, banking and lending practices in the RETA Economies, as relevant to this RETA and to a discussion of insolvency law and practices. In particular, the description of the banking and lending practices in the RETA economies is intended to draw attention to the factors that must be taken into account when considering the proposed recommendations under this RETA and when framing insolvency law and related policies.

A. The Private Corporate Sector in the RETA Economies

57. The predominant use of the corporation as a vehicle for conducting large and medium size private enterprise is common to all the RETA economies. Accompanying that is a broadly similar regulatory system that prescribes the formalities to establish and thereafter operate corporations. As a result, for example, all corporations in the RETA economies must (i) have and are managed by directors, (ii) maintain statutory records and books of account, (iii) file annual financial information, (iv) must have a minimum amount of paid-up capital, which varies in amount from type of corporation (for example, private and public) and from economy to economy; and (v) are subject to regulatory control, which at a basic level requires annual filings

of accounts, details of directors and so forth and in case of public listed companies involves a securities commission and a separate stock exchange authority. Some divergences occur, however, which are relevant to this RETA and its recommendations. These are presented below.

(i) Directors and Corporate Governance

58. Attitudes toward the proper role of and standards under which directors should operate vary among the RETA economies. In many cases it seems that many "directors" are either bare nominees or certainly persons who are controlled by others. This alone suggests that standards of director responsibility are either far from developed or of not much consequence in some of the RETA economies. Likewise, in Korea, there is a requirement that a corporation has a minimum of three directors. When that requirement is coupled with the fact that private ownership or proprietorship or control of a corporation is culturally and commercially important in Korea, it emerges that, in many cases, two of the three directors will be mere employees of the corporation. The third will be the owner or proprietor. The two employed directors will rarely, if ever, play any real part in management of the corporation. Yet it will often be a requirement of a lender that all directors guarantee the borrowings of the corporation. This can produce some unhappy consequences for the employee directors.

59. In India, the concept of a "nominee" director is recognized both legally and commercially. As a result, it is not uncommon for a lender or lenders to be represented on the board of directors of a borrower corporation, through nominee directors. This enables the lender to become reasonably well informed about the financial condition and to exert some influence or control over transactions proposed by the corporation. It should be added, however, that this involvement would not extend to day-to-day management of the corporation.

60. In Japan it is not uncommon for a "main" bank to be represented on the board of directors of a corporate borrower. Sometimes this is a result of the fact that the bank owns equity in the corporate borrower. However, in some of the other RETA economies a bank is strictly prohibited from having any relationship or association with a corporate borrower other than the relationship of lender.

(ii) Banks as Equity Holders in Borrower Corporations

61. The treatment of bank lenders as shareholders in a borrowing corporation varies in the RETA economies. For example, in India a lending bank is permitted to hold up to 30 per cent of the issued shares of a borrower corporation. In Japan it is five per cent. In Taipei, China, unless there is some special permission, a lending bank is not permitted to hold equity in the corporate borrower. In Pakistan there is no limit on the amount of equity that a lending bank may hold in a corporate borrower. In Korea it is permissible for a lending bank to own up to 15 per cent of the issued shares in a corporate borrower.

62. This can have some consequence concerning the insolvency of a corporate borrower. It might be anticipated, for example, that a main or "housebank" to a corporate borrower in Japan would normally own equity in the corporate borrower and would more than likely occupy a position on the board of directors of the corporate borrower. It is likely, therefore, that such a main bank would obtain early warnings of any financial difficulty or instability. In an insolvency rescue or work-out situation, the prospect of converting debt to equity on the part of a bank might be more facilitated in, for example, Korea and India than in Taipei, China.

(iii) Family Controlled Corporations

63. In many of the RETA powerful family ownership or control of both large and medium sized corporations is quite common. This is consistent with more fully developed countries some decades ago, when it was common for large and powerful corporations to be dominated by the interests of a family. With the greater growth of most of these corporations and a lessening of the cultural importance of family empires, the extent of powerful family influence, control or dominance in the more fully developed countries has decreased. The extent of family control or influence can have an appreciable effect if the corporation becomes insolvent because of the fear of "loss of control" and "stigma" of insolvency.

(iv) Conglomerates of Corporations

64. In some of the RETA economies the private corporate sector is dominated by large conglomerates. These are often a group of companies that are industrially linked, even though some of them might be independently owned. This is a relatively common feature of the private corporate sector of, for example, Japan, Korea and Thailand. This can present some complexity if some one or more of the members of a conglomerate become insolvent or suffer financial difficulty. It poses a problem, not only for the creditors but also for the group that constitutes the conglomerate. It could mean, for example, that additional factors have to be taken into account before a possible solution for rescue or otherwise will emerge. It was mentioned in the local study of Thailand that the inter-relationship between companies in a conglomerate is often very complex and that a purely legal analysis will not reveal the true nature of the inter-relationships.

(v) Political/Government Associations

65. In many of the RETA economies there is either a direct political involvement in or strong relationship between political forces and corporations, including banks (banking sector may be largely naturalized e.g. India and Pakistan) . These associations may be expected to be of some considerable influence in the event that financial difficulty affects a corporation. Some of the local studies, such as that of Thailand, Philippines, and Taipei,China place considerable emphasis on this factor.

B. The Banking Sector and Lending Practices(i) Financial Control and Regulation:

66. Lending and recovery practices may be dictated, to varying degrees, from central bank or finance ministry level. This control can have an effect on the availability of funds for lending and on policies of debt recovery and enforcement. Legislation in Pakistan provides, for example, that a domestic bank cannot lend on an unsecured basis. Intervention by a central bank or finance ministry may not only be directed at the banking sector but also, and more relevantly for this RETA, at the methodology to be applied by banks in an endeavor to rationalize problems of bad debt and non performing loans. This has been seen recently during the Asian financial crisis in Indonesia, Malaysia, Thailand, Korea and Japan.

67. There are some wide differences within the RETA economies in the range and levels of financial control exerted by the central authorities. Control ranges from heavy regulation to "laissez faire". At one end of the scale is Pakistan which appears as the most heavily regulated of the RETA economies. In Pakistan, the control of government, despite the

existence of a theoretically independent central bank, is most evident. Domestic banks in Pakistan were nationalized in the 1970's and remain government controlled. Three of the major banks and one major DFI have been privatized. The Government plans to privatize other banks and DFIs. That control has also produced a history of bank lending according to government, executive or political directions or dictates. Much of this lending has been made without any adequate or any proper assessment of the assets of the corporate borrower or of the capacity of the corporate borrower to repay. Often, also, there has been no control over the disposition of the loan funds. There have been many instances in which the loan funds have not been applied to the business of the corporate borrower but have been used for private purposes. Because of the political links or association of the borrower, recovery of the loan is difficult, if not impossible. In such circumstances, the employment of debt recovery, security enforcement or the insolvency law regime processes offers little prospect of recovery.

68. In Korea, there has been considerable control of the commercial banking sector through the Ministry of Finance and the Economy. The banks in Korea are mainly government owned or, certainly, government controlled. Although there may have been far less "directed" lending in Korea than in Pakistan, the overall control exercised by the government of Korea appears to have been such that much of the bank lending has been state controlled or directed. In Malaysia the balance of control was recently tipped toward greater government intervention by banking and monetary policy measures announced in September 1998. One of those measures, which is relevant to this RETA, was that the repatriation of the proceeds of the sale of secured property to an overseas lender could be delayed by up to one year.

69. The involvement of a central bank or government ministry in relationships between corporate debtors and bank creditors can, however, produce positive results. For example, in Malaysia, the central bank, Bank Negara, has been primarily responsible for the formation of the informal Corporate Debt Restructuring Committee. In Thailand, the Ministry of Finance and the Bank of Thailand will monitor the progress of debt restructuring under the recently proposed informal Framework for Corporate Debt Restructuring in Thailand. In Hong Kong, the Hong Kong Monetary Authority expressed its support for the informal Guidelines on Corporate Difficulties that were issued by the Hong Kong Association of Banks in April 1998.

(ii) Secured Lending

70. Secured or collateral lending, by which property of a corporation is used as security for the eventual repayment of a loan, depends on a number of factors if it is to be considered reasonably safe, predictable and commercially risk free. The most important of these factors relates to the development of an efficient and stable property ownership and property rights system. This requires an adequate legal regime through which precise and reliable information concerning ownership and other interests in property may be conveniently accessed.

71. All of the RETA economies possess reasonably well-developed land ownership and property rights regimes. In most of the RETA economies it is a reasonably simple and commercially efficient process to take security over land. It is not surprising, therefore, that asset based secured lending (particularly over land) is by far the most widely practiced financing technique throughout the RETA economies. Security over shares, by way of a pledge, is also quite widely practiced and, in most cases, is simple and expedient.

72. However, the taking of security over property other than land or shares is not as popular and, in some cases, presents some difficulties. The practice of taking security over

chattels (by way of a chattel mortgage) varies in the RETA economies. In Hong Kong, Malaysia and Singapore, it is a popular form of secured financing mainly because each of those countries inherited the concept known as the "floating charge" from England. It is a reasonably safe and predictable form of security. It is also popular for lenders because it covers all the assets of a corporation and may be enforced by appointing receivers and managers to take control of the corporation.

73. In most of the other RETA economies, however, the concept of the chattel mortgage, although practiced, can be more difficult and less safe because of the absence of a developed or any system of registration or recording of a chattel mortgage. Also, lease financing does not appear to be widely practiced in some of the RETA economies, nor is the taking of security over receivables (debts) a common or popular form of secured lending.

(iii) Income (Cash Flow/Profitability) Based Lending

74. Cash flow or profitability based lending, which is largely based upon an assessment of the ability of a corporation to derive income and deploy part of the income to meet recurring debt on a regular cycle, is not so apparent in the RETA economies. A number of aspects arise from this of which two are relevant to this RETA. The first is that dependence on collateral based lending often means that a lender may not make sufficient or any assessment of the ability of the corporation to service a loan and ultimately repay it (other than from the proceeds of sale of the collateral). This is because attention is focused primarily on the value of the collateral. There may be little or no assessment of income, cash flow and profitability. It inevitably follows that there may only be cursory monitoring of the borrower's financial position after the making of the loan. When the corporate borrower experiences financial difficulty, the lender may know very little about and have a poor understanding of the business and financial position of the corporate borrower. This makes it more difficult to objectively assess the causes of the financial difficulty and to consider how the financial difficulty may be arrested and improved. In other words, for a variety of reasons, the lending practices of domestic banks in some of the RETA economies may lack a degree of commercial responsibility and experience when compared with the practices of more fully developed countries, which are more intense, strict and responsible.

75. Additionally, as has been revealed by the Asian financial crisis, in many RETA economies commercial banks have breached their own liquidity requirements and have also exceeded lending limits to corporate customers.

V. FORMAL CORPORATE INSOLVENCY REGIMES IN THE RETA ECONOMIES

76. The following is a brief description of the formal corporate insolvency law regimes in the RETA Economies.

A. The Liquidation Process in the RETA Economies

77. The insolvency law regimes of the RETA economies all provide for a liquidation process in respect of an insolvent corporate debtor. In the majority of cases the liquidation process is contained in separate legislation (usually termed bankruptcy act or law). The application of some of the liquidation laws extends to banking, insurance and securities corporations (for example, Indonesia and Thailand) but the access of those corporations to the liquidation process is governed by the consent or authority of a regulatory body. For an

insolvent corporate debtor in the RETA economies, access to the liquidation process is generally easy and uncomplicated (Thailand is exceptional, as it is not possible for an insolvent corporate debtor itself to apply for liquidation). However, ease of access for a creditor of an insolvent corporate debtor varies.

78. In the Philippines, for example, it is necessary that at least three creditors join together to make an application against a corporate debtor. In Japan a possible barrier exists because there is no easy or convenient method for a creditor to prove that a corporate debtor is insolvent. Each of Hong Kong; Singapore; Malaysia; India; and Pakistan offers relatively easy access to creditors. In these jurisdictions, there is little or no evidence of any abuse of the liquidation process due to ease of access.

79. In a number of the RETA economies there is a process, in addition to a court sanctioned liquidation process, which enables an insolvent corporate debtor to be voluntarily liquidated through simple administrative actions. See, e.g., the insolvency regimes of Hong Kong, Singapore, Malaysia, India, and Pakistan. Of these, that of Singapore offers the easiest and most uncomplicated process.

(i) Single/Dual Process

80. In most jurisdictions, once the liquidation process has been initiated, there is little or no opportunity for a rescue attempt to be made in respect of the corporate debtor.¹⁷ That may not be of any real concern because very few corporate debtors might be able to fashion a rescue from a liquidation (cf. Indonesia which offers the chance of a "composition"). However, it may be of some concern that in a number of jurisdictions there is no provision to enable the rescue process to be converted into the liquidation process if either the rescue process falters or has failed. For example, in Hong Kong, India, Malaysia, Singapore and Pakistan there is no conversion process.

(ii) Effects

81. All of the regimes provide for a stay or suspension of actions, normally confined to unsecured creditors thus leaving secured creditors unaffected. In Malaysia a recent legal opinion indicates that the commencement of the liquidation process may interfere with self help enforcement of a security over land (at least so as to require a court order to effect a sale of the land). In India, it appears to be the case that the commencement of a liquidation process brings all security enforcement proceedings to a stop and they are transferred to the court in control of the liquidation proceedings.

(iii) Administration

82. In general, the procedure after the liquidation process is similar in the RETA economies. There are, however, some notable differences in procedure and functionalities. One

¹⁷ There is some debate whether the processes of liquidation and rescue should be separate processes or whether they should be both available under a single process. This is sometimes more a matter of form and perception rather than substance. For example, when a corporation is reported as having "filed for bankruptcy" (as, for example, in USA) one might fear that it is to be liquidated. In fact, this is simply the common or popular name given to the formal route toward either liquidation or the possibility of a rescue. There are cost and efficiency advantages if both processes can be accessed under the one procedure. For example, if a corporation seeks a formal reorganization, but fails, the result should be automatic liquidation without the necessity of having to commence a new procedure for liquidation.

of the most striking differences is the actual administration of the affairs of the corporate debtor. All of the RETA economies provide that the liquidation of a corporate debtor is to be conducted by an administrator but they vary considerably as to the identity and qualifications of the institution or person who is to conduct or administer the liquidation.

B. The Rescue Process

83. All of the RETA economies have a rescue process. Some RETA economies have more than one. Japan, for example, has three separate types of rescue process under three separate laws. Korea, Taipei, China, Malaysia and Singapore each have two separate rescue processes. Some of the rescue processes are of very recent origin. For example, Malaysia's Danharta Act, the amended bankruptcy act of Thailand and the amendments to the bankruptcy law of Indonesia are of very recent origin. It is difficult to judge their operation because there are, as yet, few instances of completed cases. The following is a brief description of the rescue processes in the RETA economies:

(i) Scheme of Arrangement (Hong Kong, Singapore, Malaysia, India, and Pakistan)

84. This formal procedure provides for the possibility of effecting an arrangement and compromise between an insolvent corporation and its creditors. It has long been part of the company legislation of England and of the RETA economies mentioned above. Except in Malaysia it is little used, mainly because of the formalities, cost and time involved. The procedure is cumbersome and, except possibly in Malaysia, there is insufficient protection for a corporation from its creditors, particularly secured creditors, during the lengthy process. In short, it lacks the essential elements of a modern rescue process. It is no doubt for these reasons that there is a government proposal for a completely new law in Hong Kong. There is some suggestion of a similar proposal in Malaysia. Singapore has already created a new rescue process.

(ii) Judicial Management (Singapore)

85. This is an example of a modern rescue process. It enables a company in financial difficulty (or a creditor of such a company) to apply for the appointment of a judicial manager. The application is made to a court. The court must be satisfied that there is a prospect of effecting a proposal between the company and its creditors that would provide for the rehabilitation of the company or, at worst, would be more beneficial to creditors than if the company was liquidated. A judicial manager (an independent private insolvency administrator specialist) is appointed and has all the powers of management of the company. The management of the company is effectively displaced. A stay or suspension of actions and proceedings against the property of the company becomes effective immediately. The process may, however, be completely defeated by a creditor who is secured over all the assets of the company (via the device of the floating charge). Some might regard this as a weakness in the process (cf. England, Canada and Australia).

86. The judicial management order remains in force for a period of 180 days. The judicial manager must present a proposal for consideration by creditors within 60 days (the time periods can be extended by order of the court). A meeting of creditors determines whether to approve the proposal. A proposal is approved if the majority in number and value of creditors (present and voting) accept the proposal. If the proposal is rejected the judicial management process is terminated. There is no automatic conversion to liquidation. This may be a weakness of the process. If the proposal is accepted it is the task of the judicial manager to

implement the plan. Throughout the process the court has a supervisory role and creditors have a right of application to the court.

(iii) Sick Companies (India and Pakistan)

87. The treatment of an insolvent corporation in India was and remains largely dealt with by liquidation. Under the Sick Industrial Act of 1985 (Companies Special Provisions), the Board for Industrial and Financial Reconstruction is given powerful administrative powers. A "sick" industrial enterprise is defined under the Act as one that has incurred losses in consecutive years and whose asset to liability ratio is below a nominal standard of 1:1. Under this legislation, a "sick" company is required to report its condition to the board within 60 days of finalizing its audited accounts. In addition, creditor banks and other financial institutions have the power to make a report on the company to the board. Once the company is reported, a moratorium or stay takes effect which prevents civil proceedings or other action from being taken against the company or its assets except with the consent of the board.

88. The board is required to conduct an inquiry into the financial position of a reported company and determine whether the company might, within a reasonable time, recover; whether a scheme of rehabilitation should be proposed; or whether it should be liquidated. The board may compel liquidation by requiring that the relevant court make an order to that effect under the relevant insolvency law. There appears to be very little or no formal involvement of creditors in this process. Whether there is informal involvement of creditors is unclear.

89. The Companies Ordinance (1984) of Pakistan is similar to the Sick Industrial Act though it is less elaborate than the Indian equivalent. It contains special provisions dealing with the "rehabilitation of companies owning sick industrial units". The Pakistan provisions apply to a company which "is declared as a sick company by the Federal Government". The legislation enables such a company to submit a plan of rehabilitation for approval to the government; for the plan to be notified to creditors; and for the government to approve and arrange for implementation of the plan. If the Government approves the plan, it becomes binding on all persons. Again, there appears to be no involvement of creditors.

(iv) Danharta Act (Malaysia):

90. The Pengurusan Danharta Nasional Berhad (Danharta) Act was enacted in 1998. This legislation established a government controlled corporation which is empowered to acquire debt owed by insolvent companies to a bank (and the assets of those companies, if they are secured to the bank) and to sell and otherwise deal with those assets. The powers of the government corporation also extend to appointing a special administrator to a corporate debtor (i.e., a corporation that is indebted to the government corporation as a result of the acquisition of a debt as mentioned above) which is shown to be insolvent. The appointment of a special administrator results in a moratorium over all the property of the insolvent corporation and permits the administrator to propose a plan in respect of the corporation. The government board may approve or veto the plan. If it is approved, a meeting of creditors must be convened to seek a majority vote on the acceptance of the plan. If the creditors accept the plan, it becomes binding and it is then implemented under the direction of the special administrator. This is possibly a better example of a special insolvency process but is included here because it does resemble a "rescue" regime. It is instructive that it is done through an administrative body. It also enables an insolvent corporation (by a somewhat convoluted means) to be forced into possible rescue or liquidation.

(v) Presidential Decree 902A (Philippines)

91. A rescue procedure known as "suspension of payments" under the insolvency law of the Philippines has now been largely subsumed under the jurisdiction of the Securities and Exchange Commission (the Commission). A presidential decree gave the commission jurisdiction to receive and deal with applications by corporate debtors for suspension of payments. This has now become the preferred "rescue" process in the Philippines. In effect, a corporation files a petition, a provisional suspension order is made, creditors are notified of the petition and the Commission may then appoint a management committee and rehabilitation receiver. Once such an appointment is made, there is a stay or suspension of actions against the corporation. Control of the corporation passes to the management committee or rehabilitation receiver. The management committee, however, will normally include representatives of shareholders of the corporation.

92. A proposal must eventually be put for the rehabilitation of the corporation. If such a proposal is not made or if the Commission refuses it, the Commission may order the liquidation of the corporation. Although there are no specific rules providing for the involvement of creditors in this process, as a matter of practice, it seems that a rehabilitation plan would be referred to a meeting of creditors for comment. However, the ultimate decision is that of the Commission.

93. This process is quite remarkable for a number of reasons. In effect, it has shifted what was once a judicial process into a quasi-judicial process. There appear to be few, if any, but the most basic rules to govern the process. It gives the appearance of being far from a transparent process. The involvement of creditors appears problematic. It should be noted that there is a proposal in the Philippines to amend the law and transfer jurisdiction over rescue cases from the Commission to the regular courts.

(vi) Corporate Reorganization; Composition (Korea)

94. In Korea, there are two forms of rescue process. A composition is governed by the Composition Act. Only a debtor corporation can file for a composition. The composition procedure is designed for temporary relief. At the time of filing, the debtor must propose the terms of the composition and a plan to perform the composition. A liquidation commissioner is appointed to review the corporation and the proposal. A meeting of creditors considers and votes for the approval or otherwise of the composition. If the composition is not approved, the corporation cannot be transferred to a liquidation process. The management of the corporation continues in power. It appears that an agreement must be reached for the debtor to perform its debt obligations in full.

95. The corporate reorganization process is provided for under the Company Reorganization Act. This differs from the composition procedure because it is aimed toward reorganizing or rebuilding a debtor corporation. Under the reorganization process, the company makes an application to a court which then determines if the reorganization should commence. During this process of consideration, the court can make interim orders and appointments to protect the property of the company and place the management of the company in the control of a receiver. If the court accepts the application, a permanent stay of actions takes effect and the court appoints a permanent receiver (who effectively displaces management). A timetable is set for the submission of a reorganization plan. A reorganization plan is then submitted to the creditors and must be approved by a complicated voting majority of creditors of various classes.

The court must then authorize the reorganization plan to be implemented. The implementation of the plan is under the control of the receiver.

(vii) Corporate Reorganization; Company Arrangements; Composition (Japan):

96. Japan has three potential rescue processes. The most commonly used are the corporate reorganization process under the Corporate Reorganization Law and the composition under the Composition Law. The third is the company arrangement process.

97. The company arrangement process involves an application to a court to commence the process. This is generally accompanied by an application for suspension of actions against both secured and unsecured creditors. The directors continue to manage the company under the supervision of the court. A plan of arrangement is prepared and submitted to creditors for approval. It is a requirement of this process that approval must be unanimous. If the plan is not approved, the corporation will be liquidated or the process may be converted into the composition process.

98. The composition process requires that an application is made to a court accompanied by a plan of composition. An investigator is appointed to report to the court on the plan and the condition of the corporation. Management continues as before. An application may be made to stay or suspend actions, but only actions of unsecured creditors. Unsecured creditors then consider the plan. Secured creditors are not restrained nor affected by the process in any way. Approval of a plan of composition requires a three quarter majority vote in favor by all creditors and fifty per cent of creditors present and voting at the meeting of creditors. It then becomes binding on all unsecured creditors. Performance of the plan is not, however, supervised. If the plan is not approved, the corporation is liquidated.

99. The corporate reorganization process is extremely involved and is considered to be suitable for large public companies only. The procedure requires the filing of an application with a court. Because there is no automatic stay or suspension, an application for an interim stay is made at the same time. An interim trustee is normally appointed at the same time. It takes control of management of the corporation. The court then undertakes a process of inquiry of the corporation, major creditors and shareholders, management, employees' representatives.

100. If the court is satisfied that the conditions necessary for the commencement of the case are satisfied, it issues an order to that effect. As a result, there is an automatic permanent suspension of actions. The appointment of the trustee is confirmed and the trustee continues to control the corporation. An interim meeting of creditors occurs at which the trustee and management give information concerning the corporation. The trustee is required to prepare a plan of reorganization. This can take up to two years. The plan is then submitted to the creditors for consideration. There is a complicated voting requirement for approval of the plan. In effect, this requires a majority vote of two thirds of the unsecured creditors (in value); three quarters majority of secured creditors and a majority of shareholders. The court must also sanction the plan. If the plan is not court-approved, the corporation will normally be liquidated.

(viii) Company Reorganization, Composition (Taipei,China):

101. In Taipei,China, the position is similar to that in Korea and Japan. However, the reorganization process is only available to a public company. The company must show that without reorganization it would have to cease its business activities. Either the corporation, or its shareholders and creditors may initiate the reorganization. However, a court must decide that

the reorganization may commence, and appoint reorganizers to take control of the company. A reorganization plan is submitted to a meeting of interested parties which comprises secured creditors, unsecured creditors, preferred creditors and shareholders. The plan must be approved by both creditors and shareholders. If the reorganization process breaks down or if a plan for reorganization is not approved, the court may order that the corporation be liquidated.

102. A composition may be initiated only by a debtor corporation. A composition plan is prepared which is then considered by the creditors. The corporation continues under its own management, subject to supervision by court appointed supervisors. A suspension applies to unsecured creditors but not to secured or preferred creditors. Adoption of the composition plan requires a majority vote of creditors present who represent more than two thirds of the total unsecured debts of the corporation. The composition must then be approved by the court and is then implemented.

103. One of the problems that is common to the reorganization procedures in Korea, Japan and Taipei,China is the delay between the filing of the application and its acceptance by the court. There is a process of inquiry and consultation at this vital stage. This would seem to be part of a negotiation/mediation process, facilitated by the court and its officials, to determine attitudes toward and support for a possible rescue. Viewed in that way, it may be a valuable part of the process, despite that it delays the real commencement of the rescue and is not accompanied by automatic and immediate effects.

(ix) Business reorganization (Thailand)

104. The rescue process of Thailand now appears in the Bankruptcy Act. It applies not only to corporations but also to bank, security and insurance corporations. An application may be made for business reorganization either by a debtor corporation, a creditor of a debtor corporation or the respective regulatory authorities of the banking, insurance and securities sectors. A request for reorganization is filed with a court that determines whether or not to accept the request. If the request is accepted, an immediate stay or suspension against all actions and proceedings comes into force; a government official (the official receiver) is given the legal authority to manage the affairs of the corporation; interim managers may be appointed to perform that task under supervision of the government official. All the assets and property of the company are in the control of the government official. A plan of reorganization is prepared by a plan "preparer" within three months of the appointment of that person and forwarded to the official receiver and to all creditors. A meeting of creditors is convened to approve or disapprove the plan. The court must thereafter approve the plan.

(x) Suspension of Payments/Reorganization (Indonesia)

105. There are two "rescue" processes available under the Insolvency Law of Indonesia. The first is commenced by the debtor (or creditors) filing a petition for bankruptcy. A stay or suspension of all actions takes effect for 90 days. If, within that time, the debtor corporation presents a plan of composition and it is approved by creditors, the plan takes effect. If a plan is not proposed the "insolvency" of the debtor is confirmed and the debtor is liquidated.

106. The second process is commenced by a corporation filing a request for suspension of payment of debts. This is then followed by a temporary suspension of payments for a maximum period of forty-five days during which time the proposal for the permanent suspension of payments must be prepared for negotiation between the debtor and the creditors. The affairs of the debtor corporation are jointly managed by court appointed administrators and

by the debtor. If the proposal is presented within that time the court may order a "permanent" stay which is effective for a period of 270 days. The plan must then be negotiated during that time. The creditors vote on the proposal. If it is refused the court may proceed with the liquidation of the debtor corporation.

VI. INFORMAL WORK-OUTS IN THE RETA ECONOMIES

A. Basic Elements of Informal Corporate Insolvency Practices

107. A work-out essentially involves bringing debtor and creditors (at least, the main creditors) together. It is up to the debtor and/or one or more of the main bank creditors to initiate the work-out.¹⁸ Despite the costs involved, few, if any, attempts are made at a work-out without the involvement of independent experts and advisors from various disciplines (legal, accounting, business reorganization, marketing and so forth). The informal work-out depends, for its effectiveness, on a number of well defined initial premises. These may be summarized as follows:

- the fact that there is a significant size of debt owed to a number of different creditors (mostly these would be bank or other financial institution creditors) and the present inability of the corporate debtor to service that debt;
- the attitude that it may be preferable to negotiate an arrangement for the financial difficulties of the corporate debtor, as between the corporate debtor and the financiers and also between the financiers themselves;
- the availability of relatively sophisticated refinancing, security and other commercial techniques that might be employed to alter, rearrange or restructure the debts of the corporate debtor or the corporate debtor itself;
- the sanction that if the negotiation process cannot be started or breaks down there can be relatively swift and effective resort to the application of an insolvency law; and
- the prospect that there may be a greater benefit for all through the negotiation process than by direct and immediate confrontational resort to the insolvency law.

¹⁸ None of the examples of the work-out process from more developed jurisdictions rely upon a facilitator to impose, initiate or help the process along. Sometimes this presents a difficulty. A corporate debtor may, for example, be willing to have dialogue with its main bank creditor (who might be expected to be in a position of considerable control) but may be unwilling or not appreciate the desirability of discussions with a number of creditors. As between the creditors themselves, some of them will be concerned for their own position and may not wish to participate in or contemplate a "collective" approach. These types of problems can sometimes be overcome. An approach taken in more developed jurisdictions has been to use the sanction of quick and convenient access to formal insolvency law procedures as a "bargaining" factor in the commencement and progression of an informal work-out. The availability of this type of sanction can influence both a corporate debtor and its creditors. If a corporate debtor refuses to participate in an informal process which has been initiated by some of its creditors, it will almost certainly lead either to individual creditor enforcement action or the application of the formal insolvency procedures which the debtor will not be able to delay nor defeat. Unwilling creditors face much the same sanction and may find that they are subject to a formal collective process which effectively prevents them from enforcing their individual rights.

108. To be effective an informal work-out requires the employment of a number of skills and processes:

- The creation of a "forum" in which both debtor and creditors can initially come together for the purpose of exploring and negotiating an arrangement to deal with the financial difficulty or insolvency of the debtor. This "forum" is not only for the benefit of the two sides (debtor and creditors), but also for the creditors, between themselves;
- The appointment of a "lead" bank creditor to provide leadership, organization, management and administration;
- The selection of a committee which is representative of creditors (commonly called a "steering" committee) to assist the lead creditor and to act as a provisional sounding board toward proposals for the corporate debtor;
- A "standstill" (agreement) to suspend adverse actions by both creditors and the debtor for a defined, and preferably short, time period;¹⁹ and
- The gathering and provision of complete and accurate information regarding the corporate debtor, including its business activities, current trading position, general financial position and assets and liabilities.

(i) Classes of Creditors

109. Creditors will rarely be in the same position as one another. For example, some will have security, others will not. Of those who have security, some will have better security than others. There may be issues between creditors of competing priority rights (or rights generally) in respect of the same security property. Unsecured creditors may also have different rights. Some may have guarantees from third parties. Lease finance creditors may seek to recover their equipment. Some creditors may be subrogated to others.

110. This complexity often presents critical problems, particularly if the aim of the process is to maintain the assets and business undertakings of the corporate debtor together. If some creditors have commenced recovery or enforcement action it may be difficult to dissuade them from continuing with that enforcement. Differences between creditors are best dealt with by providing a prospect of a better result through the work-out process and the threat of a formal insolvency process if the informal work-out fails.

(ii) Dissenting Creditors

111. Unanimity amongst creditors cannot be anticipated nor expected. In part, the problem of dissenting creditors can only be dealt with as mentioned above or by the application of some "peer" group pressure on the dissenting creditor (with the reminder that there may be "other occasions"). Because it is an informal process, there are no rules of enforcement by which a dissenting creditor may be compelled or bound to the view of the majority. This sometimes results in the trading of "distressed" debt. A bank creditor may not, for example, be willing to participate in the work out process or may not be prepared to wait or renegotiate the

¹⁹ The standstill may be compared to the "moratorium" or stay of actions and proceedings which has become an important feature of formal rescue insolvency law regimes.

eventual repayment of the debt. There are traders who might be prepared to acquire the debt. If this occurs the debt trader becomes the creditor and engages in the work-out.

(iii) Outside Creditors

112. In most cases of informal work-outs, it is impossible to involve every creditor in the work-out process. One problem is often the sheer number of creditors. Another is the inefficiency of involving creditors who are owed small amounts. Yet another problem is that many creditors do not have the commercial expertise and knowledge to participate in the process. But, left out from the "forum" though they may be, they cannot be forgotten nor ignored. Some of them may be important. They might be suppliers of essential goods or services or they may participate in essential parts of the production process of the debtor corporation. It is often the case in an informal work-out that these smaller creditors are paid in full and encouraged to continue their supplies of goods or services. From the perspective of the major creditors, this type of "favoritism" does not normally cause much harm.

(iv) Cash Flow/Liquidity Problem

113. If a corporation becomes a candidate for a possible work-out it will normally require continued access to established lines of credit or the provision of fresh credit. There can be a problem with both. The normal reaction of a lender will be to terminate or close off any further credit. This problem can only be dealt with by evaluation and negotiation. If the lender is already secured, there may not be a problem in permitting further credit. But the real problem arises when all lines of credit have been exhausted (or terminated) and there is a pressing need for cash flow and liquidity. This can only be provided by what is often referred to as "new money". The problem is whether the creditor or creditors who might be willing to supply this new money can be reasonably guaranteed that, if the worst happens, they will be repaid in full.

114. As between the creditors who are participating in the attempted work-out, they may agree amongst themselves that if one or more of their number provide "new money" the rest of those creditors will subrogate their claims to enable the "new money" to be repaid ahead of those claims. Thus, as between that group of creditors, there is a contractual agreement for the eventual repayment of the new money to the creditor who provides it.

115. However, if the attempt at the work-out does not succeed and the debtor corporation is liquidated, there is a further issue of how a claim for the repayment of that new money will be treated in a liquidation. Unless there is a security for the new money, it will be an unsecured claim. And because the liquidation law will normally apply the principle that treatment of creditors in the same class must be equal, the claim for payment of the new money will be the same as any other claim of a non-secured creditor. In some countries, there are legislative provisions which provide for some type of "super priority" to accommodate this type of problem. It is also desirable that the formal insolvency law requires that a contract of subrogation between creditors may be recognized, applied and enforced in a liquidation or rescue process.

B. Recent Informal Work-Out Initiatives

116. Initiatives to promote the concept of the informal work-out have been taken in Indonesia, Thailand, Korea, Hong Kong and Singapore. These initiatives are important and deserve appropriate recognition, response and support. The Indonesian, Malaysian and Korean approaches each provide for a facilitating agency to assist the process.

(i) Indonesia

117. In Indonesia, the Jakarta Initiative Task Force, appointed by the President acts as facilitator. Its principal functions are to facilitate negotiations; refer cases of “public interest” to the courts under the insolvency law; and to provide a central reference point for obtaining necessary government and other approvals to implement plans of restructure. Under this agency is an Advisory Committee whose functions include review of the workings of the informal process and making proposals for improvement and “new approaches and actions.” However, neither the Task Force nor the Advisory Committee may “dictate the terms of a restructuring plan”. Otherwise, the Jakarta Initiative largely follows the “London approach”²⁰ in process and methodology.

(ii) Malaysia

118. In Malaysia, the facilitator is a Steering Committee which “convenes meetings between debtors and creditors to consider debt restructuring”. The Steering Committee is also required to ensure that deadlines are met, mediate in disputes, expedite approvals, provide guidance in the selection of appropriate consultants and generally to assist in each case of informal rescue. A permanent administrative Secretariat has been established by the central bank, Bank Negara Malaysia. Its function is to provide administrative and other support to the Steering Committee. It receives applications for the implementation of the process. An outside professional adviser has also been appointed to “assist in formulating guidelines in the operations of CDRC and also to conduct a series of workshops and seminars to increase the level of public awareness”.

(iii) Korea

119. Korea has established an “Administrative Committee” under its informal process. In turn it has appointed a “Company Restructuring Committee” to act as facilitator. However, the Korean approach differs quite markedly from the other RETA economies. The Korean informal scheme operates on the basis of an agreement between “Creditor Financial Institutions” who have chosen to be bound by the agreement. In effect, a case of possible corporate restructure would involve a corporate debtor of one of these institutions. That institution may invoke the informal process amongst the other institutions in respect of that corporate debtor. Once that occurs a stay or suspension of actions against the corporate debtor by any of the other institutions who are party to the agreement takes effect, by force of the agreement. The Korean approach is thus more in the nature of a formal agreement between certain banks to work toward the possibility of a restructure. It differs quite considerably from the voluntary informal approach in other jurisdictions.

(iv) Thailand

120. The approach in Thailand is, again, different. Although it does not provide for a “facilitator”, it appears more heavily “regulated”. For example, the framework says that: “Any non-traditional restructuring approach such as debt forgiveness should only be considered as a

²⁰ The concept of the informal work-out emerged more than 10 ten years ago in some countries, notably the USA and England, as a serious alternative to the application of formal insolvency law processes. Some commendable pioneering work to encourage the development of this approach was done, in a non-official capacity, by the Bank of England. It has since been further developed by some of the leading English commercial banks. This development has become known as the “London approach”. In the US, the concept of informal workout is more developed and is now known as a “pre-packaged” Chapter 11.

last resort. To the extent that debt forgiveness is requested, it must be compensated in some manner such as stock and warrants". One might suspect that this type of intervention in a process of negotiation is dictated by a desire to maintain the balance sheets of banks.

VII. PRELIMINARY RECOMMENDATIONS

121. The following recommendations have emerged from the work carried out under the RETA and discussions during the Symposium. These recommendations will be further explored and developed prior to the next symposium. It is anticipated that a final set of recommendations and policy proposals will be developed taking into account the discussions at the second symposium to be held later this year.

(i) Statistics

122. It is important that there is readily available statistical information about insolvency. The number of cases of formal insolvency administrations is a valuable relevant statistic and indicator of economic trends. It is relevant to ascertaining the impact of commercial practices on different sections of the commercial community. Among other things, it can be a helpful guide to determining the possible need for law reform and the regulation of forms of corporations.

123. It is recommended that the responsible authority publish such statistical information on a quarterly basis with a yearly summary. Such information should provide details of (i) the number of companies in that quarter which have become subject to a formal insolvency administration; (ii) a breakdown of those numbers into the categories of liquidation and rescue, and within each category, details of dates of incorporation, reasons for failure and the principal business in which each corporation was engaged at or immediately prior to the commencement of the insolvency administration; and (iii) an estimation of the assets and liabilities of such companies.

124. It is also recommended that upon the completion of each corporate insolvency administration, the responsible authority record the following information to which the public would have access: (i) the name of the corporation and date of incorporation; (ii) the name of the directors; (iii) the nature of the administration, the date of its commencement and completion; (iv) the principle business of the company prior to the administration; (v) the cause/s of the insolvency; (vi) the assets (estimated and realized) and liabilities (estimated and realized); and (vii) a breakdown of payments made from the administration into general categories such as the cost of administration, employee payments, tax payments and dividend to unsecured creditors.

(ii) Technical Assistance

125. Symposium discussions revealed that there is an alarming lack of knowledge and information concerning insolvency laws and processes in many of the RETA economies. Specifically, there is little understanding of the rescue and informal work-out processes. Some of the RETA economies, such as Thailand, Indonesia, and Philippines have expressed the need for technical assistance programs in the area of modern insolvency law and practice. In particular, such RETA economies might benefit from a comprehensive program of education and training in connection with the restructuring, rehabilitation and refinancing of corporate debtors both under formal and informal processes. Some of the RETA economies would also

benefit from education and training programs for judges, court officials and officials of government agencies whose functions include the administration of cases of liquidation of insolvent corporations and cases of restructuring insolvent corporations.

126. It is recommended that the particular technical and other assistance needs of these RETA economies should be further investigated and identified through a more detailed examination of the application and operation of their existing insolvency laws and informal processes.

(iii) Regional Cooperation and Collaboration

127. Participants considered that the Symposium was invaluable for fostering an understanding of developments in insolvency law in the RETA economies. It is, therefore, desirable that a semi-permanent forum for the exchange of experience, information, new developments and education in the area of insolvency law and practice be established for the benefit of all of the RETA economies, and other economies in the region, such as Vietnam, the People's Republic of China, Mongolia, Cambodia and Laos. Such a forum should bring together government policy makers, legislators, judges, officials and insolvency practitioners on periodic basis.

(iv) Cross-Border Considerations

128. It is recommended that the RETA economies would benefit from a detailed consideration of, and a multilateral approach, to cross-border insolvency issues. In this respect, it is recommended that consideration be given by the RETA economies to the inclusion of cross-border insolvency provisions, such as the UNCITRAL cross-border model law, which would provide for recognition, relief and cooperation between and with the courts, regulators, and administrators of other countries.

(v) Restraint of Secured Creditors' Rights

129. Symposium participants agreed that some restraint of individual creditor rights is necessary to permit the rescue of a corporate debtor. It is recommended that the following principles be observed in the balancing of creditors' rights against the need for orderly and fair insolvency administration.

- It is important that there is support for the value that contractual obligations should be honored. This requires that individual enforcement and recovery rights may be effectively taken and efficiently processed. This is not only important for individual creditors. It is also important because it operates as a pressure point on a corporate debtor who cannot fulfill a contractual obligation because of financial difficulty or insolvency. A corporate debtor who wants to otherwise survive may then have to seek remedy or relief under the insolvency law or informal insolvency process.
- Remedy or relief for a corporate debtor from the enforcement of individual creditor rights should support the value of a fair and orderly collective process. The existence of an effective and efficient formal insolvency process serves that purpose.

- A formal collective process should provide for a restraint on enforcement of all individual creditor rights for a limited period of time and should only be extended if there is a certain probability of a successful rescue proposal. Otherwise the enforcement of secured and lease creditor rights should not be restrained.

(vi) Corporate Governance and Sanctions

130. The conduct and behavior of owners and directors of a corporation is primarily a matter of corporate law policy and regulation. It should not fall to an insolvency law to remedy defects in that area of legal regulation or to police corporate governance policies. Nevertheless, Symposium participants agreed that in some circumstances, such as, if the consequence of past conduct and behavior of persons connected with an insolvent corporation is that damage and loss is caused to the creditors of the corporation, it is appropriate to provide for the possible recovery of the damage or loss. It is, therefore, recommended that the following policy proposal be considered for adoption by the RETA economies:

- An insolvency law regime should contain provisions for the civil sanction of fraudulent and other conduct that causes damage or loss to creditors of an insolvent corporation.

(vii) Avoidance of Transactions

131. In like vein, past transactions to which an insolvent corporation is a party which have had the effect of either reducing the net worth of a corporation (for example, by gifting its property or transferring or selling property for less than its fair commercial value) or of upsetting the principle of equal sharing between creditor of the same class (for example, by payment of a debt to an unsecured creditor or granting a security to a creditor who is otherwise unsecured when other unsecured creditors remain unpaid), should be upset or overturned. This may result in recovery for the benefit of creditors and help to create a code of fair commercial conduct. Therefore, it is recommended that an insolvency law regime should contain adequate provisions relating to avoidance of past transactions that result in damage to creditors or conflict with the principle of equal treatment of creditors of the same class.

(viii) Informal Work-Outs

132. It is too early to determine the acceptance and application of the recent informal work-out provisions that have been adopted in a number of the RETA economies. It is recommended that individual and comparative reviews of these initiatives be conducted, and discussed at the second symposium under this RETA. It is further recommended that the following policy proposals be considered by the RETA economies when reviewing or adopting an informal work-out process for dealing with corporate financial difficulty or insolvency:

- The banking sector (ideally with the endorsement and assistance of a central bank and/or finance ministry) should promote the introduction and development of a “code of conduct” directed toward the use of an informal out-of-court work-out process for dealing with corporate financial difficulty or insolvency.

- If necessary, the work-out process might be facilitated by establishing an independent office or secretariat to perform the following roles: (i) acting as a center to enable both corporate debtors and banking and finance institutions to initiate a forum for the possible commencement of the process; (ii) assisting, if necessary, the commencement and continuation of the process through negotiation and mediation; (iii) providing continued education and training for corporations; bank and finance institutions; and creditors generally of the work-out process and techniques relating to refinancing, restructuring and rehabilitation; (iv) referring problems and difficulties that may be encountered in proposing elements of a work-out (in particular, problems caused by the absence of suitable laws or the presence of restrictive or non-facilitative laws, rules and regulations) to government with recommendations for their improvement or reform; and (v) providing references to an established panel of independent specialist experts and advisors whose services may be required for the development of refinancing and reorganization proposals.
- If necessary, insolvency laws providing for rescue should be amended to enable proposals developed as a result of the informal process to be referred to a relevant court or tribunal for the purpose of seeking approval from creditors and the sanction of the court or tribunal in accordance with the provisions for such approval and sanction as contained in the relevant insolvency law.
- An insolvency law regime should provide for the protection of "new money" in order to encourage and enhance the prospect of a successful informal work-out (and formal rescue).
- To encourage and facilitate the development of informal work-out processes, an insolvency law regime should provide convenient and quick access to its procedures.

133. The above preliminary recommendations will be reviewed prior to the second Symposium to be held under the RETA. It is envisioned that these recommendations will form the basis for further reform and follow-up actions by governments in the RETA economies and by the Bank in Bank-funded Loan and Technical Assistance projects.

Project DIAL – Development of the Internet for Asian Law

Project DIAL has created the Asian and Pacific region's largest collection of full-text legislation

Project DIAL is a regional technical assistance funded by the Asian Development Bank (ADB) which focuses on developing Internet-based resources to assist those involved in the development of legislation in the developing member countries (DMCs) of the Bank. The purpose of Project DIAL is to make available the full texts of legislation and regulations and related law reform reports to legislative draftsmen and law reform personnel in the Bank's DMCs. Under an earlier small-scale technical assistance funded by ADB, a DIAL prototype was created and is available for free use by anyone who has access to the Internet's World-Wide-Web at:

<http://www.austlii.edu.au/au/special/dial/>

The ADB has recently approved follow-on regional technical assistance in the amount of US\$600,000 for enhancement of the DIAL prototype into a full-scale operating system and to provide a program of training to targeted DMC users in full-scale DIAL operations.

Project DIAL provides three methods of assistance: DIAL Index, DIAL Search and DIALogue.

DIAL Index

DIAL Index is an easy means of finding and accessing legislative resources already on the Internet from around the world. These resources are indexed by subject matter ('Development Law Subjects'), and by the type of materials ('Legislation', 'Parliaments' and 'Law Reform'). At present, there are links to legislation and to Parliaments from more than 60 countries. A feature of the Index is that some of its links permit pre-stored searches over the full text of selected legislation, either on sites that have their own search engines, or over legislation in the 'DIAL Search' facility.

DIAL Search

DIAL Search is a facility for 'one-stop' searching of the full texts of selected legislative resources from many sites on the Internet, with a common search interface. DIAL Search operates through a search engine (known as a "targeted web spider") which indexes every word of selected legislation sites around the world. The search facilities cater for new users with **Simple Search** (just enter words or a phrase relating to the search request) and for experienced searchers with **Advanced Search** (boolean searching with relevance ranking). It is intended that DIAL Search, when developed more fully, will allow users to search legal resources across the Internet without the 'noise' of non-legal materials found on more general Internet search engines, and with more comprehensive coverage of law.

DIALogue

DIALogue is an e-mail based facility by which Authorized Users in DMCs may obtain some level of free guidance from (or make contact with) panelists on particular subjects, as well as possibly obtaining guidance from other users of the facility. Access to DIALogue is restricted to Authorized Users such as those officials involved with legislation in DMCs, legal officers of the Asian Development Bank, and selected legal panelists (the DIALogue Panels) in the subject areas where assistance is most needed by DMC Authorized Users. The assistance provided typically includes brief statements of general principles, where to find resources, which country's legislation is worth considering, or other people to contact.

Feedback Wanted

The current version is a prototype which is in the process of enhancement into a full-scale operating system under the recently approved regional technical assistance. The prototype is located on the AustLII service (at the URL indicated above) at the University of New South Wales/University of Technology in Sydney, Australia.

We welcome comments from interested browsers about how useful they find the Project DIAL facilities, and any suggestions for improvements. We would be particularly pleased to receive suggestions concerning the addresses of legislation-related sites which we have not yet included.

Please send any comments to dial@austlii.edu.au or to the Project DIAL consultant, Professor Graham Greenleaf (graham@austlii.edu.au).

LIST OF LAW AND DEVELOPMENT PUBLICATIONS

1. Law and Development at the Asian Development Bank
2. Law and Development: An Asian Bibliography
3. Law and Development Bulletin
4. Law and Development: Seminar Proceedings – Legal Aspects of Regional Cooperation
5. Law and Development: Seminar Proceedings – Roundtable Meeting of Chief Justices and Ministers of Justice
6. Governance and Regulatory Regimes for Private Sector Infrastructure Development
7. Governance – Promoting Sound Development Management
8. Executive Summary of the Study on the Role of Law and Legal Institutions in Asian Economic Development
9. Developing Mongolia's Legal Framework: A Needs Analysis
10. Strengthening the Legal Framework for Customs Administration
11. Developing the Internet for Asian Law – Project DIAL (A Feasibility Study and Prototype)