



**LAWMAKING AND INSTITUTION BUILDING IN ASIAN  
INSOLVENCY REFORMS: BETWEEN GLOBAL NORMS  
AND NATIONAL CIRCUMSTANCES**

*by Terence C. Halliday*

**Meeting held on  
27-28 April 2006**

This document reproduces a report by Mr. Terence C. Halliday written after the Fifth Forum for Asian Insolvency Reform (FAIR) which was held on 27-28 April 2006 in Beijing, China. It will form part of the forthcoming publication “Legal & Institutional Reforms of Asian Insolvency Systems”.

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## **LAWMAKING AND INSTITUTION BUILDING IN ASIAN INSOLVENCY REFORMS: BETWEEN GLOBAL NORMS AND NATIONAL CIRCUMSTANCES**

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*“The key to the impact of the legislation will lie in its implementation.”*

OECD Economic Survey–China, 2005<sup>1</sup>

It is now a truism to affirm that in all lawmaking a gap opens up between law on the books and law in action. This gap is a central focus of research for empirical socio-legal scholars of law worldwide.<sup>2</sup> It is also increasingly recognised by law and finance scholars who assert that law inherently is “incomplete,” that its effectiveness relies heavily on the institutions of implementation.<sup>3</sup> It is precisely this gap that has led the EBRD, in its surveys of Central and Eastern Europe, to measure separately the enactment and implementation (or effectiveness) of insolvency.<sup>4</sup> Effectiveness in implementation becomes the ultimate criterion for appraisal of legal change and law reform.

There are three principal decision points that occur in the design and implementation of national insolvency regimes. Each centres on a determinative question.

First, what shall be the relationship of local insolvency regimes to global norms? This raises policy considerations about the value to be obtained from conformity to global standards as that value is balanced against a distinctive

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national path that reflects the peculiarities of national culture, institutions and development. The trade-offs in this choice determine not only the degree of harmonisation or convergence with insolvency regimes in other countries, including major trading partners and sources of investment, but also the probability of effective implementation in a particular domestic situation.

Second, what is the relationship between a technical notion of insolvency law and policy factors that are presumed within or entailed by that law? Frequently, international organisations properly seek to confine themselves to “technical” matters and avoid contentious policy issues, either because political matters lie outside their mandates, or because policy conflicts would lead international norm making into contentious stalemate.<sup>5</sup> Yet technical matters invariably involve policy choices that must be confronted by national policy makers. For national reformers it is imperative that the policy implications of apparently technical recommendations be clearly identified, their implications understood, and choices around those implications made deliberately in the context of state and party ideologies, and related policies.

Third, what is the relationship of formal law to law in practice? By formal law we refer to statutes, bureaucratic regulations and court cases. Reducing the “implementation gap” becomes a critical practical problem for national reformers. Even as they negotiate a satisfactory resolution of tensions between global and national standards, they must also anticipate the difficulties that arise from their own institutional capacities, political systems, legal culture and legal institutions. The more that national lawmakers draw on international norms or foreign experiences, the more susceptible they are to legal transplants that do not work—the so-called “transplant effect.”<sup>6</sup>

This paper addresses these questions as they relate to key areas of policy choice in the implementation of bankruptcy law. It begins by arguing that there is a hierarchy of policy choices for a government. The paper then turns to seven policy issues in the construction of effective and equitable insolvency regimes. On each issue the paper considers the policy hurdles, provides examples from developing and developed countries of efforts to surmount this hurdle (some successful, some not), and reflects on their implications for policy and implementation in Asia with special reference to China.

This analysis is based on three bodies of empirical research. The first relies on empirical studies of lawmaking and implementation in Indonesia, Korea and China over the past fifteen years.<sup>7</sup> The second relies upon empirical research on global and regional international organisations that

have driven the global reform movement in corporate insolvency law. The third draws on historical research that has been undertaken on the two most important sets of bankruptcy reforms in advanced economies—the US Bankruptcy Code of 1978 and the English Insolvency Act 1986—which stimulated in substantial part the worldwide movement for insolvency reforms. The paper selects specific instances of reform in these four countries to exemplify prospects and problems in key policy issues.<sup>8</sup>

## 1) Hierarchy of policy issues

Policy issues around reforms of insolvency law and institutions can be ordered in a hierarchy from higher to lower levels of generality. While in most lawmaking such a hierarchy exists, it is especially apparent in insolvency lawmaking since bankruptcy reaches to some of the most fundamental policy debates on substantive values in a society, its political system and economy. We can distinguish three levels of policy: 1) meta-policy issues; 2) master policy issues for insolvency; and 3) insolvency-specific and collateral policy issues.

### a) *Meta-policy issues*

These issues reach to fundamental ways in which societies define their values and their institutions. A notable current example is the set of principles discussed in China’s State Council White Paper on Political Democracy.<sup>9</sup> Meta-policy issues relate to insolvency law through three institutions.

#### i) *Meta-policy issues for the market, politics and society*

The first concerns the functions and limits of *markets*. Policy makers must decide what functions markets will be permitted to perform. What values will markets serve? For example, will a distinctive kind of capitalism or market economy prevail in China—a market with “Chinese characteristics”? Scholars point to varieties of capitalism in Europe and North America.<sup>10</sup> It is conceivable that other forms of capitalism will continue to emerge in different regions of the world where circumstances are qualitatively different from those in Europe and North America. In China this policy issue might be posed as a tension between a *socialist* market economy, where the dominant principle is “socialist,” or a socialist *market* economy, where the dominant principle is “market.”<sup>11</sup> Their balance affects the substantive and procedural provisions within bankruptcy law and

constrains the scope of options in the other two levels in the policy hierarchy.

A second meta-policy issue centres on the structure of *political power* in a society. For any country it must be determined: Where will the locus of state power reside? How will holders of power be held accountable by other centres of power, by society, by citizens? Will rule *by law* or rule *of law* prevail? These questions relate to bankruptcy regimes insofar as all bankruptcy regimes assume a certain configuration of power in a society. If it is a primary condition of a bankruptcy regime to deliver competent, fair, neutral outcomes,<sup>12</sup> then courts will be integral to a bankruptcy regime. This in turn assumes their autonomy from any of three sources of corruption—the market, the state, or the public. If courts are to treat all creditors equally irrespective of location, then this presumes that local political authorities in jurisdictions where bankruptcy filings are made will restrain themselves from interference in proceedings on behalf of local actors to the disadvantage of non-local parties.

A third meta-policy issue concerns the values that will order *society*. Will a government stimulate creativity and reward entrepreneurship among its citizens? How much will government permit civil society to hold accountable government institutions? How much inequality will a government tolerate in civil, economic, political and social rights, opportunities and outcomes? How much responsibility does a government take upon itself for social protections of citizens, including those that are unemployed or thrown out of employment? Decisions on these issues affect not only substantive decisions in bankruptcy law (*e.g.* whether SOEs which have economic and social functions should be subsumed under bankruptcy law, what kinds of priorities workers should have in liquidation proceedings), but influence the shape of institutions within which bankruptcy regimes are embedded (*e.g.* various sorts of social safety nets).

Each government makes a meta-policy decision where to draw the lines between these three institutions—the market, the political system, society. A *socialist* market economy arguably will draw those lines differently from a socialist *market* economy.

#### *ii) Institutional assumptions in constructing insolvency systems*

To build an insolvency system with the attributes recommended by global norm-making institutions proceeds on sets of assumptions that are not always expressly stated. These assumptions, with special reference to China, include the following:

### (1) On markets

Markets require social infrastructure—a means of organising economic activity (*e.g.* firms, contracts),<sup>13</sup> a regulatory framework that regularises and enforces norms of market activity, and ultimately some management by government.<sup>14</sup> Markets require some measure of predictability and certainty.<sup>15</sup> That can be accomplished by several methods: informal relations, such as family and ethnic ties;<sup>16</sup> government control, such as state-led models of development;<sup>17</sup> and a rule-of-law open market approach. As China's rapid economic growth has demonstrated, a great deal of market activity can be sustained without effective formal law and its accompanying institutions. Yet China's extraordinary efforts in the past decade to create commercial law regimes<sup>18</sup> indicate it is on a course to shift emphasis from the first and second towards the third mode of obtaining certainty in market transactions, particularly for outsiders.<sup>19</sup> Insofar as the third is chosen, this implies that laws will be implemented with reference to universal standards (at least within China) and not particularistic criteria (*e.g.* local political, legal interests).

### (2) The political system

Political actors in all countries often find it difficult to restrain themselves from intervening in commercial transactions or court-led proceedings, both of which undermine the capacity of a bankruptcy system to deliver certainty and predictability and to allow investors to price risk accurately. This is particularly so for countries with state-led economic development. The effectiveness of a bankruptcy system is highly correlated with the ability of government authorities to exercise restraint. For example, for a market-led rule-of-law bankruptcy regime to work in China assumes that China's leaders have made a policy decision to restructure the distribution of power within the political system. This requires, at the very least, that the Party will be self-restrained both at the centre and locally in the functioning of the bankruptcy system,<sup>20</sup> that courts will be given independence from executive control or arbitrary government interventions, and that local municipalities, counties and provinces will change their orientations from defence of local enterprises, creditors and stakeholders at the expense of stakeholders from outside localities.

### (3) Lawmaking

The rationalisation of lawmaking significantly affects market certainty. China has taken major strides towards rationalising and developing its lawmaking system, most notably in the Legislation Law (*lifa fa*) passed by

the National Peoples' Congress (NPC) in March 2000.<sup>21</sup> This has important consequences in two directions. One is to clarify the lawmaking relationship of the NPC to sub-national peoples' congresses. Another is to clarify the lawmaking authority of the NPC in relation to State Council agencies and their rulemaking and powers of interpretation. Since struggles between the NPC and State Council agencies, and among agencies themselves, has led to much ambiguity in implementation of law, the resolution of these issues in bankruptcy lawmaking will affect substantially its effective implementation.<sup>22</sup>

***b) Master insolvency policy issues***

All countries confront three principal policy issues about insolvency regimes—two substantive, the other institutional:

*i) Liquidation versus reorganisation*

For most countries until recently bankruptcy law has functioned principally to provide an orderly set of mechanisms for firms to be liquidated. In most cases of corporate failure, secured creditors were able to seize assets outside of bankruptcy proceedings no matter what the cost to the continuation of the business or other creditors, including workers. As a result of this bankruptcy policy, many potentially viable businesses were destroyed, many creditors were needlessly harmed, and many workers were summarily dismissed.

The UNCITRAL Legislative Guide and World Bank Principles signal a global movement of law reform that is intended to save businesses that might remain viable if they were financially and operationally restructured. The Legislative Guide calls for bankruptcy law that balances provisions on liquidation with those on reorganisation. States the guide:

*An insolvency law needs to balance the advantages of near-term debt collection through liquidation (often the preference of secured creditors) against preserving the value of the debtor's business through reorganization (often the preference of unsecured creditors and the debtor). Achieving that balance may have implications for other social policy considerations, such as encouraging the development of an entrepreneurial class and protecting employment.*<sup>23</sup>

It is precisely such a shift that we observe in the latest drafts of China's Bankruptcy Law.

*ii) Universalism versus protectionism*

The more business transactions cross jurisdictional frontiers of law and courts, the more critical it is that law expand to encompass the scope of market transactions.<sup>24</sup> Liquidation regimes are unfair and reorganisation regimes are impossible when creditors in each jurisdiction seize whatever assets are available to them thereby dismembering the business. The modern movement of bankruptcy law has sought to solve this problem by adopting universal principles of jurisdiction. Once a centre of main interests of the enterprise has been designated,<sup>25</sup> then the bankruptcy proceedings are coordinated across jurisdictions and their subsidiary proceedings so they proceed as a unified whole. In this way the value of the assets is maximised and the probability of a business surviving is increased. The UNCITRAL Model Law on Cross-Border Insolvency offers a global solution to this problem.<sup>26</sup>

However, the policy issue of universalism versus protectionism also occurs within countries. Local authorities in municipalities, counties, provinces or states may use their powers to favour local creditors and businesses over those outside the jurisdiction. Empirical researchers on China identify this as a widespread issue. As Cai Dingjian writes,<sup>27</sup> local political leaders pressure judges to follow the maxim, “do not let any runoff water flow to the fields of outsiders (feishui buliu wairentian)”. Local judges discriminate against non-local parties. Unless this problem of local protectionism can be solved, the entire prospect of saving businesses and saving jobs of workers is lost.

*iii) State versus market*

Every nation-state must decide where it will locate the institutional machinery that regulates bankruptcy of enterprises.<sup>28</sup> There are many options. Some states, such as Australia, prefer the private market of professionals to carry much of the burden of liquidation and restructuring in the shadow of courts with government agencies playing a minimal role. Other states, such as France, prefer the courts to be centrally involved in all principal decisions about a company’s fate, and to watch over the public interest, although the court may rely heavily on the expertise of private professionals. The evolution of bankruptcy law in many countries can be observed as a shift from government bureaucratic control to a more diversified institutional arrangement in which private professionals, courts and government agencies distribute responsibilities among themselves.

The decisions on where to locate bankruptcy regulation depends partly on political ideology about states, markets, and the relations between them.

It also depends on the capacity of institutions to “provide certainty in the market to promote economic stability and growth; ...ensure equitable treatment of similarly situated creditors; ...and to provide for timely, efficient and impartial resolution of insolvency.”<sup>29</sup>

These three master policy issues for insolvency regimes will determine the broad policy context for specific policy determinations that affect implementation.

## 2) Insolvency policy hurdles to effective implementation

Substantive and procedural bankruptcy law does not exist in an institutional vacuum. Research on institution building<sup>30</sup> and on insolvency reforms has shown that there are several key policy choices that influence the probability of effective implementation, both substantive and institutional.

### a) *The recruitment and regulation of competent practitioners*

A modern insolvency system requires competent and ethical practitioners.<sup>31</sup> These function primarily within the private market for professional services although most countries also regulate and administer aspects of the insolvency system through government officials who must also be highly qualified.<sup>32</sup> Global norms (see Table 1) point to three sets of attributes critical to the effective professionalisation of bankruptcy practice.

First, professionals must display a level of competency comparable to the demand of practice. That competency requires both technical sophistication in the relevant law and/or accounting, and familiarity with business practice. Competency may be calibrated to the level of complexity of the task. Liquidations and reorganisations of small firms with a simple legal and financial structure, which transact business in a single jurisdiction will require very different skills from enormous enterprises with highly complex legal and financial structures, which transact business across national and international jurisdictions.<sup>33</sup>

Second, because bankruptcy professionals handle moneys and are exposed to opportunities for self-enrichment, they must be socialised in values of integrity and probity, and be embedded in regulatory structures that reinforce honest behaviour and sanction deviance.

Third, both the first and second attributes depend on the effective functioning of regulatory apparatuses. Regulation of professionals in a particular case comes from parties to the case (*e.g.* creditors) and, more

important, a court. Most important, bankruptcy professionals require a professional regulatory body that simultaneously enables them to collectively express their interests and expertise, and to facilitate qualified, competent and ethical practice.

**Table 1: Global norms on the professionalisation of insolvency practice**

<p><b>UNCITRAL Legislative Guide</b></p> <p>Qualifications (paragraphs 36-41)</p> <p>115. The insolvency law should specify the qualifications and qualities required for appointment as an insolvency representative, including integrity, independence, impartiality, requisite knowledge of relevant commercial law and experience in commercial and business matters. The insolvency law should also specify the grounds upon which a proposed insolvency representative may be disqualified from appointment.</p> <p>118. The insolvency law should establish a mechanism for selection and appointment of an insolvency representative. Different approaches may be taken, including appointment by the court; by an independent appointing authority; on the basis of a recommendation by creditors or the creditor committee; by the debtor; or by operation of insolvency law, where the insolvency representative is a government or administrative agency or official.</p>
<p><b>World Bank Principles</b></p> <p>D8 Competence and Integrity of Insolvency Representatives</p> <p>The system should ensure that:</p> <ul style="list-style-type: none"> <li>- Criteria as to who may be an insolvency representative should be objective, clearly established and publicly available;</li> <li>- Insolvency representatives be competent to undertake the work to which they are appointed and to exercise the powers given to them;</li> <li>- Insolvency representatives act with integrity, impartiality and independence; and</li> <li>- Insolvency representatives, where acting as managers, be held to director and officer standards of accountability, and be subject to removal for incompetence, negligence, fraud or other wrongful conduct.</li> </ul>

Many governments in Asia confront significant policy hurdles in the implementation of a bankruptcy profession. There may be a general deficit of skilled lawyers or accountants, a deficit of bankruptcy specialists, a derogation or marginalisation of bankruptcy work, a pattern of corruption around bankruptcy work, a lack of education in bankruptcy law and practice, and the absence or ineffectiveness of regulatory bodies for credentialing and ethical oversight. Moreover, most countries already have an established division of labour. This can produce an institutional inertia that resists adaptation to changes in the market. Professionals may be socialised in a form of practice (*e.g.* liquidation) that is inimical to changes in insolvency or wider public policy (*e.g.* a preference for reorganisation). Together these elements may be sufficient to destroy a bankruptcy regime, no matter how well crafted the substantive law.

These policy hurdles are not confined to developing countries. It is instructive to consider the case of England, which successfully solved its problems with practitioners by creating a new hybrid insolvency practitioners' profession. In the first major insolvency legislation for almost a century, Mrs. Thatcher's government sought to stimulate public confidence and investment in the market. To do so required "cleaning up" the market. Both demanded a radical reform of insolvency practice.<sup>34</sup>

The Cork Committee Report (1980) and the media criticised insolvency practice on the grounds that: 1) there were no formal qualifications for practice; 2) many practitioners and small insolvency firms were not regulated by themselves or the government; and 3) there were widely publicised cases of unethical practitioners conspiring with company directors to defraud creditors through bankruptcy proceedings.<sup>35</sup> The Insolvency Act and its implementing regulations: 1) created a new insolvency profession, including lawyers and accountants; 2) set minimum standards for professional credentials and experience; and 3) erected a complex regulatory structure that combined self-regulation with government oversight. This had the effect of resolving most problems of incompetence and unethical behaviour, and it drew more highly qualified reputable practitioners into the profession.

Indonesia, by contrast, has had a limited foundation on which to build its new receivers' profession. The results to date have been disappointing although the nature of its difficulties and attempted solutions are instructive for other countries (see Box 1).

### **Box 1: Establishment of a receivers profession in Indonesia**

In Indonesia, after 1997, professional services in general were poorly developed, and corruption was purportedly widespread in legal and accounting practices. The Indonesian government confronted the policy hurdle of developing bankruptcy professionals capable of servicing the increase in corporate restructurings and liquidations brought about by the package of reforms.

The IMF-led international agencies pressed the government of Indonesia to permit foreign professionals to practice in Indonesia, at least for a period. The government refused, in effect, by demanding that practitioners speak Bahasa Indonesia. The government did create a receivers' profession, which could be staffed by accountants, lawyers and others.<sup>36</sup> Receivers were to be regulated by a professional self-regulatory body and appointed by a court.

The indifferent success of this policy option shows how high the hurdles to be surmounted are in situations where corruption is pervasive, professionals are in short supply, the economic stakes are high, and professional regulation is weak. Researchers on bankruptcy lawyers have concluded that "professional standards of the private legal professions not only are significantly weaker than those of the judiciary but also seem to be deliberately designed to obscure and obstruct the proper administration of justice."<sup>37</sup> Other research shows that particular lawyers are associated with doubtful records that can reasonably be associated with corruption,<sup>38</sup> a belief that is widely echoed by other actors in the Indonesian insolvency system.<sup>39</sup>

Research on the receivers' profession has shown it has even more problems. While a regulatory structure was created (AKPI), and the AKPI has administered qualifying examinations, the vagueness of rules and procedures in the law, and the almost complete absence of advice, continuing education and ethical controls by the AKPI, has permitted numbers of abuses. The ad hoc appointments process, initiated by creditors, debtors and/or the court has led to a small number of the eligible receivers being appointed over and over again while others are not appointed at all.<sup>40,41</sup> This has led to allegations of corruption and collusion between practitioners and judges.

In Indonesia the policy goal was therefore frustrated by: a) incomplete or ambiguous practice rules; b) failure to specify precisely the conditions and terms of appointment in ways that forestalled favouritism, kickbacks or collusion with interested parties; c) failure to create a functional self-regulating body with powers of enforcement; and d) failure of government to provide oversight and accountability of the regulatory body.

Together these helped contribute to the abandonment of the bankruptcy process in courts by many creditors, including the International Finance Corporation of the World Bank.

The Chinese government confronts a significant policy hurdle in the construction of a vibrant sector for professional services that can both

service a bankruptcy regime and compete in the opening of the professional services market as WTO provisions come into force. China has taken notable steps to expand its professional services sector, with marked success in professional education and recruitment. Yet both the accounting and legal professions are very young and very small. A small proportion of mostly urban lawyers have university qualifications. They are disproportionately distributed across China. There are also multiple occupations providing legal services, each regulated by a different body.<sup>42</sup> Very few lawyers have experience in bankruptcy proceedings. And the form and powers of regulatory bodies for practitioners have yet to be unveiled.

In their economic development to the present, countries with advanced market economies have developed at least five models of professional regulation.<sup>43</sup> The models are suited to the particular historical development and current institutional matrix of each country. In Asia we can expect similar variation. It is not likely that the model for Japan or Korea, for instance, will be entirely appropriate for Indonesia and China, which have radically different histories and paths of development. This logic of analysis suggests that:

In a developing country where: 1) the formation of a professional services sector is very recent; 2) multiple occupations compete even within the domains of law and accounting; 3) demands for services range from the most sophisticated international standards to very simple local needs; 4) professional competence and ethics are in early stages of development; and 5) regulatory structures that are somewhat differentiated from the state are still evolving...

...a national adaptation of global norms might have the following attributes:

- Creating a tiered qualification for practice: the larger the enterprise and more complex the liquidation or reorganisation, the higher the credentials required by a professional or professional services firm for appointment as counsel or as an insolvency representative;
- Creating a unified intermediary organisation/professional association that would hold substantial regulatory powers for education, qualifications and credentials, continuing education, and ethical standards, including the powers to penalise, suspend or expel a professional from practice. This association would also have the capacity to protect professionals from illicit influence, a function critical for it to maintain its credibility among practitioners;
- Granting powers to a single—possibly new—government supervisory agency that would hold accountable the intermediary organisation;
- Creating and enforcing severe penalties for corruption; and

- Formulating precise rules of practice (*e.g.* appointment, conflicts of interest, dismissal) to be applied by the professional intermediary organisation and court, and as a reference for parties to professional services.

***b) The compensation of private insolvency professionals***

If the principal purposes of bankruptcy law are to maximise the value of assets, save businesses that are capable of being turned around, and redistribute assets to parties most capable of maximising their value,<sup>44</sup> a bankruptcy system must attract professionals with the skills capable of comprehending the complexity of current financial and operational structures, of distinguishing between businesses with no hope and those with hope, of creatively using legal means to swell the estate and obtain fresh capital, and of imagining new futures for a weak business.

The policy issues surrounding compensation become difficult because they are also politically sensitive. All these issues relate to the fundamental policy question—how to attract professionals of a competence commensurate with the complexity and stakes of the business challenge? At once, remuneration must attract the best professionals for the most complex tasks while making affordable professional services for relatively straightforward and even mundane tasks. A careful balance must be struck between preserving value for the estate and reorganisation, and allocating the value necessary to obtain competent professional services.

Global norms provide useful guidance about options. The UNCITRAL Legislative Guide points out that remuneration for an insolvency practitioner who administers a bankruptcy estate can be determined by a government agency, a professional association, creditors, or a court. The basis for determining fees varies markedly: 1) a time-based system that rewards practitioners for the hours they spend on a case; 2) a commission based system which rewards practitioners for the assets they bring into the estate; and 3) a creditor led system which has more discretion over the complexity of the case and the effectiveness of the practitioners. Each of these also balances reward with risk in different ways, and has benefits and deficits.<sup>45</sup>

**Table 2: Global norm on professional remuneration**

<p><b>UNCITRAL Legislative Guide</b></p> <p>Remuneration (paragraphs 53-59)</p> <p>119. The insolvency law should establish a mechanism for fixing the remuneration of</p>
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the insolvency representative and establish priority for payment of that remuneration.

The importance of remuneration is frequently underestimated by lawmakers. It becomes a “political football”. Yet its significance can be observed in two national cases. In one, the United States, a change in remuneration dramatically increased the flow of skilled professionals into the handling of firm and industry restructurings. In another, Indonesia, a failure to adequately resolve problems of remuneration has severely hampered the construction of an effective insolvency system (see Box 2).

Before 1978, bankruptcy law in the United States was a low prestige and marginalised practice that did not attract the best and brightest professionals. Major corporate law firms seldom included bankruptcy specialists. Judges determined fees for lawyers who acted on behalf of bankrupt companies. While, in principle, fees were determined on the basis of hours plus expenses, in practice, lawyers remained uncertain until the end of the case about their compensation because judges had discretionary powers that were often exercised in arbitrary ways. Some judges refused to pay lawyers a higher hourly fee than judges themselves received. The result could be predicted: highly qualified corporate lawyers simply avoided bankruptcy work for it offered neither prestige, nor power, nor money.<sup>46</sup>

Policy makers responsible for the 1978 US Bankruptcy Code made a fundamental decision to prioritise corporate reorganisation. This could only happen if there was a radical shift in the basis of compensation for private practitioners. Their solution: for fees to be determined on the double basis of comparability to legal work of similar complexity and the value that practitioners brought into the estate, taking into account the complexity of the case, and the effectiveness of the outcome, among other criteria. The results were dramatic. Bankruptcy practice catapulted from one of the least prestigious and lowest paid specialties to one of the most prestigious and best paid areas of law. The best marginal boutique bankruptcy firms were absorbed into major corporate law firms. The restructuring of the largest firms and entire industries (*e.g.* airlines, automobile) now lay in the hands of some of the most talented professionals in the legal services market. This gave US industry a capacity to adapt and adjust to changing market conditions.<sup>47</sup>

Policy makers in Indonesia began with a similar incentive model in mind. It is salutary to observe how the best of intentions were derailed in practice (Box 2).

### **Box 2: Remuneration of receivers in Indonesia**

In Indonesia the government proposed but ultimately failed to implement an effective compensation system. A 1998 decree mandated that receivers would be compensated on the basis of a percentage of the assets in the estate.<sup>48</sup> This offered potentially high rewards for enterprising professionals.

However, an early case that involved tens of billions of rupiahs would have paid millions of rupiahs to receivers. The Chief Judge of the Commercial Court decided this was excessive and replaced the percentage criterion by an hourly fee roughly equivalent to USD (United States dollars) 300 an hour. This included not only the lead receiver but all supporting professionals, support staff and expenses. Subsequently that figure was reduced by courts to approximately USD 200 an hour.<sup>49,50</sup> Even that figure was subject to the discretion of judges and it was not determined until the end, or close to the end, of a case.

Moreover, lack of enforcement capacity meant that fees were difficult to collect from debtors, so much so that receivers were often compelled to offer huge discounts of up to 75% of total fees in order to be paid at all. Sometimes debtors paid only in instalments or even, on occasion, with assets, not cash.<sup>51</sup> Because approval of fees depended on judicial discretion, a perverse economic incentive entered the system that encouraged corrupt practices between receivers and judges. A receiver's fee might depend on whether they were prepared to make a contribution of some part of it to a judge.

Remuneration also presents difficult policy choices for China. It is politically uncomfortable for lawmakers to rank professionals above all other creditors in liquidations or to reward professionals highly in reorganisations at precisely the moment when workers are being laid off or their compensation and benefits reduced. There is a natural tendency, therefore, for politicians to solve their political difficulties by restricting fees that would seem to increase inequality in the market. Similarly, judges in advanced and developing countries frequently resent the much higher levels of compensation of private practitioners.<sup>52</sup> Moreover, taking fees out of the estate appears to impede the capacity to reorganise successfully because it drains scarce resources required for reorganisation.

These considerations must be weighed against the value that highly qualified, expert and experienced professionals can bring to the prospects of saving large and complex enterprises. As a proportion of the present assets and future value of a company that is effectively reorganised, professional fees might be considered a very small transaction cost.

The UNCITRAL Legislative Guide makes it clear that professional remuneration can be adapted to a variety of national circumstances as nation-states vary bases for determining fees and the economic or government actors who set those fees. This logic of analysis suggests that:

In a developing country where: 1) the market for services is highly bifurcated between those that are highly complex and those that are straightforward or routine; 2) the outcomes of bankruptcy proceedings for major companies have significant impact on national or regional economies and social welfare; and 3) major creditors and debtors rely on sophisticated domestic and international professional services in their most critical commercial dealings...

...a national adaptation of global norms might have the following attributes:

- Maintaining an administrative priority for professionals in the liquidation of companies;
- Adopting a compensation system for professionals that provides incentives for the best professionals and best firms to engage in corporate bankruptcy;
- Graduating the compensation system so that professional services for middle-sized, small and routine bankruptcies are affordable by debtors and creditors; and
- Creating a bankruptcy administration within the state that handles routine bankruptcies where there are no fees from creditors or debtors, or where they are not sufficient to attract professional services.

### *c) Implementation of an effective judicial system*

With rare exceptions,<sup>53</sup> the successful implementation of a bankruptcy system depends upon the construction of an effective judiciary. This is a most formidable task—arguably the most difficult of any aspect of insolvency institution building—because in most developing countries it involves changing the structure of the state. In the vast majority of countries, the executive arm of government dominates the legislative and judicial branches.

In countries where the state has led economic development, such as China, Indonesia and Korea, administrative guidance has been vastly more important than legislative or court interventions.<sup>54</sup> And, without a tradition of the rule of law, courts are by definition weak and avoided by powerful actors in a society.<sup>55</sup> As a result, to create a market system governed by the rule of law involves the most fundamental policy decision: will significant powers be transferred from the executive, or party, or legislative institutions to courts? Or, more generally, will courts be given sufficient autonomy to make legal decisions without the arbitrary interference of a party or state officials, market actors, or the public? The answers to these questions determine whether a market-based insolvency system is possible.

Inside this fundamental policy question sit several others. The UNCITRAL Legislative Guide identifies three.<sup>56</sup> How extensively involved will courts be in proceedings and in what aspects of proceedings? How much power will be delegated by courts to other participants, such as insolvency practitioners and creditors, and which of those decisions will require court approval? And, what powers will be given to court officials? The UNCITRAL/World Bank Principles specify in some detail global norms that will produce an effective judiciary (Table 3).

**Table 3 Global norms on courts**

<b>UNCITRAL/World Bank Unified Standard</b>
D1.1 The system should guarantee the independence of the judiciary. Judicial decisions should be impartial. Courts should act in a competent manner and effectively....
D1.2 Insolvency proceedings should be... assigned, where practical, to judges with specialised insolvency expertise.
D1.3 The court's jurisdiction should be defined and clear....
D1.4 The court should... render decisions in proceedings in line with the legislation....
D1.5 The general court system must... effectively enforce the rights of... creditors....
D2.1 Adequate and objective criteria should govern the process for selection and appointment of judges.
D2.2 Judicial education and training should be provided to judges.
D2.3 Procedures should... ensure the competence of the judiciary....
D3 The court should [treat] all interested parties... fairly, timely, objectively.
D4 An insolvency and creditor rights system should be based upon transparency and accountability....
D5.1 Judicial decision making should encourage consensual resolution among parties where possible and otherwise undertake timely adjudication of issues....
D5.2 The court must have clear authority and effective methods of enforcing its judgments.

D5.3 A body of jurisprudence should be developed....

D6.1 The system should guarantee security of tenure and adequate remuneration....

D6.2 The court must be free of conflicts of interest, bias and lapses in judicial ethics....

D6.3 Persons involved in a proceeding must be subject to rules and court orders designed to prevent fraud, other illegal activity and abuse of the insolvency and creditor rights system.

There are powerful arguments for the central involvement of courts in bankruptcy proceedings: optimally, they may protect the public interest alongside interests of other parties; they provide forums in which negotiations take place or in whose shadow negotiations occur; they offer a neutral forum for dispute settlement; and they can make binding agreements among parties as well as undo agreements to the benefit of reorganisation. Yet we shall observe further below that nations differ considerably in ways they distribute functions to courts and other institutions, out-of-court bargaining forums, state agencies, or contracting among parties. That is, more or less of the work of bankruptcy may be done in courts even though a court may ultimately be the institution of last resort.

The choice by a country on how much power to vest in courts will comprise a mix of factors including: a) the historical role of courts; b) the current situation of courts in the state and market; c) the political will and level of economic investment by the state in development of the judiciary; and d) state ideology and public support for court-based dispute resolution, and checks on the powers of executive agencies and legislatures, among others.

Three empirical cases underline the policy challenges of implementing effective courts for insolvency regimes. The case of the United States is instructive. Although the US already had a sophisticated judiciary and legal profession, it confronted significant problems with bankruptcy practice. Before the 1978 reforms, federal bankruptcy courts operated at a much lower level of competence, prestige and power than the so-called Article III courts.<sup>57</sup> Low salaries, low prestige, short tenure, and limited power did not attract outstanding judges. Jurisdictions were confusing and overlapping. Judges were vulnerable to market pressures and some succumbed to corruption.

As a result, the American Bankers Association and other organisations of major creditors informed the congress they would simply avoid the courts

and subvert bold proposals for law-driven reorganisation reforms unless courts were competent, and powerful with clear jurisdictions. Congress responded by elevating bankruptcy courts to an adjunct of federal district courts, where judges would be appointed by the president on the advice of the senate for fourteen years, with increased salaries to match. Courts were given greatly enhanced powers, their jurisdictions clarified, and an appellate court structure was added. The result: the quality of judges has risen markedly, the largest creditors and debtors bring their cases to the bankruptcy court, and corruption appears to have disappeared.

In Asia, the cases of Indonesia and Korea contrast sharply. Each emerged from the Asian financial crisis with a determination to transform the role of the judiciary in governing market relationships. Yet implementation has diverged markedly (Box 3).

### **Box 3: Court reforms in Indonesia and Korea**

#### **Korea**

The post-1997 reforms brought a demand for bankruptcy judges. Korea began with an advantage—the quality of judges, by and large, was high since they were recruited through a rigorous selection process. However, for courts in general, there were problems of competence and experience in commercial cases and there were also cases of corruption. Courts had no expertise in bankruptcy matters since, on average, they handled about one bankruptcy case a year.<sup>58</sup> The most fundamental policy challenge, however, centred on the possibility that the government of Korea would relax its administrative and executive control over corporate liquidations and reorganisations and transfer those powers to market actors operating through the courts. A deep-seated scepticism existed in the Ministry of Finance and Economy that courts, previously the least developed of the branches of government, could handle some of the most difficult issues in the economy—defining the limits of the market.<sup>59</sup>

The Korean government successfully responded to these challenges with a combination of methods over several years, culminating in a comprehensive bankruptcy act: 1) rotating judges from one court to another in order to reduce their vulnerability to local pressures; 2) creating a division of the court, particularly in Seoul, that specialised in bankruptcy cases; 3) creating ad hoc panels of business leaders, accountants, and others, who can sit with judges on complex cases and provide them expert commercial advice; and 4) moving slowly to permit courts rather than administrative agencies to make decisions in major restructurings.<sup>60</sup> Through this mechanism the government still continues to exert administrative influence on restructurings before they get to court.

#### **Indonesia**

A more severe policy challenge confronted the government of Indonesia. In the wake of the 1997 financial crisis, the IMF and international creditors compelled Indonesia to engage in significant court reforms as a condition of their loan agreements and disbursements.<sup>61</sup> Creditors and debtors seldom used courts.<sup>62</sup> Court powers were limited; they failed to recruit high quality judges, and their independence was deeply compromised by political and market interventions. Indonesian courts had little experience with significant commercial cases. Over decades, Indonesia's state bureaucratic-led economic development reduced the powers and independence of the courts almost to irrelevance.<sup>63</sup>

In negotiations with the IMF, the government of Indonesia made a series of policy choices that were implemented in rolling reforms: 1) to establish a new dedicated commercial court; 2) to recruit high quality judges who would be trained in commercial law; 3) to provide ad hoc outside judges or specialists to add judges in complex cases; 4) to create civil society monitoring groups that monitor all court bankruptcy decisions; 5) to make publicly available all court decisions; 6) to enact collateral legislation and set up bodies that would guard against corruption; and, perhaps, most fundamentally; 7) to establish a judicial commission that separates it from Ministry of Justice control and provides it some financial and administrative independence from the executive.<sup>64</sup>

While advances clearly have been made,<sup>65</sup> empirical analysis shows that certain policy hurdles have not yet been surmounted. The dedicated commercial court did not receive the resources initially envisaged; commercial court judges were not paid a premium in order to attract high quality judges, nor were judges recruited from the private profession; the initial and continuing training of judges fell short of desirable minimum thresholds; appeals continued to a Supreme Court that appeared sometimes corrupt and sometimes lacking in competence; many judges continued to be exposed to efforts to corrupt their independence and some decisions suggested that some succumbed; ad hoc judges were rarely used; and major creditors, especially foreign creditors, deserted the court.

Scholarly observers argue that these difficulties in implementation go beyond insolvency law to: a lack of political will by the Ministry of Justice to radically reform the entire court system; a lack of commitment by the government to provide adequate resources to the commercial court; resistance from the Supreme Court and other judges to a special status for commercial court judges; and a laxity by the government in taking corruption seriously in any part of public administration.<sup>66</sup>

Yet, advances have been made with a judicial commission that proposes that reforms initiated in the commercial court will be widened to the entire court system, the prospect of more powerful independent courts now is debated in the public arena, and a small civil society has developed to support court reform. It remains to be seen how effectively the judicial commission and blueprint for the Supreme Court will be implemented in practice.

China has made enormous strides in the development of its courts since 1979.<sup>67</sup> Courts are moving gradually from an administrative to an adjudicatory model; the recruitment and quality of judges is incrementally being upgraded so that more judges will have prior legal training; representation of parties by counsel can be found increasingly as numbers of

lawyers and legal workers expand; and the Supreme Peoples' Court has outlined broad ambitions in its Second Five-Year Reform Plan.<sup>68</sup> Yet the most perceptive Chinese commentators identify major challenges to courts in general that will influence whether a court based bankruptcy system will succeed. In a comprehensive survey, China scholar Cai Dingjian<sup>69</sup> concludes that there is a "new crisis of people's faith in the law" and unless this is remedied quickly their "disappointment and lack of trust" could result in the "abandonment of the legal system."<sup>70</sup>

Cai Dingjian identifies several challenges for policy makers in the structure and functioning of the judiciary. First, the judiciary is not independent, either from the market through financial corruption, or from local governments which "control judicial appointments and are responsible for financing local courts." "Trial outcomes," states Cai Dingjian, "are influenced by power, money, and relationships and the dictates of local interests and the local power structure."<sup>71</sup> Second, the internal organisation of the judiciary is problematic. Rather than using single-judge regimes, courts rely on court adjudication committees in which judges remote from the case and hearings, including the president and vice-president of the court, contribute to decisions on a case. Third, judges are not well qualified whether in general legal education or in specific areas of practice, such as commercial law. Fourth, "with the advent of economic reform, such people completely lack the ability to resist the lure of money, pressure from those in power, and the corrupting influence of personal relationships. The result is an astounding amount of corruption in judicial agencies."<sup>72</sup> Fourth, enforcement of court decisions remains very weak particularly when they require confronting the instinctive protectionism of regional and local interests, not to mention those of government agencies. This analysis coincides substantially with the OECD's 2005 Economic Report on China.<sup>73</sup>

To the extent that these practices continue, they will preclude the development of a bankruptcy system that can regulate market practices, broaden lending and investment, and restructure firms. A huge gap will open up between enacted law and its implementation. This will quickly become apparent to creditors. Local protectionism is particularly perilous for bankruptcy regimes since local jurisdictions are inclined to favour local debtors and creditors over those outside a jurisdiction, which breaches a fundamental principle of bankruptcy law and discourages financing from parties outside a jurisdiction unless they have strong local relationships. Limited separation between the courts and political authorities similarly gives no confidence to creditors outside the jurisdiction or out of the country that they can extend credit with confidence and that their assets or security will be protected. If courts are not highly competent and skilled in commercial matters, especially for complex liquidations or restructurings,

then they will not gain the confidence of major parties to bankruptcy proceedings. And even if judges are competent, a failure to combine rewards and sanctions that will inoculate them from economic corruption will similarly doom a bankruptcy system.

Governments find it difficult to muster the political will to invest heavily in courts because they do not have strong political constituencies. The centrality of courts to the entire economy (not to mention the social stability of the entire society) suggests that they warrant an investment by government comparable to other critical infrastructures, such as power and transportation. The cases of Singapore and Indonesia contrast sharply in this respect. Singapore's economic development plan included a dramatic upgrading of courts with heavy financial investment, strong sanctions and heavy inducements. Lee Kuan Yew attributes a significant part of Singapore's transition from a developing to an advanced economy to his successful investment in the judiciary.<sup>74</sup> Indonesia has headed more cautiously in a similar direction. Its trajectory is promising, but political will has taken time to gather momentum and economic investment in courts by the government has been limited. India's increasing appeal to foreign investors relies in part on its reputable court system.

The difficulty of institution building must not be minimised for it confronts enormous challenges on all sides. Few developing countries achieve significant results in less than several decades, if at all. Some academic commentators are quite pessimistic about the prospects of court reform in most developing countries.<sup>75</sup>

Since the structure and functions of judiciaries varies widely across countries with advanced economies, it is to be expected that the nature of those reforms will differ significantly in Asia. This logic of analysis suggests that:

For a subset of countries where: 1) countries intend to regulate their markets by law rather than relationships; 2) the development of judiciaries has been stunted and their legitimacy poorly established; 3) the current judiciary cannot protect itself from market, political or public interference in its decision-making; 4) local protectionism permeates the judiciary; 5) recruitment of judges has not kept pace with the sophistication of market transactions and legal development; 6) judicial authority will have wide-ranging potential consequences for local and national economies; and 7) political will is strong enough to create a necessary infrastructural condition for an advanced market...

...a national adaptation of global norms might have the following attributes:

- Create a *national commercial court* that would be financed by the central government and administered by a national judicial commission;<sup>76</sup>
- Vest in the *national commercial court* jurisdiction for commercial cases in particular areas of law, perhaps above a certain monetary level and/or in cross-jurisdictional cases;<sup>77</sup>
- The national commercial court could consist of two or three layers, from courts of first instance, to intermediate courts, to a national supreme commercial court. Alternatively, appeals might be made to a supreme court;
- Create a *national judicial profession* whose members are appointed nationally (perhaps nominated by provinces) and rotated throughout regions; judges would receive high salaries/rewards; recruitment might be open from within a judicial training institute or from the private legal profession;
- Create a mechanism for bringing non-judicial experts to aid the court; and
- Create and enforce severe penalties for corruption.

If the dramatic approach is not feasible, a dramatic end result might be accomplished by incremental steps. This approach might commence with the short-term establishment of a national court, which would begin in the largest cities, then widen to other parts of the country. Similarly, the court might begin with jurisdiction in one area of law, such as bankruptcy, and progressively widen to intellectual property, antitrust, and related areas.

#### **d) *Recursivity in the lawmaking process***

Implementation itself has policy dimensions. Quite apart from the policy choices made about the substance of law or institutions, governments confront alternative ways of lawmaking. The process affects the product and therefore must also be taken seriously in the construction of functioning insolvency regimes.

Lawmaking frequently proceeds in episodes–long cycles of reform that continue until practice is normalised around policy goals set by the government.<sup>78</sup> The stabilisation of reforms occurs when the gap between formal law and law in practice is reduced sufficiently for the policy to be implemented in a form intended and acceptable by lawmakers, practitioners and stakeholders alike. If the demand for reform is held constant, better lawmaking occurs when cycles of reform are minimised–when courts and government agencies quickly converge on settled meanings of a statute. Fewer cycles also have the merit that they more readily produce predictability and certainty in the law and market.

Research on insolvency lawmaking in advanced and developing countries reveals that several pathologies can accompany lawmaking.

Research proceeds on three premises about legal change: 1) lawmaking produces statutes passed by legislatures, cases decided by judges, and regulations generated by civil servants; 2) reforms or legal change oscillate in cycles between law-on-the-books and law-in-action; and 3) what occurs during lawmaking affects law in practice and what happens in practice influences subsequent lawmaking.

Four mechanisms drive cycles of reform in insolvency and other areas of commercial reform:

- a. All lawmaking produces *indeterminacy*.<sup>79</sup> This results from ambiguities, inconsistencies or gaps in the principal governing statute and it is intensified by conflicts among rule-making agencies, general court interpretations, and limitations of particular judicial opinions. Indeterminacy is affected by the uncertain relationship between national, provincial and municipal courts.<sup>80</sup> Yet all parties that anticipate bringing actions under the law seek a measure of predictability and certainty about what law will be applied in a forum that has clear jurisdiction.<sup>81</sup> If significant players, such as financial institutions in bankruptcy proceedings, are not convinced that courts can offer the determinacy they expect, they will abandon them in favour of other arrangements.<sup>82</sup> Several instances of statutory ambiguity and judicial interpretations affected both Indonesian and Korean law reforms in adverse ways.
- b. The implementation gap can be widened or narrowed by *contradictions* that frequently are built into laws. A contradiction occurs when lawmakers seek to resolve strong conflicts among economic, ideological or political actors by giving opposing actors concessions within the law itself but without resolving the underlying tension. In insolvency politics such a tension frequently turns on the relative rights of secured creditors versus labour or unsecured creditors or debtors. Unless satisfactory bargains have been struck by the principal parties with interests in the outcome, contradictions inside law lead to unstable political settlements. Unresolved contradictions consequently lead to an implementation gap where dissatisfied parties seek to nullify in practice what they could not manage in the law. They lead inevitably to further waves of corrective laws, regulations and court opinions thereby producing more short-term uncertainty for potential users of the laws.
- c. The implementation gap can be widened by *diagnostic struggles* among players in a bankruptcy system over exactly what is right or wrong in the functioning of the system. All lawmaking proceeds on diagnoses of some problem and the prescription that will solve it.

But contentious areas of lawmaking by definition include interest groups that define the problem in different ways. In debates over drafts of the Chinese Bankruptcy Law, the powerful trade union representatives and the banking sector have very different diagnoses of the relative situations of workers and secured creditors and what should be done about them. The differences within the Standing Committee of the NPC over the relative priority of secured creditors and workers reflect differing diagnoses of the situation of companies in distress. If the law is based on a diagnosis that is wrong or biased or contestable, then this again can lead to resistance and a derailing of the law when it comes to be implemented by those whose evaluations of the problems were ignored or rejected.

- d. An implementation gap frequently arises when there is an *actor mismatch*. Very often those who implement laws and those who enact laws are not the same. In bankruptcy reforms, debtors, the business community, or company managers are often left out of lawmaking. Trade creditors, who play a critical role in economic development, seldom have a means of articulating their views. This was the case in the lawmaking of the 1978 US Bankruptcy Code, the 1986 English Insolvency Act, and in the substantive and institutional insolvency reforms in Indonesia and Korea.<sup>83</sup> In the drafting of a new Chinese bankruptcy law, it is not clear how fully private sector industry has participated in any phase of the bargaining and drafting of the law. The danger of allowing an actor mismatch to open up in lawmaking is that parties excluded from the lawmaking may fight strenuously against those laws when they come to be implemented.<sup>84</sup>

The number and extent of pathologies in reform can be avoided by anticipating and adjusting for them:

- (1) Ambiguity can be lessened by clarifying jurisdictions among lawmaking agencies. Commentators on Chinese lawmaking have observed that much indeterminacy results from conflicting interpretations by competing government agencies and the Supreme People's Court. The proposed reforms in the Five-Year Plan of the Supreme People's Court may lead to more consistency across courts and a clearer jurisprudence arising from the courts.<sup>85</sup> An advance to a comprehensive bankruptcy act that unifies jurisdiction over almost all enterprises will be a notable advance. But unless clear determinations can be made at the point of enactment about which other lawmaking entities will have responsibility for drafting regulations, interpreting the

statute, and handling conflicts, there will be adverse effects on market certainty.

- (2) Contradictions are less easy to resolve. For instance, an ideological resolution of the tension between *socialist* market economy and socialist *market* economy would substantially lessen struggles in practice. Or, if the long-running debate between workers and banks over priority cannot be resolved so that each is protected, whether inside the bankruptcy law or outside of it (see below), it is probable that one or the other will continue the fight on the battleground of implementation. Contradictions are also structural: if agency responsibilities and jurisdictions are not very clearly delineated or their powers are reduced, they will continue to fight each other or resist implementation.
- (3) Policy determinations depend on *diagnosis* of practices. Pathologies of lawmaking will be minimised if the government will build systematic data recovery and research activities into implementation. Such data may come from: a) professional practitioners, who can file data on enterprises or their management; b) courts which keep careful records of cases that pass through them; c) periodic research undertaken on samples of businesses in difficulty to track and explain the decisions made by enterprise managers to use or not use law for coping with financial difficulty; and d) government agencies which manage SOEs. These data–financial, managerial, personnel–will enable the government to construct its regime more on the facts of enterprise distress and bankruptcy than on unfounded allegations or representations by self-interested parties.
- (4) Finally, in order to forestall resistance by practitioners, who can effectively nullify a new law, their views must be clearly solicited and interests recognised in the lawmaking. Comparative research shows that unless professionals, key business groups and workers are incorporated into the bargaining, they have the capacity and often willingness to subvert new law. Already the draft bankruptcy law is well advanced and it may be too late to involve parties who have been neglected or excluded. However, it is not too late for lawmakers to identify those potentially influential actors who have not been involved in the bargaining and to anticipate how they might frustrate implementation.

National variations in lawmaking processes influence the capacity for effective implementation. This logic of analysis suggests that:

In national circumstances where: 1) critical stakeholders and implementers of law do not participate in insolvency lawmaking; 2) lawmaking organisations have blurred, conflicting or indeterminate authority; 3) there is no determinate institutional structure for clarifying the meaning of law; 4) systematic monitoring and analysis of insolvency practice is absent; and 5) political consensus has not been reached on fundamental issues of meta-policy...

...a national adaptation of global norms might have the following attributes:

- Ensure that *all* actors that have the capacity to frustrate, derail or block insolvency implementation are integrated into the lawmaking process; if they are not involved in bargaining over the principal statutory enactment, *either*, anticipate the expression of their dissent in practice and adjust for it, or, draw them subsequently into discussions that could lead to further adjustments or reforms;
- Seek to identify ideological contradictions in the substantive law and *either* resolve them to the mutual benefit of parties (*e.g.* through a balance) *or* offer future channels through which they can be resolved;
- Provide clear jurisdictions and lines of authority among lawmaking bodies (legislature, courts, regulatory agencies, professional associations) so substantive struggles unresolved in the legislature do not continue through internecine contests among government entities;
- Build transparency into all kinds of lawmaking, including cumulative reporting of regulations and cases, most notably create a systematic jurisprudence;
- Build lawmaking and implementation on a foundation of systematic diagnosis of problems; examine each source of diagnosis for bias; encourage multiple sources; build in monitoring capacities to review implementation (*e.g.* technical assistance programmes from IFIs); and
- Build incentives and a culture of reform in which professionals, civil society groups, scholars, and the media publicise, codify, critique and advance regulations and cases.

### ***e) Implementation process***

Empirical research and theory on institutional change demonstrate that reforms are highly contingent: they depend heavily on the process whereby lawmaking becomes actualised in practice.<sup>86</sup> This *process* of implementation raises at least three issues.

First, even when national reforms conform to global norms—indeed, sometimes *because* they conform to outside standards—they may be rejected

by key players or the public at large.<sup>87</sup> The greater the paradigmatic shift in thinking by the immediate stakeholders or the public, the greater the challenge to alter perspectives. Public resistance, sometimes reflected by political representatives, can be observed in the Indonesian and Korean reforms. Insolvency reforms ran into difficulty in both countries because publics and stakeholders resisted the idea that major companies could be liquidated or that they were “too big to fail.”<sup>88</sup> Reformers found it difficult to prod courts to liquidate companies, even going so far in the 1998 Korean reform to compel judges to apply an “economic criterion test” in order to remove their discretion that might preserve a company whose liabilities exceeded assets.<sup>89</sup> Citizens of both countries resented reforms that appeared to be imposed from outside, so much so that Koreans colloquially label the 1997 Asian Financial Crisis as the “IMF Crisis.”

Second, institutions must be considered legitimate if they are to function effectively. The legitimacy of government organisations rests on: a) a perception that the institution’s constituents get to participate in its composition and proceedings; b) a belief that procedures are fair and that diverse interests and differences in power have not captured the institution for sectional purposes; and c) that the organisation is or will be effective.<sup>90</sup> Insolvency reforms therefore run into either a problem of legitimating new institutions, or of re-legitimating previously discredited institutions. In Korea, government economists and officials doubted the legitimacy of the courts to take over market regulation from administrators. In Indonesia courts have been caught in a legitimacy squeeze between sceptical corporations and sceptical creditors. In China, critics of the fairness, neutrality, and effectiveness of courts suggest that they confront a major legitimisation challenge.

Third, the process of implementation can be sharply divided between those approaches that are incremental, piecemeal or gradual, versus those that are dramatic, systemic and rapid. Indonesia, Korea and China represent three different trajectories of reform. In Indonesia the key reforms were made rapidly in a few months after the crisis.<sup>91</sup> Thereafter the government made a series of corrective and compensating decisions to deal with gaps or unanticipated consequences. In Korea, by contrast, there was no dramatic change but a series of amendments to substantive and procedural law, a new corporate restructuring law in 2001, culminating in a massive comprehensive bankruptcy law that integrated all three previous acts into a single statute.<sup>92</sup> In China, bankruptcy reforms have proceeded on several tracks, most notably the administrative-led reforms of SOEs managed by the State Economic and Trade Commission,<sup>93</sup> but also experiments in SEZs, and the Shenzhen experiment, among others.<sup>94</sup> The mark of this reform effort

has been incremental and experimental despite pressure from international organisations to move more quickly.<sup>95</sup>

The policy choice between decisive and gradual change is not simple. On the one hand, the benefit of incremental change is that it reduces the likelihood of a radical mistake that would generate a sharp backlash from stakeholders or a loss of face by lawmakers. On the other hand, where a new institution is being constructed, a failure to proceed systemically, with all components in place at the outset and perceptible progress from the beginning, may also lead to a backlash from stakeholders who lose confidence quickly and de-legitimate the institution. Some Indonesian experts hold that the problems confronted by Indonesia's insolvency reforms were not that too much was attempted but that they did not go far enough fast enough.<sup>96</sup> By going too slowly, by not taking on corruption, the competence of judges, and the structure of the court system all at once, the Commercial Court quickly lost the initial support it gained from key stakeholders.

Implementation processes vary widely among countries, including those in the same region. This logic of analysis suggests that:

In national circumstances in which: 1) insolvency reforms involve a paradigmatic shift in public perceptions; 2) reforms require a reorientation of stakeholders towards problems of enterprise failure; 3) institutions lack legitimacy; and 4) incremental change may disillusion already frustrated stakeholders and the public...

...a national adaptation of global norms might have the following attributes:

- Cultivation of theorists and framers of change (*e.g.* academics, lawyers, accountants, party ideologists) who are able to conceive of new approaches to corporate restructuring in terms of culturally acceptable frameworks;<sup>97</sup>
- Cultivation of “entrepreneurs” or change agents who are able to express persuasively to publics the new concepts of insolvency (*e.g.* lawyers, accountants, journalists, party leaders);
- Mobilisation of organisational capacities by stakeholders in the new regime (*e.g.* media articles by professionals, testimonies by workers, press releases by corporate executives), including civil society groups and professions;
- Creation of new institutions, or their dramatic reform, with sensitivity to the factors that will generate and maintain legitimation by stakeholders and the public; and
- Systemic change that might be comprehensive in design (possibly stepped in by increments) and mutually supporting (*e.g.* insolvency practitioners, judges, creditors, academics).

*f) Policy exclusions from bankruptcy regimes*

Every government has enterprises that it dares not expose entirely to market forces alone. This is true not only for bankruptcy but for takeovers and investment, as we have seen recently in the US, in the attempted CNOOC acquisition of a US oil company and in France with resistance to a takeover of a flagship company by an Italian competitor. For reasons of national defence, national prestige, national autonomy/sovereignty, community protection (*e.g.* one company towns), or regional or ethnic or tribal sensitivities, nations frequently exclude particular companies or certain industries from market-only forces. This is one way of defining the limits of the market: it is not defined simply in terms of financial or economic criteria, but also by other criteria of public policy. Thus countries will trade off efficiency and growth in some sectors of the economy in order to give preference to another policy criterion. It is therefore a policy issue for developing countries to decide what the limits to efficiency are as the primary criterion of market functions as expressed through enterprise preservation or liquidation. This problem is especially acute for governments making major transitions—from command to market economies; or from state-led administrative control of the economy to market-led dynamics that are regulated through law and the courts.<sup>98</sup>

A related policy issue concerns the breadth of the principal insolvency legislation and exceptions to it or exclusions from it. In Asia, both Indonesia and Korea developed emergency institutions to handle a volume of cases that would overwhelm the courts. Indonesia created the Jakarta Initiative Task Force as a mediation mechanism to handle out-of-court restructurings for large enterprises.<sup>99</sup> While its success is still a matter of debate, it had the effect of introducing some orderliness into debtor-creditor restructurings without burdening courts that could not have handled them. Korea followed two strategies. In one, the Ministry of Finance and Economy presided over a set of “Big Deals” in 1998 in which flagship companies in critical industries were financially restructured with the government as a mediator or guide. In another, a corporate restructuring agreement among major financial institutions in 1998, roughly modelled on the London Approach, led ultimately to the Corporate Promotion Restructuring Act 2001 which sought to keep bank-led restructurings out of the courts until they found their feet.<sup>100</sup> China has followed a similar policy as the SETC presided over mergers and dissolutions of SOEs outside the Interim Bankruptcy Law and away from the courts.<sup>101</sup> The current provisions in the draft law before the NPCSC envisage that all SOEs be included under a new law except for those approximately 180 SOEs/conglomerates under the responsibility of the State Asset Supervision and Administration Commission (SASAC).<sup>102</sup>

This logic of analysis suggests that Asian states will vary considerably on their policy choices. If a state has: 1) a sophisticated professional services market; 2) competent and clean courts; 3) binding powers of enforcement; and 4) the capacity to handle the fallout of closed factories, unemployed workers and lost production (*i.e.* a safety net that is not tied to a particular firm), as is largely the case in South Korea, then it makes sense to incorporate all firms, private and public, into the bankruptcy system.

In national circumstances in which a state has: 1) a limited safety net; 2) fragile social stability; 3) weak courts; 4) limited professional expertise; 5) an untested bankruptcy law; 6) regional or ethnic inequality that is associated with failing firms; and 7) a volatile economic or political environment...

...a national adaptation of global norms might have the following attributes:

- Exclude initially a class (or classes) of enterprises that represent the most danger to other policy concerns;
- Include classes of enterprises that a reformed system will have a high probability of handling successfully;
- And/or exclude indefinitely classes of enterprises that are vital to the economic, social and political stability of the state.

Indeed it is probable that implementation will be seen to be more effective and legitimate if the reformed system works well in a restricted subset of enterprises and then gradually expands as the capacity of the system is proved and its legitimacy is strengthened.

### ***g) Collateral institution building: Social policy considerations***

Bankruptcy law and regimes are always nested in other institutions. While it is convenient for scholars and norm makers to isolate bankruptcy law as if it were purely technical, policy makers know that its effects can ramify to the most fundamental social and political issues in a country.<sup>103</sup> The most critical issue for many developing countries concerns the social welfare of workers who are laid off. Their welfare safety net can be underwritten in several ways: by their enterprises, as in the state-owned enterprises of socialist countries; by a community or state support system, such as unemployment insurance; or by the option to return to village life, if that is available, for housing, food, education and possibly work.

Each of these options has its own problems. A SOE that guarantees work at one point in a worker's life and then withdraws it at a later point implicates its owner—the government—in a double bind: if the SOE seeks to

compensate the worker for several transitional years,<sup>104</sup> then this bleeds cash from the enterprise that might be used for restructuring. And, if the SOE cannot pay the worker, or chooses to pay other creditors first, this creates anger and grievance. If SOE managers, under heavy pressure to meet financial targets, withdraw partially or completely from providing health services or contributing to a health fund, this also can feed protest. If the state has not developed an adequate safety net for unemployed workers, not only compensating them for lost wages, but also compensating unemployed SOE workers for the loss of other social supports—health, education, childcare, not to mention self-esteem—that were part of the total compensation package, then workers lose the basic necessities of life.<sup>105</sup> This too breeds social unrest. These circumstances are compounded in their potential negative effects if workers were raised on a “social contract” that guaranteed them full social security in return for low wages, long hours and difficult working conditions.<sup>106</sup> In some countries (Indonesia) it is thought that the proximity of industrial workers to their villages of origin cushioned the effect of the Asian financial crisis. This may not be true for urban workers laid-off in other countries.

Economists and IFIs often underestimate the danger to an economy and society through the immiseration of the working class.<sup>107</sup> If workers are thrown out of employment, if they have no village to which they can return, if they despair of any other options, if they sense a growing inequality in which they are excluded from the conspicuous consumption of a small proportion of the society, this can create a volatile situation for social and even political unrest. And, social and political unrest ultimately increase uncertainty and unpredictability in markets. Thus the very purpose of *economic* development through market certainty can be defeated if *social* conditions are worsened to the point of social instability. At this point, political expediency and economic goals intersect and are mutually reinforcing.

If a narrow view of economic development is embodied in global norms, there is a potential tension between global standards (which are primarily focused on insolvency and markets), and local political realities (which must take into account the social and political—and potentially economic—costs of worker disenchantment). This logic of analysis suggests that:

In national circumstances in which: 1) economic development is accompanied by rapid social dislocation; 2) workers are becoming unemployed in large numbers; 3) workers are losing access to social welfare, including health, education, and housing; 4) workers believe there has been a breach of a social contract that previously protected their social rights; 5) a smaller proportion of the workplace appears to benefit unequally from

economic growth; 6) widening inequality coincides with perceptions of regional, ethnic or religious discrimination; and (7) social protests are mounting...

...a national adaptation of global norms might have the following attributes:

- If a country can afford and implement it rapidly, vest rapidly and comprehensively a national social insurance programme for displaced SOE workers that includes: a) lost benefits from loss of employment (*e.g.* back pay, vacation, pension); b) access to lost education, health and housing benefits; and c) retraining or assistance with relocation.<sup>108</sup>
- If a country cannot afford or implement a comprehensive welfare net for a large number of displaced SOE workers, then it has the option to: a) modify financial targets for SOE managers to compensate for continued worker benefits at minimal levels; or b) exclude, at least temporarily, selected SOEs from full market forces that would lead to mass layoffs or liquidation; or c) use policy criteria to screen SOEs financially eligible for treatment by courts until wider social and political circumstances permit.

### 3) Conclusion

This paper has argued that policy issues permeate and contextualise bankruptcy reforms. It makes five general conclusions:

First, in Asia every nation must adapt global norms to its particular circumstances. There is risk in going too far in either direction: too rigid an adherence to global norms will contribute to a “transplant effect” of incomplete implementation;<sup>109</sup> too much local deviation from global norms may reduce flows of capital and trade necessary for economic development. The Chinese capture this balance perfectly in the aphorism “bankruptcy law with Chinese characteristics.” A bankruptcy regime may look different in a Chinese *socialist* market economy than a Singaporean capitalist economy or a co-ordinated German or Scandinavian market or a liberal English, US or New Zealand market. Fortunately, the global consensus represented in the UNCITRAL Legislative Guide on Corporate Insolvency provides high level principles that allow significant room for national variation within global parameters. These adaptations can adjust to levels and types of economic development.

Second, national adaptations of global norms in bankruptcy require explicit attention by policy makers to meta-policy issues. Most notable among these are definitive answers to the questions: what will be the functions and limits of markets in a society? Will political power be restructured to provide the institutional attributes necessary for a functioning

bankruptcy system? Will society be empowered and protected through bankruptcy reforms? An effective bankruptcy system requires a social and legal infrastructure in the market, a restrained executive and strengthened judiciary in the state, and a rationalising, determinate system of lawmaking that produces legitimate institutions. None of this is easy politically since it requires a restructuring of the distribution of power in the state and society.

Third, implementation and institution building are as important as—indeed arguably more consequential than—formal lawmaking. It is a dangerous illusion that the legal framework and institutions of an effective insolvency system can be done cheaply. Effective bankruptcy systems require the careful design, infrastructural expenditure, and political will comparable to major infrastructural projects in transportation or energy or defence. This is especially so in circumstances where there is rapid economic development and social dislocation in a society that had previously invested little in legal institutions. Failure of governments to act boldly and decisively can lead not only to incapacity but instability in society and ultimately the market.

Fourth, markets have limits. They are embedded in social, political and cultural contexts that define how far values (such as efficiency and growth) should impinge upon values (such as equity and concepts of justice), and how much certain global values are consistent with national values. Nation-states will vary in where they draw those limits. A political backlash against a certain concept of markets that has been exported to Latin America demonstrates that the drawing of those boundaries has significant consequences for social, political and economic stability.

Finally, the logic of this paper points to a model of co-operation between developing nations in Asia, on the one side, and international organisations and OECD member countries, on the other. On the one hand, now that global norms have been clearly articulated by UNCITRAL and the World Bank,<sup>10</sup> there is a pressing need for sophisticated models of how global norms can be consistently adapted to the variety of national circumstances. These variations can be systematised by scholars and technical assistance experts so that implementation of global needs is properly adapted to the singularity of national situations. On the other hand, the policy significance of bankruptcy reforms, as this paper has argued, leads inexorably to the conclusion that national policy makers require a political will to engage in massive institution building, a project for which they may require heavy technical assistance from international financial institutions and aid agencies of advanced economies.

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<sup>1</sup> OECD (2005), *Economic Survey—China*, OECD, Paris, p. 92.

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- <sup>2</sup> Socio-legal scholars bring the methods and theory of social science together to examine the behaviour of law.
- <sup>3</sup> Ngok, King-Iun (2002), “Law-making and China’s Market Transition: Legislative Activism at the Eighth National People’s Congress” *Problems of Post-Communism*, pp. 49:23-32; Pistor, Katharina and Chenggang Xu (2002), “Incomplete Law—A Conceptual and Analytical Framework and its Application to the Evolution of Financial Market Regulation”, working paper, Columbia University.
- <sup>4</sup> European Bank for Reconstruction and Development (1999), *Transition Report 1999: Ten Years of Transition*, EBRD, London; Ramasastry, Anita, Stefka Slavova and Lieve Vandenhoeck, “EBRD Legal Indicator Survey: Assessing Insolvency Laws After Ten Years of Transition.” *Law in Transition*, pp. 34-43.
- <sup>5</sup> See the *UNCITRAL Legislative Guide on Insolvency* (hereafter *UNCITRAL Legislative Guide*), United Nations, New York; Block-Lieb, Susan and Terence C. Halliday (2006), “How Global Law-Making is Possible: Legitimation Strategies and Rule Production in the UNCITRAL Legislative Guide on Insolvency Law”, Working Paper, American Bar Foundation.
- <sup>6</sup> Berkowitz, Daniel, Katharina Pistor and Jean-Francois Richard (2003), “Economic Development, Legality, and the Transplant Effect”, *European Economic Review*, pp. 47:165-195.
- <sup>7</sup> The first and second studies were sponsored by the American Bar Foundation, an independent inter-disciplinary research institute in Chicago, and the National Science Foundation, the US government’s funding agency for advanced scientific research.
- <sup>8</sup> Extrapolation from one national experience to another is fraught with difficulty. Although it cannot be discussed here in length, it must be said that such transfers of bankruptcy systems can be effective only when the conditions under which they succeeded or failed in a previous situation have been clearly identified. This is why proposals later in this paper begin by specifying conditions under which they might operate.
- <sup>9</sup> State Council (2005), “White Paper on Political Democracy”, State Council Information Office, Beijing, 19 October 2005.
- <sup>10</sup> Hall, Peter A., and David Soskice eds. (2000), “An Introduction to Varieties of Capitalism”, *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*, Oxford University Press, New York; Hall, Peter A. and David Soskice eds. (2001), *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*, Oxford University Press, New York.
- <sup>11</sup> The former would emphasise the distributive functions of a market and register particular concern for workers and equality; the latter might emphasise efficiency functions in markets and attend most closely to the views of investors and large credit institutions.
- <sup>12</sup> These are the values repeatedly affirmed by the global norm-making bodies on insolvency regimes, such as the IMF, World Bank and the UNCITRAL Legislative Guide, and regional banks, such as the Asian Development Bank.

- <sup>13</sup> Carruthers, Bruce G. and Sarah L. Babb (2000), *Economy/Society: Markets, Meanings and Social Structure*, Pine Forge Press, Thousand Oaks.
- <sup>14</sup> It is a myth that markets are truly “free,” particularly in periods of rapid economic development. Compare US economic history, where government guidance of the economy proved critical for its development (Moss, David A. (2002), *When All Else Fails: Government as the Ultimate Risk Manager*, Harvard University Press, Cambridge), and contemporary efforts by international institutions to create an “international financial architecture” to regulate the global economy (Gilpin, Robert and Jean M. Gilpin (2000), *The Challenge of Global Capitalism: The World Economy in the 21st Century*, Princeton University Press, Princeton, New Jersey; Stiglitz, Joseph E. (2002), *Globalization and its Discontents*, Norton, New York).
- <sup>15</sup> Weber, M. (1978), *Economy and Society*, Berkeley, University of California Press; Carruthers, B.G. and T.C. Halliday (forthcoming), “Law, Economy and Globalization: How Modern International Financial Institutions Embraced Adam Smith and Accidentally Discovered Max Weber”; Swedberg, R. and V. Nee, *The Spirit of Global Capitalism*, Stanford University Press, Stanford; *UNCITRAL Legislative Guide*; World Bank (2003), *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems*, World Bank, Washington D.C.
- <sup>16</sup> Gessner, Volkmar, Richard P. Appelbaum and William L.F. Felstiner eds. (2001), “Introduction: The Legal Culture of Global Business Transactions”, *Rules and Networks: The Legal Culture of Global Business Transactions*, Hart Publishing, Oxford, pp. 1-135.
- <sup>17</sup> Wade, Robert (1990), *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialisation*, Princeton University Press, Princeton.
- <sup>18</sup> Ngok, King-Iun (2002), “Law-making and China’s Market Transition: Legislative Activism at the Eighth National People’s Congress”, *Problems of Post-Communism*, pp. 49:23-32.
- <sup>19</sup> Cai, Dingjian (1999), “Development of the Chinese Legal System Since 1979 and its Current Crisis and Transformation”, *Cultural Dynamics*, pp. 11:135-166.
- <sup>20</sup> Paler, Laura (2005), “China’s Legislation Law and the Making of a More Orderly and Representative Legislative System”, *The China Quarterly*, pp. 301-318.
- <sup>21</sup> *Id.*
- <sup>22</sup> *Id.*
- <sup>23</sup> *UNCITRAL Legislative Guide*, p.14.
- <sup>24</sup> Westbrook, Jay Lawrence (2000), “A Global Solution to Multinational Default”, *Michigan Law Review*, pp. 98:2276-2328.
- <sup>25</sup> There are several criteria by which this centre may be determined. See United Nations Commission on International Trade Law (UNCITRAL) (1999), *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, United Nations, New York.
- <sup>26</sup> *Id.*
- <sup>27</sup> Cai, Dingjian (1999b), *op.cit.*, note 19.

- <sup>28</sup> Carruthers, Bruce G. and Terence C. Halliday (1998), *Rescuing Business: The Making of Corporate Bankruptcy Law in England and the United States*, Oxford University Press, New York.
- <sup>29</sup> *UNCITRAL Legislative Guide*, Recommendations 1 (a), (d) and (e), p.18.
- <sup>30</sup> Campbell, John L. (2004), *Institutional Change and Globalisation*, Princeton University Press, Princeton.
- <sup>31</sup> *UNCITRAL Legislative Guide 2005; World Bank Principles 2003*.
- <sup>32</sup> The UNCITRAL Legislative Guide (2005) notes that insolvency representatives, as it labels them, can be an individual, corporation or some other kind of legal entity (p. 174). The focus here is on individual practitioners although they may be organised in partnerships or firms.
- <sup>33</sup> *UNCITRAL Legislative Guide (2005)*, pp.174-5.
- <sup>34</sup> Halliday, Terence C. and Bruce Carruthers (1996), “The Moral Regulation of Markets: Professions, Privatisation and the English Insolvency Act 1986”, *Accounting, Organisations and Society*, pp. 21:371-413.
- <sup>35</sup> HMSO (1980), *Bankruptcy: Interim Report of the Insolvency Law Review Committee*, Command Paper 7968.
- <sup>36</sup> Schröder-van Waes, Marie-Christine and Kevin Omar Sidharta (2004), “Upholding Indonesian Bankruptcy Legislation”, *Business in Indonesia, New Challenges, Old Problems*, pp. 191-203.
- <sup>37</sup> *Ibid*, p. 201.
- <sup>38</sup> Suyudi, Aria (2004), “Does the Court Impose Different Treatment for Different Kinds of Creditors in Bankruptcy Petitions? A Jurimetric Analysis of Indonesian Commercial Court Decisions on Bankruptcy”, Erasmus University, Rotterdam.
- <sup>39</sup> Halliday, Terence C. and Bruce Carruthers (2003), “Conformity, Contestation and Culture in the Globalisation of Insolvency Regimes: International Institutions and Law-Making In Indonesia and China, Working Paper 2214”, American Bar Foundation, Chicago.
- <sup>40</sup> “Survey of Receivers: Final Report (2004)”.
- <sup>41</sup> The UNCITRAL standard for appointment is as follows: Appointment (paragraphs 44-47). 118. The insolvency law should establish a mechanism for selection and appointment of an insolvency representative. Different approaches may be taken, including appointment by the court; by an independent appointing authority; on the basis of a recommendation by creditors or the creditor committee; by the debtor; or by operation of insolvency law, where the insolvency representative is a government or administrative agency or official.
- <sup>42</sup> Liu, Sida (2006), “Client Influence and the Contingency of Professionalism: The Work of Elite Corporate Lawyers in China”, *Law & Society Review*, 40(4).
- <sup>43</sup> Halliday, Terence C. (2001), “Five Models for Regulating Market Professions: Comparative Notes on Lawyers, Accountants, and Insolvency Practitioners”, *The Changing Role of Government Regulation in China’s Market Economy*, State Council Office on Restructuring the Economic System, Kunming, Yunnan Province, China.
- <sup>44</sup> *UNCITRAL Legislative Guide*, Part I, Key Objectives.

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- <sup>45</sup> *UNCITRAL Legislative Guide*, pp.180-183.
- <sup>46</sup> Carruthers and Halliday (1998), *Rescuing Business*, pp. 441-449.
- <sup>47</sup> *Ibid.*
- <sup>48</sup> Minister of Justice Decree No. M.09.HT. 05.0, dated 22 September 1998, regarding Guidelines for Receivers and Administrators Fees (*Pedoman Besarnya Imbalan Jasa Bagi Kurator dan Pengurus*).
- <sup>49</sup> “Survey of Receivers: Final Report (2004)”.
- <sup>50</sup> For small firms it appears that this was a substantial remuneration; for large multi-national accounting firms it would be much less attractive.
- <sup>51</sup> Receivers Report, *op.cit.*
- <sup>52</sup> In Indonesia it was said that judges made USD 200 a month whereas receivers made USD 200 an hour. How then, asked the judges, could the receivers complain about their compensation levels?
- <sup>53</sup> Cf. the Colombian bankruptcy system which is almost entirely administrative. Australia delegates a substantial proportion of insolvency work to private actors, although the court system provides an institutional framework for negotiation, dispute resolution, and binding decisions.
- <sup>54</sup> Pistor, K. and P. Wellons (1998), *The Role of Law and Legal Institutions in Asian Economic Development, 1960-1995*, Oxford University Press, Oxford.
- <sup>55</sup> De Sousa Santos, B. (2000), “Law and Democracy: (Mis)trusting the Global Reform of Courts”, *Globalising Institutions: Case Studies in Regulation and Innovation*, Aldershot, Ashgate, pp. 253-84.
- <sup>56</sup> *UNCITRAL Legislative Guide*, pp. 43-46.
- <sup>57</sup> For a more extensive account of the politics of the new bankruptcy court in the US, see Carruthers and Halliday (1998), *op.cit.*; and Halliday, Terence C. and Bruce G. Carruthers (1998), “Making the Courts Safe for the Powerful: The Politics of Lawyers, Judges, and Bankers in the 1978 Rehabilitation of United States Bankruptcy Courts”, *Lawyers and the Rise of Western Political Liberalism: Legal Professions and the Constitution of Modern Politics*, Oxford University Press, Oxford, pp. 265-304.
- <sup>58</sup> Nam and Oh, *op.cit.*
- <sup>59</sup> Halliday, Terence C. and Bruce Carruthers (2004a), “Epistemological Conflicts and Institutional Impediments: The Rocky Road to Corporate Bankruptcy Reforms In Korea”, *Korean Law Reform*, Routledge Press. Also, Oh paper.
- <sup>60</sup> Oh, Soogeun (1999), “An Institutional Perspective on Financial Reform in Korea”, *Korea Development Bank Report*, Seoul; (2002a), “Drafting of New Insolvency Law of Korea”, FAIR Conference, Bangkok, Thailand; (2002b), “Government Intervention in Corporate Exit Mechanisms: The Corporate Restructuring Promotion Act of Korea”, Hong Kong University Faculty of Law, Hong Kong; (2003b), “Insolvency Law Reform of Korea: A Continuing Learning Process”, Forum on Insolvency Risk Management, Washington D.C.
- <sup>61</sup> Halliday and Carruthers (2006), “Foiling”.
- <sup>62</sup> Tomasic, Roman (2001), “Some Challenges for Insolvency System Reform in Indonesia”, *FAIR II, Insolvency Reform in Asia: An Assessment of the Recent Developments and*

- Role of Judiciary*; Tomasic, Roman and Peter Little (eds.) (1998), *Insolvency Law and Practice in Asia*, Sweet & Maxwell Asia, Hong Kong.
- <sup>63</sup> Lev, Daniel S. and Ruth McVey (1996), *Making Indonesia*, Cornell SEAP, Ithaca; Lev, Daniel S. (2000), “Judicial Authority and the Quest for an Indonesian Rechtsstaat”, *Legal Evolution and Political Authority in Indonesia: Selected Essays*, Kluwer Law International, The Hague/Boston, pp. 215-44.
- <sup>64</sup> Halliday and Carruthers, “Foiling”; “Conformity”; “Recursivity”; Suyudi, Aria (2004), “Does the Court Impose Different Treatment for Different Kinds of Creditors in Bankruptcy Petitions? A Jurimetric Analysis of Indonesian Commercial Court Decisions on Bankruptcy”, Erasmus University, Rotterdam; Schröder-van Waes, Marie-Christine and Kevin Omar Sidharta (2004), “Upholding Indonesian Bankruptcy Legislation”, *Business in Indonesia, New Challenges, Old Problems*, pp. 191-203.
- <sup>65</sup> *Op.cit.*, Suyudi (2004).
- <sup>66</sup> Lev, Daniel S. (2004), “Comments on the Judicial Reform Programme in Indonesia”, International Monetary Fund, Washington D.C.; World Bank, East Asia Poverty Reduction and Economic Management Unit (2003b) “Combating Corruption in Indonesia: Enhancing Accountability for Development”, World Bank, Washington D.C.
- <sup>67</sup> Peerenboom, *cf.* Randall (2002), *China’s Long March Toward Rule of Law*, Cambridge University Press, New York.
- <sup>68</sup> Supreme, People’s Court (2005), “Five Year Reform Programme”, Supreme People’s Court, Beijing.
- <sup>69</sup> Former Senior Researcher, Research Office, Standing Committee, National People’s Congress; Professor, China University of Politics and Law.
- <sup>70</sup> Cai, Dingjian (1999b), *op.cit.*, note 19, p.154.
- <sup>71</sup> *Id.*, p.160.
- <sup>72</sup> *Id.*, p149.
- <sup>73</sup> The OECD report concurs that the judiciary lacks independence in various ways, including the funding and promotion of judges by local authorities, and that courts are subordinated to local people’s congresses. It further observes that enforcement is weak, the time to resolve disputes extended, legal costs are high, and that government interference in business decisions is extensive, (OECD, 2005).
- <sup>74</sup> Yew, Lee Kuan (2000), *From Third World to First: The Singapore Story: 1965-2000*, HarperCollins, New York.
- <sup>75</sup> Garth, Bryant G. (2002), “Building Strong and Independent Judiciaries Through the New Law and Development: Behind the Paradox of Consensus Programmes and Perpetually Disappointing Results”, *DePaul Law Review*, 52:383-400.
- <sup>76</sup> The OECD recommends a narrower specialised insolvency court, a proposal also made by the Asian Development Bank. Asian Development Bank (1996), “Final Report, State Enterprise Insolvency Reform, People’s Republic of China”, Asian Development Bank.

- <sup>77</sup> Following Cai Dingjian (p. 161), jurisdiction might be determined such that national courts have jurisdiction over cases that are inter-regional, relating to the national interests, and/or large and complex.
- <sup>78</sup> Halliday, Terence C. and Bruce Carruthers (2006), “The Recursivity of Law: Global Norm Making and National Lawmaking in the Globalisation of Bankruptcy Regimes, Working Paper”, *American Journal of Sociology*.
- <sup>79</sup> On financial law, see Pistor and Xu, *op.cit.* On criminal procedure law in China, see Halliday, Terence and Sida Liu (2006), “Birth of a Liberal Moment? Looking Through a One-Way Mirror at Lawyers’ Defense of Criminal Defendants in China”, *The Legal Complex and Struggles for Political Liberalism*, Hart, Oxford.
- <sup>80</sup> Zhang, Qianfan (2003), “The People’s Court in Transition: The Prospects of the Chinese Judicial Reform”, *Journal of Contemporary China*, 12:69-101.
- <sup>81</sup> This a central presumption of all international organisations that are promulgating global insolvency norms, principles and standards. Compare UNCITRAL Legislative Guide, *op. cit.*; International Monetary Fund (1999), *Orderly and Effective Insolvency Procedures: Key Issues*, International Monetary Fund, Washington D.C.; and World Bank Principles. See also Carruthers, Bruce G. and Terence C. Halliday (forthcoming), “Law, Economy and Globalisation: How Modern International Financial Institutions Embraced Adam Smith and Accidentally Discovered Max Weber”, *The Spirit of Global Capitalism*, Stanford University Press, Stanford.
- <sup>82</sup> The American Bankers Association threatened precisely this during Congressional Hearings that preceded the 1978 US Bankruptcy Code. See Carruthers, Bruce G. and Terence C. Halliday (1998), *Rescuing Business: The Making of Corporate Bankruptcy Law in England and the United States*, Oxford University Press, Oxford.
- <sup>83</sup> Carruthers and Halliday (1998), *op.cit.*; Halliday, Terence C. and Bruce Carruthers (2003), “Conformity, Contestation and Culture in the Globalisation of Insolvency Regimes: International Institutions and Law-Making In Indonesia and China, Working Paper 2214”, American Bar Foundation, Chicago; (2004a), “Epistemological Conflicts and Institutional Impediments: The Rocky Road to Corporate Bankruptcy Reforms In Korea”, *Korean Law Reform*, Routledge Press.
- <sup>84</sup> Corporations and the non-financial business sector were scarcely consulted in the Indonesian bankruptcy reforms after 1997. As a result, corporate owners led a determined effort to resist, manipulate and even subvert both the courts and out-of-court organisations, such as the Jakarta Initiative Task Force. Halliday, Terence C. and Bruce Carruthers (in press), “Foiling the Hegemons: Limits to the Globalisation of Corporate Insolvency Regimes in Indonesia, Korea and China”, *Law and Globalization in Asia: From the Asian Financial Crisis to September 11*, Hart Publishing.
- <sup>85</sup> Cf. also the joint World Bank/UNCITRAL Legislative Guidelines, D 5.3, p.50.
- <sup>86</sup> Campbell (2000), *op.cit.*
- <sup>87</sup> Domestic politicians often have an incentive to blame difficult policy decisions on foreign influences.

- <sup>88</sup> *UNCITRAL Model Law on Cross-Border Insolvency*; Oh (2002), *op.cit.*
- <sup>89</sup> Oh (2003), *op.cit.*; Halliday, Terence C. and Bruce Carruthers (2004), “Institutional Lessons from Insolvency Reforms in East Asia”, *Forum on Asian Insolvency Law Reform (FAIR), Insolvency and Risk Management in Asia*.
- <sup>90</sup> Hurd, Ian, (forthcoming), *Legitimacy and Power in International Relations: The Theory and Practice of the UN Security Council*, Princeton University Press, Princeton; Hurd (2005), “Deliberation, Procedures, and Effectiveness: A Model of Legitimation in International Organisations Working Paper”, Northwestern University, Evanston.
- <sup>91</sup> These included a large number of amendments to the Bankruptcy Law, the establishment of the Commercial Court, the creation of the Jakarta Initiative Task Force to handle out-of-court restructurings, and the creation of the receiver’s profession.
- <sup>92</sup> Oh (2003), *op.cit.*; Oh (2002), *op.cit.*
- <sup>93</sup> World Bank (2001), *Bankruptcy of State Enterprises in China—A Case and Agenda for Reforming the Insolvency System*, World Bank, Washington D.C.; OECD (2005), *Economic Survey—China (2005)*, *op.cit.*
- <sup>94</sup> Halliday and Carruthers (2003), *op.cit.*
- <sup>95</sup> World Bank (2001), *op. cit.*
- <sup>96</sup> Lev, Daniel S. (2004), “Comments on the Judicial Reform Programme in Indonesia”, *International Monetary Fund*, Washington D.C.
- <sup>97</sup> Campbell (2004), *op. cit.* Compare the role of Kenneth Cork in the English reforms (Halliday and Carruthers, *Rescuing Business*) and of Cao Siyuan in the 1986 Interim Bankruptcy Law in China (Cao Siyuan (1998), “The Storm Over Bankruptcy (I)”, *Chinese Law and Government*: 3-93).
- <sup>98</sup> See Pistor, Katharina and Philip A. Wellons (1999), *The Role of Law and Legal Institutions in Asian Economic Development: 1960-1995*, Oxford University Press, New York.
- <sup>99</sup> The IMF reports that JITF had finalised the mediation of debt restructuring in the amount of USD 20.6 billion, or around one-third of the total corporate loans that had become nonperforming as a result of the crisis (International Monetary Fund (2004), “Indonesia: IMF Country Report No. 04/188”, International Monetary Fund, Washington, D.C.).
- <sup>100</sup> Nam and Oh, *op.cit.*
- <sup>101</sup> In the decade from 1994-2004, China closed 3 484 SOEs, involving 6.67 million employees. Through 2008 another 2 167 SOEs are slated to be shut down, throwing 3.66 million employees out of work. Naughton, Barry (2001), “SASAC Rising”, *China Leadership Monitor 14*, pp. 7-8. Cf. World Bank (2001).
- <sup>102</sup> *Id.*
- <sup>103</sup> Halliday, Terence C. and Bruce Carruthers (2004), “Institutional Lessons from Insolvency Reforms in East Asia”, *Forum on Asian Insolvency Law Reform (FAIR), Insolvency and Risk Management in Asia*.
- <sup>104</sup> A common practice in China has been for the SOE to compensate a laid-off worker at 2-3 times the worker’s salary. See World Bank (2001), *op.cit.*

- <sup>105</sup> On the current status of the social safety net in China, see the OECD's Economic Survey of China (2005), pp. 188-191.
- <sup>106</sup> Tang, Wenfang and William Parish (2000), *Chinese Urban Life Under Reform: The Changing Social Contract*, Cambridge University Press, New York.
- <sup>107</sup> Stiglitz, Joseph E. (2002), *Globalisation and its Discontents*, Norton, New York.
- <sup>108</sup> On developments in China's social insurance system see the OECD's Economic Survey of China (2005), pp. 188-191. The overall coverage of workers and pensioners is very low for private firms and SOEs.
- <sup>109</sup> Berkowitz, Daniel, Katharina Pistor and Jean-Francois Richard (2003), "Economic Development, Legality, and the Transplant Effect", *European Economic Review*, 47:165-195.
- <sup>110</sup> These norms are by no means complete. UNCITRAL is presently considering the missing topic of corporate groups in insolvency, which is of great relevance to Asia. So, too, is there a need to relate insolvency norms to concepts of corporate governance that are appropriate for Asia.