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*Legislative Reform in Rehabilitation and Insolvency Cases:
Issues and Prospects in the Philippines:
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LEGISLATIVE REFORM IN REHABILITATION AND INSOLVENCY CASES: ISSUES AND PROSPECTS IN THE PHILIPPINES

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Background

Corporate rehabilitation is a relatively new concept in the Philippine legal landscape. Until the mid-1970s, suspension of payments was the only remedy available to distressed corporations as provided in the Insolvency Act of 1909¹. It was only in 1976, with the promulgation of Presidential Decree No. 902-A, that the concept of rehabilitation as an alternative to suspension of payments was introduced. Essentially, PD 902-A² allowed illiquid corporations to apply at the Securities and Exchange Commission (SEC) for receivership or for the appointment of a management committee while they develop a rehabilitation plan.

When the Securities Regulation Code was adopted in 2000, jurisdiction over debt relief petitions was transferred from the SEC to the regular courts, prompting the Supreme Court to designate sixty (60) Regional Trial Courts (RTCs) as commercial courts and to adopt the Interim Rules on Corporate Rehabilitation. The Interim Rules, like its antecedent SEC Rules of Procedure on Corporate Recovery, implements PD 902-A. But the Interim Rules, even as it springs from the same substantive law, has introduced significant changes in the corporate rehabilitation proceedings. It removed the classification of creditors into secured and unsecured which the SEC previously made. It also contained an explicit proviso for cram down, binding all persons, including creditors who may or may not have participated in the proceedings or opposed the plan, to the provisions of the court-approved rehabilitation plan.

While the Interim Rules made bold changes in rehabilitation proceedings, the substantive law (PD 902-A) itself provides very limited remedies and is largely perceived to be inadequate in addressing the demands of a complicated and modern business environment. Indeed, under the existing legal framework, the only remedy available to distressed businesses is to undergo rehabilitation under the supervision of the court. This has turned off smaller and lower-capitalized businesses in distress which do not have the resources to engage in litigation with creditors, forcing them to either fold up or enter, under-leveraged, into negotiations. Moreover, such remedy is available only to illiquid juridical debtors, denying to businesses with debts greater than their assets but likely to be revitalized a shot at rehabilitation.

Also, under the present rehabilitation model, very little incentives are in place to attract investments in distressed but viable businesses. This, coupled with the general sentiment of

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¹ The Insolvency Act of 1909 (Act No. 1956) covered insolvency cases for both natural and juridical persons.

² PD 902-A provided an additional remedy for corporations not technically insolvent but experiencing cash flow problems. It indirectly amended the Insolvency Act in this regard. It is this legislation which the proposed law intends principally to amend.

uncertainty and the high risk associated with rehabilitation cases, has dried up financing critical to the revival of businesses and the economy in general.

Legislative Reform Objectives

To remedy this situation, reform has been in the legislative agenda since the previous congress. Such reform efforts focus on three major objectives, to wit: (1) inject speed and efficiency in the resolution of rehabilitation and insolvency cases; (2) adjust and balance the rights of creditors and debtors; and (3) adhere to international standards and best practices.

Speed and Efficiency. Essentially, the concern for a speedy and efficient rehabilitation is anchored on the need to ensure successful rehabilitation and mitigate the negative externalities arising therefrom.

In rehabilitation proceedings, a time-delay mechanism sets in whereby the enforcement of contractual rights is suspended to nurse debtors back to financial health. In our proposed legislation, this period of suspension retroacts to the date of filing with the court of a petition for rehabilitation. During this period, the enforcement of any and all claims against the debtor is prohibited while all legal proceedings by and against the debtor are consolidated in the court where the petition is filed. All other proceedings are stayed, except those filed on appeal at the CA or SC prior to the commencement date, or those filed at specialized courts/quasi-judicial agencies.³

This period of suspension is designed to preserve the status quo and pre-empt any attempt to further deplete the resources of the debtor which, if unabated, could result in the irreversible state of bankruptcy. It holds at bay creditors - specially those holding security - whose knee-jerk reaction is to foreclose on the security once indicators of illiquidity, much more insolvency, become apparent.

In so doing, however, a possible constitutional issue on the impairment of obligation of contracts arises.⁴ Thus, two mechanisms are contained in the draft law to ensure that no undue interference with the parties' contractual rights and duties will occur:

- 1) the debtor is required to meet the criterion of "substantial likelihood of rehabilitation⁵" in order for it to continue to avail of the stay and other benefits in the law. The court is mandated to determine the debtor's likelihood of rehabilitation within ninety (90) days from the date of filing of the petition, otherwise, suspension/stay automatically expires;
- 2) the period of rehabilitation is pegged at a maximum of eighteen (18) months. Within this period, the court must approve a rehabilitation plan, otherwise, the proceedings is converted to dissolution and liquidation.

³ The enforcement of claims arising from these proceedings are nevertheless subject to stay.

⁴ Sec. 10, Article III (Bill of Rights) of the 1987 Philippine Constitution provides that "*No law impairing the obligations of contracts shall be passed.*"

⁵ This is found in Sec. 23(2) of the draft law which provides: "*For purposes hereof, there is substantial likelihood for the debtor to be rehabilitated if the following minimum requirements are met: (1) the proposed rehabilitation plan submitted complies with the minimum contents prescribed by this act; (2) there is sufficient monitoring by the rehabilitation receiver of the debtor's business for the protection of creditors; (3) the debtor has met with its creditors to the extent reasonably possible in attempts to reach a consensus on the proposed rehabilitation plan; (4) there is sufficient assets with which to rehabilitate the debtor; and (5) the rehabilitation receiver submits a report that, based on the preliminary evaluation: (a) there is sufficient cash flow to maintain the operations of the debtor; (b) the debtor's stockholders, directors and officers have been acting in good faith and with due diligence; (c) the petition is not a sham filing intended only to delay the enforcement of creditors' rights; and (d) the debtor would likely be able to pursue a viable rehabilitation plan.*"

The requirement of substantial likelihood of rehabilitation determines at least two things: (1) the debtor's capacity to rehabilitate itself, and (2) its good faith. The concurrence of these would more or less provide an implied guarantee on the creditor that resort to court is a genuine act on the part of the debtor to rehabilitate itself and not an evasion of its contractual obligations. Such obligations the debtor would in fact re-assume once rehabilitation proves successful. On the other hand, the maximum period of 18 months for approval would seem a reasonable period within which debtor and creditors could draft and agree on a rehabilitation plan, and failure to do so within such period is taken as an indication of lack of interest in or failure at rehabilitation.

The debtor's capacity to rehabilitate itself is an essential requisite for the court to give due course to the petition for rehabilitation. Consistent with this, our draft law accords super-priority status to what we refer to as "new money,"⁶ or credit issued after commencement of the proceedings to the debtor to keep it operational and help it achieve rehabilitation. New money is entitled to priority in payment and preferred even over secured obligations.

An adjunct issue to this capacity to rehabilitate is the question of who could best steer the distressed debtor out of its financial problem. Two choices emerge: the current management (whose acts may or may not have induced the financial problem in the first place), or an "outsider" in the person of the rehabilitation receiver (who at best could provide the much-needed change in leadership, or at worst lacks exposure – much more expertise – in the debtor's operations). Our draft law evades this dilemma by: (1) limiting the task of the rehabilitation receiver to monitoring and oversight over the operations of the debtor during the pendency of the petition, and (2) transferring control and management of the company to the receiver only upon written consent of the debtor and the general unsecured creditors' committee.

The general rule that the debtor's management retains control over the company's operations recognizes not only the expertise acquired by the debtor's officers but also the need to keep intervention at the minimum in order to preserve the semblance of regularity in the debtor's operations. At any event, the debtor's management is made subject to the receiver's monitoring, and is made liable for suspicious acts – from refusal to divulge information to other acts tainted with fraud⁷.

Finally, the draft law takes cognizance of the fact that speed and efficiency is as much dependent on the adjudicator as it is on the parties involved. Hence, as ambitious as it may sound, the establishment of commercial courts all over the country with exclusive and original jurisdiction over rehabilitation and insolvency cases and other commercial disputes is proposed. The intent is basically to promote expertise in, and hopefully expedite, the adjudication of cases in commercial law. The glaring hindrance to this proposal is of course its massive funding requirement. Thus, it is provided in our draft that the trial courts currently assigned by the SC to entertain insolvency and rehabilitation cases continue to do so in the interim.

Adjustment and Balancing of Rights. At the core of rehabilitation efforts is the thorny issue of rights, and to what extent they may be enforced or restrained. Most often, these rights are mutually exclusive – a right granted to either a debtor or creditor diminishes and derogates that given to the other – that in the end, rehabilitation appears to be a zero-sum game.

⁶ Sec. 36 of the proposed law provides: "*With the approval of the court upon the recommendation of the rehabilitation receiver, the debtor in order to enhance its rehabilitation, may: (1) enter into credit arrangements, the payments of which shall be considered an administrative expense; or XXX*" Administrative expenses are exempt from the stay.

⁷ see footnotes 18 and 19, p. 10 of this paper.

Our proposed legislation sets the parameters of such game by foremost identifying its key players – i. e. the debtor and creditors. The draft law is concerned exclusively with juridical debtors – corporations and partnerships – and their respective creditors, whether natural or juridical. Sole proprietorship-type of businesses are excluded from its application; they will have to resort to the Old Insolvency Law (along with individuals facing insolvency). The exclusion is meant to prevent the mischief of individual debtors using their business to avail of the protective shield of the law against creditors validly pursuing their claim for personal debts.

Upon commencement⁹ of the proceedings, the debtor generally obtains two things: first, relief from claims and interest on loans in order to preserve its assets⁸; and second, the right to improve its chances at rehabilitation. The first is granted by the draft law by suspending actions which not only deplete the resources of the debtor but also add burdens on its property. It is meant to preserve the status quo and thwart any act or transaction which jeopardize the debtor's chances at rehabilitating itself. The second is made possible by giving the debtor the green light to (1) contract new loans for its rehabilitation; and (2) terminate all contracts and confirm only those which are necessary for rehabilitation. In fact, the draft law automatically terminates all contracts of the debtor sixty (60) days from commencement date⁹ in order to unload the debtor's burden from unnecessary contractual obligations. Only those contracts which the debtor confirms during this period are left in force, the

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- I. ⁸ Sec. 24 of the draft law provides: *“Unless otherwise provided for in this Act, the court’s issuance of a commencement order shall: (1) vest the rehabilitation receiver with all the powers and functions provided for in this act, such as the right to review and obtain all records to which the debtor’s management and directors have access, including bank accounts of whatever nature of the debtor, subject to the approval by the court of the performance bond filed by the rehabilitation receiver; (2) suspend all legal and other proceedings for the enforcement of claims of whatever nature and kind against the debtor subject to the provisions of sections 26 and 27 hereof; (3) prohibit the debtor from selling, encumbering, transferring or disposing in any manner any of its properties except in the ordinary course of business; (4) prohibit the debtor from making any payment of its liabilities outstanding as of the commencement date, except upon the approval of the court upon motion duly filed for the purpose; (5) suspend all actions to enforce any judgment against the debtor; (6) prohibit, or otherwise serve as the legal basis for rendering null and void the results of, any extra-judicial activity or process to seize property, sell encumbered property, or otherwise attempt to collect on or enforce a claim against the debtor after the commencement date unless otherwise allowed in this Act subject to the provisions of section 29 hereof; (7) serve as the legal basis for rendering null and void any setoff after the commencement date of any debt owed to the debtor by any of the debtor’s creditors; (8) serve as the legal basis for rendering null and void the perfection of any lien against the debtor’s property after the commencement date; and (9) consolidate the resolution of all legal proceedings by and against the debtor to the court: Provided, however, That the court may allow the continuation of cases in other courts where the debtor had initiated the suit.*

Attempts to seek legal or other recourse against the debtor outside these proceedings shall be sufficient to support a finding of indirect contempt of court.

The court may order, through its injunctive and contempt powers, the transfer of documents, return of property, the annotation of titles and other relevant documents, or provide for other appropriate relief to address any violation of this Section or to protect the interests of creditors and stakeholders.

Individuals, including the debtor’s management and directors, who refuse to accede to requests for documents or property described in this Section shall be liable for indirect contempt of court and criminal penalties, as well as all resulting costs and attorneys’ fees.

⁹ *Sec. 38 of the proposed law provides: Unless specifically cancelled by a court decree prior to issuance of the order commencing proceedings, or at anytime thereafter by the court before which the proceedings are pending, all contracts of the debtor with creditors and other third parties shall be deemed to continue in force if they are necessary for the rehabilitation of the debtor, regardless of pre-commencement defaults by the debtor: Provided, That within ninety (90) days following the commencement date, the debtor, with the consent of the rehabilitation receiver, shall notify each contractual counter-party of whether it is confirming or terminating the particular contract. Contractual obligations of the debtor arising during this period, and afterwards for confirmed contracts, shall be an administrative expense. Contracts not confirmed by the required deadline shall be considered terminated. Claims for actual damages, if any, arising as a result of the election to terminate a contract shall be considered a pre-commencement claim against the debtor.”*

assumption being that those pertain to transactions critical to the debtor's continued operation and eventual rehabilitation.

The dual advantage outlined above accrues to the debtor who elects any of the three remedies for rehabilitation, to wit: suspension of payments, pre-negotiated rehabilitation and court-supervised rehabilitation.

Among the three, suspension of payments is the familiar remedy, having been provided for in the old Insolvency Law of 1909. It enables the debtor to postpone payments for ninety (90) days from the commencement date. Thereafter, the stay against creditor claims expires automatically. To prevent the anomalous situation where a debtor would first resort to this remedy and then avail of others to prolong the benefits of suspension against claims, the draft law forfeits access by the debtor to other reliefs within one year from the commencement date.

Pre-negotiated rehabilitation approximates a market-driven type of rehabilitation. It grants a debtor that has worked out extra-judicially a rehabilitation plan with its creditors the relief of suspension of claims while the rehab plan awaits judicial approval. Upon approval, the cram-down mechanism¹⁰ takes effect making all creditors bound by the plan. Court-supervised rehabilitation meanwhile subjects the whole process of rehabilitation, specifically the drafting of the rehabilitation plan, to the administration and scrutiny of the court¹¹.

In any of these cases, the debtor obtains the benefits of the law as soon as the court issues a commencement order five (05) days upon filing of a petition sufficient in form and substance.

In cases where the juridical debtor belongs to a group of companies, the problem of free-rider arises and targeting becomes important, otherwise the law will abet the exploitation of creditors. As a general proposition therefore, the iron-clad rule is made to apply and each member of a group of companies is treated as a separate legal entity such that entitlement to the remedies of the distressed entity does not extend to other members in the group.

The Philippine context however requires that an exception be made to this rule. In our domestic business environment, members of a group of companies are oftentimes so intertwined and their operations interdependent that gains and losses are farmed-out and mutually shared. Taking this reality into consideration, our proposed law permits global filing for related enterprises, or those where conditions exist that approximate such a relationship.¹²

¹⁰ See footnote 11 on page 6 of this paper

¹¹ Where rehabilitation is impossible, or where rehabilitation efforts fail (as when the rehabilitation plan is not filed on the time, or where there is serious breach in the performance of the provisions of the plan) the draft law provides for the liquidation of the company. The provision of liquidation is important because the SRC merely transferred jurisdiction over rehabilitation cases, but not insolvency and liquidation cases, to the regular courts.

¹² Sec. 8 of the draft law provides: "*Each juridical entity shall be considered as a separate entity under the proceedings in this Act. The assets and liabilities of a debtor may not be commingled or aggregated with those of another under these proceedings unless the other is a related enterprise that is owned or controlled directly or indirectly by the same interests: provided, however, that the commingling or aggregation of assets and liabilities of the debtor with those of a related enterprise may only be allowed where: (1) there was commingling in fact of assets and liabilities of the debtor and the related enterprise prior to the commencement of the proceedings; (2) the debtor and the related enterprise have common creditors and it will be more convenient to treat them together rather than separately; (3) the related enterprise voluntarily accedes to join the debtor as party petitioner and to commingle its assets and liabilities with the debtor's; and (4) the consolidation of assets and liabilities of the debtor and the related enterprise is beneficial to all concerned and promotes the objectives of rehabilitation.*

Provided, finally, that nothing in this Section shall prevent the court from joining other entities affiliated with the debtor as parties pursuant to the Rules of Court."

As to the creditors, the draft law has two general aims: (1) to equalize treatment among them; and (2) to safeguard their claims. The draft law bats at uniformity in the treatment of creditors, and where this is not applicable, it creates avenues to empower the under-leveraged. Thus, the prohibition against the enforcement of claims is made to apply to all creditors, whether secured or unsecured, including government financial institutions. It also binds all creditors to a decision supported by a majority, through what is popularly referred to as a “cram-down mechanism.”¹³ The inclusion of this mechanism repeals the provision in the Insolvency Act which exempts secured creditors who stay away from negotiations and proceedings from the effects of the approved rehabilitation plan.

For facility in decision-making, the creation of distinct classes or sub-groups of creditors is allowed by the draft law. But the classification is meant more to promote, and not defeat, the equalization in the treatment of creditors. Where the draft law makes a classification based on the possession of security over a debt, it does so to undermine discrimination among creditors. Hence, it provides for the establishment of a General Unsecured Creditors Committee to give voice to creditors who hold no security over credits extended to the debtor. Unsecured creditors are usually under-leveraged, and are at the lower end of the hierarchy and preference of credits. The creation of their representative committee is intended to increase their capacity at protecting their claims. Such committee is granted certain powers¹⁴, among others, that of vetoing petitions for post-commencement financing requested by the rehabilitation receiver.

In general, all creditors, are given a bundle of rights aimed at safeguarding their investments/claims. This includes the following rights: (1) to initiate proceedings; (2) to notice and hearing; (3) to participate in the appointment of the rehabilitation receiver; (4) to require adequate protection for property subject of their claim; and (5) to proceed against solidary guarantors, and third party or accommodation mortgagors.

The right to initiate involuntary proceedings is given to creditors with total claims equivalent to one million Philippine pesos (Php 1,000,000.00), or 25% of the total paid-up capital or partners’ contributions, whichever is higher. This right can only be exercised when there is, or at least there exists the imminent possibility of, default in payment by the debtor.¹⁵

Understandably, the requirements for involuntary proceedings are more taxing than those for debtor-initiated proceedings because creditors are not in the best position to determine the real

¹³ Sec. 72(1) provides that: “Approval of the plan shall discharge the financial payment obligations of the debtor unless otherwise allowed to the extent called for by the plan. Contracts and other arrangements between the debtor and its creditors shall be deemed to continue to apply to the extent that they do not conflict with the payment provisions of the plan. Any compromises on amounts payable by the debtor shall be binding on all creditors regardless of whether the plan is successfully implemented. Claims arising after approval of the plan that are otherwise not treated by the plan are not subject to any suspension order.”

¹⁴ Sec. 54 gives the general unsecured creditors’ committee the right to: “(1) veto petitions for post-commencement financing requested by the rehabilitation receiver or liquidator; (2) authorize the rehabilitation receiver’s assumption of control of the debtor pursuant to Section 42 of this Act; (3) review the rehabilitation receiver’s or liquidator’s records in connection with the administration of the debtor; (4) remove the rehabilitation receiver or liquidator from his position in accordance with the procedures in this Act; and (5) participate in a decision to extend the deadline for the submission of a rehabilitation plan.”

¹⁵ Sec. 18 provides that: “Any three creditors with total claims equivalent to either one million pesos (₱1,000,000.00), or twenty-five percent (25%) of the total paid-up capital or partners’ contributions, whichever is higher, shall be entitled to initiate involuntary proceedings against a debtor if: (1) there are no genuine disputes of facts or law on their claims and the required payments have not been made for more than sixty (60) days; or (2) creditor other than the petitioners has initiated foreclosure proceedings against the debtor that will prevent the debtor from paying its debts as they come due or will render it insolvent.”

financial position, much more the viability of, a business enterprise. The stringent requirements are meant to ensure that the creditor will only exercise this right with the intention of rehabilitating the debtor (which, when successful, will ultimately allow him to collect his credit in full).

The creditor's right to notice and hearing is guaranteed in almost every stage of the rehabilitation process. The commencement order is required to be published twice for two consecutive weeks in a newspaper of general circulation.¹⁶ The rehabilitation receiver is also considered as the agent of creditors as regards the receipt of pleadings and other paper filed with the court. Further, creditors having an ownership interest in a property of the debtor, or a claim against the debtor, are to be served notice of pleadings against such property or claim. These safeguards are put in place to notify the creditor of any action that may prejudice his interest or claim, and therefore allow him to adequately prepare against such possibility.

To further protect the creditors' interest, a proposed provision in the draft law seeks not only to give creditors the right to participate in the appointment of the rehabilitation receiver but to require support by a majority of them (50% of secured and unsecured creditors) before the court could appoint a receiver. This suggestion has elicited some controversy, with some arguing that the requirement could taint the impartiality of the receiver and undermine his position as an officer of the court. There is every indication however that the provision will be retained, but checks on the acts of the rehabilitation receiver will be tightened to deter the commission of acts that prejudice parties in the proceedings.

Finally, despite the stay order, creditors are given the right to proceed against solidary guarantors and third party/accommodation mortgagors and require adequate protection for the property subject of its claim. The suspensive benefit of the commencement order is not extended to solidary guarantors and third party/accommodation mortgagors whose obligation is, by nature, subsidiary, and arises upon the failure of the debtor to perform its obligation to the creditor/s. As such, creditors are allowed to proceed with their claims against them. However, the creditor will be prohibited from doing so against third party/accommodation mortgagors when the property subject of accommodation mortgage is necessary for the rehabilitation of the debtor. In such a case, creditor's interest becomes subordinated to the objective of successful rehabilitation.

The creditor is also given the right to petition the court to order the rehabilitation receiver to take reasonable steps to prevent the depreciation of its property in the possession of the debtor. Where this is not possible, he is given the alternative of petitioning for: (1) the foreclosure of the property; (2) the conveyance of a lien or ownership interest in a substitute property of the debtor; (3) the conveyance of a lien on the residual funds from the sale of encumbered property; or (4) the sale or disposition of the property. The court is also empowered in cases where adequate protection over a property securing a creditor's claim is lacking to order the debtor to make arrangements to insure the property, provide additional or replacement security, make payments, or to allow the enforcement of a security claim against the debtor

¹⁶ Sec. 23(1) of the proposed law provides: "*The commencement order, which shall be published once a week for two (02) consecutive weeks in a newspaper of general circulation in the Philippines, beginning not later than seven (07) days after the issuance of the commencement order, shall be effective for an initial period of ninety (90) days from the date of filing of the petition, extendible for a maximum period of sixty (60) days for meritorious reasons. It shall automatically be dissolved without need of court action upon the expiration of said initial period or extended period, as the case may be, unless the court gives due course to the petition within said period on a finding that there is substantial likelihood for the debtor to be rehabilitated. If the court does not give due course to the petition, it shall order the dismissal of the petition or the conversion of the proceedings to dissolution and liquidation proceedings under sub-chapter 4 of chapter iv of this act.*" XXX

The immediately preceding rights granted to the creditor, and the mandate of the court to protect creditor property, underscore the strenuous balancing of debtor and creditor rights sought to be achieved by the proposed law. At the fulcrum of this balancing is the principle of equity, where creditor's rights are not exhumed but in fact protected, even as rehabilitation is relentlessly pursued.

This balancing of rights inevitably alter the hierarchy and preference of credits. Expenses incurred for and in the process of rehabilitation are granted super-preferred status in order to encourage creditors to invest in revitalizing distressed corporations. They are referred to as "administrative expenses"¹⁷ and are exempt from the stay/suspension order. Related to this, there exists at the moment a strong lobby for the government to waive, or at least suspend, the collection of documentary stamp tax, capital gains tax and withholding taxes on, as well as interest on late payment of taxes by, companies undergoing rehabilitation. This lobby, while it rests on the valid argument that government should also be made to assume part of the costs of rehabilitation, must however confront two major issues before it gains ground: first, that of moral hazard. Undoubtedly, it would be bad policy for the government to assume, by way of tax waiver, rehabilitation of companies in the red due to mismanagement. That would in the end not only tolerate but reward bad management. Secondly, if ever government should share in the costs of rehabilitation, exactly how much it should assume is stamped with a big question mark.

Adoption of international standards and best practices. Modern trade and commerce spill over national borders. The adoption of certain international legal standards and best practices is meant to improve the local business environment and secure to Philippine business entities which find themselves in distressed conditions in foreign jurisdictions the same protection and relief accorded to their foreign counterparts.

One such standard pertains to cross-border insolvency¹⁸ where representatives of a foreign corporation under insolvency proceedings in foreign countries are allowed to seek a judicial order stopping Philippine creditors from acting unilaterally with respect to assets located in the Philippines. Corollarilly, the court is also given the power to provide such other reliefs to a foreign debtor, taking into consideration reciprocity and the rights of local creditors.¹⁹

The draft law also increases the penalty directors and officers who cause, authorize or directly participate in the disposition of property fraudulently, or in a manner grossly disadvantageous to debtor and/or creditor; or those who conceal from creditors, embezzles or misappropriates any property. Offenders are made liable for double the value of the property, or the amount of the

2. ¹⁷ Sec. 3(a) defines Administrative expenses" as follows: "*to those reasonable and necessary expenses: (1) incurred in connection with the filing of the petition; (2) arising from such filing of the petition in connection therewith, including those incurred for the rehabilitation or liquidation of the debtor; (3) incurred in the ordinary course of business after the filing of the petition; and (4) that are otherwise authorized or mandated under this act.*"

¹⁸ Sec. 109 provides: "*The court shall set a hearing in connection with an insolvency or rehabilitation proceeding taking place in a foreign jurisdiction, upon the submission of a petition by the representative of the foreign entity that is the subject of the foreign proceeding.*"

¹⁹ The factors entitling a foreign corporation to relief is set out in Sec. 111 of the proposed law, which provides: "*In determining whether to grant relief under this Sub-chapter, the court shall consider: (1) the protection of creditors in the Philippines and the inconvenience in pursuing their claims in a foreign proceeding; (2) the just treatment of all creditors through resort to a unified insolvency or rehabilitation proceeding; (3) whether other jurisdictions have given recognition to the foreign proceeding; (4) the extent that the foreign proceeding recognizes the rights of creditors and other interested parties in a manner substantially in accordance with the manner prescribed in this Act; and (5) the extent that the foreign proceeding has recognized and shown deference to proceedings under this Act and previous legislation.*"

transaction involved, whichever is higher²⁰. The increased penalty seeks to deter acts that cause the deterioration of the value of the enterprise to the detriment of creditors.

Conclusion

The reforms currently being undertaken by the Philippine legislature seeks to update and modernize the rehabilitation and insolvency regime in the country. The inadequacy and inconsistency of the current regime are manifest in the overstretched court battle by a few significant businesses in the country, most notably the National Steel Corporation, which rehabilitation has yet to take off.

Legislative reform efforts intend to put in place a clear and predictable set of rules to infuse order in rehabilitation and insolvency proceedings. Once passed, it is hoped that the proposed law will be able to arrest the collapse of key players in the economy, especially in times of instability, swiftly re-engage productive resources into revitalized and competitive businesses, and therefore strengthen the sinews of a fragile national economy.

²⁰ The liability of directors and officers is provided in Sec. 13 of the draft law which provides that: “*Directors and officers of a debtor shall be liable for double the value of the property sold, embezzled or disposed of or double the amount of the transaction involved, whichever is higher, to be recovered for the benefit of the debtor and the creditors under the following circumstances: (1) if the officer or director, having notice of the commencement of the proceedings, or having reason to believe that proceedings are about to be commenced, disposes or causes to be disposed of any property of the debtor or authorizes or approves any transactions fraudulently or in a manner grossly disadvantageous to the debtor and/or creditors; or (2) if such director or officer conceals from the creditors or embezzles or misappropriates any of such property.*”

The court shall determine the extent of the liability of a director or an officer under this Section. In this connection, the court shall consider the amount of the shareholding or equity interest of such director or officer, the degree of control of such director or officer over the debtor, and the extent of the involvement of such director or debtor in the actual management of the operations of the debtor.”

This is reiterated in Sec. 112 which extends liability to employees. Sec. 112 reads as follows: “*A director, officer or other employee of the debtor who commits any one of the following acts shall, upon conviction thereof, be punished by a fine no more than one million pesos and imprisonment for not less than three (3) months nor more than five (5) years for each offense: (1) if he shall, either after the commencement date or prior thereto with contemplation of their commencement, hide or conceal, or destroy or cause to be destroyed or hidden any property belonging to the debtor; or if he shall hide, destroy, alter, mutilate, or falsify, or cause to be hidden, destroyed, altered, mutilated, or falsified, any book, deed, document, or writing relating thereto, or if he shall, with intent to defraud his creditors, make any payment, sale, assignment, transfer, or conveyance of any property belonging to the debtor; (2) if he shall, in any case of any person having, to his knowledge or belief, proved a false or fictitious debt against the debtor he shall fail to disclose the same to the rehabilitation receiver or liquidator within one month after coming to the knowledge or belief thereof; or if he shall attempt to account for any of the debtor’s property by fictitious losses or expenses; or (3) if he shall knowingly violate a prohibition or knowingly fail to undertake an obligation established this Act.”*