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**INSOLVENCY SYSTEMS IN ASIA: AN EFFICIENCY
PERSPECTIVE**

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***Creditor Rights: The Under-Lying Issues – The Pakistani
Experience***

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CREDITOR RIGHTS
THE UNDER-LYING ISSUES –
THE PAKISTANI EXPERIENCE

- THE LAW IS CREDITOR FRIENDLY, BUT THE KEY ISSUE IS TO RECONCILE CONFLICTING OBJECTIVES - I.E., RECOVERY OF BANK LOANS AND REVIVAL OF CLOSED / DISTRESSED UNITS.
- THE BULK OF THE LAWS CATER TO THE FIRST OBJECTIVE. THE SECOND OBJECTIVE IS POLITICALLY / SOCIALLY EQUALLY IMPORTANT.
- ABSOLUTE PRIORITY RULES MAY HAVE TO BE MODIFIED TO ACHIEVE REVIVAL AIMS.
- THIS CAN BE DONE WITHOUT DAMAGE TO THE DESIRE FOR PREDICTABILITY.
- MANY OF THE HURDLES ARE NOT LEGAL – E.G., ACCOUNTING ISSUES, GOOD CORPORATE GOVERNANCE, ISLAMIC BANKING, ETC.
- ADDITIONAL ISSUES WITH LEGAL CONNOTATIONS ARE EMOTIVE TERMS LIKE WILLFUL DEFAULTERS, ENGINEERED DEFAULT, COSMETIC RE-SCHEDULINGS, AND LOANS / WRITE-OFFS UNDER POLITICAL PRESSURES.
- MAJOR PROBLEM IN THE APPLICATION OF RECOVERY LAWS HAS BEEN THE LACK OF SPEED / TIME LAGS IN OBTAINING DECREES AND EXECUTIONS. THE END RESULT IS OFTEN CLOSURE WHICH CAUSES A HUGE DIMINUTION IN THE VALUE OF THE FIRM (E.G., CANNIBALIZATION).
- WE NEED A LEGALLY ACCEPTABLE DEFINITION OF SUSTAINABLE DEBT TO ENSURE TRANSPARENT WRITE-OFFS . IN AN ENVIRONMENT WHERE OVER TWO-THIRDS OF CORPORATE BALANCE-SHEETS HAVE BEEN WIPED OUT AND WRITE-OFFS ARE VIEWED AS A QUASI-CRIMINAL OFFENCE.

CREDITOR RIGHTS -
THE RECOVERY ACT, 1997

- THIS LAW WAS A MAJOR BREAK WITH THE PAST AND WAS INACTED OWING TO THE PRESSURE OF THE BANKS / GROWING NPL.
- HAS WORKED REASONABLY WELL IN SINGLE CREDITOR-DEBTOR RELATIONSHIPS AND HAS FAILED IN MULTIPLE RELATIONSHIPS.
- HAS FAILED TO PROTECT THE VALUE OF THE FIRM AND THE LANDSCAPE IS DOTTED WITH INDUSTRIAL CLOSURES.
- PRACTICAL PROBLEMS ARE OVERWORKED COURTS, FRIVOLOUS CLAIMS / DEFENCIES, UN-QUALIFIED AUCTIONEERS / RECEIVERS, ETC.
- EQUALLY IMPORTANT IS THE JUDICIAL / POLITICAL NEXUS WHICH TOOK ON INSTITUTION-ERODING PROPORTIONS.
- DETAILED AMENDMENTS TO THE 1997 LAW AND ADMINISTRATIVE RECOMMENDATIONS HAVE BEEN MADE AND ARE UNDER CONSIDERATION.

**CREDITOR RIGHTS -
ISSUES RELATING TO
REVIVAL / REHABILITATION /
REORGANIZATION**

- THERE IS AN INHERENT DICHOTOMY BETWEEN EXISTING LAWS (E.G., SECTION 296 OF THE COMPANIES ACT, 1984) WHICH SEEKS TO REHABILITATE A PARTICULAR COMPANY / BORROWING ENTITY AND WIDELY AGREED NATIONAL OBJECTIVES. ALSO, IN EACH CASE THE CONCEPT OF “SICKNESS WORTHY OF REVIVAL” NEEDS TO BE TESTED.
- TO AMPLIFY, SECTION 296 OR SIMILAR REVIVAL PLANS SEEK THE REVIVAL OF UNDER-LYING ENTITY (WITH THE SAME OR WITH NEW MANAGEMENT). IN AN ECONOMY WHERE INDUSTRY IS WRONGLY CONFIGURED, AND WHERE A WHOLE GENERATION OF DILETTANTE ENTREPRENEURS (RENT-SEEKERS) NEEDS TO BE EVICTED, ECLECTIC SOLUTIONS ARE NEEDED.
- ONE APPROACH IS A GENERALIZED DEBT RELIEF MODEL (EDR) WHICH WORKS THRU FORENSIC ACCOUNTING INTO THE COMPUTATION OF THE SUSTAINABLE DEBT LEVEL OF MAJOR COMPANIES / INDUSTRIES. THE MAJOR ADVANTAGES OF THIS (PRODUCT) APPROACH ARE TRANSPARENCY, SPEED, FAIRNESS / EQUITY, AND IS A NON-LITIGATION METHOD OF TRANSFER OF MANAGEMENT.
- ANOTHER APPROACH IS OBVIOUSLY CASE-BY-CASE. HERE THE METHOD BEING ACTIVELY CONSIDERED IS AN EMPOWERED BODY – I.E., A RESOLUTION TRUST, INEVITABLY THE PROCESS WOULD BE SLOWER, BUT THE OUTCOME(S) MORE POLITICALLY / SOCIALLY ACCEPTABLE.
- IN THIS CONTEXT, DEBT-EQUITY SWAPS ARE BEING CONSIDERED PRIMARILY AS A COERCIVE TOOL AGAINST EXISTING MANAGERMENTS OR AS AN INCENTIVE – BASED TOOL FOR A NEW MANAGEMENT.
- AN EXTREME VERSION OF DEBT-EQUITY SWAP BEING CONSIDERED BASED NOT ON A DEBTOR-CREDITOR RELATIONSHIP BUT ON A LANDLORD – TENANT RELATIONSHIP WITH THE EQUITY AS A FUTURE REWARD. THIS MODEL IS DESIGNED TO PROMOTE / ENCOURAGE A NEW BREED OF PROFESSIONAL ENTREPRENEURS.