

RECENT DEVELOPMENTS IN INSOLVENCY REFORM IN ASIA

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INTRODUCTION

This paper surveys recent developments in insolvency law and related areas in the Asian region.

Much of the development in the region occurred as a result of the Asian financial crisis. Enough has been written of that event, its causes and effects. It should not be necessary to repeat or add to that here. It is commonly agreed that the crisis dictated that urgent measures be taken to deal with the critical problem of systemic banking and financial sector failure. That failure was traced into corporate failure and that, in turn, resulted in a consideration of and attempts to deal with basic issues concerning corporate debt, its recovery and enforcement and corporate insolvency.

It is also commonly agreed that but for the crisis none of this development would have occurred. To that extent the crisis has produced positive results. Indeed, the claim could be made that the results have been outstanding. The evidence may be found in the number of countries that have reformed or are in the process of reforming their insolvency law systems and the extent to which many countries have developed and encouraged the adoption of informal, out of court, insolvency related processes.

But questions have been and will continue to be asked whether some of the developments and reforms are superficial and nothing much more than a masquerade, covering and hiding the fact that there has been no real application and no real progress. An analysis that goes beyond a bare recitation of the developments is therefore desirable.

Care must be taken in such an analysis. The Asian region is considerably diverse. As the note to the agenda for this forum comments: *'...reflecting different legal, economical, cultural and historical backgrounds, the current strategy varies among the countries in the region and the achievement to date differs significantly'*.

Rather than pursue a course of examining and analysing the developments on a country by country dissection, it is preferred to examine the overall developments by reference to some important areas of insolvency law and practice. Accordingly the paper is divided into five parts and covers the following:

- The fundamental aspects of a formal insolvency law regime, namely the liquidation process and the rescue process;
- The application and administration of those processes;
- Informal insolvency processes, such as private informal work outs and the more public and structured work out techniques; and
- The treatment of secured transactions in insolvency laws; and
- Cross-border insolvency issues.

PART 1 - DEVELOPMENTS IN FORMAL INSOLVENCY LAW REGIMES

The liquidation process.

Most attention in the region has been given to the reform or, in some cases, the creation of a rescue or reorganisation process in formal insolvency law regimes. But it should never be overlooked that it is the less fashionable and more traditional and conservative process of liquidation (or bankruptcy) that is at the heart of any corporate insolvency law system. Liquidation effectively underpins both a formal rescue process and an informal rescue process. It also provides unsecured creditors with a critical ultimate right of enforcement, albeit within the framework of a collective procedure.

When it is claimed that the formal rescue process of a country is not working, often the fault will not be found in that process. Rather the fault may be traced to the fact that the rescue process cannot be encouraged, facilitated or imposed because it is difficult, if not impossible, to initiate the liquidation process. There is no persuasive force to encourage a debtor to initiate the process. Likewise, if it is complained that there is considerable difficulty in encouraging the development of private informal work out processes, the reason may often be traced to the fact that there are considerable difficulties in initiating the liquidation process. If another complaint is that unsecured creditors have no real means of enforcing their claims it will often be the fact that there is no effective liquidation regime to which unsecured creditors may turn to exercise an ultimate and fundamental right of enforcement. Again, the debtor remains relatively free of any real threat of enforcement.

Viewed in this way, it may be seen that it is the liquidation process that drives, encourages and, in some cases, dictates resort to rescue processes, formal or informal. However, given the extent of recent insolvency law reform in the region, it is somewhat surprising that so little attention has been given to the liquidation process and its application. Some examples may illustrate the point.

In those countries of the region that largely inherited their insolvency law from English based legal systems (most notably Singapore, Malaysia, India, Pakistan, and Hong Kong, China), the liquidation law (as distinct from its application) is basically sound and capable of efficient application. None of those countries had to be concerned to reform that aspect of their law as a result of the crisis. In terms of application, the liquidation processes work efficiently and well in Singapore, Malaysia and Hong Kong, China. It is relevant to observe that in each of those jurisdictions there are strong, functional and well-regarded rescue processes, both formal (although not in the case of Hong Kong, China) and informal. It suggests that there is a strong correlation between an efficient liquidation law and an effective rescue process.

On the other hand the application of the liquidation process is not effective in India and Pakistan. This does not appear to be the fault of the law itself. Commentators in those countries level their criticism at the court systems (delays and impediments) and at other factors (such as corruption and political manipulation). It is therefore likely that the fault lies in either or both of insufficient resources at infrastructure level, most notably in the courts and public sector administration of insolvency cases, and the endemic problem of corruption and political intervention. But, importantly, in neither of those countries is there anything approaching a flourishing rescue process, whether formal or informal. It may be concluded that reform to the liquidation process and its application is urgently required in those countries before a rescue culture may be developed.

Thailand provides another example. It reformed its Bankruptcy Act in 1998 by adding a new rescue process. Many commentators properly commended that reform. However a problem relating to the commencement criteria under the existing liquidation or bankruptcy law subsequently emerged that was to affect the application of the new business reorganisation process. This problem concerned the definition or meaning of 'insolvency' under the law in Thailand.

Not long after the new rescue process commenced operation, both debtors and, in particular, creditors, discovered that it was necessary to establish that a corporation was insolvent by the use of a 'balance sheet'

test to promote a rescue. A balance sheet test requires proof that the liabilities of the corporation exceed its assets. Proof that such a condition exists is particularly difficult to establish by a creditor. Criticisms and complaints quickly surfaced that the new rescue process was ineffective, difficult to apply and, even, useless.

But, again, the criticisms were misdirected. The fault (if it be such) lay in the fact that proceedings under the Bankruptcy Act of Thailand could only be commenced and given effect if the debtor was insolvent on a balance sheet test. That test had been specified (albeit, not altogether clearly) in the Act since its enactment in 1940 and had been long applied to proceedings for liquidation as a result of a number of decisions by superior courts in Thailand. In the drafting of the amending legislation for the new rescue process that process was made subject to the same commencement criteria as existed for liquidation proceedings.

It would have been desirable if the new rescue process had been given different commencement criteria, to encourage attempts at rescue when there appears a possibility that a corporation may become or is insolvent, based on a cash flow test (inability to pay a due debt). But, whatever, not only was the new rescue process put under a cloud of considerable doubt, the shortcomings of the liquidation or bankruptcy process were also exposed. No revision has yet been made although the whole of the bankruptcy law regime of Thailand is now under review.

Again, this reveals the importance of examining the whole of an existing insolvency law regime and its application to ensure that both any newly introduced rescue process can operate successfully and that both it and the liquidation process may compliment one another.

Japan, Korea and Taipei, China provide some further examples of problems in the commencement criteria for liquidation proceedings. The relevant legislation in all of those jurisdictions contains only a general statement of the criteria for commencement. They do not provide specific procedural rules by which the criteria may be established. In Japan, for example, the relevant legislation provides that when a debtor is 'unable to pay' the debtor may be adjudged bankrupt and that a debtor shall be deemed unable to pay when the debtor has 'suspended payment'. There are no definitions or meanings of these terms in the law. The criteria are vague and could be difficult for a creditor to establish. Although this is not carried into the rescue processes in those jurisdictions, the vague criteria for the commencement of liquidation proceedings may mean that a creditor is denied the opportunity of, in effect, forcing or inducing an insolvent debtor into the rescue process.

Korea is, of course, undertaking a full reform of its insolvency law regime. It will be interesting to see the result of that exercise, particularly as much of the present Korean regime has extended from Japanese models.

In the Philippines, although the commencement criteria are acceptable, it is necessary that three creditors join together to prosecute a liquidation case. It is difficult to understand why one unpaid creditor should not be enough to enable a proceeding to be commenced.

The existing insolvency laws in both the People's Republic of China and Vietnam are also problematical regarding the opening of insolvency proceedings. In Vietnam, for example, one of the necessary criteria is that an enterprise has made losses for at least two years. Such a criterion for commencement is far from conducive to encouraging the application of a rescue culture. In the PRC it is necessary for some government sanction before insolvency proceedings may be commenced in relation to a state enterprise. The process becomes, therefore, much more of an administrative and controlled exercise rather than one that is consistent with the development of a market economy. However, in both these countries insolvency law reform projects have commenced or are proposed and the probability is that there will be some significant and appropriate changes to commencement criteria.

Another way of assessing the effectiveness of liquidation processes is by reference to the statistics of the number of liquidation cases. In many countries in the region the numbers are astonishingly low and bear no resemblance to the known fact that there are many insolvent corporations incapable of rescue but which

appear to be either immune or protected from liquidation proceedings. In the Philippines and Indonesia, for example, cases of corporate liquidation or bankruptcy were virtually unknown.

The above brief analysis suggests that, in a number of countries in the region, the reform process has not paid any or any sufficient attention to the vital, but unfashionable, liquidation or bankruptcy processes. In consequence those countries may experience little benefit from their respective reforms in the more fashionable area of rescue. The analysis should not, however, be interpreted as a call for radical and draconian measures to ensure that enterprises may be liquidated at the first sign of financial difficulty. That is not the thrust of the analysis. Rather, the point is that unless the insolvency law system carries with it a real prospect of a significant sanction directed at financially troubled corporations (which can only be done through a real threat of possible liquidation) the following consequences will result:

- first, endeavours to promote both formal and informal rescue processes will have no or limited effect;
- secondly, the rights of unsecured creditors will be significantly reduced and become almost meaningless; and
- thirdly, insolvent enterprises will be permitted to continue to conduct business to the prejudice of all that may deal with them.

Some of those consequences can be identified in a number of countries in the region. The cure lies in a careful examination and reform of the liquidation side of an insolvency law regime.

Rescue

By comparison with liquidation, rescue has been the centre of the insolvency law reform movement. Three countries in the region have made substantial reforms in this area – Thailand, Indonesia and Japan. Another five countries have substantial reform projects in hand to create or reform formal rescue processes – the PRC, Vietnam, Korea, Hong Kong, China, Indonesia and the Philippines. There is also a prospect of reform in this area in India, Malaysia and Taipei, China. In short, creating and/or improving formal rescue regimes has become the flavour of the times.

This endeavour is, of course, to be commended. There can be little doubt that a process that encourages and facilitates commercial negotiation under appropriate safeguards and non-intrusive regulation is more likely to produce a better and more satisfactory outcome than anything approaching a forced liquidation approach. Indeed, although it may be the case that in a liquidation environment the law has a significant regulatory role to perform, in the rescue process the principal aim of the law should not be to regulate but to facilitate and provide the system, the mechanism and the forum for the negotiation of a plan of reorganisation.

It would be unfair to attempt some comparative critical analysis of the rescue regimes of the different countries in the region. That is because they will have been constructed to take account of local commercial and other customs and practices. There is, however, some worth in examining the rescue regimes by reference to some key legal and commercial standards that would be applied by most rescue legislation. They are standards that appear to be the subject of common and, in some cases, universal acceptance. They may be conveniently listed in the form of the following propositions or questions as follows:

- Does the law enable the reorganisation process to be easily and inexpensively commenced?
- Does the law provide for an immediate automatic stay and suspension of all actions against the property of the enterprise for a limited period of time to enable a reorganisation plan to be formulated, negotiated and approved?

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- Does the law adequately provide for the ongoing management and control of an enterprise that seeks to be reorganised?
- Does the law provide for a commercially sound form of priority for the on-going finance funding that may be required to keep the enterprise liquid?
- Does the law provide for a speedy but sensible time frame for the progress of a case of reorganisation?
- Does the law provide for creditors to receive sufficient and reliable information concerning the enterprise and the reorganisation proposal or plan?
- Does the law adequately provide for creditor voting rights and their exercise?
- Does the law ensure that a plan of reorganisation meets some fundamental basic requirements, (for example, that a reorganisation should provide a better benefit to creditors than might be expected from a hypothetical liquidation of the enterprise; and that a reorganisation must ensure that the enterprise is returned to the commercial world in a solvent financial state)?
- Does the law provide for adequate overall supervision of the reorganisation process?
- Does the law provide for conversion to liquidation if creditors do not accept a reorganisation plan or if the plan is not implemented?

The work of the Asian Development Bank on its comparative study of the insolvency laws of eleven Asian economies (see Report on RETA 5795: *‘Insolvency Law Reforms in the Asian and Pacific Region’* in Law and Policy Reform at the Asian Development Bank, 2000 Edition, Vol.1) identified a reasonably high degree of application of these standards in the formal rescue legislation of the region. The following are illustrative:

- **Access.** Access to rescue processes was relatively easy in most of the jurisdictions, but sometimes problematical in Thailand (as mentioned above) and somewhat constrained with procedural requirements in Japan, Korea and Taipei,China. Since then, however, Japan has introduced an improved rescue process (the Civil Rehabilitation Law, December 1999) in which the access criteria is framed as a possibility of facing facts out of which a bankruptcy may arise. As mentioned earlier the Korean system is undergoing reform.
- **Automatic stay.** The vital ‘automatic’ stay requirement was, surprisingly, less common. The ‘English’ based law jurisdictions are the greatest offenders (Malaysia, India, Pakistan and Hong Kong, China). The judicial management process of Singapore, by comparison, featured an excellent stay provision. That is no doubt due to the fact that it is a relatively new (1987) process. The problem in the other English law jurisdictions is that their ‘rescue’ processes (they all take the form of a ‘scheme of compromise or arrangement’ process) are old, outdated, expensive and inefficient. They are all in urgent need of modernisation. In some of the other jurisdictions there is some concern at the length of the automatic stay (for example, in Japan, Korea and Taipei,China), but this appears to be largely associated with procedural requirements that greatly increases the length of time that it takes for the negotiation and approval of a plan of reorganisation. The recent introduction of the new Civil Rehabilitation Law in Japan has already alleviated much of this delay (although, interestingly, it does not impose an automatic stay upon secured property enforcement rights).
- **Continued management.** The issue of the continued management of a corporation that seeks reorganisation has produced a variety of solutions that provides some comparative interest. In Japan and Korea, for example, the reorganisation law provides for exclusive management through the appointment of an independent receiver (in Japan this position has been maintained under the civil rehabilitation law). Under the legislation of both Singapore and Thailand the law actually suspends the powers of management in favour of an independently appointed manager. That has created some

tension in Thailand because of a strong cultural aversion, mainly from owners and managers of corporations, to surrendering complete control. In most of the other jurisdictions there is something of a halfway house, with existing management continuing under supervision by a court or administrative appointee. In Vietnam, for example, existing management is expected to continue but subject to supervision by a court and an 'asset management team'.

- **Provision of 'new money'.** The appropriate means by which to encourage and facilitate continued funding of an insolvent corporation continues to cause problems. It is an issue that is not confined to the Asian region – it creates problems throughout the world. In only three jurisdictions in the region do the rescue laws expressly provide for the possibility of sanctioning the provision of 'new money' – those of Singapore, Korea and Thailand. However, of these, only Singapore, under the judicial management law, provides protection by way of priority repayment of that funding. This is an area in which considerably more study and assistance is required. The main issue concerns the effect of 'new money' funding on existing creditors, both secured and unsecured. Considerable attention must be paid to the position of secured creditors.
- **Time frame.** The time frame for the progress of an attempt at reorganisation is, in general, well structured. The respective rescue laws of Indonesia, Singapore, and Thailand prescribe strict, but commercially sensible, time limits for all stages of the procedure. They provide very good models. However, in other countries the process can be very slow and considerably delayed (in Japan and Korea, for example, the legislation permits a period of 12 months for a plan to be prepared and that can be extended by order of the court to as long as 18 months). In some other jurisdictions the process is subject to considerable delay because of problems and inefficiencies in the court system, an area that is the subject of comment later in this paper.
- **Information to creditors.** The provision of information to creditors is another vital component of a rescue regime. In most cases creditors are the decision-makers. They cannot be expected to participate in that process without reliable and independently assessed information. Although most countries in the region endeavour to apply this standard, there is some considerable variation in the degree of effective delivery. For example, the rescue laws of both Indonesia and Thailand require the delivery of relevant information but in both jurisdictions there is a problem associated with the appointment of an independent expert or advisor to ensure that the provision of information is handled professionally and objectively. Again, this is an area that concerns institutional capacity and is the subject of further comment late in this paper.
- **Voting rights and requirements.** Creditor involvement in the rescue process is achieved through meetings, voting rights and their exercise at meetings. In general, all the rescue laws of the region provide for a high extent of creditor involvement in the process. One exception, for a time, was in the Philippines where there was no provision for meetings or voting powers. That has since been remedied by procedural rules and it may be expected that this will be maintained in that country when the new insolvency law reforms are finally settled. The exercise of voting rights and requirements provide some interesting comparisons. They vary considerably – as low as a simple majority vote for the approval of a plan, to a requirement for a majority as high as 75% of value (for example in Japan under the Corporate Reorganisation Law there is a requirement for a 75% majority of secured creditors in favour of a plan) and in some jurisdictions there is a requirement for a dual standard of majority both in number and in aggregate debt of creditors (for example, Singapore). In Vietnam a plan of reorganisation must be approved by two thirds in value of all creditors, whether they are present at the meeting or not.
- **Basic requirements of reorganisation plans.** Although it is generally accepted that the law should not intervene into the ultimate compact that is negotiated between the creditors, the enterprise and other interested parties, it is generally accepted that the law should impose at least two basic requirements. One is that the result of a plan should ensure that the benefit to creditors is not less than they would be likely to receive if the enterprise was, hypothetically, liquidated. Although this might be considered axiomatic and a 'given' (where is the commercial benefit for creditors in a reorganisation?), very few formal reorganisation regimes actually spell it out. Unless a standard such

as that is required (and enforced) a reorganisation process can be much abused to the prejudice of creditors. The other very important standard is that the enterprise should not remain insolvent at the end of a reorganisation. The aim of any insolvency law regime must be to remove insolvent enterprises from the market place, not to restore them to the market place in that same condition. Thus, it must be shown that the end effect of a reorganisation is that the enterprise has ceased to be insolvent. This may appear very basic and, again, taken as a given, but so few insolvency law regimes actually spell out that fundamental policy point. In the region, somewhat surprisingly, only Singapore and Thailand provide for these basic safeguards.

- **Supervision of the process.** Consistent with the view that the law should not unnecessarily intrude into the rescue process but there should be some overall judicial or other supervision of the process, that also should not be over intrusive. The rescue laws of Japan (before the Civil Rehabilitation Law), Korea and Taipei, China place heavy emphasis on judicial involvement. That undoubtedly contributes greatly to delays in the process. It is legitimate to enquire whether this is the best use of valuable judicial time and energy. In the Philippines, until just recently, the SEC had an extraordinary power to set aside a majority 'non-approval' of a plan vote of the creditors if the SEC was of the opinion that the majority view was 'manifestly unreasonable'. There is a similar provision in the present draft of a proposed reformed insolvency law of the PRC. It may be argued that to vest such a power in a court or other tribunal runs contrary to a strong view that creditors should have freedom to contract and that they are the best judges of the commercial effect of a reorganisation plan. To empower or require a judge to, in effect, 'second guess' the commercial wisdom of people of commerce may be unnecessarily intrusive.
- **Conversion to liquidation.** Finally, there is the requirement that a rescue law should provide for the possible conversion from a failed attempt at rescue to liquidation. This standard is subject to considerable variation in the region. None of the common law jurisdictions provide for conversion (which is surprising in the case of Singapore since its rescue law is of relatively recent origin). Thailand has a provision for conversion, but it is of limited scope. Only Indonesia, Japan, Korea, Philippines and Taipei, China have an express provision for conversion. Absent such a provision if a proposed reorganisation is not approved or fails and the proceedings are terminated the enterprise remains insolvent and at large in the commercial community. In addition there is the consequent delay and the waste of costs of re-initiating the insolvency process.

In summary, the areas in which there appears to be a need for the greatest reform are:

- All of the 'English' law based countries, with the exception of Singapore, require the introduction of a modern rescue law into their respective insolvency law regimes.
- Some countries should further review the effect and operation of their automatic stay provisions.
- All countries, with the possible exception of Singapore and Thailand, require legislation to sanction and protect 'new money' that is necessary for an enterprise that seeks a genuine reorganisation.
- The degree of practice and procedure that requires consequent judicial involvement in the rescue process should be reduced as much as possible.
- The involvement of, the provision of information to and the voting powers of creditors is another area that might be usefully reviewed, particularly if a principal aim of a rescue process is to provide the forum for negotiation and resolution of a reorganisation.
- The basic safeguards or standards of the effect of a reorganisation should be expressly provided for in all formal rescue legislation.
- Automatic conversion from a failed reorganisation to liquidation should be considered in a number of countries.

PART 2 – APPLICATION AND ADMINISTRATION OF LIQUIDATION AND RESCUE PROCESSES

It is in this area that the good intentions of insolvency law reform in the region may appear decidedly fragile and ineffective. It is the failure or the inability to properly apply the law that leads to criticisms that much of the recent insolvency law reform in the region is not much more than a widow dressing and of little practical substance.

There are three areas of infrastructure development that are required in most countries in the region.

- The first is in the **courts and other tribunals** that have jurisdiction under the insolvency law regime. Problems in this area may be identified as one or more of the following: no or not enough sufficiently educated, trained and knowledgeable judges to exercise jurisdiction; not enough courts and not enough resources to ensure that the court system may deal with insolvency cases efficiently and quickly; and elements of corruption of and/or political or other interference with judges. This is a problem that seems to have become particularly evident in Indonesia, despite the establishment of a new commercial court. No doubt this is an area that will be more fully addressed in the following parts of this forum, since it is primarily devoted to a review of the role of courts and judges in the insolvency process.
- The second concerns the **administration of liquidation cases**. Very few countries have established or provided sufficient resources to a public office to handle cases of enterprise liquidation. It should be recalled that regardless of the emphasis in many countries that is placed on and the encouragement given toward reorganisation processes, most enterprises that fail will be hopelessly insolvent and will be suited only to liquidation. That very large bulk requires a public office to administer them. The best examples in the region of this type of facility are in Singapore, Malaysia and Hong Kong, China. In other jurisdictions there are public offices but they have a considerable range of functions (such as execution of judgements and enforcement of orders for the sale of secured property). They are also staffed by officials who have very little experience or knowledge in the conduct of a liquidation of, for example, a corporation.
- The third involves **management of reorganisation cases**. Here the biggest problem is the lack (sometimes the complete absence) of trained and experienced private sector professionals to take a prominent role in various aspects of a reorganisation. These aspects include the financial and other analysis of a corporation that is in financial difficulty; the ongoing management of a corporation while it seeks to reorganise; the devising of a reorganisation plan; advising various stakeholder groups (particularly unsecured creditors) in a reorganisation; and being responsible for the implementation of a reorganisation plan. Most of these functions are important in a reorganisation. The chief problem in the region is the absence of qualified people to perform them.

No amount of revision and reform of the law will count for much in the face of an inability to apply the law through weaknesses in one or more of the above three vital areas. The reform of insolvency law creates change. It may result in an area that has been dormant and unused suddenly being revitalised and in demand. It may result in the introduction of new practices and processes. That requires knowledge, training and experience.

A symposium was recently convened in Vienna jointly by UNCITRAL, INSOL International and the International Bar Association. The principal purpose of the symposium was to assist UNCITRAL to frame the areas of insolvency law upon which it might be able to produce model legislative guidelines. Many of the delegates and representatives from developed, developing and transitional countries at the symposium applauded that endeavour but continually spoke of the need for training and experience to enable insolvency law regimes to work.

That is a message that cannot be ignored. International aid agencies, legislators and regulators must bear in mind the long term continual education and training needs of many countries in the Asian region in the area of insolvency law and practice.

PART 3 - DEVELOPMENTS IN INFORMAL INSOLVENCY PROCESSES

This appears to be the area in which there has been considerable positive and beneficial development. The ADB Insolvency Report regarded this area as possibly more encouraging than the attempts at insolvency law reform and the application of those reforms. It may be deserving of more encouragement because it avoids the use of courts and formal legal processes, it encourages the use of mediation and conciliation techniques and it may, overall, be more suited to the commercial and other culture of the region because it is principally non-confrontational.

Many of the informal processes were introduced into countries in the region through semi-official structured processes. These include the process known as the 'Jakarta Initiative' in Indonesia, the Corporate Debt Restructuring Advisory Committee ('CDRAC') in Thailand, the Financial Institution Agreement for the promotion of Company Restructuring in Korea and the Corporate Debt Restructuring Committee (together with the more formal and powerful organisation known as Danaharta) in Malaysia.

Those initiatives have had varied success and it is sometimes difficult to measure their real effect because of the degree of imposition (as distinct from purely voluntary submission) that might have been imposed and issues regarding the 'quality' of some of the cases of 'reorganisation' (many would appear to be cases of debt rescheduling or postponement rather than cases of reorganisation or restructuring). However, they certainly appear to have achieved more positive results than anything under formal legal insolvency processes.

However, the importance of these informal processes for the region may not necessarily be found in the numbers they have produced and processed or in the quality of the results. Their real significance may lie in the fact that they introduced into the region the basis of, the elements to apply and the skills that are necessary to conduct informal workouts. It is also relevant that the banking sectors of both Singapore and Hong Kong, China have recently promoted guidelines for the conduct of corporate workouts, unaffected by any semi-governmental organisation to give them effect.

This is an area that is likely to receive a considerable amount of attention and promotion from the private sector in the immediate future. INSOL International, through its Lenders Group, has recently published a 'Statement of Principles for A Global Approach to Multi-Creditor Workouts'. The principles are a statement of best practices in informal workouts. Also, the Asian Development Bank will soon commence a regional technical assistance that, amongst other important goals, will endeavour to capture the benefit of the recent and continuing experiences of countries in the region in this area. This may be most vital if the experiences are to be preserved as a legacy upon which to further develop the informal technique. Already, for example, CRDAC in Thailand has been disbanded and others of the structured initiatives may soon complete their work. What is necessary in the immediate future is for the work and experiences of those agencies to be gathered together, assessed and supplemented by training and education from the private sector interests.

A final important point that should be observed in relation to informal workout processes is that they depend very much on the strength of the formal insolvency law regime, particularly the liquidation process. That may not be quite so apparent in the Asian region since the structured informal processes of the region exhibited some element of quasi-official encouragement or persuasion that required both creditors and debtors to at least consider or contemplate the prospect of an informal work out. However, the success of a purely informal work out environment, such as those sponsored or encouraged by banking sectors, relies almost entirely on commercial good sense or on the fact that the debtor will be faced with the distinct prospect of liquidation unless the informal process is initiated and progressed. Once the structured informal processes disappear the region will be left with banking sector inspired informal processes. If they are to succeed a number of countries in the region will need to strengthen their respective insolvency laws.

PART 4 - THE RELATIONSHIP BETWEEN SECURED TRANSACTIONS AND INSOLVENCY LAW REGIMES

There are a number of issues in this area that present themselves for discussion. The main two issues concern the importance of a strong and effective secured transaction enforcement regime for insolvency law purposes and the interrelationship between secured transactions and insolvency in a formal rescue regime process.

Relevance of strong secured transactions enforcement regimes. In the same way that the availability of the remedy of liquidation can promote resort to rescue processes, so too can an effective secured transaction enforcement regime, for very much the same reasons. In the case of a threat of liquidation, a debtor corporation can initiate a formal rescue process. This will normally protect the creditor from liquidation proceeding because, upon the commencement of the rescue process, actions against a debtor will be stayed or suspended by application of the automatic stay provision. This would include a stay on the commencement or continuation of liquidation proceedings. In the case of the threat of security enforcement, a debtor corporation may, again, initiate a formal rescue process because it is likely that an automatic stay provision will normally have the effect of suspending security enforcement action against a debtor.

In both cases the result is the same – the debtor may be compelled to take steps to implement the formal rescue process or suffer the consequences. Both follow as a result of the effectiveness of, respectively, the insolvency law and the secured transaction enforcement law.

Another benefit of a strong and effective secured transaction enforcement regime concerns corporate governance standards. A corporation will only take a responsible attitude toward the debts that it incurs and their discharge if there are sanctions against irresponsible treatment of or a cavalier attitude to creditors. The certain prospect of enforcement action being taken in relation to secured debts provides a powerful incentive to act responsibly.

Interrelationship between secured transactions and rescue regimes. The use of a rescue process to shield an enterprise from security enforcement action raises, of course, a major area of tension between secured transactions law and insolvency law. Proponents of secured transaction regimes would prefer that there was no interference or delay in the right to enforce security rights. On the other hand, proponents of formal rescue laws would maintain that a rescue regime might be fatally flawed unless secured transactions enforcement processes are stayed and suspended under the automatic stay provisions of the rescue regime.

There is a clear need to frame an acceptable balance between these two extremes. In a large number of jurisdictions the balance is achieved by applying the stay to the enforcement of secured transactions, but:

- limiting the time period of the stay;
- affording a secured creditor the right to apply to a court for the lifting of the stay; and,
- requiring, in some cases, that continuing obligations under the security contract (for example, the payment or accrual of interest charges) must be maintained.

In relation to issues concerning the involvement of secured creditors in a reorganisation plan and its approval, these regimes also endeavour to provide some protection to secured creditors. Generally speaking, a secured creditor cannot be bound or adversely affected by a plan unless the creditor has consented or agreed to be bound.

Secured transaction and insolvency law regimes in the Asian region are, generally, weak regarding these types of issues. Some examples may illustrate this:

- First, secured transactions legal regimes are inadequate in many of the jurisdictions in the region. In a number of jurisdictions enforcement of secured transactions must be conducted through court and related judicial enforcement procedures (for example, India, Pakistan, Indonesia and Thailand). There is usually considerable delay. In some jurisdictions enforcement may prove to be impossible. As a result there is little threat to an insolvent debtor enterprise and a consequent disregard of corporate governance standards. Coupled to a weak or ineffective liquidation remedy there is very little creditor pressure that may be applied to encourage the initiation of a rescue process.
- Secondly, although a stay or suspension of secured transaction enforcement rights may be justified under a formal rescue process, there is very little reason to apply any such stay if the debtor is being liquidated. Yet, in some Asian jurisdictions, a stay applies to the enforcement rights of secured creditors and, in some cases, the powers of enforcement are given to the official/s that conduct the liquidation. In Indonesia there is a somewhat puzzling requirement that unless a secured creditor realises the security within 2 months of the commencement of a liquidation, the secured creditor becomes responsible for part of the costs of the liquidation. It is difficult to justify why some of the above requirements are necessary.
- Thirdly, in some jurisdictions, the effect of the commencement of insolvency proceedings on secured creditors is left vague or, even, not stated at all. This results in uncertainty. An insolvency law regime should contain a positive and clear statement of the effect of the commencement of the various insolvency processes upon secured creditors.

The need for integration between secured transaction and insolvency law regimes has been the subject of a special report by the Asian Development Bank (*The Need for an Integrated Approach to Secured Transactions and Insolvency Law Reforms* in Law and Policy Reform at the Asian Development Bank, 2000 Edition, Vol.1). Also relevant is the recently published report of the ADB, entitled *Secured Transactions Law Reform in Asia: Unleashing the potential of Collateral* in Law and Policy Reform at the Asian Development Bank, 2000 Edition, Vol. II.

PART 5 - THE TREATMENT OF CROSS-BORDER INSOLVENCY ISSUES

The region is an obvious target for cross-border insolvency co-operation. Slowly it is emerging from an attitude that largely dictated territoriality toward neighbouring states on such issues. It is refreshing that the new Civil Rehabilitation Law of Japan provides that a rehabilitation proceeding commenced in a foreign country shall be effective with respect to property situated in Japan and rehabilitation proceedings commenced in Japan (Article 4). In earlier laws an insolvency proceeding commenced abroad had no effect upon property situated in Japan. Chapter X of the new law also contains special provisions for dealing with corporate insolvency cases that are infected by cross-border issues. The measures that may be employed include co-operation, provision of information and mutual participation in proceedings.

A development such as that might provide the initiative for other countries in the region to rethink and reconsider their attitudes toward cross-border insolvency issues.

This year the Asian Development Bank will commence a regional technical assistance on *Promoting Regional Co-operation in the Development of Insolvency Law Reforms*. One of its aims is the development of co-operation and assistance in relation to cross-border insolvency. This part of the technical assistance will benefit from the assistance of UNCITRAL and INSOL International. A purpose of that initiative will be to promote and encourage the adoption of the UNCITRAL Model Law on cross-border insolvency in the region.

Finally another consequence of the Asian financial crisis should be considered in this context. This concerns the flight of funds and property of insolvent corporations out of jurisdictions and, consequently, out of the reach of creditors. This became evident in a number of countries when creditors commenced debt recovery and insolvency proceedings. Creditors looked on with dismay at the apparent inability and/or unwillingness to follow and retrieve property and prosecute those responsible for such a blatant

misuse of the privilege of incorporation. Laws relating to co-operation, recognition, assistance and relief in the context of insolvency may be effectively used to pursue and recover funds and property improperly removed from the jurisdiction. At present they do not really exist in the region.