

Promoting Regional Cooperation
in the

**Development of
Insolvency Law
Reforms**

Asian Development Bank

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Foreword

Since the Asian financial crisis in 1997, the Asian Development Bank (ADB) has been extensively involved in insolvency law reform in Asia.

Under a regional technical assistance project on Insolvency Law Reform (TA 5795), principles and guidelines were developed for insolvency law reforms. The technical assistance focused on a comparative review and evaluation of insolvency law regimes and practices in eleven countries, and then examined the issues in detail in five countries (Indonesia, Korea, Malaysia, Philippines, and Thailand). The studies were presented in various symposia, and significant discussions followed on issues arising from the intersection of corporate debt financing, secured transactions, and insolvency. Many of ADB's developing member countries have gone on to reform their insolvency laws taking into account the principles and guidelines developed under this project.

As a follow up to this earlier work on Insolvency Law Reform, ADB, through a regional technical assistance project for Promoting Regional Cooperation in the Development of Insolvency Law Reforms (TA 5975), invited attention to the wider goal of regional cooperation. It had three main focus areas: (i) development of sound insolvency frameworks for handling cross-border insolvencies; (ii) regional cooperation, especially in formal and informal workouts and restructurings; and (iii) the intersection of laws relating to secured transactions and insolvency. This technical assistance would not have been possible without the cooperation extended by Indonesia, Korea, Philippines, and Thailand. Their varying experiences, state of development, and diversity provided considerable information in relation to the three focus areas. A significant outcome of the technical assistance was the adoption by the members of the Asian Bankers Association of the Guidelines for Informal Workouts and endorsement of the Model Agreement to Promote Company Restructuring.

The reports of these two regional technical assistance projects are available at www.adb.org/law/insolvency.

Over the past few years, several countries have strengthened their laws and practices, particularly in relation to the rescue and rehabilitation of insolvent companies, by adopting both formal and informal workout mechanisms. However, more needs to be done in the area of regional cooperation on cross-border insolvencies. Enforcement of claims in cross-border insolvencies is still less than predictable, leading to loss of value for creditors and other stakeholders. To achieve the full potential of trade and investment in the region, and to maximize returns to all the stakeholders in cross-border insolvencies, developing countries need to work towards a regional arrangement to deal with the consequences of cross-border insolvencies. We hope that the outputs of TA 5975 will prove useful to local policy makers, bankers, and other stakeholders in finding a way forward on regional cooperation in this important area.

Lastly, I would like to thank my colleague Clare Wee who has steered both of ADB's regional technical assistance projects on insolvency. Thanks are also due to a number of staff in the Office of the General Counsel who have assisted in the administration of these projects, including Ramit Nagpal and Caryl Benito-Hilario.



Jeremy H. Hovland
General Counsel

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Draft B – A regional non-treaty arrangement using a basic principles approach

ANNEXURE B

Model Agreement to Promote Company Restructuring – Model adaptable for use:
regionally or by a country or for a particular debtor

ANNEXURE C

Diagrammatic representation of the operation of the Model Agreement
ABA Position Paper

Acknowledgments

Part One

1. Introduction

1.1 Areas of technical assistance

This Regional Technical Assistance (RETA) Report (Report) is published under the terms of reference of the Asian Development Bank (ADB) RETA 5975: Promoting Regional Cooperation in the Development of Insolvency Law Reforms.

Some introductory discussion may assist in understanding the aims of the technical assistance.

The origins of the technical assistance may be traced back to earlier regional technical assistance of ADB. That technical assistance involved a comparative review and evaluation of the insolvency law regimes and related practices of 11 Asian countries.¹

Although the main thrust of the earlier technical assistance was directed at insolvency laws and their application,² attention was also directed at three important related areas. These were cross-border insolvency, the intersection of insolvency and secured transactions legal regimes, and informal workouts. There was a positive view among the many participants in the earlier technical assistance that work in relation to those three areas should be taken further, largely because of the view that the areas were appropriate for and important to regional cooperation. The three areas may be briefly described as follows:

1.1.1 Cross-border insolvency

Cross-border insolvency is concerned with an insolvency case that has been commenced in one jurisdiction but which is relevant to more than one jurisdiction. The relevance will arise if, for example, there are assets, creditors, or business activities of the insolvent debtor located in another jurisdiction. In the absence of a law or legal process that enables the insolvency administration to be recognized in the other

jurisdiction, it may be difficult or impossible to ensure that the affairs of the debtor are dealt with as a whole and in a coordinated way. The essential regional focus in the area of cross-border insolvency is on either the promotion and development of appropriate enabling legislation in as many countries as possible, or the adoption of some other mechanism which will facilitate that coordination.

1.1.2 Informal workout practices

Formal insolvency processes are not the only way to deal with the financial problems of a debtor. Many creditors (particularly banks and other financial institutions) and other stakeholders will prefer, in certain circumstances, to have the opportunity of dealing with the financial difficulties of the debtor outside of formal processes. This is why such an approach is generally referred to as an "informal" process. The banking and finance sector has been responsible for the development and promotion of this technique, and the principles and methodology that support it are now widely accepted and practiced in many countries. Because of the significant growth in the global nature of lending and financing, it is highly desirable that informal workout techniques be promoted and developed on a regional and global basis, such that the principles and methodology become accepted and applied internationally. The focus in the area of informal workout practices is on the regional development of those practices.

1.1.3 Intersection between secured transactions and insolvency law regimes

In commercial law and practice, the areas of secured transactions and insolvency law are allied to one another. If both regimes are reasonably strong and effective, they combine to promote credit discipline and debt responsibility. If one or both are weak, much of that discipline is lost, resulting in an absence of a credible threat to encourage, provide the incentive, or impose the need for positive action by a debtor that is in financial difficulty. Moreover, such weaknesses act as a disincentive to lending and investment generally. Beyond these broad considerations, there are more particular considerations where one regime might intrude upon the other. This is particularly relevant when, for example, an attempt might be made to reorganize (or rescue) an insolvent debtor. To

¹ Asian Development Bank (1998), RETA 5975: Insolvency Law Reform.

² In respect of which recommendations were made for the adoption of a number of good practice standards.

provide the necessary environment for that to occur, it is generally considered appropriate to subject a secured creditor to a stay or suspension of the enforcement rights and powers of the secured creditor. Further, in relation to a rescue attempt, it will invariably be necessary to ensure that a debtor has access to continuing finance so that its business activities might be preserved and continued. This may require the creation of a special priority entitlement to repayment. That, in turn, raises issues concerning the priority of existing secured creditor rights. If common ground can be reached on these areas and countries develop a common approach to them, the Asian region may benefit from a relatively certain and predictable credit environment; and the extent of credit availability may be expanded as a result, through the lowering of borrowing costs.

1.2 Aims of the technical assistance

The aims of this technical assistance in relation to each of the three areas (divided into preparatory and final stages) are:

• Cross-border insolvency:

Preparatory stage: to provide a greater understanding and appreciation of the problems and the effects of cases of enterprise insolvency that involve more than one jurisdiction and to obtain an understanding of particular national and/or regional attitudes to possible solutions.

Final stage: to encourage governments throughout the region to adopt measures (including laws) that would assist in the efficient and fair administration of such cases.

• Informal workouts:

Preparatory stage: to develop an acceptable framework for the employment of out-of-court, informal techniques to deal with the financial difficulties of enterprises.

Final stage: to encourage, in particular, financial sectors throughout the region to adopt, promote, and employ a common framework.

• Intersection of insolvency and secured transactions legal regimes:

Preparatory stage: to identify areas in which it is important that there be compatibility between insolvency and secured transactions laws and practices.

Final stage: to encourage governments in the region to examine those areas in relation to their respective laws and to promote greater compatibility.

Each of the sections on the three areas that are the subject of this technical assistance concludes with suggested action plans for the implementation of reforms.

1.3 Justification for the aims

The broad justifications for the aims of the technical assistance may be summarized as follows:

1.3.1 Maximizing value

The maximization of value to creditors, shareholders, employees, and all parties affected by insolvency underpins the rationale for reform in relation to each of the three areas of the technical assistance.

In relation to cross-border insolvency, dealing with the affairs of an insolvent enterprise as a whole is sensible and maximizes the value of the insolvent company. This is, after all, the principal basis upon which domestic insolvency law regimes operate. If, therefore, the affairs of an insolvent enterprise involve or are relevant to more than one jurisdiction, dealing with those affairs as a whole, rather than individually and in fragments, is desirable. The division of the assets of a debtor on a territorial basis is arbitrary and is highly likely to result in discrimination among creditors. The inability to deal with the assets of a company as a whole, in most cases, will lead to a lower return to creditors. The reason for this is that the assets of a business are, more often than not, more valuable as a collective whole because of "added value" factors (or to put it another way, there is likely to be an erosion of value associated with the disintegration of those assets).

Take a company that is engaged in production and has outlets for that production in two or more countries. All other things being equal, the worth of the business of the company is likely to be greater as a whole because infrastructure development, start-up costs, and distribution network costs may be legitimately factored into determining what that business is worth. If this is correct in a "sale of business" scenario (an event

that may have to happen under a liquidation), it must be equally true when applied to a company reorganization because the ability of a company to reorganize will, to a large extent, depend on the worth of the business as a going concern. That worth will be a prime consideration in determining whether, for example, the company can be refinanced, whether security is available for existing or prospective financiers, or whether there is a sound basis for entertaining a proposed debt-for-equity swap or an injection of fresh capital and so forth.

In relation to the intersection of insolvency and secured transactions regimes, both regimes are ultimately concerned with the insolvency of a debtor and both are also concerned with maximizing the value of assets. It makes good sense to avoid, to the fullest possible extent, unnecessary conflict between the two regimes that might prevent or impede dealing with the affairs of an enterprise as a whole.

In relation to informal workouts, the principal reason for seeking an alternative means (a means other than through the formal processes provided by an insolvency law regime) of dealing with the affairs of an insolvent debtor, is to maximize the prospect of achieving an earlier, quicker, and better form of restructuring than might be possible under formal processes.

1.3.2 Economic and commercial benefit

This Report makes a case, in relation to each area, of the economic and commercial benefits. They are closely allied to the maximization of value analysis mentioned above.

For example, in relation to cross-border insolvency, the degree of predicability in relation to a legal and commercial system will determine the extent of any economic benefit that might flow from globalization. The ability to predict, with some reasonable degree of assurance, the likely outcome of an insolvency case, including ones with cross-border dimensions, aids the reaping of some positive benefits from globalization. Likewise, fiscal benefits (positive contributions to the domestic economy in the form of, for example, increased trade and commerce and increased capital flows) should follow from a predictable legal and commercial system (in particular, the ability of and the way in which such a system would respond to a case of insolvency, including, in particular, a case of cross-border insolvency that involved that trade and commerce and capital inflow).

In relation to the intersection of secured transactions and insolvency regimes, a transparent and predictable system in relation to secured transactions enables the cost, availability, and extent of secured finance lending to be properly assessed. The importance of secured financing emerges only when a debtor becomes insolvent. That is when the true test of transparency and predictability becomes real. If an insolvency regime wreaks havoc on transparency and predictability in relation to secured financing, then the cost and availability of such financing is likely to be affected severely. It follows that the two regimes should avoid conflict and minimize tensions.

In relation to informal workouts, the economic and commercial benefits are associated primarily with the ability to by-pass or avoid the formal process. The perceptions and experience of the financial sector indicate that factors such as relative speed, lessening of external resource costs (such as fees and costs associated with court proceedings and formal insolvency administrations), comparative privacy and confidentiality, and a possibly greater opportunity of effecting a long-term reorganization, although difficult to quantify or assess, all contribute to such benefits.

1.4 Particular issues that confront promotion of the aims

Despite the positive reasons for promotion of the aims, there are, in relation to each area, particular issues that appear to stand in the way of that promotion.

- **Sovereignty and reciprocity:** In relation to cross-border insolvency, the main areas of confrontation appear to be related to the issues of sovereignty and reciprocity. A consideration of those issues and the evident concern that is present in the region regarding them, suggest that the promotion of a cross-border insolvency law should be focused initially on the concept of bilateral arrangements between such of the countries in the region as are willing to make such arrangements with their neighbours. Once developed, the concept might, eventually, be extended to a multi-lateral or regional cross-border insolvency law or treaty.

- Differing policies and a lack of consultation:** In relation to the intersection of secured transactions and insolvency regimes, a major contributing factor to the absence of consistency and the presence of conflict is that insolvency law and secured transactions law are often governed by different policy considerations that are framed by different government departments without sufficient consultation or resolution between them.
- Weaknesses in the application of an insolvency and other enforcement laws:** It is relatively easy to seize upon this factor as a major issue concerning the development, in particular, of informal workout processes and cross-border insolvency laws. In relation to informal workouts, for example, the absence of reasonably effective debt, secured transaction, and insolvency enforcement laws results in a corresponding lack of persuasive backup to participate voluntarily in an attempt at an informal workout.

In relation to cross-border insolvency, it may be argued that if the insolvency regime of a jurisdiction is weak and ineffectual there will be difficulty regarding recognition, relief, and cooperation in cross-border cases.

It should not, however, be assumed that the cause of such problems and difficulties is simply the result of technical deficiencies in laws. There are far wider considerations of which account should be taken. They involve differences in the levels of economic and commercial development in countries in the region, as well as general governance issues associated with the conduct of the courts and the conduct of commercial business.

The level of legal and judicial development often correlates to the level of economic and commercial development, although the latter usually precedes the former (legal development is rarely anticipatory of economic and commercial development). Progress in economic development is usually in tandem with commercial development. It is that development that usually provides the spur for legal development.

These differences will often dictate whether a particular country or jurisdiction is able or ready to embrace legal development, especially of the type contemplated in this Report.

The other intruding factor is the general level of governance standards. If those standards are low it will often, for example, be the case that similar low standards regarding impartiality, objectivity, and corruption are experienced in the courts and in the wider commercial sector. That would also significantly affect legal development of the type contemplated by this Report.

These concerns underscore the need, in all three areas, for an adequate insolvency law and for the effective application and operation of the law. Although this technical assistance is not directed at insolvency laws in general,³ nor at levels of governance standards, this issue should not be overlooked by governments that might wish to implement the proposals put forward in this Report.

1.5 Summary of work undertaken to date

An Issues Paper⁴ on the technical assistance was published in August 2002. It identified and explained the three areas covered by the terms of reference and the principal issues arising in those three areas that required consideration and review.

Following the publication of the Issues Paper, a conference was held in October 2002 at the headquarters of ADB in Manila⁵ to discuss the issues.

The Manila conference was followed by reports⁶ from each of the four countries that are participating in the technical assistance.⁷ The purpose of these country reports was to examine and present in a comprehensive and systematic manner, the issues relevant to the three areas in light of the legal and commercial practices, and

³ RETA 5795 presents the desirable elements for a strong and effective insolvency law regime.

⁴ See Issues Paper, located on the technical assistance website <http://adb.org/law/insolvency> (the TA website).

⁵ See Manila Meeting Report, located on the TA website.

⁶ See the Country Reports for Cross-Border Insolvency, Intersection Between Secured Transactions and Insolvency Law Regimes and Informal Workouts, located on the TA website. The Country Reports reflect the position in each of the subject countries at the time of the drafting of each report.

⁷ The four countries are Indonesia, Korea, the Philippines, and Thailand.

the experience, of each jurisdiction. The country reports were, in turn, the subject of discussion at a conference held in Singapore in March 2003.⁸

The proposals presented in this Report are the culmination of that extensive consultative program and research. The matters raised in the Issues Paper have been fully canvassed and discussed. Some have been discarded as not relevant, others have been given greater attention and consideration, and some further issues have been added and considered.

In early 2004, INSOL India requested ADB and the international consultants to attend a conference entitled "Balancing Recovery, Restructuring and Liquidation—the Emerging Challenges in Asia" held in February 2004 to discuss the objectives of the RETA. The conference was attended by government and business representatives as well as insolvency professionals from throughout the Asian region. Copies of the then draft of the Interim Report were circulated at the conference.

In May 2004, the Asia-Pacific Economic Cooperation (APEC) Business Advisory Council (ABAC), Pacific Economic Cooperation Council (PECC), and Asian Bankers Association (ABA) invited ADB and international consultants to present on insolvency issues that may affect the development of a regional bond market in Asia, as well as to meet with ABA and PECC to discuss the promotion of the RETA recommendations.

Subsequent to ADB's participation at the APEC Conference, two groups (ABAC and ABA) informally indicated to ADB the desire to collaborate to promote the recommendations in this Report.

First, ABAC has promoted the recommendations in this Report. ABAC raised the RETA recommendations as key areas for reform at the APEC Finance Ministers' meeting held in September 2004. As a continuation of the work of promoting the RETA, and adoption of recommendations by groups such as APEC, ADB has participated at a number of follow-up ABAC, PECC, and APEC meetings. The first meeting attended by the consultants and ADB was the 2nd Meeting of the Advisory Group on APEC Financial System Capacity Building held

in Auckland, New Zealand, on 19 August 2004. (A paper on institutional capacity building was given at that conference.) Subsequent to this meeting, the consultants and ADB have participated in a number of conferences and meetings concerning capacity building, regulatory reform, and the development of a regional bond market.

Second, the ABA wishes to consider adoption of the RETA's Principles on Informal Workouts by way of a protocol to which its member banks agree to be bound. ADB and international consultants attended the ABA's 21st General Meeting and Seminar in Hanoi, Viet Nam, on 4–5 November 2004. The consultants have produced for the ABA a model standstill agreement, which will be considered by its members in 2005.

In conjunction with the ABA, a number of consultation meetings with ABA member banks were held throughout the region in 2005 to discuss the draft model agreement to promote company restructuring. As a result of feedback at those meetings, the consultants developed a set of guidelines for informal workouts and further refined the model agreement.

The ABA, at its 22nd General Meeting and Seminar held on 17–18 October 2005 in Melbourne, Australia, formally adopted a set of guidelines for informal workouts and endorsed a Model Agreement for Company Restructuring (Model Agreement) for use by financial institutions throughout the region.

In adopting the guidelines and endorsing the template agreement, the ABA has stated that it is seeking to address the absence of an international approach to informal workouts in the Asia-Pacific region, which poses a major obstacle to the expansion of investment within the region.

During the same meeting, the ABA also released two position papers. One is entitled "Providing the Legal and Policy Environment to Support Effective Informal Workout Regimes in the Asia-Pacific Region." This contains recommendations that complement the adoption by the ABA of the guidelines for informal workouts and its endorsement of a template agreement for company restructuring. The ABA proposed five measures: (i) adoption of a fast-track formal workout regime; (ii) enactment of legislation providing for creditors' voluntary liquidation or voluntary administration; (iii) promotion of a regional center or centers for the

⁸ See the papers presented at the Singapore Conference, located on the TA website.

resolution by arbitration of cross-border disputes; (iv) strengthening of cross-border cooperation and assistance in insolvency cases; and (v) the undertaking of measures to enhance institutional capacity. The other position paper is entitled "Providing a Legislative Environment to Facilitate the Effective Operation of Guidelines to Promote Informal Workouts." This contains a recommendation that the ABA adopt the guidelines for informal workouts and endorse the Model Agreement.

Annexure B to this Report is a draft Model Agreement to Promote Company Restructuring, which embodies the informal workout principles advocated in this Report. **Annexure C** contains a diagrammatic representation of the operation of that Agreement and the ABA Position Paper on adoption of the Model Agreement.

Part Two

2. Executive summaries

2.1 Executive summary in the area of cross-border insolvency

- Adoption of a multi-lateral regional arrangement, perhaps a treaty (or similar) would appear, at least in the interim, to offer the most appropriate and expeditious basis upon which to promote recognition and assistance in respect of cases of cross-border insolvency.
- The benefits of this approach are that it:
 - addresses, to a large degree, concerns regarding issues of sovereignty and reciprocity;
 - would benefit the region and advance the economic interests of the member countries of, for example, the Association of Southeast Asian Nations (ASEAN); and
 - leaves it open for a jurisdiction to also enact unilateral cross-border recognition and assistance law (on the basis that any such unilateral enactment would apply in respect of cases not covered by the treaty, for example, cases of cross-border insolvency that arise in a jurisdiction that is not a party to the regional arrangement).
- Two alternative approaches have been suggested (drafts of different documents have been prepared to illustrate the alternative approaches).
- Both alternative approaches contemplate a basis upon which to promote a gradualist approach toward a treaty.
- One approach contemplates an expression of willingness on the part of governments to cooperate with one another in relation to matters of cross-border insolvency. This could take the form of an expression of intention, a non-treaty "agreement" (politically, but

non-legally binding), or a legally binding treaty.

- The other approach contemplates an agreed statement by involved countries of the minimum requirements that might be necessary if they sought to facilitate recognition of cross-border insolvency cases. That would be a first important step toward a later inter-governmental arrangement.
- Factors that would need to be addressed in either case include:
 - formalities for commencement of recognition proceedings (because of the urgency that is often required, little formality should be necessary, provided that suitable evidence of the opening of a foreign proceeding is provided);
 - proceedings covering both in-ound and outbound proceedings (a cross-border law should enable applications to be made from, as well as to, the jurisdiction);
 - accommodation of different types of insolvency processes (in particular, it may be desirable for proceedings to be able to be taken in respect of both formal and informal insolvency procedures);
 - nomination of relevant courts (as examples, relevant courts of Indonesia, Korea, the Philippines, and Thailand [**the Selected Countries**] are identified);
 - access to relevant courts (this primarily involves timing issues — applications for recognition require hearing and determination within a matter of days);
 - necessary evidence (this will differ according to the substantive law of the relevant jurisdiction);
 - effect of recognition (consideration is required of such matters as affect a corporate debtor, its constituent parts, and management and operation of business activities, as well as the effect on creditors and the exercise of their rights);

- cooperation between courts (this will involve communication between courts, language and interpretation difficulties, common understanding of concepts, practice and procedure issues, and use of protocols); and
- issues peculiar to the operation of overseas “branches” of an enterprise (a number of enterprises in the region operate in other jurisdictions through branches rather than subsidiaries).

2.2 Executive summary in the area of intersection between secured transactions and insolvency law regimes

A number of principles are proposed for endorsement and adoption in the region.

Principle 1:

An insolvency law may modify the rules relating to the creation of a secured transaction regarding the property of a debtor in respect of whom an insolvency case has been commenced or opened.

Such modification may take the form of, for example, prohibiting or limiting the power to create such an interest or invalidating any such creation unless it is done with the authority or sanction of a relevant authority (for example, a court, the creditors, or an insolvency representative).

It might also be necessary to subject such a prohibition or invalidation to an exception to protect an innocent third party.

Principle 2:

Clear rules regarding the creation of a secured property interest would benefit an insolvency representative because it would assist in determining whether a secured property interest had been validly created.

Principle 3:

In relation to property that is subject to a security, an insolvency law should clearly state the effect of the law (and any relevant insolvency process) regarding:

- *the property itself and, in particular, whether the property or a bundle of contractual rights in relation to the property is included in the estate of the insolvent debtor (including, where relevant, the treatment of the entitlement of a secured creditor to the fruits of secured property and after-acquired property);*
- *any restraints on enforcement to which a secured creditor might be subject; and*
- *dealings with the property, in particular who has the power of sale, when the power may be exercised and the manner in which the proceeds are to be treated.*

Principle 4:

A secured transaction should be subject to the possible application of the pre-bankruptcy transaction avoidance provisions of an insolvency law, in the same way as any other transaction.

Principle 5:

An insolvency law should provide for the participation of a secured creditor in an insolvency case, particularly a case of reorganization, including the following:

- *establishing a mechanism by which a secured creditor may be able to claim and then participate in the case as an unsecured creditor; and*
- *in a case of reorganization, enabling a secured creditor to participate in any decision-making process and, for that purpose, establishing a class of secured creditors, regulating their participation and the circumstances under which a secured creditor may be bound to a reorganization plan.*

Principle 6:

An insolvency law should provide for the possible requirement of post-commencement finance for an insolvent debtor, particularly in a case of company reorganization. If the provision of such finance would have an impact on existing secured property interests of secured creditors, the law must clearly state the conditions under

which such finance may be approved and provide for the preservation and protection of the economic and commercial interests of existing secured creditors.

Principle 7:

If an insolvency law provides that a secured creditor may be bound by a plan of reorganization, the law should provide conditions that ensure that the economic value of the secured creditor's rights are not impaired and should also permit a secured creditor to object to being bound unless such conditions are met.

Principle 8:

To assist in the efficient identification of secured property interests, a registration system for secured transactions is desirable.

Principle 9:

If registration is a requirement for the validity or perfection of a security interest in property, that system should be:

- *efficient as regards both registration and searching;*
- *centralized; and*
- *computerized.*

Principle 10:

If a secured transactions law provides for the registration of secured transactions, that law should provide for the avoidance of a non-registered secured transaction if an insolvency case is opened in respect of the debtor.

Principle 11:

An insolvency law may provide for a stay or suspension against enforcement action by a secured creditor in respect of the secured property. Such a stay should be limited in time, particularly in the case of the liquidation of the debtor, provide for limited exceptions to the stay, and permit a secured creditor to apply for the lifting of the stay in defined circumstances.

Principle 12:

An insolvency law may permit secured property to be used or otherwise dealt with during the administration of an insolvency case but such

use or dealing should be subject to the same terms and conditions that apply between the debtor and the secured creditor or otherwise under an arrangement that protects the interest of the secured creditor.

Principle 13:

An insolvency law should limit any claims of privilege or priority as they may affect secured creditors. Any such claims to which the proceeds of secured property are subject should be stated in a transparent and predictable way.

2.3 Executive summary in the area of informal workouts

- The importance, relevance and advantages of the development and employment of informal workout processes are well recognized and accepted. They should be promoted on a jurisdiction-by-jurisdiction and on a regional basis.
- The development and promotion required in the Asian region includes:
 - establishing an environment in which the banking and finance sector seeks to promote the reorganization of borrowers in financial difficulty positively;
 - promoting strong and effective insolvency and debt enforcement law regimes to provide one of the essential incentives for the employment of informal workout processes; and
 - encouraging regulatory authorities (for example, a central bank) or banking industry associations to promote standards (principles and rules) for the conduct of informal workout processes.

The following principles regarding informal workouts should be adopted and applied as banking and financial industry standards.

Principle 1:

All finance creditors (other than those whose exposure is negligible) should be eligible to participate in an informal workout process.

Principle 2:

An informal workout should only involve a debtor corporation when the circumstances are such that it appears possible to resolve any financial difficulties of the debtor and achieve long-term viability.

Principle 3:

A restructure should be based on a business plan that addresses operational as well as financial issues. A business plan should contain forecasts, prepared on documented and reasonable assumptions as to future events, which that the business of the debtor corporation can generate sufficient cash flow and profit to meet its obligations existing after the restructure.

Principle 4:

*Where a debtor is found to be in financial difficulties, all relevant creditors should be prepared to cooperate with each other and to give sufficient (though limited) time (**Standstill Period**) for information about the debtor to be obtained and evaluated and for proposals for resolving the debtor's financial difficulties to be formulated and assessed, unless such a course of action is inappropriate in a particular case. The length of such a Standstill Period should be limited to the time that is reasonably required to fulfill the above objectives.*

Principle 5:

During the Standstill Period, all relevant creditors should agree to refrain from taking any steps to enforce their claims or (otherwise than by disposal of their debt to a third party) to reduce their exposure to the debtor provided that during the Standstill Period their position relative to other creditors and each other will not be prejudiced.

Principle 6:

During the Standstill Period, the debtor should not take any action that might adversely affect the prospective return to relevant creditors (either collectively or individually) as compared with the position at the commencement of the Standstill Period.

Principle 7:

The interests of relevant creditors are best served by coordinating their response to a debtor in financial difficulty. Such coordination will be facilitated by the selection of one or more representative co-ordination committees and by

the appointment of professional advisers to advise and assist such committees, where appropriate, and the relevant creditors participating in the process as a whole.

Principle 8:

Creditors should agree to appoint one creditor (usually one of the creditors with the largest exposure to the debtor, or with particular expertise in managing workout negotiations) or an independent party to act as chairperson of the coordination committee, to lead negotiations with the debtor and to ensure the expeditious progress of the informal workout negotiations.

Principle 9:

Creditors participating in an informal workout should ensure that they take an active role by appointing an experienced and competent representative. That representative should ensure that appropriate levels of management within the creditor organization are informed of the progress of the workout at all important stages, and that the prospective and likely outcome of the workout is expected to be acceptable to the decision-makers within the creditor organization.

Principle 10:

During the Standstill Period, the debtor should provide, and allow relevant creditors and/or their professional advisers, reasonable and timely access to all relevant information relating to its assets, liabilities, business, and prospects, to enable proper evaluation to be made of its financial position and any proposals to be made to relevant creditors.

Principle 11:

The debtor should meet all reasonable costs of creditors while it is considering restructuring proposals. This would include the costs of professional advisers, and any costs necessarily incurred by the coordinating committee.

Principle 12:

Proposals for resolving the financial difficulties of the debtor and, so far as practicable, arrangements between relevant creditors relating to any Standstill Period should be based on relevant applicable law and the relative positions of relevant creditors at the commencement of the Standstill Period.

Principle 13:

Information concerning the assets, liabilities, business, and prospects of the debtor, and any proposals for resolving its difficulties, should be made available to all relevant creditors. Unless publicly available, such information should be treated as confidential, and only be used by creditors for the purpose of determining and ascertaining an informal workout proposal.

Principle 14:

If additional funding is provided during the Standstill Period or under any rescue or restructuring proposals, the repayment of such additional funding should, so far as practicable, be accorded priority status as compared to other indebtedness or claims of relevant creditors.

Principle 15

In endeavouring to determine disputes between creditors or between a debtor and its creditors, regard should be given to the possibility of referring such disputes, with the consent of those involved, to mediation.

Other recommendations

- The adoption of such principles and rules should be encouraged on a regional basis. The principles proposed for adoption are not governed by frontiers or boundaries, nor should particular domestic considerations interfere with them. The principles are universal in their nature and scope and may be applied in a multi-jurisdiction case.
- The development of expedited (or fast track) procedures under domestic insolvency laws to enable an out-of-court informal workout or reorganization plan to be speedily and efficiently converted to a formal reorganization plan should be encouraged.

Part Three

3. Case study—Asia Pulp & Paper Group

Many of the issues with which the technical assistance is concerned can be exemplified by reference to the continuing saga of the Asia Pulp & Paper Group.

For a description of that group and its activities, as well as its dealings with some of its creditors, reliance has been placed on:

- the judgment of Lai Siu Chiu J in *Deutsche Bank AG v Asia Pulp & Paper Company Limited*, delivered in the High Court of Singapore on 31 October 2002;
- the judgment of Tan Lee Meng J in *Deutsche Bank AG v Asia Pulp & Paper Company Limited* in the Singaporean Court of Appeal, delivered on 29 April 2003; and
- *Paper Tiger, Hidden Dragons* by Ed Matthew and Jan Willem van Gelder, published in 2001 by Friends of the Earth—England, Wales and Northern Ireland, London.

No further attribution is given to citations from those judgments. However, where material is extracted from *Paper Tiger, Hidden Dragons*, the reference is given.

The judgments were delivered in the course of an application for the appointment of a judicial manager to Asia Pulp & Paper Company Limited (AP&P), being the parent company in the Asia Pulp & Paper Group. Such appointments are regulated by s227A and s227B of the Singaporean *Companies Act* which read:

“227A Where a company or where a creditor or creditors of a company consider that:

- (a) the company is or will be unable to pay its debts; and
- (b) there is a reasonable probability of rehabilitating the company or of preserving all or part of its business as a going concern or that otherwise the interests of creditors would be better served than by resorting to a winding up,

an application may be made to the Court under section 227B for an order that the company should be placed under the judicial management of a judicial manager.”

“227B Where a company or its directors (pursuant to a resolution of its members or the board of directors) or a creditor or creditors (including any contingent or prospective creditor or creditors or all or any of those parties, together or separately), pursuant to section 227A, make an application by way of Petition, for an order that the company should be placed under the judicial management of a judicial manager, the Court may make a judicial management order in relation to the company if, and only if:

- (a) it is satisfied that the company is or will be unable to pay its debts; and
- (b) it considers that the making of the order would be likely to achieve one or more of the following purposes, namely:
 - (i) the survival of the company, or the whole or part of its undertaking as a going concern;
 - (ii) the approval under s210 of a compromise or arrangement between the company and any such persons as are mentioned in that section;
 - (iii) a more advantageous realisation of the company's assets would be effected than on a winding up.”

While the application was made in respect of AP&P alone, it was justified on the basis of:

“the belief that there was a reasonable possibility of rehabilitating the company and the APP group as a whole, of preserving its business as a going concern, by placing the company under judicial management instead of winding it up.”

As will be seen in more detail below, the "APP group as a whole" is a conglomerate comprised of many subsidiaries and operating in a number of jurisdictions. Be that as it may, it appears an assumption underpinned the application to the effect that if AP&P together with its Indonesian and Chinese subsidiaries could be brought under the control of a judicial manager, the essential commercial integrity of the "APP group as a whole" could be maintained.

AP&P is a public company which was incorporated in Singapore on 12 October 1994. Through its subsidiaries, it operates mills (in Indonesia and the People's Republic of China [PRC]), which manufacture the group's products. The group is one of the largest producers of paper in the world and is the largest in Asia, outside Japan. AP&P has under its umbrella more than 150 companies incorporated in PRC, Indonesia, Malaysia, Mauritius, Singapore, and the United States. The company derives its income (in part) from the management fees it charges its operating subsidiaries.

In *Paper Tiger, Hidden Dragons*, one further aspect of the structure of AP&P Group is described in these terms (at p. 38):

"Aggravating the situation [so far as concerned AP&P] is the fact that virtually all of APP's capital expenditure in China had been funded through the holding company. Profits, on the other hand, are derived from operating subsidiaries, mainly Indonesian-listed vehicles Indah Kiat and Tjiwi Kimia, and these companies are legally constrained from upstreaming enough dividends to pay down the debt coming due for the parent."

In Indonesia, AP&P has a holding company called PT Purinusa Ekapesada (**Purinusa**) which has four major Indonesian subsidiaries—PT Indah Kiat (**Indah Kiat**), PT Pabrik Kertas Tjiwi Kimia Tbk (**Tjiwi Kimia**), PT Pindo Deli Pulp & Paper Mills (**Pindo Deli**), and PT Lontar Papyrus Pulp & Paper Industry (**PT Lontar Papyrus**). Indah Kiat and Tjiwi Kimia are quoted on the stock exchanges of Surabaya and Jakarta, respectively. Purinusa, however, does not own any timber concessions or subsidiaries that supply the wood to those four subsidiaries. The timber concessions in Sumatra and Riau Island instead belong essentially to two companies; PT Arara Abadi (**Abadi**) and PT Wirakarya Sakti (**Sakti**).

AP&P and its subsidiaries are part of a larger group of companies known as the **Sinar Mas** group, which is one of Indonesia's largest conglomerates, controlled by the Widjaja family. Abadi and Sakti (**wood companies**) belong to the Sinar Mas group but are not subsidiaries of AP&P.

Although it is a public company, AP&P is not listed on Singapore's stock exchange (SGX). However, it does have one subsidiary,

Nippercraft Limited, which is listed on the SGX; and it has 15 other Singapore-incorporated subsidiaries. AP&P's American Depository Shares (ADS) were listed on the New York Stock Exchange until about 10 August 2001, when the shares were delisted after the price fell for 30 consecutive days below the minimum of US\$1.00 required by the exchange. Trading in the ADS had been suspended since 4 April 2001.

On 12 March 2001, AP&P issued a press release through its Chief Financial Officer, Hendrik Tee, announcing a debt repayment standstill. Among other things, the announcement said:

"On the advice of our financial advisors, Credit Suisse First Boston (CSFB), we intend to immediately cease payment of interest and principal on all holding company debt and on debt issued by our subsidiaries and affiliates, the obligations of which are funded by such subsidiaries. In order to allow our operating subsidiaries to continue normal operation, we will be giving priority to servicing our suppliers and trade creditors.

"... we believe it is in the best long-term interest of the Company and its creditors and we plan to seek a consensual arrangement with our creditors. We understand that a number of our creditors have initiated efforts to organize themselves globally and also separately for the China operations. We welcome these efforts. We intend to discuss the standstill and the way forward separately with each of our China operating entities and non-China creditor groups. Appropriate approaches will need to be developed for the various creditor groups based upon the particulars of their respective situations. The Company and its financial advisor will be meeting with creditor representatives to discuss the restructuring process and means for conveying information to creditors."

Creditors of AP&P, including the applicants to the High Court of Singapore for the appointment of a judicial manager, complained of its unilateral declaration of a debt standstill. Indeed, the press release was one of the reasons given for the application. Her Honour Justice Lai in her judgment noted that AP&P then had the dubious privilege of being the largest debtor (of about US\$13.9 billion) in the emerging markets, as well as being the biggest debt defaulter in Asia.

In addition to the unilateral declaration of the standstill on payments, another basis upon which the application was made were the delays in the formulation of the restructuring proposal. The applicants for the appointment of a judicial manager said that, although the press release indicated that AP&P would draw up a debt restructuring proposal within one month of the announcement, the deadline was not met. Indeed, they complained that, as at the date of the application (23 June 2003), AP&P had failed to advance a proposal which merited serious consideration by the company's creditors—the company's debt restructuring plan dated 1 February 2002 had been rejected outright, and the creditors' counter-proposals dated 2 May 2002 were not accepted by AP&P save for four items. Beyond that, there was not even agreement between AP&P and its creditors on the basic principles of restructuring. AP&P denied these claims saying that, over and above the appointment of professional and legal advisers, 24 or more meetings had taken place with creditors up to 8 May 2002, starting with one on 6 March 2001, which was before the press release announcing the standstill.

It was not necessary for the Court to resolve these disputed claims. However, it is interesting to note the following observation of the Court on the impact of the application to appoint judicial managers:

"I would add that [the] perception of APP's more vigorous approach to restructuring since the filing of the Petition, was corroborated by none other than one of the Petitioners [which had been complaining of a lack of activity]. In his third affidavit filed for [Deutsche Bank] Topp stated (in paras 4 and 5):

'In the six weeks since the Petition was filed, the following events have taken place:

- (i) the long-awaited KPMG Phase 1 due diligence report (**the KPMG report**) on the company and its subsidiaries has been released (a copy of which is annexed hereto and marked as **WHT-9**);
- (ii) the company had apparently committed to finalising a restructuring plan (of the Indonesian operations) by September 30, 2002 and that **IBRA** [Indonesian Bank

Restructuring Agency] has agreed to take leading role in the process;

- (iii) the company has apparently agreed to opening an escrow account(s) to set aside cash for the benefit of the creditors and to make regular contributions to the account(s), but the 'details are being worked out' and the company is still haggling about the amount; and
- (iv) the company has apparently agreed to augmentation of management, but again the details are being worked out.'

The Petitioners are gratified at these developments, but suspect that the company's newly stated willingness to accede (partially) to creditors' requests is due, the Petitioners' believe to some extent at least to their attempt to resist the appointment of judicial managers."

Whatever the level of cooperation between AP&P and its creditors may have been, when it came to the formulation of an overall strategy for the restructuring of AP&P Group, the Group continued to need the support of its creditors, as in April 2001:

"APP asked its creditors for additional working capital of US\$200 million for its Indonesian operating subsidiaries 'to stabilize our operations.' The request irked creditors: 'That's a bit much to ask and nobody in that room is going to give them that money' said one banker who attended the meeting, according to Reuters. There's no sense of urgency and no plan in place."

While it may be that the application to appoint judicial managers encouraged AP&P Group to pursue its restructuring proposal with more vigor, it is also the case that those associated with the Group were prepared to threaten use of their commercial influence to promote their own position. The applicants accused AP&P of using veiled threats to garner support from creditors to oppose the application. Support for that accusation was said to be found in a memorandum dated 26 June 2002 from one of AP&P's legal advisors which contained the following paragraphs:

"Attached to this memorandum is a form of support letter which APP expects to receive

from each entity or person participating in the Umbrella Steering Committee. APP asks that you send this memorandum and the form of support letter to those committee members whom you represent and ask that a support letter, in the suggested format, be delivered as soon as possible and, in any event, by no later than July 5, 2002. APP asks for your assistance in ensuring that committee members whom you represent be made aware of the contents of this memorandum, and the request that support letters be issued, as a matter of urgency.

Please note that APP is of the view that the judicial management Petition is not consistent with the consensual restructuring, out-of-court restructuring concept which has been under discussion between APP and the Umbrella Steering Committee for more than one year. The fact that one of the Petitioners is an Umbrella Steering Committee member is also a cause of concern. In the circumstances, APP expects those committee members which support the consensual restructuring concept to issue the requested letter, thereby providing tangible evidence of its support for the consensual process. The refusal or other failure by an Umbrella Steering Committee member to issue a support letter will be viewed by APP as indicating that such member does not support the consensual, out-of-court restructuring process. Should it transpire that a material number of committee members fail to issue a support letter, APP is of the view that may be material adverse consequences for the consensual debt restructuring process."

As Justice Lai noted, this was "a threat by AP&P and not a subtle one at that."

The applicants for the appointment of judicial managers alleged that creditors had appointed KPMG to conduct an independent audit of the AP&P Group. However, KPMG's progress had been hampered by AP&P's unwillingness to give the accountants access to information relating to the company's operations in PRC, inter-company debt analysis, interrelated company transactions, and accounts receivable. Consequently, KPMG missed the deadline of July 2001 for the submission of their report, as well as the revised deadlines of January and April 2002. Without the report of KPMG, it was claimed that the

creditors had not been able to assess the viability of the debt restructuring proposals put forward by AP&P Group.

This was also denied by AP&P Group which said:

"The group had spent considerable time working with KPMG in reviewing the group's financial positions for its Indonesian operations. Contrary to the Petitioners' claims, the company had not been uncooperative with KPMG. In fact, it had given easy access to all documentation, made staff/accounting staff available to answer queries and, assigned in excess of 100 staff to work with the accountants....A data room [had been created] for the benefit of KPMG and creditors....The Petitioners' claim that the company deliberately wanted to delay the release of KPMG's report [was rejected as unfounded]. Indeed, the creditors' steering committee was at fault in not monitoring the activities of KPMG and, because KPMG had to respond to a variety of creditor demands from within the creditors' steering committee, the scope of the accountants' audit had expanded beyond that of a due diligence report, resulting in considerable delay. Further, there was a genuine dispute on the fees chargeable by KPMG (which was however resolved subsequently) which delayed the issuance of their report. I should point out that phase 1 of KPMG's report was finally released on 26 July 2002 (after the first part hearing)."

Notwithstanding the allegations surrounding the audit by KPMG, at the time of the hearing of the application to appoint judicial managers, the court had before it a report from that firm. In commenting on that report, the Judge said:

"It would be fair to say that some findings in the KPMG report were a cause for concern."

As described by the Judge, those findings included:

- "(a) Questions had arisen surrounding a purchase of a huge tract of land (1,759 hectares) for US \$170m by APP's subsidiary Pindo Deli from a Sinar Mas company. In actual fact, the KPMG report stated that Pindo Deli as well as PT Lontar Papyrus had paid US \$181.6m (of which US \$110.5m was in cash) to the controlling

shareholders to purchase additional land (between January and September 2001), at a time when both subsidiaries were facing a cash crunch. Further, Pindo Deli already owned about 495 hectares of land of which only about 30% had been developed. There was therefore no reason to, nor had APP provided any plan which necessitated, acquiring such a large piece of land. Further, APP did not disclose the purchase until August 2001, after the debt standstill.

- (b) Yet another transaction which caused disquiet were the advances totalling US \$504m [from AP&P's Indonesian subsidiaries] to the wood companies, made mainly in the fourth quarter of 2000.
- (c) Other transactions which made no commercial sense and which were clearly disadvantageous to APP's subsidiaries were, fresh pulpwood purchase agreements entered into in January 2001 by Indah Kiat with Abadi and by PT Lontar Papyrus with Sakti, even though the original agreements made on 23 May 1994 and 27 January 1995 respectively between the parties, were valid for 15 years. The onerous terms in Indah Kiat's agreement included being charged for wood at agreed prices, instead of the pricing being pegged to the actual cost of production. Further, Indah Kiat could not offset the advances it had made to Abadi, against the price of wood supplied by the latter. Far worse, both agreements provided for a penalty of US \$1 billion and waiver of all outstanding balances, if either Indah Kiat or PT Lontar Papyrus obtained wood from sources other than Abadi and Sakti, respectively.
- (d) One other questionable transaction was the debts of US \$1 billion owed to the company's Indonesian subsidiaries by the five BVI [British Virgin Islands] companies. Although the company told the *Asian Wall Street Journal* that the 5 BVI companies were not related to APP, officers and agents of those companies which the journal spoke to, turned out to be APP employees.

The Indonesian subsidiaries filed 10 suits against the 5 BVI companies in the Jakarta Central Courts for claims in excess of US \$1 billion. In April 2002, Indah Kiat obtained judgments against a number of debtors for about US \$242m. However, five of the suits were discontinued

subsequently. What was even more disturbing was the company's response to these events, as can be seen from the following paragraphs in [its] affidavit [filed on its behalf]:

'315 The Indonesian Operating Subsidiaries chose to discontinue claims against five of the BVI companies because it was decided that, given the drain on management and manpower resources of the subsidiaries, it was better to focus our efforts on the more substantial claims.'

'316 There is simply no basis for the Petitioners to allege that these claims are not genuine transactions.'

Both explanations were highly unsatisfactory and were no answer to the creditors'/Petitioners' concerns which were well founded; the questionable nature of the 5 BVI companies and their apparent connection with the Widjaja family cried out for explanations which were not at all forthcoming. I found it hard to believe that the cost of manpower and other resources to be expended by APP were not commensurate with the huge sums to be recovered from the 5 BVI companies. What is even more puzzling was, why the company's subsidiaries chose to commence proceedings in the Jakarta courts instead of in the companies' place of incorporation. What is the use if the judgments obtained cannot be enforced in the British Virgin Islands and the monies thereunder recovered? Obtaining paper judgments without more, is not enough.

- (e) Other questionable transactions included APP's selective payments to creditors in Indonesia and China after the debt standstill."

In addition to the payments made to creditors in Indonesia:

"On 5 February 2001 [the month before AP&P announced the debt standstill], the Indonesian Bank Restructuring Agency (IBRA) struck a new deal with the Sinar Mas Group on loans totalling US \$1.3 billion which the Group owed to its former subsidiary, Bank International Indonesia." (BII) (*Paper Tiger, Hidden Dragons*, p. 40)

and

"On 2 May 2001, APP clarified the settlement reached between the IBRA and the shareholders of the Sinar Mas Group regarding the debt of US \$1.3 billion owed by the Sinar Mas Group to Bank International Indonesia. APP's principal subsidiaries in Indonesia each granted liens on all of their fixed assets (land, buildings and machinery), other than those fixed assets on which liens had been previously granted, to IBRA to secure the government guarantee in respect of the BII obligations. APP also granted liens on the shares of its Indonesian subsidiaries. For international creditors this means it has become much more difficult now to seize shares in those Indonesian assets as part of any legal settlement.

The Sinar Mas Group also has pledged stakes in Sinar Mas-controlled holding companies that hold majority stakes in Abadi and Sakti; [being the wood companies] These two timber firms supply wood to APP's major operating companies PT Indah Kiat Pulp and Paper and PT Lontar Papyrus, but are not part of the APP Group itself. Through the subholding companies, the government gets 96% of Arara and 80% of Wirakarya. But ... as part of the settlement, APP-subsiary Purinusa Ekapersada has agreed to acquire 51% of the shares of Bank Internasional Ningbo, a Chinese bank previously majority-owned by BII." (*Paper Tiger, Hidden Dragons*, pp. 44-45.)

In June 2002, IBRA came to an agreement with some other creditors of AP&P Group, one stipulation of which was to the effect that:

"... IBRA shall share the benefits of all fiduciary transfers, security rights, pledges and guarantees that IBRA may have or may have the right to have, under the Settlement Agreement (collectively called 'the Security') with the other unaffiliated creditors of the APP group. In sharing such benefits, IBRA may retain the Security, but may enforce such security only for the benefit of creditors generally as shall be provided under the restructuring plan."

Without traversing the allegations made in the KPMG report, the bases upon which AP&P Group resisted the application to appoint a judicial manager were principally that:

- creditors whose support was critical to the success of any undertaking by a judicial manager were opposed to the appointment; and
- judicial managers would not be able to take effective control of AP&P Group.

In essence, it was these two issues which determined the fate of the application as the Judge found:

"Counsel for the Petitioners had repeatedly stressed that, the judicial managers to be appointed fully intended to work in tandem with IBRA and with the Chinese creditors to rehabilitate APP and to better realise its assets, that the appointees would not adopt a confrontational attitude. That may well be the noble intention but the more pertinent question to ask is, would IBRA and the Chinese creditors want to work/co-operate with the judicial managers? I think not, judging from the indications given so far by both IBRA and by the Chinese creditor banks.... Without the co-operation of IBRA and the [Chinese creditor banks], the judicial managers would not be able to make any headway in the discharge of their duties outside Singapore. It bears remembering that apart from being headquartered in Singapore, APP has no or valuable assets here; its subsidiary Nippercraft Limited cannot be considered as it is a public listed company while no information was forthcoming from either party on the company's other Singapore subsidiaries. I noted further that the Petitioners' claims (and the debt instruments of other creditors whether supporting or opposing) did not provide for Singapore as the forum conveniens. The transgressions complained of by the Petitioners took place outside Singapore.

Counsel had indicated that the Petitioners intended to assume control of the APP's Indonesian and Chinese subsidiaries by exercising the company's rights as a shareholder in the subsidiaries. With respect, I am not at all optimistic that the task can be so easily achieved by such a route. That may well be the case under our system of law but may not be so under Chinese and Indonesian law, given the anticipated opposition from creditors of those subsidiaries to the judicial management order in the first place, as well

as the conflict in opinions from the parties' Indonesian and Chinese legal advisers [as to whether the courts and administrative authorities in those countries would recognize the judgment of the Singaporean court and the appointment of the judicial management]."

By way of post script, *The Jakarta Post* on 30 March 2004 reported as follows:

"APP seeks support for restructuring plan Dadan Wijaksana, The Jakarta Post, Jakarta

Asia Pulp & Paper Co. (APP), the world's leading pulp and paper producer, said on Monday it would not be able to obtain enough support from creditors for a debt work-out scheme by the March 31 deadline.

The company is now seeking creditors' consent to extend the deadline to May 30, according to G. Sulisty, deputy chairman of the APP's debt restructuring team.

In October last year, APP signed an initial restructuring agreement for its huge US \$6.7 billion debts with a number of creditors, including the largest one -- the Indonesian Bank Restructuring Agency (IBRA) -- with about \$1 billion owed.

The Master of Restructuring Agreement (MRA) stipulates that creditors who hold at least 90 percent of the debts have to give approval to the deal before it becomes effective. The deadline to obtain this approval is the end of this month.

'By then (May 30), we're optimistic we'll be able to secure the required approvals,' Sulisty told *The Jakarta Post* on Monday.

He claimed that most creditors had in principle showed no objections to the plan. 'But the problem is, it requires a lot of legal and administrative work, which is not only difficult, but also time consuming,' he said, adding that the creditors who had yet to give their approval to the deal were mostly US-based.

He did not elaborate on what the consequences would be if the extended deadline was not met.

The debt workout plan was initially signed by only 40 percent of the creditors.

Three years ago, the Singapore-based APP defaulted on its \$13.9 billion of debts, and restructuring talks have been under way ever since.

The MRA's signing was part of those restructuring efforts, but only covers debts owed by APP's four Indonesian units: PT Indah Kiat Pulp & Paper, PT Tjiwi Kimia, PT Pindodeli Pulp & Paper and PT Lontar Papyrus Pulp & Paper Industries.

Despite the signing, however, it is doubtful that APP can obtain enough support from creditors as many have previously objected to the deal - which they claim is in favour of the company's founder, the Widjaja family, rather than the creditors.

Critics point out, for instance, that the Widjaja family will continue to run the daily operations of the four firms, while the payment of the first tranche of the debts - amounting to \$1.2 billion - would only be payable after 10 years."

Use of the case study

References to the AP&P case are made throughout the remainder of the Report, principally to illustrate deficiencies and difficulties that the technical assistance seeks to overcome.

Part Four

4. Cross-border insolvency

4.1 Introduction

The aspect of the technical assistance which is concerned with cross-border insolvency regimes necessarily raises for consideration the threshold issue of: to what extent is a jurisdiction prepared to adopt laws which are interactive with, and supportive of, the laws of other countries?

That is the case because, in their essence, such regimes are concerned with the establishment of a mechanism under which the courts and other institutions of a jurisdiction will recognize and, perhaps, support the conduct of an insolvency administration which was first initiated in another jurisdiction but which impacts to some degree upon the first jurisdiction. The degree of impact might be slight in that it is reflected simply by the circumstance that the debtor owns an asset which is physically located in the second jurisdiction. Alternatively, the debtor might own and operate, say, a substantial manufacturing operation in the second jurisdiction.

In either circumstance, the creditors of the debtor (some of whom, certainly in the example of the substantial manufacturing operation, may be residents of the second jurisdiction) will be interested to ensure the effective and equitable administration of all of the debtor's assets.

AP&P case study relevance

Using the example of AP&P Group its parent company was incorporated in Singapore. Its principal operating subsidiaries were incorporated in Indonesia (which produced wood pulp and paper) and the PRC (which manufactured paper using wood pulp sourced from their related companies in Indonesia).

So there was a degree of operational interdependence between companies in the Group. There were also subsidiaries of AP&P in other jurisdictions, including Malaysia (which also supplied wood pulp to other companies in the Group) and India (which produced paper). The capacity of AP&P to service its obligations (which included not only its borrowings as a principal, but also its liabilities corporation as a guarantor) depended on service fees paid by its subsidiaries as well as interest in their net equity (if any).

While AP&P Group provides a contrary example, it appears that a number of multinational corporations in each of the Selected Countries of Indonesia, Korea, the Philippines, and Thailand operate by way of a branch rather than subsidiary. Therefore any cross-border insolvency law regime may also need to deal with the issues particular to the operation of branches.⁹

The premise of the technical assistance is that it would be beneficial for countries in the Asian region to adopt a regime which also facilitated the recognition, within their respective jurisdictions, of insolvency administrations which were initiated in other jurisdictions. However, the technical assistance is not intended to be prescriptive as to the structure of that regime. Rather, it will identify policy objections and other impediments to the adoption of such a regime for the purpose of suggesting countervailing considerations. It will also seek to identify reasons of policy which might militate in favor of their adoption. Beyond that, some different models for such regimes will be identified. These models recognize that concerns raised by some policy objections or other impediments to the adoption of such a regime may be ameliorated, if not resolved, by a particular approach to recognizing insolvency administrations initiated in another jurisdiction.

It might be noted that shortly prior to the commencement of the technical assistance, or since its inception, each of Korea¹⁰ and the

⁹ See generally the Country Report for Cross-Border Insolvency for each of the Selected Countries at Sections D, E, F, and G, located on the TA website. The Country Reports reflect the law of each of the respective countries that are the subject of the Country Reports as at the date of the relevant report.

¹⁰ See the Country Report for Cross-Border Insolvency for Korea at Section Q and also at Sections B1 and B2. Refer also to the Summary of the Korean Government's Proposed Bill for the Unified Insolvency Act (which has been enacted subsequently), located on the TA website.

Philippines¹¹ began debating the introduction of laws that will facilitate the recognition of cross-border insolvency regimes in those countries. Accordingly, some of the observations made below are not applicable to those Selected Countries. However, the legislative models that each of those countries has proposed inform the discussion as to options available to countries in the Asian region.

4.2 Recognizing cross-border Insolvencies

4.2.1 General factors for and against reform

In one commentary¹² on a proposal for the adoption of a law that facilitates the recognition of cross-border insolvencies, the following factors were identified as relevant to the debate concerning the proposal:

Factors in favor of reform

- the globalization trend (the requirement for a predictable commercial legal environment to meet the challenges presented by an increasingly borderless global economy);
- the fiscal factor (the fiscal consequences to the domestic economy and upon foreign creditors); and
- the efficiency and fairness factors (the desirability of finding pragmatic, yet just solutions to avoid unnecessary legal argument on the resolution of cross-border insolvency issues).

Factors against reform

- sovereignty (the unfettered ability of a nation to manage its domestic affairs, including the administration of the property of insolvent debtors and the regulation of the rights of that debtor's creditors); and

¹¹ See the Country Report for the Philippines at Section Q and at Sections B1 and B2. Refer also to the draft bill for the *Corporate Recovery Act* located on the TA website. The draft bill has not been enacted. It is still awaiting consideration by Congress.

¹² New Zealand Law Commission (1999), Report No. 52, *Cross-Border Insolvency: Should New Zealand adopt the UNCITRAL Model Law on Cross-Border Insolvency*, located on the TA website. See especially para. 67–111.

- the adequacy of existing law (determining whether or not the current regime of the domestic legal system is adequate, and therefore not in need of reform). This issue is not considered in the context of the technical assistance because, despite proposals for reform in Korea and the Philippines, at present none of the Selected Countries have cross-border insolvency laws.

These factors are equally relevant to a discussion of the adoption of cross-border insolvency law reform as part of this technical assistance. In addition, the arguments for and against the requirement of reciprocal recognition of insolvency administrations as a prerequisite to recognition are also considered.

4.3 The globalization trend

It is a fact of every day life that economies are becoming increasingly interdependent. From the mid-1980s (and in particular in the early 1990s), there has been a surge in private capital inflows from industrial to developing countries.¹³ That surge slowed during the Asian financial crisis.¹⁴

The work of ASEAN (including its promotion of an Asia Free Trade agreement) provides evidence of a regional example of the wider global trend. The foreign capital inflows and outflows prior to and following the Asian financial crisis demonstrate the positive and negative impact that globalization can have on economies. The world economy is not yet borderless, but it is inevitable that globalization will continue.

As a general proposition, it may be stated that trade and commerce benefit from the application of certain and predictable laws.¹⁵ If relevant laws and commercial practices are certain and predictable, then it is more likely that trade, commerce and foreign investment will be

¹³ See for example, International Monetary Fund (IMF) (2003), *Effects of Financial Globalization on Developing Countries: Some Empirical Evidence* at para. 31, located on the TA website.

¹⁴ Following the Asian financial crisis, the World Bank developed Principles and Guidelines for Effective Insolvency and Creditor Rights Systems, which can be found on the TA website.

¹⁵ This argument is developed by extension from the New Zealand Law Commission Report 52, Note 12 at para. 101, where it is stated: "Predictability of outcome on any given factual base is an important policy objective in commercial law."

encouraged and facilitated. If a jurisdiction's laws and commercial practices are unpredictable, foreign investors will either not invest at all or increase the cost of finance to reflect the greater risk that they face.

In its report entitled *Effects of Financial Globalization on Developing Countries: Some Empirical Evidence*,¹⁶ the International Monetary Fund (IMF) recorded that:

"Preliminary evidence also supports the view that in addition to sound macroeconomic policies, improved governance and institutions have an important impact upon a jurisdiction's ability to attract less volatile capital inflows and its vulnerability to crisis."

A sound system of insolvency law, including a fair and efficient regime for recognizing cross-border insolvencies, would form part of the improved governance of a jurisdiction.

The IMF investigated the correlation between the quality of various Asian countries' insolvency laws (including the four Selected Countries), and the depth and duration of the financial crisis experienced by each of them following the 1997 financial crisis. The 1999 report by the IMF entitled *Corporate Insolvency Procedures and Bank Behaviour: A Study of Selected Asian Economies*¹⁷ concluded that there was a correlation between the quality of a jurisdiction's insolvency laws and the depth and the duration of the economic recession which it experienced.

In 2003, the APEC commissioned a study on debt collection and litigation or arbitration in APEC economies. The consultants surveyed Japanese affiliated companies and also conducted field surveys. The study¹⁸ found that foreign investors are still hesitant to extend credit with security interests, and tend to rely on cash payment on delivery, because of the difficulties of acquisition and execution of

security interests. Thus, it can be concluded that lack of adequate insolvency laws has a direct impact on the provision of debt capital.

In the context of cross-border insolvency law reform, consideration must be given to whether local laws and institutions discriminate against foreign interests, and whether they are capable of adequately responding to claims by foreign creditors. An appropriate cross-border insolvency law should answer those concerns and issues, thus striking a balance between the recognized need for sovereign states to regulate economic activity within their territorial boundaries and the need to create a stable environment within which international trade and commerce, as well as foreign investment, can operate.

The country report for the Philippines stated:

"More than a few have expressed the view that one reason for the continuing reluctance of banks to lend is the unclear insolvency regime existing in the country at present...There have been reports that among the difficulties being encountered in the debt relief petition of Philippines Airlines, export credit agencies are not inclined to extend credit to Philippine countries for fear that recovery...may be difficult..."

¹⁶ IMF (2003), *Effects of Financial Globalization on Developing Countries: Some Empirical Evidence* at p. 5.

¹⁷ IMF (1999), *Corporate Insolvency Procedures and Bank Behaviour: A Study of Selected Asian Economies* at pp. 32–35, located on the TA website. See also New York Life Insurance presentation by Stanley Tai at the 2004 APEC Conference on issues in developing regional bond markets where it is stated that institutional investors perceive inadequate legal rights and overly cumbersome or unpredictable legal frameworks as a barrier to investment.

¹⁸ The study is located on the TA website.

AP&P case study relevance

Globalization is not only driven by corporate groups headquartered in either North America or Europe. AP&P Group is one example of, at least, an apparently substantial group of companies that had its headquarters in the Asian region with operations in a number of jurisdictions. Beyond that, it relied heavily on international equity and debt capital markets.

As to its equity capital, there was international participation in its shares through its ADS, which were listed on the New York Stock Exchange with the result that, other than members of the Widjaja family, its principal shareholders were from:

- PRC
- France
- Germany
- Indonesia
- Japan
- Netherlands
- Singapore
- Switzerland
- UK
- United States

AP&P Group also borrowed heavily from international financiers with the result that at the time that the Group announced its debt repayment standstill, its outstanding borrowings were from:

- PRC
- Hong Kong, China
- Indonesia
- Japan
- Singapore
- Taipei, China
- Thailand
- Europe
- North America
- South Africa
- Bahrain

These borrowings represented about 30% AP&P Group's total indebtedness.

Accordingly, at least so far as AP&P Group was concerned, foreign equity and debt investment had been crucial to its development.

4.4 The fiscal factor

The factors relevant to the exposure of a domestic economy to the fluctuations in the world economy include:

- the degree of dependence on international trade for income;
- the degree of foreign investment (debt and equity);
- comparisons between the level of international investment in the domestic economy and the level of investment by the domestic economy abroad;
- the extent to which registered banks are foreign-owned;
- the degree of foreign ownership in the domestic share market;
- the level of financial liabilities owed to nonresidents of the domestic economy;
- the ultimate destination of the domestic economy's exports; and
- whether or not exporters of the domestic economy can recover moneys owed for the sale of goods or supply of services when the entities with which they are trading overseas are placed into a formal insolvency regime.

Such factors have an impact on the ability of the relevant domestic economy to reduce transaction costs, promote trade, and increase capital flows, as well as to sell goods and provide services at competitive prices, thereby affecting the health of the domestic economy in an increasingly borderless global economy.

Each of the local consultants for the Selected Countries were asked a series of questions relating to the above factors, so as to provide an indication of the extent to which their domestic economies are influenced and affected by such factors.¹⁹

¹⁹ The questions and responses for each of the Selected Countries can be found at Part Four of the Country Report for Cross-Border Insolvency for each, located on the TA website. Also refer to the IMF article: *Effects of Financial Globalization on Developing Countries: Some Empirical Evidence*, which is also available on the TA website. The economic figures contained in this part of the Report

4.4.1 Indonesia

In 2002, international trade constituted 53.7% of Indonesia's gross national product,²⁰ indicating its high dependence on international trade for its income. In 2002, the leading export markets for Indonesia were the United States, Japan, Singapore, and PRC.²¹

The official data from Bank Indonesia²² does not reflect the then recent changes which had occurred in relation to ownership in the banking sector, which, though modest, do provide evidence of increasing foreign ownership of Indonesian banks. During 2002 and 2003, foreign investors acquired controlling assets in three major Indonesian banks, Bank Central Asia, Bank Danamon Indonesia, and Bank Niaga.

The level of foreign investment in Indonesia increased 143.9% in the first half of 2003.²³ However, in recent years there has been a significant capital outflow by foreign investors and Indonesian residents alike. In 2001, foreign direct investment declined by US\$1.45 billion, and in 2000 by US\$4.55 billion. While official figures are not available, the level of Indonesian investment abroad is believed to be substantially lower than the level of foreign investment in Indonesia.

In 2001, trading by foreign investors represented only 10.78% of total trading on the Jakarta Stock Exchange Secondary Market.²⁴ However, it has been suggested that this figure does not reflect the actual degree of foreign ownership because companies such as PT BAT Indonesia, PT Bayer Indonesia, PT Goodyear Indonesia, and PT Unilever Indonesia, are subsidiaries of foreign companies; and relatively small minority shareholdings are actually traded on the Jakarta Stock Exchange Secondary Market.

reflect the position at the time of the drafting of each of the Country Reports.

²⁰ ADB (2003), Key Indicators of Developing Asian and Pacific Countries.

²¹ Kota Keuangan dan Rancangan Anggaran Pendapatan dan Belanja Negara Tahun (2004), Chapter II at p. 9.

²² In the fourth quarter of 2000, joint venture banks constituted 4.5% of the total assets of banks operating in Indonesia. Foreign banks constituted 7.9% of total assets: Bank Indonesia, Quarterly Banking Report Q IV 2000.

²³ Kota Keuangan dan Rancangan Anggaran Pendapatan dan Belanja Negara Tahun (2004), Chapter II at p. 9.

²⁴ Annual Report of Capital Markets Supervisory Board (Bapepam) (2002).

4.4.2 Korea

The Korean economy is dependent on international trade for the bulk of its income. This is evidenced by the ratio of overseas trade volume to gross national income, which has been greater than 50% since 1997.²⁵ In 2002, the ratio for the degree of dependence on foreign trade was 65.9%. The bulk of the jurisdiction's trade was with the United States, Japan, the European Union, and the ASEAN countries. Together, Japan, PRC, the ASEAN countries, and India represented the final destination of about 58.9% of the total value of Korean exports.

The level of Korea's total financial liabilities owed to nonresidents increased significantly from US\$97.4 billion in 1994, to US\$131 billion in 2002.²⁶ Inward foreign direct investment increased from US\$8.85 billion in 1998, to US\$9.10 billion in 2002,²⁷ following which it has decreased. The degree of ownership by foreign investors in the Korean share market increased from 11.97% in 1992, to 36.01% in 2002.²⁸ An examination of the top 10 companies by market capitalization on the Korean share market indicates that each of them is predominantly owned by overseas investors.

4.4.3 The Philippines

The Philippines is dependent on international trade for the bulk of its income, and more specifically, on the export of goods and services to other nations. In 2002, foreign trade constituted 85% of the jurisdiction's gross domestic product.²⁹ The top destinations for Philippines' exports in the first quarter of 2003 were the United States, Japan, the Netherlands,

²⁵ Such calculations are based on the statistics from the Ministry of Finance & Economy, Fiscal and Financial Statistics for the second quarter of 2003.

²⁶ Ministry of Finance & Economy, Major Economic Statistics, August 2003. It is important to note that in Korea, the definition of foreign investment is not the level of Korea's liabilities owed to nonresidents. Korean official statistical agencies generally exclude from foreign investment overseas borrowing and lending, except certain long-term loans that qualify as investment under Korean laws.

²⁷ Ministry of Commerce, Industry & Energy of Korea.

²⁸ Korea Stock Exchange (2002), Yearbook of Stock Exchange Statistics.

²⁹ Bangko Sentral ng Pilipinas, accessed via the Internet at <http://www.bsp.gov.ph/statistics/spei/tab1.htm>.

Hong Kong, China, Taipei, China, Singapore, Malaysia, PRC, Thailand, and Germany.³⁰

As of 30 April 2003, P14,482 million of the P172,651 million in capital stock of the Philippine commercial banks belonged to subsidiaries of foreign banks.³¹ The degree of foreign ownership in the share market is less than 30%.³²

The level of portfolio investment in the Philippines registered with the *Bangko Sentral ng Pilipinas* increased from US\$1,778.52 million in 2001, to US\$1,862.85 million in 2002. The United States, the United Kingdom, Singapore, and Hong Kong, China comprise the largest foreign investors in the Philippines. However, it is significant to note that for the period from January to May 2003, the level of foreign portfolio investment in the Philippines registered with the *Bangko Sentral ng Pilipinas* amounted to US\$470.85 million, as compared with US\$959.48 million for the same period in 2002.³³

The level of direct foreign investment in the Philippines registered with *Bangko Sentral ng Pilipinas* increased from US\$857.87 million in 2001, to US\$1,431.41 million in 2002.

In making a comparison between the level of international investment in the Philippines and the level of investment by the Philippines abroad, the level of international investment in the Philippines is greater. For example, as of 3 April 2003, the Philippines' net financial account position, including direct portfolio and other investments, was negative US\$604 million, as compared with a positive position of US\$1,739 million for that same time in 2002.

4.4.4 Thailand

Thailand is highly dependent on international trade for its income. In 2002, the estimated gross domestic product for Thailand was US\$429 billion, comprising of exports of US\$67.7 billion, and imports of US\$58.1 billion.³⁴ In

³⁰ *Bangko Sentral ng Pilipinas*, accessed via the Internet at <http://www.bsp.gov.ph/statistics/spei/tab1.htm>.

³¹ *Bangko Sentral ng Pilipinas*, accessed via the Internet at <http://www.bsp.gov.ph/statistics/spibs/csoc.htm>.

³² This statistic is based on information provided by the Philippine Stock Exchange to the local consultant for the Philippines.

³³ *Bangko Sentral ng Pilipinas*, accessed via the Internet at <http://www.bsp.gov.ph/statistics/spei/tab10.1.htm>.

³⁴ US Government (2002), *The World Fact Book*.

terms of growth, the two most important drivers of the economic expansion in Thailand are increased domestic consumption and exports.³⁵ In 2002, the ultimate destinations of Thailand's exports were Canada, the United States, Mexico, Japan, the European Union, and the countries of ASEAN.³⁶

A number of the commercial banks in Thailand—Bank of Asia, Thai Dhanu Bank, Nakornthon Bank, Radanasin Bank, Bangkok Metropolitan Bank and Siam City—are predominantly owned by foreigners.³⁷ Foreign ownership in the share market, however, is limited under Thai law depending on the type of business.

The level of direct foreign investment in Thailand declined from US\$6.2 billion in 1998 and 1999, to US\$3.3 billion in 2000 and 2001. The local consultant for Thailand has advised that further decreases are expected because of conflicting signals from the government of Thailand concerning foreign investment, and strong competition from PRC as a destination for investment.

4.5 The efficiency and fairness factors

Predictability of outcome and consistency of decision-making, are cited as important policy objectives in commercial law³⁸ and are important to cross-border insolvency issues.

An indicator of fairness is a law that is likely to result in different states treating like cases alike, notwithstanding the differences in each state's substantive insolvency law.

Predictability of outcome and uniformity of approach by the courts of a jurisdiction and other institutions, will lead to greater efficiency due to reduced transaction costs.³⁹

³⁵ American Chamber of Commerce (2002), *Thailand Handbook*.

³⁶ Thailand Customs Department.

³⁷ Predominantly owned, as used in this context, is taken to mean about 20%.

³⁸ New Zealand Law Commission, Report 52, Note 12 at para. 101, located on the TA website.

³⁹ New Zealand Law Commission, Report 52, Note 12 at para. 101, located on the TA website, where it is stated: "With predictability of outcome, there is less need for legal argument and, in that way, the overall costs of litigation are reduced." Note also the Country Report for Cross-Border Insolvency for Indonesia at Sections H3 and H4, located on the TA website, where the local consultant

AP&P case study relevance

The absence of predictability of outcome was a significant, if not crucial, consideration in the decision on the application to appoint a judicial manager to AP&P. The applicants for that appointment contended that the judicial manager would be able to secure control of AP&P's various subsidiaries, particularly its Chinese and Indonesian subsidiaries, by exercising the rights enjoyed by AP&P as a shareholder in those subsidiaries. On the basis of expert evidence concerning the state of the relevant laws of those countries, Her Honor Justice Lai concluded that there was no certainty that such an outcome could be achieved. Moreover, on the evidence, even if that were the end result of the judicial manager's efforts, it would only come about in the absence of cooperation from AP&P Group after extensive and protracted litigation.

Without in any way reflecting on the correctness of the decision of Justice Lai or of the Singaporean Court of Appeal (which affirmed Her Honor's decision), the result of this application supports a conclusion that the fate of any attempt by the creditors of a company such as AP&P Group to appoint a single administrator to a group of companies based in Asia may be capricious.

As one commentator has observed:

"Without a doubt, the arguments of AP&P and the difficulties faced by the court in the petition underscore the need for an international insolvency code or convention with sufficient teeth, under which there is reciprocal enforcement of insolvency orders in a simplified and efficient manner, much in the same way as money judgments of Commonwealth countries are enforceable in each other's jurisdictions, or arbitration awards are enforceable by signatory countries to the New York Convention."

These recommendations are not a panacea for the problem but at the very least represent a positive first step in that direction. The implementation of such a code will constitute a strong statement of intent of the commitment of signatory nations that cross-border insolvencies should be expeditiously and efficiently resolved.

referred to improved training and education for State receivers and supervisory judges as a means of increasing the efficiency and effectiveness of the corporate liquidation and reorganization process.

It appears that local creditors are not preferred under the insolvency laws of the Selected Countries, and that the need to prefer local creditors (with the exception of banks and financial institutions) is not perceived as a major issue.⁴⁰ The access to courts and the practical operation of laws by courts and institutions is of potentially greater significance to considerations of efficiency and fairness.

4.6 Sovereignty

In the course of the technical assistance, the principal objection identified to the adoption of a cross-border insolvency regime has been the prospective erosion of a jurisdiction's ability to direct and administer its own affairs or its sovereignty. Without intending to diminish the significance of the issue or its complexity, it appears to be the case that in Indonesia and Thailand there are two fundamental aspects of the issue of sovereignty which cause it to be an impediment to the adoption of a regime under which cross-border insolvencies can be recognized.

- First, there is a general concern in those countries about the subordination of their national interests and institutions to foreign influence.
- Second, particularly in Thailand where judicial power is exercised as an aspect of the royal prerogative, it is thought to be inconsistent with both that prerogative as well as the autonomy of the jurisdiction to give recognition to the judgments of foreign courts.

One possible response to the first of these concerns is for recognition to be granted under some agreement between, say, countries in the Asian region, which agreement is undertaken by them as equals. The options available for such an agreement will be considered in further detail below.

Issues of concern about sovereignty also arise in relation to Korea and the Philippines.⁴¹

⁴⁰ See the Country Report for Cross-Border Insolvency for each of the Selected Countries at Sections P1, D3, and F7, located on the TA website. Note, however, the additional requirements referred to in the Country Report for Thailand at P1 regarding the treatment of claims of foreign creditors.

⁴¹ See generally the Issues Paper at Section 3.4, located on the TA website.

However, these countries have taken steps toward the adoption of cross-border insolvency regimes, which is an indication that the concerns are not insurmountable. It must be noted that the current steps toward reform in both Korea and the Philippines are still in draft form. The true test of how these countries approach the sovereignty issue will depend on whether, and how, these draft laws are eventually implemented.

It is acknowledged that general concern about the subordination of national interests exists. However, an alternative approach to the issue is to look at the possibility of cooperation on a regional basis. Such a cooperative approach is consistent with the maintenance by a jurisdiction of autonomy in respect of its own affairs while recognizing that its own interests might be best advanced in conjunction with those of others. In this regard, it is sufficient to observe that countries in the region already cooperate in relation to a multiplicity of matters that affect their domestic affairs as well as their international relations, for example by their participation in ASEAN. This cooperation is undertaken, it would seem, without undue concern about sovereignty. It is contended that a similar approach might be adopted to address the problems of cross-border insolvency administrations.

Therefore, one means to address concerns relating to sovereignty and, indeed, the need for reciprocity of recognition of cross-border insolvency laws, may be to approach cross-border insolvency law reform in the context of a regional treaty or other regional arrangement.

In considering the issue of sovereignty in this context, it has been implicitly assumed, at least thus far, that an insolvency administration comes about by means of a court order. This is not necessarily the case. For example, in Australia the most commonly used insolvency regime for companies is voluntary administration. That regime is initiated, in the usual case, by the directors of the company, having formed the opinion that the company is insolvent or likely to become so, resolving to appoint a voluntary administrator. Many voluntary administrations are undertaken without it ever being necessary for intervention by the courts.

Reference is made to this circumstance as it is illustrative of the more general proposition that an insolvency administration of a company involves no more than the change of a company's management. Such a change might be the result

of a court order. Equally, it might come about as a result of a resolution passed at meetings of any of a company's directors, shareholders, or creditors. A change effected by one or another of those administrative processes is not to be distinguished from the change made to a solvent company's board of directors by way of a decision of the shareholders in a general meeting. Changes of that kind are recognized across national borders without concern. The fact of a company's solvency should not predicate a different approach to recognition of a change of management effected by an administrative process. Equally, the fact that the process of change is judicial rather than administrative should not affect recognition. The critical consideration is, what should be the consequences of recognizing that change?

4.7 Reciprocity

In its formulation of the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency (**Model Law**), UNCITRAL rejected a requirement of reciprocity. In the context of the technical assistance, reciprocity has emerged as an issue of considerable significance in the discussion of cross-border insolvency law reform, especially in countries where there is resistance to such reform. It is thus cited as an essential ingredient of any cross-border insolvency law reform proposal, with the recognition of a foreign insolvency regime between the Selected Countries being dependent upon mandatory reciprocal recognition.

If the assurance of reciprocity is important, this raises for consideration the issue of building confidence within the region in relation to the respective judicial, legislative, and administrative procedures in the Selected Countries. The technical assistance provides a medium by which a mutual understanding of these matters can be obtained. A regional treaty or other regional arrangement, with its basis in mutual recognition and adoption by the Selected Countries, would ensure reciprocity.

In view of the importance that reciprocity is seen to have, there is set out here arguments for and against a requirement of reciprocity. These arguments do not support one view in preference to the other, but rather are included for the purposes of facilitating discussion among the Selected Countries.

4.7.1 *Arguments in favor of reciprocity*

- **Fairness:**

A criticism of the UNCITRAL Model Law may be that it provides for the protection and participation of foreign creditors in the distribution of the debtor's local assets, but does not provide the same measure of protection and participation for local creditors in the distribution of assets in foreign proceedings; that is to say, it involves a unilateral approach to reform.

Moreover, because a model law, by its very nature, offers a unilateral approach to reform, the UNCITRAL Model Law cannot afford local creditors the same measures of protection and participation in the distribution of assets in foreign proceedings that it is able to provide for foreign creditors in the distribution of the debtor's assets in the enacting jurisdiction.

- **Overcomes the strict territorial approach with a principle of cooperation:**

An argument against reciprocity is that a strict territorial approach benefits local creditors, but at the expense of foreign investment. The disadvantages associated with a strict territorial approach can be somewhat balanced by the principle of cooperation.

- **Protects the discretion of the court:**

A broad prerequisite of reciprocity provides the relevant court with the ability to tailor the level and extent of recognition and assistance according to the particular circumstances of each case. However, an argument to counter this is that it does so at the expense of transparency, predictability, consistency, and cost.

- **Encourages greater harmonization:**

Putting pressure on other countries to adopt a reciprocal regime for recognizing cross-border insolvency administrations encourages greater harmonization of the law.

4.7.2 *Arguments against reciprocity*

- **The resulting uncertainty:**

It is difficult to define a prerequisite of reciprocity. Ideally, any such prerequisite

should provide for the clear (and quick) ascertainment of another jurisdiction's legislation. Uncertainty may result in litigation, and thus lead to delay, inefficiency, and costs. However, uncertainty may be overcome if recognition is mandated by the relevant legislation.⁴²

- **Delay:**

The additional procedural steps that are necessary to determine whether reciprocity exists may result in delay.

- **Effect on foreign investment:**

It has been argued that reciprocity ignores global trends in commerce and law reform, and, by extension, discourages foreign investment. The preceding arguments (uncertainty and delay) are also relevant to decision-making by foreign investors.

4.8 **Different approaches to cross-border insolvency**

A survey of approaches to cross-border insolvency laws includes:

- application of the principle of comity;
- the process known as *exequatur*;
- recognition of foreign judgments;
- unilateral discretionary legislation;
- unilateral mandatory legislation;
- bilateral legislation;
- multi-lateral or regional treaty legislation;
- economic union legislation; and
- global UNCITRAL Model Law legislation.

These different approaches are discussed in greater detail below.

4.8.1 *Application of the principle of comity*

In countries that follow the common law tradition (which had its genesis in England and is

⁴² See, for example, section 581, *Corporations Act 2001* (Cth), extracted on the TA website.

a tradition observed in the United States and, for the most part, in countries that followed or adopted English law), the principle known as comity may sometimes be availed of (usually in and because of the absence of any enabling cross-border legislation) to recognize and give assistance in the administration of an insolvency case that has been opened in another jurisdiction.

The doctrine of comity is not underpinned by easily identifiable criteria for its application—for the very reason that it is a judge-made doctrine and is not supported by legislation. It is more of a principle that has guided common law courts in their consideration of whether (and to what extent) to recognize the judicial acts of courts in other countries. As it was described in an American case: "...it is the recognition which one nation allows within its territory to the...judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens, or of other persons who are under the protection of its laws."⁴³

The two main benefits of comity are that a court can apply it in the absence of a convention, a treaty, or domestic legislation and a court can tailor the level and extent of recognition and assistance according to the particular circumstances of each specific case.

The limitations, however, are that it is unpredictable in its application, it is clearly not well-suited to civil law jurisdictions, and, because it is uncertain, it may result in the expenditure of valuable resources (including time) to fund and conduct an application for assistance from the foreign court that has no certainty of success.

4.8.2 The process known as exequatur

In many civil law tradition countries, recognition of a foreign insolvency case may be possible by utilizing local civil law to obtain an enabling order (an exequatur). In effect, this is like recognition of a judgment. This type of legislation will usually enable access to a court to possibly obtain recognition of the opening of a foreign insolvency case in respect of the debtor. Possible, however, does not mean probable. In many cases, an enabling order will not be granted in respect of an insolvency proceeding because it does not conform to a recognizable foreign judgment. And most successful attempts

at exequatur do not necessarily bring about the desired result. More often than not they result in the opening of a local insolvency proceeding, to the exclusion of the foreign proceeding.

4.8.3 Recognition of foreign judgments legislation

Legislation providing for the recognition of foreign judgments may be considered, in one sense, a reflection of conduct of trade and business between persons located in different countries. Trade and commerce is based on contractual relationships that, in turn, give rise to debts for which payment is pursued. It is also a reflection, to a lesser degree, that debtors abscond and take assets with them. In a practical sense, therefore, recognition of foreign judgments legislation has something to do with insolvent debtors. However, the application of this form of legislation is, like exequatur, usually reserved to enforcing judgments in one-on-one cases and not to insolvency "judgments" that are more in the nature of collective proceedings.

Recognition of foreign judgments legislation is also more directed at enforcing specific judgments or orders (for example, requiring a party to pay money). Judgments or orders declaring or making a person bankrupt are not of the type that may be enforced without further orders—they are more usually a declaration of status and by themselves do not command that something must be done or not done.

Finally, many insolvency proceedings are not "commenced" by a court order or judgment (in some jurisdictions the mere filing is sufficient to commence whereas in other jurisdictions, commencement results from administrative actions). Thus, although in some jurisdictions it may be possible to effect some type of recognition of foreign insolvency proceedings as the functional equivalent of a judgment, this form of legislation cannot realistically deal with cross-border situations.

4.8.4 Unilateral discretionary legislation

The use of unilateral legislation is the predominant means of providing for recognition and assistance in relation to cases of cross-border insolvency. This type of initiative is no doubt the result of the perceived limitations surrounding reliance on comity, exequatur legislation, and recognition of foreign judgments legislation. The form of such legislation varies but, in general, it will:

⁴³ *Hilton v. Guyot*, 159 U.S. 113, 163—64 (1895).

- provide authority for a court to recognize and provide assistance in respect of a foreign insolvency proceeding originating in any jurisdiction;
- set out certain conditions (tests) that must be fulfilled or applied before recognition may be granted;
- provide for the procedure or process to be followed in making an application for recognition; and
- prescribe the nature and extent of assistance that can be provided.

It will be apparent, however, that unilateral discretionary legislation only facilitates in-bound cases; and there can be no assurance or guarantee of reciprocal recognition in respect of out-bound cases. Further, most of this legislation is discretionary, in the sense that the relevant court, although it must usually apply certain tests of eligibility, has an overall discretion whether to recognize the insolvency proceedings or not (see the next section for an example of mandatory unilateral legislation).

Despite its shortcomings, however, this legislation offers a relatively high degree of certainty and predictability, it is usually short and simple, it is reasonably efficient and not cost-intensive, and it is suitable as stand alone or as an expansion of *exequatur* legislation. Examples of countries that have this form of legislation are Australia, Canada, England, the United States, India, Ireland, and New Zealand. Extracts from the relevant legislation of some of those jurisdictions have been posted to the technical assistance website (TA website) at <http://adb.org/law/insolvency>.

4.8.5 Unilateral mandatory legislation

The relevant legislation in Australia is a rare example of this type of legislation that contains a built-in requirement for mandatory recognition and assistance. This is not, however, universal, because mandatory recognition is only required for cross-border cases originating in certain prescribed countries. In the case of all other jurisdictions, recognition is discretionary; and to

this extent, the Australian legislation is similar to all other unilateral discretionary legislation.⁴⁴

4.8.6 Bilateral legislation

Some countries have concluded bilateral arrangements. An example is that between Singapore and Malaysia in relation to cases of individual bankruptcy. The relevant bankruptcy laws of those countries provide for mandatory mutual recognition and assistance in such cases.⁴⁵

4.8.7 Multilateral or regional treaty legislation

Treaty or convention legislation has been rare and largely confined to countries that share a common system of law and institutions. The most notable convention legislation is the Nordic Bankruptcy Convention of 1933, the signatories to which are Sweden, Norway, Denmark, Finland, and Iceland. It has been described as a "*good example of a multi-lateral convention intended for a limited group of countries having very close mutual relations and a great deal of confidence in each other's legal systems*" (Professor Michael Bogdan).⁴⁶

The legislation provides for full automatic recognition in all contracting states of a case of bankruptcy that is opened in one of them (universal reciprocity). The law of the state in which the bankruptcy is opened determines all issues concerning the bankruptcy, except as regards some special rules in relation to particular property (for example, rights in relation to land are determined by the law of the state in which the land is situated and the rights of secured creditors in respect of property secured in another contracting state are determined in accordance with the law of that other state). Each contracting state is obliged to provide assistance and relief. No formal recognition procedure is required to be followed. It has been observed that "*the experiences with the convention are good. The absence of case law suggests that it works smoothly and does not give rise to any complications*" (Professor

⁴⁴ A copy of the relevant Australian legislation (together with the list of prescribed countries) is posted to the TA website.

⁴⁵ For example, Section (104(3) - (6) *Bankruptcy Act* 1967 (Malaysia).

⁴⁶ See "International Bankruptcy Law in Scandinavia" (1985) 34 *The International and Comparative Law Quarterly (ICLQ)* at p. 49.

Michael Bogdan).⁴⁷ A copy of the Nordic Convention is posted to the TA website.

Another example of a multilateral treaty is the Treaty of Montevideo (1940), which involves the South American countries of Argentina, Bolivia, Paraguay, and Uruguay. The treaty includes a number of provisions for dealing with cases of cross-border insolvency involving two or more of those countries;⁴⁸ however, these provisions have been rarely followed in practice.

4.8.8 *Economic union legislation*

The only example of a truly regional approach (that is, linking countries without regard to whether their respective systems of law are similar—cf. the Nordic Convention) to cross-border insolvency is between the member states of the European Community (with the exception of Denmark). The EC Council Regulation 1346/2000 on Insolvency Proceedings came into force on 31 May 2002. It applies only to and within the member states that acceded to the regulation (namely Austria, Belgium, Finland, Germany, Greece, France, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom). Cross-border insolvency cases originating in other countries must be dealt with under the domestic law obtaining in the jurisdiction in which the relevant application is made.

Although it has been a considerable time since the possibility of such a regional cross-border insolvency approach was initially conceived (the initiative for it dates back to the very foundations of the European Community in 1960), the resulting legislation is a very significant and important development, if only for the reasons that it embraces countries of both common law and civil law tradition, it involves countries in which there are considerable differences in their respective insolvency law regimes, and it covers a large number of countries. In that sense it may be described as truly regional. Moreover, it is also truly reciprocal.

Very generally, it operates on the basis that if an insolvency proceeding is opened in a member state (normally this would be the state in which the debtor has its domicile or center of its main interests):

- recognition (without formality) of that proceeding is automatic throughout the other member states;
- the law of the state in which the proceeding is opened applies;
- the insolvency representative may exercise all its powers and rights throughout other member states; and
- the relevant courts and institutions of other member states are required to render assistance and provide relief as may be required.

The opening of other (competing or secondary) proceedings in respect of the same debtor is thus restricted, and the general or overall result in most cases should be that there would be only one proceeding in respect of the debtor throughout the European Community member countries.

Another feature of the regulation is that it goes some way toward dealing with (or at least addressing) conflict-of-laws issues, particularly regarding the applicable insolvency law and also property and security rights and claims. The regulation is posted to the TA website.

4.8.9 *Global model law legislation*

Finally, there is the product of the work of UNCITRAL that was conducted from 1994 to 1997, resulting in the UNCITRAL Model Law.

The UNCITRAL Model Law was approved by a resolution of the General Assembly of the United Nations in December 1997. It is the product of the work of a working group of the member nations of UNCITRAL.

Before reviewing the content and thrust of the UNCITRAL Model Law, it should be appreciated that it is not a treaty or a convention. This has two important consequences. The first is that the UNCITRAL Model Law will only become effective if a jurisdiction legislates for it (or a version of it) as part of its domestic legislation. The second consequence is that it will not, by itself, result in reciprocity. Thus, it operates unilaterally. The effect of reciprocity may, however, be achieved between those countries that adopt the UNCITRAL Model Law, provided they do not introduce more limited reciprocity qualifications into their domestic version of it.

⁴⁷ See "International Bankruptcy Law in Scandinavia" (1985) 34 *ICLQ* at p. 49.

⁴⁸ See Articles 40–41 and 45–48 of the Treaty of Montevideo.

The broad scheme of and the basis on which the UNCITRAL Model Law is intended to operate is as follows:

- it applies to an insolvency proceeding in which the debtor is subject to the control or supervision of a foreign court for the purposes of reorganization or liquidation;
- it applies to both inbound and outbound requests for recognition and assistance, but obviously concentrates on inbound applications;
- it provides access to the courts (or other relevant institutions) of an enacting state for a foreign representative (a person or body who is authorized in a foreign proceeding to administer the reorganization or liquidation of a debtor) to apply for recognition and assistance;
- an application for recognition and assistance may be made without unnecessary formality or procedure;
- a decision on recognition should, in most cases, be quickly decided and amount to not much more than a mere formality;
- depending on the nature of the foreign proceeding and the extent of assistance that is required, automatic, immediate relief and assistance will follow from recognition. The main relief is in the form of a stay or suspension of actions and proceedings against the property of the debtor located in the enacting state; and
- the UNCITRAL Model Law provides for the possibility of cooperation between office holders, courts, and judges in the various jurisdictions that might be involved.

A copy of the UNCITRAL Model Law and the explanatory memorandum accompanying it has been posted on the TA website.

The production of the UNCITRAL Model Law and its endorsement by the United Nations have been regarded at least as significant and important (or possibly more so) as the European Community cross-border regulation, primarily because it is attempting a global approach to the

issue, unimpeded by local or regional differences. The UNCITRAL Model Law offers every jurisdiction in the world a system to effectively promote and govern access, recognition, and assistance in cases of cross-border insolvency.

Obviously, because of its unilateral character, its effect will be greatly enhanced by the number of countries that ultimately adopt it. Thus far, adoption has not been extensive. But there are sufficient and encouraging signs to indicate that adoption may soon become much more widespread.

The UNCITRAL Model Law has been largely adopted by Mexico (as part of its domestic insolvency law regime) and South Africa (through the *Cross-Border Insolvency Act 2000*). Japan enacted a modified version of the UNCITRAL Model Law in 1999 (the Law on Recognition and Assistance of a Foreign Insolvency Proceeding). The UNCITRAL Model Law has also been introduced in Colombia, Poland, Romania, Montenegro, Serbia, New Zealand, Great Britain, Northern Ireland, British Virgin Islands, and the United States. Australia has proposed the adoption of the UNCITRAL Model Law.

Of interest is the fact, as mentioned in more detail later, that some of the above-mentioned jurisdictions have created their own version of the UNCITRAL Model Law. South Africa, for example, has a provision that requires reciprocity. The Japanese legislation concentrates solely on inbound requests for recognition and assistance. This suggests that policy makers may wish to consider adoption in a way that best suits the particular circumstances of their jurisdiction.

4.9 Developments in the Asian Region

A number of options are available as to regimes for recognizing cross-border insolvency administrations. The different approaches are not mutually exclusive. So, a regional treaty or other regional arrangement that provides for cross-border insolvency cooperation may operate harmoniously with initiatives that are pursued by a selected jurisdiction independently of the others of them. That is to say, the legislative developments that are in prospect in Korea and the Philippines would not be a barrier to them undertaking a regional treaty or other regional arrangement or inhibit the effective operation of either the regional treaty or other regional

arrangement or their currently proposed reforms, which involve unilateral discretionary legislation.

4.9.1 The Philippines

The Philippines is considering adopting unilateral discretionary legislation as part of its insolvency law reform. There are draft bills before the Philippine Congress regarding corporate rehabilitation, known as the *Corporate Recovery Act*. The draft appears to have been based in part on section 304 of the United States Bankruptcy Code,⁴⁹ and includes safeguards relating to the recognition of cross-border insolvency regimes, such as the necessity for the relevant court to be satisfied that the administration is genuine and not a sham. It is submitted that there is evidence of a general willingness in the Philippines to pursue reform in this area, thereby facilitating recognition of cross-border insolvencies (albeit that bill has now been before Congress for longer than two years).

As noted previously in this section, it is possible for unilateral discretionary legislation to operate in conjunction with a bilateral or multilateral treaty or other regional arrangement. The reforms proposed in the Philippines do not in any way prevent its participation in a regional treaty or other regional instrument of the kind being proffered for consideration in the context of the technical assistance.

4.9.2 Korea

On 21 February 2003, the Ministry of Justice of Korea submitted the *Act on Rehabilitation and Bankruptcy of Debtors*, also known as the *Unified Insolvency Act (UIA)*, to the Korean National Assembly. The *Initial Draft of the UIA (IDUIA)* proposed reform to the nature of insolvency procedures (which was enacted in 2006). The IDUIA, which may be characterized as a hybrid of the UNCITRAL Model Law, provides for the recognition of foreign insolvency proceedings. The main features of the IDUIA⁵⁰ are:

⁴⁹ See, for example, the proposed ss 113–115 of the *Corporate Recovery Act* (see TA website).

⁵⁰ See the Summary of the Korean Government's Proposed bill for the *Unified Insolvency Act (UIA)*, located on the TA website. Refer also to the Country Report for Cross-Border Insolvency for Korea at Section Q and Sections B1 and B2, located on the TA website.

- **Jurisdiction:**

The collegiate court of Seoul District Court has the exclusive jurisdiction over such cases. The representative of a foreign insolvency procedure is able to file an application for recognition with the competent Korean court.

- **Judgment:**

The Korean court makes a decision on recognition within one month of the date of filing of such application. Upon such decision by the relevant Korean court, the representative of the foreign insolvency procedure may participate in, or file a petition for the commencement of, insolvency procedures in Korea.

- **Recognition:**

Under the IDUIA, the liquidator appointed in the jurisdiction in which the company is incorporated may request that the Korean court recognize the insolvency procedures commenced in the foreign jurisdiction. The liquidator could then file an application for the commencement of insolvency procedures in Korea.

- **Length of claim:**

Provided that the IDUIA is effective, it will typically take one month from the filing of the petition for the commencement of the respective procedure for an order or direction to be obtained.

- **Appointment of administrator:**

Upon recognition of the foreign insolvency procedure, the Korean court may appoint a foreign insolvency administrator. The capacity of the foreign insolvency administrator is dependent upon the laws of Korea, not the laws of the jurisdiction in which the foreign insolvency administrator was first appointed. The Korean court may also appoint a foreign insolvency administrator with authority to manage the assets of the debtor company situated in Korea.

- **Treatment of local and foreign creditors:**

Further, under the IDUIA, local and foreign creditors will be treated equally in respect of

the foreign entity's Korean assets. Foreign creditors are not required to satisfy any formal procedures or other prerequisites to prove their claims in Korea.

As noted above, the IDUIA may be characterized as a hybrid of the UNCITRAL Model Law. The advantages of the UNCITRAL Model Law include:

- its application to both inbound and outbound insolvency administrations;
- its lack of formality;
- its flexibility (for example in accommodating local policy requirements); and
- its predictability.

The comparative disadvantages of the UNCITRAL Model Law (as compared to a regional arrangement) include:

- it only operates if a jurisdiction adopts the UNCITRAL Model Law as part of the domestic legislation; and
- it is unilateral, although this effect is ameliorated if a number of countries adopt the UNCITRAL Model Law, provided that they do not introduce more limited reciprocity provisions in their domestic version of the UNCITRAL Model Law.

A hybrid model law could co-exist with a regional treaty or other regional arrangement, and the reform steps taken in Korea do not detract from any regional agreement that may result from the technical assistance.

4.9.3 Japan

The recently enacted Japanese cross-border insolvency law relating to the *Recognition and Assistance for Foreign Insolvency Proceedings* is as an example of a modified version of the UNCITRAL Model Law.

One reason advanced for the modification is that the UNCITRAL Model Law is influenced by the common law approach which, in some

circumstances, may cause confusion for civil law countries.⁵¹

However, to date the UNCITRAL Model Law has been adopted largely by countries with civil law systems, with few departures from the text as drafted.

The Japanese law also provides another example of an initiative concerning cross-border insolvency law reform that has been pursued in the Asian region. Its particular significance is reflected by the circumstance that, prior to these reforms, Japanese insolvency law was territorial and insular in its approach with the result that its focus was the protection and advancement of the interests of Japanese creditors of a debtor to the exclusion of the debtor's other creditors.

Commentary on the legislation suggests that, in principle, the law relating to the *Recognition and Assistance for Foreign Insolvency Proceedings* adopts the UNCITRAL Model Law on cross-border insolvency, and that the several differences between the two are technical, or otherwise not in conflict with the essential purpose of the UNCITRAL Model Law.⁵²

In summary, the jurisdiction for recognizing foreign insolvency administrations belongs exclusively to the Tokyo District Court. However, after a decision for recognition, the transfer of the case to another court is possible. Standing to apply for recognition is limited to a foreign representative.⁵³ Once the application is made, the court may order interim relief.⁵⁴ The court may entrust the administration of the debtor's assets to a foreign representative or another person designated by the court. As a general rule in Japan, there is "only one proceeding operating for one debtor," and various rules apply regarding the priority of proceedings, for example between plural foreign proceedings.⁵⁵

⁵¹ Yamamoto K, *New Japanese Legislation on Cross-Border Insolvency as Compared with the UNCITRAL Model Law* (2002), 20 *Insolvency Law Review* 67 at p. 68, located on the TA website.

⁵² Yamamoto K, at p. 95, located on the TA website.

⁵³ Yamamoto K, at pp. 69 and 73, located on the TA website. A foreign representative is defined as "a person or body, including one appointed on an interim basis, authorised in a foreign proceeding to administer the reorganisation or liquidation of a debtor's assets or affairs or to act as a representative of the foreign proceeding."

⁵⁴ Yamamoto K, at p. 69, located on the TA website.

⁵⁵ Yamamoto K, at p. 70, located on the TA website.

Notably, the legislation has abandoned the principle of reciprocity, replacing it with the principle of non-discrimination.⁵⁶ However, it may be that mutual recognition is relevant to considerations of public policy under the Japanese legislation.

4.10 Consensus reached

Having considered the numerous different approaches referred to above, the consensus of the participants in both conferences held during the course of this technical assistance was that:

- in the first instance, recognition of cross-border insolvency administrations was most likely to be achieved by regional cooperation, which may be facilitated by an addendum to an existing regional treaty or other regional arrangement such as that under which ASEAN was established; and
- if there was to be mutuality of recognition, then confidence in the judicial, legislative, and administrative procedures of the other Selected Countries would be imperative.

While this was the consensus reached at the conferences, it does not militate against the desirability of the Selected Countries and other countries in the Asian region continuing to give attention to the possibility of unilateral reform in this area. Without limiting the range of available options (which were, in any event, considered in the Issues Paper⁵⁷), the models adopted by Japan, and those being considered by Korea and the Philippines, are illustrative of regimes that could be considered.

The focus of the remainder of this Report is on the content and means of adoption of a regional treaty or other regional arrangement.

Any program to advance regional cooperation in this field would need to take account of the likelihood that within the region:

- (a) some countries will favor a broad or universal approach to recognizing foreign orders;

- (b) some countries will prefer to extend recognition only to selected qualifying countries, on a basis of reciprocity, and, perhaps, on a regional basis; and
- (c) other countries will be reluctant, initially, to legislate for recognition at all.

A jurisdiction in the second category would probably designate reciprocating countries in or under its legislation. No doubt it would wish first to confirm the reciprocity arrangement in writing. This could be done by an exchange of letters or in some other instrument. If desired, the instrument could go beyond a simple reciprocity undertaking and extend to detail about exceptions, qualifications, and the effect of recognized orders in various situations. If the parties thought it appropriate, the arrangement, whatever its form, could be given the status of a treaty. The procedures for conclusion of a bilateral treaty would be a matter for the countries concerned, but could involve the following steps:

- Contact being made between functional agencies of each jurisdiction (for example, the transport or justice departments). Frequently, and usually in the case of countries without an existing working relationship in the field, the proposing and arranging of treaty negotiations would be through the diplomatic channel by "third person note."
- Deciding whether the proposed bilateral arrangement in question should be a treaty instrument, formally binding at international law, or some other arrangement.⁵⁸
- The settling of the text of a bilateral treaty. This might involve adoption of a standard text without face-to-face discussion or protracted negotiation over several years. The treaty need not be expressed as a bilateral document but could take the form of an exchange

⁵⁶ Yamamoto K, at p. 70, located on the TA website.

⁵⁷ See Section 3.3 of the Issues Paper, located on the TA website.

⁵⁸ For that purpose, a "treaty" includes what some countries regard as a (binding) "executive agreement." However, a true treaty, whatever called, requires lodging with the Secretary-General of the United Nations and publication in the treaty lists of the relevant countries. Internally, a treaty might call for parliamentary approval, even if legislation is not necessary.

of letters, the text of these being pre-agreed.

For reasons of practical convenience and cooperation in various fields, most countries will find it preferable to conclude many more bilateral non-treaty arrangements, such as memoranda of understanding, than treaties.

However, in the treaty categories indicated above, a treaty rather than a non-treaty instrument is the favored vehicle. Generally, agreements that directly bear on the legal rights of individuals (such as liability to extradition) are regarded as appropriate for a treaty. Agreements that call only for executive action, like the purchase of goods or services or the grant of a license, may be of non-treaty status.

The decision to pursue a treaty rather than non-treaty instrument usually requires involvement of foreign ministries, to see that national treaty practice is followed and to oversee the relevant formalities.

Following the bilateral route could produce in due course a network of understandings that would link those countries in the region, following a universalist approach with those according recognition to a restricted number of bilateral partners. Countries in the third category could join in, if they wished, at their own speed.

An alternative to the bilateral route would be a multilateral scheme based on an assurance of reciprocity between participating countries. Again, this could be given treaty status. However, for a multilateral arrangement to be feasible, there would need to be a significant number of countries in the second category willing to extend recognition to any other jurisdiction eligible to participate in the multilateral scheme. Universalist countries, by definition, would have no need of such an arrangement between themselves.

There would be a question whether a multilateral arrangement would involve a simple undertaking of reciprocity or would extend to detail about exceptions, qualifications, and the effect of recognized orders in various situations.

If such a multilateral arrangement was to have treaty status, the following steps could be followed to put it in place:

- The jurisdiction wishing to propose a treaty would have gain support for the initiative among like-minded countries.

- Drafting a resolution to be co-sponsored by supporting delegations that the secretariat convene either an expert meeting or a diplomatic conference. This would need to be accommodated in the work program of the relevant agency.
- Holding a major conference to discuss the proposed multilateral arrangement.⁵⁹

A regional treaty would be an exercise on a smaller scale. The burdensome translation costs that apply within the United Nations would not be a consideration to the same extent—or at all if the instrument was settled in a single language.

Whatever the form of future cooperation, a constructive immediate step would be the adoption by individual governments of a considered national policy on recognition of foreign insolvencies. An early exchange of information on those national positions, perhaps through ADB as a clearinghouse, would help to determine what further steps might be appropriate

4.11 A possible regional arrangement

The proposal that consideration be given to a regional intergovernmental arrangement is based on the premises that:

- as participation is a matter for the voluntary choice of each of the countries which are party to the arrangement, its operation in any of those countries is not inconsistent with its sovereign power to regulate its domestic affairs unilaterally;
- reciprocal recognition between the countries of cross-border insolvency would be an element of such an arrangement; and
- the arrangement would include agreement on what minimum provision should be made in national laws for

⁵⁹ For a major conference, significant financial provision needs to be made and competing priorities would need to be considered. Sometimes, agreement to hold a conference is conditional on the main proponent jurisdiction agreeing to provide a venue and to bear a significant share of the administrative cost.

recognition and assistance, and for coordination of any concurrent insolvency administrations. Some form of documentation of the agreed minimum provision would be essential to an effective arrangement, whether or not that agreement was expressed only as general principles or in more specific terms.

Therefore, two different documents have been prepared which might form a basis for discussing regional cooperation:

- (a) a draft instrument that governments might consider using to express their willingness or commitment to cooperate with one another; and
- (b) a draft statement of the minimum provision that countries opting in to any future regional arrangement would make in their laws.

4.11.1 An expression of intergovernmental cooperation

There are a number of mechanisms by which governments can express either a willingness or commitment to cooperate with each other in respect of any given activity of mutual interest. These extend from a treaty to a resolution or declaration, or a paragraph in a communiqué, that might be adopted on an appropriate occasion. If the arrangement was formulated in terms of an agreement, it could be of either the legally binding kind (that is, a treaty), or the kind that is politically but not legally binding (a non-treaty agreement).

There are successful examples of cross-border agreements in Asia such as the GMS Cross-Border Transport Agreement (**GMS Agreement**).⁶⁰ The GMS Agreement is a multilateral instrument for the facilitation of the cross-border transportation of goods and people.

Formulated under the auspices of an ADB technical assistance, the GMS Agreement provides a practical approach, in the short to medium term, to streamline regulations and reduce non-physical barriers in the GMS

countries. It incorporates the principles of bilateral or multilateral action and flexibility in recognition of differences in procedures in each of the GMS countries.

The GMS Agreement includes references to existing international conventions that have demonstrated their usefulness in a broad range of countries.

The GMS Agreement is a compact and comprehensive multilateral instrument, which covers in one document all the relevant aspects of cross-border transport facilitation.

Whatever the nature of the instrument, there might be an advantage in establishing the arrangement in two steps—first, the step of adopting it, and second, the step of opting-in to it. This would enable all potential participants to take part in negotiating and adopting the arrangement without committing themselves to opt in. It would also enable national legislation to be developed and put in place before the second step was taken. Such a two-stage approach could be convenient whether the arrangement was considered within an existing framework, for example ASEAN, or at an ad-hoc meeting of potential participants.

4.11.2 Statement of minimum legislative provisions to facilitate recognition

An agreed statement by a number of countries as to the minimum legislative provisions that would need to be adopted by each of them if they wished to facilitate recognition of cross-border insolvency administrations, goes no further than an acknowledgment by each jurisdiction that it is an issue that might have to be addressed at some time in the future.

One possibility for such a statement is to use an adaptation of the UNCITRAL Model Law. Although intended by its drafters to be applied universally and adopted unilaterally, legislation along the lines of the UNCITRAL Model Law could be applied by an enacting jurisdiction to foreign proceedings defined as proceedings in only specified countries. Insolvency experts within the region might see an advantage, as between their countries, in going beyond the UNCITRAL Model Law in some respects.

Another possibility would be to have a less detailed and less complete set of agreed provisions, perhaps expressed as principles rather than drawn in statutory form. Whatever the form and content, experts from the Selected

⁶⁰ The GMS Agreement is formally known as The Agreement Between and Among the Governments of the Kingdom of Cambodia, the People's Republic of China, the Lao People's Democratic Republic, the Union of Myanmar, the Kingdom of Thailand, and the Socialist Republic of Viet Nam for Facilitation of Cross-Border Transport of Goods and People.

Countries would need to be satisfied that the draft laws or principles drew on relevant experience of actual cases, addressed the issues of most practical concern, and were sufficiently specific to be useful, while not containing elements likely to cause difficulty within any national system.

One way to proceed would be for insolvency experts to draw up a set of draft provisions or principles with a view to their possible incorporation as an annex to any future intergovernmental arrangement.

4.11.3 Illustrative drafts

Depending on the preferences of governments, four broad possibilities for a regional arrangement may be considered:

- (a) a regional treaty using a UNCITRAL Model Law approach;
- (b) a regional treaty using a basic principles approach;
- (c) a regional non-treaty arrangement using a UNCITRAL Model Law approach; or
- (d) a regional non-treaty arrangement using a basic principles approach.

For purposes of discussion, drafts are provided here that illustrate possibilities (a) and (d)⁶¹ could be readily adapted to reflect approaches (b) and (c).⁶²

The drafts are not intended to recommend, for the purposes of the technical assistance, what the final position should be on any points of substance. Rather, the primary aim of their inclusion is to facilitate discussion among the Selected Countries.

4.12 Matters to be considered

A cross-border insolvency law must be flexible enough to be able to address the myriad of possible scenarios for a cross-border insolvency.

An important threshold question for governments is what countries would participate in the regional arrangement, bearing in mind that some participants might prefer a select group of countries, while others may be more prepared to extend assistance in an open-ended fashion. Moreover, available options to facilitate

recognition of cross-border administrations can be pursued in parallel without resulting in inconsistent regimes.

Beyond that issue, a regional arrangement, with its set of proposed legislative provisions might usefully address the following points:

- the formalities required for commencement of an application for recognition;
- the need to secure recognition for both inbound and outbound insolvency administrations;
- the possible approaches to accommodating different types of insolvency administrations;
- the relevant courts that should be involved;
- ease of access to the courts;
- evidence required of commencement of insolvency administrations;
- the effect of recognition;
- cooperation between courts; and
- issues particular to the operation of branches.

4.12.1 Formalities required for commencement of application for recognition

None of the four Selected Countries have any existing laws relating to cross-border insolvency.

It is recommended that in determining what formalities might be required to commence an application for recognition in the context of cross-border insolvency law, any regional treaty or other regional arrangement will need to address this topic as a matter of importance. Given that urgency is often required in cases of cross-border insolvencies, there should be little formality required for commencement of an application for recognition, provided that suitable evidence of the validity of the foreign appointment is given.

4.12.2 The need to ensure recognition for both inbound and outbound insolvency administrations

Any regional treaty or other regional arrangement will have to apply to both inbound

⁶¹ See TA website.

⁶² See Annexure A.

and outbound administrations. At present, none of the Selected Countries have any provisions in relation to either category of administration.

However, it seems that applications have been made from Korea and the Philippines through foreign courts for access to foreign assets of Korean and Filipino companies. This can be seen in the example of Daewoo⁶³ in Korea (a major Korean motor vehicle manufacturer which had operations around the world, including the United Kingdom and Australia). While it is acknowledged that measures for both inbound and outbound administrations are required, it is suggested that a "letter of request" mechanism, such as that adopted in the case of Daewoo, may be an efficient means of addressing outbound administrations. Less formality was required when application for recognition of the Filipino administrator was made to the United States courts in relation to the administration of Philippine Airlines, where all that needed to be done, relevantly, was to prove the fact of its insolvency administration in the Philippines.

4.12.3 Possible approaches to accommodating different types of insolvency administrations

In each of the four Selected Countries, it is usual and customary, or at the very least possible (though it may depend on the case, as in Korea), for a corporate debtor that is insolvent to attempt to negotiate an informal administration prior to the commencement of formal insolvency procedures.⁶⁴ It is therefore recommended that any regional treaty or other regional arrangement make provision for recognition of both informal and formal insolvency procedures.⁶⁵

4.12.4 Relevant courts that should be involved

It appears that the relevant court in each jurisdiction would be:

- **Indonesia:** The Commercial Court having jurisdiction over the debtor's domicile;⁶⁶

⁶³ See the Country Report for Cross-Border Insolvency for Korea at Section D2, located on the TA website.

⁶⁴ See the Country Report for Cross-Border Insolvency for each of the Selected Countries at Section 14(a), located on the TA website.

⁶⁵ See Section 7 of this Report on Informal Workouts.

⁶⁶ See the Country Report for Cross-Border Insolvency for Indonesia at Sections 12(b) and (c), located on the TA website.

- **Korea:** The District Court having jurisdiction over the main office of the debtor company;⁶⁷
- **the Philippines:** The regular courts, and in particular the designated branches of Regional Trial Courts. However, the Philippine Securities and Exchange Commission retains jurisdiction over suspension of payments and rehabilitation cases pending as of 30 June 2000, until disposed of;⁶⁸ and
- **Thailand:** The Civil Courts and the Provincial Courts.⁶⁹

Any regional treaty or other regional arrangement ought to consider the position of the courts currently involved in the legal system of the Selected Countries, and take account of that in determining the relevant court that should be involved.

Quality laws, however, are not sufficient in themselves. Institutional capacity (that is, the capacity of a jurisdiction's judicial, political, governmental, and private enterprise bodies to carry out the necessary measures to provide assistance to and recognition of foreign administrators) to enforce laws must also exist.

The country report for Indonesia puts the issue of institutional capacity in very stark terms (it is accepted that the comments do not necessarily apply to all countries in the region):

- Lack of fairness in the trials, due to the questionable credibility of the presiding judge(s). It is common knowledge that corruption is rampant in the courts. Judges, prosecutors, and lawyers are all involved in such dirty games.
- Many of the bankruptcy petitions submitted involve modern and sophisticated transactions of derivatives, swaps, commercial paper,

⁶⁷ See the Country Report for Cross-Border Insolvency for Korea at Sections 12(b) and (c), located on the TA website.

⁶⁸ See the Country Report for Cross-Border Insolvency for the Philippines at Sections 12(b) and (c), located on the TA website.

⁶⁹ See the Country Report for Cross-Border Insolvency for Thailand at Sections 12(b) and (c), located on the TA website.

etc. In many cases, the judge(s) presiding over the hearing do not quite understand the transactions. This leads to misinterpretation, or to a narrow interpretation, of the documents provided by the parties.

- The unclear provisions of the Bankruptcy Law have led to problems in practice, particularly in relation to procedural matters.

The country report for Indonesia goes on to suggest solutions for these problems, which include:

- improving court procedures to provide for more transparent processes so that parties are aware of the process to be followed and are able to view the process;
- making the courts and parties more publicly accountable for their actions;
- improving the salaries of judges and other government law enforcement officials; and
- providing the judges who are in charge of the Commercial Court with more training on modern business transactions.

Other general factors that have been raised concerning institutional capacity are:

- general delays in the court system. For instance, the court system in the Philippines currently has a backlog of about 850,000 cases;
- a lack of expert judges; and
- a lack of requirements for qualification of insolvency practitioners.

Addressing institutional capacity in general is beyond the scope of this Report. However, measures that could be adopted which are relevant to effective cross-border insolvency regulation are set out below.

AP&P case study relevance

Generally stated, the basis upon which the High Court of Singapore declined to approve judicial managers to AP&P was that it would have been an exercise in futility. In an immediate sense, that conclusion was based upon the evidence that the courts of Indonesia and PRC would not recognize the order and, consequently, the authority of those judicial managers to assume control of AP&P's subsidiaries in those countries. Such a conclusion might likewise have been supported by reference to evidence of lack of institutional capacity of the kind identified in the country report of Indonesia.

4.12.5 Ease of access to the courts

This factor requires consideration of:

- who can obtain access to the relevant court;
- the ease with which a foreign insolvency representative may obtain direct access to the courts; and
- the cost, time, and formalities that would be required.⁷⁰

There are differences among the Selected Countries as to how long it typically takes to obtain an order or other direction establishing a formal insolvency administration. The period of time ranges from 30 days in the case of Indonesia (although the local consultant from Indonesia did concede that this may prove overly optimistic given the nature and complexity of the transactions involved),⁷¹ to as long as one year in the Philippines in the case of involuntary insolvency proceedings.⁷²

Any regional treaty or other regional arrangement will need to deal with such disparities, and the issues associated with them. Applications for recognition will normally be required to be heard within a matter of days rather than weeks or months.

⁷⁰ See generally the Country Report for Cross-Border Insolvency for each of the Selected Countries at Sections F3 to F8, located on the TA website. See also Supplementary Section F1 for Korea and the Philippines located on the TA website.

⁷¹ See Country Report for Cross-Border Insolvency for Indonesia at Section F4, located on the TA website.

⁷² See Country Report for Cross-Border Insolvency for the Philippines at Section F4, located on the TA website.

4.12.6 Evidence required for commencement of insolvency administrations

The evidence that will be required for the commencement of an insolvency case in a foreign jurisdiction will draw upon the differences in substantive law among the Selected Countries.

Set procedures for establishing that the foreign representative has been appointed and is authorized to make an application will have to be developed.

4.12.7 The effect of recognition

Any regional treaty or other regional arrangement will need to give consideration to the effect of recognition of foreign insolvency procedures on the corporate debtor, its constituent parts, and its business relationships, as well as to how the initiation of a second procedure, for example in a foreign jurisdiction involving the same corporate debtor, will affect the first initiated procedure.

4.12.8 Cooperation between courts

This raises for consideration issues including:

- **Communications between the courts:**

It is recommended that a set of rules be developed to address the means of communication, the level of communication, and the circumstances in which such communication should and should not occur.

- **Language and interpretation difficulties:**

It is recommended that the difficulties associated with this issue be overcome by the employment of skilled and reliable translators.

- **A common understanding of concepts:**

There is an inherent need for the courts of different countries, and the participants involved, to have a common or mutual understanding of the pertinent concepts that apply. The technical assistance goes some way toward facilitating such understanding. However, judicial conferences and a continuing exchange of information will be needed in order to develop an understanding of the relevant legal principles of other countries that are party to a regional treaty or other regional arrangement.

- **Time differences:**

While this is self-explanatory, it will need to be addressed in the context of facilitating communication and cooperation between the courts involved in the relevant procedures.

- **Practice and procedure generally:**

The approaches of each of the Selected Countries have been identified and elaborated upon elsewhere.⁷³ It is recommended that any regional treaty or other regional arrangement will need to account for the differences in practice and procedure between the courts of the relevant countries.

- **Use of protocols:**

It is submitted that the overall administration of cross-border insolvency cases would be assisted and advanced by the development of a protocol dealing with both administrative and substantive matters of concern to the relevant Selected Countries.

4.12.9 Issues particular to the operation of branches

As noted above, it appears that a large number of multinational corporations in each of the Selected Countries operate by way of branch rather than subsidiary.⁷⁴ This means that any cross-border insolvency law regime may need to deal with issues particular to the operation of branches.

4.12.10 Out-of-Court Proceedings

A premise which, at least implicitly, underpins much of the discussion thus far is that courts are necessarily involved in all aspects of an insolvency administration, including its inception and recognition across borders. That need not be so. The companies legislation in countries that adopted the model of the United Kingdom *Companies Act* provides for a procedure known as creditors voluntary liquidation. Those countries include at least Australia; Hong Kong, China; Malaysia; New Zealand; Papua New Guinea; and Singapore.

⁷³ See the Country Report for Cross-Border Insolvency for each of the Selected Countries at Section I, located on the TA website.

⁷⁴ See generally the Country Report for Cross-Border Insolvency for each of the Selected Countries at Sections D, E, F, and G, located on the TA website.

That procedure is initiated by resolutions of meetings of each of the company's shareholders and its creditors. There is also the voluntary administration process that has been developed in Australia and which is proposed to be available in New Zealand. A company enters voluntary administration by, among other means, a resolution of its board of directors.

In the case of both forms of administration, no recourse need be had to the courts as the workout of the relevant company's affairs is progressed. That is not to say that such recourse will always be unnecessary. So, for example, either if the moratorium on proceedings against the company or its property which obtains in both regimes is not observed or if the property of the company is not delivered up to its voluntary administrator or liquidator, an application to the court may be necessary. Concerns that apply in relation to the courts and the administration of justice in the context of an application to initiate an insolvency regime are also applicable in these circumstances.

Equally, the need for adequately qualified insolvency practitioners whose conduct is effectively regulated is critical to the success of and respect for each of the creditors' voluntary liquidation regime and the voluntary administration regime.

All of this being so, the essential issue is that when consideration is given to a country's formal insolvency procedures, it should not be limited by a requirement that the courts have a necessary role in all of those procedures. Moreover, in the case of recognized formal insolvency procedures, those procedures may be initiated by order of a court but that should not be a prerequisite to recognition. Formal procedures that are initiated out of court but that are subject to court supervision, such as creditors' voluntary liquidation or voluntary administration, should be susceptible to recognition.

As to cross-border recognition, if the liquidator appointed under a creditors' voluntary liquidation or the voluntary administrator of a company is recognized both in the company's place of incorporation and in all other jurisdictions in which it has assets, either as the company's governing body or as being able to exercise the powers of its board of directors, gaining control of its assets should not be problematic. However, recognizing the liquidator's or voluntary administrator's status as such will not give effect to the moratorium on proceedings or empower the institution of claims

for the clawback of the benefit of preferences or other like antecedent transactions. In any event, as the AP&P case study illustrates, it is the recognition of this power on the part of the insolvency administrator as well as the effectuation of the moratorium and the power to set aside antecedent transactions that dictates the desirability of an arrangement facilitating recognition of cross-border insolvency administrations. In the first instance, though, that recognition need not be required to be granted by a court, although it might require the intervention of a court to give it practical effect.

Part Five

5. The intersection between secured transactions and insolvency law regimes

This part of the technical assistance involves a consideration of the areas in which laws relating to secured transactions and laws relating to insolvency intersect.

Most insolvency and secured transactions regimes are created independently of and at different times from one another. It is also probable that different ministries or departments have had responsibility for each regime, with little or no consultation among them. It is often the consequence that one regime has not properly taken account of the other. This results in unnecessary and, at times, unwanted tension and conflict.

The possibility of tension and conflict between the two regimes has really emerged with the development of the modern reorganization or "rescue" remedies that are now a feature of most formal insolvency regimes. The rescue culture, as it is sometimes described, is based primarily on the proposition that, from an economic and commercial perspective, not all insolvencies are bad and not all insolvent traders should be immediately removed from the marketplace. To the contrary, there is economic justification to endeavour to save or rescue an insolvent trader because it is capable of producing better commercial (higher returns to creditors), market (supply markets might be preserved), and social (less unemployment) results.

However, to promote and encourage a rescue culture it is necessary to curb and restrict the legal rights of creditors, particularly those creditors who have a significant interest in some part or all of the assets and property of a debtor and who would otherwise be entitled to take and dispose of those assets (for example, a secured creditor who has a security over such assets). This has resulted in insolvency laws that place significant restrictions on the ability of a secured creditor to enforce rights over the assets of a debtor. Before the advent of the modern rescue legal process, insolvency laws contained little or no restriction on the enforcement rights of secured creditors because the business of the insolvent debtor would normally be immediately shut down and there was no point in applying restrictions. Now, however, the insolvency law

has to intervene and provide for restrictions in an attempt to give effect to rescue policy.

As will be seen, it is in this area that there is effective and real tension between secured transactions and insolvency law regimes.

5.1 Common ground between the two regimes

Despite the possibility of tension, there is now recognition of some considerable common ground between the two regimes. Each is concerned with debt, with relationships between debtors and creditors, and with enforcement. Individually (but, more importantly, in tandem), the two regimes are capable of exercising a considerable degree of influence on corporate governance. They also emphasize the importance of credit discipline by providing sanctions against non-payment of debt. This is often referred to as the presence of the "credible threat" and provides a strong incentive for a debtor that is experiencing financial difficulty to become proactive about its financial position.

5.2 Independent approaches

However, the two regimes diverge in their approach to these areas of common interest and in the values they seek to uphold, as might be appreciated from the following:

- Each postulates a different approach to debt. An insolvency regime endeavors to deal with the circumstance in which debts cannot be paid, whereas a secured transaction regime endeavors to assure that a secured debt will be paid.
- Each endeavors to uphold different rights. An insolvency regime is concerned with preventing a destructive race between individual creditors, but a secured transactions regime is concerned with maintaining enforcement rights of individual secured creditors.
- Each has a different stakeholder constituency. An insolvency regime looks to maximizing value for the benefit of all creditors. A secured transactions regime looks to maximizing value for individual secured creditors.

5.3 The interest of one regime in the other

A secured transactions regime will normally cover three basic areas—creation, registration, and enforcement.

Although the principal area of possible tension and conflict will occur in relation to enforcement, particularly at the point where a debtor becomes subject to a formal insolvency administration, the two other areas of intersection also attract some interest.

5.4 Creation of a security interest

As regards the creation of a secured property interest, an insolvency regime has an interest in supporting a secured transactions regime that clearly identifies the nature and type of security interests that are permitted and covered.

Identification of security interests is much more certain. In turn, this assists in the administration of an insolvent debtor because the property of that debtor that is subject to a security interest may be more easily identified and recognized.

5.5 Registration or perfection (publicity) of a security interest

An all-embracing registration system for secured property interests provides a reliable and efficient search base that benefits an insolvency regime. Such a search base provides the insolvency representative of a debtor enterprise with the facility to identify secured property and the holder of such security with relative speed and certainty. It would also assist an insolvency representative in determining the validity and enforceability of such security interests and the priority between competing security interests over the same property.

5.6 Enforcement of secured property interests

When a debtor becomes subject to a formal insolvency administration, there is a real probability of tension and possible conflict if security interests exist over assets of the debtor. The areas of potential conflict are identified below.

5.6.1 *Stay or suspension of enforcement rights and powers of secured creditors.*

It may be anticipated that when a formal insolvency administration is opened in respect of a debtor, the insolvency regime will provide for a stay or suspension of actions and proceedings in respect of the property of the debtor. The stay may be immediate and automatic or may be ordered by a court shortly after the opening of the insolvency case. It is usual for this stay to include secured creditors. The justification for the stay in the early or initial stages of the insolvency administration is that it is necessary to keep the insolvency estate intact and prevent dismemberment so as to enable a decision or course of action to be decided upon about the choice of remedy in respect of the debtor (which usually reduces to a choice between liquidation or reorganization). Provided the early initial stay is relatively time bound, the prospect of causing damage or prejudice to the interests of a secured creditor is relatively minimal.

The issue becomes more debatable, however. Secured transaction protagonists would say that if a liquidation remedy is decided upon there should be no stay on secured creditors, because the usual consequence will be that the business of the debtor is closed down and its assets dismembered. There is thus no continuing justification to continue any interference with secured creditor rights. That is a generally accepted proposition, and it is reflected by the majority of insolvency regimes. But it is also necessary to take into account that, even under a liquidation, there is still the possibility that the business of a debtor may be sold as a going concern. There is thus an argument that the stay should continue to apply to secured creditors under a liquidation process until either the business is sold or it is determined that the business should be closed. But there is common agreement that once a closure of any business has been decided upon, there is no justification to continue a stay on secured creditors.

There is also general acceptance that if the possibility of a reorganization is to be pursued, the stay on secured creditors should remain until at least a decision has been made to either abandon the attempt (and possibly convert to liquidation) or that a reorganization should occur. The issues that appear to be important here are that the stay should be time bound, that the length of the stay should be reasonably short, and that there should be a process for the possible lifting of the stay. The latter raises issues of the criteria to be applied.

5.6.2 *Involvement of secured creditors in the reorganization process (for example, participation in creditor meetings to consider a reorganization plan).*

As a general proposition, there should be no objection to such involvement and participation. Most insolvency law regimes so provide. A more critical issue concerns the relative power of a secured creditor to influence the outcome of the consideration of a proposed reorganization plan. This may materialize if an insolvency law categorizes secured creditors as a special class and requires a positive vote from such a class for the adoption of a plan of reorganization. Most insolvency law regimes provide for secured creditors to be regarded as a separate class, and some go so far as to categorize such creditors into subclasses (such as those who have mortgages over land, those who have chattel securities, holders of lease finance security or retention of title security, and so forth). This, of course, raises the issue of the extent to which any such class might be able to intervene and effectively block a reorganization proposal that has the requisite majority support of other classes or of creditors generally.

5.6.3 *Provision of post-commencement finance to enable a debtor either to continue to operate a business, to protect and/or maximize the value of certain assets, or to survive generally.*

This issue is capable of affecting established secured property interests because any provider of new finance to an insolvent debtor will require adequate assurance of repayment. If the law permits or sanctions the borrowing of such finance, the law must also provide for a realistic possibility of repayment. Here the methodologies vary. An insolvency law regime might create a simple priority for repayment of such finance, or a super priority payment entitlement ahead of all other claimants, including secured creditors. It might permit the creation of a security over property that is subject to existing security interests. Other variations are also possible. The critical issue is the criteria and conditions that should govern the provision and repayment of post-commencement finance with regard to the possible effect on existing secured property interests.

5.7 *Other areas to consider as providing possible tension between the two regimes*

Apart from the above areas, there are three other aspects to be considered in relation to the two regimes.

The first area concerns the application of the antecedent transactions avoidance provisions of an insolvency regime to secured transactions. This refers to the usual policy of an insolvency law to avoid preferential transactions, transactions involving property of a debtor that are made at an "undervalue," and transactions that are made with the intention of defeating or delaying creditors of a debtor (sometimes referred to as fraudulent transactions).

This issue is not likely to raise controversy. Most insolvency regimes would not exempt secured transactions from the application of antecedent avoidance provisions.

It is suggested, therefore, that there is no apparent policy or other reason to exempt a secured transaction from the application of the avoidance provisions of an insolvency regime.

The second area concerns the possible invalidation of a secured property interest that is not registered in accordance with the requirements of the secured transactions law. Where a secured transaction regime provides for and requires registration of secured property interests, it is not uncommon for the law to provide that an unregistered security is void and of no effect in the event that the debtor becomes bankrupt.

There should not be any great controversy about such a provision. The argument in favor of it is that it adds an additional incentive to register and publicize a secured property interest.

The third area concerns the application of the priority payment rules of an insolvency law regime to the proceeds of the realization of secured property interests. An insolvency law regime might provide, for example, that the claims of certain creditors must be paid out of the proceeds of secured property before any payment to the secured creditor. Taxation and employee claims are often prioritized in this way. A secured creditors' lobby would argue strongly against such an intrusion on the grounds that it creates uncertainty and unpredictability. Others might contend that there is social justification for such provisions.

5.8 The fundamental importance of the intersection

The importance of the intersection cannot be overemphasized because, on any analysis and on any view, security for a debt only becomes important when the debtor becomes insolvent. If a debtor is and remains solvent, it makes no difference whether a creditor is secured or unsecured because all creditors will be paid in full in the normal course. So, as trite a statement as it may be, it is when a debtor becomes insolvent that security over property becomes critically important.

5.9 Commercial and economic relevance of the intersection

UNCITRAL, in a *Legislative Guide for a Secured Transactions Law*,⁷⁵ has expressed its view of the economic value of an effective and balanced secured transactions legal regime as follows:

At a micro level: *"It is well established...that one of the most effective means of providing working capital to commercial enterprises is through secured credit."*

At a macro level: *"Creating a legal regime that promotes secured credit...can have a positive effect on the economic prosperity of States."*

The report later stated:

"...the Guide seeks to establish a balance between the interests of debtors, creditors (whether secured, privileged or unsecured), affected third persons, purchasers and transferees and the State. In so doing, the Guide adopts the premise, supported by substantial empirical evidence that creditors will accept such a balanced approach, and will thereby be encouraged to extend low-cost credit, so long as the laws (and supporting legal and government infrastructure) are effective to enable the creditors to assess their risks with a high level of predictability and with confidence that they will realise the economic value of the encumbered assets. Essential to this balance is a close coordination between the secured transactions and insolvency law regimes...."

It will be apparent that if that balance is ignored or not provided for and achieved, the economic

value will not be as great and, indeed, may not result at all.

It is sometimes suggested that the cost will always have an impact on secured credit unless a balance is achieved. But the impact is not all that one-sided. The strictures of one regime can impose cost or financial loss on stakeholders in the other. For example, if the policy of a state in relation to secured transactions was to "super protect" secured interests in property (for example, by not permitting any restraint on the enforcement of secured property rights in an insolvency context), any economic gain to the stakeholders under the secured transactions regime may be offset by the economic cost to stakeholders in the insolvency regime. Using the above example, the gain to secured creditors (no restraint on enforcement powers) would be offset by the cost to unsecured creditors because, without the assistance of such a stay or restraint, it would be difficult, if not impossible, to promote the reorganization of a financially troubled debtor and so maximize the potential return to unsecured creditors.

In one of its working papers on the development of the Legislative Guide, UNCITRAL expressed the concept of a desired balance in a slightly different fashion:⁷⁶

"In principle, the effectiveness and priority of a security right should be recognized and the economic value of the security right and the encumbered assets should be preserved in an insolvency proceeding. An insolvency regime, however, may modify the rights of secured creditors in order to implement broad social and economic policies.... If the insolvency regime does so, creditors whose security rights might be modified will incorporate this risk into their assessment of whether to extend credit and on what terms. Therefore, a State that wishes to encourage credit markets by means of a modern secured transactions regime must coordinate that regime with the insolvency regime."

It is primarily in connection with the search for an appropriate balance and coordination between the two regimes that this part of the Report is directed.

⁷⁵ UNCITRAL Report, 1 October 2002, ref: A/CN.9/WG.VI/WP.6/ADD.1., located on the TA website.

⁷⁶ Working Paper on Insolvency, A/CN.9/WG.VI/WP.9/Add.6., located on the TA website.

5.10 Division into three areas— creation, registration, and enforcement

The search for an appropriate balance and coordination between insolvency regimes and secured transaction regimes is best undertaken with an examination of the three areas into which a secured transaction may be conveniently divided (as mentioned earlier, creation, registration (publicity), and enforcement) and considering, in relation to each, aspects that are relevant to or attracted by the application of an insolvency law. A body of principles is proposed as each of the areas that attract the intersection is identified.

Some of these principles may not appear to be critical, in the sense that although they might appear fundamental to a secured transactions regime, their effect on an insolvency regime may appear marginal. However, they should be mentioned because their presence as part of a secured transactions regime can provide some ancillary support to an insolvency regime. An example may be found in the principle that promotes the desirability of an efficient registration system for secured transactions. Such a system will provide some ancillary support to an insolvency law regime because it will facilitate the easy discovery of any information concerning secured interests in the property of an insolvent debtor.

Hypothetical Example

To illustrate the relevance of each of the proposed principles, the following hypothetical case will be used during their development.

Assume that an insolvency case is opened in respect of a debtor corporation (XYZ Co.). XYZ Co. is a medium-sized corporation primarily involved in manufacturing. Its assets consist of plant and equipment, raw materials, vehicles, stock in trade, debtors, office furnishings and equipment.

The liabilities of XYZ Co. exceed its assets, and it is unable to meet its current debts as they fall due. The debts of XYZ Co. include unpaid tax and employee claims.

Before the insolvency proceedings were opened:

- One of its creditors (C1) who was owed an unsecured debt had threatened to commence recovery proceedings but agreed not to when XYZ Co. offered to provide it with a security over some of its assets. At the time the insolvency proceedings were opened, the security had not been documented.
- A relative (R) of one of the directors was given a security over some of the assets of XYZ Co., purportedly to secure a debt that was later discovered to be a nonexistent debt.

XYZ Co. has created a number of security interests over a variety of its assets.

A security interest that was created in favor of a secured creditor (SC) has not been registered.

Another of the secured creditors is under-secured (USC).

XYZ Co. has also received some supplies of raw materials under retention of title arrangements from the retention of title supplier (ROT).

XYZ Co. financed its plant and equipment under a lease finance agreement with a finance lease provider (LF), the effect of which provides XYZ Co. with a right to become the owner of the property upon completion of payments under the finance lease.

XYZ Co. intends to attempt a reorganization under insolvency laws. In the meantime, it wants to carry on its business in the normal course. For this it will require urgent funding to meet recurring outgoing payments, such as for supplies of raw materials and wages for employees. A potential lender (F) is prepared to provide finance but wants to be assured of repayment.

5.11 Creation of a secured transaction

From an insolvency law regime viewpoint, this area can be subdivided into two parts—the act of creation and the consequences of creation.

5.11.1 *The act of creation*

This primarily concerns a consideration of the laws that establish the basic formal and other legal requirements for the creation of a security interest in property between a debtor and a creditor.⁷⁷ In a number of jurisdictions, a secured transactions law may be regarded as the centerpiece of the laws of a particular jurisdiction.⁷⁸ But at its most basic, a secured transaction is constituted by a contract between a debtor and a creditor that involves the creation of an interest in property of the debtor in favor of the creditor. Thus, it may be expected that a variety of other laws will be relevant to and contribute to creation. These other laws would certainly include contract law and property law. It might also involve other laws, such as a notary law.

Since, in the usual case, a secured transaction will be created in a non-insolvency environment,

⁷⁷ The terms debtor and creditor are used throughout to avoid confusion. The term debtor refers to the grantor of a security (the person over whose property the security is created), and the term creditor refers to the grantee of a security (the person in whose favor the security is created).

⁷⁸ Indeed, it may be a self-contained code.

the laws that govern creation should, in that environment, operate free from the influence of an insolvency law. That may not, however, be the case where it is sought to create a secured transaction after an insolvency case has been commenced or opened.⁷⁹

5.11.2 *Creation of a secured transaction after the opening of an insolvency case*

If an insolvency case has been opened⁸⁰ in respect of a debtor under a relevant insolvency law, that law may properly seek to protect assets of a debtor from unauthorized actions of the debtor itself or from the manipulations of others. In this context an insolvency law may regulate the subsequent creation of a secured transaction over assets of the debtor.

Such regulation would usually take the form of a prohibition against or a provision that invalidates the creation of a security over the assets of an insolvent debtor after an insolvency case has been opened. To that extent, therefore, an insolvency law may intervene upon the creation of a secured transaction.

There should be no objection to such a prohibition or invalidation. The purpose is to protect the estate of the insolvent debtor and, thereby, the interests of creditors.

At the same time, such a prohibition should recognize that it may be commercially necessary to create security over the assets of an insolvent debtor (for example, to provide for post-commencement finance for the continued operation of the business affairs of the debtor). To that extent, an insolvency law should provide appropriate rules that enable a commercially justifiable secured transaction to be effected.⁸¹

Further, to the extent that an insolvency law prohibits or invalidates the post-commencement creation of a security, that law should also address the possibility that the prohibition may be unwittingly and innocently breached. For example, an unscrupulous insolvent debtor may create a security in favor of an unsuspecting

⁷⁹ Insolvency laws vary in the way in which an insolvency case may be commenced or opened. It might be by a filing in a relevant court, filing with a relevant regulatory body, or by a judicial pronouncement following such filing.

⁸⁰ "Opened" refers to an act that is required to formally commit an insolvent debtor to an insolvency process. The "act" may be a judicial order or judgment or administrative.

⁸¹ See later under Section 5.12.5.

third party if the circumstances are such to allow it to happen. This could occur if:

- there is inadequate publicity of the opening or commencement of an insolvency case (with the result that the third party is unaware and has no means of discovering that an insolvency case has been opened in respect of the debtor); or
- an insolvency representative fails to properly ensure that an insolvent debtor is not left or put in a position where the debtor can apparently deal with its assets without restriction.

Some exception to prohibition or invalidation may be necessary to deal with that circumstance.

A suggested principle to deal with this aspect is:

Principle 1:

An insolvency law may modify the rules relating to the creation of a secured transaction as regards property of a debtor in respect of whom an insolvency case has been commenced or opened.

Such modification may take the form of, for example, prohibiting or limiting the power to create such an interest or invalidating any such creation unless it is done with the authority or sanction of a relevant authority (for example, a court, the creditors, or an insolvency representative).

It might also be necessary to subject such a prohibition or invalidation to an exception to protect an innocent third party.⁸²

⁸² Because of the different nature of insolvency law regimes and the different manner in which insolvency cases are publicized and administered, it is difficult to state this need for a possible proviso other than in general terms.

Application of Principle 1 to hypothetical:

This is relevant to the agreement between XYZ Co. and UC. Although XYZ Co. agreed to give a security over its assets to C1, the documented security had not been created before the insolvency case was opened. If the insolvency law prohibits any assignment or transfer (including the creation of a security) of the assets of XYZ Co., C1 will not be able to enforce the agreement and will remain an unsecured creditor. The assets of XYZ Co. will not be further depleted.

If the security in favor of C1 had been created and documented before the insolvency case was opened, it would be dealt with under Principle 4.

5.11.3 Clear rules regarding creation

On a more general level, there can be little doubt that it would assist those involved in the administration of the assets of an insolvent debtor under an insolvency law regime if the 'rules' relating to creation were reasonably simple, well defined and ordered. It would assist an insolvency representative to more easily identify and determine if a secured interest over assets of a debtor has been validly created.

It might also be relevant that the secured transactions regime clearly identifies or classifies what type of financing devices (for example, retention of title transactions and finance lease transactions) are subsumed into or dealt with under a secured transactions regime.⁸³

A second principle could be:

⁸³ There are widespread differences in the approach to such devices. The Country Reports for Cross-Border Insolvency showed, for example, that in Korea, a retention of title contract is treated as a security interest. In Indonesia, the Philippines, and Thailand, a retention of title contract transaction would not be classified as a security. None of the four jurisdictions would treat a finance lease as a security. Because of such differences and the fact that there are policy issues at stake, it would not be appropriate to deal with this issue further in this technical assistance.

Principle 2:

Clear rules regarding the creation of a secured property interest would benefit an insolvency representative because it would assist in determining whether a secured property interest had been validly created.

Application of Principle 2 to hypothetical:

XYZ Co. has created a number of security interests. It would greatly assist the insolvency representative of XYZ Co. if the validity of those security interests could be easily determined by reference to clear and simple rules of creation. The fact that a security might be registered is not, under most systems, prima facie conclusive that it has been validly created. Each security must be considered on its own. Clear and simple rules regarding creation therefore assist.

It is also relevant to consider the position of ROT (the retention of title supplier) and LF (the finance lease provider) in this context. Depending on the policy adopted under a secured transactions law, both of these credit-type products may be characterized as a security interest (by reference to substance rather than form). If they were characterized as security interests, their creation would be governed by the same rules as any other security interest. Again, if they were so characterized as security interests, it would simplify a determination of their validity. This aspect is also relevant to registration, which is discussed under Principles 8 and 9.

5.12 Consequences of the opening of an insolvency case in respect of the debtor on secured transactions

When an insolvency case has been opened in respect of a debtor, there are a number of areas that will intersect, the main of which are as follows:

- the treatment generally of both secured property and secured creditors in a case of insolvency;
- the possible avoidance of a secured transaction;
- the involvement of secured creditors in the insolvency process; and

- the provision of post-commencement finance.

5.12.1 Treatment of secured property and secured creditors in a case of insolvency

The treatment of secured property in an insolvency case has two aspects to it.

One aspect is, in part, linked to the wider question of the description or definition of the insolvency estate of an insolvent debtor and what assets are included in the estate.

5.12.2 The insolvency estate

An insolvency law should include in the estate not only assets or property owned by a debtor, but also the rights of a debtor, whether proprietary, contractual, or of some other nature.

In relation to secured transactions and the estate of the debtor, the relevant issue is whether the secured property itself should be included in the estate. This will usually depend upon the issue of characterization—the form and substance of a security under the relevant secured transactions legal regime.

If a secured transaction is in the form of a contemporary style mortgage (as, for example, a typical security over land is in Korea, the Philippines, or Thailand), the substantive effect of the security or mortgage does not result in a transfer of ownership of the mortgaged property to the creditor. Ownership of the property remains with the debtor. It would follow, in the event that an insolvency case is opened in respect of the debtor, that the secured property should be included as part of the estate of the debtor because the property continues to be owned by the debtor.⁸⁴

However, if the form that such a secured transaction takes is like that which occurs in Indonesia (often described as a fiduciary security or fiduciary transfer), the effect of the transaction is that ownership of or title to the property is transferred to the creditor. It ceases to be "owned" by the debtor. In such a case, it may

⁸⁴ Of course, the property would be subject to the secured interest (the mortgage) and that involves the bundle of contractual and other rights created by the secured transactions contract (such as the right to sell the property and to apply the proceeds of the sale of the property toward payment of the secured debt).

not be appropriate to include such property in the insolvent estate of the debtor.⁸⁵ But what would be included is the bundle of contractual rights that the secured transaction contract has conferred upon the debtor in relation to the land, such as the right to reclaim (or redeem) ownership by payment of the secured debt, the right to receive any excess from the proceeds of the sale of the property (that which is in excess of the amount required to pay the secured debt), and so forth.

Another area that should be addressed concerns the entitlement to the fruits of secured property and to property acquired after the opening of an insolvency case. If a secured transactions regime permits or extends security over the fruits of secured property or permits security to be taken over after-acquired property, then that becomes relevant to issues concerning the estate of the insolvent debtor.

Most insolvency laws manage this area tolerably well, but there are a number of insolvency laws that fail to address the issue properly. That can create doubt and uncertainty in the following areas.

First is the way in which secured property and a secured creditor might be treated in an insolvency case. Whether secured property forms part of an insolvent estate or not might be relevant in determining whether the property would be subject to a stay or suspension against enforcement. A moratorium provision in an insolvency law might stay or suspend enforcement action against property forming the estate of the debtor. However, if it is not clear whether secured property forms part of the estate, there will be doubt and uncertainty as to whether the stay or suspension applies to enforcement action against the property by a secured creditor.

Second, the issue of whether secured property is part of the insolvent estate or not might also be relevant in determining how the property might be dealt with in the insolvency administration. If, for example, secured property forms part of the estate and the insolvency law gives power to an insolvency representative to deal with and sell

⁸⁵ That is in fact the case in Indonesia. According to the Indonesian Country Report for Intersection Between Secured Transactions and Insolvency Law Regimes: "property which is the subject of a valid security generally does not form part of the bankrupt estate." This statement

such property, the implication may follow that only the insolvency representative has the power to dispose of secured property.⁸⁶ On the other hand, if secured property does not form part of the estate, the implication may be that only the secured creditor would have the power to sell. Such an issue should not rest upon implication. In the interests of certainty and predictability, it should be made expressly clear.⁸⁷

To ensure that an insolvency law addresses these issues, the following principle may be usefully adopted:

Principle 3:

In relation to property that is subject to a security, an insolvency law should clearly state the effect of the law (and any relevant insolvency process) regarding:

- *the property itself and, in particular, whether the property or a bundle of contractual rights in relation to the property is included in the estate of the insolvent debtor (including, where relevant, the treatment of the entitlement of a secured creditor to the fruits of secured property and after-acquired property);*
- *any restraints on enforcement to which a secured creditor might be subject; and*
- *dealings with the property, in particular who has the power of sale, when the power may be exercised, and the manner in which the proceeds are to be treated.*

reflects the position at the time of the drafting of the Country Report.

⁸⁶ Subject to the right of the creditor to receive payment of the debt out of the proceeds of the sale.

⁸⁷ In Indonesia, for example, under the Bankruptcy Law a secured creditor has two months in which to enforce (sell) the security. If the creditor does not enforce within that time, the administrator of the estate may sell the secured property.

Application of Principle 3 to hypothetical:

It will benefit both the secured creditors of XYZ Co. and the insolvency representative to know the precise effects of the opening of the insolvency case as regards the security interests, the assets over which they were created, and the position of the security holders.

The first issue has to do with recognition of the security interests. For example, if the secured transactions law (more likely in combination with the insolvency law) makes it clear that the secured assets form part of the estate of XYZ Co., subject to the security interests, the secured creditors will be assured that their respective security interests will be recognized.

The second issue has to do with dealings with the secured property. If the insolvency law makes clear what powers may be exercised in relation to the possible sale of the secured assets, and who may exercise those powers and under what conditions, both secured creditors and the insolvency representative know where they stand and what is expected or required of them.

The final issue deals with restraints on individual secured creditor enforcement of a security interest. If the insolvency law creates a restraint on the enforcement of security interests (discussed in greater detail below under Principle 11), again, the position of the secured creditors is made more certain and predictable.

5.12.3 Avoidance of a secured transaction

An insolvency law may operate to avoid or invalidate certain transactions if their effect and the circumstances of their creation "unfairly" damage or prejudice the interests of creditors.⁸⁸ It is necessary to consider the application of such avoidance provisions to secured transactions.

There should be little or no argument against the proposition that a secured transaction should be subject to the same insolvency avoidance laws as might affect any other transaction. The insolvency law should therefore make it quite clear that a secured transaction is clearly within the ambit of the avoidance provisions.

⁸⁸ This area of intersection may also arise in relation to registration.

AP&P case study relevance

One month prior to the announcement of the debt standstill, IBRA obtained a \$1.3 billion security (by the creation of liens on fixed assets) to secure payment of a government guarantee.

It was not until over one year later that IBRA announced that the security was held in favor of all unaffiliated creditors of AP&P.

It appears that IBRA may have been forced to concede its secured position due to pressure from the other creditors rather than because such a transaction was liable to be set aside as voidable under the relevant Indonesian Law.

If there was an effective means of enforcing the law providing for the avoidance of pre-bankruptcy secured transactions, then the security in favor of IBRA might not have been created in the first place due to the deterrent effect of an effective avoidance regime or, alternatively, the transaction could have been set aside without the necessity of the application of commercial pressure.

A possible principle in this area might be:

Principle 4:

A secured transaction should be subject to the possible application of the pre-bankruptcy transaction avoidance provisions of an insolvency law, in just the same way as any other transaction.

Application of Principle 4 to hypothetical:

This concerns the creation of a security over an asset of XYZ Co. in favor of R for no consideration. If the insolvency law provides a clear statement of the types of pre-insolvency transactions that can be avoided or declared invalid (such as, in this case, the redundant creation of a security for no value), the secured transaction can be avoided and R forced to surrender the security. The creditors of XYZ Co. benefit by having the full value of the asset restored. It should be observed that the security might also be invalidated or declared to be ineffective if the secured transactions law of the relevant jurisdiction provides that the creation of a security is dependent upon the existence of an underlying debt obligation.

Another aspect concerns the security that was promised to C1. As mentioned in the discussion under Principle 1, if this security had in fact been created prior to the commencement or opening of the insolvency case involving XYZ Co., it is

liable to be avoided or declared invalid under the same provisions of the insolvency law that deal with transactions that prefer one creditor and prejudice other creditors. Again, the security would be declared invalid and C1 would be forced to surrender the security (or would otherwise not be entitled to enforce it).

5.12.4 *Involvement of secured creditors in an insolvency case*

An insolvency law will usually provide for the involvement and participation of unsecured creditors in a variety of ways, including:

- a right to notice of the opening of a case;
- a right to relevant information concerning a case;
- a right to notice of and to attend meetings;
- a right to appoint a committee to represent them;
- voting rights by reference to the amount of debt;
- voting powers on important matters connected to the administration of the case; and
- a right to file a debt claim and to have a claim admitted or to contest a rejection of a claim.

The position and rights of a secured creditor in relation to an insolvency case should also be stated to avoid uncertainty and doubt.

The following are examples of the involvement of secured creditors:

- An insolvency law should provide for the possibility that a secured creditor may be under-secured and, to that extent, may have an unsecured claim against the debtor. The law should provide mechanisms to enable a secured creditor to establish the amount of any unsecured debt (for example, by providing for the security to be valued). The law should then extend to the creditor all the rights of involvement of an unsecured creditor in respect of the amount for which the secured creditor is unsecured.
- The law should also provide for the involvement of a secured creditor in a reorganization proposal, particularly if secured property and the cooperation of secured creditors is likely to be necessary for the success of the reorganization. This may necessitate such things as giving voting powers to a secured creditor, possibly classifying secured creditors as a separate class, providing for the voting of that class, and providing to what extent and in what circumstances the class may be bound to a reorganization.⁸⁹
- An insolvency law should provide for the possibility that secured property may have to be sold and, provided that the interests of a relevant secured creditor were not adversely affected, establish a mechanism to require the relevant secured creditor to discharge the security over the property.

⁸⁹ Under the current insolvency law regime of the Philippines, creditors generally (including secured creditors) are accorded very few, if any, rights in respect of a rehabilitation proceeding. For example, creditors do not have voting powers in respect of a proposed plan of rehabilitation. The Philippines Country Report for Intersection Between Secured Transactions and Insolvency Law Regimes identifies this somewhat extraordinary situation as a cause for considerable concern in the banking and finance sector. In Indonesia, the suspension of payments (rehabilitation) process cannot bind secured creditors without their consent and, accordingly, they have no voting powers. Yet secured creditors are nonetheless subject to the stay and suspension of action provisions of that process.

A possible principle for adoption in respect of this area regarding these matters is:

Principle 5:

Insolvency laws should provide for the participation of a secured creditor in an insolvency case, particularly a case of reorganization, including the following:

- *establishing a mechanism by which a secured creditor may be able to claim and then participate in the case as an unsecured creditor; and*
- *in a case of reorganization, enabling a secured creditor to participate in any decision-making process and, for that purpose, establishing a class of secured creditors, regulating their participation and the circumstances under which a secured creditor may be bound to a reorganization plan.*

Application of Principle 5 to hypothetical:

One of the secured creditors, USC, is under-secured. The insolvency law should clearly state whether USC can be an unsecured creditor to the extent that USC's under-secured amount can be determined. USC would then be entitled to participate in the insolvency case as both a secured and an unsecured creditor.

When XYZ Co. comes to negotiate a reorganization plan, the insolvency law should be clear on the participation of secured creditors in that process—in particular, whether they may take part in any decision-making process, perhaps as members of a separate class of creditors, and whether they may be bound to a reorganization plan that is approved by other creditors (this is discussed further under Principle 7).

5.12.5 Provision of post-commencement finance

There may be a compelling need to provide finance to an insolvent debtor to enable the business to continue, particularly when a reorganization is seriously contemplated. The finance may be required to fund operating expenses, to complete partly completed projects, and so forth.

A proposed provider of finance will usually require adequate security for extending credit.

That may be difficult if the only assets over which an effective security might be given are already secured to pre-insolvency secured creditors. One way to overcome this difficulty is to permit the use of such assets as security, but subject to a safeguard protecting existing secured creditors (for example, permitting a super priority but only to the extent that the rights of pre-existing secured creditors to receive the economic value of their respective securities are preserved).

Insolvency laws should provide for this through explicit rules. The provision of clear rules means that a financier who contemplates providing secured finance to a prospective borrower can take into account the possibility that the secured property might be subject to post-commencement financing under transparent rules.

A possible principle for adoption is:

Principle 6:

An insolvency law should provide for the possible requirement of post-commencement finance for an insolvent debtor, particularly in a case of reorganization. If the provision of such finance would impact upon existing secured property interests of secured creditors, the law must clearly state the conditions under which such finance may be approved and provide for the preservation and protection of the economic and commercial interests of existing secured creditors.

Application of Principle 6 to hypothetical:

F will not provide XYZ Co. with urgently needed finance on an unsecured basis. The law will need to provide for and the conditions under which a "super priority" may be created in favor of F. The result could be that F obtains priority for payment ahead of all other creditors of XYZ Co. (including existing secured creditors) or obtains priority with the exception of existing secured creditors (the latter would only be practical if there was a likely surplus of value in the assets of XYZ Co. after taking account of the amounts owed to existing secured creditors).

The absence of any such provision in the law may mean lengthy, potentially troublesome, and ineffective negotiations with existing secured creditors. If such negotiations are not successful, the probability is that finance will be impossible to obtain and XYZ Co. would be forced into a liquidation process.

5.12.6 *Subjecting a secured creditor to a plan of reorganization*

A principal objective of a reorganization is to maximize the value of the estate of the debtor. If secured property is essential to a plan of reorganization it may be necessary to bind a secured creditor (and the secured property) to the plan. That requires a balance to be struck, however, to ensure that although bound, the effect on the secured creditor causes no impairment to the economic value of the security.⁹⁰

An insolvency law should therefore provide clear and transparent rules concerning the conditions that must be met for a secured creditor to be bound to a reorganization plan. The law should also enable a secured creditor to object to being bound by a plan.

A relevant principle could be:

Principle 7:

If an insolvency law provides that a secured creditor may be bound by a plan of reorganization, the law should provide conditions that ensure that the economic value of the secured creditor's rights are not impaired and should also permit a secured creditor to object to being bound unless such conditions are met.

Application of Principle 7 to hypothetical:

It is apparent that, if the business of XYZ Co. is to be continued and a reorganization plan negotiated as well as put into effect, it will be essential that all the assets that are subject to security interests be preserved. This means that all secured creditors will have to be bound by the plan (unless they can be paid out and the secured assets made free of security interests). This raises the issue of their participation in the reorganization process, which was discussed earlier under Principle 5.

More important, it also raises the issue of whether insolvency laws require, as a condition of binding a secured creditor to a plan, that any plan will ensure that the economic value of the rights of a secured creditor is not impaired by the

⁹⁰ In Indonesia, the suspension of payments process under the Bankruptcy Law does not apply to secured creditors, although they are nonetheless subject to a restraint on enforcement during the period permitted for a proposal to be advanced.

plan. Normally this would require that the plan provide for the continued payment of interest, regular repayments of principal, that the assets retain their value and so forth.

5.13 **Registration and perfection (publicity) of a secured transaction**

The second major area of a secured transactions regime concerns any requirement that the regime may impose for the publication (usually by way of registration) of a secured transaction. Under many regimes, registration is critical, particularly as regards third parties (for example, other actual or potential security takers and purchasers of secured property). A registration requirement provides protection and a system of priority for creditors whose security interests are registered; it protects a creditor who takes a subsequent security over property if the prior security has not been registered; and, in many cases, it protects persons who seek to purchase property of a debtor which is subject to a security interest. In some cases, the requirement for registration affects the validity of the transaction as between the parties to it. In Thailand, for example, the relevant law provides that unless a mortgage over land is registered, it has no effect at all (not even as a security between the parties).

5.13.1 *Registration system*

There can be little doubt that an insolvency law and its application in practice would benefit from a requirement that secured transactions (with limited exceptions, such as a possessory pledge of property) should be registered through an efficient registration system.

A person who is responsible for the administration of an insolvency case benefits because such a system:

- makes it easy to search for and identify secured property and a security holder;
- assists in determining validity of transactions; and
- assists in determining priority among competing security holders.

The country reports for this technical assistance (see the TA website) evidenced a number of deficiencies concerning the operation and use of registration systems (in some cases, the absence of any registration system at all) in relation to

secured transactions and the consequential problems that resulted.⁹¹

But how relevant is registration to an insolvency law and its application? Many experts and commentators point to the desirability, efficiency, predictability, and relative certainty that a registration system might provide. But that support is directed more to benefits for the users within the secured transactions system itself, rather than to benefits that might be associated with an insolvency regime. The benefit to an insolvency regime is thus only indirect. It is also the case that registration systems vary in quality and efficiency. Many countries do not support and do not provide for a registration system.⁹²

Since, as mentioned above, this technical assistance is not directed at the development and reform of secured transactions regimes, the area of registration appears to be one where any benefit that might be identified would be marginal.

This said, two principles regarding registration could be formulated as follows:

Principle 8:

To assist in the efficient identification of secured property interests, a registration system for secured transactions is desirable.

Principle 9:

If registration is a requirement for the validity or perfection of a security interest in property, that system should be:

- *efficient as regards both registration and searching;*
- *centralized; and*
- *computerized.*

⁹¹ For example, in the Philippines, the absence of a central computerized registration system makes searching a time-consuming, costly, and uncertain exercise. In Indonesia, a significant amount of rural land is not subject to a land cadastre (registration) system. According to the Indonesian Country Report for Intersection Between Secured Transactions and Insolvency Law Regimes, the consequence of this is that taking security over such land is highly problematic and uncertain. Problems are also encountered in relation to registered land in Indonesia because there are more than 400 land registries throughout the jurisdiction and no centralized national registry.

⁹² For example, Germany.

Application of Principles 8 and 9 to hypothetical:

The requirement to register security interests would, provided the registration system is efficient, assist the insolvency representative of XYZ Co. to quickly and easily determine the security interests created by XYZ Co., the identity of the secured creditors, and the identity of the assets that have been secured.

It would also assist the insolvency representative to determine, in a case where two or more security interests had been created over the same asset, the priority between those interests. That would reveal who held the primary security. That can be an important practical element in negotiating the prospect of a reorganization plan with such a secured creditor.

Depending on the characterization of the forms of transaction that constitute security interests, the issue of registration might also embrace ROT (the retention of title supplier) and LF (the finance lease provider).

Finally, if ROT is a secured creditor, an issue might arise about the priority between ROT and another secured creditor who has a security interest over the raw material assets or other trading stock of XYZ Co. Clearly, the latter security should not extend to the materials supplied by ROT. But it is the combination of an effective secured transactions law regime and a registration system that greatly assists in determining that issue. In turn, this makes it easy for the insolvency representative of XYZ Co. to deal with those competing interests.

5.13.2 A further sanction for non-registration

In systems where registration is required, mention should be made of the possible benefit of providing that a consequence of non-registration would be to invalidate or avoid a security if an insolvency case is opened in respect of a debtor. A number of countries provide for this.⁹³

The historical reason for such a sanction or consequence is based on the concept of false wealth. The argument surrounding it is that if a

⁹³ For example, Australia and England, where a non-registered non-possessory security over movable property will be invalid and of no effect against an insolvency representative in the event that the debtor becomes insolvent.

system of registration is provided and required but the parties to a secured transaction choose, for whatever reason, not to register the transaction, other persons might assume, possibly at their cost if they have subsequent dealings with the debtor, that the net worth or value of the debtor (or the property of the debtor) is considerably more than what, in truth, it is. Since the creditor involved in the unregistered secured transaction is just as much responsible for this "deception" as the debtor, the creditor should be penalized or sanctioned by, in effect, treating the security as though it does not exist in the event that the debtor becomes insolvent.

Something like this may be the reason for the approach taken in Thailand where the relevant law treats an unregistered security over land as being of no effect between the debtor and the creditor (whether or not an insolvency case is subsequently opened in respect of the debtor).⁹⁴

If this form of sanction is considered appropriate, then it should be provided for in a relevant secured transactions law (not in an insolvency law) as part of the overall policy that encourages registration.

A possible principle regarding this sanction for non-registration could be:

Principle 10:

If a secured transactions law provides for the registration of secured transactions, that law should provide for the avoidance of a non-registered secured transaction if an insolvency case is opened in respect of the debtor.

Application of Principle 10 to hypothetical:

Registration of security interests is one method of safeguarding potential creditors (including unsecured creditors) against the pretense of a debtor's "false wealth." In the hypothetical, SC has not registered its security interest. If the relevant secured transactions law provides that an unregistered security interest is invalid and of no effect if an insolvency case is commenced or opened in respect of the debtor, SC would lose the security and be reduced to the status of an unsecured creditor.

⁹⁴ The position appears to be similar in Indonesia. The Indonesian Country Report for Intersection Between Secured Transactions and Insolvency Law Regimes states that non-registration of securities over land and movables will make the security non-effective.

5.14 Enforcement

5.14.1 Importance of enforcement to the intersection of the two regimes

Enforcement is the area most likely to create tension between a secured transactions law and an insolvency law. In that regard, the IMF has stated:⁹⁵

"The impact of insolvency proceedings over the enforcement of security interests is so important that a framework for security interests cannot be designed without addressing the interaction between the two."

UNCITRAL also views the area with similar importance and has stated:⁹⁶

"In principle, the effectiveness and priority of a security right should be recognized and the economic value of the security right and the encumbered assets should be preserved in an insolvency proceeding."

The relevance may be best appreciated from a brief reconsideration of some of the competing goals and objectives of the two regimes (as mentioned above). Although both are concerned with debtor-creditor relationships, a secured transactions regime seeks to promote individual creditor rights and action and to ensure individual creditor debt satisfaction in full.⁹⁷ On the other hand, an insolvency regime deals with circumstances in which debts cannot be satisfied in full, promotes equal sharing between creditors, and seeks to maximize the value of the estate of a debtor.

Three main issues that consequently arise are:

- first, the effect of the opening of an insolvency case on individual secured creditor enforcement action and power;

⁹⁵ See IMF Policy Statement, 4 March 2002, located on the TA website.

⁹⁶ See Security Interests A/CN.9/WG.VI/WP.9/Add.6, located on the TA website.

⁹⁷ This is why, to be at all effective, it is necessary for a secured transactions regime to provide for an efficient system of enforcement. In the Selected Countries, with the exception of Korea, enforcement of a security is a problem because it is relatively easy for a debtor to obstruct and delay enforcement through restraining orders (granted by local courts) or by raising spurious objections and disputes.

- second, possession and use of and dealings with secured property during an insolvency administration; and
- third, the application of priority claims to the proceeds of the sale of secured property in the distribution of the property of an insolvent debtor.⁹⁸

5.14.2 *Restraint on the exercise of enforcement action against secured property*

It is now generally accepted that upon the commencement or opening of an insolvency case, an insolvency law may be expected to impose or otherwise provide for a restraint (in the form of a stay or suspension) on enforcement actions in respect of the property of the debtor.⁹⁹ The rationale and the object of such restraint, as mentioned above, is to prevent dismemberment of an estate for a period of time during which a decision is to be made concerning the commencement or opening of a reorganization case and to afford the time to determine whether it may be possible for a debtor to reorganize its affairs.

The insolvency regimes of many countries extend such a restraint to secured property and secured creditors. The restraint usually prohibits the commencement or continuation of enforcement action against the secured property. The prohibition usually extends to prevent a secured creditor from taking possession of the property and from selling the property.

The need to restrain enforcement of secured property interests is normally greater in the case of a proposed reorganization than it might be in a liquidation context. The removal of secured property from a business operated by a debtor may frustrate a reorganization plan (by

preventing attempts to continue the business or to sell it as a going concern).

If secured creditor enforcement action is stayed, the law should ensure that there are appropriate time limits of the stay,¹⁰⁰ that the economic position of a secured creditor is protected during the stay and that there are exceptions from the stay (to take account of, for example, secured property that is perishable).¹⁰¹ The law should also provide that a secured creditor might apply for a lifting of the stay upon certain conditions being established.¹⁰²

A principle to cover this aspect of restraint could be:

Principle 11:

An insolvency law may provide for a stay or suspension against enforcement action by a secured creditor in respect of the secured property. Such a stay should be limited in time (particularly in the case of the liquidation of the debtor), provide for limited exceptions to the stay, and should permit a secured creditor to apply for the lifting of the stay in defined circumstances.

Application of Principle 11 to hypothetical:

If XYZ Co. is to have any chance of survival, it would clearly be necessary that its core assets remain and are not threatened by secured creditors taking or continuing with enforcement action (the same would probably be true of enforcement action by ROT and LF). It is therefore usual that an insolvency law intervenes on such individual creditor rights by imposing a moratorium (stay or suspension) on enforcement action.

It is necessary, however, that a balance be sought between those competing policies. To this extent, first, any moratorium should be limited in

⁹⁸ Note that this part of the Report is not concerned with secured property enforcement generally—a secured transactions regime or other relevant law governs that. It is nonetheless important, both in relation to secured transactions generally and also in relation to informal workouts. A strong and effective secured transactions enforcement process will provide significant motivation for a debtor to seek to negotiate its position with its major creditors and that may lead to a successful informal workout.

⁹⁹ The UNCITRAL Working Group on Secured Transactions has expressed this issue of restraint as follows: "An insolvency regime...may modify the rights of secured creditors in order to implement broad social and economic policies."

¹⁰⁰ In Indonesia, in a bankruptcy there is a suspension for 90 days against secured creditors. A suspension of payments scheme provides for a 270-day suspension against unsecured creditors, but there is no suspension against secured creditors' rights.

¹⁰¹ In the Philippines, the stay against secured property enforcement that is imposed in rehabilitation proceedings is extremely wide. It offers very few protections for a secured creditor. According to the Philippines Country Report, this causes problems in the banking and finance sector regarding the availability of secured credit.

¹⁰² Such as economic impairment as a result of the stay, that the secured property is not required for the purpose of effecting a reorganization and so forth.

time (usually sufficient to enable a debtor such as XYZ Co. to develop and negotiate a proposed reorganization plan). Of course, if XYZ Co. failed to advance the reorganization plan, failed to secure the necessary approval for such a plan, or otherwise was placed in liquidation, the moratorium should lapse and secured creditors should be free to pursue their individual rights of enforcement.

Second, the law should permit exceptions to the moratorium, such as where a secured creditor can demonstrate that, for example, the secured assets are not vital or necessary to a reorganization proposal or that the secured assets are wasting or perishable or that the economic value of the rights of the secured creditor are impaired.

Finally, and as a corollary to the above, the law should provide that a secured creditor may apply for a lifting of the moratorium if such conditions are met.

5.15 Possession, use, and dealings with secured property during a stay against enforcement action

Except in the case of a possessory security, a debtor normally has possession and use of secured property. Land is occupied by the debtor, plant and equipment is used in a manufacturing business, stock in trade is bought and sold, and so forth. If an insolvency case is opened in respect of a debtor, that power to continue possession or use or otherwise deal with the property would normally pass to an insolvency representative (or in some cases, remain with the debtor, possibly under some form of supervision). Many insolvency laws will provide that the insolvency representative may exercise or cause the debtor to exercise the same rights and powers of the debtor in respect of such assets, at least until a decision is reached about the manner in which the affairs of the debtor are to be dealt with (usually reorganization or liquidation). That should be stated in the relevant law so that there is no doubt or uncertainty.

The principle can be stated as follows:

Principle 12:

An insolvency law may permit secured property to be used or otherwise dealt with during the administration of an insolvency case, but such use or dealing should be subject to the same terms and conditions that apply between the

debtor and the secured creditor or otherwise under an arrangement that protects the interest of the secured creditor.

Application of Principle 12 to hypothetical:

As discussed under Principle 11, the continued use of assets that are subject to a security interest will be vital to XYZ Co. There can be no objection to such use provided that it is done in accordance with the terms and conditions of the contractual arrangements between XYZ Co. and each individual secured creditor.

5.16 Priority claims

Insolvency laws usually identify and create a hierarchy of preferred or privileged claims and establish an order of priority in which such claims are paid in any distribution under the insolvency regime.¹⁰³ Typical of such claims are the administrative expenses of an insolvency case, unpaid wages of employees, other unsatisfied employee claims (holiday, long service, redundancy benefits), and government taxes. Historically, such priorities have only intervened on other unsecured claims of the general creditor body. If they are extended to intervene upon the entitlements of secured creditors, conflicts arise.

On the issue of such priorities, the European Bank for Reconstruction and Development has stated:¹⁰⁴

"Unless the number of preferential creditors is kept to a minimum, security interests will not achieve their ultimate objective of reducing credit risk."

UNCITRAL has expressed similar concerns:¹⁰⁵

¹⁰³ It should be noted that in many jurisdictions, other laws also impose a priority hierarchy that affects secured creditors outside of an insolvency context. For example, in Indonesia (as the Indonesian Country Report makes clear), the Civil Code establishes a number of priorities that must be accounted for before any distribution of the proceeds of the sale of secured property to the secured creditor. These include claims for wages. Also in Indonesia, the taxation law provides for unpaid taxes to be paid in priority to secured creditors who hold security over land and movables. In Korea, laws such as the Labor Standard Act, the Housing Lease Protection Act, and the Framework Act on National Taxes impose priorities on secured property.

¹⁰⁴ See European Bank for Reconstruction and Development, UNCITRAL Model Law, located on the TA website.

"The greater the uncertainty regarding the number and amounts of claims given priority over claims of secured creditors, the greater will be the negative impact on the availability and cost of credit."¹⁰⁶

It is not the purview of the technical assistance to support one or the other of the competing policies, but the current approach appears to urge caution and to promote a relatively unintrusive insolvency regime as regards the effect of priorities upon secured creditors.

A suggested principle as regards priority claims is:

Principle 13:

An insolvency law should limit any claims of privilege or priority as they may affect secured creditors. Any such claims to which the proceeds of secured property are subject should be stated in a transparent and predictable way.

Application of Principle 13 to hypothetical:

XYZ Co. has tax and employee claims. An insolvency law may afford them the special status of priority or privileged claims and provide that they must be satisfied ahead of all other claims. The issue here is whether secured creditors are subject to such a priority and if so, whether the claims must be met out of all or only some of the proceeds of the secured assets (for example, should they be given priority on the basis of a pro-rata sharing among all secured creditors). The more extensive the range and amount of such priorities, the more uncertain and unpredictable the market for secured credit.

5.17 A final issue—conflict of laws

The issue of applicable law is not normally a problem in relation to most domestic secured transactions legal regimes. But problems can arise in relation to movable property that travels

or is moved across borders.¹⁰⁷ If a debtor becomes subject to a formal insolvency process in its jurisdiction of domicile and has created a security over movable property located in and in accordance with the relevant law of that jurisdiction, an issue concerning the application of that law will arise if the secured property is subsequently located in another jurisdiction. This will also have some important consequences if, as a result of the presence of that property in another jurisdiction, the case becomes a cross-border insolvency case. There is no easy solution to this issue.¹⁰⁸ It may be appropriate, however, to try to provide for it in a law relating to cross-border insolvency, particularly if such a law takes the form of a treaty or convention.

5.18 Future aims

Assuming that the principles enunciated above have widespread acceptance, it may be appropriate to:

- examine and assess whether countries in the Asian region actually employ the principles under their respective insolvency and secured transactions law;
- identify countries that do not comply; and
- provide technical assistance to enable such deficiencies to be corrected.

¹⁰⁵ See UNCITRAL, Working Group V, Draft Legislative Guide to Insolvency Law A/CN.9/WG.V/WP.70., located on the TA website.

¹⁰⁶ In the Philippines, there is some uncertainty regarding, for example, the priority enjoyed by labor (employee) claims over secured creditors. In part this is caused by conflicting legislation. It is this type of uncertainty that can seriously affect the availability of secured credit.

¹⁰⁷ Mobile equipment (motor vehicles, trains, and planes) is probably the most notable example of such property, but goods and plant and equipment may also be moved from jurisdiction to jurisdiction.

¹⁰⁸ The European Community regulation on cross-border insolvency deals with the issue up to a point. It provides (see Article 5(1)) that the law governing the validity and effectiveness of secured property rights is governed by the law of the *lex situs* of the property at the time of the creation of the security interest, but it is silent on the applicable law if there has been a change in the location of the property subsequent to the creation of the security interest.

Part Six

6. Informal workouts

6.1 Introduction

This section of the Report deals with informal workouts.

As mentioned in the introduction section of this Report, the device or mechanism of the informal workout was developed as an alternative (or possibly a substitute) for formal insolvency processes. The concept is not, of course, new or unique. Informal arrangements between a debtor and creditors would have preceded even the earliest formal insolvency laws.

Most insolvency laws do not forbid or seek to prohibit a private compact between debtors and creditors, although some may state that an arrangement between a debtor and creditors that does not comply with the formal requirements of the law relating to "arrangements" or "compositions" is invalid or void.¹⁰⁹ But the essence of such a provision is really to prevent abuse (for example, in a case where an insolvent debtor and only some creditors agree on some form of payment arrangement between them but leaving nothing to be paid to all the other creditors). However, provided that an informal arrangement is agreed to by all creditors affected by it and no other creditors are prejudiced or adversely affected, such an informal arrangement will be as effective as any formal arrangement.

The informal workout is thus founded on two main elements. First, a private contract or consensual agreement between the debtor and those creditors that are party to the workout and second, ensuring that other creditors that are not party to the workout are not adversely affected (for example, by payment of their debts in full).

¹⁰⁹ For example, section 213 of the *Bankruptcy Act of Australia 1966* (Cth). By way of example, in the case of *British Eagle International Airlines Ltd v Compagnie Nationale Air France* [1975] 2 All ER 390, the House of Lords refused to give effect to provisions of a contract which achieved a distribution of an insolvent's property which ran counter to the insolvency legislation that provided for the payment of unsecured debts *pari passu* in that the effect of the contract under consideration was to promote the interests of the creditors who were party to it above the interests of the company's general body of creditors.

During the last 15 years or so, financial institutions, assisted by regulatory and other authorities, have been encouraged to cooperate with one another when dealing with debtors to whom they have been collectively exposed.¹¹⁰ Although such cooperation has been most apparent in periods of economic recession, there has been more general acceptance of the desirability of cooperation in any economic circumstances. This is primarily because a coordinated response provides time to help manage the impact of debtor defaults and creates an opportunity to explore and evaluate the options for consensual agreement outside a formal insolvency process.

Once the informal workout process had become generally accepted by the financial sectors in countries that led its development and application (for example, England and the United States), some areas of potential problems and tension arose. For example, in relation to a syndicate of banks involved in a financial facility with a defaulting debtor, it was sometimes the case that one or more members of the syndicate refused to agree to a proposed informal workout, and both held out for a greater return or sought to assign their part of the syndicate debt to a person outside of the syndicate.

There was also pressure to let other, not strictly financial institutions (such as insurance companies and bondholders), into the informal workout process, to which there was some reluctance and resistance because their attitudes and goals might differ quite markedly from banking sector participants. Further, the quite substantial development of markets in secondary debt has introduced the prospect of an informal workout that might initially involve only bank primary debt holders but is then suddenly composed of debt traders who have acquired debt from some of the financial creditors such as banks. To some degree, these tensions have been able to be accommodated through the employment of one means or another. For example, peer pressure can be applied in the case of recalcitrant bank syndicate members. It is also now generally accepted that insurance institutions, bondholders, and debt traders will need to be included or in some way accommodated in any informal workout process.

¹¹⁰ As noted in INSOL International (2000), Statement of Principles for a Global Approach to Multi-Creditor Workouts (referred to in this section of the Report as the INSOL principles) located on the TA website.

6.1.1 Advantages of informal workouts

There are usually material advantages for both debtors and creditors in pursuing an informal or contract-based rescue or workout. Some of the main advantages are said to be that:

- the possible cost, complexity, uncertainty, and possible extensive time of formal insolvency processes are reduced;
- because the numbers of creditors involved are relatively small, there is less need for formalities and, as a result, greater efficiency;
- a greater degree of secrecy and confidentiality may be possible (in the sense that there is no publicity or public knowledge that the debtor is in financial difficulty);
- there may be greater flexibility and less rigidity in determining a plan of action for the resolution of the financial difficulties of the debtor since the participants are not bound by constraints that might be imposed by a formal insolvency reorganization regime; and
- an informal workout that is sustained by an agreement between the debtor and its financiers provides a more sympathetic regime in which to reorganize the debtor's affairs than is usually the case in a formal insolvency administration.

6.2 Development of informal workout principles

An informal workout process normally involves a corporate debtor whose greatest level of liability is bank and other financial institution debt (often as high as 90% or more). It is usual to exclude other creditors, such as trade creditors, from the process on the basis that their interests will not be adversely affected by it and may even be enhanced. Indeed, under an informal workout, the claims of creditors such as trade creditors will often continue to be paid in full to ensure an ongoing supply of those goods and services which are necessary to maintain the debtor's business as a going concern.

The modern informal workout has to accommodate differences in the amount,

number, and variety of financial sector debt. To do this, a body of broad principles has been developed (of which the leading example is contained in the INSOL Statement of Principles), together with rules to govern the process. The application of principles and rules gives the informal workout process a structure, without which the process would probably be unmanageable and ineffective.

6.3 Incentives to participate

Submission to an informal workout process under such principles and rules by a debtor and its creditors is, of course, purely voluntary, but a necessary characteristic of an informal workout. To describe the process as voluntary, however, overlooks an essential feature that normally must be present if the informal workout process is to have any likelihood of support, success, and involvement. This additional feature may be best described as pressure of one kind or another that provides the incentive for both debtor and creditors to commence and then endeavour to negotiate an informal workout.

Usually the pressure will be found in the hovering shadow of the possible application of an insolvency law regime and, depending on the circumstances, the enforcement provisions of a secured transactions law regime. It is the prospect of the impending and effective application of one or both of these regimes that will usually compel both a debtor and relevant creditors to participate in the informal process.

As regards a debtor (and, to some extent, creditors), the presence of such a credible threat may be essential to the entry into an informal workout process.

It is at least arguable that the absence of a credible threat is one of the main reasons why a viable informal workout plan has not been agreed in the case of AP&P Group.

For relevant creditors, however, pressure might also come from other sources (for example, the type of persuasion that might be applied by an association of banks, a central bank, or ministry of finance to encourage a bank or other financial institution to participate or indeed, take a leading role in promoting informal workouts). Alternatively, banking sector participants might agree among themselves to participate in informal workouts generally, if certain criteria or conditions are met. It is these possibilities to which attention could be given in the course of any cooperative undertaking between ABA and

ADB. Certainly, the experience in Korea suggests that there is benefit to be had from a contractual regime under which financial institutions commit to be bound by a set of principles and procedures in the circumstance that a debtor or one of the financial institutions proposes an informal workout.

6.4 Development of informal workout processes in the Asian region

The real impetus for the development and deployment in the Asian region of the techniques associated with informal workouts came with the Asian financial crisis in 1997. Indeed, prior to that crisis, it may be generally stated that informal workouts of the type under discussion in this paper were relatively unknown and not practiced in the Asian region.

A significant consequence of the Asian financial crisis was that the loan portfolios or receivables of many banks operating in the Asian region were significantly depreciated in value. As a consequence, the integrity and stability of the banking system in various countries in the region was severely threatened. Absent some form of intervention by governments or central banks, there could have been a complete collapse of the financial sector.

That intervention resulted in two streams of informal workout development.

6.4.1 Structured workout processes

Initiatives were led by either the central banks or the commercial banks themselves to establish what might be best described as structured informal workout processes. This resulted in organizations or agencies creating initiatives such as the Corporate Debt Restructuring Framework in Thailand, Corporate Debt Restructuring Committee in Malaysia, the Jakarta Initiative Task Force in Indonesia, and the Financial Institutions Agreement in Korea. These organizations or agencies promoted an environment to enable banks and corporate borrowers to come together in an attempt to negotiate a settlement of non-performing loans owed to the banks. In the great majority of cases, this meant that a reorganization proposal for the borrower was essential. This process was structured in the sense that certain criteria had to be met before a corporate borrower was eligible to participate (for example, the bank or financial institution debt had to represent an amount in excess of a prescribed percentage of the debtor's

total liabilities) and eligible borrowers were required to submit to the creditors a proposed set of rules for the informal workout process. In some cases, strict rules applied to the type of agreement or arrangement that banks reached with a borrower regarding payment or settlement of its debts to financial institutions (such as, for example, prohibiting or limiting equity for debt swaps as part of the overall reorganization of the borrower's affairs). To some degree, therefore, the processes were aimed at protecting the banks, rather than accommodating insolvent debtors. The relevant details of these initiatives are as follows:

- **Korea:** The initiative was known as the Financial Institutions Agreement for Promotion of Company Restructuring, the subscribers to which were Korean banks and other financial institutions.
- **Thailand:** The process was formally known as the Framework For Corporate Debt Restructuring in Thailand. The Board of Trade of Thailand, the Federation of Thai Industries, the Thai Bankers' Association, the Association of Finance Companies, and the Foreign Banks' Association jointly initiated the process.
- **Indonesia:** The initiative in Indonesia became known as the Jakarta Initiative and was promoted by a task force appointed by the President.
- **Malaysia:** In Malaysia, the informal system was promoted by the central bank, Bank Negara Malaysia, through the Corporate Debt Restructuring Committee.

Less structured and more flexible initiatives were also undertaken in Singapore, and also in Hong Kong, China, where the initiative was largely that of the Hong Kong Association of Banks with the endorsement and support of the Hong Kong Monetary Authority.

Copies of the relevant materials relating to the above have been posted to the TA website.

6.4.2 Asset management workouts

The other development came about as a result of the activities of public sector asset management companies. Such organizations included IBRA in Indonesia, the *Danaharta*-inspired statutory

corporation in Malaysia, and the Korean Asset Management Corporation in Korea. More recently the Thai Asset Management Corporation was established in Thailand to undertake a similar activity. Those organizations, in effect, liquefied the receivables of many banks, at least to the extent that those receivables represented non-performing loans, by acquiring them. The asset management companies then dealt directly with corporate borrowers to resolve their financial obligations (which, in many cases, meant a reorganization of the debtor under an informal workout arrangement).

Although these two streams of development have greatly contributed to the evolution and development of the informal workout processes in many Asian countries, the fact that they were a direct consequence of the financial crisis and were developed in that environment has probably produced a skewed form of informal workout process. This is because the essential thrust of the processes was geared toward saving banks and re-establishing the integrity of the banking sector and system. By comparison, the environment with which the technical assistance is more concerned is one that is not overshadowed by banking sector instability, an environment in which banks and financial institutions are not so much concerned for themselves but are more concerned with the prospect of rescuing or reorganizing a borrower that is in financial difficulty.

6.5 Differences in approach in the Asian region

Part of the work involved in the technical assistance has been to explore the achievements and experience of the initiatives mentioned above, consider the results that have been obtained, and, in particular, promote the continued development of the informal process through the banking and financial sectors of countries in the region. There is a degree of variation (and resulting comparison) to be made between these processes. The comparative issues include the following:

- **Influences that encourage development.** Some have been clearly influenced by government and/or central bank policy (for example, Indonesia Malaysia, and Thailand). That influence was, however, probably required because informal workouts had not been practiced in those countries; and a development of that

nature was required to deal with significant problems in the banking sector as a result of the regional financial crisis. In other countries, the informal workout process has largely developed through the initiative of the banking and financial sector itself (for example, Hong Kong, China, Singapore, and possibly Korea). To this extent, the development reflects recognition on the part of participants in that sector (both within the Asian region and beyond) that the informal workout process often yields a better commercial result when applied to the reorganization of the affairs of a debtor than is the case with formal insolvency processes.

- **Coverage.** With respect to coverage, some essential differences can be noted. In Korea, for example, the extent of coverage depends upon which banks and financial institutions subscribed to the Financial Institutions Agreement. An attempt at an informal workout could only be conducted in respect of the affairs of a debtor of one of the subscribing banks and in circumstances where the liabilities of the debtor to the subscribing banks represented at least 90% of its total liabilities. A further limitation arose because foreign banks were largely excluded from the process. In Thailand, the eligible debtors were, in effect, either nominated by a bank or other financial institution or volunteered for the process.
- **Differences in the process.** Under the Thai process, the banks were required to subscribe to an agreement governing the process, and a debtor who sought to participate was required to "accede" to the agreement. This provided a contractual base for the process. Under the Indonesian, Malaysian, and Thai processes, a facilitator was provided in the form of a quasi-government agency. No such agency is involved in Hong Kong, China or Singapore. In Korea, the banks appointed a Company Restructuring Committee to act as facilitator.

6.6 Issues for consideration

As mentioned above, many of the informal processes in the Asian region were promoted and developed as part of a response to severe problems within the banking sector as a result of a general economic crisis. They have been tailored to fit that circumstance. Although they no doubt have been valuable and productive for the banking sector (and, possibly, for bank debtors), an issue arises about their applicability in non-crisis circumstances and to what extent banking sector involvement in such processes has molded a view or attitude on informal workouts that needs rethinking and possible redesign. For example, some informal processes (such as those in Thailand) contained prescriptions on the manner and type of "deal" that a bank might be authorized to conclude with a debtor (such as a limit on the amount of any debt write-off or a limit or ban on the amount of debt conversion to equity and so forth). If the intervention of a central bank or a ministry of finance is too intrusive (for example by dictating to banks what type of debt restructuring is acceptable), the results may not be all that encouraging. Excessive intrusion might materialize in different ways, for example by:

- Encouraging the reorganization of an insolvent debtor through the restructuring of loans or other finance facilities to enable a bank to reclassify the loan as some degree better than non-performing. That might help to improve, at least on paper, the balance sheet of the bank. But if, in essence, all that such a "reorganization" does is to extend or postpone the time for repayment of a loan or other financial assistance, very little, if anything will have been achieved. The debtor will remain in financial difficulty or insolvent, and the time for a realistic attempt to deal with the financial problems of the debtor simply will have been postponed. The result is a highly artificial and non-sustainable reorganization.¹¹¹
- Preventing, in a case that quite clearly requires it, a reduction of debt. To

¹¹¹ The Country Reports clearly evidence that in some of the Selected Countries this has indeed been the result of the employment of the semi-formal or structured forms of workout referred to in previous parts of this Report.

stipulate that a bank is not permitted to entertain or agree to a proposal for a reduction of debt or to engage in an equity-for-debt swap, removes any ability for the parties to negotiate according to commercial realities. As a result, attempts at an informal workout will fail (even though, in a liquidation, creditors may receive less than what is proposed under the informal process).¹¹²

Those type of dictates should not be applicable in non-crisis or normal circumstances.

What follows below is an analysis of various issues for consideration.

- **Are influences (in the sense of central bank pressure or credible threats) necessary, or even desirable, for the promotion of an informal workout process?**

This refers both to the banking and financial sector itself and the debtor. As regards the banking sector, the issue is whether encouragement of one form or another might be required to propel, or even compel, banking and financial institutions to participate in an informal process. A further option, which is considered below, is the prospective threat of the initiation of a formal process if a significant majority of a debtor's creditors are prepared to agree to an informal workout, but a few are resistant to the proposal. An example of the necessity for such encouragement is the attitude of the Chinese banks and IBRA in relation to the AP&P Group. The High Court of Singapore found that given the indications of IBRA and the Chinese banks, the administrators would make little headway in the discharge of their duties if appointed. A means to encourage such participation in informal workouts would need to be developed to deal with dissident creditors as part of the informal workout process. Such encouragement might come from, for example, a central bank and might take the form of a simple endorsement of the process or a directive. It might be more appropriate if encouragement comes from within the sector itself through, for example, an endorsement of an informal process by an association of banks or an

¹¹² See the Country Reports for Informal Workouts, located on the TA website.

agreement among banks themselves (as is the case under the Korean process).

As regards a debtor, a chamber of commerce or a trade association might be able to encourage participation. But, in reality, the encouragement that is required for a debtor will usually be found in the credible threat notion (for example, the prospect of enforcement of secured property interests and/or the application of formal insolvency processes). The same persuasion might also be used to induce creditors to participate (or else the debtor or majority of creditors could seek a formal remedy under the insolvency regime). The lack of a credible threat in the case of AP&P Group has resulted in there still being no agreed informal workout proposal 4 years after the unilateral standstill announcement. So a further issue that arises in this context is whether, in the absence of such credible threat, there is any other basis upon which to encourage creditor and debtor participation in the process.

- **Is it desirable to develop and employ a set of rules to govern the process to which both creditor institutions and a debtor would be required to subscribe in order to commence or initiate the process?**

Such rules would go beyond a set of principles. They would set out actions to be taken, obligations to be performed, time limits to be observed, and so forth. Rules of this nature might give an informal workout process a desirable structure and impose some discipline upon the participants. Questions that arise in this context include whether a set of rules of universal application might be developed and whether any such rules might begin to formalize the process and undermine its essential informality.

- **How are issues concerning breakaway members of a banking syndicate, bondholders, and debt traders best addressed in the context of an informal process?**

These types of issues are raised in the introduction to this part of the Report. In relation to breakaway banks, should this be addressed by the terms of the syndication agreement or peer pressure or, even, friendly central bank intervention? Issues concerning bondholders, debt traders, and the like essentially involve the possible intrusion of

non-banks with different attitudes and different agendas.

The arrangements for informal workout processes in Korea require that the assignor obtain a written commitment from the assignee that the assignee shall assume and observe all the resolutions, agreements, or decisions made by the Creditors' Financial Institution Committee (CFIC) or the major creditor bank. The assignor may only exit the workout after it secures the written commitment from the assignee. The assignee then becomes the new member of the CFIC in connection with its purchased claims.

Article 24(4) of the *Korean Corporate Restructuring Promotion Act (CRPA)* provides that the assignor must ensure that the assignee submits a written commitment stating that it will observe the CRPA provisions and procedures. Further, if the assignor fails to ensure this, the Financial Supervisory Commission may order the assignor to rectify it or face sanctions (under Article 36 of the CRPA).

- **Is it necessary or desirable to provide for a possible requirement of mediation as part of the informal process?**

Despite the best intentions of the participants, deadlock between creditors and the debtor or between creditors or groups of creditors themselves is always possible and may ultimately frustrate the informal process. In some countries that established a quasi-structured informal process, the possibility of the intervention of a representative of a committee or agency to mediate on deadlocks was provided for. Perhaps then, the issue is whether the principles or rules governing an informal process should include provision for the possibility of mediation (and if so, by whom) or whether the issue of mediation should be left to the interested parties to determine on a case-by-case basis.

- **What is needed to provide a regional or global approach to informal workouts?**

The acceptance of broad principles (such as the principles developed by INSOL International) would no doubt be a first step at establishing some common international ground. Leaving aside the acceptability of

the INSOL principles, the question arises whether it might be appropriate or desirable to seek the endorsement and promotion of such a set of principles by, for example, central banks or associations of banks in a number of countries, or even on a pan-Asian basis through an organization such as the ABA.

- **Would a domestic workout process benefit from the possibility of a fast track conversion mechanism to a formal reorganization?**

This issue contemplates that an attempt at a workout has reached a point where a majority of participating creditors have signalled their satisfaction with the terms of an informal reorganization plan. However, there are dissenters; and without their involvement, the plan may be incapable of implementation. If the majority of those in favor is such in number and value that it would comply with the requirements of creditor approval under the relevant formal reorganization process (and effectively bind dissenting creditors or groups), then a logical solution would be to provide for a conversion mechanism within the formal insolvency law regime to effectively transpose and subject the result of the informal process to the effects provided under the formal reorganization process. Such a mechanism would provide a fast track into the formal insolvency regime and would avoid having to undertake a large part of the procedure required under the formal law.

This concept and the type of legislation that might be required to implement the concept is being developed by UNCITRAL as part of its work on legislative guidelines for insolvency law. A draft of that development (together with some explanatory material) has been posted to the TA website. It should provide a useful basis for discussion of the concept.

- **Would it be possible to provide for a 'fast track' conversion mechanism in a cross-border case?**

A further issue that arises is whether a conversion mechanism might be similarly developed to deal with a cross-border informal workout case. This could arguably be provided for in cross-border insolvency laws.

The technical assistance contemplates a commercial and financial environment in which the concern is not about the banking and financial sector but more about the manner in which that sector and its individual members may seek to promote the reorganization of borrowers in financial difficulty.¹¹³ The main part of this section of the Report is directed toward the development and employment of principles for use in such an environment.¹¹⁴

6.7 Other issues

Other issues that are relevant for consideration mentioned above, including the need for strong and effective formal enforcement processes, the promotion of principles, the use of mediation processes, and the use of formal insolvency processes in conjunction with informal workout processes, are addressed in Section 6.10 of the Report.

6.8 The INSOL principles

As mentioned above, INSOL International has pioneered much of the work in the development and statement of acceptable guidelines or principles for employment in informal workouts. There is widespread acceptance of those principles. There was general agreement at both the Manila conference and the Singapore conference that the INSOL principles form a sound basis for developing principles for informal workouts in the Asian region. Because of this general acceptance and the need to promote as much harmonization as possible, the INSOL principles form the basis of the principles to be advanced as part of this Report. Section 6.9 is directed primarily at the development of such principles. It will be seen that, although all of the INSOL principles have been incorporated, there are some additional principles. These have been added for the sake of greater clarity (the INSOL principles assume some of these) and, in other instances, to provide greater detail.

¹¹³ In part that may involve consideration of cultural, political, and economic imperatives that may be present and active in the environment in which an informal workout process will operate.

¹¹⁴ To a large extent, the essential characteristics of such guidelines may be found in the work of INSOL International. See INSOL International Statement of Principles for a Global Approach to Multi-Creditor Workouts, located on the TA website.

6.9 Development of principles for informal workout processes

Similar to the approach taken in Part Five when dealing with the intersection between secured transactions and insolvency law regimes, to illustrate the relevance of each of the proposed principles, the following hypothetical case will be used during their development.

Hypothetical Example

ABC Co. is a large corporation primarily involved in manufacturing. Its assets consist of land, plant and equipment, raw materials, vehicles, stock in trade, debtors, office furnishings, and equipment.

The liabilities of ABC Co. exceed its assets, and it is unable to meet its current debts as they fall due. The debts of ABC Co. include:

- A debt of \$20 million for various finance facilities owed to a syndicate of six banks, Z Syndicate. One of the members of the syndicate, upon learning of the financial predicament of ABC Co., is seeking to withdraw from the syndicate, possibly by selling its share of its participation in the syndicate to a debt trader.
- An overdraft debt of \$5 million owed to X Bank, the usual banker of ABC Co.
- A debt of \$3 million arising from a lease finance arrangement with Y Leasing Co.
- A debt of \$8 million owed to W Bank.
- A debt of \$50,000 owed to U Bank for a building works loan.

Debts owed to about 100 trade and service suppliers. Most of these debts are less than \$10,000. However, one of the debts is for an amount of \$1 million owed to T Co. for supplies of raw materials. T Co. has security for the debt over the material it supplies. The materials supplied by T Co. are essential to the continued manufacturing operations of ABC Co.

- Bondholders of an amount of \$10 million.

- Employees whose accrued salary and other entitlements (holiday leave, long service leave) amount to \$1million.
- Revenue debts of \$1million.

In addition, a venture capital and debt-trading firm (V Co.) has offered to buy the \$8 million debt from W Bank and is considering a possible offer to buy the bonds from the bondholders.

The position of ABC Co. in relation to some of the above creditors is that:

- It has postponed payment of its debts to its financiers.
- It has been asked by X Bank, its usual banker, to provide greater security to X Bank, and has agreed to do so.
- T Co., its major supplier, has threatened to exercise its rights of enforcement as a secured creditor.
- Some of the bondholders have threatened to take insolvency proceedings against it.
- The Z Syndicate has asked it to engage in urgent discussions.
- It is aware that V Co. has been active with some of its creditors and has been also acquiring some of its shares in the marketplace.

Faced with all these problems, ABC Co. wants to attempt a reorganization. It is concerned that any adverse publicity might further damage its already difficult position and therefore wants to avoid formal insolvency processes. In the meantime it wants to carry on its business in the normal course. For this it will require urgent funding to meet recurring expenditures, such as for supplies of raw materials and wages for employees.

6.9.1 Development of first principle—to whom should informal processes primarily apply?

The first issue is to determine which creditors are relevant for the purposes of an informal workout.

The origins and the experience of informal workouts in many countries clearly indicate that the principal creditor participants in the process

should be restricted to the major financiers of a relevant debtor. There are a number of reasons for this, the main of which are that:

- Such creditors will normally be the largest, the most vital, and the most influential.
- It is not usual to include trade or commercial creditors in such a process because, generally, such creditors are either too numerous, their debts are relatively small, or their level of involvement and influence will be minimal. Moreover, because the usual proposal for and result of an informal workout is that such creditors are paid in full and are relatively unaffected by any resulting reorganization of the debtor, there is no need for them to be included.¹¹⁵

Another issue concerns fringe financial creditors, such as bondholders and debt traders. As mentioned earlier, creditors such as these will sometimes have a different approach to and a different agenda (compared with traditional banking and finance institutions) for a proposed informal workout and resulting reorganization. Because of such differences, there was some initial resistance by the banking and finance sector to their involvement in informal processes. Those attitudes have altered, however, partly because it is now recognized that, for example:

- bondholders have a significant interest and stake in the outcome of an informal workout, and their involvement is often critical; and
- debt trading has become an accepted and frequently used commercial mechanism, and there would be no point in trying to prevent a bank from selling its debt or trying to prevent a debt trader from taking the place of that bank at the negotiating table.

A relevant principle might be:

¹¹⁵ There will, of course, be occasions when it might be necessary to include a trade or commercial creditor as, for example, where the trade creditor is the primary source of supply for the business operations of the debtor.

Principle 1:

All finance creditors (other than those whose exposure is negligible, such as trade creditors with relatively small or inconsequential claims) should be eligible to participate in an informal workout process.

Application of Principle 1 to hypothetical:

To commence informal workout negotiations, the first question to be considered by either ABC Co. (if it is the initiator) or one or more of its major creditors (if they are the initiators) is which creditors should participate in those negotiations.

Clearly Z Syndicate, X Bank, and W Bank should be participants because they are all finance creditors; and their respective debts are substantial.

The fact that Z Syndicate has sought its own private discussions with ABC Co. should not cause ABC Co. to ignore the other major creditors.

Some difficulty could be caused if there are internal problems within the Z Syndicate (for example, as mentioned in the hypothetical, one of the banks is seeking to withdraw). Normally, however, a syndicate agreement will provide for such events; and it should still be possible for the syndicate to participate as a single group of creditors.

Y Leasing should also be a participant, because the debt is substantial and, although Y Leasing is not a bank, it should be treated as a finance creditor.

It is suggested, however, that U Bank, even though it is a finance creditor, may not need to be included as a participant because the size of the debt is not significant.

It might also be appropriate that T Co. be included because, although not a finance creditor, it is the principal supplier of raw materials to ABC Co., the debt owed is substantial, and T Co. holds significant security for the debt over assets of ABC Co.

The other trade and service suppliers would not normally participate because of their number, the relatively small amount of their respective and aggregate debts, and, if the workout negotiations are successful, the probability that they will be paid in full in the normal course

It may be necessary to include the bondholders because of the overall size of the debt and their threat of action against ABC Co. It might also be relevant to ensure that the bondholders are or can be organized as a collective group.

It would not be normal to include employees and the revenue authorities, given that it may be expected that they will be paid in full.

Finally, there is V Co. to consider. If V Co. in fact acquires the debt of W Bank and/or some or all of the bonds, it would be difficult to exclude V Co. from the negotiations, even though V Co. may take a quite different approach toward ABC Co. than the finance and other major creditors.

6.9.2 Development of second principle— what types of debtors should be eligible for an informal workout process?

It is suggested that only those corporations or enterprises that have a viable underlying business should be eligible for a reorganization under an informal process. This follows from the proposition that, in the economic and commercial environment addressed by the technical assistance (as mentioned in the introduction to this Report, an environment in which there is not a concern as to the stability of the financial system), the time and resources necessary to undertake an informal workout should only be spent in undertaking such a task when there is reasonable prospect that, following the restructure, the debtor will be able to service its reorganized debts and generate sufficient profit to restore share capital or provide a return to the shareholders who commit new capital to the business. If that is not a realistic prospect, it follows that all creditors will be adversely affected, and the only alternative is for the affairs of the debtor to be dealt with under formal insolvency processes.

The relevant principle can thus be stated as follows:

Principle 2:

An informal workout should only involve a debtor corporation when the circumstances are such that it appears possible to resolve financial difficulties of the debtor and to achieve long-term viability.

Application of Principle 2 to hypothetical:

If ABC Co. has a fair prospect of being able to negotiate a long-term reorganization (and not just a postponement of some or all of its finance liabilities), an attempt to promote such a reorganization should be encouraged by the finance creditors. Again, much depends on whether ABC Co. is active in initiating and instigating the process. If it is, then one might expect ABC Co. to have at least the outline of a broad plan for survival.

On the other hand, if it is one or more of the finance creditors who instigate the process, it might be expected that they will have a considerable amount of knowledge of the financial and business affairs of ABC Co. and, therefore, will be able to form a view of whether it has a prospect of survival. In many respects, the employment of this principle is closely linked to Principle 3 discussed below.

6.9.3 Development of third principle—the construction and development of a business plan

As mentioned earlier, a common concern expressed in regard to the informal workout regimes developed in the Selected Countries to date is that too many of the restructurings which result from informal workout processes are not sustainable. Further, many of the debtors that were involved will not be able to service debt after the expiry of the extended or postponed time for repayment, the interest-free periods, or the periods of reduced interest rates. This consequence occurs primarily because the assumptions that underpin the business plans prepared by the debtor corporation's management and upon which the restructuring is based are optimistic (or, indeed, nonexistent).

AP&P case study relevance

For example, in the case of AP&P, it appears that the first tranche of debts amounting to \$1.2 billion, of about \$13.9 billion owed, will only be payable after 10 years.

By definition, assumptions as to future events are not capable of determination with certainty. Nonetheless, the assumptions should be capable of rigorous due diligence, which should be undertaken by the creditors or their appointed advisers.

The relevant principle to be extracted is as follows:

Principle 3:

A restructure should be based upon an achievable business plan that addresses operational as well as financial issues. A business plan should contain forecasts, prepared upon documented and reasonable assumptions as to future events, which evidence that the business of the debtor corporation can generate sufficient cash flow and profit to meet its obligations existing after the restructure.

Application of Principle 3 to hypothetical:

This assumes that the negotiations have been initiated and that there is a willingness on the part of the major creditors to consider a possible rescue of ABC Co. It will be necessary for ABC Co. to prepare and submit a business plan for the consideration of participating creditors that, consistent with Principle 2, discloses a probability of long-term financial stability.

Such a plan will not necessarily equate to an overall restructuring plan, but rather demonstrate that at both financial and operational levels sufficient cash flow and profit will be generated to enable ABC Co. to meet its financial obligations, as they are expected to exist following a restructuring. Matters to be addressed in such a plan would include profit forecasts, cash flow forecasts, necessary financial support (and availability), and business and management strategy. As mentioned in the discussion of this principle, forecasts rely upon assumptions that should be capable of rigorous critical examination.

6.9.4 Development of the fourth principle— a period of standstill

A period of time will be necessary to allow information to be gathered to enable creditors to consider the alternatives concerning the future of the debtor. This is usually referred to as a Standstill Period and, in effect, is produced by an informal agreement or understanding between a debtor and its relevant creditors to maintain the status quo during that period. For a relevant creditor, it signals no enforcement or other action that might improve the position of a creditor against other creditors. For a debtor, it requires the conduct of business in the normal

way and no dealings with assets of the debtor other than in the ordinary course of business.¹¹⁶

The commencement date of the Standstill Period may be important. It is usual that this is the date upon which notice is given to relevant creditors of the first meeting of creditors called to consider the financial position of the debtor.

The Standstill Period will vary from case to case, but should be of sufficient time to allow for preparation and review of the financial information necessary for the creditors to consider the financial position of the debtor, and for preparation of outline restructuring proposals. It should be as short as is reasonable (although capable of extension should creditors and the debtor agree) to ensure that the issues relevant to the future of the debtor are discussed within the creditor group as quickly as possible.

The Standstill Period should also be capable of termination should any creditor or the debtor not act in accordance with its terms.

AP&P case study relevance

AP&P is an unusual case of a unilateral announcement of a Standstill Period by the debtor with no agreement from the creditors. The lack of provision of a serious debt restructuring proposal since the announcement of the Standstill Period demonstrates the need for the Standstill Period to be able to be terminated for non-compliance. Indeed, at the date of this Report no reorganization plan for AP&P Group has been agreed.

The relevant principle can be stated as follows:

Principle 4 (INSOL first principle):

Where a debtor is found to be in financial difficulties, all relevant creditors should be prepared to cooperate with each other to give sufficient time (a Standstill Period) to enable information about the debtor to be obtained and evaluated and for proposals for resolving the debtor's financial difficulties to be formulated and assessed, unless such a course of action is inappropriate in a particular case. The length of such Standstill Period should be limited to the time that is reasonably required to fulfil the above objectives.

¹¹⁶ It is usual in this period for trade and commercial creditors to be paid so that the business of the debtor may be continued.

Application of Principle 4 to hypothetical:

This primarily concerns the period of time that might be necessary for a restructuring plan to be developed; for all relevant information to be gathered, disclosed, and considered; and for the affairs of ABC Co. to be fully considered. There is no general rule as to the length of a Standstill Period since it will depend on each case, but it must be reasonably calculated by reference to what is required of ABC Co. It would normally commence at a time when agreement in principle has been reached among the major participating creditors (often by informal discussion among them) to at least consider the prospect of a restructuring, and announced in the notice or invitation to attend a first meeting of participating creditors. Alternatively it might commence only when agreed to at any such first meeting. The length of the Standstill Period that is initially agreed can always be extended.

**6.9.5 Development of the fifth principle—
the effect of the standstill on relevant
creditors**

The intention of the Standstill Period is to allow time for the management of the debtor to prepare financial information and to formulate proposals for restructuring to be considered by creditors. It is imperative that creditors are not materially disadvantaged during this period. Initially this involves a consideration of actions by creditors that might affect others of their number.

Action by one creditor to enforce a debt against the debtor would potentially advantage that creditor and disadvantage other creditors. The standstill agreement should forbid any such action during the Standstill Period.

AP&P case study relevance

The selective payments which occurred in the case of AP&P Group following a unilateral standstill may not have occurred if creditors had been prohibited from taking enforcement action.

Creditors should also be forbidden from seeking to obtain security or otherwise improving their individual positions during the Standstill Period.

At the same time, contractual relationships should be preserved and honored so that if, for example, a particular financial creditor has committed credit facilities, they should not unilaterally refuse to provide or reduce those facilities during the Standstill Period.

The financial arrangements between the debtor and creditors may not readily allow for exact maintenance of parity between creditors (for example, some finance facilities may be in different currencies, and the claims of some finance creditors may be contingent); and, in these circumstances, it may be appropriate to develop an inter-creditor agreement to govern such matters and the general relationships among creditors during the Standstill Period. Such agreements should be developed only where necessary, however; and negotiation of the inter-creditor agreement should not delay consideration of the proposals to restructure the debtor. Consequently, good practice would involve creditors agreeing in good faith to an "in principle" Standstill Period, thereby allowing the debtor to commence preparation of the financial information and development of restructuring proposals. The creditors could then agree on the details of the inter-creditor agreement while the financial information is being prepared.¹¹⁷

The relevant principle can thus be stated as follows:

Principle 5 (INSOL second principle):

During the Standstill Period, all relevant creditors should agree to refrain from taking any steps to enforce their claims (otherwise than by disposal of their debt to a third party) or to reduce their exposure to the debtor, but are entitled to expect that during the Standstill Period their position relative to other creditors and each other will not be prejudiced.

Application of Principle 5 to hypothetical:

In general, the participating creditors will need to consider among themselves whether or not to cooperate and agree to a standstill arrangement as it concerns ABC Co.

This has some particular relevance to two of the creditors.

First, X Bank: it has requested more security from the ABC Co. If X Bank participates in the negotiations and agrees to a standstill, it will not be able to obtain further security.

¹¹⁷ The nature and desirability of inter-creditor agreements is further discussed above.

Second, T Co.: T Co. has threatened to exercise security enforcement powers. If T Co. agrees to the standstill, it will not be able to proceed with its threat.

Likewise if the bondholders are participants and agree to the standstill, they, too, will not be able to implement their threat of commencing insolvency proceedings against ABC Co.

Of course, there is always the risk that some creditors may break ranks and take unilateral individual action. However, if the major creditors are actively pursuing a restructure, individual creditors, such as bondholders, are likely to recognize that it might be best to wait and consider the likely result from a restructure.

Individual small trade supply creditors who have threatened recovery action will probably be paid out in the normal course (this is relevant to Principle 6).

6.9.6 Development of the sixth principle—the effect of a standstill on a debtor

It is the intention of a standstill agreement that the business of the debtor continues in the ordinary course while proposals for its restructure are developed. Consequently, payments to, for example, trade creditors, employees, and taxation authorities that are necessary to sustain and continue the business, can usually be met during the Standstill Period (cash flow permitting). However, the debtor should not take any steps that might reduce the return to relevant creditors, such as realizing assets, pledging assets, or incurring new debt ranking in priority to the relevant creditors, without the agreement of those creditors.

AP&P case study relevance

In AP&P, the High Court of Singapore found that there were questionable transactions following the debt standstill involving selective payments to creditors in PRC and Indonesia.

The relevant principle can thus be stated as follows:

Principle 6 (INSOL third principle):

During the Standstill Period, the debtor should not take any action which might adversely affect the prospective return to relevant creditors (either collectively or individually) as compared with the position at the commencement of the Standstill Period.

Application of Principle 6 to hypothetical:

Likewise, if ABC Co. agrees to a standstill, it will need to ensure that the status quo is maintained and, in particular, that the position of any participating or other creditor is not improved during the Standstill Period.

Thus, ABC Co. could not provide X Bank with any further security.

An exception would be that ABC Co. would be able to pay trade creditors in the normal course of business and probably be able to pay outstanding trade debts, provided these were not substantial. A similar position may be taken concerning employee wages and recurring revenue-type debts.

6.9.7 Development of the seventh principle—coordination committee among relevant creditors

Depending on the number of creditors and their varying interests, it is usually desirable that the creditors agree that some of them be appointed as members of a steering or coordination committee.¹¹⁸

The purpose of such a committee is to facilitate and progress the possibility of an informal workout by, among other things, generally administering the process, liaising with the debtor, coordinating the information and evaluation process, ensuring that the standstill arrangements are honored, and assisting in the resolution of disputes between creditors or between a debtor and a creditor or other third party.¹¹⁹ In some cases, groups of creditors with

¹¹⁸ In the Selected Countries, a significant issue in informal workouts has been the apparent difficulty in generating the necessary levels of trust and communication among disparate creditor groups. Consequently, there have been instances where the coordination committee charged with negotiating with the debtor has been large. Experience has shown that a committee of more than six or seven creditors tends to be cumbersome and slow in conducting the negotiation process. This is to be discouraged because continued uncertainty has an adverse impact on the business of the debtor and, consequently, speed is desirable.

¹¹⁹ Creditors reasonably expect to recover any extra costs incurred as a result of the debtor not meeting its financial obligations, as part of their claim in the workout. The extent to which creditors can recover the costs of their own negotiating teams will be subject to negotiation as part of the workout; but it is usual for costs incurred by creditors on the coordination committee, including any costs incurred by the chairperson in convening meetings and so forth, to be met as expenses of the debtor.

similar interests might form committees among themselves that, in turn, may be represented on the main coordination committee.

A coordination committee would not have power to make any binding commercial decisions. It may determine which information is made available on a wider basis to creditors, and may determine when proposals from the debtor are presented to creditors for consideration. However, the coordination committee cannot commit creditors generally. If the coordination committee consists of the creditors holding the largest exposures to the debtor, then it may not be unreasonable for them to form a view that certain proposals from the debtor will not be acceptable to creditors. Negotiations concerning proposals of this nature should be within the competence of the coordination committee; and, consequently, it is not necessary for all issues to be referred to all creditors all the time.

Again, depending on the particular case, it would be usual for the committee to be able to appoint suitably qualified professional advisers to act for the benefit of all creditors. Such advisers would normally evaluate (and perhaps assist in the preparation of) the proposals of a debtor and advise on the processes and documentation that may be required to give effect to any proposals. The need for qualified professional advisers might arise in a variety of circumstances (for example, legal advisers where finance facility agreements may have to be substantially rewritten and adjusted, accounting and financial advisers when the accounts and financial position of the debtor require expert analysis and appraisal, or merchant bank advisers when a sophisticated or complicated capital restructuring of the debtor is proposed).

The relevant principle can be stated as follows:

Principle 7 (INSOL fourth principle):

The interests of relevant creditors are best served by coordinating their response to a debtor in financial difficulty. Such coordination will be facilitated by the selection of one or more representative coordination committees and by the appointment of professional advisers to advise and assist such committees and, where appropriate, the relevant creditors participating in the process as a whole.

Application of Principle 7 to hypothetical:

Although the number of participating creditors of ABC Co. may not seem to be many, there are at least nine banks involved, one finance company, one large trade creditor, and a number of bondholders.

It would probably be appropriate if such a group of participants was represented, at least for the purposes of moving the negotiations forward, by a committee of perhaps four, who might then be able to work in reasonably close consultation with the advisers to the creditors (lawyers, finance experts, accountants, and so forth), as well as ABC Co. and its advisers. The composition of the committee might be formed, for example, by a representative from the Z Syndicate, from X Bank (since it is more closely associated with ABC Co.), from the supplier T Co., and from the bondholders.

Representation of the bondholders might be difficult unless there is an existing agreement between them that provides for such representation or they are able to subsequently agree upon representation for the purposes of participation in the informal workout with ABC Co.

It is also necessary to contemplate in this context what the position might be if V Co. had acquired the debt owed to W Bank and/or some of the bonds. Should V Co. be given a position on the committee, bearing in mind that V Co. might have in mind a possible acquisition of ABC Co., a relatively quick restructuring of debt, or a quick turnaround and a sale of the business? The presence of V Co. on the committee (indeed, the involvement of V Co. as a participating creditor generally) might be intrusive and disruptive. On the other hand, the fact that V Co. has emerged as a major creditor of ABC Co. cannot be ignored.

6.9.8 Development of the eighth principle – appointment of a main coordinator

Depending on the circumstances, it may be desirable to appoint a person (a representative of one of the creditors) as the chairperson or leader of the coordination committee. Such appointment would usually be made in deference to the largest or most influential of the relevant creditors.

It is highly desirable that such a person has considerable experience in conducting an informal workout.

The person will bear the main administrative burden of the whole process and would usually chair meetings of the coordination committee and possibly of general meetings of all relevant creditors.

The relevant principle can be stated as follows:

Principle 8:

*Creditors should agree to appoint one creditor (usually one of the creditors with the largest exposure to the debtor, or with particular expertise in managing informal workout negotiations) or an independent party to act as chairperson of the coordination committee, to lead negotiations with the debtor and to ensure the expeditious progress of the informal workout negotiations.*¹²⁰

Application of Principle 8 to hypothetical:

Following the selection of a representative committee (notwithstanding that, although in the case of ABC Co., it is likely to only involve about four people), it would further facilitate negotiations and progress of the informal workout if one of the committee members was appointed main coordinator or chairperson of the committee. It is probable that the representative from the Z syndicate of banks would be the most eligible for election to this position because the syndicate is clearly the largest creditor. Alternatively, it might be appropriate to consider appointing the representative of X Bank, the usual banker of ABC Co., to this position.

Ideally, the chairperson would have some considerable experience of both formal and informal restructurings, particularly the latter. It would fall to the chairperson to lead the negotiations expeditiously. A further option may be the appointment of a chairman who is independent but who otherwise satisfies these criteria.

6.9.9 Development of the ninth principle—individual creditor representation

¹²⁰ Principle 7 differs slightly from the INSOL principles in as much as it suggests that the chairperson of the coordinating committee should be a creditor (or a representative of a creditor). Experience suggests, however, that having one of the largest creditors act in this capacity is usually advantageous in reaching a satisfactory workout proposal.

It may be anticipated that participating creditors will be corporations of some considerable size and standing.

It is of the utmost importance that a relevant creditor appoints an experienced and capable representative to act on its behalf, particularly as regards attending and voting at meetings, receiving information and generally participating in an informal workout process. The representative must have the necessary authority to represent the creditor properly and to act on its behalf.¹²¹ The representative will have the task of informing the relevant management body of the creditor of progress, information, evaluation, and decisions that are required.

The relevant principle can thus be stated as follows:

Principle 9:

Creditors participating in an informal workout should ensure that they take an active role by appointing an experienced and competent representative. That representative should ensure that appropriate levels of management within the creditor organization are informed of the progress of the workout at all important stages and that the prospective and likely outcome of the workout is expected to be acceptable to the decision makers within the creditor organization.

¹²¹ This reflects the concern expressed during the Manila conference that, in a number of financial institutions in the Selected Countries, restructuring proposals must be signed off at the highest levels; and consequently, in many instances, creditors' representatives at the restructuring meetings have not been of sufficient seniority to make decisions binding upon the relevant creditor. This has resulted in informal workouts being negotiated almost to completion in circumstances where one or more fundamental issues ultimately do not prove to be acceptable to one or more of the key creditors. This can cause delay and undesirable uncertainty, which impacts upon the business of the debtor.

Application of Principle 9 to hypothetical:

With the exception of the bondholders, each of the participating creditors in the case of ABC Co. may be expected to be corporations of considerable size in which decision-making is likely to be subject to a hierarchy of command or management. To overcome delay and possible misunderstanding, a senior officer or employee should be appointed to represent each creditor. That person should have sufficient authority to negotiate, to participate in decision-making, and to confirm acceptance (at least provisionally) of a proposed restructuring.

In the absence of any charter or agreement to which they are subject, the bondholders will need to agree among themselves on an authorized representative.

**6.9.10 Development of the tenth principle—
provision of relevant and reliable
information by the debtor**

As mentioned earlier, it is important that the business plan of the debtor, the projections upon which restructuring proposals are based, and the restructuring proposals themselves, are subject to adequate review, objective analysis, and, if necessary, challenge. This will necessitate that the creditors (either directly or through their professional advisers) receive complete and adequate relevant information from the debtor and undertake a due diligence of the information provided.

This review and analysis should be more detailed than a simple acceptance of information provided by the debtor; and consequently, the debtor must accept that its information will be subject to a high degree of critical examination and inquiry, by or on behalf of creditors. As a condition of the Standstill Period, the debtor must cooperate fully in that review by making information, and appropriate personnel, including those at the highest levels, available to the parties carrying out the review.

The alleged unwillingness of AP&P to give KPMG access to information relating to the company's operations in PRC, inter-company debt analysis, inter-company transactions, and accounts receivable are examples of breaches of Principle 10.

Principle 10 (INSOL fifth principle):

During the Standstill Period, the debtor should provide, and allow relevant creditors and/or

their professional advisers, reasonable and timely access to all relevant information relating to its assets, liabilities, business, and prospects, to enable proper evaluation to be made of its financial position and any proposals to be made to relevant creditors.

Application of Principle 10 to hypothetical:

ABC Co. will need to demonstrate continual willingness and good faith toward participation in the informal workout process, despite the demands that might be placed on it to give access to all relevant information. Sometimes that access and the information will be sought by advisers to the participating creditors, the costs of which will normally have to be met by ABC Co. (see Principle 11). ABC Co. must anticipate that much of its private information will have to be disclosed. That becomes relevant in a consideration of Principle 13.

**6.9.11 Development of the eleventh principle
—providing for the costs involved in
an informal workout**

The costs of undertaking the review mentioned above and of negotiating and documenting any informal workout proposal will, in all probability, ultimately be borne by those affected by the financial difficulty of the debtor (in the sense that such costs will normally reduce the funds of the debtor and may, in consequence, affect the ultimate return to creditors). Nonetheless, in the first instance, it is the usual and accepted practice that the debtor should pay such costs in a timely manner.

The relevant principle can thus be stated as follows:

Principle 11:

The debtor should meet all reasonable costs of creditors in considering restructuring proposals. This would include the costs of professional advisers and any costs necessarily incurred by the coordinating committee.

Application of Principle 11 to hypothetical:

It will be difficult for ABC Co. to avoid the cost of professional and other advisers employed by participating creditors in the informal process. It will have to factor in responsibility for those costs as part of the restructure exercise. ABC Co. might greatly reduce the amount of such costs if its financial and other records have been properly kept and have been certified to be in that condition.

6.9.12 Development of the twelfth principle—giving effect to an informal workout according to relevant applicable law

An informal workout proposal can only be properly assessed if the position of those affected is based upon their respective positions according to applicable law. By this it is meant that all matters affecting the informal workout should be measured by reference to the application of the (hypothetical) relevant insolvency law (to assess, for example, the comparison between a return or benefit to relevant creditors under a proposal and that which would be likely in a formal insolvency context). It also requires that the position of claims of individual creditors (for example, secured creditors or creditors having claims under a guarantee and rights of set-off) must also be assessed on the same basis. Assumptions may therefore need to be made as to the effect of particular contracts; and, on occasion, proposals need to take into consideration outcomes that may not be known at the time the proposal is developed and put forward.

This area has important ramifications if the business affairs of a debtor corporation involve more than one jurisdiction.

The applicable law by which the respective rights of participating creditors are determined is especially important in a cross-border situation.

The relevant principle can thus be stated as follows:

Principle 12 (INSOL sixth principle):

Proposals for resolving the financial difficulties of the debtor and, so far as practicable, arrangements between relevant creditors relating to any standstill should reflect applicable law and the relative positions of relevant creditors at the commencement of the Standstill Period.

Application of Principle 12 to hypothetical:

Relevant applicable law includes the law that would govern the formal insolvency of ABC Co. if proceedings were opened. A consideration of that law becomes relevant in determining, for example, a comparison between what might be offered under an informal plan produced by ABC Co. and that which would be obtained if ABC Co. were liquidated under the relevant applicable insolvency law. Also important in this context is a consideration of the laws that govern contracts between the participating creditors and ABC Co. and the relevant applicable secured transactions law that governs any security held by participating creditors and ABC Co.

6.9.13 Development of the thirteenth principle—information and confidentiality

It is essential that all information provided by the debtor should be treated as confidential by creditors. A number of creditors of a particular debtor are likely to be creditors of business competitors of that debtor. The requirement of confidentiality may be incorporated formally into a standstill agreement or may be the subject of undertakings given by relevant creditors. Only in this way may the debtor and its management be confident that creditors will not use information obtained during this process other than for the purpose of assessing and determining an informal workout proposal.¹²²

In addition, particular care must be taken when dealing with debtors whose shares or stocks are traded on an exchange, because creditors may become aware of price sensitive information. Creditors must not make use of information that is not available in the wider market.

The relevant principle can thus be stated as followed:

Principle 13 (INSOL seventh principle):

Information obtained for the purposes of the informal workout process concerning the assets, liabilities, business, and prospects of the debtor, and any proposals for resolving its difficulties, should be made available to all

¹²² This is of particular concern in some of the Selected Countries where financial institutions are often part of formal or informal groups of companies that may include companies that are competitors of the debtor business.

relevant creditors and should, unless such information is already publicly available, be treated as confidential, and only be used by creditors for the purpose of determining and ascertaining an informal workout proposal.

Application of Principle 13 to hypothetical:

The confidentiality of the information provided under Principle 10 (excepting information about ABC Co. that is already in the public domain), will be particularly relevant as regards V Co. (assuming that V Co. is or becomes a participating creditor). V Co. will presumably have a different agenda than other participating creditors (for example, a possible takeover, a controlling or influential shareholder interest, or a large part of the overall debt that would enable it to effectively block or even control creditor decision-making), that may result in it using confidential information supplied by ABC Co. to advance its interests.

This may require that certain information be withheld from V Co. or a more specific agreement on the part of V Co. concerning the conditions under which it may receive and use such confidential information. It is in respect of areas such as this that problems associated with debt trading in the context of informal workouts can be more finely appreciated.

6.9.14 Development of the fourteenth principle—provision of ongoing finance

It is often the case that a business being restructured will require additional funding (often referred to as new money) either during the Standstill Period or immediately thereafter. At the time this funding is required, financiers are aware of the financial difficulty of the debtor and therefore are unlikely to provide additional facilities on the same terms as pre-standstill debt.

The terms by which such funding will be provided are often negotiated as part of the informal workout.¹²³ AP&P requested \$200 million in additional funding from creditors to stabilize its operations. That request was refused.

¹²³ In the three Selected Countries that already have an informal workout process, the provision of additional funding as part of a workout is recognized. In Indonesia and Korea, "new money" is afforded priority over other debts in respect to the cash flow of the debtor, but not as regards realization of assets that are subject to specific security. In Thailand, the Bank of Thailand guidelines also recommends priority for new money.

Had clear rules granting super priority been in place for such funding, together with a regime which was otherwise consistent with there being an effective consensual workout, then the attitude of creditors could have been different.

It is normal in a workout that the priority in which the cash flow of the business of the debtor will be utilized is subject to a "waterfall," which means that the creditors and debtor agree that expenses incurred in the conduct of the business of the debtor and those that are incurred in consequence of the informal workout process will be met in a particular order of priority. The costs of servicing new money and the repayment of new money should, unless there is good reason to the contrary, be afforded a priority higher than payment of existing pre-standstill debt.¹²⁴

The relevant principle can be stated as follows:

Principle 14 (INSOL eighth principle):

If additional funding is provided during the Standstill Period or under any rescue or restructuring proposals, the repayment of such additional funding should, so far as practicable, be accorded priority status as compared to other indebtedness or claims of relevant creditors.

Application of Principle 14 to hypothetical:

ABC Co. requires urgent funding. A first step is to consider what existing finance facilities are available to it through, in particular, the Z Syndicate or its banker, X Bank, and whether, despite its financial difficulties, those facilities will remain available to ABC Co. The alternative is to seek other alternative facilities (but that would be problematic and time-consuming). Either way, the repayment of any finance provided during the Standstill Period must be assured of priority over the payment of existing pre-standstill debt. A cash flow analysis based on reasonable estimates should be able to determine the order in which cash can be used to meet debts and liabilities incurred during the Standstill Period (the "waterfall" of cash), including the repayment of further finance. The participating creditors (or their committee) would need to agree to such an arrangement.

¹²⁴ This issue is also highly relevant to Part Four of the Report.

6.10 Other issues

6.10.1 Possible use of informal workout processes as a preliminary step toward formal reorganization

A reorganization that has been negotiated through an informal process may be acceptable to a majority of the relevant creditors, but may be nonetheless obstructed because of different attitudes taken by a minority of other relevant creditors. Because the process is informal and has no legal effect, other than through what might be achieved contractually, an informal workout is always prone to potential failure because of the involvement of what are sometimes termed holdout creditors (those who seek to drive a better result for themselves).

Faced with this type of problem or impasse (and assuming that the involvement of the holdout creditors is critical and that the result that they respectively seek to obtain will not be agreed to by the majority of creditors), the debtor and its supporting creditors are faced with the prospect of either abandoning the prospect of a reorganization, or attempting to impose a reorganization on the dissenters by commencing formal reorganization proceedings under the insolvency law regime. (In that way the dissenting creditors can be bound to an approved formal reorganization).¹²⁵ In effect, the aim is to obtain formal approval of the reorganization plan that was negotiated and accepted by a majority under the informal process.

The steps necessary to convert an informal reorganization into a formal reorganization may take considerable time, and the process may be frustrated if the debtor and its creditors are required to implement all of the steps and processes that may be required under the procedures for an effective formal reorganization (a number of which may already have been implemented in a de facto sense). Because timing in many cases is critical, attention has been given in some jurisdictions to the prospect of designing a process to enable an out-of-court reorganization to proceed more rapidly through the normal reorganization procedures. The quicker process envisioned is often termed a fast

¹²⁵ Most insolvency laws would provide that if a reorganization proposal obtains the prescribed degree of voting support, then absent legitimate objections, the dissentient minority are bound by the reorganization. This is the case in Thailand and Korea under their respective insolvency laws.

track or expedited formal reorganization procedure.

Certain elements need to be considered, however, when contemplating such a procedure. For example, the basis upon which there was a negotiation and majority acceptance of the reorganization plan or proposal must substantially or fully comply with the usual formal requirements, including:

- that the debtor fits the criteria as eligible to commence formal proceedings;
- that all the affected creditors were supplied with the necessary information, assessments, and opinions as required under the law;
- that any plan complied with the requirements of the relevant law;
- that a meeting of the affected creditors was properly convened and conducted; and
- that the plan was approved by the requisite majority according to the formal voting procedures specified in the relevant law.

It follows that any fast track or conversion mechanism of an insolvency law must contain special provisions to provide for and to govern the procedure. In particular, it must provide for matters such as those identified above. That legislation should also provide for the nature and degree of expedition. If, for example, the court is satisfied with the pre-commencement processes that have been employed, the legislation might provide that the court may dispense with the need for any further solicitation among the parties, the supply of any further information, and the need for any further meeting, and, accordingly, appoint a date for the hearing of the formal application for approval of the reorganization and provide for due notice to be given to the dissenting or holdout creditors to enable them to be heard on and oppose that application.

Enhancing an informal workout process by the provision of a fast track or expedited procedure in domestic insolvency law regimes in the manner mentioned above has the following advantages:

- as noted above, the Philippines has a special chapter in its draft *Corporate Recovery and Insolvency Act* that provides for such a fast track mechanism;
- it would help to ensure in many cases that the informal process was conducted fairly and in substantial compliance with the principles advocated in this Report; and
- it would impose a further degree of incentive on both a debtor and its creditors to undertake and endeavor to reach a positive and unanimous result under the informal process.

It appears likely that a recommendation to enhance an informal workout process by the provision of a fast track or expedited procedure in domestic insolvency law in the manner mentioned above will result from the UNCITRAL work in the Legislative Guide on Insolvency Law.¹²⁶

In the meantime, Turkey has amended its existing insolvency law¹²⁷ to provide for a new form of restructuring process. This Turkish law is somewhat unique because it provides for the conversion of an agreement reached under a largely informal process to a formal approval process under the law.

In broad terms, the new Turkish law has the following features:

- An insolvent or near-insolvent company may file an application for restructuring with the relevant court if a restructuring plan has been previously negotiated and accepted by a sufficient majority of its creditors (50% in number and two thirds in value).
- The law governs the basis upon which a restructuring plan may be negotiated with creditors and provides the rules for negotiation and acceptance (including classification of creditors into affected and non-affected

creditors, division of creditors into classes, information to be provided to creditors, methods for voting, and so forth).

- Only if those rules have been followed will it be possible to file an application for the court to give formal approval to the restructure plan.
- The law does not provide for any legal stay or moratorium against creditors prior to the filing of an application for restructuring; but once an application has been filed, the law enables the court to impose a moratorium.
- Objections by any dissenting minority creditors are heard and determined at the hearing of the application for approval.
- An application for approval must be heard and determined within a period of 30 days from the date of filing.
- If the court approves a restructuring plan, it is binding on all affected creditors.
- The assistance of the court may also be invoked during the implementation of an approved restructuring plan.

The process has been designed primarily to overcome deficiencies and weaknesses in the existing "composition" process under the Turkish law. However, the design of the process has produced a model or precedent for the type of legislation that might be required to convert an informal process into a formal process expeditiously and, at the same time, provide sufficient safeguards to ensure integrity and creditor respect for the process.

It is accordingly recommended that countries in the region should consider the possible adoption of an expedited process for the conversion of an informal workout reorganization plan into a formal reorganization plan.

¹²⁶ See UNCITRAL Legislative Guide to Insolvency Law, Provisional final, 5 October 2004 pp. 218–227, located on the TA website.

¹²⁷ *Execution and Bankruptcy Law* (1932). The amendments resulted from technical assistance provided by the World Bank.

Application of recommended expedited formal process to hypothetical

The prospect of a fast track process will become highly relevant if any of the participating creditors ultimately decline to participate in a restructuring plan that has the support of the majority of their number.

Assume, for example, that the proposed plan of ABC Co. will affect each of the Z syndicate of banks (\$20 million), X Bank (\$5 million), W Bank (\$8 million), Y Leasing Co. (\$3 million), T Co. (\$1 million), and bondholders (\$10 million). That gives a total of six affected creditors in number (the Z syndicate and the bondholders each being counted as a single creditor for that purpose, with the latter possibly being accorded the status of a separate class), representing an aggregate debt amount or claim of \$47 million. If all affected creditors with the exception of W Bank were in favor of accepting the restructure plan, there would be a clear majority in favor by number (five against one) and about 80% in favor by amount. That type of majority would be sufficient under the relevant formal reorganization processes of the insolvency regimes of most countries to result in a plan that was binding on all affected creditors.

An informal process is dependent on the consensual agreement of all the affected creditors, however. If W Bank will not join that consensus for whatever reason, and the involvement of W Bank is regarded as critical to the plan (or other affected creditors are not prepared to concede any better position to W Bank than that proposed by the plan), the only manner in which the plan might be imposed on W Bank is through the formal reorganization process of an insolvency law.

Although it might be possible for ABC Co. to commence the formal reorganization process, there will be additional cost and possibly considerable time delay. On the other hand, if the relevant insolvency law provided a fast track or expedited process to deal with a case such as this (similar to the newly modified Turkish insolvency law mentioned in the text), it would be possible for ABC Co. to file an application showing that the only affected creditors were the participating creditors, that full disclosure had been made, and that more than 50% in number and 80% in value of creditors had agreed to the restructure plan. The relevant court might then consider and determine any objection of W Bank and rule on the formal approval or otherwise of the plan. If the court approved the plan, it would

be binding on W Bank. That result could be achieved in far less time and at less cost than requiring ABC Co. to undertake the whole of the reorganization procedure.

The presence of such a process might also have the indirect effect of persuading a reluctant participating creditor, such as W Bank, to have regard to the wishes of the relevant majority of affected creditors, rather than simply holding out for the prospect of a better result.

6.10.2 The possible use of mediation within the informal workout process

It is somewhat inevitable that the promotion of an informal workout will reveal or result in disputes and issues between the participants. These could be inter-creditor disputes or disputes between a debtor and some one or more or all of the relevant creditors. The resolution of disputes, disagreements, and issues between those parties may be critical.

Although mention has been made of the possible use of a coordinating committee to assist in the negotiation of such disputes, it should be further contemplated that the use of outside mediation might be desirable.

There are two reservations regarding the use of mediation in the context of an informal workout:

- First, the employment of mediation is, of course, subject to the agreement of the persons between whom it is sought to mediate. Mediation cannot be imposed.
- Second, mediation is suited to the resolution of what might be best described as one-on-one disputes. It might thus be suited to inter-creditor disputes in the context of an informal workout. However, its practical use in what is essentially a collective process (for example, between a debtor and its creditors regarding the terms of a proposed reorganization plan) may seem less improbable.
- Third, unless the parties otherwise agree, the referral of a dispute to mediation does not generally mean that the parties will accept any solution that might be proposed or suggested by the mediator (in this respect, mediation differs from formal arbitration processes).

Despite these reservations, it is at least useful to consider. It might be considered desirable, for example, to provide in an inter-creditor agreement for disputes to be initially referred to the coordinating committee for possible solution, failing which a mediator would be appointed to try to solve the dispute. During the course of the inception mission for this technical assistance, the international consultants were informed that the Jakarta Initiative Task Force provided a mediation service which was reportedly very effective.

It is therefore recommended that a further principle be considered for adoption as follows:

Principle 15

In endeavouring to determine disputes between creditors or between a debtor and its creditors, regard should be given to the possibility of referring such disputes, with the consent of those involved, to mediation.

6.10.3 *Possible need for endorsement or approval of informal workout principles (perhaps in the form of rules of agreement) by a central bank or other regulatory authority or by bank and finance sector associations*

One of the areas of concern with the informal workout process is what mechanism is available to ensure creditors and debtors actually adopt or apply principles or rules when considering a possible informal workout.

It is not, of course, possible to impose such principles or rules upon a debtor, but there may be some scope to achieve a high degree of acceptance among those involved in the financial sector. This might be achieved by at least one of:

- A central bank issuing guidelines that banking and other financial organizations regulated by the central bank would be required to follow in the event that one or more of such institutions sought to initiate an informal workout in the case of a particular debtor;¹²⁸

¹²⁸ In the Country Reports for Informal Workouts, the local consultants for Indonesia (at p. 9), Korea (at p. 15) and Thailand (at p. 26) each indicated that sponsorship by a respected domestic regulatory authority, such as a central bank, would be required to give the principles the credibility necessary to have widespread support.

- A bank or financial association issuing guidelines in a similar fashion and with similar effect; or
- A more formal style of inter-creditor agreement being developed (either by a central bank or a bank financial institution association) to which individual banks and financial institutions could subscribe.¹²⁹

The advantage of the imposition of or agreement concerning such rules or principles is that a firm precedent or practice is established. This assists in speeding up the process since those involved know or may be taken to know the manner in which the process is commenced and employed. The rules should therefore cover not only the broad basis upon which an informal workout process should operate, but also cover such areas as the criteria upon which a bank or financial institution may initiate the process being commenced, and also cover the requirement that any institution involved with the debtor participate in the process. That would provide a mini-code of practice and procedure for the financial sector to employ.

As mentioned in the introduction to Part 6 of this Report, there can be no possible objection to the imposition of or agreement for such principles and procedural matters, provided that any attempt at such formalization does not extend to dictating the scope and nature of what might be produced by the informal process.

It is therefore recommended that countries in the region consider the possibility of formalizing the basic principles and rules to be applied in respect of an informal workout process, through a facilitating agency, such as a central bank or finance industry association.

6.10.4 *Is a uniform regional approach possible?*

It would clearly be in the interests of regional harmony and cooperation if the proposals put forward in this section of the Report were taken up and implemented by as many countries in the region as possible. That would provide a significant degree of consistency in the Asian region. Possible forums to advance regional

¹²⁹ This has been the approach favored in Korea. See the Korean Financial Institutions Agreement for Promotion of Company Restructuring (see TA website).

cooperation in the area include ASEAN and APEC.

6.10.5 Cross-border considerations

Closely linked to the above issue is the problem that occurs when the affairs of a debtor involve two or more jurisdictions. A common regional approach to informal workouts by uniform adoption of the principles put forward in this Report would assist in addressing the problems that arise in a multi-jurisdiction informal workout. Indeed, the INSOL principles have been crafted with that use very much in mind.¹³⁰

Some consideration has been given to the possibility of devising a multilateral legal mechanism whereby an informal workout that was conducted under specified rules and processes in, for example, one jurisdiction might be recognized and applied in other jurisdictions in which the debtor had business interests, assets, and creditors. As yet, however, that somewhat revolutionary vision is still being contemplated.

6.10.6 Need for a strong and effective insolvency law regime

This incentive was mentioned at Section 6.1 as being vital to gain acceptability and credibility of an informal workout process. Although it is outside the terms of reference of the technical assistance to examine in any detail the insolvency law regimes of the Selected Countries (or any other jurisdiction in the region), the discussions at the Manila conference and the Singapore conference, as well as the results of the country reports, clearly indicate that the insolvency law regimes of Indonesia and Thailand are not presently capable of providing this incentive.¹³¹ Either the law itself is weak and ineffective or the application and operation of the law is severely affected by such things as an inadequate (or sometimes corrupt) court system and an absence of sufficient experienced insolvency administrators. Defects such as these are not confined to those of the Selected Countries that have been mentioned. The comparative study undertaken by ADB in 2000 (RETA 5795: Insolvency Law Reforms) provides details of a number of jurisdictions in Asia where those or similar defects also exist.

¹³⁰ Hence the title of the INSOL principles: Statement of Principles, for a Global Approach to Multi-Creditor Workouts.

¹³¹ See generally the Country Reports for Indonesia and Thailand, located on the TA website.

AP&P case study relevance

The case of AP&P provides a good example of a debt standstill being forced upon creditors due to the absence of a credible threat of a formal appointment. The uncertainty regarding recognition of a Singaporean administrator in PRC and Indonesia was one of the reasons why the High Court of Singapore refused to appoint a judicial administrator to the Group. Without a credible threat, it is possible for debtors to delay and circumvent an informal workout process.

There are encouraging signs that in some jurisdictions efforts are being made to eradicate defects and develop modern and contemporary insolvency law regimes.¹³² All that may be done under the terms of reference of the technical assistance is to impress upon legislators, banking and finance associations, and relevant professional organizations the need for continuing development and reform, including the development of institutional capacity necessary to implement such reform.

¹³² See Country Report for Cross-Border Insolvency for Korea and the Philippines, at Part One, Section Q and Part Two, Sections B1 and B2, located on the TA website.

Annexure A

DRAFT A—A REGIONAL TREATY USING A MODEL LAW APPROACH.

CONVENTION ON REGIONAL COOPERATION WITH RESPECT TO CROSS-BORDER INSOLVENCY MATTERS

PREAMBLE

The Contracting Parties to the present Convention:

- a) *Committed* to the adoption of laws that will facilitate trade and investment between them and within their region; and
- b) *Recognizing* the importance for that purpose of cooperation with respect to cross-border insolvency matters,
- c) *[other significant considerations could be referred to]*

Have agreed as follows:

ADOPTION OF AGREED LAWS

Article 1

1. Subject to paragraphs 2 and 3 of this Article, each Contracting Party shall adopt, as a basis for cooperation with each other Contracting Party, laws relating to cross-border insolvencies substantially in accordance with the Annexure to this Convention.
2. Any Contracting Party may adopt laws and practices relating to cross-border insolvencies that provide a less restrictive or more expeditious basis for cooperation with any other Contracting Party than the Annexure to this Convention.
3. Any Contracting Party may adopt laws and practices relating to cross-border insolvencies enabling cooperation to be extended to other countries as well as to other Contracting Parties. In particular, a Contracting Party may make provision for treating any other country as if it were a Contracting Party for the purpose of cooperation and coordination in the event of concurrent proceedings in more than one country in respect of the same debtor.
4. In the Annexure to this Convention, “regional country” means a Contracting Party.

PARTIES TO THIS CONVENTION

Article 2

- 1 The following countries may become party to this Convention:
 - a) *[Indonesia, Korea, the Philippines, Thailand]*
 - b) *[any member of ASEAN]*
 - c) *[any member of ASEAN, Korea and ...]*
2. After at least three countries have become party to this Convention, the Contracting Parties, acting jointly, may invite any other country to become party to this Convention.

RATIFICATION AND ENTRY INTO FORCE

Article 3

1. The original of this Convention shall be deposited with *[insert]*.
2. This Convention may be signed by any country eligible to become party to it, and is subject to ratification. The instrument of ratification shall be deposited with *[insert]*.
3. This Convention shall enter into force on the first day of the month following the expiration of three months after the date of the deposit of the instrument of ratification.
4. For each country ratifying this Convention after the deposit of the instrument of ratification, this Convention shall enter into force on the first day of the month following the expiration of three months after the date of the deposit of its instrument of ratification.

DENUNCIATION

Article 4

1. Any Contracting Party may denounce this Convention by notifying *[insert]* to that effect.
2. The denunciation shall take effect on the first day of the month following the expiration of twelve months after receipt of the notification by *[insert]*.

ANNEXURE

STATUTORY PROVISIONS FOR REGIONAL COOPERATION IN CROSS-BORDER INSOLVENCY

Preamble

The purpose of this Law is to provide effective mechanisms for dealing with cases of cross-border insolvency so as to promote the objectives of:

- a) Cooperation between the courts and other competent authorities of *[name of country]* and other regional countries in cases of cross-border insolvency;
- b) Greater legal certainty for trade and investment;
- c) Fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested persons, including the debtor;
- d) Protection and maximization of the value of the debtor's assets; and
- e) Facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.

Chapter I. General provisions

Article 1. Scope of application

1. This Law applies where:
 - a) assistance is sought in *[name of country]* by a court or representative of another regional country in connection with a proceeding in that country; or
 - b) assistance is sought in another regional country in connection with a proceeding under *[identify laws of the enacting State relating to insolvency]*; or
 - c) a regional country proceeding and a proceeding under *[identify laws of the enacting State relating to insolvency]* in respect of the same debtor are taking place concurrently; or

- d) creditors or other interested persons in another regional country have an interest in requesting the commencement of, or participating in, a proceeding under *[identify laws of the enacting State relating to insolvency]*.
2. This Law does not apply to a proceeding concerning *[designate any types of entities, such as banks or insurance companies, that are subject to a special insolvency regime in this State and that this State wishes to exclude from this Law]*.

Article 2. Definitions

For the purposes of this Law:

- a) "regional country proceeding" means a collective judicial or administrative proceeding in another regional country, including an interim proceeding, pursuant to a law relating to insolvency in which the assets and affairs of the debtor are subject to control or supervision by a regional country court, for the purpose of reorganization or liquidation;
- b) "foreign main proceeding" means a regional country proceeding taking place in the country where the debtor has its main interests;
- c) "foreign non-main proceeding" means a regional country proceeding, other than a foreign main proceeding, taking place in a country where the debtor has an establishment within the meaning of subparagraph (f) of this article;
- d) "foreign representative" means a person or body, including one appointed on an interim basis, authorized in a regional country proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as a representative of the regional country proceeding;
- e) "foreign court" means a judicial or other authority competent to control or supervise a regional country proceeding;
- f) "establishment" means any place of operations where the debtor carries out a non-transitory economic activity with human input and goods or services.

Article 3. International obligations of *[name of State]*

This Law is to be applied so as to give effect to and be consistent with the obligations of *[name of State]* under any other treaty to which *[name of State]* is a party.

Article 4. *[Competent court or authority]*

The functions referred to in this Law relating to recognition of regional country proceedings and cooperation with regional country courts shall be performed by *[specify the court, courts, authority or authorities competent to perform such functions in the enacting State]*.

Article 5. Authorization of *[insert the title of the person or body administering reorganization or liquidation under the law of the enacting State]* to act in a regional country State

A *[insert the title of the person or body administering a reorganization or liquidation under the law of the enacting State]* is authorized to act in a regional country State in a proceeding under *[identify the laws of the enacting State relating to insolvency]*, as permitted by the applicable regional country law.

Article 6. Public policy exception

Nothing in this Law prevents the court from refusing to take an action governed by this Law if the action would be manifestly contrary to the public policy of *[name of State]*.

Article 7. Additional assistance under other laws

Nothing in this Law limits the power of a court or a *[insert the title of the person or body administering a reorganization or liquidation under the law of the enacting State]* to provide additional assistance to a foreign representative or a representative of any other country under other laws of this State.

Article 8. Interpretation

In the interpretation of this Law, regard is to be had to its international origin and to the need to promote uniformity in its application and observance of good faith.

Chapter II. Access of foreign representatives and creditors to courts in this state

Article 9. Right of direct access

A foreign representative is entitled to apply directly to a court in this State.

Article 10. Limited jurisdiction

The sole fact that an application pursuant to this Law is made to a court in this State by a foreign representative does not subject the foreign representative or the foreign assets and affairs of the debtor to the jurisdiction of the courts of this State for any purpose other than the application.

Article 11. Application by a foreign representative to commence a proceeding under [identify laws of the enacting State relating to insolvency]

A foreign representative is entitled to apply to commence a proceeding under *[identify laws of the enacting State relating to insolvency]* if the conditions for commencing such a proceeding are otherwise met.

Article 12. Participation of a foreign representative in a proceeding under [identify laws of the enacting State relating to insolvency]

Upon recognition of a foreign proceeding, the foreign representative is entitled to participate in a proceeding regarding the debtor under *[identify laws of the enacting State relating to insolvency]*.

Article 13. Access of foreign creditors to a proceeding under *[identify laws of the enacting State relating to insolvency]*

1. Subject to paragraph 2 of this article, creditors in a regional country have the same rights regarding the commencement of, and participation in, a proceeding under *[identify laws of the enacting State relating to insolvency]* as creditors in *[name of State]*.
2. Paragraph 1 of this article does not affect the ranking of claims in a proceeding under *[identify laws of the enacting State relating to insolvency]*, except that the claims of creditors in a regional country shall not be ranked lower than *[identify the class of general non-preference claims, while providing that a regional country claim is to be ranked lower than the general non-preference claims if an equivalent local claim (e.g. claim for a penalty or deferred-payment claim) has a rank lower than the general non-preference claims]*.

Article 14. Notification to regional country creditors of a proceeding under *[identify laws of the enacting State relating to insolvency]*

1. Whenever under *[identify laws of the enacting State relating to insolvency]* notification is to be given to creditors in *[name of State]*, such notification shall also be given to the known creditors in any regional country that do not have addresses in *[name of State]*. The court may order that appropriate steps be taken with a view to notifying any creditor whose address is not yet known.
2. Such notification shall be made to the regional country creditors individually, unless the court considers that, under the circumstances, some other form of notification would be more appropriate. No rogatory letters or other similar formality are required.
3. When a notification of commencement of a proceeding is to be given to regional country creditors, the notification shall:
 - a) indicate a reasonable time period for filing claims and specify the place for their filing;
 - b) indicate whether secured creditors need to file their secured claims; and

- c) contain any other information required to be included in such a notification to creditors pursuant to the law of *[name of State]* and the orders of the court.

Chapter III. Recognition of a regional country proceeding and relief

Article 15. Application for recognition of a foreign proceeding

1. A foreign representative may apply to the court for recognition of the regional country proceeding in which the foreign representative has been appointed.
2. An application for recognition shall be accompanied by:
 - a) A certified copy of the decision commencing the regional country proceeding and appointing the foreign representative; or
 - b) A certificate from the foreign court affirming the existence of the regional country proceeding and of the appointment of the foreign representative; or
 - c) In the absence of evidence referred to in subparagraphs (a) and (b), any other evidence acceptable to the court of the existence of the regional country proceeding and of the appointment of the foreign representative.
3. An application for recognition shall also be accompanied by a statement identifying all foreign proceedings in respect of the debtor that are known to the foreign representative.
4. The court may require a translation of documents supplied in support of the application for recognition into an official language of *[name of State]*.

Article 16. Presumptions concerning recognition

1. If the decision or certificate referred to in paragraph 2 of article 15 indicates that the regional country proceeding is a proceeding within the meaning of subparagraph (a) of article 2 and that the foreign representative is a person or body within the meaning of subparagraph (d) of article 2, the court is entitled to so presume.
2. The court is entitled to presume that documents submitted in support of the application for recognition are authentic, whether or not they have been legalized.
3. In the absence of proof to the contrary, the debtor's registered office, or habitual residence in the case of an individual, is presumed to be the center of the debtor's main interests.

Article 17. Decision to recognize a foreign proceeding

1. Subject to article 6, a regional country proceeding shall be recognized if:
 - a) The regional country proceeding is a proceeding within the meaning of subparagraph (a) of article 2;
 - b) The foreign representative applying for recognition is a person or body within the meaning of subparagraph (d) of article 2;
 - c) The application meets the requirements of paragraph 2 of article 15; and
 - d) The application has been submitted to the court referred to in article 4.
2. The regional country proceeding shall be recognized:
 - a) As a foreign main proceeding if it is taking place in the State where the debtor has the center of its main interests; or
 - b) As a foreign non-main proceeding if the debtor has an establishment within the meaning of subparagraph (f) of article 2 in the foreign State.

Annexure A

3. An application for recognition of a regional country proceeding shall be decided upon at the earliest possible time.
4. The provisions of articles 15, 16, 17, and 18 do not prevent modification or termination of recognition if it is shown that the grounds for granting it were fully or partially lacking or have ceased to exist.

Article 18. Subsequent information

From the time of filing the application for recognition of the regional country proceeding, the foreign representative shall inform the court promptly of:

- a) Any substantial change in the status of the recognized regional country proceeding or the status of the foreign representative's appointment; and
- b) Any other foreign proceeding regarding the same debtor that becomes known to the foreign representative.

Article 19. Relief that may be granted upon application for recognition of a regional country proceeding

1. From the time of filing an application for recognition until the application is decided upon, the court may, at the request of the foreign representative, where relief is urgently needed to protect the assets of the debtor or the interests of the creditors, grant relief of a provisional nature, including:
 - a) Staying execution against the debtor's assets;
 - b) Entrusting the administration or realization of all or part of the debtor's assets located in this State to the foreign representative or another person designated by the court, in order to protect and preserve the value of assets that, by their nature or because of other circumstances, are perishable, susceptible to devaluation, or otherwise in jeopardy;
 - c) Any relief mentioned in paragraph 1 (c), (d) and (g) of article 21.
2. *[Insert provisions (or refer to provisions in force in the enacting State) relating to notice.]*
3. Unless extended under paragraph 1 (f) of article 21, the relief granted under this article terminates when the application for recognition is decided upon.
4. The court may refuse to grant relief under this article if such relief would interfere with the administration of a foreign main proceeding.

Article 20. Effects of recognition of a foreign main proceeding

1. Upon recognition of a regional country proceeding that is a foreign main proceeding,
 - a) Commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities is stayed;
 - b) Execution against the debtor's assets is stayed; and
 - c) The right to transfer, encumber, or otherwise dispose of any assets of the debtor is suspended.
2. The scope, and the modification or termination, of the stay and suspension referred to in paragraph 1 of this article are subject to *[refer to any provisions of law of the enacting State relating to insolvency that apply to exceptions, limitations, modifications or termination in respect of the stay and suspension referred to in paragraph 1 of this article]*.
3. Paragraph 1 (a) of this article does not affect the right to commence individual actions or proceedings to the extent necessary to preserve a claim against the debtor.
4. Paragraph 1 of this article does not affect the right to request the commencement of a proceeding under *[identify laws of the enacting State relating to insolvency]* or the right to file claims in such a proceeding.

Article 21. Relief that may be granted upon recognition of a regional country proceeding

1. Upon recognition of a regional country proceeding, whether main or non-main, where necessary to protect the assets of the debtor or the interests of the creditors, the court may, at the request of the foreign representative, grant any appropriate relief, including:
 - a) Staying the commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities, to the extent they have not been stayed under paragraph 1 (a) of article 20;
 - b) Staying execution against the debtor's assets to the extent it has not been stayed under paragraph 1 (b) of article 20;
 - c) Suspending the right to transfer, encumber, or otherwise dispose of any assets of the debtor to the extent this right has not been suspended under paragraph 1 (c) of article 20;
 - d) Providing for the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, affairs, rights, obligations, or liabilities;
 - e) Entrusting the administration or realization of all or part of the debtor's assets located in this State to the foreign representative or another person designated by the court;
 - f) Extending relief granted under paragraph 1 of article 19;
 - g) Granting any additional relief that may be available to *[insert the title of a person or body administering a reorganization or liquidation under the law of the enacting State]* under the laws of this State.
2. Upon recognition of a regional country proceeding, whether main or non-main, the court may, at the request of the foreign representative, entrust the distribution of all or part of the debtor's assets located in this State to the foreign representative or another person designated by the court, provided that the court is satisfied that the interests of creditors in *[name of State]* are adequately protected.
3. In granting relief under this article to a representative of a foreign non-main proceeding, the court must be satisfied that the relief relates to assets that, under the law of this State, should be administered in the foreign non-main proceeding or concerns information required in that proceeding.

Article 22. Protection of creditors and other interested persons

1. In granting or denying relief under article 19 or 21, or in modifying or terminating relief under paragraph 3 of this article, the court must be satisfied that the interests of the creditors and other interested persons, including the debtor, are adequately protected.
2. The court may subject relief granted under article 19 or 21 to conditions it considers appropriate.
3. The court may, at the request of the foreign representative or a person affected by relief granted under article 19 or 21, or at its own motion, modify or terminate such relief.

Article 23. Actions to avoid acts detrimental to creditors

1. Upon recognition of a regional country proceeding, the foreign representative has standing to initiate *[refer to the types of actions to avoid or otherwise render ineffective acts detrimental to creditors that are available in this State to a person or body administering a reorganization or liquidation]*.
2. When the regional country proceeding is a foreign non-main proceeding, the court must be satisfied that the action relates to assets that, under the law of this State, should be administered in the foreign non-main proceeding.

Article 24. Intervention by a foreign representative in proceedings in this State

Annexure A

Upon recognition of a regional country proceeding, the foreign representative may, provided the requirements of the law of *[name of State]* are met, intervene in any proceedings in which the debtor is a party.

Chapter IV. Cooperation with foreign courts and foreign representatives

Article 25. Cooperation and direct communication between a court of this State and foreign courts or foreign representatives

1. In matters referred to in article 1, the court shall cooperate to the maximum extent possible with foreign courts or foreign representatives, either directly or through a *[insert the title of a person or body administering a reorganization or liquidation under the law of the enacting State]*.
2. The court is entitled to communicate directly with, or to request information or assistance directly from, foreign courts or foreign representatives.

Article 26. Cooperation and direct communication between the *[insert the title of a person or body administering a reorganization or liquidation under the law of the enacting State]* and foreign courts or foreign representatives

1. In matters referred to in article 1, a *[insert the title of a person or body administering a reorganization or liquidation under the law of the enacting State]* shall, in the exercise of its functions and subject to the supervision of the court, cooperate to the maximum extent possible with foreign courts or foreign representatives.
2. The *[insert the title of a person or body administering a reorganization or liquidation under the law of the enacting State]* is entitled, in the exercise of its functions and subject to the supervision of the court, to communicate directly with foreign courts or foreign representatives.

Article 27. Forms of cooperation

Cooperation referred to in articles 25 and 26 may be implemented by any appropriate means, including:

- a) Appointment of a person or body to act at the direction of the court;
- b) Communication of information by any means considered appropriate by the court;
- c) Coordination of the administration and supervision of the debtor's assets and affairs;
- d) Approval or implementation by courts of agreements concerning the coordination of proceedings;
- e) Coordination of concurrent proceedings regarding the same debtor;
- f) [The enacting State may wish to list additional forms or examples of cooperation].

Chapter V. Concurrent proceedings

Article 28. Commencement of a proceeding under *[identify laws of the enacting State relating to insolvency]* after recognition of a foreign main proceeding

After recognition of a foreign main proceeding, a proceeding under *[identify laws of the enacting State relating to insolvency]* may be commenced only if the debtor has assets in *[name of State]*; the effects of that proceeding shall be restricted to the assets of the debtor that are located in *[name of State]* and, to the extent necessary to implement cooperation and coordination under articles 25, 26 and 27, to other assets of the debtor that, under the law of *[name of State]*, should be administered in that proceeding.

Article 29. Coordination of a proceeding under *[identify laws of the enacting State relating to insolvency]* and a foreign proceeding

Where a regional country proceeding and a proceeding under *[identify laws of the enacting State relating to insolvency]* are taking place concurrently regarding the same debtor, the court shall seek cooperation and coordination under articles 25, 26 and 27, and the following shall apply:

- a) When the proceeding in *[name of State]* is taking place at the time the application for recognition of the regional country proceeding is filed,

- (i) Any relief granted under article 19 or 21 must be consistent with the proceeding in *[name of State]*; and
 - (ii) If the regional country proceeding is recognized in *[name of State]* as a foreign main proceeding, article 20 does not apply;
- b) When the proceeding *[name of State]* commences after recognition, or after the filing of the application for recognition, of the regional country proceeding,
- (i) Any relief in effect under article 19 or 21 shall be reviewed by the court and shall be modified or terminated if inconsistent with the proceeding in *[name of State]*; and
 - (ii) If the regional country proceeding is a foreign main proceeding, the stay and suspension referred to in paragraph 1 of article 20 shall be modified or terminated pursuant to paragraph 2 of article 20 if inconsistent with the proceeding in *[name of State]*;
- c) In granting, extending or modifying relief granted to a representative of a foreign non-main proceeding, the court must be satisfied that the relief relates to assets that, under the law of *[name of State]*, should be administered in the foreign non-main proceeding or concerns information required in that proceeding.

Article 30. Coordination of more than one regional country proceeding

In matters referred to in article 1, in respect of more than one regional country proceeding regarding the same debtor, the court shall seek cooperation and coordination under articles 25, 26 and 27, and the following shall apply:

- a) Any relief granted under article 19 or 21 to a representative of a foreign non-main proceeding after recognition of a foreign main proceeding must be consistent with the foreign main proceeding;
- b) If a foreign main proceeding is recognized after recognition, or after the filing of an application for recognition, of a foreign non-main proceeding, any relief in effect under article 19 or 21 shall be reviewed by the court and shall be modified or terminated if inconsistent with the foreign main proceeding;
- c) If, after recognition of a foreign non-main proceeding, another foreign non-main proceeding is recognized, the court shall grant, modify or terminate relief for the purpose of facilitating coordination of the proceedings.

Article 31. Presumption of insolvency based on recognition of a foreign main proceeding

In the absence of evidence to the contrary, recognition of a foreign main proceeding is, for the purpose of commencing a proceeding under *[identify laws of the enacting State relating to insolvency]*, proof that the debtor is insolvent.

Article 32. Rule of payment in concurrent proceedings

Without prejudice to secured claims or rights *in rem*, a creditor who has received part payment in respect of its claim in a proceeding pursuant to a law relating to insolvency in a foreign State may not receive a payment for the same claim in a proceeding under *[identify laws of the enacting State relating to insolvency]* regarding the same debtor, so long as the payment to the other creditors of the same class is proportionately less than the payment the creditor has already received.

Draft B—A regional non-treaty arrangement using a basic principles approach.

MEMORANDUM OF ADOPTION OF SCHEME FOR REGIONAL COOPERATION IN CROSS-BORDER
INSOLVENCY MATTERS

THE REPRESENTATIVES OF THE GOVERNMENTS OF

[the ASEAN countries]

[the ASEAN countries and ...]

[Indonesia, Korea, the Philippines and Thailand]

[Indonesia, Korea, the Philippines, Thailand and ...]

[meeting as] [meeting at] [on the occasion of]

.....

[any preamble]

NOTING that..

AGREEING that ...

RESOLVED TO ...}

**HEREBY [ADOPT] [DECIDE TO RECOMMEND TO THEIR GOVERNMENTS THE ADOPTION
OF]**

the text of a non-treaty Scheme for the purpose of fostering cooperation and mutual assistance between countries of the [...] region in cross-border insolvency matters.

The text of the Scheme is as follows:

THE SCHEME

1. The name of the Scheme is ‘The *[Manila or other place]* Scheme for Regional Cooperation in Cross-Border Insolvency Matters’.
2. The purpose of the Scheme is to promote, among countries of the [...] region, the objectives of:
 - (a) Cooperation between their courts and other competent authorities involved in cases of cross-border insolvency;
 - (b) Greater legal certainty for trade and investment;
 - (c) Administration of cross-border insolvencies that protects the interests of all creditors and other interested persons, including the debtor;
 - (d) Protection and maximization of the value of the debtor’s assets; and
 - (e) Facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.
3. The Scheme is open to participation by
4. An eligible country may become a participant in the Scheme by giving notice to that effect to *[officer of relevant regional body or agreed coordinating point in a specified country]*. The notice should specify the authority or agency in the participating country responsible for implementing the Scheme and providing information about the country’s participation to other participants.
5. Each participant will adopt, as a basis for cooperation with each other participant, laws and practices relating to cross-border insolvencies in accordance with the principles set out in the Annexure to this

Scheme ('the Annex'). The principles will be given effect in a manner appropriate within the legal system of each participant, and not so as to require any participant to take any action that would be manifestly contrary to its public policy.

6. Any participant may adopt laws and practices relating to cross-border insolvencies that provide a less restrictive or more expeditious basis for cooperation with any other participant than the provisions of the Annex.
7. Any participant may adopt laws and practices relating to cross-border insolvencies enabling cooperation to be extended to other countries as well as to other participants.
8. In the Annex, "regional country" means a participant.
9. The participants will, on a basis of reciprocity and through their courts and other institutions, extend cooperation and mutual assistance to one another.
10. After at least three countries have become participants in the Scheme, the *[participants, acting jointly,]* *[...]* may invite any other country to become a participant in the Scheme.
11. Any participant may withdraw from the Scheme at any time by giving six months notice to each other participant.

Annex

PRINCIPLES FOR REGIONAL COOPERATION IN CROSS-BORDER INSOLVENCIES

1. In these Principles—

"regional proceeding" means a collective judicial or administrative proceeding in a regional country, including an interim proceeding, pursuant to a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control by a regional country court, for the purpose of reorganization or liquidation;

"foreign representative" in relation to a regional country, means a person or body, including one appointed on an interim basis, authorized in a proceeding in a second regional country to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as a representative of the second regional country proceeding.

2. A foreign representative is entitled to apply directly to a court in any other regional country without need for any licensing or consular action.
3. A foreign representative is entitled to apply to commence a proceeding under the insolvency laws of any other regional country if the conditions for commencing such a proceeding are otherwise met.
4. Upon recognition of a regional proceeding, the foreign representative has procedural standing to participate in an insolvency proceeding in any other regional country regarding the same debtor.
5. Creditors in a regional country have the same rights regarding the commencement of, and participation in, an insolvency proceeding in another regional country as creditors in that other regional country. This Principle does not affect the ranking of claims in that proceeding, except that the claims of the first country's creditors
 - (a) are not to be ranked lower than the general non-preference claims in the second country,
 - (b) unless an equivalent local claim (e.g. a claim for a penalty or deferred-payment claim) has a rank lower than the general non-preference claims.
6. Whenever under the laws of a regional country notification is to be given to creditors in that country, such notification shall also be given to the known creditors in any regional country that do not have addresses in the first country. The court may order that appropriate steps be taken with a view to notifying any creditor whose address is not yet known.

Annexure A

7. A foreign representative may apply to the court of a regional country for recognition of the proceeding in which the foreign representative has been appointed. An application for recognition shall be accompanied by:
 - (a) A certified copy of the decision commencing the regional country proceeding and appointing the foreign representative; or
 - (b) A certificate from the foreign court affirming the existence of the regional country proceeding and of the appointment of the foreign representative; or
 - (c) In the absence of evidence referred to in subparagraphs (a) and (b), any other evidence acceptable to the court of the existence of the regional country proceeding and of the appointment of the foreign representative.
8. An application for recognition shall also be accompanied by a statement identifying all foreign proceedings in respect of the debtor that are known to the foreign representative.
9. The court may require a translation of documents supplied in support of the application for recognition into a relevant official language.
10. An application for recognition by a foreign representative, if properly documented and submitted to the appropriate court, shall be granted by recognizing the regional country proceeding
 - (a) as a foreign main proceeding if the regional proceeding is taking place in the country where the debtor has the centre of its main interests; or
 - (b) as a foreign non-main proceeding if, in the country where the regional proceeding is taking place, the debtor has a place of operations where it carries out a non-transitory economic activity with human means and goods or services.

(In the absence of proof to the contrary, the debtor's registered office, or habitual residence in the case of an individual, is presumed to be the center of the debtor's main interests.)

11. Upon recognition of a regional country proceeding that is a foreign main proceeding,
 - (a) commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities is stayed;
 - (b) execution against the debtor's assets is stayed; and
 - (c) the right to transfer, encumber or otherwise dispose of any assets of the debtor is suspended.

The recognizing court may subject relief granted under this Principle to conditions it considers appropriate, and may, at the request of the foreign representative or a person affected by relief granted under this Principle, or at its own motion, modify or terminate such relief.

12. The scope, and the modification or termination, of the stay and suspension referred to in Principle 11 are subject to the provisions of the insolvency laws of the recognizing country relating to exceptions, limitations, modifications or termination in respect of such stays or suspensions.
13. Principle 11 is not intended to affect the right to request the commencement of a proceeding under the insolvency laws of the recognizing country or the right to file claims in such a proceeding, and paragraph (a) of Principle 11 is not intended to affect the right to commence individual actions or proceedings to the extent necessary to preserve a claim against the debtor.
14. Upon recognition of a regional country proceeding, the foreign representative has standing to initiate any actions to avoid or otherwise render ineffective acts detrimental to creditors that are available in the recognizing country to a person or body administering a reorganization or liquidation.
15. When the regional country proceeding is a foreign non-main proceeding, the court must be satisfied that the action relates to assets that, under the law of the recognizing country, should be administered in the foreign non-main proceeding.

16. Upon recognition of a regional country proceeding, the foreign representative may, provided the requirements of the law of the recognizing country are met, intervene in any proceedings in which the debtor is a party.
17. Regional countries shall cooperate with one another on cross-border insolvencies to the maximum extent possible, directly and through their courts and other institutions. In particular, persons administering reorganizations or liquidations under respective national laws may communicate directly with one another.
18. After recognition of a foreign main proceeding, a proceeding under the insolvency laws of the recognizing country may be commenced only if the debtor has assets in that country. The effects of that proceeding shall be restricted to the assets of the debtor that are located in that country and, to the extent necessary for appropriate cooperation and coordination, to other assets of the debtor that, under the law of that country should be administered in that proceeding.
19. Where concurrent proceedings with respect to the same debtor take place in two or more regional countries courts should act so as to promote cooperation, coordination and consistency of relief granted in the different proceedings. Any recognition of or assistance to a foreign proceeding may be made consistent with the local proceeding, and, if already granted when the local proceeding commences, may be reviewed and modified for that purpose.
20. Concurrent proceedings that include proceedings in a country that is not a regional country, should be conducted in each regional country in accordance with its own laws and practices, but so as to promote cooperation, coordination and consistency of relief granted in the different proceedings.

Annexure B

**Model Agreement
to Promote
Company Restructuring**

**Model adaptable for use:
regionally or
by a country or
for a particular debtor**

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Agreement to Promote Company Restructuring

Date

Parties

Each of the Financial Institutions specified in Schedule 1 who bind themselves to this Agreement in consideration of the covenants given by the other parties.

Recitals

- A. This Agreement establishes a procedure for Financial Institution Creditors in ***[specify relevant jurisdiction/s or of a particular debtor on a case by case basis]*** to collectively consider and negotiate workout arrangements with a Debtor Company during specified standstill periods.
- B. That procedure involves the following steps ***[depending on the mode of workout used it may be necessary to amend these recitals]*** :
1. an Eligible Financial Institution Creditor submitting a Workout Application to the Financial Institution Creditors of a Debtor Company and convening a First Meeting of Financial Institution Creditors;
 2. an Initial Standstill Period during which Financial Institution Creditors must not prosecute their Claims against the Debtor Company until after the First Meeting of Financial Institution Creditors;
 3. conducting the First Meeting of Financial Institution Creditors at which:
 - (a) a Workout Committee may be elected; and
 - (b) the duration of the Extended Standstill Period may be determined, being the further period during which Financial Institution Creditors must not prosecute their Claims against the Debtor Company;
 4. negotiating an agreement with the Debtor Company under which it undertakes to:
 - (a) provide the Workout Committee and the Financial Institution Creditors with financial and other information as they request to enable them to formulate and assess the viability of a Workout Agreement;
 - (b) preserve the status quo in relation to the conduct of its business and the management of its affairs;
 - (c) pay the costs and expenses incurred by the Financial Institution Creditors in connection with the negotiation of a Workout Agreement and incidental matters; and
 - (d) indemnify members of the Workout Committee in their capacity as such in respect of any actions, claims or demands made against them, subject to specified exclusions;
 5. the Workout Committee assessing information provided by the Debtor Company;

Annexure B

6. the Workout Committee negotiating a Workout Agreement with the Debtor Company; and
 7. the Workout Committee convening a meeting of Financial Institution Creditors to consider and, if agreed, adopt the Workout Agreement containing the Debtor Company's business plan.
- C. That procedure is or may be terminated if:
1. the First Meeting of Financial Institution Creditors concludes without a resolution to establish a Workout Committee having been passed;
 2. the Debtor Company refuses to give, or breaches, the Debtor Company's Covenants;
 3. an event occurs which brings the Debtor Company under the operation of the bankruptcy or insolvency law of *[specify relevant jurisdiction]*; or
 4. the Extended Standstill Period expires without a Workout Agreement having been adopted.

Operative provisions

1. Interpretation

1.1 Definitions

The following definitions apply in this Agreement.

Business Day means:

- (a) for determining when a notice, consent or other communication is given, a day that is not a Saturday, Sunday or public holiday in the place to which the notice, consent or other communication is sent; and
- (b) for any other purpose, a day (other than a Saturday, Sunday or public holiday) on which banks are open for general banking business in *[specify relevant jurisdiction]*.

[This definition may require modification in jurisdictions where a "weekend" falls on days other than Saturday and Sunday, for example Malaysia.]

Claim means any indebtedness or obligation owed by a Debtor Company to a Financial Institution Creditor, including but not limited to indebtedness for or in respect of:

- (a) money borrowed from a Financial Institution;
- (b) any acceptance credit;
- (c) any bond, note, debenture, loan stock or other similar instrument;
- (d) any finance or capital lease;
- (e) receivables sold or discounted (otherwise than on a non-recourse basis); or

- (f) any obligation in respect of any guarantee, indemnity, bond, letter of credit or any other instrument issued by a Financial Institution Creditor on account of or at the request of the Debtor Company.

[Consideration should be given to expanding this definition to include creditors such as trade financiers.]

[Consideration should also be given to extending the definition to include amounts owing by a debtor to a Financial Institution, not in connection with a finance or facility document, such as amounts owing as a trade supplier or contractor to the Financial Institution.]

Debtor Company means a company that is indebted to a Financial Institution Creditor.

[It may be necessary in some jurisdictions to include a reference to forms of commercial organisations other than companies.]

Principles 6,
10 and 11

Debtor Company's Covenants means undertakings to be given by a Debtor Company as contemplated in clauses 13.1 to 13.4 (inclusive), as amended and approved by the Workout Committee applicable to that Debtor Company.

Eligible Financial Institution Creditor means a Financial Institution Creditor of the relevant Debtor Company with a Claim against the Debtor Company which represents more than 10% of the total indebtedness owed by that Debtor Company to all of its Financial Institution Creditors ***[consideration should be given to allowing a number of financial institution creditors to group their claims to get over the 10% threshold]***.

Principles 4
and 5

Extended Standstill Period, in respect of a Debtor Company, means:

- (a) the period of 60 days; or
- (b) any period determined by a special resolution passed at the First Meeting of Financial Institution Creditors (being a meeting at which it is determined that a Workout Committee is to be appointed),

as varied under clause 7.3 or 7.4 and in the case of either period commencing on the date on which the First Meeting of Financial Institution Creditors in respect of that Debtor Company concludes.

Facility means any facility giving rise to financial indebtedness by a Debtor Company.

Financial Institution means any body that carries on a business providing financial products or financial services or any body that receives money on deposit and which is ***[e.g., either "licensed to carry on the business of banking in [specify relevant jurisdiction]" or "a member of the Bankers' Association of [specify relevant jurisdiction]".]***

Principle 1

Financial Institution Creditor means any Financial Institution which has entered into this Agreement and has a Claim against a Debtor Company.

Financial Institution Creditor Subsidiary Accession Deed Poll means a deed poll substantially in the form of Annexure B.

First Meeting of Financial Institution Creditors, in respect of a Debtor Company, means the meeting of the Financial Institution Creditors of a Debtor Company held pursuant to the Notice described in clause 3.4 for the purpose described in clause 4.

Initial Standstill Period, in respect of a Debtor Company, means the period commencing on the third Business Day after the date on which Notice of the First Meeting of Financial Institution Creditors is sent and ending on the date on (and including) the earlier of

Principles 4
and 5

- (a) the date on which that meeting (allowing for any adjournment of that meeting) concludes; or
- (b) (if the meeting stipulated by that Notice does not take place or the determinations under clause 4 do not take place at that meeting and there is no adjournment, or any adjournment does not take place) the Business Day on which that meeting was to have been held or the day to which it was to have been adjourned.

Member Accession Deed Poll means a deed poll substantially in the form of Annexure A.

Non-Financial Institution Creditor means a creditor of the relevant Debtor Company which agrees to be bound by the terms of this Agreement as though it were a Financial Institution Creditor of that Debtor Company.

Notice means a written notice, consent, approval or other communication given or required under this Agreement.

Related Party means a parent company or Subsidiary of a Debtor Company.

Security Interest means:

- (a) a mortgage, pledge, lien, charge, assignment, hypothecation, title retention arrangement, right of set-off or right to withhold payment of a deposit or other money or security interest;
- (b) any other interest or arrangement of any kind that secures the payment of money or the performance of an obligation or which gives a creditor priority over unsecured creditors in relation to any property; or
- (c) an agreement to create any of them or to allow any of them to exist.

Subsidiary in respect of either a Financial Institution or a Debtor Company means a company in which it directly or indirectly through another subsidiary owns at least 90% of the issued **[voting]** capital of that company.

Workout means the procedures adopted to promote the financial soundness of a Debtor Company through additional financing, release of mutual guarantees, capital reductions, selection of areas of business concentration, foreign capital and restructuring of obligations (including the conversion of short term loans into long term or medium term loans, the suspension of repayments of loan principal and interest accrued, reductions of, or exemptions from, interest obligations and exemptions from other obligations).

Workout Agreement, in respect of a Debtor Company, means an agreement entered into regarding a Workout between the Financial Institution Creditors and the Debtor Company which conforms to clause 9.2.

Workout Application means an application by a Financial Institution Creditor of a Debtor Company which conforms to clause 3.2.

Workout Committee means a committee of the Financial Institution Creditors of a Debtor Company formed under clause 6.2.

1.2 Rules for interpreting this Agreement

Headings are for convenience only, and do not affect interpretation. The following rules also apply in interpreting this Agreement, except where the context makes it clear that a rule is not intended to apply.

- (a) A reference to:
 - (1) legislation (including subordinate legislation) is to that legislation as amended, re-enacted or replaced, and includes any subordinate legislation issued under it;
 - (2) a document or agreement, or a provision of a document or agreement, is to that document, agreement or provision as amended, supplemented, replaced or novated;
 - (3) a party to this Agreement or to any other document or agreement includes a permitted substitute or a permitted assign of that party;
 - (4) a person includes any type of entity or body of persons, whether or not it is incorporated or has a separate legal identity, and any executor, administrator or successor in law of the person; and
 - (5) anything (including a right, obligation or concept) includes each part of it.
- (b) A singular word includes the plural, and vice versa.
- (c) A word which suggests one gender includes the other genders.
- (d) If a word is defined, another part of speech has a corresponding meaning.
- (e) If an example is given of anything (including a right, obligation or concept), such as by saying it includes something else, the example does not limit the scope of that thing.
- (f) The word agreement includes an undertaking or other binding arrangement or understanding, whether or not in writing.

1.3 Business Days

If the day on or by which a person must do something under this Agreement is not a Business Day:

- (a) if the act involves a payment that is due on demand, the person must do it on or by the next Business Day; and
- (b) in any other case, the person must do it on or by the previous Business Day.

2. Financial Institution Creditors

2.1 Representatives of Financial Institution Creditors

Principle 9

- (a) Each party to this Agreement must appoint a senior employee or officer to represent it in relation to the matters arising under this Agreement.
- (b) That representative must have written authorisation from the relevant Financial Institution to represent that Financial Institution and act on its behalf in relation to the matters arising under this Agreement, including to vote on behalf of that Financial Institution at meetings held under this Agreement.

2.2 Meetings of Financial Institution Creditors

Subject to the other provisions of this Agreement, the convening and conduct of meetings of Financial Institution Creditors is governed by the By-Laws governing the conduct of General Meetings of the Bankers' Association of *[specify relevant jurisdiction or if regionally may be the by-laws of ABA]*.

[May need to identify set of meeting rules if this agreement is used for workout of particular debtor.]

2.3 Chairman of meetings of Financial Institution Creditors

After the Initial Standstill Period, the Chairman (or his or her nominee) of the Workout Committee for a Debtor Company must chair meetings of Financial Institution Creditors of that Debtor Company.

2.4 Resolutions of meetings of Financial Institution Creditors

A resolution of a meeting of Financial Institution Creditors must be:

- (a) unless otherwise specified, an ordinary resolution. Subject to clause 2.6, an ordinary resolution is a resolution which is passed by a [majority in number] of the Financial Institution Creditors voting in person or by proxy representing a [majority of the value] of the Claims of all voting Financial Institution Creditors; or
- (b) where specified, a special resolution. Subject to clause 2.6, a special resolution is a resolution passed by a majority in number of the Financial Institution Creditors voting in person or by proxy representing **[75%]** of the value of the Claims of all voting Financial Institution Creditors.

[The thresholds in sub-paragraphs (a) and (b) above may be altered if it is considered that they are inappropriate in a particular jurisdiction.]

[It may be necessary to have a mechanism concerning the calculation of the value of claims and for disputes as to values.]

2.5 Representation of Subsidiaries of Financial Institution Creditors

For meetings of Financial Institution Creditors convened under this Agreement, the representative of a Financial Institution is also the representative of all its Subsidiaries who have acceded to this Agreement under a Financial Institution Creditor Subsidiary Accession Deed Poll.

[It is noted that certain Financial Institutions may need to deal with conflict issues arising from special purpose subsidiaries established to trade in the secondary debt market and in particular the possibility that such subsidiaries may wish to acquire the debt of a related entity.]

2.6 Computation of votes at meetings of Financial Institution Creditors

Where a Financial Institution and its Subsidiaries each have Claims against a Debtor Company:

- (a) that Financial Institution and those Subsidiaries have one vote collectively at meetings of Financial Institution Creditors; and
- (b) the value of their vote is the aggregate amount of their Claims.

[It may be necessary to have a mechanism concerning the calculation of the value of claims and for disputes as to values.]

3. Initiation of Workout

3.1 Workout Application

An Eligible Financial Institution Creditor may despatch a Workout Application to as many of the Financial Institution Creditors of a Debtor as is reasonably practicable provided that the Claims of all Financial Institution Creditors of the Debtor Company comprise at least **[90%]** of the Debtor Company's total indebtedness excluding indebtedness to its Related Parties. ***[This percentage may be too high in some jurisdictions. In some jurisdictions a percentage figure of 70% or 75% may be more appropriate.]***

[In some jurisdictions it may be necessary to obtain the consent of the debtor prior to dispatch of a workout agreement due to confidentiality/liability concerns. Whether a workout application procedure coupled with an initial standstill period is acceptable or appropriate in such jurisdictions may also be a relevant consideration.]

3.2 Content of Workout Application

The Workout Application must:

- (a) specify, to the extent that the Financial Institution Creditor is aware, details of:
 - (1) the Debtor Company and its registered office;
 - (2) the Financial Institution Creditors of the Debtor Company; and
 - (3) the indebtedness of the Debtor Company to each of those Financial Institution Creditors (including the amount and type of indebtedness); and
- (b) be accompanied by either the latest audited financial report of the Debtor Company or, if there is no such report, the latest balance sheet provided by the Debtor Company to that Financial Institution Creditor. ***[subject to the confidentiality and liability issues that may arise in certain jurisdictions.]***

3.3 Calculation of percentages in Workout Application

To calculate the percentages required to be satisfied to enable a Financial Institution Creditor to despatch a Workout Application, the information included in the audited financial report or the balance sheet submitted with the Workout Application is conclusive evidence *[in absence of manifest error]* of the relevant amounts.

[Given the lack of adequate publicly available financial information in some jurisdictions, it may be necessary to use another means to determine the relevant amounts.]

[It may be necessary to have a mechanism concerning the calculation of the value of claims and for disputes as to values.]

3.4 Notice of First Meeting of Financial Institution Creditors

The Workout Application despatched by an Eligible Financial Institution Creditor under clause 3.1 shall be accompanied by a Notice of the First Meeting of Financial Institution Creditors of the Debtor Company. That Notice shall stipulate:

- (a) the place at which the Meeting is to be held;
- (b) the hour at which the Meeting is to be held;
- (c) the Business Day on which the Meeting is to be held which shall be no less than **[10]** Business Days after the day on which the Notice was sent and no more than **[15]** Business Days after the Notice was sent; ***[These periods can be shortened or lengthened];*** and
- (d) the identity of the Chairman of the Meeting.

4. First Meeting of Financial Institution Creditors

The purpose of the First Meeting of Financial Institution Creditors of a Debtor Company is to determine:

- (a) by special resolution, whether to appoint a Workout Committee;
- (b) which Financial Institution Creditors are to be members of any Workout Committee; ***[depending on the size and complexity of the Workout specialist sub-committees the Workout Committee may also be necessary.]***
- (c) the identity of the Chairman of the Workout Committee; and
- (d) subject to a special resolution to appoint a Workout Committee having been passed, the duration of the Extended Standstill Period if it is to be other than 60 days.

Principle 7

5. Initial Standstill Period

Principles 4,
5 and 12

During the Initial Standstill Period, the Financial Institution Creditors of the Debtor Company must not take any steps to enforce Claims against either the Debtor Company or any Related Party of the Debtor Company, including:

- (a) commence or continue any action to enforce the payment of any amount owed by any of them including steps to place any of them in liquidation, administration, insolvency, receivership, business reorganisation or rehabilitation under any insolvency laws or any similar procedures in any jurisdiction;
- (b) make any demand for, or accelerate the due date for, or declare prematurely payable, any amount owing to it by any of them;
- (c) accept any payment from any of them in discharge of any indebtedness owed to it by any of them;
- (d) terminate or cancel any Facility;
- (e) amend any Facility documentation;
- (f) perfect, enforce or make a demand under any Security Interest or any guarantee indemnity or like commitment or similar support held by it in respect of any liability of any of them or under any Facility;
- (g) take any cash collateral, cash cover, guarantee, indemnity or Security Interest in respect of any Facility; or
- (h) exercise any right of appropriation, amalgamation of accounts, counterclaim or set-off in reduction of sums owing to it under any Facility;
- (i) nothing in this clause shall prevent a Financial Institution Creditor from taking such steps as may be necessary to avoid the circumstance that a Claim may not be pursued or enforced by reason of either a standstill or an agreement which limits the time within which those steps must be taken.

[Consideration must be given to whether a secured creditor should be bound by the moratorium and therefore prevented from exercising its rights to enforce its security.]

[Consideration must also be given to the status of undrawn or partly drawn facilities and revolving facilities or similar types of facilities. Consideration needs to be given to whether providers of such finance should be restrained from refusing to provide further funds during the standstill period. Cf clause 8 below which relates to priority for additional funding.]

6. Workout Committee

6.1 Application of clause

Clause 6 applies only if a special resolution is passed at the First Meeting of Financial Institution Creditors to establish a Workout Committee for a Debtor Company.

6.2 Constitution of Workout Committee

Subject to clause 12.3, the Workout Committee for a Debtor Company is to comprise:

Principle 7

(a) one nominated representative (or that representative's alternate) each from the 3 Financial Institution Creditors who have the largest Claims;

Principle 8

(b) one nominated representative (or that representative's alternate) each from three other Financial Institution Creditors. At the First Meeting of Financial Institution Creditors, each Financial Institution Creditor will vote for 3 Financial Institution Creditors. The 3 Financial Institution Creditors with the most votes will each be entitled to nominate one representative for the Workout Committee; and

(c) either:

(i) an independent chairman appointed by the First Meeting of Financial Institution Creditors; or

(ii) the nominee chairman of the Financial Institution Creditor which has the largest Claim.

6.3 Qualifications of chairman [only relevant if clause 6.2(c)(i) is adopted]

The chairman of the Workout Committee must:

(a) have:

Principle 8

(1) at least 10 years experience in the management of a Financial Institution or management in other fields relating to finance; or

(2) at least 10 years experience as a certified public accountant or a lawyer; or

(3) at least 3 years experience in company restructuring;

(b) not personally owe, or directly or indirectly own 25% or more of the issued shares in a company which owes, more than US\$5,000 to the Debtor Company or its Subsidiary;

(c) not be owed more than US\$5,000 by the Debtor Company, or not directly or indirectly own 25% or more of the issued shares in a company which is owed more than US\$5,000 by the Debtor Company;

(d) not be an officer or employee of a Financial Institution Creditor of the Debtor Company (otherwise than by reason of being a liquidator or administrator of the Debtor Company or its Subsidiary);

(e) not be an officer or employee of either any mortgagee or holder of other security of property of the Debtor Company;

(f) not be an officer or employee of the Debtor Company, or an employee of an officer or employee; or

(g) not be an auditor of the Debtor Company, or a partner or employee of that auditor.

For the purposes of this clause a reference to a Debtor Company includes a Related Party of that Debtor Company.

6.4 Role of chairman

The chairman of the Workout Committee must:

- (a) chair meetings of the Workout Committee;
- (b) oversee the gathering of financial and other information relevant to the formation of a Workout Agreement;
- (c) be the principal representative of the Workout Committee in negotiations with the Debtor Company in relation to the formation of a Workout Agreement; and
- (d) undertake any other duties or responsibilities as reasonably requested by a resolution of the Workout Committee.

6.5 Functions and Powers of Workout Committee

The Workout Committee must perform the following functions:

- (a) oversee any negotiations between the chairman and the Debtor Company to form a Workout Agreement;
- (b) gather, collate and disseminate to Financial Institution Creditors all financial and other information as they may require to assess any proposed Workout Agreement;
- (c) review and assess the commercial viability of any proposed Workout Agreement (including the Debtor Company's business plan contained in it) and report its opinion to the Financial Institution Creditors;
- (d) convene meetings of Financial Institution Creditors as in the Workout Committee's opinion are necessary:
 - (1) to review the financial and other information disclosed to the Financial Institution Creditors;
 - (2) to consider what further information is required to assess any proposed Workout Agreement;
 - (3) to consider the formation of a Workout Agreement;
 - (4) to review the progress in forming a Workout Agreement;
 - (5) to discuss amendments to any proposed Workout Agreement; and
 - (6) to adopt any proposed Workout Agreement;
- (e) establish budgets for the operating expenditure of the Workout Committee;
- (f) appoint professional advisers to advise and assist the Workout Committee and the Financial Institution Creditors;
- (g) receive any Financial Institution Creditor Subsidiary Accession Deeds Poll in respect of the Debtor Company, and provide copies on request to Financial Institutions; and

Principles 2
and 3

- (h) do anything which, in the opinion of the Workout Committee, is contemplated by, incidental to or otherwise necessary or desirable in connection with, anything described in the preceding paragraphs;

and may exercise the following powers:

- (i) to approve on behalf of and so as to bind each party to this Agreement the grant by the Debtor Company to a Financial Institution Creditor of such security as it may require in respect of the provision of any Facility by it to the Debtor Company after the appointment of the Workout Committee; and
- (j) in any case where the Chairman of the Workout Committee is unable to act as such for any reason, appoint another person to act as such during the period of the Chairman's disability.

6.6 Proceedings and resolutions of Workout Committee

The conduct of the Workout Committee and the despatch of its business are regulated by the same By-Laws as regulate those matters on the part of *[the Board of Directors of the Bankers' Association of [the relevant jurisdiction] [or of the Asian Bankers Association (ABA) if regional agreement].*

[May need to identify set of meeting rules if agreement to be used for workout of particular debtor.]

6.7 Liability for Workout Committee's expenses

Any operating expenditure and taxes of the Workout Committee which are unpaid by the Debtor Company must be paid proportionately by each Financial Institution Creditor according to the value of its Claim against the Debtor Company.

6.8 Indemnity by Financial Institution Creditors for Workout Committee members

- (a) Subject to paragraph (b), each Financial Institution Creditor severally indemnifies each Workout Committee member for its own account against, and must pay that member on demand the amount of, its proportion (which equals the proportion which its Claim bears to the total Claims) of all losses, liabilities, costs, expenses (including legal fees on a full indemnity basis) and taxes which that member incurs in connection with the performance of its functions as a Workout Committee member, except to the extent that they:
 - (1) have been finally paid by the Debtor Company under any indemnity given in accordance with clause 13.4; or
 - (2) are incurred as a result of the fraud, wilful misconduct, misrepresentation or gross negligence of that member.
- (b) A Workout Committee may only make a claim against a Financial Institution Creditor under paragraph (a) after the Debtor Company has failed for a period of 14 days to pay an amount demanded under an indemnity given in accordance with clause 13.4.
- (c) Before claiming against a Financial Institution Creditor under paragraph (a), a Workout Committee member must first claim against the Debtor Company under any indemnity given in accordance with clause 13.4.

7. Extended Standstill Period

7.1 Application of clause

Clause 7 applies only if a resolution is passed at the First Meeting of Financial Institution Creditors to establish a Workout Committee for a Debtor Company.

7.2 Extended Standstill

During the Extended Standstill Period, the Financial Institution Creditors of the Debtor Company must not take any steps to enforce Claims against either the Debtor Company or any Related Party of the Debtor Company, including:

- (a) commence or continue any action to enforce the payment of any amount owed by any of them, including steps to place any of them in liquidation, administration, insolvency, receivership, business reorganisation or rehabilitation under any insolvency laws or any similar procedures in any jurisdiction;
- (b) make any demand for, or accelerate the due date for, or declare prematurely payable, any amount owing to it by any of them;
- (c) accept any payment from any of them or discharge of any indebtedness owed to it by any of them;
- (d) terminate or cancel any Facility;
- (e) amend any Facility documentation;
- (f) perfect, enforce or make a demand under any Security Interest or any guarantee indemnity or like commitment or similar support held by it in respect of any liability of any of them or under any Facility;
- (g) subject to any resolution of the Workout Committee in the exercise of its power under sub-clause ___, take any cash collateral, cash cover, guarantee, indemnity or Security Interest in respect of any Facility; or
- (h) exercise any right of appropriation, amalgamation of accounts, counterclaim or set-off in reduction of sums owing to it under any Facility.

Nothing in this clause shall prevent a Financial Institution Creditor from taking such steps as may be necessary to avoid the circumstance that a Claim may not be pursued or enforced by reason of either a standstill or an agreement which limits the time within which those steps must be taken.

[Consideration must be given to whether a secured creditor should be bound by the moratorium and therefore prevented from exercising its rights to enforce its security.]

[Consideration must also be given to the status of undrawn or partly drawn facilities and revolving facilities or similar types of facilities. Consideration needs to be given to whether providers of such finance should be restrained from refusing to provide further funds during the standstill period. Cf clause 8 below, which relates to priority for additional funding.]

Principles 4,
5 and 12

7.3 **Extension of Extended Standstill Period**

Principle 4

If the Workout Committee considers it necessary to evaluate the commerciality of a proposed Workout Agreement or to form a Workout Agreement, the Workout Committee may convene a meeting of Financial Institution Creditors to consider a special resolution to:

- (a) extend the Extended Standstill Period; or
- (b) commence some other period with moratorium or other features to be determined by the Financial Institution Creditors during that meeting.

7.4 **Termination of Extended Standstill Period**

(a) If any of the following events occur, the Workout Committee may convene a meeting of Financial Institution Creditors to terminate the Extended Standstill Period on a specified date, subject to any ordinary or special resolution specified below as being required for termination being passed:

- (1) the Debtor Company does not give the Debtor Company's Covenants contemplated in clause 13.1 or 13.2 within 5 Business Days of the First Meeting of Financial Institution Creditors and the Financial Institution Creditors pass an ordinary resolution to terminate the Extended Standstill Period; ***[In this case, consideration needs to be given as to whether the Extended Standstill Period should be terminated automatically or should an ordinary resolution be required.]***
- (2) the Debtor Company does not give those Debtor Company's Covenants contemplated in clause 13.3 or 13.4 within 5 Business Days of the First Meeting of Financial Institution Creditors, and the Financial Institution Creditors pass an ordinary resolution to terminate the Extended Standstill Period;
- (3) in the opinion of the Workout Committee, the Debtor Company breaches a material term of the Debtor Company's Covenants, and the Financial Institution Creditors pass an ordinary resolution to terminate the Extended Standstill Period;
- (4) any event which brings the Debtor Company under the operation of the bankruptcy or insolvency or similar laws of ***[specify relevant jurisdiction]***, including:
 - (A) an order ***[or an application]*** being made, or a resolution being passed, for the winding up of the Debtor Company; and
 - (B) an administrator, controller, liquidator, provisional liquidator, receiver or trustee for creditors or in bankruptcy being appointed to the Debtor Company or any of its property, or a resolution being passed ***[or an application being made]*** for that appointment; or

[For these financial defaults, consideration needs to be given to whether the Extended Standstill Period should be terminated automatically or whether an ordinary or a special resolution should be required.]

- (5) the Workout Committee forms the unanimous opinion that no purpose is served by continuing the Extended Standstill Period and the Financial Institution Creditors pass an ordinary resolution to terminate the Extended Standstill Period.
- (b) If any event described in subparagraphs (a)(1) to (a)(5) occurs or the Extended Standstill Period expires without a Workout Agreement having been adopted by a special resolution of a meeting of Financial Institution Creditors, the Extended Standstill Period and the obligations of the Financial Institution Creditors which would otherwise apply to them during that period will terminate with effect from that date or the specified termination date as the case may require.

8. Additional Funding

Principle 14

If any Financial Institution Creditor provides additional funds to the Debtor Company to maintain the Debtor Company's continuing business operations during the Extended Standstill Period, the repayment of the additional funding should, so far as practicable, be accorded priority status as compared to other indebtedness or claims of the Financial Institution Creditors.

[Consideration should be given to whether there should be an express subordination arrangement so as to give priority to such additional funding in any event.]

[Consideration should also be given to making priority of such funding mandatory.]

[It may be necessary to expand this clause to deal with issues of partly drawn facilities and rollover facilities.]

9. Workout Agreement

9.1 Negotiation of Workout Agreement

During the Extended Standstill Period, the Workout Committee must negotiate a Workout Agreement with the Debtor Company for the restructuring of the Debtor Company.

9.2 Minimum content of proposed Workout Agreement

A proposed Workout Agreement must contain details of at least the following:

- (a) the property of the Debtor Company (whether or not already owned by the Debtor Company when it executes the Workout Agreement) which is affected by the Workout Agreement;
- (b) the nature and duration of any standstill period for which the Workout Agreement provides;
- (c) the extent to which the Debtor Company is to be released from any Claims or the extent to which those Claims are to be modified;
- (d) any conditions to be satisfied before the Workout Agreement becomes effective;
- (e) any conditions to be satisfied for the Workout Agreement to continue to apply;
- (f) the circumstances in which the Workout Agreement terminates;

- (g) the order in which proceeds of realising the property referred to in paragraph (a) are to be distributed among Financial Institution Creditors which order of distribution should, so far as is practicable, reflect the rights and obligations of the Financial Institution Creditors at the commencement of the Initial Standstill Period except to the extent to which they have been modified under an agreement made consistently with clause 8;
- (h) the day not later than the day that the Workout Application was sent on or before which Claims must have arisen under the Workout Agreement;
- (i) the Debtor Company's business plan; and
- (j) the applicable law governing the Workout Agreement.

9.3 Adoption of Workout Agreement

If the Workout Committee negotiates a Workout Agreement with the Debtor Company, convenes a meeting of Financial Institution Creditors to adopt the Workout Agreement and if that meeting of Financial Institution Creditors adopts the Workout Agreement by a majority representing at least [75%] of all Financial Institution Creditors of the Debtor Company with at least [90%] of the Claims of all Financial Institution Creditors of the Debtor Company, the Workout Agreement will bind the Financial Institution Creditors of the Debtor Company once it has been executed by the Debtor Company.

10. Assignment of Claims by Financial Institution Creditors

Principle 1

Notwithstanding any other provision of this Agreement, a Financial Institution Creditor, during either the Initial Standstill Period or the Extended Standstill Period, may assign, transfer, grant security, encumber or otherwise dispose of its Claim against a Debtor Company only if any agreement giving effect to that assignment, transfer, grant of security, encumbrance or other disposal provides that:

- (a) the assignee, grantee or disponent agrees to comply with the terms of this Agreement as if it were that Financial Institution Creditor; and
- (b) that Financial Institution Creditor holds that agreement on the part of the assignee, grantee or disponent as trustee for the other Financial Institution Creditors of the Debtor Company and their assigns.

[It is necessary to consider the impact of this clause on the ability of creditors to sell debts in the secondary debt market. The countervailing consideration is that unless assigns are bound then a holdout creditor can easily circumvent the binding nature of the agreement.]

[An issue concerns the operation of insurance policies available to Financial Institutions which, at least, limit their exposure to the risk associated with any credit. Consideration needs to be given to whether this Agreement should make any provision concerning such insurance.]

11. Breach by Financial Institution Creditor of Standstill Provisions

- (a) If a Financial Institution Creditor (the Defaulting Financial Institution Creditor) breaches any part of clause 5 or clause 7, any other Financial Institution Creditor may apply to the relevant court for an interim or final injunction or other relief as

may be required to secure compliance by the Defaulting Financial Institution Creditor with the relevant clause.

- (b) Execution of this Agreement by the Defaulting Financial Institution Creditor is conclusive evidence of its consent to the grant of that relief.

[Whilst other breaches of this Agreement may be able to be litigated in the ordinary course, a breach of standstill provisions would seem to require more immediate action to be able to be taken against the Defaulting Financial Institution Creditor. Consideration needs to be given whether this clause in an appropriate means of dealing with breaches by Financial Institution Creditors of this Agreement.]

12. Accession to this Agreement

12.1 Accession by new member of Bankers' Association of *[either ABA or relevant jurisdiction]*

If a Financial Institution becomes a member of the Bankers' Association *[of relevant jurisdiction or ABA]* after the date of this Agreement, it may accede to and become bound by the terms of this Agreement by executing a Member Accession Deed Poll and delivering it to the Association. ***[This clause will not apply to a workout for a particular debtor.]***

[A further issue is whether this clause should be mandatory.]

12.2 Accession by Subsidiary of Financial Institution Creditor

- (a) If requested in writing by the Workout Committee for a Debtor Company, a Financial Institution Creditor must require that its Subsidiary specified by the Workout Committee accedes to this Agreement only to the extent that it operates in respect of that Debtor Company and any applicable Subsidiaries or parent of that Debtor Company.
- (b) That Financial Institution Creditor must do so by causing its Subsidiary to execute a Financial Institution Creditor Subsidiary Accession Deed Poll and delivering it to the chairman of the Workout Committee.

[A further issue is whether this clause should be mandatory.]

[Consideration should be given as to what consequences should flow from a breach of this clause.]

12.3 Accession by Non-Financial Institution Creditor

If the Workout Committee forms the opinion that it is desirable that a creditor of the Debtor Company which is not a Financial Institution Creditor be bound by the provisions of this Agreement, it may request that creditor to execute a Non-Financial Creditor Accession Deed Poll. In the event that that creditor does so:

- (a) it shall be a Non-Financial Institution Creditor of the relevant Debtor Company; and
- (b) it shall be entitled to nominate a representative as a member of the Workout Committee

Otherwise, this Agreement shall be read as though a Non-Financial Institution Creditor were a Financial Institution Creditor in respect of the relevant Debtor Company as and from the date upon the Non-Financial Creditor Accession Deed Poll was executed.

13. Debtor Company's Covenants

13.1 Information

The Workout Committee must obtain an agreement from the Debtor Company, within 5 Business Days of the First Meeting of Financial Institution Creditors, that it will provide the Workout Committee with at least the following information for distribution to its Financial Institution Creditors:

Principle 10

- (a) audited consolidated accounts for the most recent financial year of the Debtor Company;
- (b) unaudited consolidated accounts for the most recent financial half-year of the Debtor Company;
- (c) cash flow forecasts of the Debtor Company;
- (d) profit and loss forecasts of the Debtor Company;
- (e) any information, access to personnel and other assistance as is necessary to enable the Financial Institution Creditors to monitor the cash flow of the Debtor Company and compare it with the cash flow and profit and loss forecasts;
- (f) information concerning the availability of ongoing financial support for the business of the Debtor Company; and
- (g) any other financial and other information in respect of the Debtor Company as the Workout Committee may request.

13.2 Effect of standstill on Debtor Company

The Workout Committee must obtain an agreement from the Debtor Company and its Subsidiaries, within 5 Business Days of the First Meeting of Financial Institution Creditors, that it will not, during the Extended Standstill Period, without the prior written consent of the Workout Committee:

Principle 6

- (a) create or permit to subsist any Security Interest over any of its assets;
- (b) dispose of all or any part of its assets except for disposals made in the ordinary course of ordinary business;
- (c) change the nature of its business or cease its business;
- (d) enter into any amalgamation, merger, demerger or reconstruction;
- (e) acquire any assets or business or make any investment;
- (f) make any loan or provide any credit to any person;
- (g) declare or pay any dividend;

- (h) open or operate any bank accounts other than for the purposes of the Workout Agreement;
- (i) repay any indebtedness owed to its shareholders or any Related Party; or
- (j) exercise any right of set-off.

13.3 Debtor Company to pay costs

The Workout Committee must obtain an agreement from the Debtor Company, within 5 Business Days of the First Meeting of Financial Institution Creditors, that the Debtor Company will meet all reasonable costs and taxes of the Financial Institution Creditors in connection with:

- (a) the preparation and negotiation of the Workout Agreement; and
- (b) all other matters undertaken by the Workout Committee in connection with the Workout Agreement.

Principle 11

Indemnity by Debtor Company for Workout Committee members

The Workout Committee must obtain an agreement from the Debtor Company, within 5 Business Days of the First Meeting of Financial Institution Creditors, that it will indemnify each Workout Committee member for its own account against, and will pay that member on demand the amount of, all losses, liabilities, costs, expenses (including legal fees on a full indemnity basis) and taxes which that member incurs in connection with the performance of its functions as a Workout Committee member, except to the extent that they are incurred as a result of the fraud, wilful misconduct, misrepresentation or gross negligence of that member.

14. Confidentiality of Information Provided by Debtor Company

Principle 13

- (a) Information concerning the assets, liabilities, business and prospects of the Debtor Company and any proposals for a Workout Agreement received by a Financial Institution Creditor or the Workout Committee must be made available to all Financial Institution Creditors.
- (b) Unless that information is publicly available, the Workout Committee and the Financial Institution Creditors must treat it as confidential, and use it only for the purposes of this Agreement and the formation and implementation of any Workout Agreement.

15. Dispute Resolution

15.1 General

- (a) Any dispute, controversy or claim arising out of or relating to this Agreement will be dealt with firstly by mediation. In the event that the dispute, controversy or claim is not settled then the matter shall be referred to arbitration under this Agreement.
- (b) A party may initiate dispute resolution proceedings by serving a Dispute Resolution Notice for Mediation or Arbitration, as the case may be, on the other party and at the same time the Chairman of the Workout Committee.

- (c) Upon receipt of a Dispute Resolution Notice issued by one of the parties, the Chairman of the Workout Committee shall within 14 days of the date of that Notice provide to the parties a list of 3 mediators in the case of a mediation or 7 arbitrators in the case of an arbitration for consideration by the parties.

15.2 Mediation

- (a) In the case of a mediation the parties shall agree and select one person from the list of mediators within 14 days of the date the Chairman of the Workout Committee provides the list of mediators to the parties for their consideration.
- (b) If the parties cannot agree on a mediator then the Chairman of the Workout Committee will appoint a mediator within 5 days of the expiration of the time stated in clause 16.2(a).
- (c) The mediator will be a neutral third party and will conduct the mediation proceedings. The mediator will, with the assistance of the parties, identify the issues in dispute, develop options and consider alternatives so that the parties may reach agreement.
- (d) In the event that the dispute, controversy or claim has not been resolved within 60 days (or other period as agreed to in writing between the parties) after the mediator has been appointed, the dispute, controversy or claim must be submitted to arbitration which shall be administered by the Workout Committee.

Principle 15

15.3 Arbitration

- (a) At the expiration of the 60 days referred to in clause (d) or upon the Chairman of the Workout Committee receiving notice that the parties,
 - (i) have not reached agreement; or
 - (ii) wish the matter to be referred to arbitration,the Chairman of the Workout Committee shall within 14 days send to the parties a list of 7 arbitrators.
- (b) The parties shall, within 14 days of receipt of the list of arbitrators from the Chairman of the Workout Committee, appoint one person each to the arbitral panel to act as arbitrator to hear and determine the dispute.
- (c) The 2 arbitrators appointed shall, within 14 days from the date the second arbitrator is appointed, meet and select a third arbitrator from the list prepared by the Workout Committee to act as Chairperson of the Arbitral Tribunal.
- (d) If at any stage the parties fail to select an arbitrator from the list sent to them by the Workout Committee or the arbitrators selected by each of the parties fail to agree and select a further arbitrator to act as Chairperson then the Chairman of the Workout Committee shall appoint either an arbitrator on behalf of one or all of the parties or, in the case of the arbitrator failing to agree, an arbitrator to act as Chairperson of the Arbitral Tribunal.
- (e) The arbitration will be conducted in accordance with and subject to the laws of **[relevant jurisdiction]**. The identification of the relevant jurisdiction should be left

to the parties in dispute or, failing agreement, the Chairman of the Workout Committee.

- (f) The seat of the arbitration shall be [*capital city of relevant jurisdiction*].
- (g) The language of the arbitration shall be English.
- (h) The arbitration will be conducted in accordance with the [*insert rules*] which rules are deemed to be incorporated by reference into this clause.
- (i) The governing law of the arbitration agreement shall be the substantive law of [*relevant jurisdiction*].

16. Notices

16.1 How to give a notice

A notice, consent or other communication under this Agreement is only effective if it is:

- (a) in writing, signed by or on behalf of the person giving it;
- (b) addressed to the person to whom it is to be given; and
- (c) either:
 - (1) (**mail**) delivered or sent by pre-paid mail (by airmail, if the addressee is overseas) to that person's address; or
 - (2) (**fax**) sent by fax to that person's fax number and the machine from which it is sent produces a report that states that it was sent in full; or
 - (3) (**email**) sent in electronic form by email to that person's email address [with a copy of that email being sent by fax as soon as possible afterwards].

16.2 When a notice is given

A notice, consent or other communication that complies with this clause is regarded as given and received:

- (a) if it is delivered or sent by fax:
 - (1) by 5.00 pm (local time in the place of receipt) on a Business Day, on that day; or
 - (2) after 5.00 pm (local time in the place of receipt) on a Business Day, or on a day that is not a Business Day, on the next Business Day;
- (b) if it is sent by mail, 3 Business Days after posting; and
- (c) if it is sent in electronic form, on the day on which it was transmitted or, if transmitted after 5.00 pm (local time in the place of receipt), on the next Business Day.

16.3 Address for notices

A person's mail and email address and fax number are those set out in Schedule 1, or as the person notifies the sender.

17. Amendment

This Agreement may be amended by a resolution to which 75% of the parties to this Agreement agree at a meeting of those parties convened and conducted in accordance with the provisions of this Agreement applicable to meetings of Financial Institution Creditors save that the chairman of the meeting shall be elected by the representatives of the parties in attendance at that meeting.

[It is to be expected that as practices in the financial sector evolve and as the operation of the Agreement is tested in practice that it will appear that amendments to its terms are desirable. An issue is whether these amendments require unanimity amongst the parties or, say, a special resolution passed at a meeting of Financial Institutions.]

18. Execution

This Agreement shall come into force and effect once it has been executed by ***[all/90%]*** of the persons nominated as parties.

[At least as a matter of common law if all the named parties to an agreement do not execute it, the agreement is not binding. The operation of that common law rule can be excluded by a provision of the agreement. The issue is whether the Agreement should be binding on those named parties who sign it irrespective of the number of them or should it only be operative once, say, a stipulated number of parties have signed it.]

19. General

19.1 Governing law

This Agreement is governed by the law in force in ***[relevant jurisdiction]***.

19.2 Giving effect to this Agreement

Each party must do anything (including execute any agreement), and must ensure that its employees and agents do anything (including execute any document), to give full effect to this Agreement.

19.3 Counterparts

This Agreement may be executed in counterparts.

19.4 Attorneys

Each person who executes this Agreement on behalf of a party under a power of attorney declares that he or she is not aware of any fact or circumstance that might affect his or her authority to do so under that power of attorney.

Schedule 1

Details of financial institutions

Financial Institution

Details For Notices

Address: [*]
Attention: [*]
Facsimile: [*]
Telephone: [*]
Email: [*]

Executed as an agreement.

[Insert the appropriate execution clauses.]

Annexure A

Member accession deed poll

Deed poll dated [*] made by [*] (the **New Member**)

Recitals

- A. Under an Agreement to Promote Company Restructuring dated [*] between [*] and others (the **Agreement**), a person may become a party to the Agreement by executing this deed poll.
- B. The New Member wishes to become a party to the Agreement.

This deed poll witnesses as follows.

1. Interpretation

1.1 Definitions

Unless otherwise defined in this deed poll, terms defined in the Agreement have the same meaning in this deed poll.

1.2 Interpretation

Clause 1.2 (**Interpretation**) of the Agreement, with the necessary changes, applies to this deed poll as if set out here in full.

2. Accession

With effect from and including [the date of this deed poll/other appropriate date]:

- (a) the New Member assumes the obligations and acquires the rights of a Financial Institution under the Agreement; and
- (b) each other party to the Agreement acquires corresponding rights against and assumes corresponding obligations towards the New Member.

3. Confirmation

The New Member confirms that:

- (a) it has received an executed copy of the Agreement, together with all other documents and information which it requires in connection with the Agreement; and
- (b) it has not relied and will not rely on any other party to the Agreement to check or enquire on its behalf into the legality, validity, effectiveness, adequacy or completeness of any of those documents or that information.

4. **Benefit of Deed Poll**

This deed poll is given in favour of and for the benefit of each party to the Agreement and its successors and permitted assigns.

5. **Notices**

For the purpose of the Agreement, the details of the New Member for service of notices are:

- Address: [*]
- Attention: [*]
- Facsimile: [*]
- Telephone: [*]
- Email: [*]

6. **Law**

This deed poll is governed by the laws of [*].

Each attorney executing this deed poll states that he or she has no notice of revocation or suspension of his or her power of attorney.

Executed as a deed poll.

Signed, Sealed And Delivered for and on)
 behalf of **[NEW MEMBER]** by its duly)
 appointed attorney under a power of)
 attorney in the presence of:)

.....
 Attorney
 Name (printed):
 Date of power of attorney:

.....
 Witness
 Name (printed):

Annexure B

Financial institution creditor subsidiary accession deed poll

Deed poll dated [*] made by [*] (the **Subsidiary**)

Recitals

- A. Under an Agreement to Promote Company Restructuring dated [*] between [*] and others (the **Agreement**), a person may become a party to the Agreement by executing this deed poll.
- B. The Subsidiary wishes to become a party to the Agreement to the extent that the Agreement applies in respect of [*insert details of nominated Debtor Company and its relevant subsidiaries and parent*] (each an **Applicable Debtor**).

This deed poll witnesses as follows.

1. Interpretation

1.1 Definitions

Unless otherwise defined in this deed poll, terms defined in the Agreement have the same meaning in this deed poll.

1.2 Interpretation

Clause 1.2 (**Interpretation**) of the Agreement, with the necessary changes, applies to this deed poll as if set out here in full.

2. Accession

With effect from and including [*the date of this deed poll/other appropriate date*]:

- (a) the Subsidiary assumes the obligations and acquires the rights of a Financial Institution Creditor under the Agreement to the extent the Agreement applies in respect of each Applicable Debtor; and
- (b) each other party to the Agreement acquires corresponding rights against and assumes corresponding obligations towards the Subsidiary to the extent the Agreement applies in respect of each Applicable Debtor.

3. Confirmation

The Subsidiary confirms that:

- (a) it has received an executed copy of the Agreement, together with all other documents and information which it requires in connection with the Agreement; and
- (b) it has not relied and will not rely on any other party to the Agreement to check or enquire on its behalf into the legality, validity, effectiveness, adequacy or completeness of any of those documents or that information.

4. **Benefit of Deed Poll**

This deed poll is given in favour of and for the benefit of each party to the Agreement and its successors and permitted assigns.

5. **Notices**

For the purpose of the Agreement, the details of the Subsidiary for service of notices are:

Address: [*]
Attention: [*]
Facsimile: [*]
Telephone: [*]
Email: [*]

6. **Law**

This deed poll is governed by the laws of [*].

Each attorney executing this deed poll states that he or she has no notice of revocation or suspension of his or her power of attorney.

Executed as a deed poll.

Signed, Sealed And Delivered for and on)
behalf of **[SUBSIDIARY]** by its duly)
appointed attorney under a power of)
attorney in the presence of:)

.....
Attorney
Name (printed):
Date of power of attorney:

.....
Witness
Name (printed):

Annexure C

Non-Financial institution creditor accession deed poll

Deed poll dated [*] made by [*] (the **Non-Financial Institution Creditor**)

Recitals

- A. Under an Agreement to Promote Company Restructuring dated [*] between [*] and others (the **Agreement**), a person may become a party to the Agreement by executing this deed poll.
- B. The Non-Financial Institution Creditor wishes to become a party to the Agreement to the extent that the Agreement applies in respect of *[insert details of nominated Debtor Company and its relevant subsidiaries and parent]* ([each an] **Applicable Debtor**).

This deed poll witnesses as follows.

1. Interpretation

1.1 Definitions

Unless otherwise defined in this deed poll, terms defined in the Agreement have the same meaning in this deed poll.

1.2 Interpretation

Clause 1.2 (**Interpretation**) of the Agreement, with the necessary changes, applies to this deed poll as if set out here in full.

2. Accession

With effect from and including [*the date of this deed poll* *or other appropriate date*]:

- (a) the Non-Financial Institution Creditor assumes the obligations and acquires the rights of a Financial Institution Creditor under the Agreement to the extent the Agreement applies in respect of each Applicable Debtor; and
- (b) each other party to the Agreement acquires corresponding rights against and assumes corresponding obligations towards the Non-Financial Institution Creditor to the extent the Agreement applies in respect of each Applicable Debtor.

3. Confirmation

The Non-Financial Institution Creditor confirms that:

- (a) it has received an executed copy of the Agreement, together with all other documents and information which it requires in connection with the Agreement; and
- (b) it has not relied and will not rely on any other party to the Agreement to check or enquire on its behalf into the legality, validity, effectiveness, adequacy or completeness of any of those documents or that information.

4. **Benefit of Deed Poll**

This deed poll is given in favour of and for the benefit of each party to the Agreement and its successors and permitted assigns.

5. **Notices**

For the purpose of the Agreement, the details of the Non-Financial Institution Creditor for service of notices are:

- Address: [*]
- Attention: [*]
- Facsimile: [*]
- Telephone: [*]
- Email: [*]

6. **Law**

This deed poll is governed by the laws of [*].

Each attorney executing this deed poll states that he or she has no notice of revocation or suspension of his or her power of attorney.

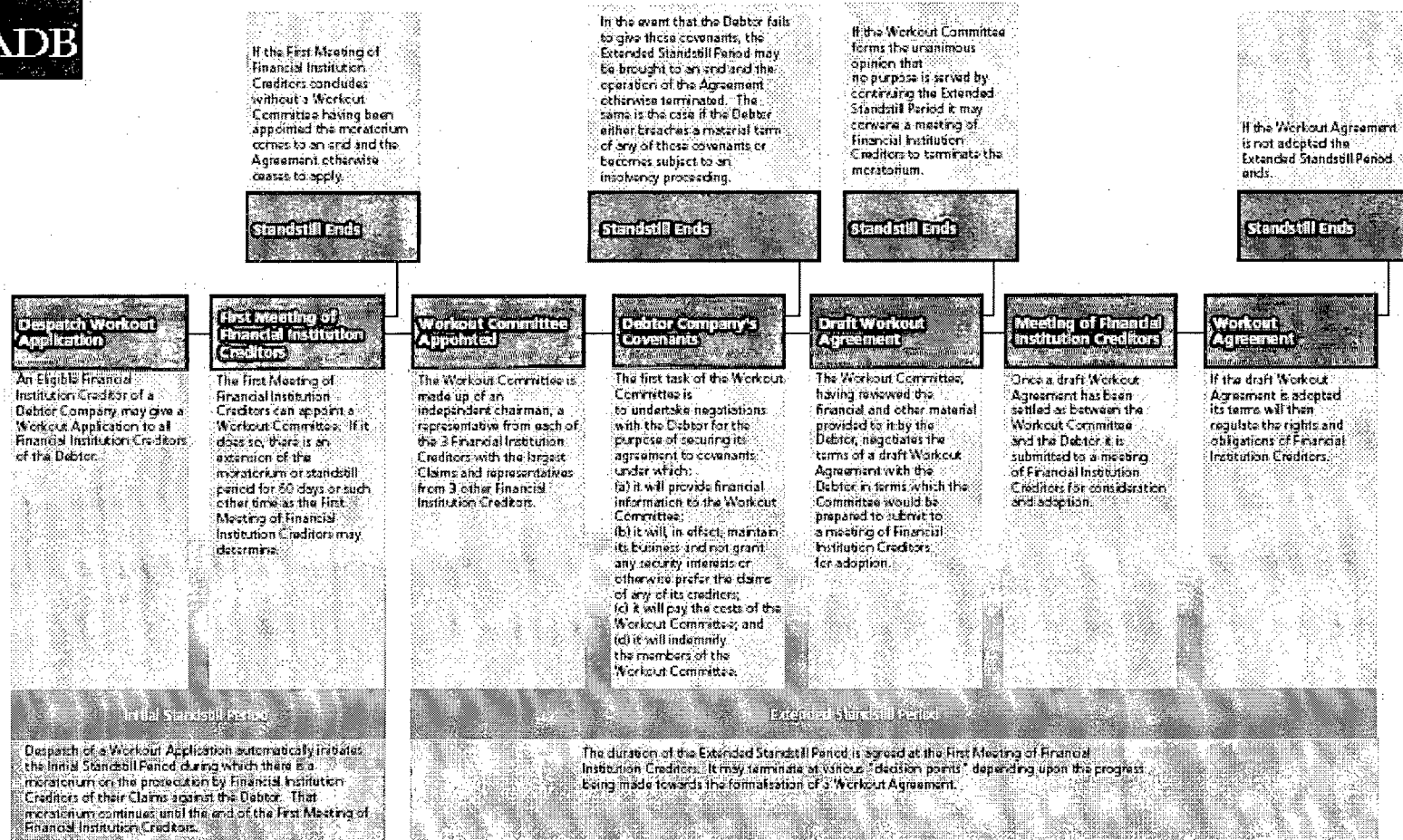
Executed as a deed poll.

Signed, Sealed And Delivered for and on)
 behalf of **[NON-FINANCIAL INSTITUTION**)
CREDITOR] by its duly appointed attorney)
 under a power of attorney in the presence)
 of:

.....
 Attorney
 Name (printed):
 Date of power of attorney:

.....
 Witness
 Name (printed):

Annexure C: Operation of Agreement to Promote Company Restructuring



Asian Bankers' Association

October, 2005

All Member Banks
Asian Bankers' Association

Asian Bankers' Association Informal Workout Guidelines – Promoting Corporate Restructuring in Asia

Introduction

This document contains principles which should guide financial institutions as to how they should deal with customers in difficulties in circumstances where the customer, is dealing with multiple financial institutions as creditors (**Financial Institution Creditors**).

It is in the interests of all stakeholders that the business of a debtor in financial difficulty should survive as a going concern if it appears to be possible to resolve those financial difficulties and to achieve the long term viability of that debtor's business.

A coordinated response by Financial Institution Creditors to a customer's financial difficulty provides time to manage the impact of defaults by that customer and creates an opportunity to explore and evaluate the options for consensual agreement outside a formal process. Advantages of pursuing an informal workout (as opposed to a formal court process) in most cases include:

- cost savings;
- simplicity;
- certainty;
- efficiency;
- confidentiality ;
- flexibility; and
- a contractually based sustainable solution to a debtor's financial affairs.

In recognition of the advantages of informal workouts, the ABA has endorsed the principles below and encourages its members to apply them whenever and wherever they are seeking to resolve the financial difficulties of a customer with borrowings from multiple Financial Institution Creditors.

In addition to those principles, a Model Agreement to Promote Company Restructuring (the **Model Agreement**) is attached. The Model Agreement can be used to facilitate an informal workout and is capable of both adaptation and adoption by some or all members of the ABA, regionally or in a particular jurisdiction or on a case by case basis. The Model Agreement is annotated and can be tailored to fit particular circumstances. A diagram is also attached detailing how the Model Agreement operates in broad terms.

The Principles

Cooperation

Where a debtor is found to be in financial difficulties, all relevant Financial Institution Creditors (whether they are secured or unsecured creditors) should be prepared to cooperate with each other. The initial attitude of Financial Institution Creditors should be one of support.

Work-outs need cooperation. Whilst Financial Institutions are likely to be reluctant to permit an increase in their exposure to a customer so that other facilities of financial institutions can be salvaged, they should be aware that, if they fail to co-operate in a work-out, the same approach may be taken against them should roles be reversed.

Breathing Space for Debtor Required

Financial Institutions should not withdraw facilities or be hasty to put the debtor in a formal insolvency administration or issue Court proceedings.

Fully Informed Creditors

Decisions should only be made based on reliable information which is shared fully with all Financial Institution Creditors.

Involvement of all Financial Institution Creditors in Workout Process

All Financial Institution Creditors (other than those whose exposure is negligible) should be eligible to participate in an informal workout process. Other creditors – such as trade creditors, trade financiers, insurance institutions and bondholders may also participate in a work-out.

Implementation

Meeting of Financial Institution Creditors Desirable

Where it has become apparent that an informal workout process may be applicable to a debtor, Financial Institution Creditors should meet to consider whether or not to implement an informal workout process. All Financial Institution Creditors (other than those whose exposure is negligible) should be invited to participate in such a meeting.

Standstill Prior to Meeting

Prior to the meeting of creditors, the status quo in relation to the debtor should be maintained. Financial Institution Creditors should not take any enforcement action, other action, or reduce their exposure to the debtor until a meeting is held.

Eligibility for Workout Process

An informal workout process should only apply to a debtor where it appears possible to resolve its financial difficulties and where its business is viable in the long term.

Experienced representatives required

Financial Institution Creditors participating in an informal workout should take an active role by appointing an experienced and competent representative. That representative should ensure appropriate levels of management within the creditor organization are informed of the progress of the workout at all important stages and that the prospective and likely outcome of the workout is expected to be acceptable to the decision makers within the creditor organization.

Appointment of Representative Committee

The interests of relevant creditors are best served by coordinating their response to a debtor in financial difficulty. Such coordination will be facilitated by the selection of one or more representative coordination committees and by the appointment of professional advisers to advise and assist such committees and, where appropriate, the relevant creditors participating in the process as a whole.

Creditors should agree to appoint one creditor (usually the creditor with the largest exposure to the debtor or with particular expertise in managing informal workout negotiations) or an independent party to chair the coordination committee, lead negotiations with the debtor and ensure the expeditious progress of the informal workout negotiations.

Standstill Period

If Financial Institution Creditors consider, at a meeting of such creditors, that it appears possible to resolve the financial difficulties of the debtor and to achieve long term viability of its business, all relevant creditors should be prepared to cooperate with each other to provide sufficient time (a '**Standstill Period**') to enable information about the debtor to be obtained and evaluated and for proposals for resolving the debtor's financial difficulties to be formulated and assessed, unless such a course of action is inappropriate.

During the Standstill Period, all relevant Financial Institution Creditors should agree to refrain from taking any steps to enforce their claims (otherwise than by disposal of their debt to a third party) or to reduce their exposure to the debtor, but are entitled to expect that during the Standstill Period their position relative to other creditors and each other will not be prejudiced.

The length of such a Standstill Period should be limited to the time that is reasonably required to fulfil the objective of restructuring the debtor's business if that is possible. The

length of a Standstill may be difficult to estimate and in some circumstances may need to be extended.

During the Standstill Period, the debtor should not take any action which might adversely affect the prospective return to relevant creditors (either collectively or individually) as compared with the position of those creditors at the commencement of the Standstill Period.

Assignment of debts

Care must be exercised when dealing with sales of debt, particularly to third parties, who have not previously been involved in the workout process. Bringing buyers up to speed and ensuring their commitment can impede progress. Sellers of debts should ensure that buyers are aware of the ABA Informal Workout Guidelines and that they would be expected to adhere to them.

Priority for funding during workout

If additional funding is provided during the Standstill Period or under any rescue or restructuring proposals, the repayment of such additional funding should, so far as practicable, be accorded priority status as compared to other indebtedness or claims of relevant creditors.

Access to Information about Debtor

During the Standstill Period, the debtor should provide, and allow relevant creditors and/or their professional advisers reasonable and timely access to all relevant information relating to its assets, liabilities, business and prospects, to enable proper evaluation to be made of its financial position and any proposals to be made to relevant creditors.

Achievable Business Plan

A restructure should be based on an achievable business plan that addresses operational as well as financial issues. A business plan should contain forecasts, based on documented and reasonable assumptions as to future events, which evidence that the business of the debtor corporation can generate sufficient cash flow and profit to meet its obligations existing after the restructure.

The underlying objective of any work out should be to obtain for Financial Institution Creditors the best deal that can be achieved.

Costs

A careful watch must be kept on costs. Financial Institution Creditors should take care that costs are minimised and reasonable, given that otherwise the debtor's cash flow will be unnecessarily worsened. Likewise the demands on the borrower for information must be reasonable

The debtor should meet all reasonable costs of creditors in considering restructuring proposals. This would include the costs of professional advisers, and any costs necessarily incurred by the co-ordinating committee.

Restructuring Proposal

Proposals for resolving the financial difficulties of the debtor and, so far as practicable, arrangements between relevant creditors relating to any standstill should reflect applicable law and the relative positions of relevant creditors at the commencement of the Standstill Period.

The terms of any restructuring proposal must be manageable for the debtor.

Confidentiality

Information obtained for the purposes of the informal workout process concerning the assets, liabilities, business and prospects of the debtor and any proposals for resolving its difficulties, should be made available to all relevant creditors and should, unless such information already publicly available, be treated as confidential, and only be used by creditors for the purpose of determining and ascertaining an informal workout proposal.

Conflicts

Any conflicts of interest should be declared openly and promptly.

Dispute Resolution

In endeavouring to determine disputes between creditors or between a debtor and its creditors, regard should be given to the possibility of referring such disputes, with the consent of those involved, to mediation.

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Mr. Kyu Sang Chung, Korea
Mr. Francis Lim, Philippines
Mr. Dej-Udom Krairit, Thailand

About the Development of Insolvency Law Reforms

Since the Asian financial crisis, ADB has worked with its member countries to reform insolvency laws. This volume examines the critical areas of cross-border insolvency, the intersection between secured transactions and insolvency law regimes, and out-of-court informal workouts. The volume proposes a way forward for improving regional coordination on cross-border insolvencies, and principles for harmonizing the functioning of insolvency and secured transaction laws. The principles for informal workouts proposed in this volume have been adopted by the Asian Bankers' Association as its guidelines for informal workouts.

About the Asian Development Bank

ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries substantially reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to two thirds of the world's poor. Nearly 1.7 billion people in the region live on \$2 or less a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance. In 2007, it approved \$10.1 billion of loans, \$673 million of grant projects, and technical assistance amounting to \$243 million.

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