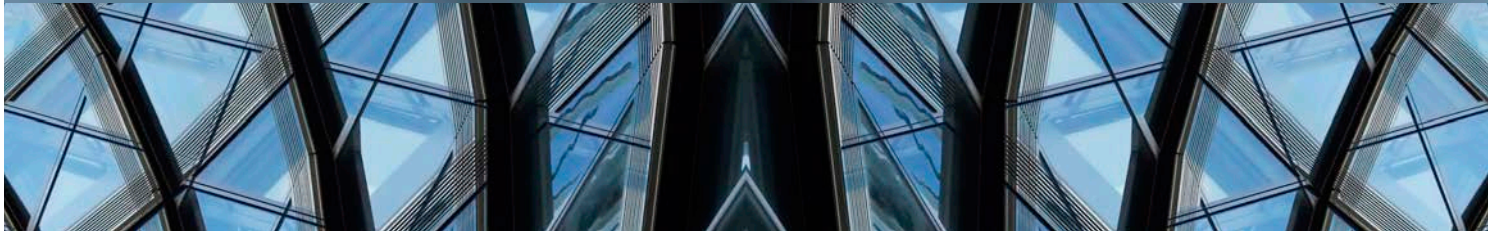
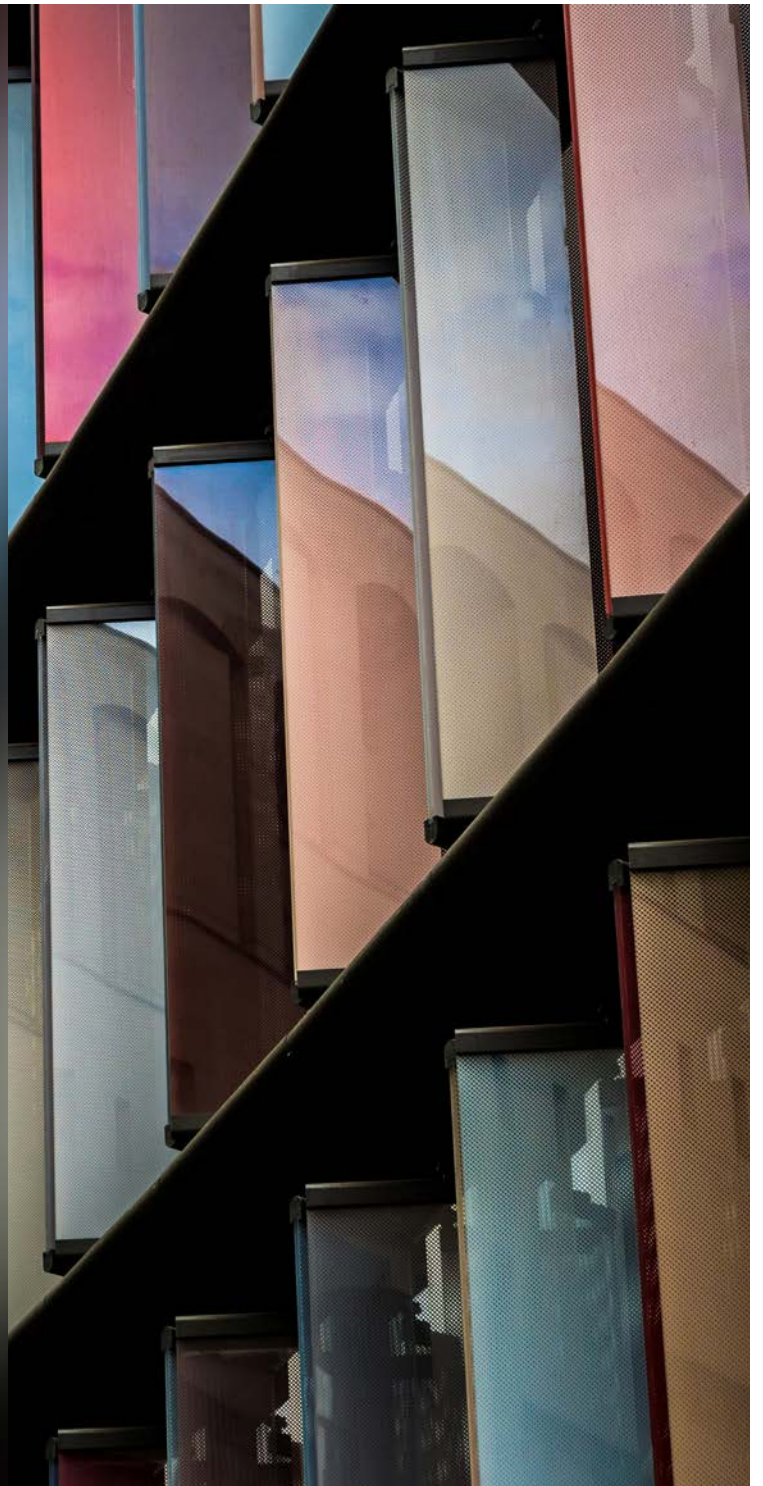


C L I F F O R D
C H A N C E



**A GUIDE TO ASIA PACIFIC
RESTRUCTURING AND
INSOLVENCY PROCEDURES**

FOREWORD



We are pleased to introduce the second edition of our guide to the restructuring and insolvency laws and procedures in a number of key jurisdictions across the Asia Pacific region.

With chapters covering **Australia, China, Hong Kong SAR, India, Indonesia, Japan, South Korea, Malaysia, Philippines, Singapore, Taiwan, Thailand** and **Vietnam**, this revised edition both provides an overview of applicable law and regulation and highlights substantial and market-moving developments.

2016 and 2017 brought significant changes of legislation in Australia, Singapore and India. Directors in Australia will have been relieved to see the introduction of a 'safe harbour' from personal liability for insolvent trading for directors who are pursuing a course of action reasonably likely to lead to a better outcome for the company than insolvency. Elsewhere the reforms in Singapore are aimed squarely at cementing its place as an international restructuring hub in Asia with the adoption of a more debtor-friendly regime than in other jurisdictions in the region, whilst the introduction of the new Insolvency and Bankruptcy Code in India has been game changing for the Indian market. Focused on speedily resolving some of the long standing financial issues that have plagued a number of prominent Indian companies, the new law has garnered much international attention as a result: indeed, India's rankings in the World Bank's 'Ease of Doing Business'¹ index has leapt up 30 places since its introduction. All should be only positive developments for restructuring and insolvency in the Asia Pacific region.

Whether you are taking your first tentative steps into the world of distressed investing in Asia, require the latest insolvency legislation updates for a potential distressed situation, are considering structures to maximise returns and minimise risks on an exit or just need a quick refresher of the key principles that will impact a credit in your portfolio, this guide can be your first port of call. For detailed advice, we are just a telephone call away.

The Guide provides just an element of the expertise and technical knowledge that we have accumulated in Asia Pacific. Together with our restructuring specialists in the Americas, the United Kingdom and across all key European jurisdictions, we deliver the expertise and experience which makes the difference in complex situations. We would like to acknowledge and express our sincere gratitude to the following firms who have kindly contributed to the country chapters on India, Indonesia, Korea, Philippines, Malaysia, Taiwan, Thailand and Vietnam, showcasing their knowledge of complex issues in the region: **AZB & Partners; Mochtar Karuwin Komar; Bae, Kim & Lee LLC; Chooi & Company; Belo Gozon Elma Parel Asuncion Lucila; Russin & Vecchi; Chandler MHM Limited; and Vilaf.**

If you would like any further information or advice on anything included in this guide or have any specific queries we would be happy to assist.



Scott Bache
Partner

A stylized, handwritten signature in black ink, appearing to read 'Scott Bache'.

This guide does not purport to be comprehensive or constitute legal advice. It is a guide only. The information and the laws referred to are correct as of May 2018 but may change quickly. If you would like any advice or further information on anything contained in this guide, please contact Clifford Chance.

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¹ World Bank: "Doing Business 2018", www.doingbusiness.org. Retrieved 26 April 2018.

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COMPARISON TABLE

Rehabilitation, moratoria, enforcement and cram down

	Australia	China	Hong Kong SAR	India	Indonesia	Japan
Rehabilitation procedure available	✓ Voluntary Administration	✓ Rectification	✗ No statutory process. ✓ Provisional liquidators in some circumstances are granted powers by the court to formulate restructuring plans.	✓ Reorganisation	✓ Suspension of Payments	✓ Civil Rehabilitation ✓ Corporate Reorganisation
Automatic moratorium on claims against the company	✓ Voluntary Administration ✗ Scheme of arrangement	✓ Rectification ✓ Compromise ✓ Bankruptcy	✓ Provisional liquidator appointment ✓ Liquidation	✓ Yes, in insolvency resolution proceedings.	✓ Bankruptcy ✓ Suspension of Payments	✓ Corporate Reorganisation ✓ Civil Rehabilitation ✓ Bankruptcy ✓ Special Liquidation
Enforcement still possible by secured creditors during moratorium without court approval	✗ Voluntary Administration: unless initiated within 13 days of notice of appointment of administrator by the secured party over all or substantially all of the assets of the company.	✗ Rectification ✓ Compromise ✓ Bankruptcy	✓ Provisional liquidator appointment ✓ Liquidation	✗ Enforcement not possible during moratorium.	✗ Bankruptcy (free to enforce after 90 days). ✗ Suspension of Payments	✓ Bankruptcy ✓ Civil Rehabilitation ✓ Special Liquidation ✗ Corporate Reorganisation
Cram down of creditors (voting thresholds required to bind all creditors)	Voluntary Administration/ Deed of Company Arrangements: – Approval of creditors representing more than 50% in number and 50% in value. Scheme of Arrangement: – Approval of each class of creditors representing more than 50% in number and 75% in value. – Court approval required.	Rectification: – Approval of each class of creditors. – Approval of creditors representing more than 50% in number (presenting at the creditors' meeting) and 66 2/3% in value in each class. – Court approval required. Compromise: – Approval of unsecured creditors representing more than 50% in number (presenting at the creditors' meeting) and 66 2/3% in value. – Court approval required.	Scheme of Arrangement: – Approval of each class of creditors representing more than 50% in number and 75% in value. – Court approval required.	Reorganisation: – Approval of creditors representing 75% in value.	Suspension of Debt Payments: – Approval of unsecured creditors representing more than 50% in number and 66 2/3% in value, and approval of secured creditors representing more than 50% in number and 66 2/3% in value.	Civil Rehabilitation: – Approval of creditors representing more than 50% in number and 50% in value. Corporate Reorganisation: – Approval required by different classes of creditors with various majority thresholds.

Korea	Malaysia	Philippines	Singapore	Taiwan	Thailand	Vietnam
✓ Corporate Rehabilitation	✓ Scheme of Arrangement	✓ Rehabilitation	✓ Judicial Management ✓ Scheme of Arrangement	✓ Reorganisation ✓ Composition	✓ Business Rehabilitation	✓ Restoration Procedure
✗ Corporate Rehabilitation	✗ Scheme of Arrangement	✓ Rehabilitation ✓ Liquidation	✓ Judicial Management ✗ Scheme of Arrangement (but automatic 30-day moratorium available upon application)	✓ Reorganisation ✓ Composition ✓ Bankruptcy	✓ Business Rehabilitation	✓ Restoration Procedure ✓ Bankruptcy
Not applicable.	Not applicable.	✗ Rehabilitation Liquidation (free to enforce security after 180 days from date of liquidation order).	✗ Judicial Management ✗ Scheme of Arrangement	✗ Reorganisation ✓ Composition ✓ Bankruptcy	✗ Business Rehabilitation (enforcement is allowed after one year (or up to 2 years if extended by the court) from the date of a petition for enforcement of security)	✗ Restoration Procedure ✗ Liquidation procedure
Corporate Rehabilitation: – Approval of secured creditors representing more than 75% in value, and approval of unsecured creditors representing more than 66 2/3% in value.	Scheme of Arrangement: – Approval of each class of creditors representing more than 50% in number and 75% in value.	Rehabilitation: – Approval of each class of creditors representing more than 50% in number.	Scheme of arrangement: – Approval of each class of creditors representing more than 50% in number and 75% in value. – Court approval required.	Reorganisation: – Approval of each class of creditors representing more than 50% in number voting. – Voting is weighted by the value of debt owed to the creditor. – Court approval required. Composition: – Approval of creditors representing more than 50% in number voting and 66 2/3% in value. – Court approval required. Bankruptcy: – Approval of creditors representing more than 50% in number voting and 50% in value. – Court approval required.	Business Rehabilitation: – Approval of each class of creditors representing more than 50% in number and at least 2/3 of debt value, or approval of one class of creditors representing more than 50% in number and at least 50% in debt value together with at least 50% in debt value of all creditors. Business Rehabilitation for registered SMEs: – Approval of creditors representing at least 2/3 of the total debts.	Restoration Procedure: – Approval of unsecured creditors representing more than 50% in number and 66 2/3% in value.

COMPARISON TABLE CONTINUED

Management, personal liability and court involvement on enforcement

	Australia	China	Hong Kong SAR	India	Indonesia	Japan
Who controls the company and/or its assets during the insolvency procedure?	Administration: – Administrator replaces management. Liquidation: – Liquidator replaces management. Receivership: – Receiver and manager replace management where provided for by debenture.	Rectification: – Court appointed administrator replaces management. – Incumbent management may apply to the court to continue to manage the business under the supervision of the administrator. Compromise: – Incumbent management retain control. Bankruptcy: – Court appointed administrator replaces management.	Scheme of arrangement: – Incumbent management retain control. Liquidation: – Liquidator replaces management.	Reorganisation: – Insolvency professional takes over management and control of corporate debtor.	Suspension of debt payments: – Incumbent management retain control jointly with appointed administrator. – Supervisory judge appointed. Bankruptcy: – Curator replaces management – Supervisory judge appointed.	Civil Rehabilitation: – Incumbent management may retain control. – Usual practice is for a supervisor to be appointed to supervise the process. Corporate Reorganisation: – Trustee(s) replace(s) management. Bankruptcy: – Court appointed bankruptcy trustee replaces management.
Personal liability for directors and officers	Liability for: – insolvent trading; – breach of duty; – fraudulent behavior.	Liability for: – breach of duty; – fraud; – misfeasance; – insolvent trading.	Liability for: – breach of duty; – fraudulent trading; – improper accounting; – failure to assist with the liquidation.	Liability for: – fraud on company; – improper accounting.	Liability for: – breach of duty; – negligent acts contributing to loss.	Liability for: – breach of fiduciary duty; – breach of obligation to act as good managers.
Receivership/ does enforcement by secured creditors require court intervention?	Receiver appointed by secured creditor.	– Not available. – Unless the debtor is willing to cooperate, enforcement of security by secured creditors requires court intervention.	– Receiver appointed by secured creditor.	– Secured creditors may enforce security in liquidation without leave of the court but not during insolvency resolution or reorganization.	– Receiver appointed by commercial court. – Enforcement of security by secured creditors can be done through public auction or the secured creditors can ask for Court assistance.	– Not available. – Unless the debtor is willing to cooperate, enforcement of security by secured creditors requires court intervention.

Korea	Malaysia	Philippines	Singapore	Taiwan	Thailand	Vietnam
Rehabilitation Plan: – Incumbent management retain control in the absence of any “cause for insolvency”. Bankruptcy: – Court appointed receiver replaces management.	Receivership: – Private receiver replaces management where provided for by debenture. – Court appointed receiver replaces management. Liquidation: – Liquidator replaces management.	Rehabilitation: – Incumbent management retain control under supervision of rehabilitation receiver and/or court. Liquidation: – Liquidator replaces management.	Receivership: – Receiver and manager replace management where provided for by debenture. Judicial Management: – Judicial manager replaces management. Scheme of Arrangement: – Incumbent management retain control, subject to the terms of the scheme. Liquidation: – Liquidator replaces management.	Reorganisation: – Administrator replaces management (although may be appointed from incumbent management). Composition: – Incumbent management retain control under the supervision of a judge and assistant supervisors. Bankruptcy: – Trustee replaces management. Liquidation: – Liquidator replaces management.	Business Rehabilitation: – Plan preparer/Plan administrator replaces management. Bankruptcy: – Official receiver replaces management.	Restoration Procedure: – Licensed Asset Manager to replace the management of the insolvent enterprise. Bankruptcy: – Incumbent management retain control under the supervision of the Licensed Asset Managers. – Licensed Asset Manager to replace the management of the insolvent enterprise.
Liability for: – willful misconduct or gross negligence in contravention of Korean law or the company's articles of incorporation.	Liability for: – breach of duty or misfeasance; – business of the company which is carried out with an intent to defraud creditors or for a fraudulent purpose; – incurring a debt with no reasonable grounds of expecting that the company will be able to repay.	Liability for: – disposals other than in its ordinary course of business; – authorising any transaction defrauding creditors; – embezzling or misappropriating any property of the company.	Liability for: – breach of duty; – failure to co-operate with liquidator; – fraud on company; – improper accounting.	Liability for: – failure to co-operate with the administrator/trustee; – fraud on company; or – improper accounting.	Liability for: – breach of duty; – fraud on company; – improper accounting.	
	– Receiver appointed by secured creditor or court. – Enforcement of a fixed statutory charge over land requires application to the court for intervention.	– Not available. – Unless the debtor is willing to cooperate, enforcement of security by secured creditors requires court intervention.	Receiver appointed by secured creditor or court.	– Not available. – Unless the debtor is willing to cooperate, enforcement of security by secured creditors requires court intervention.	– Not available. – Unless the debtor is willing to cooperate, enforcement of security by secured creditors requires court intervention.	– Not available. – Enforcement of security by secured creditors requires court intervention.

COMPARISON TABLE CONTINUED

Claw back risks

	Australia	China	Hong Kong SAR	India	Indonesia	Japan
Claw back periods (the period before the initiation of insolvency procedures in which certain transactions may be reversed)	Insolvent transactions: – 6 months to 10 years. Unfair loans: – no time limit.	Unfair preferences: – 6 months. Transactions at undervalue: – 1 year. Payment of debts not due: – 1 year.	Unfair preferences: – 6 months to 2 years. Extortionate credit: – 3 years. Avoidance of floating charges: – 1 year. Dispositions to defraud creditors: – no time limit. Transactions at undervalue: – 5 years.	– Preferential transactions and undervalued transactions (look back of 2 years for related parties and 1 year for others) – Extortionate credit transactions (look back of 2 years)	Fraudulent transactions: – 1 year. Preferences: – 1 year.	

Korea	Malaysia	Philippines	Singapore	Taiwan	Thailand	Vietnam
Unfair preferences: – 60 days to 1 year. Transactions at undervalue: – 60 days to 1 year.	Fraudulent preferences: – 6 months. Transactions at undervalue: – 2 years.	Transactions at undervalue: – no limit specified. Preferences: – 90 days+.	Unfair preferences: – 6 months to 2 years. Transactions at undervalue: – 5 years. Floating charges: – 6 months.	Applicable during a Bankruptcy only: Transactions detrimental to creditors: – 6 months. Guarantees: – 6 months. Undue payments made: – 6 months.	Fraudulent transfers: – 1 year. Preferences: – 3 months.	Unfair preferences: – 3 months. Transactions at undervalue: – 3 months.

AUSTRALIA



AUSTRALIA

CONTRIBUTED BY CLIFFORD CHANCE (PERTH AND SYDNEY OFFICES)

Key Elements:

- The objective of voluntary administration is to facilitate business rehabilitation. The procedure provides for an automatic moratorium on the commencement of legal proceedings and certain security interests.
- Receivership is generally available as a self help remedy for secured creditors.
- Significant powers are given to insolvency officeholders to overturn voidable transactions.
- New legislation was enacted in 2017 that restricts the operation of *ipso facto* clauses (clauses in contracts that enable a counterparty to terminate the contract on the insolvency of the other party). This is proposed to come into effect on 1 July 2018.
- Onerous insolvent trading regime but with 'safe harbour' available for company directors. There are significant risks of personal liability for company directors who undertake informal restructuring where a company may be insolvent outside a formal safe harbour process. Legislation was enacted in 2017 that creates a safe harbour for company directors from personal liability for insolvent trading if that director starts developing one or more courses of action that are reasonably likely to lead to a better outcome for the company.
- The Australian Government plans to introduce further law reform to address 'phoenixing' activity (mid-2018).

Introduction

This section provides a general outline of the main corporate insolvency procedures in Australia. Most of the legislation relevant to insolvency is contained in the Corporations Act 2001 (Cth) ("Corporations Act") and is supplemented by the Corporations Regulations 2001 (Cth) (the "Corporations Regulations").

The main procedures encountered in corporate insolvencies are:

- (1) voluntary administration (including deeds of company arrangement);
- (2) receivership; and
- (3) liquidation.

We also consider very briefly schemes of arrangement, voidable transactions, the personal liability of directors, lender liability, guarantees, priority of security and claims, new money lending and the recognition of foreign insolvency proceedings.

There are also bespoke insolvency regimes for certain other types of entities, such as insurance companies (the Life Insurance Act 1995 (Cth) and Insurance Act 1973 (Cth)) and banks (the Banking Act 1959 and Payment Systems and Netting Act 1998). These special regimes, together with the personal insolvency regime, are beyond the scope of this section.

Test of Insolvency

A company is insolvent if, according to the "cash flow test", it is unable to pay its debts as and when they become due and payable. This means that a company may be insolvent even if the value of its assets exceeds its liabilities. In practice, the courts assess insolvency through a consideration of the

company's financial position based on commercial reality (having regard to the prevailing circumstances at the time such as the expectation of future cash inflows) and have held a temporary lack of liquidity alone is insufficient to conclude that a company is insolvent.

Voluntary Administration

In Australia at present, voluntary administration is the most commonly used procedure for formal business rehabilitation.

Voluntary administration involves the appointment of an independent insolvency practitioner to administer the business with a view to maximising the chances of rehabilitating the business either through a compromise implemented through a deed of company arrangement or the sale of some or all of the company's assets.

Although the stated purpose of voluntary administration is business rehabilitation, in practice it is frequently used as the first step in the liquidation of a company.

Initiating a voluntary administration

A voluntary administration may be initiated at short notice by:

- the directors (by resolution of the board);
- a liquidator (or provisional liquidator) of the company; or
- a secured creditor who is entitled to enforce a security interest over the whole, or substantially the whole, of the company's property.

Effect of voluntary administration

The initiation of a voluntary administration automatically creates a moratorium during which no civil proceedings (including insolvency proceedings), may be taken without the consent of

the administrator or the permission of the court. The moratorium also prevents the commencement or implementation of any enforcement process in relation to the property of the company, including under a security interest, without the consent of the administrator or the permission of the court.

The moratorium is intended to provide the administrator sufficient time to formulate a rescue proposal for the business, or in the event that this does not prove possible, an orderly realisation of the company's assets.

There are a number of exceptions to the moratorium. The main exceptions relate to secured creditors, as noted below:

- (a) where a secured creditor with a perfected security interest over the whole, or substantially the whole, of the company's property enforces its security interest within 13 business days from the date on which notice is given to the secured creditor of the appointment of the administrator (if the security interest is not enforced during this period, then the secured creditor will be subject to the general moratorium). In practice, it is common for secured creditors to enter into a deed of forbearance with the administrator, where the secured creditor agrees not to exercise their rights to enforce immediately in exchange for the administrator agreeing to provide their consent to enforcement by the secured creditor at some later stage;
- (b) where a secured creditor takes certain actions to enforce its security interest before the commencement of the administration or where an owner or lessor of property takes certain actions to recover its property before the commencement of the administration;
- (c) where a secured creditor has a security interest in perishable property or where an owner or lessor of perishable property

seeks to recover its perishable property from the company; and

- (d) where a bank has a banker's lien (possessory security interest) over certain property of the company (including cash (in the form of notes or coins), negotiable instruments, securities or derivatives).

In addition to the moratorium, no transfer of shares or alteration in the status of members of the company may take place without the consent of the administrator or with the permission of the court. The administrator may only give consent to the transfer if he or she is satisfied that the transfer is in the best interests of the company's creditors as a whole.

Importantly, the moratorium does not extend to the exercise of *ipso facto* clauses (clauses in contracts that enable a counterparty to terminate the contract on the insolvency of the other party) although providers of certain essential services, such as electricity, gas, water and telecommunications services, are unable to terminate supply. The recent amendments to the Corporations Act will introduce an automatic stay on the enforceability of *ipso facto* clauses. The amendments impose an automatic stay on the exercise of *ipso facto* clauses when a company enters administration, where a managing controller has been appointed over all or substantially all of the company's property, or where the company is undertaking a compromise or arrangement for the purpose of avoiding being wound up in insolvency. The stay will not apply in circumstances contrary to the Payment Systems and Netting Act 1998, the Mobile Equipment (Cape Town Convention) Act 2013, or where the Minister has declared in a legislative instrument or the Corporations Regulations that the stay does not apply to certain types of contracts. As of December 2017, no Regulations have been prepared or tabled before the Australian Parliament.

Powers of the administrator

The powers vested in the administrator are extensive. He or she has the same powers that the company or any of its officers would have if the company were not under administration, and may do all such things as may be necessary for the management of the company. When performing his or her function as an administrator, the administrator is acting as an agent of the company.

Upon the appointment of an administrator, the directors' powers to manage the company are automatically suspended. However, the directors remain under an obligation to continue to assist the administrator, including by providing information to the administrator about the company's affairs. The administrator may dismiss any or all of the directors and may also appoint new directors.

The administrator has the power to dispose of property of the company (including property subject to a perfected security interest) in the ordinary course of the company's business, or with the consent of the secured creditor or permission from the court. This includes the ability to deal with any secured property that was:

- a "circulating asset" (as defined in the Personal Property Securities Act 2009) when the security interest arose; or
- subject to a floating charge,

where the company could deal with the secured property immediately before it stopped being a circulating asset or the floating charge became a fixed charge.

A secured creditor or owner/lessor may apply to the court for an order restraining the administrator from disposing of the secured

property. However, the court may only make the order if it is not satisfied that arrangements have been made to adequately protect the interests of the secured creditor or owner/lessor, as the case may be.

Role of creditors in a voluntary administration

Creditors retain a role in voluntary administration. At the meeting of creditors which must be held within eight business days of the commencement of the administration, the creditors have the power to:

- (a) resolve to appoint a committee of creditors (which will have a consultative role with the administrator); and
- (b) replace the administrator.

A second creditors' meeting is held within 20 to 25 business days of the commencement of the administration, at which time the creditors will consider the company's future. This time period is often extended by application to the court (in extreme cases, extensions can be for a year or more) for large or complex administrations.

Prior to the meeting, the administrator must provide the creditors with a report about the company's business, property, affairs and financial circumstances as well as the administrator's views on a number of prescribed questions, including whether it would be in the creditors' interests for the company to execute a deed of company arrangement, end the administration or wind up the company. At this meeting, the creditors have the power to resolve that the company will execute a deed of company arrangement, end the administration or be wound up.

A resolution will carry if approved by a majority in number of the creditors voting and by creditors owed more than 50% of the voting creditors' total debts. Unlike in a scheme of arrangement,

all creditors vote in the same pool and there are no creditor classes. If no result is reached, the administrator then has the option to make a casting vote for or against the proposed resolution and will conventionally vote consistently with the decision of the majority in value.

Conclusion of voluntary administration

A voluntary administration may be ended in a number of ways, including where:

- (a) the company enters into a deed of company arrangement;
- (b) the company's creditors resolve that the administration should end;
- (c) the company's creditors resolve that the company be wound up;
- (d) the court orders that the administration is to end; or
- (e) the court appoints a provisional liquidator or orders that the company be wound up.

Deed of company arrangement

A deed of company arrangement is essentially a compromise between a company in voluntary administration and its creditors. A company can only enter into a deed of company arrangement when it is in voluntary administration and when the company's creditors have resolved that it be entered into.

The administrator will prepare the deed of company arrangement which needs to specify a number of prescribed matters, including the property available to pay creditors' claims, the nature and duration of any moratorium period, to what extent the company is to be released from its debts, that the entitlements of eligible employee creditors will have the same priority that they would have on winding-up (unless explicitly agreed to by a meeting of those eligible employee creditors),

and the circumstances in which the deed terminates. A deed of arrangement can provide for different returns to different types of creditors, provided the deed is not unfairly prejudicial or discriminatory to one or more creditors and maximises the chances of the company continuing, or where this is not possible, results in a better return for the company's creditors and members than would result from an immediate winding-up of the company.

Once the relevant majority of creditors have resolved for the company to enter into the deed of company arrangement, the company and the administrator must execute it. Following execution, the deed is binding on all the creditors. There is no requirement to have the deed approved or sanctioned by a court.

Receivership

Receivership is a self help remedy available to creditors who hold a security interest in property of the company. The right to appoint a receiver is governed by the terms of the security as a matter of contract between the secured creditor and the company. If the appointment is not effected in accordance with the terms of the security, the receiver will be a trespasser and will be exposed to liability. Typically, the right of a secured creditor to appoint a receiver arises immediately upon a specified default by the company.

In addition to a private appointment, a receiver can be appointed in special circumstances by a court, on the application of a creditor (such as where its security is unenforceable) or the Australian Securities and Investments Commission ("ASIC") (such as where the company is under investigation and ASIC seeks to freeze the activities of the company). The receiver must be a registered liquidator.

The appointment of a receiver by a secured creditor does not prevent unsecured creditors from pursuing their outstanding

claims against the company. Accordingly, appointment of a receiver is often concurrent with the board's appointment of a voluntary administrator. As noted above, a secured creditor with a security interest over the whole, or substantially the whole, of the property of the company has 13 business days from the date on which notice is given to the secured creditor of the appointment of the administrator to enforce its security before it becomes subject to the moratorium that arises on the commencement of voluntary administration. Such enforcement action may include the appointment of a receiver by the secured creditor. In these circumstances, the receiver's powers will take precedence over those of the administrator in respect of the secured property.

Powers of the receiver

A receiver of a company generally has broad powers to do all things necessary, or incidental to, the attainment of the objectives for which the receiver was appointed. A number of additional powers are also set out in the Corporations Act, including the power to: (a) enter into possession and take control of the company's property in accordance with the terms of the court order or instrument appointing the receiver; (b) convert property of the company into money; (c) borrow money on the security of the property of the company; (d) carry on any business of the company; and (e) execute any document, bring or defend any proceedings or do any other act or thing in the name of and on behalf of the company.

The effect of receivership on the company will depend on the terms of the receiver's appointment. If the receivership is only with respect to a single asset, it may be that the directors can continue to carry on the business of the company substantially unhindered. However, as is more usually the case, where a receiver is appointed over the whole, or substantially the whole, of the property of the company, the directors will effectively relinquish their powers to the receiver.

The receiver's primary duty is to the secured creditor who appointed the receiver, although the receiver will usually be appointed as agent of the company. The receiver also has certain statutory duties to report to ASIC.

In exercising its power of sale, the receiver must take all reasonable care to sell the property for not less than its market value (if it has a market value) or otherwise the best price that is reasonably obtainable, having regard to the circumstances at the time the property is sold.

Conclusion of receivership

A receivership will ordinarily come to an end when the receiver has fulfilled the terms of his or her appointment. In the case of a privately appointed receiver, this is when the receiver has realised to the extent possible the secured assets for the benefit of the secured creditor appointing the receiver.

Liquidation

The liquidation of an insolvent company is intended to provide for the winding-up of the company and the equitable distribution of the company's assets.

There are two forms of liquidation, namely:

- (a) winding-up ordered by the court (sometimes called compulsory winding-up); and
- (b) voluntary winding-up.

Winding-up ordered by the court

A court may order the winding-up of a company in a number of circumstances. The two most common are:

- (a) the company is insolvent, often established where the company has failed to comply within 21 days with a

statutory demand served on it by a creditor with respect to a debt of at least AUD2,000; or

- (b) the court is of the opinion that it is just and equitable that the company be wound up.

An application for winding-up may be made by the company itself, a creditor (including secured creditors and contingent creditors), a member, a director (only in respect of an insolvent winding-up), a liquidator or provisional liquidator, or certain regulatory bodies.

Upon the court making an order to wind up a company, the court will appoint a liquidator. The liquidator must be an official liquidator.

Voluntary winding-up

A company may be wound up voluntarily by its members through the passing of a special resolution. A special resolution of members requires 21 days' written notice and at least 75% of the votes that may be cast at the relevant meeting, although a shorter notice period is permitted if members comprising at least 95% of the votes that may be cast at the relevant meeting agree beforehand. A members' voluntary winding-up only relates to the winding-up of solvent companies (which is a condition of a members' voluntary winding-up), so is not dealt with in any detail in this section.

Creditors' voluntary winding-up

If the company is insolvent and the company's directors are unable to provide a declaration of solvency, the winding-up must proceed as a creditors' voluntary winding-up. In these circumstances, after the members have appointed a liquidator by ordinary resolution, the liquidator has 11 days from the meeting date to convene a meeting of the company's creditors. The liquidator must give the creditors at least seven days' notice

of the meeting and with that notice provide a summary of the affairs of the company in the prescribed form. It must also provide information about the known creditors, including the estimated amounts of their claims.

Within seven days of the resolution for voluntary winding-up, the directors of the company must give the liquidator a statement, in the prescribed form, about the company's business, property, affairs and financial circumstances. At the meeting of the company's creditors, the creditors have the power to replace the liquidator.

In practice, it is common for directors of an insolvent company to initiate a voluntary administration instead of a creditors' voluntary winding-up, given the relative efficiencies and protections available under a voluntary administration.

Provisional liquidation

The court may provisionally appoint an official liquidator at any time after the filing of a winding-up application. Whilst the circumstances in which the appointment of a provisional liquidator may be made have been described as "infinite" in case law, a provisional liquidator has commonly been appointed where the company's property is in jeopardy or because of disputes between directors. A provisional liquidator derives his powers from the order appointing him although it is common practice for a provision at liquidator's powers to be substantially the same powers as a liquidator.

Effect of liquidation

Upon winding-up (whether ordered by the court or initiated voluntarily) or the commencement of a provisional liquidation of a company:

- (a) the company must (except on a provisional liquidation) cease to carry on its business except so far as is in the

opinion of the liquidator required for the beneficial disposal or winding-up of that business;

- (b) the liquidator becomes agent of the company and takes custody (but not ownership) of all of the property of the company;
- (c) the directors' powers to manage the company are suspended but the directors must continue to help the liquidator, including by providing information to the liquidator about the company's affairs;
- (d) no shares in the company may be transferred (except with leave of the liquidator or leave of the court); and
- (e) an automatic moratorium is created during which no proceeding against the company or in relation to property of the company or any enforcement process in relation to such property may be brought or progressed except with leave of the court. The moratorium does not affect the rights of a secured creditor to realise or otherwise deal with property subject to a perfected security interest.

Similar to voluntary administration, the moratorium created on commencement of liquidation does not extend to the exercise of *ipso facto* clauses. As discussed above, the Australian government implemented legislation set to commence in July 2018 that will impose a stay on the exercise of *ipso facto* clauses in certain circumstances. This includes enforcing a right against a corporation for the reason of the appointment or existence of a managing controller of the whole or substantially the whole of the corporation's property.

Realising the company's assets

A liquidator's primary role is to collect in, realise and then distribute the assets of the company to the creditors.

In recovering the assets of the company, a liquidator has broad powers to sell or otherwise dispose of the company's property. Any amounts unpaid on the shares of the company have to be paid up by the members.

The Corporations Act contains a number of "claw back" provisions, which enable the liquidator to recover further assets in certain circumstances. These provisions are summarised in the section 'Voidable Transactions' below.

Distributing the company's assets

Once the liquidator has received, evaluated and determined the proofs of debt submitted by the creditors and realised the assets of the company, it must distribute those assets to the creditors. Generally, the secured assets of the company are first distributed to the secured creditors. The remaining assets, if any, are then distributed to the unsecured creditors in a prescribed order of priority. The claims of each relevant class are paid out equally, or *pari passu*, amongst the creditors in that class. There are numerous categories of claim, each of which carry a different priority. For the purposes of illustration, these broadly comprise three groups:

- (a) the costs of the liquidation (such as the liquidator's remuneration and/or the costs of the court application for winding-up the company);
- (b) certain employee entitlements to wages, superannuation contributions/guarantees and various other payments; and
- (c) all other unsecured creditors.

If there are any surplus assets after the unsecured creditors have been paid out, these are returned to the members.

Conclusion of liquidation

Once the liquidator has realised all of the property of the company (or so much of that property that can, in his or her opinion, be realised without needlessly protracting the winding-up), and has distributed those assets to the creditors and made a final return (if any) to the members, the liquidation can draw to a close and the company can be deregistered.

Schemes of Arrangement

A scheme of arrangement is not an insolvency procedure, but rather a compromise or agreement between a company and a class or classes of creditors or members.

While schemes of arrangement involving the members of a company may be used in the context of a corporate reorganisation and are often used in connection with takeovers in Australia, schemes of arrangement involving the creditors of the company may also be used in the context of insolvency. In that form they are similar to deeds of company arrangement.

However, whilst deeds of company arrangement may be entered into without court approval but only when a company is in voluntary administration, schemes of arrangement require approval by the court but may be entered into at any time and are often used outside of a formal insolvency procedure in the Australian context.

A scheme of arrangement binds members or creditors within a class, including unknown creditors who fall within that class. The power of the majority to bind the minority in the class operates regardless of any contractual restrictions (e.g. requirements for amendments and variations set out in the loan documentation governing the debt being compromised). Classes are determined by grouping together persons who have similar legal rights against the company.

For a scheme of arrangement to be approved, a meeting of the relevant class or classes of creditors or members is convened by the court. This application to convene a meeting may be made by the company, a creditor, a member or, where the company is being wound up, the liquidator. The applicant is required to deliver prescribed information to the voting class or classes prior to the meeting. The relevant class or classes will vote on the proposal, and a proposal is passed where there is a vote in favour by a majority in number, representing debts or claims against the company in an aggregate amount of at least three quarters of the total amount of debt and claims of each class voting at the meeting. The court is then required to sanction the scheme, at which point the scheme becomes binding on the company and the relevant class or classes of creditors or members.

Until a scheme of arrangement has been approved by the court, the company does not benefit from a moratorium and creditors remain free to pursue their claims against the company.

Due to the relatively complicated and rigid procedure involved in a scheme of arrangement (including the need for at least two court hearings), the requirement to split creditors into classes and the associated costs, voluntary administration and deeds of company arrangements tend to be preferred in the context of insolvency, particularly with respect to small to medium sized companies.

In more recent times, schemes of arrangement have been used in Australia as a restructuring tool in cases where for instance:

- (a) a formal insolvency would result in significant value destruction for all stakeholders: for example, as a result of *ipso facto* clauses becoming operative and, in many instances, arbitrarily causing a company to enter premature administration in situations where it is likely to be saved; or

- (b) where secured debt is widely held (such as in the case of large secured lending syndicates or listed bonds), and it is not possible to cram down secured creditors into a compromise under the voluntary administration process as a result of the typical restrictions found in finance documents requiring a unanimous vote by the secured creditors for the amendment to key commercial terms (such as amortisation schedules and margin) or the release of security.

Voidable Transactions

Under the “claw back” provisions contained in the Corporations Act, a liquidator is able to recover property or compensation from third parties for the benefit of creditors and to avoid certain debts owing to third parties, where they relate to certain voidable transactions entered into by the company in the relevant period prior to its winding-up. These powers are only available to a liquidator, and not to a receiver or administrator.

The time periods within which such transactions are vulnerable depends on the type of transaction in question, ranging from six months in the case of an insolvent transaction to ten years for an insolvent transaction which has the purpose of defeating creditors. Unfair loans are not subject to any time limit. The court has wide powers to make orders for the recovery of property or the provision of compensation from third parties where they are found to be party to a voidable transaction. The length of the claw back period is measured backwards in time from the “relation-back day.” Generally speaking this is the date an administrator was appointed or the date the application to wind up the company was filed with the court.

Insolvent transactions

A transaction is an insolvent transaction where an unfair preference is given by the company or an uncommercial transaction is entered into by the company, at a time when the

company is insolvent or where that unfair preference or uncommercial transaction contributes to the insolvency of the company.

- **Unfair preference:** In short, a transaction is an unfair preference given by the company to a creditor if the transaction results in the creditor receiving from the company, in respect of an unsecured debt, more than the creditor would receive from the company in respect of the debt if the transaction were set aside and the creditor were to prove for the debt in the winding-up of the company.

An insolvent transaction that is an unfair preference is voidable if the transaction occurred within the six-month period ending on the relation-back day or, for transactions with related entities, the four-year period ending on the relation-back day, or, for transactions entered into for the purpose of defeating or interfering with the rights of any or all creditors, the ten-year period ending on the relation-back day.

- **Uncommercial transaction:** In short, a transaction is an uncommercial transaction if a reasonable person would not have entered into it, having regard particularly to the benefits and detriment arising from the transaction for the company.

An insolvent transaction that is an uncommercial transaction is voidable if the transaction occurred within the two-year period ending on the relation-back day or, for transactions with related entities, the four-year period ending on the relation-back day, or, for transactions entered into for the purpose of defeating or interfering with the rights of any or all creditors, the ten-year period ending on the relation-back day.

Recoveries from insolvent transactions resulting from an unfair preference are more common in Australia than in most other jurisdictions in the Asia-Pacific region because there is no requirement for the liquidator to show that the creditor that has

had the benefit of the relevant transaction had any intention to be preferred.

Unfair loans to a company

A loan is unfair if the interest or other charges payable by the company are, or were at any time, extortionate. In determining what is extortionate, the court will give regard to certain matters, including (a) the risk to the lender, (b) the value of any security, and (c) the amount of the loan. An unfair loan is voidable if it was made at any time before the date on which the winding-up of the company commenced.

Unreasonable director-related transactions

A transaction is an unreasonable director-related transaction where the company gives some benefit to a director of the company or to an associate of a director (including a payment, a transfer of property or an issue of securities) that a reasonable person would not have given, having regard particularly to the benefits and detriment arising from the transaction for the company.

Personal Liability of Directors

A director's primary duty is to act in the best interests of the company. Where the company is in financial distress, directors are also required to consider the interests of the creditors of the company and it is particularly in that context and in any eventual liquidation where a director may be pursued for a breach of his or her duties. There are numerous specific duties which flow from this under the general law and as set out in the Corporations Act.

The most relevant is the duty to prevent insolvent trading. Australia's insolvent trading regime is one of the most onerous in the world. As a result, many directors often find it difficult to conduct "informal" restructuring when the company's day-to-

day solvency may be in constant question, given the personal risk they are taking on, even though that may be in the best interests of the company. Instead, the Corporations Act provides directors with the safe haven of voluntary administration as a means of rescuing the company. In light of this background, a new 'safe harbour' for directors was introduced in 2017.

The legislation provides an exception to liability for insolvent trading to directors if they suspect the company may become insolvent and they take a course of action reasonably likely to lead to a better outcome for the company. In determining whether a course of action is reasonably likely to lead to a better outcome for the company, there are five key considerations including whether the person is:

- Properly informing themselves about the company's financial position.
- Taking appropriate steps to prevent any misconduct by officers or employees of the company that could adversely affect its ability to pay all its debts.
- Maintaining the company's financial records.
- Obtaining advice from appropriately qualified entities with sufficient information to give appropriate advice.
- Developing or implementing a plan for restructuring to improve the company's financial position.

Where a director breaches one of his or her duties to the company, the director can be liable:

- (a) where the company has suffered a loss or damage, to compensate the company by way of equitable damages or compensation payable under the Corporations Act;

- (b) where the company has incurred a debt when it is insolvent or where the company becomes insolvent by incurring that debt and at that time there were reasonable grounds for suspecting that the company was insolvent, or would become insolvent, to compensate the company or a creditor;
- (c) where the director has gained some benefit, to account to the company for that benefit;
- (d) where the director has improperly acquired some property, to return that property to the company;
- (e) to pay a pecuniary penalty under the Corporations Act of up to AUD200,000;
- (f) to disqualification from managing a company; or
- (g) to criminal prosecution, where:
 - (i) the director, in a reckless or intentionally dishonest manner, fails to exercise their powers and discharge its duties;
 - (ii) the director uses their position, dishonestly and either recklessly to or with the intention of directly or indirectly gaining an advantage for themselves, or someone else, or causing detriment to the company;
 - (iii) the director uses information obtained as a director, dishonestly and either recklessly to or with the intention of directly or indirectly gaining an advantage for themselves, or someone else, or causing detriment to the company; or
 - (iv) the director, in a dishonest manner, breaches their duty to prevent insolvent trading.

Anti-Phoenix Measures

In September 2017, the Australian Government announced that it intends to introduce further insolvency law reform to combat ‘phoenix companies’.

‘Phoenixing’ involves stripping and transferring assets from a near insolvent company to another company. Normally the new company will have the same directors and shareholders. The new company will then continue to undertake the same business and thereby avoid paying creditors of the first near insolvent company.

The Government intends to enact laws and regulations, including:

- Establishing phoenixing offences.
- Holding directors personally liable for goods and services tax liabilities.
- Prohibiting related entities to the phoenix operator from appointing a liquidator.
- Creating penalties that apply to persons and entities who promote tax avoidance schemes to capture advisers who assist phoenix operators.
- Providing greater powers for the Australian Taxation Office to recover a security deposit from suspected phoenix operators.
- Preventing directors from backdating directorship resignations to avoid personal liability or from resigning and leaving a company with no directors.

As of January 2018, these laws have not been enacted.

Lender Liability

In Australia, generally the risk of a lender being held liable to pay its customer’s debts is small. The principal risk arises where the lender is found to be acting as a “shadow director” of a company that becomes insolvent and therefore becomes subject to the same duties as a director. The concept of “shadow director” can be found in the definition of “director” in the Corporations Act. A person will be a shadow director if “the directors of the company or body are accustomed to act in accordance with [that] person’s instructions or wishes”.

Lenders may also be exposed to risks where they are held to have assisted the directors to breach their fiduciary duties, for instance, by taking security for previously unsecured debts in circumstances where the company obtains no benefit from that transaction. These considerations are particularly acute in a restructuring or work-out context.

Guarantees

A guarantee is a secondary obligation by a third party relating to a primary obligation by a contracting party (i.e. a borrower under a loan agreement). If the primary obligation is altered, discharged or fails, the guarantee may not be enforceable. Usually the document containing a guarantee will also contain a direct indemnity as an independent primary obligation. This should survive even if the guarantee is not enforceable. In the majority of Australian states, a guarantee must be in writing to be enforceable.

Guarantees are available in most circumstances, for example downstream (parent to subsidiary), upstream (subsidiary to parent) and cross-stream (between sister companies within a group).

Corporate benefit issues need to be addressed especially in the context of upstream and cross-stream guarantees.

Priority

The Personal Property Securities Act (2009) (PPSA), which came into effect in January 2012, has substantially reformed how security is taken over personal property in Australia. The PPSA removes the distinction between fixed and floating security interests, and establishes a common registry known as the Personal Property Securities Register. In short, the PPSA provides for security interests to be ranked by method and order of perfection.

Security interests in property not governed by the PPSA (for example, land) usually rank by order of creation and, where appropriate, the date of registration on any relevant register.

Broadly speaking, in the context of receivership of assets subject to a PPSA security interest, claims rank as follows:

- holders of security which rank ahead of the security under which the receiver is appointed;
- holders of security (from the proceeds of which the receiver will recover costs, remuneration and expenses);
- certain employee entitlements to wages, superannuation contributions/guarantees and various other payments (also ranks ahead of security over circulating assets);
- unsecured creditors; and
- shareholders.

The priority of payments for a liquidation are summarised in the section 'Liquidation – distributing the company's assets' above.

New Money Lending

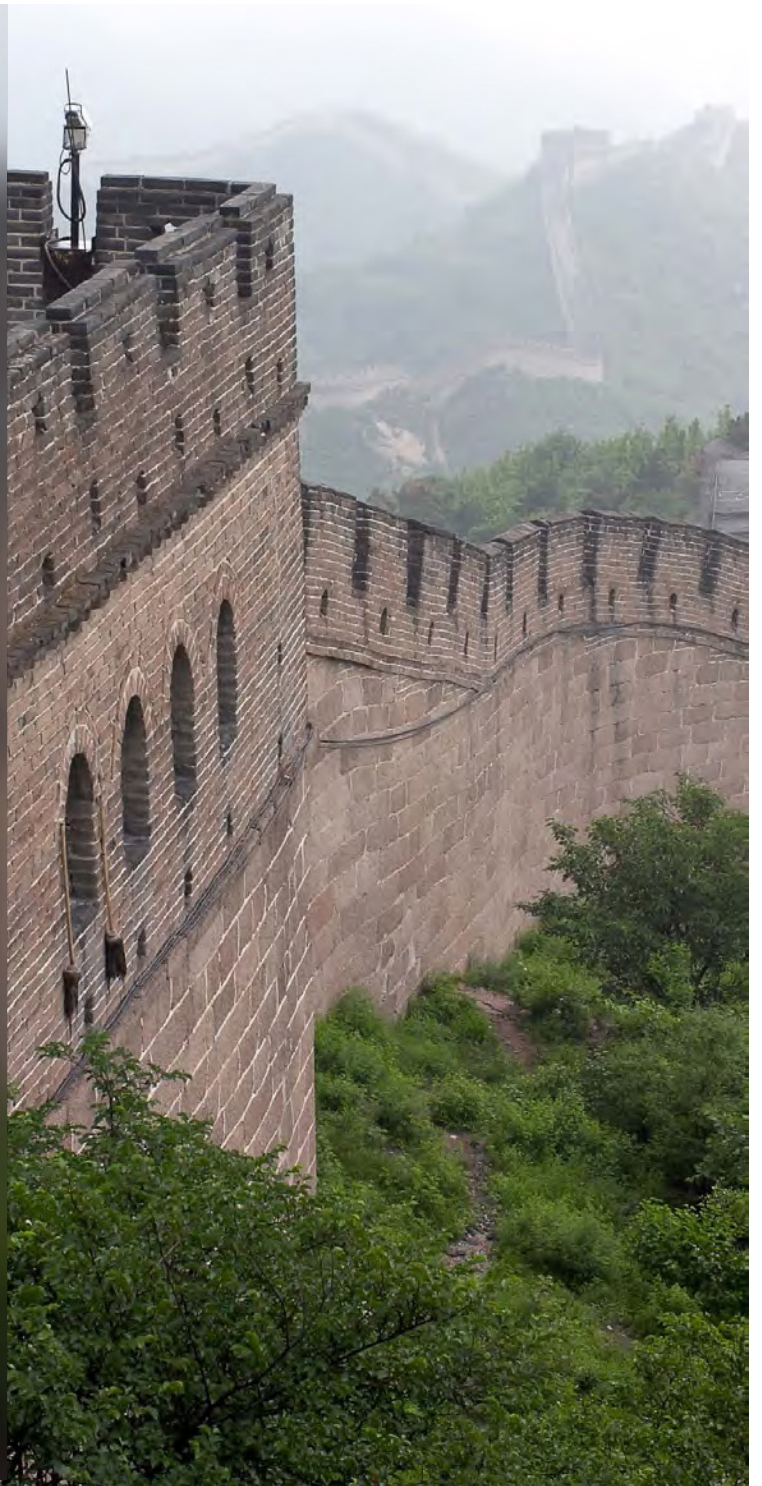
Normally lenders will insist on additional security or priority (ahead of debts incurred prior to the proceedings) before any new monies are advanced to companies after the commencement of any insolvency proceedings.

Recognition of Foreign Insolvency Proceedings

The Model Law on Cross Border Insolvency promoted by UNCITRAL was adopted in Australia in 2008 in the form of the Cross-Border Insolvency Act 2008 (Cth). This extends the Australian court's ability to recognise foreign insolvency proceedings and to provide assistance to foreign representatives in connection with foreign insolvency proceedings. The Cross Border Insolvency Act provides that, where the Model Law applies, the court and the liquidator are obliged to cooperate "to the maximum extent possible" with foreign courts and foreign representatives.

In addition to the Model Law, the court can also recognise foreign insolvency proceeding or provide assistance in corporate insolvencies pursuant to the Corporations Act, to the extent that the relevant proceedings fall outside the scope of the Model Law. The Corporations Act provides that the courts must recognise insolvency procedures initiated in certain countries (including, the United States, the United Kingdom, Malaysia, Singapore and New Zealand) whilst recognition of insolvency proceedings initiated outside of these countries remain at the discretion of the court.

CHINA



CHINA

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Key Elements:

- Insolvency procedures are court-driven.
- Managed by court-appointed administrator.
- Automatic moratorium for secured creditors with limited exceptions.

Introduction

This section is designed to provide a general outline of the main corporate insolvency procedures available in the People's Republic of China, excluding Taiwan and the Special Administrative Regions of Hong Kong and Macau ("China"). Corporate insolvency in China is principally governed by the Enterprise Bankruptcy Law of the People's Republic of China which came into force on 1 June 2007 (the "Bankruptcy Law"), and is supplemented by various judicial interpretations issued by the Supreme People's Court.

The Bankruptcy Law applies to both state-owned and privately held companies, including joint ventures and wholly foreign-owned entities, as well as, to the extent permitted by applicable law, other non-corporate entities such as partnerships. Financial institutions such as banks, securities companies and insurance companies may be subject to different rules to be promulgated by the State Council.

The main insolvency procedures available under Chinese law are bankruptcy (*pochan*), rectification (*chongzheng*), and compromise (*hejie*). Bankruptcy of state-owned enterprises previously could also be administered by administrative fiat in accordance with policies issued by the State Council; however it has since issued a guideline confirming that this procedure is no longer permitted. Bankruptcy will lead to the ultimate winding up

of a business, whereas rectification and compromise both aim to rehabilitate the debtor.

The solvent winding up of Chinese entities, known as liquidation (*qingsuan*), is not within the remit of the Bankruptcy Law. A winding up is presumed to be solvent unless a declaration of bankruptcy is obtained from the court. The procedure to be implemented will depend on the nature of the entity. Generally speaking, the solvent liquidation of a company is governed by the Company Law of the People's Republic of China. The ambit of this note will not extend to this topic.

Commencement of Insolvency Proceedings

Either the debtor or its creditors may apply to a court to commence bankruptcy or rectification. Only the debtor, on the other hand, may apply to institute compromise proceedings. Generally speaking, these three proceedings will be available provided that the test for insolvency as discussed below is met. However, except for the test for insolvency, the Bankruptcy Law does not set out any detailed test as to whether the rectification or compromise should be available, leaving the court with broad discretion.

Each insolvency procedure commences when the court accepts the application, rather than the date of filing. For bankruptcy, the court must decide whether to accept the application within 15 days of filing; however, a superior court may extend this time period to 30 days. If a creditor files an application, the court is obliged to notify the debtor within five days, after which the debtor is given seven days to object to the application. If the debtor does object, the court has ten days to accept or reject the application after the seven-day period.

An applicant may challenge the court's refusal of an application by appeal. Alternatively, if the court fails to provide a response within 15 days, the applicant is entitled to re-file its application directly with the superior court.

Test for insolvency

A debtor may apply to commence bankruptcy or compromise proceedings if it is unable to pay its debts when due, and

- (1) its liabilities exceed the value of its assets; or
- (2) it clearly lacks the ability to discharge its liabilities.

To institute rectification proceedings, the debtor must establish that, on the balance of probabilities, it will lose capacity to repay its debts. This less onerous requirement is attributed to a desire to preserve viable businesses.

For a creditor to petition for bankruptcy liquidation or rectification proceedings, however, it need only establish that the debtor is unable to pay its debts as they fall due.

Protection from creditors

The court's acceptance of an insolvency application gives rise to a moratorium on enforcement proceedings. The debtor is prohibited from disposing of its assets, and creditors are required to file their claims with the court-appointed administrator. A secured creditor generally remains entitled to enforce its security interest after the acceptance of an insolvency application. In a rectification, however, the secured creditor is prohibited from enforcing its security interest during the entire rectification period. The court may, nevertheless, allow a creditor to enforce its security interest where the asset is otherwise likely to suffer damage or diminish in value.

Administration

The court will appoint an administrator once it accepts the insolvency application. The role may be filled by a liquidation panel, a professional firm or an individual, although the court will usually only appoint an individual for simple bankruptcy matters. In order to be chosen, the administrator will be required to meet certain professional expertise and practice qualifications.

Role of administrator

The administrator's role will vary depending upon the insolvency procedure. In bankruptcy, it will replace the management in operating the debtor company, and realise the debtor's assets for the benefit of its stakeholders. In rectification, on the other hand, the administrator will either manage the debtor or supervise its operations. The administrator should report on its activities to the court, and its performance is also supervised by the creditors through the creditors' meeting and/or creditors' committee. Prior to the first creditors' meeting, it may decide whether the debtor should continue its operations, which needs further approval by the court.

Appointment of administrator

To ensure impartiality, the Bankruptcy Law provides that the court has the sole power to appoint an administrator and determine its remuneration, although creditors are able to apply for the removal of an administrator should it fail in performing its duties. The administrator may only resign with leave of the court, and not without good reason.

Bankruptcy

Once the court has accepted the application to commence bankruptcy proceedings, the administrator will take on management of the business and prepare for the company's liquidation.

Disposal of assets

The administrator is to draft plans for the disposal of the debtor's assets and its distribution of the proceeds, and submit both for approval at the creditors' meeting. These plans must also receive the acceptance of the court. Assets are priced and disposed of through an auction process, except where the creditors' meeting resolves otherwise or if the assets are subject to transfer restrictions as a matter of law or regulation.

Any creditor who submits a claim to the administrator in a bankruptcy proceeding is entitled to attend and vote at the creditors' meetings. A secured creditor's right to vote is limited; for example, it cannot vote on whether to adopt a compromise or scheme of distribution of the debtor's assets. As a general rule, a resolution of a creditors' meeting is passed by reference to a majority of the debtor's unsecured debt.

Performance of contracts

The administrator may elect to either perform or rescind a contract subject to partial performance. If the contract is continued, the counterparty is entitled to ask for security, and a failure by the administrator to do so is deemed to be a rescission of the contract. If the administrator fails to respond to the counterparty within two months of the court's acceptance of the bankruptcy application, the contract is also deemed as rescinded.

Where an investor has failed to make full payment of capital, the administrator is entitled to call him/her to do so.

Priority of claims

Secured creditors are paid in priority from the proceeds of their collateral, and sit outside the general hierarchy for distribution of assets. An amount exceeding the value of the collateral, however, will rank as an unsecured claim.

Assets are distributed in accordance with the ranking below:

1. "bankruptcy expenses and debts for common benefit", i.e. expenses incurred in bankruptcy for the good of the estate, such as contracts due to be performed, and salaries paid to continue the debtor's operations;
2. Employment-related claims, such as unpaid employees' wages, social security payments into employees' account and medical benefits;
3. Other social insurance contributions and taxes; and
4. Unsecured claims.

Where the proceeds are insufficient to pay out a class in full, distribution is made to the members of that class on a *pro rata* basis. Any remaining assets will be used to repay the capital contributions of the shareholders.

Rectification

Corporate rectification is a procedure intended to rehabilitate viable businesses that require temporary protection from creditors. It is a three-stage process.

Stage 1: Application

The debtor or a creditor applies to the court to bring proceedings for rectification. Any shareholder holding an equity share in the debtor equal to or greater than 10% is also entitled to file an application after the court accepts a bankruptcy application and before the declaration of bankruptcy.

Stage 2: Rectification

The administrator generally assumes management of the company, although the debtor may apply to the court for the right to continue to manage its business under the administrator's supervision. There is no clear guideline as to

when such an application will be accepted, but it is usually the exception rather than the rule.

Within six months of commencing the rectification period, the administrator (or debtor) must prepare a plan aimed at improving the debtor's financial situation and business performance. For example, the administrator must draft a scheme for the repayment of creditors and restructuring of debt. Once this has been submitted, the court will convene a creditors' meeting to vote on the plan.

Stage 3: Implementation

Similar to the voting procedure used in other jurisdictions, creditors will be divided into different classes, e.g. secured creditors, unsecured creditors, and employment-related creditors. The approval of each class must be obtained, which is determined by the affirmative vote of a majority of creditors in the class that are present and voting, and who must comprise at least two-thirds of the value of the debt held in that class.

If the rectification plan is approved by the creditors, a further application must be made to the court to obtain its sanction before the plan can be implemented. If the creditors reject the plan, the debtor and/or administrator may nevertheless apply to the court for approval provided certain conditions are met.

Compromise

A debtor may apply for a court order to initiate a compromise procedure, whereby the debtor is given the opportunity to propose a settlement of debts with its creditors. The debtor will draft a settlement agreement that is later submitted to the creditors' meeting. The creditors may accept the agreement by

a simple majority present at the meeting, which equates to no less than two-thirds of the value of the unsecured debt. It must also receive the approval of the court. If the creditors' meeting fails to accept the agreement, the court will declare the debtor bankrupt.

There is no time limit within which a creditors' meeting must be held for compromise proceedings. Debtors sometimes will attempt to stall proceedings by making tactical applications for rectification or compromise.

The moratorium for secured creditors is lifted once an order permitting a compromise is issued. It thus appears that a compromise is a viable option for small to medium-sized debtors who have mainly unsecured debt.

Set-Off

If a creditor incurs a debt to the debtor prior to the court's acceptance of the bankruptcy, the creditor may propose a set-off to the administrator, except in the following circumstances:

- the creditor's right was acquired from a third-party creditor of the debtor after the court accepted the bankruptcy application;
- the creditor was aware of the debtor's actual or potential insolvency when incurring the debt liabilities, unless the liabilities were incurred by operation of law or for reasons that occurred one year or more before the bankruptcy application was made; or
- a debtor of the debtor acquired creditor rights when aware of the debtor's actual or potential insolvency, save where the creditor rights were obtained by operation of law or for reasons that occurred one year or more before the bankruptcy application was made.

Challenges to Antecedent Transactions

The Bankruptcy Law sets out certain circumstances that render a transaction entered into by the company before bankruptcy as either voidable, at the application of the administrator to the court, or void. This aims to prevent the bankrupt company from acting beyond its ordinary course of business to diminish the value of its assets available to unsecured creditors. It also ensures that no unjustified preference is given to certain unsecured creditors at the expense of others.

Voidable transactions

The following acts are voidable, provided they take place within the year prior to the date the court accepts the bankruptcy application:

- the sale or transfer of assets at no value or at an unreasonable value;
- the provision of security for an unsecured debt;
- the early payment of debts which are not due; and
- a waiver of a creditor's rights.

Where, in the six months prior to the date the court accepts the bankruptcy application, a debtor has made preferential payment to creditors whilst insolvent, the administrator may also apply to the court to declare such payments invalid.

Void transactions

The following acts are deemed to be void:

- concealment or diversion of the bankrupt company's assets to avoid liabilities; and
- acknowledgment of "untrue debts" or the fabrication of liabilities.

An administrator is entitled to recover these lost assets. Furthermore, if such acts harm the "interests of creditors", the legal representative of the debtor and other responsible personnel may be called upon to indemnify the resulting losses.

Director Liability

Civil liability may be incurred by a director, a member of the supervisory board, or a senior manager for the debts of a bankrupt company in a limited number of circumstances. For this purpose, the "supervisory board" refers to the component of China's two-tier corporate governance structure responsible for supervising decisions of the board of directors.

Under Chinese law, directors are obliged to act in good faith and diligence. If either of these duties are breached, and as a result the company is placed into bankruptcy, the director may incur civil liability. The director may also be prohibited from assuming the position of director, supervisor or senior management in any PRC company for a period of three years from the date of the conclusion of the bankruptcy.

Any administrator that acts to harm the interests of a creditor may also be liable for compensation. Please see **Challenges to Antecedent Transactions** for further information.

The legal representative and, if required by the court, the financial management personnel and other operational management personnel of the debtor must render their cooperation to the court and the creditors' meeting during insolvency. For the duration of the bankruptcy proceedings, the court may detain or fine the debtor's staff and management if they leave their place of domicile.

Lender Liability

The risk in China of lenders being held liable to pay their customers' debts is rather remote. Whilst the principal risk for a lender under certain common law jurisdictions (such as England and Wales) arises where the lender is found to be acting as a shadow director of a company that becomes insolvent, the terms "shadow director" or "shadow manager" are not legal concepts under Chinese law. Generally speaking, Chinese law does not impute liability to a lender, as a shadow director or otherwise, where the lender takes actions to protect its interests in a company that is in financial difficulty.

Guarantees

If the guarantee is granted by a domestic entity in favour of an overseas lender for the debt of an offshore debtor, it will generally require registration with the State Administration of Foreign Exchange ("SAFE"). If the guarantee is granted by an offshore entity in favour of a PRC bank for the debt of a domestic debtor, the bank also needs to file this guarantee with SAFE. Otherwise, there is no SAFE registration/filing requirement for other types of cross-border guarantee.

There are no express requirements for corporate benefit under Chinese law. The company must comply, however, with the provisions set out in its articles of association. These can include:

- guarantee limits, and
- requirements to obtain board or shareholder approval.

If a company provides a guarantee for the debts of a shareholder or the actual controlling party of the company, that guarantee

must be approved by a shareholders' resolution. This vote shall not include the guaranteed shareholder or the shareholder controlled by the guaranteed actual controlling party.

To be effective under Chinese law, a guarantee must be made in writing. The agreement should also specify whether it is a general guarantee, in which the guarantor only assumes liability after distribution of the bankrupt entity's assets, or a guarantee with joint and several liability, where the creditor can seek direct redress against the guarantor. If this is not clearly specified, the court will construe the guarantee as joint and several.

For an obligation secured by both a guarantee and other forms of security, the guarantor is only liable for the unsecured portion.

Government authorities and institutions set up for public welfare, such as schools and hospitals, are legally incapable of granting a guarantee.

New Money Lending

Normally lenders may only advance new monies to debtors subject to bankruptcy proceedings after the court has approved the rectification petition or a compromise between the debtor and its creditors. In the context of restructuring, an administrator or debtor may enter into a secured loan for the purpose of continuing business operations. In the context of compromise, lenders need to carefully assess the company's ability to perform the compromise agreement (so that the bankruptcy proceedings would not be resumed due to its default) and the impact of the compromise on the company's ability to repay any new loan (e.g. whether any substantial amount of debt has been exempted or extended, and if so, on what conditions).

Cross-Border Insolvency

The Bankruptcy Law extends the effect of Chinese bankruptcy procedures to debtor's assets located overseas, although this relies on the cooperation of foreign courts. Foreign bankruptcy proceedings may also be binding in China with respect to the China-based assets of a debtor.

Foreign proceedings are binding where:

- (a) there is a treaty for reciprocity, or reciprocity in practice, in the recognition of insolvency proceedings;
- (b) the foreign insolvency proceedings do not contravene the basic principles of Chinese law and Chinese sovereignty, security and public interest; and

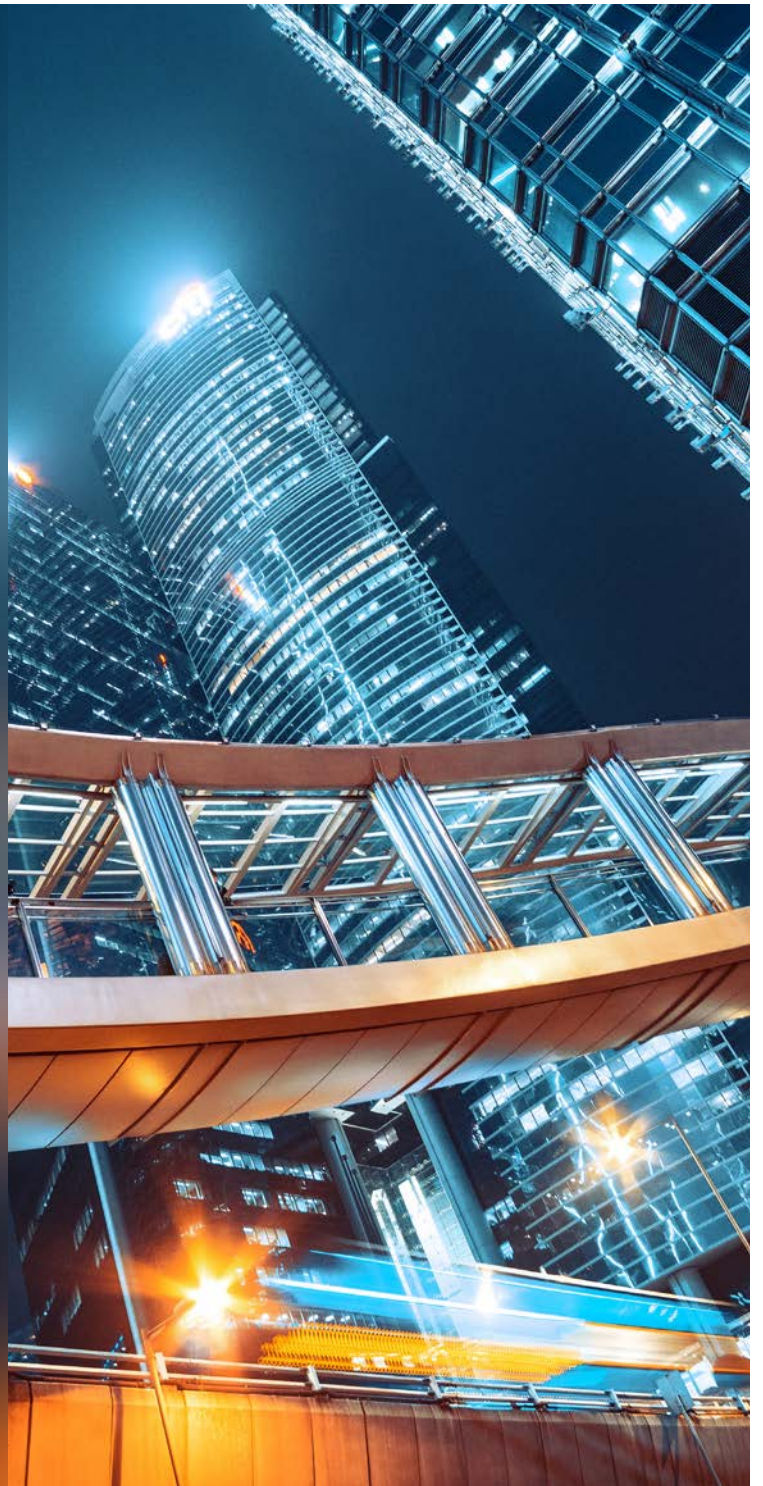
- (c) the foreign bankruptcy proceedings do not impair the legal interests of a Chinese creditor.

There are presently around 40 treaties for reciprocal enforcement of judgments between China and other jurisdictions, none of which specifically refer to bankruptcy proceedings and few, if any, involve China's major trading partners. Similar requirements apply to the enforcement of foreign judgments in China. Concepts such as "public interest" and "impair" have been used to refuse recognition of otherwise meritorious cases.

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HONG KONG



HONG KONG

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Key Elements:

- No statutory procedure for the rehabilitation of companies.
- No statutory moratorium preventing the enforcement of security.
- Receivership available as a self help remedy for secured creditors.
- Anti-avoidance mechanisms available to liquidators in order to maximize recoveries for creditors.
- Scheme of arrangement available to compromise claims of creditors and contributories.

Introduction

This section provides a general outline of the main corporate insolvency procedures in Hong Kong. Hong Kong corporate insolvency law is governed primarily by the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) as amended by the Companies (Winding Up and Miscellaneous Provisions) Amendment Ordinance 2016 (as amended, “CWUMPO”) which came into effect on 13 February 2017. It is based on the laws of England and Wales and tends to be creditor-friendly.

There is no statutory procedure in Hong Kong for the rehabilitation of companies comparable to administration in England or Chapter 11 in the US. Therefore the majority of companies in financial difficulties will either enter an informal restructuring process (with the aim of restructuring the company’s debts in order to continue operating) or go into liquidation. The primary purpose of liquidation is to realise the assets of the company and distribute the proceeds to the

company’s creditors and, in the event that there is a surplus, to the company’s shareholders. Liquidation is discussed further below. The stated intention as set out in the Financial Services and the Treasury Bureau’s Legislative Council Brief of 30 September 2015 was that an amendment bill introducing corporate rescue and insolvent trading would be introduced to the Legislative Council in 2017 or 2018. However, to date, no such bill has been announced.

We also briefly consider receivership, schemes of arrangement, challenges to antecedent transactions, the personal liability of directors, lender liability, guarantees, priority of security and claims, new money lending and the recognition of foreign insolvency proceedings.

On 7 July 2017, the Financial Institutions (Resolution) Ordinance (Cap. 628) (“FIRO”) came into effect, which sets out the bulk of the provisions for the specialist resolution regime for financial institutions and Hong Kong has now largely met its obligations as a member of the Financial Stability Board. In theory the winding up in Hong Kong of an international bank remains possible, but in the case of its financial distress, some form of resolution under FIRO is the most likely scenario.

There are also bespoke insolvency regimes for certain other types of companies, such as insurance companies. These special regimes are beyond the scope of this section.

Liquidation

There are two types of liquidation:

- (1) winding up by the court (also called “compulsory winding up”); and
- (2) voluntary winding up.

There are two types of voluntary winding up, both of which do not involve the court:

- (a) *members' voluntary winding up* – this is not an insolvency process, as in order for the company to qualify for a members' voluntary winding up its directors must file a declaration of solvency with the Companies Registry certifying that the company will be able to pay its debts in full; and
- (b) *creditors' voluntary winding up* – this is normally initiated by the shareholders or directors of an insolvent company. Typically, once the directors have concluded that the company is insolvent and there is no real prospect of a restructuring, the directors will convene a meeting of members to pass a special resolution to wind up the company and nominate a liquidator.

Section 228A of CWUMPO allows the directors, without first consulting the shareholders, to commence a voluntary winding up of the company and appoint a provisional liquidator. This procedure is rarely used because it is only available where winding up under another route is not reasonably practical, and the directors are required to give detailed reasons as to why this is the case. Further, the scope of actions available to a provisional liquidator appointed under this provision has been curtailed as a result of the new section 228B of CWUMPO.

Winding up by the court is normally initiated by a creditor (secured or unsecured) but is also available to the company itself where the shareholders of the company have passed a resolution for winding up. The liquidator is typically an accountancy professional, and the liquidation process takes place under the supervision of both the court and (to a much lesser extent) the Government (through the Official Receiver).

Compulsory Winding Up

Grounds for a winding up order

Most applications for a company to be wound up by the court are made by unsecured creditors and usually on the grounds that the company is unable to pay its debts. A company is deemed unable to pay its debts where:

- (a) the company fails to satisfy within three weeks of the service of notice in the prescribed form a debt in the sum of or exceeding HKD10,000;
- (b) the enforcement of a judgment of the court against the company has not been satisfied in full; or
- (c) it appears to the court that the company is unable to pay its debts, taking into account the contingent and prospective liabilities of the company. The usual test relied upon is the cash flow test but the balance sheet test is also applicable. Other grounds for compulsory winding up are available, the most common of which is that the court is of the opinion that it is just and equitable that the company should be wound up. This 'just and equitable' ground has been held to include that the company was formed to carry on an illegal or fraudulent purpose or that the main purpose of the company has gone.

Impact of presentation of winding up petition

At any time after the making of the winding up application and before the making of a winding up order, the court may (if requested by the company or any creditor) stay any legal proceedings against the company on such terms as it thinks fit.

Where a winding up order has been made, or a provisional liquidator has been appointed, there is an automatic stay of legal proceedings and no legal proceeding can be proceeded

with or commenced against a company except with the leave of the court, and subject to such terms as the court may impose. Court-based enforcement proceedings against a company or its assets, such as attachment and execution, become void on the commencement of a winding up. The commencement date is (retrospectively) the date on which the winding up petition is presented (in a winding up by the court) or the date on which the resolution is passed (in a voluntary winding up).

A winding up (whether compulsory or voluntary) has no formal effect on the process of security enforcement (subject to the possibility of an antecedent challenge, as summarised below). In respect of contracts to which the company is a party, it is generally the case for both compulsory and voluntary winding up that the contracts will continue, subject to the liquidator's powers to disclaim onerous contracts (discussed below). Employment contracts are an exception to the rule: employees engaged under service contracts are automatically dismissed from the date of publication of the winding up order, although the liquidator may permit the employment of some or all of the company's employees to continue, usually on a short-term basis, if the liquidator intends to carry on the business of the company. The winding up order also has the effect of terminating the directors' powers of management and control over the company.

Provisional liquidation (before the winding up order)

Following the presentation of a petition for winding up, the court may make an order for the appointment of a provisional liquidator (or, usually, for two provisional liquidators who act jointly and severally). The usual reason for the appointment of a provisional liquidator is to preserve the assets and records of a company for the benefit of the creditors during the period following the presentation of the winding up petition and before the granting of the winding up order (usually this is a period of

about two months). The most common ground for seeking the appointment of a provisional liquidator is that there is a perception that the assets and affairs of the company are in jeopardy, primarily because the directors and/or shareholders may dissipate the assets while the petition for winding up is pending.

With the exception, in certain circumstances, of specific but limited powers to protect the company's assets without the sanction of the court, a provisional liquidator has no statutory or implied powers, and therefore his powers need to be set out in full in the court order appointing him. The court may vest a range of powers in the provisional liquidator for managing the affairs of the company and continuing the business in the ordinary course. On occasions, the provisional liquidator is given all the powers of a liquidator.

On and following the appointment of a provisional liquidator, the company continues to exist and the identity and character of the company is not altered but the appointment has the effect of displacing the directors' powers of management. The provisional liquidator assumes control of the company and takes into his custody or control all the property and things in action to which the company is or appears to be entitled. The appointment of a provisional liquidator has the effect of automatically revoking the authority of any agent of the company who was appointed by or on behalf of the company. The entry into provisional liquidation does not of itself lead to the termination of the contracts of the company.

The provisional liquidator is an officer of the court and so does not represent any creditor or class of creditors. On the appointment of a provisional liquidator, all legal proceedings against the company are stayed.

Choice of liquidator

The Official Receiver becomes the provisional liquidator when a winding up order is made, unless a provisional liquidator has already been appointed in which case the provisional liquidator will continue to act as such until another person becomes the liquidator.

With the exception of cases which qualify for the summary liquidation procedure (discussed briefly below), the provisional liquidator is required to call separate meetings of the creditors and contributories to decide upon an application to be made to the court for the appointment of a liquidator. Creditors have the power to nominate their preferred candidate to be appointed as liquidator. If no nomination has been received by the Official Receiver for the appointment of a liquidator, then, by the operation of the roster system of the Administrative Panel of Insolvency Practitioners for Court Windings Up (a 'cab-rank' system), the name of the next person on the roster will be put to creditors at the meeting. If the creditors and contributories do not agree on the choice of the liquidator, then the court may make such order as it thinks fit. The court will act in the interests of all the parties and is not in any way bound by the recommendations of the creditors or contributories. As is the case for provisional liquidators, the usual practice is to appoint two liquidators who act jointly and severally. Where the court is satisfied that the assets of the company are unlikely to exceed HKD200,000, the court may order that the company is to be wound up in a summary manner. One of the main effects of such an order is that the Official Receiver or the provisional liquidator shall be the liquidator, without there being any meetings of creditors or contributories.

Liquidator's ability to disclaim contracts

The liquidator of a company may, with the leave of the court, disclaim onerous property (including shares or stock in companies and unprofitable contracts) of the company being wound up, at any time within 12 months after the commencement of winding up (or such longer period as may be allowed by the court), though the court in Hong Kong has displayed a reluctance to sanction a disclaimer of property in cases where the rights of third parties may be adversely affected. Accrued rights and obligations will not be affected by any such disclaimer.

Distributing the company's assets

As a general principle, creditors' claims in a winding up will rank in the following order:

- (a) particular expenses (receivers' or liquidators' expenses and other expenses in relation to the insolvency);
- (b) creditors preferred by statute (e.g. tax and remuneration of employees);
- (c) unsecured creditors; and
- (d) shareholders, according to their rights and interests in the company.

Distribution among each class is *pari passu* by reference to the value of claims as accepted by the liquidator. *Pari passu* distribution is mandatory and is one of the fundamental principles of Hong Kong corporate insolvency law.

The distribution of the proceeds of the enforcement of security generally falls outside the winding up: these proceeds are used to satisfy the debts of the creditors who had the benefit of the relevant security interest, with any excess proceeds then distributed in accordance with the order set out above. The

exception to this is in relation to security created by way of a floating charge, where preferential debts must be paid before the charge holder is paid.

Secured creditors may enforce rights

In the ordinary course of events, a secured creditor is entitled to rely on the terms of a properly drafted security document to enforce its security. In a compulsory or voluntary liquidation of the company, the secured creditor remains entitled to enforce its security rights, either by itself, or through the appointment of a receiver.

Any creditor (secured or unsecured) may apply to the court to put a company into compulsory winding up, although unsecured creditors normally initiate this process. Creditors cannot initiate a voluntary winding up.

In practice, a secured creditor will normally recover its debt by enforcing its security and will claim in the liquidation only in relation to the unsecured balance of the debt (if any).

Admissibility of debts

In a winding up, debts of all descriptions are properly provable by a creditor, which include liquidated and unliquidated claims, certain and contingent debts, existing and future debts ascertained, any obligation to pay damages, periodic payments and claims for interest.

Interest on a debt is provable as part of the debt, except in so far as it is payable in respect of any period after (in the case of a compulsory winding up) the date of the winding up order, or (in the case of a voluntary winding up) the date of the passing of the relevant resolution. The amount of any admissible debt (and interest) is calculated as at that date.

Mandatory set-off also applies. Only mutual credits, mutual debts or other mutual dealings between the company and the creditor, determined as at the date of the commencement of the winding up (for this purpose, in a compulsory winding up the commencement of the winding up is taken as the date of the winding up order), can be set-off against each other.

Creditors of a company may contractually agree (for example by an intercreditor agreement) how their claims should be ranked prior to and on the winding up of the company. Intercreditor agreements are not unusual. The extent to which an intercreditor agreement will be enforceable in insolvency is unclear.

Receivership

A secured creditor can exercise its rights under a security document to appoint a receiver over the assets of the company covered by the security. A security document usually provides that a secured creditor may appoint a receiver upon the occurrence of one or more specified events of default. In addition, a receiver can be appointed by the court (although this is rare in practice).

The receiver's primary duty is to manage and realise assets, in order to remit the proceeds to the secured creditor which appointed him. The scope of the receiver's powers will be set out in the security document and the document appointing him, or in the court order. A receiver also has common law duties and specific duties set out in CWUMPO.

There is no legal reason why the company should be wound up after the secured creditor has been paid, but in practice very often a company is wound up after the appointment of a receiver.

Schemes of Arrangement

This is not an insolvency procedure, but a mechanism contained in section 673 of the Companies Ordinance (Cap. 622) (“Companies Ordinance”) which allows the court to sanction a compromise or arrangement that has been agreed between a prescribed majority of the relevant class or classes of creditors or members and the company.

A scheme of arrangement binds all creditors or members within a class, including unknown creditors who fall within that class. The power of the majority to bind a minority in the class operates regardless of any contractual restrictions (e.g. requirements for amendments and variations set out in the loan document which governed the debt being compromised). A scheme of arrangement is typically proposed by the company as a means of avoiding liquidation.

There is no process under Hong Kong law to put in place a moratorium to prevent secured creditors from realising their security or unsecured creditors from bringing or continuing legal proceedings against the company whilst a scheme of arrangement (or an informal restructuring) is attempted. However, under Hong Kong law the appointment to a company of provisional liquidators (pursuant to the presentation of a petition to wind up the company, and pending the making of the winding up order) has the effect of staying all legal proceedings (including attachment proceedings) against the company (but does not prevent secured creditors from realising their security). The High Court in Hong Kong has in recent years granted provisional liquidators powers to formulate restructuring plans, thereby providing a moratorium on legal proceedings during which a scheme of arrangement can be developed. There remains however a requirement to show a jeopardy to the assets of the company before a court will appoint provisional liquidators.

This jeopardy to assets test has been (partially) overcome by the Hong Kong court recognising the appointment of provisional liquidators in other, usually offshore, jurisdictions where such a test is not mandatory.

In order to initiate a scheme of arrangement effecting a compromise of creditors’ claims, an application is filed with the court. Once the court’s agreement to the convening of meetings of creditors (or classes of creditors) has been obtained, an explanatory statement and notices convening such meeting(s) are then sent to all known creditors.

At the meeting of creditors (or of a class of creditors), a majority in number and three-quarters in value of the creditors (or the classes of creditors) who are present and voting either in person or by proxy must accept the proposal in order for it to be binding on all the creditors (or all the creditors of the class, as the case may be).

Following the creditors’ meeting(s), the scheme must be sanctioned by the High Court: this requires a formal hearing in full court. The scheme takes effect upon filing with the registrar of companies the court order sanctioning the scheme.

If creditors’ claims have been addressed in a scheme of arrangement, and if the scheme of arrangement is approved, there is an effective ‘cram down’ of creditors’ claims (even if a relevant creditor voted against the scheme). Any creditors whose claims have not been addressed in the scheme retain their full original rights against the company after the scheme has been put in place. Putting in place a straightforward scheme of arrangement is likely to take four months, with more complex schemes taking more than six months to put in place.

In the context of a restructuring, if a scheme of arrangement is proposed and is not approved, or is approved and put in place but not successfully implemented, the winding up of the company is very likely to follow.

Informal Workout

Financial institutions are often at the forefront of restructuring proposals, and banks tend to adhere to a set of informal guidelines jointly issued by the Hong Kong Association of Banks and the Hong Kong Monetary Authority. As the guidelines apply only to banks, difficulties can arise when an informal workout involves other types of creditors. This informal corporate rescue process is effected by contract between the company and (usually) its lender creditors, leaving other creditors (usually trade creditors) free to pursue other remedies as they see fit.

Challenges to Antecedent Transactions

Security granted by a company, and transactions entered into by a company, are subject to the risk of the security being invalid, or the transaction being voided, if it is granted, or entered into, during the applicable risk period (known as the “hardening period”) before the making of an application for that company’s winding up. The length of the risk period varies, depending on the type of challenge and the circumstances in existence at the time the security was created.

Unfair preferences: sections 266 – 266D CWUMPO

An unfair preference is an act (e.g. granting of security or guarantee) which has the effect of putting a creditor, a surety or a guarantor in a better position than it would otherwise have been in upon a winding up of the company. The general risk period is six months, but is increased to two years if the unfair preference is not a transaction at an undervalue and is granted

to a person who is connected with the company, for example, a company in which the company in winding up holds one-third or more of the votes capable of being cast at a general meeting. The legislation is not entirely clear, but the general view is that, in order for the relevant transaction to be invalidated as an unfair preference, the company must have been insolvent at the relevant time and must have been influenced in deciding to give the preference by a desire to produce the effect of putting the relevant creditor, surety or guarantor in a better position.

Extortionate credit transactions: section 264B CWUMPO

A credit transaction is extortionate if (taking into consideration the credit risks) credit is provided for grossly exorbitant payments (either actual or contingent e.g. on default) or the transaction grossly contravenes principles of fair dealing. The risk period is three years.

Avoidance of floating charges: sections 267 and 267A CWUMPO

Where a floating charge has been created (a) in favour of a person who is connected with the company within two years of the winding up, or (b) in favour of any other person within 12 months of the winding up and, at the time of creation, the company was unable (or became unable) to pay its debts, the floating charge will be invalid except to the extent of any money paid to or at the direction of the company, or any property or services supplied to the company, in each case at the same time as the creation of the charge and in consideration for granting the floating charge, and interest on it.

Fraudulent conveyances: section 60 conveyancing and property ordinance

Although rarely invoked, this section provides for the voidability of dispositions made with the intent to defraud

creditors. There is no time limit, and the section applies whether or not the company making the disposition is being wound up or insolvent.

Transactions at an undervalue – sections 265D-E and 266B-D CWUMPO

New provisions in the amended CWUMPO provide for the voidability of transactions at an undervalue entered into within five years of commencement of the winding up and was unable (or became unable) to pay its debts at the time of the transaction, unless the company entered into the transaction in good faith and for the purpose of carrying on its business and there were at the time reasonable grounds for believing that the transaction would benefit the company. A transaction is at an undervalue if the company makes a gift or where there is no consideration or where the consideration is significantly less than the value of the consideration provided by the company.

Personal Liability of Directors

Directors can incur civil and criminal liability for the debts of an insolvent company in a number of ways. Persons liable under these provisions often include not only existing and past directors, but also existing and past officers (which includes managers and company secretaries), promoters of the company and any liquidator or receiver of the company, as well as persons occupying the position of director by whatever name called. The scope of persons potentially subject to liability therefore needs to be looked at carefully on a case by case basis.

The principal areas of risk for directors are breach of duty and fraudulent trading. Hong Kong does not currently have a statutory insolvent trading regime (unlikely, for example, such regimes that exist in England or Australia).

Breach of duty

Civil law actions can be taken by the company against a director on the basis of a breach of directors' duties to the company. In particular where a company is insolvent or near insolvency, directors have a duty to the company to take into account the interests of the general body of creditors. There is often an overlap between breach of directors' duties and statutory provisions: a breach of duty to creditors might also amount to fraudulent trading (discussed below). Equitable remedies are available, and a liquidator can also take action under the statutory provision for misfeasance, which provides for a summary procedure for the enforcement of existing rights that the company has against directors. Under the misfeasance provisions, the court can order directors to compensate the company for its losses.

Other directors' duties which might be relevant on a winding up include exercising powers for improper purposes, misapplication of corporate property, breach of restrictions on maintenance of capital and breach of the duty to act with care, skill and diligence.

Fraudulent trading: section 275 CWUMPO

This section enables the liquidator, the Official Receiver and any creditor or contributory of a company to apply for contributions from any persons (i.e. not only directors and shadow directors) who were knowingly party to the carrying on of business with intent to defraud creditors. The section requires a finding of dishonesty, and applies whether or not the company is wound up. The court may declare that any such persons are personally liable for all or any of the debts or other liabilities of the company. In addition, where the company is wound up, such persons are guilty of an offence and are liable to imprisonment and a fine.

Share redemption or buy-back out of the company's capital

If the company has made a payment out of capital in respect of a redemption or a buy-back of its own shares from a shareholder within one year from winding up, this shareholder and the directors who signed the solvency statement required to be made under the Companies Ordinance would be liable to contribute to the company's assets. Liability is limited to the amount of such share buy-back or redemption.

Criminal liability

In addition to fraudulent trading, the breach of certain other provisions of CWUMPO may also result in criminal liability. These include defrauding creditors (which overlaps to a certain extent with the provisions on fraudulent trading), failure to keep proper accounts, falsification of books, and failure to assist with the liquidation.

Disqualification of directors

Hong Kong also has provisions for the disqualification of directors, similar to those in England and Wales. Grounds for disqualification include conviction for certain indictable offences, breaches of certain provisions of CWUMPO, fraudulent trading or other fraudulent conduct in winding up, and conduct rendering such person unfit to be a director of a company.

Lender Liability

Generally speaking, the risk in Hong Kong of lenders being held liable to pay their customers' debts is small. In theory, the principal risk for a lender arises where it is found to be acting as a shadow director of a company that is wound up.

The expression "shadow director" is defined in section 2 of CWUMPO as "...a person in accordance with whose directions or instructions (excluding advice given in a professional capacity)

the directors, or a majority of the directors, of the body corporate are accustomed to act".

In other common law jurisdictions, generally the greatest risk to lenders who are found to be shadow directors comes from the application of an insolvent trading regime, which Hong Kong does not have. It is conceivable that a lender which was found to be a shadow director might be liable under the fraudulent trading regime or for another of the offences referred to above, but we have not seen this in practice.

Guarantees

Guarantees are available in most circumstances, for example downstream (parent in respect of the obligations of its subsidiary), upstream (subsidiary in respect of the obligations of its parent) and cross-stream (a company in respect of the obligations of its sister company). However, the rules on financial assistance provide that where a person has acquired, is acquiring or is proposing to acquire shares in a company, it is not lawful for the company or any of its subsidiaries to give financial assistance (which includes the granting of a guarantee) directly or indirectly for the purpose of that acquisition. Exceptions to this prohibition apply where the company acquired is not listed and certain conditions (including as to the financial condition of the company giving the financial assistance) are satisfied.

Corporate benefit issues will also need to be addressed especially in the context of upstream and cross-stream guarantees.

A guarantee is a secondary obligation by a third party relating to a primary obligation by a contracting party (i.e. a borrower under a loan agreement). If the primary obligation is altered, discharged or fails, the guarantee may not be enforceable. Usually the document containing a guarantee will also contain a direct

indemnity as an independent primary obligation. This should survive even if the guarantee is not enforceable. Strictly, a guarantee need not be in writing to be enforceable, but in practice guarantees in business transactions are always in writing.

Priority of Security Interests

Security is generally available over all types of assets in Hong Kong. If a company is giving security over as many of its assets as possible, there will usually be one security document called a debenture which will include a number of fixed charges and a floating charge (a charge over a changing pool of assets).

It is possible for the court to re-classify a fixed charge as a floating charge if there are, for example, inadequate restrictions on what the company can do with the asset or the proceeds of the asset subject to the charge. This may affect the priority of the security, as a floating charge will normally rank behind all fixed security.

Security usually ranks by chronological order of creation, but to preserve the priority position, notice may need to be given. For some assets, registration is required in an asset or document register (e.g. land and buildings) and security will rank by the date of registration. Legal security will usually have priority over equitable security provided that it is properly created, even though it may be created after equitable security is created.

Most types of security given by a company must be registered with the Companies Registry in Hong Kong within one month of the date of creation of the security: if they are not so registered, they will be void against any liquidator of the company. Registration is required where security is granted by a company incorporated in Hong Kong or by a company incorporated outside Hong Kong (and registered as a non-Hong Kong company under Part 16 of the Companies Ordinance) and creating security over assets in Hong Kong. Third parties who could reasonably be expected to

make a search with the Companies Registry may be treated as having notice of security registered at the Companies Registry.

Particular rules apply to security taken by mortgage and ranking of further advances secured by a mortgage against subsequent mortgages.

New Money Lending

Where lenders have agreed to advance new monies to a company which has entered into winding up proceedings, they will usually insist on being provided with additional security or priority (ahead of debts incurred prior to the proceedings), thereby giving the new monies a 'super priority' should the company go on to be wound up.

Recognition of Foreign Insolvency Proceedings

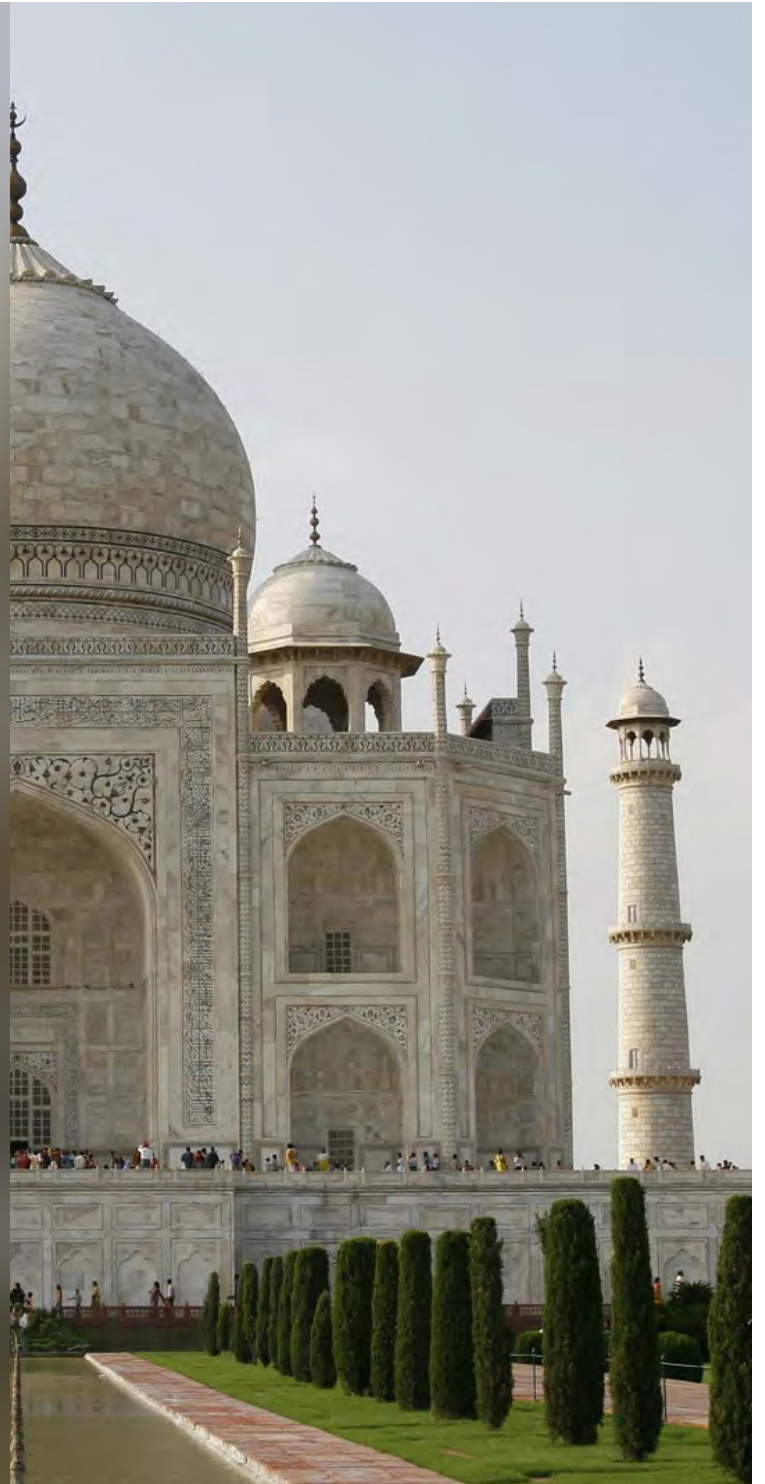
CWUMPO confers jurisdiction on the Hong Kong courts to wind-up companies incorporated outside Hong Kong. However, the court will exercise the power to wind up a foreign company only where it can be demonstrated that:

- (a) the foreign company has a sufficient connection, or nexus, with Hong Kong to support the court exercising its discretion to make a winding up order;
- (b) there is a reasonable possibility, if a winding up order is made, of benefit to those applying for the winding up order; and
- (c) one or more persons interested in the distribution of assets of the company are persons over whom the court can exercise jurisdiction.

There is no statutory basis for recognition or assistance with foreign insolvency proceedings. However, the courts in Hong Kong have shown a willingness to cooperate with the courts of

foreign jurisdictions. As a practical matter, the courts in Hong Kong will recognise foreign insolvency proceedings and representatives appointed in such proceedings, and will recognise the foreign representatives' powers to collect assets (although the Hong Kong courts will require proceeds of assets to be applied in accordance with the order of distributions prescribed by Hong Kong law). It is recommended that separate winding up proceedings be initiated in Hong Kong where a foreign representative seeks to protect the collective nature of the foreign proceedings (e.g. by restraining creditors from attaching assets).

INDIA



INDIA

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Key Elements:

- A new comprehensive law, the Insolvency and Bankruptcy Code, 2016 has been put into effect which consolidates and amends the laws on reorganization and insolvency resolution of corporate persons in a fixed time period.
- Employees and workmen dues are conferred a relatively high priority in liquidation.
- Enabling provisions put in place related to extra-territorial jurisdiction over the assets or property of the corporate debtor situated outside India.

Introduction

This section provides a general outline of the corporate insolvency procedures in India. The Indian insolvency regime has undergone a significant change since 2016. In May 2016, the Parliament of India passed the Insolvency and Bankruptcy Code, 2016 (“IBC”). The IBC replaces in most relevant respects the entire gamut of insolvency laws in India and is applicable to corporate persons (i.e. companies and limited liability partnerships) as well as individuals and partnerships. Only the provisions relating to corporate persons have been notified with effect from December 2016. The IBC covers insolvency resolution, liquidation as well as voluntary liquidation (or solvent liquidation) for corporate persons.

Unlike the earlier regime, the IBC is a single comprehensive law that: (a) empowers all creditors (whether secured, unsecured, domestic, international, financial or operational) to trigger resolution process; (b) enables the resolution process to start at the earliest sign of financial distress; (c) provides for a single forum i.e. the National Company Law Tribunal (“NCLT”) to oversee all insolvency and liquidation proceedings; (d) enables a moratorium where new proceedings do not derail existing ones; (e) provides for replacement of the existing management of the corporate debtor during the continuation of the insolvency proceedings while maintaining the enterprise as a going concern; (f) offers a finite time limit within which the corporate debtor’s viability can be assessed; and (g) lays out a direct liquidation mechanism.

Further, certain provisions of the Companies Act, 2013 (“CA 2013”) will govern corporate insolvency and supplement the regime set up under the IBC. The notification of these provisions of CA 2013 has led to the simultaneous replacement the provisions of the Companies Act, 1956 (the legislation previously governing the primary aspects of corporate law in India). The Parliament has also repealed the Sick Industrial Companies (Special Provisions) Act, 1985 (“SICA”) which dealt with the rescue and rehabilitation of sick industrial units.

In addition, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (“SARFAESI Act”) deals with the enforcement of security by creditors, including in the case of liquidation of a company.

In this section, we will be setting out the various processes laid down under the IBC, which now stands as the primary legislation governing corporate insolvency and winding up in India. This section will also briefly set out the grounds for winding up a corporate entity under CA 2013.

Processes Under the IBC

A. Corporate insolvency resolution process Initiation

Under the IBC, an application may be filed by a financial creditor, an operational creditor or a corporate applicant to initiate a corporate insolvency resolution process (“CIRP”) against a corporate debtor on a payment default of more than INR100,000 (Indian Rupees Hundred Thousand only).

Unlike most jurisdictions, the IBC makes a distinction between financial creditors and operational creditors. Financial creditors are creditors who are owed a debt along with interest, if any, which has been disbursed against the consideration for the time value of money. Financial creditors typically include banks, financial institutions and bond holders. Operational creditors are creditors who are owed a debt in lieu of provision of goods and services and also includes government dues. Operational creditors typically include trade suppliers, employees and persons owed statutory dues. Further, a corporate applicant may also initiate CIRP against itself and includes: the corporate debtor; a shareholder authorised under its constitutional documents; an individual who is in charge of managing the operations and resources of the corporate debtor; or a person who has the control and supervision over the financial affairs of the corporate debtor.

A financial creditor may file an application if a payment default by the corporate debtor has been made against that creditor or

to another financial creditor (i.e. a cross default). An operational creditor may only file an application if the payment default has been made against itself.

A financial creditor need not provide a notice to the corporate debtor prior to filing an application to initiate a CIRP. An operational creditor is required to serve a demand notice (provided in Form 5 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016), ten days prior to filing an application to initiate CIRP. However, financial creditors should serve a demand notice on the corporate debtor prior to filing an application as good practice.

The application to initiate CIRP must be filed at the relevant bench of the NCLT where the registered office of the corporate debtor is located. The NCLT is the adjudicating authority with jurisdiction on matters under the IBC that relate to corporate persons. The applicant must also propose an insolvency professional who shall act as the interim resolution professional (“IRP”) during the CIRP.

On hearing the insolvency application filed, the NCLT makes a determination, within 14 days or such longer time as may be dictated by the courts, as to whether a payment default has taken place. If the payment default has taken place and certain other conditions are met, the NCLT must admit the application and initiate CIRP against the corporate debtor.

On admission of the application, the NCLT (i) imposes a moratorium for the duration of the CIRP i.e. 180 days (extendable by a maximum of 90 days) the (“CIRP Period”) during which no suits may be filed against the corporate debtor and all actions to enforce or foreclose security are stayed (including any action under the SARFAESI Act); and (ii) appoints the proposed IRP for

running the CIRP of the corporate debtor. If the CIRP is not completed within the prescribed time limit, the corporate debtor is mandatorily put into liquidation.

Management

The IBC establishes a cadre of regulated insolvency professionals (“IPs”). An IP, who is registered with the Insolvency and Bankruptcy Board of India (“IBBI”) (the regulator established under the IBC), can be appointed by the NCLT during the CIRP. Such IP is empowered to effectively run and manage the entity, including its assets, as a going concern during the CIRP Period, thereby addressing concerns of asset-stripping or siphoning during the CIRP Period. Under IBC, the IBBI is responsible for registering IPs, prescribing qualifications and monitoring their performance.

The NCLT, while admitting the application to initiate CIRP, appoints an IP in its capacity as the IRP of the corporate debtor. The IRP, on appointment, displaces the board of directors of the corporate debtor and takes over its management. The term of the IRP is for a period of 30-days.

In the 30-day tenure, the IRP must make a public announcement to initiate the process of collection of claims (within three days of his appointment). Further, the IRP shall appoint two registered valuers to ascertain the ‘liquidation value’ of the corporate debtor (within seven days of his appointment). ‘Liquidation value’ is the estimated realizable value of the assets of the corporate debtor if the corporate debtor were to be liquidated on the insolvency commencement date (“ICD”), being the day the NCLT passes an order initiating CIRP.

Proof of claim

All creditors must submit their proofs of claim to the IRP within 14 days from the date of the IRP’s appointment in the relevant

forms prescribed under the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2017 (“CIRP Regulations”).

The last date for submission of claims is 14 days from the date of the public announcement. In the event claims are not submitted within this time, all decisions taken prior to admission of such claim will not be changed. The IRP shall verify all claims within seven days from last date of receipt of claims. On collection and verification of claims, the IRP collates all the admitted claims and keeps a record of all the creditors of the company. On this basis, the IRP forms the committee of creditors (“CoC”).

IRP must also prepare a brief information memorandum by the first meeting of the CoC and a detailed information memorandum within 14 days of the first meeting of the CoC.

Decision making

With the new regime set up under the IBC, India has moved from a ‘debtor-in-possession’ model to a ‘creditor-in-possession’ model. The CoC is a committee formed by the IRP on collation of claims and is vested with the responsibility of deciding the future of the corporate debtor – resolution or liquidation.

The CoC consists of only the financial creditors, excluding related parties of the corporate debtor. In the event a corporate debtor has no financial creditors (or all financial creditors are related parties), the CoC will comprise a total of 20 operational creditors (i.e. 18 largest operational creditors by value of debt owed, one representative of workmen and one representative of employees).

The CoC drives all major decisions relating to the company during the CIRP Period. At its first meeting, the CoC must

confirm whether they want the IRP to continue as the resolution professional ("RP") or replace the IRP. The CoC must endeavour to restructure the capital and operations of the corporate debtor as a going concern by approving a resolution plan. In the event the CoC is unable to approve a resolution plan before the expiry of the CIRP Period, the NCLT is required to pass an order of liquidation against the corporate debtor. The CoC may also resolve to liquidate the corporate debtor at any time during the CIRP Period.

Decisions of the CoC are determined by a vote of 75% of its members (by value of debt owed). The resolution plan approved by the CoC must be structured to provide that the dissenting financial creditors and operational creditors are assured of liquidation value (i.e. the value that they would have received had the corporate debtor been liquidated on the day the CIRP commenced). The mandatory conditions for a resolution plan are detailed below.

Resolution plan

As discussed above, a resolution plan must be approved by the CoC and thereafter, the NCLT. Once approved by the NCLT, a resolution plan is binding on all stakeholders including all creditors, the corporate debtor and employees. Violation of the resolution plan is a ground for liquidating the company. To ensure the resolution plan is just and equitable, the IBC prescribes certain mandatory conditions that a resolution plan must adhere to. If any plan adheres to these conditions, then the NCLT must approve such plan and may not otherwise challenge the commercial agreement in which the resolution plan is based. The mandatory conditions are as follows:

- (a) The resolution plan must provide for payment of 'insolvency resolution process costs' ("IRPC") to be paid first in priority. IRPC includes all costs of the CIRP such as fees of the IRP and RP, any interim finance raised during CIRP and other costs for running the corporate debtor as a going concern.
- (b) The resolution plan must ensure that all operational creditors are paid at the minimum their 'liquidation value'¹ within 30-days of approval of the resolution plan by the NCLT.
- (c) Any dissenting financial creditors (who vote against the resolution plan) must also be paid their liquidation value and such payment must be made prior to any recoveries being made by the assenting financial creditors.
- (d) The resolution plan must not contravene any provision of law.

Further, the IBC has been recently amended and has laid down certain disqualifications for persons proposing a resolution plan or buying assets in liquidation. For instance, persons that are convicted of any criminal offence punishable with imprisonment or 2 years or more are disqualified from proposing a resolution plan.

B. Liquidation

An order of liquidation may be passed against the corporate debtor in the following circumstances: (a) if the CoC resolves to liquidate the corporate debtor during the CIRP Period; (b) if the CoC does not approve the resolution plan and the CIRP Period expires; or (c) the resolution plan that has been approved is violated.

The NCLT shall on satisfaction of any of the above conditions, order the initiation of liquidation proceedings against the corporate debtor, such date being the liquidation commencement date ("LCD").

¹ 'Liquidation value' is the estimated realisable value of the assets of the corporate debtor if the corporate debtor were to be liquidated on the LCD.

A moratorium becomes applicable on the LCD where no suits or other legal proceeding may be instituted by or against the corporate debtor (except by the corporate debtor with approval of the NCLT). However, unlike in CIRP, the moratorium in liquidation does not extend to enforcement of security by secured creditors. Further, the order for liquidation is deemed to be a notice of discharge to the officers, employees and workmen of the corporate debtor (except when the business is continued by the liquidator).

The liquidation of the corporate debtor is intended to be conducted within two years failing which the liquidator must give reasons to the NCLT for not completing the process within the prescribed timeframe.

Priority of distributions

The priority of payments in liquidation is as follows:

- (a) IRPC and costs of liquidation (including fees of the IRP, RP, liquidator and interim finance);
- (b) amounts due to secured creditors (if security relinquished with the liquidator and not enforced separately) and workmen dues (workmen dues will be capped at two years);
- (c) employees' dues (capped at one year);
- (d) amounts due to unsecured financial creditors;
- (e) amounts due to central and state government (capped at two years) and any shortfall due to secured creditors (if security was enforced separately outside liquidation process);
- (f) any remaining debt (this is where operational debt would be paid out);
- (g) preference shareholders; and
- (h) equity shareholders or partners.

Liquidator

The RP appointed for the CIRP of the corporate debtor shall continue as the liquidator, unless replaced by the NCLT. The liquidator is vested with all the powers of the board of directors, key managerial personnel and the partners of the corporate debtor. The fee payable to the liquidator shall form part of the liquidation cost and shall be decided by the CoC before a liquidation order is passed. In the event the fee is not decided, the liquidator shall be entitled to a fee as a percentage of the amount realized net of other liquidation costs and of the amount distributed so as to incentivise the liquidator to liquidate the assets in a fixed time period and maximise realisation.

Powers and duties of the liquidator

The liquidator is entrusted, with the following powers and duties (amongst others):

- (a) making public announcements and calling upon stakeholders to submit their proof of claims within five days of his appointment;
- (b) verifying claims of all the creditors;
- (c) taking into his custody or control all the assets and property of the corporate debtor;
- (d) consulting with stakeholders (such consultation shall not be binding on the liquidator);
- (e) appointing professionals who meet the 'independence' criteria in order to assist the liquidator in the discharge of his duties and obligations;
- (f) approaching the NCLT to direct any personnel of the corporate debtor to cooperate with the liquidator;

- (g) applying to the NCLT within six months of the LCD to disclaim onerous property including contracts;
- (h) appointing at least two registered valuers to value the assets; and
- (i) applying to the NCLT to avoid any fraudulent preference or undervalued transactions.

Reporting requirements

Unlike CIRP, in liquidation there is no CoC to supervise or make any decisions and therefore, the role of the NCLT is greater. The liquidator must report to and make various filings to the NCLT:

- (a) a preliminary report within 75 days of the LCD which shall include, among other things:
 - (i) the capital structure of the corporate debtor;
 - (ii) the estimates of the assets and liabilities of the corporate debtor as on the LCD; and
 - (iii) proposed plan of action for carrying out the liquidation, including the timeline and the estimated liquidation costs;
- (b) an asset memorandum within 75 days of the LCD (on formation of the liquidation estate);
- (c) progress reports within 15 days of the end of every quarter;
- (d) sale reports (on sale of an asset and enclosed with the progress report);
- (e) minutes of consultation with stakeholders; and
- (f) final report prior to dissolution.

The liquidator must also maintain certain records in relation to the liquidation of the corporate debtor, including a cash book, ledger and distributions register.

New money lending

The IBC recognises the concept of raising interim finance in a company undergoing CIRP. Section 5(15) of the IBC defines “interim finance” to mean any financial debt raised by the IRP or RP during the CIRP. The IBC allows the IRP or RP to raise interim finance for the purpose of protecting and preserving the value of the property of the corporate debtor and managing its operations as a going concern.

Under the IBC, all IRPC get the highest priority of payment in a resolution plan or in liquidation. IRPC includes, amongst other things, any interim finance raised for the corporate debtor along with the cost of raising such interim finance. Therefore, interim finance has the highest priority when payments are being made under a resolution plan or in liquidation. However, payments of any interim finance *inter se* other IRPC shall be *pari passu* to such other IRPC. Similarly, in liquidation also, the distribution waterfall set out in Section 53 of the IBC provides for highest priority to IRPC (which must be paid out of the liquidation estate).

Secured creditors

During CIRP, a moratorium is placed on the corporate debtor by an order of the NCLT. The moratorium prevents and suspends all legal proceedings against the corporate debtor and also restricts any recovery action or enforcement of security interest. Therefore, during the CIRP Period, secured creditors are not permitted to enforce their security or take any action towards enforcing security.

However, once the CIRP Period lapses and an order of liquidation is passed against the corporate debtor, the moratorium is lifted. A secured creditor in the liquidation proceedings may then:

- (a) relinquish its security interest to the liquidation estate and receive proceeds from the sale of assets by the liquidator; or
- (b) realise its security interest outside of the liquidation process.

The IBC incentivises secured creditors to relinquish their security interest by placing such secured creditors very high in the distribution waterfall (at level 2 – please refer to section on ‘Priority of Distributions’). However, in the event the secured creditor enforces their security outside the liquidation process and is not able to recover its entire debt then such secured creditor is placed at level 4 to the extent of the shortfall.

Director liability

Directors’ liability under IBC may be classified into two broad categories:

- (a) Disgorgement-based liability – wrongful trading

Section 66(2) of IBC introduces the concept of “wrongful trading.” Under this provision, a director is liable to make contributions to the assets of the company and the NCLT may disgorge such amounts from the director’s personal assets if two conditions are satisfied:

- (i) The director knew or ought to have known that there was no reasonable prospect of avoiding the commencement of a CIRP against the company; and
- (ii) The director did not exercise due diligence in minimizing the potential loss to the creditors of the company. A director is said to have exercised sufficient due diligence if such diligence was reasonably expected of a person carrying out the same functions as the director.

- (b) Punitive liability

The punitive liability to a large extent codifies the regime against directors for actions such as defrauding creditors, asset stripping and falsification of books of accounts of the company. Though the imposition of fines and imprisonment raises concerns, it is the interpretation of the new disgorgement-based liability that could pose greater risk to directors.

Voidable transactions

Under section 43 and section 45 of the IBC, the NCLT may reverse any transaction which it deems to be a preferential transaction or an undervalued transaction, in the period leading up to the commencement of the CIRP. The relevant look-back period for scrutinising suspected transactions is two years in case of related party transactions and one year with any other person. Under section 50 of the IBC, the NCLT may reverse any transaction which is deemed to be an extortionate credit transaction, in the two-year period leading up to the commencement of the CIRP.

Guarantees

Indian companies may issue financial or performance guarantees in relation to the obligations undertaken by another company (whether or not the other company is related to the guarantor company). There are, however, certain restrictions that apply to the issue of such guarantees.

Under the CA 2013, for instance, a public limited company may not issue a guarantee should its value exceed 60% of its paid-up share capital, free reserves and securities premium account, or 100% of its free reserves and securities premium account (whichever is higher), unless a special resolution has been passed by the shareholders of the company. These limits are not applicable in certain circumstances.

Moreover, since India is an exchange-controlled jurisdiction, cross-border guarantees are subject to compliance with the Foreign Exchange Management Act, 1999 and the related rules and regulations. Therefore, Indian subsidiaries will not, generally speaking, be permitted to issue guarantees for obligations of their direct or indirect foreign parent entities without regulatory approval.

Recognition of foreign insolvency proceedings

The IBC provides enabling provisions for cross border insolvency and states that the central government may enter into agreements with foreign governments to enforce provisions of the IBC. Further the IRP, RP or liquidator have powers to make an application to the NCLT if the corporate debtor has assets which are located abroad (in a country which has reciprocal arrangements with India). The NCLT on receipt of such application, may issue a letter of request to enforce provisions of IBC (or other request) to a court or other competent authority of such country to deal with such request.

Further, India has been considering the adoption of the UNCITRAL Model Law on Cross-Border Insolvency to equip Indian law with the ability to deal better with issues relating to cross border insolvency and cater to the deficiency of recognition of foreign insolvency proceedings.

Small business winding up

The IBC provides for a separate set of provisions and regulations for the CIRP and liquidation of smaller companies ("Fast Track CIRP"). Fast Track CIRP is intended to cover the following kinds of corporate persons:

- (a) a small company being a company other than a public company;

- (i) with share capital which does not exceed INR5,000,000; or
 - (ii) with turnover which as per its last profit and loss account does not exceed INR20,000,000;
- (b) a startup company (other than the partnership firm); or
- (c) an unlisted company with total assets not exceeding INR10,000,000.

Broadly, the provisions relating to the CIRP for corporate debtors under the IBC are applicable to the Fast Track CIRP. However, the two processes are not identical. The key differences between Fast Track CIRP and CIRP are as follows:

- (a) Time: Fast Track CIRP has to be completed within 90 days (with a further extension of up to 45 days possible).
- (b) Claims and CoC: The claims have to be collected within ten days from the appointment of the IRP. The report certifying the constitution of the CoC has to be filed within 21 days from the appointment of the IRP.
- (c) Registered valuer: Only one registered valuer has to be appointed to calculate liquidation value.
- (d) Conversion of processes: The IRP may file an application for conversion of the Fast Track CIRP to a CIRP if it believes that the corporate person is not eligible to undergo the Fast Track CIRP with the report certifying the constitution of the committee of creditors.

C. Voluntary liquidation

The IBC, inter alia, envisages two processes for companies:

- (a) resolving the 'insolvency' of companies and liquidating insolvent companies; and
- (b) liquidation of 'solvent' companies.

A company may be liquidated under (a) above in the event the company has defaulted in its payment obligations to any person (which may include any other individual or other company). Alternatively, if a company has not made any payment defaults (threshold is INR100,000) to any person and wants to be wound up, then such company may choose to be liquidated under (b) above. We have set out the voluntary liquidation process in brief below:

- (a) The board of directors of the company must ensure that the company has not defaulted in its payment obligations to any person.
- (b) A majority of the board of directors to make a declaration (along with an affidavit in support):
 - (i) that the directors have made a full inquiry into the affairs of the company and they have formed an opinion that either the company has no debt or that it will be able to pay its debts in full from the proceeds of assets to be sold in the liquidation;
 - (ii) listing debt of the company as on the date of the declaration and stating that the company will be able to pay its debts in full from the proceeds of the liquidation; and
 - (iii) stating that the directors are not liquidating the company to defraud any person.
- (c) This declaration is to be accompanied with:
 - (i) audited financial statements of the company for the previous two years (or period since incorporation, whichever is later); and
 - (ii) report of valuation of the assets of the company, if any prepared by a registered valuer.
- (d) The board of directors must call an extraordinary general meeting of its shareholders ("EGM").
- (e) Within four weeks (or a shorter period approved by 95% shareholders of the company) of the aforementioned meeting of the board of directors, the Company to hold the EGM, where the shareholders may pass the following special resolutions (i.e. by at least 75% shareholders) approving:
 - (i) the voluntary liquidation of the company;
 - (ii) appointment of an insolvency professional that will act as the liquidator for the liquidation of the company; and
 - (iii) fixing the terms of appointment of the liquidator including remuneration.
- (f) Liquidation of a company is deemed to have commenced from the date of passing of the special resolution at the EGM (subject to creditors approval, if applicable) (i.e. the LCD).
- (g) In the event the Company owes any debt to any person, creditors (representing two-thirds of the value of the debt) to approve the special resolution passed by the members in EGM within seven days of the EGM. In case this approval is required, then the LCD will be such day.
- (h) The company to notify the IBBI and the Registrar of Companies of the passing of the above special resolution within seven days of its passing or approval of the creditors, as the case may be.
- (i) Within five days from appointment of the liquidator, the liquidator to make a public announcement:
 - (i) calling for claims of stakeholders (which will include counterparties to the contracts executed by the company);

- (ii) providing the last date for submission of claims (30-days from the LCD);
 - (iii) a public announcement must be published in English and in a regional newspaper where the company's registered office and principal office is located; and
 - (iv) public announcement must be published on website of the company and website of the IBBI.
- (j) The liquidator must endeavour to complete liquidation of the company within 12 months of the LCD. In practice, however, since the process under the IBC is relatively new, it is difficult to estimate how much time the voluntary liquidation process is likely to take.
 - (k) On completion of the liquidation, the liquidator must prepare a final report and submit it to the NCLT along with an application for the company's dissolution.
 - (l) The NCLT may pass an order of dissolution and may give appropriate directions to the company to effect the dissolution.
 - (m) Within 14 days of the NCLT order, a copy of the same is to be forwarded to Registrar of Companies/the authority company is registered with.

Companies Act Grounds

The CA 2013 lays down certain grounds under which a petition may be presented at the NCLT to wind up a company. These are grounds for a direct winding up/liquidation. A company may be wound up by the NCLT:

- (a) if the company resolves by a special resolution to be wound up by the NCLT;
- (b) if the company has acted against the interests of the sovereignty and integrity of India, the security of the state, friendly relations with foreign states, public order, decency or morality;
- (c) if on an application made by the Registrar of Companies or any other person authorised by the government, the NCLT is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up;
- (d) if the company has made a default in filing its financial statements or annual returns with the Registrar of Companies for the immediately preceding five consecutive financial years; or
- (e) if the NCLT is of the opinion that it is just and equitable that the company should be wound up.

INDONESIA



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Key Elements:

- Bankruptcy or suspension of debt payments involves appointment of a curator or an administrator.
- Moratorium available (and extends to secured creditors).
- Suspension of debt payments procedures focuses on company rescue.
- Cram down of creditors available.

Introduction

This section provides a general outline of the main corporate insolvency procedures in Indonesia. Indonesia's insolvency law is primarily governed by Law No. 37 of 2004 on Bankruptcy and Suspension of Debt Payments (the "Bankruptcy Law") and supplemented by Law No. 40 of 2007 on Limited Liability Companies (the "Company Law"). The Bankruptcy Law applies to both corporations and individuals.

The Bankruptcy Law is both rehabilitative and distributive in nature. There are two types of proceedings which may be instituted under the Bankruptcy Law: (1) bankruptcy; and (2) suspension of debt payments.

In bankruptcy, the debtor's assets are liquidated and distributed to creditors based on their respective priorities. Suspension of debt payments provides the debtor with relief against creditors by way of a moratorium to allow the debtor to reorganise and continue its business on terms agreed by the creditors.

Insolvency Procedure

Insolvency procedures in Indonesia are commenced through the Commercial Court by the filing of:

- (1) a bankruptcy petition; and/or
- (2) an application for suspension of debt payments.

If the bankruptcy petition and the application for suspension of debt payments are brought concurrently, the petition for suspension of debt payments must be adjudicated upon first. If the petition for suspension of debt payments is submitted after the bankruptcy petition, in order to be adjudicated upon first, it must be submitted at the first session of the bankruptcy petition examination.

Bankruptcy Petition

The procedure for filing a bankruptcy petition is based on the due date of the unpaid debt. The Commercial Court may declare a debtor bankrupt where it has two or more creditors, has not paid at least one of its debts that have fallen due and those facts can be proven simply.

To prevent a debtor from disposing of its assets and prejudicing the interests of the creditors, the petitioner may file a petition with the Commercial Court to seize all or part of the assets of the debtor. The Commercial Court may also appoint an interim curator to supervise the management of the business of the debtor, the payment of its creditors, and the assignment or encumbrance of the debtor's assets, which in bankruptcy falls under the authority of the curator.

The following persons may submit a bankruptcy petition to the Court:

- the debtor;
- one or more creditors of the debtor;
- the Public Prosecutor, if the matter is of public interest;
- the Bank of Indonesia (i.e. the central bank), in the instance that the debtor is a bank as defined under Indonesian banking law;
- the Indonesian Financial Services Authority, if the debtor is a securities company, stock exchange company, clearing and custodian institution, or settlement and depository institution; and
- the Minister of Finance, if the debtor is an insurance company, a reinsurance company, pension fund or state owned enterprise engaging in a field of public interest (i.e. an enterprise whose entire capital is owned by the state and is not divided by shares).

The creditor must be represented by a lawyer qualified under Indonesian law, unless the petition is filed by the Public Prosecutor, the Bank of Indonesia, the Financial Services Authority, or the Minister of Finance.

The Commercial Court will hand down a decision within 60 days of the petition's registration date. If the Commercial Court accepts the petition, it may declare the debtor bankrupt and appoint a supervisory judge and a curator (receiver). An appeal of the decision by the Commercial Court can be made to the Supreme Court.

If the Commercial Court's decision is appealed, the bankruptcy will continue, with the curator responsible for the management of the company and the settlement of any claims until the Supreme Court hands down its decision. If the bankruptcy

declaration is reversed by the Supreme Court, any actions taken by the curator prior to the notice of cancellation will remain valid and binding upon the debtor.

The curator is required to take all necessary steps to preserve the bankrupt estate and will attend to the realisation of the company's assets, review the creditors' claims, and co-ordinate their acceptance in conjunction with the supervisory judge. It will also attend to the distribution of funds to creditors according to their respective priorities.

The scale of fees for curators is determined by a panel of judges after the bankruptcy has been concluded, and is based on the remuneration guidelines specified by the Ministerial Regulation, which calculation depends on the outcome of the bankruptcy proceedings (i.e. whether the bankruptcy proceedings will result in an agreed settlement and debt restructuring proposal or in liquidation and distribution of assets of the bankrupt debtor). Under the new Ministerial Regulation issued on 3 March 2016, as amended on 31 March 2017, in case the bankruptcy declaration is cancelled by the Supreme Court at the level of cassation or civil review, the fees of the curators must be borne by the petitioner or the petitioner and the debtor on a jointly basis, which proportion will be determined by the court. The Bankruptcy Law imposes personal liability on a curator for any loss to the bankrupt estate caused by the "fault or negligence" of the curator in performing his duties.

Effect of Bankruptcy Declaration

A bankruptcy declaration does not automatically deem that the debtor is insolvent. Under the Bankruptcy Law, a debtor may be declared bankrupt by the Commercial Court if it has two or more creditors and has not paid at least one of its debts that have fallen due. Upon the issuance of a bankruptcy declaration, however, the

debtor forfeits the right to manage its assets. The management and settlement of the bankrupt estate, which includes all assets of the bankrupt debtor together with any assets acquired post-bankruptcy, will be carried out by the appointed curator.

Whilst secured assets are not included in the bankrupt estate, secured creditors are prevented from executing their rights for a maximum period of 90 days from the date of the bankruptcy declaration or upon the bankrupt debtor entering the stage of insolvency, whichever is the earlier.¹ Such a stay does not apply to enforcement of security in the form of cash. The secured creditors can enforce their security by selling the encumbered assets through public auction or they can ask for the assistance of the court.

The curator may temporarily continue to operate the debtor's business subject to approval of the supervisory judge. In doing so, it may borrow funds secured against any of the debtor's unencumbered assets. Any contract entered into by the debtor after the declaration of bankruptcy may not be paid from the assets of the bankrupt estate, unless it is for the estate's benefit. The curator may bring or defend lawsuits concerning the rights and obligations of the debtor.

The curator may enter into new agreements or adopt pre-bankruptcy agreements with third parties, who as a result become creditors of the company with priority to repayment over pre-petition liabilities. The curator may also terminate employment contracts, leases and other agreements. In relation to leases, the curator may only terminate according to the

notice period stipulated in the lease. In the event that advance payments have been made, the lease may not be terminated prior to the expiry of the period covered by the payments. The Bankruptcy Law does not specify a timeframe within which a curator may terminate contracts, although the supervisory judge may determine the timeframe. Losses or damages arising as a result of a curator not adopting a pre-bankruptcy contract are treated as unsecured claims against the bankrupt estate.

Legal proceedings against a debtor will fall by operation of law. Legal action commenced by the debtor prior to the bankruptcy may be adjourned by the defendant in order to afford the curator the chance to consider whether to proceed with the action. The Bankruptcy Law does not specify the timeframe in which a curator must respond to temporary adjournments of legal proceedings.

A secured creditor, namely one who possesses a lien, security interest, mortgage or other collateral right, may enforce its rights during bankruptcy save for during the first 90 days, during which a stay of enforcement of security exists. This stay of proceedings is not applicable to creditors who possess security over cash deposits or the right to set-off debts. Creditors who enforce their security must account to the curator for the balance of any proceeds remaining after payment of the debt, interest and costs of realisation due to the secured creditor.

Creditors' Claims

Within 14 days from the declaration of bankruptcy, the supervisory judge will determine the deadline for the filing of

¹ Note that for certain aircraft objects that are subject to the Convention on International Interests in Mobile Equipment, by virtue of Law No. 1 of 2009 on Aviation and the declarations made by Indonesia in connection with the said Convention, the waiting period is shortened to 60 days.

creditors' claims and the time and place of the creditors' meeting for the verification of such claims. The curator will notify the creditors in writing within five days of the determination of this date. The first creditors' meeting must be held within 30-days from the date of the bankruptcy declaration.

The creditors may also establish a creditors' committee to consult with the curator. The curator is obliged to obtain instructions from the creditors' committee on certain matters, but it is not bound by the advice of the committee. If the curator does not agree with the instructions of the creditors' committee, the creditors' committee may request the supervisory judge to decide the matter.

The creditors' claims must be submitted in writing to the curator, indicating the amount and the nature of the debt, and must be accompanied by evidence substantiating the amount. The curator will determine which claims are acceptable and enter them into a list of acknowledged debts, which will be legally enforceable on bankruptcy. The curator is required to provide copies of the lists of accepted claims and contested claims to the creditors and notify them of the time and place for the debt verification meeting. Creditors have the right to request information from the curator in relation to their claim. The contested claims will be settled in a separate hearing before the court.

Suspension of Debt Payment Procedures

The suspension of debt payments process is a court-supervised rehabilitative mechanism which provides the debtor with time to put forward a settlement and debt restructuring proposal for creditors to consider whilst the debtor is under the protection of a moratorium. Payments to creditors may be suspended for a maximum period of 270 days.

A debtor may also voluntarily apply for a suspension of debt payments, for the purpose of submitting a composition plan that will include an offer of payment to unsecured creditors for all or part of its debts. The petition for the suspension of payments may be filed by:

- the debtor;
- one or more creditors of the debtor;
- the Bank of Indonesia, in the instance that the debtor is a bank as defined by Indonesia's banking laws;
- Indonesia's Financial Services Authority, in the instance that the debtor is a security house, stock exchange company, clearing and custodian institution or settlement and depository institution; or
- the Minister of Finance, in the instance that the debtor is an insurance company, a reinsurance company, pension fund or state owned enterprise engaging in a field of public interest.

Effect of Suspension of Debts

If the debtor files the petition, the court will grant a temporary suspension of debt payments and appoint a supervisory judge and one or more independent administrators, who will, with the debtor's management, jointly manage the debtor's assets. If the petition is filed by a creditor, the court will, within 20 days from the date of filing the petition, or if the petition is filed by a creditor, the court will, within three days from the date of filing the petition, grant temporary suspension of debt payments unless the court deems that the requirements for the declaration of the suspension of payment are not met.

The administrator must immediately announce the decision on the provisional suspension of debt payments in the Official Gazette of the Republic of Indonesia and in at least two daily

newspapers designated by the supervisory judge. The announcement must include an invitation to creditors to attend a court proceeding for the purpose of approving or rejecting the debt settlement plan proposed by the debtor. The creditors' meeting must be conducted within 45 days from the date the temporary suspension of debt payments order was made.

The supervisory judge will chair the meeting and each creditor is entitled to be heard. If the composition plan is attached to the petition for temporary suspension of debt payments, a vote on whether to accept the plan may take place. Alternatively, at the request of the debtor, the creditors will decide whether to grant or refuse a permanent suspension of debt payments with the intention of allowing the debtor, administrator and creditors time to consider and agree to a composition plan at a future meeting. The maximum period for both the temporary and permanent suspension of debt payments together is 270 days. If the creditors decide not to grant a permanent suspension of debt payments, the debtor will be declared bankrupt.

The granting of the permanent suspension of debt payments and extension in which the debtor is required to submit a composition plan requires the approval of: (i) more than half of the unsecured creditors who are present at the hearing and who represent at least two-thirds of unsecured claims; and (ii) more than half of the secured creditors who are in attendance at the hearing and who represent at least two-thirds of secured claims.

The suspension of debt payments gives rise to a moratorium over unsecured claims, as well as a stay of proceedings over any legal actions commenced against the debtor. Debt payments due to secured creditors are not suspended,

however secured creditors and creditors with preferred rights over certain assets of the debtor are subject to a moratorium and stay of proceedings.

The administrator may disclaim contracts entered into by the debtor with third parties prior to the suspension of debt payments. The party contracting with the debtor is obliged to seek confirmation from the administrator as to whether he or she will continue or terminate the contract. A contracting party may submit a claim for damages arising from the termination of a contract which will rank as an unsecured debt.

Once a composition plan has been prepared and presented to the creditors, the creditors will vote on the plan. Adoption of the plan, which is binding on all creditors, requires the approval of: (i) more than half of the unsecured creditors who are present at the hearing and who represent at least two-thirds of unsecured claims; and (ii) more than half of the secured creditors who are in attendance at the hearing and who represent at least two-thirds of secured claims.

According to the Bankruptcy Law, a request to terminate the suspension of debt payments process may be initiated by the supervisory judge, one or more creditors, or the Commercial Court in the following circumstances: (i) the debtor acts in bad faith in operating the business during the suspension of payment process; (ii) the debtor attempts to prejudice the rights of its creditors; (iii) the debtor engages in conduct resulting in new obligations without the administrator's approval; (iv) the debtor fails to perform obligations imposed by the court or the administrator; (v) during the period of suspension of debt payments, the condition of the debtor's business substantially deteriorates to the extent that it is evident that it is not in the interest of creditors for the suspension of debt payments to

continue; or (vi) the condition of the debtor is such that it cannot be expected to satisfy its obligations.

An application for the termination of suspension of debt payments is heard by the court in the presence of the applicant, the debtor (via legal counsel) and its directors. If the debtor makes the application, the administrator, creditors and the debtor's management will be present and arguments will be made for and against the application. If the court terminates the suspension of debt payments process, the debtor is then declared bankrupt.

Director Liability

The Bankruptcy Law contains civil sanctions. If a debtor is declared bankrupt and does not have sufficient assets to satisfy its liabilities, the directors may be held personally liable for any losses unless it can be established that the losses were not directly attributable to their negligence. The breach of any director's duties will also give rise to civil penalties under Indonesian law. Criminal sanctions under the Indonesian Criminal Code may also be imposed on the directors of a bankrupt company. For example, a director may face criminal sanctions if he authorised or permitted the incurring of further obligations at a time when bankruptcy was inevitable.

Guarantees

An Indonesian limited liability company can provide a guarantee subject to obtaining the required corporate approval as set out in the company's articles of association and provided there is also a corporate benefit. A guarantee may be susceptible to challenge if it is granted by a potentially bankrupt company.

Priority

Secured creditors have a priority claim over the proceeds of the sale of any encumbered assets that have been secured in their favour. The priority of claims in descending order is broadly set out as follows:

- court costs of foreclosure of movable and immovable goods, which are to be paid from the proceeds of such foreclosure and enjoy priority over all secured claims and privileged claims pursuant to the Indonesian Civil Code;
- tax liens;
- secured creditors (pledgees, mortgagees, fiduciary transferees and fiduciary assignees);
- creditors holding privileged claims under the Indonesian Civil Code and employee entitlements under the Indonesian Manpower Law; and
- all remaining claims.

Claims denominated in foreign currencies are determined by the prevailing exchange rate on the date of bankruptcy and must be expressed in Indonesian Rupiah.

New Money Lending

The curator is able to borrow funds either on an unsecured basis, or on a secured basis against any unencumbered assets of the debtor.

Cross-Border Insolvency

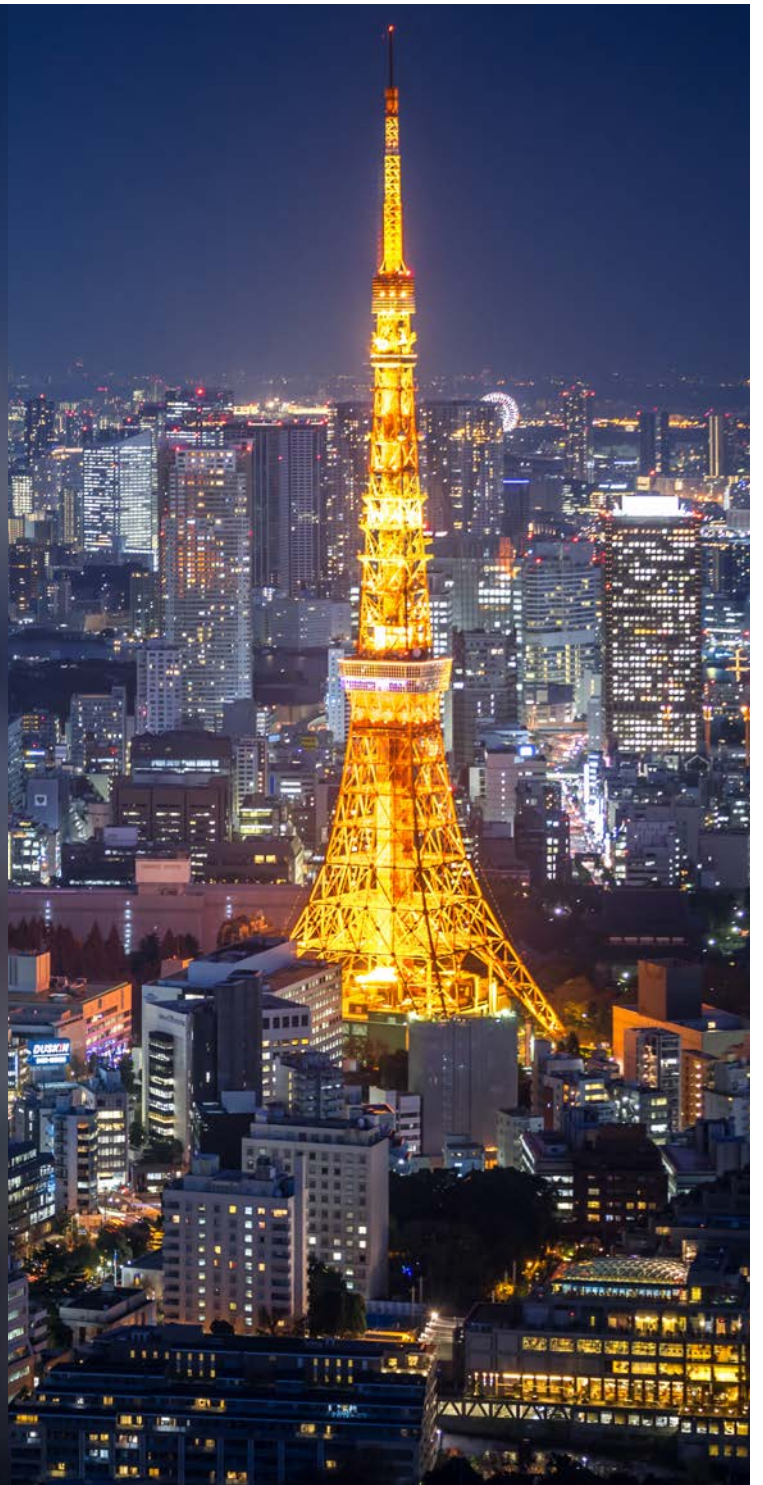
Foreign creditors' claims are recognised on the same basis as the claims of Indonesian creditors. There are no additional

requirements for foreign creditors' claims to be recognised by Indonesian Courts except that, in practice, such claims and their supporting documentation are usually required to be translated into and submitted in Indonesian.

The Bankruptcy Law adopts universal principles with respect to cross-border insolvency issues arising from a bankruptcy in Indonesia, so that local bankruptcy proceedings cover the assets of the debtor located outside Indonesia. However, Indonesian law adopts the territorial effectiveness principle with respect to bankruptcy proceedings commenced in foreign courts. As a result, foreign insolvency decrees, orders or declarations will not be recognised in Indonesian Courts nor

directly impact upon assets of the debtor located in Indonesia. Foreign court judgments with respect to enforcement of a debt or attachment to assets of an Indonesian debtor are not recognised by Indonesian Courts unless provided for by specific treaty arrangements. At present, there are no existing treaties with respect to insolvency laws. The Courts may, however, consider these claims as part of legal action commenced in Indonesian Courts. Foreign debtors who obtain a judgment in a foreign court against an Indonesian debtor will need to commence local proceedings in the Indonesian Courts in order to enforce the judgment against the assets of the Indonesian debtor.

JAPAN



JAPAN

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Key Elements:

- Civil rehabilitation is a debtor-in-possession reorganisation process.
- Debtor-in-possession financing available in certain circumstances.
- Injunction available to stay proceedings.

Introduction

This section provides a general outline of the main corporate insolvency procedures in Japan. Under Japanese insolvency law, there are four types of statutory proceedings. These are divided into procedures for the reorganisation and rehabilitation of the debtor, and terminal proceedings that end in the liquidation of a corporation.

Procedures for the liquidation of companies:

- (1) Bankruptcy (*hasan*) is a proceeding of last resort for a debtor under the Bankruptcy Act (*hasan ho*), whether as an original proceeding or as a consequence of the failure of corporate reorganisation, civil rehabilitation or special liquidation. This procedure aims to completely dissolve the insolvent business, liquidate the debtor's assets and distribute the realised cash to creditors on a *pro rata* basis.
- (2) Special liquidation (*tokubetsu seisan*) is a corporate liquidation procedure under the Companies Act (*kaisha ho*). This procedure is used when a special resolution of a shareholders' meeting has been passed to dissolve a company that is suspected to have excessive debts.

Procedures governing reorganisation/rehabilitation:

- (1) Corporate reorganisation (*kaisha kosei*) under the Corporate Reorganisation Act (*kaisha kosei hou*) is intended to be used for the rehabilitation of large corporate debtors and contains some significant limitations on the rights of creditors. Its purpose is to maintain and reorganise the debtor's business by (i) changing the company's structure, and (ii) restricting the rights of both secured and unsecured creditors against the debtor.
- (2) Civil rehabilitation (*minji saisei*) aims to implement fair, orderly and efficient proceedings for the rehabilitation of corporate debtors and individuals. This option has been available since 1 April 2000 under the Civil Rehabilitation Act (*minji saisei hou*), which replaces the now defunct Composition Act (*wagi hou*).

The Act on Recognition of and Assistance for Foreign Insolvency Proceedings (*gaikoku tosan shori tetsuduki no shonin enjo ni kansuru horitsu*) provides procedures for dealing with foreign court insolvency proceedings of multi-national enterprises.

In addition to the above, a non-statutory voluntary arrangement (*nin-i seiri*) is commonly used for the liquidation/dissolution or rehabilitation of insolvent companies.

Bankruptcy (*hasan*)

All types of companies and individuals (including foreign companies and individuals) may be the subject of bankruptcy proceedings. The proceedings apply to the debtor's assets located both inside and outside Japan (in the case of assets outside Japan, the recognition of Japanese insolvency

proceedings in the foreign country is required). The Bankruptcy Act is applicable to a foreign company, so long as the foreign company has a business office, other office or assets in Japan. In relation to this point, claims which may be enforced by courts in Japan are deemed to be located in Japan.

If a company (a) is unable to meet its payment obligations as they fall due (*shiharai funou*), (b) suspends payment of its debt (*shiharai teishi*) (unless there is evidence that the company is able to meet its payment obligations), or (c) has total liabilities that exceed the value of its assets (*saimu choka*), a petition for bankruptcy can be filed by: (i) any of the company's creditors; (ii) any of the company's directors (in case the debtor is a joint-stock company (*kabushiki kaisha*; "KK")); or (iii) the company itself.

Following the submission of a petition, the court will consider whether there are sufficient grounds for bankruptcy. If the debtor files a petition for bankruptcy, the court will generally require a lower standard of proof than if the petition was lodged by a creditor.

Under Japanese law, the filing of the petition for bankruptcy itself does not cause an automatic stay to be imposed. Therefore, there is a risk period between the time of filing the bankruptcy petition and the making of the commencement order. In order to protect the debtor's estate, the petitioner usually files an injunction at the same time that it files the bankruptcy petition to avoid the situation where creditors rush to the debtor to demand payment, obtain security, or repossess goods by cancelling sales and so forth. The injunction typically contains a prohibition against the disposition of the debtor's assets, and a prohibition against collection and payment of pre-injunction debts. Such payments of pre-injunction debts are null and void if the creditor was aware of the injunction at the time of

the payment. Therefore, the debtor should give notice of the injunction to all creditors that are likely to make final efforts to collect or improve the position of their claims.

With the commencement of bankruptcy proceedings, a bankruptcy trustee (*hasan kanzainin*) is appointed by the court, usually from among practising attorneys. The bankruptcy trustee has the power to manage and dispose of the property in the bankrupt estate (*hasan zaidan*). The bankruptcy trustee's role is to ensure fair treatment of creditors including the right of avoidance, the right of separation and the right to set-off. Assets that belong to the bankrupt estate will be liquidated by the bankruptcy trustee with the permission of the court and distributed to creditors.

Right of Separation (*betsujo ken*)

Secured creditors retain the right to enforce their security interest without complying with the general procedures of the bankrupt estate. However, it is common for the bankruptcy trustee and a secured creditor to co-operate in order to sell secured assets voluntarily. In addition, there is a system allowing the bankruptcy trustee to petition the court to discharge such security interests through the voluntary sale of secured assets when it would benefit the interests of creditors generally and would not unreasonably harm the affected secured creditors' interests. The secured creditor may recover its claim from the sale proceeds of the secured assets paid to the court in accordance with the priority of the security interest, but a portion of the proceeds of the sale may be paid to the bankrupt estate at the request of the bankruptcy trustee. The secured creditor may challenge the petition to dispose of the security interest, and is entitled either: (i) to declare that the creditor itself or some other party will purchase the property for an amount resulting in proceeds of 105% or more; or (ii) to foreclose the security interest.

Right to Set-Off (*sousai ken*)

A creditor who also owes a debt to the debtor at the time of commencement of the bankruptcy proceedings is entitled to set-off such debt against its claim.

However, claims obtained by a creditor against the debtor arising after commencement of the bankruptcy proceedings may not be set-off against existing debts owed to the debtor by the creditor.

Priority of claims

The claims in bankruptcy proceedings are broadly prioritised as follows:

1. Superior obligations (*zaidan saiken*) – superior obligations have priority over claims of unsecured creditors and may be paid outside bankruptcy proceedings, and include the costs and expenses incurred in the course of the administration of the bankrupt estate, pre-commencement order taxes, unpaid salary that accrued within three months prior to the commencement of bankruptcy and severance pay equivalent to three months' salary;
2. Priority bankruptcy claims (*yusenteki hasan saiken*) – unpaid salary, bonus and severance pay;
3. Ordinary bankruptcy claims (*ippan hasan saiken*) – claims arising from any cause before the date of commencement of bankruptcy proceedings, e.g. trade claims and other claims without priority;
4. Subordinated bankruptcy claims (*retsugoteki hasan saiken*) – interest, default interest and penalties that accrue after the bankruptcy proceedings commence; and

5. Contractually subordinated bankruptcy claims (*yakujo retsugo hasan saiken*) – claims which were agreed to be subordinated to the above subordinated bankruptcy claims.

After the creditors have submitted their claims, they will be examined by the bankruptcy trustee and other creditors. At the claims hearing, which is held by the court when necessary, the bankruptcy trustee will admit or reject certain claims. The hearing will then continue with respect to claims that are not admitted or rejected. Creditors may also raise objections to other creditors' claims. Creditors whose claims are rejected may appeal against the bankruptcy trustee's decision.

The court may hold a creditors' meeting at its discretion. At the creditors' meeting, the bankruptcy trustee will report to the creditors the causes and background of the bankruptcy, the past and present status of the debtor and the estate, and other matters. Creditors may appoint at least three and up to ten representatives to form a creditors' committee (*saikensha iinkai*) to represent the creditors' views in court or to the bankruptcy trustee.

Finally, when the assets of the bankrupt estate have been liquidated into a sufficient amount of cash for distribution, the creditors will be paid according to their respective priorities. A secured creditor, who retains access to the secured assets, is excluded from the distribution unless it proves that the claim amount became unsecured after the bankruptcy proceedings commenced, or proves the amount of deficiency after foreclosure on the secured assets.

Special Liquidation (*tokubetsu seisan*)

This procedure is only available for KKs. It is quicker than a bankruptcy proceeding and can avoid a company being declared bankrupt. It also distributes the company's remaining assets to its creditors and shareholders in an expeditious and flexible manner. This procedure is often used by parent companies to liquidate loss-making subsidiaries.

In order for special liquidation to take place, the company must first pass a resolution for the dissolution (*kaisan*) of the company at a shareholders' meeting, where the majority of issued and outstanding shares are represented. The resolution must be supported by two-thirds or more of the votes of the shares represented. Upon the passing of the resolution for dissolution, the liquidation proceedings (*seisan tetsuzuki*) will commence and the company will have a liquidator (*seisan nin*) appointed. The liquidator is required to make a public announcement, without delay, requesting creditors to report their respective claims to the liquidator within a given period (at least two months). The same request will be mailed to creditors already known to the company.

If it is suspected that the company's liabilities exceed its assets, the liquidator is required to file with the court a petition for special liquidation. Creditors, statutory auditors and shareholders may also petition for special liquidation. An injunction may also be requested by the petitioner at the same time in order to preserve the assets during the interim period between the filing of the petition and the issuance of a commencement order.

The court shall make an order to commence special liquidation if: (i) there are circumstances that would seriously impede the liquidation of the company (such as a large number of creditors

or extremely complex rights and obligations involved), or there is a suspicion that liabilities exceed assets; and (ii) there is a possibility of the successful termination of the proceedings through confirmation of the plan for distribution or independent settlement with all the creditors. Under the special liquidation procedure, the following are suspended and no further proceedings can be commenced: (i) compulsory execution proceedings and orders; (ii) provisional injunctions; and (iii) provisional attachment orders. The court may also suspend any bankruptcy proceedings which may be pending.

Upon issuance of the commencement order, the liquidator becomes the special liquidator who will be responsible for conducting the special liquidation procedure for the benefit of the company, creditors and shareholders. Upon issuance of the commencement order, the special liquidator disposes of the company's assets and collects its receivables, and submits to the court an agreement (*kyotei*) for distribution of the estate to creditors and shareholders under the court's supervision.

Secured creditors have the right to enforce their security interests outside the special liquidation proceedings (*betsujo ken*). There is no proof of claim proceedings, and the right of avoidance does not apply. Creditors' rights to set off debts obtained after the commencement of the proceedings, which are provided under the Civil Code (*min pou*) of Japan, may be restricted under this procedure.

After the preparation of a list of properties, following issuance of the commencement order, a creditors' meeting is convened for the purpose of explaining the company's current status and the procedures for special liquidation. The company may submit an agreement to the creditors' meeting or settle with each of the creditors to liquidate the company's assets and distribute them to such creditors. The agreement submitted to the creditors'

meeting is required to give all creditors substantially equal treatment. The requirement for distribution according to priorities is applied more flexibly than in a bankruptcy scenario. Secured creditors can join the unsecured creditors, or, in principle, enforce their security interest outside the special liquidation proceedings. The agreement should also treat the remaining liabilities as forgiven so that the balance sheet of the corporation shows no deficit.

The agreement must be approved at a creditors' meeting by the majority of creditors present and by creditors with aggregate claims of two-thirds or more of the total debt owed by the company. If the agreement is not approved, then bankruptcy proceedings will commence at the court's discretion.

Once the agreement is approved by the prescribed majority at a creditors' meeting and by the court, it becomes binding on all unsecured and consenting secured creditors. In principle, the agreement can treat certain creditors preferentially, but in practice, this will make it difficult for the agreement to be approved. If the agreement is not approved by creditors, the court may declare the company bankrupt. Bankruptcy procedures will then apply.

When the agreement is fully performed, or when the liabilities of the company no longer exceed the value of its assets, the court will order termination of the proceedings and the company will cease to exist.

Corporate Reorganisation (*kaisha kosei*)

The corporate reorganisation process is only available to KKs and to foreign companies of a similar nature with a business office in Japan, where (a) a company is unable to pay its debts as they fall due without causing serious difficulties in continuing

business; or (b) events may occur that could cause bankruptcy. The corporate reorganisation procedures apply to all company assets located inside and outside Japan (in the case of assets outside Japan, the recognition of Japanese insolvency proceedings in a foreign country would be required). This procedure is usually only suitable for large companies due to the high cost and length of time required for its implementation. Accordingly, it is less frequently utilised than the civil rehabilitation procedure.

The following parties can make an application to the court for corporate reorganisation: (i) the company itself; (ii) (in the case of (a) above only) creditors (whether secured or unsecured) having a claim equal to not less than one-tenth of the amount of the share capital of the company; or (iii) (in the case of (a) above only) shareholders with 10% or more of the voting rights of voting shares in the company.

After an application has been made, the court will consider whether it is apparent that a reorganisation plan for the continuation of the business is unlikely to be prepared, adopted or approved. As corporate reorganisation is mainly used for large companies, usually, it takes one month from the application to the grant of the order for the commencement of corporate reorganisation proceeding. In the meantime, the court usually issues certain orders (*hozen kanri meirei*) to preserve the assets of the company and will appoint a preservative administrator (*hozen kanrinin*) to manage the business and assets of the company.

If the court finds probable grounds that the statutory requirements for the corporate reorganisation of the company are satisfied, it may order the commencement of the reorganisation. Upon such order, the court typically appoints

two trustees (*kanzainin*): one lawyer and one businessperson. The trustees are vested with the exclusive rights to manage and control the business and assets of the company.

The trustees may elect to rescind contracts which remain to be performed or request performance by the other party in return for due performance by the company.

Secured creditors may enforce their security interest only in accordance with the reorganisation proceedings and reorganisation plan. However, certain preferential claims (*kyoei saiken*) may be paid outside the reorganisation proceedings and have priority over other creditors. Rights of set-off (*sousai ken*) can be exercised until the deadline for submission of creditors' claims, after which set-off is prohibited.

DIP (debtor-in-possession) type corporate reorganisation

There is another type of reorganisation process where a trustee (*kanzainin*) may be appointed from any member of the management of the reorganising company (so-called "DIP type corporate reorganisation"). Although they are not provided in law, there are four requirements (i) the managers of the reorganising company have never conducted any illegal activities (i.e., fraudulent activities etc.) which caused any damage to the reorganising company or a third party; (ii) no objection is made by the major creditors in respect of the managers to participate in the reorganisation proceedings; (iii) the sponsor (if any) approves the managers' involvement in the reorganisation proceedings; and (iv) any circumstance where the managers' involvement may jeopardise the proper implementation of the proceedings is not recognised) which the Tokyo District Court established have to be met in practice in order to implement the DIP type corporate reorganisation.

In the DIP type corporate reorganisation, the court does not appoint a preservative administrator (*hozen kanrinin*) but rather issues a supervising order to appoint a supervisor (*kantoku iin*) and an investigation order to appoint an investigator (*chosa iin*). Once the court has made the Reorganisation Order, it will appoint a trustee (*kanzainin*).

Priority of claims

The claims in corporate reorganisation proceedings are broadly prioritised as follows:

1. Superior obligations (*kyoei saiken*) – superior obligations have priority over other claims and may be paid outside reorganisation proceedings, and include the costs and expenses incurred in the course of administration of reorganisation proceedings, pre-commencement order taxes, unpaid salaries that have accrued within six months prior to the commencement of corporate reorganisation proceedings and severance pay principally equivalent to six months' salary;
2. Secured reorganisation claims (*kousei tanpoken*) – claims secured by certain security interests existing at the commencement of the reorganisation proceedings, which arise from a cause that has occurred before such commencement or fall under specific categories;
3. Priority reorganisation claims (*yusenteki kousei saiken*) – unpaid salaries, bonuses and severance pay;
4. Ordinary reorganisation claims (*jippan kousei saiken*) – claims arising from any cause before the date of commencement of reorganisation proceedings, which will be paid in accordance with the reorganisation plan, e.g. trade claims and other claims without priority;

5. Contractually subordinated reorganisation claims (*yakujo retsugo kousei saiken*) – claims which were agreed to be subordinated to subordinated bankruptcy claims, if bankruptcy proceedings were commenced, and are treated as subordinated to the above ordinary reorganisation claims; and
6. Post-commencement claims (*kaishigo saiken*) – claims arising from a cause that occurs after the commencement of reorganisation proceedings (excluding the claims above), which cannot be paid until the payment period specified in a reorganisation plan expires.

The trustees prepare a reorganisation plan and submit it to the court for approval. However, the company, shareholders and creditors who filed a claim may also submit plans. The reorganisation plan may include rescheduling of the company's repayments, reduction or loss of shareholders' capital and a list of secured and unsecured creditors waiving part of their claims. Classes of creditors and shareholders vote on the reorganisation plan in a stakeholders' meeting, and each class has different majority requirements as set out below.

(a) Unsecured creditors

The reorganisation plan shall be approved by unsecured creditors having voting rights (measured by the amount of the claim) equal to more than half of the overall voting rights of the unsecured creditors.

(b) Secured creditors

- (i) Any grace period in respect of the payment of secured claims shall be approved by secured creditors having voting rights of not less than two-thirds of the overall voting rights of the secured creditors;

- (ii) any change in security interests other than (i) above shall be approved by secured creditors having voting rights of not less than three-quarters of the overall voting rights of the secured creditors; and
- (iii) cessation of the entire business of the company shall be approved by secured creditors having voting rights of not less than nine-tenths of the overall voting rights of the secured creditors.

For the purposes of paragraphs (i) through (iii) above, the voting entitlement of a secured creditor is the lower of (x) the amount of that secured creditor's claim or (y) the market value of the assets securing that claim as of the date of commencement of the proceedings.

(c) Shareholders

The reorganisation plan shall be approved by shareholders having rights equal to more than half of the total voting rights of the shareholders.

Once the plan is approved by creditors or shareholders, the court will also decide whether or not to approve the plan. If no plan is approved, the court may declare the company bankrupt or allow the company to apply for civil rehabilitation. Bankruptcy or civil rehabilitation procedures will then apply.

Civil Rehabilitation (*minji saisei*)

Civil rehabilitation is Japan's general debtor-in-possession reorganisation procedure and is broadly similar to the US Chapter 11 proceedings. All types of companies (including foreign companies with a place of business or assets in Japan) and individuals (including foreigners with connections with

Japan) are eligible. The civil rehabilitation procedure was introduced primarily for small and medium-sized companies, since the corporate reorganisation procedure is available to larger companies. However, a significant number of large companies have also used the civil rehabilitation procedure for the reasons outlined above.

If a company (a) considers that events may occur which could cause bankruptcy, or (b) appears to be unable, without causing material difficulty to its ongoing business, to pay its debts as they fall due, the company itself or (in the case of (a) only) the creditors may make an application to the court for civil rehabilitation. There is no minimum requirement with regard to the amount of the creditors' claim.

Filing for civil rehabilitation does not have the effect of an automatic stay. In order to preserve the assets of the debtor during the period between the filing of a petition for the civil rehabilitation proceedings and the commencement of the proceedings the debtor, or a creditor, may file a petition for an injunction. The court may also issue an injunction on its own accord, even without any petition for an injunction being filed.

Meanwhile, the court usually appoints a supervisor (*kantoku iin*) who supervises the rehabilitation process and considers the financial and business status of the company to assist the court in determining whether it is capable of rehabilitation. Once the court is persuaded that the requirements for commencement of civil rehabilitation proceedings have been met, the court will order the commencement of the proceedings unless certain events exist which persuade the court otherwise (e.g., it is clear that a civil rehabilitation plan cannot be formulated or approved by creditors, or confirmed by the court or where the filing was made for unfair purposes or otherwise lacked good faith). After the commencement, provisional injunctions, all compulsory

execution proceedings and orders, provisional attachments and other specified procedures are suspended.

In civil rehabilitation proceedings, the debtor may continue to operate its business even after commencement of proceedings, but the usual practice is for a supervisor to be appointed. Only a supervisor with specific avoidance authority or a trustee can exercise rights of avoidance. The supervisor may also rescind bilateral contracts or request performance by the other party of its obligations in return for due performance by the company.

However, if the court considers that the management of the debtor's assets is inappropriate or that it is necessary for the rehabilitation of the debtor's business, the court may appoint a provisional administrator (*chosa iin*) or trustee (*kanzainin*) to manage the business and assets in certain circumstances (and the debtor will cease the day-to-day management of the company).

Right of separation (*betsujo ken*)

Secured creditors have, in principle, the right to enforce their security interest outside the proceedings. However, the court has the power to discharge a security interest where the secured assets are indispensable for the continuation of the debtor's business. In such a case, the company may be freed of the secured rights by depositing an amount of money equivalent to the fair value of the collateralised assets with the court, if it finds that the assets are necessary to rehabilitate the company.

Right to set-off (*sousai ken*)

Creditors' rights to set off debts created in good faith, which are provided under the Civil Code of Japan, may be restricted under this procedure.

Priority of claims

The claims in civil rehabilitation proceedings are broadly prioritised as follows:

1. Superior obligations (*kyoei saiken*) – superior obligations have priority over claims of unsecured creditors and may be paid outside rehabilitation proceedings, and include the costs and expenses incurred in the course of administration of rehabilitation proceedings, any claim of a counterparty arising from borrowings or any other contract made (i) by the debtor after the commencement of rehabilitation proceedings; or (ii) by the preservative administrator (*hozen kanrinin*) or the debtor upon obtaining the court's permission, before the commencement of rehabilitation proceedings;
2. Ordinary priority claims (*ippan yusen saiken*) – ordinary priority claims have priority over claims of unsecured creditors and may be paid outside rehabilitation proceedings, and include taxes, unpaid salaries, bonuses and severance pay;
3. Rehabilitation claims (*saisei saiken*) - claims arising from any cause before the date of commencement of rehabilitation proceedings, which will be paid in accordance with the rehabilitation plan, e.g. trade claims and other claims without priority;
4. Contractually subordinated rehabilitation claims (*yakujo retsugo saisei saiken*) – claims which were agreed to be subordinated to subordinated bankruptcy claims, if bankruptcy proceedings were commenced, and are treated as subordinated to the above ordinary rehabilitation claims; and
5. Post-commencement claims (*kaishigo saiken*) – claims arising from a cause that occurs after the commencement of rehabilitation proceedings (excluding the claims above),

which cannot be paid until the payment period specified in a rehabilitation plan expires.

The debtor and its creditors may propose rehabilitation plans. Such plans may include: (i) rescheduling the company's repayments; (ii) reduction or loss of shareholders' capital; and (iii) a list of secured and unsecured creditors prepared to waive part of their claims.

For a plan to be approved, the consent of one-half or more in number and value of creditors present or represented at the creditors' meeting, or voting by ballot, is required. Once the plan is approved by creditors and the court, the rights of unsecured creditors are altered according to the plan. If a plan cannot be approved or an approved plan turns out not to be feasible during the rehabilitation process, the court may declare the company bankrupt and bankruptcy proceedings will begin.

The Civil Rehabilitation Act has been effective since 1 April 2000. It generally conforms to recent international practice to allow extra-territorial authority for liquidators or bankruptcy administrators. The law defines the rights of foreign liquidators or bankruptcy administrators who are entitled to make an application to the court for civil rehabilitation, attend creditors' meetings, and to express their views at court and/or creditor meetings.

Right of Avoidance (*hinin ken*)

Under bankruptcy proceedings, the bankruptcy trustee can avoid certain transactions such as the following acts with the hardening periods and burdens of proof described below:

- (i) an act which the debtor conducted knowing it would harm creditors, if the bankruptcy trustee proves the same (unless the counterparty proves it was unaware of such harm);

- (ii) gratis acts which the debtor conducted after or within six months before its suspension of payments generally or the application for the commencement of bankruptcy proceedings, if the bankruptcy trustee proves the same; and
- (iii) the creation of security interests for pre-existing debts or other acts for discharging pre-existing debts, which the debtor conducted after it became unable to pay its debts as they fell due or the application for the commencement of bankruptcy proceedings, if the counterparty knew about (a) the debtor's suspension of payments generally or its inability to pay, or (b) the application for the commencement of bankruptcy proceedings, if the bankruptcy trustee proves the same.

The above right of avoidance expires upon the earlier of a statutory limitation of two years from the commencement of bankruptcy proceedings, or 20 years from the relevant act.

The right of avoidance under corporate reorganisation and civil rehabilitation is almost the same as described above for bankruptcy proceedings. However, under special liquidation, there is no right similar to the right of avoidance described above.

Other Procedures

Special mediation (*tokutei chotei*)

Special mediation aims to provide debt relief to potentially insolvent debtors through civil mediation (*minji chotei*) proceedings to achieve an agreement between the debtor and each individual creditor, under the court's supervision. This is mainly used by individuals and small companies.

Director Liability

The debtor's directors or officers who have breached their obligation to act as "good managers" or their fiduciary duty shall be jointly and severally liable to indemnify the debtor for any loss which may be incurred by the company. The trustee (in the case of bankruptcy or corporate reorganisation proceedings) or the debtor (in the case of civil rehabilitation or special liquidation proceedings) may petition for the assessment of such liability through a special procedure, or bring ordinary proceedings to seek damages against the directors or officers.

Lender Liability

There is no statute specifically providing for lender's liability. Although the lender's liability issue has been discussed as a general law matter, e.g. a tort, there is presently no established theory on this point.

Guarantees

There is no law against the provision of financial assistance in Japan. A borrower may receive an upstream guarantee from its Japanese subsidiaries if the Japanese subsidiaries are directly or indirectly wholly-owned subsidiaries of the borrower. There is also no restriction on a downstream guarantee, provided there is some corporate benefit for the parent company.

New Money Lending

If a preservation order has been issued by the court after an application for corporate reorganisation or civil rehabilitation proceedings has been made, the debtor company cannot borrow working capital or other money unless the court grants a special exemption to do so. Debtor in possession (DIP) finance is provided by financial institutions upon obtaining an exemption from the court. Furthermore, for the purpose of securing

DIP finance, debts arising under DIP finance are given priority over the debts of other unsecured creditors. For corporate reorganisation proceedings, this also applies to secured creditors. For civil rehabilitation proceedings, however, debts under DIP finance do not have priority over secured creditors in respect of the secured assets.

Cross-Border Insolvency

As part of the Japanese insolvency law, a legal framework exists with regard to cross-border insolvency, modelled on the UNCITRAL Model Law on Cross-Border Insolvency. The legal framework has been established by the enactment of, amongst others, the Act on Recognition of and Assistance for Foreign Insolvency Proceedings (“ARAF”)

Under the ARAF, a foreign trustee who has the power to manage the business and assets of the debtor in any foreign jurisdiction (*gaikoku kanzainin*) is not granted any right or privilege by him/her merely obtaining recognition of the foreign proceedings in Japan. The foreign trustee must file a petition for appropriate assistance on a case-by-case basis, and obtain a court order for such assistance. The court will hand down a recognition order if it is convinced that the foreign insolvency proceedings meet the necessary requirements for assistance in Japan (e.g. the debtor’s address, residence, or business or other office exists in the country where the relevant foreign insolvency proceedings are pending, the commencement of the foreign insolvency proceedings have been formally ordered and where it is not clear that assistance is unnecessary under ARAF for the foreign insolvency proceedings).

Pursuant to a recognition order, various orders will be handed down according to necessity. Examples of orders are: (i) a temporary suspension order against a compulsory execution

proceeding, provisional attachment, other injunction, lawsuit or administrative proceeding, with regard to the company’s assets in Japan; (ii) an injunction prohibiting the debtor from disposing of assets and making payments; and (iii) other orders that the court deems appropriate.

The court may order that the foreign trustee is required to obtain the court’s approval for any disposition or outbound delivery of the debtor’s assets located within Japan in order to protect creditors in Japan.

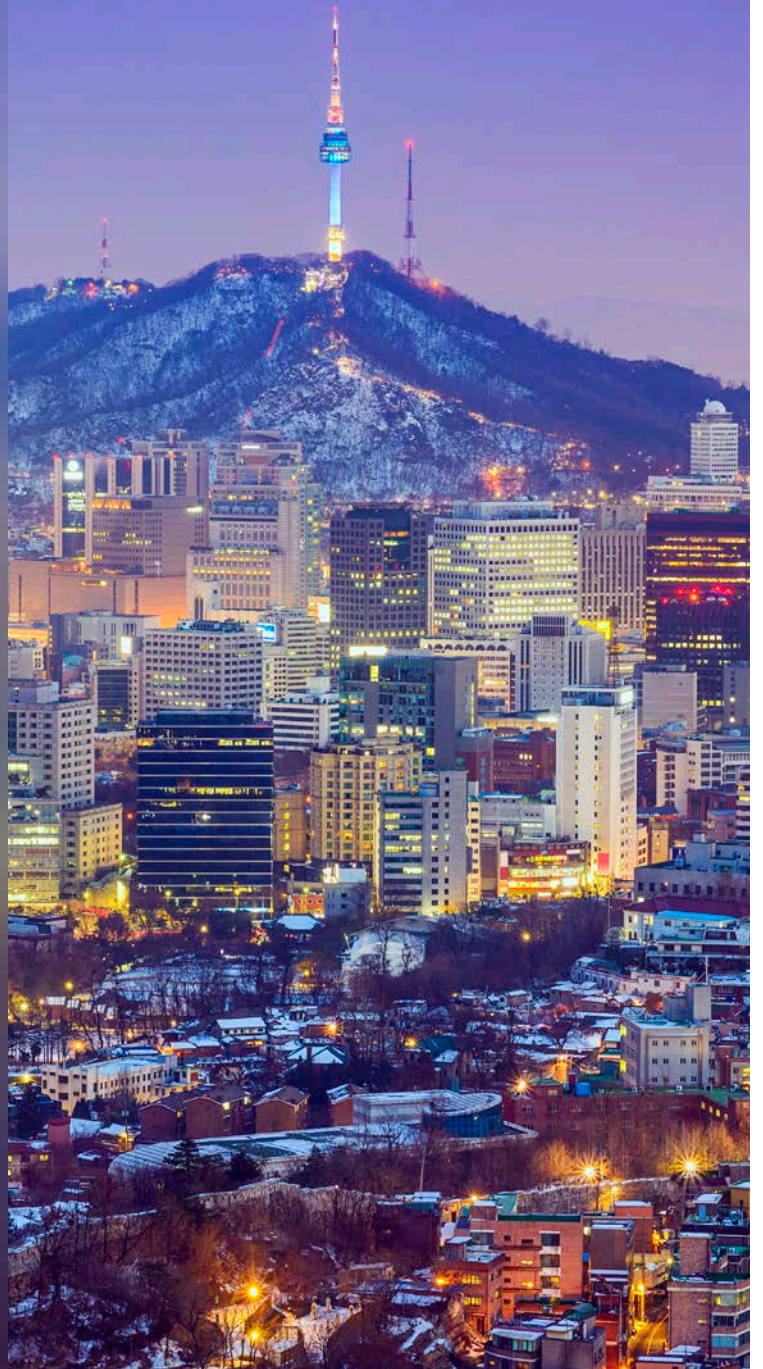
A foreign trustee will lose its power to manage the business and assets of the debtor where the foreign insolvency proceedings are terminated or where the requirements for recognition of foreign insolvency proceedings are no longer met.

On the other hand, under the Japanese insolvency laws, bankruptcy proceedings and the authority of a provisional trustee and trustee extend to the company’s assets outside Japan.

In addition, the Japanese insolvency law also implements the “hotchpot rule” – any recovery of a creditor, obtained by the exercise of its rights, from the debtor’s assets located outside Japan shall be credited against payment under the proceedings in Japan.

Under the Civil Rehabilitation Act, the Japanese court has jurisdiction over an insolvency proceeding, so long as the debtor has its address, offices, business or assets within Japan. The Civil Rehabilitation Act has also abandoned the mutuality principle. The revised bankruptcy law provides equal treatment to foreign parties regardless of whether the foreign party’s home country provides reciprocal recognition of insolvency proceedings initiated in Japan.

SOUTH KOREA



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Key Elements:

- Rehabilitation procedure focuses on company rescue.
- Moratorium available.
- Onerous treatment of related transactions.
- Management may retain degree of control in rehabilitation.
- Out of court procedures available.

Introduction

This section is designed to provide a general outline of the main corporate insolvency procedures available in Korea. Insolvency proceedings in Korea are governed by the Debtor Rehabilitation and Bankruptcy Act (“DRBA”), which came into force in April 2006. The DRBA is also referred to as the “Consolidated Insolvency Act”; because it consolidates the Corporate Reorganization Act, the Composition Act, the Bankruptcy Act and the Act on the Rehabilitation of Individual Debtors.

The DRBA provides for two corporate insolvency procedures, namely rehabilitation and bankruptcy. Rehabilitation is designed to rehabilitate the debtor with creditor consent by providing debt reductions and/or grace periods for the payment of debts. This occurs by operation of protective measures under the supervision of the court. Bankruptcy, on the other hand, seeks to regulate the liquidation of the debtor and the fair distribution of the debtor’s liquidated assets.

We also briefly consider out-of-court insolvency procedures; namely the private workout arrangements for Korean financial institutions, and the statutory workout arrangement under the Corporate Restructuring Promotion Act (“CRPA”). The ambit of this section is limited to insolvency procedures applicable to corporate entities, and does not extend to the insolvency of individuals.

Rehabilitation

The rehabilitation procedure under the DRBA allows for streamlined and expeditious corporate restructuring under court supervision. The main steps under the rehabilitation proceeding are discussed below.

Filing of application

An application for corporate rehabilitation may be filed in the following circumstances:

1. a company is unable to pay its debts when they fall due (unless restructuring of debt is not possible, in which case, it may be more appropriate for the company to go into bankruptcy);
2. there is a legitimate fear that a company will be insolvent (suspension of payment is deemed as insolvency); or
3. there is a legitimate fear that the total debts of the company will exceed its total assets.

Companies typically file for corporate rehabilitation on a voluntary basis. Creditors with claims equal to at least 10% of the debtor’s total paid-in capital, or shareholders owning at least

10% of the total issued and outstanding shares are also permitted to file for corporate rehabilitation.

Stay order

The filing for corporate rehabilitation in Korea does not itself trigger the official commencement of corporate rehabilitation proceedings. The DRBA provides for an interim period between the filing of the application and the official commencement of the proceedings, where the company's assets are "preserved" for rehabilitation and distribution under the rehabilitation plan.

The court must decide whether to grant a stay order within seven days of filing the application. This order generally prohibits the debtor from taking certain steps or actions without the approval of the court, including repaying debts, disposing of property, or obtaining new loans. In certain exceptional cases, the court will appoint one or more interim receiver(s) to manage the debtor during the preservation period.

The commencement order is issued within one month of the filing of an application for rehabilitation proceedings. In practice, therefore, in the absence of any issue with the integrity of the debtor's existing management, there is generally no need to appoint an interim receiver.

The court may also, at its discretion or by application of an interested party, issue a comprehensive stay order. This will bar creditors from enforcing their claims in respect of the debtor's assets through compulsory execution, preliminary attachment or preliminary injunction. This order will become effective upon service of the order on the debtor.

Official commencement of rehabilitation proceedings

The court is required to decide whether to commence rehabilitation proceedings within one month from the date of

filing for corporate rehabilitation. On the commencement of corporate rehabilitation, the court will appoint one or more receivers, or replace any interim receiver with one or more permanent receivers. Authority to manage the business operations and assets of the debtor shall vest in the permanent receiver, subject only to the court's supervision.

Generally, the representative directors of the company are appointed as receivers in the absence of any "cause for insolvency" attributable to such representative directors. A "cause for insolvency" generally does not stem from poor commercial decisions. Should a poor commercial decision, however, made by a representative director cause the financial condition of the debtor to deteriorate significantly, the court may decide not to appoint such representative director as the receiver.

The court will select the receiver from a pool of qualified candidates (comprised of professional business managers and officers) who have undertaken special training recognised by the court office.

Since a creditor is an interested party, the court will generally avoid the appointment of a candidate recommended by a creditor. The court may also abstain from the decision to appoint a receiver, and instead permit the representative director of the debtor to undertake the role. In practice, Korean courts tend to avoid the appointment of a receiver for large corporations. This leads to increased corporate autonomy for the debtor companies that are subject to rehabilitation proceedings, because shareholders and directors may at any time resolve to reallocate the role.

Examination of financial status of company

On the commencement of corporate rehabilitation, the court will appoint an examiner (normally an accounting firm or a credit rating agency) to examine and submit a report on, amongst

other matters, the debtor's liquidation value and the going-concern value of its business, as well as the status of total assets and its debt repayment capability.

If the court determines (based primarily on the findings of the examiner's report) that the going-concern value of the business is higher than its liquidation value, it will order the receiver and allow other interested parties to submit a rehabilitation plan. Interested parties include any legal person that has reported to the court; such as the debtor itself, its shareholders, and its secured and unsecured pre-rehabilitation creditors. The examiner will in turn conduct a feasibility review on the draft rehabilitation plan, and report whether the plan will guarantee the liquidation value in the interest of the creditors. If it finds, based on the examiner's reports, that the going-concern value is less than the liquidation value of the business of the debtor, by application of the debtor or any interested party above, the court will order the termination of the corporate rehabilitation proceedings and may subsequently order the commencement of liquidation proceedings against the debtor.

Filing of claims and examination

Any creditor, secured or unsecured, that seeks repayment must file a report and proof of its claim with the court within a fixed time period. The DRBA provides that the receiver shall make and submit a list of the secured and unsecured pre-rehabilitation creditors. If a creditor is listed, the creditor shall be regarded as having reported its claims. The date of submission must be scheduled by the receiver between two weeks to two months from the official commencement date. Failure to report claims within the specified period will generally discharge the debtor from its obligations in this respect. The creditor must file all information and documents giving rise to the underlying claim in a court-prescribed form. This includes the claim amount, whether the claim is secured, whether legal proceedings have

been commenced in relation to such claim, whether there is a legal preferential right (such as a tax claim) granted in respect of the creditor's claim, and any other material information.

Interested parties, such as the receiver, debtor and other creditors, may examine and object to each claim filed during the prescribed period. The examination will only look to whether the claim exists. Other matters, such as the seniority of the claim (or whether a claim should be equitably subordinated), are subject to later review. If a claim is denied, it will be excluded from the rehabilitation plan, unless the claimant successfully challenges the denial through "confirmatory" proceedings.

As a general rule, any creditor whose claim against the debtor arose prior to the commencement of rehabilitation is unable to receive distributions on its claim, unless the distribution is provided for under the rehabilitation plan adopted at the meeting of interested parties and thereafter approved by the court.

Submission of draft rehabilitation plan

The corporate rehabilitation plan will outline all modifications of the rights of creditors or shareholders, and also provide for any transfer or lease of the debtor's business or property and any other matter necessary for the debtor's rehabilitation.

Restructuring of a company's debts may involve substantially reducing the principal owing and/or (in some cases completely exempting) interest payments. The court will order the receiver to submit a draft rehabilitation plan. Other interested parties, however, may also prepare and submit a draft rehabilitation plan to the court within the specified date. This includes the debtor, secured creditors, unsecured creditors, and shareholders. There have recently been instances where the creditor group of a debtor has prepared its own version of the draft rehabilitation plan and submitted it to the court.

It is also possible to submit a pre-packaged rehabilitation plan when applying for rehabilitation proceedings. This was rather uncommon, in the past as it assumes consensus among the many classes of creditors, but several pre-packaged rehabilitation plans were submitted in 2017, and this trend is expected to continue in the future. From a legal standpoint, a majority of the total creditors must consent to submission of the pre-packaged plan. If the plan is filed, the entire process up until the approval of the rehabilitation plan can be reduced by up to two months.

Interested parties' meetings

The rehabilitation plan is formally determined and approved over the course of three or more statutory meetings of interested parties. The first meeting is convened mainly to present the receiver's report and to provide the interested parties with an opportunity to express their opinion on the administration policy of the debtor. Alternatively, pursuant to 2015 amendment of the DRBA, the court may skip the first meeting of stakeholders and instead have the receiver distribute its report to the interested parties or hold a short session explaining the results of its findings. Thereafter, the court will order the receiver to submit a draft rehabilitation plan.

The second meeting is held for the purpose of deliberating on the draft rehabilitation plan, which the receiver must prepare and file (in conjunction with the debtor's major financial institutional creditors) within four months from the expiration date of the claims filing period.

The third meeting is convened to vote on a resolution for approval of the draft rehabilitation plan. In the absence of special circumstances, the court often holds the second and third meetings on the same date.

The draft rehabilitation plan is subject to approval by the requisite amount (rather than number) of each class of shareholders and secured and unsecured pre-rehabilitation creditors. The shareholders, however, have voting rights only when the total value of the assets of the debtor exceed the total value of the debts. The voting requirement for the adoption of a rehabilitation plan by the interested parties is approval by creditors constituting three-quarters of the secured pre-rehabilitation claims, two-thirds of unsecured pre-rehabilitation claims, and a majority vote of the shareholders present at the meeting. Creditors belonging to the same class will vote together. To the extent that the value of the secured assets is insufficient to satisfy the repayment of claims, the excess amount of loan or debt claim over the value of the secured assets will be treated as an unsecured claim. The value of the secured assets will be determined by the examiner after the commencement of the rehabilitation proceedings.

Court approval of the rehabilitation plan

Once the interested parties have approved a draft rehabilitation plan, it will be submitted to the court for approval. In making its determination, the court will analyse whether the plan meets all of the legal requirements under the DRBA and is fair to the interested parties. The court's decision in the majority of cases will be made on the date of the third meeting of interested parties, although the procedure may sometimes last until approximately one week after the third meeting of interested parties. The rehabilitation plan takes immediate effect on court approval.

Even where the interested parties have not approved the rehabilitation plan, the court at its discretion may order a cram down and adopt the rehabilitation plan over the objection of some creditor classes.

Subordination of claims

The DRBA provides an exception to the general rule that a group of creditors belonging to the same class must be treated equally. This applies to a rehabilitation plan where the transactions involve specially related persons; namely where a loan is made by or guarantee is provided by the debtor to a person with whom it has a special relationship, or where a guarantee is provided by that person to the debtor itself.

The Enforcement Decree to the DRBA provides that if the debtor is a corporate entity, its specially related persons include:

- (a) its officers;
- (b) its affiliated companies (including the associated officers) as defined under the Monopoly Regulation and Fair Trade Act ("MRFTA");
- (c) certain prescribed individuals; and
- (d) any company in which the prescribed individual, alone or together with the companies and/or individuals referred to in (a), (b) and (c) above, holds at least a 30% equity share, or controls the management, for instance, through the appointment of officers.

Prescribed individuals include persons who, alone or together with their relatives and/or the companies' officers, own 30% or more shares in the debtor. It also extends to these individuals' family members, and the appointed officers of companies (other than directly affiliated companies) that fall under the individual's control.

Under the MRFTA, a subsidiary will be deemed as an affiliated company of the parent if, alone or together with its related persons, it has:

- (a) 30% or more shares in its subsidiary;

- (b) the power to elect a representative director or appoint at least 50% of the board members; and
- (c) influence over major management or operational matters of its subsidiary, such as changing the corporate structure or making new investments.

Bankruptcy proceedings

Bankruptcy is related to the liquidation of an insolvent company. An application for bankruptcy may be made either by the debtor or its creditors. For a creditor to apply, it must prove the existence of a claim against the debtor with supporting evidence. Unlike rehabilitation, which looks to the going concern value of the debtor, the present value of the debtor's assets is the most relevant factor in the court's decision whether to adjudicate the debtor bankrupt. In bankruptcy, the majority of the debtor's assets are transferred to the bankrupt estate, and any proceeds are distributed to the creditors in accordance with the priority of the claim. Once bankruptcy proceedings have been commenced, creditors must report their claims to the bankruptcy court, and their recovery is limited to the proceeds from the sale of the assets of the bankrupt corporation.

Priority of Claims

Creditors' claims generally rank as follows:

Separation claims representing pre-bankruptcy security interests

A creditor with a secured claim, such as a lien, pledge or mortgage, or a lessee of real property with a perfected security right, may exercise its rights outside bankruptcy. Furthermore, a lessee of residential or commercial property with a perfected right to the security deposit, where such security deposit is below the legal threshold, holds a preferential right of payment over other holders of a separation claim up to the amount of the

security deposit. If the proceeds from the enforcement of the collateral are insufficient to satisfy the secured creditor's claim, it may claim the remainder as an unsecured creditor in the bankruptcy proceedings.

Unlike the bankruptcy proceeding, a secured creditor in a rehabilitation proceeding cannot exercise its rights (whether in the form of secured or unsecured claim) outside the rehabilitation proceeding, and is required to report its rehabilitation claim with the court. Further, a creditor with a secured claim in a rehabilitation proceeding can only be repaid in accordance with the rehabilitation plan.

Common benefit claim

A common benefit claim covers administrative expenses that serve the common benefit of all parties to the bankruptcy proceedings. It generally includes the costs related to the management, disposition and distribution of the bankruptcy estate and generally covers claims that arise after the declaration of bankruptcy. Certain claims, however, such as tax, wages or severance claims are recognised as a common benefit claim, regardless of whether they arise before or after the declaration of bankruptcy, for reasons of public policy. A common benefit claim may be paid from time to time outside the bankruptcy proceedings whenever cash is available for distribution, and it ranks senior to an unsecured bankruptcy claim.

Unsecured bankruptcy claim

Unsecured bankruptcy claims relate to events that occur prior to the declaration of bankruptcy that are not secured by collateral. Such claims may be repaid during the bankruptcy proceedings. They comprise:

(a) bankruptcy claims with preferential rights;

(b) general bankruptcy claims; and

(c) subordinated bankruptcy claims.

Preferential bankruptcy claims include, without limitation, those prescribed in the Korean Civil Code, the Korean Commercial Code, the Insurance Act and Mutual Savings Bank Act, and these claims have priority over other general bankruptcy claims.

Subordinated bankruptcy claims are those claims prescribed in the DRBA. These include interest accruing after the declaration of bankruptcy, costs for participation in the bankruptcy proceedings, penalties and fines, or claims stated to be subordinated to other claims by agreement between the debtor and the creditor. Subordinated bankruptcy claims may be repaid only after full repayment of other unsecured bankruptcy claims.

In the case of the rehabilitation proceeding, unsecured claim is classified into rehabilitation claims with preferential rights and general rehabilitation claims, and there is no concept of subordinated rehabilitation claims.

Voidable transactions

Under the DRBA, a rehabilitation receiver or a bankruptcy administrator may avoid certain actions of the debtor company which constitute a preference. Actions subject to claw back on the grounds of preference include:

(a) an act performed by the debtor with knowledge that it will harm the interests of unsecured or secured pre-rehabilitation creditors (but it is not subject to claw back if the beneficiary of the act did not have knowledge that the act caused harm to the interests of the unsecured or secured pre-rehabilitation creditor at the time of performance of the act);

- (b) the provision of security or the repayment of debt obligations by the debtor that cause harm to the interests of unsecured or secured pre-rehabilitation creditors after the debtor's payment obligations have been suspended or the filing of an application for commencement of rehabilitation proceedings or bankruptcy proceedings (provided that the provision of security or the repayment of debt obligations is voided only if the beneficiary of the security or repayment was aware of either (1) the payment suspension or the filing of an application, or (2) the fact that such act could harm any unsecured or secured pre-rehabilitation creditor at the time of performance of such act (in connection with the proviso, knowledge is imputed where the beneficiary is a "specially related person"));
- (c) the provision of security or the repayment of debt obligations by the debtor where the debtor is not under an obligation to provide security or repay debt obligations (including where the debtor repays prior to the due date), which is performed within 60 days before or after the debtor's payment obligations have been suspended or the filing of an application for the commencement of rehabilitation proceedings or bankruptcy proceedings (provided that such act is not voided if the creditor was not aware of the fact that such act harms other unsecured or secured pre-rehabilitation creditors (in connection with the proviso, knowledge is imputed in case the beneficiary is a "specially related person" and 60 days is extended to one year for such "specially related person"));
- (d) any gratuitous act or act for valuable consideration that may be deemed identical to a gratuitous act, which is performed by the debtor before or after six months from the date the debtor's payment obligations have been suspended (six months is extended to one year in case the beneficiary is a

"specially related person") or the filing of an application for the commencement of rehabilitation proceedings or bankruptcy proceedings.

Specially related persons

Under the DRBA, unlike independent third parties, specially related persons are presumed to have knowledge that the debtor company has:

- applied for rehabilitation or bankruptcy; and
- committed actions that cause harm to creditors.

Furthermore, the look back period for the provision of collateral or release from indebtedness increases from 60 days to one year (from (a) the suspension of payment, or (b) the filing for rehabilitation or bankruptcy) for a specially related person of the debtor company.

Out-of-court proceedings

The most commonly adopted out-of-court restructuring for corporate entities are:

- private workout; and
- joint management under the CRPA.

Private workout

A private workout is generally only available when there are few creditors. As a voluntary process, private workouts allow for greater flexibility and autonomy in rehabilitating the debtor company. It may, however, lack enforceability in comparison to court-administered proceedings as some creditors may opt not to participate in the process. In a private workout, a debt rescheduling plan is binding only on those creditors that individually agree to the plan. If the debtor company is restructured by way of private work out, any non-participating

creditors continue to retain their full claim amount and are required to be repaid in accordance with their existing contractual terms originally entered into with the debtor company.

Corporate restructuring promotion act

The CRPA was adopted to address the foregoing problem of some creditors benefiting from a private workout by not participating. While the debtor has the right to apply for a workout under the CRPA, it is up to the council of financial creditors to accept such an application. Under the CRPA, all major creditor banks or the committee of creditors must belong to the council of financial creditors. The CRPA affords the council of financial creditors of an “insolvency-symptomatic” company (the “Insolvency-Symptomatic Company”) the right to approve one of the procedures for supervision or monitoring of the debtor company if it determines that such company is in significant financial difficulties. The supervision available under the CRPA may be one of (i) joint supervision by financial creditors, or (ii) supervision by primary correspondent bank. If the council of financial creditors resolve to commence the joint supervision by financial creditors in the first meeting of the council of financial creditors which is summoned by the primary correspondent bank of the Insolvency-Symptomatic Company, then claims of the financial creditors may be frozen for a maximum period of four months.

Subject to the new requirement referred to below, if creditors with voting rights corresponding to at least three-quarters of the total voting rights in the council consent to the proposed workout plan, then all members of the council (including dissenters) will be bound by the resolutions and the claims of such creditors may be repaid only in accordance with the terms

of the workout agreement to be adopted by the creditors. If a financial creditor dissented to the resolution to commence joint management or the workout plan, and does not wish to be bound by the CRPA, it is entitled to demand that other members buy out its claims against the debtor. The remaining consenting creditors usually buy out, or cause the debtor to buy out, the claims held by the dissenting creditor at a price equal to the liquidation value of the claims. If the creditors of the Insolvency-Symptomatic Company believe that rehabilitation through one of the supervision procedures set forth above is not feasible, they may apply to the court for commencement of the rehabilitation proceedings under the DRBA.

The CRPA was initially enacted to be effective from September 2001 until the end of 2005, but was subsequently reintroduced in 2007 (expiring on 2010) and again in 2011 to expire at the end of 2015. The earlier CRPA indeed expired at the end of 2015, but several months thereafter, the new CRPA was enacted in March 2016, which is scheduled to expire on 30 June 2018. The CRPA as amended expands the scope of creditors subject to the act from certain specified financial creditors to all financial creditors, and any debtor with less than 50 billion Won of debt can become subject to the act. Further, instead of requiring approval of creditors having at least three-quarters of the total voting rights to approve the proposed workout plan, if a single creditor’s claim amount exceeds three-quarters of the total claim amount, approval of two-fifths of the total number of creditors is also required, thereby prohibiting a single creditor from taking any unilateral action. In an effort to confront any challenge on legality of the act, the amendment also contains several measures to protect minority creditors and dissenting creditors.

Director Liability

Korean law does not impose additional liability on directors or other officers of a debtor company during insolvency. According to the Korean Commercial Code, directors are generally held liable to the company for any action or inaction taken by willful misconduct or gross negligence in contravention of Korean law or the company's articles of incorporation. The only distinction for insolvent companies is that, under the DRBA, the procedure for an insolvent company to claim compensation against the directors is simpler than under general Korean civil proceedings.

Guarantees

Except where specifically prohibited under the anti-trust or any other mandatory laws and regulations, a guarantee issued by a Korean company is generally recognised as a legal and valid obligation of the guarantor. In rehabilitation or bankruptcy, a guarantee issued by the debtor company may be recognised as a rehabilitation claim or a bankruptcy claim. Any guarantee, however, issued within six months from the filing of a petition for rehabilitation by the debtor or the bank's suspension of payment obligation by the debtor is regarded as a "gratuitous act" that can be voided by the receiver on the grounds of preference. The Korean Supreme Court does not view any renewal of an existing guarantee within the six-month period as a voidable preference.

New Money Lending

Once a stay order has been issued, the debtor company may raise additional financing only with the approval of the court. Any financing raised by the debtor company after the issuance of a stay order, or any money borrowed by the receiver after the initiation of rehabilitation proceedings with the approval of the court is characterised as a common benefit claim. Common benefit claims rank senior to both unsecured rehabilitation

claims and secured rehabilitation claims (but do not rank senior to the security created over any specific asset of the debtor company), and may be repaid when due with available cash. In the case that the debtor company's assets are insufficient to repay the entire common benefit claim, any new debt is given a super-priority ranking over other common benefit claims, and the common benefit claims are repaid *pro rata* after the new debt has been paid in full. It is questionable, however, whether such super-priority ranking may be given to new debt in the case of bankruptcy proceedings that follow rehabilitation proceedings.

Cross-Border Recognition

The DRBA provides a system for the recognition of foreign insolvency proceedings in Korea. In order for foreign insolvency proceedings to be effective, court approval must be obtained. First, an application for a support order must be filed with the Korean court and the following elements must then be satisfied:

- (a) an application in the form prescribed by the court must be submitted, along with the relevant evidentiary documents;
- (b) a court-prescribed fee must be paid to the court; and
- (c) recognition of the foreign insolvency proceedings in question must not be contrary to the general principle of good morals and social order of Korea.

Item (c) above is the key element that needs to be satisfied in order to be recognized by the Korean court. The Korean court generally accepts an application for recognition of foreign insolvency proceedings unless, for instance, the priority of claims significantly differs from Korean law or where the creditors are deprived of procedural rights under the relevant foreign insolvency proceedings.

Once the foregoing elements are satisfied and the Korean court approves the foreign insolvency proceedings, the applicant may further apply to the court for one or more of the following measures:

- (a) suspension of lawsuits or administrative procedures in respect of the insolvent company's business or assets in Korea;
- (b) prohibition or suspension of any enforcement proceedings, such as compulsory enforcement, enforcement of security, or a preliminary attachment or preliminary injunction in respect of the insolvent company's business or assets in Korea;
- (c) order for the prohibition of repayment by the insolvent company, or an order for the prohibition of disposal of the insolvent company's assets in Korea; and

- (d) appointment of an international insolvency receiver/administrator; or any other measure necessary for the protection of the insolvent company's business or assets or the interest of creditors in Korea.

In addition to the insolvent company's assets in foreign jurisdictions, the assets of the insolvent company located in Korea may become part of the bankrupt estate for the benefit of all creditors.

The DRBA does not limit the applicability or effectiveness of Korean insolvency proceedings in foreign jurisdictions.

MALAYSIA



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Key Elements:

- Scheme of arrangements focused on company rescue.
- Receivership available for secured creditors.
- Moratorium available at the discretion of the court.
- Powers of management can be displaced by an interim liquidator or receiver.
- New provisions on corporate voluntary arrangements and judicial management introduced through Companies Act 2016, but not yet in force.

Introduction

This section provides a general outline of the main corporate insolvency procedures in Malaysia. The primary legislation governing corporate insolvency in Malaysia is the Companies Act 2016, the Insolvency Act 1967 and the Companies (Winding-Up) Rules 1972. The legislative framework provides for:

- (1) the rehabilitation of companies;
- (2) the rights of secured creditors, equity holders and other creditors where rehabilitation is not possible; and
- (3) sanctions for officers who are guilty of intentionally contributing to the insolvency of a company.

Provisions on corporate voluntary arrangements and judicial management have been introduced through the Companies Act 2016 but have yet to come into force.

Insolvency law falls under the civil jurisdiction of the High Court. In states and territories where the High Court is divided into various divisions, insolvency matters are dealt with by commercial division judges.

The following insolvency procedures are available under the Malaysian legal system:

- (1) liquidation of corporate entities;
- (2) private and court-appointed receivers (and managers); and
- (3) court approved schemes of arrangement.

Liquidation

Under the Companies Act 2016, there are two types of liquidation – voluntary and compulsory.

Voluntary liquidation

Voluntary liquidation is divided into two types:

- (1) members' voluntary winding-up; and
- (2) creditors' voluntary winding-up.

A members' voluntary winding-up requires a declaration of solvency by the directors stating that the company is able to pay its debts in full within a period not exceeding 12 months after commencement of the winding-up. Where this is not possible, voluntary liquidation may only proceed by way of the creditors' voluntary winding-up process.

Members' voluntary winding-up

A solvent liquidation requires a declaration of solvency by the directors, followed by the passing of a special resolution to wind-up the company and to appoint a liquidator. Upon the liquidator's appointment, the transfer of shares or alteration in the status of members is void, the directors' powers of management cease, and business is discontinued unless the liquidator is of the view that continuing the business would be beneficial. This option is only available if the company is still solvent and proceeds from the winding-up can satisfy all outstanding debts. If the company is found to be insolvent, the liquidator must take steps to change the mode of winding-up to a creditors' voluntary winding-up.

Creditors' voluntary winding-up

Where a company is insolvent and a declaration of solvency is not possible, the directors of a company may choose to initiate the creditors' voluntary winding-up process to liquidate the company. This requires the passing of a special resolution by the company's members to wind-up the company, followed by a special creditors' meeting to formally appoint the liquidator. As in the case of a members' voluntary winding-up, upon the liquidator's appointment, the transfer of shares or alteration in the status of members is void, the powers of management cease and the business is discontinued.

Compulsory liquidation

A court may order the winding-up of a company in a number of circumstances, although the most common ground is where the company is unable to pay its debts. The company is presumed insolvent when it fails to pay a creditor after the service of a statutory demand.

The aim of this process is to liquidate the business in an orderly manner, and to distribute the proceeds to the creditors (and in

the event of a surplus, to the members). Once a winding-up order has been granted, the court appoints a liquidator and the directors' powers of management cease. Any disposition of property, transfer of shares or alteration in the status of members made after commencement of the winding-up is void unless the court orders otherwise.

Winding-up proceedings are commenced by the presentation of a winding-up petition to the court, which is then served on the company. The compulsory winding-up process may be initiated by a creditor, the company, contributory member or other specified persons. The winding-up petition and the date for the hearing must be advertised in at least two national newspapers. All creditors may appear at the hearing to support or oppose the petition provided a "Notice of Intention to Appear" has been filed. Once the winding-up order has been obtained, a liquidator will be appointed to oversee the liquidation process to ensure the orderly realisation of assets and distribution of proceeds to creditors and, where there is a surplus, members.

Inability of a company to pay its debts

A company is deemed unable to pay its debts if:

- (a) a creditor, to whom the company is indebted in a sum exceeding MYR10,000 then due, has served on the company a written demand (known as a statutory demand) requiring the company to pay the sum due, and the company has for 21 days neglected to pay the sum or to secure or compound for it to the reasonable satisfaction of the creditor;
- (b) a judgment against the company is unsatisfied; or
- (c) it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due.

In order to obtain a winding-up order it may not be necessary for a creditor to have served a statutory demand on the company or to have an unsatisfied judgment debt, if it has other evidence to demonstrate that the company is insolvent.

Interim liquidator

At any time after a winding-up petition has been presented to court and before a winding-up order has been made, an application may be made by any creditor, contributory (member) or by the company itself for the appointment of an interim liquidator where the company's property is in danger or where it is alleged the company's management is misappropriating or wasting the company's assets.

Duties and powers of the liquidator

The liquidator in a compulsory liquidation is subject to the supervision of the Official Receiver, or where the Official Receiver is the liquidator, the relevant minister. He or she is accountable to the creditors for the conduct of the liquidation and remains so accountable until his or her release as liquidator. The functions of a liquidator in a compulsory liquidation are to ensure that the company's assets are realised and the proceeds distributed to the company's creditors and, where there is a surplus, members. The liquidator or the interim liquidator (as the case may be) takes into his or her custody, or into his or her control, all the property to which the company is or appears to be entitled. The liquidator has very broad powers, some of which may only be exercised with the sanction either of the court or of the committee of inspection. However, the liquidator only has limited power to carry on the business (to the extent necessary to collect and realise the assets) and in practice it is relatively unusual for a liquidator to achieve a sale of the business as a going concern.

Powers of the company's management

The powers of a company's management are displaced upon the appointment of an interim liquidator or a liquidator appointed by the court in winding-up proceedings.

Interests of members

Interests of members are generally unaffected by the insolvency procedures, although in such circumstances there is likely to be little value in their shareholdings. The legislative framework, however, restricts members' rights to dispose of the company's property, transfer shares or to prefer the payment of one creditor over another once a winding-up has commenced.

Contracts to which the company is a party

Contracts do not automatically terminate when a winding-up order is made. However, the liquidator, with leave of the court or committee of inspection, can disclaim unprofitable contracts within 12 months after the commencement of winding-up or any such extended period allowed by the court.

The remedies of specific performance and damages for breach of contract remain available to a contracting party even after a liquidator has been appointed.

Legal proceedings to which the company is party

At any time after a winding-up petition has been presented to the court and before a winding-up order has been made, the company or any creditor or contributory (member) may apply to the court to stay or restrain pending legal proceedings against the company. Once a winding-up order has been made, or an interim liquidator has been appointed pending the winding-up order, proceedings may not be commenced or continued against the company except with leave of the court. At this point, creditors will generally cease their court proceedings and file their proofs of debt directly with the

liquidator. However, a secured creditor remains free to enforce its security during this period.

Creditors' claims

The following types of creditor claims are admissible under Malaysian law for payment during the course of liquidation:

- unliquidated damages for breach of contract and breach of trust;
- all debts and liabilities (other than unliquidated claims not mentioned above) whether present or future, certain or contingent (and an estimated value shall be placed on all debts that do not bear a certain value); and
- without derogating from the above, salary, wages, rent, interest and liquidated damages.

The creditor claims need to be substantiated by lodging a proof of debt with the liquidator for approval. In the event the liquidator rejects the claims, the creditor may appeal to the High Court against such rejection. In respect of secured creditors, a proof of debt may be lodged with the liquidator for the unsecured balance of their claims.

Any claims disputed by the liquidator may be adjudicated by the High Court.

Receivership

Private receiver

Under the terms of a debenture, a secured creditor is generally entitled to appoint a receiver in the event of a default by the borrowing company. The receiver is empowered to take possession of the assets subject to the charge in the debenture instrument, and he or she may opt to dispose of those assets

by private sale or seek expressions of interest by way of advertisements in the major newspapers.

Special considerations arise in relation to land. If there is a statutory charge on the land, the chargee may institute foreclosure proceedings in the High Court pursuant to the National Land Code 1965 to obtain an order for sale.

Alternatively, the lender may appoint a receiver and manager (where provision has been made for his or her appointment in the security agreement) who may then either sell the land by private treaty or commence foreclosure proceedings. The option to sell by private treaty is not available once an order for sale is obtained in foreclosure proceedings. Once an order for sale has been obtained, the charged land must be sold by public auction.

Most debentures also provide for the receiver to be appointed as both the receiver and manager of the company, in which case the directors' powers to manage the company are suspended upon appointment. When a company in receivership is placed into liquidation, the receiver and manager may continue to act as receiver and exercise all powers of a receiver in respect of property or assets secured under the debenture appointing the receiver.

Court-Appointed Receiver

Where there is no express contractual power to appoint a receiver, a court-appointed receiver may be sought to preserve assets thought to be in jeopardy. The powers of a court-appointed receiver are set out in his or her appointment order. A court appointed receiver must be independent, and has an obligation to balance the interests of all parties concerned, including those of the company and the company's creditors. A receiver appointed

by a debenture holder owes his or her primary duty to their appointer and must ensure that the interests and returns of the debenture holder are protected.

The process of appointing a court-appointed receiver is initiated by an application by a member or creditor of the company to the court.

Contracts to which the company is a party

A privately appointed receiver may choose to adopt contracts to which the company is a party.

Even after a receiver is appointed, the remedies of specific performance and damages for breach of contract remain available to a contracting party. It should be noted, however, that in a receivership, specific performance requiring payment of funds by the receiver is not permitted.

Legal proceedings to which the company is a party

The continuation or commencement of legal proceedings against the company is not affected by the appointment of a private or court-appointed receiver.

Court approved schemes of arrangement

Schemes of arrangement are used as a method of formal corporate rescue. Schemes require approval by 75% in value and a simple majority in number of each class of creditors or members present and voting, as well as the subsequent sanction of the High Court. Secured creditors are generally categorised into their own class or classes. A scheme of arrangement is initiated by filing an application in court to seek the court's leave to call and convene meetings of classes of creditors and members of the company to consider and vote on a scheme of compromise and arrangement. Thereafter, notices of class meetings are to be

sent to the company's creditors and members. The company's incumbent management retains its powers for the duration of the scheme proceedings.

Once the proceedings seeking leave have been filed, the company or any member or creditor can apply to the High Court seeking a stay order to restrain any further proceedings against the company until the court makes a determination on the scheme. A stay order will typically preclude the appointment of a receiver and manager under a debenture as well as the enforcement of security. If the scheme is approved, all creditors subject to the scheme are bound and must comply with its terms.

Challenges to Antecedent Transactions

In some circumstances, the transfer, mortgage, delivery of goods, payment, execution or other act relating to company's property may, if made within the six months prior to the presentation of a winding-up petition or the passing of a resolution to voluntarily wind-up the company, constitute a fraudulent preference and be clawed back by a liquidator.

Similarly, where any property, business or undertaking has been acquired at an overvalue or sold at an undervalue to a related party of the company, within a period of two years before the commencement of the winding-up of the company, the liquidator may recover the difference between the consideration paid and the value of the property, business or undertaking.

In addition, disposals of the company's assets subsequent to the presentation of a winding-up petition are void without the sanction of the court.

Personal Liability for Directors

Directors are generally not held personally liable for the debts of the company. If during the course of liquidation, however, it appears the business of the company has been carried out with intent to defraud creditors or for a fraudulent purpose, a court may hold any person knowingly a party to such conduct personally liable without any limitation of liability for all or any of the debts or other liabilities of the company. An application may be made by a liquidator, creditor or contributory (member) to the court seeking an order that the offending person be held personally liable for such debts. In addition to personal liability, criminal sanctions against such conduct include imprisonment for a term not exceeding ten years and/or a fine not exceeding MYR1,000,000.

An officer of the company who knowingly incurs a debt with no reasonable grounds of expecting that the company would be able to repay is criminally liable to imprisonment for a term not exceeding five years and/or to a fine not exceeding MYR500,000. The court may also inquire into the conduct of the company's officers and order the officers to make restitution or pay damages where they misapply or wrongfully retain the company's property, or are otherwise guilty of any misfeasance or breach of duty.

Lender Liability

In general, the risk of a lender being held liable to pay its customer's debts is small.

Guarantees

A guarantee is a secondary obligation by a third party relating to a primary obligation by a contracting party (i.e. a borrower under a loan agreement). If the primary obligation is altered, discharged or fails, the guarantee may not be enforceable.

Guarantees are available in most circumstances, for example downstream, upstream or cross-stream guarantees. Corporate benefit issues need to be addressed especially in the context of upstream and cross-stream guarantees.

Guarantees may be challenged and set aside if they amount to an unfair preference transaction.

Guarantees given by a company which subsequently goes into liquidation, whether granted in favour of its parent, a subsidiary or sibling company, will generally remain valid.

Priority

In Malaysia, the order of priority for the distribution of proceeds to creditors is prescribed by the Companies Act 2016.

Secured creditors are paid out of the proceeds from the realisation of secured assets. If the proceeds are insufficient to discharge the secured obligations in full, the portion remaining outstanding ranks as an unsecured debt.

Claims in liquidation (without deferment of a floating charge) rank as follows:

- cost and expenses of winding-up, including costs of the petitioner and remuneration of the liquidator;
- wages and salaries not exceeding MYR15,000 for services rendered within the four months prior to the commencement of winding-up;
- worker's compensation which accrued prior to the commencement of winding-up;
- remuneration payable for vacation leave which accrued prior to the commencement of winding-up;

- Employees Provident Fund (“EPF”) contributions for the 12 months prior to the commencement of winding-up;
- federal taxes; then
- unsecured creditors.

Claims in liquidation (involving a deferment of a floating charge) rank as follows:

- cost and expenses of winding-up;
- wages and salaries not exceeding MYR15,000 for services rendered within four months prior to the commencement of winding-up;
- remuneration payable for leave which accrued prior to the commencement of winding-up;
- EPF contributions for the 12 months prior to the commencement of winding-up;
- any floating charges;
- worker’s compensation which accrued prior to the commencement of winding-up;
- federal taxes; then
- unsecured creditors.

New Money Lending

New monies provided by lenders during the rehabilitation procedure do not give rise to any priority in terms of repayment unless such priority forms part of the scheme of arrangement duly sanctioned by the court.

Recognition of Foreign Insolvency Proceedings

The courts of Malaysia generally recognise foreign insolvency proceedings commenced in foreign jurisdictions in accordance with the rules of private international law as they apply in Malaysia. A foreign liquidator of a foreign company placed into liquidation in its place of incorporation is recognised as having the powers and functions of a local liquidator. The High Court may, however, appoint a local liquidator to realise or dispose of the assets of a foreign company located in Malaysia. In both circumstances, any proceeds arising from the sale of the assets located in Malaysia will be distributed to the foreign liquidator only after discharging the foreign company’s outstanding debts and liabilities incurred in Malaysia.

Claims by foreign creditors are not subject to any special or additional requirements to be proved in insolvency. However, under the Exchange Control Act 1953, the approval of the Controller of Exchange Control (i.e. Bank Negara Malaysia) is required to repatriate any amounts recovered. In practice, the Bank Negara Malaysia will usually grant such approval.

Foreign insolvency administrators are entitled to claim, take control of, and realise or deal with the property of a foreign company situated within Malaysia if the exercise of such powers is authorised by the law of the country where the foreign company is incorporated.

THE PHILIPPINES



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Key Elements:

- Rehabilitation focuses on company rescue.
- Moratorium available has ability to restrict secured creditors.

Introduction

This section is designed to provide a general outline of the main corporate insolvency procedures available in the Philippines. The insolvency regime in the Philippines was recently revised, with the Financial Rehabilitation and Insolvency Act of 2010 ("FRIA") taking effect from September 2010. It replaces the Insolvency Law of 1907. The aim of the FRIA is to ensure the effective and efficient rehabilitation or liquidation of companies in a manner that guarantees certainty and predictability in commercial affairs, preserves the value of the assets of companies and recognises creditor rights and claims.

There are also bespoke insolvency regimes for certain other types of companies/entities, such as banks, insurance companies, as well as national and local government agencies and units (although government financial institutions including government owned and controlled corporations are subject to the FRIA).

These are expressly excluded from the operation of the FRIA, and are beyond the scope of this guide.

There are two principal insolvency procedures in the Philippines, namely:

- (1) rehabilitation; and
- (2) liquidation.

Under the regime's transitional arrangements, the FRIA will apply to all proceedings commenced after September 2010 in relation to any pending rehabilitation or liquidation procedures which were initiated under the previous regime. The previous regime will continue to apply however where, in the opinion of the court, the application of the FRIA would not be feasible or would give rise to an injustice.

Rehabilitation

Rehabilitation is principally a procedure intended to rescue companies which are or may become insolvent. The procedure is only available where it is shown that creditors will recover more if the company continues as a going concern than if it were immediately liquidated.

Three rehabilitation processes exist under the FRIA, namely:

- (1) court-supervised rehabilitation;
- (2) pre-negotiated rehabilitation; and
- (3) an out-of-court informal restructuring agreement or rehabilitation plan.

Court-supervised rehabilitation

There are two types of court-supervised rehabilitation procedures, namely voluntary rehabilitation and involuntary rehabilitation.

In a voluntary rehabilitation, the company files a petition for rehabilitation with the court. The process is initiated by a majority vote of the board of directors or trustees and is subsequently authorised by a vote of the stockholders representing at least two-thirds of the outstanding capital stock or, in the case of a non-stock corporation, by a vote of at least two-thirds of the members.

In an involuntary rehabilitation, the creditors of the company initiate the proceedings by filing a petition with the court. This is only available, however, to creditors with an aggregate claim of the higher of PHP1,000,000 or at least 25% of the subscribed capital stock. In addition:

- (a) there must be no genuine issue in fact or law in respect of the claim, and the claim must be due and/or demandable and no payments must have been received for at least 60 days;
- (b) the company must have failed generally to meet its liabilities as they fall due; or
- (c) a creditor, other than the petitioner, must have initiated foreclosure proceedings against the company that will prevent the company from paying its debts as they fall due.

Effect of court-supervised rehabilitation

Where the court is satisfied of the viability of the company's rehabilitation, it will issue an order that appoints a rehabilitation receiver ("Commencement Order"). A copy of the Commencement Order must be published in a newspaper of general circulation and for a voluntary rehabilitation, a copy of

the petition is required to be delivered to the company's creditors.

The Commencement Order prohibits the company's suppliers from withholding the goods or services where the company makes payment for goods and services after the date of the order, creates a moratorium during which no insolvency proceedings or other legal proceedings, including enforcement of security, can be taken without the permission of the court (although pending proceedings may be continued), and renders void the exercise of set-off rights by any of the company's creditors.

The Commencement Order also prohibits the use of self-help remedies in relation to the seizure or sale of the company's property, prohibits the company from selling, encumbering, transferring or disposing in any manner any of its property except in the ordinary course of business, and prohibits the company from making any payment of its liabilities outstanding as of the commencement date.

Management of the company remains with the existing directors. However all powers in relation to payments or the sale, disposal, assignment, transfer or encumbrance of property require approval of the rehabilitation receiver and/or the court.

All contracts of the company with creditors and other third-parties continue provided the company confirms the contracts within 90 days following the commencement of proceedings. Contractual obligations arising or performed during this election period or after the contracts have been confirmed are not subject to the moratorium and are to be paid when they fall due. Contracts not confirmed within the required deadline are terminated and any resulting claims become subject to the moratorium.

Powers of the rehabilitation receiver

The primary duties of the rehabilitation receiver are to preserve and maximize the value of the company's assets, determine the viability of the rehabilitation process, prepare and submit a rehabilitation plan to the court and implement the rehabilitation plan once approved.

The rehabilitation receiver has power to take custody or control of the company's property to preserve its value, recover all amounts owing to the company, recover any fraudulent payments made by the company or payments which constitute undue preferences of its creditors, and to monitor the operations and business of the company. Importantly, the rehabilitation receiver has no power to assume control of the company or to sell the property of the company unless the court orders otherwise.

The rehabilitation receiver may apply to the court for authorisation to sell the company's unencumbered property outside its ordinary course of business where it can show that the property is perishable, costly to maintain, susceptible to devaluation or otherwise in jeopardy.

Similarly, the rehabilitation receiver may apply to the court for authorisation to dispose of the company's encumbered property or property of others held by the company where:

- (a) the rehabilitation receiver obtains the consent of the secured creditor or property owners;
- (b) the court determines the disposal is necessary for the continued operation of the company's business; and
- (c) the company provides a substitute lien or ownership right that provides an equal level of security for the counterparty's claim or right.

Where the company's property is in danger or where it is alleged that those in control of the company are misappropriating or wasting the company's assets, an application may be made by any interested party to the court for a rehabilitation receiver or management committee to assume control of the company.

Initial hearing

Within 40 days of the initial hearing, the rehabilitation receiver must submit a report to the court including his or her preliminary findings and recommendations. If the court finds that the company is insolvent and there is a substantial likelihood of the company being successfully rehabilitated, it will make an order upholding the rehabilitation petition and direct the rehabilitation receiver to consult with the company and its creditors and revise or recommend action on the rehabilitation plan.

If the court finds that the company is insolvent but rehabilitation is unlikely, it will place the company into liquidation. Finally, the court may dismiss the petition where it finds that:

- (a) the company is not insolvent;
- (b) the petition is a sham intended only to delay the enforcement of the rights of the creditors;
- (c) the petition contains materially false or misleading statements; or
- (d) the company has defrauded its creditors.

If the petition is dismissed, the court may, in its discretion, order the petitioner to pay damages to any creditor or to the company injured as a result of the filing of the petition.

Rehabilitation plan

Once the rehabilitation receiver finalises the rehabilitation plan, he or she will put it to the company's creditors for approval. The

rehabilitation plan is only approved where it is passed by all classes of creditors (secured or unsecured) whose rights are adversely modified or affected by the plan. This requires creditors holding more than 50% of the total claims in each class to vote in favour of the plan. Once approved, the court is then required to confirm the plan, at which point the plan becomes binding on the company and all classes of creditors. Rehabilitation plans may only be confirmed by the court if it meets certain statutory requirements. Importantly, rehabilitation plans must maintain the security interest of the secured creditors and preserve the liquidation value of their security. The moratorium continues except in relation to claims arising after approval of the plan.

The court may confirm a rehabilitation plan in the absence of creditor approval where it is of the opinion that the company's creditors would receive greater compensation than if the company were placed into liquidation.

Terminating the rehabilitation plan

Any stakeholder or the rehabilitation receiver may apply to the court seeking termination of the rehabilitation proceedings. If the court finds the implementation of the rehabilitation plan has been successful, it will terminate the proceedings lifting any moratorium or other court orders. If, however, the court finds the implementation of the rehabilitation plan has failed, it will place the company into liquidation.

Secured creditors

Secured creditors are also subject to the moratorium, however may apply to the court for orders to preserve their security if they can show they do not have adequate protection over the property securing their claim (for example, where insurance lapses) or to enforce their security where the property is not required for the rehabilitation of the company. The rehabilitation procedure is not intended to diminish the value of security or

rights of a secured creditor, except insofar as it suspends the right to enforce during the moratorium period.

Rehabilitation plans may only be confirmed by the court if they maintain the security interest of the secured creditors and preserve the liquidation value of their security.

Pre-negotiated rehabilitation

This proceeding is initiated either by the company or the company jointly with any of its creditors. A petition for a rehabilitation plan may be filed for approval by creditors holding at least two-thirds of the total liabilities of the company. This must include creditors holding at least 50% of the total secured claims, and creditors holding at least 50% of the unsecured claims. If the petition is satisfactory in form and substance, the court must grant an order requiring a copy of the order be distributed to the company's creditors and published in a newspaper of general circulation, appoint a rehabilitation receiver (if provided for in the plan) and provide for a moratorium on enforcement.

The court must approve the pre-negotiated plan unless a creditor or other interested party submits an objection. If the court determines that either the company or the creditors who support the rehabilitation plan acted in bad faith, or that the objection is non-curable, the court may place the company into liquidation. A finding by the court that the objection has no substantial merit or that the objection has been cured will be deemed to be an approval of the rehabilitation plan. Similarly, the court has a period of 120 days from the date of filing the petition to approve the rehabilitation plan, after which time the rehabilitation plan is automatically approved.

Out-of-court informal restructuring agreements or rehabilitation plans

The FRIA recognises out-of-court restructuring agreements and rehabilitation plans which have the same legal effect as a plan sanctioned by the court, provided:

- it is agreed to by the company; and
- approved by the creditors holding at least 85% of the total liabilities of the company, which must include the creditors representing at least 67% of the secured obligations, and those representing at least 75% of the unsecured obligations of the company.

Such plans require publication for at least three consecutive weeks in a newspaper of general circulation in the Philippines. The rehabilitation plan or restructuring agreement takes effect after 15 days have elapsed from the date of the last publication of the notice.

Liquidation

The liquidation of an insolvent company is intended to provide for the winding up of the company and the equitable distribution of the company's assets.

There are two forms of liquidation, namely:

- (1) involuntary liquidation (sometimes called compulsory winding up); and
- (2) voluntary liquidation.

At any time during the course of the court-supervised or pre-negotiated rehabilitation proceedings, the company or its creditors may apply to the court to place the company into liquidation. Similarly, the court of its own volition may place the company into liquidation during the course of court-supervised

or pre-negotiated rehabilitation proceedings, or following a recommendation by the rehabilitation receiver who has formed the view that rehabilitation of the company is not feasible.

Voluntary liquidation is initiated by the company and requires a petition establishing its insolvency.

Involuntary liquidation is initiated by at least three creditors with an aggregate claim that is equal to or exceeds PHP1,000,000 or 25% of the subscribed capital stock of the company. In addition, the qualified creditors must show:

- (a) there is no genuine issue in fact or law in relation to the claims of the petitioners;
- (b) the claim is due and/or demandable and no payments have been received for at least 180 days, or that the company has failed generally to meet its liabilities as they fall due; and
- (c) there is no substantial likelihood that the company may be rehabilitated.

Effect of a liquidation order

In both a voluntary and involuntary liquidation, the court must issue a liquidation order if the petition is satisfactory in form and substance. The liquidation order will deem the company dissolved and its corporate existence terminated. Legal title and control of all the company's assets, except those exempt from execution, will vest in the liquidator or, pending his or her election or appointment, with the court. The liquidation order will also direct all payments and any claims or conveyance of property due to the company be made to the liquidator, prohibit payments or the transfer of any property by the company, authorise the payment of administrative expenses as they fall due, and direct all creditors to file their claims with the liquidator.

All contractual obligations of the company will be terminated and/or breached unless the liquidator declares otherwise and the contracting party agrees within 90 days from the date of his or her assumption of office.

The order provides for a moratorium such that no separate actions for the collection of an unsecured claim will be allowed, and those already pending will be transferred to the liquidator to settle or contest.

Secured creditors may enforce rights

Although liquidation has the effect of suspending legal proceedings against the company, liquidation does not override the rights of secured creditors who remain free to enforce their security and to retain the proceeds of enforcement in priority to the claims of unsecured creditors. However, no foreclosure proceedings are permitted for a period of 180 days from the date of the liquidation order.

General unsecured claims are settled in the following order: claims constituting legal liens under article 2241 or 2242 of the Civil Code, followed by preferential creditors (such as employees and labourers of the company as defined by article 2244 of the Civil Code) and, finally, unsecured creditors.

Powers of the liquidator

The liquidator is an officer of the court and subject at all times to the control of the court. He is responsible to the creditors for the conduct of the liquidation and remains so responsible until his release as liquidator. The functions of a liquidator in a compulsory liquidation are to ensure that the company's assets are collected in (including recovery of any property fraudulently conveyed by the company), realised and distributed to the company's creditors, and to pay any surplus

to the persons entitled to it. The liquidator takes into his custody all the property to which the company is or appears to be entitled. The powers of the directors cease. The liquidator has very broad powers, some of which may only be exercised with the sanction either of the court or of the liquidation committee of creditors.

Within three months from the liquidator's assumption of office, the liquidator is required to submit a liquidation plan to the court which must include a list of the company's assets and schedule for the liquidation of those assets and payment of claims. Once approved by the court, the liquidator is empowered to sell the company's assets and settle creditor claims.

The liquidator will generally sell the unencumbered assets of the insolvent debtor at a public auction. However, a private sale may be allowed with the approval of the court if:

- (a) the goods to be sold are of a perishable nature, are likely to quickly deteriorate in value or are disproportionately expensive to keep or maintain; or
- (b) the private sale is in the best interests of the company and its creditors.

With the approval of the court, the company's unencumbered property may also be conveyed to a creditor in satisfaction of its claim.

Challenges to antecedent transactions

Any transaction occurring prior to the issuance of a liquidation order or a petition for rehabilitation proceedings (the "Commencement Date"), may be rescinded or declared null and void where it was executed with intent to defraud the creditors or where it constitutes an undue preference of creditors. These include transactions which:

- (a) within a 90-day period prior to the Commencement Date, provide unreasonably inadequate consideration to the company, involve the accelerated payment of a claim to a creditor or provide security or additional security;
- (b) involve creditors, where a creditor obtained, or received the benefit of, more than its *pro rata* share in the assets of the company, executed at a time when the company was insolvent; or
- (c) are intended to defeat, delay or hinder the ability of the creditors to collect claims where the effect of the transaction is to put assets of the company beyond the reach of creditors or to otherwise prejudice the interests of creditors.

The rehabilitation receiver or any creditor with the rehabilitation receiver's consent may initiate an action to rescind or declare a transaction void.

Guarantees

In the Philippines, the concepts of “guarantee” and “suretyship” are distinguished under the Civil Code. Pursuant to the Civil Code, the essential characteristic of a suretyship is that primary liability falls on the surety. That liability is wholly independent of any liability which may arise between the debtor and the creditor. In contrast, under a guarantee, the guarantor is under a secondary obligation which is dependent on the default of the debtor.

Guarantees are available in most circumstances and may be given as credit support for future debts, the amount of which may be unknown at the time of granting the guarantee. As a general principle, the guarantor cannot be compelled to pay the creditor unless the creditor has first exhausted all recourse against the debtor. However, the parties may contract out of this

general principle or it may be disappplied as a result of other exceptions contained in the Civil Code. In addition, the enforceability of a guarantee can also be prejudiced as a result of certain actions taken by the creditor, including, for example, the granting of an extension to the debtor without the consent of the guarantor or, in the context of a contract involving co-guarantors, the release of one guarantor without the consent of the other guarantors.

New Money Lending

Normally lenders will insist on additional security or priority (ahead of debts incurred prior to the proceedings) before any new monies are advanced to companies after the opening of any insolvency proceedings. The company, with the approval of the court, may enter into new finance arrangements and encumber its property to aid in its rehabilitation. Payment obligations arising out of any new finance arrangements are not subject to the moratorium and are to be paid when they fall due.

Personal Liability of Directors

Directors and officers who willfully:

- (a) dispose or cause to be disposed any property of the company other than in its ordinary course of business;
 - (b) authorise any transaction in fraud of creditors or in a manner grossly disadvantageous to the company or its creditors; or
 - (c) embezzle or misappropriate any property of the company,
- are liable to double the value of the transaction involved or property disposed of or embezzled, whichever is higher.

Recognition of Foreign Insolvency Proceedings

The FRIA adopted the Model Law on Cross-Border Insolvency of the United Nations Commission on International Trade Law (UNCITRAL).

If there is a rehabilitation proceeding filed by a foreign entity in another jurisdiction, a petition may be filed by the representative of the foreign entity and the court may issue an order:

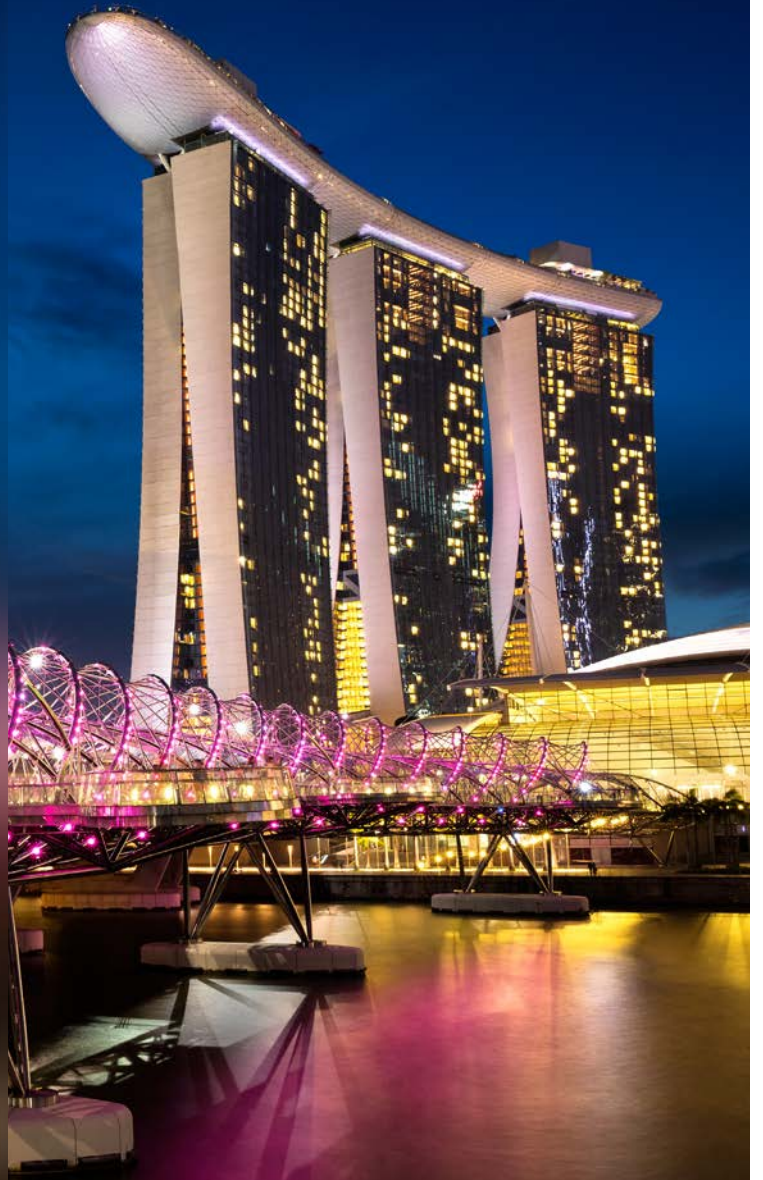
- (a) suspending any action to enforce claims against the entity, or otherwise seize or foreclose on property of the foreign entity located in the Philippines;
- (b) requiring the surrender of property of the foreign entity to the foreign representative; or
- (c) providing other necessary relief.

In determining whether to grant relief to a foreign entity, the court must consider;

- (a) the protection of creditors in the Philippines, and the inconvenience in pursuing their claim in a foreign proceeding;
- (b) the just treatment of all creditors through resort to unified insolvency or rehabilitation proceedings;
- (c) whether other jurisdictions have given recognition to the foreign proceeding;
- (d) the extent to which the foreign proceeding recognises the rights of creditors and other interested parties in a manner substantially in accordance with the FRIA; and
- (e) the extent to which the foreign proceeding has recognised and shown deference to proceedings under the FRIA and previous legislation.

These rules shall also apply to liquidation proceedings filed by a foreign entity in another jurisdiction.

SINGAPORE



SINGAPORE

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Key Elements:

- Judicial Management and Schemes of Arrangement procedures focus on company rescue and provides for an automatic moratorium.
- Receivership available as a self help remedy for secured creditors.
- Challenges to antecedent transactions.

Introduction

This section provides a general outline of the main corporate insolvency procedures in Singapore. The principal legislation in Singapore governing corporate insolvency is the Companies Act (Chapter 50). It is supplemented by the Companies (Winding Up) Rules. Certain provisions of the Bankruptcy Act (Chapter 20) also apply to corporate insolvency in Singapore. The insolvency regime in Singapore is mainly categorised into liquidation (Part X of the Companies Act) and rehabilitation (Part VII and Part VIIA of the Companies Act).

In May 2017, the Companies Act was amended to implement significant changes to Singapore's insolvency regime with the stated objective of attracting more foreign debtors to restructure their debts in Singapore, thereby positioning Singapore as an international centre for debt restructuring. The scope of existing insolvency and pre-insolvency processes have not only been widened and enhanced; familiar features from leading insolvency regimes worldwide, such as the United States Title 11 debtor-in-possession regime, have also been adapted and incorporated.

The main procedures encountered in corporate insolvencies are:

- (1) receivership;
- (2) judicial management/schemes of arrangement; and
- (3) liquidation.

We also consider very briefly, voidable transactions, the personal liability of directors, lender liability, guarantees, priority of security and claims, new money lending and the recognition of foreign insolvency proceedings.

Tests for Insolvency

There are two principal tests for insolvency: the cash flow test and the balance sheet test. Under the cash flow test, a company is insolvent if it is unable to pay its debts as they fall due. Under the balance sheet test, a company is insolvent if its liabilities exceed its realisable assets.

In Singapore, an application may be presented to the court for an order that a company is to be wound up compulsorily if it is unable to pay its debts. A company is deemed to be unable to pay its debts where:

- (a) a sum exceeding SGD10,000 has fallen due and following the service of a formal demand, it remains unpaid for three weeks or more;
- (b) the execution or other process issued in relation to a judgment has been unsuccessful in whole or in part; and
- (c) the court is satisfied upon considering the contingent and prospective liabilities of the company that it is unable to pay its debts.

* Clifford Chance Asia is a Formal Law Alliance in Singapore between Clifford Chance Pte Ltd and Cavenagh Law LLP.

Receivership

Receivership is regulated by Part VIII of the Companies Act.

A receiver is a person who is appointed to collect, protect and receive property and income from property. A receiver may be appointed in respect of a company encompassing its entire business and undertaking, or in respect of a particular asset or assets of the company. He or she may be appointed by the court or out of court by persons entitled to do so pursuant to contractual arrangements (e.g. debenture holders – receivership is the typical method of enforcing a debenture in the event of default). The court may appoint a receiver in respect of a company where, for example:

- (a) the company is incapable of managing its own affairs;
- (b) its assets are in jeopardy and creditors need protection;
- (c) shareholders are in dispute and it is necessary to appoint an impartial receiver to preserve the status quo; and
- (d) a receiver is necessary in aid of execution of a judgment.

A body corporate or an undischarged bankrupt cannot be appointed as a receiver. Although the court has power to appoint a receiver, it will usually not exercise the power unless it is satisfied that there is a real concern that the company's assets may be in jeopardy or dissipated.

The primary function of a receiver is to realise the company's assets to discharge the debt owed to the debenture holder. This is subject to paying any preferential creditors' claims from assets secured by a floating charge. Secured creditors will rank in priority to other creditors.

A receiver appointed by the court is not an agent of any person but is an officer of the court. A receiver appointed out of court may be the agent of the person appointing him. Unless the debenture provides otherwise, receivers appointed out of court are not agents of the company. A receiver's primary duty is not to the company but to the debenture holders who appointed him or her. However, the acts of the receiver are deemed to be the acts of the mortgagor, and will bind the mortgagor accordingly. He may, however, owe limited fiduciary duties to the company and must exercise diligence and care when disposing of the company's assets. A receiver is also required to ensure that all correspondence of the company states that a receiver has been appointed and to lodge with the Registrar of Companies detailed accounts.

In certain circumstances, a receiver may be liable for any debts incurred by him or her during the course of the receivership. If a receiver is not appointed under a debenture, an application can be made to the court to appoint a receiver on behalf of the debenture holders or other creditors of the company. After the debenture holder has been paid off, the company may continue to trade. However, in most cases, the company will not be in a position to continue and will be wound up.

The office of "receiver" *per se* does not confer any power to carry on the business of the company. If the company is to continue to trade at all, it is necessary to appoint a receiver and manager.

In the event of winding up, the receivership continues insofar as it is not inconsistent with the winding up.

Judicial Management

Judicial management is intended to operate as a means to rehabilitate and/or facilitate the restructuring of troubled companies. Under Part VIIIA of the Companies Act, the company, its directors, or a creditor may apply to the court to appoint a judicial manager if the court is satisfied that the company is likely to be unable to pay its debts and that the grant of a judicial management order is likely to achieve one or more of the following purposes:

- (a) the survival of the company or its undertaking as a going concern;
- (b) the approval of a compromise or a scheme of arrangement with the creditors; or
- (c) a more advantageous realisation of the company's assets than in a winding up.

The court may make a judicial management order if it considers that the public interest so requires, even if the above purposes may not be fulfilled. A judicial management order is unlikely to be granted if creditors are able to achieve the intended purposes of the judicial management order through some other way without any detriment to the company, or if the creditors would suffer irreparable loss as a result of the judicial management order.

If a judicial management order is granted, the court will appoint a judicial manager who will manage the affairs, business and property of the company.

Upon the making of an application for the appointment of a judicial manager, the court has the power to appoint an interim judicial manager pending the making of a judicial management order. The applicant would have to provide good reasons why such an appointment should be made, such as where there is a danger that the assets of the company will be dissipated in the interim.

Once the application for a judicial management order (or an interim judicial management order as the case may be) is made, there is a statutory moratorium preventing legal proceedings from being commenced or continued against the company without the leave of court. The moratorium also restricts a secured creditor from enforcing any of its security over the company's property.

A judicial manager acts as the agent of the company. Accordingly, the company will be bound by any contracts or transactions the judicial manager enters, within his or her authority, on the company's behalf. The company has a duty to indemnify the judicial manager in respect of any debts or liabilities under such contracts entered into by the judicial manager, in priority to all other debts except those subject to certain security interests specified in the Companies Act.

Judicial management is deemed to have commenced at the time of the making of the application for judicial management.

The judicial management order made by the court is valid for 180 days. However, it is open to the judicial manager to apply to the court for an extension of the judicial management order and it is a matter for the court's discretion whether to grant the extension.

Schemes of Arrangement and Reconstruction

Section 210 of the Companies Act provides that where a compromise or arrangement is proposed between the company and its creditors, the court may order a meeting of creditors to consider such compromise or arrangement.

The first formal step towards obtaining approval for a scheme of arrangement is for the company proposing the scheme to apply to the Court for leave to convene a meeting of all or certain of its creditors to consider and if thought fit, to approve the scheme. One of the key tasks and responsibilities of the promoter of a scheme of arrangement is to consider whether the scheme creditors should be classified differently according to their separate interests and if so, to hold separate creditors' meetings. After leave has been obtained, the prospective scheme creditors will typically be requested to submit their proofs of debt along with any supporting documents to the chairperson of the creditors' meetings for his/her adjudication. The chairperson of the creditors' meetings is usually the prospective scheme manager or his/her nominee.

The conduct of the creditors' meeting is the second stage of the section 210 process. At the creditors' meeting, the approval by a majority in number representing 75% in value of the creditors' claims must be obtained, either voting in person or by proxy, to approve the compromise or arrangement. Unanimous consent of the creditors is therefore not required. Upon approval by the court, the terms of the compromise or arrangement will be binding on all creditors, including secured creditors, whose rights are affected by the compromise or arrangement. However, there is nothing to stop the secured creditors from realising their secured assets or the unsecured creditors from

bringing actions against the company while the company is still undergoing restructuring, unless a court order is sought and granted to restrain legal proceedings from being taken against the company once a scheme of arrangement is proposed.

After the creditors' meetings have been conducted, the third and final stage is the application to court for the approval of the scheme. In determining whether to approve the compromise or arrangement, the court must be satisfied of the following matters:

- (a) whether the statutory provisions have been complied with (i.e. whether the creditors' meetings have been held in accordance with the terms of the court order granting leave to convene the said meetings);
- (b) whether those who attended the creditors' meetings were fairly representative of the class of creditors (or members as the case may be) and that the statutory majority did not coerce the minority in order to promote the interests adverse to those of the class whom the statutory majority purported to represent; and
- (c) whether the scheme is one that a reasonable creditor or member, being a member of the class concerned and acting in respect of his interest, would approve.

If the court is satisfied of the above matters, it will approve the proposed scheme of arrangement (the "Sanction Order"). The scheme will become effective and binding on all parties upon the lodgement of the Sanction Order with the Registrar of Companies.

An application to the court for approval of a scheme of arrangement may be made by the company, any creditor or

member of the company or the liquidator of the company (where the company is being wound up).

The company may apply for a moratorium to restrain or stay proceedings against the company where it is proposing a scheme of arrangement. An automatic 30-day stay of all proceedings against the company arises upon the filing of an application for such moratorium. The moratorium may also restrain the appointment of a receiver or receiver and manager. The company applying for the moratorium is required to provide evidence of support from creditors, a brief description of the intended scheme of arrangement and sufficient information relating to the company's financial affairs which will place the creditors in a better position to assess the feasibility of any proposed scheme of arrangement. The company is also required to provide the court with an undertaking that it will make the application for the scheme of arrangement as soon as practicable. A creditor may apply to the court to vary or terminate the moratorium, especially if the applicant company has not filed the information required.

Pursuant to the amendments to the Companies Act, a moratorium can be granted on the application of a subject company's "related company" (i.e. the subject company's subsidiary, holding company, or ultimate holding company) and applies to acts taking place in Singapore or elsewhere as long as the creditor is in Singapore or within the jurisdiction of the court.

A scheme of arrangement that has been approved by the court may only be amended by way of an order of court. A scheme of arrangement approved by the court will need to be lodged with the ACRA before it becomes binding.

Both reconstructions (i.e. the rationalisation of operations by the transferring of assets and liabilities between related companies) and mergers may be effected through a scheme of arrangement under section 210. The court has the power to make orders to facilitate reconstructions and mergers in relation to companies incorporated in Singapore.

A foreign company may be subject to a Singapore scheme of arrangement if there is sufficient nexus between the foreign company and Singapore and a reasonable possibility that the company's creditors will benefit from the scheme.

A scheme of arrangement may be proposed by the company, any member, any creditor, a judicial manager (if the company has been placed in judicial management) or a liquidator (if the company is being wound up).

Liquidation – Voluntary Winding Up

There are two types of voluntary winding up, a members' voluntary winding up and a creditors' voluntary winding up, the essential difference being that the former applies to solvent companies and the latter to insolvent companies. Accordingly, voluntary liquidation is not always an insolvency procedure and is not dealt with in any detail in this section.

Liquidation – Creditors' Voluntary Winding Up

If the company is unable to pay its debts, the company can convene a creditors' meeting to consider the voluntary winding up of the company.

If the directors consider that the company cannot pay its debts, they can resolve that the company be placed in an insolvent

liquidation. A members' meeting would be held and if the members resolve to wind up the company, they will also appoint a liquidator, subject to any preference the creditors may have as to choice of liquidator. Usually, the business of the company will cease to operate once winding up commences. Creditors are required to provide their proofs of debt on the commencement of the winding up process.

In urgent cases, the board of directors can resolve to place the company into liquidation and appoint a liquidator immediately. The decision must later be ratified by the subsequent resolutions of the members and creditors. The commencement of the winding up is deemed to be at the time of passing of the resolution to wind up. The resolution must be filed with the Registrar of Companies within seven days. Other than in urgent cases, the company must give notice of the resolution in one or more newspapers circulated in Singapore within ten days of the resolution to wind up.

Where a company is already in voluntary winding up, the court may still grant leave to wind up the company compulsorily if it is satisfied that it is necessary to do so in the interests of the company's creditors and contributories.

Liquidation – Compulsory Winding Up

The company, creditors, contributories, liquidator, judicial manager, or the Minister may present an application to the court to wind up the company. The court may order a winding up of the company on various grounds including (amongst others):

- (a) where the company is unable to pay its debts as and when they fall due;
- (b) where the court is of the opinion that it is just and equitable that the company be wound up; or

- (c) an inspector, appointed under Part IX of the Companies Act, has reported that the company is unable to pay its debts or it is in the public interest that the company be wound up.

Once the order is granted, the court may appoint the official receiver or an approved company auditor to act as the liquidator. Usually the party presenting the winding up application will nominate the liquidator and a court order will make the appointment. If a liquidator is not appointed when the winding up order is made, the Official Receiver will become the provisional liquidator until such other person is appointed as the liquidator of the company.

The liquidator will assume custody of the company's property, carry on the company's business and endeavour to repay the creditors' debts.

Liquidation of a Foreign Company

Section 377 of the Companies Act governs the cessation of business in Singapore of a foreign company that is registered in Singapore, for example, where it operates through a branch in Singapore. A foreign company has an obligation to notify the Registrar of Companies where the foreign company ceases to carry on business in Singapore or goes into liquidation in its place of incorporation.

Liability of Directors of the Company in Liquidation

Directors of a company in liquidation may incur civil and criminal liability in certain instances.

The Companies Act imposes criminal liability on directors of a company who will be liable to a fine of up to SGD10,000 or up to two years' imprisonment. Criminal sanctions do however

require an intention to defraud and therefore an officer who acted honestly could be regarded as having a valid defence.

The circumstances in which a director may be criminally liable include:

- (a) failure to disclose fully to the liquidator all property of the company;
- (b) failure to deliver up property, books or papers of the company in his custody or possession;
- (c) within 12 months prior to the commencement of the winding up or at any time thereafter, concealment of any property of the company or any debt due to or from the company to the value of SGD200 or upwards;
- (d) within 12 months prior to the commencement of the winding up or at any time thereafter, fraudulent removal of any property of the company to the value of SGD200 or upwards; or
- (f) destruction, mutilation, alteration or falsification of any books or papers belonging to the company.

In addition to criminal liability, a director may be personally liable for the debts and liabilities of the company if he or she is found to be responsible for the carrying on of the business of a company with the intent to defraud creditors or for any fraudulent purpose.

A director may also be liable to compensate the company if he or she has misapplied or retained or becomes liable for company property or is guilty of any misfeasance or breach of trust or duty in relation to the company.

Challenges to Antecedent Transactions

Transactions at an undervalue

A liquidator may apply to the court to set aside transactions at an undervalue entered into within five years prior to the onset of insolvency. For this purpose a transaction is at an undervalue if it constitutes a gift or if the value of the consideration received (in money or moneys worth) is significantly less than the consideration provided by the company.

The transaction however will not be set aside if the court is satisfied that the relevant transaction was entered into in good faith and there were reasonable grounds for believing the transaction would benefit the company. The grant of security may possibly be the subject of a challenge as a transaction at undervalue.

Unfair preference transactions

A liquidator may apply to set aside transactions which occurred within six months prior to the onset of insolvency (this period is extended to two years for transactions involving connected parties) which had the effect of putting the creditor, surety or guarantor in a better position in the liquidation than would otherwise have been the case. A company must have been influenced in deciding to give the preference by a desire to produce the effect of putting the creditor in a better position. If this desire is missing the transaction will not be invalidated.

Priority of Claims

A secured creditor need not prove for its debt and can realise its security despite the commencement of liquidation proceedings. If the security is inadequate, the secured creditor is entitled to prove in liquidation the balance due as an unsecured debt. All unsecured creditors will have to lodge a proof of debt with the liquidator.

Generally, the order of priority for the distribution of the assets of a company in liquidation is as follows:

- (a) secured creditors;
- (b) liquidator's costs and remuneration, and the cost of realising charged assets;
- (c) preferential creditors (may be paid out of floating charge assets, where there are insufficient unencumbered assets);
- (d) unsecured creditors; and
- (e) members of the company.

Guarantees

Guarantees are available in most circumstances, for example downstream, upstream or cross-stream guarantees. Corporate benefit issues need to be addressed especially in the context of upstream and cross-stream guarantees.

A guarantee is a secondary obligation by a third party relating to a primary obligation by a contracting party (i.e. a borrower under a loan agreement). If the primary obligation is altered, discharged or fails, the guarantee may not be enforceable.

Guarantees may be challenged and set aside if they amount to an unfair preference transaction.

New Money Lending: Rescue Financing

The May 2017 Companies Act amendments have introduced provisions on “rescue financing”, which refers to any financing that is either (i) necessary for the survival of the company as a going concern, or (ii) necessary to achieve a more advantageous realisation of the assets of the company than on a winding up of the company.

The new amendments empower the court to grant one of four levels of priority over other secured and unsecured debts, i.e for the rescue financing to: (i) be treated as part of the costs and expenses of the winding up, (ii) have super-priority over preferential debts, (iii) be secured by a security interest on property not otherwise subject to any security interest or that is subordinate to existing security, or (iv) be secured by a security interest, on property subject to an existing security interest, of the same or a higher priority than the existing security interest.

The availability of an order for priority for rescue financing depends on the level of priority sought, whether the company has made a scheme application and/or moratorium application, or whether there is a judicial management order in force. In particular, in order for the rescue financier to be granted the priority levels as per (ii) to (iv) above, it must be shown that the company is unable to obtain the rescue financing from other persons unless the rescue financier is accorded that particular level of priority. Further, in order for an existing secured interest to be over-ridden (i.e. level (iv) above), the court must be satisfied that the existing secured creditor is ‘adequately protected’.

Lender Liability

A lender may possibly be held to be liable to pay the company's debts if it was found to be acting as a shadow director of the company. A shadow director is considered to be a director, as the definition of a “director” in the Companies Act includes “a person in accordance with whose directions or instructions the directors of a corporation are accustomed to act”. The liquidator is able to apply to the court to make any person who was party to carrying on the company's business in a fraudulent manner liable for the company's debts. If the

lender, as shadow director, has authorised the contracting of a debt when it had no reasonable expectation of the debt being repaid, the liquidator may apply to the court to make the lender liable to pay that debt. However, the burden of proving fraudulent intent to establish such fraudulent trading is generally difficult to discharge.

Cross-Border Assistance

Pursuant to the new section 354B(1) of the Companies Act, the UNCITRAL Model Law on Cross-Border Insolvency (“Model Law”) will have force of law in Singapore and will facilitate the resolution of cross-border insolvencies by (among other things):

- (a) streamlining and clarifying the process for recognition in Singapore of foreign insolvency proceedings;

- (b) facilitating access by foreign insolvency representatives to the Singapore Court, as well as the granting of relief in Singapore to assist foreign proceedings; and
- (c) promoting cooperation and coordination between courts of different jurisdictions and insolvency administrators.

Together with the abolition of the ring-fencing rule in respect of foreign companies under Part XI of the Companies Act, the introduction of the Model Law is a marked departure from the traditionally territorial conception of cross-border insolvency and is emblematic of the shift towards the principle of modified universalism.

TAIWAN



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Key Elements:

- Composition and reorganisation procedures focus on company rehabilitation.
- Moratorium available.
- Director liability.

Introduction

This section is designed to provide a general outline of the main corporate insolvency procedures available in Taiwan. Most of the legislation relevant to insolvency is contained in the Company Law (1929) and the Bankruptcy Law (1935). Under the Company Law, the terms “insolvency” and “bankruptcy” are used interchangeably.

The Taiwanese government and legislature have for several years been in the process of reviewing draft amendments to the Bankruptcy Law which, if enacted, would rename the law as the “Debt Clearance Law” and incorporate the reorganisation provisions currently found in the Company Law into the renamed Act. The new legislation was made public for comment on January 29, 2007. However, the current status of the proposed legislation is unclear, and there is no reliable timeline as to whether and when it may be enacted.

Under the existing legislation, there are four types of insolvency proceedings available in Taiwan:

- (1) Composition;
- (2) Reorganisation;

(3) Bankruptcy; and

(4) Special liquidation.

Composition proceedings are conducted with the involvement of either the court or a local chamber of commerce, whilst the other proceedings are required to be supervised by the court. The aim of the composition and reorganisation processes is to rehabilitate the entity.

There are also specific regulatory actions which may be taken to override general insolvency proceedings where the insolvent entity is in certain industries such as the banking or insurance industries. Such regulatory actions are beyond the scope of this section.

Composition

Composition allows for the compromise of debts by agreement among the creditors. Accordingly, there is no need to obtain a formal court order declaring the company bankrupt. A composition is only available where there is more than one creditor.

An application for a composition may only be made by the company where it is unable to pay its debts. The court will consider a company's failure to pay its debts as evidence of an inability to satisfy its debt. The company may apply to the court (or the local chamber of commerce) for a supervised composition. The company must include a statement of affairs and a proposal for satisfying the creditors' claims. The court must either approve or dismiss the application for composition

proceedings within seven days of receiving the application. No appeal against this ruling is allowed.

If the court approves the application, it will provide notice to the public of the approval, following which creditors are required to register their claims. Within one month after the expiration of the creditors' registration period, a creditors' meeting must be held to accept the composition. A resolution to accept the composition requires a majority vote of creditors present at the creditors' meeting holding at least two-thirds of the total unsecured debts. The resolution of composition is then subject to court approval.

Once the composition is approved, the court will typically designate a judge to supervise the implementation of the composition arrangement and select up to two assistant supervisors from among chartered public accountants, persons designated by the local chamber of commerce or other appropriate persons. The primary duty of the assistant supervisors is to ensure that no action is taken to prejudice the interests of creditors. The company will then continue business under its incumbent management acting under the supervision of the supervisors.

An appeal against the approval of the resolution of composition may be filed with the court. This appeal, however, is only available for creditors who have previously objected to the court in relation to the composition, or whose participation in the composition has been rejected.

During the composition period, secured creditors are free to enforce their security. A moratorium, however, is effective in respect of unsecured creditors. All existing compulsory execution proceedings initiated by unsecured creditors are

suspended. Any debts incurred after the commencement of the composition are not affected by the moratorium period.

If a court dismisses a composition application or does not approve the resolution of composition, and finds the company meets the requirements for bankruptcy, the court may declare the company bankrupt.

A company is also permitted, without first applying to the court for composition or bankruptcy, to apply directly to the local chamber of commerce for a supervised composition. Certain (but not all) provisions with respect to the composition procedure supervised by the court (e.g. the process, reasons for dismissal of composition application, restriction on compulsory enforcement, and effect of the resolution of composition approved by the court) are generally applicable to the composition procedure supervised by the local chamber of commerce.

A resolution of composition approved by the court is generally binding on all creditors whose claims arise before the composition application was made.

Reorganisation

Reorganisation is principally a procedure intended to rescue companies which are or may become insolvent. The process is available exclusively to companies with publically listed shares or corporate bonds in circumstances where the company suspends its business due to financial difficulties, or where there is apprehension that the business will be suspended due to financial difficulties. The reorganisation procedure is initiated by an application to the court by the directors of the company, shareholders holding at least 10% of the total shares for not less than six months, or creditors whose claims are equivalent to at least 10% of the total share capital.

A court is required to issue a reorganisation ruling to approve or dismiss an application for reorganisation within 120 days of receiving the application. The 120-day period may be extended twice provided that each such extension is not permitted to exceed 30-days. A company is not eligible to apply for, and the court will not approve a reorganisation where there is no possibility that the company will be able to rehabilitate itself. A court will dismiss an application for reorganisation if the insolvent company fails to meet the statutory requirements – in particular, (i) if the company fails to comply with the application procedure; (ii) if the company is not a publicly listed company; (iii) if the company has been declared bankrupt by the court; (iv) if the company has reached a resolution of composition as stated above; (v) if the company has been dissolved; or (vi) if the company has been suspended from business and required to clear its debts.

Prior to the court approving the reorganisation, the company or certain interested parties (being creditors or shareholders of a certain percentage) may apply to have the company's assets preserved for a period of up to 90 days (which may be extended once for an additional 90 days).

Once an application for reorganisation is approved by the court, any bankruptcy, composition and/or litigation proceedings (including compulsory execution against the company) are suspended.

On appointment of an administrator the directors are displaced and their powers of management are vested in the administrator. All creditors (including creditors with priority, secured creditors and unsecured creditors) and shareholders are required to register their claims or shareholder rights, within the time limit and at the place set out in the reorganisation ruling, to participate in the reorganisation procedure and exercise their rights. Unlike bankruptcy, creditors with priority

and secured creditors are not exempt from registering their claims in a reorganisation.

An administrator must prepare a restructuring plan which is subject to (i) the approval of meetings of each interested party group (i.e. creditors with priority, secured creditors, unsecured creditors and shareholders) requiring approval by majority vote of each group (voting within the creditor groups is weighted by the amount of debt, while voting within the shareholder group is weighted by the number of shares held), and (ii) the approval by the court. However, if the company has negative net worth, shareholders lose their rights to vote over the plan.

If a restructuring plan is not approved by the interested parties, the court may order revisions of the restructuring plan and order the interested parties to vote again on the revised plan within one month. If the revised plan is still not acceptable to the interested parties, the court is required to terminate the reorganisation procedure and, if the company meets the requirements for bankruptcy, declare the company bankrupt.

Upon completion of a reorganisation of a company:

- (i) all unregistered claims and those registered claims which are not provided for in the plan are extinguished;
- (ii) unregistered shareholder rights and shareholder rights which are reduced or cancelled by the plan are extinguished; and
- (iii) any bankruptcy, composition, compulsory execution and other litigation proceedings against the property of the company commenced prior to the completion become ineffective.

Corporate reorganisation is a lengthy process and has been abused by companies which have used the procedure as a negotiation tool to reduce the amount of debt and/or interest owed to creditors. Accordingly, this process is not favoured by creditors.

Special Liquidation

The effect of a liquidation is that the liquidator will take over the management of the company. No business activity can be carried on unless it is necessary for the liquidation. The liquidator, within the claim registration period, is not able to make payments to unsecured creditors but may, with the court's approval, pay secured claims.

The court may, at its discretion or acting upon the petition of the regular liquidator, shareholder or creditor, order a special liquidation. This is performed in circumstances where a company has been placed into liquidation and there is difficulty in conducting a liquidation or doubts as to the accuracy of the company's books. Subject to the rights of secured creditors and preferential creditors, distributions are made on a *pro rata* basis. During a special liquidation, unsecured creditors' meetings may be held at the liquidator's discretion or upon the request of unsecured creditors representing not less than 10% of the total unsecured debts of the company. The liquidator may propose an agreement of settlement to be approved in an unsecured creditors' meeting attended by unsecured creditors representing more than one-half of the unsecured debts and approved by unsecured creditors representing not less than three-quarters of the total unsecured debts. If an agreement of settlement is not approved or is not feasible, the court has discretion to order the commencement of the bankruptcy procedures.

Bankruptcy

Bankruptcy is declared against a company that is unable to pay its debts, and the bankrupt company loses the right to manage and dispose of property forming part of the bankrupt estate.

These powers vest in the trustee or liquidator of the company upon a declaration of bankruptcy.

If a company's assets are not sufficient to satisfy its debts, the liquidator is required to apply to the court to declare the company bankrupt.

The court will regard a failure by the company to pay its debts as evidence that the company is unable to satisfy its debts. A bankruptcy application may be lodged at any time by the company or a creditor, including during the composition procedure. The court is required to declare the company bankrupt or dismiss the application for bankruptcy within seven days (which may be extended once for an additional seven days) of receiving the application. The court will dismiss the application if (i) it forms the view that there is a possibility of a successful composition, or (ii) the court finds through investigation that the bankruptcy proceeding would generate no benefit to a large majority of creditors given that the company has no assets or only nominal assets which are insufficient to pay even the bankruptcy trustee's fees.

Where a company is declared bankrupt, all pending litigation proceedings against the property of the insolvent company are suspended and a trustee in bankruptcy will be appointed by the court. The court is also required to state in the bankruptcy declaration, a period of between 15 days and three months for unsecured creditors to register claims (secured creditors are exempt from such registration requirement). Unregistered unsecured creditors are unable to share in the proceeds of the liquidated company. The trustee will prepare a list of creditors' claims.

A creditors' meeting will be called by the court on the application of the trustee in bankruptcy, where resolutions may be passed:

- (a) electing one or more supervisors to represent the creditors in the bankruptcy process;

- (b) prescribing the method of the administration of the bankrupt's estate; and
- (c) determining whether the business of the bankrupt should continue.

To carry, the resolution generally requires the consent by a majority vote of creditors present at the creditors meeting holding more than one-half of the total claim amount (which refers to the total "registered" claim amount).

Distributions are made on a *pro rata* basis. Secured creditors, however, have exclusive rights in respect of the secured property and are free to enforce against the secured property through foreclosure anytime throughout the bankruptcy proceedings.

Trustee fees, debts arising out of actions taken by the trustee for the management of the debtor property during the bankruptcy procedure, tax claims and employee claims enjoy priority over the claims of unsecured creditors in the distribution of proceeds.

The trustee or assistant supervisors may be punished for soliciting or receiving bribes or other unjust interests.

Liquidation

Where a company is subject to dissolution process, the directors of the company will serve as liquidators unless the articles of incorporation of the company, law or a shareholder resolution otherwise provide, to process liquidation. The effect of a liquidation is that the liquidator will take over the management of the company. No business activity can be carried on unless it is necessary for the liquidation. The liquidator, within the claim registration period, is not able to make payments to unsecured

creditors but may, with the court's approval, pay secured claims. If the liquidator finds that the aggregate of the assets of the company is insufficient to satisfy its liabilities, the liquidator shall file an application for declaration of bankruptcy.

Challenges to Antecedent Transactions

During the bankruptcy procedure, the trustee has the power to disclaim (i) any agreements made by the company prior to the declaration of bankruptcy that are considered detrimental to creditors, or (ii) guarantees made within the six-month period prior to the adjudication of bankruptcy. The trustee may recover any undue payment made within the six-month period prior to the declaration of bankruptcy. The trustee also has the power to disclaim any lease contract entered into by the company as lessee, and the lessor has no remedy in such event. There are no other specific provisions providing a basis to challenge antecedent transactions except for general Civil Code rights of revocation.

Enforcement Process by Secured Creditors

Once insolvency proceedings (other than a reorganisation) have been commenced, a moratorium comes into effect but it does not prevent secured creditors from enforcing their security. Where reorganisation proceedings are underway, secured creditors are generally barred from enforcing their security over property through foreclosure.

Personal Liability of Directors

As a general rule, directors of a company do not have personal liability for the debts of the company. However, in connection with a reorganisation, a director of the company (as well as the supervisor, manager or other staff) will be liable to one-year

imprisonment, retention and/or criminal fines if he or she engages in any of the following:

- (a) refusing to transfer the management of business or property to the administrator;
- (b) hiding or destroying the account records in relation to the company's business or financial status;
- (c) hiding or disposing the company's assets or engaging in any disposal which is detrimental to creditors;
- (d) refusing to respond to the administrator's inquiry as to the company's business and financial status without justifiable reasons; or
- (e) fabrication of debts or acknowledgement of untrue debts.

A director of the company under a composition or bankruptcy procedure is liable to the following:

- (a) one-year imprisonment if the director violates its obligation to provide or transfer the statements or account records to the trustee, refuses to respond to the trustee's inquiry or makes a false statement to the trustee;
- (b) five-year imprisonment if, within one year before the bankruptcy declaration or during the bankruptcy proceedings, the company is found to petition a bankruptcy in fraud with the intent to damage the creditors;
- (c) five-year imprisonment if the company is found to apply for a composition in fraud with the intent to damage the creditors after its approval of the composition; and

- (d) one-year imprisonment if, within one year before the declaration of bankruptcy, the company (i) wastes the assets of the company or improperly increases the company's debt, (ii) assumes debts, makes purchases or disposes of goods under terms which are disadvantageous to the company with the intention to delay the bankruptcy, (iii) provides collateral where there is no obligation to provide collateral or incurs fraudulent debts in favor of specific creditors with the knowledge that the company is in bankruptcy, or (iv) releases debts with no due consideration.

Lender Liability

At present there are no laws, regulations or court precedents imposing liability on lenders in connection with insolvency proceedings.

Guarantees

Under Taiwanese law, creditors' rights against guarantors of the insolvent company's debts and joint-debtors with the insolvent company will not be affected by the composition or reorganisation procedure.

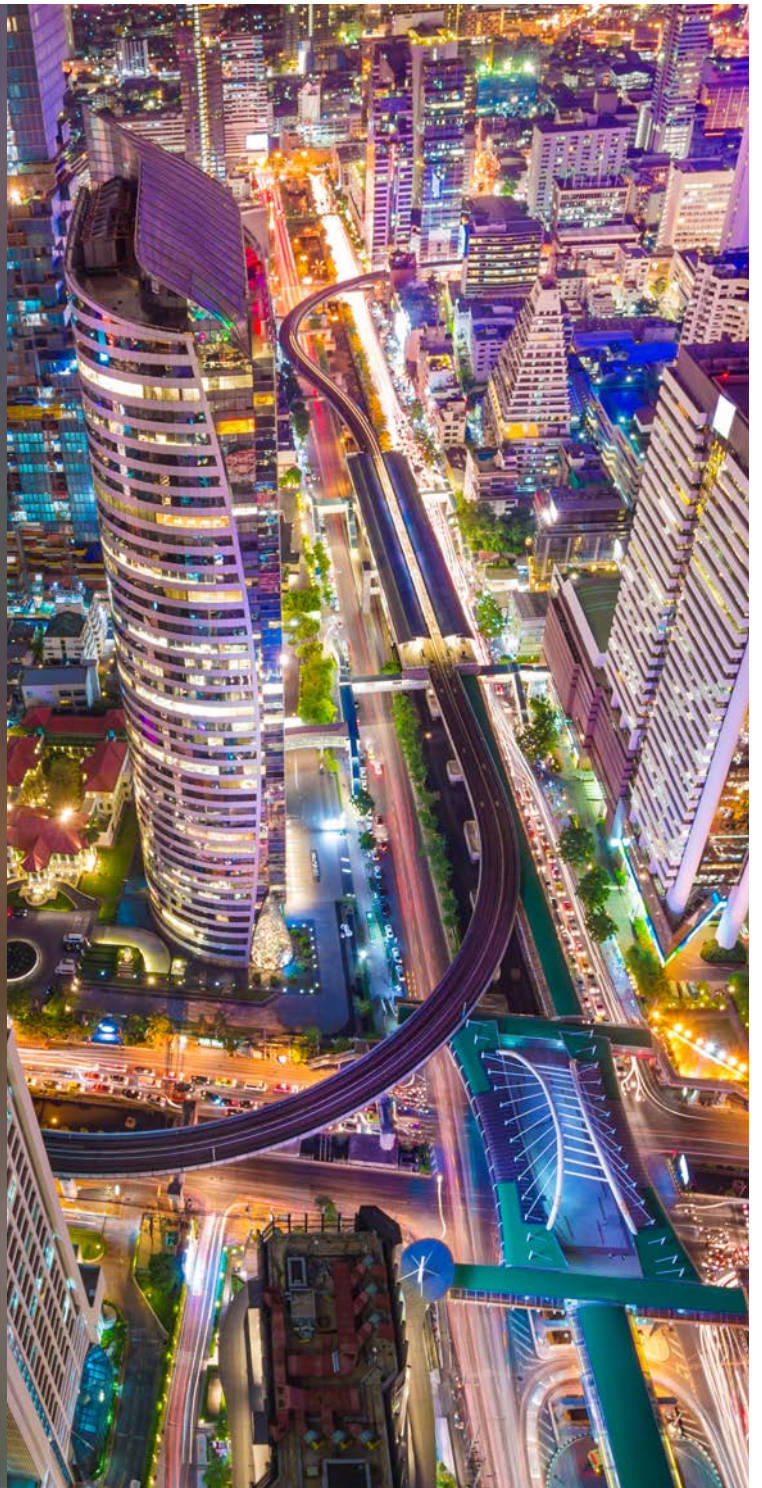
New Money Lending

The administrator of a reorganisation procedure and a liquidator of a special liquidation procedure, subject to the consent of the supervisor, are permitted to borrow money on behalf of the insolvent company. Any borrowings and other debts incurred for the purpose of maintaining the company's business during the reorganisation procedure will have priority over other unsecured debts of the company. Debts arising out of any action taken by the trustee for the management of the debtor's property during the bankruptcy procedure will also have priority over other unsecured debts of the company.

Recognition of Foreign Insolvency Proceedings

In principle, a foreign final judgment or ruling, subject to certain conditions, will be recognised by Taiwan. However, Taiwanese Bankruptcy Law states that a composition reached in a foreign country or a bankruptcy declared in a foreign country does not have any influence on the company's property located within the territory of Taiwan.

THAILAND



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Key Elements:

- Automatic moratorium for business rehabilitation.
- No voluntary bankruptcy procedure available to debtors.
- Insolvency procedures are conducted or supervised by official receivers.

Introduction

This section provides a general outline of the main corporate insolvency procedures in Thailand. Corporate insolvency in Thailand is principally governed by the Bankruptcy Act 1940 (last amended in 2018) (the “**Bankruptcy Act**”) and the Civil and Commercial Code (“CCC”).

The main procedures encountered in corporate insolvencies are:

- (1) bankruptcy (including composition); and
- (2) business rehabilitation.

A debtor or its creditors may file for business rehabilitation. Bankruptcy, on the other hand, may only be initiated by creditors.

The competent body to exercise jurisdiction in insolvency matters is the Central Bankruptcy Court (the “Court”). A solvent liquidation may be undertaken by any person. An insolvent liquidation, however, may only be conducted by the official receiver. Thai law does not provide for a voluntary bankruptcy procedure.

This section will not cover solvent winding up procedures or the bankruptcy of individuals.

Insolvency Test

The debtor is presumed to be insolvent where:

- (a) the debtor declares to the Court or informs its creditors that it cannot pay its debts;
- (b) the debtor has submitted a proposal for composition of its debt to two or more creditors; or
- (c) the debtor has received not less than two demand letters within 30-days and has not yet paid a sum according to the demand.

In addition to the tests relating to failure to pay, a debtor will also be deemed insolvent where:

- (a) The debtor has transferred its assets or the rights to manage its assets to another person for the benefit of that other person’s creditors.
- (b) The debtor has transferred or delivered its assets with dishonesty or fraudulent intent.
- (c) The debtor has transferred or created rights which would, in the situation of bankruptcy, be considered an act of preference.
- (d) The debtor has delayed its payment by closing its business, consented to a judgment order for a payment which it should not pay, or has removed assets out of the court’s jurisdiction.
- (e) The debtor’s assets are attached under a writ of execution, or there are no assets capable of attachment.

Bankruptcy

If a creditor is owed more than THB2,000,000 by a debtor company, it may commence bankruptcy proceedings against the insolvent debtor by filing a petition or claim with the Court. The main objective of bankruptcy is to place the debtor into receivership and appoint an official receiver to liquidate the debtor and distribute the proceeds to creditors.

Appointment of official receiver

The court will schedule a preliminary hearing date, usually six weeks after the claim is filed with the court, to examine witnesses and schedule future hearing dates for a trial. If, by the end of the trial, the Court issues an absolute receivership order, it will be published in the Royal Gazette and at least one daily newspaper.

Once a receivership order is issued, the debtor is prohibited from dealing with its assets except by order of the Court or with the approval of the official receiver or the creditors (provided at a creditors' meeting). Only the Minister of Justice can appoint an official to be an official receiver.

Eligible creditors must file a claim within two months from the date of publication of the order of absolute receivership except for the event where a force majeure has occurred and is continuing, a creditor may file a claim after such two-month period by provide evidence showing that he could not file the claim within two months due to an event of force majeure. However, such creditor may only receive a repayment from a residual fund after the allocation of the debtor's assets to other creditors.

Non-resident creditors may be granted a further two-month extension, however they must prove that Thai creditors enjoy reciprocal rights to participate in proceedings in their respective

countries, and must agree to relinquish any property of the debtor outside Thailand for the benefit of all creditors.

A creditor cannot file a claim for the repayment of a debt where the creditor knew the debtor was insolvent at the time the debt was incurred, unless the debt was incurred in order for the debtor's business to be able to continue its operations.

Functions and duties of the official receiver

The official receiver will examine all claims submitted by the creditors. If there is an objection by the debtor or its creditors, the official receiver will then consider and order whether to accept or reject such claims. However, any stakeholder may challenge the official receiver's order by filing a claim to the Court.

The official receiver will automatically be empowered to take control of the debtor and manage the debtor's business, including taking custody of its property and acting on behalf of the debtor in civil actions. The official receiver can also call creditors' meetings and offer a compromise for the settlement of debts with the debtor's creditors.

If the creditors decide that the debtor should be declared bankrupt, the Court will issue a bankruptcy order and the liquidation process will commence. The proceeds from the realisation of the debtor's assets by the official receiver will then be distributed to the creditors in the following order of priority (on a *pro rata* basis if proceeds are insufficient for any category):

- (a) official receiver's costs and expenses for managing and realising the debtor's property;
- (b) court fees for collecting the debtor's property;

- (c) fees of the petitioning creditor and counsel's fees as the Court or the official receiver may prescribe;
- (d) taxes due within six months prior to the court order for receivership and wages of the debtor's employees; and
- (e) any other debts.

Secured creditors

Secured creditors are entitled to enforce their security without filing a claim for repayment under the bankruptcy procedure. However, in order to be entitled to vote as a creditor under the bankruptcy procedure, a secured creditor is required to file a claim for repayment.

Composition

A debtor may submit a proposal for the composition of its debts, whereupon the official receiver must call a creditors' meeting as soon as possible to consider whether the proposal should be accepted or whether the debtor should be declared bankrupt.

A resolution will carry if approved by creditors representing more than 50% in number and at least 75% in value.

If the composition plan is accepted by creditors, it must then be approved by the Court at which point it will become binding on all creditors. After the Court approves the composition plan, the debtor will not be at risk of bankruptcy, other than for claims relating to tax and the debtor's fraudulent behavior. At the same time, incumbent management will retain control of the company subject to the direction of the Court.

Business Rehabilitation

Business rehabilitation is a court-supervised formal attempt to restructure the finances of a distressed enterprise. The procedure may be commenced by a debtor, creditor or competent governmental authority empowered under the Bankruptcy Act to supervise certain businesses (for example, the Bank of Thailand in respect of a commercial bank). A petition for business rehabilitation may be filed with the Court if the debtor:

- is insolvent or unable to pay debts as scheduled; and
- owes at least THB10,000,000 to one or more creditors.

Upon the Court accepting the petition, an official receiver is appointed to supervise the business rehabilitation and an automatic stay comes into effect. Secured creditors will not be able to enforce their security without court approval. The automatic stay will continue until the rehabilitation plan has either expired or been executed.

A court hearing will be held to determine whether a rehabilitation order should be made. Factors taken into account include the financial status of the debtor and the potential for a successful rehabilitation of the business.

Once the rehabilitation order is made, the Court will appoint a person who is generally nominated by the debtor as a plan preparer to formulate and prepare the business rehabilitation plan. If the Court is of the opinion that such person is not suitable to formulate a plan, the Court will order the official receiver to call a creditors' meeting as soon as possible to consider a suitable replacement. The automatic stay remains in effect during this period.

The plan preparer must categorise the creditors into the following separate groups for the purpose of voting for approval of the business rehabilitation plan

- (a) each secured creditor with secured debt equal to or in excess of 15% of the total debts claimable in the business rehabilitation process;
- (b) secured creditors other than those referred to in (a) above;
- (c) unsecured creditors (who may be further divided into different sub-categories); and
- (d) subordinated creditors.

Creditors within the same group must be treated equally in the business rehabilitation plan.

The proposed plan must be approved by either 2/3 of debt value and 50% in number of each class of creditors, or 2/3 of debt value and 50% in number of one class of creditors together with 50% in debt value of all creditors.

Creditors with debts that were incurred before the date of the rehabilitation order must file their claims with the official receiver within one month of the publication of the appointment of the plan preparer in the Royal Gazette.

Where the plan is not approved by creditors, the Court will issue an order canceling the business rehabilitation order and the automatic stay will cease to apply. The Court may continue any bankruptcy proceedings commenced before the business rehabilitation procedures began.

If the plan is approved by the creditors and the Court, a plan administrator will be appointed in order to implement the approved business rehabilitation plan. Under the plan, creditors

will be categorised into several classes with differing treatment in respect of each class.

Creditors may file a motion with the Court challenging the plan on the basis that it fails to treat creditors of the same class equitably.

If the business rehabilitation is not successfully implemented within the allotted time period, which is usually five years, but up to a maximum of seven years (if two extensions for a period of one year each are allowed), the Court may declare the debtor bankrupt and order the commencement of liquidation.

Since 2016, business rehabilitation procedures can be applied to registered SMEs, who may be individuals, groups of persons, partnerships or companies. Such persons or entities are entitled to more relaxed requirements such as a lower threshold of debts (between at least THB 3 million and up to THB 10 million), less complex creditors' voting (at least two-thirds of the total debts) and the shorter implementation period of a rehabilitation plan. However, a similar moratorium and other requirements (e.g. plan making) remain in place.

Challenges to Voidable Transactions

Each of the official receiver, the plan preparer and the plan administrator have the power to file a motion with the Court for an order to cancel a fraudulent act or undue preference.

A fraudulent act under the CCC is a transaction entered into by the debtor where the debtor and the counterparty have acknowledged that such action would prejudice other creditors. If the transaction involves a gratuitous act, only the debtor needs to have knowledge that such action would be prejudicial to creditors. A prejudiced creditor is entitled to

request the cancellation of the offending transaction by the Court of Justice. In addition, under the Bankruptcy Act, the official receiver, the plan preparer and the plan administrator have the power to file a motion with the Court for an order to cancel a fraudulent act if the act took place within one year prior to the filing of a petition for bankruptcy or business rehabilitation, or occurred anytime thereafter.

In the case of an undue preference, the official receiver, the plan preparer and the plan administrator have the power to file a motion asking the Court to cancel any transfer of an asset or any act carried out by the debtor with the intention to give the undue preference to a creditor, where the transfer or act occurred within three months (or one year if the transfer/act was done with a “connected person”) prior to the filing of a petition for bankruptcy or business rehabilitation, anytime or thereafter.

Director Liability

The Bankruptcy Act states that for a period of one year prior to the bankruptcy of a debtor or anytime thereafter, but before the issuance of a receivership order, the debtor, an officer, a liquidator, a director, representative or employee of the debtor is liable to imprisonment or a fine for:

- (a) fraudulently tampering with accounts or documents relating to the business of the debtor;
- (b) omitting to record material matters or making false entries in the accounts or documents relating to the debtor’s business or assets;
- (c) pledging, mortgaging or disposing of the property which was obtained on credit for which the price has not been paid (unless in the ordinary course of business and in the absence of any intentional fraud); and/or

- (d) receiving goods on credit using false pretences.

It should be noted that personal liability may be imposed on a director by virtue of other laws such as in relation to fraud (Section 341 of the Criminal Code) or where a director does not comply with obligations under the Determining Offence relating to the Register Partnership, Limited Partnership, Limited Company, Association and Foundation B.E. 2499. This includes, for example, a director that does not summon an extraordinary meeting under the CCC, or conceals from the meeting a material matter that relates to the company’s financial statements.

Under the CCC, a director has a duty to conduct the business of the company with the diligence of a careful businessman. If a director causes loss to a company through non-compliance with this duty, the company or its shareholders can claim against the director for the loss suffered. Similarly, in relation to a public company, a director has a duty to conduct business in compliance with all laws, the objects, the articles of association of the public company, and the resolutions of shareholder meetings. Directors must also act in good faith and with care to preserve the interests of the company. If a director fails to discharge these duties, the public company or its shareholders can make a claim against the director.

Where the company is a listed company, the directors must also comply with the Securities and Exchange Act which imposes a fiduciary duty on directors towards the company, and imposes criminal sanctions if the directors fail to comply.

Guarantees

There is no restriction that prohibits a Thai company from giving a guarantee if it has the legal capacity to do so and it is within the company's objects. This applies to both upstream and downstream guarantees. Please note, however, that guarantee under Thai law has specific legal formality that should be carefully observed and cross-border guarantee may involve foreign exchange and foreign business licence issues. A guarantee given by a bankrupt company or a company subject to business reorganisation may be subject to challenge, for example, where it would constitute a fraudulent act or an undue preference under the Bankruptcy Act (see Challenges to Voidable Transactions).

New Money Lending

Unless otherwise provided in the business rehabilitation plan, the status of new funds provided during the rehabilitation procedure can be separated into the following two categories:

- (1) Funds provided during the period between when the Court issues an order to rehabilitate the business and when the Court appoints the plan preparer.

In order for a creditor to be entitled to repayment, the debt must only be incurred by the official receiver or interim executive, and the creditor must have a letter confirming the claims issued by the plan preparer.

In this regard, creditors are not required to file a claim pursuant to the procedures under the Bankruptcy Act. Instead, creditors are entitled to repayment according to the time periods stipulated in the business rehabilitation plan.

- (2) Funds provided after the Court approves the plan for business rehabilitation pursuant to the plan.

As above, creditors are entitled to repayment in accordance with the business rehabilitation plan and are not required to file a claim pursuant to procedures under the Bankruptcy Act. A creditor who provides a loan will not be subject to the automatic stay of the Bankruptcy Act and may enforce its rights when the debt matures.

Lender Liability

A lender or creditor may attract liability from (i) involvement in a fraudulent act, or (ii) earning a benefit that constitutes an undue preference. The official receiver, the plan preparer and the plan administrator can file a motion with the Court for an order to cancel a fraudulent act or undue preference (see Challenges to Voidable Transactions).

Whether the fraudulent act or undue preference results in liability to the creditor will depend on the act itself. For example, if a debtor's property is transferred to a creditor to prevent the other lenders from receiving payment, such an act would constitute an offence by the debtor and this carries a punishment of imprisonment for a period not exceeding two years or a fine not exceeding THB200,000. A creditor will also be deemed to have committed an offence where it assists or supports the debtor in committing such an act or takes part in the commission of such action.

Moreover, if a creditor helps or supports the debtor to commit a fraudulent act or grant an undue preference, and this causes the loss of property or any other right of the other creditors, the offending creditor may be liable on the basis of tort under the CCC. Aggrieved creditors may take legal action against the creditor to recover their loss. An example of a fraudulent act is the creation of a non-existent liability or debt to dilute the proportional rights of the existing creditors.

Cross-Border Insolvency

There is no established procedure or practice regarding the recognition of foreign insolvency proceedings in Thailand.

The Bankruptcy Act clearly states that the receivership of an asset or a bankruptcy action relates only to the assets of the debtor located within the Kingdom of Thailand. The receivership of an asset or a bankruptcy action initiated in a foreign country has no bearing or effect on the assets of a debtor located in the Kingdom of Thailand.

Thailand is not a party to any convention which recognises foreign judgments, and therefore foreign judgments are not enforceable in Thailand. Thai courts may, however, accept foreign judgments as evidence for the purposes of local insolvency.

VIETNAM



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Key Elements:

- Restoration procedure focuses on the rescue of the enterprise.
- Licensed individual or entity on asset administration and liquidation (“Licensed Asset Manager”) appointed to assist in the supervision of the enterprise.
- Test for insolvency requires a failure to pay due debts.
- Emergency measures for the benefit of creditors.

Introduction

This section provides a general outline of the main corporate insolvency procedures in Vietnam. The legislation governing insolvency in Vietnam is set out in:

- (1) the Law on Bankruptcy (No. 51-2014-QH13), dated 19 June 2014 which came into effect on 1 January 2015 (“Bankruptcy Law”). The Bankruptcy Law is the primary source of insolvency legislation in Vietnam and has been further clarified and added to by a number of implementing regulations and guidelines issued by the Supreme Court, the Ministry of Finance and the Ministry of Justice (“MOJ”);
- (2) the Law on Enterprises (No. 68-2014-QH13) dated 26 November 2014 which came into effect on 1 July 2015 (“Law on Enterprises”). The Law on Enterprises provides that any enterprise which is in bankruptcy is subject to the Bankruptcy Law; and

- (3) the Law on Credit Institutions (No. 47-2010-QH12) dated 16 June 2010 which came into effect on 1 January 2011 (“Law on Credit Institutions”). The Law on Credit Institutions provides that any credit institution which is in bankruptcy and cannot be recovered by measures implemented by the State Bank of Vietnam (“SBV”) pursuant to the “special control” regime (if applicable) is subject to the Bankruptcy Law.

The Bankruptcy Law applies to enterprises and co-operatives operating under Vietnamese law. Currently, there is no such regime which governs the bankruptcy or insolvency of individuals.

The Bankruptcy Law provides for a general bankruptcy procedure, which is a court supervised process that results in the court placing the enterprise into either:

- a “restoration procedure”, a process designed to rehabilitate the enterprise so that it may continue to operate as a going concern; or
- a “liquidation procedure”, which provides for the liquidation of the enterprise and the distribution of proceeds to its creditors.

The Bankruptcy Law repealed the old Bankruptcy Law of 2004 in an effort to address recent increases in the number of insolvencies in Vietnam and resolve a number of inadequacies in the old Bankruptcy Law.

The Bankruptcy Law for the first time also governs the bankruptcy procedures relating to any credit institutions after the

SBV issues a written notice on termination of its “special control” regime or does not apply the restoration procedures on such insolvent credit institution.

Test of Insolvency

Pursuant to article 4.1 of the Bankruptcy Law, an enterprise is considered insolvent if it is “unable to pay the due debts within three months from the due date”. Due debts must be expressly recognised by the relevant parties, supported by adequate documentation and free from dispute.

Bankruptcy Procedures

On the failure of an enterprise to pay its due debts within three months from the due date, any unsecured or partially secured creditor (to which a due debt remains unpaid) or shareholders or a group of shareholders who hold at least 20% share capital of the enterprise for at least six consecutive months (unless otherwise stated in the charter of the enterprise) or the legal representative of the enterprise may file a bankruptcy petition with the court. The trade union or employees of an enterprise may file a bankruptcy petition against such enterprise if the enterprise has failed to comply with its obligation to pay wages and other debts to the employees for three consecutive months or more. The filing of a bankruptcy petition by a creditor must be supported by documentation that shows the creditor has made a request to the enterprise for payment of a due debt and that the enterprise has failed to comply with the request. Supporting documentation often includes a written payment demand or an extension of payment terms offered by the creditor.

Accordingly:

- (a) an enterprise will not be insolvent unless its debts have fallen due for over three months, even if the enterprise is insolvent on a cash flow or balance sheet basis;

- (b) when considering a bankruptcy petition, the court will consider whether the enterprise has been given adequate opportunity by its creditors to agree on the extension of payment terms and/or to arrange sufficient financial resources to pay its creditors; and
- (c) an enterprise will only be deemed insolvent where the enterprise fails to pay its due debts within three months from the due date and its creditors do not agree to any further payment extensions.

Milestones in the bankruptcy procedures

The bankruptcy procedures in Vietnam are as follows:

- (a) the filing of a bankruptcy petition with the court;
- (b) discussion between creditors and the enterprise on withdrawal of the bankruptcy petition (if applicable);
- (c) acceptance or rejection of the petition (if the court accepts the petition, it has 30-days in which to decide whether or not to commence bankruptcy proceedings);
- (d) appointment of the Licensed Asset Manager;
- (e) first creditors meeting; and
- (f) either:
 - (i) at the creditors meeting, the creditors agreed to place the enterprise into the restoration procedure with a view to restoring the enterprise as a going concern (“Restoration”). If Restoration fails, the court will declare the enterprise to be bankrupted and place the enterprise into liquidation;
 - (ii) at the creditors meeting, the creditors failed to agree to place the enterprise in Restoration, so the enterprise will be declared to be bankrupted by the court and placed into liquidation with a view to realising the enterprise’s

assets and distributing the proceeds to its stakeholders in the relevant order of priority ("Liquidation"). The final act of the Liquidation is a declaration of bankruptcy by the court after all the liquidation procedures are completed; or

- (iii) at the creditors meeting, the creditors agreed to suspend the bankruptcy procedure if, during the period from the commencement date of the bankruptcy procedure to declaration of bankruptcy, the enterprise is no longer considered insolvent ("Suspension").

(together referred to as the "Bankruptcy Procedures").

At any stage during the Bankruptcy Procedures, the court may convert the Restoration proceedings into Liquidation proceedings and declare the enterprise bankrupt.

Furthermore, the Bankruptcy Procedures shall be simplified and the enterprise shall be declared bankrupt immediately after the filing or acceptance of the bankruptcy petition if:

- (a) the bankruptcy petition is filed by the enterprise itself and such enterprise cannot pay the bankruptcy fee and make advance for bankruptcy cost; or
- (b) the enterprise cannot afford the bankruptcy cost after the bankruptcy petition is accepted by the court.

Parties eligible to file bankruptcy petitions

The following parties may file a petition with the court to commence the Bankruptcy Procedures against an enterprise:

- (a) the enterprise itself (i.e. the legal representative or the chairman of the board of management/members' council of the enterprise, who is required to file a petition upon being aware that the enterprise is insolvent);

- (b) shareholders or a group of shareholders who have the right to file a bankruptcy petition as stated in the charter or as resolved in a general meeting of shareholders;
- (c) unsecured or partially secured creditors; and
- (d) the trade union or employees of the enterprise.

Any person who files a dishonest petition or a petition without due cause together with intention to harm the honour, reputation or operations of an enterprise, is liable to an administrative penalty and to compensation for any damage suffered by the enterprise.

Filing and acceptance of a petition for bankruptcy procedures

A petition for the Bankruptcy Procedures must be accompanied by evidence of the enterprise's insolvency status and the applicable fee. An unsecured or partly secured creditor is not required to wait until the due date for payment has passed before filing a bankruptcy petition if other due debts remain outstanding by the enterprise beyond three months from the respective due date. A petition may be submitted so long as there is an outstanding debt and the enterprise is on the verge of bankruptcy. If the enterprise can prove it is not insolvent, the court will reject the petition. The enterprise and the creditors may request the court for mutual discussion on withdrawal of the petition and such mutual discussion shall not go beyond 20 days from the filing of the petition. If the Court accepts the petition, it must notify the enterprise within three days of acceptance. The Court will issue a decision on whether it will initiate the Bankruptcy Procedures within 30-days from the date of acceptance of the petition. Creditors and debtors of the enterprise are also entitled to notice of the decision.

Unsecured or partly secured creditors must submit with their petition a list of due debts together with supporting documentation of any requests for payment of such debts. Supporting documentation often includes a written payment demand or an extension of payment terms offered by the creditor (at the request of the indebted enterprise).

Where the enterprise is on the verge of bankruptcy, a failure by the enterprise to pay wages and other debts owed to employees provides grounds for employees to file a bankruptcy petition.

Unpaid employees must itemise in the petition the number of months their salaries remain unpaid and the total amount of salaries and other debts which are owed to them.

If the bankruptcy petition is submitted by the enterprise itself or by shareholders, other supporting evidences for the insolvency status of the enterprise is required, such as the latest three year financial statements, list of creditors, explanatory statements, a detailed list of the enterprise's assets.

Applicable court

Pursuant to the Bankruptcy Law, the Bankruptcy Procedures are to be handled by a single judge in the district court, and by a single judge or a panel of three judges in a provincial or municipal court.

The bankruptcy jurisdiction of the district court is limited to co-operatives whose businesses have been registered in the relevant district. Meanwhile, provincial or municipal courts shall have jurisdiction over cases:

(a) involving enterprises registered in such provinces, cities;

- (b) involving overseas assets or participants or branches, representatives offices or real-estate located in various districts or cities; or
- (c) being under the jurisdiction of the district court but due to the complexity of the case, such case is taken by the provincial or municipal courts.

Commencement of bankruptcy procedures

After careful consideration of the evidence of the enterprise's bankruptcy status, the court will decide whether to initiate the Bankruptcy Procedures. It is also at this stage that the court decides whether to place the enterprise into the Restoration or Liquidation proceedings or to declare the enterprise bankrupt.

If the court places the enterprise into the Restoration proceedings, the enterprise must submit to the court:

- (a) a statement of profit and loss explaining the cause of its unpaid debts;
- (b) a report on measures taken to remedy the situation;
- (c) a detailed list of the enterprise's assets;
- (d) a list of creditors detailing secured and unsecured debts that are outstanding and not yet due; and
- (e) a list of debtors detailing secured and unsecured debts that are outstanding and not yet due.

The creditors of the enterprise are also required to submit to the court details of their payment requests.

Appointment of licensed asset manager

After the court initiates the Bankruptcy Procedures, an enterprise may continue to conduct its business under the supervision of the court and the Licensed Asset Manager. The

Licensed Asset Manager is appointed after a petition to commence the Bankruptcy Procedures is accepted by the court. The party which files the bankruptcy petition can suggest a Licensed Asset Manager for the court's consideration.

The court may also appoint a person as manager and operator of the enterprise's business if the existing management of the enterprise lacks the ability to operate the business or where allowing the existing management of the enterprise to continue would put the preservation of the enterprise's assets at risk.

The Licensed Asset Manager is responsible for supervising incumbent management in organising and managing the assets of an enterprise that has been placed into the Bankruptcy Procedures and serves as an intermediary between the court, the enterprise and its creditors. The Licensed Asset Manager also advises the court on matters related to the Restoration, Liquidation or bankruptcy of the enterprise and carries out any court orders regarding the liquidation of assets.

The following assets form the bankrupt estate of the enterprise and are dealt with according to the Bankruptcy Procedures:

- (a) assets and rights to assets which the business had at the time the court accepted the bankruptcy petition;
- (b) profits, assets and rights to assets which the business had prior to the court accepting the bankruptcy petition;
- (c) if a secured party is over-collateralised, then the excess proceeds from the sale of the secured asset will constitute an asset of the business and be subject to the Bankruptcy Procedures;
- (d) the value of any land use rights;
- (e) dispersed and hidden assets which are confiscated; and
- (f) assets and rights to assets which are confiscated from invalid transactions.

Permitted business activities during bankruptcy procedures

Although the enterprise may continue its operation as usual during the Bankruptcy Procedures, it will be subject to the supervision of the court and the Licensed Asset Manager. During the operation of the Bankruptcy Procedures the enterprise may not, without prior written consent of the Licensed Asset Manager, undertake any of the following activities:

- (a) borrow, pledge, mortgage, guarantee, buy, sell, assign or lease any asset, sell or transfer shares, or transfer ownership rights of assets;
- (b) terminate performance of a valid contract; or
- (c) pay any new debt arising after commencement of the Bankruptcy Procedures or the wages of employees.

After commencement of the Bankruptcy Procedures, the enterprise is prohibited from:

- (a) concealing or disposing of assets;
- (b) paying any unsecured debt (except for such debt arising after the commencement of the Bankruptcy Procedures for payment of employee salaries);
- (c) abandoning or reducing any right to claim a debt; and
- (d) converting unsecured debts into debts secured by assets of the enterprise.

Moratorium during bankruptcy procedures

An automatic moratorium arises from the date a bankruptcy petition is accepted by the court, during which time: (i) civil enforcements shall be suspended; (ii) legal, arbitral proceedings related to the financial obligations of the enterprise shall be suspended; and (iii) enforcement of secured assets by secured creditors shall be suspended (except for the secured assets which are likely to be damaged or dramatically devalued, in which case secured creditors may enforce their seniority over such assets upon approval by the court).

Restoration Procedure

With information from both the enterprise and its creditors at hand, the court will convene a meeting of the enterprise's creditors to:

- (a) discuss the enterprise's financial situation;
- (b) if the creditors consider that the enterprise is recoverable, approve a resolution to recover the enterprise's business; and
- (c) place the enterprise into Restoration.

If the creditors consider that the enterprise's business is not recoverable, then the court will declare the enterprise to be bankrupted and place the enterprise into Liquidation.

The Restoration proceedings commence once the creditors' meeting has passed a resolution approving the placement the enterprise in Restoration. Within 30-days from the resolution, the enterprise is obliged to make a plan to rescue the business, detailing how the enterprise intends to repay its debt and restructure its business operations ("Restoration Plan"). However, a creditor or any other party also has the right to formulate a Restoration Plan for consideration by the court.

The Restoration Plan must identify the measures to be taken for the recovery of the business operations, including:

- (a) raising new sources of capital;
- (b) reducing, exempting or postponing debts;
- (c) changing production and business goods of an enterprise;
- (d) renewing production technology;
- (e) restructuring the enterprise's or the cooperative's management apparatus and merging or de-merging production divisions to enhance productivity and production quality;
- (f) issuing new shares to creditors or other investors;
- (g) selling or leasing unnecessary assets; or
- (h) other measures not contrary to law.

Once the Restoration Plan has been prepared, it shall be submitted to the court for consideration and approval before being submitted to creditors for approval. This requires a vote by a majority of unsecured creditors holding at least 65% of the total unsecured debts of the enterprise. Once the Restoration Plan receives both the court's and the creditors' approval, notice of the approval will be sent to all creditors and published in a newspaper, and the Restoration Plan will become effective. After the Restoration Plan is approved by court and creditors, all the restrictions and prohibitions to the business of the enterprise shall be lifted.

The Bankruptcy Law provides that the Restoration Plan must be implemented within the duration as approved by the creditor or within three years from the date of the creditor's meeting approved the Restoration Plan. During the three-year implementation period, the enterprise must submit semi-annual

reports to the Licensed Asset Manager, who will later notify the court and creditors.

Any amendments to the Restoration Plan must be approved by the requisite majority of creditors and the court.

Secured Creditors in Restoration

An automatic moratorium arises from the date a bankruptcy petition is filed with the court. Secured creditors may only enforce their security with the approval of the court. Otherwise, the secured assets shall be handled in accordance with the resolution of the creditor's meeting on restoration. For this, if it is decided by the creditors' meeting that the secured assets are not necessary for the Restoration of the enterprise, secured creditors can enforce their security in relation to those assets accordingly.

Liquidation

In the Liquidation proceedings, the assets of the enterprise shall be liquidated and the proceeds thereof shall be distributed to its creditors. A court will order the liquidation of an enterprise where:

- (a) the Restoration Plan fails such that the enterprise is unable to repay its due debts at the request of its creditors;
- (b) the creditors' meeting is unsuccessful as a result of:
 - (i) the legal representatives of the enterprise failing to participate in the creditors' meeting without plausible reasons;
 - (ii) the creditors' meeting failing to achieve quorum after having already been adjourned once (where the petitioner is the legal owner or legal representative of the enterprise); or
- (c) after the creditors' meeting, the requisite majority of creditors have passed a resolution to develop a Restoration Plan but:
 - (i) the enterprise fails to formulate a Restoration Plan within 30-days of the date on which the initial creditors' meeting resolved to recover the business;
 - (ii) the creditors' meeting rejects a resolution approving the Restoration Plan; or
 - (iii) the enterprise fails to implement or implements improperly a court-approved Restoration Plan.

A concerned party may appeal the decision to commence the Liquidation procedure.

Priority of claims and distribution

After being declared to be bankrupt, the assets of enterprise shall be evaluated and sold by normal methods or via auction. The court must also prescribe a plan for the distribution of proceeds in accordance with the following priority:

- (a) fees and costs of the bankruptcy proceedings;
- (b) unpaid wages, allowances for termination of employment, social insurance, and other interests under signed collective labour accords and labour contracts;
- (c) debts arising after the commencement of the Bankruptcy Procedures for the purpose of restoring the business of enterprises, or cooperatives; and
- (d) financial obligations to the state, unsecured debts owed to creditors whose names appear on the list of creditors, and secured debts where the value of the assets secured are not enough to cover such debts.

Any balance remaining after all creditors have been paid in full is distributed to the members or equity holders of the enterprise.

Secured creditors in liquidation

A secured creditor may only enforce its security during the Liquidation procedure with the approval of the court. Priority is granted to secured creditors subject to such security being in place prior to the date on which the court accepted the petition. Where the value of the secured assets is insufficient to cover the debt of a secured creditor, the secured creditor can claim as an unsecured creditor for the shortfall.

Declaration of bankruptcy

Once the Liquidation procedure is complete, the court will declare the enterprise bankrupt. Once an enterprise is declared bankrupt the court will forward the declaration to the business registration office for removal of the bankrupt enterprise's name from the business registry.

Licensed Asset Manager – Emergency Procedures

The Licensed Asset Manager or the parties eligible to file bankruptcy petitions may apply to the court to seek temporary emergency measures to protect the assets of an insolvent enterprise for the benefit of its creditors. The temporary emergency measures as specified under article 70 of Bankruptcy Law include the ability to:

- (a) permit the sale of perishable goods, goods near their end of use date, or goods which may be difficult to sell unless sold at the right time;
- (b) permit the harvest and sale of farm products or other products;

- (c) physically secure the assets of the business;
- (d) freeze the bank accounts of the business and the assets of the business being stored at warehouses;
- (e) secure the funds of the business;
- (f) seize the accounting records and related business data;
- (g) prohibit the transfer of rights to assets;
- (h) keep the current conditions of the assets unchanged;
- (i) prohibit or force the business to perform certain activities;
- (j) force the employer to pay advance for salaries, wages and other benefits; and
- (k) other temporary emergency measures under laws and regulations.

Voidable Transactions

The following transactions are invalid if entered into by an insolvent enterprise anytime within the six-month period prior to the commencement of the Bankruptcy Procedures by the court (except for any insolvent credit institution which is being under the “special control” regime of the SBV):

- (a) disposal of assets which is not for market price;
- (b) the granting of security or partial security for any existing unsecured debt;
- (c) set-off of debts in favour of any creditor whose debt has not become due or in excess of the due debt;
- (d) donation of property to other persons;
- (e) the entry into any transaction which is outside the authorised activities of the enterprise; or

- (f) the entry into any other transaction for the purpose of disposing of the assets of the business.

Additionally, transactions entered into by the insolvent enterprise and its related persons within 18 months before the commencement of the Bankruptcy Procedures could also be considered null and void. For any null and void transactions of the insolvent enterprise, the assets involved in such transactions shall be recovered to be put back to the pool of assets of the insolvent enterprise for being dealt with in accordance with the Bankruptcy Procedures.

Personal Liability

Following the declaration of an enterprise as bankrupt, a person who held a managerial position of the bankrupt business may be prohibited from establishing, or to act as a manager of, an enterprise or co-operative within the period of three years from the declaration of the bankruptcy if they have committed certain violations during the Bankruptcy Procedures of that enterprise (such as failures to comply with requirements by the court or the Licensed Asset Managers or committed any prohibited activities).

The general directors, chairman and members of the board of management of a bankrupt state owned enterprise ("SOE") with 100% state capital will be permanently prohibited from holding the same position in any SOE. A person assigned to represent the state's equity in any enterprise that is declared bankrupt will be permanently prohibited from holding any managerial position in any enterprise with state capital. The only exception to the prohibitions discussed above is when the bankruptcy arises due to reasons of force majeure.

Lender Liability

There is no requirement under Vietnamese law which renders a lender liable to pay its customers' debts.

New Money Lending

Any new borrowing by an enterprise during the Bankruptcy Procedures requires the prior consent of the Licensed Asset Manager. There is no restriction on lenders providing new credit facilities to enterprises that are subject to the Bankruptcy Procedures, however it is uncommon for credit institutions to lend money to such enterprises in these circumstances. When this does occur, as expected, lending conditions and security requirements are tighter.

Guarantees

Vietnamese law allows a party to give a guarantee to secure the performance of obligations of another party, regardless of whether the two parties are related. As long as the guarantee is executed in accordance with Vietnamese law (e.g., in writing, and in some circumstances notarised or certified, and signed by an authorised signatory of the guarantor), the guarantee is enforceable against the guarantor.

The guarantee should explicitly refer to the obligations being guaranteed and should state that in the event that the principal is unable to perform its obligations owed to the beneficiary, the guarantor will perform the guaranteed obligations in accordance with the original agreement or on other agreed terms acceptable to the beneficiary.

However, a Vietnamese entity must obtain an approval of the Prime Minister for the purpose of giving a guarantee to secure the performance of obligations of an offshore party.

Bankruptcy procedures relating to credit institutions

If a credit institution is at risks of being insolvent, it shall have to notify the SBV. The credit institution shall be placed under the “special control” regime by SBV in one of the following cases:

- (a) the credit institution is at risk of being insolvent;
- (b) the credit institution has irrecoverable debts which are at risk of resulting in insolvency;
- (c) the cumulative loss of the credit institution exceeds 50% of the actual value of its charter capital and reserve funds as stated in the latest audited financial statement;
- (d) the credit institution has been ranked poorly by SBV for two consecutive years; or
- (e) the credit institution fails to maintain the minimum capital safety ratio for one year or has this ratio fallen below 4% for six consecutive months.

If the credit institution is placed under the “special control” regime, SBV shall establish a Special Control Board to give directions and supervise the activities and plans to restore the business of such credit institution.

If the “special control” regime is ended but the credit institution remains insolvent, a bankruptcy petition can be submitted by creditors, employees, trade union, shareholders, group of shareholders, or the credit institution itself in accordance with the provisions of the Bankruptcy Law.

Upon liquidation, the priority of claims and distributions relating to the debts of the bankrupt credit institution shall be as follows:

- (a) repayment of the special loans granted by SBV and/or other credit institutions during the “special control” regime;

- (b) costs and expenses incurred during the Bankruptcy Procedures;
- (c) unpaid wages, allowances for termination of employment, social insurance, and other interests under signed collective labour accords and labour contracts of the employees;
- (d) deposits, amounts that the deposit insurers must pay to the depositors at the credit institution; and
- (e) financial obligations to the state; unsecured debts owed to creditors whose names appear on the list of creditors; secured debts which the secured assets are not enough to cover such debts.

The assets entrusted, kept or managed by the credit institution under contracts shall be returned to owners.

Recognition of foreign insolvency proceedings

There is no formal recognition of foreign insolvency proceedings by Vietnamese courts. Creditors are required to institute local proceedings or obtain a judgment in a foreign court and seek to have it recognised by the Vietnamese courts. Only recognised foreign judgments may be enforced against the assets of an enterprise which are located in Vietnam.

Recognition of a foreign judgment

Foreign judgments are recognised and enforced in Vietnam subject to bilateral treaty on enforcement or on a reciprocal basis between Vietnam and the relevant foreign countries.

To enforce a foreign judgment in Vietnam, the judgment holder (the applicant) must apply to the appropriate Vietnamese court to have the foreign judgment recognised. This requires submitting a request to the MOJ together with the documents required by the

relevant treaty. Within five working days of receiving a completed application, the MOJ will transfer the file to the court authorised to handle such proceedings. The authorised court is required to accept the case for hearing, and a pre-hearing will take place within four months from the date of acceptance of the case. The time limit may be extended by two months if the court requires the applicant or the foreign court which handed down the judgment to clarify any unclear issue.

During the pre-hearing, the court may suspend the hearing or proceed directly to the hearing. If the court decides to conduct a full hearing, the hearing must commence within one month from the date of the court's decision to do so. The court will then issue a decision on whether it will recognise the foreign judgment. The court may decline to recognise the foreign judgment where:

- (a) the foreign judgment does not meet the requirements for recognition and enforcement specified in the relevant treaty;
- (b) the foreign judgment is not effective according to the law of the country where the foreign judgment was made;
- (c) the judgment debtor or his or her legal representative did not attend the trial or hearing before the foreign court because he or she was not legally summoned or the documents of the foreign court were not served within reasonable time;
- (d) the case can only be adjudicated by a Vietnamese court;
- (e) the case was also considered by a Vietnamese court and the judgment issued thereto has become effective;
- (f) the case was settled by another foreign court whose judgment has previously been recognised by the Vietnamese court;

- (g) the case has previously been accepted and considered by a Vietnamese court before the foreign court accepted the case and handed down its judgment;
- (h) the time limit for enforcement of the foreign judgment has expired according to the law of the country where the foreign judgment was made or according to Vietnamese law (which is currently five years);
- (i) the enforcement of the judgment has been terminated or cancelled in the country of the foreign court who issues such judgment; or
- (j) the recognition and enforcement of the foreign judgment in Vietnam is contrary to the fundamental principles of Vietnamese law. There is currently no guidance on the types of claims which might be contrary to the fundamental principles of Vietnamese law.

Enforcement of a foreign judgment

Under the Civil Procedure Code, a foreign judgment which has been recognised by a Vietnamese court will have the same effect as a judgment rendered by a Vietnamese court. The enforcement of the judgment is governed by the Law on Enforcement.

An application for the enforcement of a judgment must be filed within five years from the effective date of the judgment or arbitral award. Where a time limit for fulfilling an obligation is set out in the judgment or arbitral award, the five-year time limit will begin from the date the obligation is due to be performed. For judgments and arbitral awards subject to periodical enforcement, the five-year time limit will apply to each period and be counted from the date the obligation is due to be performed.

Judgments of foreign courts and foreign arbitral awards recognised by Vietnamese courts must be enforced by the relevant provincial-level enforcement agencies.

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