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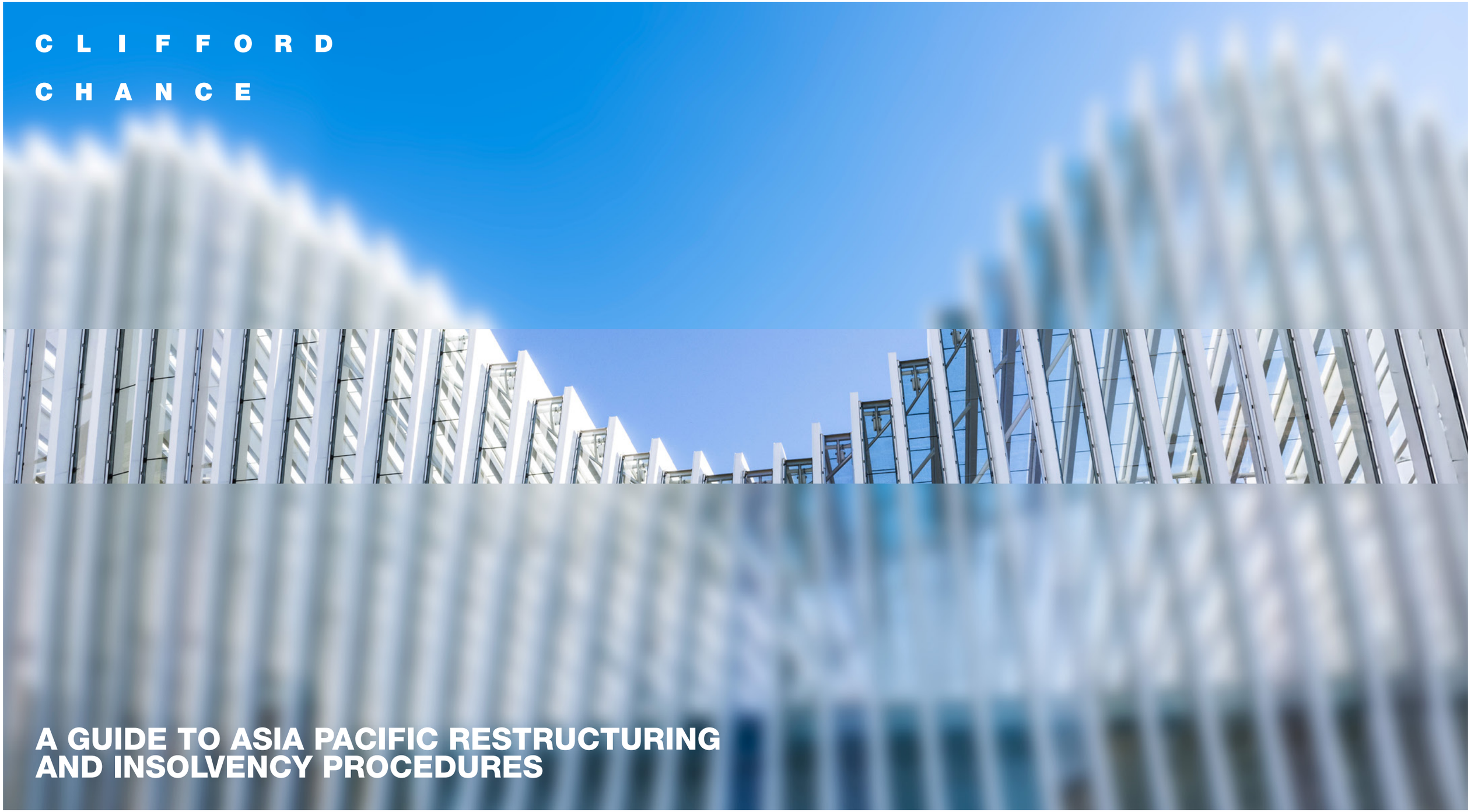

A GUIDE TO ASIA PACIFIC RESTRUCTURING AND INSOLVENCY PROCEDURES

We are pleased to present the third edition of our guide to restructuring and insolvency laws and procedures across key jurisdictions in the Asia Pacific region.

With chapters covering **Australia, Mainland China, Hong Kong SAR, India, Indonesia, Japan, South Korea, Malaysia, the Philippines, Singapore, Taiwan, Thailand** and **Vietnam**, this updated guide provides an overview of each jurisdiction's applicable laws and regulations on key areas of concern.

Restructuring and insolvency activity remains elevated across the region, coming out of the tail end of the COVID-19 pandemic and a period of higher interest rates. Meanwhile, local structural and other factors are driving activity in specific jurisdictions, such as ongoing distress in the Mainland China property sector.

In the period since we launched the second edition of the Guide in 2018, there have been significant legislative changes in certain jurisdictions including Australia, Malaysia, India and Singapore. Singapore and Malaysia's new provisions for cramdowns in schemes of arrangement, pre-pack schemes and super-priority rescue financing are particularly noteworthy. Meanwhile, the development of cross-border insolvency continues in Mainland China with the introduction of pilot arrangements for the mutual recognition of insolvency proceedings between Hong Kong SAR and Mainland China.

Since 2018, Clifford Chance has gone from strength to strength in the Asia Pacific region with partners Shaun Langhorne and Nikki Smythe joining us in Singapore and Australia in 2020 and 2024, respectively. We remain one of the few law firms in the market with on-the-ground coverage across the key markets of Greater China, South East Asia and Australia. Our mandates increasingly engage with cross-border businesses and structures, which, in the current market, often leads to large multijurisdictional restructurings. Our extensive on-the-ground presence and experience in these key markets positions us as the go-to advisers for complex cross-border restructuring.

Last but not least, we acknowledge and express our sincere gratitude to the following firms who have kindly contributed to the guide by drawing on their knowledge of complex issues in their respective jurisdictions: **AZB & Partners (India); ABNR (Indonesia); Bae, Kim & Lee LLC (South Korea); SyCipLaw (the Philippines); Shearn Delamore & Co. (Malaysia); Russin & Vecchi (Taiwan); Chandler MHM Limited (Thailand)**; and **VILAF (Vietnam)**.

This guide is intended to serve as your initial point of reference for each key jurisdiction. For detailed advice, feel free to contact us by telephone or email. If you need further information or assistance on any topic covered in this guide, we are here to help.

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Rehabilitation procedure available	✓ Voluntary Administration/ Deed of Company Arrangements. ✓ Scheme of arrangement.	✓ Reorganisation. ✓ Compromise.	× No statutory process. ✓ Provisional liquidators in some circumstances are granted powers by the court to formulate restructuring plans.	✓ Corporate insolvency resolution process. ✓ Scheme of arrangement.	✓ Suspension of Payments (PKPU Composition Plan).	✓ Civil Rehabilitation. ✓ Corporate Reorganisation.	✓ Rehabilitation.	✓ Scheme of Arrangement. ✓ Judicial management.	✓ Rehabilitation.	✓ Judicial Management. ✓ Scheme of Arrangement.	✓ Reorganisation. ✓ Composition.	✓ Business Rehabilitation.	✓ Restoration Procedure.
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Rehabilitation, moratoria, enforcement and cramdown (continued)

	Australia	Mainland China	Hong Kong SAR	India	Indonesia	Japan	South Korea	Malaysia	Philippines	Singapore	Taiwan	Thailand	Vietnam
Cramdown of creditors for rehabilitation processes (voting thresholds required to bind all creditors)	Voluntary Administration/Deed of Company Arrangements: – Approval by creditors representing more than 50% in number and 50% in value. – No 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 by each class of creditors representing more than 50% in number (present at the relevant creditors' meeting) and 66 2/3% in value. – Court approval required. Compromise: – Approval by creditors representing more than 50% in number (present at the relevant creditors' meeting) and 66 2/3% of the total value of the unsecured claims. – Court approval required.	Scheme of Arrangement: – Approval by each class of creditors representing more than 50% in number and 75% in value. – Court approval required.	Scheme of arrangement: – Approval by each class of creditors or shareholders (present and voting at the relevant meetings) representing more than 50% in number and 75% in value. – NCLT approval required. Corporate insolvency resolution process: – Approval by unrelated financial creditors representing 66% in value. – Court approval required.	Suspension of Debt Payments: – Approval by unsecured creditors representing more than 50% in number and 66 2/3% in value and secured creditors representing more than 50% in number and 66 2/3% in value.	Civil Rehabilitation: – Approval by creditors representing more than 50% in number and 50% in value. Corporate Reorganisation: – Approval by: (a) unsecured creditors with 50% or more of voting rights; and (b) in connection with: – any changes to grace periods for payment of secured claims, at least 66 2/3% of secured creditors with voting rights; – any other changes to the interests of secured creditors, at least 75% of secured creditors with voting rights; or – in connection with cessation of the business, at least 90% of secured creditors with voting rights.	Rehabilitation: – Approval by secured creditors representing more than 75% in value of secured claims, unsecured creditors representing more than 66 2/3% in value of unsecured claims and a majority of the shareholders present at the relevant meeting. – Cross-class cramdown available (with court approval). – Court approval required.	Scheme of Arrangement: – Approval by each class of creditors representing more than 50% in number and 75% in value. – Cross-class cramdown is available if approved by at least one class of creditors and 75% of the total value of creditors. – Court approval required.	Rehabilitation: – Approval by each class of creditors representing 50% of the total value of claims of each voting class. – Cross-class cramdown is available if certain criteria are satisfied. – Court approval required.	Scheme of arrangement: – Approval by each class of creditors (present at the relevant creditor meetings) representing more than 50% in number and 75% in value. – Cross-class cramdown is available if approved by more than 50% in number and 75% in value of creditors (present at the relevant creditor meetings) subject to various conditions. – Court approval required.	Reorganisation: – Approval by each class of creditors and shareholders representing more than 50% of the vote. – Voting is weighted by the value of debt owed to the creditor or number of shares held respectively. – Court approval required. Composition: – Approval of creditors representing more than 50% in number and 66 2/3% in value of the total unsecured debts. – Court approval required.	Business Rehabilitation: – Approval by each class of creditors representing more than 50% in number and 66 2/3% in value, or one class of creditors representing more than 50% in number and at least 66 2/3% in value of that class together with at least 50% in value of all creditors. – Approval by the court. Business Rehabilitation for registered SMEs: – Approval by creditors representing at least 66 2/3% in value of the total debts. – Approval by the court.	Restoration Procedure: – Approval by more than 50% in number and at least 65% in value of the unsecured creditors.

Management, personal liability and court involvement on enforcement

	Australia	Mainland China	Hong Kong SAR	India	Indonesia	Japan	South Korea	Malaysia	Philippines	Singapore	Taiwan	Thailand	Vietnam
Who controls the company and/or its assets during the insolvency procedure?	Receivership: – Receiver and manager replace management where provided for by debenture. Administration: – Administrator replaces management. Liquidation: – Liquidator replaces management.	Reorganisation: – Either court-appointed administrator replaces management, or incumbent management apply to court to continue to manage the business under the supervision of the administrator. Compromise: – Incumbent management regain control after the settlement agreement is approved by the creditors' meeting and the court. Bankruptcy: – Court-appointed administrator replaces management.	Scheme of arrangement: – Incumbent management retain control. Liquidation: – Liquidator replaces management.	Scheme of arrangement: – Incumbent management retain control. Reorganisation: – Insolvency professional who acts on the instructions of the CoC takes over management and control of company.	Suspension of debt payments: – Incumbent management retain control jointly with appointed administrator. Bankruptcy: – Court-appointed receiver replaces management.	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.	Rehabilitation Plan: – Incumbent management retain control in the absence of any "cause for insolvency" which is attributable to the relevant directors. Bankruptcy: – Court-appointed receiver replaces management.	Receivership: – Receiver and manager replace management where provided for by debenture. Scheme of Arrangement: – Incumbent management retain control. Judicial management: – Judicial manager 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. Special Liquidation: – Liquidator replaces management under the supervision of a supervisor and a judge.	Business Rehabilitation: – Plan administrator replaces management (although they may be appointed from existing management). Bankruptcy: – Official receiver replaces management.	– Incumbent management retain control under the supervision of the Licensed Asset Manager and the court (provided that certain asset-related transactions must be approved by the Licensed Asset Manager). – Licensed Asset Manager may propose to replace the legal representative (normally the general director) of the insolvent enterprise where they are unable to continue the operation of the business or violate the law.

Management, personal liability and court involvement on enforcement (continued)

	Australia	Mainland China	Hong Kong SAR	India	Indonesia	Japan	South Korea	Malaysia	Philippines	Singapore	Taiwan	Thailand	Vietnam
Personal liability for directors and officers	Liability for: – insolvent trading; – breach of duty (statutory, common law, fiduciary); – misleading or deceptive conduct; – fraud; – other statutory regimes such as work health and safety; and – environmental laws.	Liability for: – breach of duty; – abnormal income and misappropriation; and – voidable/void transactions for which they are held accountable.	Liability for: – breach of duty; – fraudulent trading; – share redemption or buybacks within one year of insolvency; – improper accounting; and – failure to assist with the liquidation.	Liability for: – wrongful trading; and – defrauding creditors, asset stripping and falsification of books of the company.	Liability for: – fault or negligence leading to bankruptcy and the company's inability to repay creditors.	Liability for: – breach of the duty of loyalty; and – breach of obligation to act as good managers.	Liability for: – wilful 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 being carried out with an intent to defraud creditors or for a fraudulent purpose; and – 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; and – concealing, embezzling or misappropriating any property of the company.	Liability for: – breach of duty; – failure to cooperate with liquidator; – wrongful/ fraudulent trading; – concealment of debts.	Liability for: – refusing to transfer management and/or property of the company to the administrator; – hiding or destroying the account records; – hiding, disposing or transferring assets in a manner which is detrimental to creditors; – refusing to respond to the administrator's inquiry; or – fabrication or acknowledgement of untrue debts.	Liability for: – fraudulently tampering with company accounts or documents; – omitting or making false entries in the company accounts or documents; – pledging, mortgaging or disposing of the property which was obtained on credit; and/or – receiving goods on credit using false pretences.	Liability for: – failure to comply with Licensed Asset Manager or court requirements; – intentionally undertaking prohibited activities, including actions which involve concealing assets, paying unsecured debts, giving up the right to claim debts and converting unsecured debts into secured debts; and – failing to file a bankruptcy petition.

Clawback risks

	Australia	Mainland China	Hong Kong SAR	India	Indonesia	Japan	South Korea	Malaysia	Philippines	Singapore	Taiwan	Thailand	Vietnam
Clawback 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. Unreasonable director-related transactions: – 4 years.	Preferential payments: – 6 months. Transactions at undervalue: – 1 year. Repayment of debts not due: – 1 year. Provision of security for an unsecured debt: – 1 year. Waiver of rights: – 1 year. Void transactions: – no time limit.	Unfair preferences: – 6 months to 2 years. Extortionate credit: – 3 years. Avoidance of floating charges: – 1 year to 2 years. Dispositions to defraud creditors: – no time limit. Transactions at undervalue: – 5 years.	Preferential transactions and undervalued transactions: – 2 years for related parties and 1 year for non-related parties. Extortionate credit transactions: – 2 years. Fraudulent transactions: – no time limit. Undervalued transactions entered into with a fraudulent intent: – no time limit.	Legal actions and/or transactions carried out prior to bankruptcy which were detrimental to creditor rights: – no time limit.	Harmful acts to creditors: – no look-back period. Gratuitous acts: – within 6 months of suspension of payments or commencement of bankruptcy proceedings. Creation of security interests for pre-existing debts or discharging pre-existing debts: – no look-back period.	Transaction to harm creditors while insolvent: – no time limit. Provision of security or repayment of debt that causes harm to creditors after suspension of obligations or the filing of an application to commence rehabilitation proceedings or bankruptcy proceedings: – no time limit. Provision of security or repayment of debt that causes harm to creditors with unfair preference: – 60 days or 1 year (if a specially related person is involved). Gratuitous act: – 6 months before or after the act, and 1 year (in case of a specially related person).	Undue preferences: – 6 months. Transactions at overvalue or undervalue: – 2 years.	Transactions at undervalue: – 90 days. Undue preferences and transactions entered to defraud creditors: – No limit specified.	Unfair preferences: – 1 year for unconnected parties or 2 years for connected parties. Transactions at undervalue: – 3 years. Floating charges: – 1 year for unconnected parties or 2 years for connected parties.	Transactions detrimental to creditors: – 6 months. Guarantees: – 6 months. Undue payments made: – 6 months.	Fraudulent acts: – 1 year. Undue preferences: – 3 months (1 year for related party transactions).	Transactions at an undervalue: – 6 months or 18 months for related party transactions. Granting of security for an existing unsecured debt: – 6 months or 18 months for related party transactions. Payment or off-setting of debts before due: – 6 months or 18 months for related party transactions. Donation of property: – 6 months or 18 months for related party transactions. Entry into a transaction outside the authorised activities of the enterprise: – 6 months or 18 months for related party transactions. Entry into a transaction (other than the above) for the purposes of disposing of assets of the enterprise: – 6 months or 18 months for related party transactions.

AUSTRALIA

AUSTRALIA

Contributed by Clifford Chance (Perth and Sydney Offices)

Introduction

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

The main insolvency procedures in Australia include:

(a) voluntary administration (including deeds of company arrangement);

(b) receivership; and

(c) liquidation.

We also briefly consider 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 specific types of businesses/entities, such as insurance companies (the *Life Insurance Act 1995* (Cth) and *Insurance Act 1973* (Cth)) and banks (the *Banking Act 1959* (Cth) and *Payment Systems and Netting Act 1998* (Cth)). These special regimes, together with the personal insolvency regime, are beyond the scope of this section.

Test of Insolvency

A company is insolvent if it is unable to pay its debts as and when they become due and payable (i.e. the "*cash flow test*"). This means that a company may be insolvent even if the value of its assets exceeds its liabilities. Insolvency is highly fact-specific (e.g. a temporary lack of liquidity does not necessarily mean that a company is insolvent).

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).

Voluntary Administration

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

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

If a company cannot be rehabilitated/recapitalised, the company will go into liquidation.

Initiating a voluntary administration

A voluntary administration may be initiated at short notice by:

(a) the directors (by resolution of the board);

(b) a liquidator (or provisional liquidator) of the company; or

(c) 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 creates an automatic moratorium. Civil proceedings (e.g. claims or enforcement proceedings against the company) cannot be taken without the consent of the administrator or the permission of the court. The moratorium also prevents the commencement or continuation 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 gives an administrator sufficient time to formulate a rescue proposal for the business or, in the event that this is not possible, an orderly realisation of the company's assets.

There are 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

Key Elements:

- The objective of voluntary administration is to facilitate business turnaround/rehabilitation. The procedure provides for an automatic moratorium on: (1) the commencement of legal proceedings; and (2) the enforcement of certain security interests.
- Receivership is generally available as a self-help remedy for secured creditors (for the enforcement of their security).
- Significant powers are given to liquidators to clawback voidable transactions.
- Broadly speaking, since July 2018, contract clauses that allow a counterparty to terminate the contract solely due to the insolvency of the other party (i.e. "*ipso facto clauses*") have not been enforceable (with exceptions depending on the type of contract/transaction).
- Australia generally has a creditor-friendly insolvency regime where Directors can be exposed to personal liability for insolvent trading. Since 2017, directors have had protection from insolvent trading liability (e.g. while undertaking turnaround/restructuring) under the "safe *harbour*"

regime. Eligibility for safe harbour protection is highly conditional. For one, employee entitlements must be paid, and tax filings must be made, on time. The directors must also develop and/or implement one or more courses of action that are reasonably likely to lead to a better outcome for the company and its stakeholders.

- Anti-Phoenixing Laws were strengthened in mid-2018 that are reasonably likely to lead to a better outcome for the company and its stakeholders.

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.

In 2018, amendments to the Corporations Act introduced an automatic stay on the enforceability of "*ipso facto clauses*" (with exceptions). The automatic stay applies 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* (Cth), the *Mobile Equipment (Cape Town Convention) Act 2013* (Cth) 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.

Powers of the administrator

Administrators have broad powers. They have the same powers that the company or any of its officers would have if the company were not under administration and may do all things as may be necessary for the management of the company. When performing their functions 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) a "*circulating asset*" (as defined in the *Personal Property Securities Act 2009* (Cth)) when the security interest arose; or

(b) 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 are the key stakeholders in a 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/or

(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 for large or complex administrations (usually by three to six months).

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 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, in effect, a compromise between a company in voluntary administration and its creditors. A company can only enter 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 negotiate and prepare the deed of company arrangement with the proponent. The deed must include 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 company 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.

The deed requires a majority of creditors in value and number to vote for it for it to be executed. Following execution, the deed is binding on all the creditors (except secured creditors, unless they voted in favour of the deed). 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). A 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, the appointment of a receiver is often concurrent with the board's appointment of a voluntary administrator (or in some cases, a dual appointment by the secured creditor). 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 an agent of the company. The receiver also has certain statutory duties (including to provide reports to ASIC from time to time).

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 their 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 AUD $4,000; 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 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 their powers from the order appointing him, although it is common practice for a provision of 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 "*clawback*" 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 carries 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 involves a compromise or agreement between a company and a class or classes of creditors or members.

Schemes are not an insolvency procedure (as such). Members' schemes of arrangement may be used in the context of a corporate reorganisation and are often used in connection with takeovers in Australia. Creditors' schemes of arrangement are less common (but can be deployed well before a company is insolvent).

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 for 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.

Recently, 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; 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 cramdown 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 "*clawback*" 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 can be clawed back depend on the type of transaction in question, ranging from 6 months in the case of an insolvent transaction to 10 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 clawback period is measured backwards in time from the "*relation-back day*". Generally, 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.

(a) 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.

(b) 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 10-year period ending on the relation-back day.

(c) 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 detriments arising from the transaction for the company.

(d) 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 10-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. The relevant transaction must have occurred up to four years before the appointment of the liquidator.

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 creditor-friendly (relative to other jurisdictions). As a result, it can be difficult to undertake "*informal*" restructuring when the company's day-to-day solvency may be in issue (or fluctuating), given the personal liability directors are exposed to for insolvent trading. Since 2018, subject to a number of eligibility criteria being met, directors can use the safe harbour regime to mitigate the risk of personal liability for insolvent trading (which has led to fewer voluntary administrations being commenced precipitously).

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; or
- 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 AUD $200,000;

(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 their duties;

(ii) the director uses their position, dishonestly and either recklessly, to, or with the intention to, directly or indirectly gain an advantage for themselves, or someone else, or cause detriment to the company;

(iii) the director uses information obtained as a director, dishonestly and either recklessly, to, or with the intention to, directly or indirectly gain an advantage for themselves, or someone else, or cause detriment to the company; or

(iv) the director, in a dishonest manner, breaches their duty to prevent insolvent trading.

Anti-Phoenix Measures

"*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.

New laws passed in 2020 were intended to:

- establish phoenixing offences;
- hold directors personally liable for goods and services tax liabilities;
- prohibit related entities to the phoenix operator from appointing a liquidator;
- create penalties that apply to persons and entities who promote tax avoidance schemes to capture advisers who assist phoenix operators;

- provide greater powers for the Australian Taxation Office to recover a security deposit from suspected phoenix operators; and
- prevent directors from backdating directorship resignations to avoid personal liability or from resigning and leaving a company with no directors.

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 considered closely, especially in the context of upstream and cross-stream guarantees.

Priority

The *Personal Property Securities Act 2009* (Cth) ("PPSA"), which came into effect in January 2012, has substantially changed how security is taken over personal property in Australia. The PPSA removes the distinction between fixed and floating security interests and establishes a common, public 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 rank 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.

MAINLAND CHINA

MAINLAND CHINA

Contributed by Clifford Chance (Beijing and Shanghai offices)

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. Previously, the bankruptcy of certain state-owned enterprises could also be administered by administrative fiat in accordance with policies issued by the State Council, however the State Council has since issued a guideline confirming that this procedure is no longer permitted.

The main insolvency procedures available under Chinese law are bankruptcy (*pochan*), reorganisation (*chongzheng*) and compromise (*hejie*). Bankruptcy will lead to the ultimate winding up of a business, whereas reorganisation 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 reorganisation. Only the debtor, on the other hand, may apply to institute compromise proceedings. Generally speaking, these three types of proceedings will be available to a debtor 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 reorganisation 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, 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. In this scenario, the court then has 10 days to accept or reject the application after the seven-day period. The aforementioned periods for the court to make decisions can be extended for an extra 15 days with the approval of a superior court.

An applicant may appeal the court's refusal of an application before the superior court within 10 days of receipt of the court's ruling.

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 reorganisation proceedings, the debtor, alternatively, may choose to establish that, on the balance of probabilities, it will lose the ability 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 reorganisation 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 application for bankruptcy or compromise. In a reorganisation, however, the secured creditor is prohibited from enforcing its security interest during the entire reorganisation 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.

Key Elements:

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

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 reorganisation, 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, the Administrator may decide whether the debtor should continue its operations, which requires 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 only with good reason.

Bankruptcy

Once the court has accepted the application to commence bankruptcy proceedings, the administrator will take on the 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 relatively limited; for example, in circumstances where it has not forfeited its preferential right to repayment with respect to the relevant secured assets (in its capacity as a secured creditor), 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 which has been partially performed by the parties. If the contract is continued, the counterparty is entitled to ask for security for performance, and a failure by the administrator to provide such security is deemed to be a rescission of the contract. If the administrator fails to notify the counterparty within 2 months of the court's acceptance of the bankruptcy application, or fails to reply within 30 days upon receipt of a reminder from the contractual counterparty, the contract is also deemed as rescinded.

Where an investor has failed to make full payment of any required capital contributions, 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' accounts 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 or surplus after the aforementioned distribution will then be used to repay punitive claims such as civil punitive claims, administrative fines and criminal fines incurred prior to the acceptance of the bankruptcy application. Finally, any remaining assets or surplus will be used to repay the capital contributions of the shareholders.

Reorganisation

Corporate reorganisation 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 reorganisation. 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. The court then decides whether to accept the application, and the reorganisation period commences from the date of the court's acceptance of the reorganisation application.

Stage 2: Reorganisation

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 6 months of commencing the reorganisation period (i.e. the date of the court's acceptance of the reorganisation application), the administrator (or debtor) must prepare a plan aimed at improving the debtor's financial situation and business performance. For example, the administrator (or debtor) 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 voting procedures 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, comprising at least two-thirds of the value of the debt held in that class.

If the reorganisation 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, provided that the creditors voting in favour represent no less than two-thirds of the total value of the unsecured debt. It must also receive the approval of the court. After the agreement is approved by creditors and the court, the administrator shall return control of the assets and business back to management. If the creditors' meeting fails to approve 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 reorganisation or compromise.

The moratorium applying to secured creditors is lifted once an order permitting a compromise is issued. A compromise is therefore 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 the debtor incurred the relevant 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 outside 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 (in practice, the court is more likely to hold that such restriction does not extend to security provided for a new unsecured debt in support of the debtor's operations after the court's acceptance of the bankruptcy application);
- the early repayment of debts which are not due; and
- a waiver by the debtor of its rights as creditor.

Where, in the 6 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 and senior management.

Any administrator that acts to harm the interests of a creditor may also be liable for compensation.

Under Chinese law, directors are obliged to act in good faith and with diligence. If either of these duties is breached, and as a result the company is placed into bankruptcy, the director may incur civil liability in their personal capacity. The director may also be prohibited from assuming the position of director, supervisor or member of senior management in any PRC company for a period of three years from the date of the conclusion of the bankruptcy. Specifically, if any director, supervisor or member of senior management exploits their position to obtain abnormal income from the debtor or misappropriate the assets of the debtor, such property may be recovered from that person and returned to the debtor. Further, if any director, supervisor or member of senior management is held to be directly accountable for any voidable or void transaction (as described above) to the detriment of creditors' interests, they may also be personally liable to pay compensation.

The directors of a company are responsible for the solvent winding up or liquidation (*qingsuan*) of that company and must set up a liquidation group within 15 days of the date on which the relevant event requiring the dissolution of the company occurs. The liquidation group will then handle the liquidation (*qingsuan*) of the company. In the circumstance where a company has been dissolved but has not yet completed the liquidation (*qingsuan*) process and its assets are insufficient to settle its debts, the directors are required to apply to the court to commence bankruptcy proceedings.

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 the insolvency of the debtor. For the duration of the bankruptcy proceedings, the court may detain or fine the debtor's legal representative and management if they leave their place of domicile.

Lender Liability

The risk in China of lenders being held liable to pay their borrower counterparties' 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, 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

Validity of 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. While the failure to register the guarantee may result in potential administrative penalties by SAFE, it will not lead to the invalidity of the guarantee per se. Nevertheless, there remain uncertainties in terms of whether payment under the unregistered guarantee can be completed in practice. It is very likely that the relevant parties would still be required to complete a supplementary registration with SAFE before any cross-border payment under the guarantee can be made.

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. The shareholder (for whom the guarantee is to be provided) or the shareholder controlled by the actual controller (for whom the guarantee is to be provided) shall not participate in the voting.

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 when the debtor fails to perform specific obligations, 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 a general guarantee.

Generally speaking, government authorities and institutions set up for public welfare, such as schools and hospitals, are legally incapable of granting a guarantee save for limited exceptions.

Guarantees in bankruptcy proceedings

If a debtor whose obligations are guaranteed by a third-party guarantor enters into bankruptcy proceedings, a guaranteed creditor, after submitting claims to the administrator, may directly request the guarantor to perform its guarantee obligations in parallel. The guarantor, after paying off all the creditor's claims, may substitute itself for the creditor in the bankruptcy proceedings.

Upon the conclusion of the bankruptcy proceedings, the guarantor shall remain liable in respect of outstanding obligations owed to the guaranteed creditor under the guarantee.

New Money Lending

After an application for bankruptcy is accepted, the debtor may borrow money to continue its business subject to a resolution passed by the creditors' meeting or subject to approval by the court before the first creditors' meeting. 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, the debtor may continue to borrow money, although the lenders will generally 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 may be recognised in China 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 refers 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 "impairing the legal interests of a Chinese creditor" have been used to refuse recognition of otherwise meritorious cases.

Notably, recent practice highlights the legal cooperation in cross-border bankruptcy proceedings between the Mainland and Hong Kong. Relevant arrangements were signed in May 2021, followed by detailed guidelines from the PRC Supreme People's Court. This new insolvency cooperative framework enables liquidators from Hong Kong to apply to Mainland courts for recognition of insolvency proceedings in Hong Kong. Currently, this cross-border recognition mechanism is limited to Shanghai, Xiamen and Shenzhen as specified pilot areas in Mainland China.

On 15 December 2021, in response to a request letter issued by the Hong Kong High Court, the Shenzhen Intermediate People's Court granted a ruling to recognise and assist the liquidators appointed by the former court, which is the first Hong Kong liquidation proceeding to be formally recognised in the Mainland under the new cooperative framework, reaching a milestone in the progress of cross-border insolvency practice in China.

Disclaimer

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HONG KONG SAR

HONG KONG SAR

Contributed by Clifford Chance (Hong Kong Office)

Introduction

This section provides a general outline of the main corporate insolvency procedures in Hong Kong (as at 31 July 2024). Hong Kong corporate insolvency law is governed primarily by the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) (as amended from time to time) ("CWUMPO"). 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 difficulty will either enter into 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.

During the COVID-19 pandemic in 2020, the Hong Kong Government announced it was considering (re-)introducing an amendment bill to implement corporate rescue and insolvent trading provisions which have been in discussions since 1996. An August 2023 report to the Legislative Council by The Law Reform Commission of Hong Kong indicated that the Financial Services and the Treasury Bureau introduced a specific legislative proposal in 2020, but there was no clear consensus in views among the stakeholders. To date, there is no clarity as to whether corporate rescue legislation will be introduced in Hong Kong.

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 is curtailed as a result of 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).

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 maximise recoveries for creditors.
- Scheme of arrangement available to compromise claims of creditors and contributories.

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 prscribed form a debt in the sum of or exceeding HKD 10,000;

(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 situations where the company was formed to carry on an illegal or fraudulent purpose or where the main purpose of the company has ceased to exist.

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 2 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 their powers need to be set out in full in the court order appointing them. 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 occasion, 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 are 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 their 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.

Winding up order and 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 Winding 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 HKD 200,000, 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) liquidation 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 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 demonstrate an appropriate basis for the appointment (which in many

cases involves jeopardy to the assets of the company) before a court will appoint provisional liquidators. If the company in question is incorporated in an offshore jurisdiction (such as Bermuda or the Cayman Islands) where it is possible to seek a moratorium under local law for the purposes of pursuing a restructuring, a practice had in the past developed for the company (through insolvency officers appointed offshore, if appropriate) to seek insolvency protection in its jurisdiction of incorporation, followed by an application for recognition in Hong Kong under common law and a request to the Hong Kong court to extend moratorium protection to the company in this jurisdiction.

However, the approach taken by the Hong Kong court in recent years has shifted from recognition of insolvency proceedings commenced in the jurisdiction of incorporation to a preference for recognition of proceedings commenced in the company's centre of main interests ("COMI"). This has resulted in a falling away of the practice of seeking recognition in Hong Kong for offshore insolvency proceedings for the purpose of pursuing a restructuring here.

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 'cramdown' 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 4 months, with more complex schemes taking more than 6 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 6 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.

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

Transactions which are at an undervalue entered into within five years of commencement of the winding up, and where the company was unable (or became unable) to pay its debts at the time of the transaction, can be set aside, 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.

Fraudulent conveyances: section 60 Conveyancing and Property Ordinance (Cap. 219)

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.

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 (unlike, 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 the directors know or ought to know 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 and, where liquidation is inevitable, to consider whether to take steps to put the company into liquidation since the creditors' interests become paramount. 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 a 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.

Mainland China imposes foreign exchange controls which limit the ability of onshore Chinese companies to provide guarantees in favour of foreign creditors for offshore liabilities. A practice has developed whereby the onshore Chinese parent company provides credit support for offshore debts of its subsidiaries through keepwell arrangements, which effectively involve contractual undertakings to keep offshore debtors solvent and ensure their ability to discharge their financial obligations as they fall due. In the context of keepwell arrangements governed by English law, the Hong Kong court has held that keepwell arrangements are generally enforceable, but the enforcement of keepwell arrangements against the onshore Chinese parent company in Mainland China remains relatively untested.

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 or creditor 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 that 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.

Winding up of Foreign Companies in Hong Kong

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.

Recognition of Foreign Insolvency Proceedings

Hong Kong has not adopted the UNCITRAL Model Law on Cross-Border Insolvency. While there are no statutory provisions which give the Hong Kong court a power to recognise and provide assistance to foreign insolvency officeholders, the Hong Kong court has power arising from common law to recognise foreign insolvency proceedings and provide assistance to foreign insolvency officeholders.

Generally, the courts in Hong Kong will recognise foreign insolvency proceedings and provide assistance to foreign insolvency officeholders appointed in such proceedings where it can be demonstrated that:

(a) the foreign insolvency proceedings are collective insolvency proceedings;

(b) the foreign insolvency proceedings are conducted in the insolvent company’s COMI; and

(c) the assistance is necessary for the administration of a foreign winding up and for the foreign insolvency officeholders to carry out their functions, and the assistance is not contrary to any Hong Kong substantive law and public policy.

The Hong Kong court can provide general assistance to foreign representatives, such as the power to gather information and documents relating to the company from third parties in Hong Kong. However, statutory powers under CWUMPO are available only to liquidators appointed by the Hong Kong court, and these powers cannot be extended to foreign representatives by way of a recognition and assistance order.

There exists a separate regime for mutual recognition and assistance for Hong Kong and Mainland China insolvency officeholders, which was established by the “Record of Meeting concerning Mutual Recognition of and Assistance to Insolvency Proceedings between the Courts of the Mainland and the HKSAR” between the Supreme People’s Court of Mainland China and the Hong Kong Government. Under this cooperation mechanism, subject to the relevant legal requirements being met, Hong Kong liquidators may seek recognition of their appointment and assistance from certain Intermediate People’s Courts in connection with Hong Kong insolvency proceedings, though this is currently limited to Shanghai, Xiamen and Shenzhen as the pilot areas in Mainland China.

INDIA

INDIA

Contributed by AZB & Partners, Mumbai, India

Introduction

This section provides a general outline of the 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. The IBC covers insolvency resolution, liquidation, voluntary liquidation (or solvent liquidation) for corporate persons, pre-packaged insolvency resolution process for micro, small or medium enterprises and insolvency resolution and bankruptcy for individuals who have provided guarantees to corporate persons.

This chapter also briefly discusses schemes of arrangement, the limited statutory self help remedies available to creditors, liability of directors, voidable transactions, guarantees, and the recognition of foreign insolvency proceedings.

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 a resolution process; (b) enables the resolution process to start an early stage of financial distress; (c) provides for a specified forum i.e. the National Company Law Tribunal ("NCLT") for the corporate persons and Debt Recovery Tribunals ("DRT") and NCLT for individuals, as the case may be, to oversee all insolvency and liquidation/bankruptcy proceedings; (d) enables a moratorium where any proceedings against the debtor are restricted; (e) provides for suspension 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; (g) lays out a robust liquidation mechanism for corporate persons; (h) provides for a cross-class cramdown; and (i) allows for a clean slate for a company that has undergone the relevant IBC process.

Further, certain provisions of the Companies Act 2013 ("CA 2013") supplement the regime set up under the IBC. The introduction of these provisions of CA 2013 have led to the simultaneous replacement of the provisions of the Companies Act 1956 (the legislation previously governing the primary aspects of corporate law in India).

In addition, the secured creditors have recourse to the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 ("SARFAESI Act") which deals with the enforcement of security by creditors, including in the case of liquidation of a company.

In this section, we set out the various processes laid down under the IBC. 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 INR10,000,000.

Unlike most jurisdictions, the IBC makes a distinction between financial creditors and operational creditors. Financial creditors is a reasonably wide definition but typically includes 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 including taxes. Operational creditors typically include trade suppliers, employees and persons owed statutory dues.

Further, a corporate applicant may also initiate CIRP against itself. The corporate applicant includes: the corporate debtor; a shareholder authorised under the debtor's 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).

Key Elements:

- The Insolvency and Bankruptcy Code 2016 consolidates and amends the laws on reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time-bound manner to maximise the value of assets of such persons, to promote entrepreneurship, the availability of credit and balance the interests of all the stakeholders including alteration in the order of priority of payment of government dues.
- Enabling provisions have been put in place related to extra-territorial jurisdiction over the assets or property of a corporate debtor situated outside India.

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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 at least 10 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.

Information Utilities ("IU(s)") play a crucial role in assisting the courts in identifying defaults to initiate the insolvency resolution process. These professional organisations are registered with the Insolvency and Bankruptcy Board of India ("IBBI") (the regulator established under the IBC) and are responsible for collecting, validating, and storing financial information about debtors. By providing authenticated data on debts and defaults, IUs help reduce information asymmetry and disputes amongst stakeholders, thereby facilitating quicker and more efficient insolvency proceedings. This system ensure that all parties involved have access to reliable information, which is essential for making informed decisions during the resolution process.

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. These timelines through judicial pronouncements have been deemed to be merely advisory. If a payment default has taken place, 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), which can be further extended at the discretion of the NCLT up to a period of 330 days and in some circumstances beyond that ("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 the running of the CIRP of the corporate debtor. If the CIRP is not completed within the prescribed time limit or no resolution plan is approved, the corporate debtor is put into liquidation.

During a moratorium, supply of essential goods or services to the corporate debtor shall not be terminated, suspended or interrupted.

Management

The IBC establishes a cadre of regulated insolvency professionals ("IPs"). An IP, who is registered with the IBBI, 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 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 until the date of appointment of the resolution professional ("RP").

Until the RP is appointed, the IRP must make a public announcement inviting claims from the creditors (within three days of their appointment), verify and collate all the claims submitted by the creditors and constitute the committee of creditors ("CoC").

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").

A creditor, who fails to submit claim with proof within the time stipulated in the public announcement, may submit their claim with proof to the IRP or the RP, as the case may be, up to the date of issue of request for resolution plans or 90 days from the insolvency commencement date, whichever is later. In case there is a delay of more than 90 days from the insolvency commencement, the creditor shall provide reasons for such delay in submitting the claim. In the event claims are not submitted within time, all decisions taken prior to admission of such claim will be binding on such creditor. 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 CoC.

Decision making

With the new regime set up under the IBC, India has moved from a 'debtor-in-control' model to a 'creditor-in-control' 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, who are not 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 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 or there are no resolution plans received 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 66% of its members (by value of debt owed). 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 in priority to all other payments. 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) All operational creditors must be paid a value no less than their recoveries in the event of a liquidation; or the amount that would have been paid to such creditors, if the amount to be distributed under the resolution plan had been distributed in accordance with the statutory order of priority, whichever is higher, and shall be paid in priority over the financial creditors.

(c) Any dissenting financial creditors (who vote against the resolution plan) must also be paid their liquidation value[1] 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.

If the mandatory requirements are satisfied, a resolution plan may cramdown dissenting financial creditors and other stakeholders.

The IBC provides the flexibility to the resolution applicant to obtain the necessary approval required under any law for the time being in force within a period of one year from the date of approval of the resolution plan by the NCLT or within such period as provided for in such law, whichever is later.

Further, the IBC has laid down certain disqualifications for persons proposing a resolution plan or buying assets in liquidation, such as undischarged insolvents or individuals convicted of certain criminal offences.

The IBC also allows for the withdrawal of an insolvency application admitted against a corporate debtor. The withdrawal can be permitted by the NCLT if the applicant secures the approval of at least 90% of the voting share of the CoC. This mechanism provides a way for the parties to settle the matter amicably even after the initiation of the insolvency process. This provision was introduced to address concerns that the IBC could lead to the liquidation of viable companies that might otherwise be resolved through mutual agreement.

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) if 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").

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 liquidator shall liquidate the corporate debtor within a period of one year from the LCD, failing which the liquidator shall make an application to the NCLT to continue such liquidation, along with a report explaining why the liquidation has not been completed and specifying the additional time that shall be required for liquidation.

A company in liquidation may be sold as a going concern. Unlike partial sale, where only specific assets are transferred, this preserves the value of the corporate debtor during the liquidation process. This approach aims to maintain continuity and maximise value for stakeholders.

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. Where no fee has been fixed, the consultation committee (which shall comprise all creditors of the corporate debtor) may fix the fee of the liquidator in its first meeting. In the event the fee is not decided, the liquidator shall be entitled to a fee as a percentage of the amount realised 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 their appointment;

(b) verifying claims of all the creditors;

(c) taking into their 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);

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 ICD.

(e) appointing professionals in order to assist the liquidator in the discharge of their 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 6 months of the LCD to disclaim onerous property including contracts;

(h) appointing at least two registered valuers to value the assets where the liquidator after consultation with the consultation committee is of the opinion that fresh valuation is required; and

(i) applying to the NCLT to avoid any fraudulent preference or undervalued transactions.

Reporting requirements

The liquidator is required to form a consultation committee, comprising all creditors of the corporate debtor, within 60 days from the LCD to advise the liquidator on various matters. The liquidator is also required to report to and make various filings to the NCLT from time to time comprising:

(a) a preliminary report within 75 days of the LCD which shall include, amongst 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) the proposed plan of action for carrying out the liquidation, including the timeline and the estimated liquidation costs;

(b) an asset memorandum within 30 days of the LCD where the valuation has been conducted during the CIRP and within 75 days in case fresh valuation is being conducted;

(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). If the resolution of the corporate debtor fails and it goes into liquidation, interest on interim finance receives this higher priority for either 12 months or for the period from the LCD until repayment of interim finance, whichever is lower.

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, 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.

The IBC liquidation waterfall at level 2 (please refer to section on 'Priority of Distributions') does not distinguish between the secured creditors holding the first-charge and subordinate-charge or an exclusive charge and a *pari passu* charge when it comes to repaying the secured creditors who have relinquished their security. This remains an area of contention.

Secured debt may be owed to certain government creditors based on the charge created by statute.

C. Pre-packaged insolvency resolution process

An MSME that has committed a default of INR 10,00,000 may, with the approval of 66% of its financial creditors in value terms and subject to certain other prerequisites, file an application for the initiation of a pre-packaged insolvency resolution process ("PPRIRP"). Prior to seeking approval of the financial creditors, the corporate debtor presents the financial creditors with a base resolution plan.

Upon admission of the application, the PPIRP operates for a period of 120 days during which time a limited moratorium prevails which prevents, *inter alia*, enforcement of security interest by creditors. After commencement of the PPIRP, the CoC may either approve the base plan proposed by the corporate debtor if the plan does not impair the claims of the operational creditors or approve a resolution plan invited from other resolution applicants. Importantly, a PPIRP is not a creditor-in-control construct but debtor-in-possession model with the supervision of the IP. This option also has the cross-class cramdown and allows the debtor to achieve a clean slate when it comes to creditors. All of the above combined with the shortened period is expected to incentivise owner-managers to resolve stress early (given that they have historically tended to avoid the CIRP processes).

D. 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 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 latter 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) stating that the company has no debt or will be able to pay its debts in full, from the proceeds of assets to be sold in the liquidation process;

  (iii) stating that the directors are not liquidating the company to defraud any person; and

  (iv) stating that the company has made sufficient provision to meet the obligations arising on account of pending proceedings or assessments before statutory authorities, and pending litigations, in respect of the company.

(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% of the 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% of the 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 of 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) which must be published in English and in a regional newspaper where the company's registered office and principal office is located; and

  (iv) which must be published on the website of the company and website of the IBBI.

(j) The liquidator must endeavour to complete liquidation of the company within 270 days from the LCD in case there are creditors. In other cases, it shall be completed within 90 days of the LCD.

(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 the Registrar of Companies/the authority the 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 has, by special resolution, resolved that the company 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 purposes 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.

The IBC as introduced in 2016 also led to an amendment under the CA 2013 to restrict the grounds for initiating winding up proceedings under the CA 2013 to exclude default.

E. Self-help remedies available to creditors

The SARFAESI Act sets out a procedure for creditors to enforce security interests when a borrower defaults on certain classes of secured debt. The creditor must classify the account as a non-performing asset ("NPA") prior to initiating actions under the SARFAESI Act. An NPA is a loan or advance for which the principal or interest payment has remained overdue for a period of 90 days. The creditor is required to issue a notice to the borrower, demanding repayment within 60 days of issuance of the demand notice. If the borrower fails to comply within this period, the creditor can take actions such as taking possession of the secured assets, including the right to transfer by way of lease, assignment or sale for realising the

secured asset, taking over the management of the business of the borrower, appointing any person to manage the secured assets and requiring any person who has acquired any of the secured assets from the borrower and from whom any money is due or may become due to the borrower, to pay the secured creditor any amount up to the amount of the secured debt. Once the creditor has taken possession of the secured assets, they can proceed with the auction process to recover the outstanding loan amount. Such creditors typically do not need to approach a court before undertaking such a sale process.

F. Schemes of arrangement

The CA 2013 allows for restructuring via a scheme of compromise and arrangement ("Scheme"). This provision is applicable not only to insolvent companies but to any company seeking to restructure. On an application made by a creditor, member, or liquidator of a company, the NCLT may order a meeting of creditors or shareholders or classes thereof. A notice of such meeting, along with details of the Scheme and other requisite documents, is sent to all creditors, shareholders (and classes thereof), and debenture holders of the company. Notice is also sent to the central government, income tax authorities, and other sectoral regulators and authorities that are likely to be affected by the Scheme to enable them to make adequate representations. The Scheme is required to be approved by a majority in number representing 75% in value of those creditors or shareholders in each class who are present and voting. It is important to note that no moratorium arises as part of a Scheme. Thus, approval of the Scheme by the NCLT is required to bind the dissenting and abstaining creditors.

G. Director liability

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

(a) **Wrongful trading giving rise to disgorgement based liability**
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 required to establish wrongful trading 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 minimising 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) **Other actions by directors giving rise to punitive liability**
Directors may also be liable for offences such as defrauding creditors, asset stripping and falsification of books of accounts of the company. The liability that is imposed under the IBC is punitive.

H. 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. Under Section 49, undervalued transactions entered into with a fraudulent intent do not have a lookback period.

I. 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.

The IBC amendments in 2019 brought personal guarantors within its ambit, allowing simultaneous or independent insolvency proceedings against them when the corporate debtor undergoes insolvency. The NCLT has jurisdiction over insolvency proceedings for both corporate debtors and their guarantors, ensuring a comprehensive resolution process. Independent insolvency proceedings against guarantors can be initiated without initiating insolvency proceedings against the principal borrowers.

J. 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.

Pending the adoption of the UNCITRAL Model Law, ad hoc protocols between insolvency practitioners across jurisdictions have been used to facilitate a coordinated restructuring process. These protocols, which have received the approval of the adjudicating authorities of the domestic and foreign jurisdiction, are designed to streamline insolvency proceedings and maximise stakeholder value.

INDONESIA

INDONESIA

Contributed by ABNR Counsellors at Law

Introduction

This section provides a general outline of the corporate insolvency procedures under Indonesian law.

Financial restructuring and insolvency can be addressed through court-supervised proceedings, or via an out-of-court procedure. The principal legislation governing court-supervised restructurings and insolvencies in Indonesia exists in Law No. 37/2004 on Bankruptcy and Suspension of Payments (Indonesian Bankruptcy Law, "IBL").

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On the other hand, out-of-court procedures for a company are governed by contract law in the Indonesian Civil Code ("ICC") and other sectoral laws, depending on the organisation type and industry.

The IBL provides two mechanisms for court-supervised restructuring and insolvency proceedings that can be initiated either voluntarily (by the debtor) or involuntarily (by creditors):

(i) bankruptcy proceedings (*Kepailitan*) with the aim of liquidation (in which one or more curators (receivers) are appointed) ("Bankruptcy"); and

(ii) suspension of debt payments (*Penundaan Kewajiban Pembayaran Utang*, "PKPU") proceedings (in which one or more administrators are appointed).

Under the IBL, Bankruptcy and PKPU are often intertwined as: (i) Bankruptcy can lead to a restructuring if the debtor offers a plan to restructure its debts (a "Composition Plan") that is satisfactory to its creditors; and (ii) a PKPU may lead to Bankruptcy if the Composition Plan fails to satisfy the interests of creditors.

The following sections provide an overview of the procedures of Bankruptcy and PKPU. If petitions for a PKPU and a Bankruptcy are submitted at the same time, the PKPU petition is given priority.

Bankruptcy

General Overview of Bankruptcy and Substantive Tests

The objective of the Bankruptcy procedure is to impose a general attachment on all of a bankrupt debtor's assets and collect and realise such assets in order to satisfy creditors' claims. The Bankruptcy procedure applies to all companies that have their domicile or place of business in Indonesia.

The IBL does not recognise the cash flow test (where a company is unable to pay its debts as they fall due) or the balance sheet test (where a company's assets exceed its liabilities) in determining insolvency. Instead, the debtor will be declared bankrupt once both of the following tests ("Substantive Tests") for Bankruptcy are summarily proven in a Bankruptcy proceeding before the Commercial Court:

(i) the debtor has at least two creditors; and

(ii) the debtor has failed to pay at least one of its debts that has become due and payable.

A dispute over the amount of debt being claimed does not automatically render the Bankruptcy petition invalid.

Who is eligible to file for Bankruptcy?

Under the IBL, a Bankruptcy petition may be filed by: (i) one or more creditors; (ii) the debtor; (iii) the public prosecutor (in the public interest); or (iv) prescribed regulatory agencies for certain business sectors. For example, the Bankruptcy of banks, securities companies, and insurance companies can only be initiated by the Financial Services Authority (OJK), whilst the Bankruptcy of state-owned enterprises operating in the public interest (whose capital is not divided into shares) can only be initiated by the Ministry of Finance. The special provisions of the Bankruptcy regime for these financial and state-owned companies are beyond the scope of this chapter.

A Bankruptcy decision and its legal remedies

Once a Bankruptcy petition is submitted to the Commercial Court, it must decide on the Bankruptcy petition within 60 days of its filing.

Once both the Substantive Tests for Bankruptcy have been fulfilled, the Commercial Court must declare the debtor bankrupt.

Key Elements:

- Bankruptcy involves the appointment of a receiver or curator.
- The suspension of debt payments (PKPU) procedure focuses on company rescue and offers a moratorium for a Composition Plan to be considered by creditors.
- Cram-down of creditors is available.
- Moratoriums are available covering both secured and unsecured creditors.

The decision can be appealed in cassation before the Supreme Court within eight days of the Commercial Court's decision (the "Cassation Filing Period"). Within 60 days of a cassation petition being received by the Supreme Court, the latter must decide whether to affirm or annul the Commercial Court decision. In specific cases, a further civil review appeal (*peninjauan kembali*) can be lodged against a final and binding Commercial Court decision (which has not been appealed within the Cassation Filing Period) or the Supreme Court's decision at cassation.

Stay Period

Upon the issuance of the Commercial Court decision declaring the Bankruptcy of the debtor, an automatic stay of claims in relation to the Bankruptcy estate will be triggered. Secured creditors' rights to enforce their security are subject to an automatic stay of up to 90 days, however this does not apply to security over or in the form of cash. Set-off is also prohibited when the stay is in effect. The automatic stay period may be less than 90 days if the Bankruptcy proceedings are terminated or if the court declares that the company is in a 'state of insolvency', which will commence the liquidation of assets by the receiver. After the end of the stay period, secured creditors may enforce their security.

Status of Debtor's Assets and Post-Bankruptcy Declaration Procedures

When it declares a debtor bankrupt, the Commercial Court will appoint one or more receivers who will be in charge of the administration, management and control of the debtor's assets, along with a supervisory judge who will monitor the receiver's discharge of their duties and responsibilities and the Bankruptcy proceedings generally.

A bankrupt debtor will forfeit its right to control and manage its assets from the date of the pronouncement of the Bankruptcy declaration. Consequently, the board of directors will lose its power to manage the company's assets. The authority to manage the company is transferred directly to the receiver who is under a duty to act in the best interests of the creditors, under the supervision of the supervisory judge.

Within 14 days of the Bankruptcy declaration, the supervisory judge must determine the deadline for verifying creditors' claims, tax verification, and then schedule a creditors' meeting at which claims are to be verified.

After determining the schedule for these processes, creditors must submit their claims to the receiver in writing, specifying the debt amount and type, with supporting evidence. Claims will be verified at a creditors' meeting, which is a court-supervised meeting held at the Commercial Court attended by the debtor, the creditors, the receiver, and the supervisory judge. At this meeting, the receiver will verify the claims and issue a list of acknowledged debts in the form of a permanent list of claims (*Daftar Piutang Tetap*) that contains a list of acknowledged claims of each creditor and the nature of the claims (secured or unsecured claims) that are legally binding in the Bankruptcy proceeding. Disputed claims are to be adjudicated in a distinct court proceeding.

Possibility of offering a Composition Plan

When a debtor is declared bankrupt, it is entitled to propose a Composition Plan containing comprehensive restructuring terms applicable to all its creditors. The Composition Plan must be provided at least eight days prior to the scheduled claim verification with the court registrar. The Composition Plan must be discussed at the creditors' meeting and a decision regarding it must be made as soon as possible after the claim verification meeting has concluded. The court can allow for a maximum period of 21 days after the claim verification meeting for the decision to be made under certain circumstances.

The decision to approve the Composition Plan requires the affirmative votes of: (a) more than half of unsecured creditors present or represented at the meeting and whose rights are acknowledged or provisionally acknowledged; and (b) creditors who represent at least two-thirds of the total amount of unsecured claims of unsecured creditors present or represented at the meeting, whose rights are acknowledged or provisionally acknowledged.

Secured creditors are not entitled to vote to accept or reject the submitted composition plan in a Bankruptcy proceeding, unless they relinquish their security prior to voting and therefore become unsecured creditors.

Powers of the Bankruptcy receiver

Under the IBL, following the issuance of a Bankruptcy decision, the receiver can continue the bankrupt debtor's business as a going concern provided that they obtain the approval of the supervisory judge (or, if there is a creditors committee, its approval). Where a going concern proposal is raised during or after the claim verification meeting, the receiver can continue the company as a going concern if that proposal is approved by creditors representing a total of more than half of all acknowledged unsecured creditors' claims. The court will need to issue a stipulation confirming such creditor approval has been obtained for the proposal to be effective.

Subject to the approval of the supervisory judge, the receiver can also obtain loans secured against any of the debtor's unencumbered assets, provided that such loans are obtained for the purpose of increasing the value of the estate. Contracts made by the debtor subsequent to the Bankruptcy declaration cannot be settled using the estate's assets unless they serve the estate's interests. The receiver is authorised to initiate or contest legal actions related to the debtor's rights and obligations.

A Bankruptcy receiver may also elect to continue or terminate various ongoing contracts. Where advance payments have been made in a lease, it may not be terminated until the expiry of the period covered by that prepayment. Where a Bankruptcy receiver elects to terminate a contract, the damages claim against the bankrupt estate will be included as an unsecured claim in the Bankruptcy and will be repaid *pro rata* along with the other unsecured creditors.

The objective of continuing the business activities of a bankrupt debtor as a going concern is to preserve or increase the value of the Bankruptcy estate for the benefit of creditors. Therefore, should the receiver determine that the bankrupt debtor's business remains viable, the receiver may continue the bankrupt debtor's business despite the assets being under general attachment.

Effect of declaration of Bankruptcy

A declaration of Bankruptcy is followed by the stay period. During this period, the debtor still has an opportunity to propose a composition plan to its creditors. However, once this period has elapsed and if no composition plan is successfully proposed, the court will declare the debtor to be in a 'state of insolvency'. Once the debtor is declared to be in a 'state of insolvency', the receiver will start to liquidate all of the bankrupt debtor's assets for distribution to satisfy creditors' claims. Secured creditors with collateral over the debtor's assets are entitled to unilaterally enforce their respective collateral within 2 months of the expiry of the date of the initial 90-day stay. This 90-day period can be shortened by the Court. If a secured asset is not successfully enforced against by a secured creditor during that period, the receiver is required to request the delivery of the secured asset and its supporting documents for sale by the receiver. Where the receiver enforces over a secured asset, proceeds are distributed to the relevant creditor(s) secured on that asset only after deducting mandatory preferred claims ranking above the secured creditors (such as certain wage and tax arrears) and the Bankruptcy costs (including the receiver's fees and other associated costs). However, if the secured

creditors successfully unilaterally enforce against the secured asset, such Bankruptcy costs are not deducted from the proceeds.

Timing for distribution of liquidated assets depends on the outcome of the asset sales carried out by the receiver. In practice, distributions may be carried out in multiple stages depending on the ability to sell and liquidate debtor's assets. Therefore, no fixed schedules or periods exist for distributing the proceeds to the creditors during Bankruptcy that leads to liquidation.

Enforcement of Security in Bankruptcy Proceeding

The IBL outlines does not specify any specific procedure for secured creditors to enforce their security during Bankruptcy proceedings. Secured creditors are permitted to utilise any available methods under their security agreements for enforcement. Typically, enforcement is carried out through a public auction. However, this method presents two major practical challenges. First, auction houses frequently request a court order, even though it is not legally required. Second, the two-month time limit referred to above is often insufficient to complete the sale. A private sale may be an alternative if the relevant debtor has given their approval.

Should the secured creditor fail to enforce their security within the two-month window, the IBL mandates that the appointed Receiver must carry out the enforcement through a public auction. If the public auction fails to achieve the sale of the security, the sale can proceed privately with authorisation from the Supervisory Judge.

Priority

The general rule on distributing the proceeds of a Bankruptcy estate to unsecured creditors is one of equality in proportion to the value of the claim they hold. In other words, the *pari passu* principle is followed. There are statutory priority rights in relation to certain categories of creditors. Shareholders rank behind all creditors in the distribution of the proceeds of the Bankruptcy estate. In principle, the ranking order for Bankruptcy estate distribution is:

1. bankruptcy estate claims (e.g. the Receiver's fees and costs incurred during the asset liquidation process);
2. preferential claims (e.g. outstanding wages, tax liabilities);
3. secured claims (claims that are secured with *in rem* security rights); and
4. unsecured claims (claims that are not secured with *in rem* security rights, and have no privilege under the prevailing laws and regulations).

Outcomes of Bankruptcy process

In the event that the assets of the Bankruptcy estate are insufficient to cover the Bankruptcy costs, upon the recommendation of the supervisory judge, and after having heard the temporary committee of creditors (if any) and the bankrupt debtor, the Commercial Court may order that the Bankruptcy be terminated immediately. If so, the bankrupt debtor is dissolved upon termination of the Bankruptcy by a final and binding decision of the Commercial Court, on the grounds that the assets of the Bankruptcy estate are insufficient to cover the Bankruptcy costs.

Alternatively, if all creditors' claims can be satisfied from the Bankruptcy estate, the Bankruptcy will be terminated, which the receiver will announce in the State Gazette and a newspaper. In such a scenario, the debtor is entitled to file a petition of rehabilitation, which is the restoration of the debtor to its original position prior to the Bankruptcy, through a court decision declaring that the debtor had fulfilled its obligations.

Personal Liabilities of Directors and Commissioners

The Board of Directors ("BoD") of a bankrupt debtor may be held jointly and severally liable for the company's debts if the Bankruptcy resulted from their fault or negligence, and the company's assets were insufficient to settle its debts owed to the creditors. The BoD could be exempt from such liability if they can prove all of the following:

(i) the Bankruptcy is not due to their fault or negligence;

(ii) they managed the company in good faith, with prudence, and full responsibility, in the interests of the company and within the objectives and purposes of the company;

(iii) the directors did not have a conflict of interest, either directly or indirectly, with respect to the management acts that the board of directors has performed; and

(iv) the directors took measures to prevent the occurrence of Bankruptcy.

Similar liabilities and exemptions also apply to the Board of Commissioners ("BoC") of the bankrupt debtor if the Bankruptcy resulted from their fault or negligence in overseeing the management of the BoD, and that the company's assets were insufficient to settle its debts toward the creditors.

In order to prove the culpability or negligence of the BoD, a separate lawsuit must be filed by the court-appointed receiver.

Clawback

Indonesian Bankruptcy proceedings recognise the concept of clawback (*actio pauliana*) where, in the interests of the Bankruptcy assets, the court-appointed receiver could request nullification of legal actions carried out by the bankrupt debtor before its Bankruptcy, if such legal action were considered detrimental to creditors. To initiate nullification, the following requirements must be fulfilled:

(i) the legal action was performed by the debtor before it was declared bankrupt;

(ii) the debtor was not obligated by contract (existing obligation) or by law to perform such legal action;

(iii) the legal action was prejudicial to the creditors' interests; and

(iv) the debtor and a third party had or should have had knowledge that such legal action would prejudice creditors' interests.

There are no provisions in the IBL which stipulate a specific clawback period. However, if the relevant transaction was carried out within the period commencing one year before the Bankruptcy declaration (and that transaction was not mandatory on the debtor), both the debtor and the counterparty would be deemed to have known that the transaction was detrimental to creditors if it fell into one of the following three categories:

(i) it is an agreement in which the consideration that the debtor received was substantially less than the estimated value of the consideration given;

(ii) it is a payment or granting of security for debts that are not yet due; or

(iii) it is a transaction the debtor enters with a relative or a related party (a member of the board of directors/commissioners, majority shareholder, etc.).

Notwithstanding the above, there is nothing which restricts a receiver from commencing a legal proceeding to nullify a transaction which occurred more than one year prior to the Bankruptcy declaration.

PKPU

General Overview of PKPU and Substantive Tests

Unlike the Bankruptcy procedure which aims to liquidate the debtor's estate, the PKPU aims to restructure the debtor's debts and allow the debtor to continue as a going concern. The PKPU is aimed at facilitating negotiations between debtors and creditors by giving them time to agree a mutually beneficial Composition Plan. The objective is to give the debtor ample time to consider various Composition Plans to allow the company to survive as a going concern and ultimately satisfy creditors' claims. The PKPU will commence immediately after the Commercial Court issues its decision to approve the request for the PKPU.

In addition to the above Substantive Tests, the additional test to determine whether to grant a PKPU petition is whether the debtor cannot or foresees (or their creditor(s) foresees) that it will be unable to pay its debts as they become due and payable.

Who is eligible to file for PKPU?

A PKPU petition may be filed by: (i) one or more creditors; (ii) the debtor on a voluntary basis; (iii) the public prosecutor (in the public interest); or (iv) particular institutions for certain debtors. A petition may be filed by the debtor on its own initiative and as a defence against a Bankruptcy petition being filed against it.

PKPU Decision

The Commercial Court must decide on a PKPU petition within either: (i) three days of filing a PKPU petition where the debtor itself has made the petition; or (ii) 20 days of filing a petition for an involuntary PKPU by creditors. The decision rendered by the Commercial Court in this case cannot be appealed.

Post-PKPU Decision Procedure

If the Commercial Court grants the PKPU petition, the Commercial Court is required by law to grant a provisional PKPU for up to 45 days, commencing from the date that the provisional PKPU is granted. Subject to creditors' approval, the 45-day provisional PKPU may be extended several times, up to 270 days from the date the provisional PKPU is granted. If this is not forthcoming and the 45-day provisional period expires, the PKPU will end and the debtor will be put into Bankruptcy.

Additionally, once the Commercial Court has granted the PKPU, it must appoint one or more administrators and a supervisory judge. The administrator is required to announce the PKPU decision as soon as possible in the State Gazette and at least two daily newspapers determined by the supervisory judge. The announcement must contain:

(i) the deadline for creditors to submit claims to the administrator;

(ii) the name of the supervisory judge as well as the name and address of the administrator; and

(iii) an invitation for the creditors to attend: a claim pre-verification meeting (as relevant); a claim verification meeting; a creditors' meeting on the discussion of a Composition Plan; and a creditors' meeting to vote on the Composition Plan.

All three meetings must be held within 45 days of the PKPU decision in accordance with a court-stipulated schedule. However, if the meeting agenda cannot be completed within these 45 days (for instance, the Composition Plan is not ready to be voted on), the debtor may request an extension of the PKPU period from the creditors which will convert the provisional PKPU into a permanent PKPU. The meetings can be held within this extension period if they could not be completed during the initial 45-day period. The PKPU extension period can vary from 45 to 90 days in length per extension, with extensions possible for a period of up to 270 days from the date of granting the provisional PKPU. After the creditors grant their approval for an extension, the supervisory judge will report this to the panel of judges. Each PKPU extension will need to be validated by the panel of judges in a deliberation hearing, based on the report received from the supervisory judge. If the creditors reject the composition plan or the request to convert the provisional PKPU into a permanent PKPU, the debtor will be declared bankrupt (and in the scenario where the composition plan is rejected, the debtor will then immediately be in a 'state of insolvency' with no opportunity to submit a new or revised Composition Plan to its creditors).

Legal Effect of PKPU Status

Upon the pronouncement of the Commercial Court decision granting the PKPU, there will be an automatic stay of actions against the debtor. Payment of debts to unsecured creditors during the PKPU cannot be made unless the payment is made to all creditors proportionally. The debtor is not excused from making payments to its secured creditors. However, even if the debtor fails to pay secured creditors during this period, secured creditors are unable to enforce their security rights as they will be subject to a stay of proceedings for the full duration of the PKPU.

Similar to a Bankruptcy situation, a third party may approach the administrator to confirm if their contract is being terminated or continued in the PKPU proceedings. If the contract is terminated, the resulting damages arising from that may be included as an unsecured claim against the debtor to be considered in the PKPU.

The debtor remains entitled to manage and dispose of its assets, but only in conjunction with the administrator. The debtor is prohibited from exercising management or ownership rights relating to all or part of its assets without the administrator's approval, such as disposals or dissipation of assets. Violation of this provision allows the administrator to take necessary action to ensure that the debtor's assets are not jeopardised by the debtor's action. An obligation performed by the debtor, without administrator consent, and arising after commencement of PKPU proceedings, may only affect the debtor's assets to the extent that the debtor's assets benefit from its performance.

Composition Plan

The debtor's main goal in PKPU proceedings is to provide satisfactory terms and conditions of payment as set out in the draft composition plan to all its creditors, presenting the proposal and obtaining approval within the PKPU period. The composition plan determines the rights of each creditor against the debtor's estate and may – and most often does – alter the content of their agreement with the debtor. The law does not specify what the composition plan must include, thereby providing flexibility in its content.

It is theoretically and practically possible for a debtor to apply different restructuring terms to various groups of creditors (such as bank creditors, customer creditors or vendor creditors) in the composition plan.

Voting Thresholds in a PKPU Composition Plan

For the composition plan to be approved, it must obtain the affirmative cumulative votes of two classes of creditor satisfying the below conditions:

- Unsecured creditors: support from unsecured creditors: (a) who in number account for more than half of the unsecured creditors present or represented at the meeting in number, whose rights are acknowledged or provisionally acknowledged; and (b) whose claims represent at least two thirds of the total amount of unsecured claims of unsecured creditors present or represented at the meeting, whose rights are acknowledged or provisionally acknowledged; and
- Secured Creditors: support from secured creditors: (a) who in number account for more than half of the secured creditors who are present or represented at the meeting

in number; and (b) whose claims represent at least two thirds of the total amount of secured claims of secured creditors present or represented at the meeting.

Possible Outcomes of PKPU: Homologation or Bankruptcy

If the Composition Plan is voted for by the requisite majority of the creditors and confirmed (homologated) by the Commercial Court in accordance with the PKPU procedures, the approved version will bind all creditors (secured and unsecured), except dissenting secured creditors, who will be compensated by the debtor at the lower of either the value of the collateral or the actual claim directly secured *in rem* (relating to property, not personal) rights.

In other circumstances (i.e., the plan is rejected in the voting process, no plan is submitted, or the approved plan is not confirmed (homologated) by the Commercial Court), Bankruptcy will be declared immediately. Alternatively, the supervisory judge or one or more of the creditors may submit a request to terminate the PKPU due to the debtor's conduct, such as where the debtor prejudices the rights of creditors, acts in bad faith, or manages or disposes of its assets, without the administrator's consent. Creditors may also be able to request to terminate the PKPU if there is a change in the debtor's assets situation which makes it impossible to continue the PKPU, or where there is a significant adverse change in the debtor's business to the detriment of the creditors, such that it cannot satisfy its obligations. Granting such a request to terminate the PKPU would result in the debtor's Bankruptcy.

Legal Remedies with regard to a confirmed (homologated) Composition Plan

No legal remedy is available against a decision of the Commercial Court to reject the confirmation (homologation) of an agreed Composition Plan. However, a petition for cassation (appeal) to the Supreme Court may be submitted by the creditor against the decision of the Commercial Court that ratifies an agreed composition plan within eight days of pronouncement of the decision.

Moreover, the creditor of the debtor under PKPU proceedings may request the nullification of a confirmed (homologated) composition plan if the debtor is negligent in complying with the plan, in which case the debtor will automatically be declared bankrupt.

International Aspects of Indonesian Restructuring and Insolvency Laws

Universality

The IBL adopts the universality principle, in which the general confiscation of the bankrupt debtor's assets is not limited to assets within the jurisdiction of Indonesia but includes those located abroad. In practice, the powers and authorities of an Indonesian receiver under the IBL can be exercised in a foreign country only if the law of that country permits it.

Territoriality

In respect of foreign restructuring or insolvency proceedings, Indonesian law adopts the principle of territorial effectiveness, meaning that foreign court judgments in foreign insolvency proceedings are not recognised in Indonesia. As a result, judgments from overseas restructuring and insolvency proceedings cannot be enforced within the country. This means that a foreign creditor who obtains a judgment overseas will still need to relitigate the matter through a local proceeding regulated under the IBL (either the PKPU or the Bankruptcy proceeding).

Foreign Creditors

All creditors, whether domestic or foreign, are treated equally under Indonesian law. There are normally no additional requirements for the recognition of claims by foreign creditors. The IBL, nevertheless, contains specific provisions that allow creditors domiciled abroad to submit claims in Bankruptcy/PKPU proceedings after expiry of the claim submission deadline, provided that certain other requirements are also fulfilled.

JAPAN

JAPAN

Contributed by Clifford Chance (Tokyo Office)

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 a corporate reorganisation, civil rehabilitation or special liquidation process. 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.

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 the 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.

Key Elements:

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

With the commencement of bankruptcy proceedings, a stay on enforcement will arise (although as noted below this does not apply to secured creditors) and the bankruptcy trustee (*hasan kanzainin*) is appointed by the court, usually from amongst 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 cooperate 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 3 months prior to the commencement of bankruptcy and severance pay equivalent to 3 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.
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 10 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 2 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 automatically suspended without the need for a separate application to the court and no further proceedings can be commenced: (a) compulsory execution proceedings and orders; (b) provisional injunctions; and (c) provisional attachment orders. The court may also suspend any bankruptcy proceedings that 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 the 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 a reorganisation plan for the continuation of the business is likely 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. With the commencement of corporate reorganisation proceedings, a stay on enforcement will arise, which prevents creditors including secured creditors from enforcing their rights.

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 only enforce their security interest in accordance with the reorganisation proceedings and reorganisation plan. However, certain preferential claims (*kyoeki 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 under statute, there are four requirements which the Tokyo District Court has established have to be met in practice in order to implement the DIP type corporate reorganisation, specifically:

(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) the managers' involvement will not jeopardise the proper implementation of the proceedings.

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 (*kyoeki 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 6 months prior to the commencement of corporate reorganisation proceedings, and severance pay principally equivalent to 6 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 (*ippan 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.
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 have 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 in paragraph (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

To the extent that the voting rights are given to the 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 and/or shareholders, the court will 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 (*kyoeki 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.
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 unless the counterparty proves it was unaware of such harm;

(ii) gratuitous acts which the debtor conducted after or within 6 months before its suspension of payments generally or the application for the commencement of bankruptcy proceedings; 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.

The ability to enforce a right of avoidance expires upon the earlier of a statutory limitation of two years from the commencement of bankruptcy proceedings, or 10 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 duty of loyalty 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. Such guarantee may be subject to the right of avoidance.

New Money Lending

If a preservation order has been issued by the court after an application for corporate reorganisation or civil rehabilitation proceedings have 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

SOUTH KOREA

Contributed by Bae, Kim & Lee LLC

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 Reorganisation Act, the Composition Act, the Bankruptcy Act and the Act on the Rehabilitation of Individual Debtors.

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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.

Preservation and comprehensive stay orders

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 preservation 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.

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.

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 in principle 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.

Where the court forms the view that it would not be appropriate for the existing representative director of the company to be appointed as a receiver, it 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. In exceptional cases, 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, if warranted given the situation surrounding the relevant company, Korean courts may elect not to appoint a receiver, including in the case of large corporations. If this is the case, as a matter of Korean law, shareholders and directors have the authority to appoint the receiver, but they may face practical difficulty in appointing the receiver if having regard to the circumstances of the matter the Court is not agreeable to such course of action by the debtor company.

Examination of financial status of company

On the commencement of corporate rehabilitation, the court will appoint an examiner (normally an accounting firm) 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 2 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 outside of the rehabilitation proceeding, 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. Thus, there have 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 amongst the many classes of creditors, but submitting pre-packaged rehabilitation plans when applying for rehabilitation proceedings is no longer uncommon practice, especially where a debtor applies for corporate rehabilitation proceedings following an out-of-court restructuring procedure. 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 2 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 the 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 4 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 exceeds 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 cramdown 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 in the rehabilitation proceeding. 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 addresses 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 in bankruptcy proceedings

Creditors' claims in bankruptcy procedures 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, an 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 in rehabilitation and bankruptcy proceedings

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 clawback 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 clawback 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).There is no limit on the clawback period;

(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"). There is no limit on the clawback period;

(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")); and

(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 6 months from the date the debtor's payment obligations have been suspended (6 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 restructurings 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 the 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 4 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 in 2001, and was effective until the end of 2005. But it was subsequently reintroduced in 2007, again for a limited term. Following several expirations, extensions, and re-enactments, the current CRPA, which was re-enacted on 25 December 2023 as a temporary law, is scheduled to expire on 25 December 2026.

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 wilful 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 6 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 preservation 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 and salary claim (including severance and disaster compensation claims) are given a super-priority ranking over other common benefit claims, and the common benefit claims are repaid 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 recognised 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

MALAYSIA

Contributed By Shearn Delamore & Co.

Introduction

This section contains a general outline of the main corporate insolvency procedures in Malaysia. The principal legislation in Malaysia governing corporate insolvency is the Companies Act 2016 (the "CA 2016"). It is supplemented by the Companies (Corporate Rescue Mechanisms) Rules 2018, which came into force on 1 March 2018 and contain the rules that complement and underpin these corporate rescue mechanisms.

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In April 2024, the CAA 2024 came into force, incorporating significant amendments to, amongst others, the judicial management and scheme of arrangement frameworks in the CA 2016 to substantially increase their effectiveness and to keep pace with legislative developments elsewhere.

The main corporate insolvency processes under Malaysian law which will be discussed below are:

- schemes of arrangement;
- Corporate Voluntary Arrangement ("CVA");
- receivership;
- judicial management; and
- liquidation.

There is a separate regime which applies to licensed financial institutions known as conservatorship. However, this is outside the scope of this chapter.

We also consider, very briefly, the avoidance of antecedent transactions and cross-border insolvency under the insolvency legislative framework in Malaysia.

Schemes of arrangement

A scheme of arrangement is a statutory process that enables a debtor company to meet its obligations to creditors by restructuring its debts and, if necessary, adjusting the rights of the creditors. A scheme may be initiated by any company, creditor (or class of creditors) or member (or any class of members) of a company, liquidator (if a company is in the process of being wound up), or judicial manager (if a company is in judicial management).

Court involvement is required throughout the entire process of initiating a scheme. The applicant must obtain a court order to convene meetings of the company's members and various classes of creditors. To approve the terms of a scheme, a statutory voting threshold of 75% of the total value of creditors or class of creditors and members or class of members present and voting at the court-convened class meeting(s), in person or by proxy, must be met. Under the CAA 2024 amendments, the High Court now has the power upon the application of the company to order a cross-class cramdown to allow a scheme to be sanctioned even if there is a dissenting class of creditors.

The High Court has the power to appoint an approved liquidator to assess the viability of the proposed scheme. The approved liquidator will have to prepare a report for submission to the applicant. This report will then be presented at the court-convened class meetings for consideration by the members and creditors before voting.

Any scheme that has achieved the requisite statutory voting majorities still needs to be approved by the High Court, as the scheme derives its binding effect from the court order. In considering whether to approve the scheme, a Malaysian court will normally consider whether:

- all procedural requirements have been fulfilled;
- the approved liquidator's report had indicated that the scheme is viable;
- the members and creditors had all the relevant and necessary information required to make an informed decision; and
- the scheme is sufficiently fair and reasonable that an honest and intelligent member or creditor, as the case may be, would approve it.

Key Elements:

- Debtor in possession options available to assist distressed companies via schemes of arrangement and corporate voluntary arrangements.
- Powers of management can be displaced by a judicial manager, interim liquidator or receiver.
- The Companies (Amendment) Act 2024 (the "CAA 2024") came into force, incorporating significant amendments to, amongst others, the judicial management and scheme of arrangement frameworks to increase their effectiveness.
- Moratorium protection and super-priority rescue financing available.

A restraining order ("RO") to prevent creditors from taking any actions against the company and/or enforcing any security over assets of the company can be concurrently applied for upon initiation of a scheme of arrangement. From the date of lodgement of the application for an RO, a two-month automatic moratorium applies to prevent creditors from taking any such actions and/or enforcing such security. Within such time, the court will hear and determine the scope of the RO, which it may extend to include related

companies. Once the RO is ordered by the court, it remains effective for a period of 3 months and may, on further application, be extended for a period of not more than nine months. The threshold for the granting of an RO requires that a proposed scheme of arrangement covers more than half of all the debts of a debtor company and, for further extension, the court must additionally be satisfied that the RO is necessary for the scheme of arrangement. If granted by the court, a person nominated by the majority creditor is appointed to act as a director. While an RO is in force, the company is not permitted to dispose of any property or to acquire any new property other than in the ordinary course of its business and, if it does, the disposition or acquisition will be void.

Creditor classification is based on the similarity or dissimilarity of legal rights against the scheme company, not on interests unrelated to those rights. However, wholly-owned subsidiaries or related parties should not be placed in the same class as other creditors due to their special interest in promoting the scheme. The court holds ultimate discretion in deciding whether to discount or disregard votes from certain scheme creditors.

There is no exact mathematical formula or absolute rule for discounting votes from related-party creditors or wholly-owned subsidiaries. In making the decision to discount or disregard those votes, several factors will be considered, including the benefits of the scheme compared with liquidation, the likelihood of achieving a better scheme, the presence of special or ulterior interests adverse to creditors' interests, and the genuine nature of adjudicated debts.

Based on a recent decision, while the existence of separate or special interests of related-party creditors does not automatically justify disregarding their votes, any scheme that places such related companies and third parties in the same class as other creditors will be liable to be rejected at the sanction stage.

Pursuant to the CAA 2024, some notable new provisions relating to schemes of arrangement include:

- the introduction of specific prohibited or restrained acts during the subsistence of a temporary restraining order;
- the introduction of a new power of the High Court to grant a restraining order on the application of a related company of the scheme applicant company;
- the prohibition of granting a restraining order if one has already been granted within the preceding period of 12 months;
- a new provision for rescue financing and super-priority status to the rescue financing debt, which is subject to many safeguards and requirements;
- a power to cramdown dissenting creditors if at least one class of creditors has consented, provided that at least 75% of the overall value of creditors across all classes have agreed to the scheme;
- several new proof of debts processes; and
- a power to approve a scheme of compromise and arrangement without a meeting of creditors.

The CAA 2024 confirms that the new amendments introduced by this legislation will not apply retrospectively and as such the CA 2016 in its unamended form applies to all scheme proceedings that were commenced before 1 April 2024.

Corporate voluntary arrangements

Since the implementation of the CAA 2024, the CVA procedure encapsulated in the CA 2016 has been revised. It is now available to all companies, including public companies, except companies that are holding licences issued under the FSA and the Capital Markets and Services Act 2007 (the "CMSA") as well as companies approved under Part II of the Securities Industry (Central Depositories) Act 1991 (the "SICDA").

A company under judicial management may make a CVA proposal through the judicial manager. A liquidator of a company under liquidation may also make a proposal. The CVA process begins with the appointment of a nominee, who must be a licensed insolvency practitioner. The proposed CVA and a statement of affairs must be submitted to the nominee. The nominee is required to monitor the company's affairs during the moratorium. He or she is required to form an opinion as to whether the proposed arrangement has a reasonable prospect of being approved and implemented, and whether the company will have sufficient funds during the moratorium to enable it to carry on business. Where a judicial manager or a liquidator initiates a CVA, they may also assume the role of the nominee.

There is an initial 28-day moratorium that commences when the CVA documents are lodged with the High Court. The effects of the moratorium, *inter alia*, include preventing the presentation of a winding up petition. Meetings of members and creditors of the company are summoned to consider the proposed voluntary arrangement. At these meetings, the members and creditors may extend the moratorium period to a maximum period of 60 days. The period would be critical for the company and its creditors to consider the plan or arrangement with the objective of rehabilitating the company.

The CVA voting thresholds have been set at a majority in excess of 50% of members and 75% in value of creditors. Once the statutory meetings approve the proposed voluntary arrangement, it becomes binding on all creditors, regardless of how they voted. The appointment of a supervisor, who is responsible for implementation of the arrangement, is also provided for in the CAA 2024. The supervisor may be the original nominee but may also be any other licensed insolvency practitioner.

A secured creditor's right to enforce its security is preserved, notwithstanding the approval of the CVA proposal.

Receivership

Receivership is regulated by Division 7 of the CA 2016.

Malaysian law contemplates the private appointment of either one or more receivers or, alternatively, one or more receivers and managers, depending on the powers conferred on the debenture holder in the debenture. The distinction between a receiver and a receiver and manager is that the latter has the authority to undertake the duties of a receiver *and* carry on the trade or business of the company. The CA 2016 expressly contemplates the possibility that a receiver, or receiver and manager, may also be appointed by the court.

The CA 2016 introduced a statutory list of powers of a receiver or receiver and manager. These comprise the typical powers of a receiver or receiver and manager.

In the case of a private appointment, the primary duty of a receiver, or receiver and manager, is to the debenture holder. His or her duty is principally to take possession of the assets of the company and realise them for the benefit of the debenture holder, subject to a duty owed to the company to obtain the best possible price reasonably attainable under the market conditions at the time of sale. Where the appointment is by the court, the receiver, or receiver and manager, will be regarded as an officer of the court and therefore must act fairly and even-handedly in the interests of all parties. The CA 2016 provides that, after commencement of the winding up of a company:

- a receiver may continue to act as receiver and exercise all the powers of a receiver in respect of all the assets comprised in his or her appointment under the terms of the debenture in question;
- a receiver and manager may exercise all the powers of a receiver and manager for the purpose of carrying on the business of a company provided that the receiver and manager secured the consent of the liquidator or, failing such consent, the consent of the court; and
- if the receiver and manager does obtain the requisite consent, then, when carrying on the business of the company, he or she will continue to be an agent of the company.

Judicial management

Judicial management is a corporate rescue mechanism that allows a Malaysian company that is or will be unable to pay its debts, or its directors or creditors, to apply to the High Court for a judicial management order ("JMO") to be made and for a judicial manager to be appointed over the company. The applicant for a JMO has a duty to make full and frank disclosure. The court has the inherent jurisdiction to set aside a JMO if it has been obtained without full disclosure or with *mala fides*.

Other than certain specific exceptions (notably companies in the financial and securities industry regulated by the central bank, CMSA, and/or SICDA), most companies, now including public listed companies, are eligible for judicial management.

There are several conditions that must be satisfied before a company is eligible for judicial management:

- the company is or is likely to be unable to pay its debts; and
- making a judicial management order will be likely to achieve one or more of the following purposes:
  - the survival of the company or its undertaking (whether in whole or part) as a going concern;
  - the company will obtain the approval of a scheme of compromise or arrangement; or
  - a more advantageous realisation of the company's assets would be achieved compared to through a winding up.

A debenture holder has a statutory veto. It may object to the JMO application, and if it signals that it intends to appoint a receiver, or receiver and manager, the court must dismiss the JMO application unless public interest requires that the court should override the debenture holder's objection.

During the period between the application being made and either a JMO or dismissal of the application being made, a 60-day moratorium automatically applies to restrain creditors from taking certain actions against the company and/or enforcing any security over the assets of the company. A JMO initially lasts for 6 months but can be extended for a longer period as the court may allow.

Following a JMO, a wider range of creditor action is restrained by statute. A secured creditor may, after giving notification to the judicial manager, enforce security over the company's movable property or repossess any goods in the company's possession while a JMO is still in force on any or all of the following conditions:

- the judicial manager confirms that the goods or movable property are not required by the company which is under the JMO;
- the JMO poses a high risk to the existence of the goods or movable property; or
- the value of the goods or movable property decreases due to the JMO.

The appointment of a judicial manager displaces the directors. He or she manages the business and must within 60 days (which can be extended by the court) present a proposal to the creditors of the company. The judicial manager has to summon a meeting of creditors to consider and vote on the proposal. The voting threshold is 75% in value of creditors whose claims have been accepted by the judicial manager, present in person or by proxy. Any proposal that is approved is binding on all creditors, regardless of how they voted.

The judicial manager oversees the implementation of the proposal. Once the purpose of judicial management has been achieved, he or she may apply to discharge the order. If a proposal is not approved at the creditor meeting, the court would normally discharge the JMO, and either receivership or liquidation beckons.

Super-priority rescue financing

The CAA 2024 introduced the concept of super-priority rescue financing into both the judicial management and scheme of arrangement frameworks. Rescue financing prioritises rescue financiers over other creditors of the company in distress, and therefore incentivises financiers to provide companies in distress with further financing that might not otherwise be available through conventional means.

The Court may, on the application by the judicial manager – or by the applicant in a scheme of arrangement – grant one or more of the following orders for the company in distress to receive rescue financing:

- the Court can order that the debt arising from any rescue financing obtained by the company shall be paid immediately after the costs and expenses of the winding up have been paid. This priority would therefore sit above preferential debts;
- the Court can make an order to secure a debt arising from any rescue financing by the creation of security over unsecured assets; and
- the Court can make an order to secure a debt arising from any rescue financing by the creation of security interest of the same priority or even higher priority over existing security provided that the interests of the existing security interest holder are adequately protected.

Liquidation

As was the case under the CA 1965, there are two types of liquidation under the CA 2016, namely voluntary liquidation and compulsory liquidation.

Voluntary liquidation

There are two categories of voluntary winding up – members' voluntary liquidation and creditors' voluntary liquidation. Both types are commenced when a special resolution by members to wind up the company is passed, but the liquidation can only be a members' voluntary liquidation if the company is solvent and its directors are able to make a statutory solvency declaration. Under a members' voluntary winding up, as the company is supposed to be solvent, it is envisaged that all creditors will be paid in full. The members therefore appoint the liquidator.

Creditors' voluntary liquidation

However, if it is not possible for a solvency declaration to be made, or if one is not made for any reason, then the voluntary winding up can only proceed as a creditors' voluntary winding up, in which case the creditors appoint the liquidator.

A creditors' voluntary winding up may also be initiated at the instance of the directors. The directors shall make a statutory declaration stating that the company cannot by reason of its liabilities continue its business and the meetings of the company and of its creditors have been summoned for a date within 30 days of the date of the declaration.

A company should commence voluntary winding up by a special resolution. The CA 2016 provides for a "limited exception", which allows a company to commence the voluntary winding up process for a limited period of one month by appointing an interim liquidator without a special resolution passed by the company's contributories. The appointment of an interim liquidator shall only take effect after the lodgement of the statutory declaration with the Registrar of Companies and the official receiver.

The CA 2016 provides that the creditors' winding up shall commence:

- where an interim liquidator has been appointed "before the resolution for voluntary winding up is passed", at the time when the statutory declaration is lodged with the Registrar; and
- in any other case, at the time of the passing of the resolution for voluntary winding up.

Compulsory liquidation

Compulsory liquidation is typically initiated by the filing of a winding up petition by a creditor, invariably for non-payment of debts as and when they fall due, although it is also possible for a member to file a petition to wind up the company on various grounds, including shareholder conduct that makes it just and equitable to wind up the company. The petition can also be presented by the company, contributories, the liquidator, the Minister, the Central Bank of Malaysia, the Registrar, and the Malaysia Deposit Insurance Corporation.

After the presenting of a winding up petition, the court may, upon the application of any creditor or contributory of the company, appoint the official receiver or an approved liquidator as an interim liquidator before the making of a winding up order. The interim liquidator shall have and may exercise all the functions and powers of a liquidator subject to such limitations and restrictions as may be prescribed in the rules or as the court may specify in the order appointing him.

After the winding up order is made, the petitioner shall notify the Registrar of Companies, official receiver and liquidator of the order and its date, and the name and address of the liquidator, within seven days from the making of the order. Unless an approved liquidator, other than the official receiver, has already been appointed as interim liquidator, the official receiver will automatically assume the role of liquidator until either they or another individual is formally appointed as the liquidator. Upon the making of a winding up order or appointment of an interim liquidator, no action or proceeding shall be proceeded with or commenced against the company except by leave of the court and in accordance with such terms as the court imposes. Nonetheless, a secured creditor can still exercise their statutory remedies without court permission if the security was granted through a legal charge on land, properly registered according to the National Land Code's provisions.

Commencement of winding up

Voluntary winding up is considered to commence from the date of the members' resolution. On the other hand, in the case of compulsory winding up, if the presentation of a petition to wind up a company in court was preceded by a resolution to voluntarily wind up the company, the winding up by the court is deemed to commence from the date of the members' resolution, and, in any other case, the winding up by the court is deemed to commence from the date of the winding up order and not the date of presentation of the petition.

Avoidance of antecedent transactions

Void Transactions

Any disposition of property of the company (including the transfer of any shares or alteration in the status of the members of the company), other than an exempt disposition, made after the presentation of a winding up petition shall be void unless validated by court. This restriction extends to any attachment, sequestration or distress or execution put in force against the Company after the presentation of the winding up petition.

Undue preference transactions

Malaysia's undue preference provisions provide that every transaction falling within the 6 months prior to the date of presentation of the winding up petition (for a court-ordered winding up) or the date of the resolution for the voluntary winding up of the company (for voluntary liquidation), as the case may be, is statutorily deemed to be a fraudulent preference, regardless of the parties' actual intentions or the actual effect on the estate of the company. However, if the creditor or other person dealing with the company in the course of that transaction has in fact provided valuable consideration and had no notice at the time of entering into the transaction of the company's inability to pay its debts or of the winding up proceedings having been commenced in court, or of a resolution for voluntary winding up having been passed, it would not be treated as a preference. A liquidator may not set aside transactions outside of that six-month period.

Transactions at an overvalue and undervalue

The liquidator of a company may, where a property, business or undertaking has been acquired by the company for cash consideration at an overvalue within the two years before presentation of a winding up petition against the company (compulsory winding up) or when the resolution to wind up the company is passed (voluntary winding up), recover the difference in value from the relevant person/company from which such property was acquired. Conversely, if the company has disposed of assets in a transaction in which the cash consideration is undervalued, the liquidator may recover the difference in value from the relevant

person/company such property was sold to. For the purposes of these provisions, the relevant person/company is limited to:

(a) a person who was, at the time of the sale, a director of the company or a person connected with a director; or

(b) a company of which, at the time of sale, a person was a director who was also a director of the first-mentioned company, or a person connected with a director.

Examples of undervalue transactions include giving gifts, paying more or less for services or assets, undertaking a burden for no consideration in return, providing security for an unsecured loan and conferring a right of set-off against an owed debt. These transactions follow a common theme, that being not obtaining the true value of the transaction, receiving too little or nothing, or paying too much.

Cross-border insolvency

In Malaysia, there are no formal substantive legislative provisions in the corporate insolvency space that govern cross-border insolvency and corporate rescue provisions. The insolvency and rescue processes, as explained above, are limited to a purely domestic context in terms of scope and applicability.

At common law, as far back as 1916, the Court of Appeal in the Federated States of Malaya was able to grant recognition to the Official Assignee of a bankruptcy in Singapore. Further, section 104 of the Bankruptcy Act 1967 provides that "*the High Court shall in all matters of bankruptcy and insolvency act in aid of and be auxiliary to the courts of the Republic of Singapore or any designated country having jurisdiction in bankruptcy and insolvency so long as the law thereof requires its courts to act in aid of and be auxiliary to the courts of Malaysia*". This is limited to Singapore as matters stand, and it does not extend to corporate insolvency.

Recognition and assistance by the Malaysian courts to official representatives and insolvency office holders appointed by foreign courts and under foreign insolvency processes is possible through the application of common law principles and conflict of laws rules.

Directors' Liability

Under the doctrine of separate legal personality, a company is treated as being separate and distinct from its members/directors. However, directors may be held jointly or severally liable for offences committed by or liabilities of a company (during the director's tenure) where provided for by statue.

Specifically in relation to a company being placed in liquidation, if it appears that the company has carried on its business with the intent to defraud creditors or has incurred debts with no reasonable grounds of expecting that the company will be able to repay, the court may hold any person responsible personally liable to the creditors for any debts or other liabilities incurred by the company as a result thereof. To establish intent to defraud creditors, the element of dishonesty must be shown based on the facts of the case and on the balance of probabilities.

At the same time, directors also owe broad statutory and common law duties to the company itself and may be liable for any breach of such duties or misfeasance.

PHILIPPINES

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Contributed by Sycip Salazar Hernandez & Gatmaitan

Introduction

This section aims to offer an overview of the primary corporate insolvency procedures available in the Philippines. The primary legislation governing insolvency is the Republic Act No. 10142, also known as the Financial Rehabilitation and Insolvency Act of 2010 (the "FRIA"), which replaced the Insolvency Law of 1907.

The purpose of the FRIA is to facilitate the effective and efficient rehabilitation or winding up of businesses to ensure clear and consistent outcomes in commercial dealings, maintain the value of corporate assets, recognise creditor rights and respect the priority of claims, and ensure the equitable treatment of creditors.

Special insolvency frameworks also exist for different entities, including banks and insurance companies, along with certain government agencies and subdivisions. These are beyond the scope of this guide.

There are two principal insolvency procedures under the FRIA: (1) rehabilitation; and (2) liquidation. Rehabilitation proceedings are not subject to procedural rules under the ordinary Rules of Court. The Supreme Court of the Philippines has issued two rules of procedure in connection with the FRIA: the Financial Rehabilitation Rules of Procedure (2013) and Financial Liquidation and Suspension of Payments Rules of Procedure (2015).

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Rehabilitation

Rehabilitation aims to rescue corporations which are or may become insolvent through the adoption of a rehabilitation plan.

Rehabilitation is not necessarily available in all cases, including where insolvency is unavoidable or where the sole purpose of seeking to undertake rehabilitation is to delay creditors' enforcement of their legitimate rights.

There are three types of rehabilitation:

1. Court-supervised rehabilitation
2. Pre-negotiated rehabilitation
3. Out-of-court informal rehabilitation

Court-supervised rehabilitation

Court-supervised rehabilitation procedures include voluntary rehabilitation and involuntary rehabilitation. Each requires the filing of a petition with the Court which must establish the insolvency of the company and the viability of its rehabilitation.

A voluntary rehabilitation is commenced by the relevant insolvent company filing the petition. This requires a majority vote of the board of directors or trustees that is 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.

An involuntary rehabilitation is commenced by a creditor or group of creditors filing a verified petition for rehabilitation with the Court. The amount of the relevant creditor's claim must exceed the greater of PHP 1 million or 25% of the subscribed capital stock or partners' contributions. To file such a petition either of the following conditions (a) or (b) must be satisfied:

(a) in respect of the filing of a creditor's claim:
   i) there must be no genuine issue in fact or law; and
   ii) either:
      (1) the claim must be due and/or immediately payable on demand, and no payments are received for at least 60 days; or
      (2) the company must have failed generally to meet its liabilities as they fall due; or

(b) a creditor, other than the petitioner, must have initiated foreclosure proceedings against the company that would prevent the company from paying its debts as they fall due.

In each case, the court will issue a commencement order if satisfied of the viability of the petition.

For a court-supervised rehabilitation, creditor claims are initially submitted to the court through the petition, which contains a schedule of the company's liabilities.

Key Elements:

- Rehabilitation focuses on company rescue.
- Moratorium available, can restrict secured creditors.
- Cramdown available depending on the feasibility of the restructuring plan and the reasonableness of creditors' opposition.

The rehabilitation receiver has 20 days from his or her appointment to accept applications for recognition of claims and establish a preliminary registry of claims. After 30 days from the expiry of such period, interested parties may challenge the receiver's actions. The rehabilitation receiver may disallow claims, and a creditor may appeal such disallowance to the court.

Effect of an order for court-supervised rehabilitation

If the court approves the petition for rehabilitation, it will issue a commencement order, which will, amongst other things:

- appoint a rehabilitation receiver;
- establish relevant deadlines for the rehabilitation process including timing for the filing and adjudication of creditor claims;
- prohibit the company from making any payment of its outstanding liabilities;

- result in a moratorium which restricts enforcement of security against the company's assets, although secured creditors may apply to the court for orders to preserve their security if they can demonstrate that the assets are in jeopardy or the property is not required for the rehabilitation of the company; and
- result in the imposition of national and local taxes, fees, penalties and surcharges being waived until the approval of the rehabilitation plan or the dismissal of the petition.

The commencement order will also provide for an initial hearing to take place not more than 40 days from the date of filing of the petition to determine if there is a substantial likelihood for the company to be rehabilitated. At the initial hearing, the court will:

- determine the creditors who have timely filed their notice of claims;
- hear and determine any objection to the qualifications of the appointment of the rehabilitation receiver and, if necessary, appoint a replacement;
- direct the creditors to comment on the petition and the rehabilitation plan within a period of not more than 20 days; and
- direct the rehabilitation receiver to evaluate the financial condition of the company and to prepare a report, within 40 days from the initial hearing, which may form the basis of a subsequent decision by the court to put the company into liquidation if it finds there is no substantial likelihood of a successful rehabilitation.

Contracts with creditors and third parties will continue, provided they are confirmed within 90 days after proceedings begin. Contracts entered into after proceedings have commenced, or which have been confirmed, must be paid or performed on time and are not subject to the moratorium. Contracts not confirmed by the deadline are terminated, and a claim for damages (if any) arising as a result of the election to terminate will be subject to the moratorium as a pre-commencement claim against the company.

Whilst in rehabilitation, the company may use or dispose of funds or property in the ordinary course of business or if necessary to finance the administrative expenses of the rehabilitation proceedings. Unencumbered assets of the company may be sold outside of the ordinary course of business only with court authorisation, upon application of the rehabilitation receiver. The application must show that the property, by its nature or because of other circumstances, is perishable, costly to maintain, susceptible to devaluation or otherwise in jeopardy. The court may also authorise the sale of unencumbered assets in certain other limited circumstances.

Meanwhile, the sale of encumbered property of the company, or property of others held by the company, where there is a security interest pertaining to third parties under a financial, credit or other similar transaction, may be undertaken with court authorisation. This is possible upon the application of the rehabilitation receiver, with the consent of the affected owners of the property or secured creditors, and after notice and hearing. The court will only grant authorisation if it determines that:

- such sale, transfer, conveyance or disposal is necessary for the continued operation of the company's business; and
- the company has made arrangements to provide a substitute lien or ownership right that provides an equal level of security for the counterparty's claim or right.

Rehabilitation Receiver

The main duty of the rehabilitation receiver is to safeguard and enhance the value of the company's assets, assess the feasibility of the rehabilitation process, develop and present a rehabilitation plan to the court and execute the plan upon its approval.

The appointment of the rehabilitation receiver does not displace the current directors and management of the company, who may continue to manage the affairs of the company. However, the court may, upon motion of any interested party, including a creditor, appoint and direct the rehabilitation receiver or a management committee to assume the powers of management of the company if there is actual or imminent danger of dissipation of the company's assets or if there is gross mismanagement of the company, fraud or other wrongful conduct by existing management.

Period After the Initial Hearing

Within 40 days from the initial hearing, the rehabilitation receiver must submit a report to the court with their preliminary findings and recommendations. If the court determines that the company is insolvent but has a good chance of completing a successful rehabilitation, it will uphold the rehabilitation petition and instruct the receiver to consult with the company and creditors to revise or act on the rehabilitation plan.

The court may undertake a review of the petition either on a motion filed by an interested party or at its own discretion. Upon review of the petition, the court may decide to dismiss it if the court determines that:

(a) the company is not insolvent;

(b) the petition is a sham delaying creditors' rights of enforcement;

(c) the petition contains materially false or misleading statements; or

(d) the company has defrauded its creditors.

Throughout the duration of the rehabilitation proceedings, either the company or its creditors can request the court to initiate liquidation. Additionally, the court itself may choose to order liquidation during these proceedings or act on a recommendation from the rehabilitation receiver if the court determines that:

(a) the company is insolvent; and

(b) there is no substantial likelihood of successful rehabilitation.

Requirements for a Rehabilitation Plan

The rehabilitation plan must indicate how the insolvent company will be rehabilitated and compare the amounts expected to be received by the creditors under the rehabilitation plan with those that they will receive if the liquidation commences within the next 120 days. This, and other information the company is required to provide under the FRIA, is meant to provide various classes of creditors with a reasonable basis for determining whether supporting the plan is in their financial interest when compared with the immediate liquidation of the company, including any reduction of principal interest and penalties payable to the creditors.

As regards the treatment of creditors, the plan must provide for equal treatment of all claims within the same class or subclass, unless a particular creditor voluntarily agrees to less favourable treatment. This is known as "concurrence" and is broadly equivalent to the *pari passu* principle in other jurisdictions. Payments made under the plan follow the priority established under the provisions of the Civil Code on the principle of "preference of

credits" and other applicable laws. The plan must maintain the security interest of secured creditors and preserve the liquidation value of the security unless such has been waived or modified voluntarily.

The rehabilitation plan must contain (a) material financial commitments to support the rehabilitation plan; and (b) a proper liquidation analysis. A rehabilitation would be unavailable if insolvency appears to be unavoidable and may lead to the court rejecting the rehabilitation plan. Insolvency may be apparent from: (i) the absence of a sound and workable business plan; (ii) baseless and unexplained assumptions, targets and goals; and (iii) speculative capital infusion or a complete lack thereof, for the execution of the business plan.

The priority of claims may be modified through confirmation of a rehabilitation plan which binds the company and all participating creditors.

The FRIA does not expressly provide for third-party releases, and thus, generally, each debtor company in a corporate group seeking to restructure its debt would need to enter into a separate rehabilitation plan to compromise its debts. However, a group of companies may jointly file a petition for rehabilitation when either:

- one or more of the companies foresees that it will be unable to pay its debts when they fall due and the financial distress would likely adversely affect the financial condition or operations of the other companies within the group; or
- the participation of the other companies within the group is essential under the terms and conditions of the proposed rehabilitation plan.

Approval of a court-supervised rehabilitation plan

The rehabilitation receiver is required to inform creditors and stakeholders of the purposed rehabilitation plan. Within 20 days of this notification, the rehabilitation receiver must convene a meeting of the creditors to vote on the rehabilitation plan.

Unless a cramdown is applied (see below), a rehabilitation plan must be approved by all classes of creditors whose rights are adversely affected by the plan. This requires approval by 50% of the total value of claims of each voting class.

The FRIA provides a non-exhaustive list of potential classes of creditors that may be recognised, including:

- secured creditors;
- unsecured creditors;
- trade creditors and suppliers; and
- employees of the company.

It is possible to have a different series of classes depending on the nature of the company's debt. While there are no formal restrictions on the constitution of classes, in practice they usually follow the categories provided by the FRIA, and there will usually be a reasonable degree of distinction between the rights of different classes.

If the rehabilitation plan is approved by the creditors, the plan must be submitted to the court for confirmation. An objection may be filed by a creditor within 20 days from receipt of the court notice regarding the submission of the rehabilitation plan for confirmation.

The court will approve the rehabilitation plan if no objections are filed within the relevant period or, if objections are filed, the court finds them lacking in merit, determines that the basis for the objection has been cured or determines that the company has complied with an order to cure the objection.

The court can approve a rehabilitation plan which does not have the requisite creditor approval (notwithstanding the objections of the creditors), effectively cramming down dissenting classes of creditors if it can be shown that:

- the rehabilitation plan complies with the requirements specified in the FRIA;
- the rehabilitation receiver recommends the confirmation of the rehabilitation plan;
- the shareholders, owners or partners of the company will lose at least their controlling interest as a result of the rehabilitation plan; and
- the rehabilitation plan would likely provide the objecting class of creditors with compensation which has a net present value greater than that which they would have received if the company were in liquidation.

Where a court exercises its discretion to approve the plan without creditor approval, there is no requirement for at least one class to have voted in favour, provided the above conditions are met.

The court is given one year from the filing of the petition to confirm a court-supervised rehabilitation plan. If the creditors have not approved the plan and the court has not exercised its cramdown powers within the one-year period, resulting in no confirmed rehabilitation plan, this is a ground for converting the proceedings into liquidation – which may be instituted upon a motion by any interested party, the rehabilitation receiver or by the court of its own accord.

Pre-Negotiated Rehabilitation

An insolvent company, by itself or jointly with any of its creditors, may file a petition with the court for the approval of a pre-negotiated rehabilitation plan. This must be filed with

evidence showing that the plan was approved by creditors holding at least two-thirds of the total liabilities of the company. This must also include secured creditors holding more than 50% of the total secured claims and unsecured creditors holding more than 50% of the total unsecured claims.

The court has a maximum of 120 days from the date of the filing of the petition to approve the rehabilitation plan, after which the plan will be automatically deemed to be approved.

If satisfied of the merit of the petition the court will issue an order that, amongst other things:

- declares that the company is under rehabilitation;
- appoints a rehabilitation receiver, if provided under the plan;
- 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; and
- states that copies of the petition and the rehabilitation plan are available for examination and copying by any interested party.

The court must approve the rehabilitation plan within 10 days from the date of the second publication of the order, unless a verified objection is filed by a creditor or other interested party within eight days of the date of the second publication of the order. Objections are limited to the following grounds:

- facts contained in the petition or the rehabilitation plan are materially false or misleading;
- the majority of any class of creditors do not support the rehabilitation plan;
- the rehabilitation fails to accurately account for a claim against the company and that claim has not been categorically established to be a contested claim; or
- the support of the creditors, or any of them, was induced by fraud.

The rehabilitation plan shall be deemed approved upon a court determination that the objection has no substantial merit or that the same has been fixed. If the court finds merit in the objection, it will direct the company, when feasible, to cure the defect within a reasonable period. If the defect is not cured within a reasonable period, the court may exercise its discretion to convert the proceedings into a liquidation or allow for additional time for compliance.

Out-of-Court or Informal Restructuring or Workout Agreement or Rehabilitation Plan

Under the FRIA, an out-of-court or informal restructuring or workout agreement or rehabilitation plan (an "OCRA") will be given the same legal effect as one sanctioned by a court one provided that the company agrees to it and it is approved by:

- creditors representing at least 67% of the secured obligations;
- creditors representing at least 75% of the unsecured obligations; and
- creditors holding at least 85% of the total liabilities, secured and unsecured.

The OCRA must be published once each week for at least three consecutive weeks in a newspaper of general circulation in the Philippines. The rehabilitation plan takes effect upon the lapse of 15 days from the date of the last publication of the OCRA.

Referral to Arbitration

Under the FRIA, any dispute involving the rehabilitation plan or the rehabilitation proceedings may be referred by the court to arbitration or other dispute-resolution mechanisms if doing so will help the court resolve the dispute more quickly, fairly and efficiently and if it will not prejudice the one-year period for the confirmation of the rehabilitation plan.

Amendment or termination of rehabilitation after a plan is approved

If the company fails to perform its obligations thereunder, or there is a failure to realise the objectives under the timelines and conditions for implementation of the plan, the court may issue an order directing that a breach or defect be cured within a specified period of time, failing which the proceedings may be converted to a liquidation, or directly order a liquidation of the company.

The court may also allow the company or rehabilitation receiver to revive the rehabilitation proceedings by submitting amendments to the rehabilitation plan provided such amendments are approved by the requisite majority of creditors required to approve the original rehabilitation plan.

If it is subsequently discovered that fraud was committed for the purposes of securing the approval of the rehabilitation plan or its amendment, any affected party may, by motion, request the termination of the rehabilitation and conversion of the proceedings to liquidation.

Liquidation

The purpose of liquidating an insolvent company is to facilitate its winding up and ensure a fair distribution of its assets.

There are two forms of liquidation:

(1) voluntary liquidation; and

(2) involuntary liquidation (compulsory liquidation).

Voluntary liquidation is initiated by the company and requires a petition establishing its insolvency. Under the Corporation Code, certain actions may be taken involving the Securities and Exchange Commission which will result in the company being deemed to be voluntarily dissolved.

Involuntary liquidation can be initiated by at least three creditors whose combined claims either equal or exceed PHP 1,000,000 or 25% of the company's subscribed capital stock. The relevant creditors must establish:

- there is no genuine dispute concerning the facts or law related to the petitioners' claims;
- each claim is due and payable with no payments made for at least 180 days, or that the company has generally failed to meet its obligations as they come due; and
- there is no substantial likelihood of the company's successful rehabilitation.

In a liquidation, creditor claims are initially submitted to the court through the petition, which contains a schedule of the company's liabilities. The liquidator has 20 days from his or her appointment to accept applications for recognition of claims and establish a preliminary registry of claims. After 30 days from the expiry of such period, interested parties may challenge the liquidator's actions. The liquidator may disallow claims, and a creditor may appeal such disallowance to the court.

Involuntary liquidation can also be initiated by a receiver or trustee and upon the occurrence of certain other situations such as the expiration of the term provided in the original articles of incorporation, legislative enactment, a failure to formally organise and commence the transaction of its business within two years of the date of incorporation, or an order from the SEC.

Effect of a liquidation order

In both voluntary and involuntary liquidations, the court must grant a liquidation order if the petition is sufficient in terms of substance and form. This order will declare the company dissolved and officially terminate its corporate existence.

All assets of the company, other than those exempt from execution, will be transferred to the liquidator or the court until a liquidator is appointed.

The liquidation order will, among other matters:

- require that all payments and claims due to the company be made to the liquidator;
- prevent the company from making any payments or fund transfers;
- allow for administrative expenses to be paid as needed; and
- direct creditors to submit their claims to the liquidator.

All contractual obligations of the company will be considered terminated or breached unless the liquidator expressly adopts the contract and the contracting party consents within 90 days from the date of the liquidation order appointing the liquidator.

The order also establishes a moratorium, prohibiting separate actions for the collection of unsecured claims, and any pending actions will be transferred to the liquidator for settlement or defence.

Secured creditors' enforcement rights

Secured creditors may only enforce their rights where (1) court approval is obtained, or (2) the company cooperates with the enforcement (and either way no foreclosure action is permitted for a period of 180 days following the date of the liquidation order).

Powers of the liquidator

The liquidator, an officer of the court, is controlled by the court. Their role involves collecting (including recovery of any property fraudulently conveyed by the company), realising and distributing the company's assets to creditors and paying any surplus to shareholders and/or any other parties entitled to it.

The liquidator takes custody of all company property and has the right and duty to take all reasonable steps to manage and dispose of the company's assets. While having broad powers, some actions require the court's or creditors' committee's approval. Within 3 months of taking office, the liquidator must submit a liquidation plan to the court setting out the assets and liabilities of the company and the proposal for liquidation of the assets and settlement of the claims. Post-approval, the liquidator can proceed with selling assets and paying creditors. The liquidator must also inform, through publication of a notice, the creditors and stakeholders of the company of the place and time for inspection of the registry of claims.

Priority of Claims Under Philippine Law

Philippine law classifies creditor claims in insolvency proceedings into three general categories as follows:

- **special preferred credits**, which attach as liens or encumbrances on the specific moveable or immoveable property to which they relate. There is a two-tier order of preference: the first tier comprises taxes, duties and fees due to government entities, whilst the second tier includes all other special preferred credits which are to be satisfied, *pari passu* and *pro rata*, out of any residual value of the specific property (that is, after taxes, duties and fees due to government entities have been satisfied);
- **ordinary preferred credits**, which give relevant creditors a preferential right to the residual property of the company after the special preferred creditors have been paid out and are subject to a specific order of priority as between themselves. These include unpaid wages of employees and labourers of the company, legal expenses and other expenses incurred in the liquidation process; and
- **common credits**, which are claims held by unsecured creditors with no preferential rights. Their claims are satisfied *pro rata* regardless of the date on which they were incurred.

Void and Voidable Transactions and Clawback

Transactions entered into to defraud creditors or which constitute an undue preference of creditors before rehabilitation or liquidation proceedings are commenced may be rescinded or declared null and void. Certain acts give rise to a disputable presumption that the transactions were undertaken with intent to defraud creditors, provided they take place within 90 days prior to the commencement of a rehabilitation or liquidation. These include providing inadequate consideration to the company, accelerated payments of claims, and the provision of security. Alternatively, a transaction involving a creditor obtaining a greater benefit than its *pro rata* share in the assets of the company at the time the company is insolvent is also vulnerable to challenge. In this regard, undervalue transactions may be rescinded or declared null and void if executed within 90 days prior to the commencement of a rehabilitation or liquidation.

In rehabilitation proceedings, the court can rescind transactions entered into after the commencement of the rehabilitation if they are not in the ordinary course of business of the company. There are exceptions to this, including where the transaction is to facilitate a rehabilitation plan, provide a substitute lien, mortgage or pledge of property or to pay or meet administrative expenses as they arise.

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). Such guarantees, however, must comply with regulations governing related-party transactions, which require that the guarantees be entered into at arm's length and that these guarantees be disclosed annually to the tax authorities.

A guarantee is a secondary obligation by a third party relating to a primary obligation by a contracting party (e.g. a borrower under a loan agreement). Generally, the primary obligation must be valid for a guarantee to be constituted. Guarantees must be expressly provided in writing and cannot be construed to extend to more than what is expressly stipulated. If the primary obligation is materially altered, with the effect of making it more onerous, the third party may be released from the guarantee.

Philippine law distinguishes between guarantees and suretyship; the latter creates an independent primary obligation owed by the surety to the beneficiary. Under a surety arrangement there is no requirement to first claim against the underlying obligor before claiming against the surety (unlike in the case of a guarantee).

New Money Lending and Other Credit Arrangements

The company, with the approval of the court upon the recommendation of the rehabilitation receiver, and in order to enhance its rehabilitation, may:

- enter into credit arrangements, including credit arrangements secured by mortgages of its unencumbered property, or secondary mortgages of encumbered property with the approval of senior secured parties with regard to the encumbered property; or
- incur other obligations as may be essential for its rehabilitation.

There is no specific provision under the FRIA permitting or prohibiting a company in liquidation from obtaining secured or unsecured loans or credit. However, because the liquidation order has the effect of dissolving the company and terminating its juridical existence, and because legal title to and control of all of the company's assets are deemed vested in the liquidator, in practice a company in liquidation may not be able to obtain loans or credit.

Directors and Officers

Under Philippine law, save in certain exceptional circumstances, a corporation's liabilities are limited to its own obligations, and individual directors, officers and employees are not typically liable for the corporation's liabilities.

Under the FRIA, directors and officers of a company may be liable if they, having notice of the commencement of the rehabilitation or liquidation proceedings, or having reason to believe that proceedings are about to be commenced, commit certain acts. This includes disposing or causing to be disposed of any property of the company other than in the ordinary course of business or authorising or approving any transaction to defraud creditors or in a manner grossly disadvantageous to the company or creditors. Alternatively, if they conceal property of the company from creditors, or authorise or approve their concealment, or embezzle or misappropriate any property of the company, they may incur liability. The liability in both instances shall be the value of the property

sold, embezzled or disposed of, or twice the transaction amount involved, whichever is higher, to be recovered for the benefit of the company and the creditors.

Cross-Border Insolvency

Insolvency courts in the Philippines may recognise a foreign insolvency proceeding and grant any necessary relief, including those granted under the UNCITRAL Model Law on Cross-Border Insolvency. This can include orders suspending enforcement against a foreign entity over property located in the Philippines. It may also require the surrender of the property of the foreign entity to the foreign representative.

If necessary to protect the assets of the company or the interests of the creditors, the court may also, upon request of the foreign representative of a foreign insolvency proceeding, grant appropriate relief. This includes protecting the company's assets by suspending the right to transfer, encumber or otherwise dispose of any assets of the company. The court may also assist foreign proceedings by providing for the examination of witnesses, the taking of evidence or the delivery of information concerning the company's assets, affairs, rights, obligations or liabilities.

It may also assist foreign representatives by entrusting them with the administration or realisation of all or part of the company's assets located in the Philippines.

Foreign creditors have the same rights regarding claims as creditors in the Philippines in cross-border insolvency proceedings, subject to the rule of reciprocity and without prejudice to the ranking of claims in a proceeding under relevant laws. The FRIA expressly adopts the UNCITRAL Model Law. Accordingly, the treatment of foreign creditors in liquidations and reorganisations is based on the Model Law, which provides them direct access to Philippine courts.

Recognition of Foreign Judgments

To date, the Philippines is not signatory to any treaty on international insolvency or on the recognition of foreign judgments. Nonetheless, Philippine case law recognises that while there is no obligatory rule derived from treaties or conventions that require the Philippines to recognise foreign judgments, or allow the enforcement thereof, these are recognised pursuant to generally accepted principles of international law, which under the Constitution form part of Philippine laws.

A foreign judgment may be enforced in the Philippines through a petition filed with the appropriate regional trial court with territorial jurisdiction. The effect of a judgment or final order of a tribunal of a foreign country is conclusive upon the title to an object with which that judgment is concerned. If a judgment or final order is against a person, the judgment or final order is presumptive evidence of a right as between the parties and their successors in interest by a subsequent title.

The foreign judgment may be challenged by evidence of lack of jurisdiction, want of notice to the party, collusion, fraud or clear mistake of law or fact (Rule 39, section 48 of the 1997 Rules of Civil Procedure). Additionally, the defendant may claim that the foreign judgment is contrary to morals and public policy.

SINGAPORE

SINGAPORE

Contributed by Clifford Chance Asia*

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 Insolvency, Restructuring and Dissolution Act 2018 (the "IRDA"). It is supplemented by the Companies Act 1967 (the "Companies Act") and the Companies (Winding Up) Rules.

In July 2020 the IRDA took effect, consolidating many of the insolvency laws and the laws relating to debt restructurings into a single piece of legislation.

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

Insolvency is the inability to pay debts as they fall due and can be understood in the context of the requirements for a winding-up petition. Insolvency can be proven in one of three ways:

1. an unpaid statutory demand for a sum exceeding SGD 15,000 remains outstanding for three weeks;
2. an unsatisfied execution of court order; or
3. if the court is satisfied that the company is unable to pay its debts (including contingent and prospective debts) as they fall due (the "cash flow test").

Under the "cash flow test", the court will evaluate liabilities which are immediately due and payable and those liabilities which are due and payable in the reasonably near future. Only those debts falling due in the reasonably near future, generally within the next 12 months, should be taken into consideration (discounted for contingencies and deferment). In addition, the court will consider, among other things, the quantum of debts due, the likelihood of payment being demanded, the value of the company's current assets and its expected net cash flow.

Receivership

Receivership is regulated by Part 6 of the IRDA.

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 either by the court or out of court by persons entitled to do so pursuant to contractual arrangements. For instance, receivership is the typical method that debenture holders use to enforce 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 and owes duties to the general body of creditors as a whole. In contrast, a receiver appointed out of court may be the agent of the person appointing him or her. Unless the debenture provides otherwise, receivers appointed other than by the court are not agents of the company. A receiver's primary duty is owed 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 or she, however, must exercise diligence and care when disposing of the company's assets. A receiver is also required to ensure that all correspondence issued by or on behalf of the company states that a receiver has been appointed and to lodge with the Registrar of Companies detailed accounts. A receiver who enters into possession of any property of the company is personally liable for any debts incurred during the course of the receivership but is typically indemnified out of the property of the company for such debts.

Key Elements:

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

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

If a receiver is not or cannot be 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 holders have 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 in so far 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 the IRDA, a company may enter judicial management either: (i) by making an application to court or (ii) with the consent of its creditors.

First, the company, its directors or a creditor may apply to the court to appoint a judicial manager. The court must be satisfied that the company is, or likely to become, 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.

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.

While such a court order is pending, on top of the statutory moratorium (see below) there are various interim protections for creditors:

- the court may appoint an interim judicial manager pending a judicial management order, taking into consideration, among other things, the danger that the assets of the company will be dissipated in the interim; and
- creditors may also apply to restrain any exercise of powers, disposals or transfers by the company.

Secondly, a company may enter judicial management with its creditors' consent without requiring a court order. This can also involve the appointment of an interim judicial manager who can be confirmed as judicial manager at a subsequent creditors' meeting. The appointment of an interim judicial manager requires certain conditions to be met including, among other things:

(a) consent of the members of the company (or the board of directors if duly empowered under the company's constitution);

(b) no ongoing judicial management application in court;

(c) notice of such appointment to be given to various parties; and

(d) specific filings and declarations to be made.

At the creditors' meeting, to be held within 30 days of the interim appointment, the creditors must approve, by a majority in number and value of the creditors present and voting, the appointment of the judicial manager.

A moratorium comes into effect once a court application is made or notice of the appointment of an interim manager is given, as the case may be. This moratorium prevents (i) legal proceedings from being commenced or continued against the company without the leave of court and (ii) a secured creditor from enforcing any of its security over the company's property.

When a company enters judicial management, any receiver, or receiver and manager, must vacate office. 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 IRDA.

Judicial managers are expressly empowered to assign proceeds of various types of legal claims belonging to the company. This includes, among others, claims for transactions at an undervalue, fraudulent or wrongful trading and unfair preferences. These may be assigned to third-party funders to pursue the claims in the company's name.

Judicial management expires 180 days (after the date of the order or approval of appointment at the creditors' meeting as the case may be). Extensions may be obtained either (i) through a court order any number of times for a specified period or (ii) once by a creditor majority for not more than 6 months.

Schemes of Arrangement

The IRDA 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 a compromise or arrangement or consider such a compromise or arrangement without a meeting.

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 legal rights against the company 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' meetings is generally the second stage of the process. However, on application to the court, a scheme may be approved without a meeting of creditors if the court is satisfied, among other things, that if a meeting or meetings had been convened the Requisite Threshold (as defined below) would have been obtained. Such schemes are described as "pre-pack schemes".

If creditors' meetings are held, then the scheme must generally be approved at each creditors' meeting by a majority in number representing 75% in value of the creditors' claims (the "Requisite Threshold").

However, the Court may still approve a scheme even if the Requisite Threshold is not obtained at each meeting of the relevant classes of creditors if: the scheme receives the approval of a majority in number and 75% of the value of all the creditors present and voting at the scheme meeting (regardless of classification); the scheme does not discriminate unfairly between two or more classes of creditors; and it is fair and equitable to each dissenting class.

In determining whether to approve the compromise or arrangement, the court must further 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 or her interest, would approve.

If the court is satisfied on all 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 statutory 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 (provided no application has been made in the previous 12 months). The moratorium may also restrain the appointment of a receiver or receiver and manager.

The company applying for the statutory moratorium is required to provide evidence of support from creditors for the moratorium, a brief description of the intended scheme of arrangement containing 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 and a list of secured and unsecured creditors of the company.

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.

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 an order of court. A scheme of arrangement approved by the court will need to be lodged with the ACRA before it becomes effective.

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. 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, members' 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.

In terms of process, when the directors consider that the company cannot pay its debts, they resolve and make a statutory declaration that the company be placed in an insolvent liquidation. A members' meeting would then be held, and, if the members pass a special resolution to wind up the company, they will also appoint a liquidator, subject to any preference the creditors may have as to choice of liquidator. The creditors' meeting is then called and a creditors' resolution passed. 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 place the company into liquidation by appointing a provisional liquidator immediately and by making the relevant statutory declaration. The decision must be adopted by the subsequent resolutions of the members and creditors within 30 days. The commencement of the winding up is deemed to be at the time of lodgement of the statutory declaration. The statutory declaration must be lodged with the Registrar of Companies within seven days. Once the members' resolution is passed, the company must give notice of the resolution in one or more newspapers circulated in Singapore within 10 days.

Where a company is already in voluntary winding up, the court may still grant leave to wind up the company compulsorily and will consider, among other things, whether the applicant has a strong sense of legitimate grievance if the company was not wound up compulsorily.

Liquidation – Compulsory Winding Up

The company, any of its directors, creditors, contributories, liquidator or 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) where the company is unable to pay its debts as and when they fall due (section 125(1)(e) of the IRDA).

When making a winding-up application, the party presenting the winding-up application must nominate a licensed insolvency practitioner to be the liquidator. The Official Receiver may only be nominated when the applicant has taken reasonable steps but has been unable to obtain the consent of a licensed insolvency practitioner to be appointed as a liquidator and the Official Receiver consents to being nominated as liquidator.

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

A foreign company that is not registered in Singapore may still apply to a Singapore court for winding up where it is able to demonstrate a substantial connection with 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 Officers of the Company

Officers of a company in liquidation or judicial management may incur civil and criminal liability in certain instances. This includes criminal liability of up to two years' imprisonment and/or a fine of up to SGD 10,000.

The circumstances in which a director may be liable include, among others:

(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 or her custody or possession;

(c) within 12 months prior to the commencement of the winding up or judicial management 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 SGD 500 or more;

(d) within 12 months prior to the commencement of the winding up or judicial management or at any time thereafter, fraudulent removal of any property of the company to the value of SGD 500 or more; or

(e) within 12 months prior to the commencement of the winding up or judicial management or at any time thereafter, destruction, mutilation, alteration or falsification of any books or papers belonging to the company.

A director can be personally liable if he/she knew that the company was trading wrongfully or ought reasonably to have known that the company was trading wrongfully. A company will be held to be trading wrongfully if the company, when insolvent, incurs debts or other liabilities without a reasonable prospect of meeting them in full or incurs debts or other liabilities that it has no reasonable prospect of meeting in full and that results in the company becoming insolvent. However, the Court can determine not to impose a penalty on an individual director if the relevant director was acting honestly. In addition, a director may be personally liable 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 made at an undervalue in the three years prior to the winding up. A transaction will be at an undervalue if the company receives no or significantly less consideration than the value of the goods or services provided.

However, the transaction 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 entered into with the intention of giving and which result in a creditor or guarantor obtaining an unfair preference over other creditors and which were executed within the one year prior to the company's winding up (or two years if the preference was given to a connected party). The creditor or guarantor receiving the preference must be left in a better position than they would have been in a winding up.

Priority of Claims

A secured creditor need not prove 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 (to the extent of their security interest);

(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.

New Money Lending: Rescue Financing

The IRDA includes provisions relating to "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 provisions allow 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) through (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 overridden (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 or the majority of 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 as it requires evidence of an intent to defraud and requires actual knowledge demonstrating that the director was knowingly a party to the carrying on of business with the intent to defraud creditors.

Cross-Border Assistance

Under the IRDA the UNCITRAL Model Law on Cross-Border Insolvency ("Model Law") has force of law in Singapore and facilitates 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 co-ordination between courts of different jurisdictions and insolvency administrators.

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

TAIWAN

TAIWAN

Contributed by Russin & Vecchi

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 29 January 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 three types of insolvency proceedings available in Taiwan:

(a) Composition;

(b) Reorganisation; and

(c) Bankruptcy.

Composition proceedings are conducted with the involvement of either the court or a local chamber of commerce, while the other proceedings are required to be supervised by the court. The aim of the composition and reorganisation processes is to rehabilitate the entity.

This chapter also briefly covers liquidation which, while not requiring insolvency to commence, may be converted to bankruptcy if balance sheet insolvency is found or when the court, in its own discretion, orders to commence bankruptcy upon the occurrence of certain events. It is an important procedural route that should be noted by companies moving towards insolvency.

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. 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 and when they fall due 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.

Key Elements:

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

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 that the company meets the requirements for bankruptcy, the court may declare the company bankrupt.

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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

Availability of the reorganisation process

Reorganisation is principally a procedure intended to rescue companies which are or may become insolvent. The process is available exclusively to companies with publicly 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.

Reorganisation commenced by the company

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 6 months, creditors whose claims are equivalent to at least 10% of the total share capital, labour unions or two-thirds or more of the employees of the company.

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, the company is placed into administration and the administrator is appointed by the court in the court's approval decision. The administrator can be appointed from the former directors or management of the company. An administrator is required, among other things, to prepare, and implement, a restructuring plan and manage the business during the reorganisation until the reorganisation is completed or terminated. In the meantime, any bankruptcy, composition and/or litigation proceedings (including compulsory execution against the company) are suspended.

Reorganisation when the company is in administration

Upon a company being placed into administration, the directors are displaced and their powers of management are vested in the administrator. However, as noted above, the administrator can be appointed from the former directors or management of the company. 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) 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.

Effect of reorganisation

Upon completion of a reorganisation of a company:

(a) all unregistered claims and those registered claims which are not provided for in the plan are extinguished;

(b) shareholder rights which are reduced or cancelled by the plan are extinguished; and

(c) 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.

Liquidation

Neither a special liquidation nor an ordinary liquidation is an insolvency process. This means that there is no requirement of insolvency to commence either. However, if in the course of either process the liquidator finds that the aggregate of the assets of the company is insufficient to satisfy its liabilities, the liquidator must file an application for a declaration of bankruptcy, and in a special liquidation the court has discretion to order the commencement of the bankruptcy process.

Where a company is subject to the 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.

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. Under special liquidation, a creditor meeting may appoint a supervisor, and any meaningful asset disposal by the liquidator is subject to the supervisor's or the court's approval. 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. The powers of the trustee to deal with property of the bankrupt estate vest in the trustee 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 and when they fall due 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 is appointed by the court. The court is also required to state in the bankruptcy declaration a period of between 15 days and 3 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.

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.

Unless the debtor is willing to cooperate, enforcement of security by secured creditors requires court intervention.

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 of 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;

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 ICD.

(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.

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, the director of such company is subject to five years' imprisonment.

A director of the company under a bankruptcy procedure is liable to the following:

(a) one year of 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 years' 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; and

(c) one year of 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 favour 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

THAILAND

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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 (the "CCC").

The main procedures encountered in corporate insolvencies are:

(a) bankruptcy (including composition); and

(b) business rehabilitation.

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A debtor, its creditors or a competent governmental authority may file for business rehabilitation in relation to a debtor. On the other hand, only creditors may initiate the bankruptcy of a debtor.

The competent body to exercise jurisdiction in insolvency matters is the Central Bankruptcy Court (the "Court").

A liquidator may undertake a solvent liquidation in relation to a company. An insolvent liquidation, however, must be referred to the Court to place the debtor into bankruptcy (also referred to as receivership) and hand over the matter to the official receiver to arrange for the distribution of assets.

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 (in a court case or hearing) or informs its creditors that it cannot pay its debts;

(b) the debtor has submitted a proposal for a composition of its debt to two or more creditors;

(c) the debtor has received not less than two demand letters within 30 days and has not yet paid the demanded amount;

(d) the debtor has transferred its assets or the rights to manage its assets to another person for the benefit of the debtor's creditors;

(e) the debtor has transferred or delivered its assets with dishonesty or fraudulent intent;

(f) the debtor has transferred or created rights which would, in the situation of bankruptcy, be considered an act of preference;

(g) the debtor has delayed 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; or

(h) the debtor's assets are attached under a writ of execution, or there are no assets capable of attachment.

Bankruptcy

If a debtor that is a juristic person (i.e. a corporation) becomes insolvent or owes debts in an amount of not less than THB 2,000,000 to one or more creditors, and the debt amount is determinable, creditor(s) may commence bankruptcy proceedings against the insolvent debtor by filing a claim with the Court. Both unsecured creditors and secured creditors may commence bankruptcy proceedings, however secured creditors are required to prove to the court that the value of their security is insufficient to discharge the secured debt.

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 (subject to the Court's availability), to examine witnesses or 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 an absolute 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). An official receiver is a government official appointed to the role by the Minister of Justice.

Key Elements:

- Automatic moratorium for business rehabilitation.
- No voluntary bankruptcy procedure available to debtors.
- Insolvency procedures are conducted or supervised by official receivers.

Eligible creditors (being unsecured creditors and secured creditors the value of whose security is insufficient to discharge the secured debt) must file a claim for the repayment of debts within 2 months from the date of publication of the order of absolute receivership. Except in circumstances where a force majeure has occurred preventing a creditor from filing its claim for the repayment of a debt, subject to the Court's approval of the creditor's petition, the creditor may file a claim after such two-month period. However, such creditor's right to receive a repayment will only be applicable to the remaining assets of the debtor as of the date of filing the claim. The allocation of the debtor's assets to other creditors, prior to the submission of the claim of such creditor, shall not be affected.

Non-resident creditors may be granted a further two-month extension to file a claim for the repayment of debts, 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 and determine whether to allow repayment to the creditors. If there is an objection by the debtor or its creditors, the official receiver will then consider and order whether to allow full repayment, partial repayment or to 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 at the creditors' meeting resolve 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 6 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 (as discussed further below). However, in order to be entitled to claim repayment where the proceeds from the enforcement of their security do not cover the outstanding debts, 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. All creditors whose claims have been approved by the official receiver for repayment are eligible to attend and vote. Accordingly, eligible creditors may include both unsecured creditors and secured creditors.

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 behaviour. 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:

(a) the debtor is insolvent or unable to pay debts as scheduled;

(b) the debtor owes debts in a determinable amount of not less than THB 10,000,000 to one or more creditors; and

(c) there are reasonable grounds and prospects for the rehabilitation of the debtor's business.

Upon the Court accepting the petition, an automatic stay will come into effect. Secured creditors will not be able to enforce their security without court approval for a period of one year after the Court accepts the petition, or up to two years if the period is extended by the Court. The automatic stay will continue until the rehabilitation plan has either expired or been executed or the Court dismisses the petition, cancels the rehabilitation order or issues an absolute receivership order.

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 power to manage the debtor's business and assets will be transferred from the existing directors or management to a person appointed by the Court as a plan preparer to formulate and prepare the business rehabilitation plan. The Court may appoint a person nominated and listed in the petition for business rehabilitation or a person approved by a creditor's meeting, which in both cases may include an existing director or member of management.

Whilst the appointment of a plan preparer is pending, the Court may appoint an interim executive to manage the debtor's business and assets until the plan preparer is appointed. 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 (i) each class of creditors representing at least two-thirds of debt value and more than 50% in number of creditors voting, or (ii) one class of creditors representing at least two-thirds of debt value and more than 50% in number of creditors voting in that class, together with creditors from other classes, forming at least 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 cancelling 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 consider whether the debtor should be declared bankrupt and issue an absolute receivership order.

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 3,000,000 and up to THB 10,000,000), 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 has 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 3 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.

Enforcement by Secured Creditors

In a business rehabilitation scenario, a secured creditor will not be able to enforce their security without the Court's approval for a period of one year following acceptance of the petition for business rehabilitation (which may be extended to two years by the Court). Once the rehabilitation plan is approved by the Court, the rights of the secured creditor will be subject to the terms of the rehabilitation plan.

In a bankruptcy scenario, a secured creditor may enforce their security in accordance with the specific procedures provided by law for that type of security (which for some types of security may require Court assistance).

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, a representative or an 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 objectives. This applies to upstream, downstream and cross-guarantees. Please note, however, that guarantees under Thai law have specific legal requirements that should be carefully observed, and cross-border guarantees 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:

(a) 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 an interim executive appointed by the Court, 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; and

(b) 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 which they would have received had there been an enforcement of such property, 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 THB 200,000. 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 proceedings.

VIETNAM

VIETNAM

Contributed by VILAF

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 (the "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 Justice (the "MOJ") and the Ministry of Finance;

(2) the Law on Enterprises (No. 59/2020/QH14), dated 17 June 2020, which came into effect on 1 January 2021 (the "Law on Enterprises"). The Law on Enterprises sets out certain rights and obligations applying to the members of an LLC, shareholders in a JSC and the company subject to bankruptcy proceedings, including rights to petition for bankruptcy and the distribution of any balance remaining after the liquidation of a company's assets; and

(3) the Law on Credit Institutions (No. 32/2024QH15), dated 18 January 2024, which came into effect on 1 July 2024 (the "Law on Credit Institutions").

The Law on Credit Institutions provides that any credit institution which is insolvent (but cannot be returned to solvency through the State Bank of Vietnam's (the "SBV") measures implemented pursuant to the "special control" regime, if applicable) is subject to the Bankruptcy Law. This is outside the scope of this chapter.

The Bankruptcy Law applies to enterprises and cooperatives incorporated in Vietnam. Currently, there is no 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 also governs bankruptcy procedures relating to any credit institution in relation to which the SBV has issued a written notice of termination of its "special control" regime (or in relation to which restoration procedures are not applied or are otherwise terminated) and the credit institution cannot be returned to solvency. In that case, the credit institution must file a bankruptcy petition with the court and the proceedings will be subject to the Bankruptcy Law. The Law on Credit Institutions 2024 provides guidance on the formulation and implementation of a bankruptcy plan in relation to an 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 3 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 3 months from the due date, an eligible party (the concept of which is further explained below) may file a bankruptcy petition with the court.

Accordingly:

(a) an enterprise will not be insolvent for the purposes of the Bankruptcy Law test unless its debts have fallen due for over 3 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 to be insolvent where the enterprise fails to pay its due debts within 3 months from the due date and its creditors do not agree to any further payment extensions.

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 with the supervision of the enterprise.
- Test for insolvency requires a failure to pay due debts.
- Emergency measures available for the benefit of creditors.

Milestones in the bankruptcy procedure

The bankruptcy procedure in Vietnam is as follows:

(a) the filing of a bankruptcy petition with the court;

(b) discussion between petitioning 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;

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(e) first creditors' meeting; and

(f) one of the following:

(i) at the creditors' meeting, eligible creditors (being creditors which have sent a request for payment of debt(s) to the Licensed Asset Manager and are included in the list of creditors formulated by the Licensed Asset Manager) agree to place the enterprise into a restoration procedure with a view to restoring the enterprise as a going concern (a "Restoration"). If Restoration fails, the court will declare the enterprise to be bankrupt and place the enterprise into liquidation;

(ii) at the creditors' meeting, eligible creditors fail to agree to place the enterprise into Restoration, so the enterprise is declared bankrupt 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 (a "Liquidation"); or

(iii) at the creditors' meeting, eligible creditors agree to suspend the Bankruptcy Procedure if, during the period from the commencement date of the bankruptcy procedure to any declaration of bankruptcy by the court, the enterprise is no longer considered to be insolvent (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 if the enterprise fails to implement the Restoration Plan. Alternatively, upon the expiry of the timeline for implementation of the Restoration Plan, if the enterprise remains insolvent, the court may suspend the implementation of the Restoration Plan and declare bankruptcy.

Furthermore, the Bankruptcy Procedures may be simplified and the enterprise 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 court fee and makes an advance in respect of bankruptcy costs; or

(b) the enterprise cannot afford to fund bankruptcy costs 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 becoming aware that the enterprise is insolvent);

(b) shareholders or a group of shareholders who have the right to file a bankruptcy petition (who hold at least 20% share capital (or a lower ratio as stated in the charter) for at least six consecutive months);

(c) unsecured or partially secured creditors; and

(d) the trade union or employees of the enterprise (but who are subject to requirements slightly different to those of other eligible parties).

Any person who files a dishonest petition or a petition without due cause together with the intention to harm the honour, reputation or operations of an enterprise is liable to an administrative penalty and to pay compensation for any damage suffered by the enterprise.

Certain individuals, including the legal representative of the enterprise, the individual owner of any private enterprise and the chairman of the Board of Management (in respect of a JSC) or Members' Council (in respect of an LLC), are required to file a bankruptcy petition with the court in relation to the insolvent enterprise. Failure to file the petition when the enterprise remains insolvent could subject the relevant individual to legal consequences, including monetary fines, compensation in relation to damages arising from such failure and/or prohibition from setting up a new enterprise or taking managerial positions in any enterprise for three years.

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 court 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 of the petitioning creditors with respect to the enterprise remain outstanding beyond 3 months from the respective due date(s). A petition may be submitted so long as there is an outstanding debt of such petitioning creditor which is 3 months overdue.

If the enterprise can prove it is not insolvent for the purposes of the Bankruptcy Law test, the court will reject the petition. The enterprise and the creditors may request the court to order a mutual discussion on the withdrawal of the petition, and such mutual discussion shall not extend 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. Notice of the decision will be given to creditors and debtors of the enterprise.

Unsecured or partially secured creditors must submit with their petition a list of due debts together with supporting documentation, including 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).

If the bankruptcy petition is submitted by the enterprise itself or by shareholders, other supporting evidence for the insolvency status of the enterprise is required, such as financial statements for the most recent three years, a list of creditors, explanatory statements and/or 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 enterprises and cooperatives whose businesses have been registered in the relevant district. Meanwhile, provincial or municipal courts shall have jurisdiction over cases involving enterprises and cooperatives registered in such provinces or cities and:

(a) involving overseas assets or participants; or

(b) where the insolvent enterprise or cooperative has branches, representative offices or real estate located in relevant districts or cities; or

(c) where the relevant entity is 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, the court will decide whether to initiate the Bankruptcy Procedures.

If the court places the enterprise into 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 claims.

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.

An individual must obtain a practice licence in order to act as a Licensed Asset Manager. He/she must be a lawyer, an accountant or otherwise a holder of a bachelor's degree in law, economics, accounting or finance with at least five years' experience in the relevant sector.

An enterprise which is a partnership or private company can also register to become a Licensed Asset Manager, subject to certain conditions, including that the owner or general director must themselves be a Licensed Asset Manager (as discussed in the preceding paragraph).

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 the enterprise 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 together comprise 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 or voided transactions.

Permitted business activities during Bankruptcy Procedures

Although the enterprise may continue its operations 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 any assets;

(b) terminate the performance of a valid contract; or

(c) pay any new debt arising after the commencement of the Bankruptcy Procedures, or the wages of employees.

After the commencement of the Bankruptcy Procedures, the enterprise is prohibited from:

(a) concealing or disposing of any assets;

(b) paying any unsecured debt (except for such debt arising after the commencement of the Bankruptcy Procedures, or 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 are suspended; (ii) legal and arbitral proceedings related to the financial obligations of the enterprise are suspended; and (iii) enforcement of secured assets by secured creditors is 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 eligible 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 return the enterprise to solvency; and

(c) place the enterprise into Restoration.

If the creditors consider that the enterprise's business is not recoverable and the enterprise cannot be returned to solvency, then the court will declare the enterprise to be bankrupt and place the enterprise into Liquidation.

The Restoration proceedings commence once the creditors' meeting has passed a resolution approving the placement of the enterprise into 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 in order to return the enterprise to solvency ("Restoration Plan"). The creditors are entitled to review and comment on the Restoration Plan before finalisation.

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) restructuring production and business operations of the enterprise;

(d) issuing new shares to creditors or other investors;

(e) selling or leasing assets; or

(f) other measures not contrary to law.

Once the Restoration Plan has been prepared, it shall be submitted to the court for consideration before being submitted to creditors for approval. The quorum of the creditors' meeting requires creditors representing at least 51% of total unsecured debts. The approval of the Restoration Plan requires a vote by a majority of unsecured creditors holding at least 65% of total unsecured debts of the enterprise. Once the Restoration Plan receives creditors' approval, the court will recognise the approval by the creditors, and the Restoration Plan will become effective. The notice of the approval will be sent to all creditors and published in a newspaper. After the Restoration Plan is approved by creditors and recognised by the court, all the restrictions and prohibitions applicable to the business of the enterprise shall be lifted.

The Bankruptcy Law provides that the Restoration Plan must be implemented within the time period approved by the creditors or within three years from the date the creditors' 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 recognised by the court.

Secured creditors in Restoration

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 creditors' meeting on restoration. For this, if (i) the Restoration involves any secured assets, the resolution of the creditors' meeting on Restoration must specify how it is intended the secured assets will be dealt with and the resolution must be consented to by the secured creditors, or (ii) it is decided by the creditors' meeting that the secured assets are not necessary for Restoration of the enterprise, secured creditors can enforce their security in relation to those assets accordingly.

Liquidation and declaration of bankruptcy

In Liquidation proceedings, the assets of the enterprise shall be liquidated and the proceeds thereof distributed to its unsecured creditors and its secured creditors (in case the value of the secured assets is not sufficient to cover the relevant secured debts). 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;

(c) the creditors' meeting fails to achieve a quorum after having already been adjourned once; or

(d) after the creditors' meeting, the requisite majority of creditors passes 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 improperly implements a court-recognised Restoration Plan.

A concerned party may appeal the decision to commence the Liquidation procedure.

Priority of claims and distribution

After being declared bankrupt, the assets of an enterprise shall be evaluated and sold by normal methods (such as a private bilateral sale) or via public 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 the enterprise or cooperative; and

(d) financial obligations to the state, unsecured debts owed to creditors whose names appear on the list of creditors and unpaid secured debts where the value of the secured assets is not enough to cover such debts.

If the proceeds are insufficient to cover the above items, each entity having the same rank of priority will receive payment prorated to its debts owed by the enterprise.

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 owed to a secured creditor, the secured creditor can claim as an unsecured creditor for the shortfall.

Declaration of bankruptcy

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. Within three business days after receiving the court's declaration, the business registration office will register such declaration on the national business portal and update the bankruptcy status of the enterprise on the national database on business registration.

Licensed Asset Manager – Emergency Procedures

The Licensed Asset Manager or any party eligible to file a bankruptcy petition 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 specified under article 70 of the 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) seize the assets and funds of the enterprise;

(d) freeze the bank accounts of the enterprise and assets being stored at warehouses;

(e) seize accounting records and related documents and business data;

(f) prohibit the transfer of rights to assets of the enterprise;

(g) keep the current conditions of the assets unchanged;

(h) prohibit or force the enterprise and other related parties to perform certain activities;

(i) force the employer to pay in advance for salaries, wages and other benefits to the employees; and

(j) take other temporary emergency measures under laws and regulations.

Voidable Transactions

The following transactions are invalid if entered into by an insolvent enterprise any time within the six-month period prior to the commencement of the Bankruptcy Procedures by the court (except for any insolvent credit institution under the "special control" regime of the SBV):

(a) disposal of assets which are not for market price;

(b) the granting of security or partial security for any existing unsecured debt;

(c) payment or 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 enterprise.

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 and will form part of the pool of assets of the insolvent enterprise available to be dealt with in accordance with the Bankruptcy Procedures.

Personal Liability

Holders of managerial positions in a bankrupt enterprise may be prohibited from establishing, or acting as a manager of, an enterprise or cooperative for a period of three years from the declaration of bankruptcy, where they are found to have committed certain acts such as intentionally committing prohibited activities or failing to comply with the requirements of the court or the Licensed Asset Managers during the bankruptcy procedure.

Prohibited activities include (i) concealing, dispersing or donating assets; (ii) repaying unsecured debts (except for unsecured debts arising after the commencement of bankruptcy proceedings or paying salaries to employees); (iii) giving up the right to claim debts; and (iv) converting unsecured debts into secured debts or partially secured debts using the enterprises' collateral.

Certain persons may also be subject to personal liability where they fail to file a bankruptcy petition when the enterprise becomes insolvent: (i) the legal representative of the enterprise, (ii) the individual owner of any private enterprise, (iii) the chairman of the Board of Management (in respect of a JSC) or the chairman of the Members' Council (in respect of an LLC), and (iv) the owner of a single-member LLC.

The general directors, chairman and members of the board of management of a bankrupt state-owned enterprise (an "SOE") with 100% state capital will be permanently prohibited from holding the same position in any other 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 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 (except for certain restrictions on public companies); however, it is uncommon for credit institutions to lend money to such enterprises in these circumstances. When this does occur, it would be expected that lending conditions and security requirements would be 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 (except for certain restrictions on public companies). 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 the approval of the Prime Minister for the purpose of giving a guarantee to secure the performance of obligations of an offshore party.

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 the existence of a bilateral treaty on enforcement, or alternatively on a reciprocal basis, between Vietnam and the relevant foreign country.

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 4 months from the date of acceptance of the case. That time limit may be extended by 2 months if the court requires the applicant or the foreign court which handed down the judgment to clarify any issue that is unclear.

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 which issued such judgment; or

(j) the recognition and enforcement of the foreign judgment in Vietnam are 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.

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