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CONTENTS

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Japan & China (including Hong Kong): Introduction to the Tools Available for Corporate Rescue & Cross-Border Insolvency[1]

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1. Introduction

This session will focus on the tools available for corporate rescue in the People's Republic of China (PRC) and Japan, but this paper will also discuss corporate rescue in Hong Kong and cross-border recognition in the PRC and Hong Kong. These three jurisdictions offer an excellent contrast of what is necessary to create a well-functioning system and of the combination of infrastructures and underlying factors that must be in place for corporate rescue mechanisms to achieve their goals. In terms of the quality of the formal corporate rescue laws: the ranking is (1) Japan; (2) the PRC; and then (3) Hong Kong. Of the three jurisdictions, Japan has engaged in the most law reform, with a continuing series of reforms that commenced in the aftermath of the Asian Financial Crisis (AFC) in 1997 and continue to this day. Next comes the PRC, which enacted a modern corporate rescue procedure in 2006 that came into operation in 2007, and has established a specialized bankruptcy court system, and has developed a vibrant on-line insolvency platform. Last on the list is Hong Kong, which in the early 1990s was one of the first two jurisdictions in Asia to commence the law reform process to enact a new corporate rescue law.[2] Back in 1996, the Law Reform Commission of Hong Kong (LRC) called for the enactment of "provisional supervision." The enactment of various versions of this corporate rescue mechanism has been "on the horizon" for over a quarter century– and the Hong Kong government continues to discuss getting it enacted. However, at present, Hong Kong still does not have a formal corporate rescue law in place.

Yet, as will be seen below, of the three jurisdictions, in terms of the best place in which to undertake a corporate rescue, the ranking is as follows: (1) Hong Kong; (2) Japan; and then (3) the PRC. The inconsistency of this ranking with the quality of the applicable laws can be explained by differences in the following factors: the strength of the corporate rescue culture; the expertise and creativity of the insolvency profession (both lawyers and accountants); and the quality of the judiciary. Moreover, for insolvency laws generally – and corporate rescue laws in particular – to function effectively, there should be transparency, predictability, and efficiency. Hong Kong leads in these areas as well. Thus,

[1] The earliest version of this draft was originally prepared in conjunction with the INSOL Global Insolvency Practice Course Class of 2015/2016 - Module B, session 15, held in Dubai, UAE, on January 22, 2016 and has been updated since.

[2] Singapore is the other – unlike Hong Kong, Singapore enacted its new laws at that time and has continued to modernize its insolvency laws and commercial law infrastructures, most dramatically over the last few years.

even though Hong Kong has the worst law of the three jurisdictions, it is the best of the three in which to restructure a company or a corporate group.

2. Responses to the AFC

Clearly, the need for corporate rescue mechanisms in Asia existed before the onset of the AFC. That being said, back in 1997 the norm in Asia for companies in distress was a liquidation model. Singapore was the only jurisdiction in the region at that time with a modern, formal corporate rescue system. The AFC was like a financial tsunami that hit the region, and some countries were hit harder than others. The three types of responses that led to the development of corporate rescue mechanisms were (1) insolvency law reform, (2) the promulgation of out-of court workout guidelines, and (3) for countries with systemic insolvency in the financial sector, the enactment of administrative reforms, usually in the form of the establishment of Asset Management Companies (AMCs) to address high levels of Non-Performing Loans (NPLs) accumulating at banks.

With the onset of the AFC, there were immediate calls for insolvency law reform and the first wave of reform commenced in 1997 and 1998 in many of the jurisdictions hardest hit by crisis. New legislation or significant reforms were enacted in Indonesia, Malaysia, the Philippines, Japan, South Korea, Chinese Taipei, and Thailand. In many of these countries, further reforms followed. The second wave occurred several years later, and included new bankruptcy laws enacted in Vietnam (2004), China (2006), and Cambodia (2007). Ironically, as mentioned above, although Hong Kong started its law reform process before the onset of the AFC, the legislative stalemate continues and the jurisdiction remains without a formal corporate rescue procedure. A third wave of reform is underway in Singapore – with its designs set on becoming Asia's corporate rescue hub – as well as in Laos and Bhutan.

Although the enactment of formal insolvency laws receives much attention in the press, the time taken to enact and implement such legislation is inevitably protracted, and additional time elapses as cases work their way through the courts. Thus, law reform proved less of a solution to the AFC than the beginning of the laying of the groundwork to address future crises. The second type of reform – the promulgation of out-of-court workout guidelines – had a more immediate effect on saving individual companies. The guidelines enacted in many Asian jurisdictions (eg, the *HKAB/HKMA Guidelines* in Hong Kong, the *Bangkok Approach* in Thailand, and the *Jakarta Initiative* in Indonesia) had their origins in the *London Approach* originally promoted in the 1970s by the Bank of England as an alternative to formal court-based corporate insolvency proceedings involving multiple financial creditors. The basic tenet of this approach is that it is in the interest of financial creditors to act in concert rather than in competition with each other – and thereby to preserve and benefit collectively from the going concern value of the company in distress rather than suffer from lower values if the company is liquidated.

These guidelines are primarily used by financial institutions and were particularly well suited for adoption in Asia where the majority of corporate debt was bank issued. Since the banking community in most Asian jurisdictions was smaller and more collegial than in many Western countries, once the guidelines were put into place, it was often possible to achieve consensus. In those jurisdictions where banks were less willing to collaborate (eg, Malaysia), the guidelines needed to include mechanisms to force recalcitrant bankers to the negotiating table.

A further benefit of the guidelines was that they were in harmony with Asian business culture. Asian companies prefer to resolve their difficulties discreetly, as quickly as possible, and without adverse publicity. Thus, the best solution for many companies in the aftermath of the AFC was to come to an out-of-court agreement with their major bankers for the rescheduling of corporate debt and overall re-financing.

It should be noted that out-of-court workouts occur in the shadow of the law. In countries that enacted effective formal corporate rescue procedures that included clear voting mechanisms setting out the percentage of assenting creditors and/or debt necessary to bind all creditors, holdout creditors came to have very little leverage; in cases where a dissenting creditor voted against an out-of-court workout, other creditors or the debtor itself would be able to file a corporate reorganization petition and have a plan proposed that would be able to garner the necessary votes and bind the dissenting creditor.

Lastly, as is clearly evident from the more recent Global Financial Crisis (GFC) that engulfed the financial sector in the United States and spread worldwide, dramatic administrative steps must be taken to save financial institutions in an effort to stop contagion from spreading to other financial institutions and generally throughout the economy. Thus, in the aftermath of the AFC, many Asian countries set up national AMCs to help strengthen the balance sheets of their banks that were in difficulty.

From the discussion below of the PRC, Japan, and Hong Kong, it will be seen that each of these jurisdictions has developed its own assortment of tools to foster corporate rescue.

3. The PRC[3]

A. Background to the development of Chinese bankruptcy law

The development of the PRC's bankruptcy and corporate rescue law is part of the broader evolution of its transition that started in the 1980s from a centrally-planned socialist economy to a more market-oriented economy. Early on, the backbone of the PRC economy comprised large state-owned enterprises (SOEs) that were funded with government-directed "policy loans" from the large state-owned commercial banks (SOCBs), with little concern as to the SOEs' capacity to repay the loans. With the transformation of both the SOCBs and the SOEs into entities increasingly responsible for their own balance sheets and economic performance, it was clear that many SOEs would be unable to make this transition and would remain unable to repay their debts.

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[3] Parts of this section are adapted from Chapter 14, *PRC Bankruptcy Law,* in Charles D. Booth, Stephen Briscoe & ELG Tyler, The Hong Kong Corporate Insolvency Manual (3rd ed) (Hong Kong: LexisNexis in association with HKICPA, 2015); Chapter 15, *PRC Bankruptcy Law,* in Charles D. Booth, ELG Tyler, Ludwig Ng & Terry Kan, The Hong Kong Corporate Insolvency Manual (4th ed) (Hong Kong: LexisNexis in association with HKICPA, 2018); Charles D. Booth, *The 2006 PRC Enterprise Bankruptcy Law: The Wait is Finally Over,* 20 SINGAPORE ACADEMY OF LAW SPECIAL ISSUE 275-315 (2008), available at http://ssrn.com/abstract_id=1547464.

Over the years, the Chinese government instituted a variety of administrative procedures and legal reforms to address the problems confronting these inefficient, insolvent SOEs, including the enactment of the Law of the People's Republic of China on Enterprise Bankruptcy (Trial Implementation) on 2 December 1986, which came into operation on 1 October 1988 (1986 EBL). This law, comprising 43 articles, applied only to SOEs and lacked sufficient detail. Other enactments addressed the problems with non-SOEs. There were many gaps in coverage as well as inconsistencies between the bankruptcy procedures for SOEs and non-SOEs. To address these problems, the Supreme People's Court (SPC) issued a series of judicial interpretations.

In the first five years after the enactment of the operation of the 1986 EBL – from 1989 through 1993 – only 1,153 cases under the 1986 EBL were accepted by the Chinese courts. Although reorganization was in theory possible under these laws (but only for SOEs), the People's Courts handled the cases under a liquidation approach. Moreover, only a small fraction of insolvent enterprises used these laws. By 1994, the Chinese government realized that these laws were insufficient and the Financial and Economic Committee of the National People's Congress (NPC) established the Bankruptcy Law Drafting Working Group to draft a new, comprehensive bankruptcy law that would create a legal framework for the reorganization and more efficient liquidation of both SOEs and non-SOEs. However, it is important to realize that this law reform process was but one part of the Chinese government's arsenal of reforms and remedies to address the historical problems resulting from the ongoing economic transition, namely (1) the SOEs' dangerously high levels of NPLs; (2) the resulting weak balance sheets of the main SOCBs; and (3) the complicated issues relating to the need to resettle and retrain the workers of insolvent (and often the largest) SOEs. Thus, at the same time that the government pursued bankruptcy law reform, it also experimented with a broad range of administrative mechanisms, the most important of which were the use of State Council bankruptcy policy decrees to facilitate debt restructuring on a large scale through merger and acquisition and bankruptcy under the Capital Structure Optimization Program (CSOP). The State Council decrees provided that the resettlement rights of workers could leap frog over the existing rights of secured creditors, and thus were inconsistent with the 1986 EBL's treatment of workers' rights.

When the AFC spread throughout the region, the PRC saw the dire consequences resulting from the collapse of the financial sector in many of its neighbors, and the Chinese government realized that SOE reform and bankruptcy law reform could not prove successful without first putting the SOCBs on a more sound financial footing. Thus, in 1999, China established four AMCs to deal with the high levels of NPLs of each of the four main SOCBs.

The drafting process for the new bankruptcy law proved contentious and over the years the Bankruptcy Law Drafting Working Group prepared several drafts of a new law. Many of the changes from draft to draft were quite significant and reflected divergent views within the drafting group. Finally, after more than a decade of discussion and debates, on August 27, 2006, the Chinese government enacted the Enterprise Bankruptcy Law (2006 EBL), which came into operation on June 1, 2007. Although back in 1994 it was envisioned that the new law would assist with the restructuring of the SOEs most in need of assistance, by the time the law came into operation the insolvency of thousands of SOEs had already been addressed under the CSOP policy bankruptcy approach. Moreover, Article 133 of the 2006

EBL created a further exception for SOE bankruptcies even after the promulgation of the new law:

> The particular issues concerning the bankruptcy of State-owned enterprises within the scope and time limits specified by the State Council before this law takes effect shall be handled in accordance with the relevant regulations of the State Council.

Thus, the 2006 EBL, rather than serving as the engine for the reform of SOEs, continues to take a back seat to the State Council policy bankruptcy approach. As recently as September 2015, the PRC State-Owned Assets Supervision and Administration Commission of the State Council (SASAC) issued guidelines for SOEs that continue this policy approach outside the scope of the 2006 EBL.

B. The 2006 EBL in general

Although the 2006 EBL with its 136 articles is much more comprehensive than the 1986 EBL and the other earlier bankruptcy laws that it replaced, it does not deal comprehensively with all insolvency topics. Moreover, for a bankruptcy law to function efficiently, detailed bankruptcy rules and regulations must be in place. However, the Chinese government failed to promulgate such rules and regulations at the same time as enacting the 2006 EBL, and as of December 2015, still has not done so. In the meantime, to address some of the implementation problems that have arisen, the SPC has issued a variety of provisions, opinions and interpretations to assist with the administration of the 2006 EBL, including the 2007 Administrator Designation Provisions and the 2011 SPC Judicial Interpretation (relating to procedural issues involving the acceptance of bankruptcy petitions by the People's Courts). More recently, the SPC has been releasing SPC Meeting Minutes, including the recent Notice of the SPC on Issuing the Minutes of the National Court Work Conference on Bankruptcy Trials, published on March 4, 2018.

At the outset, a few unusual aspects of the Chinese system must be kept in mind. Firstly, although the 2006 EBL provides a much more comprehensive and detailed legal infrastructure than did the pre-1994 legal patchwork – the 1,973 bankruptcy cases in 2010; 1,331 cases in 2011; 2,100 cases in 2012; 1,998 cases in 2013; and 2,059 cases in 2014 harked back to levels from the 1993-1995 period (710 cases in 1993; 1,625 cases in 1994; and 2,344 cases in 1995). After the enactment of the 2006 EBL, the number of bankruptcy cases declined each year through 2011.

From 2007-2016, the number of cases each year since the enactment of the EBL was below – and until 2016, far below – the high of 8,939 cases in 2001 under the 1986 Chinese Bankruptcy Law. The record level in 2017 was the first time under the EBL that the annual number of cases exceeded the record number under the old law. Clearly, an important psychological barrier has been crossed, and it appears that the trend will continue upwards. This increase in cases is largely due to the improvement in the public's knowledge of the EBL and the development of an on-line filing system.

These low levels of cases do not mean that the Chinese economy is strengthening and that the number of enterprises that fail is rapidly decreasing. Rather, the opposite is actually occurring, and commentators are increasingly worried about the fallout that will result from the current weakening of the Chinese economy. It must be kept in mind that in China, failing enterprises usually pursue avenues outside the 2006 EBL. It is estimated that for each bankruptcy case accepted by the courts, at least another 100-250 enterprises are closed down either through the use of out-of-court administrative procedures or simply disappear (many through deregistration and license cancellation). There are also many zombie companies that just carry on and are not included in the data.

Secondly, one of the reasons for the low number of cases had been the failure of many People's Courts to follow the 2006 EBL and comply with the various deadlines and requirements. In some cases, petitioners never even heard back from the court about the status of a bankruptcy petition. The 2011 SPC Interpretation was adopted to deal with this problem, but did not have any immediate effect. However, the tide finally appears to be turning. With the promulgation of the Notice Concerning the Plan for Establishing Liquidation and Bankruptcy Trial Divisions in Intermediate Courts issued by the SPC in August 2016 and the introduction of the on-line filing system (part of the Information Website for National Bankrupt Enterprises Recombinational Cases, launched in August 2016), the Courts' compliance with procedures has been further improving.

Thirdly, the government continues to play an important role in Chinese insolvencies. The difficulty is that the involvement is not transparent. The PRC has not established a semi-independent supervisory administrative agency for administrating insolvency cases, although a proposal to that effect has recently been made. Rather, the State Council plays an important role in policy bankruptcies, as does SASAC. Local governments also have a large say in bankruptcy cases and exert great influence over the local courts, especially since the local governments fund the court system. Especially in matters involving SOEs and cases involving large numbers of workers or significant labor issues, courts are reluctant to accept cases in the absence of government support.

Fourthly, the judiciary plays a major role in the administration of bankruptcies in China. One of the innovations of the 2006 EBL was the creation of a new functionary in the bankruptcy process called the "administrator," who was intended to take control of the debtor's assets and exercise a broad range of administrative responsibilities. The idea was to replace government control of the liquidation committee with professionalism and insolvency expertise through the appointment of outside administrators (law firms, accounting firms, bankruptcy liquidation firms, or other public intermediary bodies). Although it was anticipated that administrators would play a significant role in the insolvency process, the judiciary has frequently proved reluctant in allowing administrators to do so. Instead, many courts prefer to utilize the liquidation committee, which was the norm under the old law (and which is still permitted under Article 24 of the 2006 EBL). In essence, there is an ongoing debate in the PRC as to whether the insolvency process should be guided by independent professionals with restructuring experience or government and administrative officials with the connections (guanxi) to navigate the insolvency process. Many cases are increasingly utilising a compromise approach in which a liquidation committee is appointed (and the government plays a leading role) and an independent professional is retained as a financial advisor. The administrator provisions were intended to change the way in which cases were administered, but in the face of the judicial opposition, a hybrid system has instead emerged.

Fifthly, there is often a significant gap between what the 2006 EBL provides in respect of employees' claims and what happens in practice. For larger cases involving many workers (often in the high thousands), it is unlikely that a judge will even accept a bankruptcy case unless the local government is supportive of the proposed treatment of workers. And in most cases, it is unlikely that the bankruptcy process will proceed smoothly unless workers are satisfied with their proposed treatment. There have been anecdotal reports of workers resorting to self-help and robbing corporate premises when told that the operations would be closed or of workers "detaining" management until a satisfactory settlement could be concluded.

C. Overview of the formal Chinese reorganization procedure

As noted above, corporate rescue was possible for SOEs under the 1986 EBL, but more in theory than in practice. The hope was that with the enactment of the 2006 EBL, corporate rescue could become a reality. The insolvency law reform process emphasised the need for corporate rescue and reorganisation provisions are included in Chapter 8 of the EBL.[4] Pursuant to Article 70 of the EBL, both debtors and creditors are permitted to file an application for reorganisation.[5] Although reorganisation is no longer limited to SOEs to be used at the discretion of the government,[6] it is important to keep in mind the government often still plays a very important role.

The application for the reorganisation is submitted to the court. The PRC has developed a hybrid procedure providing for the administration of the debtor's property by either the administrator or by the debtor itself under the supervision of the administrator.[7] Once the reorganisation ruling has been made by the court, the administrator or the debtor (as the case may be) will have a period of six months within which to come up with a rescue plan that will then have to be placed before the creditors and ultimately before the court (EBL, Art. 79).

While this period of six months may be sufficient for most companies, it is possible to envisage that for larger companies, whose affairs are more complex, it will be difficult if not impossible to organise a restructuring within such a relatively short period. There are provisions for the six-month period to be extended for another three months when justified (EBL, Art. 79) but that may also prove insufficient. The creditors are divided into four groups for the purposes of voting on the plan – secured debts; workers' claims; tax debts; and ordinary unsecured claims (EBL, Art. 82). Once the administrator's plan has been approved by the creditors by a simple majority in number and two thirds in value of each group (EBL, Art. 84), it is then submitted to the court for approval (EBL, Art. 86). The law provides procedures for where the plan does not gain the approval of all four groups, including a limited "cramdown" power (EBL, Art. 87). Surprisingly, cramdowns are being used much more frequently than had been anticipated.

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[4] Chapter 9 sets forth a conciliation procedure to enable the debtor to enter into an agreement with its unsecured creditors regarding the settling of debts and which is only binding on those creditors involved in the conciliation. This is a streamlined process for dealing with unsecured claims; it does not affect secured claims (2006 EBL, art. 101).

[5] Investors who hold more than 10% of the registered capital of the company may also file in defined circumstances.

[6] Or of the shareholders in the absence of a superior department in charge.

[7] Art. 73 of the 2006 EBL provides that the debtor may apply to the court for approval to administer its assets, and thereby serve as a debtor-in-possession (DIP). If approval is granted, the debtor will administer its property and business affairs under the supervision of the administrator.

It can be seen from this brief description that the Chinese reorganisation procedure borrows heavily from Chapter 11 of the United States Bankruptcy Code, and this is a point frequently made by the PRC government and academics. However, although the two laws are quite similarly phrased, in practice they operate quite differently. Firstly, reorganisation remains the exception under Chinese law, rather than the norm. Secondly, China has adopted the wording, but not the spirit, of the US approach. For example, China has not yet developed a corporate rescue culture that lies at the heart of US Chapter 11. Thirdly, Chapter 11 is about negotiation and reaching a compromise, but the emerging trend in China is to force a deal on uncooperative parties through the use of the cramdown. (The authorities are aware of this and are trying to get the courts to be more cautious when approving cramdowns when none of the voting classes have approved the plan.) Fourthly, the Chinese procedure lacks the insolvency infrastructure (comprising, eg, strong creditors' committees with independent, experienced counsel; an outside regulator in the form of the US Trustee; and knowledgeable and experienced bankruptcy judges.) Fifthly, although Article 75 of the 2006 EBL provides that the debtor or the administrator may borrow money and create security for loans secured to help carry on the business of the company, at present the PRC lacks the sophisticated financing mechanisms at the heart of the US system. Perhaps the better comparators for Chinese restructuring law are the US policy bankruptcies involving General Motors and Chrysler that arose during the recent GFC and in which the US government played a significant role.

All of this being said, in the brief time that the new law has been in operation in China, there have been some successful reorganisations, certainly more than in the close to twenty years under the old regime; but the number of reorganisation cases is still very low. From the enactment of the 2006 EBL through 1 June 2015, there were only 59 reorganisations of listed companies and around 100 non-listed enterprise reorganisations.[8] Even in regard to A-Share Listed Companies (listed on the Shanghai Stock Exchange and largely available only to domestic investors), the cases have involved companies that have been closed for a significant period of time and have few assets. The aim of the proceedings generally has not been to deal with on-going business operations with a view to saving corporate goodwill and jobs, but rather to salvage the value of the stock exchange listing and to find a purchaser for the listing shell – in other words to entice prospective purchasers with a back-door stock exchange listing.[9]

Nevertheless, there have been several, high-profile restructurings in China, including Suntech, Chaori Solar, Ambow Education, Sino-Environment Technology Group Ltd, and Sino Forest. At a symposium organized by IAPBL and the Hong Kong TMA Chapter in Hong Kong in October 2014, leading Insolvency Professionals (IPs) based in Hong Kong and Shanghai who were involved in these and other recent Chinese cases offered their insiders' perspective on the successes and failures of restructurings in the PRC:

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[8] Data from the Bankruptcy Law & Restructuring Research Center, China University of Politics and Law, Beijing, China.

[9] Through October 2010, there were 30 such cases. See Alan CW Tang & Christina LM Lam, *Update on Reorganisation in Practice under the New PRC Enterprise Bankruptcy Law,* Handout 4, Workshop: Mainland PRC Recoveries, 12 January 2013, HKICPA Diploma In Insolvency 2012/13.

> The speakers noted that in some recent cases, good results have been achieved under the circumstances – not ideal by Western standards – but much better than in previous cases in China. One theme stressed by several speakers is that foreign IPs must realise at the outset that local Chinese management often has strong ties with local government officials and local creditors and is credited in the local communities for creating jobs, bringing in high levels of investment, and paying local taxes. Many challenges remain in the Chinese insolvency process and there are very few cases, but when the right conditions exist, foreign IPs have been appointed as administrators or advisors and, in some cases, have been able to increase value. The speakers were generally in agreement that the better results have been achieved when it has been possible to achieve consensus amongst the parties. Nevertheless, there is still much less transparency than would be found in insolvencies in Hong Kong. From their experiences in China, the speakers shared the following lessons for IPs: you need to identify where you share common ground with other parties; you need to recognise the changing role of government in PRC insolvencies; at the outset, you must decide not whether to restructure a business in China, but rather whether the business is, in fact, salvageable; you need to identify where you are best able to apply leverage; opportunities come to those who are pro-active, not to those who sit back and wait; and you must be realistic in assessing the situation.[10]

Lastly, although it may at first appear surprising, in corporate reorganisations in China, pre-packs are the norm rather than the exception. This is because it is unlikely that a People's Court will accept such a case without local government support. By the time a case has been accepted, the government has likely been intricately involved in the negotiations with creditors, the enterprise and bankers, and perhaps has even identified a purchaser of the corporate assets or listing shell. Although the parties usually prefer an out-of-court solution, this is sometimes not possible and the bankruptcy case will be necessary to secure the affirmative vote of the creditors for the draft reorganization plan and then the approval of the People's Court.

D. Informal workouts

As noted in Section 3.B., above, the majority of insolvencies in China are handled outside the formal bankruptcy/reorganisation process. Where there is value in an enterprise being reorganised, out-of-court rescues will likely be pursued. For larger enterprises, local government support of a proposed reorganisation and worker resettlement issues will also be necessary. Over the years, the government has experimented with a variety of out-of-court mechanisms for rescuing companies including the following: merger and acquisition of SOEs; debt for equity swaps; the Changchun out-of-court approach; and policy bankruptcies by decree.

The PRC government is quite flexible and pragmatic in the variety of approaches that it has experimented with to foster corporate rescue. However, one of the overall problems with out-of-court rescue in China is that it is too government-driven, rather than market-oriented. This has delayed the development of a rescue culture from the bottom up. A further problem is the restriction that banks face in writing off bad debts in full or in part. This has further hindered the development of a rescue culture.

E. Cross-border insolvency

None of the old national PRC insolvency laws included provisions specifically applying to

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[10] *Unlocking Value in the PRC: The Changing Nature of Restructurings on the Mainland* – A Summary of a Symposium held in Hong Kong on October 10, 2014.

cross-border insolvency. Historically, when confronted with both inbound and outbound inbound cross-border insolvency issues, Chinese courts traditionally adopted the territoriality approach. However, over the last decade or so – and leading up to the enactment of the 2006 EBL, changes were beginning to occur. Hong Kong liquidators began reporting that they increasingly were able to secure co-operation, especially in Guangdong. (Interestingly, recognition of a Hong Kong liquidator might be more likely in a voluntary liquidation commenced by the company's shareholders or directors than in a compulsory winding up.) Similarly, in the light of Article 73 of the 2002 SPC Provisions, some commentators began arguing that Chinese law was extra-territorial in scope.

These issues were all addressed by the enactment of the 2006 EBL. Article 5 of the 2006 EBL explicitly asserts extraterritorial jurisdiction and makes it easier for Chinese representatives to seek assets and co-operation abroad. However, the treatment of inbound transactions in the new law is not as explicitly universal in scope. Article 5 provides as follows:

> Where any legally effective judgment or ruling made by a foreign court involves any debtor's assets within the territory of the People's Republic of China and if the creditor applies to or requests the people's court to confirm or enforce it, the people's court shall, according to the relevant international treaties that China has concluded or acceded to or according to the principles of reciprocity, conduct an examination thereon and, when believing that it does not violate the basic principles of the laws of the People's Republic of China, does not damage the sovereignty, safety or social public interests of the state, and does not damage the legitimate rights and interests of the creditors within the territory of the People's Republic of China, grant confirmation and permission for enforcement.

This article grounds the basis of co-operation in either a treaty or reciprocity; the difficulty with this approach is that China has not yet entered into any cross-border insolvency treaties, and reciprocity requires that a foreign jurisdiction will first have recognized a PRC insolvency case. China and Hong Kong have not yet even entered into a bilateral cross-border insolvency agreement. This is especially unfortunate given the amount of cross-border commercial activity between China and Hong Kong. However, it appears that changes are underway – the Hong Kong government in early 2019 announced that Hong Kong and China are in the midst of discussing a framework for resolving cross-border insolvency issues involving the two jurisdictions.

Overall, new Article 5 of the 2006 EBL is a step in the right direction, but difficult for foreign representatives to rely on. The requirement for a treaty or reciprocity sets a very high bar. Although it is unlikely to dramatically increase the recognition of foreign bankruptcies by the Chinese courts in the short term, it rejects the territoriality approach of China's earlier bankruptcy laws.

On June 11, 2014, the SPC issued a decision in *Thumb Environmental Technology Group v Sino-Environmental Technology Group.* This case provided for the recognition of a foreign representative (from Singapore) not on the basis of Article 5 of the 2006 EBL, but rather on the basis of Article 14 of the Law for Foreign-Related Civil Legal Relationships of the PRC. This creative approach produces a favorable result that fosters cross-border co-operation, but the fact that the court bypassed the application of Article 5 of the EBL exemplifies the deficiencies of the approach set out in the new law.

Chinese restructurings are further complicated by the increasing use of Cayman Islands or BVI holding companies in the corporate group chain. The emerging corporate business structure of choice – with holding companies in the BVI or the Cayman Islands, layers of subsidiaries in Hong Kong (and elsewhere in Asia) and ultimately other subsidiaries holding assets in the PRC leads to cross-border complications when insolvency occurs. Difficult issues must be addressed involving offshore and onshore restructurings and competing interests amongst offshore and onshore creditors. These corporate failures often involve bankruptcy or reorganisation filings in several countries by different corporate entities in the group and/or the need to enter into parallel schemes of arrangement.

As is noted in Section 3.F immediately below, China and Hong Kong Kong have finally entered into cross-border agreement regarding cooperation in cross-border insolvency cases.

F. Recent developments

There are six important recent developments of note. First, in August 2016, the SPC issued the Notice Concerning the Plan for Establishing Liquidation and Bankruptcy Trial Divisions in Intermediate Courts. On September 26, 2016, Beijing established the first specialized bankruptcy courts under this structure under its No. 1 Intermediate People's Court. Similar reforms are underway in eleven other provinces. There are now more than 100 courts in China that have established specialized liquidation and bankruptcy trial courts, including four high courts, 47 intermediate courts and 22 lower courts.

Second, in August 2016, China also launched an Information Website for National Bankrupt Enterprises Recombinational Cases. The Website is intended to operate as a centralized information system for disseminating information and official notices relating to bankruptcy cases, as well as a mechanism to be used by parties in individual cases. Two working platforms have been established – the Judge's Working Platform and the Bankruptcy Administrator's Working Platform. The Judge's Working Platform allows for the submission of bankruptcy applications and the Bankruptcy Administrator's Working Platform provides for a variety of actions by creditors including the submission of claims, attending meetings and voting, and challenging a bankruptcy administrator's decision in regard to a claim.

Third, the Notice of the Supreme People's Court on Issuing the Minutes of the National Court Work Conference on Bankruptcy Trials, published on March 2018, were issued and increase the likelihood of selecting competent and qualified administrators, especially in large, complex cases.

Third, efforts are underway in Taizhou (2019), Wenzhou (2019) and Shenzhen (2021) to test early versions of personal insolvency laws. Shenzhen will arguably prove to be the most important one to follow, but it must be kept in mind that even if the trial laws there prove successful that does not necessarily offer predictive value for the rest of the country.

Fourth, in May of 2021, China and Hong Kong entered into their first formal agreement regarding cooperation in cross-border insolvency cases: Mutual Recognition of and Assistance to Bankruptcy (Insolvency) Proceedings between the Courts of the Mainland and of the Hong Kong Special Administrative Region. This is a significant development and, at the outset, will extend to Shanghai, Xiamen, and Shenzhen.

On December 15, 2021, the Shenzhen Intermediate People's Court formally recognized the liquidators of a Hong Kong company, Samson Paper Company (Samson). Samson is part of the corporate family headed by Samson Paper Holdings, which is incorporated in Bermuda and listed on the HK stock exchange. Justice Harris of the Hong Kong High Court had earlier granted, in July 2021, the liquidators' application to seek recognition in the mainland.[11] A few weeks after the Shenzhen recognition of Samson, Justice Harris issued a second letter of request to the Intermediate People's Court – for the recognition of the joint liquidators of Zhaoheng Hydropower (Hong Kong). It is likely that many more cases will follow.

Lastly, in the Supreme People's Court Circular on the Promulgation of the Guiding Opinions on Several Issues Concerning Property Handling Civil Cases Related to COVID-19 Epidemic in Accordance with the Law (May 15, 2020), the Supreme Court set forth a variety of reforms to supplement/amend the procedures in the 2006 EBL. For example, the Circular provides for the following: involving the People's Court in guiding pre-insolvency measures; making changes to the moratoria; and better coordinating enforcement and insolvency proceedings. The objective of these changes is to increase the likelihood of saving enterprises that have been adversely affected by COVID-19.[12] If these measures prove beneficial, it will be interesting to see if they lead to more permanent changes being incorporated into the 2006 EBL.

4. Japan

A. Background to the development of Japanese Law

Japan was very hard hit by the AFC. In effect, it was struck by a double whammy: (1) its economy, which had collapsed years earlier with the bursting of the Japanese property market bubble, was struck hard by the crisis; and (2) problems were compounded by the fact that many Japanese companies had invested throughout the region (eg, Japan had the largest exposure to Indonesia) and these investments were severely affected by the impact of the AFC on its neighbors. After the AFC occurred, many Japanese companies were in dire shape and the Japanese financial sector was also in difficulty.

Unlike the PRC, which was grappling with the application of a recently enacted law when the AFC occurred, Japan had a very different problem: the Japanese legal infrastructure comprised a fragmented continental system with a US overlay. Looking at the history of Japanese insolvency law involved an exercise in legal archaeology:

- The Commercial Code 1890 was derived from French law.
- The Bankruptcy Act 1922 was derived from German law. It provided for a liquidation model controlled by the courts.
- The Composition Act 1922 was derived from Austrian law. It provided temporary relief until creditors voted on a composition plan. It bound unsecured, but not secured, creditors.

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[11] This description is drawn from Ben Clarke, *Mainland court recognizes Hong Kong liquidators for first time,* GRR, (14 Jan 2022).

[12] See INSOL-World Bank Group Global Guide, PRC.

- The 1938 Corporate Arrangement Proceeding in the Commercial Code was based on the English Scheme of Arrangement procedure.
- The Corporate Reorganization Act 1952 was derived from Chapter X of the US Bankruptcy Act 1898, as revised in 1938. It was better suited for larger, public companies, was trustee-controlled, and applied to both secured and unsecured debt.

Thus, unlike the PRC, Japan had many formal laws on its books, which had been in operation for decades. The problem for Japan is that these laws came from very different cultures and did not work well together. Even with all of these alternatives on the books, Japan had a very low level of bankruptcy filings, with an average of only 2,254 cases per year.

B. Post-AFC legal reforms in Japan

Japan pursued aggressive, comprehensive insolvency legal reform in the aftermath of the AFC and reforms continue to be enacted. Among the many amendments and enactments in Japan are the following:

- The Commercial Code was amended in 1997 to rationalise the procedures for corporate mergers. Further changes were made in 2000 to allow for corporate splits.
- The Civil Rehabilitation Act was enacted in 1999, and came into effect as of April 1, 2000. (The Composition Act was repealed in 2000.) On application, the court can stay secured creditors – with the goal of trying to get creditors to negotiate and reach a settlement.
- The Law on Recognition and Assistance of Foreign Insolvency Proceedings (UNCITRAL Model Law) was enacted in 2000 and came into effect in April 2001. (Covered in another INSOL Fellows Lecture.)
- Revisions to the Corporate Reorganization Law became effective in 2003.
- The Bankruptcy Act was amended in 2004.
- A Special Liquidation Proceeding was adopted as part of a new Company Code in 2005.

The goal of this broad array of reforms was not to radically change the structure of Japanese insolvency procedures, but rather to address many of the weaknesses of the old procedures and to make the law more flexible, more cost-effective, faster, more useful, and better able to be used for corporate rescue. The changes streamlined the procedures and tried to facilitate settlement. The new Civil Rehabilitation Act addressed problems with undersecured creditors and the number of cases skyrocketed to over 25,000 per year (although that number also included individuals). The laws made it easier for a debtor to sell all or parts of its business and the new corporate reorganization law made it easier to use pre-packs where necessary.

Japan was the only jurisdiction in Asia that saw a dramatic increase in the number of insolvency cases under its new/revised insolvency laws. A key to the success of the reforms was the high quality of the Japanese judges. Unlike the judges in the PRC, the Japanese judges were receptive to the changes in the procedures and proved flexible in interpreting the new legislation and trying to make it work.

C. Post-AFC out-of-court workout reforms

Although the legal reforms proved successful in Japan, they were insufficient to address the full scope of the problems. A serious issue in Japan was the insolvency culture. Unlike companies in the West, Japanese companies were generally reluctant to file for bankruptcy protection; similarly, Japanese banks were reluctant to push their debtors into bankruptcy. The result was that the government realized that it needed to get more actively involved and try to foster corporate rescue and assets sales. In the aftermath of the AFC, the Japanese government pursued a variety of mechanisms to achieve these goals, including the following:

- Guidelines for Multi-Financial Creditors Workout (based on INSOL principles and the London Approach) were put into place in 2001.
- The Industrial Revitalization Corporation of Japan (IRCJ) was established pursuant to the Industrial Revitalization Corporation Act on April 16, 2003. It operated from May 8, 2003 to March 2, 2007 with the goal of revitalizing the banking sector by eliminating some of the banks' debt overhang through the rehabilitation of the banks' corporate debtors. It assisted 41 corporate groups and helped companies in distress to deleverage and improve their balance sheets, which, in turn, took some of the pressure off their bank lenders.
- SME Turnaround Associations were established in all 43 prefectures and assisted with the reorganization of many SMEs.
- The Business Reorganization ADR (BRADR) was commenced in 2009 and operated in the private sector with experts.
- The Enterprise Turnaround Initiative Corporate (ETIC) was established in 2010. It was similar to the IRCJ. Although originally established to focus on SMEs it handled the massive filing of JAL, the "big whale."
- The Financial Reconstruction Program of the Financial Services Agency (FSA) instituted the "Takaneka Plan" that required Japanese banks to lower their NPL levels by 50% from 2002-2005.

This broad variety of out-of court approaches and administrative institutions were designed to allow the government to give a "push" to the insolvency and restructuring processes. These state-backed turnaround bodies were able to infuse large amounts of cash into companies in distress. By utilizing private sector expertise, the goal was to end the "long lived lazy culture" and facilitate the development of a corporate rescue culture. The approaches pursued by the Japanese government were much more transparent than those pursed by the PRC and attempted to utilize the strengths of both the public and private sectors.

D. On-going developments

The Japanese government is in the midst of another major reform – in essence, enacting a statutory mechanism for out-of-court workouts that does not require unanimity. This enactment will offer a further alternative to be used for corporate rescue.

E. Recent developments

Japan's COVID-related measures included the following: providing emergency financing and subsidies to business entities, with a focus on SMEs; enabling the Development Bank of Japan to address the needs of larger entities; using SME enterprise revitalisation support councils to help turnaround SMEs; and the Tokyo District Court launching a special conciliation programme.[13]

One of the interesting developments in Japan during the Covid-19 pandemic is that several medium- and large-sized businesses withdrew from unprofitable businesses and refocused their efforts on core business areas. And these withdrawals occurred through out-of-court workouts.[14] Time will tell whether this significant change in corporate culture is pandemic-related, or whether it is the beginning of a longer-term trend.

5. Hong Kong[15]

A. Introduction

The Joint Declaration of the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the People's Republic of China on the Question of Hong Kong in 1984 provided for the return of Hong Kong to the PRC and the Basic Law of the Hong Kong Special Administrative Region became Hong Kong's constitution on July 1, 1997. Under the negotiated "one country, two systems" model, Hong Kong was "to enjoy a high degree of autonomy" and the Hong Kong laws in force in Hong Kong at the time of the transfer were to remain in force unless they contravened the Basic Law. Thus, Hong Kong has a completely different insolvency regime from the one in place in the PRC. And that regime, for the most part, has its origins in old British company law procedures from the early 20th century colonial era.

Hong Kong has a unique claim to fame – it is one of the few commercial centers in the world – or perhaps the only – without a formal corporate rescue regime. Although the insolvency law reform effort commenced in Hong Kong in 1990 and proposals for a corporate rescue mechanism were made by the LRC in 1996, when the AFC erupted Hong Kong was using an antiquated corporate insolvency regime – with detailed liquidation (winding-up) procedures and an abbreviated scheme of arrangement procedure for use in corporate rescue. That combination continues to this day. Hong Kong's banking sector was

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[13] Hajime Ueno, Masaru Shibahara & Hiroki Nakamura, *Measures Relating to Business Turnaround During and Post-Covid 19 in Japan,* THE ASIA-PACIFIC RESTRUCTURING REVIEW 2022 (2021: GLOBAL RESTRUCTURING REVIEW).

[14] Hajime Ueno, Masaru Shibahara & Hiroki Nakamura, *Measures Relating to Business Turnaround During and Post-Covid 19 in Japan,* THE ASIA-PACIFIC RESTRUCTURING REVIEW 2022 (2021: GLOBAL RESTRUCTURING REVIEW), p. 5.

[15] Parts of this section are adapted from my contributions to Chapter 11, *Corporate Rescue and Restructuring,* and Chapter 15, *Cross-Border Insolvency,* in Charles D. Booth, Stephen Briscoe & ELG Tyler, The Hong Kong Corporate Insolvency Manual (3rd ed) (Hong Kong: LexisNexis 2015).

in much better shape than that of many of its neighbors and the Hong Kong government did not need to utilize administrative measures to protect the sector. However, the Hong Kong government did take steps to support its stock market.

B. Schemes of arrangement

Until recently, Hong Kong's corporate rescue mechanism was included in Section 166 of the Companies Ordinance (Cap 32). With the recent changes to Hong Kong law, the procedure is now included in Sections 666 to 675 of the revised Companies Ordinance (Cap 622). These sections set forth a procedure whereby a company can come to a binding compromise or arrangement with its shareholders and/or creditors. They can be useful for binding dissenting creditors. However, it is important to keep in mind that this procedure is not limited to insolvent companies, which is why the provisions are included in the Companies Ordinance and not in the Companies (Winding-up and Miscellaneous Provisions) Ordinance (C(WUMP)O) (Cap 32).

The procedure typically enables a scheme of arrangement to be made binding on *all* the company's creditors where: (a) it has been voted on and accepted by all the various classes of the company's creditors (each class must have a separate meeting and approval is by a majority in number of the creditors present and voting (the so-called "headcount test") and by a 75% majority in terms of value at the relevant meeting(s)); and (b) the scheme is subsequently approved by the court.

Since there is little in the way of statutory detail, schemes of arrangement usually lead to expensive, time-consuming litigation over the determination of the appropriate classes for the purposes of voting. Further difficulties are caused by the lack of a moratorium on creditor actions. In other words, the fact that a company is pursuing a scheme of arrangement does not prevent an individual creditor from suing the company, seizing the company's property or presenting a winding-up petition. In fact, some (often smaller) creditors will deliberately take such actions once they know that major creditors are in favour of a scheme of arrangement – since a small creditor can in this way make such a nuisance of himself that there is always the chance that he will get a better deal or even be paid off in full. Of course, where a winding-up order has been made or a provisional liquidator has been appointed, a moratorium would come into effect – but, again, not without significant extra costs and time delays.

The process is substantially court-driven, particularly in its early stages, which further adds to the cost. A further problem is that secured creditors cannot be forced to participate in the process, which gives them great leverage. There is no doubt that the scheme of arrangement procedure is a useful tool for restructuring, but it does not function well when it is the only available tool.

C. Provisional Supervision

In 1996, the LRC proposed a framework for a new rescue regime called "provisional supervision," by which a qualified specialist called a "provisional supervisor" would after commencement of the process take control of the company and be responsible for drafting a proposal for creditor agreement. The first draft bill proposing the Provisional Supervision procedure was gazetted in 2000 and proposed as a Bill in 2001. It offered many advantages over the then current law, but a primary flaw was the proposal that employees' salaries and certain defined benefits be satisfied in full before a provisional supervision could commence. Satisfaction of these claims could be made either through payment in full or placing sufficient funds in a trust account for that purpose. The government later amended the procedure by proposing a cap on the amounts paid, but these amendments proved insufficient to gain support for passage of the bill. In 2009, the Hong Kong government re-commenced its efforts to enact Provisional Supervision and proposed alternative, more reasonable procedures for addressing the treatment of workers' claims, but these proposals were never enacted. Now, a decade later, the Hong Kong government will attempt for the third time to get the provisional supervision mechanism incorporated into Hong Kong law. The corporate rescue law reform process in Hong Kong has proven to be a sorry state of affairs and, regardless of the result, this will likely be the final time that a provisional supervision bill comes before LegCo.

D. Provisional liquidation

Fortunately for Hong Kong, creative practitioners stepped into the law reform gap and attempted to adapt the liquidation procedures for use as a corporate rescue mechanism. In a line of cases beginning in 2002 with *Re Keyview Technology (BVI)* [2002] HKCFI 91, the Hong Kong judiciary was receptive to allowing provisional liquidation to be used to facilitate corporate rescue. The idea was to take advantage of the moratorium that comes into effect upon the appointment of a provisional liquidator and to extend the provisional liquidator's normal powers of appointment to enable him to try to work out a rescue before the court had to determine whether to wind up the company. Several other cases headed down this path, but the use of provisional liquidation to assist with corporate rescue was narrowly re-interpreted in the case of *Re Legend International Resorts Ltd.* [2006] HKCA 75, which required that a company's assets first be in jeopardy for a provisional liquidator to be appointed. Although this decision did not end the use of provisional liquidation for the purposes of facilitating a rescue, it put the brakes on the further evolution of this line of development and demonstrated the importance and need for the Hong Kong government to work apace in the drafting of a new corporate rescue bill. Non-government law reform proposals have also been circulating to tweak the existing winding-up legislation and clarify that provisional liquidation may be used for the sole purpose of facilitating restructuring. Codification of provisional liquidation for restructuring and the enactment of provisional supervision would provide Hong Kong with a two-pronged approach to corporate rescue.

E. Informal workouts

Parallel to the efforts being taken to enact a formal corporate rescue law, in the aftermath of the AFC, Hong Kong enacted a version of the *London Approach* called the *Guidelines on the Hong Kong Approach to Corporate Difficulties*. The *Guidelines* were jointly issued by the Hong Kong Association of Banks (HKAB) and the Hong Kong Monetary Authority (HKMA) (*HKAB/HKMA Guidelines*). The basic features of the *HKAB/HKMA Guidelines* are as follows:

- Firstly, when it becomes apparent that a company is in financial difficulty, no bank should individually take steps to put the company into receivership or liquidation or withdraw banking facilities. Instead, there should be a "standstill", so that breathing space is given to the company, during which time an informed decision can be made as to whether the company is salvageable.

- Second, during this process, a single bank should not act selfishly or try to gain some separate advantage for itself; the objective should be the best deal for all lenders. (It will be noted that a bank that acts selfishly to maximise its own recovery at the expense of other lenders might find the position reversed in later cases).

- Third, a lead bank should be nominated to head up negotiations with the company, but any agreement ultimately reached cannot be forced upon an individual bank without its agreement.

- Fourth, during this collective process the banks should share relevant information, while ensuring that confidential information about the company's affairs does not leak out to third parties.

Other aspects of the *HKAB/HKMA Guidelines* are the ability to hire outside advisors and provide post-standstill financing. The *Guidelines* were generally well received by the close-knit Hong Kong banking community. Corporate lending in Hong Kong is unusual by Asian standards. Hong Kong companies rarely have just one or two lenders. During the AFC, it was not unusual to hear of Hong Kong companies with 10, 20, or even 30 or more different bankers. With that many financial creditors involved, it would be difficult, if not impossible, for any agreement to be reached in the absence of co-operative guidelines. There were some complaints made by local banks that some of the foreign Asian banks (eg, from Japan and Korea) were not as co-operative as they could have been, in part because they were not given as much autonomy to negotiate and had to constantly check with their home office. In the few instances where banks were upset by the lack of co-operation of a fellow bank, the HKMA was known to have called in the bankers for a "cup of tea" to discuss the matter.

The following statement in November 1999 by Mr David Carse, the then Deputy Chief Executive of the HKMA, was made in respect of the *HKAB/HKMA Guidelines.* However, the substance of his comments apply equally well to the guidelines adopted elsewhere in the region:

> Usually the best way of achieving . . . [the] best return [for lenders] is not to rush to put a company into liquidation at the first sign of financial difficulty, but instead to co-operate with the company and with the other lenders to try to salvage the company and keep it going. Keeping commercially viable companies going is in itself desirable as it preserves employment and productive capacity. But the more immediate advantage from the lenders' point of view is that giving such companies the time to restructure their operations and financial position can ultimately improve their ability to service and repay their debt. Bearing in mind the generally low recovery rate that unsecured creditors obtain from liquidations, workouts will usually be the better option as far as maximizing the lenders' return is concerned. But it is important to note that workouts should not be seen as a soft option for the debtor or an act of charity on the part of the creditors. Banks will generally only be prepared to embark on a workout if the prospect of eventual recovery is greater than it would be in a liquidation. And the threat of liquidation must always be there to provide an incentive for the debtor to face up to its

problems and to agree to co-operate with the banks. Co-operation, and a recognition of shared interests, is integral to the workout process.[16]

F. Cross-border insolvency

As with corporate rescue, Hong Kong does not have a statutory mechanism in place for cross-border insolvency. There are no statutory provisions in C(WUMP)O or the Companies Ordinance that govern the recognition of foreign insolvencies. Instead, Hong Kong applies a common law approach based on "modified universalism," pursuant to which it recognises foreign insolvency proceedings, but still allows domestic, independent insolvency proceedings to proceed in Hong Kong. Under this approach, Hong Kong applies its own substantive insolvency law, but nevertheless exercises its discretion to co-operate with a foreign jurisdiction where possible, and perhaps to order the turnover of property to the overseas court or provide other relief to the foreign office holder.

The guiding principles regarding recognition may be found in the case law. There are not many Hong Kong cases discussing this topic (although an increasing number over the last few years), but the Hong Kong courts also follow applicable English cases. The basic principles include the following:

- Hong Kong law draws a distinction between the recognition of foreign bankruptcies and the recognition of foreign liquidations.

- As a rule, Hong Kong courts will recognize a foreign winding-up order made in the place of the company's incorporation. However, this is not the sole ground of recognition, and additional criteria include the following:

    (i) that the company carries on business within the jurisdiction of the foreign court;
    (ii) that the company submits to the insolvency jurisdiction of the foreign court; or
    (iii) that a liquidation is unlikely to take place in the jurisdiction in which a company is incorporated.

- Even where one of these criteria is satisfied, the court may refuse to grant recognition where:

    (i) the recognition of the foreign insolvency would be contrary to Hong Kong public policy;
    (ii) the foreign insolvency decree was made as a result of fraud or is in breach of the rules of natural justice; or
    (iii) the foreign insolvency proceedings are an attempt to enforce a foreign penal or revenue law.

- Foreign reorganisations may be recognized as cases involving foreign liquidations.

16 HKMA, QUARTERLY BULLETIN (Feb. 2000), p. 70.

In the typical cross-border insolvency case, the foreign representative comes to Hong Kong to seek to secure assets, gather information and/or gain the assistance of the Hong Kong courts. In pursuing his goals, he may pursue either non-insolvency or insolvency options. The following aspects of Hong Kong law are relevant for the non-insolvency options:

- A foreign order vesting title in a foreign trustee operates to vest in the foreign trustee movable property in Hong Kong that is not subject to prior attachment, execution, or valid charge – provided that the foreign law extends to the property located in Hong Kong. Although title usually does not vest in a foreign liquidator, the Hong Kong courts will usually recognise the powers of a foreign liquidator appointed by the court in the place of the company's incorporation to represent a foreign company in Hong Kong and deal with its assets in Hong Kong, subject to any pre-existing attachment, execution or charge – again, provided that the foreign law extends to the property located in Hong Kong.

- Hong Kong courts have the inherent jurisdiction to assist a foreign representative from any jurisdiction, including by recognising his appointment and powers over the insolvent company's assets.

- The foreign representative may commence civil proceedings, seek injunctive relief, seek a declaration regarding the effect of foreign insolvency proceedings, try to recover debts, and submit a proof of debt in a Hong Kong insolvency.

- The foreign representative may provide a "letter of request" to the Hong Kong court requesting assistance.

If the foreign representative pursues the liquidation option, the following information is relevant.

- Foreign companies (non-Hong Kong companies) in Hong Kong are wound up as unregistered companies pursuant to the provisions in Part X of C(WUMP)O.

- A foreign representative should consider filing, or procuring the insolvent company to file, a winding-up petition where unsecured creditors would benefit from the application of the stay, or of a liquidator's avoidance or investigatory powers as provided for under C(WUMP)O. The safest route at present is for foreign liquidators to procure the foreign company to file a petition in the form of "the Company (in liquidation)."

- The provisions in Part X of C(WUMP)O commonly relied on for the winding up of foreign companies are Section 326, which defines "unregistered company and Section 327, which provides that subject to the provisions of Part X, any unregistered company may be wound up under C(WUMP)O, subject to the exceptions and additions mentioned in Section 327.[17]

With the exception of a jurisdictional reference in Section 327A, Part X of the C(WUMP)O is silent as to the jurisdictional connection that must exist between a foreign company and

[17] Section 327A, which is entitled, "Overseas companies may be wound up although dissolved," may also be used.

Hong Kong for a foreign company to be wound up in Hong Kong. The result is that the jurisdictional criteria are not fixed, but can vary from case to case. This lack of a clear jurisdictional test is one of the major weaknesses of Hong Kong law in this area, and leads to unnecessary and expensive litigation. Historically, the jurisdiction to wind up a foreign company in Hong Kong, as in England, was based on the presence of assets. On the basis of the English decision in *Re A Company (No 00359 of 1987)* [1988] 1 Ch 210, it became generally accepted that assets need not be present in the jurisdiction, and that "provided a sufficient connection with the jurisdiction is shown, and there is a reasonable possibility of benefit for the creditors from the winding up, the court has jurisdiction to wind up the foreign company."

In 1991, the sufficient connection test was expressed in the following form as one of three core requirements by the court in *Re Real Estate Development Co* [1991] BCLC 210:

> (1) There had to be a sufficient connection with England, but this did not necessarily have to consist in the presence of assets within the jurisdiction;
>
> (2) there must be reasonable possibility that the winding-up order would benefit those applying for it; and
>
> (3) the court must be able to exercise jurisdiction over one or more persons interested in the distribution of the company's assets.

In the application of this test in Hong Kong, the presence of assets has become but a factor – granted, a key factor – to be considered under a sufficient connection test.

A recent issue arising in Hong Kong is whether a Hong Kong court should be able to exercise its jurisdiction to wind up an unregistered company in a case in which the third core requirement from *Re Real Estate Development* is not satisfied. In the recent case, *Re China Medical Technologies, Inc*, unrep, HCCW 435/2012, 9 April 2014, Harris J stated:

> As I explained in paragraph 27 [sic] of my judgment in *Re Pioneer Iron and Steel Group Company Limited* in my view there may be cases in which the connection with Hong Kong is sufficiently strong and the benefits of a winding-up order sufficiently substantial that a court considers it a proper case in which to exercise its discretion despite the third core requirement not being satisfied. The core requirements constitute guidance as to the circumstances in which the discretion should be exercise and their application can be moderated if the circumstances clearly call for it.

The making of the winding-up order is a matter of discretion. Once a court finds that the jurisdictional criteria have been met, the court must then decide whether ordering relief is warranted.

When the winding-up order is made in Hong Kong, the Hong Kong winding-up is called a "concurrent liquidation" as it proceeds concurrently with the foreign insolvency. In some concurrent liquidations, the Hong Kong liquidator is on equal footing with his foreign counterpart and each jurisdiction administers its assets and makes payments to creditors in the respective liquidation. In a distinctive type of concurrent liquidation called an "ancillary insolvency," the Hong Kong court decides to act in an ancillary capacity and assist the foreign liquidator in the collection and preservation of the assets within Hong Kong. Under such an approach, the Hong Kong court applies Hong Kong substantive insolvency law, but nevertheless exercises its discretion to co-operate with the foreign jurisdiction.

One of the unusual aspects of Hong Kong company practice is that many companies that are based in Hong Kong are incorporated elsewhere, such as in the Cayman Islands or BVI. When such a company collapses, insolvency proceedings are usually commenced both in the place of incorporation and the primary place of business (ie, Hong Kong). In many such cases, the same individuals are appointed as liquidators in both insolvencies. The use of protocols has emerged as a pragmatic solution for harmonising and co-ordinating concurrent liquidations. They are especially useful when dealing with insolvencies involving corporate groups and where the laws of the relevant jurisdictions are similar.

C(WUMP)O is silent on the extraterritorial jurisdiction of Hong Kong liquidations. Nevertheless, it is clear from Hong Kong case law that that a Hong Kong liquidator may go abroad to protect the assets of companies being wound up in Hong Kong. It is also clear that after taking legal advice and getting judicial approval, a liquidator may commence insolvency proceedings abroad and seek a turnover of overseas assets for distribution in the Hong Kong insolvency proceedings. Thus, Hong Kong liquidators may commence insolvencies abroad of companies in liquidation in Hong Kong, including for example by seeking recognition in the United States under Chapter 15 of the US Bankruptcy Code.

The current common law approach being utilized in Hong Kong is insufficient and Hong Kong needs to enact a modern, domestic legal framework for resolving cross-border disputes and issues. In 1996, the LRC considered recommending that Hong Kong adopt the UNCITRAL Model Law on Cross-Border Insolvency. Hong Kong could have been the first Asia-Pacific jurisdiction and perhaps the first in the world to adopt the UNCITRA Model Law, but the LRC feared to do so. Over 20 years have passed and Hong Kong still has not enacted the Model Law. However, the Hong Kong government is again in the midst of reconsidering the enactment of the Model Law.

Meanwhile, business corporate structures have evolved to cause further problems under Hong Kong's antiquated legal regime. It is clear that current structures involving holding companies in the BVI or the Cayman Islands, layers of subsidiaries in Hong Kong (and elsewhere in Asia) and ultimately other subsidiaries holding assets in China create insolvency labyrinths when corporate groups collapse. The recent enactment of the bi-lateral agreement with the PRC regarding cross-border insolvency issues is an important development in dealing with many of the problems noted above.

6. Conclusion

With the PRC, Japan, and Hong Kong, we have three jurisdictions with three very different approaches to corporate rescue.

Japan has the best law of the three jurisdictions, but with the general reluctance of the corporate and banking sectors to utilize the law, the overall success of the Japanese process has been achieved through a combination of good laws, the backing of an experienced judiciary, and a strong push by the government through the establishment of government-backed workout bodies that work in tandem with private sector experts. The Japanese model is based on reaching consensus and the Japanese process is developing a new procedure based on the codification of a non-unanimous out-of-court workout process.

Perhaps the use by Japanese corporates of early-stage, out-of-court workout efforts during the ongoing pandemic will come to represent the beginning of a cultural shift.

Historically, legal reforms have not proved as effective in China; but recently it appears that the government is responding more quickly to lacunae and inefficiencies in the procedures. The judiciary has become more adept in administering the law; and the Chinese government remains heavily involved in the corporate rescue process. The Chinese strength remains the government's administrative flexibility and its crafting of administrative solutions. Individual corporate successes have been achieved and are occurring on a more frequent basis, but often on a top-down basis and often there remains a lack of transparency or predictability in the process. However, the recent initiatives to establish specialized bankruptcy courts and to create a web-based platform, have begun to take hold, and the government is focused on improving both the capacity of the judiciary and the overall bankruptcy process. It will be interesting to see what effect these reforms have on the annual insolvency cases levels and on the adjudication of cases.

The irony is that Hong Kong, which lacks a formal corporate rescue law, remains the best of the three jurisdictions in which to rescue companies. There is no doubt that Hong Kong's free market, common law heritage gives it certain advantages in the area of corporate rescue, but the main reasons for its successes in this area are the creativity of its lawyers and accountants, the receptiveness of the judiciary to allowing liquidation-based procedures to be used to facilitate corporate rescue, the availability of financing for corporate rescues, and the development of a corporate rescue ethos among the insolvency professionals and banking communities.

INSOL INTERNATIONAL

GLOBAL INSOLVENCY PRACTICE COURSE

Japan & China: Introduction to the Tools Available for Corporate Rescue

By Professor Charles D. Booth
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I. What is necessary for an effective corporate insolvency system?

- Legal provisions and principles
- Supporting factors and conditions

Legal Provisions & Principles

- Collective proceeding & case administration
- Emphasis on corporate rescue
- Clear commencement criteria
- Procedures for protecting assets
- Automatic stay
- Post-petition lending
- Avoidance/investigation powers
- Cross-border insolvency
- *Pari passu* distribution
  - But, is there special protection for workers?

Supporting Factors and Conditions

- Insolvency is the exception rather than the rule
- Corporate rescue culture (in and out of court)
- Competent judges and professionals
- Market-based mechanisms for fairly valuing assets
- Internationally accepted accounting standards
- Efficient means of debt and security enforcement
- Good corporate governance

II. Background to Insolvency Law Reform in Asia

- Beneath the facade of the Asian miracle, troubles were brewing

Problematic Features

- Antiquated insolvency laws
  - Japan: Legal archaeology – Continental European, a little British, with later US overlay
  - Hong Kong: Old British company law
- New laws – China (1986)
- Regardless of history - Lack of detail & inconsistent/unclear provisions
- Low rate of bankruptcy given high rate of corporate failure
  - Liquidation, not rescue regimes

Problematic Features (2)

- Barriers to corporate workouts/rescues
  - Ineffective sanctions to force parties to compromise
  - Lack of effective formal reorganization laws
  - Lack of experienced insolvency professionals
  - Corporate culture of secrecy
  - No protection for post-petition lenders
  - No stays or moratoriums

Problematic Features (3)

- Interaction between insolvency and other laws
  - Undeveloped secured transaction laws and absence of effective legal enforcement mechanisms
  - Poor corporate governance, weak disclosure rules and lack of internationally accepted account standards
- Lack of a well-trained, experienced judiciary
- Lack of creditor confidence in the impartiality of the courts and rule of law generally

Problematic Features (4)

- Corruption, fraud and nepotism
- Systemic insolvency problems in financial and corporate sectors

Bank Loans to Corporate Sector as a % of all Corporate Funding

- Deloitte Global Fin ServsIndGrp (May 2004)

	1990	1992	1994	1996	1998	2000	2002
China	100	100	99	97	96	93	91
United States	50	47	49	48.5	47	46	41
United Kingdom	78	75.5	72	70	67	62	61
Japan	76	75.5	72	70	70	67	62.5

III. The Responses to the Crisis

- 1. Individual creditor rights (e.g., appoint a receiver)
- 2. Out-of-court corporate rescue guidelines and procedures
- 3. Administrative reforms (for countries with systemic insolvency in the financial sector)
- 4. Legal reforms – formal court-controlled liquidation and corporate rescue laws

2. Out-of-court Corporate Rescue Guidelines

- Most crucial – address problems now
- For banking and financial creditors
- Based on the London Approach
  - Lead creditor and steering committee
  - Standstill agreement
  - Outside advisors and sharing of information
  - Consensual arrangement; everyone takes a haircut

3. Administrative Reforms

- Temporary procedures for insolvent financial institutions in which a government agency takes control of non-performing loans (NPLs) owed to the financial institutions by corporate debtors
  - Based on US Resolution Trust Company (RTC) model for the S&L crisis
  - Most have been terminated

4. Legal Reforms – First Wave

- Indonesia – New bankruptcy regulations, new business reorganization chapter in the law,

  and the creation of a new commercial court
- Japan & Korea – Corporate insolvency laws changed
- India and Pakistan – New laws for reforming sick companies
- Thailand – New business reorganization law and creation of bankruptcy court

Philippines – Corporate Recovery Rules & Procedures and transfer of jurisdiction to courts

Legal Reforms – Second Wave

- **China** – Enactment of new bankruptcy law in 2006; came into operation on 1 June 2007
- **Vietnam** – New law came into operation on

  15 October 2004

  Cambodia – New law promulgated 18 December 20072001-2, 2008-9 and 2014,
- **Hong Kong** – Provisional supervision model

  dates back to the 1990s and attempts to enact in 2001-2, 2008-9 and 2014 were unsuccessful. Another attempt is on-going.

Legal Reforms – Current Wave 1 Singapore

- Aim: become the Asian hub for commercial law

Rand insolvency dispute resolution

  - Companies Act Revision 2017, incorporated into the Insolvency, Restructuring and Dissolution Act (effective 30 July 2020)
  - Super-charging schemes of arrangement with tools modelled on US Chapter 11.
    - Automatic 30-day moratorium upon commencement of scheme of arrangement
    - In personam extraterritorial effect
    - Super priority rescue financing
    - Cross-class cram downs/prepacks
  - Insolvency, Restructuring and Dissolution Act (effective 30 July 2020)

Legal Reforms – Current Wave (2)

- Laos – Enacted Law on Rehabilitation and Bankruptcy of Enterprises (effective June 2020) and is in the process of starting training for judges and IAs and drafting of subsidiary rules and regualtions.
- Brunei – Insolvency Order 2016
- India – Insolvency and Bankruptcy Code 2016
- Malaysia – Companies Act 2016.
- Myanmar – Insolvency Law 2020,
- Bhutan – Drafting a new law (on hold).

IV. China's Old Insolvency Framework

- Two national laws – one for SOEs (1986) and one for non-SOE legal person enterprises (1991)
- Judicial interpretations – especially those of the Supreme Court in 2002
- Policy decrees for certain SOEs
- Local rules and regulations

V. China’s Reform Efforts

- Movement from centrally-planned economy to a more market-based economy
- On-going insolvency law reform efforts since 1994
- Current framework is a result of China’s response to the effect of the AFC on its neighbors

1. Administrative Solutions

- Flexible, practical, pragmatic & multi-faceted administrative out-of-court solutions
  - Liquidate inter-SOE triangular debt
  - Merger and acquisition (with or w/out bankruptcy)
  - Debt for equity swaps
  - Bankruptcy/liquidation & reorganization
  - Separation of good assets from bad assets
  - Injection of funds/liquidity
  - Sale by auction

1. Administrative Solutions (2)

- Separation of business operations and social benefits
- Use of tax policy
- Creation of AMCs
- Simultaneously focused on SOE and bank restructuring
- Improve corporate governance
- IPOs
- Policy decrees
- Took advantage of rising property prices to resolve resettlement of workers

2. Aspects of New Chinese Law

- Collective proceeding & case administration
  - New position – administrator
- Emphasis on corporate rescue
  - Modified debtor in possession & creditors' committee
- Clearer commencement criteria
- Procedures for protecting the assets
- Automatic stay
- Post-petition lending & avoidance/investigation powers
- *Pari passu* distribution
- Debate: Secured creditors v workers

3. Assessment of China's Law Reform Efforts

- Huge improvement over old law
- So-called harmonization
- Emphasizes reorganization – have been some successes
- Scope of law
  - Treatment of SOEs is still key
  - Applies to partnerships and sole proprietorships through other legislation
  - Does not currently apply to consumers, but local personal bankruptcy law trials in force in Shenzhen, Wenzhou & Taizhou.

3. Assessment cont (2)

- Lack of transparency & delayed implementation of new bankruptcy law
  - Workers remain top priority
  - Stunted role of administrators
    - Professional panels established
    - Reluctance of judges to appoint
    - Even in listed company reorganizations, the courts often resort to using the old committee approach

  BUT see 2018 SPC Meeting Minutes

Number of PRC Bankruptcy Cases

Year	No. of cases
1989	90
1990	32
1991	117
1992	428
1993	710
1994	1,625
1995	2,344
1996	6,233
1997	4,515
1998	6,148
1999	4,591
2000	7,528
2001	8,939
2002	6,463
2003	6,380

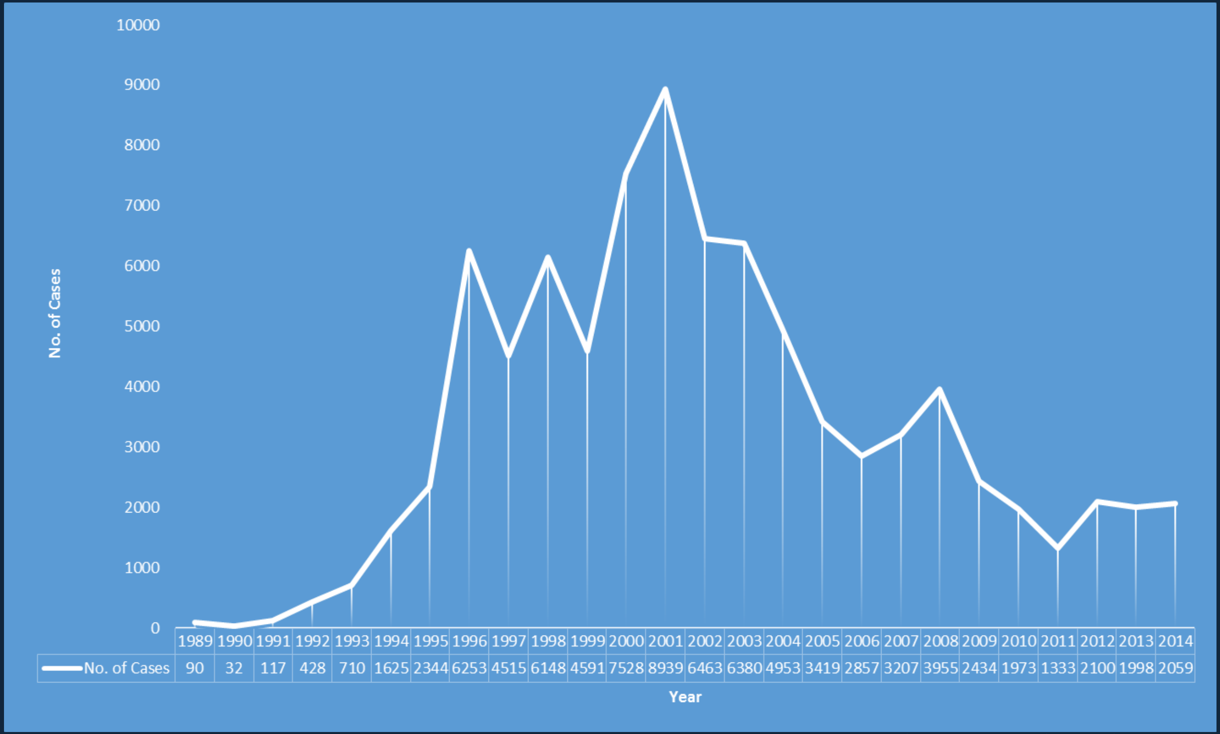
Year	No. of cases	
2004	4,953	
2005	3,419	
2006	4,253	
2007	3,819	*
2008	3,139	**
2009	3,128	
2010	2,366	
2011	1,869	
2012	1,521	
2013	1,929	
2014	2,031	
2015	3,568	
2016	5,665	
2017	8,984	

Note:

•Includes cases under the 1986 Law ; ** All cases are under the EBL;

•Data for 1989-2005 from Beijing Siyuan Consultants; Data for 2006-2017 from INSOL International , 'PRC Enterprise Bankruptcy Law and Practice in China: 2007 to a record breaking 2017' (paper written by Wang Xin Xin, Xu Yang Guang and Alan CW Tang.

Number of PRC Bankruptcy Cases (2)



Source: Beijing Siyuan Consultants

Note:

The 2007 figure includes cases under the 1986 Bankruptcy Law; from 2008, all cases are taken from the EBL.

Data for 1989-2011 from Bankruptcy Law and Restructuring Research Centre, China University of Politics and Law, Beijing, China.

3. Assessment cont (3)

- Low number of cases until increase in filings in 2015:
  - Must be kept in mind – for each case that is accepted it is estimated that there are at least another 100-250 enterprises that are closed down through the use of out-of-court administrative procedures or that simply disappear (through deregistration and license cancellation)

3. Assessment cont (4)

- Why so few cases?
  - Judges were reluctant to accept cases; they even ignored them
  - Feared need for approval?/Judicial incentives?/Feared to act in face of inability to protect workers?
  - Pressure on court not to accept a case until a solution to employees' claims had been found – better for judge to do nothing
  - Need for government support
  - Lack of predictability – disincentive for debtor and creditors to file

4. Government Responses to Address Weaknesses

- Address delay in drafting implementing rules and regulations
  - Original plan was to issue a single, comprehensive judicial interpretation – this never happened
  - Instead, SPC began issuing informal internal opinions
  - New regulations finally issued in 2011 to address procedural issues relating to judicial reluctance to accept cases – eg, clarify EBL art 2, right to appeal for applicants who never heard back from courts

4. Government Responses – Significant Changes (2)

- Creation of new bankruptcy courts
  - More than 100 courts in China have established specialized liquidation and bankruptcy trial cts, including four high courts, 47 intermediate courts and 22 lower courts.
- Creation of new information website with three platforms
  - Centralized informational platform
  - Judge's Working Platform
  - Bky Administrator's Working Platform
- Cross-border cooperation mechanism with Hong Kong agreed in May 2021
- On-going training for judges

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5. Cross-Border Insolvency Issues

- With increased foreign trade and investment, it is the exception in Asia for an insolvency in one country not to have cross-border implications
- Contributing to this situation is the increasingly common corporate structure with a holding company parent in the Cayman Islands or the BVI, subsidiaries in Hong Kong and Singapore (often for banking facilities), and ultimately assets on the ground in other entities in other countries

5. Cross-Border Insolvency Issues (2)

- Implications of Belt & Road initiative
  - Inability of debtor countries to pay for infrastructure projects

6. COVID-19 & Recent Developments

- Property market collapse
  - Evergrande, Modern Land
- COVID-19
  - Fiscal stimulus/fin. support to continue production
  - Stabilize employment
  - May 2020 Supreme Court COVID Guiding principles
    - Court shall guide pre-insolvency measures
    - Extend moratoria
    - Increase on-line activities (e-filings/hearings).

VI. Old Japanese Law

- 1890 Commercial Code (French law)
- 1922 Bankruptcy Law (German law)
  - Liquidation
  - Control by courts
- 1922 Composition Law (Austrian Law)
  - Provided for temporary relief until creditors voted on a composition plan
  - Covered corporate and individual debtors' unsecured – but not secured – debt

Old Japanese Law (2)

- 1938 Corporate Arrangement Proceeding in Commercial Code (English scheme of arrangement)
- 1952 Corporate Reorganization Law (former Chapter X of USBC of 1898, rev 1938)
  - Better suited for larger, public companies
  - Trustee controlled
  - Secured and unsecured debt
- Very low rate of filings – 2254 per year

VII. New Japanese Law

- Insolvency Law Reforms
- Out-of-Court Restructuring
  - Operated by private sector organization = under Revised Industrialization law
  - With government involvement, ETIC
  - Other rescue measures for extraordinary crisis

New Japanese Law (2)

- 1999 Civil Rehabilitation Law
- 2000 Law on Recognition and Assistance of Foreign Insolvency Proceedings (UNCITRAL Model Law)
- 2002 New Corporate Reorganization Law
- 2004 New Bankruptcy Law
- 2005 Special Liquidation Proceeding in New Company Code

New Japanese Law (3)

- Civil Rehabilitation Law
  - New name
  - Focus on corporate restructuring
  - Protect debtor's assets
  - Streamlines procedures
  - Still covered corporate and individual debtors' unsecured – but not secured – debt
  - Nominal review of filing
  - On application, court can stay secured creditors – try to get creditor to negotiate

New Japanese Law (4)

- Civil Rehabilitation cont
  - Key is not substance but change in practice of judges and lawyers
  - Addresses problems with undersecured creditors
  - Cases jumped to over 25,000 (corp and ind) 9x more than under the old law
  - Faster procedures; successful sale of profitable businesses

New Japanese Law (5)

- Corporate Reorganization Law
  - Same as above
  - Improve cost-effectiveness; speed up process
  - Increase flexibility
  - Use pre-packs where necessary
  - Reorganizing debtor is able to sell all parts of its business and assets at early stage of proceedings before a plan is drafted
    - Not as flexible as USBC 363

New Japanese Law (6)

- Corporate Reorganization cont
  - Trustee controlled
  - Secured and unsecured debt
  - Consolidation of parent-subsidiary cases
- Revised Bankruptcy Act
  - Control of debtor cases by the bar
  - Consolidation of parent-subsidiary cases

New Japanese Law (7)

- Increase in the number of cases
  - Peak of 10,000 cases in 2002
- High quality judges
- Judges proved flexible in interpreting new leg
- Simplification
- Match company size with law
  - SMEs – Civil Rehabilitation Law
  - Large companies – Company Reorg. Law

VIII. Out-of-court Restructuring

- 2001 Guidelines for Multi-Financial Creditors Workout (INSOL Principles and London Approach)
- 2003-7 Industrial Revitalization Corporation of Japan (IRCJ)
- 2003 SME Turnaround Associations
  - In all 43 prefectures
  - Assisted with reorganization of many SMEs

Out-of-court Restructuring (2)

- 2009 Business Reorganization ADR (BRADR)
  - Licensed by Japanese gov't
  - Operated with private sector experts
- 2010 Enterprise Turnaround Initiative Corporation (ETIC)
  - Similar to IRCJ
  - Focus is on SMEs

IRCJ

- Helped give rise to turnaround and management experts – to change culture
- Revitalize companies
- Revitalize banking sector by eliminating some of the banks' debt overhang by reorganizing of some of the banks' corporate debtors.
- Assisted 41 business corp. groups between May 2003 and March 2007

ETIC

- Launched in Oct 2009
- Similar to IRCJ: State-backed turnaround body
- Help leading companies and SMEs revitalize local economies
  - But massive JAL filing – “big whale”
- Ability to infuse large amounts of money as debt or equity
- Sunset company (5-year life)

COVID-19 & Recent Developments

- During the pandemic, several medium- and large-sized businesses withdrew from unprofitable businesses and refocused their efforts on core business areas.
  - Used out-of-court workouts.
- Covid-19 initiatives
  - Providing emergency financing and subsidies to business entities, with a focus on SMEs;
  - enabling the Development Bank of Japan to address the needs of larger entities;
  - using SME enterprise revitalisation support councils to help turnaround SMEs; and
  - the Tokyo District Court launching a special conciliation programme.

IX. Japanese Strategies

- Speed is the key
  - If liquidating: minimize losses
  - If restructuring: preserve/increase going concern value
- Need to apply market strategies
- Results oriented: both in-court and

  out-of-court

X. Conclusions

- Overall – in extraordinary times, need more than just legal solutions
  - China: Admin. solutions are the strength - but several recent efforts to strengthen the legal infrastructure are taking hold.
  - Japan: Effective laws in tandem with admin. Solutions and involvement of private sector
- Key admin. solutions – quite effective
  - China: Creation of AMCs/SOE regs
  - Japan: IRCJ & ETIC
- Creation of rescue culture – ongoing in both China and Japan

Conclusions (2)

- Legal reforms
  - Slow to take hold in China – but recent changes have jumpstarted the process
    - In 2017, for the first time the number of cases under the new law exceeded the levels under the old law – development of new courts
    - Creditors' skepticism – beginning to give way
    - Evolution of insolvency judges and practitioners – training underway
  - Successful in Japan from the get-go
    - Dramatically increased use
    - Judges and practitioners are strong
    - But still need push by government
    - Focus on training private sector

GRR

ASIA-PACIFIC
RESTRUCTURING REVIEW
2022

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Contents

Preface

Welcome to *The Asia-Pacific Restructuring Review 2022*, one of Global Restructuring Review's special, yearbook-style reports. GRR, for the uninitiated, is the online home for professionals who specialise in high-stakes, international restructuring and insolvency, telling them all they need to know about everything that matters.

Throughout the year, GRR delivers pitch-perfect daily news, surveys and features; organises the liveliest events ('GRR Live') – covid-19 allowing; and provides our readers with innovative tools and know-how products.

In addition, assisted by external contributors, we curate a series of regional reviews – online and in print – that go deeper into local developments than the exigencies of journalism allow. *The Asia-Pacific Restructuring Review*, which you are reading, is part of that series.

This edition contains insight and thought leadership from 19 pre-eminent figures in the region.

Across seven chapters and 110 pages, they provide an invaluable retrospective on the year just gone. All contributors are vetted for their standing and knowledge before being invited to take part. Together, they capture and interpret the most substantial developments, complete with footnotes, relevant charts and statistics.

This edition covers China, Hong Kong, India, Japan, Malaysia, Singapore and South Korea.

As always with these annual reviews, a close read yields many gems. With covid, that is doubly true; this book has never been so helpful. Among the nuggets mentally filed away by this reader:

- China's highest court has clarified that arbitration clauses remain valid post-bankruptcy;
- it has been a year of innovation in Hong Kong's courts (see page 17 onwards for an analysis of the biggest rulings);

- India's new insolvency regime is viewed as a pretty huge success, despite a few teething problems;
- Japan's government cannot impose lockdowns on the public – even during a state of emergency;
- proposed reforms in Malaysia 'do not go far enough' to quote our authors; and
- South Korea has three established ways of restructuring businesses and the key differences between them are adumbrated in two helpful charts.

Plus much, much more. We hope you enjoy the review. If you have any suggestions for future editions, or want to take part in this annual project, my colleagues and I would love to hear from you. Please write to insight@globalrestructuringreview.com. My thanks to all of our authors and to GRR editorial board member Look Chan Ho, review editor, for steering us so well.

David Samuels
Publisher
August 2021

Editor's Introduction

Look Chan Ho
Des Voeux Chambers

Insolvency law, by nature, flourishes in difficult times. Just like last year, 2021 continues to be one of the most difficult in modern history; nevertheless, restructuring and insolvency activity in 2021 continues to flourish all over the world, together with rapid insolvency law reform.

The Asia-Pacific region has seen a fair share of recent financial distress and solutions to distress, as this edition of the *Asia-Pacific Restructuring Review* demonstrates. Each of the jurisdictions covered in the *Review* has its own domestic economic challenges, its own prescribed solutions and probably too many insolvency developments to write about.

The experts in each jurisdiction have, therefore, helpfully culled the most recent and pertinent developments and practices to share with readers. Many of the cross-border developments are modelled on practices in other parts of the world and may sometimes serve as a model for international practices within the region. A case in point is the interaction between mainland China and Hong Kong. Mainland Chinese insolvency proceedings are now recognised in Hong Kong, and the mainland authorities have commenced a historic pilot project to recognise and assist Hong Kong insolvency proceedings. Future cross-border insolvency reform depends on the success of this pilot project.

As restructuring and insolvency practices are ever-changing, it is helpful to take stock once in a while. In that regard, the *Review* may serve as an informative snapshot summary of the most recent trends.

LOOK CHAN HO

Des Voeux Chambers

Look is the only barrister in Hong Kong listed in *Who's Who Legal: Restructuring & Insolvency*. He specialises in corporate insolvency and restructuring, with a particular emphasis on cross-border matters. He is internationally well-known for his high level of legal expertise and frequently advises on transactions involving novel and complex legal issues. He often works on prominent and precedent-setting cases.

Before joining the Bar, he practised for more than 15 years as a solicitor in London and Hong Kong at Freshfields Bruckhaus Deringer and was the Asia head of restructuring and insolvency. His experience includes advising on the first and second cases of Hong Kong recognition of mainland Chinese insolvency proceedings and the first reported case of a Hong Kong scheme of arrangement compromising debts governed by mainland Chinese law.

Look has published extensively on insolvency matters, and his publications are widely cited internationally, including with approval by the Hong Kong High Court, the UK Supreme Court and the US Bankruptcy Court, among other courts.

Des Voeux Chambers (DVC) is a leading set of chambers based in Hong Kong. Building on its history and Tier 1 reputation, its members have cultivated a reputation for combining intellectual rigour with effective advocacy. DVC is home to over 80 astute legal minds, many of whom have spearheaded ground-breaking cases.

DVC houses leading specialists in administrative and public law, arbitration and mediation, construction law, chancery and commercial law, company and insolvency law, competition law, criminal law, employment and anti-discrimination law, family law, intellectual property, international trade, land and planning, securities law and tax law. This broad range of expertise makes DVC a convenient one-stop shop for all areas of civil and commercial dispute resolution and advisory work.

DVC has a strong track record of distinguished judicial and public appointments. Some of our members have been appointed as Justices of the High Court, including the present Companies Judge. Our senior members sit as Recorders and Deputy High Court Judges of the Court of First Instance.

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Major Developments in China's Surging Restructuring Market

Nuo Ji, Lingqi Wang, Jessica Li and Sylvia Zhang
Fangda Partners

IN SUMMARY

This article outlines China's latest developments in bankruptcy and restructuring. The Supreme People's Court has released several influential judicial documents. There have also been notable developments on cross-border bankruptcy, active reform in the personal bankruptcy regime and the introduction of rules targeted at safeguarding bondholders' rights and remedies in bankruptcy proceedings.

DISCUSSION POINTS

- Key judicial documents released recently in relation to bankruptcy
- Recent developments on cross-border bankruptcy in China
- Recent pilot projects on personal bankruptcy regime in China
- Recent rules and development on rights and remedies of bondholders

REFERENCED IN THIS ARTICLE

- Notice of the Supreme People's Court on Issuing the Minutes of the National Court Work Conference on Bankruptcy Trials
- Interpretation on Several Issues Concerning the Application of the PRC Enterprise Bankruptcy Law (III)
- Minutes of the National Working Conference on the Trial of Civil and Commercial Cases by Courts
- Minutes of Symposium on the Trial of Bond Dispute Cases by Courts Nationwide
- Minutes on Mutual Recognition of and Assistance to Bankruptcy Proceedings between the Courts of the Mainland and the HKSAR
- Opinion on Taking Forward a Pilot Measure in relation to the Recognition of and Assistance to Bankruptcy Proceedings in the HKSAR
- In re Reward Science and Technology Industry Group Co Ltd
- In the matter of CEFC Shanghai International Group Limited (in Liquidation in the Mainland of the People's Republic of China) and in the matter of the inherent jurisdiction of the Court

Getting started

Since its first promulgation in 2006, the Enterprise Bankruptcy Law of People's Republic of China (the "Bankruptcy Law") has been playing an increasingly important role in the business environment in China. To facilitate the implementation of the Bankruptcy Law and to guide courts of all levels to deal with bankruptcy cases in a more efficient way, the Supreme People's Court of China (the "SPC") issued three judicial interpretations and one meeting minutes; besides, another SPC meeting minutes on civil and commercial cases contains one chapter regarding bankruptcy. Companies in financial distress, creditors, and potential investors now have a clearer understanding of the bankruptcy procedures.

Key judicial documents released recently in relation to bankruptcy

Overview

The most important updates in the legal practices of bankruptcy law in recent years are reflected in:

- the Notice of the Supreme People's Court on Issuing the Minutes of the National Court Work Conference on Bankruptcy Trials (the 2018 SPC Meeting Minutes), published on 4 March 2018;
- the Interpretation on Several Issues Concerning the Application of the People's Republic of China Enterprise Bankruptcy Law (III) (the Interpretation III), published on 27 March 2019;
- the bankruptcy chapter in the Minutes of the National Working Conference on the Trial of Civil and Commercial Cases by Courts (the 2019 SPC Meeting Minutes), published on 8 November 2019;
- the Minutes on Mutual Recognition of and Assistance to Bankruptcy Proceedings between the Courts of the Mainland and of the Hong Kong Special Administrative Region (the Minutes); and
- The Supreme People's Court's Opinion on Taking Forward a Pilot Measure in relation to the Recognition of and Assistance to Insolvency Proceedings in the Hong Kong Special Administrative Region (the Opinion).

In general, these judicial documents released by the SPC were issued to facilitate the supply-side structural reforms to get rid of 'zombie companies', to optimise the business environment, to promote high-quality development and to disperse market risks. These judicial documents have provided guidelines on various disputed issues regarding bankruptcy.

This article will address five major aspects: substantive consolidation; selection of bankruptcy administrators; automatic stay and restrictions on creditors; reorganisation; and cross-border issues between mainland China and Hong Kong.

Substantive consolidation

Substantive consolidation among affiliated debtor entities is a double-edged sword: on the one hand, it is helpful to prevent the debtor's fraudulent conduct and asset manipulation that jeopardise the creditors' interest; on the other hand, the abuse or overuse of substantive consolidation may unfairly reduce the recovery rate of some creditors.

In light of a number of controversial consolidation cases encountered by local courts, the 2018 SPC Meeting Minutes stress that substantive consolidation should only be used in exceptional circumstances and lay down strict criteria and remedial procedures.

Criteria for consolidation

As an exception to the general rule of respecting the company's independent legal personality, substantive consolidation can only be invoked when the legal personality of each affiliate is highly mingled; the differentiation of each affiliate's assets is excessively costly; and the separation of bankruptcy proceedings will result in unfair treatment of the creditors.

Special procedures for consolidation

- Hearings: upon the court's receiving of a petition for consolidation, it notifies the interested parties and convenes a hearing among them. It also makes the consolidation decision, taking into consideration various factors, including the extent and duration the affiliates' assets have been mingled, inter-party debts and claims among the affiliates, the impact of consolidation on the overall interests of creditors and the impact of consolidation on the likelihood of successful reorganisation.
- Remedies: should any interested party oppose the consolidation decision, it may petition a higher level court for a review of the consolidation decision.

Legal consequences

The assets of the consolidated affiliates are deemed as a single estate, the debts and claims between the consolidated affiliates are extinguished, and creditors of the consolidated affiliates will participate and receive payments through one bankruptcy proceeding.

In case of reorganisation, only one reorganisation plan will be made to cover all consolidated affiliates, and one affiliate remains after the reorganisation.

Selection of bankruptcy administrators

A bankruptcy administrator is the main facilitator and executor in bankruptcy cases; thus, their capabilities are crucial in the effective handling of bankruptcy cases. The SPC issued the Provisions on Designating the Administrator during the Trial of Enterprise Bankruptcy Cases (the Administrator Designation Provisions) in 2007, soon after the Bankruptcy Law came into effect, to set out rules on how bankruptcy administrators should be selected and appointed in bankruptcy cases.

According to the Administrator Designation Provisions, higher courts at the provincial level should prepare their roster of qualified bankruptcy administrators, and only institutions, including law firms, accounting firms and liquidation firms, that have offices or branches in that particular province are eligible for the roster. For normal bankruptcy cases, the bankruptcy administrator will be selected from the roster by lottery, and for more complex cases, the courts may sometimes select the bankruptcy administrator through a bidding process.

With the increasingly frequent emergence of large-scale and complex bankruptcy cases in recent years, the SPC felt that the Administrator Designation Provisions no longer met the practical needs in selecting competent and appropriate bankruptcy administrators. Consequently, it proposed three improvements in the 2018 SPC Meeting Minutes to:

- encourage a competition mechanism to select bankruptcy administrators, especially in high-profile cases, such as the bankruptcy of a listed company, to guarantee the competency of the selected administrator;
- expand the roster pool of certified bankruptcy administrators by introducing professionals in bankruptcy and enterprise management experts and reaching out to external bankruptcy administrators from other provinces when needed; and
- facilitate the establishment of bankruptcy administrators associations and the setting up administrators' compensation funds.

Automatic stay and restrictions on creditors

Removal of asset preservation measures

The Bankruptcy Law imposes an automatic stay on any legal proceedings against the debtor upon the acceptance of bankruptcy by the court. In particular, after the court accepts the bankruptcy application, any asset preservation measures (eg, attachment, seizure and freezing) against the debtor's assets must be removed.

In practice, there were controversies regarding, among other things, whether the asset preservation measures referred only to those in civil legal proceedings and whether the asset preservation measures were automatically ineffective or needed to be separately removed by the relevant authority.

The 2018 SPC Meeting Minutes clarify that, after receiving the court order on acceptance of the bankruptcy application, the enforcement court should remove the asset preservation measures against the debtor's assets or issue letters handing over the disposal right of the assets preserved to the court accepting the bankruptcy application. If the enforcement court refuses to remove the asset preservation measures, the court accepting the bankruptcy application can apply to the upper-level court of the enforcement court for correction.

The 2019 SPC Meeting Minutes reiterate the above contents and further clarifies that authorities other than the courts – such as the tax authorities, public security bureaus and customs – should also refer to the above procedures and remove the asset preservation measures accordingly.

Enforcement of security

In accordance with the Bankruptcy Law, enforcement of any security against the debtor's assets is suspended during the reorganisation period, provided that the secured creditor may apply to the court to resume enforcement, if the collateral is likely to suffer damage or substantial depreciation in value, which will impair the interest of the secured creditors. There were disputes on under what circumstances the secured creditors may apply for resuming the enforcement.

The 2019 Meeting Minutes clarify that the administrator or the debtor in possession should confirm in a timely manner whether the collateral is necessary for reorganisation, and if the collateral is not necessary for reorganisation, the administrator or the debtor in possession should, in a timely manner, dispose of the collateral and use the proceeds to repay the secured creditors.

The 2019 Meeting Minutes further provide that where the secured creditor applies to the court for resuming enforcement, if the condition mentioned in the first paragraph is not satisfied, or if it is satisfied but the administrator or the debtor in possession has evidence showing that the collateral is necessary for the reorganisation and provides security of compensation corresponding to the damage or depreciation, the court should disapprove the creditor's application.

Acknowledgement of arbitration

The Bankruptcy Law provides that after a court accepts an application for a debtor's bankruptcy, any civil lawsuit regarding the debtor can only be brought before the court accepting the bankruptcy application. It is widely considered that this provision requires the court to exercise jurisdiction over litigation only, but does not challenge the validity of an arbitration clause between a creditor and the debtor.

Interpretation III confirms that if an arbitration clause is entered into before a bankruptcy application is accepted, the party should apply to the selected arbitration institution to confirm the claims and debts. It is generally considered that this provision further confirms the validity of an arbitration clause in bankruptcy cases.

Reorganisation

Pre-packaged reorganisation

The Bankruptcy Law does not contain the concept of pre-packaged reorganisation, which allows the debtor and its major creditors, investors and other key stakeholders to formulate and agree on a reorganisation plan, and then have the court approve the agreed plan expeditiously.

In practice, there have been pilot experiments of pre-packaged reorganisation in some provinces. For instance, debtors in Zhejiang province can pre-register with local courts before commencing formal bankruptcy proceedings; thus, relevant parties are able to start negotiations at a relatively early stage to prevent a further deterioration of the debtors' financial condition.

The SPC also recognises the value and importance of pre-packaged reorganisation. The 2018 SPC Meeting Minutes encourage the courts to explore different approaches to pre-packaged reorganisation and confirm that the reorganisation plans can be prepared by out-of-court agreements reached by the debtors, creditors and other stakeholders.

The 2019 SPC Meeting Minutes further emphasise the transition from pre-packaged reorganisation to reorganisation proceedings: if the out-of-court agreement reached by the debtor and some of the creditors before the court accepts that the reorganisation application is consistent with the reorganisation plan formulated in the reorganisation proceedings, the consent of the creditors on the out-of-court agreements should be deemed as their consent on voting for the reorganisation plan. However, if the reorganisation plan revises the out-of-court agreement and has adverse impacts on the relevant creditors, or is related to the relevant creditors' major interests, the affected creditors may have another vote on the reorganisation plan.

Debtor in possession

In accordance with the Bankruptcy Law, a debtor can, under the administrator's supervision, manage its assets and business itself in reorganisation upon the court's approval of its application. It is not clear under what circumstances the court will approve the debtor's application for such debtor in possession (DIP).

The 2019 SPC Meeting Minutes have shed some light on this issue. The Minutes clarify that the court may approve the debtor's DIP application if the following conditions are met:

- the debtor's internal governance mechanism still works normally;
- the debtor's DIP is favourable for its continuance of operation;
- the debtor has not hidden or transferred its assets; and
- the debtor has not acted seriously against the interests of the creditors.

Different from the DIP system in the United States, a DIP in China can exercise the administrator's powers only in respect of asset management and business operation, rather than all the administrator's powers. The other powers to investigate assets, to review the creditors' claims, to claw back certain transactions, to represent the debtor in litigation, etc, should still be exercised by the administrator.

The 2019 SPC Meeting Minutes further confirm that the administrator should supervise the DIP process. If the DIP is found to act seriously against the creditors' interests or to have other aspects that are not suitable for DIP, the administrator can apply to the court for termination of DIP. If the administrator fails to apply to the court, the interested parties, such as the creditors, may also apply to the court.

Further guidance on cramdown

The 2018 SPC Meeting Minutes require the courts to exercise extra caution when cramming down a reorganisation plan that is not approved by any voting class. Specifically, the SPC imposes two additional conditions for the use of cramdown:

- if there are multiple classes of creditors, at least one class has approved the reorganisation plan; and
- the dissenting votes in each class are entitled to no less than what they could have received had the debtor been liquidated.

Amendment of reorganisation plans

The 2018 SPC Meeting Minutes allow the debtor or the administrator to amend the approved reorganisation plan once, given that the original plan becomes infeasible owing to changes to national policies, laws and regulations. Debtors or the bankruptcy administrators may petition to amend the reorganisation plan, and the amendment must go through the voting procedure again. If the proposed amendment is not approved, the court will convert the reorganisation proceedings into liquidation proceedings.

Recent developments on cross-border bankruptcy in China

Article 5 as the basis for recognition and enforcement

Article 5 of the Bankruptcy Law provides the basis and criteria for recognising foreign bankruptcy proceedings. First, recognition must be based on treaty or reciprocity. Second, recognition cannot be contrary to the basic principles of Chinese law; jeopardise China's sovereignty, security or public interest; or impair the legitimate rights and interests of domestic creditors.

To our knowledge, despite it being effective for over a decade, article 5 has never been invoked. This is mainly because there are few, if any, treaties or conventions to which China is a signatory that provide for a basis for recognition of foreign bankruptcy proceedings, and the Chinese courts have long adopted a narrow theory of factual reciprocity, which means reciprocity cannot be established unless Chinese bankruptcy proceedings have first been recognised in the relevant foreign jurisdiction.

Recent development on reciprocity

In the past six years, there has been a slight but discernible change in the courts' attitude regarding reciprocity. In Several Opinions of the Supreme People's Court on Providing Judicial Services and Safeguards for the Construction of the 'Belt and Road' by the People's Courts (the 2015 SPC Opinion), the SPC opens the door for lower courts to adopt a more flexible theory of reciprocity, allowing Chinese courts to take the first step in recognising judgments of other jurisdictions after considering factors such as past communications with the other jurisdiction on the intention to build international judicial cooperation and its commitment of providing judicial reciprocal treatment.

Despite the more liberal reciprocity theory, questions remain on whether the 2015 SPC Opinion extends to foreign bankruptcy proceedings or merely applies to civil and commercial judgments outside the bankruptcy scenario, as well as whether the Opinion should be limited to cases or jurisdictions in relation to the Belt and Road Initiative or reflects a broader change of position.

Aside from the development of the reciprocity theory, in 2015 the US Bankruptcy Court for the District of New Jersey recognised a Chinese bankruptcy proceeding in relation to Zhejiang Topoint Photovoltaic Co Ltd, where an order was issued approving the debtor's petitions of the bankruptcy proceeding commenced in China to be recognised as a 'foreign main proceeding' under Chapter 15 of Title 11 of the US Code and of relevant judicial assistance to be taken in the United States, including the automatic stays, etc.[1]

Four years later in 2019, the US Bankruptcy Court for the Southern District of New York recognised Chinese reorganisation proceeding in relation to Reward Science and Technology Industry Group. The judge, upon considering the creditors' objections, issued an order to recognise the Chinese proceeding as a foreign main proceeding; give the Chinese administrator full authority to administer the debtor's assets and affairs in the United States; and stay on any action concerning the debtor's assets in the United States, including two sets of litigation launched by the dissented creditors, etc.[2]

More recently, the High Court of Hong Kong successively recognised the appointment of bankruptcy administrators of two Chinese companies, CEFC Shanghai International Group Limited and Shenzhen Everich Supply Chain Co Ltd, in January and May 2020.[3] In the *CEFC* case, Mr Justice Harris commented that '[t]he extent to which greater assistance should be provided to mainland administrators in future will have to be decided on a case-by-case basis and the development of recognition is likely to be influenced by the extent to which the court is satisfied that the mainland, like Hong Kong, promotes a unitary approach to transnational insolvencies.'

The above precedents appear sufficient to fulfil even the strictest factual reciprocity requirement. Chinese courts are more likely to recognise the bankruptcy proceedings of jurisdictions that have already recognised Chinese bankruptcy proceedings. In addition, given that Mr Justice Harris hinted at the potential implications of Chinese courts' attitudes towards cross-border bankruptcy, it would be interesting to see how the Chinese courts will respond to the *CEFC* case.

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1 *In re Zhejiang Topoint Photovoltaic Co Ltd*, No. 14-24549 (Bankr DNJ).

2 *In re Reward Science and Technology Industry Group Co Ltd*, No. 19-12908 (Bankr SDNY).

3 *In the matter of CEFC Shanghai International Group Limited (in Liquidation in the Mainland of the People's Republic of China) and in the matter of the inherent jurisdiction of the Court*, [2020] HKCFI 167. *In the matter of Shenzhen Everich Supply Chain Co Ltd (in Liquidation in the Mainland of the People's Republic of China) and in the matter of the inherent jurisdiction of the Court*, [2020] HKCFI 965.

Improvements in the 2018 SPC Meeting Minutes and the future outlook

The 2018 SPC Meeting Minutes have two general provisions on cross-border bankruptcy. They stress the importance of balancing different interests in cross-border cases and encourage lower courts to explore 'new methods' of applying reciprocity (which may be read to echo the 2015 SPC Opinion). They further state that, if recognition is granted pursuant to article 5, the foreign debtor's assets in China should first be used to pay off domestic priority creditors (ie, secured creditors and employment-related and tax creditors), and the remaining assets can be distributed according to the rules of the foreign court.

Recognising the urgent need for detailed rules on handling cross-border bankruptcy, the SPC is said to be working on further guidelines in respect of recognition of foreign bankruptcy proceedings.

Developments in 2021 on cross-border insolvency between mainland China and Hong Kong

Owing to the lack of relevant arrangements, cross-border insolvency cooperation between mainland China and Hong Kong has long been a puzzle to practitioners. Starting from the 1990s, mainland courts, especially courts in Guangdong, have adopted various approaches in dealing with Hong Kong proceedings involving mainland elements; however, since there was no clear guidance, the approaches were not consistent, and most courts tended to be conservative when handling cross-border issues.

On 14 May 14 2021, the SPC published the Minutes and the Opinion. According to the Minutes, intermediate courts of mainland China and the High Court of Hong Kong are able to mutually recognise and assist in insolvency proceedings. The Opinion subsequently sets out 24 articles regarding several basic questions in cross-border cooperation. As a starting point, the Opinion will first take pilots in Shanghai, Xiamen and Shenzhen.

Types of proceedings

According to the Opinion, only collective insolvency proceedings opened in Hong Kong have the possibility to be recognised, specifically a compulsory winding up, a creditors' voluntary winding up and schemes of arrangement for the purpose of restructuring debt, initiated by a liquidator or provisional liquidator and sanctioned by Hong Kong court. Other proceedings, for example, receivership, are excluded as they are not considered collective proceedings.

Main and non-main proceedings and jurisdiction

The Opinion does not introduce the concept of main proceedings and non-main proceedings proposed by the UNCITRAL Model Law. Under the current arrangement, recognition only applies to proceedings taking place in Hong Kong where the debtor has its centre of main interests (COMI).

A debtor's COMI is presumed to be in Hong Kong if it is registered therein. At the same time, the courts will consider the following open-ended elements: the main place of representation or business and the place where the main assets are located. In addition, the COMI is determined at least six months prior to the commencement of the recognition application.

Rights of the Hong Kong administrator

After recognition, a Hong Kong administrator (ie, liquidator or provisional liquidator) may exercise rights, including taking possession of property, seals, account books, documents and other data of the debtor; investigating the financial position of the debtor; managing and disposing of the debtor's property; participating in legal actions on behalf of the debtor; and accepting and examining declarations of claims by creditors in mainland China. Material disposal of the debtor's assets (eg, waiving property rights, attaching security to the debtor's assets, lending loans to others and transferring assets out of mainland China) requires additional approval by the mainland Chinese courts.

Relief

On application, preservation measures are available in accordance with mainland Chinese law from the time of receipt of an application for recognition and assistance until the application is determined.

After recognition of Hong Kong proceedings, three types of relief are automatically granted: all payments of debts made by the debtor are invalid; there is a moratorium on civil claims (litigation and arbitration); and all preservation measures are lifted.

Distribution

The Opinion adopts the concept of modified universalism, giving priority to fair distribution but also taking into consideration the interests of domestic creditors. Only after distribution to priority claims in accordance with mainland Chinse bankruptcy law (ie, employees' salary, tax and secured claims) can the remaining assets of the debtor be further distributed to creditors on a pari-passu basis pursuant to the Hong Kong proceedings.

The Opinion is a milestone for the long-waited cooperation between mainland China and Hong Kong; however, as a non-statutory arrangement document, it only draws an outline for deeper cooperation and awaits the provision of a detailed mechanism. For example, the Opinion allows a Hong Kong administrator or creditors to apply to have a mainland Chinese administrator appointed by a mainland Chinese court, but it is silent on ancillary proceedings. The Opinion also mentions parallel proceedings between the two places without identifying the main or non-main proceedings.

In general, although many issues remain unresolved compared with the UNCITRAL Model Law, the Minutes and the Opinion demonstrate China's active response to the rapid development of global economic activities and its efforts to further deepen international cooperation.

Recent pilot projects on personal bankruptcy regime in China

In China, bankruptcy proceedings apply to legal persons only, and there is no personal bankruptcy system under the Bankruptcy Law; however, China is exploring personal bankruptcy in certain places and intends to promote personal bankruptcy legislation.

In 2019, courts in Wenzhou and Taizhou, Zhejiang province, successively published rules on trials in respect of the personal debt clean-up procedure, which is similar to the bankruptcy procedure.

In late 2019, a court in Wenzhou concluded the first case of the personal debt clean-up procedure. According to the bulletin published by the Intermediate People's Court of Wenzhou, the creditors agreed on the repayment plan proposed by the debtor (repayment of 1.5 per cent of the total claims within 18 months). The debtor promised that, within six years of the time that he will have completed performance of the repayment plan, if his family's annual income exceeds 120,000 yuan, he will use 50 per cent of the surplus to repay the unpaid claims of the creditors. The court then issued an order on the debtor, restricting certain behaviours, such as high consumption. Those restrictions would be removed upon his application, provided that the repayment plan has been completely performed and that certain conditions on the repayment rate and the performance period are satisfied.

On 1 March 2021, the Personal Bankruptcy Regulation of the Shenzhen Special Economic Zone came into effect. The practice of this regulation may help promote the national legislation regarding personal bankruptcy.

Recent rules and the development on rights and remedies of bondholders

In July 2020, the SPC issued the first guidelines on trials of bond disputes, the Minutes of Symposium on the Trial of Bond Dispute Cases by Courts Nationwide (the Bond Minutes). The Bond Minutes cover contractual, tortious and bankruptcy issues related to bonds.

Bankruptcy petition against the issuer

The persons that can file bankruptcy petitions against the bond issuer as the debtor used to be unclear and disputed. In accordance with the Bond Minutes, the following parties may file a bankruptcy petition against the bond issuer:

- the bond trustee can file a bankruptcy petition in its own name, representing the bondholders based on the documents regarding bond raising, the agreement on bond trusteeship or the authorisation by resolution of bondholders' meeting;
- the other bondholders can file a bankruptcy petition individually or in concert, where the bondholders' meeting resolves to authorise the bond trustee or a representative to claim rights; and
- the bondholders can file a bankruptcy petition individually or in concert based on this resolution, where the bondholders' meeting resolves that the bondholders may claim rights themselves since the bond trustee is negligent in claiming rights.

Responsibilities and liabilities of the bankruptcy administrator

Apart from those provided in the Bankruptcy Law, the Bond Minutes specify some of the particular responsibilities and liabilities of a bankruptcy administrator of a bond issuer.

- After a bond issuer enters into bankruptcy proceedings, the bankruptcy administrator is responsible for information disclosure in respect of the relevant bonds issued, unless the bond issuer is approved to act as a DIP. In this regard, the administrator ensures the authenticity, accuracy and completeness of the disclosed information. The bankruptcy administrator is liable for any misrepresentation, misleading statement or major omission in the information disclosed by it after taking over the bond issuer, which may affect the investors' judgement on the issuer's solvency.
- The bankruptcy administrator must confirm in a timely manner the claims registered by the trustee on behalf of the bondholders according to the position registration documents issued by the bond registration authority. If the bankruptcy administrator fails to confirm the claims without justifiable reason, it is liable for

compensation of reasonable expenditure of the trustee, such as the litigation costs, attorneys' fees and business trip expenses, as well as the interest losses arising from the delay.

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Latest Developments in Hong Kong Restructuring Law

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IN SUMMARY

This article introduces the potential features of the new corporate rescue bill, the courts' rulings on interactions between winding-up petitions and arbitration agreements, the general principles in recognising and assisting foreign insolvency proceedings in Hong Kong and the new arrangement of mutual recognition of and assistance to bankruptcy proceedings between Hong Kong and mainland China.

DISCUSSION POINTS

- Development of the corporate rescue legal framework in Hong Kong
- Interactions between winding-up petitions and arbitration agreements
- Recognition of foreign insolvency proceedings
- Recognition of foreign provisional liquidators appointed on a soft-touch basis
- Recent developments on sanctioning schemes of arrangement
- Hong Kong-mainland China mutual recognition of and assistance to bankruptcy proceedings

REFERENCED IN THIS ARTICLE

- *Dayang (HK) Marine Shipping Co, Ltd v Asia Master Logistics Ltd*
- *Re CEFC Shanghai International Group Ltd*
- *Re the Joint and Several Provisional Liquidators of China Oil Gangran Energy Group Holdings Limited*
- *Re Lamtex Holdings Ltd*
- *Re Ping An Securities Group (Holdings) Ltd*
- *Re China Singyes Solar Technologies Holdings Ltd*
- *Re Ando Credit Ltd*
- Record of Meeting of the Supreme People's Court and the Government of the Hong Kong Special Administrative Region on Mutual Recognition of and Assistance to Bankruptcy (Insolvency) Proceedings between the Courts of the Mainland and of the Hong Kong Special Administrative Region

Introduction

As a special administrative region of the People's Republic of China under the 'one country, two systems' principle, Hong Kong retains a common law legal system that is different from the system of law in mainland China.

As one of the world's leading international financial centres, Hong Kong is a prime location for financial services and is home to many financial institutions. With minimal government intervention, Hong Kong's financial markets operate under effective and transparent regulations that are in line with international standards and have attracted foreign investments from investors around the world.

Hong Kong also plays a vital role in offshore fundraising for Chinese enterprises. As at the end of 2020, 1,431 mainland Chinese companies were listed in Hong Kong – comprising H-share, red-chip and private companies – with total market capitalisation of around US$4.9 trillion or 80 per cent of the market total. Since 1993, mainland Chinese companies have raised more than US$935 billion via stock offerings in Hong Kong.[1]

The promulgation of the Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area on 18 February 2019 further signified Hong Kong's role as the 'super connector' in the development of the Greater Bay Area. It is expected that Hong Kong, with the full support of the central government, will proactively integrate itself into the overall national development, thereby generating new impetus for growth to bring new development opportunities to different sectors of the community.[2]

Development of the corporate rescue legal framework in Hong Kong

In Hong Kong, corporate insolvency is primarily governed by the remaining provisions of the old Companies Ordinance, renamed as the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32), as amended by the Companies (Winding Up and Miscellaneous Provisions) Amendment Ordinance, which came into effect on 13 February 2017 (the Amendment Ordinance).

There is no statutory restructuring procedure available under Hong Kong law; however, it is possible for creditors of a Hong Kong company to negotiate an informal contractual restructuring agreement with the company, which will in general require the cooperation of all creditors of the company as any one creditor may still exercise

1 'Economic and Trade Information on Hong Kong', research from the Hong Kong Trade Development Council: https://research.hktdc.com/en/article/MzIwNjkzNTY5.

2 'Overview of Greater Bay Area': www.bayarea.gov.hk/en/about/overview.html.

its right to wind up the company. It is only possible to achieve a corporate rescue of a financially distressed company in Hong Kong through an out-of-court workout, a scheme of arrangement or following the appointment of provisional liquidators, which leaves the company's creditors with limited options to rescue the company in times of financial difficulty.

With the impact brought about by the covid-19 pandemic, the number of corporate failures is expected to increase. In March 2020, the Hong Kong government announced that the drafting of the new corporate rescue bill has reached an advanced stage, and it intends to hold a fresh round of consultations on specific areas in the draft bill, with the aim of finalising the bill for introduction to the Legislative Council in the first half of the 2020/2021 legislative session; however, in June 2021, given the complexity of the issues, the number of the stakeholders involved and the different views expressed, the Hong Kong government indicated that it would continue to engage stakeholders to refine the legislative instructions.[3]

In July 2014, the Hong Kong government published detailed legislative proposals on the introduction of a new statutory corporate rescue procedure and insolvent trading provisions (the 2014 Proposal).[4] It remains to be seen the extent to which the key features of the 2014 Proposal would be included in the upcoming new bill, and how the government would address the concerns by various stakeholders in the previous legislative exercise.

If the legislation is enacted as envisaged under the 2014 Proposal, a financially distressed company would be given the option to initiate the corporate rescue procedure with a view to turning around its business as much as possible instead of pursuing winding-up immediately. The directors of those companies would also have to consider the financial position of those companies carefully before allowing them to continue to trade.

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3 www.hkreform.gov.hk/en/implementation/index.htm and Report No. 44 of the List of Reports Tabulated according to Implementation Status by the Law Reform Commission of Hong Kong (www.hkreform.gov.hk/en/docs/ajls2021.pdf).

4 Legislative Council Panel on Financial Affairs, 'Consultation Conclusions on Corporate Insolvency Law Improvement Exercise and Detailed proposals on a new Statutory Corporate Rescue Procedure', 7 July 2014.

Recent developments on the interaction between winding-up petitions and arbitration agreements

As an international arbitration hub, and with growing policy emphasis on the use of arbitration, the Hong Kong Court has seen a growing number of winding-up cases where the parties' underlying agreement contains an arbitration agreement. The impact of such an arbitration agreement on the Court's discretion to grant a winding-up order has been reviewed by the Court.

Traditional approach

Traditionally, the courts will only dismiss a winding-up petition in favour of arbitration if the opposing debtor is able to prove that it has a bona fide defence on substantial grounds to the underlying debt. This is because winding-up petitions are considered as a class remedy available to all creditors and do not involve the enforcement of a creditor's rights against the debtor.

In practice, the courts will grant the creditor's application to wind up the debtor if the debtor has failed to pay a debt without a credible defence, without requiring the parties to commence arbitration (the traditional approach).

Re Southwest Pacific Bauxite (HK) Ltd

In 2018, Mr Justice Jonathan Harris, being the judge in charge of the Companies Court, in *Re Southwest Pacific Bauxite (HK) Ltd*[5] broadly followed the English Court of Appeal's approach in *Salford Estates (No 2) Ltd v Altomart Ltd (No 2)*,[6] giving substantial weight to the policy consideration underlying the Arbitration Ordinance (Cap 609), which encourages and supports party autonomy in determining the means by which a dispute arising between them should be resolved.

Citing the related authorities, Harris J held that the courts should generally dismiss an insolvency petition in favour of arbitration when the following three requirements are met:

- the opposing debtor disputes the petitioning debt (it is sufficient for the debtor to show that the debt is not admitted);
- the contract under which the petitioning debt is alleged to arise contains an arbitration clause that covers any dispute relating to the debt; and

5 [2018] 2 HKLRD 449.
6 [2015] Ch 589.

- the opposing debtor takes steps required under the arbitration clause to commence the contractually mandated dispute resolution process (the *Lasmos* approach).

Under the *Lasmos* approach, the debtor is able to stay insolvency proceedings in Hong Kong, simply by not admitting the underlying debt, and force the creditor to arbitrate, even though there is no 'real' dispute about the debt. The ruling in the *Lasmos* case establishes a substantial obstacle to winding-up petitioners where the underlying agreements contain an arbitration clause.

But Ka Chon v Interactive Brokers LLC

In mid-2019, the *Lasmos* approach was further considered in *But Ka Chon v Interactive Brokers LLC*[7] by the Court of Appeal on an obiter basis. In light of the statutory right conferred on creditors to petition for the winding up or bankruptcy of an insolvent debtor, the Court of Appeal took the view that such right is part of Hong Kong law, and absent any evidence of the legislative intent of the Arbitration Ordinance to change the insolvency legislation, the *Lasmos* approach represents 'a substantial curtailment' of creditors' statutory rights by requiring the courts to exercise the discretion only in favour of arbitration except in wholly exceptional circumstances if the three requirements are met.

Although it remains to be seen how the Court of Appeal will rule in the future, and each case would be decided based on its facts, these obiter remarks indicate that there is a possibility that it may not follow the *Lasmos* approach.

Dayang (HK) Marine Shipping Co, Ltd v Asia Master Logistics Ltd

Recent developments in respect of the issue of winding-up petitions with the existence of an arbitration agreement in the underlying contract have shown that the court has shifted from the traditional view to the *Lasmos* approach and back to a more moderate approach in the *But Ka Chon* case.

In a recent judgment in *Dayang (HK) Marine Shipping Co, Ltd v Asia Master Logistics Ltd*[8] on 12 March 2020, Deputy High Court Judge William Wong SC deviated from the *Lasmos* approach and held that to dispute the existence of a debt, a debtor must show there is a bona fide dispute on substantial grounds, and that a bare denial or non-admission of the debt is not enough, regardless of whether the

7 [2019] HKCA 873.
8 [2020] HKCFI 311.

debt has arisen from a contract incorporating an arbitration clause. Further, the court must exercise discretion, irrespective of whether there is an arbitration agreement, and commencing arbitration proceedings itself is not sufficient proof of the existence of a bona fide dispute on substantial grounds, but may constitute relevant evidence of such a dispute.

The court in the *Dayang* case relied primarily on the traditional approach in deciding in favour of the creditor. The court spent over three-quarters of the judgment reviewing the recent developments in this area. Although it did not come to a conclusion on the matter in the judgment, in spending much time analysing it, the court demonstrated a clear intention to resolve this issue; therefore, we envisage that further developments in this area will be forthcoming.

Recognition of foreign insolvency proceedings

In recent years, the Hong Kong Court has extensively granted recognition and assistance orders, most commonly to facilitate debt restructuring of Hong Kong listed companies incorporated in an offshore jurisdiction.[9]

However, in *Re CEFC Shanghai International Group Ltd*,[10] for the first time the Court granted an order for recognition and assistance to mainland liquidators of a mainland China-incorporated company.

It was held that two criteria must be satisfied before recognition and assistance is granted to insolvency proceedings opened in a civil law jurisdiction: first, the foreign insolvency proceedings must be collective insolvency proceedings; and second, the foreign insolvency proceedings must be opened in the company's country of incorporation.[11]

Further, the Court noted that there are principles that circumscribe the common law power of assistance that could be exercised:

> *(a) The power of assistance exists for the purpose of enabling foreign courts to surmount the problems posed for a world-wide winding up of the company's affairs by the territorial limits of each court's powers. Therefore, the power of assistance is not available to enable foreign office holders to do something which they could not do even under the law by which they were appointed.*

9 See, for example, *Re Z-Obee Holdings Ltd* [2018] 1 HKLRD 165.

10 [2020] 1 HKLRD 676.

11 Para 8, supra.

> *(b) The power of assistance is available only when it is necessary for the performance of the foreign officeholder's functions.*
> *(c) An order granting assistance must be consistent with the substantive law and public policy of the assisting court.*[12]

The Court refused to follow the decision in *Galbraith v Grimshaw*,[13] where the House of Lords chose not to stay a garnishee order application, despite there being an appointment of trustee in bankruptcy. Had this case been followed, the effect would have been that no assistance would have been granted to the liquidators. It was explained by the Court that the decision in *Galbraith* is inconsistent with contemporary cross-border insolvency law, given that it was made well before the development of common law cross-border insolvency assistance.

Recognition of foreign voluntary liquidation

Contrary to the Privy Council's obiter objection to recognising foreign voluntary winding up in *Singularis Holdings Ltd v PricewaterhouseCoopers*,[14] the court in *Re Joint Liquidators of Supreme Tycoon Ltd*[15] held that the mere fact of a foreign liquidation being a voluntary liquidation does not prevent the court from recognising and assisting that liquidation under the principle of modified universalism.

In considering whether a foreign insolvent liquidation commenced by a shareholders' resolution is eligible for common law recognition and assistance, the key issue for cross-border insolvency assistance is not whether the foreign insolvency office holder is or is not an officer of the foreign court. Rather what matters is whether the foreign insolvency proceeding is collective in nature in the sense that it is 'a process of collective enforcement of debts for the benefit of the general body of creditors'.[16]

Even though the company's liquidation was commenced by a shareholders' resolution, it was observed by the court that the company's liquidation was a collective insolvent proceeding; therefore, the court granted the recognition order sought to allow the liquidators appointed to investigate the affairs of the company.

12 Para 11, supra.
13 [1910] AC 508.
14 [2015] AC 1675.
15 [2018] HKCFI 277.
16 Para 15, supra.

However, where the foreign liquidation is a solvent liquidation that is more akin to a 'private arrangement' as referred to by the Privy Council in *Singularis Holdings Ltd*, it would not fall within the principle of modified universalism and, hence, would not be recognised or assisted by the court.

A similar approach was adopted in the English case of *Re Sturgeon Central Asia Balanced Fund Ltd (No 2)*,[17] where the court terminated the recognition order concerning a Bermuda solvent liquidation because the solvency liquidation fell outside the scope of the UNCITRAL Model Law on Cross-Border Insolvency in Great Britain.

No approval for an examination that constitutes a fishing expedition

In *Re A Civil Matter Now Pending in United States District Court for the Western District of Washington*,[18] the court rejected two letters of request issued by the United States District Court, Western District of Washington at Seattle (the Washington Federal Court) seeking to compel two distressed debt investors in Hong Kong to appear and provide oral testimony regarding certain alleged receivables owing to a foreign company.

In arriving at the decision, the court pinpointed that the requirements under section 75 of the Evidence Ordinance (Cap 8) (EO) must be met before an order for the taking of evidence in Hong Kong is to be granted. The court must be satisfied:[19]

> *(a) that the application is made in pursuance of a request issued by or on behalf of a court or tribunal (the requesting court) exercising jurisdiction in a country or territory outside Hong Kong; and*
> *(b) that the evidence to which the application relates is to be obtained for the purposes of civil proceedings which either have been instituted before the requesting court or whose institution before that court is contemplated.*

17 [2020] EWHC 123 (Ch).

18 [2019] HKCFI 1738.

19 Para 22, supra.

Considering the above, the court stressed that the discovery was sought against persons who were not party to the judgments made by the Washington Federal Court and was for the purpose of 'plotting the course' of unspecified, possible future proceedings; hence, the proposed examination was found to be a pretrial discovery, which was essentially a fishing expedition that ought to be prohibited under section 76(3) of the EO.

The significance of this case in the context of insolvency and restructuring is that if liquidators wish to seek an order from the Hong Kong Court for the taking of evidence pursuant to a foreign court's request, they should be careful in respect of whether the Court will construe their application as a fishing expedition that may jeopardise the chance of success of their application.

Recognition of foreign provisional liquidator appointed on soft-touch basis

In recent cases, the Hong Kong courts have held that their lack of power to appoint provisional liquidators only for facilitating restructuring and corporate rescue (ie, on a soft-touch basis) does not prevent the courts from recognising and assisting foreign liquidators appointed for this purpose.

Re Joint Provisional Liquidators of Moody Technology Holdings Ltd

In *Re Joint Provisional Liquidators of Moody Technology Holdings Ltd*,[20] the Hong Kong Court of First Instance granted a recognition order to foreign provisional liquidators, who were appointed on a soft-touch basis, to explore and facilitate the restructuring of a company. This order was made despite soft-touch provisional liquidation being impermissible in Hong Kong.

The joint and several liquidators (JPLs) of Moody Technology Holdings Limited (Moody), a company incorporated in Bermuda, were appointed by an order made by the Supreme Court of Bermuda (Bermuda Court). Moody's JPLs applied to the Hong Kong Court for recognising their appointment and powers as set out in the letter of request issued by the Bermuda Court.

20 [2020] HKCFI 416.

Moody's JPLs were appointed on a soft-touch basis to restructure Moody and its debts in Bermuda. The key question before the Hong Kong Court was whether it should give recognition to Moody's JPLs while under current Hong Kong law, according to the Court of Appeal decision in *Re Legend International Resorts Ltd*,[21] soft-touch provisional liquidation is impermissible.

The Court held that where circumstances warrant appointment of provisional liquidators, the provisional liquidators may be granted powers to explore and facilitate a restructuring of the company.

Re the Joint and Several Provisional Liquidators of China Oil Gangran Energy Group Holdings Limited

In *Re the Joint and Several Provisional Liquidators of China Oil Gangran Energy Group Holdings Limited*,[22] the Hong Kong court continued the trend of recognising foreign soft-touch provisional liquidators.

Joint and several provisional liquidators were appointed over China Oil Gangran Energy Group Holdings Limited (China Oil's JPLs) by the Cayman court, with a view to pursuing a debt restructuring. China Oil's JPLs applied to the Hong Kong court for recognition of their appointment.

The court considered the general principles of recognising foreign insolvency proceedings in *Re CEFC Shanghai International Group Ltd*, and its past practice of recognising foreign soft-touch provisional liquidation,[23] and accordingly granted the recognition order.

These two recent decisions reflect the Hong Kong court's commitment to universalism and its position to facilitate cross-border restructurings. Although the Hong Kong court may not appoint domestic soft-touch provisional liquidators, the same cannot constitute a bar to recognising and assisting foreign soft-touch provisional liquidators.

Problematic use of soft-touch provisional liquidation

In *Re Lamtex Holdings Ltd*,[24] the court refused to grant the adjournment of the winding-up petition sought by the joint provisional liquidators appointed in Bermuda and made an immediate winding-up order. The court was of the view that Lamtex

21 [2006] 2 HKLRD 192.
22 [2020] HKCFI 825.
23 For example, see footnote 19.
24 [2021] HKCFI 622.

did not have a credible plan to restructure its debt and was likely using the application in Bermuda as an attempt to engineer a de facto moratorium, which could not be obtained under Hong Kong law. The soft-touch provisional liquidation was described by the court as 'questionable'.

In *Re Ping An Securities Group (Holdings) Ltd*,[25] there were two proceedings concerning Ping An Securities. In the earlier proceedings, the court decided to adjourn the winding-up petition presented by the creditor for two months and make an order for recognition and assistance for the soft-touch provisional liquidation of the debtor in Bermuda. Notwithstanding the creditor's opposition, the court was of the view that since the debtor satisfied the relevant criteria as explained in *Re China Huiyuan Juice Group Limited*, including the feasibility of restructuring, the petition should be adjourned.

However, in the later proceedings, as the provisional liquidators made no effort to contact the creditor and did not provide the creditor with any information about the progress of the restructuring, the court was of the view that the progress of the matter was entirely unsatisfactory and expressed concerns about the way soft-touch provisional liquidation, generally referred to as the *Z-Obee* technique,[26] was being used. The court eventually exercised its discretion to order a normal winding-up order.

In both *Re Joint Provisional Liquidators of China Bozza Development Holdings Ltd*[27] *and Re Joint and Several Provisional Liquidators of Victory City International Holdings Ltd*,[28] the court was sceptical towards similar use of soft-touch provisional liquidation. More pertinently, *in Re China Bozz*a, the court only granted an order for recognition as a matter of private international law and, for the first time ever, refused to grant the general assistance that was granted on previous occasions, because the way the joint provisional liquidators had approached the matter had failed to satisfy the court that they were protecting the creditors' interests.

25 [2021] HKCFI 651, [2021] HKCFI 1394.
26 [2018] 1 HKLRD 165.
27 [2021] HKCFI 1235.
28 [2021] HKCFI 1370.

Scheme of arrangement

A scheme of arrangement in Hong Kong is an effective tool to compromise debts, even those governed by non-Hong Kong law, despite the old common law *Gibbs* rule.[29]

In *Re China Singyes Solar Technologies Holdings Ltd*,[30] the Hong Kong court considered an exception to the *Gibbs* Rule and more generally the principles of sanctioning a scheme.

China Singyes Solar Technologies Holdings Limited (Singyes) is incorporated in Bermuda and listed in Hong Kong. In 2018, as Singyes and its subsidiaries' financial condition seriously deteriorated, Singyes defaulted in its mainland China and offshore obligations, comprising convertible bonds and notes.

Singyes proposed a Hong Kong scheme, compromising convertible bonds governed by English law and notes governed by New York law (the Scheme). In considering whether to sanction the Scheme, the court considered whether the Scheme would be effective in the relevant jurisdictions.

The court concluded that the Scheme would be substantially effective in those jurisdictions, even though there was no application to the English and US courts for recognition of the Hong Kong scheme. The court reasoned that the Scheme was effective in its place of incorporation because there was a parallel scheme in Bermuda.

It also reasoned that although the convertible bonds were governed by English law, there was no need to seek recognition of the Scheme in England. This is because 100 per cent of the holders of the convertible bonds voted in favour of the Scheme, which constituted an exception to the *Gibbs* rule. In reaching this decision, the court considered the observation in *Re OJSC International Bank of Azerbaijan*:[31]

> *[T]here is an exception to the rule if the relevant creditor submits to the foreign insolvency preceding. In that situation, the creditor is taken to have accepted that his contractual rights will be governed by the law of the foreign insolvency proceeding.*

Therefore, the Scheme would be effective in England.

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29 According to this well-established English principle laid down in *Antony Gibbs & Sons v La Société Industrielle et Commerciale des Métaux* [1890] 25 QBD 399, a foreign composition does not discharge a debt unless it is discharged under the law governing the debt.

30 [2020] HKCFI 467.

31 [2018] EWCA Civ 2802; [2019] Bus LR 1130 at [28] (Henderson LJ).

The court also accepted that there was no need to seek recognition of the Scheme under US law as more than 99 per cent of the noteholders had acceded to the restructuring support agreement and voted in favour of the Scheme. The remaining creditors had not come forward, and there was no reason to believe that any of them would try to enforce their pre-scheme claims in the United States. The court accepted that the risk of adverse enforcement by a dissenting scheme creditor in the United States was de minimis.

Ultimately, the court held that the guiding principle is that the court should not act in vain or make an order that has no substantive effect or will not achieve its purpose. The principle does not require worldwide effectiveness nor worldwide certainty. The court will sanction a scheme provided it is satisfied that the scheme would achieve a substantial effect.

Although the *Gibbs* rule will continue to be valid in Hong Kong, this recent case shows that the rule is not a bar for parties to the success of cross-border restructuring.

Hong Kong-mainland China mutual recognition of and assistance in insolvency proceedings

In *Re Ando Credit Ltd*,[32] the court dealt with the first-ever application for the appointment of provisional liquidators over a Hong Kong company with the purpose of seeking recognition in mainland China. The application was made with a view to allowing the Hong Kong liquidators to recover the very substantial receivables believed to be owed to the company by its debtors in mainland China.

The court affirmed the open attitude towards recognition and assistance in mainland Chinese insolvency proceedings and hinted at the possibility of reciprocity between Hong Kong and mainland Chinese courts to hear applications for recognition and assistance from liquidators of the two jurisdictions.

On 14 May 2021, the 'Record of Meeting of the Supreme People's Court and the Government of the Hong Kong Special Administrative Region on Mutual Recognition of and Assistance to Bankruptcy (Insolvency) Proceedings between the Courts of the Mainland and of the Hong Kong Special Administrative Region'[33] was signed. The arrangement highlights the unique role played by Hong Kong under 'one country, two systems' and will foster further legal cooperation in civil and commercial matters between the two jurisdictions.

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32 [2020] HKCFI 2775.

33 www.doj.gov.hk/en/mainland_and_macao/pdf/RRECCJ_RoM_en.pdf.

The framework aims to facilitate the rescue of financially troubled businesses and provides better protection for the assets of the debtor company, as well as the interests of the creditors, and is conducive to the promotion of an orderly and efficient insolvency regime. The framework also covers bankruptcy compromise and reorganisation in mainland China, as well as debt restructuring in Hong Kong, thereby encouraging the use of debt restructuring to revive businesses, with a view to reaching consensus among creditors from both jurisdictions and abroad.

Shanghai, Xiamen and Shenzhen have been designated as pilot cities by the Supreme People's Court, given their close trade ties with Hong Kong.

A liquidator or a provisional liquidator in insolvency proceedings in Hong Kong may apply to the relevant Intermediate People's Court for:

- recognition of compulsory winding up, creditors' voluntary winding up and corporate debt restructuring proceedings brought by a liquidator or provisional liquidator as sanctioned by a Hong Kong court in accordance with the laws of Hong Kong;
- recognition of his or her office as a liquidator or a provisional liquidator; and
- grant of assistance for discharge of his or her duties as a liquidator or a provisional liquidator.

An administrator in Mainland bankruptcy proceedings may apply to the Hong Kong High Court for:

- recognition of bankruptcy liquidation, reorganisation and compromise proceedings under the Enterprise Bankruptcy Law of the People's Republic of China;
- recognition of his or her office as an administrator; and
- grant of assistance for discharge of his duties as an administrator.

A set of opinions[34] and a practical guide[35] have been issued by the Supreme People's Court and the Hong Kong government, respectively.

34 www.doj.gov.hk/en/mainland_and_macao/pdf/RRECCJ_opinion_en_tc.pdf.
35 www.doj.gov.hk/en/mainland_and_macao/pdf/RRECCJ_practical_guide_en.pdf.

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Overview of India's Insolvency and Bankruptcy Code

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IN SUMMARY

This overview contains a summary of the most significant developments in Indian insolvency and bankruptcy law since August 2020. Where possible, the legislative changes and relevant case law are discussed simultaneously to give the reader an understanding of the letter of the law and its interpretation. Some trendsetting judgments are also discussed, and a small overview of the changes brought about by the covid-19 pandemic is provided. The overview also outlines a brief summary of legislative changes in the pipeline.

DISCUSSION POINTS

- Amendments to the Insolvency and Bankruptcy Code
- Changes related to the covid-19 pandemic
- Whether the commercial wisdom of the committee of creditors is unassailable
- Steps taken to ensure that the corporate debtor has a clean slate
- Changes to Indian insolvency law expected in the coming year

REFERENCED IN THIS ARTICLE

- Insolvency and Bankruptcy Code 2016
- *Anuj Jain, Interim Resolution Professional for Jaypee Infratech Limited v Axis Bank Limited*
- *Arun Kumar Jagatramka v Jindal Steel and Power Limited*
- *Committee of Creditors of Essar Steel India ltd v Satish Kumar Gupta*
- *Gujrat Urja Vikas Nigam Limited v Amit Gupta*
- *Jaypee Infratech Limited v Axis Bank Limited*
- *Jaypee Kensington Boulevard Apartments Welfare Association v NBCC (India) Limited*
- *Jet Airways (India) Limited v State Bank of India and Another*
- *K Sashidhar v Indian Overseas Bank*
- *Lalit Kumar Jain v Union of India*
- *Manish Kumar v Union of India*

Introduction

The Insolvency and Bankruptcy Code 2016 (IBC) was intended to be a transformative piece of legislation. It sought revolutionary and cultural transformation in the insolvency and bankruptcy landscape by (i) creating a comprehensive code for insolvency and bankruptcy for corporates and individuals; (ii) establishing a new architecture, comprising a committee of creditors (COC) and dedicated adjudicating authorities (AA) for insolvency resolution and liquidation; and (iii) bringing judicial discipline in the process.

Each of the three elements was intended to address the problems that affected the bankruptcy regime in India. Although the Companies Act 1956 and the Companies Act 2013 contained provisions for winding up companies, they were found to be inadequate. The Sick Industrial Companies (Special Provisions) Act 1985 (SICA), which provided an insolvency resolution framework for sick industrial undertakings, had failed to deliver. The insolvency and bankruptcy regime for individuals was based on colonial legislation that needed to be revamped to be in sync with 21st century requirements.

In this context, the IBC was groundbreaking. Besides prescribing a legislative framework for insolvency resolution and bankruptcy, it established the Insolvency and Bankruptcy Board of India (IBBI) as the regulator, which can proactively respond to the changing realities through its regulatory powers. The IBC has succeeded in establishing distinct jurisprudence for insolvency resolution. The government and the IBBI have also been proactive in clarifying and resolving issues as and when they appear through the implementation of the legislation. This explains frequent amendments to both the IBC and the various regulations issued under it; however, the fact that the IBC is not yet fully operational despite it being almost five years since its enactment raises a few red flags on its report card.

The National Companies Law Tribunal (NCLT), which existed as a forum for adjudication of disputes for companies, became the AA for corporate insolvency resolution and liquidation. Since the IBC came into force, the NCLT has become pre-eminently a forum for insolvency resolution and liquidation, with its caseload predominantly comprising insolvency cases. According to the annual report of the Ministry of Corporate Affairs for 2019–2020,[1] a total of 19,733 fresh cases were filed

1 www.mca.gov.in/Ministry/pdf/AnnualReport2019_20_17042020.pdf (last accessed: 4 August 2021).

at various benches of the NCLT, of which 12,089 were filed under the IBC. Similarly, of the total 13,884 cases disposed of by various NCLT benches, 7,365 were under the IBC. The Ministry of Corporate Affairs has not published similar data for 2020–2021.

A large caseload, particularly at the NCLT benches in Delhi and Mumbai, has often led to delays in adjudication of disputes. While the setting-up of regional benches across various states and an increase in bench strength at the Delhi and Mumbai benches were intended to improve the pendency issues, the reality is different. At present, of the sanctioned strength of 63 members, there is a 40 per cent vacancy.[2] Further, many regional benches are not fully functional, leading to the diversion of the resources of other benches. The Supreme Court has been forced to interfere and direct the government to take prompt action in this regard.[3] Unless those structural issues are resolved, the number of pending cases under the IBC will only rise.

Enforcing judicial discipline in insolvency resolution was one of the principal objectives of the IBC. In this respect, the IBC has fared much better than its predecessor, SICA; however, many argue that its record is far from satisfactory. The IBC imposed a strict timeline of 180 days for the corporate insolvency resolution process (CIRP), which is extendable by another 90 days, at the discretion of the AA. This was further extended to 330 days through an amendment to the IBC in 2019.

According to the data released by the IBBI, the average time taken for CIRPs that resulted in resolution plans is 406 days (after excluding time permitted by AAs). Further, the CIRPs that ended up in liquidation took an average of 351 days for conclusion.[4] Many cases take much longer (Essar Steel's CIRP took as long as 866 days to complete).[5]

The delays have resulted in eroding value for creditors, and they may arguably have contributed to larger haircuts by all stakeholders. The number of days taken for the CIRPs has also swelled owing to the disruptions caused by the covid-19 pandemic and the resultant circuit breaker measures adopted by Indian government. Further, as per the data released by the IBBI, a total of 4,376 CIRPs have commenced under the IBC up until 31 March 2021. Of those, 1,723 are ongoing.

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2 *National Company Law Tribunal and Appellate Tribunal Bar Association v Ministry of Corporate Affairs*, 2021 SCC OnLine SC 406.

3 ibid.

4 Insolvency and Bankruptcy Board of India, *Insolvency and Bankruptcy News*, Vol. 18, January–March 2021.

5 Aashish Aryan, 'NCLAT opens window to let firms exit resolution process — and settle', *The Indian Express* (19 July 2020).

The trend of more corporate debtors choosing liquidation instead of resolution plans continues. According to available data, of the 2,653 CIRPs closed, AAs passed orders for liquidation in 48.13 per cent of the CIRPs. The number of corporate debtors going forward with a resolution plan was a low 13.12 per cent.[6]

In most cases, the disruption of timelines is attributable to judicial intervention. The courts have been liberal in interpreting the boundaries set by the timelines, which has led to the timelines being construed as merely advisory in nature. The government and Parliament's attempts to fix the timelines have been repeatedly thwarted by the courts. The Supreme Court, in the case of *Committee of Creditors of Essar Steel India Ltd v Satish Kumar Gupta*,[7] has held the newly inserted timeline of 330 days to be advisory and not mandatory, holding that the word 'mandatorily' is unconstitutional.

The government has largely played a constructive role in facilitating the implementation of the IBC. It has successfully aligned the banking regulator, the Reserve Bank of India (RBI), to push the banking system into using the IBC as the principal mechanism for resolving debt. This approach has predictably suffered certain setbacks owing to the covid-19 pandemic. Where challenges have been faced in IBC implementation, the government and the IBBI have stepped in to amend the legislation and the regulations. While, by and large, the amendments have made the implementation smoother, there have been instances where frequent amendments have caused confusion.

Recent legislative amendments

The IBC is perhaps the most frequently amended legislation in recent years, and some of the changes were necessary to avoid unintended consequences. In the past year, the legislative changes to the IBC have focused on the need to address issues arising from the covid-19 pandemic.

The second 2020 amendment

Like governments in many other countries, the Indian government brought about changes to mitigate the effects of the pandemic on corporations. On 5 June 2020, it promulgated the Insolvency and Bankruptcy (Amendment) Ordinance 2020 (the Suspension Ordinance).[8] The Suspension Ordinance suspended section 7 (initiation

6 Supra note 4.

7 2020 219 COMP CASE 97 (SC).

8 In *Ramesh Kymal v Siemens Gamesa Renewable Power Private Limited*, the SC clarified that section 10A is retrospective in so far as although it was introduced on 5 June 2020, it protects

of insolvency resolution by a financial creditor), section 9 (initiation of insolvency resolution by an operational creditor) and section 10 (initiation of insolvency resolution by a corporate debtor itself) of the IBC for six months (extendable to one year) (the suspension period) in respect of any default that occurred after 25 March 2020. This Suspension Ordinance was later substituted by the Insolvency and Bankruptcy (Second Amendment) Act 2020 (the Suspension Act) by Parliament.

The Suspension Act has had its critics. Some argue that the language leaves much scope for improvement. The proviso to the newly inserted section 10A of the IBC states that no application for the initiation of the CIRP shall ever be filed in respect of a default that occurred during the period of suspension. The Suspension Act stipulates that a default occurring after 25 March 2020 cannot be used to bring about a CIRP of the corporate debtor. This may potentially result in worsening the crisis for banks and other stakeholders that may not be able to pursue the remedy under the IBC for defaults during the suspension period. The suspension period was progressively increased and finally came to an end on 25 March 2021.

Another significant consequence of the Suspension Act is that although the CIRP cannot be initiated against the corporate debtor, the insolvency resolution process under the IBC can be initiated against personal guarantors of those corporate debtors. It is difficult to think of any reason why a default arising from the extraordinary situation of the covid-19 pandemic has been excused for corporate debtors but not personal guarantors.

In addition to suspending the IBC for a period, the government has also raised the threshold of debt for initiation of the CIRP to 10 million rupees from the existing threshold of 100,000 rupees.[9] It is relevant to highlight that this change is prospective in nature[10] and, therefore, should not impact creditors' petitions that had already been filed before 24 March 2020.

any default committed by a corporate debtor after 25 March 2020 when the nationwide lockdown in response to the covid-19 pandemic was announced.

9 Notification F No. 20/9/2020-Insolvency dated 24 March 2020 issued by Ministry of Corporate Affairs, Government of India.

10 *Foseco India Limited v Om Boseco Rail Products Limited*, CP (IB) No. 1735/ KB/2019. See also *Arrowline Organic Products Private Limited v Rockwell Industries Limited*, IA/341/2020 in IBA/1031/2019.

The 2021 Amendment Ordinance

On 4 April 2021, the government promulgated the Insolvency and Bankruptcy (Amendment) Ordinance 2021 (the 2021 Ordinance), which introduced the pre-packaged insolvency resolution process (PPIRP) for micro, small and medium-sized enterprises (MSMEs) as defined under the Micro, Small and Medium Enterprises Development Act 2006. This amendment was felt to be necessary to help MSMEs tide over widespread distress induced or exacerbated by the pandemic.

To initiate the PPIRP, the corporate debtor requires the approval of its members by special resolutions or three-quarters of its partners, and the approval of unrelated financial creditors representing 66 per cent of the debt (or approval of the operational creditors where there are no unrelated financial creditors).

Upon initiation of the PPIRP, a resolution professional proposed by the financial creditor representing at least 10 per cent of the debt and approved by unrelated financial creditors representing at least 66 per cent of the debt is appointed to manage the process. The corporate debtor must submit a base resolution plan for approval of the COC, which may approve the base plan if it does not impair the claims of the operational creditors. If the base resolution plan is not approved by the COC or if it impairs the claims of the operational creditors, other resolution plans may be invited to compete with the base resolution plan.

The amended IBC also provides a shorter timeline of 120 days for completion of the PPIRP. The PPIRP enables an MSME to work on a resolution plan while the corporate debtor and its management stays in possession of the company (ie, debtor-in-possession model as opposed to the creditor-in-control model for the CIRP).

Key regulatory changes

While the IBC contemplates the insolvency and bankruptcy regime for individuals, it has not been fully notified as yet. The same was notified in a limited manner with effect from 1 December 2019, insofar as it applies to personal guarantors of corporate debtors.

The notification of those provisions was challenged as being unconstitutional on the basis that there was no intelligible basis to the difference between individuals per se and individuals who had issued guarantees in respect of the debt of corporate entities. The Supreme Court of India in *Lalit Kumar Jain* v *Union of India*[11] dismissed the

11 2021 SCC OnLine SC 396.

challenge and upheld the notification. It also held that if a resolution plan is approved in respect of a corporate debtor, it does not absolve the personal guarantor of his or her liability that arises out of a separate contract.

To give effect to the provisions, the Insolvency and Bankruptcy (Application to Adjudicating Authority for Insolvency Resolution Process for Personal Guarantors to Corporate Debtors) Rules 2019 and the Insolvency and Bankruptcy (Application to Adjudicating Authority for Bankruptcy Process for Personal Guarantors to Corporate Debtors) Regulations 2019 were also notified. This allowed creditors to initiate and maintain proceedings against both the corporate debtor and the guarantor of the corporate debtor in the NCLT.

Previously, in the case of *Vishnu Kumar Agarwal v Piramal Enterprises Limited*,[12] the National Company Law Appellate Tribunal (NCLAT) had held that if insolvency proceedings under section 7 of the IBC have been admitted against the principal borrower, then a second application by the same creditor on the same claim cannot be maintained against the corporate guarantor; however, the uncertainty created by this judgment has been clarified by the judgment in *Lalit Kumar Jain*. There is anticipated that there will be an increase in insolvency proceedings against personal guarantors with a view to improving recovery for banks and financial institutions.

In accordance with an amendment to the CIRP Regulations,[13] the COC is required to simultaneously vote on all resolution plans received by the insolvency resolution professional (IRP) that comply with the requirements of the CIRP Regulations and the IBC. If only one plan is received, it shall be considered approved by the COC if it receives 66 per cent of the votes. If there is more than one plan, the plan that receives 66 per cent of the votes shall be considered approved, failing which the plan that receives the highest votes shall be voted on again. This process gives the COC the ability to simultaneously examine various plans, as opposed to voting on plans individually, which may potentially lead to the rejection of all the plans. This is likely to make the process more efficient.

With a view to bringing timely conclusion to the liquidation process, the IBBI has amended the Liquidation Process Regulations 2016 to permit liquidators to assign a 'not readily realisable asset' to a person who is not ineligible under section 29A of the IBC through a transparent process and in consultation with the stakeholders'

12 2019 SCC OnLine NCLAT 542.

13 Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) (Fourth Amendment) Regulations 2020.

committee. 'Not readily realisable assets' have been defined to include contingent or disputed assets, and assets underlying proceedings for undervalued, extortionate, fraudulent and preferential transactions. This amendment could potentially spur the tapping of value of disputed arbitral awards in favour of corporate debtors, particularly, by professional third-party litigation funders.

Other changes related to the pandemic

On 6 August 2020, the RBI issued a circular[14] allowing companies a one-time restructuring (OTR) of loans without classifying them as non-performing assets. This mechanism had been applicable for all commercial banks, cooperative banks, All India Financial Institutions and non-banking financial companies. The accounts that were eligible for an OTR were those that were classified as 'standard' and, at the same time, were not in default for more than 30 days as at 1 March 2020.

The restructured framework was to be invoked by 31 December 2020. For personal loans, it needed to be implemented within 90 days of the invocation date, and for corporate loans within 180 days of the invocation date. The invocation date was the date on which the borrower and the lender agreed to proceed on the OTR plan.

As an additional measure, the RBI constituted an expert committee to suggest ways in which the restructuring can be implemented. The committee made recommendations for sector-specific financial parameters to be considered for the OTR. The recommendations, which were broadly accepted by the RBI, were notified on 7 September 2020 by the RBI as guidelines for OTRs.[15]

Given the rise in the number of cases in 2021 in India, the RBI issued a new circular on 5 May 2021,[16] providing a new framework. The new framework allows individuals, small businesses and MSMEs whose accounts were 'standard' as at 31 March 2021 with exposure not exceeding 250 million rupees to seek restructuring of their debt by 30 September 2021. As part of the restructuring, the lenders are permitted to grant a moratorium on the repayment of the debt of up to two years, along with an extension of residual tenor of the loan facility by also up to two years. Resolution plans under this framework must be finalised and implemented within 90 days of the date of invocation of the process.

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14 Circular No. DOR.No.BP.BC/4/21.04.048/2020-21 dated 6 August 2020.

15 See Circular No. DOR.No.BP.BC/13/21.04.048/2020-21.

16 See Circular No. RBI/2021-22/31 DOR.STR.REC.11/21.04.048/2021-22.

Trendsetting judicial developments

The COC's control of corporate debtors and their decision-making upon commencement of the CIRP is the cornerstone of the IBC. The NCLAT's decision in *Essar Steel*[17] attempted to curtail the powers of the COC by circumscribing it with considerations of equity between different classes of creditors.

The NCLAT's decision was challenged and reversed by the Supreme Court in *Committee of Creditors of Essar Steel Limited v Satish Kumar Gupta*.[18] The judgment reinstated the primacy of the COC in approving the resolution plan and reinforced its position in *K Sashidhar*[19] that the commercial wisdom of the COC cannot be challenged by the AA except on very limited grounds set forth under the IBC. In doing so, the Court also clarified that the COC is not acting in fiduciary capacity for any class of creditors; it is merely taking a commercial decision by requisite majority. On the 'fair and equitable' distribution principle introduced through the 2019 amendment, the Court clarified that it does not give the AA an additional ground to reject a resolution plan as long as the interests of all classes of creditors have been looked into and taken care of.

Recognising the need to offer a clean slate to the resolution applicant, the Court allowed an IRP to record disputed claims on notional value to enable a resolution applicant to take the same into account in a resolution plan. The creditors of the disputed claims or those who fail to submit claims should not be able to reagitate their claims against a successful resolution applicant.

Finally, the Court held the 330-day timeline introduced by the 2019 amendment to be merely advisory in nature, holding that the word 'mandatorily' is unconstitutional.

Another trendsetting judgment was pronounced by the Supreme Court in the case of *Anuj Jain, Interim Resolution Professional for Jaypee Infratech Limited v Axis Bank Limited*.[20] The Court was called upon to determine:

- whether mortgages provided by Jaypee Infratech Limited (JIL) for loans by its parent company Jayprakash Associates Limited (JAL) were preferential transactions under section 43 of the IBC; and
- whether lenders of JAL could be classified as financial creditors of JIL by virtue of a security interest created by JIL.

17 *Standard Chartered Bank v Satish Kumar Gupta, RP of Essar Steel Ltd and Others*, Company Appeal (AT) (Ins) No. 242 of 2019.

18 2019 SCC OnLine SC 1478.

19 *K Sashidhar v Indian Overseas Bank*, 2019 SCC Online SC 257.

20 2019 SCC OnLine SC 1775.

The Court held that the mortgages created by JIL for the benefit of JAL were preferential transactions on the basis that:

- while there was no creditor-debtor relationship between JIL and lenders of JAL, JAL was the ultimate beneficiary of the transactions;
- since JAL was the operational creditor of JIL, the transactions put JAL in an advantageous position, as otherwise it would have stood much lower in priority; and
- the transaction was not in the ordinary course of business as JIL could not be said to be in the business of offering security for its parent company.

On the issue of whether lenders of JAL could claim to be financial creditors of JIL, the Court held that since JIL did not owe any sum of money to lenders of JAL, mere mortgages would not make those lenders financial creditors of JIL.

Throughout 2019, there was a string of orders in which the NCLT and the NCLAT directed resolution professionals to allow schemes of arrangement and compromise under sections 230 to 232 of the Companies Act 2013, where a liquidation order had been passed.[21] A number of promoters who were otherwise ineligible to submit a resolution plan in respect of the corporate debtors under section 29A of the IBC saw this as a back-door entry to regain control.

The lacunae were closed with the insertion of a proviso in Regulation 2B of Insolvency and Bankruptcy (Liquidation Process) Regulations, 2016, which barred persons ineligible to submit resolution plans from being party to a compromise or arrangement. The Supreme Court in *Arun Kumar Jagatramka v. Jindal Steel and Power Limited*[22] upheld the same. It is now settled that a person who is ineligible in terms of section 29A of the IBC cannot submit a scheme for compromise and arrangement in those cases.[23] This move is seen as levelling the playing field and ensuring that dishonest promoters are not able to take control of the companies again.

After the introduction of the IBC and the inclusion of homebuyers as financial creditors, a large number of individual homebuyers approached the NCLT against developers who failed to deliver projects or refund money. From June 2018 (when the amendment was made to the IBC to include homebuyers as financial creditors) until

21 *S C Sekaran v Amit Gupta & Ors*, 2019 SCC OnLine NCLAT 517.

22 2021 SCC OnLine SC 220.

23 *Jindal Steel & Power Limited v Arun Kumar Jagatramka*, 2019 SCC OnLine NCLAT 759. See also *First Global Finance Private Limited v IVRCL Limited and Another*, Company Appeal (AT) (Ins) No. 918-919 of 2019.

30 September 2019, a total of 1,821 cases were filed under the IBC by homebuyers.[24] Admission of insolvency proceedings on an application of a single homebuyer had the effect of stalling the completion of various projects.[25]

To prevent this situation, the Insolvency and Bankruptcy Code (Amendment) Act 2020 (the First 2020 Amendment) prescribed that an insolvency application in relation to a real estate project can be initiated only by a minimum of 100 allottees or 10 per cent of the allottees in a project, whichever is less. The constitutional validity of this amendment was upheld by the Supreme Court in *Manish Kumar v Union of India*.[26]

The resolution of insolvency in the real estate sector remains riddled with complexities. The resolution of *Jaypee Kensington Boulevard Apartments Welfare Association v NBCC (India) Limited*[27] (*Jaypee*) (one of the 12 largest cases) came to fruition, but this also saw many twists and turns.

In *Jaypee*, the Supreme Court was confronted with appeals against the orders of the AA, whereby the resolution plan approved by the COC had been modified. The Supreme Court once again reiterated the supremacy of the COC and the limited scope of judicial interference by the AA in those matters.

Ultimately, the Supreme Court exercised its extraordinary powers under the Constitution to direct the two resolution applicants (NBCC and Suraksha Realty) to file afresh; however, from the perspective of real estate sector insolvencies, the Supreme Court also emphasised that an individual homebuyer or an association of homebuyers cannot maintain a challenge to the resolution plan if the homebuyers as

24 This is according to the statement made by Shri Anurag Thakur, Minister of State for Finance and Corporate Affairs in Lok Sabha. The statement is available at http://164.100.24.220/loksabhaquestions/qhindi/172/AU32.pdf (last accessed: 4 August 2021).

25 The problem created for the real estate sector perhaps led to the decisions in *Flat Buyers Association Winter Hills-77 Gurgaon v Umang Realtech Private Limited through IRP*, Company Appeal (AT) (Insolvency) No. 926 of 2019. In this case, the NCLAT held that the corporate insolvency resolution process initiated by a homebuyer or a financial institution would be limited to the project concerned and not impact other developers' projects. It observed that the 'reverse corporate insolvency resolution process' can be followed in the case of real infrastructure companies in the interest of the allottees and survival of the real estate companies. Clearly, such an interpretation is not in accordance with the provisions of the IBC.

26 2021 SCC OnLine SC 30.

27 2021 SCC OnLine SC 253.

a class have given their consent to any of the resolution plans. Since then, Suraksha Realty's resolution plan has been approved by the COC, and it is likely that this will finally bring down the curtains on this CIRP.

The Supreme Court has also come to the aid of corporate debtors undergoing a CIRP and, in aid of maintaining their status on a going-concern basis, it has held that the termination of an agreement (eg, a power purchase agreement) solely on the ground of initiation of a CIRP is not valid[28].

In *Gujrat Urja Vikas Nigam Limited v Amit Gupta*, the SC analysed the law on the validity of ipso facto clauses globally and concluded that if the corporate debtor is continuing to perform its obligation (in this case, power supply) then the power purchaser could not have terminated the PPA. The first 2020 amendment had also extended the scope of the moratorium under section 14 of the IBC to provide that licences, permits, concessions, clearances, etc, issued by a government authority shall not be suspended or terminated on the ground of insolvency during the moratorium period if current dues are being paid. Furthermore, the supply of goods or services critical to maintaining the corporate debtor's going-concern status shall not be suspended if the current dues are being paid during the moratorium period.

The provision offers flexibility to the IRP to determine what he or she considers critical to protect or preserve the value of the corporate debtor. The amendment has been necessitated to ensure that certain critical suppliers of goods and services do not compel the IRP into making payments of past dues as a priority over other creditors.

Group insolvency

The IBC contemplates insolvency of companies on a stand-alone basis. Companies, by default, even if they are part of a larger conglomerate, are viewed as separate legal entities for the purposes of initiating insolvency proceedings against them. In isolated cases, AAs have ordered the clubbing of insolvency proceedings of group companies for the purposes of hearings; however, no definite legal framework governing group insolvency exists in India.

28 *Gujrat Urja Vikas Nigam Limited v Amit Gupta*, Civil Appeal No. 9241 or 2019.

The IBBI constituted the Working Group on Group Insolvency under the chairmanship of Mr U K Sinha to propose a legal framework within which group insolvency proceedings may be conducted in India. The Working Group submitted its report on 23 September 2019.[29]

The Working Group recommended a cautious approach in a phased manner to implementing a group insolvency regime. It stressed the enabling and voluntary nature of the framework, recommending that with the exception of communication, cooperation and information sharing (among insolvency professionals, AAs and COCs of various group companies), no other provisions should be made mandatory. In the first phase, it was suggested that provisions relating to procedural coordination alone should be implemented. Procedural coordination could be achieved through joint application by group companies before an AA, the appointment of a single IRP and a common COC, and coordination between creditors of various group companies.

Meanwhile, various branches of the NCLT took the lead in some matters in consolidating insolvency proceedings of various group companies. For example, NCLT Mumbai consolidated insolvency proceedings of various group companies of *Lavasa Group in Axis Bank Limited v Lavasa Corporation Limited*,[30] on the basis that the insolvency of the subsidiaries depended on the outcome of the insolvency of the parent company. Similarly, in the case of *Edelweiss Asset Reconstruction Company Limited v Sachet Infrastructure Pvt Ltd*,[31] insolvencies of five group companies involved in developing a common township were consolidated by the NCLAT, in the interest of homebuyers.

However, where group companies are self-sustainable and are not interlinked, courts have also denied consolidation. In the case of *Videocon group companies*, while NCLT Mumbai allowed consolidation of the insolvencies of 13 group entities, it disallowed the consolidation of two other group companies.[32]

29 www.ibbi.gov.in/uploads/whatsnew/2019-10-12-004043-ep0vq-d2b41342411e65d9558a8c0d8bb6c666.pdf (last accessed: 4 August 2021).

30 MA 3664 of 2019.

31 2019 SCC OnLine NCLAT 592.

32 *State Bank of India v Venugopal Dhoot*, MA 1306 of 2018.

Cross-border insolvency

The Report of the Working Group on Cross-Border Insolvency noted that the existing provisions in the IBC (sections 234 and 235) do not provide a comprehensive framework for cross-border insolvency matters.[33] The proposal to provide a comprehensive framework for this purpose based on the UNCITRAL Model Law on Cross-Border Insolvency 1997 has been pending for some time. It was initially believed that an amendment bill would be introduced in the winter session of Parliament in 2019.[34]

While amendments to the IBC are awaited, the NCLAT advised a framework of cooperation between the administrator appointed by a Dutch court in respect of Jet Airways (having its regional hub in Amsterdam) and the resolution professional appointed by the AA in a petition filed by a financial creditor.[35] The protocol was designed on the principles of the UNCITRAL Model Law and provides a robust framework for cross-border coordination, maintaining respect for independent jurisdictions of the Dutch court and the NCLAT. Since Jet Airways was an Indian company with its centre of main interest in India, the IBC proceedings in India were the main insolvency proceedings, and the Dutch proceedings were non-main proceedings.[36]

In the case of *Videocon Industries*, the AA in India permitted the inclusion of the foreign assets held through other companies to be included in the resolution process. Further, the AA also declared that the moratorium under section 14 of the IBC is applicable to those foreign assets.[37] However, in the absence of a clear framework, these matters have to be dealt with on a case-by-case basis.

Conclusion

Insofar as any legislation can have a transformative effect, the IBC has achieved that objective. Unlike its predecessor regimes, the IBC has been adopted well by the system. When compared to SICA, the IBC has also resulted in better value realisation by various stakeholders.

33 Report of Insolvency Law Committee on Cross-Border Insolvency (October 2018).

34 KR Srivats, 'Cross-border insolvency framework-related amendments likely in Winter session', *The Hindu BusinessLine* (24 September 2019).

35 *Jet Airways (India) Limited v State Bank of India and Another*, 2019 SCC OnLine NCLAT 385.

36 ibid.

37 *Venugopal Dhoot v State Bank of India*, MA 2385/2019 in C.P.(IB)-02/MB/2018.

The government has been proactive in ensuring that problems are dealt with, and the courts have also (with the exception of some occasional stray orders) refrained from overturning the decisions of the COC. For international lenders and stakeholders, this is good news as it also points to the robustness of the IBC to meet evolving challenges.

The covid 19 pandemic and its resultant economic stress on certain businesses is likely to result in a greater number of IBC proceedings. The government will do well to fill the vacancies in NCLT in time to enable the judicial system to rise up to the occasion.

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Sarthak Advocates & Solicitors is a full-service law firm with a strong focus on corporate and commercial law. The firm advises on commercial transactions and disputes across industry sectors.

The firm blends its transactions and dispute resolution experience with an active role in public policy intervention. In a short time, we have had the privilege of being invited by several standing committees of Parliament to depose as experts on a range of bills, such as the Higher Education and Research Bill 2011, the National Academic Depositories Bill 2011, the Registration (Amendment) Bill 2013, the Forward Contract Regulation (Amendment) Bill 2011 and the Consumer Protection (Amendment) Bill, 2011.

The firm also acts as legal adviser to a number of public sector undertakings and government bodies, such as Bharat Heavy Electrical Limited, the Bureau of Energy Efficiency, Convergence Energy Services Limited (an EESL subsidiary) and the National High Speed Rail Corporation.

The firm has won several awards and recognitions from various leading publications. Asialaw Profiles recognised the firm as a 'Notable Firm' for its corporate M&A, restructuring and insolvency, energy and infrastructure, and disputes practices for the year 2021. The firm's energy practice has been recognised as a winning firm by the 2021 India Law Firm Awards and its energy and dispute resolution practices as finalists in the ALB India Law Awards 2021. Asian Legal Business and IFLR have also ranked the firm's M&A practice. The firm's construction, commercial and transactions, insolvency and government and regulatory practices have been ranked by Benchmark Litigation for 2020.

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Measures Relating to Business Turnaround During and Post-Covid-19 in Japan

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IN SUMMARY

This article introduces and summarises the current economic circumstances during the covid-19 pandemic in Japan, explains measures relating to business turnaround and provides a brief outlook on anticipated post-covid-19 business restructuring.

DISCUSSION POINTS

- Overview of the current situation in Japan (2020 to 2021)
- Measures relating to business turnaround during the pandemic
- Outlook on restructuring and insolvency proceedings after the pandemic

REFERENCED IN THIS ARTICLE

- Emergency financing
- Equity-cushion subordinated loan
- Subsidies for employment adjustment, rent, business sustainment and business restructuring
- Postponement of payment of taxes and social security premiums
- SME revitalisation support councils
- Turnaround ADR

Overview of the state of the Japanese economy

It is still uncertain when the covid-19 pandemic will come to an end, and the true depth of the pandemic's impact on the global economy remains to be seen. In Japan, although vaccinations are rapidly being made available to citizens, it is still uncertain whether the supply will be sufficient to inoculate all those who elect to be vaccinated. The large numbers of people flying into and commuting within Japan for the Tokyo Olympic Games has further contributed to this uncertainty surrounding the outlook for the covid-19 situation in Japan and its impact on the Japanese economy and nation as a whole.

Pandemic response

The covid-19 pandemic first arose in Japan when the mass infection of passengers aboard a cruise ship, which had docked in Japan after cruising around the world, came to light. Since then, the national and municipal governments in Japan, like those in other nations and jurisdictions around the world, have been in constant battle against the nano-sized 'monster' responsible for the pandemic.

The Japanese government has been actively promoting measures to aid and support ailing businesses since the start of the pandemic. A primary conundrum for the government, as in other nations, has been and continues to be how to strike a proper balance between the health and safety of citizens and the continuation of economic and commercial activities; each of those priorities calls for measures to prevent the spread of infection, but the balance of those measures shifts depending on the priority placed on those vital factors.

One characteristic feature of Japan's battle against the covid-19 pandemic, which differs in comparison with other nations, is that Japan does not have the legal infrastructure required to mandate or forcibly implement lockdowns, curfews, stay-at-home orders or other measures to suspend economic activities – even when a state of emergency has been declared by the national government. Only a few exceptions exist, which permit the shutdown of certain commercial complexes and commercial establishments that refuse to comply with government requests.

Nonetheless, potentially owing to Japanese citizens' diligent compliance with government requests, their willingness to and familiarity with wearing masks, and their habit of washing hands often and thoroughly with soap and using alcohol-based sanitisers for self-protection, Japan has been one of the more fortunate nations, where the pandemic has been less severe in terms of the fatality-population ratio and other medical statistics.

Impact on industries

That said, the pandemic's effect on Japan has been far from positive. The compliance of Japanese citizens – both individual and corporate – with government requests has slowed down, and the pandemic has had a massive negative impact on the nation's economic activities, stemming from individuals and enterprises having refrained from non-urgent and unnecessary transport, travel and gatherings, which has halted or slowed down economic and commercial activities. While the true extent of the impact is still unclear, it is obvious that many industries have been severely affected.

Those that have evidently been negatively impacted by the pandemic include the food service and hotel industries, airlines and transportation, automotive and other mobility companies, manufacturers of automotive parts and non-essential products, theatres and movie complexes, clothing and other apparel, and various retail shops and franchises. Generally, the smaller the enterprise, the more susceptible it has been to the impact of the pandemic.

For example, according to Teikoku Databank, as at 2 July 2021, of 1,710 covid-19-related bankruptcy filings, only 0.3 per cent were large-scale bankruptcies involving debts of 10 billion yen or more. The top three industries in which those bankruptcies occurred were restaurants, construction, and hotels and accommodation.

Olympic Games

Contributing to the negative effect of the pandemic is the situation regarding the Tokyo Olympic Games. Although the government initially hoped that the Olympic Games would have a strong, positive economic effect on various facets of the Japanese economy, the prevailing mood at the beginning of the Games was that it will not have as large an economic impact on the economy as expected, contrary to the government's original expectations. This is because the government declared a fourth state of emergency for the Tokyo metropolitan area on 12 July 2021.

It certainly did not help that the government, at both the national and municipal levels, decided not to allow spectators to attend Olympic events. There were also reports of more than 10,000 Olympic volunteer staff members who had quit or withdrawn over covid-19 concerns, and as at the beginning of the Games sales of Olympic goods were less than one-third of what was originally expected. The hotel, restaurant, tourism and aviation industries, which were expected to benefit from the Olympic Games, have not reaped nearly as many of the anticipated benefits from economic and commercial activities surrounding the Games.

Insolvency and restructurings

With regard to insolvency – including bankruptcies – and restructurings, contrary to initial expectations, especially those formed during the first three to six months of the World Health Organization's pandemic declaration, Japan has not seen a rapid spike in the number of insolvency and restructuring cases; rather, there has been a decrease in the number of insolvencies and restructurings.

According to Tokyo Shoko Research, 2020 had the fourth-lowest level of recorded bankruptcies for any year in the 50-year period since 1971. This is believed to be, at least in part, because of government efforts to actively promote measures to aid and support ailing businesses since the start of the pandemic. It is at least fair to say that those measures have been somewhat successful in allowing enterprises to avoid immediate bankruptcy or insolvency, and that they have prolonged the lives of impacted enterprises. This is especially notable considering that, in Japan, by contrast with other foreign countries and jurisdictions where courts were shut down for extended periods, the bankruptcy courts in Japan did not close for any significant period.

However, the existing measures mostly comprise emergency loans and guarantees, as well as extensions on taxes and other public payments, with only small amounts of grants and subsidies; hence, it is expected that an increasing number of enterprises are or will be carrying more debts than they can repay, and that those businesses are, or soon will be, facing financial difficulties, despite the little breathing room the government measures have provided. In other words, there is no guarantee that those well-intended measures will be enough to allow troubled enterprises to sustain their business endeavours or maintain manageable debt service levels. If this proves to be true, more likely than not, banks and other financial institutions will accelerate their disposition of non-performing loans, especially once the economy returns to a more normal state.

Measures relating to business turnarounds during the pandemic

Emergency financing

To assist business operators affected by the covid-19 pandemic, the national government has implemented several emergency financing programmes. Of those financing measures, provisions of credit, in the form of both loans and guarantees, are intended to be fine-tuned depending on the size of the affected enterprises –specifically, both loan programmes provided by government-affiliated financial institutions and guarantee programmes provided by public credit guarantee associations, which guarantee loans extended to affected enterprises by private financial institutions, classify the amount of available credit by the size of the affected enterprise, as determined by the number of employees and the amount of registered capital, as well as the degree of impact suffered, as determined by the rate of decreased sales.

The available types of emergency loans include de facto interest-free loans (de facto in that the interest payments will be covered by support granted by public institutions), significantly low-interest loans, subsidies for guarantee fees, deferment periods before principal repayments, long-term loan periods and lump-sum repayment options. Clearly, the main targets of those emergency loan programmes are small and medium-sized enterprises (SMEs), which have weaker financial and credit conditions than large companies. According to publicly available information, from April 2020 to March 2021, the credit guarantee performance for SMEs in Japan increased by 20 trillion yen, and as at March 2021 the amount of emergency response financing granted to SMEs in Japan by government-affiliated financial institutions was 15 trillion yen.

'Equity-cushion' subordinated loans and preferred stock

For larger enterprises, the Development Bank of Japan (DBJ), a government-affiliated financial institution, has been acting on behalf of the government as the designated financial institution to respond to emergency financing needs arising from the covid-19 pandemic. According to a press release dated 9 June 2021, the total amount of loans extended by DBJ to covid-19-affected recipients as at March 2021 was 2.2 trillion yen. Of those loans, 99 per cent were extended to large and medium-sized enterprises.

More significantly, in addition to emergency response loans (which rank as senior loans), equity-cushion subordinated loans are also being provided by DBJ on a wider-than-usual basis in the wake of the pandemic. Equity-cushion subordinated loans are a type of mezzanine financing with an intermediate debt and equity nature. They have the advantage of improving the affected enterprises' financial stability through an improved capital structure without diluting shareholdings and advancing their capital adequacy ratios as, if correctly structured, rating agencies will count subordinated loans as equity when calculating capital adequacy.

The DBJ's loan periods for equity-cushion subordinated loans to battle financial difficulties arising from the pandemic are more than five years, with interest rates starting at 1 per cent for the initial three years, under the interest replenishment programme, and rising to 3 per cent thereafter (but remaining at 1 per cent for medium-sized companies in deficit).

Furthermore, the DBJ has been utilising a particular fund sourced by the government and specifically provided to the DBJ in accordance with a financial framework called the Novel Corona Revival Growth Foundation Enhancement Fund. The fund was established to let the DBJ support the rapid and steady recovery and growth of enterprises that are developing new businesses and collaborating with businesses in other industries, but that are being affected by the pandemic. With the fund, the DBJ has been subscribing preferred stock issued by affected enterprises, rather than merely extending credit through debt instruments.

In March 2021, the DBJ also set up a fund to underwrite preferred stock specifically aimed at providing capital to the food and beverage industries, mainly to restaurants but also to hotels and other accommodation, in response to a request from the government. As a general rule, the fund's preferred stock is set up as redeemable, non-voting preferred stock, with a preferred dividend ratio of 4 per cent and an investment period of one year (extendable for up to two years).

The use of proceeds received through those emergency loans and preferred stock offerings is limited to funds required for the recipient enterprises to battle the impacts of the pandemic; naturally, the funds cannot be used to repay existing loans or to pay for the costs of lay-offs or worker furlough. With regard to mezzanine financing, the key point is whether a business plan can be drawn up in a way that includes a restructuring plan that explains the outlook for repayment, such as whether an accounting surplus is available for dividends on preferred stock when it reaches the redemption due date or whether the financial position of subordinated loans is such that they can be refinanced through regular loans.

Subsidies

The government has implemented various subsidy programmes to support SMEs that have been significantly affected by the pandemic. For example:

- subsidies made available to SMEs affected by the government's quarantine measures, such as state of emergency declarations, as well as initiative programmes incentivising the development of new industries or business models, business transformations, or business and industry conversions;
- subsidies to support new challenges that SMEs face in their business restructuring efforts; and
- subsidies to support capital investments in SMEs' efforts to combat manufacturing challenges, disruptions in supply chains, business-sustaining challenges that call for widening of sales channels and challenges involving reinforcement and strengthening of IT to permit remote working and other digital transformations.

There were also grants aimed at providing affected SMEs with assistance with rent payments; however, the application periods for those grants have closed.

Subsidies made available to larger corporations also include employment adjustment grants. In Japan, a provision in the Labour Standards Act requires employers to pay workers leave allowances equivalent to at least 60 per cent of their average wages if the workers are absent from work based on 'reasons attributable to the employer'. The employment adjustment grants are intended to assist enterprises with payment of this leave allowance to their employees and other eligible workers.

In particular, in respect of companies affected by the pandemic, a system has been implemented to provide full compensation to companies that retain their employees as opposed to engaging in lay-offs and terminations. According to publicly available information, as at 8 July 2021, 3.9 million grant decisions have been made in connection with this programme, and the aggregate amount of grants made through the programme has reached 3.8 trillion yen.

There is some delay between the application for these subsidies and the time the payments are actually provided; as a practical matter, this means impacted enterprises must come up with other sources of available cash to sustain their businesses while waiting on disbursement of the subsidies.

Postponement of taxes and social security premiums

The government has established a grace period system that allows companies, regardless of size, to delay and postpone taxes and social security premiums. First, in light of the fact that the revenues of many businesses decreased dramatically owing to government measures aimed at preventing the spread of the pandemic (eg, the government's requests for people to stay at home) and for the closure of certain commercial complexes and establishments (eg, restaurants and theatres), a special exemption has been established that permits business operators that have seen a substantial decrease in revenue to suspend tax payments for one year without being required to provide collateral or pay penalties, such as those assessed on delinquent taxes.

As at the time of writing, those special exemptions have been terminated, but the government continues to engage in flexible handling of enterprises experiencing significant losses owing to decreased profits, etc; for example, in principle, if an enterprise cannot make a lump sum payment for taxes or social security premiums, the business can postpone the relevant payments by an amount up to the amount of the losses suffered, with a reduced or waived delinquency tax, for one year (or for two years, depending on the circumstances).

In other words, as a general rule, the grace period for taxes and public payments is only up to a single year, and enterprises that made use of the grace period system in 2020 may not be granted any further deferments; however, in practice, long-term instalment payments on deferred payments are permitted, and it appears that the system has been designed so that insolvency of those enterprises can be avoided to the extent possible.

Considering that it is always difficult to waive or reduce taxes and other public duties – even through the use of in-court insolvency procedures – when an enterprise aims or purports to restructure its business operations, finances or capital structure via restructuring efforts, it remains true that the payment of taxes and other public duties will have to be factored into restructuring plans.

Outlook: once the dust settles?

One interesting aspect of the pandemic's impact on economies worldwide is that the financial markets, and equity markets in particular, have not stagnated. Rather, with most – if not all –central governments taking proactive measures to support their economies, and central banks lowering interest rates to allow more funds to flow through to the economy, stock exchanges and private equity markets are booming in many countries.

This can also be said of the Japanese market. With investors pouring more funds into the market, money has currently become more available to many enterprises, regardless of their fundamental situation. As a result, concerns have been raised that the number of 'zombie' companies is increasing, on top of the already high number of zombie companies that resulted from the prolonged, extremely low-interest rate market and deflation that existed in Japan for more than two decades prior to the onset of the covid-19 pandemic.

It is expected and desired that government-affiliated financial institutions, private financial institutions and private equity funds will play a significant role in supporting business operators' financial situation and that enterprises in Japan will experience business transformations and other developments, while simultaneously providing a much-needed boost to industry.

The pandemic has caused immense changes to people's way of life; however, it is also possible that it merely accelerated some much-needed changes, which enterprises could not push themselves to undertake before facing this unprecedented level of difficulty.

We are already starting to see large and medium-sized enterprises responding to these long-awaited changes through withdrawing from unprofitable businesses, returning their focuses to core businesses via selection and concentration, and funding these efforts through the use of preferred stock and subordinated loans from DBJ. Financing to companies in industries affected by the pandemic, such as the ANA

Group (aviation), the Kintetsu Group (public transport and travel), the Marui Group (department stores), the Royal Group (restaurants and food chains) and the Watami Group (restaurants and food chains), has been catching the eye of market participants; these companies have been able to avoid in-court insolvency or restructuring procedures through tapping early-stage out-of-court workouts.

The enterprises struggling most in the face of the pandemic are SMEs. According to 2016 statistics, 3.57 million SMEs were operating in Japan – a number higher than most other countries in the world. When looking at SMEs that have received funding support for the pandemic, given that the grace periods for taxes and social security premiums that began being offered in 2020 have lapsed as a general rule, SMEs for which funding is tight will need to begin workouts in the not-too-distant future, owing to the need to resume payment of taxes and public duties.

However, difficulties associated with making those payments continue to arise because the business base is still being affected by the pandemic; the sales, cash and revenue flows of SMEs have fallen, and it will continue to be difficult for those enterprises to come up with the funds required to restructure and to establish the workout plan required to come up with the funds to finance restructuring. It may be necessary to adopt more drastic revitalisation measures – as opposed to earlier stage workouts – to assist enterprises that cannot gain access to extended grace periods, other rescheduling or other sources of financing before the economy returns to its normal state. The measures may include severe options, such as liquidation of the corporation, transfer of a company's business to a sponsor, the offloading of any remaining debt and the closure of businesses. It could well be that the use of rule-based workout initiatives will be a 'last ditch' effort to avoid the final option of liquidation.

In Japan, the low-interest rate environment and the prevalence of deflation markets resulted in the adoption of a number of rule-based workout initiatives. Among them are two rule-based out-of-court workout initiatives that are often used by SMEs: the turnaround programmes for SME revitalisation support councils and turnaround alternative dispute resolution (ADR). These workouts are designed to be easy to use and provide a moratorium (or stay), and both call for financial institutions to sit at the bargaining table (and government agencies have been asking that financial institutions do so). From the perspective of financial institutions, in addition to the predictability of those procedures, they are easier to accept because they contain explicit statutory grounds for non-taxed write-offs being permitted when financial debts are waived through those procedures.

Turnaround programmes for SME revitalisation support councils

SME enterprise revitalisation support councils are fair and neutral public institutions that have been established in each prefecture under the Industrial Competitiveness Enhancement Act for the purposes of supporting efforts to regenerate SMEs. Through the councils, experts (lawyers, certified public accountants, tax accountants, SME consultants, financial institution alumni, etc) with knowledge and experience in corporate revitalisation provide support to individual companies, from consultation and advice on revitalisation to the formulation of revitalisation plans – all tailored to match the characteristics of each SME. Since the councils' workout programmes are sponsored by the councils, which are public institutions for SMEs, the procedural costs are lower than the costs for turnaround ADR.

In May 2020, the councils launched new support proceedings (covid-19 special rescheduling programmes) for SMEs whose sales have decreased by 5 per cent or more compared with the previous year or two. The councils collectively request the deferral of principal repayments to financial creditors on behalf of the debtor, assist the debtor with drafting a special one-year restructuring plan, encourage consensus-building among financial creditors to consent to the plans and help the debtor obtain new loans from banks, if necessary. After the plan is approved, the councils continue to check in with the debtor enterprise and advise on its cash flow.

In addition, if an SME meets the following four requirements, a revitalisation support scheme will be adopted to support the drafting of a concrete and achievable revitalisation plan that clearly states the details of the financial assistance request (rescheduling, additional loans, debt waivers, etc):

- the SME is in a difficult management situation, mainly owing to excessive debt, and it would be difficult for the SME to regenerate its profits on its own;
- the business that is subject to revitalisation has business value, such as profitability and future potential, and there is a possibility of revitalisation with the support of the relevant parties;
- there is a risk that the debtor's creditworthiness will be negatively affected by applying for in-court proceedings, and its business value may be severely damaged thereby, which may hamper revitalisation; and
- the plan is economically reasonable for creditors, for example, owing to the prospect of recovering more than could be recovered through in-court procedures.

The contents of the proposed revitalisation plan must:

- resolve substantial excess debt within five years of the date of the start of the first new business year after establishment of the plan, and

- if ordinary income is in the red, ensure ordinary income will be converted into a surplus within approximately three years of the date of the start of the first new business year after establishment of the plan.

However, if an emergency loan is provided before the introduction of the revitalisation support plan, adjustment of the interest on existing loans and emergency loans will not be easy to calculate, and there have been discussions relating to whether, in the case of an unsecured emergency loan, a creditor will be able to receive certain priority payment in an out-of-court workout or an in-court procedure if the workout fails; by contrast, emergency loans received during turnaround ADR are protected even in the event of a transition to in-court procedures.

Turnaround ADR

Turnaround ADR is another popular rule-based out-of-court workout procedure in which third-party experts coordinate communications between creditors, such as financial institutions, and debtors for purposes of supporting debtor companies' earlier stage business revitalisation.

The Japanese Association of Turnaround Professionals, as a specific certified dispute resolution business operator, is responsible for conducting the ADR procedures. There is no limit on the size or industry of debtor companies that can apply for the use of turnaround ADR. The system can be used by SMEs and larger companies, and as it does not involve any court oversight or supervision, no cramdown is available, either in class or cross-class, and unanimous consent of the relevant creditors is required.

From the pre-consultation stage, a debtor contemplating use of the procedure is called upon to conduct its own due diligence and develop an outline of its business revitalisation plan. The debtor's efforts are surveyed and overseen by a third-party expert, who is also scheduled to be retained by the Association to serve as the overseeing expert.

If the proposed plan has a possibility of being approved, an official application will then be made, a suspension notice will be sent to target creditors, mainly financial institutions, and a creditors' meeting will be convened to appoint the third-party expert as a procedural implementer who will explain an outline of the debtor's proposed business revitalisation plan to the creditors.

If any creditors disagree with the plan, it is assumed that special conciliation, as described below, will be used or a transition to in-court insolvency procedures will occur. In the case of a transition to in-court procedures, to allow smooth transit (which,

in turn, incentivises relevant parties to do as much as possible within the ADR procedure), the following support measures, which respect the results and actions taken during the course of the turnaround ADR, have been institutionalised and codified:
- facilitation of priority payment of commercial claims in in-court procedures;
- facilitation of priority payment of bridging loans (pre-DIP finance); and
- simplified procedures relating to the expedition of special conciliation procedures, etc.

The three concepts listed above have been introduced statutorily, rather than just in the Association rules, and under the amended Act on Strengthening Industrial Competitiveness, which came into effect in June 2021.

Further, a transition to simplified civil rehabilitation procedures will also be facilitated if more than three-fifths of the creditors whose total claims are covered agree to the plan, even if there are also opposing creditors.

Special conciliation

Special conciliation is a conciliation, the process for which is governed by the Act on Special Conciliation Proceedings for Expediting Arrangement of Specified Debts, that pertains to an adjustment or arrangement of debts to contribute to the economic rehabilitation of debtors who are likely to become unable to pay debts. It thereby aims to expedite the arrangement of interests pertaining to monetary debts of the debtors.

From April 2020, the Tokyo District Court has launched a programme to expedite a special conciliation process, within the court divisions that handle civil rehabilitation cases and corporate reorganisations, when only a certain creditor or set of creditors oppose a plan presented in a prior out-of-court workout. The target companies are those whose proceedings have converted from formal, rule-based out-of-court workouts or who already have held creditors meetings for their financial creditors and have had property assessment reports evaluated by certified public accountants or rehabilitation plans based on those assessments.

According to article 17 of the Civil Conciliation Act, if an agreement among the parties is unlikely to be reached, the court may issue a necessary order to resolve the case. The order has the same effect as a successful conciliation if no parties object within a certain period, and the court announces positive use of the order as necessary.

If out-of-court workouts using the rule-based procedures outlined above or special conciliation do not work (eg, owing to an inability to obtain the unanimous consent of the creditors) or if the transition from turnaround ADR to simplified civil rehabilitation does not meet the relevant requirements, conventional civil rehabilitation procedures and corporate reorganisation procedures must be used to restructure a business, as those in-court restructuring processes are usually the only remaining choices.

Closing remarks

At the earlier stages of the covid-19 pandemic, people in Japan anticipated that the number of insolvencies, especially bankruptcies, would increase rapidly; however, the number of insolvencies and restructuring cases did not spike dramatically. For example, bankruptcies triggered by the pandemic have has reached neither the number arising from the global financial crisis stemming from the Lehman shock, nor those triggered by the Tōhoku earthquake and tsunami. This is owing to quantitative easing and the cooperation of financial institutions.

However, attempts at solutions have been provided only in the context of postponements and tentative rescheduling, which merely prolongs the life of struggling enterprises by delaying the problems rather than offering real resolutions; this causes a lot of groping in the dark, with no exit clearly visible.

In Japan, as in other parts of the world, the path to economic recovery will gradually become clearer as mass vaccination progresses. Moreover, there is probably no way around the fact that a clear divide will grow between enterprises that adapt to the new way of life, often referred to as the 'new normal', and those that are less successful in adapting to the new normal. For example, even in industries where overall sales recover to pre-pandemic levels, there will be enterprises that are unable to return to pre-pandemic sales levels owing to their failure to adapt to the changing times; on the other hand, there also will be enterprises that will have gained more momentum than they had pre-pandemic.

Some economists and market participants are calling this phenomenon a 'K-shaped economic recovery', where there will be a mix of companies that return to successful performance and those that do not return to pre-pandemic sales levels. Importantly, in terms of insolvencies and restructuring, as we move towards this anticipated K-shaped economic recovery, we anticipate a wave of accelerated restructuring, both in terms of operational restructuring and financial restructuring (to finance operational restructuring) as, more likely than not, there will be an abundance of enterprises that unfortunately will be left behind in adapting to the new normal.

In addition to responding to post-pandemic ways of life and changes in how our societies function, changes in the business environment, such as digital transformations and responses to sustainable development goals, will be constant and will continue to grow in importance. In that respect, we expect that insolvencies and restructuring will place more importance on facilitation and acceleration of each enterprise's business metabolism, as well as that of the industries and the economy overall, as we move into an ever-and-faster-changing business and commercial landscape.

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NISHIMURA & ASAHI

Nishimura & Asahi is the largest law firm in Japan, with over 700 attorneys, providing a full range of legal services both in Japan and overseas. We provide expeditious and high-quality legal services, particularly for cross-border cases that require an ability to resolve complicated international issues, and projects that require a high level of expertise to traverse multiple jurisdictions and various practice areas requiring specialised professionals.

We have the largest team of restructuring/insolvency attorneys in Japan, with over 60 attorneys highly specialised in restructuring/insolvency practice. Our group provides first-class service for all types of restructuring and insolvency proceedings, whether in court or out of court. Our strengths include our capability of employing the most suitable team for each case, collaborating with our firm's attorneys in other practice areas and providing attorneys on site via our numerous overseas offices. Our restructuring and insolvency team has won numerous international awards and has been recognised as a top-tier team in all notable rankings.

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The Path to Corporate Rescue Reform in Malaysia

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IN SUMMARY

Corporate voluntary arrangement (CVA) and judicial management were corporate rescue mechanisms that were introduced with the Companies Act 2016. These mechanisms complemented the existing scheme of arrangement procedure as corporate restructuring processes. The CVA take-up rate was low, while enhanced statutory tools were needed to boost the effectiveness of judicial management and schemes of arrangement. In 2020, important reforms modelled on equivalent reforms in Singapore were proposed. However, Parliament was not able to sit for most of 2021; thus, the much-needed reforms have not become law.

DISCUSSION POINTS

- Existing corporate rescue mechanisms under Malaysian law
- Inadequacies of the existing corporate rescue mechanisms
- Proposed Malaysian corporate rescue enhancements and intended effects
- Discussion of the proposed reforms

REFERENCED IN THIS ARTICLE

- *AirAsia X Berhad v BOC Aviation Ltd & Ors*
- Companies Act 2016
- Singapore Companies Act
- Singapore Insolvency, Restructuring and Dissolution Act
- UK Enterprise Act 2002
- *Re Design Studio Group Ltd & other matters*
- *Re Attilan Group Ltd*
- Australian Treasury Laws (Amendment) (2017 Enterprise Incentives No 2) Act 2017 (Commonwealth)
- Companies Commission Malaysia

Introduction

August 2016 saw two significant milestones in company law reform in Malaysia. The first was the enactment of the Companies Act 2016 to replace the Companies Act 1965, which was outdated and in need of a comprehensive overhaul. The Companies Act 2016 received the Royal Assent on 31 August 2016, and most parts of the new statute came into force on 31 January 2017.

The second milestone was the formal introduction of two corporate rescue mechanisms through the Companies Act 2016. Until then, none had existed under Malaysian law. The corporate rescue mechanisms are corporate voluntary arrangement (CVA) and judicial management. Both mechanisms came into force on 1 March 2018, more than a year after the Companies Act 2016 came into force. The introduction of those two processes was a major development in itself.

Despite being new processes with good intentions, the CVA and judicial management have been plagued by inadequacies in the legislative framework. The eligibility criteria for companies that could use the CVA process had been narrowly drawn in section 395. First, it was restricted to private companies only; second, the CVA process could only be utilised by companies that had not granted any security by way of a charge over their assets. Those criteria reduced the pool of eligible companies; thus, the take-up rate for the CVA has not been as high as the legislators might have hoped.

The judicial management mechanism, on the other hand, was imported from legislative provisions first introduced in Singapore in 1987, but without the benefit of the proposed reforms that Singapore was in the process of introducing following the Final Report of the Singapore Insolvency Law Reform Committee in October 2013[1] and the Report of the Committee to Strengthen Singapore as an International Centre for Debt Restructuring in April 2016.[2] In 2017, the Singapore judicial management framework was updated and improved with amendments to the Singapore Companies Act (SCA), thereby enacting most of the recommendations of the two committees.

In mid-2020, with Malaysian corporates beset by operating restrictions because of movement control orders issued by the government's health authorities owing to the covid-19 pandemic, as well as attendant cash flow problems and survival concerns, the Companies Commission of Malaysia (CCM) initiated a private consultation with various specialist professional bodies and regulatory agencies on reform measures that

1 Singapore Ministry of Law, Insolvency Law Review Committee, Report of the Insolvency Law Review Committee: Final Report 2013.

2 Singapore Ministry of Law, Report of the Committee to Strengthen Singapore as an International Centre for Debt Restructuring (20 April 2016).

would make the CVA and judicial management processes more rescue-orientated and accessible to a wider range of eligible corporates in Malaysia. A formal public consultation followed.

The CCM issued a public consultation document: the Consultative Document on The Proposed Companies (Amendment) Bill 2020.[3] The document contains a number of policy statements and guiding principles aimed at amending not only the corporate restructuring and insolvency provisions but also various other parts of the Companies Act 2016. The policy statements that are relevant to corporate rescue and insolvency will be described in greater detail in this article.

Before the introduction of the CVA and judicial management, the sole corporate rescue tool had been the scheme of arrangement process that was contained in the Companies Act 1965 and re-enacted, with some limited improvements, in the Companies Act 2016. As has been the case in Singapore and elsewhere, the scheme of arrangement process has become a valuable debtor-in-possession restructuring tool, despite the fact that the scheme of arrangement process is not a true collective insolvency proceeding or a unique corporate rescue mechanism in its own right.[4]

The CCM public consultation document also contained proposals for major reforms to the scheme of arrangement procedure in the Companies Act 2016. The policy statements relating to those proposed reforms to the scheme of arrangement process will be outlined in more detail below.

Existing corporate rescue mechanisms under Malaysian law

There are three main corporate rescue processes under Malaysian law: schemes of arrangement, CVAs and judicial management.

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3 Companies Commission of Malaysia, Consultative Document on the Proposed Companies (Amendment) Bill 2020.

4 See Christian Pilkington, *Schemes of Arrangement in Corporate Restructuring*, 2nd ed, Sweet & Maxwell, 2017, paragraphs 2-002 to 2-004. Nevertheless, in a recent decision involving AAX, the long-haul carrier arm of Asia's largest low-cost carrier, AirAsia, the Malaysian High Court held, after considering expert testimony from eminent English insolvency lawyers (given that the interests involved were governed by English law) that where a scheme of arrangement is formulated on the basis of insolvency, it is capable of constituting an 'insolvency-related event' for the purposes of the Cape Town Convention on International Interests in Mobile Equipment and the Protocol on Matters Specific to Aircraft Equipment. This was on the basis that the extent to which the assets and affairs of the debtor were involved sufficiently made it a collective proceeding, and although the management of the debtor remained in control, the process was subject to the control or supervision of the Court. See *AirAsia X Berhad v BOC Aviation Ltd & Ors* [2021] MLJU 189 [278] to [280] per Ong Chee Kwan JC.

Scheme of arrangement

A scheme of arrangement is not a true corporate rescue mechanism. Scheme of arrangement proceedings are not exclusively intended for insolvent companies and are widely used by solvent entities to achieve solvent corporate restructurings and transfers of undertakings. Nevertheless, companies experiencing cash flow problems and with a debt burden, frequently utilise the scheme of arrangement process.

The process has become adapted over time to the needs of corporate rescue. It is a debtor-in-possession type process that does not require the appointment of an insolvency official or practitioner who might displace management. It allows for a court-approved restructuring scheme that has been approved by all classes of creditors with the necessary voting majorities to be imposed on dissenting creditors and members.

The scheme of arrangement process also allows an applicant company to seek restraining orders that restrain creditor action and security enforcement while a scheme is pending; however, problems with the statutory requirements that must be satisfied before a restraining order can be granted have led to problems with achieving a proper space for a company to successfully restructure its debt.

The reforms that are proposed by the CCM through the public consultation aim to overcome these drawbacks with the process and to simplify the process of securing interim protection while a scheme is being formulated, proposed, voted on and approved.

CVA

The CVA is the newly introduced corporate rescue mechanism under the Companies Act 2016. It provides a consensual statutory restructuring tool that is available to private companies only. The CVA process permits a proposed voluntary arrangement to be imposed on and, thereby, bind all creditors, provided the statutory voting threshold is achieved but without any significant court involvement.

Judicial management

Judicial management is another of the new corporate rescue mechanisms under the Companies Act 2016. It allows for the appointment by the Malaysian High Court of a judicial manager over an insolvent corporate debtor, provided it can be shown that there is a reasonable prospect of, among other things, preserving all or part of the company as a going concern, and that interests of creditors would be better served than on a winding-up.

The inadequacies of the existing corporate rescue mechanisms

Malaysia's existing rescue mechanisms proved to be barely adequate in the three years prior to the start of the covid-19 pandemic. The weaknesses of those mechanisms and processes were amplified and problems were exacerbated with the onset of the pandemic. The shortcomings of each of the processes will be briefly described below.

CVA

The CVA process was intended to be a relatively streamlined procedure that did not require the involvement of a court, except for certain statutory filing requirements. It was intended to enable a company to expeditiously reach an arrangement voluntarily with its unsecured creditors.

A company experiencing cash flow problems or financial difficulties could approach all its creditors with a proposal for a voluntary arrangement. It could do so with the aid of a moratorium of up to 60 days to protect it from creditor action, or one or possibly two insolvency practitioners who would provide oversight.

Despite these good intentions, as a corporate rescue mechanism, the CVA process had a number of inadequacies and drawbacks.

- It is limited to private companies; therefore, public companies cannot use the CVA procedure. This is unnecessarily limiting.
- Any company that has granted security over its assets cannot undertake a CVA. This eliminates many eligible private companies.
- The CVA cannot be used in the case of any company that is subject to the Capital Markets and Services Act 2007.
- There is no provision for securing new money or for rescue financing or super priority.
- There is presently no provision ensuring the continuity of essential supply contracts or protecting the company from the exercise of termination rights under ipso facto clauses in contracts while the CVA negotiations are ongoing, despite the benefit of an automatic moratorium that comes into effect on commencement of a CVA.

Judicial management

The judicial management process is a process that allows a creditor or the company to apply for a judicial management order that enables the appointment of an insolvency practitioner as the judicial manager of the company. The appointee is empowered to take control of a company and to come up with a rescue proposal for the company. It comes with the benefit of a wide-ranging statutory moratorium.

As a practical and effective corporate rescue mechanism, the pre-reform judicial management framework has a number of inadequacies.

- Unlike Singapore, public listed companies in Malaysia cannot use judicial management as a rescue process.
- Judicial management is not available to any company that is subject to the Capital Markets and Services Act 2007.
- A judicial management application is subject to a secured creditor veto, which is antithetical to the notion of corporate rescue.
- As with CVA, there is no provision for rescue financing or super priority or any provision to protect new money.
- The judicial management framework does not provide for the continuity of essential supply contracts, nor does it protect the company from the exercise of termination rights under ipso facto clauses in contracts notwithstanding the moratorium that comes into effect.

The scheme of arrangement procedure

Given that it has existed for more than 50 years, the scheme of arrangement procedure under the Companies Act 1965 and re-enacted in the Companies Act 2016 is the oldest procedure in Malaysia for corporate rescues. It is not exclusively meant for corporate rescue, and it is widely used for non-insolvency-related purposes, after being adapted by insolvency practitioners to suit the needs of distressed companies.

The scheme of arrangement process is a debtor-in-possession restructuring process, so management continues in office and remains in control of the process. In its existing form, there is no role for an external insolvency practitioner's appointment.

While a distressed company taps the scheme process, it can obtain protection against creditor enforcement through a restraining order granted by the High Court on application. If a restraining order is granted, it protects the company pending the passage of the scheme of arrangement through class meetings and up to final court sanction.

Nevertheless, the existing framework for schemes of arrangements has a number of shortcomings.

- The Malaysian courts have restrictively interpreted the restraining order provisions in section 368(2) of the Companies Act 2016 to extend to only existing proceedings against a company, as opposed to future proceedings – a result that is incongruous and illogical.

- The operative provision empowering a court to grant restraining orders is unclear in respect of when and how it is to be fulfilled. One of the requirements is for the nomination of a director who will represent the creditors. Fulfilling this requirement is a prerequisite to the court's ability to grant a restraining order. The statute requires the nomination to achieve at least 50 per cent creditor support. Failure to meet this hard number for the nomination of a director to represent creditors during the passage of the scheme of arrangement process has effectively given creditors an indirect way of negating a restraining order before it can even be sought.
- A further issue is the problem of interpreting exactly what sort of matters fall within the term 'proceedings'. Section 368(2) empowers a court to restrain 'proceedings', but there is doubt over whether that includes extra judicial proceedings, such as the appointment of a receiver, the repossession of chattels and equipment, and enforcement of security.
- Owing to the phrasing of the empowering provision in section 368(2), there are issues about whether the four prerequisites contained therein must be fulfilled at the time of the company's initial application for a restraining order of three months' or only at the stage when a scheme company seeks a further extension of the initial restraining order.
- In its current form, the legislation provides for a maximum period of nine months in total for any restraining order. The impact of lockdowns resulting from measures to combat the covid-19 pandemic makes a longer period of protection a necessity in Malaysia.
- The current framework does not allow a court to restrain proceedings and other enforcement action against guarantors that have guaranteed debts of the applicant company.
- There is presently no protection for companies that are related to the applicant company, such as the holding company or a subsidiary or related group companies, against creditor enforcement, while the applicant company's scheme proposals are pending.
- The existing provisions in the Companies Act 2016 do not contain any cross-class cramdown provisions that could enable a court to approve a scheme of arrangement at the final sanction stage where there is overwhelming support for a scheme but one dissenting class of creditors.

- As with judicial management and the CVA, there is currently no provision for the continuity of essential supply contracts or the protection of the company from the exercise of termination rights under ipso facto clauses in contracts while the scheme of arrangement is pending.

The level of use of the corporate rescue mechanisms

Statistics relating to the use of each of the three processes[5] are as follows.

Year	Restraining orders in scheme of arrangement (as at May 2021)	CVA (as at April 2021)	Judicial management (as at April 2021)
2018	32	3	16
2019	5	1	9
2020	14	1	36
2021	28	1	10

The figures make for interesting reading. First, in the first two years after coming into force, the numbers were relatively low for both CVA and judicial management. Second, the numbers confirm the low take-up rate for the CVA, despite it being the simplest corporate rescue mechanism in terms of process and timeline. Finally, at least in 2021, schemes of arrangement seem to be used more compared with judicial management.

The proposed adoption in Malaysia of corporate rescue reforms

In August 2020, the CCM issued a formal public consultation document. The proposed reforms were expressed as a series of policy statements and guiding principles. The policy statements cover areas outside corporate restructuring and insolvency.

In the public consultation paper, SSM proposed the following reforms that are relevant to corporate rescue and restructuring:

- enhancement of the scheme of arrangements framework, including:
  - empowering the Court to grant an automatic moratorium upon an application of a restraining order under section 368;
  - empowering the Court to restrain proceedings against a subsidiary or holding company;
  - empowering the Court to order a meeting for a revote of the proposed compromise or arrangement;

5 The CVA and judicial management processes came into force on 1 March 2018.

    - empowering the Court to approve a compromise or an arrangement without having the meeting of creditors;
    - empowering the creditor to apply to the Court for a review of the decisions made by the company during the moratorium;
    - allowing super priority for rescue financing;
    - introducing cross-class cramdown provisions; and
    - permitting creditors to apply to restrain dispositions of a debtor's assets during moratorium;
- enhancement of the corporate rescue mechanisms framework by:
    - empowering secured creditors to recover certain categories of properties during moratorium, and
    - allowing super priority for rescue financing; and
- introducing provisions to deal with contractual termination clauses to ensure continuous supply of essential goods and services by:
    - restricting ipso facto clauses; and
    - ensuring continuity of supplies.

Singapore 2018 reforms as foundation for proposed Malaysian reforms

Singapore undertook a corporate rescue reform process between 2010 and 2018. The reform process culminated in the enactment of an omnibus insolvency statute known as the Insolvency, Restructuring and Dissolution Act (IRDA) in 2018.

In Malaysia, a public consultation paper of the CCM used the Singapore reforms as a basis for reforming the Malaysian corporate rescue provisions. Many of the proposed reforms under the various policy statements have been taken from Singapore's reforms in 2017 to the judicial management provisions in the SCA.

Some reforms in Singapore, such as the introduction of an out-of-court pathway towards a company placing itself in judicial management (similar to the out-of-court administration process under the UK Insolvency Act 1986) are not part of Malaysia's proposed reforms.

Proposed Malaysian corporate rescue enhancements and intended effects

Wider access to CVA and judicial management

One of the more pressing areas for reform is access to the CVA and judicial management. The Malaysian proposals, specifically policy statements 10 and 12, broaden access to those rescue mechanisms.

Under policy statement 10, all companies – whether private or public and whether listed or not – can now avail themselves of the CVA process, except in the case of two narrow exceptions.

The policy statement 12 still excludes publicly listed companies. In this regard, the contrast with Singapore remains, and listed companies will not be able to rescue themselves through judicial management. It is unclear why this should continue to be the case.

Introduction of rescue financing

The availability of rescue financing, in particular under proposed policy statement 3, has the potential to be significantly impactful in ensuring the prospects of success in schemes of arrangement and judicial management. Local Malaysian practitioners, companies and their specialist advisers will undoubtedly have a steep learning curve in familiarising themselves with this new tool.

Given that it is likely that the proposed rescue financing reforms in Malaysia will mirror the equivalent Singapore provisions, section 211E of the SCA and section 67 of the IRDA will provide the template for any new Malaysian provisions. As such, it is expected that the same ground covered in Singapore court decisions on rescue financing since 2017, such as *Re Design Studio Group Ltd & other matters*[6] and *Re Attilan Group Ltd*,[7] will need to be tread afresh in Malaysia. The proposed introduction of rescue financing has been exciting for specialist providers in this field.

Cross-class cramdown in schemes of arrangement

Proposed policy statement 5 in the Malaysian public consultation document envisages the introduction of a power, possibly similar to that in section 211H of the SCA and section 70 of the IRDA, that would enable a court to order a cross-class cramdown in the event that the scheme fails to obtain approval from all classes of creditors. This power would confer on a Malaysian court the power to order a cross-class cramdown to override the lack of approval by a specific class and the failure to achieve the overall requisite statutory majority.

Any such power is also likely to have to provide for the application of the absolute priority rule, whether as a whole or in a modified form, given that the Singapore provisions have imported most of the equivalent provisions in the US Bankruptcy

6 *Re Design Studio Group Ltd & other matters* [2020] SGHC 148.
7 *Re Attilan Group Ltd* [2018] 3 SLR 898.

Code, 11 USC sections 1126 and 1129. If enacted, then in practice the complexities of satisfying the absolute priority rule when ordering a cross-class cramdown will prove to be a major challenge.

Ordering a revote in a scheme of arrangement

Proposed policy statement 6 concerns a power enabling the court before which a scheme of arrangement is pending to order a revote in the class meetings, without having the entire process be restarted from scratch. This is essentially based on section 211G of the SCA and section 69 of the IRDA.

Reforms relating to filing, inspection and adjudication of proofs of debt

There is a reform proposal under policy statement 7 that will introduce new provisions dealing with the filing, inspection and adjudication of proofs of debt in schemes of arrangement. This may take the same form as section 211F of the SCA and section 68 of the IRDA.

Approval of scheme of arrangement without holding class meetings

Empowering the Malaysian courts to approve a compromise proposed by a scheme company in a scheme without going through a meeting of the creditors of the company is a reform proposal under proposed policy statement 8. It is likely that the proposed provision conferring this power on the Malaysian courts will mirror section 211 I of the SCA and section 71 of the IRDA. Ideally it should contain all the preconditions and safeguards that are contained in the equivalent Singapore provisions.

Court review of company actions post-approval of a scheme of arrangement

Proposed policy statement 9 concerns a new power being conferred on the Malaysian courts to review any act, omission or decision of the scheme company after the scheme of arrangement has been sanctioned by the court. This is to ensure that the scheme company observes all the terms of the scheme, and that aggrieved creditors have some recourse to the courts. This is likely to be a reproduction of section 211J of the SCA and section 72 of the IRDA.

Introduction of automatic moratorium in schemes of arrangement

The proposed introduction of an automatic moratorium in schemes of arrangements is a welcome development. This is covered in proposed policy statement 1.

Given the problems faced by scheme applicant companies with complying with the four preconditions in section 368(2) of the Companies Act 2016, the introduction of an automatic moratorium will help companies be sure there will be protection against creditor enforcement from day one, without being tangled up with satisfying the four preconditions. The automatic moratorium is a feature of Singapore law relating to schemes of arrangement under the IRDA.

Restraining creditor action against companies related to scheme applicant company

A related reform that has been proposed under proposed policy statement 2 is the introduction of an additional power to be conferred on the Malaysian courts to restrain proceedings, etc, against a subsidiary or holding company of a scheme applicant company on the basis that, among other things, the related company concerned plays a necessary and integral role in the scheme. If enacted, this would essentially comprise a reproduction of section 211C of the SCA and section 65 of the IRDA.

Restraining dispositions of scheme company property during a moratorium

Under proposed policy statement 4, there is a proposal to introduce a restraint on dispositions of property of a scheme company during the period a moratorium is in force. Depending on what the final form looks like, this could be a reproduction of section 211D of the SCA and section 66 of the IRDA.

Any such provision must take care to avoid an overlap with the existing section 368(4) of the Companies Act 2016. Section 368(4) already provides an automatic restraint on any disposition of any property other than in the ordinary course of business unless the Court orders otherwise.

Permitting secured creditor enforcement during judicial management moratorium

Proposed policy statement 13 proposes that in a judicial management, secured creditors be permitted to enforce security while a moratorium is in force, following the creation of a judicial management order. Section 227D of the SCA does not contain this particular provision in favour of secured creditors.

The Malaysian consultation document clarifies that secured creditors will be able to enforce their security in three situations:

- if the property is not required by the company during the period for which a judicial management order is in force;

- if the period for which a judicial management order is in force poses a high risk to the existence of the property; or
- if the value of the property decreases in value owing to the judicial management order.

Therefore, the secured creditor's ability to exercise any right relating to secured property while the judicial management order is in force is tied to circumstances that either have a prejudicial effect on the value of the property or where the property is not required by the company under judicial management.

Restrictions on ipso facto clauses and ensuring continuity of supply during CVA and judicial management

Proposed policy statement 15 relates to a new provision for the protection of continuity of essential supplies and for a prohibition on the exercise of ipso facto clauses while a company is undergoing a CVA or is under judicial management. This reform will protect companies undergoing restructuring through a CVA or judicial management against both the termination of essential supplies (eg, water, electricity and telecommunication services) and other supply contracts that are crucial to the continuity of their businesses.

This reform is also likely to extend to provisions in contracts where one party can terminate the contract on the grounds that the other party has commenced or become subject to some form of restructuring. Such a restriction exists under the IRDA.

Similar provisions were introduced in Australia under the amendments to the Australian Corporations Act 2001 by the Treasury Laws (Amendment) (2017 Enterprise Incentives No 2) Act 2017 (Commonwealth) (introducing, among other things, the new section 451E).

Proposed reforms do not go far enough

In some respects, the reforms are not far-reaching enough to make a difference to any applicant company experiencing financial difficulties. The judicial management process in particular is in need of bolder reform.

There are areas of concern in respect of the judicial management process in its present form, as well as in its future iteration if the proposed amendments to its framework are enacted. There is a need to expressly provide that the rescuing of the company as a going concern is the primary objective of the judicial management process, as in the 2003[8] introduction of the same objective as the primary aim of an administrator under the UK administration regime, rather than the narrowly drawn grounds set out in section 405(1)(a) and (b) of the current Companies Act 2016.

There is also a need to consider a recalibration of the competing interests of secured creditors holding a debenture over the assets and undertaking of the company against the interests of other creditors and the interests of the company itself. The current Malaysian judicial management provisions contain a provision requiring an application for a judicial management order to be dismissed (subject to the limited power of the court to override this if the public interest requires it) if a secured creditor opposes the application or if the holder of a debenture has appointed or intends to appoint a receiver and manager over the whole or substantially the whole of the applicant company's property.[9]

In the reforms enacted in 2017, Singapore rebalanced the equivalent Singapore provision by empowering a court under section 227B(5) of the SCA to override the secured creditor veto in the case that the prejudice caused to the unsecured creditors if a judicial management order is not made is wholly disproportionate to the prejudice caused to the secured creditor if the company is placed in judicial management.[10]

Malaysia did not move to introduce any reform to the secured creditor veto power as part of the reform proposals for judicial management under the 2020 public consultation. The CCM should consider following the Singapore reform in this area under the IRDA, if not the UK reforms under the Enterprise Act 2002.

There is also no move under the Malaysian reforms to introduce a framework for cross-border insolvency. Singapore introduced the UNCITRAL Model Law on Cross-Border Insolvency under the IRDA as part of its efforts to strengthen Singapore as an international debt restructuring centre.

8 As a result of changes made to the Insolvency Act 1986 (c45) (UK) by the Enterprise Act 2002 (c40).

9 Section 409(a) and (b) of the Companies Act 2016

10 See the description of the Singapore reforms in Rabindra S Nathan, 'Does Judicial Management in Malaysia Sufficiently Embody a Rescue Culture?', *Singapore Academy of Law Journal*, Vol. 32, No. 518, 2020, at No. 70 to 74 on pp. 558–561 and the primary sources cited in the footnotes thereto.

Why there is a delay in introducing the new reforms

In January 2021, the Malaysian monarch, acting in his constitutional role on the advice of the government, issued a *proclamation of emergency* under article 150 of the Constitution on the grounds that the extent of the covid-19 pandemic constituted a grave emergency within the meaning of article 150.[11]

Consequently, Parliament has not been able to sit as it has been temporarily suspended as part of the measures to combat the pandemic. Although Parliament managed to pass the Temporary Measures For Reducing the Impact of Coronavirus Disease 2019 (COVID-19) Act 2020 in October 2020, the government was unable to get a bill encompassing the proposed reforms to the Companies Act 2016 presented to Parliament before the proclamation of emergency set in.

Although the state of emergency ended on 1 August 2021, and while Parliament is expected to sit from September 2021 onwards, there may not be sufficient parliamentary time for this proposed bill until later in 2021.

11 Prime Minister's Office of Malaysia, Speech Text of The Special Announcement of Emergency (12 January 2021).

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Adapting Singapore's Insolvency Regime In Covid-19 Times

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IN SUMMARY

This article examines the key changes to Singapore's insolvency regime following the introduction of its omnibus legislation (IRDA), against the backdrop of the covid-19 pandemic. It highlights recent legislative developments, local cases of interest and the impact of Singapore's covid-19 laws on insolvency and restructuring. It also considers the latest trends and preferences of corporate debtors, with a view to considering the market's response to the IRDA, which was introduced in line with Singapore's aim to become the forum of choice for debt restructuring.

DISCUSSION POINTS

- Legislative developments: introduction of the IRDA Amendment Act
- Additional measures to assist distressed companies in view of the pandemic
- Covid-19 laws and their impact on the insolvency regime
- Effectiveness of temporary measures and potential risks upon their expiry
- Lessons to be learnt from recent cases
- Latest trends: foreign debtors eyeing Singapore's restructuring offering

REFERENCED IN THIS ARTICLE

- Insolvency, Restructuring and Dissolution Act No. 40 of 2018
- Insolvency, Restructuring and Dissolution (Amendment) Act No. 39 of 2020
- Insolvency, Restructuring and Dissolution (Amendment) Act 2020 (Commencement) Notification 2021
- COVID-19 (Temporary Measures) Act No. 14 of 2020
- Insolvency, Restructuring and Dissolution (Debt Repayment Scheme) Regulations 2020
- Companies Act
- *Sun Electric*
- *Superpark Oy v Super Park*

Insolvency laws are highly jurisdiction specific. Most territories have their own unique sets of rules, despite being driven by the universal aim to provide distressed companies with a conducive environment to settle their financial woes.

Singapore's stance on insolvency is no different. With the Insolvency, Restructuring and Dissolution Act No. 40 of 2018 (IRDA) taking effect on 30 July 2020, Singapore has strived to provide a robust framework for debt restructuring and to establish itself as the forum of choice for foreign debtors.

Not even the outbreak of the covid-19 pandemic has slowed Singapore's progress in implementing the new IRDA; with the swift introduction of schemes to assist affected companies, covid-19-related legislation and amendments to the IRDA, Singapore has been proactive in its attempts to soften the blow of the global pandemic with its forward-looking insolvency regime.

This article will examine the latest legislative developments in Singapore's insolvency regime, local cases of interest and the impact of the pandemic on restructuring and insolvency, with a view to analysing the reception of the IRDA to date.

Legislative developments

Simplified Insolvency Programme

The covid-19 pandemic seemingly came out of nowhere and brought with it a slew of lockdowns and other related restrictions. With the economy struggling to cope with the onslaught of the pandemic, smaller businesses have emerged as obvious victims.

In response to those extraordinary circumstances, Singapore was quick to amend the IRDA within months of its implementation through the Insolvency, Restructuring and Dissolution (Amendment) Act No. 39 of 2020 (the IRDA Amendment Act), the relevant provisions of which came into force on 29 January 2021.[1] While the IRDA is geared towards companies with substantial assets, the IRDA Amendment Act facilitates the liquidation and restructuring of small and micro companies (MSCs) through the introduction of the Simplified Insolvency Programme (SIP).[2]

The SIP is a simplified, quicker and low-cost route for MSCs to restructure their debt or be wound up. In particular, for viable MSCs with a hopeful future, the Simplified Debt Restructuring Programme (SDRP)[3] serves as an improvised form of

1 Insolvency, Restructuring and Dissolution (Amendment) Act 2020 (Commencement) Notification 2021.

2 Sections 4 and 5 of the IRDA Amendment Act.

3 Section 4 of the IRDA Amendment Act.

the existing pre-packaged scheme of arrangement (SOA) under Part 5 of the IRDA; while the latter is an option available to corporate debtors in general, the SDRP is exclusive to qualifying MSCs.

The key features of the SDRP are that:

- only one court application is required for the scheme to be sanctioned (as opposed to two court applications for the traditional SOA in the IRDA, one being for leave to convene a creditors' meeting and another for the scheme's sanction);
- the approval of two-thirds of creditors in value (with no requirement of a majority in number) is required under the SDRP compared to a majority in number representing 75 per cent in value needed for the approval of the traditional SOA under the IRDA (although under the SDRP, votes of related parties will be disregarded); and
- a temporary moratorium and restriction on ipso facto clauses will come into force until the date of the MSC's discharge from the SDRP.

Once a company has been accepted to the SDRP, the official receiver will appoint a restructuring adviser (an experienced insolvency practitioner) to formulate a compromise, and a deposit of S$18,750 will be collected from all applicants to defray the costs. The company will be guided through the restructuring process with a view to completing the SDRP within three months.

The SIP also covers clearly unsustainable MSCs that are faced with the reality that there is no better alternative than to be liquidated. For those companies, the Simplified Winding-Up Programme (SWUP)[4] provides a shorter, smoother runway to being wound up at minimal costs.

As a starting point, to avail themselves of the SWUP, applicants must be qualifying MSCs. The SWUP is modelled after the creditors' voluntary winding-up regime under Part 8 of the IRDA; however, unlike the latter regime, which is open to corporate debtors in general, the SWUP, which is open only to qualifying MSCs, does not require a court application to commence the winding-up process.

Under the SWUP, companies may skip ahead of additional steps, such as distribution of dividends, provided that the liquidator is of the view that the company has insufficient assets to satisfy its liabilities and there is no need for further investigation into its affairs. To enter into the SWUP, an application must be made to the official

4 Section 5 of the IRDA Amendment Act

receiver by the applicant company, accompanied by a special resolution authorising the company's impending winding up and a statement of affairs showing the applicant company's inability to satisfy its liabilities.

Once a company's application has been accepted, the SWUP essentially streamlines the traditional winding-up process as there is no need for a creditors' meeting to be convened, and the official receiver is automatically appointed as the liquidator. A small deposit of S$2,700 is also payable, along with an application fee of S$450.

To be eligible for the SIP, an MSC must have 30 or fewer employees, 50 or fewer creditors, a maximum liability of S$2 million and a maximum annual sales turnover of S$10 million. The SWUP further requires that the value of an MSC's realisable unencumbered assets not exceed S$50,000. In addition to those basic requirements, the applicant MSC must be a company incorporated in Singapore and must have been a suitable candidate for SIP (without other live court applications or orders to wind up or restructure the company, provided that the restructuring or winding up was not expected to require significant resources or specialised expertise). The duration of the SIP was stated to be six months from the commencement of the IRDA Amendment Act, ending on 28 July 2021.

Sole Proprietors and Partnerships Scheme

Although Singapore has made great strides in its recovery from the covid-19 pandemic, it has had several mini-lockdowns and new restrictions in areas where clusters of covid-19 infections have emerged to prevent a full-blown outbreak. As Singapore moves forward with its controlled reopening, sole proprietors and smaller partnerships continue to face potential insolvency.

To help shoulder the burden for those businesses and to complement the SIP, the Association of Banks in Singapore and the Ministry of Law jointly launched the Sole Proprietors and Partnerships Scheme (SPP), which commenced on 2 November 2020.[5] Under the SPP, qualifying businesses will be allowed to pay lower monthly instalment payments for unsecured debts, with an extension of the repayment period by up to eight years. Interest rates for the restructured loans, subject to the underlying loan's contractual terms, may be subject to a maximum of 7 per cent interest per annum.

5 Ministry of Law press release, 'Sole Proprietors and Partnerships (SPP) Scheme launched to help businesses in financial distress' (1 November 2020).

Sole proprietors and partnerships that are likely to bounce back – although they may currently be struggling to return to pre-pandemic productivity levels – if given time and concession for their loan repayments are the most suitable candidates for the SPP. Their total unsecured debts cannot exceed S$1 million, and they must owe unsecured debts to two or more lenders.

Businesses may also avail themselves of the Extended Support Scheme – Standardised of the Monetary Authority of Singapore, through which they may defer 80 per cent of the principal repayments on their secured loans, hire purchase agreements and loans granted under the loan schemes of Enterprise Singapore (ESG).

The Extended Support Scheme – Customised (ESS-C) goes one step further: it facilitates the restructuring of the credit facilities of small and medium-sized enterprises (SMEs) across multiple banks and companies where the SIP and the SPP are not applicable. Those SMEs could apply for the ESS-C with any of their lending banks or finance companies from 2 November 2020.[6]

Re-Align Framework

Given the unprecedented amount of government stimuli, most businesses have found a way to adapt to the 'new norm'; however, Singapore's calibrated resumption of economic and social activities, social distancing and travel restrictions continue to impact many sectors.

For businesses grappling to meet their contractual obligations, the Re-Align Framework, which commenced on 15 January 2021, provides much-needed respite.[7] The Re-Align Framework allows for selected contracts to be renegotiated by way of mutual agreement with the counterparties. If they are unable to come to an agreement, the contract may then be terminated within certain parameters. Although liability for outstanding obligations will remain, parties can dodge payment of termination penalties.

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6 ibid.

7 Ministry of Law, 'Re-Align Framework to Renegotiate Contracts for Businesses Significantly Impacted by COVID-19'.

Covid-19 impact on restructuring and insolvency

Apart from the IRDA and other developments geared specifically towards insolvency, another milestone enactment that cannot be ignored is Singapore's legislative response to the covid-19 pandemic, the COVID-19 (Temporary Measures) Act No. 14 of 2020 (the COVID Act), which was passed by Parliament on 7 April 2020. The Act deals with a plethora of issues, including the institution of crucial measures to support businesses that were caught off guard by the pandemic.

It comes as no surprise that the insolvency regime was at the top of the legislative agenda in the formulation of the COVID Act. The government has clearly shifted its focus (albeit temporarily) to favour the debtor to stave off a situation where large numbers of businesses are forced into insolvency under the pandemic's crushing financial toll. It is also interesting that the COVID Act refers to both the current IRDA regime as well as some relevant provisions under the pre-IRDA era (eg, the Bankruptcy Act and certain provisions of the Companies Act) that are likely to cover legacy issues and provide for a less turbulent transition.

The COVID Act increased the thresholds for personal and corporate insolvency. In terms of personal insolvency, the threshold to commence bankruptcy proceedings against a debtor was raised from S$15,000[8] to S$60,000[9] under the COVID Act. Pursuant to the Debt Repayment Scheme (DRS), debtors with unsecured debts not higher than S$150,000 may avoid bankruptcy if the official assignee deems the debtor a suitable candidate. The threshold to qualify for the DRS was also raised in the COVID Act from S$150,000[10] to S$250,000,[11] and the time for an individual debtor to respond to a statutory demand was increased from 21 days[12] to 6 months.[13] Those measures appear to have had the intended effect as it was reported that the number of bankruptcy applications reached record low levels as at February 2021.[14]

8 Section 311(1)(a) of the IRDA.
9 Section 21(1)(d) of the COVID Act.
10 Section 289(2)(a) of the IRDA, read with Regulation 4(1) of the Insolvency, Restructuring and Dissolution (Debt Repayment Scheme) Regulations 2020.
11 Section 21(1)(a) of the COVID Act.
12 Section 312(a)(i) of the IRDA.
13 Section 21(1)(e) of the COVID Act.
14 Joyce Lim, 'Bankruptcy cases in Singapore at 5-year low amid Covid-19 relief measures', *The Straits Times* (1 February 2021).

In respect of corporate insolvency, the threshold for when a company is deemed to be unable to pay its debt was increased from S$15,000[15] to S$100,000.[16] Further, the period before a company is deemed to be unable to pay its debts (if no payment is made in respect of the debt demanded in the statutory demand by a creditor) increased from 3 weeks[17] from the date of service of a statutory demand to six months.[18]

Crucially, the COVID Act prescribed that directors are relieved from their obligation to prevent the company from trading while insolvent, as long as the debts are incurred in the company's ordinary course of business;[19] however, the COVID Act does not absolve directors of criminal liability if the debts are incurred fraudulently.

Finally, the COVID Act provides relief from legal and enforcement actions (including corporate and personal insolvency proceedings) for those who are unable to perform their contractual obligations in respect of specified types of contracts when the inability is materially caused by the pandemic.[20]

The above measures only apply to individual and corporate insolvency applications made on or after the commencement of Part 3 of the COVID Act (which is aimed at temporary relief for financially distressed individuals, firms and other businesses) on 20 April 2020. There is also no requirement set out in the COVID Act for an individual or corporate debtor to demonstrate that he or she is unable to satisfy the debt as a result of the advent of the pandemic before the measures in respect of the higher thresholds under the insolvency regime apply. The measures introduced in the COVID Act in respect of introducing higher thresholds under the insolvency regime ended on 20 October 2020, without any extension.

While the government extended the relief period from legal and enforcement actions for inability to perform contractual obligations, it declined to do so for the measures discussed above in respect of the thresholds concerning the insolvency regime. Accordingly, it is expected that the number of insolvency cases will begin to rise this year.

15 Section 125(2)(a) of the IRDA.
16 Section 23(1)(a) of the COVID Act.
17 Section 125(2)(a) of the IRDA.
18 Section 23(1)(b) of the COVID Act.
19 Section 23(2) of the COVID Act.
20 Part 2 of the COVID Act.

Statistics released by the Insolvency Office of the Ministry of Law have shown that since the relief period for the insolvency regime ended in October 2020, the figures for the number of bankruptcy cases have been steadily increasing.[21] Researchers have also cautioned that the gradual phasing out of the strong government measures originally put in place in 2020 could result in a delay of insolvencies from 2020 and drive Singapore's insolvency numbers up in the near future.[22] It remains to be seen if the pandemic may cause further relief measures that impact the insolvency regime to be enacted.

There remains the risk that, once the temporary protections under the COVID Act are lifted, a 'legal epidemic' may set in, where parties seek to enforce contractual obligations hitherto suspended.[23] This is where the IRDA's rule against ipso facto clauses under its section 440 plays a critical role in mitigating the dire effects of the legal epidemic.

Section 440 of the IRDA has been dubbed as the 'single most controversial aspect of the reforms';[24] it serves to prevent parties to a contract with a company from asserting their rights merely because the company is insolvent. Prior to the IRDA, there was no such restriction, and it was commonplace to see those clauses being expressly embedded in contracts to serve as an added protection to contractual parties in the event of insolvency. The timely introduction of section 440 serves to remove this contractual time bomb, giving distressed companies some leeway to conduct their restructuring without any obstructions (eg, accelerated repayments).[25]

Local cases of interest

Despite the ongoing pandemic, the development of Singapore's jurisprudence in relation to insolvency continues apace, as illustrated by several landmark decisions made by the nation's highest court. In this article, we examine two cases to shed some light on the application and interpretation of the insolvency laws going forward.

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21 Ministry of Law, 'Number of Bankruptcy Applications, Orders Made and Discharges as at 30 June 2021'. See also Ministry of Law, 'Companies in Compulsory Liquidation' for compulsory corporate winding up statistics

22 Theo Smid and Iulian Ciobica, '2021: A turn of the tide in insolvencies', *Atradius* (24 March 2021).

23 VK Rajah and Goh Yihan, 'The Covid-19 pandemic and the imminent legal epidemic', *The Straits Times* (7 May 2020).

24 Paul Apathy, Emmanuel Duncan Chua and Rowena White, 'Singapore's New "Omnibus" Insolvency, Restructuring and Dissolution Bill', *Law Gazette* (January 2019).

25 Meiyen Tan and Keith Han, 'A Comparative Look at the Ipso Facto Regime', *SAL Practitioner* 12 (16 April 2021).

Sun Electric

In *Sun Electric Power Pte Limited v RCMA Asia Pte Ltd (formerly known as Tong Teik Pte Ltd)* (*Sun Electric*),[26] the appellant, Sun Electric Power Pte Ltd (SEPPL), applied to place itself in judicial management and interim judicial management. The respondent, RCMA Asia Pte Ltd (RCMA), objected to both applications, and both applications were eventually dismissed by the court.

The court ordered a sum of S$11,500 in costs to be paid by SEPPL to RCMA. RCMA issued a statutory demand to SEPPL's registered office to demand for payment of the costs plus interests (the statutory demand). On the 22nd day after service of the statutory demand, SEPPL paid S$3,000 into RCMA's solicitors' client account, thus reducing the outstanding balance to S$8,568.88. RCMA filed an application for SEPPL to be wound up.

A winding-up order was made against SEPPL at first instance on the basis that SEPPL was deemed unable to pay its debts and was insolvent under sections 254(2)(a) and (c) of the Companies Act.[27] SEPPL appealed against the winding-up order under the direction of its sole director.

The key issues for determination before the Court of Appeal, and the Court's ultimate answers, were, among other things:

1. whether the sole director had the standing to bring the appeal, as SEPPL's directors would be functus officio upon its winding up; and
2. whether the court at first instance had erred in finding that SEPPL was deemed unable to pay its debts and was insolvent under the Companies Act.

In respect of (1), the Court of Appeal clarified that the sole director was able to bring the appeal. In particular, it found that a company has the right to appeal a winding-up order even without leave of court, and its directors or shareholders have the right to control the conduct of the appeal, subject to two general rules:

- the directors or shareholders controlling the conduct of the appeal should expect to pay any costs incurred by the company in prosecuting the appeal out of their own pockets, instead of using the funds of the company, and if the appeal succeeds, the directors or shareholders can reclaim from the company the funds that they had expended from their own pockets in prosecuting the appeal; and

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26 *Sun Electric Power Pte Limited v RCMA Asia Pte Ltd (formerly known as Tong Teik Pte Ltd)* [2021] SGCA 60.

27 Companies Act (Chapter 50) (now sections 125(2)(a) and (c) of the IRDA).

- the directors or shareholders controlling the conduct of the appeal should expect to be personally responsible for the payment of any party and party costs awarded in favour of the respondent if the appeal fails.

In respect of (2), the Court of Appeal found that SEPPL was insolvent on the evidence. In this regard, the courts have traditionally applied both the cash flow test and the balance sheet test[28] to assess the solvency of a company. In the present case, the Court of Appeal clarified that the cash flow test is the only test under section 254(2)(*c*) of the Companies Act to determine whether a company is unable to pay its debts.

The cash flow test assesses whether the company's current assets exceed its current liabilities such that it can meet all debts as and when they fall due. 'Current assets' and 'current liabilities' refer to assets that will be realisable and debts that will fall due within a 12-month time frame, as this is the standard accounting definition for those terms. The Court of Appeal also provided a non-exhaustive list of factors to consider under the cash flow test (which may be found at paragraphs 50 to 69 of the judgment).

The Court also observed that where a company makes partial payment of the debt demanded in a statutory demand within the prescribed three-week period such that the remaining amount payable falls below S$10,000 (being the threshold amount for presumption of inability to pay), the company should not be deemed unable to pay its debts pursuant to section 254(2)(a) of the Companies Act.

The Court of Appeal's decision in *Sun Electric* is a noteworthy departure from the traditional approach of the cash flow and balance sheet tests in determining insolvency under section 254(2)(c) of the Companies Act.[29] The Court of Appeal's confirmation of the cash flow test as the sole applicable test going forward makes *Sun Electric* an important and useful reference for practitioners and commercial entities alike. The safeguards laid down by the Court of Appeal are also a welcome judicial response against errant directors and shareholders who seek to deplete company funds through an unmeritorious appeal, when the funds ought to be better applied towards paying off the company's creditors.

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28 The balance sheet test compares a company's total assets with its total liabilities.

29 Now section 125(2)(c) of the IRDA.

Superpark v Super Park

The appellant in *Superpark Oy v Super Park Asia Group Pte Ltd and others* (*Superpark v Super Park*),[30] Superpark Oy (Superpark), was the 78.33 per cent majority shareholder of the first respondent, Super Park Asia Group Pte Ltd (SPAG). SPAG's other owners are Treasure Step Global Limited (Treasure) and Vintex Oy (Vintex). Kumarasinhe is a director and shareholder of Treasure.

In light of a deteriorating relationship, Kumarasinhe tabled a board resolution over a Zoom meeting to put SPAG in provisional liquidation without notice. The resolution passed despite Superpark's objections. Superpark commenced an action for, among other things, a declaration that the provisional liquidation and any voluntary winding up of SPAG be terminated at an extraordinary general meeting of SPAG. It also filed applications for:

- an injunction to restrain the provisional liquidators from taking any further steps in the provisional liquidation of SPAG; and
- the injunction against itself, which the provisional liquidators had obtained to restrain Superpark from taking any action inconsistent with SPAG's provisional liquidation, to be lifted.

The judge at first instance, among other things, allowed the provisional liquidators to continue with their efforts to dispose of SPAG's assets. Superpark was to, within a set amount of time, either put SPAG in judicial management or secure other means to restructure or rehabilitate SPAG, failing which the court would allow the liquidation process of SPAG to continue to its conclusion. Superpark appealed against this decision.

The Court of Appeal allowed the appeal and held that SPAG had never been put into liquidation and that the provisional liquidators should not have been allowed to dispose of the company's assets. The key question for determination was whether the creditors of a company had the capacity to voluntarily wind up a company if no special resolutions to that effect were passed by the company's members. The Court answered this in the negative, with the following reasoning:

- it is clear from the plain and unambiguous wording of section 290(1) of the Companies Act[31] that a company may only be wound up voluntarily if the Constitution provides a certain time frame to do so or a special resolution is passed;

30 *Superpark Oy v Super Park Asia Group Pte Ltd and others* [2021] SGCA 8.

31 Now section 160(1) of the IRDA.

- allowing a company to be voluntarily wound up by its creditors in the absence of a member's special resolution is at odds with the notion of voluntariness; and
- to allow creditors to voluntarily wind up the company would render section 290(1)(b) of the Companies Act otiose; there would be no need for the passing of a special resolution by the company's members if creditors had the power to wind up the company voluntarily.

Although *Superpark v Super Park* considers provisions under the pre-IRDA insolvency regime, it stands as good authority in shedding light on the interpretation of the in pari materia provisions of the IRDA[32] (ie, creditors have no means to voluntarily wind up a company without a special resolution from the company to that effect). The Court of Appeal's clarification on the relevant winding-up provisions in *Superpark v Super Park* is much welcomed; without it, any meaningful distinction between a compulsory and voluntary winding-up would be rendered futile.

Hyflux

On the topic of notable insolvency precedents, Hyflux's restructuring, being one of the most high-profile local insolvency cases, also cannot be overlooked. The case was adjourned an unprecedented 12 times as at October 2020.

Although the delays may affect Singapore's reputation as a speedy forum for foreign debtors to conduct their restructuring, it does appear that the judicial process 'left no stone unturned' in the *Hyflux* case.[33]

Closing remarks

On a closing note, a discussion of the trends in insolvency in Singapore will be incomplete without considering the industry's initial response to the IRDA, which has been in place for only one year as at July 2021. Companies have generally shown a preference for the SOA, which can be reasonably attributed to the availability of the enhanced moratorium, cross-class cramdown and formal proof of debt mechanisms. Market consensus shows that the SOA is a particularly appealing option for less contentious restructurings, where there are high levels of support from the creditors.[34]

32 Sections 160 and 161(6)(a).

33 Stefania Palma and Leo Lewis, 'Court delays hit Singapore's bid to be global restructuring hub', *Financial Times* (16 October 2020).

34 KC Vijayan, 'Singapore well-placed to meet rise in debt restructuring demand amid Covid-19', *The Straits Times* (9 November 2020).

The SOA has also proven to be popular among foreign debtors, with Indonesian companies increasingly looking to Singapore to carry out their restructuring using IRDA's SOA.[35] Credit must be given to Singapore's flexibility in applying its substantial connection test, which is a prerequisite that foreign companies must satisfy before embarking on insolvency in Singapore.

Although a list of factors has been provided that would support a determination of substantial connection, the Singapore courts have applied the ejusdem generis approach to statutory interpretation, confirming that the enumerated factors were not exhaustive. The courts rationalised that the presence of business activity, control or assets with some degree of permanence in Singapore would suffice.[36]

Overall, it appears that the IRDA could not have come at a better time, leaving Singapore well equipped to meet the increase in demand for debt restructuring during the covid-19 pandemic.

35 ibid.

36 Meiyen Tan, Keith Han, Angela Phoon and Zephan Chua, 'Recent Developments in Singapore's Restructuring Regime', *Global Restructuring Review* (16 November 2020).

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He has represented clients as counsel in domestic and international arbitration conducted under various institutional rules, such as SIAC, ICC, LCIA and the Swiss Rules of Arbitration. He has also been involved in ad hoc arbitration proceedings applying the UNCITRAL Rules.

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RPC is a modern, innovative and commercially focused international law firm. Its market-leading lawyers provide top-quality legal services to businesses worldwide, across a wide range of industry sectors and practices.

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RPC Premier Law is one of a few international law firms operating in Singapore under a joint law venture, our clients are able to obtain seamless advice from a single entity. We draw together the international expertise and resources of RPC and the local knowledge of Premier Law to provide an exceptional service. Our team of leading lawyers combine decades of experience in the region with unrivalled expertise in their respective markets.

Through RPC Premier Law Pte Ltd – known as RPC Premier Law – we can provide an extensive range of advice on multi-jurisdictional transactions involving English and Singapore law. Our clients are also able to receive representation in the Singapore courts through Premier Law LLC.

We offer a comprehensive range of services in Singapore with expertise in legal sectors including construction; corporate and commercial; dispute resolution (including banking and financial disputes); energy; international arbitration; insurance and reinsurance; and shipping and international trade.

Singapore is an important hub for Asia, and together with local firm Premier Law, our clients can expect a comprehensive service throughout the region. In jurisdictions where we don't have an office, we have strong relationships with some of the best local firms across Asia. We ensure that clients not only receive the best advice about the law in a particular jurisdiction, but also receive practical and commercial advice focused on resolving their problems.

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Corporate Insolvency Proceedings in South Korea

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IN SUMMARY

This article is an overview of insolvency proceedings available to a corporate entity in Korea. It also includes recent trends in the Korean corporate insolvency market, as well as the cross-border insolvency regime in Korea.

DISCUSSION POINTS

- Korean rehabilitation proceedings
- Korean bankruptcy proceedings
- Out-of-court restructuring
- Recent trends in corporate rehabilitation proceedings
- Cross-border insolvency

REFERENCED IN THIS ARTICLE

- Debtor Rehabilitation and Bankruptcy Act
- Corporate Restructuring Promotion Act
- Seoul Bankruptcy Court
- UNCITRAL Model Law on Cross-Border Insolvency

Introduction

There are two categories of insolvency proceedings in Korea: court-administered proceedings and out-of-court proceedings. The former category relates to bankruptcy proceedings, rehabilitation proceedings and personal rehabilitation proceedings under the Debtor Rehabilitation and Bankruptcy Act of Korea (DRBA). The latter category consists of consensual out-of-court restructurings, which include voluntary restructuring through a workout process (workout) provided for under the Corporate Restructuring Promotion Act (CRPA), and voluntary workout accord between the debtor and creditors to which the CRPA is not applied (voluntary workout accord). Such out-of-court restructurings are often preferred by restructuring market participants, particularly debtor companies, because they afford more flexibility and generally cause less disruption to the debtor's business.

A rehabilitation proceeding is a reconstructive insolvency proceeding that seeks to rehabilitate debtors in financial distress via means such as debt rescheduling. A personal rehabilitation proceeding, another type of reconstructive insolvency proceeding, is directed towards individual debtors who earn regular income and bear relatively small amounts of debt; the debtor repays part of the liabilities with his or her income and has the rest discharged.

In contrast to these two procedures, a bankruptcy proceeding is a liquidation proceeding where a court-appointed trustee takes into custody and realises the entire property of a debtor, who is deemed to have no possibility of rehabilitation. The proceeds from the sale of the debtor's property are then distributed fairly to the creditors.

This article will elaborate on insolvency proceedings to which corporate entities may be subjected. It will first explain rehabilitation proceedings and bankruptcy proceedings. A workout will be discussed briefly by comparing them to rehabilitation proceedings. Given the nature of this report, an explanation on personal rehabilitation proceedings will be omitted. It will, however, briefly cover recent trends in the Korean corporate rehabilitation market and examine Korean cross-border insolvency policies.

Rehabilitation proceedings

Persons entitled to file for commencement of rehabilitation proceedings and causes for commencement

The following may file for the commencement of rehabilitation proceedings: the debtor, the creditors whose total amount of claims is equal to or exceeds one-tenth of the debtor's paid-in capital, and shareholders who own more than one-tenth of the debtor's paid-in capital.[1]

For rehabilitation proceedings to commence, either the debtor is unable to repay a matured debt without causing significant encumbrance to the continuation of its business, or there is a concern that a cause for bankruptcy may arise with the debtor. The cause for bankruptcy refers to when the debtor's inability to repay its debt in an ordinary, continuous manner owing to the lack of the capacity to effect performance or when the amount of the debtor's liabilities exceeds the value of its assets.

The Supreme Court of Korea held that filing for the commencement of rehabilitation proceedings by a debtors' representative director requires a board resolution as it is not within the representative director's scope of ordinary affairs.[2]

Asset preservation order and a comprehensive stay order

In Chapter 11 proceedings in the United States, an automatic stay takes effect immediately when a petition is filed, thereby preserving the debtor's assets and preventing creditors from exercising their rights.

In rehabilitation proceedings in Korea, however, such a stay is not automatic; the court, upon filing of an application or by its own motion, separately issues a preservation order against the debtor to prevent the debtor from dissipating its assets, and a comprehensive stay order to prevent creditors from enforcing their claims against the debtor until rehabilitation proceedings are formally commenced.[3] The Korean court's response at the time of filing is relatively fast, and when necessary, the asset preservation order and the comprehensive stay order can be issued on the same day the petition is filed or the day after; therefore, in practice, asset preservation orders and comprehensive stay orders function similarly to an automatic stay in the United States.

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1 Article 34 of the DRBA.

2 Supreme Court Decision 2019da204463, rendered on 14 August 2019.

3 Articles 44 and 45 of the DRBA.

Effect of commencement of rehabilitation proceedings

Rehabilitation proceedings formally commence when the court issues a decision to commence rehabilitation proceedings in respect of a debtor.

When the court issues an order to commence rehabilitation proceedings, all compulsory enforcements are automatically stayed, and the secured creditor cannot foreclose on assets of the debtor provided as security without court approval.[4] Further, rehabilitation claims and secured rehabilitation claims can only be repaid as set out in the rehabilitation plan.

The court must appoint a receiver at the same time it issues an order to commence rehabilitation proceedings. A receiver is authorised to take charge of the management and disposition of the debtor's assets under court supervision. In principle, the existing management of a debtor company is appointed as the receiver; however, in exceptional circumstances, such as when a material cause of the debtor's financial deterioration can be attributed to the existing management of the debtor, the court must appoint a third-party receiver.

In principle, the court's decision to commence rehabilitation proceedings is issued within one month of the filing of the petition; however, the Seoul Bankruptcy Court recently introduced the Autonomous Restructuring Support (ARS) programme, which allows the court to defer the commencement of rehabilitation proceedings for up to three months, during which the court will issue temporary stay orders to allow the debtor to attempt to negotiate a deal with its creditors or otherwise try to obtain debtor-in-possession (DIP) financing.

If the debtor succeeds in negotiating a deal and reaches settlement, it may withdraw the petition altogether or file a pre-packaged plan (P-Plan) with the court if necessary. If the debtor fails to negotiate a deal with its creditors, the court will issue an order to commence rehabilitation proceedings.

Since the introduction of the ARS programme, the P-Plan and the ARS programme have been utilised in many proceedings and, in many cases, encouraged the debtor to try and negotiate a deal with its creditors, thereby raising the possibility of a successful restructuring of the debtor and early closing of the rehabilitation proceedings.

Differences between rehabilitation claims and common benefits claims

In rehabilitation proceedings, a creditor's claims are divided into three categories:

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4 Article 49 of the DRBA.

- a rehabilitation claim;
- a secured rehabilitation claim; and
- a common benefits claim.[5]

A rehabilitation claim is one that arises from grounds that existed before the commencement of rehabilitation proceedings, and a secured rehabilitation claim is a rehabilitation claim secured by collateral that is under title of the debtor. These can be repaid only in accordance with the rehabilitation plan. A common benefits claim, on the other hand, is paid on a rolling basis, regardless of the rehabilitation plan.

A good example of a common benefits claim is one incurred by the receiver with approval of the court after commencement of rehabilitation proceedings. Common benefits claims are similar to allowed administrative expenses under the US Bankruptcy Code and include the following, among other things:

- wages, salaries and commissions for services rendered by the receiver, their proxies, examiners and advisers, etc;
- claims against the debtor arising from the receiver's borrowing of money or other actions conducted on behalf of the debtor;
- claims arising from delivery of products within 20 days prior to the filing of the petition;
- certain tax claims; and
- certain wages, severance payments and compensation for industrial accidents claims of employees.

In this regard, in February 2020, the DRBA was revised to provide priority for DIP financing. In other words, if a DIP lender, with court approval, extends loans to a debtor after its filing of a petition for the commencement of rehabilitation proceedings, and the rehabilitation proceedings are later converted to bankruptcy proceedings, the claims of the DIP lender are treated as an estate claim, which has priority over other estate claims (except for wage claims and severance payment claims) and bankruptcy claims.

The purpose of this revision is to provide the DIP lender with priority not only during the life of the rehabilitation proceedings, which had already been available, but also when restructuring fails and the proceedings are converted to bankruptcy proceedings. This much-awaited revision was made with the purpose of providing

5 Articles 118, 141 and 179 of the DRBA.

more assurance to the DIP lenders to encourage them to inject more fresh cash into distressed companies, thereby facilitating faster recovery and normalisation; however, since the DIP lender does not have priority over wage claims and severance payment claims, it is yet to have super priority, and DIP financing in Korea has yet to become the general trend.

Unless specified otherwise, the explanation below about claims is relevant to rehabilitation claims and secured rehabilitation claims.

Executory contract

An executory contract refers to an agreement wherein obligations relevant to both parties have not been performed in their entirety at the time of the commencement of the rehabilitation proceedings.[6] This type of contract receives special treatment from those proceedings; the receiver may choose to perform or terminate an executory contract. The receiver may exercise the termination right only until the closing of the meeting of interested parties that is convened for reviewing the proposed rehabilitation plan.

The counterparty may issue a notice to the receiver urging for a decision on whether to terminate the contract. Should the receiver fail to provide confirmation within 30 days of the notice, the receiver will lose the termination right. The court may shorten or extend this 30-day period upon request from the receiver, the counterparty or by the court's own motion.

If the receiver decides to perform the contract, the other party may enforce the contract as a common benefits creditor. By contrast, if the receiver chooses to terminate the contract, the other party's damages claims arising from the termination are treated as rehabilitation claims.

To protect the receiver's right to choose, numerous scholars have argued that an ipso facto clause, which states that filing a petition for the commencement of rehabilitation proceedings is an event of termination of the contract, should be deemed invalid. The Korean court's position on this matter has not been very clear, although there have been cases where the court has held that the clause was valid in relation to contracts that require mutual trust.[7]

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6 Articles 119, 120 and 335 of the DRBA.

7 See, for example, Seoul Central District Court Decision 2013*kahap*80074, rendered on 24 January 2014.

The DRBA provides a similar provision for treating an executory contract in bankruptcy proceedings. The bankruptcy trustee may choose to perform or terminate an executory contract. The Supreme Court of Korea recently issued a detailed decision discussing the bankruptcy trustee's right to terminate an executory contract involving a public-private partnership.[8] In the decision, it held that article 335 of the DRBA would be applicable to an implementation agreement in a public-private partnership, even if the partnership has the nature of a public law relationship.

The Supreme Court divided the partnership into three phases: the planning phase, the implementation phase and the management phase. It went on to state that in determining whether there is an executory contract, the court should examine the parties' obligations at the specific phase concerned rather than comparing the parties obligations throughout the relationship as a whole.

The Supreme Court concluded that there was no executory contract at the management phase as both parties' obligations were not legally and economically intertwined in terms of their formation, performance and existence to function as security ensuring the other's performance.

Investigation and confirmation of claims

When rehabilitation proceedings are commenced, the receiver prepares a list of creditors (and their claims).[9] Separately, each creditor may file his or her respective proofs of claim with the court within the reporting period designated by the court. Even if the reporting period had lapsed, however, there are exceptions whereby the proofs of claim can be filed afterwards. In any event, the latest that a proof of claim can be filed is before the interested parties' meeting for reviewing the proposed rehabilitation plan. If any (secured) rehabilitation claims are not included in the list of creditors and reported by the creditor, the rehabilitation claims are discharged upon approval of the rehabilitation plan.

As for claims for which proofs of claim have been filed or included in the creditors' list filed by the receiver, the receiver or other interested parties (eg, other rehabilitation creditors) may file an objection to those claims. In such an event, the creditor whose claims are contested may file with the bankruptcy court an application for

8 Supreme Court Decision 2017*da*273441, rendered on 6 May 2021.

9 Articles 147, 148 and 170 of the DRBA.

allowance of the claim, and the scope of the contested (secured) rehabilitation claims are determined during the claim investigation and confirmation procedure by the bankruptcy court.

The Seoul Bankruptcy Court recently enacted a new practice guideline, which requires the Bankruptcy Court to expedite the claim investigation and confirmation procedure. According to the new rule, the Bankruptcy Court must conclude the claim investigation and confirmation procedure before the meeting of the interested parties if the objection is made within the reporting period. For proofs of claim filed after the reporting period, the Bankruptcy Court must conclude the claim investigation and confirmation procedure within three months of the application for allowance of the claim.

Limitation on set-off and avoidance rights

Once rehabilitation proceedings commence,[10] creditors may offset claims (receivables) with debts (payables) if their claims are due before expiry of the claim reporting period. The exercise of the set-off right must take place towards the receiver (and not the debtor) within the aforementioned term.

The creditors may not offset receivables or payables acquired after a certain time. Depending on the type of claims or obligations, this may be the time of the petition requesting the commencement of rehabilitation proceedings or the commencement of those proceedings.

If the debtor has acted in a way that prejudices other unsecured creditors, the receiver may exercise avoidance rights and recover from the party that has benefited from that act, as long as the statutory requirements are met. Generally speaking, a transfer can be avoided if the transfer was made by the debtor with the intention to prejudice rehabilitation creditors, the transfer was made when the debtor was already facing financial crisis, or the transfer was made without any consideration within six months prior to the debtor's suspension of payment.

10 Articles 100, 108, 144 and 145 of the DRBA.

Restructuring through a rehabilitation plan

A rehabilitation plan typically includes the basics of the debtor's rehabilitation, such as adjustment of claims, repayment methods, adjustment of shareholder rights, matters regarding mergers and acquisitions (M&A), and revisions to the articles of incorporation of a debtor.[11]

After commencement of rehabilitation proceedings, the court generally appoints an examiner (usually an accounting firm) to review the overall status of the debtor's assets, liquidation value and value as a going concern. If the debtor's liquidation value is higher than its value as a going concern, the court may terminate the rehabilitation proceedings, and the case will close without the filing of a rehabilitation plan.

In practice, however, it is becoming more and more common for debtors with higher liquidation value to seek out investors who are willing to inject fresh cash into the corporation, with a view to reviving their business and increasing their overall value as a going concern. In those cases, the receiver may seek the court's approval to proceed with an M&A process before confirmation of a rehabilitation plan and avoid dismissal.

A merger and liquidation process in this case usually includes:

- engagement of professionals to manage the public bidding process;
- distribution of bid proposals;
- a public bid; and
- signing of the M&A contract by the parties.

Although the process may differ significantly in detail, in essence, it is akin to a 363 sale process in the United States. The process may even involve a stalking horse bidder, as is often the case in 363 sale processes in the United States.

In the more common cases where the debtor's going concern value is higher than its liquidation value, the receiver prepares and proposes a rehabilitation plan based on the report prepared by the said examiner. A rehabilitation plan is proposed and reviewed at the meeting of the interested parties, and may be accepted by a quorum of:

- three-quarters or more of the total amount of secured rehabilitation claims;
- two-thirds or more of the total amount of rehabilitation claims; and
- half or more of the total number of shares present at the meeting (provided that if the total amount of debt exceeds the total amount of assets on the date of commencement, the shareholders do not have a right to vote).

11 Articles 87, 193, 237 and 242 of the DRBA.

When the proposed rehabilitation plan is accepted by a resolution passed at a meeting of interested parties, the court may confirm the rehabilitation plan. Exceptionally the court may also confirm a rehabilitation plan that was not passed in the meeting; in this case, the court may reinforce the terms pertaining to the protection of creditors in the rehabilitation plan.

The debt rescheduling for rehabilitation claims includes partial discharge, partial debt-equity swap and repayment in instalments after deferment. In the case of disposing of collateral securities, it is common for the rehabilitation plan to include terms that provide that the concerned secured rehabilitation claims shall have priority in repayment at the disposed value. A considerable portion of shares ordinarily go through capital reduction via retirement or consolidation.

Generally the rehabilitation plan is a 10-year plan; however, the Seoul Bankruptcy Court adopted a simplified examination report that allows a five-year or a seven-year plan in simplified rehabilitation proceedings for a debtor whose debt is less than 5 billion won.

Implementation of plan and closing of rehabilitation proceedings

When a rehabilitation plan is confirmed,[12] the rights of creditors and shareholders are adjusted according to the rehabilitation plan. Rehabilitation claims and secured rehabilitation claims not included in the approved plan shall be discharged by operation of law.

If the debtor begins repayment under the rehabilitation plan, and there is no hindrance to carrying out the rehabilitation plan, the court may issue a final order to close the rehabilitation proceedings. In that event, the debtor regains its authority over its assets and business.

Termination of rehabilitation proceedings

The court may terminate the rehabilitation proceedings even before the approval of the rehabilitation plan:

- if it finds that the liquidation value of the debtor clearly exceeds the value as a going concern;
- if a rehabilitation plan proposal is not submitted; or

12 Articles 251, 257 and 283 of the DRBA.

- if the rehabilitation plan proposal is not approved by the creditors or the plan is not confirmed by the court.[13]

The court may also terminate the proceedings if, after approval of the rehabilitation plan, it is clearly determined by the court that the rehabilitation plan cannot be carried out. In that event, if the debtor has cause for bankruptcy, the court must declare the debtor bankrupt and convert to bankruptcy proceedings.

Bankruptcy proceedings (comparison with rehabilitation proceedings)

Since the provisions on bankruptcy proceedings are stipulated by the DRBA, as with their rehabilitation counterpart, most of the detail explained above in relation to rehabilitation proceedings is also applicable to bankruptcy proceedings; however, given the difference between the purposes of the two insolvency procedures, it is worth highlighting notable disparities.

The following table summarises the comparison between rehabilitation and bankruptcy proceedings.

	Rehabilitation proceedings	Bankruptcy proceedings
Creditors entitled to file a petition	May be filed by creditors whose claim amounts add up to at least one-tenth of the debtor's paid-in capital	Creditors may file for the debtor's bankruptcy regardless of the pecuniary amount of their claims
Effect on the secured creditors	A secured rehabilitation creditor is unable to execute the security right; he or she receives repayment as per the rehabilitation plan	A secured creditor may execute the security right regardless of the bankruptcy proceedings
Right to manage and dispose of the debtor's property	The court usually appoints an existing representative of the debtor company as the receiver	The court usually appoints an attorney as the bankruptcy trustee
Failure to file proof of claims	Undeclared claims (claims not included in the creditor's list and without a proof of claims filed) are discharged after the rehabilitation plan is confirmed	Although undeclared claims are not discharged, no dividend is paid to those claims
Set-off right	Limited in time as well as in other aspects	Unlimited in time, although limited in other aspects

13 Articles 286 and 288 of the DRBA.

	Rehabilitation proceedings	Bankruptcy proceedings
Restructuring	Restructuring occurs in accordance with the rehabilitation plan	There is no debt restructuring
Cessation of the juristic personality	The debtor's juristic personality continues to exist after the completion of the rehabilitation proceedings	The debtor ceases to exist as a company once the bankruptcy proceedings are completed

Workouts (comparison with rehabilitation proceedings)

Workouts differ from rehabilitation proceedings in the sense that they are directed and conducted by creditors who hold financial claims against the debtor, whereas rehabilitation proceedings are administered by the court. The CRPA defines 'financial claims' as claims that arise from a credit offering, such as loans, promissory notes and sureties.

Debtors tend to prefer workouts to rehabilitation proceedings since they have less impact on the debtor's managerial rights in comparison with rehabilitation proceedings. Workouts can be a better means of restructuring than rehabilitation proceedings for debtors that must maintain the relationship of trust with their clients because the procedures do not affect business claims. Many shipbuilding and construction companies in financial distress have undergone workouts for this reason.

On 30 June 2018, the CRPA expired amid discussions in favour of and against permanent legislation regulating out-of-court restructuring. A new CRPA was finally promulgated on 16 October 2018, with minimum changes to its provisions and with a five-year expiry.

In the new enactment, the National Assembly added an opinion directed to the Financial Supervisory Committee of Korea to evaluate the corporate restructuring policies for their accomplishments and effectiveness and, after gathering the opinions of the court, relevant institutions and professionals, to submit a report to the relevant standing committee within the National Assembly. While there are more steps to take to introduce permanent legislation regulating out-of-court restructuring, the overall conclusion of the report issued in December 2019 is positive about the permanent legislation.

The comparison between workouts and rehabilitation proceedings (a restructuring insolvency procedure under the DRBA) is as follows.

	Rehabilitation proceedings	Workout
Supervising entity	The court	A committee comprising financial creditors, with the main creditor bank representing the committee and performing the actual supervisory work
Debtor subject to the proceedings	For both corporate and personal debtors	For corporate debtors only
Person entitled to file a petition	The debtor, creditors with a certain volume of claims or shareholders with a certain shareholding ratio	The debtor
Right to manage the debtor's property	The court-appointed receiver has the right to manage and dispose of the debtor's property	The existing management continues to manage the debtor company; however, the debtor ordinarily enters into an agreement with the council of financial creditors, under which the council or the principal creditor bank may control the management of the debtor
Scope of affected creditors	Business claims and financial claims	Financial claims only
Failure to declare claims	Undeclared claims are discharged after the rehabilitation plan is finalised	Undeclared claims are not discharged
Set-off right	Limited	Offsetting with financial claims is prohibited
Restructuring	Restructuring is decided by the meeting of interested parties and occurs as per the court-approved rehabilitation plan, with the requirements for the approval of the meeting of interested parties being by a quorum of: • three-quarters or more of the total amount of secured rehabilitation claims; • two-thirds or more of the total amount of rehabilitation claims; and • half or more of the total number of shares present at the meeting	Restructuring occurs in accordance with the decision of the council of financial creditors, with the approval of the council of financial creditors requiring: • the consent of financial creditors that own at least three-quarters of the total value of the financial claims; and • the consent of financial creditors that own at least three-quarters of the secured claims

Impact of covid-19 on corporate insolvency

While the number of insolvency cases in Korea had been constantly increasing every year, there was a slight decrease in 2020. This is partly because the government prepared special funds for key industries that would have been impacted by the pandemic. Further, there were moratoriums for businesses affected by the pandemic implanted at various levels and institutions to allow companies to stay afloat. Some examples of announced or imposed moratoriums include:

- financial authorities (the Financial Services Commission and the Financial Supervisory Service) and financial institutions (Korea Federation of Banks, Korea Financial Investment Association, etc) entering into an agreement to provide covid-19-related support, including extensions of loan maturity dates and a moratorium on payment of interest;
- the Korea Deposit Insurance Corporation announcing that it will impose a moratorium of up to one year and discharge interest payment obligations for financially vulnerable debtors, who are currently under instalment repayment plans; and
- the Credit Counselling and Recovery Service (CCRS) announcing a six-month moratorium for debtors who have had their debt adjusted through programmes provided by the CCRS and who are experiencing a decrease in income owing to the pandemic.

Such moratoriums have been further extended a couple of times owing to the continuation of the pandemic.

The Seoul Bankruptcy Court has been open and fully operational during the pandemic, although it has adjusted some of its hearing schedules in accordance with the Supreme Court's instructions.

Cross-border insolvency

The DRBA has incorporated the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law) as section 5 of the DRBA.

Rehabilitation proceedings have universal effect, reaching beyond the borders of Korea. For Korean rehabilitation proceedings or bankruptcy proceedings to be effective in a foreign country, the receiver (as the foreign representative of the Korean rehabilitation proceedings) may apply for recognition of the rehabilitation proceedings in the competent court of that country and seek other necessary support.

Such measures have proved to be especially beneficial for shipping companies in Korea, which have obtained recognition from various countries to preserve the debtor company's vessels and other operating assets. Notable cases include the *STX Pan*

Ocean case in 2013, where STX Pan Ocean sought recognition of the Korean insolvency in 14 jurisdictions and obtained recognition from at least 10 jurisdictions: the United States, the United Kingdom, Japan, Canada, Mexico, Australia, New Zealand, Belgium, Singapore and the Philippines.

A few years later in 2016, Hanjin Shipping also filed for the commencement of rehabilitation proceedings in Korea and obtained recognition from at least eight jurisdictions: the United States, the United Kingdom, France, Japan, Canada, Australia, Belgium and Spain.

Likewise, the representative of foreign insolvency proceedings may file an application for recognition of the proceedings with the Korean court, and ask the Korean court for relief to preserve the debtor's assets in Korea. Since the adoption of the Model Law, Korean courts have been proactive in recognising foreign insolvency proceedings and granting assistance to foreign representatives by, for example, authorising the foreign representatives to dispose of the foreign debtors' assets that are located in Korea and allowing for the movement of funds from Korea to the country where the foreign insolvency proceedings are pending, thereby facilitating fair distribution of funds between creditors.[14]

In an effort to facilitate coordination in cross-border cases, the Seoul Bankruptcy Court has signed memoranda of understanding with the US Bankruptcy Court for the Southern District of New York and the Supreme Court of Singapore. It has also adopted the Judicial Insolvency Network Guidelines and its Modalities of Court-to-Court Communication.

The DRBA Revision Committee is currently considering adoption of more recent insolvency texts adopted by UNCITRAL, namely the UNCITRAL Model Law on Enterprise Group Insolvency and the UNCITRAL Model Law on Recognition and Enforcement of Insolvency-Related Judgements.

14 See, for example, Seoul Bankruptcy Court Case No. 2014 *kookji* 1, where the Seoul Bankruptcy Court authorised transfer of the debtor's funds in Korea to the United States, where Chapter 11 bankruptcy proceedings were pending in the US Bankruptcy Court, Eastern District of Virginia. Similarly, in another case where administration and scheme of arrangement proceedings were pending in the UK courts, the Court issued an order authorising the foreign representative to manage the debtor's assets in Korea, file reports with the Bankruptcy Court and seek the Court's approval when the foreign representative decides to move any of the debtor's assets overseas.

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Chul Man Kim mainly practises in the areas of financial disputes and bankruptcy. Before joining Yulchon, he served as a judge at Seoul Southern District Court and Seoul District Court. He acquired extensive expertise in the area of bankruptcy as an adviser in bankruptcy proceedings of major conglomerates (Kia, Haitai, Halla, Jinro, Daewoo, etc) during the Asian financial crisis of 1997 and has since acted on a wide range of restructuring and insolvency works as a litigator. Recently, he has advised on a number of bankruptcy and rehabilitation proceedings, including the rehabilitation proceedings of country club operators, such as Shilla, Castle Pine and Pine Creek.

SUN KYOUNG KIM
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Sun Kyoung Kim mainly practises in the areas of financial disputes and bankruptcy. In recent years, he has performed the authorisation process for the resolution of the debenture holders' meeting for the voluntary agreement of Hyundai Merchant Marine, and advised Keangnam Enterprises and its subsidiaries on the rehabilitation proceedings and provided representation therein. Most notably, he also advised STX Pan Ocean on the rehabilitation proceedings and provided representation therein.

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Sy Nae Kim mainly practises in the areas of cross-border disputes and insolvency-related matters. Her experience in insolvency-related matters includes recognition of Korean insolvency proceedings and seeking assistance for insolvency representatives in foreign courts, advising clients on complex out-of-court and in-court corporate restructurings, and representing clients in disputes where cross-border insolvency issues arise. Her recent work includes advising Pan Ocean (formerly STX Pan Ocean) in various cross-border insolvency matters and related disputes, and Hyundai Merchant Marine in its conditional workout; representing major creditor financial institutions in Dong-A Tanker's rehabilitation proceedings; and working on various international arbitration matters involving insolvency issues.

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Woo Suk Jung mainly practises in the areas of cross-border disputes, construction and insolvency-related matters. He has achieved a number of victories for his clients both in Korean and foreign courts on insolvency-related matters. His recent work includes representation of POSCO in international arbitration covering the Japanese rehabilitation proceedings.

Yulchon's insolvency and corporate restructuring team comprises a number of attorneys specialising in insolvency and corporate restructuring who have in-depth understanding of insolvency proceedings in general, which allows careful management and risk analyses, as well as experience accumulated over the years and by undertaking numerous cases. Knowledgeable in court customs, the direction of government policies, and the ways of various industries, the attorneys are capable of making decisions in multifaceted situations to the satisfaction of creditors and debtors located inside and outside Korea. The team includes attorneys with expertise in tax, finance and corporate law, mergers and acquisitions, and real property, as well as accountants, attorneys licensed to practise in the United States and international arbitration specialists who provide clients with legal consultation that is meticulously custom-made for their needs. The team also has at its disposal insolvency and corporate restructuring experts who speak several languages, including English and Japanese, to accommodate foreign clients in matters that involve international issues.

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CHAPTER 15

PRC BANKRUPTCY LAW

15.1 INTRODUCTION

It might seem strange to talk about the application of a bankruptcy law in a country where in theory there should be no bankruptcy. However, the PRC has had a bankruptcy law in place since 1988 (it was enacted in 1986) and began drafting a new bankruptcy law in 1994. This culminated in the enactment of the Enterprise Bankruptcy Law in 2006 ('EBL'), which came into operation on 1 June 2007. The development of China's bankruptcy law is part of the broader evolution of China's transition from a centrally-planned socialist economy to a more market-oriented economy.

IPs must also be aware of the scope of PRC bankruptcy law. For more than a quarter century, the PRC has had a framework for resolving the affairs of *certain* insolvent business entities. In the modern era, bankruptcy laws in China were first enacted in 1986 to deal with State-Owned Enterprises ('SOEs'). Five years later, provisions were enacted to deal with the bankruptcy of non-SOE legal person enterprises. Under the old law there was no system for dealing with the affairs of individuals or partnerships.

Even with the enactment of the EBL, there still is no system in place for dealing with personal insolvencies. Earlier drafts of the new bankruptcy law did extend the law to partnerships, but the EBL rejects this approach. Rather, although the EBL does not address partnership insolvencies, Article 135 of the EBL provides that where other laws include insolvent liquidation procedures for non-legal person entities, the procedures set forth in the EBL shall apply *mutatis mutandis*. On the same day the EBL came into operation, the PRC Amended Partnership Enterprise Law also came into operation and provides for the insolvent liquidation of partnerships. Only a partnership's creditors may petition; the partnership itself may not file; and significantly, individual partners remain liable for the partnerships' debts and are not eligible for bankruptcy relief.

Although the EBL does not currently apply to personal insolvency, the situation could change. Since 2009, the Finance and Economic Committee of the National People's Congress ('NPC') of the PRC has been considering the merits of enacting personal insolvency legislation, and, at the time of the writing, steps are being taken in this direction in Shenzhen. However, in this chapter, when considering the application of PRC bankruptcy law, the focus is on SOEs and the corporate sector.

To get a clearer understanding of the EBL, it is helpful to take a look at the earlier legal landscape. The old PRC bankruptcy regime comprised:

(a) The Law of the PRC of Enterprise Bankruptcy (Trial Implementation) ('1986 Bankruptcy Law'), which applied only to SOEs. This law was enacted on 2 December 1986 and came into operation on 1 October 1988. It included only 43 articles.

(b) Chapter XIX of the PRC Civil Procedure Law, which applied to the bankruptcy of non-SOE enterprises with legal person status. This law was approved on 9 April 1991 and included only 8 articles.

(c) A series of interpretations issued by the Supreme People's Court. These interpretations were issued to address some of the gaps and omissions in the laws, as well as some of the inconsistencies between the bankruptcy procedures for SOEs and those for non-SOE legal person enterprises. Of these interpretations, the interpretation issued on 30 July 2002, Several Issues Concerning the Trial of Enterprise Bankruptcy Cases ('2002 Interpretation') was the most significant.

(d) Provisions in the PRC Company Law and PRC Liquidation Procedures of Foreign Investment Enterprises, which provided for cases arising as solvent liquidations to be fed into the insolvency provisions of the Civil Procedure Law where it appeared that the debtors were insolvent. Another provision of the Company Law also supplemented the Civil Procedure Law in the bankruptcies of PRC companies.

(e) Local legislation, such as the Shenzhen SEZ Enterprise Bankruptcy Regulations, enacted on 10 November 1993.

It can be seen that in the early 1990s, the PRC bankruptcy legal landscape included a patchwork of national and local laws and judicial interpretations. Many aspects of these laws governing enterprise bankruptcies were at best unpredictable, with the consequence that it was extremely difficult to advise any party to the proceedings as to the likely outcome. As part of the accession of the PRC to the World Trade Organisation, it was recognised that a modern bankruptcy legislation was essential to cope with the rapidly modernising economic environment in the PRC.

In fact, work started on drafting the new legislation in March 1994, with the formation of a Bankruptcy Law Drafting Working Group. The working group familiarised itself with bankruptcy approaches used elsewhere, as well as with best international practices. Over the next decade, many drafts of the law were released for comment.

Parallel to the drafting process was the growing use of bankruptcy policy decrees. In 1994, the State Council and other administrative organs started issuing these decrees to facilitate debt restructuring under the Capital Structure Optimisation Program ('CSOP'). These decrees were applicable in pilot cities, and over the years the number of trial cities increased. Significantly, these decrees applied to some of the largest and most inefficient SOEs in the PRC. Also, significantly, these decrees gave special protection to workers – especially in the form of their resettlement rights – and some of the decrees provided that certain claims of employees could be paid out of the realisations of assets belonging to the secured creditors, prior to the holders of the security being paid. This was completely at odds with the system in place in the 1986 Bankruptcy Law and the provisions in the Civil Procedure Law, as well as the procedures in place in most other countries.

In June 2004, a draft law was submitted to the NPC. Those drafting this law had made references to international best practices and initially it seemed likely that it would be enacted quite speedily, receiving its first reading before the Standing Committee of the NPC in June 2004 and the second reading in October 2004 (with some changes to the draft).

However, it was at this time that progress ground to a halt. Stories were circulating as to the reasons for the delays, but there were no announcements and everything was in the realm of speculation. However, it soon became clear that the main reason for the delay in promulgating the new legislation was to resolve how to deal with the competing claims of secured creditors and employees.

On the one side, there were arguments that the protection of workers in the policy bankruptcies should be continued in the new law for workers generally. This approach followed in the tradition of giving employees in the Chinese political, social and economic system extremely high priority. However, it is also clear that on the other hand, there were equally strong arguments that the new legislation in the PRC should meet international norms, at least in broad terms. Moreover, one can imagine arguments being put forward that it was essential to protect the rights of secured creditors, failing which there might be an adverse effect on inbound investment into China by foreign enterprises.

No one will probably ever know what arguments were put forward and by whom, but the result was that on 27 August 2006, with little or no warning, a compromise was reached on the conflict involving workers' rights and the rights of secured creditors and the Standing Committee of the 10th National People's Congress adopted the new EBL.[1]

1 See Chapter 15.8.

As with any new piece of legislation, in whichever country, it will inevitably take some time for the new law to settle down to a position where there can be some certainty as to its interpretation. The UK Insolvency Act 1986 was still throwing up anomalies 15 years after it was implemented. There is no reason why the PRC law should have been any different; any significant new piece of legislation takes time to mature and to allow the law to deal with practical issues that cannot always be envisaged when the legislation was being written. That being said, the EBL has not led to the filing of many cases. In 2008, the first year for which the filing data includes only cases filed under the EBL, there were only 2,955 cases. The number of cases then declined each year through 2011. There was an increase in 2012 and then a small dip in 2013. Since then the number of cases has started to rise, reaching 5,665 cases in 2016, and then the record level of 8,984 cases in 2017.

From 2007-2016, the number of cases each year since the enactment of the EBL was below – and until 2016, far below – the high of 8,939 cases in 2001 under the 1986 Chinese Bankruptcy Law. The record level in 2017 was the first time under the EBL that the annual number of cases exceeded the record number under the old law. Clearly, an important psychological barrier has been crossed, and it appears that the trend will continue upwards. This increase in cases is largely due to the improvement in the public's knowledge of the EBL and the development of an on-line filing system. which will be discussed in more detail at Chapter 15.4.

Chart 1 Number of PRC Bankruptcy Cases 1989–2017

Year	No of cases	Year	No of cases	
1989	90	2004	4,953	
1990	32	2005	3,419	
1991	117	2006	4,253	
1992	428	2007	3,819	*
1993	710	2008	3,139	**
1994	1,625	2009	3,128	
1995	2,344	2010	2,366	
1996	6,233	2011	1,869	
1997	4,515	2012	1,521	
1998	6,148	2013	1,929	
1999	4,591	2014	2,031	
2000	7,528	2015	3,568	
2001	8,939	2016	5,665	
2002	6,463	2017	8,984	
2003	6,380			

Notes:

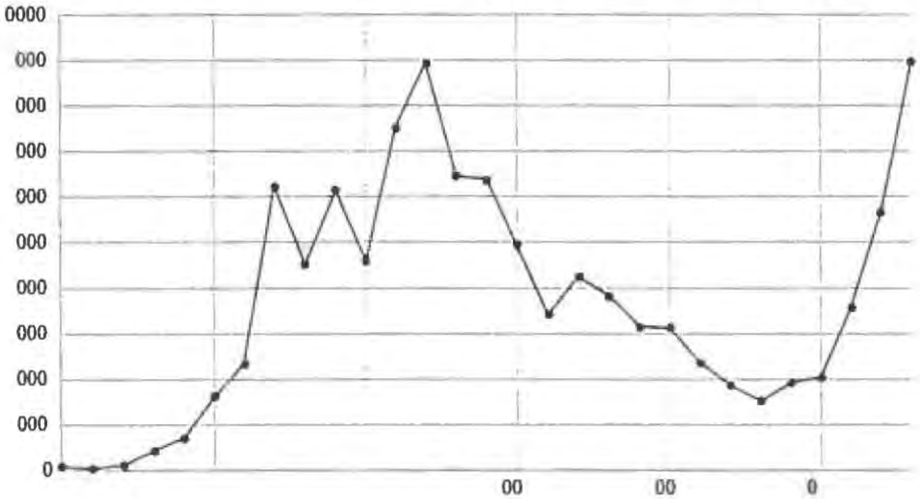
*Includes cases under the 1986 Bankruptcy Law.

**All cases are under the EBL.

Data for 1989–2005 from Beijing Siyuan Consultants.

Data for 2006–2017 from INSOL International, 'PRC Enterprise Bankruptcy Law and Practice in China: 2007 to a record breaking 2017' (paper written by Wang Xin Xin, Xu Yang Guang and Alan CW Tang).

Chart 2 Number of PRC Bankruptcy Cases 1989–2017: Graph



Notes:

The 2007 figure includes cases under the 1986 Bankruptcy Law; from 2008, all cases are under the EBL.

Data for 1989–2005 from Beijing Siyuan Consultants.

Data for 2006–2017 from INSOL International, 'PRC Enterprise Bankruptcy Law and Practice in China: 2007 to a record breaking 2017', above.

At the outset, it must be kept in mind that the majority of business failures are not handled under the Chinese bankruptcy law. For each case administered under the Chinese bankruptcy law, it is estimated that there are at least another 100–250 enterprises that are closed down either through the use of out-of-court administrative procedures or which simply disappear through deregistration or license nullification. There are also many other zombie companies that just carry on and are not included in the data. Even taking this into account, it is clear that the overall number of cases under the EBL is much lower than had been anticipated when the new law was enacted.

The delay in implementing comprehensive bankruptcy rules and regulations – in the form of a comprehensive judicial interpretation – has hampered the implementation of the new Chinese bankruptcy law. Until 2015 or so, the judiciary showed a general reluctance to accept bankruptcy cases. The Supreme People's Court issued a judicial interpretation in 2011 to address the problem, but it had little immediate effect.[2] Even in those bankruptcy cases that have gone forward, the judiciary in general has been slow to embrace many of the changes that were intended to modernise the law. The result has been that tensions often remain between workers and other creditors; the role of the administrator has not developed as fully as had been intended; and there have been relatively few restructurings.[3]

These 'teething problems' do not detract from the fact that the enactment of the EBL was a big step forward. Over the last few years steps have been taken to address these problems. The number of cases are on an upswing and the judiciary is developing the capacity to handle the increased caseload and to more effectively implement the EBL.

15.2 Problems with the Old Law

One of the most serious weaknesses of the old bankruptcy legal framework was the confusing patchwork of laws and judicial interpretations. The 1986 Bankruptcy Law was enacted to deal only with the affairs of insolvent SOEs. With the enactment several years later of laws to deal with the insolvency of non-SOE legal enterprises, the demand began to grow to enact a unified law to replace the old patchwork.

A further problem of the old laws was that since they were quite short and lacked detail, they were unable to deal with the myriad of problems that arose in the administration of cases and had to be frequently supplemented by the issuance of judicial provisions. Demand began to grow to enact a more comprehensive and detailed piece of insolvency legislation.

Liquidations under the old regime were controlled by a liquidation committee, rather than by a single trustee or administrator. In the case of SOEs, the committee was comprised principally of government and administrative officials, who, generally speaking, had little experience in handling the affairs of an insolvent company. Moreover, there was a serious timing problem under the old law until the issuance of the 2002 Interpretation – the liquidation committee was not appointed until 15 days after the date on which the court made the adjudication order. During the intervening gap period, it was not uncommon for assets to go missing. Demand began to grow for professional administrators to

2 See Chapter 15.3.

3 See Chapters 15.5, 15.8 and 15.9.

be put into place in bankruptcy cases to better take control of debtors' assets and manage debtors' estates.

Although in theory the old laws provided for the possibility of corporate rescue or rehabilitation, in practice this proved near impossible. It came to be seen that the liquidation procedure needed to be supplemented by a workable corporate rescue procedure.

It was with some of these difficulties in mind that the drafting of the new legislation was approached, to ensure that the deficiencies in the old legislation were addressed and that the new system adhered to international norms, at least as far as possible, given the particular circumstances of the PRC.

15.3 SCOPE OF THE EBL

Before looking at some of the detailed provisions in the EBL, it is important to note that this law is not the sole recent enactment on the topic of bankruptcy. Even before the EBL came into operation, the Supreme People's Court issued rules regarding the designation of administrators and the setting of administrators' remuneration.

At the time of the publication of the Second Edition of this *Manual*, it was understood that the drafting of a comprehensive judicial interpretation was underway and would perhaps be in place by the end of 2009. This never came to be. Rather, between the publication of the Second and Third Editions of this *Manual*, two judicial interpretations of the EBL were enacted. The first interpretation, Provisions of the Supreme People's Court on Certain Issues Relating to the Application of the EBL of the PRC (I) ('2011 EBL Judicial Interpretation I') was adopted on 29 August 2011 and became effective on 26 September 2011. This Interpretation focuses on the acceptance of bankruptcy cases by the People's Courts. The second interpretation, Provisions of the Supreme People's Court on Several Issues Concerning the Application of the EBL of the PRC (II) ('2013 EBL Judicial Interpretation II') was adopted on 29 July 2013 and became effective on 16 September 2013. This Interpretation focuses on issues relating to the identification of the debtor's assets during the hearing of bankruptcy cases by the People's Courts. Since then, a series of notices and practical procedures have been promulgated by the People's Courts to strengthen the operations of EBL. These notices include:

(a) Notice concerning pilot practices for commencement of bankruptcy cases in selected courts (Nov 2014), setting up 21 bankruptcy courts in mainland China;

(b) Supreme People's Court's 'Interpretation on Civil Procedure Law' (Articles 513 to 516) (Feb 2015), invoking EBL for insolvent companies subject to enforcement actions by creditors;

(c) Ten Model Cases regarding Trial of bankruptcy Cases according to the Law and Promotion of the Supply-Side Structural Reform (June 2016), providing case briefing and application of EBL on ten model real life cases;

(d) Notice of the Supreme People's Court on Issuing the Provisions on the Information Disclosure regarding Enterprise bankruptcy Cases (for Trial Implementation) (August 2016), lounging the official information website of cases subject to EBL;

(e) Notice of the Ministry of Finance on Issuing the Provisions on the Accounting Treatment Regarding Enterprise Bankruptcy Liquidation (December 2016), regulating the Administrator's accounting and disclosure requirements of enterprise in liquidation, in accordance with the Accounting Law of the People's Republic of China and EBL; and

(f) Guiding Opinions on Transferring Enforcement Cases for Bankruptcy Examination (January 2017), providing guidance for judicial co-operations in transferring enforcement cases from enforcement court to bankruptcy court.

These Interpretations have begun to assist with the development of the law in a systematic way. Of course, as time goes on, it is expected that there will be further clarifications handed down by the Supreme People's Court and additional legislative amendments enacted by the NPC.

As noted in Chapter 15.2, a goal of the new law was the enactment of a unified legal regime. On its face, this goal appears to have been achieved, as separate legislative treatment for SOEs and non-SOE legal person enterprises are now both subject to the EBL. Thus, the EBL applies to enterprises with legal person status, including SOEs and Foreign Investment Enterprises ('FIEs') such as Equity Joint Ventures ('EJVs'), Co-operative Joint Ventures ('CJVs') and Wholly Foreign Owned Enterprises ('WFOEs'). However, Article 133 of the EBL states that particular bankruptcy issues of some SOEs (within the period and scope as prescribed by the State Council prior to the effective date of the EBL) shall continue to be subject to State Council regulations. Many of these SOEs were/are in sunset industries, either strategic in nature or whose closure could have potentially serious social consequences. In essence, the EBL was not given control of the bankruptcy of many of the oldest, largest and most inefficient SOEs.

As long as the State Council and Chinese administrative organs continue to regulate the closure of significant SOEs, the new law will very likely not provide a unified treatment of SOE bankruptcies. This still seems to be the case. As at the time of writing of the Second Edition of this *Manual*, serious problems were confronting SOEs, and it appeared that solutions would again operate through a policy approach outside the scope of the EBL. On 7 September 2015, the *South China Morning Post* reported that the PRC State-Owned Assets Supervision and Administration Commission ('SASAC') had issued new guidelines for SOEs that would split them into two groups: commercially-oriented enterprises and not-for-profit entities. The government was to seek stock listings and equity investors for the former and retain state control over the latter, perhaps with greater involvement by the Communist Party.[4] This initiative appears to have taken shape in 2017 as the government has begun to bring foreign investors on board to SOEs in the hope of driving SOE reform in China,[5] notwithstanding that there are concerns that the profit-oriented market approach of foreign investors may be conflicting with the social purposes of SOEs.[6] Likewise, the policy approach by way of debt-to-equity swaps with major bank creditors has returned to the market in recent years, which supplements the move to improve the performance of SOEs. It was estimated that the changes proposed in 2015 could affect tens of thousands of SOEs with an estimated collective value of US$20 trillion.[7]

The issue of whether financial institutions should be subject to the EBL was also debated throughout the law reform process. Article 134 of the EBL empowers the financial regulatory authority under the State Council to apply for the bankruptcy or reorganisation of a financial institution. However, the EBL is unclear as to the ability of creditors or debtors to file petitions. Article 134 also provides that where a financial institution becomes bankrupt, the State Council may formulate implementing measures in accordance with the provisions in the EBL and other laws. The China Banking Regulatory Commission ('CBRC') is still in the process of assisting with the development of new legislation/procedures setting out a resolution mechanism for banking and financial institutions. An announcement is anticipated in the near future. In the meantime, on 29 October 2014 the State Council promulgated Regulations on Deposit Insurance (pursuant to

4 See 'Overhaul of Chinese state-owned firms split them into commercial and non-for-profit operations', South China Morning Post, 7 September 2015, at: http://www.scmp.com/news/china/policies-politics/article/1856060/overhaul-chinese-state-owned-firms-will-split-them.

5 See 'Don't panic! Party leadership is China's answer to West's corporate governance issues, say SOE bosses', South China Morning Post, 8 December 2017, at: http://www.scmp.com/business/investor-relations/article/2123502/dont-panic-party-leadership-chinas-answer-wests.

6 *See 'Ex-Morgan Stanley Asia head warns against 'Japan-like' approach to Chinese SOE reform'*, South China Morning Post, 15 December 2017, at: http://www.scmp.com/business/investor-relations/article/2123502/dont-panic-party-leadership-chinas-answer-wests.

7 See 'Overhaul of Chinese state-owned firms split them into commercial and non-for-profit operations', note 4 above.

Order No 660 of the State Council of the PRC), and the effective date for the Order was 1 May 2015. These Regulations establish a deposit insurance scheme for defined Insured Institutions, insuring deposits up to RMB500,000. The goals of the Regulations include 'guarding against and defusing financial risks, and maintaining financial stability' (Article 1).

As noted in Chapter 15.1, the new law continues the old policy of excluding individual debtors – hence consumers – from the scope of the bankruptcy law. However, with the growth of consumer debt in the PRC in the form of housing and car loans, it is quite likely that it will only be a matter of time – most likely at least several years away – before insolvency legislation or regulations are put in place to cover individual persons.

In fact, over the last several years, government officials, judges, administrators and academics in the field of PRC insolvency law have seriously discussed the merits of enacting a personal bankruptcy law as a response to both (1) the rapid development of market economic activities of corporations and business entrepreneurs resulting in many unsettled corporate debts that are guaranteed by corporate founders and shareholders and (2) the dramatic growth of consumer debt in China. These efforts have reached an advanced stage in Shenzhen. The Shenzhen People's Intermediate Court has since 2014 (if not earlier) taken the lead in completing extensive research into bankruptcy jurisprudence and the creation of an appropriate legislative framework. In early 2017, the Shenzhen People's Intermediate Court put forward its legislative proposal for personal bankruptcy to the NPC through the People's Congress of Shenzhen Municipality. The bill sets out the legislative framework for general personal bankruptcy procedures, the regime to invoke individual debt restructuring arrangement (akin to the Individual Voluntary Arrangement in Hong Kong) and summary procedures for small bankruptcy and small debt restructuring arrangements. 'Small' personal bankruptcy case refers to the insolvent debtor's total liability being no more than RMB 1 million. At the time of writing, there appears to be no timetable as to when the new law would be enacted but the new personal bankruptcy regime is unlikely to be too far away.[8]

This Chapter does not intend to offer a comprehensive overview of Chinese bankruptcy law. Rather, the discussion in Chapters 15.4–15.11 looks at the substantive provisions in the new legislation in several

8 '*Shenzhen is ready to recommend legislation of the personal bankruptcy law to the National People's Congress*, Southern Metropolis Daily (9 January 2017) http://www.oeeee.com/nis/201701/09/484921.html; and 'China needs a personal bankruptcy system to forgive entrepreneurial failure in business', Legal Daily (21 September 2017) http://www.legaldaily.com.cn/Lawyer/content/2017-09/21/content_7325076.htm?node=75895.html.

important areas of the law, namely, the commencement of the bankruptcy process, the creation of the new independent administrator position, remuneration of administrators, the creditors' committee, priority in distribution, avoidance powers, reorganisation and conciliation, and cross-border insolvency. The discussion will also highlight the relevance of the recent judicial interpretations to these areas of the law.

15.4 PETITIONING FOR BANKRUPTCY

Under the EBL, it is possible for either the debtor company or one of its creditors to petition for bankruptcy. That much is clear. However, the ambiguous and apparently conflicting wording of Articles 2 and 7 of the EBL led to confusion from the start (as well as to differing interpretations by commentators). In short, Article 2 provides that for an enterprise to be eligible for liquidation or reorganisation it must be unable to repay its debts when due ('cash flow' test) and its assets are insufficient to pay off all its debts ('balance-sheet') test or 'apparently lack the ability to pay off [its] debts' (which is also translated in some versions of the law as being 'obviously insolvent'). Furthermore, a debtor can also be eligible for reorganisation solely on the basis that it has 'apparently forfeited the ability to pay off [its] debts'.

Article 7, in turn, sets out the requirements for the application and acceptance of bankruptcy petitions. It states that where a debtor satisfies the requirements of Article 2, it may apply for reorganisation, compromise or bankruptcy. However, it further provides that where the debtor cannot pay off its debts, a creditor may apply for the debtor's reorganisation or liquidation.

The ambiguity of the language and conflicting wording of these sections led to more questions than it answered. For example:

(a) How would a party prove that a debtor was unable to pay its debts?

(b) What does it mean that a debtor is 'obviously insolvent'?

(c) Does the balance-sheet test apply only to debtors' petitions or does it also apply to creditors' petitions?

It was difficult for the law to get off to a strong start when it was unclear as to what the parties need to prove for a case to be accepted. Nevertheless, more than 4 years passed before the Supreme People's Court issued a clarification in the form of the 2011 EBL Judicial Interpretation I, which became effective on 26 September 2011. This Interpretation was a significant step forward and resolved much (but not all) of the ambiguity and confusion.

For example, in regard to the 3 questions above, the Interpretation provides as follows:

(a) Article 2 of the Interpretation provides that the People's Court shall determine that a debtor is unable to pay its debts if a valid debtor-creditor relationship has been established under the law, the period for debt repayment has expired, and the debtor has not paid off the debts.

Note: Further efforts are needed to clarify that the expiration of the time for repayment does not extend to the life of the loan, but rather to scheduled payments, non-payment of which triggers an event of default.

(b) Article 4 provides that despite a debtor satisfying the balance-sheet test, the People's Court shall determine that a debtor apparently lacks the repayment capacity where the debtor is unable to pay off its debts:

(i) 'due to a serious shortage of funds or the inability to turn its assets into cash';
(ii) 'because the whereabouts of its legal representative cannot be ascertained, and there is no other person responsible for managing the assets';
(iii) 'despite enforcement by the People's Court';
(iv) 'because it has been in the red for a long time, and has difficulty to return to be profitable'; or
(v) where the debtor falls under any other circumstances leading to the loss of its repayment capacity.

Note: This expansive definition of 'apparently lacks the repayment capacity' makes serious inroads into the notion that the debtor needs to also satisfy a balance-sheet test.

(c) Article 6 provides that where a creditor petitions for a debtor's bankruptcy, the creditor must provide 'evidence proving that the debtor is unable to repay its due debts.' The People's Court shall accept the application 'if the debtor raises no objection on the creditor's application to the People's Court within the statutory time limit, or if the objections raised cannot be substantiated.'

Note: It appears from this language that in the case of a creditor's petition, the balance-sheet test will not be relevant where the debtor fails to raise an objection. Moreover, given that the next paragraph of Article 6 of the Interpretation provides that the People's Court does not even require the debtor to submit information relating to the balance sheet until after acceptance of the creditor's petition (which tracks the language in Article 11 of the EBL), this calls into question the applicability of the balance-sheet test to creditors' petitions. This was the position taken in the Second Edition of this *Manual*.

The process for a creditor applying for bankruptcy under the EBL is as follows:

(a) The creditor applies to the People's Court for bankruptcy;

(b) The People's Court then notifies the debtor of the application for bankruptcy within 5 days of receiving the creditor's petition (EBL, Article 10);

(c) The debtor may object and appeal to the People's Court within 7 days of receiving notification (EBL, Article 10);

(d) Following the expiration of the 7-day period, the People's Court shall issue a ruling on the acceptance of the petition within an additional 10 days (subject to a 15-day extension, if necessary, to be granted by the People's Court at the next higher level) (EBL, Article 10);

(e) Where the debtor does not make any objection, the People's Court shall issue a ruling on the acceptance of the case within 15 days of receiving the petition (EBL, Article 10);

(f) Where the People's Court decides to accept the case, it shall notify the debtor of its decision within 5 days of the date of its decision and the debtor shall have an additional 15 days therefrom to submit various required information (EBL, Article 11);

(g) When the People's Court decides to accept a case, it shall appoint an administrator as the same time (EBL, Article 13);

(h) Where the People's Court decides not to accept the case, it shall notify the creditor within 5 days from the date of its decision and explain the reasons why. Where the creditor is dissatisfied with this decision, the creditor may appeal to the People's Court at the next higher level within 10 days of receiving notice of the decision (EBL, Article 12);

(i) The People's Court then notifies known creditors within 25 days of its ruling accepting the case and publicises the ruling of the acceptance of the petition (EBL, Article 14);

(j) Creditors are then invited to submit claims; and

(k) The first meeting of creditors is then held. At the meeting, the creditors may resolve to apply to the court to appoint a replacement administrator.

The process for a debtor's petition will be somewhat shorter, in that the debtor will make the initial application to the People's Court. The People's Court will then issue its ruling on the acceptance of the petition and the appointment of the administrator within 15 days of the filing of the petition (subject to 15-day extension, if necessary, by the People's Court at the next higher level) (EBL, Article 10).

Note: This is how the process is supposed to work. In practice, many People's Courts have failed to comply with the various deadlines. In some cases, petitioners never even heard back from a court about the status of a bankruptcy petition. Articles 7 and 9 of the 2011 EBL Judicial Interpretation I were intended to deal with these problems. Article 7 provides that, 'Upon receipt of a bankruptcy application, a People's Court shall issue a written acknowledgement to the applicant that it has received the application and the accompanying evidence.' Article 7 then goes on to provide that the People's Court shall 'promptly examine the capacity of the applicant, the capacity of the debtor, the reasons for bankruptcy, ... and *make a ruling on whether or not to accept the application in accordance with Article 10 of the Enterprise Bankruptcy Law*' (emphasis added). In other words, Article 7 of the Interpretation requires that the People's Court must give the creditor a written confirmation of receipt and then requires judges to follow the procedures set out in the EBL.

Article 9 of the Interpretation further provides for situations in which the People's Court either does not accept a bankruptcy application or does not follow Article 7 of the Interpretation (and thereby Article 10 of the EBL) – in such instances, the applicant is allowed to file the bankruptcy application with the People's Court at the next higher level (and interestingly, no deadline is provided) and the People's Court at the next higher level is required to order the original People's Court that initially received the application to examine the application and to 'promptly' rule on it. If the initial People's Court fails to comply, the People's Court at the higher level may make the ruling.

It is apparent that the enactment of the EBL has posed challenges to PRC courts at all levels, as judges were forced to familiarise themselves with the new requirements under the EBL and to develop an understanding of how the EBL should interplay with the PRC company law and other civil laws and enforcement provisions. This certainly was an important factor contributing to the delay in the acceptance of bankruptcy petitions for many years after the EBL was enacted.

However, the length of delays in the acceptance of bankruptcy cases has been decreasing, and PRC courts have been accepting an increasing number of cases in recent years. As the judges in the Supreme People's Courts have been improving their knowledge and skillsets for handling insolvency matters, the administration of cases has been proceeding more efficiently and the courts have been accepting more cases.

The recent increase in cases is primarily due to the public's increased knowledge of the EBL. The public has become much better informed about the EBL as the Chinese government has been advocating for greater use of the new law. And then, in August 2016, the government launched an Information Website for National Bankrupt Enterprises

Recombinational Cases, which has further raised the profile of the law. The Website is intended to operate as a centralized information system for disseminating information and official notices relating to bankruptcy cases, as well as to serve as a mechanism to be used by parties in individual cases. Two working platforms have been established – the Judge's Working Platform and the Bankruptcy Administrator's Working Platform. The Judge's Working Platform allows for the submission of bankruptcy applications and the Bankruptcy Administrator's Working Platform provides for a variety of actions by creditors including the submission of claims, attending meetings and voting, and challenging a bankruptcy administrator's decision in regard to a claim. The Website is a novel development – and by allowing for voting on line, the Chinese might well be setting a new international standard for other countries to strive for. The Website, with its various functions, is already playing a valuable function in keeping parties active and informed, in making it easier to file petitions, and in ensuring that the judges and administrators are processing their cases more efficiently and meeting relevant deadlines.

A second factor is the ongoing training of insolvency professionals in China. PRC insolvency professionals increasingly are interacting with each other and with Hong Kong and foreign practitioners at Chinese and international insolvency forums, such as the annual Beijing Bankruptcy Symposium, and in training courses organised by the World Bank[9] and local professional organisations. As an example, over 800 delegates attended the 2017 Beijing Bankruptcy Symposium. One of the speakers at the Symposium suggested a pro-debtor, reorganisation approach to Chinese insolvencies and suggested that at the outset of the case acceptance process under the EBL an attempt should be made to classify companies into 3 categories to facilitate a fast-track determination of whether to pursue reorganisation or liquidation: (1) companies with viable business in the market but facing a short-term credit crunch should attempt to restructure their debts; (2) companies facing insolvency due to the lack of technological support in product development should go through restructuring and during the process be provided with additional support to address the technological deficiencies and help revitalise their businesses: and (3) companies that fall behind the market pace but could likely be turned around should be given opportunities to pursue reorganisation and explore new product and market opportunities. Insolvent corporations that

9 Training seminars organised by the *World Bank, the International Development Law Organization and the PRC Supreme People's Court* for 200 PRC Bankruptcy Judges in Beidaihe, June 2012.

do not fall into one of these 3 categories should be forced on to a liquidation track and commence bankruptcy procedures.[10]

Lastly, another development that will have great significance in the future also needs to be highlighted. In August 2016, the SPC issued the Notice Concerning the Plan for Establishing Liquidation and Bankruptcy Trial Divisions in Intermediate Courts. On September 26, 2016, Beijing established the first specialized bankruptcy courts under this structure under its No 1 Intermediate People's Court. Similar reforms are underway in eleven other provinces. As of February 2017, 73 courts in China have established specialized liquidation and bankruptcy trial courts, including 4 high courts, 47 intermediate courts and 22 lower courts. These bankruptcy courts will play important roles in the future development of the Chinese bankruptcy processes.

15.5 THE INDEPENDENT ADMINISTRATOR

The EBL introduces the concept of the independent administrator into the insolvency administration. This was intended to lead to significant changes in the administration of insolvent companies in the PRC and was one of the most important reforms of the EBL. Historically, liquidations were dealt with by liquidation committees comprising principally government and administrative officials without detailed insolvency knowledge or experience. The new system envisages large-scale private sector involvement, effectively for the first time, in dealing with insolvent companies in the PRC. The long-term goal is to professionalise the administration of bankruptcy cases.

The administrator is appointed by the court. Once appointed, the administrator's role is to manage the affairs of the company and control its administration, with regular reporting as agreed with the court and subject to satisfying requests made by the creditors' committee. The administrator's duties and powers include the following: taking control of the assets of the company; investigating the debtor's property status; managing the company's affairs; deciding whether the debtor shall continue to carry on business prior to the convening of the creditors' meeting; administering and disposing of the debtor's property; participating in litigation, arbitration, or other legal proceedings on behalf of the debtor; convening the creditors' meeting; performing other duties as the court thinks appropriate; seeking the application of avoidance powers; and playing an integral role in a debtor's reorganisation.

10 Opening speech at the 8th China Bankruptcy Law Forum and Seminar for the 10th Anniversary of Enterprise Bankruptcy Law, 3 June 2017.

In April 2007, the Supreme People's Court issued the Supreme People's Court Provisions on Designation of Bankruptcy Administrators. These Provisions set forth guidelines for application and announcement procedures regarding the appointment of administrators. The appointment practice is not uniform throughout the PRC and varies from jurisdiction to jurisdiction. Each separate People's Court has its own panel of administrators. There are at least several thousand administrators in the PRC. They are usually accounting firms, law firms or firms specialising in bankruptcy proceedings. Some courts also allow individuals to be appointed. Admission to these panels is dependent upon the provision of information to the local People's Court. It appears that there are some differences in the information required by the various courts, but in general the core information sought from potential administrators by the courts is not greatly dissimilar. Essentially, the People's Court should assess the qualifications of the applicants (be they qualified accounting firms, law firms or firms specialised in the area of corporate bankruptcy matters) on the basis of their professional qualifications, their scale of operations and track records in carrying out bankruptcy engagements. Generally, the applicant should have, inter alia, a practising licence for at least 3 years, with 10 PRC qualified accountants or 5 PRC qualified lawyers depending on the applicant's type of firm.

Taking as an example the Shenzhen Economic Zone, the Shenzhen Intermediate People's Court has, since 2012 and 2013, set out guidelines for applicants to follow when registering with the court as a panel administrator. The Court has established a 3-tier ranking system for those firms that have qualified and registered for handling bankruptcy cases: complex cases, normal cases and small cases. Complex cases are those bankruptcies involving financial institutions, securities firms, insurance companies, listed companies and companies with assets over RMB100 million or cases involving complex issues. Normal and small cases are classified by the amount of the assets of the insolvent company, ranging from RMB100 to 1 million for normal cases and below RMB1 million for small cases. Under this 3-tier panel system, panel firms that qualify for the highest ranking can take up all 3 types of cases; firms in the second ranking can only take up the lower two levels of cases; and firms in the third and lowest ranking are restricted to small cases only. Panel firms are subjected to performance assessment by the Shenzhen Intermediate Court: depending on the assessment received, firms may be promoted or downgraded or even removed if the Court determines that they have failed to satisfy the performance assessment.[11]

11 See '*Guidelines for the performance assessment of bankruptcy administrators*', issued by The Shenzhen Intermediate People's Court, available online at: http://ssfw.szcourt.gov.cn/frontend/pochangongkai/column/71/information/585;jsessionid=BEE20DF99B05DC5FA425993F501E29C1

In contrast, the 2-tier panel system (ie Panel A and Panel T appointments) as adopted for almost 2 decades in Hong Kong does not provide any continuing assessment to facilitate firms that have acquired sufficient practical skills and knowledge to be advanced from Panel T to Panel A or to penalise panel firms by lowering their ranking. Panel T firms can only submit new applications to the Official Receiver's Office should they satisfy the admission criteria for Panel A firms.

The guidelines for admission as an administrator primarily apply to PRC qualified professionals, and hence initially there were some concerns that foreigners would not be allowed to serve as administrators. This, however, has proved not to be the case. In fact, some international accounting firms have been included on the administrator panels (eg in Beijing) and appointed in individual cases. Significantly, a foreign accountancy firm, KPMG, was chosen to act as a co-administrator in a very significant fairly recent case.[12]

Appointment is subject to the firm having a physical presence in the area covered by the relevant court and being approved by the court in question. The general practice that has emerged since the EBL came into operation is for administrators to be appointed on a rotation system. In some places, firms are interviewed before the court makes its decision. For example, in *Shanghai Chaori Solar Energy Science & Technology Co Ltd*, KPMG was interviewed on two days' notice and was in competition with 17 other firms.

One unexpected problem that has emerged in practice is the reluctance of some People's Courts to welcome the independent administrator into the process. Article 24 of the EBL provides an 'out' for courts that prefer to retain the old practice – it provides that a liquidation committee 'composed of persons of the departments or authorities concerned' may serve as an administrator. Several years ago, one of the authors of the Third Edition of this *Manual* was present at a debate between a PRC judge and a PRC administrator regarding the best way to administer Chinese insolvencies. The administrator argued that the appointment of independent professionals with restructuring experience and legal or accounting skills would be the best way to assist companies with complex commercial and economic issues; the judge responded that it was more important to have government and administrative officials take the lead in the process as they have the connections to enable them to navigate a path through the insolvency and government bureaucracies. At present, in many cases a liquidation group is appointed (and the government plays a leading role) and

12 KPMG and King & Wood Mallesons were chosen as co-administrators by the Shanghai First Intermediate Court on 26 June 2014 in *Shanghai Chaori Solar Energy Science & Technology Co Ltd*. In this case, KPMG was arguably appointed precisely because it was foreign and had much experience pursuing and collecting assets overseas.

an independent professional is retained as a financial advisor. Some professionals think that this is perhaps a good compromise for now. In the restructuring of 38 of the 50 listed companies in reorganisation, the appointment of the administrator has taken the old form of the liquidation committee, comprising government officials, but with the inclusion of some experienced bankruptcy professionals.[13]

Retaining the old form involving the liquidation committee may cause concerns that prove to be counterproductive. The administrator is expected to be impartial and professional and to carry out work with due care and diligence and in the interests of creditors. Failure to do so may run the risk for the administrator to be penalised by the court, according to Article 130 of the EBL.[14] Rule 33 of the 'Provisions of the Supreme People's Court on Several Issues Concerning the Application of the Enterprise Bankruptcy Law of the People's Republic of China (II)',[15] provides that if the administrator breaches any duties or commits gross negligence that leads to financial losses for third parties, the court may award a cost order against the administrator should there be insufficient assets in the bankruptcy estate to settle the claims. In the event that the appointment of the administrator adopts the mode of a liquidation committee, such arrangements may cause confusion when it comes to the responsibility and liability of the administrator. In the worst-case scenario, where there are claims for gross negligence or contractual disputes arising from the administration, those who are acting in the capacity as administrators in theory should be jointly and severally liable for any claims that arose in respect of their actions. However, should the administration be heavily composed of government officials, one would naturally be concerned of the uphill battle that will arise when raising legal challenges in respect of any wrongdoings of, or contractual disputes with, such individuals.

Time will tell whether the role of the independent, more market-oriented administrator will eventually be allowed to develop as originally intended.

15.6 REMUNERATION OF THE ADMINISTRATOR

The remuneration of the administrator is controlled by the court, subject to rules formulated by the Supreme People's Court. In April 2007, the Supreme Court issued Provisions on Remuneration of

13 See Chapter 15.10.

14 See Article 130 of the EBL.

15 See *Provisions of the Supreme People's Court on Several Issues Concerning the Application of the Enterprise Bankruptcy Law of the People's Republic of China (II)*. This translation was published on the website of the People's Court Press, http://www.globalchinalaw.com

Bankruptcy Administrators. As a general rule, remuneration is based on a sliding scale but with the court given the power to adjust within a narrow band (some 30%) depending upon a variety of factors including the complexity of the case, the administrator's performance and local levels of income and costs of living.

The Supreme Court Provisions also include guidelines to assist where the creditors' meeting objects to an administrator's remuneration. However, there are concerns emerging in the PRC that the fees for administrators are too low.

For small bankruptcy cases, there may be situations where there is limited funding or where asset realisation proves insufficient to meet the bankruptcy costs and expenses. To address this issue, since 2014, Shenzhen has been experimenting with a subsidy scheme in aid of any bankruptcy administrations where there is a lack of funds. Under the scheme, the Shenzhen Intermediate People's Court shall determine the remuneration of the administrator, and, if the administrator is found to be fit, the court shall provide funding to the administrator if it is determined that the prospect of immediate asset realisation is remote. In the event that there is a subsequent asset realisation, the funding provided to the administrator shall be repaid by the administrator as a bankruptcy expense with priority.[16]

15.7 Creditors' Committee

With the introduction of the concept of a creditors' committee, the EBL explicitly gives creditors the right to become directly involved in the bankruptcy and/or restructuring process.

Pursuant to Article 67 of the EBL, the committee, which can comprise a maximum of 9 members (but with no minimum, which may create issues) is appointed at the first meeting by the creditors, subject to court approval. There must be at least one employee or labour union representative on the committee. The creditors' committee is intended to play an actual role in the bankruptcy process, including supervising the management and disposition of the debtor's property. The committee is also entitled to request that the administrator make explanations or to supply relevant documents. The administrator is required to report to the committee on the progress of the administration. Unlike in Hong Kong, the creditors' committee will have no say in the remuneration of the administrator, as the fees of the administrator are based on a scale as fixed by the Supreme People's Court (subject to minor local adjustments). However, the creditors' meeting is permitted to

16 See *The guidelines for the provision of subsidy funding and its usage for administrator*, issued by Shenzhen Intermediate People's Court on 18 July 2013 (and revised on 12 March 2015) available at: http://ssfw.szcourt.gov.cn/frontend/pochangongkai/column/68/information/588.

file objections to the administrator's remuneration; in such cases, the guidelines in the Provisions on Remuneration of Bankruptcy Administrators are applicable.[17]

15.8 Priority in Distribution

Article 109 of the EBL provides that creditors secured by specific property of the debtor have priority in repayment from the specific property.

Thus, secured claims have first priority. Next come unsecured claims. Article 113 of the EBL provides for the payment of unsecured claims in the following order

First, unsecured priority claims:

(a) Bankruptcy expenses (as set out in EBL, Article 41):

  (i) litigation expenses in the bankruptcy case;
  (ii) expenses needed for the management, appraisal and distribution of the debtor's property; and
  (iii) the expenses and remuneration of the bankruptcy administrator for the performance of his duties and the expenses of hiring staff.

(b) Common benefit claims (as set out in EBL, Article 42):

  (i) debts arising from the request of the administrator or debtor requesting a contract counterparty to perform a contract which has not been completely performed by the parties;
  (ii) debts incurred from the management of the debtor's property;
  (iii) debts incurred from the unjust enrichment of the debtor;
  (iv) labour remuneration and social insurance contributions payable for continuing the debtor's business operations and other debts generated therefrom;
  (v) the debts incurred from any damage to another person caused by the administrator or other relevant person in the performance of their duties; and
  (vi) the debts incurred by any person from any damage caused by the debtor's property.

Then,

(c) a variety of claims (salaries, medical expenses, injury claims, disability allowances, and pensions) of workers and staff members; basic old age insurance contributions and basic medical insurance contributions owed by the debtor and to be paid into individual staff and worker accounts, and compensation payable

17 See Chapter 15.6.

to staff and workers in accordance with law and administrative regulations (EBL, Article 113(1));

(d) social insurance contributions owed by the debtor other than those listed immediately above and the taxes owed by the debtor (EBL, Article 113(2); and

(e) unsecured creditors (EBL, Article 113(3)).

Article 113 goes on to say that where there are insufficient assets to satisfy all of the creditors in the same group, the distribution shall be made *pro rata*.

It is important to keep in mind that the key issue that delayed the implementation of the EBL was the treatment of the rights of the secured creditors *vis a vis* the rights of employees. Article 132 of the EBL addresses this issue and provides a compromise that allowed for the enactment of the EBL. This article provides different treatment for workers' claims arising in future bankruptcies (actually in regard to workers' claims arising *after* 27 August 2006, the date on which the legislation was given final approval by the NPC) and workers' claims that accrued but remain unpaid *as of* 27 August 2006.

With regards to workers' claims arising *after* 27 August 2006, secured creditors retain their priority rights over the proceeds of sale of the assets over which they hold security (pursuant to EBL, Article 109). The claims of employees in respect of unpaid wages, severance pay, pension entitlements etc are to be paid according to the priority set out in Article 113 of the EBL.

However, a broad range of employment-related claims, including wages, medical and insurance claims – which accrued but remain unpaid *as of* 27 August 2006 – are to be paid in priority to the secured creditors' assets if the unsecured assets of the debtor are insufficient to pay the workers' claims in full. The inclusion of this special protection for pre-existing workers' claims was part of the compromise that led to the enactment of the EBL. In many cases, these claims might well be substantial in value because it was not unusual for workers of SOEs in financial difficulty to go for months and, in some instances, even years, without being paid. Moreover, what is unusual about this special protection in the EBL is that it extends to all workers – including those employed by non-SOE legal person enterprises – and not just to workers employed by SOEs under the old 'iron rice bowl' system. In practice, the number of cases in which employees will be able to lay claim to assets belonging to a secured creditor will be limited and will diminish over time.

Note: There is often a significant gap between what the EBL provides in respect of the treatment of employees' claims arising *after* 27 August 2006 and what happens in practice. The reality is that workers' claims usually come first, regardless of the priorities set out in the EBL. The satisfaction of workers' claims – especially in SOE insolvencies – is high on the 'radar screen' for local governments. In particular, it is difficult for a bankruptcy case to be accepted or for a restructuring plan to go forward unless the local government is confident that there are sufficient funds to cover workers' claims. Similarly, in reorganisation and liquidation cases in China involving cross-border aspects, foreign liquidators frequently comment on the inability to 'strike a deal' unless Chinese workers feel that they have been adequately compensated (which may well be at a level substantially above that set forth in the EBL).

15.9 AVOIDANCE PROVISIONS

The avoidance provisions allow the administrator to go back as far as one year from the date of acceptance of the case in his efforts to unravel certain transactions that have been entered into to the disadvantage of creditors.

Article 31 of the EBL permits the administrator to seek the avoidance of 5 types of transactions that occurred within one year of the acceptance of the bankruptcy case:

(a) transferring property without consideration;

(b) entering into a transaction at a transparently unreasonable price;

(c) providing security for an unsecured debt;

(d) paying off a debt not yet due; and

(e) releasing a claim of the debtor.

Article 32 of the EBL permits the administrator to seek avoidance of a preferential payment made by a debtor to a creditor within 6 months of the date of acceptance of the bankruptcy filing, if the payment was made at a time when the debtor was unable to pay its debts, unless the repayment was beneficial to the debtor's property.

Article 33 of the EBL provides that the following transactions are null and void:

(a) transactions in which the debtor concealed or transferred property to evade repayment of debts; and

(b) transactions in which the debtor fabricated a debt or admitted an unreal debt.

Article 36 of the EBL permits the administrator to recover:

(a) the abnormal income obtained by any director, supervisor or senior executive of a debtor from the enterprise; and

(b) any property of the enterprise embezzled by any such person by taking advantage of his position.

Avoidance powers are important tools to enable an administrator to undo unfair or inappropriate transactions entered into by a debtor. However, this part of the EBL is quite short and lacking in detail, and the wording of the avoidance powers leaves them open to subjective interpretation and debate. Articles 9–17 of the recently enacted 2013 EBL Judicial Interpretation II provide some clarification and further detail to assist with the application of Articles 31, 32, and 33 of the EBL. They are an important step in the right direction, but further clarifications are needed.

15.10 Reorganisation and Conciliation

15.10.1 Reorganisation – a brief summary

Corporate rescue was possible under the 1986 Bankruptcy Law, but more in theory than in practice. The hope was that with the enactment of the EBL, corporate rescue could become a reality. In the brief time that the new law has been in operation there have been some successful reorganisations, certainly more than in the close to 20 years under the old regime; but the number of reorganisation cases is still very low. These successful restructurings are a significant move forward, and, for the first time, debtors and creditors alike in the PRC can perhaps envisage the prospect of a business or company being rescued rather than liquidated.

The insolvency law reform process emphasised the need for corporate rescue. The reorganisation provisions are included in Chapter 8 of the EBL. Pursuant to Article 70 of the EBL, both debtors and creditors are permitted to file an application for reorganisation.[18] Although reorganisation is no longer limited to SOEs to be used at the discretion of the government,[19] it is important to keep in mind the government often still plays a very important role.

The application for the reorganisation is submitted to the court. The debtor may apply to the court for approval to administer its assets (EBL, Article 73). The PRC has developed a hybrid procedure providing for the administration of the debtor's property by either the administrator or by the debtor itself under the supervision of the administrator. Once the reorganisation ruling has been made by the court, the administrator or the debtor (as the case may be) will have a period of 6 months within which to come up with a rescue

18 Investors who hold more than 10% of the registered capital of the company may also file in defined circumstances.

19 Or of the shareholders in the absence of a superior department in charge.

plan which will then have to be placed before the creditors and ultimately before the court (EBL, Article 79).

Whilst this period of 6 months may be sufficient for most companies, it is possible to envisage that for larger companies, whose affairs are more complex, it will be difficult if not impossible to organise a restructuring within such a relatively short period. There are provisions for the 6-month period to be extended for another 3 months when justified (EBL, Article 79) but that may also prove insufficient.

The creditors are divided into 4 groups for the purpose of voting on the plan – secured debts; workers' claims; tax debts; and ordinary unsecured claims (EBL, Article 82). Once the administrator's plan has been approved by the creditors by a simple majority in number and two thirds in value of each group (EBL, Article 84), it is then submitted to the court for approval (EBL, Article 86). The law provides procedures for where the plan does not gain the approval of all 4 groups, including a limited 'cramdown' power (EBL, Article 87). Surprisingly, cramdowns are being used much more frequently than had been anticipated.

Although the EBL sets forth a corporate rescue procedure, reorganisations are progressing with more notable cases but not yet the norm in China. From the enactment of the EBL through 1 June 2015, there have been only 50 listed companies and around 100 non-listed enterprise reorganisations.[20] Nevertheless, there have been several recent, high-profile restructurings in China, including Suntech, Chaori Solar, Ambow Education, Sino-Environment Technology Group Ltd, and Sino Forest. On 10 October 2014, IAPBL and the Hong Kong TMA Chapter organised a symposium entitled *Unlocking Value in the PRC: The Changing Nature of Restructurings on the Mainland.* At the symposium, leading IPs based in Hong Kong and Shanghai who were involved in these and other recent Chinese cases offered their insiders' perspective on the successes and failures of restructurings in the PRC.

The speakers noted that in some recent cases in China, good results have been achieved under the circumstances – not ideal by Western standards – but much better than in previous cases. One theme stressed by several speakers was that foreign IPs must realise at the outset that local Chinese management often has strong ties with local government officials and

20 Data from the Bankruptcy Law & Restructuring Research Center, China University of Politics and Law, Beijing, China.

local creditors and is credited in the local communities for creating jobs, bringing in high levels of investment, and paying local taxes. Many challenges remain in the Chinese insolvency process and there are very few cases, but when the right conditions exist, foreign IPs have been appointed as administrators or advisors and, in some cases, have been able to increase value. The speakers were generally in agreement that the better results have been achieved when it has been possible to achieve consensus amongst the parties. Nevertheless, there is still much less transparency than would be found in insolvencies in Hong Kong. From their experiences in China, the speakers shared the following lessons for IPs: you need to identify where you share common ground with other parties; you need to recognise the changing role of government in PRC insolvencies; at the outset, you must decide not whether to restructure a business in China, but rather whether the business is, in fact, salvageable; you need to identify where you are best able to apply leverage; opportunities come to those who are pro-active, not to those who sit back and wait; and you must be realistic in assessing the situation.[21]

15.10.2 Reorganisation - listed companies in practice

Since the introduction of reorganisation procedures in the EBL, 50 PRC listed companies have been restructured through the provisions in Chapter 8 of the EBL. Of these 50 companies, 25 are SOEs, 23 are private enterprises, and the remaining 2 are other types of enterprises.[22]

Issues in common amongst these failed listed companies include their loss-making positions for 3 years prior to insolvency, high gearing debt ratios contrasted with a low level of liquidity, and low turnover but suffering from high operational costs and cash flow problems.

According to the EBL, the debtor, creditor or shareholder can apply to commence reorganisation. In the 50 cases, creditors filed 43 applications (86% of the total). Six cases (or 12%) were commenced by the debtor, initially as bankruptcy proceedings, but subsequently converted to reorganisation proceedings.[23] The remaining one case (or 2%) was one in which the debtor commenced reorganisation procedures

21 'Unlocking Value in the PRC: The Changing Nature of Restructurings on the Mainland' – A Summary of a Symposium held in Hong Kong on 10 October 2014.

22 Liu Yan Ling and Zhao Kun Cheng, *Listed Company Reorganization Case Study*, Law Press China Chapter 1, p6.

23 Liu Yan Ling and Zhao Kun Cheng, *Listed Company Reorganization Case Study*, Law Press China Chapter 1, p8.

directly. In terms of the choice of administration during reorganisation, 12 of the 50 listed companies were under the supervision of an administrator, being either a law firm, an accounting firm or a firm specialised in bankruptcy matters; while the remaining 38 companies were placed under the control of the administrator under the old arrangement of appointing a liquidation committee, which comprises government officials, but with the addition of professional restructuring advisors such as law firms, accounting firms, bankruptcy advisory firms etc.

Three general restructuring approaches were implemented for these 50 listed companies in trouble. The first approach was the 'Entire Asset Stripping' model, in which the administrator disposes of the old business or all the assets and injects new assets or a business offered by a new investor into the listed company, thereby replacing the core business with new initiatives to be pursued upon completion of the reorganisation. Twenty-five cases (50%) of the listed companies have adopted this model. The second restructuring approach was the 'Partial Asset Stripping' model. This model focuses on the disposal of inefficient business of the company leaving the viable business unchanged. Nine of the 50 companies (18%) pursued this approach. The third approach was the 'Asset Reservation Model', in which the listed company retained all the core assets and business after the reorganisation. With the injection of new capital and assets, this model aims to strengthen the original business of the listed company. The balance of the 16 remaining companies (32%) followed this model. It is envisaged that more reorganisations in the future will adopt the Asset Reservation Model, largely as a result of the new rules for the restructuring of listed companies after 2012, ie the listed company should retain its net assets position to avoid any significant asset devaluation whilst undergoing a corporate reorganisation.

As far as the return to creditors is concerned, in these 50 cases outstanding employee entitlements and tax dues were paid in full. Secured creditors generally enjoyed their rights of priority of payment on the secured assets and most unsecured creditors with small claims were paid in full. The recovery rates for other unsecured creditors ranged as follows: 5% in 5 of the cases; 10% to 30% in 25 of the cases; 31% to 70% in 16 cases; and 100% in 2 cases. The remaining 2 listed companies did not disclose the rate of return to unsecured creditors. On average, the time to complete the restructuring process for the majority of the 48 companies was within 148 days, less than the 6-month period as stipulated under the EBL.[24]

15.10.3 Conciliation

The EBL retains the conciliation procedure (EBL, Chapter 9), but unfortunately, the definition of conciliation is not set out anywhere in the legislation. However, it is generally assumed that it has the accepted meaning of the debtor company reaching some form of agreement with its creditors regarding settling of its debts. Only the debtor may commence the conciliation procedure (EBL, Article 95). The application for conciliation comes after the court has accepted the insolvency case but before the bankruptcy is declared (EBL, Article 95).

Where conciliation is sought, the court will convene a meeting of creditors to consider the conciliation plan that again requires a simple majority in number and two thirds in value (EBL, Article 97). If the plan is accepted by the creditors' meeting and approved by the court, the conciliation procedure will be terminated (EBL, Article 98) and the conciliation agreement will be binding on the debtor and all creditors involved in the conciliation (EBL, Article 100). If the plan fails to be adopted by the creditors' meeting or approved by the court, the court will terminate the conciliation procedure and declare the debtor bankrupt (EBL, Article 99).[25]

15.11 Cross-Border Insolvency

15.11.1 Introduction

None of the old PRC insolvency laws included provisions specifically applicable to cross-border insolvency cases, and historically when PRC courts were confronted with cross-border requests for assistance, they adopted a 'territorial' approach by which they refused to recognise the extraterritorial application of a foreign jurisdiction's laws and refused to allow a foreign representative to claim assets of a foreign debtor located in the PRC.[26] However, even during the last few years leading up to the enactment of the EBL, Hong Kong liquidators were able to secure more co-operation in the PRC, especially in Guangdong.

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24 Liu Yan Ling and Zhao Kun Cheng, *Listed Company Reorganization Case Study*, Law Press China Chapter 1, p31.

25 The conciliation procedure in the EBL is rarely used.

26 For further discussion of cross-border insolvency terminology, see Chapter 15.1–15.2.

15.11.2 Inbound transactions

Unlike the old laws, the EBL includes a provision addressing cross-border insolvency issues, and the language of the provision rejects the territoriality approach of the old laws. Nevertheless, the provision is structured in such a way that, at least in the short term, cross-border co-operation will remain difficult to obtain from PRC courts under the EBL.

Pursuant to Article 5 of the EBL, the new law grounds the granting of co-operation in either an international treaty to which the PRC is a party or on the basis of reciprocity with the jurisdiction seeking assistance, provided that the foreign judgment or written bankruptcy order:

(a) Does not contradict the basic principles of the law of the PRC;
(b) Does not violate China's sovereignty, security, and social and public interest; and
(c) Does not infringe upon the lawful rights and interests of creditors in the PRC.

If these factors are satisfied, the court *shall* make an order to recognise and enforce the foreign judgment or bankruptcy order. Nevertheless, it will be quite difficult for a foreign representative to satisfy the provision because at present the PRC has not yet entered into any cross-border insolvency treaties or reciprocal relations with other jurisdictions. Hong Kong insolvency practitioners should be aware that the PRC and Hong Kong have not entered into a bi-lateral cross-border insolvency agreement. Thus, at this stage, the wording of the law has improved but co-operation will be difficult to obtain.

However, attention must be paid to the decision of the Supreme People's Court on 11 June 2014, in *Thumb Environmental Technology Group v Sino-Environmental Technology Group*. This case provided for the recognition of a foreign representative (from Singapore) not on the basis of Article 5 of the EBL, but rather on the basis of Article 14 of the Law for Foreign-Related Civil Legal Relationships of the PRC. This creative approach produces a favourable result that fosters cross-border co-operation in insolvency cases, but the fact that the court bypassed the application of Article 5 of the EBL exemplifies the deficiencies of the approach set out in the EBL.[27]

27 For a discussion of this case, see Guangjian Tu and Xiaolin Li, 'The Chinese Approach Toward Cross-Border Bankruptcy Proceedings: One Progressive Step Ahead, (2015) 24 *International Insolvency Review* 57. Also available online at: http://onlinelibrary.wiley.com/doi/10.1002/iir.1231/full.

15.11.3 Outbound transactions

For outbound transactions, Article 5 of the EBL is explicit that PRC bankruptcies have an extra-territorial effect whereby assets of the PRC debtor situated outside the PRC will be subject to the PRC proceedings. (The Hong Kong courts grappled with this issue as it arose under the old PRC law in the case of *CCIC Finance Ltd v Guangdong International Trust & Investment Corp* [2005] 2 HKC 589 (HCA 15651/1999, 31 July 2001).[28] However, the PRC administrator will still need to apply to the relevant foreign court for permission to enforce his rights over these foreign assets. It will be interesting to see how foreign courts treat such applications.

15.11.4 Cross-border restructurings

Chinese restructurings[29] are further complicated by the increasing use of Cayman Islands or BVI holding companies in the corporate group chain. The emerging corporate business structure of choice – with holding companies in the BVI or the Cayman Islands, layers of subsidiaries in Hong Kong (and elsewhere in Asia) and ultimately other subsidiaries holding assets in China leads to cross-border complications when insolvency occurs. Difficult issues must be addressed involving offshore and onshore restructurings and competing interests amongst offshore and onshore creditors. These corporate failures often involve bankruptcy or reorganisation filings in several countries by different corporate entities in the group and/or the need to enter into parallel schemes of arrangement.

15.11.5 Case study: *Re Kaisa Group Holdings Ltd*[30]

Kaisa is one of the high-profile cases raising significant exposure of cross-border insolvency issues and involved massive levels of claims held by both onshore and offshore creditors.

The company was incorporated in the Cayman Islands and registered as a non-Hong Kong company. Since 2008, it has been listed on the Hong Kong Stock Exchange, with a large number of intermediate holding companies

28 See Chapter 15.4.

29 See Chapter 15.10.

30 [2017] 1 HKLRD 18, [2016] HKCU 2765 (HCMP 708/2016, 10 June 2016).

incorporated in Hong Kong, the British Virgin Islands and the Cayman Islands; many subsidiaries within the group are in the mainland China. Its principal business is property development, mainly in the Guangdong province. The *Kaisa* group was financed by both onshore PRC debts and offshore debts outside mainland China, and it fell into insolvency in 2014; the trading of shares of *Kaisa* was suspended on 31 March 2015.

Onshore creditors were mainly holding bank loans and trust loans in the sum of RMB49 billion, which represented roughly 72% of Kaisa's aggregate debts of RMB68 billion. Offshore debts, which accounted for the balance of US$2.9 billion (or 28% of the total debts) including bank loans, convertible bonds and high yield notes governed by Hong Kong, English and New York laws. PRC courts froze substantial assets of Kaisa, as a result of preservation orders pursued by creditors.

The success of the debt restructuring of Kaisa hinged on the negotiations of restructuring terms between Kaisa and its onshore and offshore creditors. It is interesting to note that both onshore and offshore creditors were offered a full repayment of principal of the loans. Onshore creditors were offered a 30% 'hair-cut' on the interest portion of their loans, with repayment terms extended from 3 to 6 years; while offshore creditors were offered a 50% hair-cut on the interest portion of their loans, with repayment terms extended to 5 years. In the bankruptcy scenario analysis of *Kaisa*, onshore creditors may receive a recovery rate of 29% as compared to 6% recovery for offshore creditors. It was obvious that the return offered to both onshore and offshore creditors in the restructuring, with no hair-cut on principle debt but only certain percentage reduction in interest element on loans with delayed repayment terms, were significantly better than what they could receive in the bankruptcy scenario.

In June 2016, the Hong Kong Court sanctioned a scheme of arrangement under s 673 of the CO, which was supported by the offshore debtholders. The key terms of the scheme were to repay the principal in full, extend the debt maturities, and reduce the interest rates. The new instruments offered to creditors under the scheme aimed to realign the company's debt maturity profile with projected cash flows and to maximize recoveries for scheme creditors over time. The Hong Kong scheme was sanctioned by the court on

10 June 2016. The restructuring for Kaisa's onshore debts was completed by 30 June 2016.[31]

In most restructuring cases, the terms offered by the investor are pivotal to the outcome of the restructuring. In the case of *Kaisa*, the restructuring negotiations occurred against the backdrop of the rising property market in Shenzhen, which perhaps was the market force, as advocated in recent years by the Chinese government, driving the momentum for Kaisa to strike a restructuring deal that was acceptable to all parties concerned.

15.12 SUMMARY

The EBL is a significant piece of legislation on the complex subject of corporate insolvency that offers major improvement over the 1986 Bankruptcy Law. The EBL has now been in operation for over 10 years. Although the level of cases under the new law is lower than had been anticipated at the time of the law's enactment, the filing trend has reversed and the number of cases is now increasing. It is clear that there have been successes in individual cases that could not have been achieved under the old law. The operation of the EBL in high-profile cases has led to the involvement of IPs from China, Hong Kong, the United States and elsewhere and the development of a unique Chinese approach to restructuring and liquidation. The practical implementation and development of the EBL will undoubtedly involve the development of a new generation of insolvency practitioners, the training of a new generation of judges with experience in insolvency matters and the professionalising of the administration process. The application of the legislation has improved over the last few years, and there have been many recent government-led innovations to improve the efficiency of the bankruptcy process. In 2017, bankruptcy filings were at record levels and it looks like the trend will continue upwards. Practitioners now have available to them a set of modern tools with which to facilitate the rescue of distressed companies and to handle the efficient winding up of those that have no future. Time will tell whether the new law fully takes hold and achieves its potential.[32]

31 See announcement made by Kaisa Group Holdings Limited 'Fulfilment of all resumption conditions', on 26 March 2017, also available online at: http://www.hkexnews.hk/listedco/listconews/sehk/2017/0326/LTN20170326119.pdf

32 For further analysis of the EBL and its development, see Booth, Charles D, 'Drafting Bankruptcy Laws in Socialist Market Economies: Recent Developments in China and Vietnam', (2004) 18(1) *Columbia Journal of Asian Law* 93; Booth, Charles D, 'The 2006 PRC Enterprise Bankruptcy Law: The Wait is Finally Over', (2008) 20 *Singapore Academy of Law Special Issue* 275.

1. Government fiscal response measures

1.1 General fiscal stimulus measures adopted

Following the COVID-19 outbreak, the Chinese Central Government has issued various measures and special directives aimed at controlling the spread of the disease. These measures impact how companies operate in China. In addition, the Government at all levels, State Council, state-level ministries and agencies, as well as the provincial governments (including major municipal cities), have released measures to help companies to resume production.

The Chinese Central Government has announced a number of economic policy responses designed to mitigate the impact of COVID-19 for businesses and individuals. At the National People's Congress (NPC), which took place at the end of May 2020,[1] the Chinese Government announced in its annual work report a number of new measures to revitalize China's economy out of the COVID-19 crisis including a fiscal stimulus package of almost RMB 3.6 trillion.[2] As part of this package, the Chinese Government planned to issue RMB 1 trillion of treasury bonds[3] and increase the local government special bond issuance quota to RMB 3.75 trillion.[4] China's stimulus package has been substantial and similar in size to the response to the 2008 financial crisis. Corporate taxes and fees were planned to be reduced by RMB 2.5 trillion to stimulate the economy. Small and midsize companies (SMEs) could delay paying loans and interest by a further nine months, through March 2021, and lending to SMEs by big commercial banks should grow more than 40%.

On 18 January 2021, the National Bureau of Statistics (NBS) published an analysis report concerning how the Chinese economy fared in the aftermath of COVID-19 in 2020. According to the report, in the year 2020, 1) the index of Services Production was the same as that of the previous year, 2) the total value added of the industrial enterprises above the designated size increased by 2.8% over the previous year, 3) the total retail sales of consumer goods reached 39,198.1 billion yuan, down by 3.9% over the previous year.[5]

Furthermore, the fact that China has become the world's largest recipient of foreign direct investment (FDI) in 2020, according to a recently published report of the United Nations Conference on Trade and Development (UNCTAD),[6] was probably not expected by anyone at the moment of the outbreak of the coronavirus crisis in December 2019 but it shows that China has in the meantime successfully responded to the severe impact of the pandemic. Despite this positive news, certain sectors such as airlines have been hit hard and for example HNA Group has recently entered bankruptcy restructuring proceedings, although the said insolvency has not mainly been caused by COVID-19.[7]

So far, most policies and aid measures have been introduced by local governments instead of the Central Government, and therefore vary from place to place. The individual measures of provinces and cities other than Beijing and Shanghai are not considered in this chapter.

1.2 Support for businesses

China has been supporting businesses to manage challenges imposed by COVID-19 at both central government level and provincial government level. The measures include but are not limited to the following.

1.2.1 Central government level

To respond to the COVID-19 epidemic, the General Office of the State Council announced an 'Implementation Opinions on Strengthening and Stabilizing Employment Measures to Respond the Epidemic' on 18 March 2020 (no expiry date was indicated).[8] These measures include but are not limited to:

- Improving the convenience of resumption of production and service, cancellation of unreasonable approvals, and resolute correction of unreasonable regulations that restrict the return of workers.
- Increasing efforts to reduce burdens and stabilise positions including speeding up the implementation of tax and fee reduction policies and providing benefits to small and medium sized enterprises that do not lay off or that reduce layoffs. The benefit can be up to 100% of the unemployment insurance premium paid by the enterprise and its employees in the previous year.
- Optimizing the self-employment environment including deepening the reform of 'separation of certificates and licenses', promoting the 'reduce licenses policy', simplifying approval processes, streamlining the registration procedures of residences (business premises), and allowing applicants to register by submitting the 'legal use certificates of premises'.
- Providing special assistance for SMEs with great potential and innovative power.[9]
- Financial support to enterprises.
- Offering financial support to high-quality enterprises related to the "One Belt One Road" Initiative, supported by China Development Bank and the Department of Commerce.[10]
- The Central Government has paid great attention to the well-being of SMEs by introducing a series of measures that include but are not limited to:

1. Normally the parliament session is held in March, but it was delayed as a result of COVID-19. For the first time since the Chinese Government began publishing such goals (1990), it did not set a GDP growth target for 2020 due to the continued COVID-19 uncertainty.
2. http://www.xinhuanet.com/politics/2020lh/2020-05/22/c_1126018545.htm?baike.
3. These government bonds are a key source for infrastructure funding. For example, the Chinese government also used this method to stimulate investments and growth after the 2008 global financial crisis. However, according to Premier Li Keqiang, the package also intends to foster employment and social stability.
4. Local government bonds could generally be used to fund infrastructure projects, while special treasury bonds could be used to support companies and regions hit by the virus outbreak.
5. National Economy Recovered Steadily in 2020 with Main Goals Accomplished Better Than Expectation, 18 January 2021, available at: http://www.stats.gov.cn/english/PressRelease/202101/t20210118_1812432.html
6. https://unctad.org/system/files/official-document/diaeiainf2021d1_en.pdf. Pursuant to the report, China attracted total inflows of $163 billion whereby the return to positive GDP growth (+2.3%) and the government's investment stimulus programme helped stabilize investment after the early lockdown.
7. https://www.scmp.com/business/companies/article/3119812/hna-group-goes-bankrupt-chinas-largest-global-asset-buyer; https://www.ft.com/content/0bd72906-e3eb-444d-a62b-6e16daf49ed0.
8. http://www.gov.cn/zhengce/zhengceku/2020-03/20/content_5493574.htm.
9. http://www.gov.cn/zhengce/zhengceku/2020-02/28/content_5484685.htm.
10. Shang He Han [2020] No. 61 (商合函 [2020] 61 号).

- Issuing policies by offering adequate credit support.
- Encouraging commercial banks to provide more SME-tailored services.
- Improving external policy environments and incentive-discipline mechanisms.
- Maximizing financial support from all levels of capital markets.
- Building a better designed SME credit system.
- Upgrading financing environment on the local level.
- Strengthening the leadership of related parties.[11]

1.2.2 Shanghai government level

Following the guidelines and instructions on resolutely winning the battle against epidemic prevention and control, and fully implementing the decisions and arrangements of the Communist Party of China Central Committee and the State Council, Shanghai has adopted comprehensive measures to support business, as indicated in the 'Notice of the Shanghai Municipal People's Government on printing and distributing several policies and measures to prevent and control the epidemic situation and support the stable and healthy development of enterprises in Shanghai'.[12] The measures in the notice will be extended for three months after the epidemic is ended. The measures include but are not limited to:

- Granting financial support to enterprises by:
  - supporting enterprises in relation to epidemic prevention and control in public offerings, refinancing, mergers and acquisitions, issuing bonds, asset-backed securities, and so on;
  - encouraging the technological innovation of enterprises in relation to epidemic prevention and control to be listed on the science and technology innovation board;
  - encouraging venture capital and equity investment institutions to guide social capital to invest in the research and development and production of relevant medical equipment, vaccines and medicines; and
  - providing extensive support to enterprises with difficulties in working capital. Increasing credit support to tourism, accommodation and catering, wholesale and retail, transportation, logistics and warehousing, culture and entertainment, exhibitions, and other industries that are affected by epidemics by means of changing repayment arrangements, extending repayment periods, renewing loans without repayment of principal, and so on.
- Reducing the general burden on enterprises by:
  - relieving enterprises' rent on premises;
  - extending the period for tax return filing;
  - granting tax incentives to enterprises and individuals; and
  - exempting individually owned businesses from paying taxes on a regular and fixed-amount basis.
- Promoting the resumption of work and production of enterprises by:
  - putting a focus on the demands of various enterprises for the resumption of work, production and operation, and strengthening the supply of epidemic prevention materials including gauze masks, thermometers, and disinfectants; and
  - cultivating and supporting the development of new technology enterprises as well as new business modes and formats and increasing support for technological innovation vouchers for technology-oriented SMEs.

Furthermore, the Shanghai Municipal government has also adopted several measures against the epidemic in specific industries, such as service enterprises[13] and foreign-trade enterprises.[14]

In addition to the efforts that aimed to recover the enterprise sector, the Shanghai Municipal People's Government has also issued certain measures to recover confidence in the private consumer sector. On 23 April 2020, the Shanghai Municipal People's Government released "Several measures to boost consumer confidence and strongly release consumption demand"[15] (no expiry date is indicated), including hosting shopping festivals, supporting online shopping, stimulating tourism and the "night" economy, etc.

1.3 Supporting the flow of credit

The People's Bank of China (PBOC) has introduced a series of measures to provide reasonable and sufficient liquidity as well as financial services for epidemic prevention and control, resumption of production and to foster the development of the real economy. In 2020, PBOC adopted and implemented the following key measures:[16]

- Providing long-term liquidity up to RMB 1.75 trillion. On the basis of cutting the Required Reserve Ratio (RRR) for RMB deposits by 0.5% that released RMB800 billion at the beginning of 2020, PBOC further announced targeted RRR cuts in March 2020 which released RMB 550

11. Yin Fa (银发 [2020] 号) No. 120 [2020]120 available at: http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/4032186/index.html.
12. Shanghai Prevention and Control Notice, Hu Fu Gui [2020] No 3.(沪府规 [2020] 3 号) available at: http://www.shanghai.gov.cn/nw48835/20200826/0001-48835_64455.html.
13. Notice of Shanghai Municipal People's Government on Issuing Several Polices and Measures for Fully Controlling the Epidemic Situation and Supporting the Stable and Healthy Development of Service Enterprises, 7 February 2020, available at: http://www.shanghai.gov.cn/nw49654/20201010/e218d549e5c146e7bb708cff13b65697.html.
14. Notice of Shanghai Municipal People's Government on Issuing Several Policies and Measures for Fully Controlling the Epidemic Situation and Supporting the Stable and Healthy Development of Foreign Trade Enterprises, 11 March 2020, available at: http://service.shanghai.gov.cn/xingzhengwendangku/XZGFDetails.aspx?docid=REPORT_NDOC_006173.
15. https://baijiahao.baidu.com/s?id=1664742756385271734&wfr=spider&for=pc.
16. http://www.pbc.gov.cn/rmyh/3963412/3963426/4002107/index.html.

billion of long-term funds and finance for the purpose of inclusive finance.

- Providing tailored support for refinancing and re-discounting, and establishment of a special refinancing fund of RMB 300 billion for epidemic prevention, with more than half to be invested in SMEs.
- After the financial discount is taken into account, the interest cost borne by SMEs is less than 1.3%. In addition to the above RMB 300 billion, PBOC has added a new refinancing fund up to RMB 500 billion, lowering the interest rate of agricultural debt for support purposes by 0.25%, from the original 2.75% to 2.5%. PBOC has also used low-cost inclusive funds to support SMEs in key areas to resume production. In April 2020, another RMB 1 trillion was added to the previous amount for SMEs and industries severely hit by the epidemic.[17]
- Reducing the loan interest rate: on 30 March 2020, PBOC conducted reverse repurchase (repo) agreements which decreased the bid interest rate by 0.2%. From 1 January 2020 to 3 April 2020 it fell by a total of 0.3%.
- Arranging joint efforts of the financial system, PBOC urged large state-owned banks to increase their support for inclusive finance, implemented special credit support for policy banks, guided local banks to provide good services to grassroots organisations, and increase counter-cyclical adjustments.

1.4 Rent moratorium

Rent-related policies are generally formulated and issued by both provincial governments and the central government.

For example, Shanghai has issued such policies. Please refer to the rent exemptions set out in in section 2.3 below for more details.

Rent exemption policies apply where state-owned enterprises (SOEs) are acting as lessors, and non-SOEs, SMEs and companies engaging in production are acting as tenants. In such a set-up, the latter may be able to enjoy certain preferential treatment under those policies. For instance, SOE lessors are encouraged to help their SME tenants by offering a rent exemption of up to three months.[18]

The Supreme People's Court also issued rules in favour of SME tenants, to give effect to prior agreements reached between the lessor and tenant providing that temporarily the rent will not be enforced against the tenant.[19]

2. Legislative reforms impacting on stakeholders dealing with companies in financial distress

2.1 Employees

At-will employment arrangements are not recognised, and employees generally can only be terminated during their probation period, at the end of their employment contract, if they have violated the employment contract (provided they were warned and given ample opportunity to improve) or through negotiation. The COVID-19 crisis has not changed this basic rule. Similarly, payment reductions are not a privilege of the employer and generally are only possible through negotiations. An exception, however, is the newly enacted regulation relating to suspension of business operations as a result of COVID-19 (see below).

In addition, enterprises affected by COVID-19 and, as a result, suffering difficulties in business production and operation may, through consultation with their employees, adopt measures including adjusting salary, rotating work and shortening working hours, delaying payment of salaries, and other measures to stabilize employment, and avoid having to lay off employees. The emphasis here is negotiation. This cannot be a unilateral decision of the employer, but rather the result of a dialogue whereby the employer convinces the employees that these measures are required for the business's survival and in which the employer persuades the employees to agree to these measures.

In the wake of COVID-19 the Chinese Government has published specific rules to supplement the general rules and guide companies.[20]

2.1.1 Quarantine employees

Companies are not allowed to terminate employees who are unable to provide normal work due to COVID-19 infection, the Government's quarantine measures or the medical observation period (this applies equally to so-called 'dispatched contract' employees employed through a human resource agency). If a labour contract has expired during this period, it is extended until the end of the medical period, the medical observation period or the quarantine period imposed by the Government (as applicable). Payment of salary must continue during these periods in accordance with the standard in the labour contract.[21]

2.1.2 Redundancy for employees unwilling to work

If an employee is unwilling to return to work despite the employer meeting all requirements of a healthy working environment, the company through its labour union (if it has one) or directly (if there is no labour union) is required to discuss this with the employee and assure the employee of

17. http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/4021012/index.html.
18. Fa Gai Tou Zi Gui [2020] No. 734 (发改投资规 [2020]734 号).
19. Fa Fa [2020] No. 16 (法发 [2020] 16 号).
20. 'Notice on how to handle labour relationship during the Covid-19 virus period', 24 January 2020, available at: http://www.gov.cn/zhengce/zhengceku/2020-01/27/content_5472508.htm.'The opinions on stabilising labour relationship and supporting enterprises' resumption during the Covid-19 virus period', 7 February 2020, available at: http://www.gov.cn/zhengce/zhengceku/2020-02/08/content_5476137.htm.
21. 'Notice on how to handle labour relationship during the Covid-19 virus period', 24 January 2020, available at: http://www.gov.cn/zhengce/zhengceku/2020-01/27/content_5472508.htm.

the prevention methods it is taking and the importance of returning to work. If the employee still refuses to return without reasonable cause after the patient persuasion process, the enterprise may handle the labour relationship according to the law.[22] This does open the door to dismissal of the employee provided the general law and the labour contract are followed.

2.1.3 *Benefits for enterprises with lower layoff rate*

SMEs are able to apply for a refund of 50% of paid unemployment insurance premiums if the layoff rate is lower than 5.5% or (in the case of enterprises with fewer than or equal to 30 employees) if the layoff rate is lower than 20%.

2.1.4 *Salary payment of enterprises suspending business operations*

A rule released on 12 February 2020 deals with suspension of operations as a result of the COVID-19 crisis. According to a regulation released by the Ministry of Human Resources and Social Security, if an enterprise suspends business operations within a salary payment cycle, the enterprise is required to pay its employees' salaries according to the standard stipulated in the labour contract. However, if the suspension of operation period exceeds one cycle, if the employee continues to work during the suspension period (as his / her work is required even through suspension), the salary may be reduced to no less than the local minimum wage standard from the second salary cycle onwards. If the employee does not work during the suspension period (from the second salary cycle onwards), the enterprise is required to pay living expenses to the employee at a level determined in accordance with the standard prescribed by each province.[23] In terms of practical application, it is important to check with the local labour administration and to notify all employees.

Additionally, in March 2020, the local government and multiple departments of Shanghai, for instance, adopted the following employee-related measures to help ease the economic repercussions resulting from COVID-19:[24]

- The Government confirmed that it will refund 50% of the total amount of the unemployment insurance premiums actually paid by the employers and employees in the previous year provided these employers laid off few or no employees.
- For enterprises requisitioned for epidemic control during the Spring Festival in 2020, a compensation of RMB 1500 was paid to every employee and a maximum compensation of RMB 5 million was paid to every enterprise.[25]
- For enterprises with fewer than or equal to 30 employees paying unemployment insurance by the end of 2019, the layoff rate was increased to no more than 20%.[26]
- The annual social insurance contributions (including medical insurance) were adjusted from 1 July 2019 to 30 June 2020, whereby this was postponed for three months, and the annual social insurance contributions in 2019 was postponed to 1 July 2020.
- Those unable to join social security programs or pay fees in time due to the epidemic are allowed to go through the process after the epidemic is over. If employers fail to pay the social insurance premium during the period of the epidemic, after reporting to the competent department, those employers are allowed to pay the premium within three months after the end of the epidemic. No overdue pay will be charged, and employees' records will not be affected.
- The enterprises in Shanghai who organise employees (including dispatched workers) to participate in various kinds of online vocational training programs during the period of the coronavirus outbreak enjoyed a 95% subsidy of the actual training cost. This subsidy was paid from the local education additional special fund in each district. Online commerce enterprises and platforms received similar benefits.

2.2 Lenders

In the following section, we summarise measures published by authorities at the state level in China and at the local level in Shanghai to help ease some of the financial burden caused by COVID-19.

2.2.1 *Central Government level*

- The payment of fees for electricity, water and gas can be postponed, and the supply of these should be continued during the period of arrears.[27]
- SMEs can apply for a certificate of *force majeure* if their foreign trade orders failed to be completed or were unable to be completed on time due to the epidemic.[28]
- Loan interest rates are reduced appropriately, and availability of credit loans and medium and long-term loans are increased.[29]
- SMEs are able to delay their interest and principal payments to the end of March 2021.[30]

2.2.2 *Shanghai Government level*

- The approval process for a loan application has been shortened for SMEs if they lost their income due to the epidemic.[31]
- The interest rate for loans shall not be more than 3.9%.[32]

22. 'The opinions on stabilizing labour relationship and supporting enterprises' resumption during the Covid-19 virus period', 7 February 2020, available at: http://www.gov.cn/zhengce/zhengceku/2020-02/08/content_5476137.htm.
23. http://www.mohrss.gov.cn/SYrlzyhshbzb/SYgundongxinwen/fybmrszxd/zcjc/zcjc_fwdx/202002/t20200212_359626.html.
24. http://rsj.sh.gov.cn/201712333/xwfb/zxdt/01/202002/t20200203_1303016.shtml.
25. 'Hu Ren She Jiu [2020] No. 87 (沪人社就 [2020] 87 号).
26. Ibid.
27. 'Notice on helping SMEs to recover production during the period of the coronavirus outbreak', Article 3, 9 February 2020, available at: http://www.gov.cn/zhengce/zhengceku/2020-02/10/content_5476684.htm.
28. Ibid Article 18.
29. Ibid Article 8.
30. http://www.xinhuanet.com/politics/2020lh/2020-05/22/c_1126018545.htm?baike.
31. 'Notice on stabilizing employment during the period of the coronavirus outbreak', 9 February 2020, available at: http://rsj.sh.gov.cn/201712333/xwfb/zxdt/01/202002/t20200209_1303095.shtml.
32. 28 policies issued by Shanghai government to support enterprises, 8 February 2020, available at: http://rsj.sh.gov.cn/201712333/xwfb/zxdt/99/202002/t20200210_1303107.shtml.

- The financing guarantee rate for new SME loan applications has been reduced to 0.5% per year.[33]
- The Shanghai Council for the Promotion of International Trade will issue certificates of *force majeure* for enterprises that failed to or were unable to perform international trade contracts due to the epidemic.[34]
- Enterprises will not be listed on the 'blacklist' for behaviour, such as delayed delivery, delayed repayment of loans, and overdue performance of contracts, which was caused by their participation in epidemic prevention activities.[35]

By the end of April, the Shanghai banking industry has granted over RMB 133 billion of loans in connection with epidemic prevention, in support of over ten thousand companies.[36] The Shanghai banking industry has also reduced the loan principals and interests of companies seriously affected by COVID-19.

2.3 Third parties

For certain sectors that were severely affected by COVID-19 (e.g. transportation, restaurants / catering, tourism and accommodation), the loss carry-forward period has been extended from five to eight years.

Civil aviation companies are exempted from the civil aviation development fund.

Financial support for airlines (both foreign and domestic) operating international passenger flights between and from domestic destinations and overseas destinations includes a reward of RMB 0.0176 per seat kilometre for a total flight and a reward of RMB 0.0528 per seat kilometre for a solo flight. International air cargoes without passengers also enjoy different levels of rewards, depending on flight distance and weight of cargoes.[37]

Taxpayers are exempted from value-added tax (VAT) on income derived from public transportation services, living services (e.g. accommodation, catering / restaurants, education, medical services, and tourism), and courier delivery of residents' essential supplies.

For loans granted to SMEs from banks, the interest rate for central bank lending is reduced from 2.75% to 2.5%.

From 1 March 2020 to 31 May 2020, small-scale VAT taxpayers (including self-employed businesses and small enterprises) in Hubei Province were exempt from VAT. The VAT rate for small-scale VAT taxpayers outside Hubei Province was reduced from 3% to 1%.

From 1 May 2020 to 31 December 2020, small low-profit enterprises could defer the payment of corporate income tax to the first period for filing tax returns in 2021.[38]

Other local economic remedies include:

- deadlines for tax declarations of enterprises may be postponed;[39]
- social insurance payments may be postponed for three months;[40]
- online vocational training programs during the period of the coronavirus outbreak will enjoy a 95% subsidy of the actual training cost;[41] and
- rent exemptions.

On 5 February 2020, the Beijing Municipal People's Government announced several measures in response to COVID-19 infections to promote the sustainable and healthy development of SMEs.[42] According to the Beijing measures, in relation to real estate in Beijing owned by SOEs and leased to SMEs to engage in production and operation activities, if such enterprises continue operating in accordance with government requirements or close operations in accordance with coronavirus prevention regulations with no or few layoffs, the rent for February 2020 would be exempted. For office buildings they were given a 50% reduction in rent for February 2020.

Pursuant to the Shanghai Prevention and Control Notice,[43] SMEs that lease operating property of SOEs in Shanghai (such as various development zones and industrial parks, entrepreneurial bases, and technology business incubators) to engage in production and operation activities were exempt from February and March 2020 rent.[44]

2.4 Unemployed individuals

In order to better guarantee the basic living standard for unemployed individuals during the epidemic, a Notice concerning Expanding the Coverage of Unemployment Insurance was issued by the Ministry of Human Resources and Social Security and the Ministry of Finance on 29 May 2020.[45] Accordingly, the following measures have been taken:

- The period of receiving unemployment insurance for the aged unemployed individuals who have not yet been employed after the insured period and who will reach the retirement age in less than one year is extended to the statutory retirement age.
- A provisional unemployment subsidy policy was implemented from March 2020 to December 2020. Specifically, the unemployed individuals who had not yet been employed after the insured period and the insured individuals who did not qualify for benefiting from the unemployment insurance could apply to receive unemployment subsidies for a period of six months from the date that the unemployed individuals are qualified for such application until the expiration of six months but no later than 31 November 2020, the rate of which does not exceed 80% of the amount prescribed according to the standard of the local unemployment insurance.

33. Ibid.
34. Ibid.
35. Ibid.
36. https://www.jfdaily.com/news/detail?id=250439.
37. Cai Jian [2020] No. 119 (财建 [2020] 119 号).
38. http://www.chinatax.gov.cn/chinatax/n810341/n810760/c5150527/content.html.
39. Above, n 35.
40. http://rsj.sh.gov.cn/201712333/xwfb/zxdt/01/202002/t20200203_1303016.shtml.
41. Ibid.
42. Jing Zheng Ban Fa [2020] No7. (京政办发 [2020] 7 号).
43. Hu Fu Gui [2020] No 3 (沪府规 [2020] 3 号).
44. 28 policies issued by Shanghai government to support enterprises, 8 February 2020, available at: http://rsj.sh.gov.cn/201712333/xwfb/zxdt/99/202002/t20200210_1303107.shtml.
45. Notice by the Ministry of Human Resources and Social Security and the ministry of Finance of Expanding the Coverage of Unemployment Insurance, 29 May 2020, available at: http://www.mohrss.gov.cn/SYrlzyhshbzb/shehuibaozhang/zcwj/202006/t20200609_375841.html.

- Provisionally increasing the price subsidies. The provisional price subsidies granted to those entitled to receiving unemployment insurance benefits and unemployment subsidies were doubled between March and June 2020.

3. Legislative reforms for companies in financial distress

On 15 May 2020, the Supreme People's Court issued a Circular on the Promulgation of the Guiding Opinions on Several Issues Concerning Property Handling Civil Cases Related to COVID-19 Epidemic in Accordance with the Law (II) (Guiding Opinions II),[46] section III (Handling of bankruptcy disputes)[47] of which prescribes certain flexible measures as to both pre-insolvency and formal insolvency procedures. The Guiding Opinions II make no substantial changes to the existing Enterprise Bankruptcy Law (EBL). Generally speaking, the measures aim to prevent debtors from insolvency and maintain the debtor's ability to continue in business.

3.1 Revision of obligations of directors and managers

The Guiding Opinions II has made no amendments to directors' and managers' duties. For the time being, all existing unmodified duties continue to apply, though this may change.

3.2 Adoption of pre-insolvency measures

The EBL does not offer any pre-insolvency procedure. A formal insolvency procedure is initiated upon the petition by the debtor, creditor or the responsible person who is liable for the liquidation pursuant to Article 7 of the EBL. However, the Guiding Opinions II offer preliminary insolvency measures to respond to the COVID-19 epidemic. In its 17th paragraph, the Guiding Opinions II state that where the creditors file an application for the insolvency due to the epidemic or the epidemic prevention and control measures, the people's courts shall actively guide the negotiation between the debtor and the creditor, by adopting instalments, extending the debt maturity and adjusting the contract price to avoid the causes of the bankruptcy application, or guide the debtor through ways to resolve the debt crisis such as out-of-court mediation, out-of-court restructuring and reorganization, and save the enterprise as early as possible.

> "When examining whether an enterprise meets the conditions for bankruptcy, the people's courts shall treat the enterprises differently based on whether they encounter difficulties due to the epidemic or the epidemic prevention and control measures. For enterprises that were in good business conditions before the epidemic, but unable to pay off due debts due to the difficulty of business operation and capital turnover caused by the impact of the epidemic or the epidemic prevention and control measures, the ability to repay the debts should be comprehensively determined based on factors such as the enterprises sustainable operating ability and the development prospects of the industry, and it is necessary to prevent the ruling of an enterprise that originally had the ability to survive into bankruptcy, simply based on the capital flow and assets and liabilities of the enterprise in a specific period. Enterprises that have fallen into a predicament before the outbreak of the epidemic, whose production and operation have been further deteriorated due to the epidemic or epidemic prevention and control measures, and who already have the cause of bankruptcy, should be accepted the bankruptcy application in a timely manner in accordance with the law to realize the survival of the fittest in the market and the reallocation of resources." (para. 18 Guiding Opinions II).

3.3 Changes to moratoria

In the absence of the epidemic, the debtors or insolvency administrator are obliged to submit a draft of the re-organization plan to the courts and the creditors' meeting within six months, according to Article 79 (1) of the EBL. However, the Guiding Opinions II authorize the courts to reasonably determine the term not to be included within the aforesaid six months according to the impact of the epidemic or the epidemic prevention or control measures. Such term must not exceed six months. If the reorganization plan or the settlement agreement has been implemented in the enforcement stage, but the debtor is unable to carry it out due to the impact of the epidemic or the epidemic prevention and control measures, the people's courts shall actively guide the parties to make changes through full consultation. If the reorganization plan or the settlement agreement is altered through negotiation, a vote shall be taken in accordance with the Articles 19 and 20 of the Minutes of the National Court Work Conference on Bankruptcy Trials and submitted to the court for approval. However, if only the time limit for enforcement is changed, the people's courts may make a ruling directly upon the application of the debtor or the creditor, and the extended time limit shall generally not exceed six months. (para. 20 Guiding Opinions II).

3.4 Other changes to formal and informal insolvency processes

Paragraph 19 of the Guiding Opinions II further provides for the promotion of the coordination between enforcement and insolvency proceedings. Where the courts found that the enforced enterprises are subject to insolvency due to the epidemic but have the possibility to revive, the creditor or the enforced enterprises shall be guided to transfer the enforcement procedure to the insolvency review procedure so as to save the enforced enterprises.

If the judicial auction procedure is initiated before the relevant court of enforcement makes the decision on the transfer, it may continue after the decision has been made. If an auction is completed, the auction target will no longer be included in the debtor's property in the bankruptcy proceedings, but the proceeds from the auction shall be distributed in accordance with the bankruptcy proceedings. If an asset appraisal report or audit report has been made in

46. http://cicc.court.gov.cn/html/1/218/62/84/1582.html.
47. Section I and II deal with the handling of contractual and financial disputes.

the enforcement procedure, and the appraisal conclusion is valid within the period of validity, or the audit conclusion meets the needs of the bankruptcy case, it may continue to be used in the bankruptcy procedure.

Creditors' substantive and procedural rights shall be effectively protected, and it is necessary to reduce the adverse impact of the epidemic or epidemic prevention and control measures on the exercise of creditors' rights. The time limit for the declaration of creditors' rights in cases affected by the epidemic or the epidemic prevention and control measures may be set as the statutory maximum time limit according to the specific circumstances. Creditors who are unable to declare their rights or provide relevant evidence on time due to the impact of the epidemic or the impact of epidemic prevention and control measures shall make supplementary declarations within 10 days after the obstacle has been removed. Supplementary applicants may not bear the costs of reviewing and confirming the supplementary declarations. If it is really necessary to postpone the hearing or the creditors' meeting due to the epidemic or the epidemic prevention and control measures, relevant extension procedures shall be gone through in accordance with the law, and the administrator shall inform the creditors and other relevant parties 15 days in advance and make explanations. (para. 21 Guiding Opinions II).

Pursuant to para. 22 Guiding Opinions II, it is necessary to maximize the maintenance of the debtor's ability to continue business and give full play to the system function of debt financing of common liabilities to provide financial support for continuing businesses. If the debtor is capable of continuing to operate or is capable of producing and marketing epidemic prevention supplies, the people's courts shall actively guide and support the administrator or the debtor to continue the business of the debtor in accordance with the Articles 26 and 61of the EBL. On the basis of protecting the interests of creditors, it is necessary to choose an appropriate operation and management model and make full use of the coordination mechanism between the government and the people's courts to explore and release the capacity of enterprises. It is necessary to adhere to the principle of maximizing the value of property disposal, actively guide the administrator to fully evaluate the impact of the epidemic or epidemic prevention and control measures on the asset disposal price, accurately grasp the timing and method for disposal, and avoid affecting the interests of creditors due to improper derogation of the asset value.

4. Financial and regulatory measures

4.1 Financial conduct authorities

The China Securities Regulatory Commission (CSRC) has introduced several measures, together with other regulators, to further strengthen financial support for epidemic prevention and control and has implemented the following measures until April 2020 (with no specific expiry date given by CSRC).[48]

- *Improving service efficiency for bond issuance and encouraging enterprises to submit online application materials*: in order to ensure the stable operation of financial markets, CSRC has increased support efforts and tried to establish 'green channels' for those areas severely affected by the epidemic. The promotion of remote filing and registration has also helped enterprises to operate normally without using face-to-face communication.
- *Adjusting regulatory matters such as enterprise information disclosure in a flexible way*: enterprises affected by the epidemic may have difficulties in disclosing their annual reports for 2019 or quarterly reports for the first quarter of 2020 within the statutory period. CSRC will properly arrange an extension of time in such circumstances, appropriately lower the relevant regulatory standards for risk control indicators for securities and fund the future operations of institutions in areas seriously hit by the epidemics.
- *Appropriately extending the time limit for handling relevant matters on the capital market*: based on the fact that it is difficult for enterprises to carry out mergers and acquisitions, especially on-the-spot investigations, under such epidemic conditions, CSRC has decided to extend the validity period of financial information for the administrative licence for mergers, acquisitions and reorganisations and the time limit for issuing a notice of convening the general meeting of shareholders after the disclosure of a reorganisation plan.
- *Reducing and exempting certain fees for listing of companies in areas seriously affected by the epidemic*: In particular, with respect to Hubei province, CRSC has decided to exempt the 2020 annual listing fees and listing fees payable by listed companies to the local stock exchanges.

4.2 Central Bank (PBOC)

In order to guarantee the normal financial service needs of enterprises and residents in the industries greatly affected by the epidemic, the PBOC has conducted a series of measures. In 2020, PBOC had introduced the following key measures:[49]

- *Issuing two innovative monetary policy tools directed towards a substantial economy*: Firstly, PBOC has provided monetary initiatives to commercial banks so that the repayment of instalments and interests of debt issued by commercial banks towards SMEs could be extended. The total affected debt amount reaches RMB 7.3 trillion. Secondly, PBOC has required financial institutions to increase support to SMEs in the form of issuing loans with lower interest. The total amount of debt issued on this basis has reached RMB 3.9 trillion,

48. 'Notice on further strengthening financial support for the prevention and control of the epidemic caused by novel coronavirus-infected pneumonia', 31 January 2020, available at: http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3965911/index.html.
49. Ibid.

with a year-on-year growth of RMB 1.6 trillion.

- *Increasing credit support for fields related to epidemic prevention and control*: PBOC has encouraged financial institutions to strengthen their service to relevant hospitals, medical research institutions and related enterprises and to provide an up to RMB 300 billion refinancing fund, benefiting approximately 7600 SMEs in those fields, so that the financing needs of those enterprises can be met, and adequate medical materials can be produced.
- *Encouraging financial institutions to provide differentiated preferential financial services for industries and enterprises*: Regarding the industries seriously affected by the epidemic, PBOC has provided RMB 1.5 trillion quota for debt towards them so that work and production could be resumed. The number of benefited SMEs are estimated to be 600,000.
- *Supporting commercial banks to increase their credit support*: PBOC has encouraged the said banks to adjust credit arrangements and increase the ratio of debt, with preferential interest rates issued to SMEs up to 10%.
- *Maintaining reasonable and adequate liquidity to ensure the stable operation of interest rates on the money market and maintain adequate liquidity*: PBOC has used various monetary policy tools such as open market operations, standing lending facilities, re-loans, and re-discounts.
- *Improving the efficiency of financial services during the epidemic period*: PBOC has encouraged financial institutions to establish and initiate fast examination and approval channels, simplify procedures and effectively improve business-handling efficiency. In the regions under traffic control, financial institutions are to use innovative methods like holding online conferences to ensure the speedy approval of loans for enterprises.

4.3 Other regulators

China Banking and Insurance Regulatory Commission (CBIRC), which supervises the banking and insurance institutions, has also introduced several measures to promote business. Pursuant to the 'Notice on strengthening financial services for coordinated resumption of work and production across the industrial chain' (with no specific expiry date given), the following measures have been implemented:

- *Strengthening financial support for core enterprises in the supply chain*: these companies are supported in appropriate ways by financing such as loan credit, bonds and other means, as well as assisting SMEs in the upstream and downstream sectors of these industries to solve problems such as tight liquidity.
- *Optimising financial services for upstream and downstream enterprises in the supply chain*: credit support for SMEs in this area will be enhanced through accounts receivable financing, purchase contract financing, advance payment financing, inventory and warehouse receipt pledged financing, and so on.
- *Supporting policies such as temporarily postponing repayment of principal and interest on loans to SMEs will be further implemented*: insurance institutions are encouraged to further expand the coverage of short-term export credit insurance. In addition, efforts are made to improve financial service technology in the supply chain.

In accordance with Meeting of the Solvency Supervisory Committee held by CBIRC,[50] "*At the end of 2020 Q3, the average comprehensive solvency ratio of the 178 insurance companies reviewed at the meeting was 242.5%, and the average core solvency ratio was 230.5%......It was pointed out at the meeting that in the third quarter of 2020, the CBIRC coordinated epidemic prevention and regulation of banking and insurance industries, taking effective measures to hedge the adverse effect of Covid-19 and forestall risks of all sorts. The overall solvency of the insurance industry thus remained adequate and stable*."

5. Specific measures for micro and small businesses

No simplified measures addressing small business insolvency have been adopted.

The existing EBL only applies to enterprises, including legal persons and unincorporated organisations but excluding natural persons. No legislative reform of the EBL has been announced during the period of the COVID-19 outbreak.

6. Measures introduced by the courts to deal with increased insolvency cases

6.1 Increased e-filings and virtual hearings

According to a Supreme People's Court notice,[51] Chinese courts have utilised and made full use of information technology in litigation since the outbreak of COVID-19.

From February to March 2020, Chinese courts at various levels have received nearly 550,000 cases online across the country, made over 440,000 payments online, held over 110,000 court sessions online, and conducted online mediation more than 200,000 times. The number of exchanges of evidence and electronic deliveries made online was more than 130,000 and 1.67 million, respectively.

Insolvency cases are no exception. According to the Bankruptcy Court of the Third Intermediate

50. http://www.cbirc.gov.cn/en/view/pages/ItemDetail.html?docId=946787.
51. http://english.court.gov.cn/2020-03/31/content_37534820.htm. See also para. 23 Guiding Opinions II.

People's Court of Shanghai (Bankruptcy Court Shanghai),[52] it has actively used network means to convene a meeting of bankruptcy creditors and achieved a good result. Since the end of 2019 until February 2020, 61 online creditor meetings have been held by the Bankruptcy Court Shanghai, accounting for 75% of the total number of creditor meetings held during the same period. More than 1,400 creditors participated in the meetings via the internet, with an attendance rate of 87%.

In February 2020, the Supreme People's Court issued various principles and procedural rules to encourage and regulate e-filings and virtual hearings.[53] Guangdong Province followed suit by providing multiple online platforms and services.[54]

To date, since the control over COVID-19 is progressing quite well, on-site hearings have been re-adopted for most cases, however lawyers and participants are required to bring valid health certificates to enter the courts. From our daily experience, virtual hearings are more common for cross-province cases and have become a useful supplement to on-site hearings.

The Court has also issued a typical case (no names of the parties were given) concerning the transition from liquidation procedure to compromise procedure.[55] In this case, a construction material enterprise was unable to pay its debts. However, some of its major projects have won bids and the company is therefore expected to have good prospects and worthwhile operations in the future. In addition, while a small part of the due receivables cannot be recovered due to the impact of the epidemic, there are still a large number of outstanding receivables. The court held that the difficulties of the insolvency enterprise were temporary, and it could be saved by compromise and ruled that the case shall shift from the liquidation procedure to compromise procedure.

6.2 Increased hiring of court staff

To date, no resources have been committed by the Central Government or provincial governments to hire additional court staff as part of the COVID-19 response.

6.3 Increased use of out-of-court mechanisms

No mandatory measures have been introduced, but all courts are actively encouraging parties to seek to resolve matters in general (i.e. not specific to insolvency) by consent and to consider telephone or video conference mediations if an immediate resolution cannot be reached. Jiangsu Province reported a 5.2% year-on-year increase in terms of cases solved by the People's Mediation Committee in the first half of 2020.[56]

7. Other pending reforms

There are no other pending reforms at present.

52. http://www.hshfy.sh.cn/shfy/gweb2017/xxnr.jsp?pa=aaWQ9MjAxNTg0MjcmeGg9MSZsbWRtPWxtNDYwz&zd=xwxx.
53. Fa [2020] No. 49 (法 [2020] 49 号).
54. http://sft.gd.gov.cn/gkmlpt/content/2/2927/post_2927519.html#1196.
55. https://www.pkulaw.com/pfnl/a6bdb3332ec0adc463f91c66b54d5d9445eba1ed6c8604d6bdfb.html?keyword=%E6%96%B0%E5%86%A0%E7%96%AB%E6%83%85%20.
56. http://news.jstv.com/a/20200630/32ff02e0955f4a8285b8689dc6e28919.shtml.

On 8 April 2020[1] (first time) and 7 January 2021 (second time), a state of emergency was declared in Japan. The Government also approved a stimulus package worth JPY108 trillion, the largest in Japan's history with direct fiscal spending of JPY39.5 trillion, also the largest in Japan's history. The stimulus package is of a size that rivals the JPY102 trillion national budget (spending from the Government's general account) for 2020. The following provides an overview of the circumstances as of 31 January 2021, which, due to the extraordinary circumstances, is subject to change.

1. Government policy responses

1.1 General fiscal stimulus measures that have been adopted

1.1.1 Guarantees

Credit guarantee corporation (CGC) guarantees

Japan, like many other countries of the world, has a system of CGCs which guarantee loans from private banks. With the guarantee of a CGC, even if the debtor goes insolvent, the bank can be certain that it can recover the guaranteed amount through the CGC. Normally, there is a 'maximum of JPY280 million for general guarantees'; however, with the current Covid-19 situation, two layers of guarantees have been added: the safety net guarantee in the amount of JPY280 million; and an 'emergency related guarantee' for a further JPY280 million, giving a total maximum of JPY840 million. By taking this action, the Government can encourage lending by financial institutions. The CGC can guarantee the repayment the entire loan in the case of for Covid-19 related loans. Normally the CGC guarantees provides for only up to 80% of the amount of the loan.

1.1.2 New loans

Short-term funding facility with a particular objective

In order to support the financing and prevent the insolvency of businesses that have been impacted by the Covid-19 outbreak, the Government has promoted lending by governmental financial institutions and established a system of lending full of valuation as explained below. Summary of each type of lending system is as follows.

i. Lending by the Japan Finance Corporation[2]

- Special lending to respond to novel Coronavirus outbreak

  As the core of the lending system for responding to the Covid-19 outbreak and to support strong financing of businesses that have suffered a fall in sales as a result of the Covid-19 outbreak, the following provisions have been introduced:

  – JPY80 million by the Japan Finance Corporation and JPY600 million for Small Business has been readied, allowing each to provide a relatively large amount of financing;

  – an interest rate lower than the normally used basic rate of interest has been established;

  – the 'Interest Aid System' making it possible to provide effectively interest free / unsecured loans to certain businesses has been established;[3] and

  – the repayment period has been extended, setting the repayment of funds for equipment within 20 years (instalment within five years), the repayment of working capital within 15 years (instalment within five years) and flexible treatment in accordance with the debtor's financing situation.

- Funds to improve the management of small businesses

  In order to support the financing of relatively small businesses, in addition to the usual lending limit of JPY20 million, it has been made possible to lend a further JPY10 million in order to respond to the Covid-19 outbreak, for a total JPY30 million, and with a lower rate of interest than normally applied,[4] as well as a longer period for repayment.[5]

- Special loan to respond to drastic changes in the hygiene environment

  A system to provide support particularly for funding with respect to the life hygiene activities of hotel businesses, barbershops, public baths, restaurants, and others which are susceptible to a downturn in business due to the outbreak of the novel coronavirus.[6]

ii. Japan Finance Corporation[7]

- Safety net loans (Japan Finance Corporation)

  This type of loan is to respond to major changes in the management environment and has been used in the past for earthquake disasters and the like. This will also be available for responding to the Covid-19 outbreak. The lending limit of JPY720 million for the Finance Corporation for Small Business allows for a broad scope of financing needs to be met.[8] It also offers an increase in the various kinds of support methods depending on the amount of decrease in earnings.

- Emergency response loans from the Shoko Chukin Bank

1. Subsequently, the Japanese government announced the lifting of the state of emergency for Tokyo and Hokkaido with effect from 26 May 2020 following the lifting of the state of emergency in Osaka, Kyoto and Hyogo prefectures on 21 May 2020 and 39 other prefectures prior to that on 14 May 2020.
2. Japan Finance Corporation: https://www.jfc.go.jp/; Ministry of Finance: https://www.mof.go.jp/2020_coronavirus/index.html; METI: https://www.meti.go.jp/covid-19/index.html; Shoko Chukin Bank: https://www.shokochukin.co.jp/disaster/corona.html.
3. The institutions to actually provide the interest aid are to be designated by the Japanese Government. The actual rate is normal rate of interest - 0.9 per cent.
4. The normal rate of interest - 0.9 per cent.
5. Funds for equipment within 10 years (instalment within four years), working capital within seven years (instalment within three years).
6. Limit on amount of lending: JPY10 million (JPY30 million for hotel businesses), repayment period: for working capital within seven years (instalment within three years), for funds for equipment within 10 years (instalment within four years), basic rate of interest: basic rate of interest (in certain cases, basic rate of interest - 0.9 per cent).
7. Japan Finance Corporation: https://www.jfc.go.jp/.
8. Repayment period: funds for equipment within 15 years (instalment within three years), working capital within eight years (instalment within three years).

As a non-secured, non-guaranteed loan with a lending limit of JPY600 million, this assistance is characterised by the ability to disburse a relatively large loan. Further, it is expected that certain specified businesses will be able to use the 'Interest Aid System'[9] which will make it possible for such businesses to receive an effectively no-interest, non-secured loan.

1.1.3 *Stimulus packages aimed at protecting employees*

Aid 6+6 will be provided with respect to a portion of leave allowance and wages for employers who wish to keep employees employed.[10]

The overall scope is approximately JPY 2.8 trillion and applies to all business with respect to assistance with leave allowances and wages. The purpose of this aid is to incentivise employers to maintain the employment of the employees and prevent unemployment.

1.1.4 *Major sectors that have received government support*

- Loans for specified businesses

  The aforementioned life hygiene-related business for hotel businesses, barbershops, public baths and restaurants may receive loans with advantageous terms from governmental financial institutions.

- Post-coronavirus response for the tourism business

  Primarily, for the post-coronavirus stage, the Government plans to spend JPY2.7 trillion on a series of stimulus packages, such as facilitating tourism.

1.1.5 *Bail-out package*

- Support for SME Support Councils and distressed SMEs to make a cash flow plan for one year and ask for creditor banks to suspend payment for one year.

2. Legislative reforms impacting on stakeholders dealing with companies in financial distress

2.1 Employees

The Japanese Government has approved the implementation of the following measures.

2.1.1 *Support during leave for those caring for children*

In order to make it easier for caregivers with children in elementary school to take time off during the temporary closures of the schools to care for such children, the Government will support the living conditions of such caregiver.

- Where the caregiver is an employee, aid will be provided to businesses who allow such employees to take leave (JPY8,330 per day).
- Where the caregiver is a freelancer / sole proprietor, in the event that the caregiver is unable to engage in their business in order to care for an elementary school child during the temporary closure of the school, aid will be provided based on the number of such days (JPY4,100 per day).

2.1.2 *Emergency loans for households experiencing a fall in income*

This is to increase the amount of the small emergency loans for households which experience a fall in income due to the outbreak of the novel coronavirus, expanding the lending limit to JPY200,000 and to also make the terms of such loans more relaxed, effectively making them non-interest loans. Further, for those who become unemployed, the Government plans to provide loans on a monthly basis as a comprehensive support fund.

2.1.3 *Grace period for paying national taxes and social insurance premiums*

The Government has implemented relaxed measures such as a grace period for the payment of national taxes whereby taxpayers now have a grace period of one year to pay their taxes and will be exempted from the 13 per cent interest on arrears.[11] It is also planned that a grace period will be given before taxpayers will be subject to foreclosure or conversion of assets.

2.1.4 *Grace period for paying public utility charges*

The Government has called for local utility providers to give those who have been affected by the outbreak of the novel coronavirus with a grace period for paying public utility charges.[12]

2.2 Third parties

The Government will, through governmental financial institutions, provide assistance for restructuring supply chains:

- in order to support the restructuring of the Japanese supply chain, the Development Bank of Japan (DBJ) and the Shoko Chukin Bank Ltd will respond to the emergency by implementing JPY204 billion in financial measures;[13] and

9. The institutions to actually provide the interest aid are to be designated by the Japanese Government. The actual rate is normal rate of interest - 0.9 per cent.
10. Ministry of Health, Labour and Welfare: https://www.mhlw.go.jp/stf/seisakunitsuite/bunya/koyou_roudou/koyou/kyufukin/pageL07_00002.html.
11. National Tax Authority: https://www.nta.go.jp/taxes/nozei/nofu_konnan.html.
12. Ministry of Internal Affairs: https://www.soumu.go.jp/menu_news/s-news/01zaisei06_02000237.html.
13. Ministry of Finance: https://www.mof.go.jp/2020_coronavirus/index.html.

- through the Japan Bank for International Cooperation (JBIC), funding needs of up to a maximum of JPY500 billion will be made available for the purpose of financing operations or securing the supply chain for overseas operations.[14]

3. Legislative reforms for companies in financial distress

3.1 Special measures for corporations going bankrupt on the basis of deficit[15]

There will be a limitation on petition by creditors for bankruptcy proceedings against debtors on the basis of deficits caused by the Covid-19 outbreak. Of course, petitions by debtor corporations for the commencement of bankruptcy proceedings will not be limited.

3.2 Flexible measures regarding residency eligibility

The Ministry of Justice is responding by taking flexible measures with respect to extending residency eligibility or amendment for foreigners living in Japan. For example, the validity period of certificates of eligibility has been extended from three to six months, and, for technician apprentices for whom it is difficult to return to their home country, the Japanese Government is taking the approach of treating such persons more favourably with respect to changing their residency eligibility.[16]

3.3 Extension of filing deadlines with respect to disclosures under the Financial Instruments and Exchange Act (FIEA)

Under the FIEA, certain enterprises are required to submit annual securities reports and other filings to the relevant financial regulator. Due to the outbreak of Covid-19, it has become possible to extend such deadlines.[17]

3.4 Extension of filing deadline for tax returns

Normally, the deadline for tax returns for income tax is 15 March or the immediately following business day if the 15th falls on a holiday in the particular year (for example, this year the deadline would have been 16 March as 15 March was a Sunday). However, due to the outbreak of Covid-19, this year the deadline was extended by one month to 16 April 2020.[18] It is believed that the intention is to minimise the need for taxpayers to go outside in order to file their tax returns.

4. Financial and regulatory measures

4.1 Broader financial sector measures that have been implemented by the regulators

4.1.1 Financial conduct authorities

As discussed above, it has become possible to extend the filing deadlines for disclosures under the FIEA.

- Central Bank

  Policy interest rate cuts and purchasing of Exchange Traded Funds as a buying operation have been introduced.[19]

  The purchase target of ETFs has been doubled from JPY 6 trillion to JPY 12 trillion.

  Up to JPY 35 trillion can be used to purchase CP and corporate bonds by the end of November 2021.[20]

  Japan's central bank will actively purchase government bonds without limit, instead of targeting the JPY 80 trillion purchase limit announced previously.

4.2 Specific measures that have been implemented

4.2.1 Tax treatment of haircuts

The Government has implemented relaxed measures such as a grace period for the payment of national taxes and social insurance. Other measures include the following:

- Taxpayers now have a grace period of one year to pay their taxes.
- Taxpayers can be exempted from the 13 per cent interest on arrears.[21]
- It is also planned that a grace period can be given before taxpayers will be subject to foreclosure or conversion of assets.
- There are also circumstances under which a grace period can be given before premiums for employee pension insurance are paid.[22]

4.2.2 Delayed tax payment treatment

Normally, the deadline for tax returns for income tax is 16 March 16. However, due to the outbreak of Covid-19, this year the deadline has been extended by one month to 16 April 2020 as discussed above.

14. The JBIC's 'Growth Investment Facility' to be used for these purposes.https://www.jbic.go.jp/ja/information/news/news-2019/0131-013038.html.
15. Act on Special Measures for Pandemic Influenza and New Infectious Diseases Preparedness and Response, Article 57, paragraph 1; Act on Special Measures concerning Preservation of Rights and Interests of Victims of Specified Disaster, Article 5, paragraph 1.
16. Ministry of Justice: http://www.moj.go.jp/hisho/kouhou/20200131comment.html.
17. Japan Financial Services Agency (JFSA): https://www.fsa.go.jp/news/r1/sonota/20200210.html.
18. National Tax Authority: https://www.nta.go.jp/taxes/tetsuzuki/shinsei/annai/hojin/annai/1554_12.html.
19. Bank of Japan: https://www.boj.or.jp/about/bcp/corona/index.html/.
20. https://www.jiji.com/jc/article?k=2020121200376&g=eco.
21. National Tax Authority: https://www.nta.go.jp/taxes/nozei/nofu_konnan.html.
22. Japan Pension Service: https://www.nenkin.go.jp/service/sonota/sonota/202000319.html.

4.2.3 *Relaxed regulatory requirements*

- *Relaxation of listing standards*

  In response to the crisis caused by Covid-19, the Tokyo Stock Exchange has determined to temporarily relax listing standards as follows:[23]

  – the grace period for delisting of companies in deficit has been extended from one year to two years;

  – in the event that the company's corporate auditor is unable to provide an opinion due to the Covid-19 situation, the company will be exempted from delisting; and

  – with respect to IPO examinations, a flexible approach will be taken with respect to the standards by which the issuer's profitability is examined.

- *Extension for implementation of Basel III*

  The Group of Governors and Heads of Supervision, which is the oversight body of the Basel Committee on Banking Supervision, has extended the period for the implementation of Basel III by one year.[24]

4.2.4 *Other*

- Benefits for Japanese citizens

  Japanese citizens can be paid JPY 100,000 per person from the government to support their living.

- Benefits for business enterprises

  Small and medium sized companies which suffer more than a 50% decrease in monthly earnings compared to that of the prior month can receive payments for such loss up to JPY 2 million per company.

  There is also provision for money to be provided to business entities to support office rent.

- Notices regarding the timing of the annual shareholders' meeting

  – General rule: under the Japanese Companies Act, a Japanese corporation must 'convene its annual shareholders meeting by a certain time after each business year' (Article 296, paragraph 1). Such 'certain time' may be set specifically in the articles of incorporation of the corporation (e.g., 1 May). However, the norm is for corporations to convene their annual shareholders meetings within three months after the last business year. In light of the Covid-19 situation, the Ministry of Justice has issued guidelines as follows with respect to such 'certain time'.[25]

  – In the event that the corporation is unable to convene its annual shareholders' meeting due to the Covid-19 situation, the corporation may convene the annual shareholders' meeting within a reasonable period after such situation has subsided, even if the articles of incorporation specify a date for the annual shareholders meeting to be convened (e.g., 1 May).

  – The Companies Act does not provide that corporations must convene their annual shareholders' meetings within three months after the last business year.

  – In the event that the corporation is unable to distribute dividends as of a specific record date set forth in the articles of incorporation for the distribution dividends due to the Covid-19 situation, the corporation may distribute the dividends on a date that is different from the relevant record date.

- Interpretative comments announced by the Ministry of Economy, Trade and Industry (METI) regarding the method for convening shareholders' meetings (virtual annual shareholders meetings

  – General rule: under the Japanese Companies Act, the notice of convocation of an annual shareholders' meeting must specify the 'date / time and place' for the meeting to be held. Accordingly, it can be interpreted that in order to exercise a shareholder's voting rights, physical attendance at the venue for the shareholders' meeting is required, and, accordingly, annual shareholders' meetings by way of internet conferencing have been debated. In this regard, METI has announced guidelines which provide that, with respect to the form of an annual shareholders' meeting, there are cases where it is possible for shareholders to exercise voting rights without physical attendance at the venue of the meeting. This is called a 'hybrid attendance virtual shareholders' meeting'. This is a method by which a shareholder can attend the shareholders' meeting by way of internet conferencing without physically going to the venue for the meeting and, after participating in the deliberations together with shareholders in physical attendance, participate in the vote. METI has recognised the validity of this form of meeting on condition that there is real-time two-way communication between the venue and the shareholder.[26]

- Subsidies (promotion project for revolutionising productivity)

  The Government will subsidise the costs of insourcing or moving operations back to Japan

23. Japan Exchange Group, Inc: https://www.jpx.co.jp/corporate/news/news-releases/0020/20200302-01.html.
24. JFSA: https://www.fsa.go.jp/inter/bis/20200330/20200330.html.
25. Ministry of Justice: http://www.moj.go.jp/MINJI/minji07_00021.html.
26. METI 'Hybrid type virtual shareholders meeting implementation guide' https://www.meti.go.jp/press/2019/02/20200226001/20200226001.html.

due to damage to the supply chain, as well as costs relating to the adoption of information technology, such as telework tools, in order to newly adopt work from home programmes.[27] The Government has also budgeted for JPY220 billion in subsidies to induce Japanese companies to move their manufacturing functions back to Japan.

5. Specific measures for micro and small businesses

5.1 Promotion of telework

For SMEs that adopt telework:

- the expenses will be subsidised (approximately JPY1 million per enterprise); and
- free consultations with information and communication technology specialists will be promoted for enterprises planning to adopt telework.[28]

6. Measures introduced by the courts to deal with increased insolvency cases

As discussed above, special rules have been put in place for corporations that go bankrupt on the basis of deficit.

7. Miscellaneous

The Japanese Government has announced that it will take measures as follows.

7.1 The declaration of national emergency and its effectiveness

The declaration of national emergency was made by the Prime Minister pursuant to the Act on Special Measures for Pandemic Influenza and New Infectious Diseases Preparedness and Response. As a result of this declaration, the national Government as well as local governments have been enabled to take the following actions. However, most of these are requests rather than orders:[29]

- to 'request' the cooperation of the public with measures such as not going outside. (Article 45, paragraph 1);
- to request the restriction of the use of event space facilities and the holding of events (Article 45, paragraph 2);
- appropriation of private land in order to set up temporary medical facilities (Article 49) in the event of which such landowners are to be compensated (Article 62);
- to request the sale of resources such as medical products and beverages (Article 55, paragraph 1) and, where the request is not complied with, such accommodation may be compelled (Article 55, paragraph 2). The owner of the resources may also be asked to store them (Article 55, paragraph 3), provided, however that the loss must be compensated (Article 62). Penalties may be applied for non-compliance (Articles 76 and 78);
- procedures for burial and cremation may be simplified (Article 56, paragraph 1). Also, burial and cremation may be compelled for the purposes of avoiding risk to the public (Article 56, paragraph 2);
- administrative or criminal liability for delay in performance may be excused (Article 57, paragraph 1, specified contingencies Article 4, paragraph 1);
- the bankruptcy of a corporation against which a creditor has petitioned for bankruptcy proceedings on the basis of the debtor's deficit can be postponed (Article 57, paragraph 1);
- a grace period may be imposed for the repayment of a monetary debt (Article 58, paragraph 1);
- emergency lending by governmental financial institutions will be promoted (Article 60); and
- illness suffered by medical practitioners who are requested to perform medical services is to be compensated (Article 63).

7.2 Various government funding

- The government has taken a variety of actions in order to prevent the spread of infection, such as establishing the supply of medical services (JPY669.5 billion) and responding to the issues relating to the temporary closure of schools (JPY167.3 billion).[30]
- The government is also providing emergency support to other countries impacted by Covid-19.

7.3 Other pending reforms – response by private banks

Private banks have adopted artificial intelligence (AI) to accelerate their loan examination processes. Mitsubishi UFJ Bank uses AI to review loan applications and is providing financial services within two days of applications at the earliest.[31] The thinking behind this is that, due to the outbreak of the novel coronavirus, there are increasing numbers of SMEs who do not have

27. METI (Small and Medium Enterprise Agency) https://www.chusho.meti.go.jp/koukai/yosan/index.html.
28. Novel Coronavirus Response Headquarters: https://www.kantei.go.jp/jp/singi/novel_coronavirus/taisaku_honbu.html.
29. Act on Special Measures for Pandemic Influenza and New Infectious Diseases Preparedness and Response. e-gov: https://elaws.e-gov.go.jp/.
30. Novel Coronavirus Response Headquarters: https://www.kantei.go.jp/jp/singi/novel_coronavirus/taisaku_honbu.html.
31. Nikkei online version of 24 March 24, Mitsubishi UFJ Bank: https://lending.corporate.bk.mufg.jp/?link_id=p_houjin_visual_biz_lending.

recourse to a governmental financial institution and who are therefore applying for private bank loans.

8. Closing comments

Subsequent to the writing of the body of this report, the Japanese Government made a state of emergency order again in most areas of Japan. Japan now needs to rebuild supply chains, demand forecast and safeguards for unemployment.

It is likely that further policies will be announced by the Government taking into consideration the safety of the nation and the economy. Notably, the Government has asked the Diet to strengthen penalties under the Act (on Special Measures for Pandemic Influenza and New Infectious Diseases Preparedness and Response) to encourage corporations and individuals to comply with the state of emergency order.