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Editors' Column

Joe Bannister
Hogan Lovells International LLP (UK)

Jay Carfagnini
Goodmans LLP (Canada)

Anyone receiving £1 for each occasion on which he has heard a commentator speculating whether the British economy was entering or leaving a double dip recession would earn a tidy sum. The same would go for the lucky recipient of US$ 1 for each reference made by the 2012 US presidential candidates to whether or not the US economy was about to fall off a fiscal cliff. Yet anyone able to predict with certainty the future development of the Chinese economy could stand to become a millionaire many times over. Day by day, we hear references to difficult economic times in China. The Chinese market continues to produce a number of the most complex fundholder restructurings, Sino Forest being a high profile example.

Yet everything is relative. Economists acknowledge that Chinese output has fallen for the past seven quarters and they predict worse to come. Those "falls" however are to levels of output the West could only dream of. For example, the British economy shrunk by 0.4% in the second quarter of 2012, according to the Office of National Statistics. By contrast, the Chinese economy grew by 9.23% in 2011, according to IMF data for that time. The growth figure for the third quarter of 2012 is 7.4%.

It is occasionally suggested that these figures are optimistic but even if they are correct, the steady fall in output can only mean that over time, more and more Chinese businesses and individuals will encounter financial difficulty and need to turn to China's bankruptcy laws for support and protection. Those laws received a major overhaul as from 1 June 2007, when China introduced a new Enterprise Bankruptcy Law. The fifth anniversary of that law is an opportune moment to assess its effectiveness and the extent to which the Chinese authorities are now adopting, with variations appropriate to local market and social conditions, concepts and practices of creditor treatment that are long accepted features of Western restructurings and insolvencies.

The Editors are therefore very grateful to Leonard Goldberger, INSOL fellow and member of the Editorial Board of INSOL World, for assembling the comprehensive "retrospective" analysis of the development of Chinese bankruptcy practice over the past five years that are contained in this issue. The articles have been written by some of the most eminent Chinese academics or practitioners. Together they cover many of the issues that will be of concern to those wishing to gain an understanding of the development of restructuring and insolvency law and practice in the world's second largest economy as a new generation of leaders prepares to take office.

Li Shuguang and Wang Zuofa consider the way in which first instance and higher Chinese courts deal with bankruptcy cases in practice and draw out the differences between the manner in which practice differs from the legislative provisions. Their comment that courts are reluctant to take bankruptcy cases on account of their complexity is striking. This is especially so as the reason given is the continuing measurement of judicial performance by reference to the number of cases tried by an individual judge. The difference between law and practice is also vividly and clearly brought out by John Marsden and Phoebe Lo's discussion of the way political factors can impinge on the development and implementation of individual restructuring cases.

Donggen Xu and Zoe Qiao explain how far Chinese cross border bankruptcy cases may have come since the liquidation of the BCCI Shanghai branch in 1991, where the frozen assets of the bank were ultimately distributed to domestic creditors of the branch in accordance with local law. This piece and the review by David Kidd and Kathleen Wong of the FerroChina case suggest that with the passage of time, foreign creditors should continue to fare better in Chinese restructurings and insolvencies than has previously been the case.

Summaries of the development of the role of workers' co operatives in Argentinian rescues, ISDA closeouts and the way bankruptcy deals with individuals in the current Greek crisis, along with possible developments for "Centre of main Interests", complete this quarter's offering. We are indeed blessed with "interesting times" to paraphrase that old Chinese proverb.

Joe Bannister
Hogan Lovells International LLP (UK)

Jay Carfagnini
Goodmans LLP (Canada)

President's Column

By Gordon Stewart
Allen & Overy LLP
London, UK

OUTLOOK: MIXED

Reasons not to be cheerful

Gore Vidal, the über-cynic, once commented *"It is not enough to succeed. Others must fail."* I have always assumed Mr Vidal said this tongue in cheek but, even if you don't take it at face value, it is still possible to feel uncomfortably daunted by the exploits of others. At INSOL 2001 in London, our inspirational speaker was Sir Ranulph Fiennes, the explorer. Sir Ranulph has been just about everywhere, done everything. Well, to be fair, he hasn't gone backwards up K2 in his underpants but his latest endeavour seems almost as challenging. He intends to go across Antarctica on skis during the southern hemisphere's winter, in the dark…. Why? Well, it hasn't been done before and a Norwegian rival had started mentioning it as a possibility. Sir Ranulph is the sort of man who just cuts off the end of his fingers if they've got frostbite, and I don't know about you dear reader but he makes me feel as about as energetic as Jabba the Hut or as full of self worth as the Squonk in the song of that name from Genesis's *Trick of the Tail* album (a Squonk is so ugly and miserable it sometimes dissolves itself in its own tears). Anyway, best wishes to Sir Ranulph and his team for next (northern hemisphere) spring when he and his team start their trek.

In the last few months I have heard any number of economists saying, orally or in writing, that there will be no early emergence of the world economy from the current gloom. On the other hand, I have heard one or two investment bankers announce that they are "optimistic" and, if you believe that confidence can be generated without reference to any underlying economic substance, then I can understand bankers saying such things to rally the troops as it were. More chillingly, at the end of a recent presentation, one economist announced that the world will need to produce in the next 50 years the same amount of food as it has produced in the last *10,000* years.

Finally, I veer between despair and hysteria at legislators who refuse to find space in the legislative timetable for important reforms to insolvency law yet out of the blue suddenly propose laws which have unintended consequences in the restructuring sphere. In Europe currently we are having a serious debate about a proposed new law which was conceived with the best of intentions. The plan was to prevent debtors from moving their assets round Europe to avoid their creditors. A nut, but a small one. So to create a massive sledgehammer with the potential to cause real collateral damage while crushing that nut is, to say the least, unfortunate. We in the restructuring profession all know that cash is king and for a company in genuine - honest - financial distress to find that its disgruntled creditors are readily freezing its bank accounts all over the place does not strike many of us as supportive of the rescue culture.

Air miles update

In July I had the pleasure of attending the annual conference of the Canadian practitioners' organisation, CAIRP, in Banff, Alberta. The air was so clear and pure it dazzled the eyes and hurt the chest of this city dweller, used only to varying degrees of pollution in his daily existence.

The only alarming aspect of the trip was the warning that if one was intending to walk on the trails through the gorgeous surrounding hills, you should go in a group of four. The somewhat basic thinking of this approach is that bears will decide whether or not to attack you by reference to how big you seem to be and walking four abreast creates a size that represents a sufficient disincentive to the short-sighted bear. Now, as a lawyer, I spend my life asking "What if?". So, what if one or two of your number have a call of nature? And at just that point, the grizzly comes round the corner regretting that he forgot to have half a dozen salmon or a couple of mountain goats for breakfast? Hmmm. Mind you, I can't imagine Sir Ranulph Fiennes being intimidated by that sort of warning. Or by a grizzly bear for that matter.

Upcoming in a busy autumn, at the time of writing I have visits to Cairo and Dubai to speak at conferences on law reform in the Middle East, to Brussels to speak at INSOL Europe's traditionally well-attended annual conference and a trip to South Africa as a guest of SARIPA to speak at their annual conference and to hear more about their new rescue law and how it is playing out in practice.

Reasons to be cheerful

There are, on the other hand, a number of reasons why we can and should be cheerful. The US is undertaking a full review of its already much emulated Chapter 11 process which demonstrates an admirable desire on the part of the States to continue to improve its restructuring laws. INSOL International is delighted to be on an ABI committee reporting on certain international aspects. The UK Government has launched a "Red Tape Challenge" pursuant to which they are, as the name suggests, seeking to find ways to remove red tape and hence improve the UK's business environment generally and this may have some benefits in the restructuring and insolvency fields. As we see from this edition of INSOL World, the PRC's new laws have been in force for some five years and business rescue seems to be developing in this most important of global economies. UNIDROIT has just held a conference and is making recommendations designed to ensure that netting is effective in all key financial jurisdictions. Netting is vital for banks in organising their exposure and regulatory capital needs and so this is to be applauded. INSOL was pleased to have attended the conference in the role of observer. And the EU has put out a paper with its latest thinking on the future of bank resolution. Bank resolution is a massively difficult and complicated area but this is another step forward.

Finally, may I recommend smiling to all readers. I do so from experience. For a variety of family reasons I found myself recently catching a train from the north of England to London. When I got on I was at first bemused by the chaotic scenes I found: weary people sleeping across two seats; coffee cups, sandwich packets, soft drinks bottles everywhere. It transpired that the train had originally set off from the very north of Scotland and had accordingly been in transit for several hundred miles already. I had caught an earlier train than intended and so did not have a specific booked seat. There was an elderly couple occupying two seats out of a set of four and I enquired politely whether it would be possible for me to take one of the window seats. I sensed that perhaps they had been looking for a bit of peace and quiet on their own and I was soon made aware that this was the case when they explained in great detail how torrid the journey from Scotland had been. I tuned out much of the story I have to confess but I did catch phrases such as "buffet car a mile away", "screaming kids", "rubbish everywhere", "and even a hen party…." The couple's train nightmare was, however, soon over and they left at the next stop. As it had been a long day and my start had been early, I decided that a short snooze would be in order. However my pod of four seats was now invaded by two people whom I ultimately took to be from the advertising profession. And they started a conversation. Well that is not strictly accurate: one of them started to speak at the other one with the intonation and at the volume of a well-known UK TV game show host. The piercing Stewart glare failed miserably to have any effect. I decided to try turning up the volume on my iPod. I put on something poppy that one of my daughters had given me (*The Constant* by I Blame Coco – if you're interested) and put the volume up such that my ears were gently bleeding. I shut my eyes but still the conversation defeated the music. Now, a number of books I have read recently, including the one I was reading on the train (*Thinking, fast and slow* by Daniel Kahneman – if you're interested), referred to experiments which demonstrate that not only do we smile when we are happy but that the very act of smiling creates a feedback loop and makes us feel better. At a loss for anything else to do, I kept my eyes shut and started to smile. I do recall Mr Game Show Host saying at one point "I have been made redundant so many times…." and I do recall thinking "You don't say…" but the next thing I knew I was waking up as the train arrived in King's Cross station. So, if I may, I will wholeheartedly recommend a quiet smile - if not technically as a *reason* to be cheerful, then at least as a way to be cheerful.

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Timing May Be Everything for Recognition of Foreign Insolvency Proceedings in the United States

By
H. Bradford Glassman
and
Chiara Spector-Naranjo
Lewis Baach PLLC
Washington D.C., USA

Chapter 15 of the U.S. Bankruptcy Code provides the mechanism for representatives of insolvent foreign debtors to seek comity and judicial assistance from the U.S. courts.[1] Recognition of a foreign representative under Chapter 15 is not automatic; the bankruptcy court must make certain findings, including that the debtor has sufficient connection with the situs of the insolvency proceeding to warrant recognition of that jurisdiction's appointee. Courts have taken the responsibility of making this determination seriously, noting that Chapter 15 recognition is "not to be rubber stamped," and sometimes denying recognition even in the absence of any objection to recognition or any competing insolvency proceeding.[2]

Recognition is vital to foreign liquidators if they are to obtain full access to the U.S. courts, but, strikingly, courts have diverged on a key component of the Chapter 15 analysis – namely, the relevant timeframe for analyzing the debtor's contacts with the foreign country hosting the insolvency proceeding. While most courts considering the issue have focused on the debtor's activities in the foreign country as of the time the Chapter 15 petition is filed – thus including post-insolvency, liquidation-related activities – a recent decision focuses instead on the debtor's activities as of the time when the foreign insolvency proceeding commenced (thus excluding post-insolvency petition activity).

This split among the country's federal courts may make or break foreign liquidators' efforts to gain recognition in the United States, especially where insolvency proceedings are taking place outside the country where the debtor's brick-and-mortar business is or was operated. The issue is presently before the United States Court of Appeals for the Second Circuit, the federal appellate court with jurisdiction over New York and certain surrounding states and the preeminent intermediate appellate court for business issues.[3]

Often a Chapter 15 petition is filed shortly after the initiation of the foreign insolvency proceeding. In these cases, the timing analysis is usually not crucial. But in other cases, months or even years may pass between the foreign insolvency petition and the Chapter 15 petition, and sometimes the period of the liquidation activity greatly exceeds the life of the insolvent company as a going concern. In these cases, recognition may hinge on the timing analysis.

Consider the following scenario: the foreign debtor, incorporated in Country X, conducted its business from Country Y. Insolvency proceedings were commenced in Country X, all business activity in Country Y ceased as of that time, and the liquidator has been actively engaged in winding up the foreign debtor's affairs for the past 2 years from Country X. The liquidator files a Chapter 15 petition in a U.S. bankruptcy court seeking recognition of the insolvency proceeding in Country X. There is no competing insolvency proceeding in Country Y or elsewhere. Will the U.S. courts recognize and assist the liquidator appointed by the courts of Country X? At present, the answer appears to depend on the judge who considers the petition.

Chapter 15 provides for recognition of foreign insolvency proceedings only if they are found to be "main" or "nonmain" proceedings, but the statute provides only limited guidance as to what these terms mean. Chapter 15 defines a main proceeding as "a foreign proceeding pending in the country where the debtor has its center of its main interests," or COMI.[4] Courts have likened the COMI analysis to a "principal place of business" or "nerve center" analysis.[5] There is a rebuttable presumption that a debtor's registered office is its COMI, but courts have made it clear that this presumption does not relieve the petitioner of its burden of proof. Moreover, the determination of the debtor's COMI is required even where the relevant foreign liquidation is the only one – i.e., where there is no competing liquidation that has been launched in another jurisdiction.

The Chapter 15 case law is fact-intensive. Courts have articulated a list of non-exclusive factors that may be considered as part of the COMI analysis: (i) the location of the debtor's headquarters; (ii) the location of those who actually manage the debtor; (iii) the location of the debtor's primary assets; (iv) the location of the majority of the debtor's creditors or a majority of the creditors who would be affected by the case; (v) the jurisdiction whose law would apply to disputes; and (vi) the expectations of third parties with respect to the location of a debtor's COMI.[6]

A nonmain proceeding is "a foreign proceeding, other than a foreign main proceeding, pending in a country where the debtor has an establishment."[7] An "establishment" is "any place of operations where the debtor carries out a nontransitory economic activity."[8] The petitioner has the burden of proving that the debtor has an establishment in the country where the foreign insolvency proceeding is pending. There is no statutory presumption for the establishment analysis. In determining whether a debtor has an establishment in the foreign country, courts consider whether the debtor conducts or conducted business in that country.

Most courts considering the timing issue have tied the COMI analysis to the date when the Chapter 15 petition was filed and have therefore taken into account the activities of foreign liquidators and other third parties post-

1 Certain categories of foreign insolvency proceedings are excluded from Chapter 15 and are beyond the scope of this article. See 11 U.S.C. § 1501(c).
2 *See In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd.*, 374 B.R. 122, 125-26 (Bankr. S.D.N.Y. 2007), *aff'd*, 389 B.R. 325 (S.D.N.Y. 2008); *see also In re Basis Yield Alpha Fund (Master)*, 381 B.R. 37, 51 (Bankr. S.D.N.Y. 2008).
3 *See In re Fairfield Sentry Ltd.*, Appeal No. 11-4376-cv (2d Cir. filed Oct. 19, 2011).
4 11 U.S.C. § 1517(b).
5 *In re Bear Stearns*, 374 B.R. at 129; *In re Fairfield Sentry Ltd.*, 440 B.R. 60, 64 (Bankr. S.D.N.Y. July 22, 2010).
6 *See In re Bear Stearns*, 374 B.R. at 128; *In re Fairfield Sentry Ltd.*, 2011 WL 4357421, at *4 (S.D.N.Y. Sept. 16, 2011); *In re British Am. Isle of Venice*, 441 B.R. 713, 720 (Bankr. S.D. Fla. Dec. 23, 2010).
7 11 U.S.C. § 1502(5).
8 11 U.S.C. § 1502(2).

liquidation. Courts taking this approach seem to be motivated by a desire to provide comity and assistance to foreign court appointees and to prevent them from being ousted from U.S. courts – particularly where there are no competing liquidations claiming priority.

A recent decision rejects this approach, however, concluding that the relevant date for determination of a debtor's COMI is the date of commencement of the foreign proceeding.[9] In the opinion, Judge Gropper of the United States Bankruptcy Court for the Southern District of New York reasons that a debtor does not have a "principal place of business" after its business ceases operations, and observes that reliance on the date of the Chapter 15 filing to determine COMI could lead to forum shopping by allowing a debtor (or its creditors) to determine residence for purposes of a later Chapter 15 petition.[10] Judge Gropper currently stands alone in orienting the COMI analysis to the date of the foreign insolvency petition, but his stature as a senior member of the bankruptcy court with jurisdiction over Manhattan will ensure that his views are taken into account by other courts, if not necessarily embraced by them.

A further paradox arises out of the timing issue. It should, in theory, be easier to qualify for "nonmain" as opposed to "main" recognition, since merely showing an "establishment," i.e., nontransitory business activity, is easier than demonstrating a nerve center or principal place of business. Moreover, the same temporal analysis should apply to the COMI and establishment analyses because the key statutory language is similar, and, in particular, both provisions are worded in the present tense. Nevertheless, one court following the majority view for the main-recognition analysis has declined to consider post-insolvency activity for the nonmain-recognition ("establishment") analysis.[11] The problem may lie in the statutory definition of an "establishment" as "any place of operations where the debtor carries out a nontransitory *economic* activity" (emphasis added).[12] By contrast, COMI is not statutorily defined, leaving the courts interpretive latitude.

At present, the majority view is that a debtor's COMI should be determined as of the filing of the Chapter 15 petition. This means that where extensive post-liquidation activities have been conducted in the country hosting the foreign insolvency proceeding, foreign liquidators have a good chance of obtaining main recognition of those proceedings. But only time will tell whether other courts will follow Judge Gropper's lead and focus their analysis on the time, potentially many years prior, when the foreign insolvency proceeding commenced. If the Second Circuit decides the timing issue, it will resolve the split within the Manhattan federal courts and very likely engender agreement in the other U.S. circuits. Until then, however, many foreign judicial appointees will be left guessing whether their requests for comity and judicial assistance will find favor with the U.S. courts.

9 *In re Millennium Global Emerging Credit Master Fund Ltd.*, 458 B.R. 63 (Bankr. S.D.N.Y. 2011). Notably, Judge Gropper granted main recognition even without considering post-liquidation activity, and hence he did not have to confront the prospect of denying recognition to a foreign judicial appointee requesting his assistance under Chapter 15. Judge Gropper's decision was affirmed by the United States District Court for the Southern District of New York, but the district court did not consider the timing issue. 474 B.R. 88 (S.D.N.Y. 2012).

10 Judge Lifland, who also sits on the Bankruptcy Court for the Southern District of New York, shares Judge Gropper's concern regarding forum shopping. In *In re Fairfield Sentry Ltd.*, 440 B.R. at 66, Judge Lifland rejected the petitioners' argument that the COMI determination should be based solely on the time of filing of the Chapter 15 petition and instead advocated for a "broader temporal COMI assessment" if there is evidence of an "opportunistic shift" or "any biased activity or motivation to distort factors" relating to the debtor's COMI.

11 *See In re British Am. Ins. Co. Ltd.*, 425 B.R. 884, 915 (Bankr. S.D. Fla. 2010).

12 A possible solution is to recognize that liquidation activity may be accurately characterized as "economic" activity even if it is not "business" activity in the narrow sense of active trading by the debtor as a going concern.

Focus: A Five-Year Retrospective on China's New Bankruptcy Law

Photo: freeimages.co.uk

Introduction by Leonard P. Goldberger

Stevens & Lee, P.C.
Fellow, INSOL International
INSOL World Editorial Board

China's new business bankruptcy law, the Enterprise Bankruptcy Law of the People's Republic of China, is now 5 years old. And it is coming of age just in time.

By all accounts, China's economy now faces challenging times. Despite various targeted governmental stimulus efforts, China's economic growth continues to slow in the face of headwinds from the Eurozone financial crisis, decreasing exports as a result of the struggling U.S. economy and the general global slowdown, and its own cooling real estate market. These difficulties are further compounded by the uncertainties surrounding this year's once-in-a-decade upcoming national political leadership transition. The only question is whether China's economy will face a hard or a soft landing.

As China continues to cope with the fallout from these changing economic conditions, its new bankruptcy law will face an important test as loan defaults and business failures inevitably increase. This timely retrospective collects articles by leading academics and insolvency practitioners that examine how the new Chinese bankruptcy law has developed during its first five years and, more importantly, where it appears to be going.

The Function of China's Court in Enterprise Bankruptcy and the Future Trend – Observations from the Background of the Four Year Implementation of China's Existing Bankruptcy Law

By Prof. Li Shuguang and Wang Zuofa

Bankruptcy Law & Restructuring Research Center,
China University of Politics and Law,
Beijing, PR China

Introduction

The Bankruptcy Court generally functions as organizer, supervisor and referee in bankruptcy cases. It pushes the bankruptcy procedure forward effectively by properly performing these functions. It should be an impartial referee dealing with bankruptcy cases based on fundamental bankruptcy principles and rules. The court will only be seen as providing adequate support for financially troubled businesses if it is seen to act independently and impartially.

The existing bankruptcy law of China, The Enterprise Bankruptcy Law of the People's Republic of China, which was promulgated on August 27, 2006 and took effect in June 1, 2007, is often referred to as "the new bankruptcy law". This is because this law is fundamentally different from the 1986 bankruptcy law of the PRC. This was the PRC's first bankruptcy law and it became effective in 1988.

The 1986 bankruptcy law was passed to regulate state-owned enterprises operating within a state controlled economy. By contrast, the new bankruptcy law is a market economy-oriented modern statute passed that takes account of the experiences of developed market economies. The new law also reflects the particular circumstances of China's ongoing economic transition.

However, the new bankruptcy law (hereinafter referred to as 'the bankruptcy law') has encountered some problems in its implementation. There is a big gap between the expectations of the bankruptcy law and the manner of its implementation.[1] There are multiple factors affecting the implementation of the bankruptcy law and the function that the court performs in the implementation of the bankruptcy law is one of great importance. This article discusses the function that the court has performed in the implementation of the bankruptcy law in the four years since it came into force.

A. The Function of China's Court in Enterprise Bankruptcy

The Functions Authorized by Legislation

i) The Functions under the bankruptcy law

First, since there is no specialized bankruptcy court in China, bankruptcy cases are categorized as commercial cases and submitted to the civil and commercial tribunal of court. Under the bankruptcy law, the functions that court performs in bankruptcy cases generally consist of two types – procedural and substantive powers.

[1] See Li-Shuguang and Wang-Zuofa, China's Bankruptcy Law after Three Years: The Gaps between Legislation Expectancy and Practice and the Future Road, International Corporate Rescue, Volume 7, Issue 5-6, 2010.

Procedural powers mainly include the power to accept the case, appoint the administrator, to convene the first creditors' meeting, to approve the asset realization plan and the distribution and the plan of reorganization, to declare the debtor bankrupt, to terminate the procedure and to supervise the implementation of the plan of reorganization. The court performs its function of initiating and pushing forward the case through the use of its procedural powers. Substantive power of the court refers to its power to determine the rights and responsibilities of different players in the bankruptcy case. The major substantive power of court is its adjudication of those matters affecting the amount and value of the bankruptcy estate, including revocation of preferences and fraudulent transactions, determining the claims of the parties in relation to their entitlement to the ownership of some of the properties in the bankruptcy estate and approving their application to take back their ownership and approving the application of set off rights. The court may also exercise its powers to identify and set aside illegitimate pre-bankruptcy transactions. The bankruptcy law also gives the court a number of punitive powers. For instance, article 6 of the bankruptcy law allows the court to investigate the management of the debtor to determine the extent of its legal responsibility for the debtor's bankruptcy.

Under China's judicial system, the bankruptcy law also gives the Supreme People's Court of PRC (hereinafter referred to as the SPC) the power to make judicial interpretations to further specify the functions of the court. Article 22 of the bankruptcy law provides that the matters relating to the appointment and payment of administrators are subject to judicial interpretations made by the SPC. This further enhances the powers of the court in the bankruptcy process.

ii) The role of Judicial Interpretations by the Supreme Court

Under the judicial system of China, the judicial interpretations made by the SPC have quasi-legislative force. As at the date of publication of this article, the SPC has made six judicial rulings interpreting the bankruptcy law, two of which are closely related to the functions of court. They are Supreme People's Court Regulation on the Appointment of Administrators and Supreme People's Court Regulation on Compensations of Administrators.

Under these rulings, the local courts shall make a list of local administrators and in conventional bankruptcy cases administrators are appointed by the court by drawing lots from a list provided to them. In high profile cases, the administrator will be a "liquidating group" (*Qing Suan Zu*). "Liquidating group" is a concept unique to the particular context of China's bankruptcy law and practice. It is not an organization established to wind up the debtor. It is an organization to act as administrator in some special bankruptcy cases under the bankruptcy law. This term originates from the 1986 Bankruptcy Law. The bankruptcy law keeps this term in order to ensure the smooth transfer from the old bankruptcy law to the new law. But in real practice this organization is being used to act as

administrators of large bankruptcy cases. The members of the liquidating group may come from a wide spectrum of sectors such as the government sectors in charge of the lines of trade where the debtor operates and market intermediaries like lawyers and financial experts. The members of the liquidating group are not territorially restricted by the legislation; they come from around the country. The compensation of administrators is calculated with certain percentage based on the total assets value of the debtor.

The bankruptcy law and its judicial interpretations give the court material supervisory powers in dealing with bankruptcy cases. These powers are sufficient to push forward the bankruptcy case efficiently. What is the real function that court performs in bankruptcy practice?

B. The Real Function that Court Performs in Practice

i) Trial Court of Bankruptcy Cases

Courts are divided into four levels under China's court system. These are basic-level courts, intermediate courts, high courts and the SPC. Basic-level courts are located in small counties or districts of cities and deal with trial cases within the judicial jurisdiction of the court. Intermediate courts are located in large and medium sized cities and deal with trial cases of important influence within the city and appellate cases. High courts are the highest level courts within a province, provincial level autonomous region or a city directly governed under the central government. They deal with trial cases of great importance within their jurisdiction or appellate cases.

The SPC deals with trial cases of national importance or appellate cases. Article 2 of the bankruptcy law stipulates that bankruptcy cases are heard by the courts within whose jurisdiction the debtor is located. Since there is no special bankruptcy court in China and bankruptcy cases are submitted to the civil and commercial tribunals of the court, trial bankruptcy cases are usually heard by basic courts, that is, courts in small counties or districts of cities. High profile Bankruptcy trial cases are heard by intermediate courts. Only in special circumstances will bankruptcy trial cases be heard by the higher courts.

From our empirical observation, the trial courts of bankruptcy cases are generally heard by county courts, district courts and intermediate courts. Only very few trial bankruptcy cases are heard by high courts. That is, the bankruptcy cases are heard in accordance with the domicile of the debtor and the jurisdiction of bankruptcy cases generally has no relation to the importance of the cases except for listed corporations.

Listed corporations are considered as important market entities in China and all the bankruptcy cases of listed corporations are heard by intermediate courts. Until the end of 2011, there were 33 reorganization cases of listed corporations accepted by courts and the courts are all intermediate courts. Until May 2010, there were 116 reorganization cases of private corporations accepted by courts, among which 32 cases were heard by county courts or district courts, one case was heard by high court, and all the remainder were heard by intermediate courts. Liquidation cases are similar. For instance, in the eastern coastal areas where the economy is the most advanced in China, many trial bankruptcy cases with substantial liabilities and large numbers of creditors around the country are heard by county courts or district courts, although these cases are high profile cases in themselves. For instance, the Beicang District Court of Ningbo city has tried eight bankruptcy cases within three years. The total amount of liabilities in these cases is more than fifteen billion CNY and the number of creditors involved is more than 1500. For another example, Shunde District Court of Guangzhou City accepted a bankruptcy liquidation case on June 23, 2008, with total liabilities of more than 84 million CNY and more than 104 creditors nationally.

ii) Appellate Court of Bankruptcy Cases

Many problems or disputes in bankruptcy cases can be appealed. For instance, an order of the court to approve the compensation of an administrator, to approve or reject a plan of reorganization, to approve or reject the appointment of DIP can be appealed. The bankruptcy law also provides for the rights of appeal in respect of some matters. For instance, Article 12 of the bankruptcy law provides that the bankruptcy applicant may appeal if the trial court does not accept the case or reject the case.

We are aware of only one bankruptcy appeal case under the bankruptcy law. This is the first bankruptcy liquidation case in China's airline industry. In this case, five creditors led by GE Commercial Aviation Services Limited filed bankruptcy proceedings in relation to Wuhan Intermediate Court and the court accepted the case. But another ten creditors led by China Aviation Oil Limited and a shareholder, Wuhan Dongxing International Tourist Co. Ltd filed for reorganization in the Wuhan Intermediate Court respectively and these proceedings were rejected by the court. They appealed to the High Court of Hubei Province and that appeal also failed.

There was, however, a retrial of a bankruptcy case in China's XinJiang Province. The debtor is a wine producing company named Tian Shan Wine Brewery Corporation (*Tian Shan Jiu Ye*). The debtor failed to provide social security for its employees and the employees filed bankruptcy against it. The court of the county where the company is located accepted the case and sealed the building and plant of the debtor. However, the legal representative, some shareholders and employees of the company opposed the filing and they submitted a letter of disagreement to the court. But the court did not answer the letter. The debtor asked the intermediate court for a retrial of the case and the intermediate court accepted the application. Under the civil procedure law of China, appeals relate to judgments or orders and these will be of no effect until the appeal process is concluded.

iii) The Powers Affecting the Function That Court Performs in Bankruptcy Cases

The legislation envisages the courts having strong supervisory powers. However, the function of court is complicated in practice. Generally, the following factors determine those functions.

Local Government

Local government is the most important factor influencing court's function in hearing bankruptcy cases. On the one hand, the staffing and budgeting of the courts is determined by local government. On the other hand, the courts dealing with bankruptcy cases have direct economic and political impacts on local government. Economic impacts mainly include two matters:

(1) Winding up an enterprise may reduce local government financial income while turning around an enterprise may maintain its income;

(2) Winding up an enterprise imposes pressure on the local government to reach a settlement with the redundant employees.

This is a key issue for China's developing economy. Parallel to economic impact is political impact. The winding up of enterprises is considered to be politically disadvantageous by most local governments. Further, if settlements with laid off workers are not satisfactory, the workers' protests may undermine social stability. In China's transitionary economy, maintaining social stability is an important political factor affecting the decisions of local governments. Thus, China's judicial system results in the lack of independence of the courts from local government while the economic and political context of China in transition gives local governments strong incentives to intervene in bankruptcy cases.

Intervention in bankruptcy cases by the local government may cause uncertainty for the implementation of bankruptcy law. Take the reorganization of Yin Guangxia as an example. Yin Guangxia is a listed corporation with its major business in western China's Ningxia Hui Nationality Autonomous Region. In this case, the reorganized debtor needed good quality assets to restart its business. To achieve that, the debtor required a counterparty able to provide the debtor with good assets. Ningxia State-owned Assets Supervision and Administration Committee, which is the administrative body for local state-owned assets, preferred a local enterprise to restructure the debtor. The major creditors and shareholders preferred to have a company from outside Ningxia to restructure the debtor as that external party was better placed to provide good consideration and assets to implement a restructuring.

The court's role was to act as an impartial referee to ensure that the highest bidder gained control of the reorganized corporation. In this case, the court ordered the two proposed restructuring counterparties to compete. The court should then have ruled in favour of the party prepared to pay the best price. But in this case, the court seems to have been caught in the middle of the conflict between Ningxia State-owned Assets Supervision and Administration Committee and the creditors and other shareholders of the debtor.

The same thing has happened in some winding up cases. In the bankruptcy of Sanlu Milk Group Corporation, the lawyers in the liquidation group of the debtor proposed a reorganisation the debtor to protect those future claimants who were the victims of milk products containing melamine produced by the bankrupt debtor. In fact the court yielded to the local government and wound up the debtor in accordance with the wishes of local government.

The China Securities Regulatory Commission (CSRC)

CSRC may impose its influence on the court in bankruptcy cases for listed corporations. Since the CSRC as the major regulator of China's capital market, considers the stability of capital market to be its top regulatory target CSRC tends to be quite sensitive to the delisting of corporations. This affects the conduct of the bankruptcies of listed corporations. Although many listed corporations have faced financial distress, [2]there have been no cases of listed corporations being liquidated and dropped out of the capital markets since the bankruptcy law came into effect. There are even some distressed corporations which have lost their major businesses and are still listed on the capital markets as shell companies. Yet the CSRC, as the regulator of the capital markets, is concerned that some listed corporations may carry out fraudulent acts under the shield of the bankruptcy process. Hence the CSRC tends to be very cautious in approving the reorganization of listed corporations. The CSRC's approach will definitely affect the way in which the courts deal with the bankruptcies of listed corporations.

[2] According to our investigation, there are 171 listed corporations on the domestic stock. Markets were in severe distress in 2010.

Thus, the reorganization of listed corporations in China requires bargaining between local government, the CSRC and the court. The present result of this bargaining process is that the reorganization of listed corporations must adopt the following procedure: The filing party must obtain a letter of comfort from the local government, guaranteeing that the reorganization of a certain listed corporation will not affect local stability. Then the filing party must exchange the letter of comfort for a letter of approval from the CSRC. Next the filing party goes to the SPC to obtain the approval of reorganization with reference to the letter of comfort and letter of approval. Only following approval from the SPC can the court hear the bankruptcy case to approve the reorganization of the listed corporation.

The Upper Level Court

The court system has developed an interesting practice as court procedures have evolved over the longer term. The lower level court tends to pass difficult cases to the higher level courts or even to the SPC. The higher courts then give directions to the lower courts. The SPC has formulated numerous judicial directions through the use of this process. Some of the directions have gained judicial force and become legal precedents for the lower courts in their conduct of subsequent bankruptcies. This practice will detract from the independence of the lower courts. This is especially the case in corporate reorganisations where we have seen evidence of co ordination between the higher and the lower courts.

The State-owned Assets Supervision and Administration Committee (SASAC)

The SASAC is a special sector established by the state council to deal with the huge amount of state-owned assets in China. There is a central SASAC directly subject to the state council and some local SASACs. Under the Enterprise State-owned Assets Law of the PRC, central and local SASACs perform the function of equity investors in state-owned assets acting on behalf of the state council and local governments respectively. The central SASAC supervises central state-controlled enterprises and local SASACs supervise local state-controlled enterprises.

There are three types of state-controlled enterprises – the state might be the sole equity holder of the enterprise, the major equity holder of the enterprise or simply a common equity holder of the enterprise. No matter what type of equity investment, so long as there is state equity in the enterprise, the SASAC may take part in the bankruptcy procedure of that enterprise. The extensive amount of state-owned assets in China makes the SASAC an important stakeholder in the court driven bankruptcy process. The local SASACs generally act as a member of the liquidating group in bankruptcy cases involving state-owned assets and impose their influence on the case. In the Yin Guangxia case, the local SASAC selected another local state-owned enterprise to restructure the debtor against the wishes and interests of other shareholders and creditors. This placed the local courts in a very difficult situation.[3]

I. The Impact of the Court's Real Function on the Implementation of the Bankruptcy Law

It will be clear from this description that there is a discrepancy between the functions of the court as provided for by the legislature and its functions in practice. The legislation intends to entrust the court with strong

[3] But this local SASAC does not have equity in the corporation, which makes this case rather curious.

control of the bankruptcy procedure, especially the power to appoint administrators. However, the functions of court are rather uncertain in practice because of the roles adopted by different stakeholders. This lack of certainty has adversely affected the implementation of the bankruptcy law. The following two matters are the clearest examples of this:

A. Many Courts Are Reluctant to Accept Bankruptcy Cases

There are generally two factors making the courts reluctant to accept bankruptcy cases. The first is the government intervention mentioned above. This can affect the court's attitude toward bankruptcy cases. The other factor is the administrative system for evaluating the performance of the courts. The judges in China are categorized as public servants and their performance is evaluated by a quantitative system. The result is that judges are evaluated by the number of cases they try. Bankruptcy cases are generally complex and time consuming with the result that it is possible to try fewer such cases than is the case in other branches of the law.

B. Some Important Bankruptcy Principles Are Abused

The most typical example is the abuse of cram down in the reorganization of listed corporations in China. Up to now, all filings for the reorganization of listed corporations have been accepted and the plans of reorganization have been approved. Even though some of the plans of reorganization have been rejected by creditors or small or medium shareholders, the courts have overruled many of these rejections. Cram down is used so frequently that even though some creditors may oppose the plans of reorganization they tend to be reluctant to raise their oppositions because they anticipate the final result will be cram down anyway. It appears that the major factor which causes the court to use cram down so often is administrative pressure. The problem for the court is that if the listed corporations are liquidated without using cram down, the courts will be blamed for the consequent increase in redundancies and the resultant fall in government income.

The Future

Although the court system of China limits the ability of the courts to play a full role in the conduct of bankruptcy cases it remains possible to make positive changes within the court system. We believe that, considering the existing court system of China, the court will and is able to improve its functions in bankruptcy cases by making changes in two aspects. First, the courts may themselves change their procedures; second, the Supreme Court may make compulsory changes by using its quasi-legislative powers.

The Supreme Court is an important player between the court system, local government and other administrative forces. The local courts and even local government sectors give some deference to the authority of the Supreme Court. For instance, in 2009 when China was hit by the global financial crisis, the Supreme Court issued 14 anti-crisis judicial interpretations or orders. Among these was an order restricting enterprise bankruptcy liquidation. Local courts actively formulated local anti-crisis rules to respond to the Supreme Court.

We have seen some courts taking positive action. For instance, the second intermediate court of Beijing established the first special tribunal to collect experts with bankruptcy expertise and deal with bankruptcy cases before this tribunal. This was self help but that self help may lead others to follow the same approach.

The on going series of judicial rulings made by the Supreme Court will give the local courts good grounds for resuming their conduct of bankruptcy cases. The first part of the series of judicial rulings, "Several Issues in the Application of the Enterprise Bankruptcy Law of PRC (No.1)", was promulgated on September 26, 2011 and came into effect on September 27, 2011. This part specifies the court's power to determine whether the debtor is qualified to enter the bankruptcy procedure taking account of the fact that in practice many local courts have had difficulty applying the tests of whether a bankruptcy order should be made. They hesitate to accept bankruptcy filings without clear evidence in support of those filings.

The role that the courts play in the evolution of China's bankruptcy law is complex and interesting. This article provides a broad description of that role. We shall address it in more details in future publications.

Experiencing the Great Wall – Reorganisations under the PRC Enterprise Bankruptcy Law

Photo: freeimages.co.uk

By John M. Marsden and Phoebe Lo
Mayer Brown JSM
Hong Kong

Those who thought that the implementation of the PRC Enterprise Bankruptcy Law ("Law") would bring about a increase in the number of Chinese bankruptcy cases would be sorely disappointed. Statistics indicate that the number of bankruptcy cases admitted by the PRC courts have been on a steady decline - the number of cases in 2007, 2008 and 2009 were 3817, 3139 and 3128 respectively.[1] Contrasted with the 800,000 business licences revoked each year, it is clear that the vast majority of enterprises are exiting the market without going through proper bankruptcy procedures.

The PRC courts appear to be reluctant to accept bankruptcy cases due to their complexity and time consuming nature. Courts have turned away petitioners by requiring court fees and extensive supporting evidence without following the formal procedures in the Law. It is hoped that the promulgation of the Interpretation (1) of the Supreme People's Court on Several Issues concerning the Application of the Enterprise Bankruptcy Law of the People's Republic of China in September 2011 can give petitioning creditors greater certainty.

There are additional hurdles for reorganisation applications under the Law, with some PRC courts being of the view that only companies which are capable of rescue should be considered for application of the procedure.

Success and Failure

At the outset, industry players should keep in mind that bankruptcies and reorganisations are viewed in the PRC as very much a political issue. The failure of a major business, who often are significant employers, can lead to social unrest. Governments at both local and provincial level often have a vested interest in ensuring any reorganisations (if they are to take place) are speedy and successful, employee claims are settled and the business recommences operations as quickly as possible. Uncooperative creditors "rocking the boat" are not welcomed. Courts are naturally mindful of such concerns.

The majority of successful reorganisation cases relate to "ST companies" - PRC listed companies that have been making losses for a specific period and which are at high risk of being delisted. The local court and government officials are eager to avoid the massive implications for employees and investors arising from the collapse of these companies, and as a result there is a great pressure on these companies to restructure. As of 30 October 2011, 30 ST companies listed on the Shanghai Stock Exchange and the Shenzhen Stock Exchange have undergone reorganisation under the Law.[2]

While hailed as "successful" from the perspective of the company, the outcome of these reorganisations is more doubtful from the perspective of a creditor. In the reorganisation of Shanghai Worldbest Co., Ltd., a ST company whose shares are listed on the Shanghai Stock Exchange, the return for unsecured creditors was only 3.3 A shares valued at RMB4.37 each for every RMB100 of claim at a recovery rate of 14.42%, and cash repayment at a recovery rate of 1.09%. This low recovery rate is far from the exception - it has been suggested that a recovery rate of 10% would be considered on the high end of the scale.[3]

The political nature of corporate reorganisations mean that success often (if not always) hinges on the support of the local government. The management of a failing company will often have strong business and family ties in the region, and enjoy a close relationship with the local government which most foreign creditors or foreign potential investors will find difficult to match. Many will recall the restructuring of Asia Aluminum Holdings Limited, and how Norsk Hydro, a Norwegian aluminium company who was a possible bidder for the business assets, failed to make any offer due to lack of support from the local government officials, who favoured the local investor and did not wish to see the company being acquired by foreigners.

Overall foreign creditors are faced with a general lack of transparency in PRC legal proceedings and potentially hostile attitude of local government officials. This makes restructuring outcomes in the PRC tend to be unpredictable at best.

1 http://www.legaldaily.com.cn/index_article/content/2010-06/26/content_2179993.htm?node=5954
2 Presentation on "An update on the PRC Enterprise Bankruptcy Law", given on 12 October 2011 by Alan C.W. Tang
3 刘宁，《破产法》在实务中的困境与出路——以淄博法院受理破产案件为例

Issues Arising from Cross-border Restructuring

Cross-border restructurings remain a difficult area, not least because of the lack of guidance as to how cases are to be dealt with under the Law.

Article 5 of the Law provides that foreign judgments and decisions in relation to the bankruptcy of a PRC company may be recognised by the PRC courts on the basis of reciprocity based on international treaties and bilateral agreements to which the PRC is a party. This is, however, subject to the exception that the foreign judgment or decision must not be against the fundamental principles of PRC laws, and it must not impair the sovereignty of the PRC, safety and public interest, or the rights of creditors in the PRC. Whether this exception is triggered in a particular case very much depends on the view of the PRC courts. Recognition of foreign insolvency proceedings can therefore be an uncertain matter.

Foreign creditors may face additional difficulties arising from the financing structure of the business. Foreign creditors often lend to an offshore holding company which channels the funds into the borrowers subsidiary operating companies in the PRC. This is no issue when the business is profitable, but once the company enters into a distressed situation, more likely than not, whether through a formal or informal procedure, any proceeds from asset realisations will be used to repay creditors at the onshore level first. This comes about often by actions taken by local governments to protect PRC employee interests. Local governments will often seek orders from PRC courts freezing assets of the insolvent entity.

One way of overcoming the structural subordination issue is to lend at the onshore level, or obtain onshore security, but this may not always be viable.

The Law Going Forward

Forward thinking judges and academics do recognise the existing limitations, and there have been attempts to bring the Law in line with international standards. A notable example is the reorganisation of Zhongheng Holdings Co., Ltd. and its subsidiaries, in which the assets and liabilities of the group were substantively consolidated to overcome difficulties arising from poor corporate governance and to facilitate a fair and speedy return to creditors.

We can hope that with time, the continued efforts of the courts and practitioners in the PRC will bear fruit. In the meanwhile, foreign lenders and investors who are considering entry into the China market during these turbulent times may wish to keep in mind the "Great Wall" that still exists between the insolvency regime in the PRC and the developed jurisdictions.

Potential Issues in Cases of Affiliated Enterprise Bankruptcy and Reorganization in Mainland China

By Helena Huang, Harry Liu and Zhaohui Hao
King & Wood Mallesons
PR China

The Law of the People's Republic of China on Enterprise Bankruptcy (hereafter "Enterprise Bankruptcy Law") has officially come into force. One of the most notable highlights of the new Enterprise Bankruptcy Law, compared to the former law, is the introduction of a reorganisation procedure. Recently, after the implementation of the Enterprise Bankruptcy Law, the PRC courts have heard approximately over 150 reorganisation cases, including many affiliated enterprise reorganisation matters.

"Affiliated enterprise" refers to the combining of different enterprises for specific economic purposes. There exist dominant and subordinate relationship roles between different enterprises. The fundamental character of an affiliated enterprise is that it is an enterprise combination. While each member of the affiliated enterprise possesses its independent legal character, there must be internally connected relationships formed by multiple links between affiliated enterprises.

Reorganization is still a new concept in mainland China. Moreover, due to the complicated affiliated relationships formed by equity control, agreement control and personnel control, etc. between affiliated enterprises, courts have been confronted with various issues when dealing with affiliated enterprise reorganisation cases, including the following:

I. The principle of "substantive consolidation" is not stipulated in the Enterprise Bankruptcy Law. However, courts in practice have already applied the principle of "substantive consolidation" to the affiliated enterprise reorganisation cases, leaving the interests of creditors vulnerable.

The principle of "substantive consolidation" is a rule of equity borrowed from American bankruptcy law. It refers to the consolidation of assets of several independent legal entities of a corporate group in the bankruptcy procedure for the purpose of liquidating all debts together. The application of the substantive consolidation principle in American bankruptcy practice is based on the premise of prudence. This is because the substantive consolidation principle is determined in the light of a comprehensive analysis and examination of related factors after the debtor enterprise has fallen into bankruptcy, which cannot be foreseen by the creditors beforehand. In addition, the independence of a company's legal personality, which is a fundamental principle of company law, also should be respected.

In mainland China, courts have applied the substantive consolidation principle when hearing reorganisation cases, such as in the cases of Guangdong Zhonggu Sugar Group Co., Ltd and its affiliated companies, Hunan Taizinai Biotechnology Co., Ltd. and its affiliated companies, and others. In these cases, the PRC courts consolidated and reorganised these companies and all or some of their affiliated companies. They consolidated the assets of these entities and of all or some of their affiliated corporations, drew up a unified reorganisation plan, and compensated the creditors of those companies and their affiliated companies uniformly with the post-consolidation assets in one reorganization procedure. The following issues arise in practice:

1. There is no unified standard for the application of the principle of "substantive consolidation" by the courts. Instead of acting conservatively in applying this principle, the PRC courts tend to apply the principle liberally in the absence of a uniform standard.

Notwithstanding the crucial role it plays in reorganisation, the principle of "substantive consolidation" should be applied with prudence in consideration of those creditors who rely on the principle of separate corporate personality. Due to the absence of this principle in the Enterprise Bankruptcy Law, there is no unified standard for its application in mainland China. As a consequence, sometimes courts do not apply the "substantive consolidation" principle where needed. On other occasions, they apply the principle when it should not be applied. Some courts have also applied the "substantive consolidation" principle only for their convenience in an individual case. Nowadays, there is a tendency to broaden the application of the "substantive consolidation" principle as part of the process of affiliated enterprise reorganisation in mainland China.

In the reorganisation case of Hualun Group Co., Ltd., the Fuyang Intermediate People's Court in Zhejiang Province found that the prerequisite for applying the principle of "substantive consolidation" existed among Hualun Group Co., Ltd. and its affiliated companies including Zhejiang Hualun Communication Group Joint Stock Limited Compay, Zhejiang Hualun Communication Equipment Installation Co., Ltd., Fuyang Heshan Wire and Cable Co., Ltd., Hangzhou Wangzi Optical Fibre Co., Ltd., and Zhejiang Laite Communication Material Co., Ltd. The court used an alternative doctrine due to the absence of such a principle in the Enterprise Bankruptcy Law. Upon the application of the bankruptcy administrator, the court ordered Hualun Group Co. Ltd. and the aforementioned affiliated enterprises to be treated together in the bankruptcy proceedings under the provisions of the Company Law of the People's Republic of China. The court then continued the subsequent bankruptcy and reorganisation process, treating the post-merged Hualun Group as a new legal entity. Taking account of the circumstances of the Hualun Group and its affiliated enterprises, the court could apply the "substantive consolidation" principle. However, due the lack of explicit law, the court had to adopt an alternative method in order to accomplish the objective of substantive consolidation.

On the other hand, in the reorganisation case of Hunan Taizinai Group Biotechnology Co., Ltd., Hunan Taizinai

Group Supply and Sales Co., Ltd. and Zhuzhou Taizinai Biotechnology Development Co., Ltd., the Zhuzhou Intermediate People's Court in Hunan Province, mainly for its own convenience, ordered these three companies to be consolidated without solid evidence demonstrating that it was appropriate to apply the principle of substantive consolidation. Indeed, in this reorganization case, there were other affiliated companies that were factually in distinct from Hunan Taizinai Group Supply and Sales Co., Ltd. and ZhuzhouTaizinai Biotechnology Development Co., Ltd., such as Chengdu Taizinai Biotechnology Development Co., Ltd., Beijing Taizinai Biotechnology Development Co., Ltd., Hubei Taizinai Biotechnology Development Co., Ltd., and KunshanTaizinai Biotechnology Co., Ltd. Yet, the court did not add these companies into the bankruptcy reorganization procedure. Coincidentally, these companies fell outside the territorial jurisdiction of the Zhuzhou Intermediate People's Court. This further confirmed that the court applied the "substantive consolidation" principle only for the convenience of adjudication.

2. Generally, the courts apply the "substantive consolidation" principle upon the application of the bankruptcy administrator. Creditors do not have the right in law or practice to initiate "substantive consolidation."

In the majority of cases where the "substantive consolidation" principle is applied, the PRC courts' order to consolidate affiliated companies in the reorganization process was initiated upon the application of the appointed administrator, not upon the application of the creditors. Further, before ordering the consolidation of the affiliated companies, the courts did not inquire into the creditors' opinions, leaving the impression that the creditors did not have the opportunity to express their own opinions. After consolidation orders were made, there was also no mechanism or procedure for the creditors to appeal against the making of those orders. In reorganization cases such as Guangdong Zhonggu Sugar Group Co., Ltd and its affiliated companies, Hunan Taizinai Group Biotechnology Co., Ltd. and its affiliated companies, Zhejiang Weier Industrial and Trading Co., Ltd. and its affiliated companies, the courts did not inquire into the stance of the creditors prior to delivering their ruling on consolidation.

II. Given the "Deep Rock Doctrine" is not expressly provided for in the Enterprise Bankruptcy Law, there is the potential for the debtor's affiliated companies (acting as the creditors of the debtor) to exert undue influence on the voting approval process of the draft reorganization plan by taking advantage of the voting mechanism provided for in the Enterprise Bankruptcy Law.

The "**Deep Rock Doctrine,**" also known as Equitable Subordination Rule or Creditors' Right Subordination Rule, is a doctrine established under Anglo-American law. For the purpose of protecting the legitimate interests of the creditors of the subordinated companies from prejudice by the controlling companies, the law provides that during the liquidation and reorganization process of the subordinated companies, creditors' rights over the controlling companies against the subordinated companies, will be subordinated to the satisfaction of other creditors' rights against the subordinated companies.

The Enterprise Bankruptcy Law provides a voting mechanism for approving a draft of the reorganization plan. Specifically, creditors are divided into different groups according to the nature of each creditor's rights. Each group of creditors is deemed a "voting group" for the purpose of the approval process for the draft reorganization plan. Approval of the draft plan will only be effective if approval is given by more than half of the members of a voting group. Additionally, the credit amount represented by those approving members must constitute more than two-thirds of the amount of the whole group.

Due to the absence of rules similar to the "Deep Rock Doctrine" under the Enterprise Bankruptcy Law, where affiliate companies of the debtor are also creditors of the debtor, (which is very common when there are numerous affiliated companies in the reorganization process), these affiliated creditors will be placed into the same voting group as creditors of the same class for the purpose of considering the approval of the draft reorganisation plan. In such circumstances, if the number of the affiliated creditors or the amount owing to them matches the corresponding amounts under the Enterprise Bankruptcy Law, then those affiliated creditors will be able to influence the voting results of the creditors' meeting in passing the draft of the reorganization plan.

This situation actually arose in some reorganization cases in mainland China. For example, when a company enters into the reorganization process, its controlling parent company is its biggest ordinary creditor and the proportion of the creditor's rights owned by the controlling shareholder surpasses two-thirds of all debts held by creditors in the ordinary creditors' group. Hence even if all the other ordinary creditors vote for the draft of the reorganization plan, the draft will not be passed if the controlling parent company voted against it.

III. Enterprise Bankruptcy Law does not provide any special restriction on the exercise of set-off rights between the affiliated enterprises, where this is detrimental to the interests of external creditors.

Even though the Enterprise Bankruptcy Law stipulates three situations where set-off rights cannot be exercised, affiliates of the debtor may continue to exercise such rights in the debtor's bankruptcy.

In cases when subsidiary companies of the affiliated enterprises enter into the reorganization process, the controlling company of the affiliated enterprises enjoys creditors's rights over the subordinated companies. At the same time, the controlling company will be liable to the subordinated companies for the abuse of its controlling status, e.g. by misappropriating funds of the subsidiaries and by using funds to purchase office equipment for the controlling companies. When controlling companies exercise the set-off right, due to the fact that the set-off right as claimed does not fall into the scope of any prohibited situations under the Enterprise Bankruptcy Law, the exercise of that right will nonetheless remain legitimate. In fact, when the controlling company exercises this kind of set-off right and is subsequently repaid in full, the interests of the debtor's external external creditors will already have been prejudiced.

From Territoriality to Limited Universality of the Chinese Enterprise Bankruptcy Law: Thoughts on Extraterritorial Effect on Article 5

By Donggen Xu and **Zoe (Zhe) Qiao**

Shanghai Jiaotong University
Shanghai, PR China

Yingke Law Firm,
New York, USA

The problem of the extraterritorial effect of the Chinese Enterprise Bankruptcy Law concerns interests of foreign investment companies in China as well as that of the Chinese oversees becoming subject to bankruptcy proceedings.

I. Principle of Territoriality and the Typical Case of BCCI Shenzhen Branch

The legal effect of the bankruptcy procedure in China has developed from the principle of territoriality to that of limited universality. The principle of territoriality has been generally accepted by Chinese courts in their treatment of bankruptcy cases involving foreign elements. A typical case was the Bankruptcy of Bank of Commerce and Credit International (BCCI)[1]. BCCI was a major international bank founded in 1972 by Agha Hasan Abedi, a Pakistani financier. The Bank was registered in Luxembourg with head offices in Karachi and London. Within a decade BCCI touched its peak. It operated in 78 countries, had over 400 branches, and had assets worth in excess of US$20 billion, making it the 7th largest private bank in the world by asset class[2]. BCCI opened a branch in Shenzhen in China. Creditors filed numerous lawsuits against BCCI and BCCI became the focus of a massive regulatory battle in 1991. A bankruptcy petition against the BCCI Shenzhen Branch and the commencement of debt repayment was launched by the Bank of China, Shenzhen Branch, as the major creditor. The property of the BCCI Shenzhen Branch, located within the territory of the PRC, was frozen by the Shenzhen Intermediate Court (SIC) on the application of the Chinese creditor.

Under Article 5 of Shenzhen Rules and Article 243 of Civil Procedure Law of the PRC, SIC appointed a liquidation committee to take charge of the liquidation of BCCI Shenzhen Branch. The report completed and submitted by the liquidation committee shows that the aggregate amount of the property of BCCI Shenzhen Branch located within China was about US$20 million, while the liabilities of the BCCI Shenzhen Branch was nearly US$80 million[3]. The frozen property of the BCCI Shenzhen Branch were ultimately distributed among domestic creditors in accordance with Chinese bankruptcy law by SIC, without regard to any other lawsuit against the same defendant in any foreign country. In this case, the approach adopted by the SIC accelerated the rate of payments to Chinese creditors at the expense of giving them a lower recovery rate[4].

It is a paradigm case which demonstrates that the principle of territoriality was accepted by Chinese Courts at an earlier stage in the development of Chinese cross-border insolvency. Chinese creditors involved in this case did not participate in the global BCCI settlement.[5]

II. Article 5 of the Chinese Enterprises Bankruptcy Law and its Interpretation

The principle of territoriality dominated Chinese bankruptcy law and practice for more than a decade until the Enterprise Bankruptcy Law of the PRC came into effect on June 1, 2007. The Enterprise Bankruptcy Law of the PRC, clarified the cross-border operation of Chinese bankruptcy law and practice in respect of the property and assets of the debtor, whether or not located in China.

Article 5 of the above law provides that *"The bankruptcy procedure initiated in accordance with this Law shall be effective in respect to the debtor's property outside the territory of the People's Republic of China."*

The Enterprise Bankruptcy Law also clarifies the legal effect in China of bankruptcy proceedings instituted abroad. This is why, Article 5, Clause 2, provides as follows: *"Where an application or request is filed with a people's court to recognize and enforce a legally effective judgment or order made by a foreign court for a bankruptcy case that involves the property of a debtor within the territory of the People's Republic of China, the people's court shall conduct an examination pursuant to the international treaties China has concluded or acceded to or on the basis of the principle of reciprocity. If the application or request neither violates the basic principles of the laws of the People's Republic of China, nor damages the sovereignty and security of the State or the social public interest, nor harms the lawful rights and interests of the creditors within the territory of the People's Republic of China, the people's court shall make a decision to recognize and enforce the judgment or order."*

1. Legal Effect of Bankruptcy beyond the Territory of the PRC

1 For the story of the Bank of Commerce and Credit International, BCCI, see Joseph Finder, The Worst of All Possible Banks, The New York Times, May 2, 1993.
2 Kanas, Angelos, Pure Contagion Effects in International Banking: The Case Of BCCI's Failure, Journal of Applied Economics, Sunday, May 1, 2005.
3 See Xu Donggen, Advanced Course of International Financial Law, University of International Business and Economics Press, 309 (2009).
4 See Dr. Shi Jingxia, Chinese Cross-Border Insolvencies: Current Issues and Future Developments, 2006-5-5, http://ielaw.uibe.edu.cn/html/wenku/falvyingyu/20080505/8886_7.html.
5 For commentary on the global settlement about BCCI's bankruptcy, see Christopher K. Grieson, Shareholder Liability, Consolidation and Pooling, in Current Issues in Cross-Border Insolvency and Reorganization, E. Bruce Leonard and Christopher W. Besant (edited), 220-225 (1994); See also Christopher K. Grieson, Insolvency of Financial Institutions, 5 Int'1 Bus. Lawyer, 213 (1996).

Photo: freeimages.co.uk

Under Article 5 Clause 1 of the Enterprise Bankruptcy Law, the extraterritorial effect of Chinese bankruptcy law is described as follows:

(1) The assets of the bankrupt are not limited to the property of the debtor located within the territory of the forum. They extend to the property of the debtor located outside China;

(2) All debtors of the debtor, including overseas debtors of the debtor, shall repay their liabilities to the debtor's bankruptcy committee;

(3) Any settlement concluded in relation to the debtor overseas without regard to any bankruptcy proceedings of the debtor in China shall be void and of no effect.

2. Effectiveness of Judgment made by foreign Court in the Territory of the PRC

Under the second Clause of the Article 5, the Peoples' Court may recognise foreign judgments or orders in respect of the property of a debtor in China.

A foreign judgment or order should meet the general and the specific requirements of the Civil Procedure Law of the PRC. The legal effect of a foreign judgment or order shall be recognised if that foreign judgment or order meets the conditions set by the Chinese law as prescribed by the People's Court. The property of the debtor located within the territory of the PRC should be dealt with together with the property of that debtor subject to bankruptcy proceedings commenced in relation to that debtor overseas. All property of that debtor should then be distributed *pari passu* to its creditors.

Under Article 5 Clause 2, the people's court shall conduct an examination of the foreign judgment or order by reference to to the international treaties China has concluded or acceded to or on the basis of the principle of reciprocity. If the recognition application or request neither violates the basic principles of the laws of the People's Republic of China, nor damages the sovereignty and security of the State or its public policy, nor harms the lawful rights and interests of the creditors within the territory of the People's Republic of China, the people's court shall enforce the judgment or order. The purpose of Article 5 Clause 2 is to protect Chinese national sovereignty.

III. From Territoriality to the Limited Universality: the Concerns of Article 5

The location of assets of a Chinese company both in China and abroad reflects the increasingly international nature of Chinese business. The question of whether or not to give effect to overseas rulings is thus an important matter for the Chinese legislature.

Failure to deal with overseas judgments and assets of a debtor subject to Chinese bankruptcy proceedings would seriously dilute the effect of those proceedings.

A foreign judgment or order shall be recognised and enforced by the People's court, where that judgment or order has not prejudiced the legitimate rights and interests of creditors of the debtor domiciled in the territory of the People's Republic of China. The treatment of the bankruptcy of the BCCI Shenzhen Branch would have differed materially, had Article 5 of the Enterprise Bankruptcy Law of 2006 been in effect at that time.

Article 5 of the Enterprise Bankruptcy Law gives effect to the principle of limited universalism, as against either the territoriality or universality. A Chinese bankruptcy will apply to the property of a debtor abroad and bankruptcy proceedings in respect of a debtor abroad may be recognised in China by order of the People's Court.

Equality or Disparity Between Foreign Creditors and Chinese Creditors?

By David Kidd and **Kathleen Wong**
David Kidd & Co
Hong Kong, PR China
Allen & Overy LLP
London, UK

When the People's Republic of China Enterprise Bankruptcy Law (the PRC Bankruptcy Law) came into effect on June 1, 2007, scholars and practitioners alike were quick to point out many areas of uncertainty but one point has always been clear: there is no distinction between treatment of the claims of a foreign creditor and a Chinese creditor. The same regime applies, regardless of nationality and location. There were some doubts as to whether this principle would be observed in practice, but foreign creditors of debtors in China were reassured by the outcome of the FerroChina case.

FerroChina, a Bermudan steel manufacturer listed on the Singapore Stock Exchange, owned various operating companies in Jiangsu, China. FerroChina had taken on significant offshore and onshore debt to finance its expansion and, when the global financial crisis hit in 2008, it could no longer repay its debts when due and its directors fled the sinking ship. The insolvent Chinese operating companies underwent a formal reorganisation process under the PRC Bankruptcy Law. Within a year, a reorganisation plan was agreed among the creditors and sanctioned by the court. The approved plan provided for a distribution to the creditors on the basis of whether a claim against the Chinese subsidiaries was secured or unsecured. It was irrelevant whether that creditor was Chinese or foreign. However, creditors who had lent to offshore members of the FerroChina group were left out of the reorganisation plan which only provided for recovery among creditors of the Chinese subsidiaries. Offshore creditors ranked with the onshore companies' equity and there was no surplus available after the settlement of onshore debts.

Photo: freeimages.co.uk

Considered to be the first real test under the Bankruptcy Law, the FerroChina case both confirmed the equal treatment of foreign creditors and Chinese creditors and served as a stark reminder to foreign financiers of the risks of lending offshore. The key to equality in China is not whether a creditor is Chinese, but whether the debt claim is against the enterprise that is going through the bankruptcy proceeding in China. The value of recovery is dictated by structure, not nationality, but it is easy to see why these two issues are often confused.

China's foreign exchange controls restrict the ratio of foreign debt that a company in China can have in relation to its equity. This in a large part drives the majority of foreign investment into China to be made by way of offshore financing to the offshore parent, which in turn channels the funds into its Chinese subsidiary through an equity injection or a shareholder loan. Foreign investors are also more comfortable with lending into jurisdictions where the legal system is tested, stable and predictable and where the insolvency laws are more than five years old.

In these offshore financings, creditors will typically take security over the equity interest of the offshore company and the onshore operating company. Due to restrictions under PRC law, the onshore company's assets in China cannot be used as security for their parent's offshore debt. When distress hits, creditors in the offshore financing will often find themselves with limited enforcement rights, a lack of control over the onshore assets and little influence over any onshore bankruptcy process. This is not to say however that these offshore creditors have no leverage whatsoever.

The PRC Bankruptcy Law entitles a holder of more than 10 per cent of the debtor's registered capital to apply to the Court to convert a bankruptcy liquidation process into a reorganisation process, which aims to rehabilitate the business. Offshore creditors with security over the shares of the onshore holding company may enforce that security and appoint a receiver or a liquidator to the offshore holding company. The receiver or liquidator may then take steps to gain recognition in China as a shareholder representative of the Chinese subsidiary. If successful, it can play a formal role, as shareholder, in the bankruptcy proceedings in China. In any case, by taking either or both enforcement and insolvency action offshore, the creditors can create sufficient noise and cause enough of a shake-up that the onshore players have little choice but to take note.

China Sun, a corn starch manufacturer, defaulted on around USD100 million of offshore bond debt.

Unsuccessful negotiations with bondholders went on for months. Bondholders lost patience and took enforcement action. They enforced the offshore security over shares of the offshore holding companies and started provisional liquidation proceedings in the Cayman Islands. They changed all the directors and management offshore, and they began to take steps to do the same at the onshore level. The bondholders had made themselves heard and negotiations started to take a different course. Bondholders eventually received 36 cents on the dollar – not an entirely bad result considering that at the outset of negotiations, China Sun's best offer was 10 cents on the dollar now and 10 later.

Foreign investors have in recent years actively looked for alternative financing structures in an effort to improve their recovery rates. Some investors, to the extent they have onshore lending licenses, have made a small loan directly to the Chinese subsidiary, in addition to the main financing to its offshore parent. The onshore loan is made as a defensive move which enables foreign investors to take security over the onshore assets of the Chinese subsidiary (but only to secure the onshore loan), so preventing to an extent adverse dealing with such assets and ensures them a place at the negotiation table as creditors of the Chinese operating company when distress hits. Other investors have granted offshore financing, backed by standby letters of credit issued by Chinese banks or foreign banks with branches in China.

Structuring solutions remain limited however given the prevailing regulatory controls in China. There has been some relaxation of the Chinese regulatory regime in the last couple of years, but mostly to help Chinese companies in their campaigns to invest abroad. Fundamental changes to the financing structures adopted by foreign investors so as to obtain closer access to the sources of cash should things go wrong will not be possible until policy and law makers in China agree to open up the borders to a free flow of foreign exchange. In the meantime, foreign investors are taking greater steps to build in control and monitoring rights into their deals. Some investors appoint co-signatories to offshore and onshore bank accounts of their borrowers and their Chinese subsidiaries. In other cases, company seals (known as "chops") are kept under escrow by agents appointed by the financiers. The board of directors of the Chinese companies may also include nominees of the foreign investors.

These practical measures do not eliminate the inequality arising between the creditors of the offshore company and the creditors of the Chinese company when the Chinese company goes bankrupt, but by gaining greater visibility of the operations in China, the offshore creditors are aiming to have sufficient notice and information to deal with any signs of financial difficulty before it becomes too late and avoid bankruptcy altogether in the first place.

RICHARD TURTON AWARD 2012

Richard Turton had a unique role in the formation and management of INSOL Europe, INSOL International, The Insolvency Practitioners Association and R3, the Association of Business Recovery professionals in the UK. In recognition of his achievements the four organisations jointly created an award in his memory. The Richard Turton Award is an annual award providing an educational opportunity for a qualifying participant to attend the annual INSOL Europe Conference.

In recognition of those aspects in which Richard had a special interest, the award for 2012 was open to applicants who fulfilled all of the following:

- Work in and are a national of a developing or emerging nation;
- Work in or be actively studying insolvency law & practice;
- Be under 35 years of age at the date of the application;
- Have sufficient command of spoken English to benefit from the conference technical programme;
- Agree to the conditions below.

Applications for the award were invited to write a statement detailing why they should be chosen in less than 200 words. A panel representing the four associations adjudicated the applications. The panel members are as follows: Stephen Adamson – INSOL Europe, Neil Cooper – INSOL International, Patricia Godfrey – R3 and Maurice Moses – IPA. The committee received an outstanding number of applications of exceptional quality for the award this year and it was a very close run decision as the standard of applicants was superb. We are delighted that the award has attracted such enthusiasm and response from the younger members of the profession and know that Richard would also be extremely pleased that there had been such interest.

The Committee is delighted to announce that the winner is Edvīns Draba from Latvia. Edvīns currently works for Bunkus Law Firm as an associate. He gained his Master's degree in Law at the University of Latvia, Faculty of Law. Edvīns is highly involved in the activities of the Association of Latvian Certified Insolvency Proceedings Administrators and has also contributed an article to Eurofenix and assisted with the glossary of insolvency terms for Latvia for INSOL Europe.

As part of the award Edvīns was invited to attend the INSOL Europe Conference held on the 11-14 October 2012 in Brussels, Belgium. He will be writing a paper that will be published in summary in one or more of the Member Associations' journals and in full on their websites. We would like to congratulate Edvīns fōr his excellent application and also thank all the candidates who applied for the award this year. There were many excellent submissions and the judges task was particularly difficult this year.

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Prior to the main Congress the INSOL Academics Group will meet on Saturday and Sunday for a full two-day programme. Additionally there is a dedicated Insurance Insolvency Ancillary Programme on Sunday. The Tenth Multinational Judicial Colloquium held jointly with UNCITRAL and The World Bank will also take place on the 18th & 19th May 2013. This is a closed meeting for judges, regulators and judicial officials. Details of this meeting can be requested from Penny Robertson at pennyr@insol.ision.co.uk

On Sunday afternoon there will be an open committee meeting for smaller practitioners affording the opportunity to meet early on at the Congress and a dinner for smaller practitioners will also be hosted for those who wish to attend on Monday evening. The Younger Members Committee is hosting a lunch on Tuesday and members interested in attending can contact **dorothy@insol.ision.co.uk**

Fellows of the Global Insolvency Practice Course are also holding a function kindly sponsored by RESOR NV. More details of this will be sent directly to the Alumni. The Fellowship Alumni goes from strength to strength with each qualifying class and we have over sixty Fellows now active in the Alumni. They will have their own exhibition stand at INSOL 2013 where you can meet some of them and learn more about the Global Insolvency Practice Course. If you cannot wait that long we can put you in touch with a Fellow to learn more about the course, as applications are now being taken for the Class of 2013. Module A next year takes place prior to the Congress and the participants of the course then join the Congress.

The technical programme of the Congress is well under way with the Technical Chairs and session chairs now working out the detail of the individual sessions. It looks to be a very exciting programme, especially with our showcase film *A tale of two businesses one good….one bad….* Casting for the actors is nearly complete and the film will be recorded in November. As we wish to maintain the element of surprise with regard to the film it's a closely guarded secret as to the detail and those involved but it will be an excellent focal point for the Wednesdays proceedings.

We are considering providing a conference App for delegates and have just surveyed the delegates who attended INSOL Miami to get a view from them as to whether this would have been useful.

A description of an App is a mobile application that can be downloaded on to your Smartphone or iPad in order that you don't have to carry huge piles of paper with you at the conference. A conference App would provide you with all the details that appeared in the final delegate A5 folder you received in Miami, in addition the extra papers that were available on the CDROM. Some Apps are live and need internet connectivity but our first stage App would not require this as it could be downloaded to your Smartphone in advance. If you have a view on INSOL producing an App please let Heather Callow know at **heather@insol.ision.co.uk**

We would like to take this opportunity to thank the INSOL 2013 Technical Committee for their hard work in devising the programme and their ongoing involvement in the planning.

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Register now to attend the Congress to guarantee your place and take advantage of the early booking rate and please also book your hotel room at one of the three Congress hotels, before they sell out.

The three hotels are the Steigenberger Kurhaus Hotel, the Bel Air Hotel or the Novotel Den Haag. More details about the hotels can be found on our website. We look forward to seeing you all in The Hague next Spring!

With thanks also to our main sponsors for their support:

Legal Analysis on the Bankruptcy Rectification Of Chinese Listed Companies

By Zhaoxin Geng[1]
Beijing C&H Law Firm
Beijing, PR China

One of the important differences between the Law of the People's Republic of China (the "P.R.C.") on Enterprise Bankruptcy implemented as from June 1, 2007 (the "Enterprise Bankruptcy Law"), and the repealed Enterprise Bankruptcy Law, is that the Enterprise Bankruptcy Law has adopted a bankruptcy rectification procedure. Since the bankruptcy rectification procedure came into implementation, the bankruptcy rectification of listed companies has become a "hot" subject.

It is reported that, as from the implementation of the Enterprise Bankruptcy Law, there have been around thirty listed companies, which have gone into the rectification procedure: five of those have completed both debt rectification and asset rectification, eighteen are in the process of asset rectification, and five are in the process of debt rectification. (Liu, 2011) This article discusses the principal factors and issues involved in the rectification procedure for listed companies.

Essential Factors

There are three decisive factors which will contribute to the successful completion of the bankruptcy rectification procedure: finding the reorganization party; formulating a draft rectification plan; and the approval of the draft rectification plan. Usually, the bankruptcy custodian will look for a reorganization party who intends to achieve a reverse merger with capital and/or profitable assets. This will substantially improve the repayment ability of the reorganised company. The adjustment of capital contributors' rights and interests and the debt settlement plan are the two essential plans of the draft rectification plan.

In practice, the main element of the adjustment plan for capital contributors' rights and interests is the percentage of shares to be released by each shareholder to the reorganization party in exchange for its capital and profitable assets. Here, the support of the major shareholders is the determinative factor. For example, the top three shareholders of *ST Xin'an (*ST 000719) controlled 28.99%, 28%, and 5% of the company's shares. Under its rectification plan, the compromised percentages of these major shareholders respectively are 70%, 67%, and 50%, as compared with a 15% compromised percentage for the public shareholders. (Xin'an, 2008) Since the plan required a two-third vote by the shareholders, and the major shareholders controlled 62% of the shares, the rectification plan was easily adopted.

The design of the debt settlement plan is also of great importance. Generally speaking, all debt settlement plans must protect employees' rights as well as the rights of creditors with collateral, and provide for the payment of outstanding taxes. The rectification plan will also provide for a debt write off that is acceptable to unsecured creditors. The (partial) statistics currently available give the average return to unsecured creditors as no more than 20%. (Yao, 2011) To ensure that the debt settlement plan can be approved smoothly by each voting group of the creditors, especially the unsecured creditors' voting class, a debt settlement plan must be drafted with the objective of obtaining the support of at least 1/2 of the creditors who are owed at least 2/3 of the total debt.[2]

The adoption of a rectification plan will only be the first step on the road leading to the renaissance of the restructured company. The success of reverse merger and private placement are important and pricing will be a determinative factor in this. According to the document *Supplementary Provision on Pricing Shares Issued in the Material Asset Rectification of Bankrupt Listed Companies for Restructuring*, as from November 12, 2008, two-thirds or more of the voting rights shall approve the price of the issued shares. It changed the original regulation that rigidly required the price of the issued shares should be linked to the market price that normally went up after the reorganization news was released. Therefore, this approval threshold helps the restructured company and the reorganization party reduce the reorganization cost.

Related Issue

Unsuccessful Restructuring

Under the provisions of the Enterprise Bankruptcy Law, where a restructuring plan fails to be adopted, the court may terminate the process the procedure and declare the debtor insolvent. However, no detailed regulations have been formulated to guide a listed company through the bankruptcy liquidation procedure. This has created a legal vacuum between the Enterprise Bankruptcy Law and securities legislation. As at the date of this article, no listed company restructurings have failed.

Information Disclosure

Presently, there are no unified regulations or court opinions with respect to when and what information should be disclosed to non-creditor stakeholders including but not necessarily limited to the potential reorganization parties, and the creditors of the shareholders or the creditors of the restructured company. However, since these stakeholders have no right to participate in the reorganization procedure under the Enterprise Bankruptcy Law, they should consider imposing a duty to disclose on their debtors via agreements.

Mandatory Approval

In certain circumstances, the Enterprise Bankruptcy Law allows the court to approve a rectification plan even though creditors and in particular unsecured creditors have not voted in favour of it. In such cases, the court can approve the plan, in its discretion, based on the particular situation of each case.

The Supreme People's Court of China, the China Securities Regulatory Commission, and other relevant authorities are currently in the process of formulating a set of jointly issued legal interpretations to fill the legal vacuum between the Enterprise Bankruptcy Law and securities legislation, to facilitate the debt restructuring of listed companies, and to improve the certainty of the process for all stakeholders.

1 The author wishes to thank Professor Guy Padula of Temple University LL.M. Beijing Program for his advice with English editing.
2 Article 84 of the Enterprise Bankruptcy Law provides that, "where at the creditors' meeting 1/2 or more of the creditors in the same voting class representing 2/3 or more of the debtor's total liabilities vote in favour of the restructuring plan, they shall be deemed to have adopted it."

Closing out ISDA Contracts: a Practical Guide

By Kingsley Ong
Eversheds
Hong Kong
and
Jonty Lim
KPMG
Hong Kong

Introduction

Despite global efforts, the 2008 financial crisis seems far from over. Since the collapse of Lehman Brothers, the world of derivatives trading has attracted unprecedented attention. Although this financial crisis was primarily attributed to unsound lending practices, securitisation, collateralised debt obligations (CDOs) and derivatives (especially credit default swaps or CDS) have been widely blamed for spreading the losses much further than would otherwise have been the case.

It is estimated that the notional amount of over-the-counter (OTC) derivatives contracts currently stands at about US$648 trillion (i.e. 43 times the size of annual US GDP). Unsurprisingly, regulators around the world are concerned about the size of the OTC derivatives market and its adverse impact to the systemic stability of the global financial system. For example, a European credit event could easily trigger a domino default across the global financial system causing a catastrophic collapse. In many jurisdictions, legislative process is underway to enact regulatory reforms for OTC derivative trading, although this ex post facto effort cannot resolve the existing crisis.

The standard form ISDA Master Agreement (which comes in either the 1992 or 2002 versions) remains the pre-eminent market standard contract used to document OTC derivative transactions. It is becoming increasingly essential for insolvency professionals to be familiar with closing out ISDA contracts. This article provides a general overview of the process and common pitfalls in 10 basic steps.

1. Collect and review all relevant documentation

Before making any decision (e.g. whether to terminate an ISDA contract), it is important to understand your legal position. The first and most important step is to collect all the relevant documentation in order properly to ascertain your rights.

Documents include:

- The ISDA Master Agreement;
- The Schedule to the ISDA Master Agreement;
- All transaction confirmations;
- Any credit support documentation;
- Any other agreements that affect the terms of the ISDA Master Agreement; and
- Any amendments, supplements or restatements in respect of any of the above.

2. Events of Default and Termination Events

Next, determine if any Event of Default or Termination Event is applicable (s. 5 and 6 of the ISDA contract, as amended or supplemented). Look for any applicable conditions (e.g. grace periods) to close out as well. Insolvency is an Event of Default under s.5(a)(vii) of the ISDA Master Agreement.

(a) Automatic Early Termination ("AET")

Check if AET is applicable - if so, your contract may have already terminated (even without your knowledge). If you are unsure of the Early Termination Date or find that the date is unfavourable, speak to your counsel.

(b) Designation of Early Termination Date

Where an Event of Default has occurred and is continuing, and AET does not apply or has not been triggered, the Non-defaulting Party may give notice to designate an Early Termination Date with respect to all outstanding Transactions.

If you are the Non-defaulting Party, refrain from rushing to designate an Early Termination Date. Seek counsel's advice about the most optimal termination date as well as rights to withhold payment in the meantime.

If you are the Defaulting Party (e.g. if acting for an insolvent estate), unless your counterparty is also in default, the ISDA Master Agreement does not give you any right to terminate the contract.

(c) Anti-Deprivation Rule

Note that s.2(a)(iii) of the ISDA Master Agreement allows the Non-defaulting Party to suspend its payment and delivery obligations under the ISDA contract if the Event of Default is ongoing. Non-defaulting Parties may indefinitely delay termination especially if they are out-of-the-money under the contract. In such event, creditors of an insolvent estate would be effectively deprived of the benefit of a valuable in-the-money ISDA contract. This controversial effect has been the subject of recent litigations around the world. The outcome is conflicting: the US court held that these contractual provisions violate US bankruptcy law; whereas the English court upheld these ISDA provisions. For more information, see: Kingsley Ong, "The ISDA Master Agreement: Insolvency Stalemate and Endgame Solutions for Hong Kong Liquidators" *(INSOL World, 2011 Q1, p. 14)*.

(d) Notice Requirements

If you are entitled to terminate the ISDA contract and you wish to do so, and your chosen event requires a notice to be issued, ensure that any notice you give is in accordance with s.12 of the ISDA Master Agreement (as amended). This is usually considered a clerical process where quite often, amateurish errors are made. Mundane errors like whether the notice should be in writing, sent by courier, etc may render the notice invalid. The content of the Notice is also important and should contain sufficient and correct information. Notices rendered invalid due to ambiguous references and clumsy mistakes could be very costly.

3. Recovery - Enforcing security/guarantee

Under the ISDA credit support documents and any

guarantee, you may be entitled to enforce security over all posted collateral or call on the guarantee. Check if the conditions for enforcement are met.

4. Determine Termination Payments

If you have a 1992 ISDA contract, check which prescribed methodologies should be used: Market Quotation or Loss, and First Method or Second Method. The 2002 ISDA contract only provides for the Close-out Amount methodology.

(a) Market Quotation

If you are the Determining Party, seek exactly four quotations from four Reference Market-makers. If a Reference Market-maker does not provide a quotation, do not seek further quotations - otherwise your counterparty may accuse you of picking the four best quotations out of many.

The Market Quotation for each Terminated Transaction or group of Terminated Transactions is determined according to the number of quotations obtained (as set out in below table).

Number of Quotations Obtained	Determination of Market Quotation
Four	Average of remaining two quotations after highest and lowest quotations are discarded
Three	The remaining quotation after highest and lowest quotations are discarded
Two or that Fewer	Fallback to Loss because it will be deemed Market Quotation cannot be obtained

If you believe that Market Quotation would not produce a "commercially reasonable result", then you may elect to use the Loss methodology instead. This is a call that should be exercised judiciously (especially during periods of market stress).

(b) Loss

Loss is the amount required to put the Determining Party in the position that it would have been in had the contract been performed.

(c) Close-out Amount

The Close-out Amount is the sole methodology provided in the 2002 ISDA contract. The Close-Out Amount is intended to reflect the losses or costs/gains to the Determining Party in replacing or providing the economic equivalent of material terms of the Terminated Transactions and the options rights of the parties in respect of the Terminated Transactions under the prevailing circumstances.

If unsure, seek counsel for advice on what may and may not be included in the determination of Loss and Close-out Amount.

5. Determine interest on Unpaid Amounts

Unpaid Amounts accrue interest on every day elapsed from the date when the relevant amount should have been paid. The applicable rate for such interest depends on your particular situation and your version of the ISDA contract. Seek counsel to ensure that the correct rate of interest is applied.

6. Conversion to Termination Currency

If any amount of Loss, Market Quotations, Unpaid Amounts and Close-out Amounts are not denominated in the Termination Currency (specified in the Schedule), such amounts should be converted into the Termination Currency.

7. Adjustment for Bankruptcy

Where AET applies, s.6(e)(iii) of the ISDA Master Agreement permits adjustments to the amount due in respect of the close-out for payments or deliveries made during the period between such Early Termination Date and the date on which the close-out amount is due.

8. Set-off

Set-off can be used to reduce the amount owed by either party. The 1992 ISDA contract does not expressly allow a party to set-off payments due on close-out against any sum that is due under another agreement (but check if any set-off provision is provided in the Schedule).

The 2002 ISDA contract expressly provides for set-off of the close-out amount to take place at the option of the Non-defaulting or Non-affected Party. If the exact amount of your obligation is unascertained, you may make a good faith estimate for applying set-off provided you account to the other party once that exact amount is ascertained.

The laws applicable to set-off are complex as there are many factors that could affect the ability to effect a valid set-off, including conflict of laws issues. Before attempting to exercise any right to set-off, seek counsel's advice.

9. Calculation statement

Each party must prepare a calculation statement of the close-out amounts payable in reasonable detail, and provide this to its counterparty. This should be done "on or as soon as reasonably practicable following the occurrence of an Early Termination Date".

If you are the Non-defaulting Party, remember to include all reasonable out-of-pocket expenses (including legal fees, execution fees and stamp duty) incurred in enforcing and protecting your rights under the ISDA contract. Seek counsel to ensure your calculation statement is in your best interest.

10. Payment date

The amount calculated in respect of a close-out is payable:

(a) in the case of an Event of Default, on the date on which the calculation statement is effective and;

(b) in the case of Termination Event, two Local Business Days following the date on which the calculation statement is effective.

Interest will accrue on this amount from the due date until such payment is made. Reasonable expenses incurred by a Non-defaulting Party after the due date may also be recoverable.

Conclusion

Given market volatility in the current economic climate, mistakes and delays can be costly. By its nature, derivatives are complex financial instruments and dealing in derivatives contracts generally require specialist knowledge. The information contained in this article is intended for general guidance purposes only and should not be regarded as a substitute for taking professional advice. The views expressed in it are personal to the authors and do not necessarily represent the views of the institutions that they are associated with.

China Enterprise Restructuring Regime and Preservation of Shell Resources

By members of Deloitte China

headed by Edmund Yeung and Derek Lai
Hong Kong

General Descriptions of China Enterprise Restructuring Regime

The Enterprise Bankruptcy Law of the People's Republic of China became effective on June 1, 2007. It was approved by the Standing Committee of the National People's Congress on August 27, 2006 after a long period of deliberation.

The new Enterprise Bankruptcy Law ("New Law") has replaced the PRC State Enterprise Bankruptcy Law (Trial Implementation) ("Old Law"). It offers a unified bankruptcy regime for enterprises with legal person status i.e. both state-owned and privately-owned companies, including foreign investment enterprises.

The New Law, which is more detailed than the Old Law, contains concepts similar to the bankruptcy regimes of many developed countries and has been expected to move China's law closer to that of other market economies.

The New Law has introduced a restructuring or rehabilitation mechanism. This could benefit companies with underlying viable businesses that require temporary protection from creditors. The debtor may apply to court for permission to continue to manage its business under the supervision of an administrator, or the administrator may manage the property and affairs of the debtor.

The administrator or debtor is required to submit a restructuring plan to the court and a meeting of creditors should take place within six months.

If a restructuring is permitted by the court, an automatic moratorium will prevent secured creditors from realizing secured assets during the restructuring period, although secured creditors may apply to court to be exempt from the moratorium if their secured assets would otherwise be at risk, or suffer from a fall in value.

Shell Resources, the Very Purpose of Enterprise Restructuring

The term "Shell resources" broadly refers to certain qualifications possessed by an enterprise such as brand, sales network, special operating licenses, and listing status. Their maintenance is dependent on the enterprise continuing in existence and not being dissolved. These intangibles have a value (because of the costs incurred in their creation or acquisition or because of scarcity or the presence of restrictions which prevent others obtaining the subject qualifications). That value may be realized if these intangibles can be transferred to a purchaser.

The establishment of brands, sales networks and reputations can take years. Their destruction may take place in days. Sometimes, enterprises have competitive advantages arising out of their own operations; these may comprise their own people and practices. The "death" of the enterprise may in turn eradicate these advantages.

It is not unusual for restrictions to be imposed on the issuance of special operating licenses for certain businesses or industries or for their operation in designated locations. Such licenses may not be transferable from one enterprise to another, but an enterprise which owns a special operating license may continue to hold it even though the enterprise itself has changed hands.

The lengthy time and onerous requirements placed on an enterprise wishing to go public have led to consideration of using the reverse takeover route as a simpler means of achieving the same end. In China, policy factors are influential in determining the process of obtaining approval for enterprises to go public. A number of listed companies appear to have been maintained more for the sake of resale than for pursuing their own existing businesses. For example their trading prices may not appear to reflect the present or future value of their existing businesses or assets. Trading prices may appear instead to depend upon rumours or plans for the development of the business.

As a result, it can be argued that the very purpose of enterprise restructurings is the preservation of shell resources. In other words, it is the pursuit of shell resources that drive enterprises in trouble towards restructuring rather than towards liquidation or dissolution. Hence the higher the value of relevant shell resources, the higher will be the incentive to seek to 'restructure' an enterprise.

Listing Status as One Typical Kind of Shell Resource

While the total number of bankruptcy cases in China continues to fall below the numbers expected when the New Law was launched, the New Law does provide a court-sanctioned route for enterprise restructuring where consulting with, and obtaining approval from each and every single creditor on a restructuring scheme, may be impracticable. This has been particularly the case in relation to listed companies where preservation of listed status has been an end in itself.

Nevertheless, use of the New Law has not been entirely without incident. Remarkably the law courts and the China Securities Regulatory Commission ("CSRC") are responsible for the different elements of a restructuring. The principles they adopt may differ. In particular, local law courts implement restructurings by reference to the procedures set out in the Bankruptcy Law. The CSRC by contrast relies on the Securities Law and Administrative Measures in relation to the Acquisition of Listed Companies, resulting in a lack of clarity in some cases.

Under Article 87 of the Bankruptcy Law, the courts may at their discretion sanction a restructuring plan (which may include certain 'major' acquisitions and/or disposals), notwithstanding that certain groups of stakeholders (including shareholders) fail to support certain resolutions. In such cases, restructurings may proceed, provided that certain subjective criteria are met. Examples are proof that the terms of the restructuring or business plan must be "fair and impartial."

Some express the view that, in addition to the subject company and its creditors, shareholders should be empowered to make applications on bankruptcy restructuring under Article 70 of the Bankruptcy Law.

Practitioners continue to await the formulation of new

rules for the restructuring of listed companies.

Case Study – Beisheng

Guangxi Beisheng Pharmaceutical Co., Ltd. ("Beisheng") was principally engaged in the production and distribution of pharmaceuticals. On November 27, 2008, the local law court ordered the company to be restructured on the application of two creditors. The court appointed a liquidation committee, members of which comprised government officials and professionals, to act as the Restructuring Administrator.

Beisheng had assets as at November 27, 2008 with an appraised value of RMB950 million. The liquidation committee admitted 235 claims with liabilities in a total amount of RMB1772 million, including secured liabilities and preferential claims in a total amount of RMB732 million and unsecured liabilities in a total amount of RMB1040 million. The total amount of the unsecured liabilities increased to 1195 million after taking account of the unsecured portion of secured liabilities (based on an appraised value of relevant assets). The estimated recovery to unsecured creditors was 27.43%.

On December 29, 2008, the creditors of Beisheng approved in a meeting the restructuring plan that had been prepared by the liquidation committee. On December 30, 2008, the local law court sanctioned the restructuring plan and stipulated that the restructuring period should run from January 1, 2009 to October 30, 2009. Under the restructuring plan, unsecured creditors with claims below RMB50,000 would be fully paid. The recovery to unsecured creditors with claims over RMB50,000 would be improved to 50.44% through the grant of 91 million new shares in the company, in addition to cash from the proceeds of asset disposals.

On October 28, 2009, the liquidation committee filed with the local law court a supervision report reporting on the implementation of the restructuring plan. On October 29, 2009, the local law court ordered that the liquidation committee be discharged.

On August 14, 2009, the Administrator, among other things, announced progress with asset realizations under the restructuring plan. He also announced, with regard to the resumption of the company's listed status that he was in discussion with a shortlist of possible strategic investors. On January 20, 2010, the company announced details of a major acquisition of 100% of the interest in Zhejiang Joy on Real Estate Co., Ltd. ("Joy on"), which had a market value of RMB3510 million. The announcement stated that if the acquisition were completed the then shareholders of Joy on would obtain 75% of the increased share capital of Beisheng.

On August 30, 2011 the company announced that it had received notice from the relevant government authority that the company's assets injection plan, involving real estate assets, did not conform to the government's current macro control measures. On October 21, 2011 the company announced that it had withdrawn its proposed assets injection plan for Joy on.

The lessons to be drawn from this case in relation to Chinese restructurings are as follows:

i. Government involvement. 11 of the 13 liquidation committee members came from the government or regulators, including the chairman who was then Deputy Mayor of Bei Hai City. The company was formerly controlled by a local entrepreneur, He Yu-liang, who passed away in April 2008. Since then, a number of transactions in relation to the restructuring have proven to be questionable.

ii. Pre-pack. The whole process from the filing of an application for bankruptcy restructuring was filed with the court to the formulation of a restructuring plan by the liquidation committee appeared to have been "pre-packed". This was because all elements of the plan appeared to have been well-coordinated.

iii. Divide-and-conquer. Judicial approval from the court and administrative approval from the regulator (CSRC) were not aligned. The debt burden was firstly removed through a court sanctioned restructuring plan. Revitalisation of businesses through proposed asset injections and corresponding new share issues to be approved by CSRC was delayed until a later stage. As a result, creditors had to compromise their debts as the value of shares to be granted to them under the debt equity swap was highly uncertain.

iv. The criteria for regulatory approval will be dependent upon government policy of the day.

The story has not come to an end. On February 23, 2012 the company announced that it had agreed to enter into a major asset restructuring transaction with Zhejiang Topoint Photovoltaic Co., Ltd. ("Topoint"). It had been rumoured that Topoint was aiming to use Beisheng as a listed shell to float its solar businesses). Nevertheless, on September 25, 2012 the company announced that, due to unfavourable global conditions affecting the solar industry and a decrease in revenue, its discussions with Topoint would terminate.

If Beisheng fails to revitalize its businesses whether through a suitable asset injection or otherwise, its shares will be delisted. The 91 million new shares received by unsecured creditors two years ago on the implementation of the court-sanctioned restructuring plan and on which unsecured creditors have relied to improve their estimated recovery from 27.43% to 50.44%, will be nullified.

INSOL Africa Round Table 2012

By Adam Harris
Bowman Gilfillan
Cape Town, South Africa

"The policy makers are in fact actively listening to the ongoing debate, and are taking the issues on board". This comment by the Solicitor General in the Ministry of Justice of Zambia, Mr Musa Mwenye, characterised the success of one of the main aims of the INSOL Africa Round Table (ART) project. It elevated the ART from being merely a discussion forum, to being a knowledge resource for the participant jurisdictions regarding best practices for the Region.

ART 2012, supported by the World Bank Group, was extremely successful, attended by more than 70 delegates representing more than 20 jurisdictions from across the African continent. This project has grown in stature, and is now firmly entrenched.

The meeting was opened by the Attorney General of Kenya, Professor Githu Muigai. He spoke in strong support of the aims and importance of the ART, particularly taking account of the fact that on that very day two major bills – a new Insolvency Bill and a new Companies Bill – were to be introduced to the Kenyan Parliament. Amongst other reforms and innovations, the Attorney General reported that a form of business rescue was to be introduced as part of the new legislation. The ART project, focusing on "best practices" was therefore extremely well timed.

The Deputy Solicitor General in the State Law Office in Kenya, Ms Christine Agimba, reported that the Kenyan Government had considered the international regimes of amongst others the UK, Australia, Canada and New Zealand, and she expressed the view that the ART was extremely useful in observing African experiences. It was, as Ms Agimba put it, an opportunity to interrogate regional best practices with a view to designing legislation that fitted within the intended context.

Ms Agimba expressed concerns which were echoed by other speakers about IPs maximising fees and eventually "leaving for dead" the business that they were supposed to be administering. The regulation and licensing of IPs was important, and it was essential to ensure a minimum level of professional standards. Thus, training institutions had to be made to create programmes for skills development with a view to ensuring that there would be a professional group of insolvency practitioners. For this reason, the ART, which was intended to draw out and highlight experiences in other African jurisdictions, was extremely valuable.

The importance of converging best practices with their implementation in the African context was dealt with by the Registrar General and Official Receiver in the State Law Office in Kenya, Ms Bernice Gachegu. Ms Gachegu emphasised the need to modernise and to improve insolvency practice. In a phrase often quoted by speakers thereafter, her view was that "one size fits all" did not apply in the insolvency context. However, the approach of punishing, embarrassing and stigmatising debtors in the insolvency process was seen to be inappropriate. Modification and reform of the insolvency laws would be necessary.

Ms Gachegu noted that although there had previously been little emphasis on the reform of commercial laws in Kenya, this had now gained momentum. The new insolvency bill introduced a company voluntary arrangement procedure, along with the concept of administration. The insolvency practitioner would be required to be qualified and the aim of the legislation was to "help the profession to clean up its act". Challenges to implementation were, amongst other things:

- Legislating for a modern insolvency legal framework;
- The acceptance of that framework by society;
- Explaining to stakeholders how the system would function;
- Ensuring that the laws were passed by Parliament and then establishing the institutions necessary to implement them;
- The presence of sufficient legal and economic expertise to implement the new regime.

The role of the IP was one of the most regularly revisited topics throughout the ART. Fidelis Oditah QC of 3-4 South Square, London, in an interactive session, took the lead in viewing the IP as the key, in whatever framework he or she operated. It was essential to ensure that the IPs were in terms of objective and verifiable criteria, suitably qualified and had basic skills in:

- Knowledge of procedure;
- A minimum experience threshold;
- Personal attributes such as integrity;
- Suitability for their tasks;
- The physical capacity to be able to deal with matters entrusted to them;
- Independence in the matter; and
- To have acquired the confidence and the trust of all stakeholders.

The pivotal role of the Courts and the time taken to resolve matters was another key aspect of best practice identified at the ART, and Justice Daniel Musinga of the Commercial Court in Kenya gave the background to the establishment and functioning of the Commercial Court, which had been

Mahesh Uttamchandani, World Bank Group and Adam Harris, INSOL Board Director

Some of the ART attendees

particularly successful in reducing the backlog of cases. Judge Musinga emphasised the need for specialised knowledge and training in this field. Additional training would be required once the new Kenyan legislation became law.

The session dealing with the deployment of alternative dispute resolution (ADR) in facilitating informal corporate workouts was moderated by Fidelis Oditah QC who pointed out the advantages of such workouts not being constrained either by the Courts or by statute but only by the "imagination and expertise of the participants". Some of the advantages of ADR were in regard to the speed with which matters could be attended to, the lower cost and concomitant higher recovery. Judge Geoffrey Kiryabwire, Head of the Commercial Court in Uganda, emphasised the need to reform insolvency laws, and reported that the Ugandan courts had in fact adopted and embraced ADR. But, to ensure that the settlement be given efficacy, it was possible to immediately have the settlement made a judgment of the court.

The ART achieved particular success attributable in part to two major factors - the quality of the speakers and panels which led the discussions, and the debate and interaction amongst those who attended. Judging from the attendance, the stature of the participants, the quality of the presentations and the enthusiasm of the debate, there is no doubt that the INSOL ART has been firmly established as an important mechanism to facilitate interaction and debate. The theme of the INSOL ART 2012 in dealing with various aspects of best practice was both timely and appropriate. As the one session was aptly named – the project has become "a state of ART".

Panellists of the "Building institutional, technological and human capacity" session

INSOL INTERNATIONAL ACADEMICS' GROUP

Academic Steering Committee

In accordance with the planned rotation of membership of the ASC, some of the founding members of the committee have retired following the Miami conference. As we welcome the new members to the committee – Professor Lienne Steyn, Dr Juanitta Calitz, Professor Adrian Walters and Bob Rajan, it is appropriate to thank the retiring members – Professor Paul Omar and Professor Charles Booth – for their valuable contribution to the success of the Group's activities over the past three years.

15th Colloquium of the Academics' Group
The Hague, May 18-19, 2013

Call for Papers

Arrangements are in place for the Group's 15th colloquium to take place in The Hague on the weekend preceding the main INSOL Congress, which will be the ninth of the quadrennial international congresses that mark a high point in the INSOL cycle of events. In planning for the Group's meeting, we have identified several topics around which we hope to build an attractive and stimulating programme. We warmly encourage members to contact the Chairman, at their earliest convenience, with proposals for papers which they would be prepared to deliver at the colloquium, and which would correspond to one of the following themes.

Topics for Consideration:

- Revision of the EU Insolvency Regulation.
- New ideas and emerging best practices in the treatment of individual insolvency (including, but not limited to: issues concerning consumer bankruptcy; court-based versus administrative procedures; repayment plans – vices and virtues).
- Secured transactions: perils and pitfalls.
- Sovereign debt in the 21st Century: challenge and response.
- Special focus on Eastern European insolvency issues.
- Joint session with the INSOL Fellows and participants in the GIPC course in 2013 (see below).
- Research Forum (see below).
- Caribbean Insolvency Issues.

Following the successful experiences of our last two colloquiums, we are also planning to devote a session of the programme to a joint meeting with the participants on the INSOL Global Insolvency Practice Course, at which INSOL Fellows who have successfully completed the GIPC in previous years will join in presenting papers on agreed topics.

Once again there will be a session entitled "Research Forum", providing an opportunity for those currently undertaking a research project (including PhD students currently engaged in Doctoral studies) to deliver a brief account of their work, and to generate discussion. Please contact the Chairman if you wish to be included in the arrangements for this session, or if you are supervising a PhD student who could speak about his/her research in progress.

In addition to the subjects listed above as potential themes to be included in the colloquium programme, the chairman is happy to consider offers of papers on other themes for possible inclusion. Offers of joint papers are also very welcome. Please make contact i.f.fletcher@ucl.ac.uk

Quasi-insolvency Proceedings for Non-merchant Individuals

By
Stathis Potamitis
(Fellow, INSOL International),
Ioannis Kontoulas and
Eleana Nounou
POTAMITISVEKRIS
Athens, Greece

The Greek Insolvency Code has always applied to merchants, whether individuals or legal entities. Individuals other than merchants (and similarly other persons who are not involved in commercial activities, e.g. not-for profit entities) are unable under the Greek law to escape the trap of insolvency and to manage their debts.

The current brutal economic crisis in Greece has made the need for such legislative intervention all the more pressing. A combination of declining income and mounting interest rates, combined with the absence of new consumer credit has left many middle income families unable to meet their debts as they fall due.

Faced with these external pressures in 2010, the Greek Parliament introduced (Law No. 3869/2010, as amended by art. 85 of Law No. 3996/2011) certain protective measures for individuals facing financial distress. Should debtors' estates, as well as their current and foreseeable income, be insufficient for the satisfaction of their creditors' claims, non-merchant individuals may agree to the partial payment of their debts on favourable terms. Debtors will then be discharged from all their remaining debts provided that they honor their obligations under their repayment plan or any corresponding court decision.

Any non-merchant debtor who is genuinely unable to meet its financial obligations as they become due and payable (a test identical to the insolvency threshold as established by the Greek Insolvency Code) may benefit from the protection introduced by the aforementioned law.

The law provides relief against all types of debts, both present and future, excluding debts incurred within one year prior to the filing of the petition for the debts' settlement. There is also relief from debts attributed to intentional wrongdoing, fines and penalties imposed by public authorities, state taxes and contributions owed to social security organisations.

An individual seeking relief under these provisions must first attempt an out-of-court settlement with its creditors. The establishment of such an obligation has raised concerns for some researchers and legislators, given that in the vast majority of cases, credit institutions seem reluctant to reach an out-of-court settlement with their debtors. It has been maintained by some that the pursuit of such a settlement imposes an unjustified financial burden on the debtor as well as a further delay to the procedure and Hence, the abolition of this debtor's obligation has been argued as being of the paramount importance.

In other cases, there are significant grounds for both debtors and creditors to exploit the out-of-court settlement phase. The reason for doing so is that the new law enables debtors to conclude more flexible arrangements with creditors. They may agree on lump sum payments, they may reduce debt by providing guarantees and they may protect assets of the debtor by means not available outside this legislation, Debtors may also avoid any further costs associated with the judicial procedure. Even if debtors violate an agreed upon out of court arrangement, they are not restricted from repeating the process since the law explicitly provides that only judicial debt settlement or discharge is available once. Creditors may obtain swifter repayment of their debts and they may obtain a higher level of repayment than would otherwise be possible.

A creditor may within six months following the failure of any attempt to reach an out-of-court settlement file a petition for the settlement of its debts before the Magistrates' court of the district in which the debtor has its habitual residence.The petition must include information relating to the debtor's property, the debtor's current and foreseeable income, as well as the income of the debtor's spouse. The petition must also contain a list of all creditors of the debtor and the sums owed to the debtor, divided into principal, interest and expenses, as well as a debt arrangement plan that will reasonably match creditors' interests with the debtor's assets, income and marital status.

An individual debtor may file a petition for the imposition of a moratorium on all enforcement rights and remedies of creditors against it. The moratorium will last until the order on the petition for the settlement of debts is granted. As soon as the Court imposes a stay, any disposal of the debtor's estate is precluded.

The debtor must serve the petition on all creditors. This can be costly in Greece and may thus render the procedure less attractive to insolvent individuals. A less expensive alternative (i.e. the establishment of a reduced bailiff's fee when compared to the service of other legal documents) is possible. Service of a petition does not stop interest accruing on secured claims (contractual interest rather than default interest applies). For unsecured claims, by contrast, interest ceases to accrue from service of the

petition. Within two months of the service of the petition, creditors may consent to the plan or expressly reject it. The statute creates a non-rebuttable presumption of consent to the plan by those creditors who failed promptly to provide comments on the plan.

The Court will ratify the plan as filed or as amended if no creditor opposes the plan or all creditors either explicitly or implicitly consent. The court will also ratify the plan if creditors representing the majority of debts, including all secured creditors' claims and creditors representing the majority of debts attributed to labor claims either explicitly or implicitly, consent to it.

Alternatively, the Court will determine a compromise plan, taking into consideration the debtor's assets, current and potential income, possible spousal contributions and the needs of individual debtors and their respective families. Subsequently, the Court will order the making of monthly payments to the creditors for a period that may not exceed 4 years. All creditors' claims rank equally. If the debtor has immovable property that may be liquidated, the Court will appoint a liquidator and it will order the realisation of the debtor's estate. In such an occasion, secured creditors' claims are treated as priority claims. Following the settlement of secured creditors' claims, unsecured creditors will rank *pari passu* for payment of the sums owed to them.

An important innovation under Greek law in comparison to corresponding foreign legislation is a provision where the debtor may seek relief from the sale of the family home, in which case the Court will order the monthly payment of an amount that may not exceed 85% of the market value of the family home. These payments cannot be made for periods in excess of 20 years. This 20 year payment schedule will start following the lapse of the four-year period, described above. The preservation of the family home does not discharge the debtor of his or her debts. It also does not prejudice creditors' rights as the debtor will end up 'repurchasing' the family home on more favorable repayment terms.

In exceptional cases, the Court may discharge the debtor from all payments. From time to time, the Court may re-evaluate the debtor's assets and income and amend its decision.

The Court will absolve the debtor from all remaining debts, if he or she fulfills his or her obligations under the ratified plan of reorganisation or the court decision establishing a four-year payment schedule and the twenty-year payment schedule for preservation of the family home. This release from liability applies in respect of all creditors who fail to renounce their claims. However, if the debtor fails to make the payments prescribed by the plan for three consecutive months, creditors will again be able to enforce their original claims. The Court's decision to release the debtor from all liabilities is subject to appeal.

The statute contains no provisions for the imposition of a stay on creditors' enforcement measures absent a decision of the Court of Appeal, if the Magistrates' court rejects the debtor's petition. This will leave the debtor exposed to recovery proceedings by individual creditors. Another issue that has raised concerns and may be the subject of legislative amendment is the stay on creditor enforcement actions against the debtor's family home.

The purpose of insolvency is the collective satisfaction of creditors through the liquidation of the debtor's estate or the continuation of the debtor's business. The statute seeks to mitigate the adverse consequences of insolvency by achieving the social and economic reincorporation of the debtor, through writing-off debts that the debtor would otherwise be unable to pay.

The statute provides a means for resolving the problems resulting from the expansion of consumer credit in Greece, made more acute by the economic crisis. That has in turn resulted from many Greek individuals taking out loans and other types of credit bearing high interest rates. The law does not endeavour to broaden the scope of insolvency in this manner. It seeks to apply various insolvency-related techniques to redress the usual balance of power between consumers and banks, taking account of the fact that both consumers and banks are currently suffering from the effects of the global economic crisis. Although the legislature may develop a more comprehensive insolvency regime for non-merchants, its focus at present would appear to be on assisting individuals within the context of the current economic crisis, while minimally benefitting banking institutions.

Fellow of INSOL International

International Association of Restructuring, Insolvency & Bankruptcy Professionals

Congratulations to Class of 2012!

INSOL International is pleased to announce the fourth graduating class of the Global Insolvency Practice Course. The successful participants are now formally recognised as a Fellow, INSOL International.

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The Global Insolvency Practice Course is the pre-eminent advanced educational qualification focusing on international insolvency.

With the fast growing number of cross-border insolvency cases and the adoption in many jurisdictions of international insolvency rules and provisions, the turnaround and insolvency profession faces increasing challenges in the current economic environment. The current outlook demonstrates that the practitioners of tomorrow need to have extensive knowledge of the transnational and international aspects of legal and financial problems of businesses in distress.

The format of the fellowship programme is intensive, carried out over three modules. The first module was held in London from the 16-18 January at University of London. The second module took place in Miami from the 18-20 May 2012, prior to the INSOL annual conference. The last module involved the students utilizing web enabled technology which included a virtual court and undertaking real time negotiations for a restructuring plan involving multiple jurisdictions. The platform for this module was made available through the generous support of the University of British Columbia, Vancouver, Canada. A number of senior judges from around the world took part in Module C in order for the participants to gain experience of court to court situations. The judges included The Hon. Robert Drain, US Bankruptcy Judge, Southern District of New York; Sir David Richards, Justice of the High Court, Chancery Division, Royal Courts of Justice, London; The Hon. Judge Sidnei Beneti, Superior Court of Justice, Brazil; The Hon. Judge Rares, Federal Court of Australia: The Hon. James Farley, retired, Ontario Superior Court of Justice (Commercial List), Toronto, Canada; The Hon. Judge Eberhard Nietzer, Heilbroon Bankruptcy Court, Germany.

Admission to the course is limited to a maximum of 17 candidates each year. This ensures academic excellence and the opportunity for good personal contact between students and faculty. Potential candidates must already hold a degree or equivalent to be considered for this programme and must have a minimum of 5 years experience in the field. Participants represent the different jurisdictions of the world.

A video of testimonials from both participants and lecturers can be viewed on our web site **www.insol.org**
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COMI Confusion – The Imperative for Model Law Clarification

By Scott A. Atkins
Fellow, INSOL International
Henry Davis York
Sydney, Australia

This year marks the 15th anniversary since adoption of the UNCITRAL Model Law on Cross-Border Insolvency.[1] As the Model Law has passed its infancy and is now well into adolescence, it is tempting to honour this milestone with a monumental review of its success, replete with a cornucopia of superlatives. The Model Law deserves as much. At the simplest level, the impact it has had in facilitating the efficient recognition of foreign insolvencies in courts around the globe entitles it to celebratory praise, effusive and abundant in its terms.

The Model Law and its core conceptual framework have seamlessly entered the lexicon of cross-border practitioners globally and with homogeneity. It would be the envy of international agencies in their quest to harmonise other cross-border laws outside the realm of insolvency. And in the best traditions of 'timing is everything', the foresight of UNCITRAL and the Model Law's architects was prescient and impeccable, leaving a sufficient period for it to be tested and to mature before the emergence of the current pandemic of unprecedented economic challenge and distress.

But a more meaningful contribution on this milestone is to advance an argument for revision of the meaning of COMI. 'Centre of main interests' is perhaps the single most important precept of the Model Law and its operation. Unfortunately, its lack of definition has induced a disproportionate contribution to the volume of judicial consideration and academic and practitioner commentary. It is a shackle upon the Model Law's ability to achieve its laudable goals of promoting and facilitating international judicial co-operation, efficient administration of cross-border insolvencies, facilitation of business rescue and the protection of debtors' and creditors' interests.[2] Worse, it may give credence to the stance of UN Member States who have failed to adopt the Model Law and who rely upon its perceived shortcomings – to their discredit – in justifying their position.

Cross-border insolvency enthusiasts will confidently recite Article 16(3) of the Model Law. In the absence of proof to the contrary, the debtor's registered office, or habitual residence in the case of an individual, is presumed to be the centre of the debtor's main interests. It follows under Article 17(2) that a foreign proceeding will be recognised as a foreign main proceeding if it is taking place in the State where the debtor has its COMI or a foreign non-main proceeding if it has only an establishment rather than its COMI in the foreign State. And it is Article 20 which provides the imperative for divining the location of the debtor's COMI, as it prescribes the automatic effect and potential range of powerful relief which may be conferred by the court upon recognition of a foreign main proceeding.

The essential complaint about COMI is that the presumption in Article 16(3), in the absence otherwise of a sound definition, has resulted in the development of an inconsistent and unpredictable approach to determining a debtor's COMI. In determining the location of a debtor's COMI in circumstances where it is alleged to be somewhere other than the place of registration, courts have focused on various different factors thought to be relevant to the rebuttal of the presumption. And what has emerged is a cacophony of disparate factors, with a discernible absence of any one factor or factors which is consistently determinative of COMI. That is despite the imperative in Article 8 when interpreting and applying the Model Law: it calls for regard to be had not only to its international origins but also to the need to *promote uniformity* in its application. It is also important to note that the concern here is not in respect of the diversity of approach to interpreting COMI consequent upon the different forms of the Model Law adopted across twenty Member States. Rather, it is a concern as to the range of meanings which have proliferated as a result of the definitional and interpretive vacuum within the Model Law and the Guide to Enactment.

Space does not permit an analysis jurisdiction by jurisdiction, but a review of the approach to COMI by Australian courts over the past two years illustrates the point. The Federal Court of Australia first considered the appropriate test for COMI in an application for recognition of a corporate debtor's foreign main proceeding in *Akers v Saad Investments*.[3] Justice Rares opined that COMI in Australia will be determined by having regard to objective ascertainable factors known by third parties concerning the debtor.[4] In this way, the court can avoid the unnecessary untangling of numerous transactions, whose true position may not be known for many years, determine applications efficiently and in a timely manner upon filing and thereby reduce the costs involved. The court expressly adopted the principles in *Re Eurofoods IFSC Ltd*[5]and *Re Stanford International Bank Ltd*.[6] The Court expressly rejected the approach adopted in the seminal decision of *Re Bear Stearns (in prov. liq.)*,[7] as such an

1 The Model Law text is available at www.uncitral.org/uncitral/en/uncitral_texts/insolvency.html
2 See the Preamble to the Model Law and Article 1
3 *Akers v Saad Investments Co Limited (in official liq)* (2010) 118 ALD 498; [2010] FCA 1221
4 [2010] FCA 1221 at [49]
5 [2006] Ch 508
6 [2010] 3 WLR 941; [2010] EWCA Civ 137
7 (2008) 389 BR 325

approach does not foster speed and efficiency in dealing with recognition applications and in many circumstances leads to an increase in costs to the parties. The court observed in *Saad*, however that "the question as to what is a COMI is by no means settled".[8]

Track forward less than two years. The Federal Court of Australia had cause again to consider the meaning of COMI in *Gainsford, in re Tannenbaum v Tannenbaum*[9]. The question in that Model Law recognition application (which, incidentally, failed) was whether Mr Tannenbaum's COMI was South Africa, being the jurisdiction of his bankruptcy. The bankruptcy trustee relied upon Article 16(3) and contended that the bankrupt's COMI was presumed, in the absence of proof to the contrary, to be his habitual place of residence. Justice Logan provides a comprehensive and useful review of the development of habitual residence (with particular reference to its usage in international conventions) and of the development of COMI in the context of applications for recognition concerning individuals (with useful guidance drawn from relevant New Zealand authority).[10]

But here is the rub. Whilst Justice Rares in *Saad* relied upon objective ascertainable factors known by third parties concerning the debtor, Justice Logan in *Tannenbaum* expressed deep concern that, "fundamentally, to treat criteria which go to how a debtor presents its/him/her self to the outside world as a factor carrying determinative weight, as opposed to being relevant, in the determination of COMI would be to violate the principles of interpretation"[11] which naturally flows from "an objective examination of the whole of the evidence". In other words, the Court in *Tannenbuam* found reliance upon objective ascertainable factors known by third parties (that is, the *Saad* test) as an unsound and unreliable basis for the determination of a debtor's COMI. Rather, a preferred approach is for "the inquiry as to COMI [to be] a broad, factual one".[12]

The Model Law's further development and utility would be prejudiced if its application in myriad circumstances globally became frustrated by an abandonment of the presumption as to COMI in preference for a regressive "broad, factual" analysis on each occasion that a recognition application came before a court. That outcome would be inconsistent with the speed and efficiency of determination that the Model Law promotes.

It is therfore reassuring that the imperative to consider reforming the Model Law's treatment of COMI is the central concern of the ongoing work of UNCITRAL's Working Group V (Insolvency Law). The Working Group most recently addressed issues concerning the Model Law and in particular COMI at its forty-first session earlier this year.[13] In short, the Working Group's focus is on clarifying a number of the concepts used by the Model Law through amending the Guide to Enactment of the UNCITRAL Model Law on Cross-Border Insolvency.[14] The Guide to Enactment is a key tool, often cited by judges as a tool in aid of the Model Law's interpretation.

The Working Group has observed that the presumption in Article 16(3) has given rise to considerable commentary in relation to the proof required to rebut the presumption as to the location of a debtor's COMI.[15] (It must, however, be recognised that while there is a diversity of approach to the determination of COMI, a distillation of the decided cases suggests that objective ascertainment by third parties dealing with the debtor at relevant times has emerged and solidified as the touchstone for determining the location of COMI.[16])

The recommendations arising from Working Group V provide encouragement that the COMI quagmire may soon be an historical antecedent of the Model Law's growth pains as it matures through its adolescence. There is much to commend in the suggestion of Working Group V to revise the Guide to Enactment to reflect the following principal factors, when considered as a whole, to ascertain whether the location in which the proceeding has been filed is the debtor's COMI, namely:

- the location is readily ascertainable by creditors;
- the location is one in which the debtor's principal assets or operations are found; and
- the location is where the management of the debtor takes place.[17]

These will be the factors which the court will need to take into consideration if it determines that there is proof to the contrary to the presumption in Article 16(3). It must be emphasised that this enquiry is activated only when the presumption fails. And it must be further emphasised that the scheme of the Model Law is underpinned by an imperative for speed of recognition and efficiency, so any tinkering, however well intentioned, must not result in courts being deflected into inquiries as to matters tangential or irrelevant.

Finally, and while making observations of the Model Law's evolution on the occasion of its 15th anniversary, it behoves us that a comment is made about the Model Law's adoption generally. The UN has 193 Member States.[18] There are unquestionably many critically important initiatives of the UN – particularly focused around peacekeeping, conflict prevention and humanitarian assistance – which rightly deserve priority in their implementation and pursuit – both by the UN and its Member States.

Yet during a time of systemic global economic crisis of unprecedented proportions, never has the imperative for nations to have effective and robust insolvency systems – equipped with a capacity to deal with cross-border insolvencies - been so compelling. Hence the adoption of the Model Law in only 19 of 193 Member States[19] – less than 10% – is unacceptable in today's global economy .

It is in the interests of the continued growth of both mature and developing economies that there be a recognised and harmonious system to deal with cross-border insolvencies. At the bare minimum, professional associations of INSOL domiciled in UN Member States should be among the most active in supporting their nation's endeavours to adopt the Model Law.

8 [2010] FCA 1221 at [32]. Space does not permit a fulsome discussion but see further Ho, LC (General Editor), Cross-Border Insolvency: A Commentary on the UNCITRAL Model Law (3rd ed, Globe Law and Business, 2012) at pp.200 - 206
9 [2012] FCA 904
10 [2012] FCA 904 at [36] to [45]
11 [2012] FCA 904 at [46]
12 [2012] FCA 904 [46]
13 Report of Working Group V (Insolvency Law) on the work of its forty-first session (New York, 30 April – 4 May 2012), United Nations Commission on International Trade Law A/CN.9/742; Insolvency Law – interpretation and application of selected concepts of the UNCITRAL Model Law on Cross-Border Insolvency relating to centre of main interests (COMI), United Nations Commission on International Trade Law A/CN.9/WG.V/WP.103 and WP.103/Add.1
14 www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model.html
15 Note 13 above, WP.103/Add.1 at para. 123B
16 Note 13 above, WP.103/Add.1 at para. 123G
17 Note 3 above, A/CN.9/742 at para. 52 (123F) and 53
18 www.un.org/en/aboutun/index.shtml
19 www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html

Crises Trigger Solutions

By members of the "Second Chair of Economic Law II" headed by Carlos A. M. Ferrario[1]

School of Economics, Universidad de Buenos Aires
Buenos Aires, Argentina

Experience shows that in times of crisis, the persons most affected by them seek and take measures to mitigate those aspects of the crisis which are most detrimental to them. That is, perhaps, a reflex reaction, resulting rather from the survival instinct than from rationality.

Economic and financial crises invariably produce social unrest. They affect everyone, directly or indirectly, who live in the place where such crises occur. Those affected by economic fallout will seek to mitigate the effect of those crises. The loss of employment and thus social esteem is often the most significant consequence. It can destroy the confidence and self esteem of those who lose their jobs as a result of the economic turmoil.

In 2001 and 2002 Argentina underwent a profound institutional, economic and financial crisis that was acknowledged by the National Government and which prompted the passing of emergency legislation to address it.

The crisis had a strong impact on companies, many of which lost their capital, substantially increased their liabilities and had great difficulty selling their products on account of the substantial false in demand that resulted from the crisis.

These matters led to the reorganisation or bankruptcy of many companies.

In many cases employees actually took over the factories of such companies, beginning a practice of seeking to preserve the underlying business in order to secure their employment. Though open to criticism in normal times, these attitudes were tolerated, under certain conditions, by the commercial courts (in bankruptcy cases) and by the national and provincial governments.

Employees organized workers' cooperatives to carry out these operations. This gave rise to the – mainly – so called "Recovered Factories Movement", a Non-Governmental Organization (NGO) which worked to reopen over one hundred factories taken by the workers.

As often happens with economic events, the laws which give a legal framework to them were enacted after the occurrence of these events.

Thus and taking into account several legal antecedents which addressed the continuation of the operations of a bankrupt company (Law 18832 –year 1970–, Law 19551 –year 1972– and Law 24522 –year 1995–), in 2011 Law 26684 was enacted. This provision makes some reforms of workers' rights with particular regard to the position of rhose employees of a company that continues in business after bankruptcy and workers' cooperatives.

Law 26684, despite its defects, fall outside the scope of this article makes it possible for the employees of a bankrupt company to manage that company.

Law 26884 implemented a regime which permits a company to continue in business after its bankruptcy. The purpose of this regime is to facilitate the disposal of the company as a going concern.

Hence the legislature provides that in the cases when employees, organized as a cooperative, express their intention to continue with the operations of the company, the views of those employees must be taken into account.

This legal reform represented an exception from the general principle of bankruptcy, the principal purpose of which is to liquidate a company's assets and distribute their proceeds proceeds pari passu. As a matter of fact, the principal purpose of bankruptcy purpose was to liquidate the company as soon as possible, save for those cases those cases in which for the sake of improving the value of the company on sale, its continuation was ordered.

The spirit of Law 26684 by amending section 190 is to give priority to achieving the survival of the bankrupt company through the establishment of a workers' cooperative established by former employees.

Law 26684 thus seeks to reconcile the interests of: a) of the workers in keeping their source of work, and b) of the creditors in the liquidation of the assets so as to maximise the prospect of creditors recovering sums owed to them (the sale of the company as a going concern should make it it possible to obtain a higher return to creditors).

Most of the provisions of the Law are the product of judicial experience, which sought to achieve a practical solution of the issues facing financial creditors and other stakeholders in a distressed business.

In effect, during the crisis of the 80's, (while that was not as deep as the 2001 recession) employees' claims were addressed judicially. The courts facilitated employees taking over the management of distressed co operatives. One example was "Artes Graficas Crufer" handled in Commercial National Court. This started as a court appointed cooperative which continued to operate a

[1] Authors: Former Judge Carlos A. M. Ferrario (Chairman), Judge Jorge S. Sicoli, Judge Fernando Javier Perillo, and Court Secretary Guillermo M. Pesaresi.

printing house until it was sold. In the case of "Frigorífico Yaguané", the cooperative "Tra.fri.ya ltda.", ran the plant following its appointment by the court.

Since the 2001 crisis, judges have allowed the development and survival of cooperatives in continuing the operation of companies in a broad range of circumstances. This has enabled workers' efforts to establish and run co operatives in a broad range of circumstances.

So great was the support of co operatives that in the well known case of "Comercio y Justicia Editores S.A.", the courts authorised the direct sale of the assets of a bankrupt undertaking to a workers' cooperative organized by about 70% of the former employees of the company.

In the case of "Adzen S.A.C.I.F.", a lease agreement was entered into by a bankrupt company with a cooperative seeking to continue the business of the debtor. This happened even though the co operative did not fully adopt the obligations of the debtor under the lease. The same happened in the case of "Enrique Sanz".

In the case "Cerámica Cuyo SA" the rules regarding lease and bankruptcy were reconciled and the cooperative was permitted to lease the property, until its sale. The court acknowledged the temporary and interim nature of such arrangements. This was because the ultimate purpose of a bankruptcy is to liquidate the assets of the debtor, so as to distribute the proceeds of sale to the debtor's creditors in accordance with bankruptcy rules.

In the "Industrias Ganaderas Inga" case, the following circumstances led to the lease of the premises of a bankrupt company to its employees: a) the cooperative was duly registered, and taking active steps to obtain governmental support (declaration of municipal interest, subsidies, guarantees); b) the former employees of the bankrupt (and members of the cooperative) showed their effort and interest in keeping their livlihoods and in reaching a bankruptcy agreement providing for full payment; c) the cooperative purchased the insurance required by the court, filed budgets for the appropriate expenses and provided evidence of the support of potential customers, d) several sale auctions had failed previously on account of the lack of bidders, and e) expert evidence was tendered in support of the feasibility of the project.

The reported cases made it possible to enact the amendment made by Law 26684, which operates on three levels: the first being the participation of the workers – whether creditors or not – in the control of the handling of the reorganization and bankruptcy proceedings through their participation in the steering committee; the second one being the amendment of provisions supporting the operation of co operatives, and the third being the creation of a wide range of provisions giving workers co operatives flexible powers to purchase the business of a bankrupt company.

The first matter, that is to say the participation of a representative of the workers appointed by them, to control the proceedings, does not seem to be more effective than the control by creditors (without workers), set forth in the prior legislation. In practice, the original law worked effectively on the rare occasions on which it was applied because of the apathy of the creditors it was supposed to protect.

The second matter is the participation of the workers in a workers' cooperative who may apply for the continuation of the operations of the company.

Until the reform of the law, the continuation of the company was the exception rather than the rule. prior to its reform, the law operated more often than not as an accelerated liquidation procedure.

In contrast, company rescue now occurs where the failure of the company could lead to a material fall in the realiseable value of the company's assets. It is also said that in any bankruptcy where the continuation of the company's operations by a workers' cooperative has been ordered, the State must give the co operative the technical assistance it needs to continue the company's business.

Another change made by the new law is the requirement to recognise workers' cooperatives formed by two thirds of the company's employees for the continuation of the company, based on the need to preserve its business or to facilitate its disposal as a going concern. The genesis of this provision lies in the section 190 of the old law. This already provided for recognition, albeit in limited grounds.

Workers' co-operatives may also buy a company out of bankruptcy or where a "cramdown" plan fails. The greatest weakness of the reform lies in the ability of the co-operative to buy the company in a cramdown, offsetting against the purchase price employee claims arising both before and afer the cramdown.

While Law 24522 contains several means for preserving the operations of a bankrupt company, the procedure does not prevent the State from appropriating the assets of the company to facilitate its continuation. The State may do this to further the public interest.

The state may exercise these appropriation powers to maximise the realisation of the company's assets. For instance, Law 1253 of the City of Buenos Aires, declared to be for public benefit the temporary occupation a real property owned by a bankrupt, to be used for a period of two years for the development of sports, recreation and cultural activities open to the community by a civil association. This meets the public interest requirement set out in section 17 of the Argentine Constitution.

To conclude, the courts' role is to police the operation of these legislative provisions and ensure that they are given effect in a manner that reflects the public interest. This is a fundamental aspect of the operation of these provisions in a modern democracy.

Conference Diary

February 2013				
6-8	TMA Distressed Investing Conference	Las Vegas, NV	TMA	www.turnaround.org
20-12	Personal Property Security Law: Local and Global Perspectives	Adelaide, Australia	University of Adelaide	www.law.adelaide.edu.au/events
20-22	ABI VALCON 2013	Las Vegas, NV	ABI	www.abiworld.org
March 2013				
13-15	INSOL New Zealand Annual Corporate Insolvency Conference	Auckland, NZ	INSOL New Zealand	sian.abel@lexisnexis.co.nz
April 2013				
18-21	ABI Annual Spring Meeting	National Harbor, MD	ABI	www.abiworld.org
May 2013				
19-22	INSOL 2013 Ninth World International Quadrennial Congress	The Hague, The Netherlands	INSOL International	www.insol.org
June 2013				
13	INSOL International Sao Paulo One Day Seminar	Sao Paulo, Brazil	INSOL International	www.insol.org
July 2013				
11-13	ABI Northeast Bankruptcy Conference	Newport, Rhode Island	ABI	www.abiworld.org
18-21	ABI Southeast Bankruptcy Conference	Amelia Island, FL	ABI	www.abiworld.org
September 2013				
25-26	INSOL Europe Academic Forum Conference	Paris, France	INSOL Europe	www.insol-europe.org
26-29	INSOL Europe Annual Conference	Paris, France	INSOL Europe	www.insol-europe.org
November 2013				
7	INSOL International Cayman Islands One Day Seminar	Cayman Islands	INSOL International	www.insol.org

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Asociación Argentina de Estudios Sobre la Insolvencia
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Association of Insolvency and Restructuring Advisors
Business Recovery and Insolvency Practitioners Association of Nigeria
Business Recovery and Insolvency Practitioners Association of Sri Lanka
Canadian Association of Insolvency and Restructuring Professionals
Canadian Bar Association (Bankruptcy and Insolvency Section)
China University of Politics and Law, Bankruptcy Law and Restructuring Research Centre
Commercial Law League of America (Bankruptcy and Insolvency Section)
Consiglio Nazionale Dei Dottori Commercialisti e degli Esperti Contabili
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Hungarian Association of Insolvency Practitioners
INSOL New Zealand
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Insolvency Practitioners Association of Malaysia
Insolvency Practitioners Association of Singapore
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Instituto Iberoamericano de Derecho Concursal
Institute of Certified Public Accountants of Singapore
(Special Interest Group of Insolvency)
International Association of Insurance Receivers
International Women's Insolvency and Restructuring Confederation
Japanese Federation of Insolvency Professionals
Law Council of Australia (Business Law Section)
Malaysian Institute of Certified Public Accountants
Nepalese Insolvency Practitioners Association
Non-Commercial Partnership Self-Regulated Organisation of Arbitration Managers
"Mercury" (NP SOAM Mercury)
Recovery and Insolvency Specialists Association (BVI) Ltd
Recovery and Insolvency Specialists Association (Cayman) Ltd
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Schools of Economics
Russian Union of Self-Regulated Organizations of Arbitration Managers
Society of Insolvency Practitioners of India
South African Restructuring and Insolvency Practitioners Association
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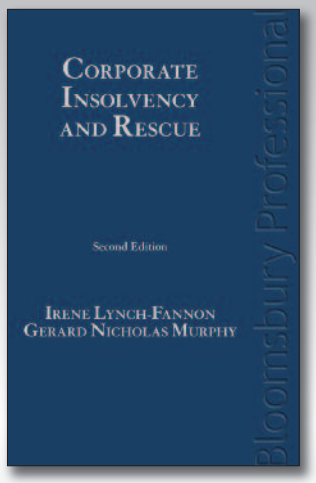

Corporate Insolvency & Rescue, Second Edition

Irene Lynch-Fannon and Gerard Nicholas Murphy, Bloomsbury Professional, 2012, 752pp, ISBN 978-1-84766-379-5

Review by Jim Luby,

McStay Luby, Dublin, Ireland

Professor Irene Lynch-Fannon and Gerard Nicholas Murphy have produced an impressive addition to the list of essential texts for Irish insolvency practitioners, legal advisors, lenders and for those outside Ireland requiring a detailed reference work on the operation of Irish insolvency law and practice.

The commercial landscape in Ireland has changed very significantly since the first edition of this work, which was co-authored by Professor Lynch Fannon with Jane Marshall of McCann Fitzgerald, Solicitors and Rory O'Ferrall of Deloitte.

This edition reflects the increased focus on business rescue, and in particular, the Examinership legislation and practice which has been used so successfully in this area.

Detailed commentary is included on the work of the Office of the Director of Corporate Enforcement in improving the corporate governance of companies, and the liquidators' responsibility to investigate and report so that in appropriate cases restriction and disqualification sanctions can be imposed.

The significant role of NAMA in the distressed property market probably warrants a book in itself. The powers of the NAMA Statutory Receiver are explained in detail.

As in the first edition, the authors are not afraid to criticise legislation, Court decisions (or NAMA!) and to recommend improvements.

In the present recession, insolvency practitioners have turned to more inventive forms of rescue in appropriate cases. I am impressed by the treatment given in the text to pre-pack receiverships and schemes of arrangement, tools which are of increasing assistance.

The Administration of insurance companies, which has seen a resurgence since 2009 are also dealt with in some detail.

The book also contains a useful treatise on the impact of the European Insolvency Regulation on cases affecting Ireland, and on the continuing difficulties with COMI.

The authors are to be congratulated for their significant achievement in producing this exceptional work.

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For Bankruptcy, Insolvency, Restructuring & Litigation advice, please contact:

Robin Mayor
Bermuda
T: +1 441 299 4929
E: robin.mayor@conyersdill.com

Mark Forté
British Virgin Islands
T: +1 284 852 1113
E: mark.forte@conyersdill.com

Nigel Meeson QC
Cayman Islands
T: +1 345 814 7392
E: nigel.meeson@conyersdill.com

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