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Consultation Paper on Resolving Corporate Insolvency in APEC Economies in the Aftermath of the COVID-19 Pandemic

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ABBREVIATIONS

AMC	Asset Management Company
APEC	Asia-Pacific Economic Cooperation
COMI	Center of Main Interests
CRPA	The Korean Corporate Restructuring Promotion Act
EODB	Ease of Doing Business
FRIA	Philippine Financial Rehabilitation and Insolvency Act
GDP	Gross Domestic Product
NPLs	Non-Performing Loans
OCWs	Out-Of-Court Workouts
OECD	Organization for Economic Cooperation and Development
SOIFX	Strength-Of-Insolvency Framework Index
UNCITRAL	United Nations Commission on International Trade Law
U.S.	United States
USAID	United States Agency for International Development
WHO	World Health Organization

PREFACE

This consultation paper grew out of a longstanding APEC effort to help member economies enhance their business and investment enabling environments. Central to this approach has been the World Bank's Ease of Doing Business (EODB) Index. APEC leaders in 2009 committed to using the metrics in the index to evaluate and improve formal rules, implementing institutions, and private practices in their respective economies. The resulting action plan saw improvement in the index of more than 25% across several priority areas: starting a business, getting credit, trading across borders, enforcing contracts, and dealing with permits.

Early in 2020, APEC commissioned a deeper analysis of EODB's Resolving Insolvency indicator as a potential new priority area under the Third Phase of the EODB Action Plan. Building consensus for change has traditionally been a challenge in this area. Resolving Insolvency generally sees fewer successful reforms than many other aspects of its index.

The COVID-19 pandemic will likely result in thousands of companies across APEC heavily in debt. A good portion of them will look to both informal and formal means of resolving these obligations with their creditors. These efforts could very well overwhelm the insolvency regimes of APEC economies that are not fully prepared for this potential insolvency wave.

Traditionally papers in this EODB series have involved a "deeper dive" study of the progress of member economies under a particular area, offering particularized recommendations on how to improve the business and investment environment as measured by the index. This consultation paper holds to that central mission. It focuses on formal rules (as measured by EODB's Strength of Insolvency Framework Index) and institutions (as measured by the amounts creditors will likely recover in a prototypical insolvency case).

But given the unprecedented challenges posed by the pandemic, this consultation paper raises several issues in addition to those covered by EODB metrics. For instance, the paper discusses out-of-court debt restructuring, which played a substantial role in resolving company insolvencies during past crises, helping simultaneously to reduce burdens on formal insolvency resolution systems. With insolvency cases that are formally initiated, the paper discusses, for instance, opportunities to use technology to enhance transparency and encourage more active creditor involvement. From an economy level perspective, the paper reviews the tendency of companies to seek government bailouts during financial crises, and how insolvency laws can help decision makers and implementers respond to such requests.

In all, the paper offers thirty-one potentially actionable recommendations for APEC economies to consider. Many build on policy and implementation guidance offered by the World Bank, the International Monetary Fund, and UNCITRAL, among others.

To date, most APEC economies have implemented insolvency measures designed to contain the crisis rather than enact reforms designed to facilitate debt restructuring. This document focuses on the latter. Hopefully it will help inform discussions among APEC policy makers and implementers as they tackle the longer-term, debt-related consequences of the COVID-19 pandemic.

EXECUTIVE SUMMARY

The COVID-19 pandemic has produced unprecedented global economic dislocation. To lessen the shock, many APEC economies have offered financial support to businesses while broadly restricting rights to enforce claims and evict non-paying tenants. In several economies where creditors often file insolvency cases, this right has been restricted as well.

These programs, while blunting immediate effects, will likely lead to tens of thousands of companies at risk of insolvency once the various restrictions on debt collection are lifted. A good portion of them will be seeking ways to resolve their debts while continuing to operate.

Generally, an economy can address company financial distress through two related but distinct channels: (i) out-of-court workouts (“OCWs”) and (ii) in-court insolvency proceedings. In an OCW, a debtor and its creditors negotiate solutions that bring the debtor’s future payment obligations to a sustainable level. Where successful, they channel cases away from insolvency courts, which are at risk of otherwise being overwhelmed with insolvency filings. Because they are based on contract, however, OCWs cannot prevent a non-cooperative creditor from pursuing judicial measures against the debtor while others are negotiating, nor bind non-cooperative creditors to the concessions or other arrangements that the majority has agreed to. These risks are manageable with small groups of repeat players. As creditors become less cohesive, however, OCWs tend to fray, or even fail.

In-court insolvency proceedings allow debtors to engage with creditors and restructure operations more comprehensively. The World Bank’s Ease of Doing Business (“EODB”) program measures, among other things, the extent to which insolvency legislation facilitates in-court reorganizations. While APEC economies fare relatively well in this regard, individual components of the index suggest that several economies have opportunities to implement relatively non-controversial reforms. These would include facilitating post-commencement financing and encouraging the continuation of contracts crucial to a debtor once an insolvency case has begun.

Further, EODB metrics reveal low recovery rates in a third of APEC economies, demonstrating that these economies perform relatively poorly in practice despite enjoying relatively high marks for their policy frameworks. In several of these economies, contract enforcement is also difficult, and use of insolvency proceedings is relatively rare. This gives rise to concerns that even though many companies might become insolvent in the coming months, they and their creditors may eschew formal insolvency proceedings due to potential risk and low likelihood of positive results. This could create zombie companies that prove effective at fending off creditors but contribute little to economic growth and recovery.

These observations, coupled with the looming challenge of widespread company insolvency, lead to 31 potentially actionable recommendations. Given the diversity of APEC economies, policy makers will need to choose and prioritize the actions that are best suited for their own economies. The proposed reforms in this consultation paper are introduced below and have also been summarized in Section 15 with respect to (1) likely decision-maker, (2) clarity of policy, and (3) impact.

First, *APEC economies should encourage efforts by debtors to resolve indebtedness out of court.* They can start with promotion and education, using materials developed by the World Bank and others.

While this approach is scalable, it is potentially limited as it requires broad consensus amongst a debtor's creditors to succeed. To address situations where OCWs cannot reach the necessary consensus, *APEC economies should consider establishing hybrid procedures that allow a government agency to approve plans where minority creditors refuse to sign on to an otherwise beneficial arrangement.*

Next, most APEC economies offer in-court procedures to achieve results that cannot be achieved in an OCW. A good portion of APEC economies have opportunities to improve their court systems in the coming months to meet the anticipated increase in company insolvencies. *APEC economies may wish to stress test their insolvency courts.* This test could reveal potential performance gaps that might be remedied by increasing judicial specialization and more effectively monitoring insolvency representatives.

Court performance also depends on creditor engagement. In most cases creditors are a diverse lot, inexperienced with procedures and with little incentives to learn them. *Increasing opportunities for creditors to sell their claims would allow some a quicker exit from the proceedings and result in a smaller number of more experienced creditors participating.* APEC economies should thus review and reconsider applicable regulatory impediments to debt trading. They should also consider reviving programs that facilitate bank sales of non-performing loans to asset management companies, who also have the capacity to engage constructively in judicial reorganizations.

More information can also empower creditors. Although the cost of sharing information has plunged in recent years, it appears that in many APEC economies the information readily available to creditors has barely increased. *Opportunities to make improvements to sharing information quickly seem compelling here.* In addition to improving court and creditor performance, *several APEC economies should consider various reforms to facilitate in-court reorganizations.* For instance, proceedings could be made shorter (through pre-packaged plans and stricter deadlines) in some economies. In others, a better balance might be struck between secured creditor protections and supporting a reorganization effort. Further, to the extent possible, APEC economies should explore ways to make in-court reorganizations more useful to small companies, as several have done already.

Where reorganization is not feasible, *APEC economies should consider less disruptive liquidation methods,* where assets are more likely to be bundled together in a sale, or the company being sold as a going concern. This can save jobs and preserve enterprise value.

It is very likely that in the coming months at least several large, systemically important companies will come under severe distress in the region, leading to calls for government bailouts. To prepare for this, *APEC economies should develop and publish a set of principles that govern whether and how to grant a bailout.* The use of insolvency proceedings should be included as a potential solution. In economies with well-developed insolvency regimes, such procedures can offer the potential bailout beneficiary breathing space and financing. Insolvency regimes also tend to impose costs on parties who are most cognizant and tolerant of risk (such as shareholders and unsecured creditors).

Reforms and initiatives that appear to have the greatest consensus with respect to policy, and the potential for greatest impact include:

- Establishing hybrid procedures for approving out-of-court restructuring plans;
- Undertaking stress tests at courts to determine preparedness for increases in insolvency cases;
- Encouraging the use of prepackaged reorganization proceedings;

- Facilitating the continuation of contracts with the debtor despite the reorganization;
- Allowing companies to be liquidated as a going concern when efforts to approve an in-court reorganization plan fail. /

Hopefully, this paper contributes to discussions and reforms as APEC economies grapple with the fallout from the pandemic.

INTRODUCTION

The COVID-19 pandemic and the resulting behavior and travel restrictions to address it have ravaged economies across the globe, slamming the tourism, transport, entertainment, and energy sectors, to name a few. Businesses reliant on on-site customer participation have suffered an enormous and sudden collapse in demand with little opportunity to adjust fixed costs and other ongoing contractual obligations.

Economies have responded quickly with a range of measures to ameliorate the effects of the pandemic and lockdown-type measures. This includes direct and indirect subsidies, restrictions on private debt collection, and waivers and delays with respect to obligations under insolvency and bankruptcy laws.

While these actions have certainly helped blunt the impact of the crisis, to a great extent they are deferring the pain, rather than curing it. An increasing number of insolvency experts predict that an unprecedented number of companies in the coming months will find themselves overwhelmed with overdue debt, especially after the various temporary ameliorative restrictions begin to expire.

This may cause a wave of potential insolvency cases in APEC economies. If not addressed and further prepared for now, this wave will likely overwhelm efforts to settle these debts informally, or have them resolved through formal bankruptcy/insolvency proceedings.

The objective of this paper is to stir discussion among APEC decision makers on two crucial questions: how prepared are they for this coming wave, and what can they do to enhance effectiveness potential responses?

The result of a desktop review undertaken in April and May 2020, this paper provides both assessment and recommendation, broken into five parts:

Part 1 reviews recent events and longer running factors likely to create a substantial increase in business insolvency cases over the coming months in many APEC economies.

Part 2 offers perspectives on corporate insolvency, to help APEC policy makers evaluate their existing mechanisms for resolving company indebtedness.

Part 3 offers a range of proposed reforms, interventions, and institutional enhancements that could improve and accelerate debt resolution efforts both in and out of court.

Part 4 discusses how APEC economies can use the insolvency laws to reduce moral hazard and conserve fiscal resources in response to calls to bailout systemically important, non-financial companies.

Finally, **Part 5** offers priorities with respect to potential reform initiatives offered in this consultation paper, summarizing thirty-one potentially actionable recommendations in terms of likely decision makers, policy clarity, and potential impact.

Terminology to describe insolvency proceedings varies from economy to economy. The paper generally employs the terminology used in EODB. For readers needing some background on insolvency resolution, **Annex I** discusses some of its basic elements and the incentives often driving participant behavior.

Annex 2 summarizes support structures facilitating out of court workouts in selected economies during the Asian Crisis. **Annex 3** provides details on alignment of APEC insolvency regimes with particular policies tracked by the EODB indicators, and **Annex 4** provides basic, economy-level impressions on the intensity of use of insolvency regimes in APEC economies.

Finally, a note on sources: unless specified otherwise, the materials informing this consultation paper are available on the Internet. Two notable sources, however, are not: *Corporate Restructuring and Insolvency in Asia, 2020* by the Asian Business Law Institute (surveying 16 jurisdictions, 12 of which are APEC economies) and the *Guide to Restructuring, Turnaround and Insolvency in Asia Pacific* by the Herbert Smith Freehills law firm (12 of the 18 jurisdictions covered are in APEC). Some, but not all, of the economies in the two surveys overlap.

The Asian Business Law Institute offers its survey for sale in electronic form, either individually or for the entire set. The Herbert Smith Freehills survey, also in electronic form, is developed for its clients but was graciously shared with the author.

PART I: THE EXPECTED WAVE OF COMPANY INSOLVENCIES

Part I of this consultation paper summarizes circumstances that could potentially leave thousands of companies in need of formal insolvency protection in the coming months.

SECTION 1. THE IMPACT OF THE COVID-19 PANDEMIC ON BUSINESS AND LENDERS

By the end of August 2020, six months after the World Health Organization declared the COVID-19 outbreak a pandemic, the results have become painfully clear. Various APEC economies are suffering unprecedented declines in growth rates. The economies of Australia, Canada, Japan, Mexico, Russia, and the United States will likely contract more than 5% in 2020. Other APEC economies will experience substantial slowdowns from high growth rates in 2019, with only China and Brunei among APEC economies expected to show any growth at all in 2020.

The industries hit hardest by the pandemic include air transport, retail, and energy, as well as the various industries in the hospitality sector—hotels, restaurants, and events. Manufacturing and trade have fallen off sharply as well, primarily from interruptions in international supply chains.

Banking sectors have demonstrated resilience, partly due to reserves and other stabilizing measures installed after the Global Financial Crisis. Nevertheless, the system has suffered strains. Banks are provisioning billions for bad debts, and corporate bonds, especially those below or just above investment grade, have experienced widespread panic selling. Government interventions to ensure bank liquidity and settle bond markets, however, have kept the larger financial system relatively stable.

SECTION 2. CONTAINMENT MEASURES AND THEIR EFFECT ON COMPANY BALANCE SHEETS

In response to the pandemic, APEC economies have imposed restrictions designed to reduce viral transmission: restricting travel, imposing quarantines, and establishing stay-at-home orders. As vital as they may be to public health, they have amplified the costs the pandemic was already imposing on various sectors reliant on travel and on-site customer participation.

To ameliorate the effects of the pandemic and lockdowns, APEC economies have offered various support and relief measures to businesses. For purposes of this consultation paper they are characterized as government support programs, restrictions on enforcement of private claims, and relief from obligations and deadlines imposed by insolvency laws. Each of them will likely have an impact on insolvencies and their resolution in the coming months.

2.1 GOVERNMENT SUPPORT PROGRAMS

These include accommodative monetary policy, corporate tax cuts, direct grants from governments to businesses, direct loans from governments, loan guarantees, corporate bond purchases, and equity injections. Direct payments to individuals help indirectly by stimulating consumer demand.

With a few exceptions, virtually every APEC economy is implementing, or contemplating, these measures in some form or another. In terms of absolute size the United States has offered the largest stimulus in the world. Australia, Canada, Japan, and Malaysia have launched substantial stimulus packages

as well. Peru's stimulus package, though smaller than others, is large in relation to its gross domestic product ("GDP") (approximately 12%)¹. Other economies, the Philippines for instance, were planning to launch stimulus packages as this consultation paper was being finalized.

These programs are relieving financial pressures that would otherwise result in companies defaulting on their obligations. However, as seen by a rising number of bankruptcy filings in the United States, they cannot save all companies and cannot last forever.

While involving substantial fiscal cost, direct assistance will have less effect on future insolvencies than the measures below. Potentially their most substantial direct impact lies in positioning government bodies as creditors or owners of companies that are in formal proceedings or out-of-court debt resolution talks. This is discussed in Section 9.4.

2.2 RESTRICTIONS ON ENFORCEMENT OF PRIVATE CLAIMS

To supplement direct support, various APEC economies blunted the enforcement of rights that private sector actors normally have. Most involve temporary restrictions on debt collection and tenant evictions. Some of them are cast as outright moratoria, while others are described as suggestions, requests, or entirely voluntary measures.² Several economies have paired these deferrals with measures that compensate, usually through various tax rebates, the party whose rights have been impacted by the restriction.

Court closures and working-hour restrictions are also commonplace. They have generally delayed efforts to enforce rights not necessarily restricted by the various pandemic-related restrictions.

These measures, not seen in some economies since the Great Depression, have limited the second order dislocations that would likely result from evictions and foreclosures. They nevertheless have pushed obligations farther down the road, leading to potentially disruptive impacts once the restrictions on debt collection and eviction are lifted.

2.3 RELIEF FROM OBLIGATIONS AND DEADLINES IMPOSED BY INSOLVENCY LAWS

Several APEC economies have policies designed to bring insolvent but reluctant companies into formal proceedings. While useful under normal circumstances, fears have arisen that they would swamp insolvency resolution court systems. Several APEC economies have thus suspended these measures. Further, where cases have already started, the courts in several economies have allowed deadlines to be extended.

Restrictions on Creditor-Initiated Cases

In most APEC economies, debtors tend to initiate insolvency cases. Nevertheless, in several APEC economies and elsewhere, creditors have used insolvency laws to collect debts, either by filing an insolvency case or threatening to do so.

¹ MercoPress. April 9, 2020. [Peru Launches Economic Stimulus Plan Equivalent to 12% of its GDP](#).

² For instance, the Thai Bankers' Association announced a year-long grace period on loan repayments to exporters, importers, retailers and companies in the tourist sector. Phoonphongphiphat, Apornrath. March 4, 2020. [Thai Banks give Coronavirus-hit Borrowers One-year Moratorium](#). *Nikkei Asian Review*.

Several APEC economies moved quickly to delay or deter creditors from initiating cases. Australia increased the minimum size of the unpaid claim required to start a case and increased the period of time for a company to pay the claim in order to prevent a filing. Singapore has enacted similar provisions.

Russia declared a moratorium on creditor-initiated petitions against debtors in hard hit industries.³ The moratorium, set to last for six months, applies to thousands of companies.

Easing of Requirements by Debtors to Initiate Cases

Several APEC economies require company directors to consider the interests of creditors when chances increase that their company may not be able to pay all of them. In practical terms, this translates into an obligation to file an insolvency case if the debtor's liabilities are above, or close to exceeding, its assets, or if the debtor is unable to pay debts as they come due. Board members risk personal liability for creditor losses should they fail to do so.

Several APEC economies, such as Australia, New Zealand, Russia and Singapore, suspended these requirements for six months.

Extension of Deadlines in Existing Cases

In most formal insolvency cases, time is the enemy, eroding the good will, relationships and human resources necessary to save a distressed company. Deadlines force parties to make difficult decisions they might otherwise prefer to defer. Nevertheless, given the challenges posed by the pandemic, courts have allowed cases to be delayed as parties adjust their plans and positions in light of new realities.⁴ Furthermore, various court closures and operational cutbacks connected with lockdowns have likely delayed ongoing cases.

SECTION 3. ADDRESSING INSOLVENCIES AFTER THE GREAT DEFERRAL

As of August 2020, government programs, creditor restraints, and insolvency law adjustments appeared to be working. Apart from airlines and retailers that had been laden with pre-pandemic debt, relatively few companies had filed for formal insolvency protection. Nevertheless, practitioners, academics, and development experts were increasingly warning of a “tsunami” (to borrow one metaphor) of insolvencies that would hit various economies in the coming months. Some of the reasons behind these concerns are discussed below:

3.1 PRE-PANDEMIC DEBT

Fueled by low interest rates and relatively benign economic outlooks, companies had been taking on increasing amounts of debt since 2007. By the end of 2019, these obligations amounted to more than 90% of the GDP of mature and emerging markets tracked by the Institute for International Finance. With respect to APEC economies tracked by the institute, the ratios ranged from 219.4% of GDP in

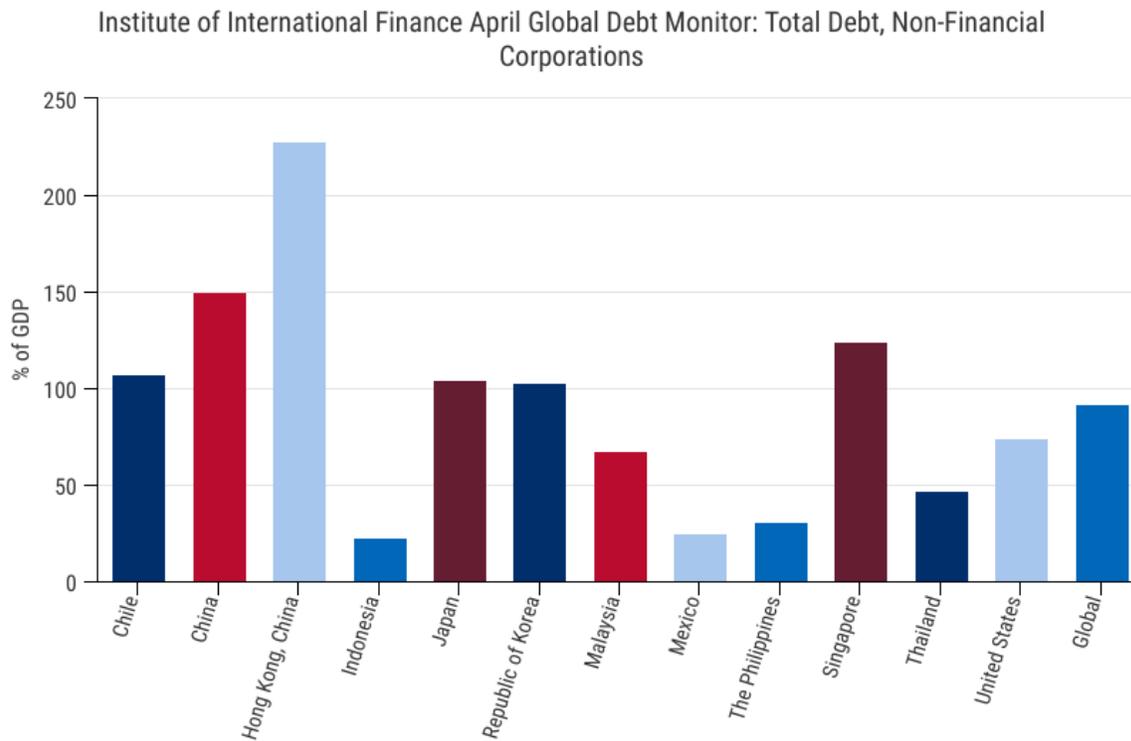
³ Linklaters. May 6, 2020. [Regime of Bankruptcy Moratorium has been Enacted in Russia.](#)

⁴ Lennox, Heather and Moss, Dan. May 8, 2020. [Temporary Suspension of Bankruptcy Cases During Pandemic.](#) *Bloomberg Law.*

Hong Kong, China to 23.4% of GDP in Indonesia. See Figure 1. In Canada, Chile, the Philippines, Singapore, and the United States, these debts were at record-, or near-record levels.⁵

The type of debt matters as well. Since the Global Financial Crisis, companies in various economies had been steadily accessing bond markets as an alternative to commercial bank financing. By the end of 2019, the outstanding amount of corporate bonds had reached \$13.5 trillion, notably \$10.5 trillion owed by companies from advanced economies (more than half from US companies) and \$3 trillion from companies in emerging markets (with Chinese issues accounting for nearly two thirds of the outstanding amount from that group).⁶ See Figure 2.

Figure 1. Total Debt Issued by Non-Financial Corporations in Selected APEC Economies⁷

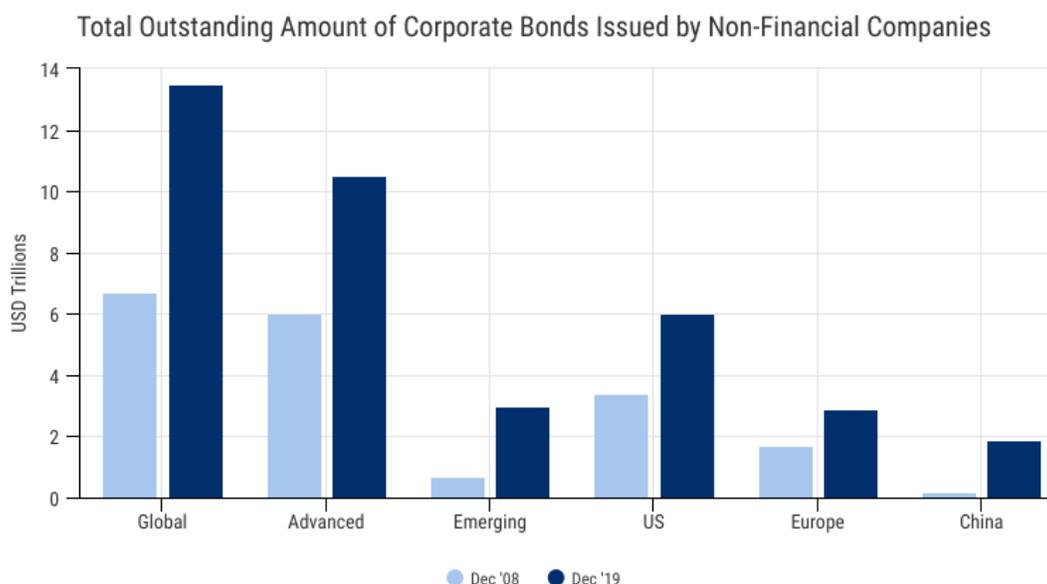


⁵ Tiftik, Emre and Mahmood, Khadija. April 6, 2020. *Global Debt Monitor: Covid-19 Lights a Fuse*. Institute of International Finance, p. 2.

⁶ Çelik, Sedar, Demirtaş Gul and Isaksson, Mats. 2020. *Corporate Bond Market Trends, Emerging Risks and Monetary Policy*. OECD Capital Market Series, p. 12.

⁷ Tiftik, *supra*, note 5, p. 2.

Figure 2. Outstanding Value of Corporate Bonds⁸



Approximately a third of these bonds will mature between 2020 and 2023.⁹ A large percentage of these are at the lower end of “investment grade quality” (i.e., BBB) or below (i.e., junk bonds). During prosperous times, the high yields offered by these instruments would attract buyers thereby allowing the refinancing of principal coming due at maturity.

Bond rollover practices such as this will likely be difficult for many lower rated issuers under current market conditions. They will be facing large payment obligations at maturity with no affordable ways to refinance them. In the United States, default rates for these companies are expected to reach 13% by the end of the year and 21% in two years.¹⁰

To be sure, the debt causing so much concern in late 2019 had been issued primarily by US companies. But the Chinese corporate bond market, which had grown in size second only to the United States, was already sustaining a record number of corporate defaults in 2019 amounting to \$18.6 billion in local currency bonds and \$2.9 billion in those denominated in US dollars.¹¹

In APEC economies outside the United States and China, the larger corporate bond markets include Australia, Japan, and Korea, all of which have at least some BBB rated issuers. Malaysia, Singapore, and Thailand have smaller but nevertheless active markets. In Indonesia, the Philippines, and Viet Nam, only a handful of the most well-established corporations float bonds, with the rest relying on commercial banks and other sources for financing.

⁸ Çelik, *supra*, note 6, p. 12.

⁹ *Ibid.*, p. 11.

¹⁰ Wiltermuth, Joy. April 17, 2020. [Fed’s Foray into Buying Junk-Rated Corporate Debt won’t Stop Wave of Defaults that could Reach 21%, Analysts Warn.](#) *MarketWatch* (13% by year end and 21% in two years).

¹¹ Wineland, Don. April 30, 2020. [Corporate Defaults in China Surge in 2019 to Record High \\$18.6bn.](#) *Financial Times*.

3.2 DEFERMENT OF OBLIGATIONS

Singapore passed legislation in April 2020 in response to the COVID-19 pandemic to provide a temporary moratorium for the inability to perform specified contracts¹² due to COVID-19. The Parliament of Singapore emphasized that its action did not discharge debt, but rather deferred it.¹³ As yet there are no indications of an APEC economy passing legislation that would discharge corporate debtors from their obligations. In most cases, interest and penalties will continue to accrue. While interest rates in most economies remain low, penalties and compounding could result in debts growing more quickly than most businessmen would necessarily expect. Thus, like the bond issuers described above, many businesses across the region face an existential day of reckoning when the debt deferrals expire.

Timelines for various deferral programs vary. In an attempt to mitigate this “cliff effect” of an immediate obligation to repay accrued interest on obligations, the Parliament of Singapore passed an amendment to its COVID-19 legislation in November 2020 to provide leverage to small and micro businesses to renegotiate certain contracts with their counterparties through the Re-Align Framework. Under the Re-Align Framework, if renegotiations are unsuccessful, the specified contract may be terminated with prescribed consequences of termination. Generally, this means that obligations which have accrued on or before the date of termination remain payable and prospective obligations after the date of termination are discharged. This approach by Singapore should be documented and explored further to determine its effectiveness at encouraging efficient settlement for the discharge of future obligations.

3.3 UNREALIZED AWARENESS IN APEC ECONOMIES

By August 2020, awareness of the risks of business debt accumulation appear to vary among APEC economies. Despite articles,¹⁴ a survey of risk professionals,¹⁵ and an open letter by renowned academics¹⁶ increasingly pointing to the risk of widespread insolvency, very few leaders of APEC economies have warned about the potential risks, or possible steps to prepare for it.

The problem might be the side-effect of what some have come to call the “Great Deferral.” Many creditors, whether banned or not from doing so, are apparently not enforcing their claims to the same extent they would otherwise. The lack of pressure has allowed businesses to focus on more immediate concerns, a very valid choice, but one that risks a challenging future.

¹² The specified contracts include (i) leases or licenses of non-residential immovable property; (ii) hire-purchase agreements for any plant, machinery or fixed asset used for manufacturing, production or other business purposes or for commercial vehicles; (iii) loan agreements to small and medium enterprises where the loan facility is secured against any commercial or industrial immovable property in Singapore, but do not include corporate bonds.

¹³ Wessing, Taylor. May 8, 2020. Singapore Proposes Temporary Measures to Support Businesses and Individuals in Managing Contract Obligations and Insolvency Risk Arising from the COVID-19 Outbreak. *Lexology*.

¹⁴ For example, Mijer, Eric. May 26, 2020. Australia Risks 'Insolvency Tsunami' when Coronavirus Aid Ends. *Nikkei Asian Review*. Walsh, Mary. June 18, 2020. A Tidal Wave of Bankruptcies is Coming. *New York Times*.

¹⁵ The survey, conducted by the World Economic Forum, identified a “surge in bankruptcies . . . and a wave of industry consolidation” as the second most likely fallout of the pandemic (behind a “prolonged recession of the global economy”). The risk professionals surveyed also considered these factors to be “the most worrisome for their company” in the same order. World Economic Forum. May 2020. COVID-19 Risks Outlook: A Preliminary Mapping and Its Implications, pp. 51 and 53.

¹⁶ Bankruptcy & COVID-19 Working Group. May 27, 2020. Open Letter to Members of Congress.

3.4 USING TIME WISELY

As noted by the Bank for International Settlements, “no other recession in modern times has hit the corporate sector . . . as badly as the COVID-19 shock.” How the corporate sector copes with the coming second shock of the insolvency wave will play a substantial role in helping economies recover from the pandemic.

To date, the outlook appears grim. The various subsidies and restrictions during the Great Deferral have delayed some reckoning, only perhaps to make it more painful later. Moreover, in economies where support is substantial, record amounts of pre-pandemic debt may very well be the factor that sends companies into insolvency. The Great Deferral has given businesses some breathing room to make arrangements with creditors on repayment schedules before the latter start clamoring for payback. Little evidence, however, has surfaced of debtors negotiating at the levels necessary to avert an insolvency crisis beginning in the final months of 2020.

With a few exceptions, most of the insolvency related reforms enacted to date have focused on short-term measures to ease application that would otherwise be welcome under normal circumstances. Far less attention has been paid to deeper solutions to improve systems themselves on grounds that such reforms consume substantial time and political capital. A survey of 17 APEC economies published in May 2020 indicated that only Chile, China, and Hong Kong, China had considered deeper solutions.¹⁷ More recently Peru has established a new set of hybrid procedures designed to help companies accelerate adjustment of debts with their creditors.¹⁸

A writer reflecting on measures used to combat insolvency during the Asian and Global Financial Crises, distinguished between those used during “crisis containment” and those used during “subsequent debt restructuring.”¹⁹ Interventions described in Section 2 fall within the former category. Those described in Sections 7-11 fall within the latter.

¹⁷ The other economies include Australia, Canada, Indonesia, Japan, Russia, Malaysia, Mexico, the Philippines, Singapore, Chinese Taipei, Thailand, the United States, and Viet Nam. Baker McKenzie. 2020. Global Restructuring and Insolvency Guide Comparison.

¹⁸ See discussion in Section 7.4.

¹⁹ Laryea, Thomas. January 26, 2010. Approaches to Corporate Debt Restructuring in the Wake of Financial Crises. *IMF Staff Position Note*, p. 7.

PART 2: INSOLVENCY RESOLUTION SYSTEMS AND THEIR CURRENT STATUS IN APEC ECONOMIES

As noted by the World Bank and United Nations Commission on International Trade Law (“UNCITRAL”), the performance of insolvency resolution systems depend on a multitude of factors and systems working together.²⁰ This consultation paper focuses on how APEC economies can improve two of these systems — out-of-court workouts and formal insolvency proceedings — to meet the challenges made pressing by the COVID-19 pandemic. Thus, in order to frame the recommendations in Part 3, Part 2 will review the extent and effectiveness of OCWs and formal proceedings in APEC economies. This begins, however, with a brief review of unilateral contract enforcement — often a major factor in a debtor’s decision to bargain collectively with creditors.

SECTION 4. CONTRACT ENFORCEMENT IN APEC ECONOMIES

In economies where contract enforcement is relatively swift and effective, companies tend to proactively engage with creditors through a workout or initiation of a formal case in order to forestall individual enforcement measures. In economies where contract enforcement is slower, more expensive, and less certain, a company can stall or demand concessions, knowing that judicial enforcement procedures will be slow and expensive to complete.

The metrics for contract enforcement with the broadest coverage among APEC economies comes through the World Bank’s EODB program. The metrics contemplate a scenario involving initiation and enforcement of a disputed claim worth 200% of an economy’s income per capita or \$5000, whichever is greater.

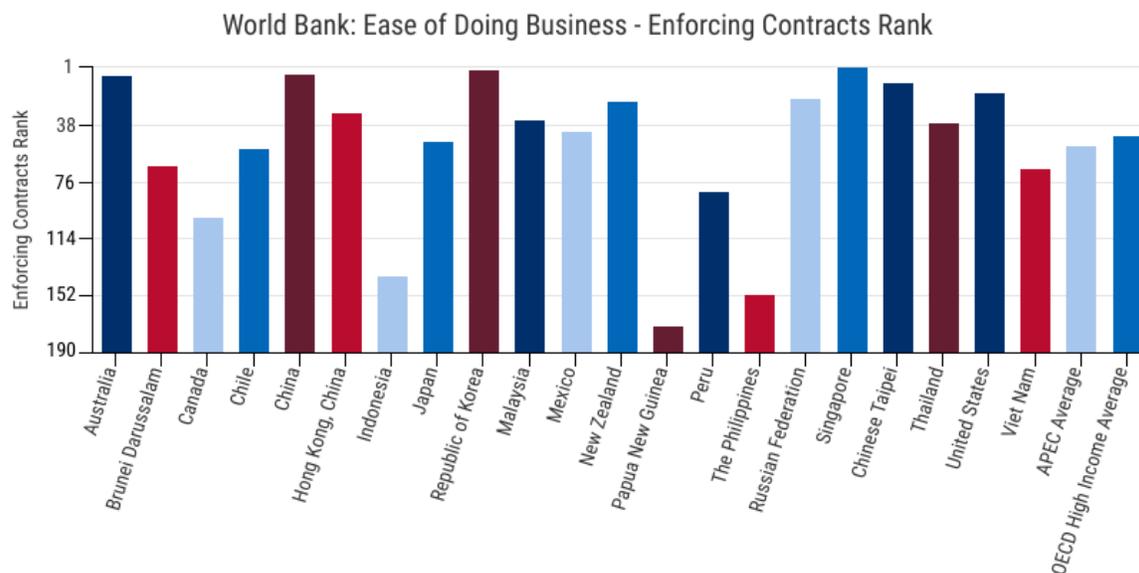
The metrics track court performance as measured by the time and the cost of a contract enforcement action. Further, they assess conformity with best practices: “court structure and proceedings, case management, court automation and alternative dispute resolution.”

APEC economies diverge substantially on these criteria. Twelve score better than the average rank of 46 for “OECD High Income” economies,²¹ the highest among economy groups ranked by Doing Business. The remaining nine are broadly spaced out in ranking, with two of them falling outside of 145—the average rank for “South Asian” economies (the lowest ranked economic grouping tracked by Doing Business.). See Figure 3.

Figure 3. EODB Ranking of Enforcement of Contracts in APEC Economies

²⁰ Leroy, Anne-Marie and Grandolini, Gloria M. January 1, 2016. Principles for Effective Insolvency and Creditor/Debtor Regimes. World Bank, p. iii (noting the role insolvency resolution regimes play in a “broader credit infrastructure”) (hereinafter “Insolvency Principles”). UNCITRAL. 2005. Legislative Guide on Insolvency Law. United Nations, p. 15 (including “security interests, property and contract rights, remedies and enforcement procedures” among issues of key importance to insolvency) (hereinafter “UNCITRAL Legislative Guide”).

²¹ Note that seven APEC economies are also in the OECD High Income group: Australia, Canada, Chile, Japan, Korea, New Zealand, and the United States.



Regardless of their baseline efficiency, it is quite likely that contract enforcement will suffer as the result of the pandemic. The temporary restrictions on enforcement, coupled with the case slowdowns from court closures, could result in many courts being swamped with claims once the restrictions are lifted. In cases that do get before a judge, many defendants will likely raise defenses of the doctrine of frustration of purpose, contractual impossibility, or other pleas designed to position them as victims of a common disaster worthy of judicial favor. This could slow down enforcement as courts, and society at large, wrestle with these questions.

As discussed in more detail in Section 6.2, the slow contract enforcement observed here might very well contribute to near-perpetual insolvency for many companies.

SECTION 5. OUT-OF-COURT WORKOUT CAPACITY IN APEC ECONOMIES

As discussed in Section 3, companies in APEC economies are under substantial economic distress. This will become acute as various moratoria on debt collection efforts expire in the latter half of 2020. Depending on the jurisdiction, creditors might pursue a host of measures against companies with overdue debt: resuming or initiating enforcement actions, seizing the debtor’s properties, setting off claims, or refusing to provide essential supplies, services or credits.

Debtors attempting to forestall such actions may attempt to negotiate with some or all of their creditors through out-of-court workouts (“OCWs”).

An OCW is the primary alternative to a formal insolvency proceeding. Rather than going to court, with its additional costs and potential uncertainties, a debtor or its creditors initiate a discussion with the goal of amending the debtor’s future payment obligations to a sustainable level. Debtors usually seek reductions in principal and interest, as well as the extension of payment schedules. Creditors look to minimize their concessions while decreasing the likelihood of greater threat to repayment, such as a piece-meal liquidation, or a lengthy, in-court insolvency proceeding. Creditors sometimes demand, and receive, modifications that make their ability to collect easier should the debtor later default, such as a promissory note evincing their claim, or collateral securing it.

OCWs are primarily private undertakings. Nevertheless, during the Asian Financial Crisis they channeled cases away from insolvency courts, thereby allowing these institutions to focus on companies where informal processes proved insufficient. Several APEC economies, namely Indonesia, Korea, Malaysia and Thailand, actively facilitated OCWs where banks were the primary creditors. Agencies established by these economies carried out a range of activities, for instance, issuing workout guidelines, offering tax incentives, or mediating/arbitrating debt disputes. Annex 2 summarizes various aspects of these programs.²²

As a result of this past experience, there remains a strong workout culture among a good number of APEC economies, in several cases supported by government guidelines and/or agencies. For instance, in Hong Kong, China, the bankers' association and the Monetary Authority oversee the "Hong Kong Approach to Corporate Difficulties." Under it, banks work cooperatively with debtors in line with guidelines established during the Asian Financial Crisis. The goal is for banks to collectively "agree to a restructuring plan among themselves" with "scrutiny from regulators if they fail to do so."²³ Thailand's central bank also coordinates and encourages "good faith workouts" by financial institutions, with the possibility of tax exemptions for the debtor on "gains received" therefrom.²⁴

Because they are based on contract, out-of-court workouts generally suffer from two shortcomings. They cannot (1) prevent a non-cooperative creditor from pursuing judicial measures against the debtor while others are negotiating, nor (2) bind non-cooperative creditors to the concessions or other arrangements that the majority has agreed to. These risks are often manageable with the help of societal pressure among smaller groups of repeat players. Indeed, it is common practice for small groups of the larger creditors in such workout to tolerate smaller, more numerous creditors receiving payment in full in order to avoid the costs and discontinuities of a full, in-court proceeding.

In many economies though, bond holders and vulture funds have increasingly challenged the clubby relationships among creditors that often allowed OCWs to succeed. This puts more demand on courts if, for instance, a judicially approved reorganization plan is the only way to bind dissenting minorities.

Several economies have attempted to establish out-of-court procedures that can solve some of these problems. These have been described as hybrid procedures: combining out-of-court speed and simplicity with restrictions on creditor rights to enforce claims and authority to bind minority dissenting creditors.

Korea's hybrid procedures are well tested, the Philippines' remain essentially untried, and New Zealand's is extremely new. They are discussed below.

Korea

During the Asian Financial Crisis, a broad agreement among banks played a key role in facilitating OCWs. Over time, however, certain non-bank financial institutions refused to negotiate, during the

²² More recently, Japan has established a program to encourage debtors and their financial creditors (e.g., banks and other money lenders) to work out debts through mediation services offered by an association of turn around professionals. Abe, Shinichiro *et al.* Report on Japan, p. 364 in *Corporate Restructuring and Insolvency in Asia*. *Asian Business Law Institute* (hereinafter "ABLI Corporate Restructuring"). The ABLI document is not freely available on the Internet. Please see notes on sources in the Introduction for details.

²³ Pugh, Tom. 2020. Report on Hong Kong, China, p. 211 in *ABLI Corporate Restructuring*, *supra*, note 21.

²⁴ Jullamon, Kanok. Report on Thailand, p. 738 in *ABLI Corporate Restructuring*, *supra*, note 21.

banks to put the debtor into formal proceedings. This led to the enactment of the Corporate Restructuring Promotion Act (“CRPA”) in 2001. It allowed the financial creditors of a debtor (acting jointly as a council) to suspend individual enforcement rights and approve (by 75% majority) restructuring agreements that would bind all members of the council. Those opposing could apply for buyouts of their claims, but at an amount equal only to that if the debtor were liquidated.

Although some observers have questioned the constitutionality of provisions within the CRPA,²⁵ it has proven rather successful.²⁶ Initially enacted as a temporary law, it has been extended or reenacted several times. It is now scheduled to expire in 2023.²⁷

The Philippines

The Financial Rehabilitation and Insolvency Act (“FRIA”) allows creditors, in agreement with the debtor, to impose a 120-day standstill period pending negotiation and finalization of an out-of-court informal restructuring/workout agreement or a rehabilitation plan. This standstill period shall be approved by *majority of the creditors* and not exceed 120 days from the date of effectivity. *A notice of said agreement shall also be published in a newspaper of general circulation in the Philippines once a week for two consecutive weeks.* Believing that the initiated OCW deviates from the FRIA, creditors may, however, challenge the standstill period and said plan through a court proceeding.

Like Korea’s CRPA, questions have been raised about the constitutionality of imposing standstills and restructuring plans without prior court approval. The Philippine Supreme Court, however, at least implicitly endorsed this approach in 2013 when it issued rules governing these procedures.²⁸

Unlike Korea’s CRPA, however, little publicly available evidence indicates that any creditors in the Philippines have attempted to use these provisions in the ten years since the law was enacted.

New Zealand

Legislation enacted in response to the COVID-19 pandemic allows a company to put its debts into “hibernation.” By submitting a notice to the business registrar, a debtor may obtain a one-month standstill against creditor actions. This may be extended for an additional six months if the debtor can demonstrate that it has notified its creditors of the initial standstill and has obtained the support of 50% of its creditors holding at least 50% of its debt.

This arrangement emphasizes simplicity. It neither precludes nor mandates any kind of negotiation with creditors over debt restructuring. Nevertheless, by putting the onus on the debtor to initiate the process and begin discussions with creditors as a group, it may prompt further discussions among them, to resolve debts using other mechanisms under New Zealand law.

²⁵ International Financial Law Review. June 2, 2010. Corporate Restructuring Promotion Act.

²⁶ For instance, it has been used to restructure the debts of several companies in the Hyundai group, among others. Rim, Chiyong, Report on South Korea, p. 672 in ABLI Corporate Restructuring, *supra*, note 21.

²⁷ *Ibid.*, p. 671.

²⁸ Supreme Court of the Philippines. 2013. Financial Rehabilitation Rules of Procedure. A.M. No. 12-12-11, Rule 4.

SECTION 6. IN-COURT INSOLVENCY RESOLUTION IN APEC ECONOMIES

Section 5 noted how debtors in APEC economies under financial distress may attempt to initiate OCWs with their creditors. These might prove insufficient for several reasons:

- Certain creditors are refusing to abide by any standstill agreement and moving forward on collecting their debts.
- Certain creditors are holding out on a proposed compromise plan, causing other creditors to rethink their decision to compromise on their claims.
- The debtor is finding it difficult to obtain credit to meet operational needs.
- The debtor has several ongoing contracts that are burdening its operations (such as unnecessary leases with penalties for early termination) and needs to continue several contracts with crucial suppliers, who are reluctant to continue.

Modern insolvency laws offer solutions to these fundamental challenges. A court-imposed stay or moratorium stops most enforcement cases and consolidates them with the insolvency court. A plan to rehabilitate or rescue the debtor is voted on by creditors under court supervision. And if approved, minority dissenting creditors have their claims modified in accordance with the plan and in line with other similarly situated creditors.

These laws offer operational benefits as well. Many insolvency systems grant a preference to creditors who lend to the debtor after the commencement of formal proceedings, thereby facilitating access to “rescue financing” that can keep the debtor’s business running as it seeks to reorganize.

Debtors under formal proceedings in many systems can also reject contracts with minimal penalties, and continue, or even reinstate, contracts that are crucial to continued operation.

But a modern insolvency law more than just fills the gap left by the limits of an OCW. If creditors suspect that a debtor’s management or owners are stripping assets or offering favorable deals to insiders, they can file an insolvency case and use the proceedings to recover transferred assets and cancel sweetheart deals.

The World Bank’s EODB indicators for resolving insolvency offer insight on how well these systems work in APEC economies. Section 6.1 below reviews the alignment of APEC economies with emerging norms on how an insolvency regime should operate, at least on paper. Section 6.2 reviews the methods and results of EODB evaluations on how well insolvency regimes are in fact being implemented.

6.1 APEC IN-COURT INSOLVENCY FRAMEWORKS: CONSISTENCY WITH EMERGING NORMS

EODB measures the legislation and procedural rules governing insolvency resolution through a 16-point Strength-of-Insolvency Framework Index (“SOIFX”). It consists of four sub-indices:

- The commencement of proceedings index,
- The management of debtor assets index,
- Reorganization proceedings index, and
- The creditor participation index.

As a group, APEC economies average 10.6 on the SOIFX. This compares generally favorably with the average score of the economies in the OECD High Income group.

The Philippines, which passed major insolvency reform legislation in 2010, scored a 14 on the 16-point index. Among APEC economies, the only economy scoring higher was the United States, whose Chapter 11 provisions have served as models for numerous economies' reform legislation. The Financial Rehabilitation and Insolvency Act of the Philippines adopted more than several restructuring approaches found in Chapter 11.²⁹

The two economies lowest on the index were Hong Kong, China and Papua New Guinea, each scoring 6 on the 16-point scale. The framework of Hong Kong, China is based on “the regime that was applicable in England and Wales” prior to insolvency law reforms in the mid-1980s, with certain updates provided in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32), passed in 2017, that updates the insolvency framework to include clearer provisions for winding up an insolvent company.³⁰ Hong Kong, China lacks statutory provisions for corporate reorganization. Papua New Guinea, lacks stand-alone insolvency legislation. Its Companies Law contains just a few provisions on insolvency.

Details on how APEC insolvency regimes align with other indices under the SOIFX³¹ are discussed in Annex 3.

6.2 IMPLEMENTATION OF INSOLVENCY LAWS IN APEC ECONOMIES

As with many other complex laws, implementation can be just as important as written legislation. Sub-section 6.2.1 reviews the effectiveness of APEC economies in implementing insolvency laws as measured by EODB metrics. Sub-section 6.2.2 evaluates the extent that debtors and creditors are utilizing insolvency laws, which can also shed light on the extent that commercial actors perceive implementing institutions to be effective.

6.2.1 Effectiveness of implementation according to EODB

To track the performance of courts in resolving insolvencies, EODB asks evaluators to contemplate a relatively detailed scenario of a hotel suffering from financial distress. EODB then calculates the time and cost to restore the hotel to a financially viable state, using a given economy's insolvency resolution system. These then factor into a recovery rate for secured creditors as a percentage of their claims.

The table below presents average results under these metrics for APEC economies. OECD High Income economies are included for the sake of comparison.

²⁹ Dumlao, Doris and Lam, Anna. February 4, 2010. Congress passes Bankruptcy Bill on Bankruptcy Framework. *Philippine Daily Inquirer* (noting that the new law introduced much needed “Chapter 11-like provisions” to assist companies in restructuring efforts).

³⁰ Pugh, Tom. Report on Hong Kong, China, p. 201 in ABLI Corporate Restructuring, *supra*, note 21.

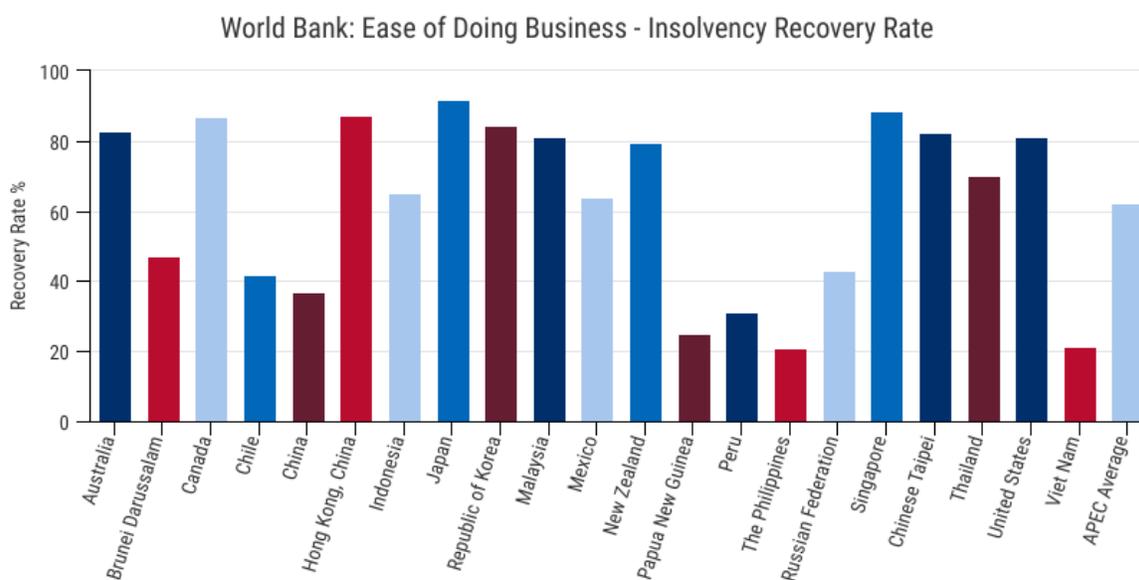
³¹ The EODB's Strength of Legal Rights Index for Getting Credit.

Table 1. Average Metrics for In-Court Resolving Insolvencies in APEC

Group	Average Time (Years)	Average Cost (as a % of the estate)	Average Recovery %
APEC	1.8	11.6	62.5
OECD High Income	1.7	9.3	70.2

As noted above, average recovery percentage accounts for both time and cost of the proceeding. Focusing on this, ten APEC economies had recovery rates at close to 80% or above. On the other end of the spectrum, eight economies had recovery rates below 50%, with the average recovery less than half that of the top ten.

Figure 4. World Bank Ranking on Insolvency Recovery Rate in APEC Economies



No doubt there many possible factors could explain this disparity in performance. One to safely rule out though is overall conformity with the SOIFX. The SOIFX score for those economies within the top ten in recovery percentage was 10.3. The average score for those below 50% was higher: 10.8.

An alternative that might at least partly explain this disparity is the effectiveness of the institutions that implement insolvency laws, namely judges and the judicial system; and insolvency representatives and the agencies that regulate them. Addressing how to improve these institutions will be a major focus of Part 3.

6.2.2 Private sector use of formal insolvency proceedings

EODB does not track the volume of insolvency cases in APEC economies. It is, however, possible to roughly identify economies where practice is substantial and where it has historically been less so. Based

on sources reviewed in Annex 4, a half dozen APEC economies could safely be characterized as substantially active with respect to insolvency and another half dozen could be described as relatively less active. The table below breaks these economies down into these two groups with their SOIFX scores, recovery rates, and rank with respect to enforcing contracts.

Table 2. Volume of Insolvency Cases in APEC Economies

Corporate Insolvency Practice Substantially Active				Corporate Insolvency Practice Relatively Inactive			
Economy	SOIFX Score	Recovery %	Enforcing Contracts Rank	Economy	SOIFX Score	Recovery %	Enforcing Contracts Rank
Australia	11.0	82.7	6	Brunei	10.5	47.2	66
Canada	11.0	86.7	100	Mexico	11.5	63.9	33
China	13.5	36.9	5	Papua New Guinea	6.0	24.9	173
Malaysia	7.5	81.0	35	Peru	9.5	31.3	83
Russia	11.5	43.0	21	Philippines	14.0	21.1	152
United States	15.0	81.0	17	Viet Nam	8.5	21.3	68
Average	11.5	68.6	31	Average	10.0	34.9	96

A full treatment of the relationship between intensity of use and effectiveness of an insolvency regime is beyond the scope of this paper. Suffice it to say that there might be at least several economies within APEC where the insolvency resolution regime has been underused. Of course, it is possible that the structure and growth of an economy (such as the lack of substantial pre-existing private sector debt) is contributing substantially to underuse. This might be difficult to explain, though, in some of the larger and more diversified APEC economies where companies are expected to fail even under optimal economic conditions.

If sub-optimal use in some economies is indeed the case, the metrics on recovery percentage and contract enforcement could very well offer the reasons behind it. As shown in the right-hand columns, insolvency practice tends to be less active where recovery rates are lower and contract enforcement is more difficult. Without the pressure imposed by contract enforcement, debtors have fewer incentives to negotiate out of court, and to seek the protection of insolvency proceedings if such talks should fail. If recovery rates are indeed as low as suggested, both creditors and the debtor may often conclude that a formal proceeding is not worth the effort.

The consequences of this pattern continuing through the aftermath of the COVID-19 pandemic are unsettling. Rather than adjusting debts, operations, and ownership through completion of a formal insolvency proceeding, a substantial number of companies might resolve to muddle through in distress,

becoming a new breed of “zombie” company, incurring debt and consuming capital, resistant to repair or liquidation.

PART 3: PROPOSALS FOR MANAGING THE EXPECTED WAVE OF COMPANY INSOLVENCIES

As discussed in Part 1, APEC economies need to brace for a wave of company insolvencies beginning at the end of 2020 and continuing into 2021. Effective audit and supervision of corporations, particularly those in the financial sector, can help economies to better understand the characteristics of this insolvency wave, anticipate systemic weaknesses, and help to revise its bundle of policies and interventions to fit the needs of insolvent firms. Debtors and creditors can handle some of these on their own through OCWs. But many will need institutional help, either through hybrid procedures or effective, court-led insolvency proceedings.

Addressing these concerns, Part 3 offers recommendations on how insolvency implementation could be improved, especially in economies where recoveries are low. First, it will offer suggestions to improve outcomes in OCWs. Although primarily a private undertaking, OCWs could be enhanced through several measures, including the use of government agencies as facilitators, as during the Asian Financial Crisis, or even as official approving bodies of debt restructuring agreements that lack full consensus. These are discussed in Section 7.

Section 8 offers suggestions on how APEC economies can improve the performance of courts and insolvency representatives. Section 9 discusses ways to facilitate creditor engagement, to more effectively monitor courts and insolvency representatives and hold them accountable. Section 10 will focus on some substantive changes to insolvency laws that could facilitate implementation of reorganizations, primarily in economies where recoveries are already above the norm. The final section of Part 3, Section 11, looks at how liquidation outcomes might be improved in the event a reorganization plan is ultimately rejected.

Together, these proposals suggest a layered approach to debt resolution, beginning with OCWs and ending with liquidations. See Table 3 below.

Table 3. Recommendations for Improvements to Insolvency Regimes

Method	OCWs	Hybrid Procedures	Pre-Packaged Judicial Reorganizations	Judicial Reorganizations	Liquidations
Government Involvement	Possibly as a mediator or promotor, following precedents from the Asian Financial Crisis	Agency acts as approver of a plan	Court approves plan and various restructuring measures	Court oversees negotiations and approves plan	Court oversees liquidation sale and payout of creditors

Method	OCWs	Hybrid Procedures	Pre-Packaged Judicial Reorganizations	Judicial Reorganizations	Liquidations
Impact on Debtor and Owners	Continues to operate with owners remaining	Continues to operate with owners remaining	Continues to operate with ownership likely diluted	Continues to operate with ownership likely diluted	Debtor ceases to exist; company operations might continue if sold as going concern
Extent of Debt and Ownership Restructuring	The need to achieve a consensus works against extreme measures	Limited only to specific classes of creditors	Usually more comprehensive than OCWs and hybrids	Usually more comprehensive than hybrids or pre-packs	None. Creditors simply paid out according to priority.
Opportunities for Widespread Implementation	Substantial	Substantial, though less than OCWs	Limited by preparation efforts and capacity of legal system	Limited by capacity of legal system	Limited by political constraints
Shortcomings	Cannot bind minority dissenting creditors Could be unwound subsequently if appears suspicious	Cannot provide longer-term protection, financing or reversal of transactions	Substantial pre-court work Risk that marginalized persons and unfavored constituencies may lose out on a court's protections for due process	Lengthy, expensive, possibility of surprising results	Possibility of value destroying sale of debtor's assets on a piecemeal basis; possibility that government and secured creditors take substantial portion of sales proceeds

SECTION 7. FACILITATING DEBT REDUCTION THROUGH OUT-OF-COURT WORKOUTS

As noted in Section 5, distressed debtor companies and their creditors regularly attempt OCWs in many APEC economies. The suggestions below might enhance their effectiveness.

7.1 PROMOTE THE BENEFITS OF OCWS AND PROVIDE STAKEHOLDERS WITH TOOLKITS FOR IMPLEMENTING THEM

Given the current economic crisis, tens of thousands of companies across APEC will likely be searching for ways to resolve indebtedness. A substantial portion, along with their creditors, will be undertaking these efforts for the first time. No doubt, professional advisors will emerge to assist at least some of these efforts, but they may not be fully available or affordable, depending on the size of the company and the debt needing resolution.

A recent World Bank publication may be of some assistance under these circumstances. A *Toolkit for Out-of-Court Workouts*, published in 2016, is designed to “help stakeholders implement informal corporate restructuring principles in order to successfully rescue failing enterprises.”³² In addition to background and instructions, it offers various sample documents to illustrate how the process might work. APEC economies may wish to consider adapting and distributing these and other materials³³ via local chambers of commerce and other business groups.

7.2 EQUALIZE THE TAX TREATMENT OF DEBT FORGIVENESS IN OCWS WITH SIMILAR TRANSACTIONS APPROVED BY A COURT

It is a common policy among tax authorities to treat the forgiveness of debt as income received by the debtor, hence creating a new tax liability. In order to facilitate company recovery, tax rules of various economies exempt debtors from such treatment, but usually if such adjustment receives court approval.

This policy might push debtors to eschew OCWs in favor of in-court proceedings to obtain the tax benefit. This might add to court burdens that could have otherwise been avoided.

APEC economies should consider the extent such rules are inadvertently discouraging OCWs. Providing tax relief to debtors who obtained debt forgiveness obtained through informal methods might, of course, be subject to abuse. This needs to be weighed against the benefits of channeling debtors out of formal proceedings, especially if large volumes of cases are expected.

At least one APEC economy appears to have found middle ground. Thailand appears to allow exemption from such taxes if the OCW is done under the auspices of its central bank.³⁴

7.3 INSULATE TRANSACTIONS MADE IN GOOD FAITH DURING AN OCW FROM SUBSEQUENT REVERSAL IN A FORMAL PROCEEDING

As noted in Annex 3.4, nearly all APEC economies allow the reversal of transactions occurring prior to an insolvency case that unfairly prejudice creditors, such as selling assets to insiders at below-market value, or granting certain creditors preferential rights. These rules, however, can potentially unravel arrangements made through an OCW. Imagine, for instance, bond holders surrendering their unsecured claims for reduced claims that are secured by the debtor’s collateral. If the debtor goes into liquidation sometime after the workout, the bondholders who made the deal will likely benefit. Unsecured creditors who were not part of the deal might conclude that they were prejudiced by it and seek a reversal as an unfair preference.

There are two ways to address this problem. Either create a broad and clear “safe harbor” for these arrangements or create a standard by which they could be judged. The former offers greater certainty but might be subject to abuse. The latter is less certain, but forces the parties to the workout to carefully document the benefits to the debtor and to creditors in general.³⁵

³² World Bank. 2016. *A Toolkit for Out-of-Court Workouts*, p. vii.

³³ Stanghellini, Lorenzo *et. al.*, eds. 2018. *Best Practices in European Restructuring: Contractualised Distress Resolution in the Shadow of the Law*. University of Florence.

³⁴ Jullamon, Report on Thailand, p. 739 in ABLI Corporate Restructuring, *supra*, note 21.

³⁵ Garrido, José M. 2011. *Out-of-Court Debt Restructuring*. World Bank, Section 23(d).

Finally, if a government agency is involved either as a mediator among the parties or as an approver of a restructuring plan, APEC economies should consider a rule that, at least initially, presumes the validity of the transactions therein.

7.4 CONSIDER HYBRID MECHANISMS TO BIND MINORITY DISSENTING CREDITORS UNDER THE AUSPICES OF REGULATORY AGENCIES

The contract-based foundation of a traditional OCW creates the need for near consensus in order to obtain an effective agreement. As discussed in Section 5, a growing number of APEC economies have either installed or are exploring mechanisms to solve the creditor holdout problem without the need of expensive court procedures. Such hybrid procedures should carefully balance simplicity and speed with adequate legal protections to creditors who would be bound by a majority vote. Such procedures would likely work best when limited to very specific, easily defined classes of creditors where the existence of the debt and the amounts owed are readily ascertainable. This could include bank loans, bonds, utility debts, and even certain government taxes.

Peru recently enacted temporary, hybrid measures in response to the pandemic. It appears to meet many of the criteria described above. The procedure allows a temporary stay of claim enforcement at the request of the debtor, who also submits a restructuring plan. Creditors, primarily those holding financial and trade related claims, decide on the debtor's plan, all to be done via electronic methods. Although persons holding labor and consumer related claims are not allowed to participate, any restructuring plan needs to account for such claims. Forty percent of resources going toward payment of claims must go to workers claims, and 10% to those of consumers.³⁶ A decision by the voting creditors binds the minority.

SECTION 8. IMPROVING THE PERFORMANCE OF COURTS AND INSOLVENCY REPRESENTATIVES

As noted in Part 3, several courts in APEC economies, despite guidance from laws generally in line with international best practices, have produced recoveries for secured creditors below 50%. In a good portion of these economies, businesses have tended to avoid formal insolvency proceedings.

However, as discussed in Part 1, a combination of economic shock and expiring debt collection moratoria could result in a wave of companies facing accumulated debt due all at once, without the means of paying it all on time. There are at least three possible scenarios if this occurs, none of them optimal:

(1) Debtors will file insolvency cases, seeking in good faith to restructure their businesses. Instead, many will find themselves attempting to resolve arcane and complex issues in courts that have little time to address them properly due to court overload. Others may encounter complex and sometimes conflicting rules, implemented by parties who seem to have an agenda apart from saving the company and guarding creditor interests.

³⁶ Vera-Portocarrero, Anthony. August 2020. [Restructuring Review – Edition 13: Peru](#).

(2) Debtors, seeking to maximize leverage with creditors, will file cases to frustrate debt collection efforts indefinitely, or manipulate the process to emerge with the current ownership essentially unaffected and creditors undercompensated.

(3) Debtors and their creditors, consistent with previous practice of many of their peers, will avoid formal insolvency proceedings and instead muddle through, counting on inefficiencies in debt collection to keep them in business, albeit heavily indebted and unable to attract additional investors or credit.

The suggestions below are offered to minimize the possibilities that these scenarios will occur, with debtors and creditors instead utilizing insolvency courts to adjust debt, ownership, and operations sufficient to revitalize company operations going forward. APEC policy makers may wish to incorporate the suggestions below into a stress test for courts to prepare for a substantial increase in cases (see Section 8.4).

8.1 CONSIDER ESTABLISHING INSOLVENCY RESOLUTION COURTS OR ENHANCING THE CAPACITIES AND PERFORMANCE OF THOSE THAT CURRENTLY EXIST

Court specialization often produces superior results with issues that are arcane and complex.³⁷ The World Bank recognizes that insolvency cases, where practicable, should be heard by judges experienced and knowledgeable on the subject.³⁸ A recent study of the gradual introduction of specialized insolvency courts in China noted improvements in judicial performance after these courts were established in various provinces.³⁹

A minority of APEC economies have identified particular courts in their respective systems to hear insolvency cases. Some are dedicated entirely to insolvency cases (i.e., they hear no other cases) while others have responsibility to hear insolvency cases as they arise, in addition to cases involving other matters. This latter approach makes sense where insolvency cases tend to be less frequent.

Table 4. Insolvency Courts in APEC Economies

Insolvency Courts in APEC Economies	
Courts with dedicated specialized jurisdiction	China; Korea; Thailand; United States
Courts specifically identified to hear insolvency cases in addition to other matters	Hong Kong, China; ⁴⁰ Indonesia; Peru (administrative agency); Philippines; Singapore
No specialization	Australia; Canada ⁴¹ ; Chile;; Japan; ⁴² Malaysia; Mexico; New Zealand; Papua New Guinea; Chinese Taipei; Viet Nam

³⁷ Gramckow, Heike and Walsh, Barry. January 2013. *Developing Specialized Court Services: International Experiences and Lessons Learned*. World Bank, p. 6 (noting enhanced efficiency, quality, and consistency).

³⁸ Insolvency Principles, *supra*, note 19, Principle D1.2.

³⁹ Li, Bo and Ponticelli, Jacopo. March 14, 2019. *Going Bankrupt in China*. Social Science Research Network.

⁴¹ There are commercial lists of judges that specialize in hearing insolvency matters in some provinces in Canada.

⁴² The Tokyo and Osaka district courts, however, have each established bankruptcy and insolvency chambers, where judges are likely to be more experienced. Abe *et al.*, Report on Japan, p. 371 in ABLI Corporate Restructuring, *supra*, note 21.

Several factors could potentially inform a decision to create a specialized court for insolvency cases. A tradition of specialized courts in various areas, and sufficient numbers of insolvency cases would be at least two. Another could be the extent to which direct judicial involvement is needed. In Australia; Canada; Hong Kong, China; Malaysia; and New Zealand, insolvency law is less procedurally oriented, with less need for judicial approvals to drive the case.

Two economies identified as having low recovery rates may wish to undertake reforms in this area. Viet Nam may wish to consider establishing specialized insolvency courts as has been done with several of its neighbors in the region.⁴³ Currently district level courts handle insolvency cases of companies that have headquarters within their districts.⁴⁴

The Philippines, which has already committed itself to judicial specialization in this area, may wish to consider further consolidation, especially if cases begin increasing. Sixty different courts, spread across the economy and consisting of one judge each, have jurisdiction over insolvency cases. These courts were assigned this responsibility in 2000, when “corporate rehabilitation” cases were transferred from the economy’s securities regulator to the courts.⁴⁵ In addition to this transfer, the Supreme Court expanded the jurisdiction of these special commercial courts to cover cases governed by FRIA for insolvency of individuals, corporations, partnerships, and other business associations, among others. In the years prior to 2000, the securities regulator operated hearing rooms located in Manila and two provincial centers, one in the middle and one in the southern part of the economy (all well-connected by flights). Such a semi-centralized arrangement might be worth reconsidering, given that insolvency cases tend to have stakeholders that are distributed over a broad geographic area.

For the specialized courts in China, Korea, Thailand, and the United States, decision makers should consider additional resources for these courts, at least temporarily. Reassigning judges, or bringing some out of retirement, might prove to be workable solutions. Such recommendations have already been proposed in the United States.⁴⁶

8.2 ESTABLISH BODIES TO LICENSE, NOMINATE, AND MONITOR INSOLVENCY REPRESENTATIVES

Annex 3.2.1 notes that, as a general principle, insolvency representatives are held accountable to creditors in most APEC economies. But, as seen in recent complaints about “administrator malfeasance” voiced in Australia and New Zealand,⁴⁷ this principle is not necessarily easy to practice.

Many creditors, as will be discussed in Section 9, lack the skills and incentives necessary to monitor these individuals effectively. Further, if an insolvency representative is under performing, but only at the

⁴³ For more details on factors to consider in establishing an insolvency court, see OECD. February 7-8, 2001. Synthesis Note: Insolvency Reforms in Asia: An Assessment of the Implementation Process and the Role of Judiciary, Point 4.

⁴⁴ Fish, Robert. December 22, 2014. Vietnam Legal Update: New Law on Bankruptcy to take Effect in January. *Lexology*.

⁴⁵ Supreme Court of the Philippines. November 21, 2000. Resolution Designating Certain Branches of Regional Trial Courts to Try and Decide Cases formerly Cognizable by the Securities and Exchange Commission *En Banc*. A.M. NO. 00-11-03-SC.

⁴⁶ Iverson, Ben and Roe, Mark. May 5, 2020. Planning for an American Bankruptcy Epidemic. *Project Syndicate*.

⁴⁷ Restructuring Insolvency and Turnaround Association of New Zealand. December 1, 2016. Increasing Trust in Insolvency Practitioners.

expense of a particular group, it may not be easy to obtain the consensus among creditors sufficient to have him or her dismissed.

Of course, creditors could rely on judges to appoint competent insolvency representatives and discipline them when they err, but painful experience in several emerging markets has demonstrated that judges sometimes become too close to insolvency representatives in the day-to-day administration of a case, losing their objectivity, and sometimes integrity, in the process.

A solution recognized by UNCITRAL⁴⁸ and endorsed by the World Bank⁴⁹ is to establish a government body or association authorized to certify and monitor insolvency representatives. This body could license insolvency practitioners and appoint them when cases arise. Through their licensing power they can enforce standards and ensure transparency and accountability.

To be sure, this solution is not foolproof. A government regulator such as this is vulnerable to capture and manipulation by the insolvency representatives themselves. It is thus advisable to ally such organizations with strong institutions. In Australia, insolvency representatives are subject to oversight by the securities and investments regulator.⁵⁰ In Singapore, the regulatory and licensing functions in respect of insolvency representatives has been consolidated under the Insolvency and Public Trustee's Office under the Ministry of Law. In Mexico, the Federal Institute of Specialists in Commercial Bankruptcy, which is attached to the Council of the Federal Judiciary, performs this service.⁵¹ In the United States, the United States Trustee Program of the Department of Justice, was established more than 30 years ago to nominate and oversee private trustees for most bankruptcy actions.⁵²

At least two APEC economies lack a single regulatory body for insolvency administrators. The Philippines has neither a state regulatory body nor a regulating association. Indonesia has three non-government associations, which, in the past at least, have appeared to compete with each other.

8.3 LIMIT COMMUNICATIONS BETWEEN INSOLVENCY REPRESENTATIVES AND JUDGES TO COURT ROOM DISCUSSIONS AND FORMAL SUBMISSIONS

Most judicial codes of conduct limit the communications that judges may have with parties and their attorneys outside the courtroom or through formal submissions. In at least several economies, such restraints do not apply to communications between judges and insolvency representatives.

Applying such a rule to these communications might add to formalities and paperwork. They would, however, enhance transparency, reduce potential for corruption, and better differentiate the roles of a judge and an insolvency representative in such cases. This has been the working arrangement for insolvency representatives in the United States since at least 1978. In 1991, this prohibition was extended to bankruptcy examiners, even though they were considered officers of the court, further enhancing transparency in the system. The only exceptions to this ban are “communications with the court to discuss general problems of administration and improvement of bankruptcy administration”,

⁴⁸ UNCITRAL Legislative Guide, *supra*, note 19, p. 177.

⁴⁹ Insolvency Principles, *supra*, note 19, Principle D7.

⁵⁰ O'Brien, Maria and Sackar, Timothy. Report on Australia, p. 30 in ABLI Corporate Restructuring, *supra*, note 21.

⁵¹ Other economies with a regulator include Canada; Chile; Hong Kong, China; Malaysia; New Zealand; Peru; Russia; Thailand; and the United States.

⁵² United States trustees nominate and oversee private trustees, rather than court officials, to protect against the moral hazard of a court deciding disputes involving parties appointed by those courts.

and are limited to United States Trustees, and excludes others including reorganization representatives.⁵³

To be sure, this could amount to a substantial shift in practice in some economies. In considering such a proposal, decision makers may wish to identify the actual instances under their respective laws where a judge needs to provide legally required input behind closed doors. If such instances do exist, the focus should be on how those discussions could be done with greater procedural protections.

Finally, if a shift is made to more open discussions, decision makers should consider the impact of any court-room rules on advocacy and representation (i.e., attorneys only). A non-attorney insolvency representative should be able to address a judge without necessarily engaging an attorney to do so.

8.4 UNDERTAKE A RIGOROUS REVIEW OF CURRENT COURT CAPACITY TO HANDLE CASES, UNDER CURRENT CONDITIONS AND THOSE EXPECTED IN THE NEAR FUTURE

In 2007, an OECD publication focused on various ways to “close the implementation gap” with respect to insolvency systems in Asia.⁵⁴ While there has been much progress since then, it is likely that this gap remains, and that in certain economies it is sub-optimally wide.

It is beyond this consultation paper to identify all implementation gaps across 21 APEC economies. With the challenges looming for insolvency regimes in the region, decision makers should consider stress testing their courts and the agencies (if any) that regulate insolvency representatives. The twelve questions raised below can serve as a start:

1. How many cases have commenced under the formal insolvency system during the past five years?
2. How many judges have more than three years of insolvency experience?
3. To what extent is up-to-date information regarding the filing and resolution insolvency cases, collected, centralized and published?
4. To what extent does the court system publish key documents about, and generated by, the proceedings?
5. To what extent are insolvency representatives appointed and monitored by a regulatory agency?
6. To what extent are the availability of court facilities consistent with the geographic location of companies likely to file insolvency cases?
7. How many times in the past five years has an insolvency representative been removed or sanctioned for incompetence or malfeasance?
8. With what kind of effectiveness could an insolvency court receive and process claims of over 200 creditors in a particular case?
9. How often are insolvency cases appealed? What have been the effects of such appeals on the progress of a case?
10. How many reorganizations have been approved by a court?
11. How many liquidations have been carried out under the auspices of the court or an insolvency representative?

⁵³ Prohibition of Ex Parte Contacts, Rule 9003 of the Federal Rules of Bankruptcy Procedure; Fed. R. Bankr. P. 9003(b).

⁵⁴ OECD. November 26, 2007. Asian Insolvency Systems: Closing the Implementation Gap.

12. How effectively would the relevant insolvency courts handle insolvency cases if the historical number of filings tripled over the coming six months and continued at that pace for the following year?

SECTION 9. ENCOURAGING EFFECTIVE CREDITOR ENGAGEMENT IN INSOLVENCY PROCEEDINGS

Sub-optimal court performance with insolvency cases has traditionally been characterized as a supply problem. But it's a demand problem as well. At its essence, a company in formal insolvency proceedings represents a corporate governance problem — one with profound potential for stakeholder dysfunctionality.

When a company is operating normally, its governance is framed by principal-agent dynamics: the principals are the shareholders and the agents are company managers.⁵⁵ When a company comes under insolvency, creditors displace shareholders as the primary principals. Likewise, the insolvency representative and, to a certain extent, the judge presiding over the insolvency case, become the agents.

It is well-recognized that shareholders face challenges in monitoring and disciplining managers under normal operating conditions. This challenge substantially increases when creditors become the new principals, often with little prior notice, or knowledge of the rules or practices of governance in an insolvency setting.

Many private creditors, especially those that are unsecured, expect to be one-time participants in an insolvency procedure. They also expect repayment amounting to only a fraction of the face value of their claims. Such conditions provide little incentive to learn these rules and exercise their rights as private creditors. The government, by contrast, is often a repeat player in these proceedings. It often lacks, however, the tools and flexibilities to engage constructively in an insolvency proceeding.

The result is an oversight deficiency that offers the agents in an insolvency case opportunities to divert resources at potentially extortionary levels.

There are four routes to improving governance of insolvency cases from a demand perspective: encouraging trades of distressed debt, improving transparency of case-related information, encouraging use of virtual creditor meetings, and minimizing the disruptive effects of government-controlled debt.⁵⁶ These are discussed below.

9.1 CONSOLIDATE AND IMPROVE THE PROFESSIONALISM OF CREDITORS THROUGH DISTRESSED DEBT TRADING

In at least several APEC economies, claims of distressed companies are traded on a regular basis, albeit in informal markets. Anecdotal evidence indicates that trading volumes have grown in recent years, and

⁵⁵ Jensen, Michael and Meckling, William. July 1976. *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*. *Journal of Financial Economics*, v.3, pp. 305–360.

⁵⁶ It should be noted that recommendations on creditor committees, which a majority of economies currently allow, are not included in this section. They certainly have their place in larger cases, especially where the debtor's management is acting as the insolvency representative (sometimes described as a debtor in possession). Nevertheless, they can add an additional level of complexity to cases and can also be the source of self-dealing and abuse. While there is no doubt that creditor committee practice can be improved in a number of economies, tackling the nuances involved in their establishment and operation is beyond the scope of this consultation paper.

in the United States, at least, have “revolutionized bankruptcy by making it a much more market driven process.”⁵⁷

9.1.1 Distressed Debt and Governance

From a creditor's point of view, the possible sale of a claim against a distressed debtor to a third party, albeit at a discount in most cases, offers a chance to gain an immediate payment and discard a longer-term headache. For the debtor, it means negotiating with fewer persons, as trading leads to consolidation of claim holders. For the insolvency representative, it potentially means more work, keeping track of who the creditors might be at any given time. It also might mean more demands from savvy creditors seeking accountability and transparency.

Allowing and even facilitating the trading of claims against distressed companies could improve creditor performance as effective stakeholders. Purchasers of such claims tend to be repeat players who understand the relevant insolvency regime and have incentives to build on such learning. Furthermore, having purchased claims at a discount in most cases, distressed debt investors have greater latitude in compromising, while still retaining a profit.

9.1.2 Minimizing Transactional Costs of Debt Trading

The largest markets for distressed debt are the various corporate bond exchanges operating in APEC economies. For instance, the volume of bonds traded on US markets of companies that have defaulted and/or have entered Chapter 11 is approximately \$36 billion⁵⁸ and will likely go higher.

Outside of bond markets, most APEC economies generally allow creditors to assign their claims to third parties. Nevertheless, reputable law firms and others have documented obstacles in several economies. For instance:

- In Japan, the purchaser of a claim cannot assert rights against the debtor unless the assignor gives notice to the debtor of the transfer.⁵⁹
- In Malaysia, the central bank imposes various restrictions on the transfer of non-performing loans (“NPLs”).⁶⁰
- In the Philippines, non-resident foreign purchasers of debt risk running afoul of licensing requirements for doing business in the economy.⁶¹ Furthermore, one commentator notes that the Philippine Civil Code limits the debtor’s liability under a claim to the amount the assignee paid for it, if the assignee obtained it after the commencement of litigation.⁶² However, the

⁵⁷ Levitin, Adam. 2009. *Bankruptcy Markets: Making Sense of Claims Trading*. *Brooklyn Journal of Corporate, Financial and Commercial Law*, v. 64, p. 65.

⁵⁸ Friedman, Jeff. May 13, 2020. *Introducing “Stress Performing Credit”*. *GMO* (tracking the price of bonds of Frontier Communications after it entered reorganization proceedings in the United States).

⁵⁹ Gilmore, David, Report on Japan, in *Guide to Restructuring Turnaround and Insolvency in Asia-Pacific*. October 2018. *Herbert Smith Freehills*, p. 112 (hereinafter “HSF Guide”). This is not freely available on the Internet. Please see notes on sources in the Introduction for details.

⁶⁰ Godwin, Peter and Cooper, Glynn. Report on Malaysia, p. 127 in HSF Guide, *supra*, note 56.

⁶¹ Pamfilo, Jose. Report on the Philippines, p. 190 in HSF Guide, *supra*, note 56.

⁶² Espiritu, Alberto. March 17, 2015. Conference Presentation: Debtor’s Options and Other Remedies (citing to Article 1634 of the Philippine Civil Code). Not available on Internet. Copy on file with Nathan Associates.

consolidated enrolled Financial Institutions Strategic Transfer (FIST) Bill⁶³, which was signed into law on February 16, 2021, will help protect the financial system by allowing financial institutions to dispose their non-performing assets (NPA) and loans to free up capital for sectors and consumers that need it most.

- In Thailand, several court decisions have voided transfers of claims made at a substantial discount when the transferee is not a licensed asset management company.⁶⁴

Addressing these and perhaps other frictions with respect to the trading of claims could lead to creditors performing their role as stakeholder more effectively.

Furthermore, several APEC economies have supported the formation of asset management companies (“AMCs”) for purposes of purchasing NPLs from banks. Such programs give financial institutions the political and legal cover to acknowledge NPLs, to transfer them for some compensation, and to refocus on their regular business.

To date, NPLs are not a major factor in the economic crisis. Accelerating or reviving various AMC-supportive programs should be considered if NPLs begin to impinge on private sector lending. Lifting existing restrictions on who may buy such debt, such as foreign investors, is likely to increase prices and bring in more energy and greater diversity to the mix of creditors in a restructuring negotiation. Recent efforts of such reform are provisions in Phase I of the recent economic and trade agreement between the United States and China. The agreement allows American firms to “apply for asset management company licenses that would permit them to acquire non-performing loans directly from Chinese banks.”⁶⁵

Beyond corporate bonds and NPLs, markets become extremely murky. Unsecured claims, represented by a large and potentially lucrative set of instruments, are held by a diverse group of commercial lenders, trade creditors, workers, and even mass tort claimants. The face value of the claim (unlike a bond or promissory note) is often unclear, and the claim itself is not even certain until approved in an insolvency proceeding. Markets for invoices exist in various locations, but they generally represent small groups of repeat players trading within a particular industry. Several companies have attempted to create claim trading platforms. None have appeared to thrive.

A potentially impactful reform across many APEC economies would be to increase visibility of approved claims against a debtor. A list of approved claims (with creditor contact details) published online with creditors’ consent would likely attract potential buyers in many economies.

9.2 EMPOWER CREDITORS THROUGH ENHANCED TRANSPARENCY

The World Bank’s Insolvency Principles emphasize the need for transparency in insolvency proceedings. Rules regulating insolvency regimes should “ensure ready access to relevant court records, court

⁶³The FIST Bill has been ratified by the bicameral committee last 15 December 2020, http://legacy.senate.gov.ph/photo_release/2020/1215_01.asp

⁶⁴ Thongpakdee, Chinnawat and Phesprasert, Amornwit. Report on Thailand, par. 25 in HSF Guide, *supra*, note 56.

⁶⁵ Economic and Trade Agreement Between the Government of the United States of America and the Government of the People’s Republic of China, January 15, 2020, Article 4.5(2).

hearings, debtor and financial data, and other public information.”⁶⁶ The goal was to “enable creditors to effectively monitor and participate in insolvency proceedings to ensure fairness and integrity.” Before widespread rollout of the Internet, this would mean either attendance at meetings or requests for paper reports.

This has all changed. For instance, Frontier Communications recently went into Chapter 11 proceedings in the United States. On Frontier’s investor relations webpage there is a button labeled “Frontier Communications Restructuring Information,” which brings the reader to a page of links about its Chapter 11 filing and its effort to have a restructuring plan approved. Need more information? A site run by Prime Clerk, a designated claim and noticing agent, aggregates information on Chapter 11 cases. A quick look-up of Frontier Communications leads the reader to a menu where the reader can decide to file a claim, read the restructuring proposal, or seek to join a creditors’ committee.

In China, the Supreme People’s Court offers substantial amounts of information on debtors in insolvency proceedings through its National Enterprise Bankruptcy Information Disclosure Platform.⁶⁷ The recent launch of this site is part of an effort of the court, as noted in recent guidance, to emphasize the use of technology to facilitate creditor participation and make the proceedings more efficient.⁶⁸ Indonesia, which already posts information of cases on line, is planning to increase the amount of information on cases in the coming months.⁶⁹

Individually debtors are beginning to use the Internet to provide information to creditors, as seen recently with Thai Airways and LATAM, two airlines that recently came under reorganization proceedings in Thailand and Chile respectively.

To be sure, Thai Airways and LATAM are high profile companies that need to engage their customers as much as their creditors. Nevertheless, similar opportunities exist at a more modest scale. Thousands of businesses in the Asia-Pacific region have essentially moved their corporate sites to Facebook, which allows users to form special interest groups and post photos, documents, maps, schedules, all free of charge. Articles on stakeholder engagement through social media appear in business journals and websites with increasing frequency.

To address the need for information, EODB suggests that creditors be given the right to request it (a pull model). But, given the plunging cost of information sharing, this consultation paper proposes that the courts and insolvency representatives be required to make information available online. There are two possible ways in which this could work:

- (1) Offer information directly through a central site (see description of China’s information platform).
- (2) Designate private judicial support services to take on clerical functions with respect to cases with respect to a sizable number of creditors. The U.S. offers such an example.

⁶⁶ Insolvency Principles, *supra*, note 19, Principle D4.

⁶⁷ The site, <https://pccz.court.gov.cn/pcajxxw/index/xxwsy>, is in Chinese language only. Google, however, offers a relatively workable translation to English.

⁶⁸ Yang, Zhang and Steele, Stacy. 18 June 2020. [COVID-19 and the Current State of Insolvency in China](#).

⁶⁹ Nurmansyah, Emir and Sidartha, Kevin. August 2020. [Restructuring Review – Edition 13: Indonesia](#).

- (3) Require that insolvency representatives utilize low-cost Internet tools to share information on the cases they manage. This might encourage private parties to offer these services in multiple cases.

The exact solution most likely depends on the extent to which burdens for creditor communications is shared between the courts and the insolvency representative. Regardless, it would seem that low-cost technological solutions are readily available.

9.3 EXPAND OPPORTUNITIES FOR CREDITORS TO PARTICIPATE IN MEETINGS ELECTRONICALLY

In response to the pandemic several economies are encouraging the use of technology to reduce risk of meeting in person and to increase participation by creditors. The Supreme People’s Court of China is actively encouraging the use of technology to convene creditor meetings and its online information site is directly facilitating such use.⁷⁰ In Indonesia, a commercial court, in cooperation with the insolvency representatives, utilized “online meeting platforms” to discuss the debt restructuring of a group of indebted textile companies. Although in response to the pandemic, observers noted how this innovation could become the “new normal” for many future cases.⁷¹

To organize these meetings and reduce possibilities for objection, decision makers should review the extent that the underlying insolvency laws allow for such meetings and to issue interpretive guidance for judges and insolvency representatives.

9.4 MINIMIZE THE DISRUPTIVE IMPACT OF GOVERNMENT CLAIMS

In many APEC economies, government claims (e.g., for unpaid taxes) enjoy preferred status *vis a vis* general unsecured creditors.⁷² In some economies they are superior to even secured claims.

These policies create challenges. They are addressed in turn:

9.4.1 When Government Claims are Superior to Secured Claims. This undermines lender certainty, which translates into stricter loan requirements and higher interest rates. Furthermore, it makes secured lenders extremely reluctant to support or participate in insolvency proceedings. Many economies used to recognize such rights, sometimes referred to as the “crown preference.” Reforms in at least two APEC economies (Australia and New Zealand) have replaced the crown preference with a more equitable sharing of risk when a debtor comes under financial distress.

9.4.2 When Government Claims are Superior to Unsecured Claims. Unsecured creditors are likely to receive far less in a liquidation, and in most cases, a reorganization. This greatly diminishes their interest or encourages them to distort the proceedings to avoid this result.

9.4.3 When Government Claims arise from Market Activities. To blunt the effects of the crisis, governments have been guaranteeing loans or making them directly. Both types of transactions could result in governments as creditors in an OCW or in-court proceeding. Should this become an increasingly likely event, APEC economies should clarify the priority such claims have. Presumably, a

⁷⁰ Yang, *supra*, note 64.

⁷¹ Nurmansyah, *supra*, note 65.

⁷² Thailand appears to be a notable exception. See Jullamon, Report on Thailand, p. 753 in ABLI Corporate Restructuring, *supra*, note 21.

government claimant having acquired a commercial claim, should stand as a commercial creditor. That has not always been the case, though. Such uncertainty could lead to conflict and delay if not clarified.

Whatever their priority amongst other claimants, there remains an additional challenge: government creditors rarely demonstrate the flexibility and independence regularly exercised by private creditors in deciding whether to support a reorganization. It would take substantial training and institutional commitment to develop government units capable of making these decisions on a predictable, consistent, and sustainable basis. In such cases, the best result might be to have government creditors stand equally with unsecured creditors in terms of treatment. With respect to voting, government creditors would defer to the judgment that private unsecured creditors would make, subject to judicial scrutiny to ensure that government interests are not unfairly prejudiced.

SECTION 10. ADJUSTING SUBSTANTIVE RULES AND PROCEDURES TO FACILITATE IN-COURT RESTRUCTURING

Apart from institutional performance, the EODB metrics point to several potential reforms that should be considered in particular by the economies that demonstrated relatively high recoveries.

10.1 CONSIDER A MORE EQUITABLE BALANCE BETWEEN PROTECTIONS FOR SECURED CREDITORS AND MAINTAINING THE DEBTOR'S BUSINESS AS A GOING CONCERN

The protection of secured creditors' rights is crucial for a vibrant market economy. In APEC economies where these rights are particularly strong, policy makers should consider how to balance their protections against policies that encourage in-court reorganizations.

The tension is this: companies in financial distress often need additional financing. They also might need breathing space from actions by secured creditors trying to seize and sell their collateral. But to allow a debtor to use already-mortgaged collateral as security for a new loan threatens the secured creditor's chances of being repaid in full. Likewise, if a debtor can keep collateral during a reorganization, and that collateral loses value over time, a secured creditor's repayment chances decrease.

EODB asks questions relating to both these issues, and in both situations, they reveal reluctance by several APEC economies to jeopardize secured creditor rights.

These concerns are very legitimate, but they can be allayed by rules that nevertheless allow the debtor its post-commencement financing and breathing space if it can show that the secured creditors nevertheless have "adequate protection." In other words, they will still receive full payment (or at least an amount equivalent to what they would have received were they allowed to foreclose on the collateral). To make this balance work, APEC economies need to ensure that they establish insolvency regimes with strict time limits and sensible judges who can understand the issues and make commercially reasonable judgments.

Judges in the United States have been striking these balances since 1978, when Chapter 11 was enacted. Singapore recently enacted amendments to permit post commencement financing and enhance the moratorium to provide more breathing space for debtors, with various safeguards included to protect creditors' interests. At least two other APEC economies are considering similar reforms (Malaysia and Hong Kong, China). Of the two reforms, post commencement financing seems more crucial, and can

actually help manage the risk. Very strict debtor covenants over the terms of post-commencement financing (perhaps through a line of revolving credit) can help control the debtor during plan negotiation.

10.2 REDUCE TIME SPENT IN FORMAL PROCEEDINGS

As implied by the discussion above, time is often the enemy of a successful insolvency reorganization. There are two ways to keep things short: clear and enforceable time limits for plan approval, and pre-packaged insolvency cases.

10.2.1. Time Limits on the Negotiation Process

Almost all APEC economies that contemplate judicial reorganization proceedings impose limits on the negotiation period. Negotiation periods can be, for instance, from 30 days to 9 months.

Typically, insolvency laws allow for creditors to begin enforcing their claims, or to have the case converted to a liquidation once the period has expired.

The problem is that procedural deadlines tend to be extendable, whether rules allow extension or not. It is not unusual to find cases continued month-by-month in hopes that an outside investor will emerge to inject capital sufficient to save the company, or that the parties will finally come to a workable consensus on a reorganization plan. The temptation to delay grows when the business is still active, and a liquidation would mean dismissal of workers. Shareholders, incumbent managers, and junior creditors, who tend to be more comfortable with delays, understand this dynamic and will often use it to gain leverage. Rules that avoid some of the more painful results of a liquidation, however, can make it easier to convert a case to that type of proceeding. See Section 11.

10.2.2. Pre-Packaged Cases

During the first dozen years after its introduction in the United States, many considered Chapter 11 a failure. Debtors and their owners seemed to have too much leverage. Cases went on too long or produced reorganization plans that were unrealistic. Or cases would come back to the courts for another round of reorganization proceedings, which practitioners sardonically described as “Chapter 22s.”⁷³

Times have changed. Many Chapter 11 cases now last only a few months, with plans that tend to be less favorable to incumbent owners. One of the main reasons for this evolution was the growing popularity of plans that were essentially agreed to before a case was filed. With all the negotiating completed, the main steps after filing involved the judge’s *pro-forma* approval of a creditors’ vote.⁷⁴

Parallel to this evolution in practice, several APEC economies (e.g., Chile, Mexico, the Philippines, and Singapore) specifically allow for pre-packaged plans in their legislation. China recently recognized pre-packaged plans through regulations issued by the Supreme People’s Court.⁷⁵

⁷³ Roe, Mark. 2017. *Three Ages of Bankruptcy*. Harvard Business Law Review, v. 7, p. 187 (noting the “bargaining deadlocks, incumbent entrenchment, and delays that afflicted Chapter 11’s first decade”).

⁷⁴ Morrison, Edward and Saavedra, Andrea. 2020. *Bankruptcy’s Role in the COVID-19 Crisis*. Columbia Law School Scholarship Repository, p. 5 (noting the role played by pre-packaged bankruptcies in completing “speedy” reorganizations of large businesses).

⁷⁵ Ma, Xiao. March 3, 2020. *China Continues to Issue New Rules Promoting Corporate Rescue Culture, Facilitation of Bankruptcy Proceedings*. Harvard Law School Bankruptcy Roundtable.

APEC decision makers in other economies might consider a similar reform. Efficiency gains must not extinguish fairness; creditors' consent must not be illusory and parties whose claims or interests are being extinguished by the plan must be provided with meaningful opportunities to present their positions before the court based upon a full record. The Philippines insolvency law as well as Singapore's Insolvency, Restructuring and Dissolution Act 2018 offer clear examples of procedures involving pre-packaged plans.

10.3 FACILITATE REJECTION OF CONTRACTS THAT ARE BURDENSOME TO THE DEBTOR

EODB recommends as good practice provisions that allow the debtor in an in-court proceeding to reject contracts that are burdensome to it.⁷⁶ Nearly all APEC economies reportedly allow such rejections. At this level of abstraction, this seems rather simple. Parties are free to reject contracts under most legal systems subject to the penalties that the law may impose. Beyond that, though, numerous questions arise:

- How long does the insolvency representative have to inform a counterparty about a rejection?
- Does the insolvency representative need permission from the judge to reject a contract?
- What are the consequences of an insolvency representative failing to express a decision on the contract?
- What is the status of any penalties or damages called for under the contract?
- What is the status of claims by the counterparty for services performed after the filing but before the notice of rejection?
- What obligations does the counterparty have to perform prior to hearing from the insolvency representative? What are the consequences of failing to perform?
- To what extent should restrictions on employer termination of labor contracts apply during an insolvency reorganization?

Questions such as these are fraught with difficult choices that usually lead to complex rules and disputes before judges.⁷⁷ Reform efforts in this area are not likely to yield clear and beneficial results quickly.

10.4 FACILITATE CONTINUATION OF CONTRACTS CRUCIAL TO THE DEBTOR'S OPERATIONS

As it does with the right to reject contracts, EODB supports “explicit and direct provisions” in insolvency law that would authorize “continuation of contracts . . . for goods and services essential to the debtor’s business operations.” As noted in Annex 3.1.4, not all APEC economies follow this advice. EODB identified Australia; Brunei; Canada; Hong Kong, China; Malaysia; New Zealand; Papua New Guinea; Peru; Russia; Thailand; and Viet Nam as hesitant to allow such continuation.

As with terminating these ongoing contracts (Section 10.3), the issue is fraught with difficulty, raising many of the same questions. However, unlike the termination question, reforms here might lead to clearer results that could facilitate successful reorganizations.

Attention should be focused on the validity of contractual provisions that call for the automatic termination of the relationship with the debtor upon the filing of an insolvency case. These provisions, often referred to as *ipso facto* clauses, are found in many standard commercial contracts. Australia and

⁷⁶ EODB. [Resolving Insolvency, Good Practices](#). World Bank, p. 6.

⁷⁷ Pottow, John. 2018. [A New Approach to Executory Contracts](#). *Texas Law Review*, v. 96(7) (“Few topics have bedeviled the bankruptcy community as much as the proper treatment of executory contracts”).

Singapore have recently restricted the rights of counterparties to exercise rights under these clauses when a debtor comes under insolvency proceedings.

But what happens when a debtor has already breached a contract prior to filing for insolvency (for instance, failing to pay rent on a commercial lease) but then wishes to continue? Some insolvency systems will allow the debtor to continue the contract so long as it “cures the breach,” i.e. pays back past moneys owed. Others do not require this, allowing the arrangement to continue so long as debtor meets obligations going forward. The first approach takes into account concerns about freedom of contract and the rights of the counterparty. The second approach maximizes the use of the debtor’s resources. There are several intermediate solutions as well.⁷⁸

While jurisdictions differ on obligations to cure, most insolvency regimes give priority status to any claims of the continued counterparty arising from activities after the filing, as they are expenses of reorganization.

10.5 REDUCE REGULATORY REQUIREMENTS FOR ISSUANCE OF NEW SHARES OF A COMPANY IN INSOLVENCY PROCEEDINGS

A potentially useful tool in reorganization is the debt-equity swap. In such transactions, a group of creditors agree to have their claims against the debtor canceled or reduced in exchange for shares in the company. This arrangement can strengthen the debtor’s balance sheet, reduce the relative shareholdings of existing owners, and give the former creditors a chance to share in the future profits of a reorganized company.

Most APEC economies allow for these transactions but impose heavy regulatory burdens on a key aspect of the deal: the issuance of new shares. The regulations are often justified by the need to protect investors, but do not contemplate shares being issued during an insolvency proceeding. Policy makers should consider whether some of these regulatory protections could be discarded, given the need for quick resolution, and disclosures that likely exist in a reorganization plan.

Perhaps a more difficult choice is whether shareholder consent, usually required by applicable corporate governance rules, is still required once the debtor comes under insolvency proceedings. APEC economies diverge on this. A rule that requires consent in line with normally applicable corporate governance rules gives the shareholders considerable leverage in a reorganization case. If a debt-equity swap is crucial to a successful reorganization, and they have a veto right over that swap pursuant to a need for their consent to issue more shares, they can use the veto to extract concessions from creditors.⁷⁹ This leverage increases to the extent a liquidation is likely to harm the interests of other creditors (i.e., leave them facing a partial payout or no payout).

⁷⁸ UNCITRAL Legislative Guide, *supra*, note 19, pp. 126–128.

⁷⁹ Yee, *supra*, note 69, pp. 25–26. See also Kargman, Steven. August 25, 2020. Challenges of Emerging Market Restructurings in the Age of COVID-19. *Harvard Law School Bankruptcy Roundtable* (observing the tendency of controlling shareholders to resist a restructuring plan that “seeks to diminish or set limits on their control of the company in question).

The alternative is to discard rules requiring shareholder consent, which Thailand has apparently done,⁸⁰ or to allow a judge to override the withholding of this consent where it appears unreasonable and in bad faith. Such actions are discussed in more detail in Section 10.6.3.

10.6 CAREFULLY CONSIDER PROCEDURES THAT MINIMIZE THE POSSIBILITY OF HOLDOUTS BY SHAREHOLDERS AND CERTAIN CLASSES OF CREDITORS

As noted in Section 5, OCWs suffer from the possibility that some creditors would hold back on agreeing to an otherwise fair compromise on claims, hoping that others will nevertheless agree, allowing them to be paid in full. In an in-court proceeding, hold-out problems continue to exist, but this time the holdouts are entire classes of creditors or, as described in Section 10.5, shareholders.

Class-wide holdouts can put an otherwise fair, equitable and economically viable reorganization effort at risk. There are several ways to reduce this possibility. They are discussed below, with the most straightforward ones discussed first.

10.6.1 Minimize the Number of Classes that Vote on a Reorganization Plan

Insolvency reorganizations would be greatly simplified if all creditors were in the same class and voted as one large group. This, however, never happens. Special rights for secured creditors, workers and the government in the event of a liquidation invariably mean that the vote to avoid a liquidation (i.e., to undertake a reorganization) needs to be approved by these classes as well as by the general, unsecured creditors.

To the extent the laws of APEC economies call for classes beyond the minimum number, they should be looked at carefully. Each additional class is a potential holdout.

10.6.2 Allow for Deemed Consent by Creditors Unimpaired by the Reorganization

In some cases, secured creditors and some senior creditors will be confident of payment even if the company is liquidated. To avoid the possibility of them using this to gain even more concessions through a reorganization, it is useful for reorganization planners to call for repayment of all arrears, penalties, etc., and to resume payments according to the original contract after plan approval. Under such circumstances, courts in nine APEC economies can deem that these creditors have essentially approved the plan (See Annex 3.3). This reduces the chance for them to act strategically.

In ten economies⁸¹ though, the consent of such creditors is still required. Allowing the presiding court to deem that these creditors have approved the plan would be a relatively straightforward process with little downside risk.

10.6.3 Allow Judicial Overrides of Strategic or Bad Faith Class Holdouts

As discussed earlier, voting on reorganization plans often occurs by class. In most jurisdictions with class-based voting, majorities for each class must support the plan in order for it to be approved. Economies diverge though on options when a particular class votes to reject a plan. In several APEC economies, for instance Australia, Canada, Malaysia, and New Zealand, this means that the effort to

⁸⁰ Thongpakdee, Report on Thailand, par. 28 in HSF Guide, *supra*, note 56.

⁸¹ They are Australia, Brunei, China, Indonesia, Malaysia, Mexico, New Zealand, Peru, Singapore, and Chinese Taipei.

reorganize fails, with the debtor normally going into liquidation. Other economies allow the presiding court to essentially override the dissenting class if certain criteria are met. China, Japan, Philippines, Thailand and the United States allow for these so-called cross-class cram downs. Singapore recently did as well.⁸² Outside of APEC, the United Kingdom and the European Union have recently introduced, or are in the process of introducing, cross-class cram downs.

The policy behind allowing cross-class cram downs is to prevent a fair and reasonable reorganization plan to be rejected due to unreasonable or strategic voting by a particular class. In the United States, where cram downs have been allowed for more than 40 years, it appears to have worked. Recorded court decisions feature numerous examples of “cram down plans” being approved and several commentators have suggested that the mere threat of a cram down (with perhaps a harsher result) can prompt a class to approve a plan.⁸³

Nevertheless, the introduction of such cram down procedures is risky. It vests the court hearing the case with substantial power over whether a plan should be approved, power that normally sits with the stakeholders in a reorganization proceeding.

The court’s power stems from the standards for imposing the cram down. While the criteria vary, a key requirement is that the creditors in the objecting class receive via reorganization as much as they would receive if the debtor were liquidated.⁸⁴ A concern prevalent in many jurisdictions, these decision are essentially “comparative valuations between rescue and liquidation, which are often speculative or in some cases nuanced to make rescue sound more attractive.”⁸⁵ Where this decision is highly contested, it can turn into a complex battle of experts, allowing the court to appear reasonable whichever side it chooses. This could lead to lengthy litigation, appeal, and potential for corruption.

Economies weighing such reforms should closely study the recent debates on these standards in Singapore, the United Kingdom, and the European Union. Substantial weight should be given to the capacity of judges to make such decisions in a predictable manner, and possibly less judicially intensive alternatives, such as those discussed above, or by making liquidations more palatable as an alternative to reorganization. This is discussed in Section II.

10.7 CONSIDER EXCEPTIONS TO FOREIGN EQUITY OWNERSHIP OBTAINED THROUGH DEBT RESTRUCTURING

Many APEC economies impose limits on the extent of foreign equity investment in domestic companies. During economic crises, new capital for companies in distress often becomes scarce. Several APEC economies have allowed for exceptions to these restrictions to facilitate new capital to help resolve insolvency. Such exemptions should be considered.

⁸² See section 70 of Singapore’s Insolvency, Restructuring and Dissolution Act (2018).

⁸³ Broude, Richard. 1984. Cramdown and Chapter 11 of the Bankruptcy Code: The Settlement Imperative, vol. 39/2, p. 441 (available via registration). LoPucki, Lynn and Whitford, William C. 1990. Bargaining Over Equity’s Share in the Bankruptcy Reorganization of Large, Publicly Held Companies. University of Pennsylvania Law Review, vol. 139, p. 125.

⁸⁴ In the United States, this is a per-creditor requirement called the “best interest of creditors test”: even if an impaired class accepts the plan, the court cannot confirm the plan if a creditor in that class will not receive or retain an equivalent or greater amount than what the creditor would receive in a chapter 7 liquidation.

⁸⁵ Yee, *supra*, note 69, p. 20 (quoting the concerns of the minority of the Insolvency Law Reform Commission).

10.8 DEVELOP SIMPLIFIED PROCEEDINGS FOR SMALLER ENTERPRISES

Despite various programs by APEC economies to provide economic assistance to smaller businesses, there is little doubt that many will be skirting financial ruin by the time various restrictions end, consumers regain confidence, and commerce returns to some semblance of normalcy. Some may be able to negotiate an OCW, but others might need the tools available only in an in-court proceeding.

In-court reorganizations, unfortunately, are particularly challenging for smaller companies for at least two reasons. The first is cost. In-court cases are expensive, and while smaller cases might be cheaper than bigger cases, certain fixed costs cannot be avoided. Larger companies can absorb these costs easier than smaller ones.

The second is the confluence of company value and ownership. A major facilitating technique in larger reorganizations is to “liquidate the ownership” i.e., wipe out shareholders’ equity, replacing it with shares held by new owners. This is difficult to do when the owners of a smaller company tend to be its managers. Wiping out that capital, i.e., by separating owners from the company, often means a substantial loss of value.

Nevertheless, there are two approaches to this problem, both of which could be the subject of entirely separate consultation papers. They are discussed briefly below.

10.8.1. Confirmation of Limited Liability for Owners of Small Businesses and the Possibility of Individual Insolvency Proceedings where such Protection is not Available

It is often said that one of the benefits of insolvency is the “fresh start” it gives companies and entrepreneurs. When a business fails, the owner loses many of his/her assets, but can start anew after an insolvency proceeding, free of creditor claims.

To a great extent this already exists outside of insolvency in the form of restrictions on the ability of creditors to pursue business owners for the debts of their businesses. This limited liability, as it is commonly known, normally applies if the owners of the company have incorporated it separately from them, have made the company’s limited liability status known, and have operated it as a separate entity in a commercially reasonable manner with generally adequate capital.

The combination of personal capital and limited liability gives entrepreneurs some leverage with creditors in an OCW. A threat to put the company into liquidation is real. And creditors know that the value of the assets minus the owners’ ongoing participation are considerably less. This creates opportunities for a successful OCW, which APEC economies should consider supporting through the recommendations described in Section 7. In particular the creation of mechanisms that allow creditors voting as a group to bind minority dissenting creditors combined with active promotion of negotiation toolkits would likely be among the more effective interventions.

Problems occur, though, if the owner has personally guaranteed some or all of the debts of the company. Under such conditions, the owner’s threat to walk away from the business is less credible. This also implicates the concept of individual bankruptcy, which will be addressed as part of the World Bank’s anticipated recommendations on insolvency proceedings for smaller companies (see below).

10.8.2. In-Court Insolvency Proceedings for Small and Medium-Sized Businesses

While all APEC economies offer various forms of assistance to small and medium-sized enterprises, less than a third (Chile, Japan, Korea, Thailand, and the United States) have established separate insolvency rules for them. In 2019, the United States updated its legislation to remedy perceived shortcomings.⁸⁶ In 2020, in response to the pandemic, it made these procedures available to a broader swath of businesses. In view of the COVID-19 pandemic, Singapore's recently passed Insolvency, Restructuring and Dissolution (Amendment) Bill (Bill No. 36/2020) will provide for temporary measures in the form of simplified insolvency procedures for micro and small companies (i.e. companies with annual revenue of less than SGD 1 million and SGD 10 million respectively) when it comes into force. The Insolvency, Restructuring and Dissolution (Amendment) Act 2020 has come into force on 29 January 2021, and a company may, during a prescribed period of 6 months commencing 29 January 2021, apply to be accepted into the programme for the simplified procedures.

The World Bank has been studying options for small and medium-sized enterprises in insolvency proceedings. In 2018, it published an assessment of various regimes for these firms and a set of proposals for best practices.⁸⁷ It has announced plans to publish by the middle of 2020 an updated set of Principles for Effective Insolvency and Creditor/Debtor Regimes. It will include an emphasis on insolvency of small and medium enterprises.⁸⁸

In the meantime, below are some key facets of insolvency regimes for such enterprises gleaned from practices of APEC economies:

- Creditor stay/moratorium
- Procedures for binding minority dissenting creditors
- Standardized forms
- Simplified reporting requirements
- No avoidance actions for unfair preference or transactions
- Formulas for pay schedules

In the legislation it passed last year, the United States created greater opportunities for business owners to keep their ownership, even when a repayment schedule would compromise the claims of creditors. This should increase the attractiveness of these proceedings. The pro-debtor provisions of this act are balanced by the imposition of a private trustee, appointed by the United States Trustee, to oversee the progress of a case through the judicial proceeding and seek to aid in the negotiation of a consensual plan of reorganization. If the plan is “non-consensual” and confirmed through a cram down, the trustee will serve as disbursing agent for plan payments.

⁸⁶ Since 1994, the United States has had provisions specific to the reorganization of small businesses, which include debtors with noncontingent and liquidated secured and unsecured debts of less than a certain threshold, current set at \$2.7 million. However the Small Business Reorganization Act of 2019 expanded the availability of relief.

⁸⁷ World Bank. 2018. [Saving Entrepreneurs, Saving Enterprises: Proposals on the Treatment of MSME Insolvency](#).

⁸⁸ Pazarbasioglu, Ceyla and Mora, Alfonso. May 18, 2020. [Strengthen Insolvency Frameworks to Save Firms and Boost Economic Recovery](#). *World Bank Blogs*.

10.9 ADDRESS CROSS-BORDER ISSUES THAT ARISE IN INSOLVENCY PROCEEDINGS

Companies involved with cross-border trade and investment frequently acquire assets located in more than one economy. They very easily can have contractual counterparties, and hence creditors, located in various economies as well.

In the past, when such a company came under insolvency proceedings in its home economy, it would need to send an insolvency representative to these various locations to collect and sell assets. Economies where such assets were located would often balk at such practices, denying the foreign representative this right in favor of local creditors. Likewise, creditors seeking to collect on their claims in foreign proceedings could not be guaranteed that they would receive treatment equal to domestic creditors in that economy.

Various economies' laws tried to resolve this by use of comity and reciprocity, but this tended to produce inconsistent results. To address this UNCITRAL developed the Model Law on Cross-Border Insolvency (Model Law). The law facilitates cooperation and communication on these matters, with the notion that one jurisdiction should serve as the debtor's center of main interests ("COMI"). In general, issues involving the debtor, its reorganization, or the disposal of its assets and the payment of creditors should be handled by the economy where the COMI is located.

To date, 23 jurisdictions have adopted the Model Law. Ten of them are APEC economies: Australia, Canada, Chile, Japan, Korea, Mexico, New Zealand, the Philippines, Singapore, and the United States. Thailand is reportedly considering its adoption.⁸⁹ Other APEC economies are urged to consider it as well.

SECTION 11. IMPROVING OUTCOMES IN LIQUIDATIONS

Although this consultation paper focuses on OCWs and in-court reorganizations, there are several aspects of liquidation procedures that can affect the dynamics of negotiations over a reorganization plan. Traditionally, liquidations contemplate termination of the debtor's operations, with sale of its assets on a piecemeal basis. Unless the debtor's business model is hopelessly obsolete, piecemeal sales tend to recover less than if the debtor continued to operate. Furthermore, piecemeal liquidations usually entail the dismissal of employees.

For these reasons, it is not difficult to imagine reluctance on the part of judges to terminate a reorganization effort and convert it to liquidation. Owners and junior creditors (facing little likelihood of payment) may attempt to exploit this and push for either delay or treatment in a reorganization disproportionate to what they would be otherwise entitled. One way to address this dynamic is to lessen the likelihood of a harsh liquidation result. Three possible methods are discussed below.

11.1 DISCOURAGE SECURED CREDITORS FROM ENFORCING ON THEIR COLLATERAL SEPARATE FROM THE MAIN LIQUIDATION

Annex 3.1.1 notes that several APEC economies allow secured creditors to move against their collateral in the event of default, even when the debtor is attempting a reorganization. The likelihood of this

⁸⁹ Jullamon, Report on Thailand, p. 761 in ABLI Corporate Restructuring, *supra*, note 21.

happening increases during a liquidation, when the company, in most cases, no longer has a future as a going concern.

This policy helps secured creditors, but it frustrates the opportunity of a liquidator to bundle certain assets to increase overall sales value. One approach is to give the liquidator a limited period of time to sell the collateral on behalf of the secured creditors, as long as the secured creditors are guaranteed full payment. After expiration, secured creditors can move against the property separately.

11.2 ENCOURAGE THE USE OF CREDIT BIDDING

An effective means of increasing the value of assets in a liquidation is to facilitate credit bidding, i.e., letting a secured creditor bid for assets using any amount up to the face value of its loan in lieu of cash. Although many APEC economies do not prohibit this practice, very few specifically allow for it. This has caused problems in jurisdictions invoking strict interpretation of liquidation sale rules. Policy makers should consider making such rights explicit.

11.3 ENCOURAGE LIQUIDATION OF DEBTOR COMPANIES AS GOING CONCERNS

Many APEC economies contemplate alternatives to piecemeal sales. In Australia and Singapore, secured creditors are often given the right to appoint a receiver of a company in default and sell it as a going concern. Going concern sales also occur pursuant to reorganization proposals, sometimes referred to as “liquidating plans.”

Peruvian insolvency law allows a liquidation of the debtor’s assets as a going concern so long as the creditor meeting specifically approves. So far, such attempts have been rare.

To cite an innovative practice trend outside of APEC, liquidators in India have begun selling the assets of debtors as a going concern, pursuant to insolvency legislation passed in 2016.⁹⁰ Although this approach is still being worked out in India, sales in this manner have reportedly produced results superior to a piecemeal liquidation.⁹¹

⁹⁰ Agrawal, Ashmika. 2020. Liquidation As Going Concern Under Insolvency and Bankruptcy Law. *Social Science Research Network*.

⁹¹ Saikat, Das. June 5, 2018. In a First, Firm Liquidated as a Going Concern. *Economic Times*.

PART 4: BAILOUTS AND INSOLVENCY PROCEEDINGS

Despite efforts to delay debt collection and facilitate out-of-court resolution, substantial numbers of companies in APEC economies will need additional assistance in one form or another to avoid full or partial shutdowns. In such cases, and when a company is particularly large or enjoys a high profile, it may be tempted to petition the government for assistance to avoid a shutdown and the negative resultant effects.

The most obvious negative effect is greater unemployment, which entails both political and economic costs. The shutdown of some firms, though, can cause deep systemic impacts as well. Financial institutions are the best example of this. Nearly all APEC economies have established frameworks to avoid, or manage, fallout from their failure.

Examples of non-financial firms who requested government intervention to avoid potential knock-on effects of failure include General Motors and Chrysler (company failure could affect auto parts manufactures during the Global Financial Crisis), Philippine Airlines (importance to overseas foreign workers raised during the Asian Financial Crisis), and Renong Bhd (effect on Malaysian banking system during same).

Outside the financial services industry, legal frameworks rarely determine which firms deserve bailouts. Decisions to bailout firms often appear to be *ad hoc*, reflexive, and sometimes politically motivated. When they drift from well considered justifications, bailouts can waste government resources, create moral hazard, and impinge on competition.

SECTION 12. TYPES OF BAILOUTS

A bailout has been described as a “form of government assistance or intervention specifically defined or intended to assist enterprises facing financial distress and to prevent enterprise failure.”⁹² Past practice and analysis suggest that bailouts of non-financial firms can fall into three broad categories: overt bailouts, covert bailouts, and insolvency resolution bailouts. These are discussed below.

12.1 OVERT BAILOUTS

Overt bailouts involve well publicized transfers of government resources to a firm in financial distress. They usually take the guise of direct loans or, more often, loan guarantees, purchases of equity, or, under extreme circumstances, direct grants.

A direct loan might be preferred where other sources of private finance have dried up and the government needs to move quickly. Where financial institutions are available to lend on the basis of a government guarantee, such is generally preferable to a direct loan as it involves far less out-of-pocket transfers for the government. It does create a contingent liability, however, whose risk might be underestimated, thereby causing its own distortions (see covert bailouts below).⁹³

⁹² Block, Cheryl. 1992. *Overt and Covert Bailouts: Developing a Public Bailout Policy*. *Indiana Law Journal* v. 67(4), p. 960.

⁹³ Heald, David and Hodges, Ron. February 15, 2018. *Accounting for Government Guarantees: Perspectives on Fiscal Transparency from Four Modes of Accounting*, *Accounting and Business Research*, v. 48(7), pp. 782-804 (describing government guarantees as a “new generation of fiscal risks”).

These loans and loan guarantees amount to subsidized credit. They are often coupled with conditions that the debtor's other lenders, shareholders, and workers make concessions. This reduces the moral hazard of the bailout, appears more equitable, and increases the chances that the intervention will achieve its goals. Such conditions, though, take longer and add complexity. Furthermore, they begin to resemble an OCW, with its inherent shortcomings: holdouts and unilateral enforcement actions.

A purchase of newly issued shares by the government also transfers resources to the distressed firm. At the same time, it reduces the influence of the incumbent owners, who, as a result, have a relatively smaller percentage of the total shares. Assuming the government purchases the shares at a price reflecting the distressed value of the firm, the incumbent shareholders (normally the most risk tolerant) are the ones bearing the brunt of the losses. It also gives the government a chance to participate in any upside appreciation in the price of the shares that could result when the company recovers.

By making an equity purchase, though, the government is (unlike a credit guarantee) employing funds that could be used elsewhere. It also makes the government a shareholder, which can affect the governance of the company. If the company fails again, the company's shares, along with those of the government, could be extinguished in an insolvency proceeding.

Sophisticated bailouts often combine loan guarantees with options to obtain shares to ameliorate some of the downsides of these choices.

Finally, a government grant is just that, a no-strings transfer of funds to a firm, or firms in distress. The U.S. airline industry received a grant of US\$5 billion after the 9/11 attacks. These were cast as compensation for the order to ground flights in the days after September 11.⁹⁴

12.2 COVERT BAILOUTS

As noted above, overt bailouts require political will and fiscal resources. When such is lacking, policy makers have been tempted to employ covert bailouts. The author who coined the term described some of the ways they might arise.

Assistance may be provided to a troubled enterprise through special tax breaks. Covert bailouts may also be provided in the form of relief from compliance with burdensome regulation. Finally, covert bailouts may be provided through trade restrictions, tariffs, and quotas on foreign imports.⁹⁵

To be sure, firms in nearly all economies lobby for favorable regulatory and fiscal decisions. The covert bailout is usually directed to a single firm that requires assistance that could otherwise be provided by an overt bailout or a bailout through insolvency resolution. Concrete examples include:

- The imposition of tariffs on large motorcycles imported into the United States in the 1980's when only one firm in the United States was producing such rigs.
- The decision to loosen environmental regulations for the beleaguered U.S. steel industry.

⁹⁴ Casey, Anthony and Posner, Eric. 2015. [A Framework for Bailout Regulation](#). Working Paper No. 530. *University of Chicago Public Law & Legal Theory*, p. 29.

⁹⁵ Block, *supra*, note 87, p. 968.

- The creation of a government loan guarantee program where only one particular troubled company could meet the specified criteria.⁹⁶

Other well documented forms of covert bailouts are included in the literature on soft budget constraints with state owned enterprises. Closer to the topic of this paper, the tolerance of debtor-friendly insolvency proceedings could in itself serve as a covert method for bailing out less competitive enterprises.

Covert bailouts are attractive because their costs are borne by private sector parties rather than the government. This is particularly tempting where an economy finds itself fiscally constrained. The downside is that they undermine the rule of law and the protection of creditors' rights, which then translate into fewer opportunities for the companies, as well as others, to obtain credit on workable terms.

12.3 INSOLVENCY RESOLUTION BAILOUTS

In September 2008, the crisis brewing in the U.S. financial services industry exploded into the Global Financial Crisis, leading to the most severe downturn since the Great Depression. What was the single avoidable cause of the Global Financial Crisis according to many experts? It was the decision to deny an investment firm – Lehman Brothers — a bailout, leaving it to file for Chapter 11 bankruptcy. The filing reportedly caused a chain of events that jeopardized the solvency of financial firms across the globe.⁹⁷

Approximately eight months later a U.S. bankruptcy court approved the Chapter 11 reorganization of the Chrysler Corporation, one of the economy's "Big Three" auto manufacturers. Less than two months later General Motors, another of the Big Three, was sold pursuant to a Chapter 11 plan. In both cases the U.S. government provided bridge, or rescue, financing. Creditors and shareholders suffered losses, but both companies continued operations. This rescued the parts manufacturing supply chain and preserved "jobs up and down the entire auto industry."⁹⁸ With the benefit of ten years' hindsight, it is not difficult to view these two cases as milestones in the recovery from the Global Financial Crisis.

The bankruptcies of Lehman Brothers and GM/Chrysler illustrate some of the risks and benefits of using an insolvency regime to channel government resources into saving companies considered critical for an economy. For instance, allowing a strategically important company to enter a sometimes-hard-to-predict procedure places much power in a judge, who, depending on his or her independence, may have an entirely different approach to addressing the problem. Furthermore, as discussed earlier, insolvency proceedings can be slow and expensive.

Nevertheless, done strategically, where the government serves as the provider of post-commencement financing or takes an active role as a creditor pursuant to tax claims, insolvency-augmented bailouts can avoid many of the problems of overt and covert bailouts discussed above.

For example, insolvency regimes usually impose losses on owners, the stakeholders most cognizant and tolerant of risk. Furthermore, insolvency regimes can give troubled firms breathing space from aggressive creditors and access to financing (as more and more regimes allow and encourage the use of

⁹⁶ *Ibid.*, p. 972.

⁹⁷ Ayotte, Kenneth and Skeel, David. 2010. Bankruptcy or Bailouts? *The Journal of Corporation Law* 35(3) ("the conventional wisdom . . . points to the Lehman bankruptcy as the singular defining moment of the financial crisis").

⁹⁸ Morrison, *supra*, note 72, p. 6.

post-petition or “rescue money”). If correctly constructed, the rules that allow for rescue money can alleviate the need for government loans, because the incentives exist for the private sector to provide loans. This allows the use of government resources elsewhere.

If the government has an ownership stake in the debtor, a reorganization plan could call for their transfer to creditors in exchange for debt forgiveness, or a sale of the government shares with proceeds going to repay creditors. Though this might implicate policies on state ownership, it could lead the post-insolvency debtor in a more commercially oriented direction, away from future financial crises.

The recent decisions of the Thai government with respect to state-owned Thai Airways vividly illustrates this dynamic. In the early months of 2020, the government was considering a 50 billion baht (US\$1.57 billion) loan to an airline already \$7.7 billion in debt. Instead, it decided to file for “rehabilitation” in the Thai Bankruptcy Court, wherein it plans to negotiate with creditors and reduce its state ownership in an effort to stabilize and revitalize the flagship carrier.

SECTION 13. THE BEGINNINGS OF A POLICY FRAMEWORK FOR COMBINING BAILOUT AND INSOLVENCY PROCEEDINGS

The decision of the Thai government to pursue an insolvency procedure rather than a bailout for the economy’s flagship air carrier represents thinking in line with bailouts to the U.S. auto industry channeled through insolvency proceedings during the Global Financial Crisis. Nevertheless, reports described debates within the Thai government about taking such action.

In the wake of the Global Financial Crisis, APEC economies attempted to establish *ex ante* rules to determine when funds for bailouts should be used. Almost all of the focus was on the financial sector, perhaps personified by U.S. legislation (aka “Dodd-Frank”) that sought to deter future financial crises and the bailouts that accompanied it. Few laws in APEC economies, however, directed government action with respect to potential bailouts in the non-financial sectors prior to the current crisis.

Soon after the COVID-19 crisis hit, several APEC economies rolled out stimulus packages of unprecedented size. It will take some time to sift through and distill the scope and effectiveness of these programs, many of which continue. Suffice to say that in many of the stimulus packages, funds have gone toward payments to workers, or to companies specifically to pay workers, rather than companies in general.

To be sure, the U.S. Federal Reserve has been buying corporate bonds and the Bank of Japan has been buying shares in companies. However, these purchases, which are made indirectly via purchases of exchange traded funds holding these instruments, are focused more at maintaining financial stability than necessarily bailing out a specific company.

Nevertheless, with the expected wave of insolvencies, there will be more and more difficult decisions, such as that with Thai Airways.

Although a law on non-financial sector bailouts is likely too constraining, it might be helpful for APEC economies to consider principles with respect to the use of government funds to mitigate or prevent company failure in non-financial sectors going forward. These could then be used to frame decisions, keep them relatively consistent, and defend them in public discussions.

The following is offered as a start for these discussions:

First, do no harm. It should first be stated that an intervention regarding industrial bailouts must not be taken lightly. Substantial industry bailouts undertaken without clear macroeconomic policy coordination. Bailouts, whether overt, covert, and insolvency resolution bailouts undertaken without careful macroeconomic coordination could adversely disrupt this macroeconomic interface and are, therefore, potential sources of adverse shocks or crises that could be magnified and compounded across the real, financial, external and monetary sectors of the domestic economy. The impacts could further spread across economies thus creating a contagion.

Intervene to avoid dislocations with respect to companies whose potential failure creates a systemic risk. This is where various negative, second-order effects could arise after a company failure or the initiation of an insolvency proceeding. A properly prepared and resourced insolvency regime should be able to handle most company reorganizations while minimizing secondary effects.

Protect companies rather than shareholders. In most cases, shareholders are the investors best able to tolerate risk and absorb losses. It is less disruptive and more equitable if a company (and the jobs it represents) is saved but the ownership is essentially replaced.

Protect companies at the expense of the government, not via restrictions on alternatives in the private sector (competition) or impairment of contractual rights (rule of law). This avoids the covert bailout problem described above.

Focus fund transfers on smaller companies rather than larger ones. Smaller companies face greater challenges in attempting to reorganize through formal procedures.

Where an overt bailout of a large company is needed, fund transfers should be offered only on condition of dilution of shareholders and compromises by creditors negotiated with clear deadlines for agreement. This is the equivalent of an OCW. If a solution is not found quickly the company should be allowed, and perhaps even encouraged, to file for in-court reorganization proceedings.

Avoid overt bailouts merely to prevent companies from seeking an in-court reorganization. This is dependent on the confidence of the APEC economy in the reliability and efficiency of its formal insolvency regime.

Establish a unit of individuals that can defend government interests represented by tax claims and other government-owned credit. If such individuals are not capable of making decisions, then establish rules for voting in line with the majority of unsecured creditors.

Avoid interventions to protect government shares in state-owned companies. If the company is in formal insolvency proceedings the shares are of little value and the company essentially belongs to the creditors (many of which could be government creditors).

If the necessary consensus with respect to a systemically important company cannot be reached in a restructuring case, allow a liquidation, but encourage the sale of the company as a going concern. A liquidation can prove to be far simpler than a reorganization. If dislocations of a

liquidation can be avoided through a going-concern sale, this could prove to be a positive result. Allowing such liquidations also will encourage creditors to compromise in future negotiations.

PART 5: SELECTING AND PRIORITIZING REFORMS

This consultation paper offers 31 policy and institution-enhancing recommendations. While they were chosen with the goal of providing APEC economies with possible starting points for reform, it is difficult to imagine that each one of them is appropriate for every given economy. A selection process is offered below.

SECTION 14. SELECTION PROCESS AND CRITERIA

The process below envisions a confirmation of the applicable rules for a given issue. This is followed by consideration of three criteria that can help determine the best candidates for reform efforts.

What are the applicable existing rules and practices for a given economy?

The EODB economy reports and economy metrics are a good start. This consultation paper uses these, as well as various surveys and reports on insolvency law produced by various law firms and think tanks. Most of these are available on the Internet, free of charge. Before moving forward, however, these starting points on existing law should be confirmed with local practitioners. Insolvency law is far too complex and nuanced to rely on secondary or tertiary sources.

Which reforms can be achieved in the near future?

Predicting the likelihood of success with respect to almost any reform requires subtle and tactile understanding of an economy's political economy. What is clear is that reform in the insolvency area is difficult. Of the areas tracked by EODB, Resolving Insolvency has had the fewest success stories over recent years. Nevertheless, the current economic crisis presents a potential opportunity for achieving reforms that would not necessarily be feasible under normal conditions. As noted by an IMF position paper on debt restructuring under conditions analogous to this, the current crisis containment phase might prove to be an opportune time for "advancing law reform" when the "feasibility of debt restructuring is already limited."⁹⁹ Indeed as discussed in the World Bank's *Challenges of Bankruptcy Reform* financial and economic crises have historically offered opportunities to enact reforms that might otherwise "face opposition from lobbies of judges, administrators, and lawyers poised to derail change."¹⁰⁰

Even if reforms are worth trying, though, the likelihood of success among the proposals will vary substantially. This too requires an understanding of political conditions of a particular economy as well as the preferences, flexibilities, and motivations of the relevant decision makers.

In terms of guidance on this question, the best this consultation paper can offer is a suggestion of who the likely decision maker might be for a particular reform. See the table below. Once confirmed, or even corrected, advocates and policy makers can then begin to ascertain whether a particular reform effort is feasible.

⁹⁹ Laryea, *supra*, note 18, p. 16.

¹⁰⁰ Cirmizi, Elena, Klapper, Leora, and Uttamchandi, Mahesh. *The Challenges of Bankruptcy Reform*. World Bank Policy Research Working Papers No. 5448, p. 16.

What reforms offer the clearest benefits?

A consistent challenge with insolvency reform is that there are few easy answers. Some issues are painfully difficult to resolve. This consultation paper has proposed reforms where a reasonable consensus of benefits have formed with a minimum of downsides. Still, some are more controversial than others.

The chart below presents a somewhat subjective but nevertheless soberly considered rating of policy clarity. A rating of 1 means that there are substantial countervailing arguments with respect to a particular recommendation. A rating of 4 indicates that there are substantially fewer, at least relative to other recommendations. Scores of 2 and 3 represent intermediate shades of policy clarity.¹⁰¹

What reforms might have the largest impacts?

As with policy clarity, the reforms this consultation paper proposes vary in terms of potential impact. The summary table below rates them from minor impact (1) to substantial impact (4). This is elaborated further in the comments accompanying each rating.

SECTION 15. A SUMMARY OF PROPOSED REFORMS

The table below summarizes 31 proposed reforms in terms of likely decision makers, policy certainty, and potential impact, according to the discussion above.

Table 5. Proposed Reforms to Insolvency Regimes

	Summary of Proposal (Reference in consultation paper)	Possible Decision Maker(s) w/r/t Proposal	Policy Clarity	Impact	Comment
1	Promote the benefits of OCWs and provide stakeholders with toolkits for implementing them (7.1)	Minister of Economy (or equivalent) Chambers of Commerce	4	3	OCWs will still be limited by the need to achieve near consensus among creditors.
2	Equalize the tax treatment of debt forgiveness in OCWs with similar transactions approved by a court (7.2)	Legislature Tax Authorities	3	3	Potential for abuse exists with agreements to forgive debt outside of court.

¹⁰¹ An example of a policy proposal that could evoke substantial downside concern: allowing an insolvent debtor's management to remain in place without an insolvency representative directly involved. While this idea has merits, it was not included due to potential controversy. See Block-Lieb, Susan and Haliday, Terence. 2017. Global Lawmakers: International Organizations in the Crafting of World Markets. Cambridge University Press, p. 128 (characterizing the approach as controversial, given that it effectively put "the fox in charge of the henhouse as many characterized the US debtor-in-possession system" when the World Bank was crafting its insolvency principles in the late 1990s).

	Summary of Proposal (Reference in consultation paper)	Possible Decision Maker(s) w/r/t Proposal	Policy Clarity	Impact	Comment
3	Insulate transactions made in good faith during an OCW from subsequent reversal in a formal proceeding (7.3)	Legislature	4	2	Impact will be enhanced in jurisdictions where there is evidence of widespread reversals.
4	Establish hybrid mechanisms to bind minority dissenting creditors outside of a court proceeding (7.4)	Legislature	4	4	Few reforms in this consultation paper are this clearly supported and potentially impactful.
5	Consider establishing insolvency resolution courts or enhancing the capacities and performance of those that currently exist (8.1)	Judicial authorities Legislature	3	4	Establishment of specialized courts involves consideration of many factors other than the scope of specialized jurisdiction. Specialization, however, can likely improve court performance substantially with respect to insolvency resolution.
6	Establish bodies to license, nominate and monitor insolvency representatives (8.2)	Legislature Judicial authorities	3	3	Establishing an effective agency and licensing system would require unusually rapid policy reform and institution building in order to have an impact on companies suffering from the current crisis.
7	Limit communications between insolvency representatives and judges to court room discussions and formal submissions (8.3)	Judicial authorities	3	3	This is the second best alternative when insolvency representatives are not subject to agency oversight and launching an agency to regulate insolvency representatives is not feasible in the coming months.
8	Undertake a rigorous review of current court capacity to handle cases under current conditions and those expected in the near future (8.4)	Judicial authorities	4	4	Although not a policy proposal <i>per se</i> , it is an important step in determining opportunities and priorities to deal with the coming challenge.
9	Minimize Transactional Costs of Debt Trading (9.1.2)	Legislature Judicial Authorities	3	4	There are some who have expressed worry about the concerns distressed debt investors have for the long-term health of a company. The benefits, though, of having fewer and more experienced creditors far outweigh any such concerns.

	Summary of Proposal (Reference in consultation paper)	Possible Decision Maker(s) w/r/t Proposal	Policy Clarity	Impact	Comment
10	Empower creditors through transparency (9.2)	Judicial authorities	4	3	Proposals for enhancing transparency can address any concerns about trade secrecy and general confidentiality. Some creditors may remain passive regardless of what information is made available to them.
11	Expand opportunities for creditors to participate in meetings electronically (9.3)	Judicial authorities if not specifically precluded by legislation	4	4	Although made necessary as a result of the pandemic, economies can benefit from making it a standard option for creditors.
12	Revoke rules that place tax authorities above secured creditors in terms of payment priority (9.4.1)	Legislature	4	4	Despite these being well grounded and potentially impactful reforms, they will face substantial resistance in economies where such rules continue to exist.
13	Revoke rules that place tax authorities above unsecured creditors in terms of payment priority (9.4.2)	Legislature	3	3	Having tax claims standing superior to unsecured creditors is less disruptive than having them above secured creditors.
14	Clarify the commercial status of various commercial claims against a debtor acquired by the government (9.4.3)	Ministry of Finance (or equivalent) Judicial authorities (interpretation)	4	3	Few are likely to object to clarifications in this area.
15	Have government representatives representing tax claims vote with the majority of unsecured creditors (9.3)	Ministry of Finance (or equivalent) Legislature	2	4	Officials representing the government often have trouble acting in a commercial manner in reorganization cases. Addressing the challenges involved with this reform goes beyond the scope of this consultation paper.
16	Allow a lender providing post-commencement (new money) financing to a debtor in insolvency proceedings to enjoy a priority superior to that of secured creditors (10.1)	Legislature	3	4	This type of financing can be critical to a debtor's survival during a reorganization. Questions will arise as to whether the priority needs to exceed that of secured creditors.

	Summary of Proposal (Reference in consultation paper)	Possible Decision Maker(s) w/r/t Proposal	Policy Clarity	Impact	Comment
17	Prohibit secured creditors from enforcing their rights against collateral held by the debtor, subject to “adequate protection” rules (10.1)	Legislature	2	2	Balancing the rights of secured creditors against a reorganization effort demands substantial perspective and discernment from judges. At the same time, an insolvency representative is likely to mollify creditor concerns sufficient to have collection efforts abandoned (at least temporarily) by a secured creditor.
18	Impose time limits on reorganization proceedings (10.2.1)	Legislature Judicial authorities	4	2	Time limits can almost always be extended.
19	Encourage the use of pre-packaged reorganization cases (10.2.2)	Legislature Judicial authorities	4	4	Pre-packaged cases combine out-of-court negotiation with the potential for obtaining the benefits of in-court reorganization
20	Facilitate rejection of contracts that are burdensome to the debtor (10.3)	Legislature	2	2	There are many nuances to consider with this reform with payoff to the debtor that appears only to be marginal as compared to other reforms.
21	Facilitate continuation of contracts crucial to the debtor’s operations (10.4)	Legislature	3	4	While there are nuances with this proposal, the payoffs to the debtor and a potential reorganization is much greater.
22	Reduce regulatory requirements for issuance of shares of a company in insolvency proceedings (10.5)	Securities market regulator Legislature	3	3	There might very well be investor protection concerns behind regulatory requirements.
23	Minimize the number of classes that vote on a reorganization plan (10.6.1)	Legislature	4	3	Fewer classes reduce the chance any given one will decide to holdout for strategic or bad-faith reasons.
24	Allow for deemed consent by creditors unimpaired by the reorganization (10.6.2)	Legislature Judicial authorities	3	2	The impact of this reform is tempered by the fact that most creditors unimpaired by the plan will likely go along with it.

	Summary of Proposal (Reference in consultation paper)	Possible Decision Maker(s) w/r/t Proposal	Policy Clarity	Impact	Comment
25	Allow judicial overrides of class holdouts done for strategic or bad faith reasons (10.6.3)	Legislature	2	4	Wielded by judges who can make quick, rational, and merit-based decisions, the power to impose a cross-class cram down is potentially very impactful. Wielded by judges with less experience and/or integrity, it can create sub-optimal results.
26	Consider exceptions to restrictions on foreign equity ownership obtained through a reorganization (10.7)	Legislature	2	3	Legislation that opens up markets to foreign investment can be controversial. Domestic capital may be sufficient to fill this gap, so long as sufficient trust exists in the proceedings.
27	Establish in-court Insolvency proceedings for micro, small and medium sized businesses (10.8.2)	Legislature	2	2	In-court proceedings tend to be expensive propositions for smaller debtors, even with simplified procedures.
28	Adopt the model UNCITRAL Model Law on Cross-Border Insolvency Proceedings (10.9)	Legislature	3	3	The model law may raise sovereignty concerns in some circles. It is possible to still conduct cross-border proceedings without resort to the model law.
29	Discourage secured creditors from enforcing on their collateral separate from the main liquidation (11.1)	Legislature	2	3	Liquidation is generally associated with piecemeal sales. Allowing the secured creditor separate enforcement is consistent with that understanding. An insolvency representative is likely to mollify creditor concerns sufficient to abandon collection efforts when he or she needs to sell the assets as a whole or as a going concern.
30	Encourage the use of credit bidding (11.2)	Judicial authorities Legislature	4	3	Parties wishing to credit bid often arrange for it with a bit of legal assistance.
31	Encourage liquidation of debtor companies as going concerns (11.3)	Legislature	3	4	This concept is still relatively novel in a liquidation setting. By preserving company value in a sale, it makes liquidations far more attractive as alternatives.

ANNEX I: ELEMENTS AND INCENTIVES OF AN INSOLVENCY SYSTEM

As the Global Financial Crisis resolved itself in the early teens, corporate financial distress and insolvency faded from the headlines. To refresh recollections, as well as orient readers new to this topic, below are some basic terms and concepts useful for reading this consultation paper. To the extent possible, usage follows EODB terminology.

I.1 THE PROBLEM AND THE PROCESS

Insolvency and bankruptcy: A company is considered insolvent when it cannot pay its debts as they come due (cash flow insolvency), or when its liabilities exceed its assets (balance sheet insolvency). Bankruptcy, strictly speaking, describes a judicial decision and process recognizing insolvency and addressing it. In other words, insolvency describes a financial condition, and bankruptcy describes the process that resolves it. The term bankruptcy, however, is rarely used outside the United States. To describe the cure for insolvency, it would be accurate to say insolvency resolution. But when combined with other terms, it makes a mouthful. Writers on the topic often drop “resolution” from the term. This consultation paper does so as well.

Insolvency law: This refers to the law that usually governs in-court proceedings to resolve insolvency.

Insolvency proceedings or in-court proceedings: This is the judicial process to resolve insolvency. It can be instituted by a creditor, but is increasingly be initiated by debtors in order to gain insolvency protection.

Insolvency representative: A professional appointed to oversee the debtor and administer the insolvency case. Often referred to as an insolvency receiver or administrator.

Insolvency regime: This includes an insolvency law and the institutions (courts, regulatory agencies, insolvency practitioners) that implement it.

Claim: This is a legally recognized right to collect money owed by a debtor. A person with a claim is a creditor. Most laws recognize many types of claims and many types of creditors.

Secured claim: This claim is said to be secured by the right to seize particular property of the debtor and sell it to generate funds for repayment. The property securing the claim is usually referred to as collateral.

Administrative claim: This is a claim against the debtor that arises from activities after the insolvency proceedings commence. The debtor’s unpaid utility bills during periods after commencement would be a simple example.

Unsecured claim: Unsecured claims carry rights against the debtor’s property, but only the property in general. Unsecured creditors can seize and sell property of the debtor to repay debts, but only after going to court and only (in practical terms) with respect to property that is not serving as collateral.

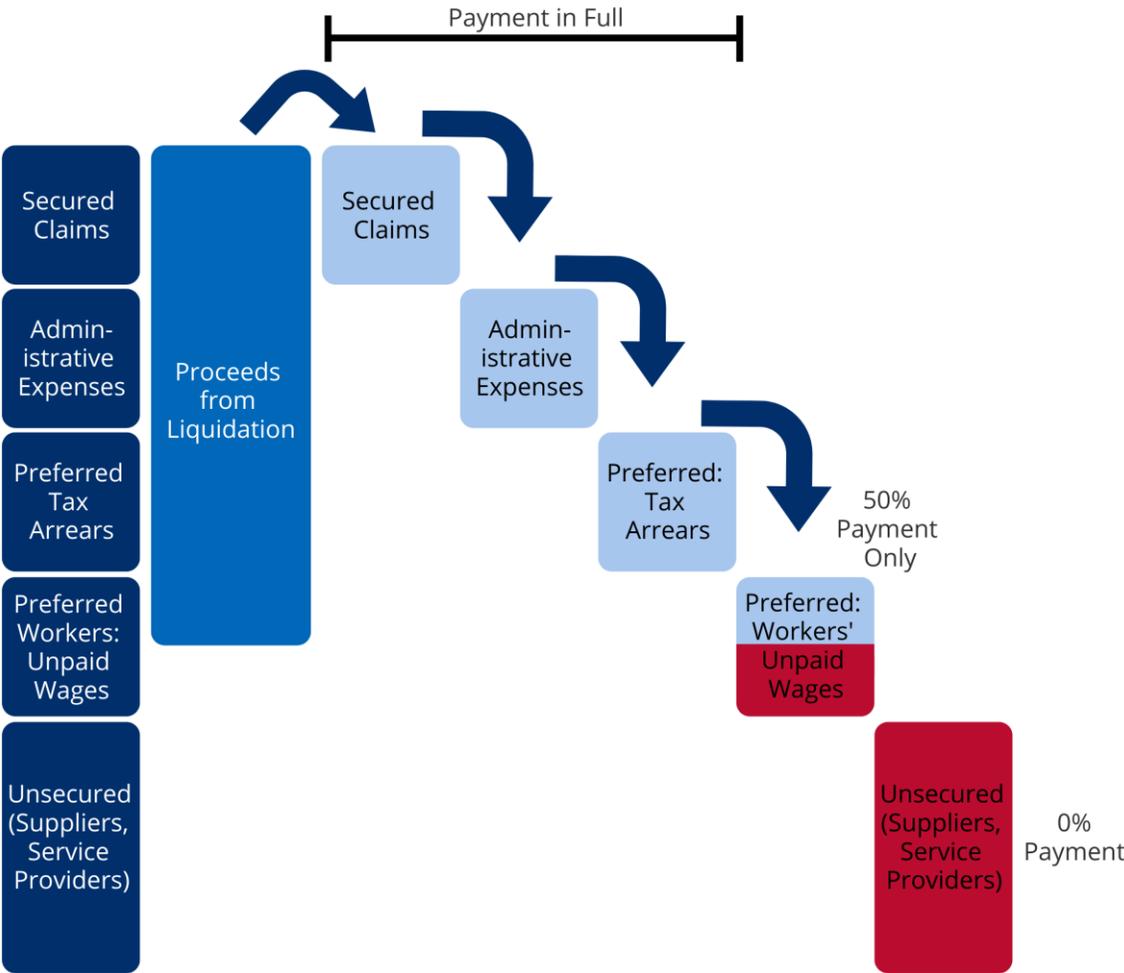
Priority of payments in liquidation: When a company goes out of business, its property is often sold in a liquidation. The liquidation proceeds are used to pay creditors. When funds are insufficient to satisfy all

claims, a liquidator pays the creditors according to rules on priority of payments, which are usually established by legislation, oftentimes in an insolvency law.

1.2 PAYMENT WATERFALL IN A LIQUIDATION

It is very rare for creditors to equally bear the losses from non-payment when liquidation funds fall short of the total claims against the company. Instead, priority-of-payment rules require different classes of creditors to be paid off in tiers. A creditor class in a lower tier cannot be paid unless the class above receives payment in full. This has been likened to a cascading waterfall where each pool represents a different tier of creditors. When a pool along these cascading tiers fills only partly due to exhaustion of supply, no water thereafter may reach the pools below. See diagram.

Figure 5. Payment Waterfall in Liquidation



Although many companies in an insolvency case never reach liquidation, the payment waterfall nevertheless establishes the baseline entitlement for creditors to be paid in the alternative, such as in a reorganization. Tensions arise when creditors try to move themselves up to a higher tier (leaving less water for those below) or attempt to divert flows from upper tiers to produce more water at their level. Large shareholders often prove skillful in this.

Preferred creditors: These creditors occupy pools higher up on the liquidation waterfall. Preferred claims differ by insolvency regime. They nevertheless often include claims of the government for unpaid taxes, claims of workers for unpaid wages, and administrative expenses.

Creditor class: Generally, these are creditors sharing the same pool along the payment waterfall.

Shareholders: These are the owners of the company that has come under insolvency protection. They occupy the lowest tier on the waterfall should a liquidation occur, so much so that payments to shareholders are exceedingly rare. Because large shareholders often hold inside information and special skills important to the insolvent company's future, they often gain more from a reorganization (usually through retained ownership rights) than what might otherwise be expected.

Stakeholders: All the various groups above.

I.3 ADMINISTRATION, REORGANIZATION, AND RESTRUCTURING

Reorganization: Most stakeholders want to avoid liquidation. To do so, they will petition a court to put the debtor company under insolvency protection. During that time, the debtor and/or its creditors will consider operational and financial measures to return the debtor to a viable state, resulting in a reorganization plan. If the creditors approve, the debtor is considered “rescued” or “rehabilitated” and emerges from the insolvency proceeding. How to make this more likely in APEC economies is the focus of this consultation paper.

Insolvency protection: These encompass the various restrictions on claims by creditors that protect a debtor once it has filed for an insolvency proceeding.

Stay: Sometimes referred to as a “moratorium” or a “suspension of claims” this refers to a temporary legal prohibition against a creditor filing, continuing to enforce, or collecting on a claim. This is a form of insolvency protection. It gives the debtor's management or an insolvency representative a respite in order to liquidate or reorganize the debtor. Secured creditors often oppose the stay, as their payment is likely assured through a liquidation or through a foreclosure on the collateral. Unsecured creditors and shareholders usually benefit from the stay, because it delays a liquidation or foreclosure, which will most likely result in little or no proceeds for them.

Post-commencement financing: This refers to financing that lenders sometimes make available to the debtor after an insolvency case commences. Depending on the jurisdiction, it might be referred to as rescue financing or new money financing.

Restructuring: Sometime referred to as debt restructuring. It usually refers to the changes to a debtor's obligations as the result of an OCW or perhaps a scheme of arrangement.

Scheme of arrangement: This is the device used by companies in several jurisdictions based on English law to adjust debts. It usually contemplates putting creditors into classes and having them vote for the “scheme” that adjusts the claims of all creditors in the class if voting thresholds are met. Court approval is normally required to ensure that the proceedings were fair and in the creditors' interests.

ANNEX 2: ASPECTS OF OCW SUPPORT STRUCTURES UTILIZED DURING THE ASIAN CRISIS

Feature	Indonesia	Republic of Korea	Malaysia	Thailand
Name of initiative or coordinating body	Jakarta Initiative Task Force (JITF)	Corporate Restructuring Coordination Committee (CRCC)	Corporate Debt Restructuring Committee (CDRC)	Corporate Debt Restructuring Advisory Committee (CDRAC)
Basic approach	Forum for negotiations, followed by adoption of time-bound mediation procedures	Forum for negotiations	Forum for negotiations	Forum for facilitation, superseded by contractual approach (debtor- creditor agreements)
Onset of the crisis	Late 1997	Late 1997	Late 1997	Late 1997
Resolution of inter-creditor disputes	No special procedure	Possibility to have loan of opposing creditor purchased; also, arbitration committee consisting of private experts	Nothing special, apart from persuasion by central bank	Three-person panel to attribute differences, but any concerned creditor can opt out
Default structure for failure to reach agreement	JTIF may refer uncooperative debtor to government for possible bankruptcy petition	Foreclosure, liquidation through court receivership	Foreclosure, liquidation or referral to asset management company with super-administrative powers	If less than 50 percent support the proposed workout, debtor-credit agreement obliges creditors to petition court for collection of debts

Source: Laryea, *supra*, note 81. P.16 (drawing from Claessens, Stijn. 2005. Policy Approaches to Corporate Restructuring around the World: What Worked, What Failed? in *Corporate Restructuring: Lessons from Experience* (Washington: World Bank), p. 16 (not available on the Internet)).

ANNEX 3: ASPECTS OF INSOLVENCY LAWS TRACKED BY EODB

The consistency of APEC insolvency systems with specific elements of the SOIFX and other indices¹⁰² is discussed below.

3.1 FACILITATION OF CONTINUED OPERATIONS DURING NEGOTIATIONS

In order to find a solution to its financial distress a debtor often needs breathing space from existing creditors and “new money” such as a line of credit, to support operations. A progressive insolvency regime provides for both.

3.1.1 SUSPENDING THE RIGHTS OF CREDITORS TO ENFORCE CLAIMS AGAINST THE DEBTOR

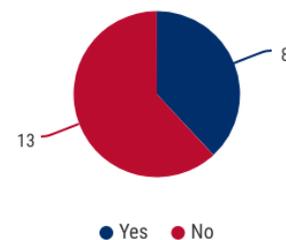
In many economies the biggest threat to operations is an enforcement action by a creditor (e.g., a claim for breach of contract, request to foreclose on mortgaged property etc.). Although not tracked by EODB, almost all economies offer a “stay” (i.e., a temporary moratorium) against unsecured creditor claims in the context of an in-court reorganization.

Debtors in nearly all APEC economies are allowed to initiate such proceedings.¹⁰³ The exception is Papua New Guinea¹⁰⁴ whilst in Hong Kong, China, in the absence of a bespoke statutory procedure, the same effect of a “stay” is achieved by the provisional liquidation regime.¹⁰⁵

While in-court procedures will generally halt enforcement efforts of unsecured creditors, APEC economies diverge on whether such a stay should also apply to creditors with claims secured by collateral. Only eight APEC economies impose an “automatic stay on enforcement when a debtor enters a court-supervised reorganization procedure.”¹⁰⁶

The divergence on whether to stay the enforcement efforts of secured creditors no doubt reflects differences of opinion on how to balance protections for a cornerstone creditor right against the need to support reorganization efforts. Indeed, even economies that enforce stays against secured creditors condition them on actions to ensure that a creditor’s security is not eroded during the course of the

Are secured creditors subject to an automatic stay on enforcement when a debtor enters a court-supervised reorganization procedure? Does the law protect secured creditors’ rights by providing clear grounds for relief from the stay and sets a time limit for it?



¹⁰² The EODB’s Strength of Legal Rights Index for Getting Credit.

¹⁰³ Doing Business tracks whether a debtor may file for in-court “reorganization.”

¹⁰⁴ Mugambwa, John and Amankwah, Harrison. 2007. Commercial and Business Organizations Law in Papua New Guinea, pp. 528-529 (noting how the economy’s formal remedies for debtors during insolvency are limited to liquidation and receivership). Note, however, that during a liquidation proceeding, the Companies Act of Papua New Guinea allows for a “compromise proposal” that, if approved by a majority of creditors and the court, could bind minority dissenters. If carefully planned and executed, this could have the same practical effects as an in-court restructuring.

¹⁰⁵ “Hong Kong does not offer an insolvency process that provides for the restructuring of a failing corporation, whereby the company may continue to trade in the way permitted in US Chapter 11 proceedings or administration in England and Wales.” Pugh, Report on Hong Kong, China, p. 203 in ABLI Corporate Restructuring, *supra*, note 21.

¹⁰⁶ This is tracked by EODB’s strength of Legal Rights Index for Getting Credit.

proceedings.¹⁰⁷ Such determinations are often difficult to make. UNCITRAL’s guidance on insolvency legislation notes “the potential cost and complexity of those measures, including valuation” and the need for courts “to be able to make difficult commercial decisions on the question of protection.”¹⁰⁸

Given the complexity of these determinations, it is not difficult to imagine reluctance to subject the claims of secured creditors to such vagaries. The risk, however, is that aggressive creditors secured by collateral crucial to the debtor’s continued viability (for instance, passenger planes of a commercial airline) could prevent an otherwise workable reorganization through their enforcement actions (such as seizing the planes as they land in a foreign airport).

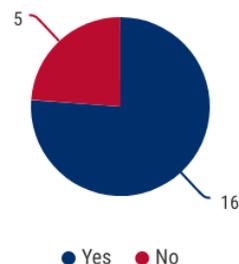
3.1.2 HELPING THE DEBTOR OBTAIN ADDITIONAL CREDIT DURING THE PROCEEDINGS

Many companies rely on lines of credit and other short-term financing to conduct business. This can dry up during periods of financial distress with existing creditors terminating credit lines and new creditors reluctant to lend.

To address these circumstances, insolvency laws often grant preferred status to creditors who lend to the debtor after a proceeding begins. According to EODB and other surveys, 16 out of 21 APEC economies provide for this possibility. Those that do not include Malaysia, New Zealand, Papua New Guinea, Viet Nam, and Hong Kong, China.

Among the economies that do allow such financing, there is less consensus on whether such lenders deserved repayment rights superior to secured creditors. Of the 16 that reportedly contemplate such financing, only seven would go so far as to promote these new money creditors to “prime” pre-existing secured creditors.¹⁰⁹ This reluctance most likely reflects concerns over the possibility that secured lenders could find their claims eroded by profligate, post-commencement financing.

Does the insolvency framework provide for the possibility of the debtor obtaining credit after commencement of insolvency proceedings?



¹⁰⁷ For instance, insolvency laws of the United States and the Philippines call for “adequate protection” of secured creditor claims during proceedings. US courts have granted such relief, even to the detriment of a reorganization effort.

¹⁰⁸ UNCITRAL Legislative Guide, *supra*, note 19, p. 95.

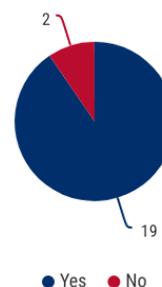
¹⁰⁹ Of the remaining nine, six would allow the new lenders a claim superior to other unsecured creditors only. One (Indonesia) assigned no priority to such credit. Note that a recent survey reports that new legislation in Singapore allows for priority. Sandrasegara, Report on Singapore, p. 632 in ABLI Corporate Restructuring, *supra*, note 21.

3.1.3 TERMINATING BURDENSOME CONTRACTS

As noted above, a debtor sometimes needs to reject contracts that might prove burdensome moving forward. While most economies allow parties to breach a contract, the result might be burdensome penalties. In an extreme case, a debtor, without specific protection under an insolvency law, might find itself facing an order to compel performance.

EODB reports that all APEC economies but Peru and Chile allow these contracts to be rejected. EODB does not report on how penalties will be treated. For instance, penalties could be ruled invalid (debtor friendly), made an administrative expense (not debtor friendly), or considered an unsecured claim, even if the rejection occurs after the insolvency case begins (a balanced approach).

Does the insolvency framework allow the rejection by the debtor of overly burdensome contracts?

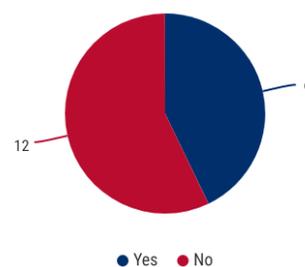


3.1.4 CONTINUING CONTRACTS CRUCIAL TO THE DEBTOR'S BUSINESS

As much as the debtor might identify certain contracts to reject, it might need others for continued operation, such as a commercial lease where it conducts business. In response to the COVID-19 pandemic and enforced lockdowns, several APEC economies have temporarily prevented lessors from evicting tenants for non-payment. These restrictions will eventually end, however, bringing rights under these lease contracts to the forefront.

EODB reports that ten of the APEC economies would “allow the continuation of contracts supplying essential goods and services to the debtor.” They include Chile, China, Indonesia, Japan, Korea, Mexico, the Philippines, Chinese Taipei, Singapore, and the United States.

Does the insolvency framework allow the continuation of contracts supplying essential goods and services to the debtor?



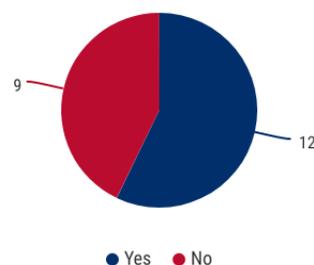
3.2 ENCOURAGEMENT OF CREDITOR PARTICIPATION

Creditor participation is crucial to the success of an insolvency proceeding. A competent and responsive insolvency representative certainly can facilitate creditor involvement, as can access to information. EODB metrics offer some insights in this area.

3.2.1 HAVING A QUALIFIED AND MOTIVATED INSOLVENCY REPRESENTATIVE ADMINISTER THE PROCEEDINGS

Nearly every APEC economy requires the appointment of an insolvency representative to handle, or at least oversee, case administration and the debtor’s commercial affairs. These individuals play a crucial role in a reorganization effort. Outcomes often turn on their competence, loyalty, and integrity. Doing Business thus allocates higher scores to economies that allow creditors to approve the appointment of this individual.

Does the insolvency framework require approval by the creditors for selection or appointment of the insolvency representative?



According to EODB, creditors apparently have such rights in slightly more than half of the APEC economies. The lack of consensus on creditor input during appointment most likely stems from practical

questions of assembling creditors to make approval early in a case, when assistance from an insolvency representative is crucial. Just as important is the right to remove an insolvency representative and a means of policing the performance of these individuals over time. See Section 8.2 for recommendations in this area.

3.2.2 PROVIDING CREDITORS WITH SUFFICIENT INFORMATION TO FOLLOW AND PARTICIPATE IN THE PROCEEDINGS

EODB notes the importance of creditors having access to information about the “financial state of the debtor on a continuous basis . . . without significant impediments.” Consequently, it asks whether the insolvency framework gives creditors the “right to request information from the insolvency representative.” Eight APEC economies offered such rights, according to EODB. This paper urges economies to consider going further, requiring broader disclosure of information through low-cost Internet based channels (See Section 9.2).

3.3 FACILITATION OF DEBTOR-CREDITOR NEGOTIATIONS

As noted above, in an OCW, negotiated arrangements to modify creditor claims traditionally bind only those who sign on to collective or individual agreements. Although not recorded explicitly by EODB, it is clear that all APEC economies have court-supervised processes that allow creditors to vote on proposed adjustments to their claims. These adjustments apply to all creditors (with certain exceptions) should the vote meet the required threshold.¹¹⁰

Creditors, however, rarely vote as a general group. Insolvency regimes instead divide them into classes when voting. The rules on classifying creditors vary, but a major principle is to define them by what they would likely receive in a liquidation. Normally if a debtor is liquidated, secured creditors receive substantially more than unsecured debtors (See Annex 1.2, description of the Payment Waterfall in a Liquidation). As a result, secured creditors vote separately from unsecured creditors, with even more sub-classifications possible.

EODB reports that nine APEC economies undertake voting in this manner. This appears low. It is very likely that EODB is not counting creditor voting that occurs to approve a scheme of arrangement, which is often used to adjust creditor claims in economies such as Australia and Singapore.

EODB also tracks whether the “dissenting creditors in a reorganization receive at least as much as what they would obtain in liquidation.” That requirement is meant to prevent debtors from devising plans that treat creditors unfairly. In most cases creditors should be able to protect themselves if classes are fairly established, if the contents of the proposal are accurately disclosed, and if voting is fair.

¹¹⁰ There appears to be some disagreement over whether votes on an arrangement would modify claims of dissenting creditors in Papua New Guinea. EODB indicates that there is no opportunity to vote on a “proposed reorganization plan” in either jurisdiction. This may very well be a matter of semantics. In Hong Kong creditors may vote on “schemes of arrangement.” Pugh, Report on Hong Kong, China, p. 212 in ABLI Corporate Restructuring, *supra*, note 21. Despite the current absence of a statutory regime for corporate rescue in Hong Kong, China, debt restructuring is possible via schemes of arrangement. In practice, the evidence in support of a proposed scheme submitted to the Hong Kong court for sanction of the scheme always compares the payouts under the proposed scheme and a hypothetical liquidation. In Papua New Guinea a similar arrangement with unsecured creditors is at least theoretically possible through “a compromise proposal” under Sections 242–246 of the Companies Act of 1997.

This requirement, endorsed by the UNCITRAL Legislative Guide and the World Bank’s Insolvency Principles, is meant to serve as a back-up to fair voting procedures. A dissenting creditor in a jurisdiction with this requirement could use this requirement to object to the plan after losing the vote.

The challenge with this requirement is that it calls on the presiding judge to compare the creditor’s expected future treatment under a reorganization plan with a hypothetical liquidation that is never supposed to happen if all goes well. This is a considerable task for a judge in any jurisdiction.

It is perhaps for these reasons that only seven of the 21 APEC economies appear to adhere to this requirement.

Finally, EODB tracks whether a “reorganization plan is voted on only by the creditors whose rights are modified or affected by the plan.” For this to occur this must mean that creditors that are not affected by the plan are deemed to have approved it.¹¹¹ Nine of the APEC economies appear to allow such determinations, which minimize chances that a class of creditors might vote against a plan even when it gives them their entire claim.

3.4 PREVENTION OF ASSET STRIPPING AND OTHER ABUSES

The effects of the COVID-19 pandemic have very likely thrown thousands of companies in APEC economies into financial distress. It is possible during this period that some of them might attempt to transfer assets and other resources to third parties at less-than-full value or enter into arrangements that give certain creditors unfair preferences over others.

Many insolvency laws allow reversal of such transactions so long as they meet specific criteria. While varying by jurisdiction, the criteria tend to focus on:

- Deviations from commercial reasonability (e.g., the debtor sells goods sold at prices substantially below fair value or allows an unsecured creditor to collateralize its loan with the debtor’s property);
- The counterparties to the transaction (more concerns where the recipients of the goods or the beneficiaries of a contract are related to management or owners of the debtor);
- The time period when the transaction occurred (more concerns when the transactions are executed when the debtor is insolvent).

Accordingly, EODB reports that all APEC economies allow for the avoidance of “preferential” transactions. All APEC economies but Malaysia allow for the avoidance of “undervalued” transactions.

¹¹¹ Language to this effect can be found in the U.S. and Philippine insolvency laws, among others.

ANNEX 4: FREQUENCY OF INSOLVENCY CASES IN APEC ECONOMIES

Economy	Data or Estimates	Source
Australia	8,324 companies entered one of several forms of external administration under Australian insolvency in 2019	https://download.asic.gov.au/media/5580717/asic-insolvency-statistics-series-1-published-may-2020.pdf
Brunei Darussalam	Approximately a half dozen companies are wound up (liquidated) a year. Statistics on reorganizations are apparently not kept. An electronic search of articles of a major independent newspaper revealed no references to formal insolvency proceedings over the past several years.	http://judiciary.gov.bn/SJD%20Site%20Pages/Supreme%20Court%20Statistics.aspx https://borneobulletin.com.bn/category/business/
Canada	More than 1,500 businesses and corporations file proposals for reorganization under the Bankruptcy and Insolvency Act each year. A smaller number, approximately 30-40, file for reorganization under the Companies' Creditors Arrangement Act.	https://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br04270.html
Chile	In 2019, 48 businesses were reorganized and 1,653 were liquidated. In 2020, 58 businesses were reorganized and 1,827 were liquidated.	https://www.superir.gob.cl/wp-content/uploads/2020/01/Bolet%C3%ADn-Estad%C3%ADstico-Mensual-Diciembre.pdf ; Boletín-Estadístico-Mensual-Diciembre-2020.pdf (superir.gob.cl)
China	Chinese courts process thousands of insolvency cases each year. These numbers have increased sharply in recent years.	Yuhan, Shen and Fei, Peng. Report on China, p. 191 in ABLI Corporate Restructuring, <i>supra</i> , note 21.
Hong Kong, China	Hong Kong, China courts normally receive several hundred petitions for compulsory winding up per year. The number of final orders is lower, possibly owing to settlements with creditors that stopped the wind up.	https://www.oro.gov.hk/cgi-bin/oro/stat.cgi?stat_type=W&start_year=1989&end_year=2020&end_month=4&Search=Search
Indonesia	During the first quarter of 2020 over 116 petitions for suspension of payments were filed in the five Commercial Courts designated to handle these cases. During the same period, 27 petitions were received seeking company bankruptcy (liquidation).	https://nasional.kontan.co.id/news/pekerja-pkpu-terus-meningkat-praktisi-hukum-pertanda-ekonomi-memasuki-resesi (in Indonesian language, Google translate available).
Japan	More than 100 companies have gone into bankruptcy proceedings since the pandemic started. At the same time many companies are turning to out-of-court workouts with greater frequency.	http://www.asahi.com/ajw/articles/13342781 Gilmore, David, Report on Japan, p. 113 in HSF Guide, <i>supra</i> , note 49.

Economy	Data or Estimates	Source
Republic of Korea	Korea opened the Seoul Bankruptcy Court in 2017. This was a response to the growing number of cases being filed.	http://m.koreaherald.com/view.php?ud=20170302000940
Malaysia	Thousands of companies are liquidated each year. Records on schemes of arrangement are not officially tracked.	http://www.data.gov.my/data/en_US/dataset/statistik-kes-penggulungan-syarikat-terpaksa-terkumpul
Mexico	Practitioners note the preferences for out-of-court solutions as opposed to in-court procedures.	https://thelawreviews.co.uk/edition/the-restructuring-review-edition-13/1229314/mexico
New Zealand	“There are few publicly available statistics on the restructuring market in New Zealand, and none which are comprehensive.”	https://practiceguides.chambers.com/practice-guides/insolvency-2019-second-edition/new-zealand
Papua New Guinea	No evidence of active insolvency practice.	No sources available.
Peru	Reorganization cases are lengthy.	https://www.indecopi.gob.pe/web/indecopi_ingles/division-with-jurisdiction-over-bankruptcy-proceedings
The Philippines	Searches on insolvency-related cases revealed references to a property developer, a ship builder, and a retailer (which had been under corporate rehabilitation since the late 1990s). It is possible that debtors are utilizing the out-of-court provisions under the financial rehabilitation law, but there appears to be no public reporting of such.	Various online sources.
Russia	Thousands of companies each year come under bankruptcy proceedings often initiated by creditors. A smaller, but nonetheless substantial number initiate formal efforts to restructure their debts.	The Unified Federal Register on Bankruptcy Data. https://fedresurs.ru/ (in Russian only).
Singapore	Hundreds of companies each year enter into restructuring. While official statistics on various restructuring efforts are not readily available, the media is covering several large restructuring cases.	https://io.mlaw.gov.sg/files/CompaniesLiquidation.pdf
Chinese Taipei	“Very few high profile or controversial insolvency cases in recent years.”	Chen, Edgar and Chuang, Eugenia. Report on Taiwan, p. 243 in HSF Guide, <i>supra</i> , note 49.

Economy	Data or Estimates	Source
Thailand	<p>A Thai newspaper reports on more than a half dozen corporations filing for bankruptcy or rehabilitation at the economy's Central Bankruptcy Court over the past several years.</p> <p>One survey notes that 23 reorganization proceedings were initiated in 2018.</p>	<p>Various news accounts in The Nation, https://www.nationthailand.com/Search?q=Bankruptcy%20Court https://practiceguides.chambers.com/practice-guides/insolvency-2019-second-edition/thailand</p>
United States	<p>The number of Chapter 11 filings, already sizable in 2019, is growing as a result of the pandemic and lockdowns.</p>	<p>https://www.abi.org/newsroom/bankruptcy-statistics</p>
Viet Nam	<p>In a workshop on the status of the implementation of the Bankruptcy Law and its guiding regulations conducted by the Supreme People's Court of Viet Nam in 2018, it was reported that there were 439 bankruptcy cases accepted and handled by the courts in 2017, but among these cases only 45 enterprises were declared bankrupt.</p>	<p>https://practiceguides.chambers.com/practice-guides/insolvency-2019-second-edition/vietnam</p>