ASIA-PACIFIC RESTRUCTURING REVIEW 2023

The Asia-Pacific Restructuring Review 2023 contains insight and thought leadership from 13 pre-eminent Asian figures. Across 75 pages, their articles comprise an invaluable retrospective on the year just gone. All contributors are vetted for their standing and knowledge before being invited to take part. Together, they capture and interpret the most substantial legal and practice-related developments of the year just gone, complete with footnotes, relevant charts and statistics.

This edition covers, in impressive depth, China, Hong Kong, India, Japan and Malaysia.

Edited by Look Chan Ho

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Preface

Welcome to *The Asia-Pacific Restructuring Review 2023*, one of Global Restructuring Review's special, yearbook-style reports. GRR, for the uninitiated, is the online home for all professionals who specialise in high-stakes, international restructuring and insolvency, telling them all they need to know about everything that matters in their chosen professional niche.

Throughout the year, GRR delivers our loyal subscribers pitch-perfect daily news, plus regular surveys and features; organises the liveliest events (as 'GRR Live'); and curates innovative tools and know-how products.

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

This edition contains insight and thought leadership from 13 pre-eminent Asian figures. Across 79 pages, their articles comprise an invaluable retrospective on the year just gone. All contributors are vetted for their standing and knowledge before being invited to take part. Together, they capture and interpret the most substantial legal and practice-related developments of the year just gone, complete with footnotes, relevant charts and statistics.

This edition covers, in impressive depth, China, Hong Kong, India, Japan and Malaysia.

As always with these annual reviews, a close read yields many gems. With world affairs as they are, that is doubly true; this book has never seemed so relevant (as I also remarked last year!). On this occasion for the reader, the nuggets filed away include:

- there have been a lot of insolvency and restructuring developments in Asia since the last edition ("Probably too many to write about" to quote our editor Look Chan Ho);
- China continues to have some problems with the recognition of foreign bankruptcy proceedings;
- Hong Kong still lacks clarity on when winding up petitions give way to arbitration;
- India is about to get a new Model-Law style recognition process (possibly as soon as "by the end of monsoon season this year" according to one newspaper);
- Japan faces particularly tough economic times for a variety of reasons;

- helpfully, however, it has not only an out-of-court restructuring process, but also an out-of-court liquidation process, not to mention a mediated restructuring process (known locally as turnaround ADR), which are reasonably tried and tested; and
- by contrast, publicly listed Malaysian companies still cannot take advantage of the statutory rescue mechanism (until the law on companies is changed), but their subsidiaries can.

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

David Samuels

Publisher, Global Restructuring Review

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Editor's introduction

Look Chan Ho

Des Voeux Chambers

Insolvency law, by nature, flourishes in difficult times. Just like last year, restructuring and insolvency activity in 2022 continues to flourish all over the world, together with rapid insolvency law reform.

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

The experts in each jurisdiction have, therefore, helpfully culled the most recent and pertinent developments and practices to share with readers. Many of the cross-border developments are modelled on practices in other parts of the world and may sometimes serve as models for international practices within the region. A case in point is the development of the Hong Kong common law recognition regime. Matching international standards, the Hong Kong common law recognition regime now uses the concept of centre of main interests as the recognition yardstick, as opposed to the 19th-century concept of jurisdiction of incorporation.

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

Look Chan Ho

Des Voeux Chambers

Look is the only barrister in Hong Kong listed in *Who's Who Legal: Restructuring & Insolvency*. Look has over two decades of extensive experience in company, commercial and financial disputes and advisory work. He is internationally well known for his high level of legal expertise and frequently advises on transactions involving novel and complex legal issues. He often works on prominent and precedent-setting cases. He also often provides expert evidence in foreign court and arbitration proceedings.

Look has internationally renowned expertise in corporate insolvency and restructuring, with a strong focus on cross-border matters.

Look is also a Door Tenant at Erskine Chambers in London, a widely recognised, pre-eminent set of barristers for company, insolvency and commercial disputes and advisory work.

Before joining the Bar, he practised for more than 15 years as a solicitor in London and Hong Kong at Freshfields Bruckhaus Deringer and was the Asia head of restructuring and insolvency.

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

德輔 Des Voeux Chambers

Des Voeux Chambers (DVC) is a leading set of chambers based in Hong Kong. Building on its history and Tier 1 reputation, its members have cultivated a reputation for combining intellectual rigour with effective advocacy. DVC is home to over 90 astute legal minds, many of whom have spearheaded ground-breaking cases.

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

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

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Major developments in China's surging restructuring market

Nuo Ji, Lingqi Wang, Jessica Li and Sylvia Zhang

Fangda Partners

In summary

In the past year, the Supreme People's Court released several influential judicial documents, and there were developments in cross-border bankruptcy, active reform in the personal bankruptcy regime and the introduction of rules targeted at safeguarding bondholders' rights and remedies in bankruptcy proceedings.

Discussion points

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

Referenced in this article

- Notice of the Supreme People's Court on Issuing the Minutes of the National Court Work Conference on Bankruptcy Trials
- Interpretation on Several Issues Concerning the Application of the PRC Enterprise Bankruptcy Law (III)
- Minutes of the National Working Conference on the Trial of Civil and Commercial Cases by Courts
- Minutes of Symposium on the Trial of Bond Dispute Cases by Courts Nationwide
- Minutes on Mutual Recognition of and Assistance to Bankruptcy Proceedings between the Courts of the Mainland and the HKSAR
- Opinion on Taking Forward a Pilot Measure in relation to the Recognition of and Assistance to Bankruptcy Proceedings in the HKSAR
- Meeting Minutes of the National Symposium on Foreign-Related Commercial and Maritime Trial Work

Getting started

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

Key judicial documents released recently in relation to bankruptcy

Overview

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

- the Notice of the Supreme People's Court on Issuing the Minutes of the National Court Work Conference on Bankruptcy Trials (the 2018 SPC Meeting Minutes), published on 4 March 2018;
- the Interpretation on Several Issues Concerning the Application of the People's Republic of China Enterprise Bankruptcy Law (III) (the Interpretation III), published on 27 March 2019;
- the bankruptcy chapter in the Minutes of the National Working Conference on the Trial of Civil and Commercial Cases by Courts (the 2019 SPC Meeting Minutes), published on 8 November 2019;
- the Minutes on Mutual Recognition of and Assistance to Bankruptcy Proceedings between the Courts of the Mainland and of the Hong Kong Special Administrative Region (the Minutes);
- the Supreme People's Court's Opinion on Taking Forward a Pilot Measure in relation to the Recognition of and Assistance to Insolvency Proceedings in the Hong Kong Special Administrative Region (the Opinion); and
- the Meeting Minutes of the National Symposium on Foreign-Related Commercial and Maritime Trial Work (the 2021 SPC Meeting Minutes).

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

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

Substantive consolidation

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

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

Criteria for consolidation

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

Special procedures for consolidation

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

Legal consequences

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

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

Selection of bankruptcy administrators

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

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

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

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

Automatic stay and restrictions on creditors

Removal of asset preservation measures

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

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

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

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

Enforcement of security

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

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

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

Acknowledgement of arbitration

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

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

Reorganisation

Pre-packaged reorganisation

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

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

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

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

Debtor in possession

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

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

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

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

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

Further guidance on cramdown

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

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

Amendment of reorganisation plans

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

Recent developments on cross-border bankruptcy in China

Article 5 as the basis for recognition and enforcement

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

To our knowledge, despite it being effective for over a decade, article 5 has rarely been invoked. This is mainly because there are few, if any, treaties or conventions to which China is a signatory that provide for a basis for recognition of foreign bankruptcy proceedings, and the Chinese courts have long adopted a narrow theory of factual reciprocity, which means reciprocity cannot be established unless Chinese bankruptcy proceedings have first been recognised in the relevant foreign jurisdiction.

Improvements in the 2018 SPC Meeting Minutes

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

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

Recent development on reciprocity

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

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

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

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

1 *In re Zhejiang Topoint Photovoltaic Co Ltd*, No. 14-24549 (Bankr DNJ).
2 *In re Reward Science and Technology Industry Group Co Ltd*, No. 19-12908 (Bankr SDNY).

More recently, the High Court of Hong Kong successively recognised the appointment of bankruptcy administrators of two Chinese companies, CEFC Shanghai International Group Limited and Shenzhen Everich Supply Chain Co Ltd, in January and May 2020.[3] In the *CEFC* case, Mr Justice Harris commented that:

> *[t]he extent to which greater assistance should be provided to mainland administrators in future will have to be decided on a case-by-case basis and the development of recognition is likely to be influenced by the extent to which the court is satisfied that the mainland, like Hong Kong, promotes a unitary approach to transnational insolvencies.*

The above precedents appear sufficient to fulfil even the strictest factual reciprocity requirement. Chinese courts are more likely to recognise the bankruptcy proceedings of jurisdictions that have already recognised Chinese bankruptcy proceedings. In an order[4] rendered by the Xiamen Maritime Court in August 2021, the court invoked article 5 of the Bankruptcy Law and recognised the capacity of a judicial manager appointed by the Singapore High Court in HC/ORC 6341/2020 and HC/ORC 2696/2021. The Xiamen Maritime Court acknowledged the existence of reciprocity between China and Singapore since the Singapore High Court and Chinese courts have recognised each other's civil and commercial judgments many times, and the Singapore High Court has also recognised Chinese bankruptcy proceedings.

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

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

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

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

4 *In re Xihe Holdings (Pte) Ltd and Xin Bo Shipping (Pte) Ltd* ((2020) Min 72 Min Chu No. 334).

Types of proceedings

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

Main and non-main proceedings and jurisdiction

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

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

Rights of the Hong Kong administrator

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

Relief

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

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

Distribution

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

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

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

Chinese courts' first recognition order under the Opinion and future outlook

On 15 December 2021, the Shenzhen Intermediate People's Court rendered an order[5] recognising the creditors' voluntary winding up proceedings of Samson Paper Co Ltd (Samson Paper), a Hong Kong-incorporated company, and the appointment of liquidators and permitting the liquidators to carry out certain duties in mainland China; in other words, taking over the assets, seals, financial books, papers, etc, of Samson Paper; deciding its internal management matters; deciding its daily expenditure and other necessary expenditures; and managing and disposing of its assets (but the liquidators should seek the court's approval for matters relating to the waiver of asset interests, the provision of security,

5 *In Re Samson Paper Company Limited* ((2021) Yue 03 Ren Gang Po No. 1).

the extension of a loan, the transfer of assets out of mainland China or other disposing acts that have substantial impact on creditors' interests).

This order marks the first step Chinese courts have made towards cross-border insolvency under the Opinion. It remains to be seen whether there will be more and more recognition orders in pilot cities and other cities, and even orders recognising insolvency proceedings in jurisdictions other than Hong Kong.

Recognition of the status of foreign insolvency officeholders

The Minutes of the Second Meeting on Foreign-Related Commercial and Maritime Trial work with Foreign Elements, released early in 2005, provided that if the foreign party to the legal proceedings in China becomes bankrupt or enters liquidation during the proceedings, the court must notify its insolvency office holder to participate in the proceedings.

In judicial practice, Chinese courts have also recognised the capacity of foreign insolvency office holders to represent the debtor in the legal proceedings, without recognition of the foreign insolvency proceedings. An important case is *Sino-Environmental Technology Group v Thumb Environmental Technology Group*,[6] heard by the SPC in 2014.

The 2021 SPC Meeting Minutes further confirm that for a company incorporated outside the territory of China, if the court of the country of incorporation has designated a judicial manager, liquidator or bankruptcy administrator owing to the corporate deadlock, dissolution, reorganisation, bankruptcy or other reasons, such insolvency office holder may participate in the litigation in China on behalf of the company. The 2021 SPC Meeting Minutes make it clear that the foreign insolvency office holder should submit the notarised and legalised judgment or ruling made by the court of the country of incorporation, and the other party cannot challenge it merely because this judgment or ruling has not been recognised by a Chinese court.

Recent pilot projects on personal bankruptcy regime in China

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

6 *In Sino-Environmental Technology Group v Thumb Environmental Technology Group* ((2014) Min Si Zhong Zi No 20 Civil Ruling).

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

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

In addition, courts of certain places, including places in Zhejiang, Jiangsu, Shandong and Sichuan provinces, successively published rules on trials in respect of the personal debt clean-up procedure, which is similar to the bankruptcy procedure.

Recent rules and the development on rights and remedies of bondholders

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

Bankruptcy petition against the issuer

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

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

- the bondholders can file a bankruptcy petition individually or in concert based on this resolution, where the bondholders' meeting resolves that the bondholders may claim rights themselves as the bond trustee is negligent in claiming rights.

Responsibilities and liabilities of the bankruptcy administrator

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

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

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Latest developments in Hong Kong restructuring law

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In summary

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

Discussion points

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

Referenced in this article

- *Re Hong Kong Bai Yuan International Business Co Ltd*
- *Re CEFC Shanghai International Group Ltd*
- *Nuoxi Capital Ltd v Peking University Founder Group Co Ltd*
- *Re Lamtex Holdings Ltd*
- *Re China Singyes Solar Technologies Holdings Ltd*
- *Re Samson Paper Co Ltd*

Introduction

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

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

Hong Kong also plays a vital role in offshore fundraising for Chinese enterprises. As at the end of 2021, 1,368 Chinese companies were listed in Hong Kong – comprising H-share, red-chip and private companies – with total market capitalisation of around US$4.3 trillion or 79 per cent of the market total. Since1993, Chinese companies have raised more than US$1,019 billion via stock offerings in Hong Kong.[1]

The promulgation of the Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area on 18 February 2019 further signified Hong Kong's role as the 'super connector' in the development of the Greater Bay Area.

On 14 May 2021, a record of meeting concerning the mutual recognition of and assistance in insolvency proceedings between Hong Kong and mainland China[2] (the Record of Meeting) was signed, fostering further legal cooperation in civil and commercial matters between Hong Kong and mainland China. At the time of writing, this mutual recognition and assistance mechanism applies to three mainland China cities (Shanghai, Xiamen and Shenzhen) as pilot cities given their close trade ties with Hong Kong.

It is expected that Hong Kong, with the full support of the central government, will proactively integrate itself into the overall national development, thereby generating new impetus for growth to bring new development opportunities to different sectors of the community.[3]

1 'Economic and Trade Information on Hong Kong', published on 27 May 2022, available at https://research.hktdc.com/en/article/MzIwNjkzNTY5.

2 'Record of Meeting of the Supreme People's Court and the Government of the Hong Kong Special Administrative Region on Mutual Recognition of and Assistance to Bankruptcy (Insolvency) Proceedings between the Courts of the Mainland and of the Hong Kong Special Administrative Region', signed on 14 May 2021, available at http://www.doj.gov.hk/en/mainland_and_macao/pdf/RRECCJ_RoM_en.pdf.

3 'Overview of Greater Bay Area' available at http://www.bayarea.gov.hk/en/about/overview.html.

Development of the corporate rescue legal framework in Hong Kong

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

There is no statutory restructuring procedure available under Hong Kong law; however, it is possible for creditors of a Hong Kong company to negotiate an informal contractual restructuring agreement with the company, which will in general require the cooperation of all creditors of the company as any one creditor may still exercise its right to wind up the company. It is only possible to achieve a corporate rescue of a financially distressed company in Hong Kong through an out-of-court workout, a scheme of arrangement or following the appointment of provisional liquidators, which leaves the company's creditors with limited options to rescue the company in times of financial difficulty.

With the impact brought about by the covid-19 pandemic, the number of corporate failures is expected to increase. In March 2020, the Hong Kong government announced that the drafting of the new Companies (Corporate Rescue) Bill (the Bill) has reached an advanced stage, and it intended to hold a fresh round of consultations on specific areas in the Bill, with the aim of finalising it for introduction to the Legislative Council in the first half of the 2020/2021 legislative session; however, in June 2021, given the complexity of the issues, the number of the stakeholders involved and the different views expressed, the Hong Kong government indicated that it would continue to engage stakeholders to refine the legislative instructions.[4] At the time of writing, there are no further updates as to when the Bill will be put on a legislation timetable in the Legislative Council.

However, for financial institutions facing difficulties, the Financial Institutions (Resolution) Ordinance (Cap 628) contains provisions that restrict counterparties from triggering certain default event provisions solely owing to the financial institutions' entry into resolution or exercise of resolution powers, as long as the substantive obligations provided for in the relevant contracts continue to be performed. These provisions, including an instrument of a temporary stay on termination rights for up to two business days, provide strong support for the orderly resolution of failing financial institutions.

Moreover, under the non-statutory guidelines jointly issued by the Hong Kong Monetary Authority and the Hong Kong Association of Banks in 1999, banks should demonstrate a supportive attitude to borrowers experiencing financial

4 See http://www.hkreform.gov.hk/en/implementation/index.htm and 'Report No. 44 of the List of Reports Tabulated according to Implementation Status by the Law Reform Commission of Hong Kong', published on 21 June 2021, available at http://www.hkreform.gov.hk/en/docs/ajls2021.pdf.

difficulties, ensure sufficient liquidity to borrowers, and 'should not withdraw their existing facilities or hastily put the borrower into receivership, or issue writs demanding repayment'.[5]

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

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

Traditional approach

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

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

Re Southwest Pacific Bauxite (HK) Ltd

In 2018, Mr Justice Jonathan Harris, being the judge in charge of the Companies Court, in *Re Southwest Pacific Bauxite (HK) Ltd*[6] broadly followed the English Court of Appeal's approach in *Salford Estates (No 2) Ltd v Altomart Ltd (No 2)*,[7] giving substantial weight to the policy consideration underlying the Arbitration Ordinance (Cap 609), which encourages and supports party autonomy in determining the means by which a dispute arising between them should be resolved.

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

5 'Hong Kong Approach to Corporate Difficulties' published in November 1999, available at https://www.hkma.gov.hk/media/eng/publication-and-research/reference-materials/banking/fa03.pdf.
6 [2018] 2 HKLRD 449.
7 [2015] Ch 589.

- the opposing debtor disputes the petitioning debt (it is sufficient for the debtor to show that the debt is not admitted);
- the contract under which the petitioning debt is alleged to arise contains an arbitration clause that covers any dispute relating to the debt; and
- the opposing debtor takes steps required under the arbitration clause to commence the contractually mandated dispute resolution process (the *Lasmos* approach).

Under the *Lasmos* approach, the debtor is able to stay insolvency proceedings in Hong Kong, simply by not admitting the underlying debt, and force the creditor to arbitrate, even though there may not be any 'real' dispute on the debt. The ruling in the *Lasmos* case establishes a substantial obstacle to winding-up petitioners where the underlying agreements contain an arbitration clause.

But Ka Chon v Interactive Brokers LLC

In mid-2019, the *Lasmos* approach was further considered in *But Ka Chon v Interactive Brokers LLC*[8] by the Court of Appeal on an obiter basis. In light of the statutory right conferred on creditors to petition for the winding up or bankruptcy of an insolvent debtor, the Court of Appeal took the view that such right is part of Hong Kong law, and absent any evidence of the legislative intent of the Arbitration Ordinance to change the insolvency legislation, the *Lasmos* approach represents 'a substantial curtailment' of creditors' statutory rights by requiring the courts to exercise the discretion only in favour of arbitration except in wholly exceptional circumstances if the three requirements are met.

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

Post-Lasmos cases

In a recent judgment in *Dayang (HK) Marine Shipping Co Ltd v Asia Master Logistics Ltd*[9] on 12 March 2020, Deputy High Court Judge William Wong SC deviated from the *Lasmos* approach and held that to dispute the existence of a debt, a debtor must show there is a bona fide dispute on substantial grounds, and that a bare denial or non-admission of the debt is not enough, regardless of whether the debt has arisen from a contract incorporating an arbitration clause. Further, the court must exercise discretion, irrespective of whether there is an arbitration

8 [2019] HKCA 873.
9 [2020] HKCFI 311.

agreement, and commencing arbitration proceedings itself is not sufficient proof of the existence of a bona fide dispute on substantial grounds, but may constitute relevant evidence of such a dispute.

Subsequent to the *Dayang* case, the Hong Kong Court again visited the vexing question regarding the interplay between a creditor's winding-up petition and an arbitration clause in *Re Hong Kong Bai Yuan International Business Co Ltd*[10] in March 2022. In choosing between the Hong Kong approach, to demonstrate a bona fide dispute on substantial grounds, and the UK and Singapore approach, to meet the 'prima facie standard', the presiding judge Madam Justice Linda Chan held that the debtor bears the onus to show there has been 'a genuine dispute on the debt which requires the determination of an arbitral tribunal' in either approach. The Hong Kong Court refused to follow the *Lasmos* approach, and held that, while in its exercise of discretion the court would give considerable weight to the existence of an arbitration agreement between the parties, as well as other relevant circumstances, it would be incumbent upon the debtor to show a genuine dispute on the debt requiring the determination of an arbitral tribunal.

Akin to the reasoning in the *But Ka Chon* case and the *Dayang* case, the court in the *Hong Kong Bai Yuan* case relied primarily on the modern approach in deciding in favour of the creditor. Based on the recent legal development and a string of post-*Lasmos* cases, it appears that the existence of an arbitration agreement without a genuine or bona fide dispute in respect of the debt may not by itself guarantee a stay or dismissal of a winding-up petition, and whether the *Lasmos* approach will be followed in future decisions remains a live issue to be seen.

Recognition of cross-border insolvency proceedings under common law

To date, Hong Kong is not a signatory to, and has not enacted, the UNCITRAL Model Law on Cross-Border Insolvency. The Hong Kong Court is armed with the power to recognise and assist cross-border insolvency proceedings derived from common law and the legal doctrine of 'modified universalism'.

In recent years, there has been a proliferation of recognition and assistance orders granted by the Hong Kong Court, most commonly to facilitate debt restructuring of Hong Kong-listed companies incorporated in an offshore jurisdiction.[11]

However, in *Re CEFC Shanghai International Group Ltd*,[12] for the first time the Hong Kong Court granted an order for recognition and assistance to mainland liquidators of a mainland China-incorporated company.

10 [2022] HKCFI 960.
11 See, for example, *Re Z-Obee Holdings Ltd* [2018] 1 HKLRD 165.
12 [2020] 1 HKLRD 676.

It was held that two criteria must be satisfied before recognition and assistance is granted to insolvency proceedings opened in a civil law jurisdiction: first, the foreign insolvency proceedings must be collective insolvency proceedings; and second, the foreign insolvency proceedings must be opened in the company's country of incorporation.[13] In granting the recognition, the court was satisfied that the mainland liquidation was a collective insolvency proceeding and thus qualified for recognition in Hong Kong.

In the course of its reasoning, the court refused to follow the decision in *Galbraith v Grimshaw*, where the House of Lords chose not to stay a garnishee order application, despite there being an appointment of trustee in bankruptcy.[14] Mr Justice Jonathan Harris concluded that the House of Lords decision in *Galbraith* 'is inconsistent with contemporary cross-border insolvency law, given that it was made well before the development of common law cross-border insolvency assistance'.

In 2021, upon the administrator's application and receipt of a letter of request from the Hainan Province Higher People's Court, the Hong Kong Court in *Re HNA Group Co Ltd*[15] granted the first-ever order for recognition of and assistance to reorganisation proceedings in mainland China. Applying the two well-settled criteria in *Re CEFC Shanghai International Group Ltd* as stated above, Mr Justice Jonathan Harris found that the reorganisation proceedings constituted a collective insolvency process and took place in mainland China where the distressed company is incorporated.

While acknowledging the fact that the cooperation agreement signed by the Secretary for Justice and the Supreme People's Court on 14 May 2021 did not include Hainan as one of the pilot cities, and the possibility that the Hainan Court would not recognise Hong Kong insolvency proceedings and liquidators, the Hong Kong Court concluded that this lack of reciprocity is not an automatic bar to recognition.

As cross-border insolvency is increasingly active in Hong Kong, the above two milestone cases exemplify the Hong Kong Court's readiness, open mind and welcoming attitude to provide recognition and assistance to cross-border insolvency proceedings. It is expected that Hong Kong cross-border insolvency law will continue to develop and mature, which would reinforce Hong Kong's position as Asia's leading financial and debt restructuring hub.

13 Para 8, supra.
14 [1910] AC 508.
15 [2021] HKCFI 2897.

Cross-border insolvency and keepwell deeds

Keepwell deeds are a form of credit enhancement commonly adopted by Chinese companies to facilitate the issuance of offshore bonds by their subsidiaries. In *Nuoxi Capital Ltd v Peking University Founder Group Co Ltd*[16] and *Citicorp International Limited v Tsinghua Unigroup Co Ltd*,[17] Mr Justice Jonathan Harris held that keepwell disputes should be determined in Hong Kong in accordance with the contractual exclusive jurisdiction clause, notwithstanding the court's recognition of the keepwell provider's mainland China insolvency proceedings.

This truly marks a momentous and groundbreaking decision where the Hong Kong Court has called for judicial cooperation between the two courts in respect of insolvency proceedings (ie, with the Hong Kong Court adjudicating on contractual disputes and the mainland China court working out the reorganisation).

Recognition of foreign voluntary liquidation

The principle of modified universalism is a common law power to recognise and assist foreign liquidation. But the general rule is, according to *Singularis Holdings Ltd v PricewaterhouseCoopers*,[18] that this principle would not apply when the foreign liquidation is voluntary and that the company is balance-sheet solvent. An exception to the general rule can be found in *Re Joint Liquidators of Supreme Tycoon Ltd*[19] where the courts held that the mere fact of a foreign liquidation being a voluntary liquidation does not prevent the court from recognising and assisting that liquidation under the principle of modified universalism.

Therefore, in considering whether a foreign insolvent liquidation commenced by a shareholders' resolution is eligible for common law recognition and assistance, the key issue for cross-border insolvency assistance is not whether the foreign insolvency office holder is or is not an officer of the foreign court. Rather, what matters is whether the foreign insolvency proceeding is collective in nature in the sense that it is 'a process of collective enforcement of debts for the benefit of the general body of creditors'.[20]

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

16 [2021] HKCFI 3817.
17 [2022] HKCFI 1558.
18 [2015] AC 1675.
19 [2018] HKCFI 277.
20 Para 15, supra.

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

No approval for an examination that constitutes a fishing expedition

In *Re A Civil Matter Now Pending in United States District Court for the Western District of Washington*,[21] the court rejected two letters of request issued by the United States District Court, Western District of Washington at Seattle (the Washington Federal Court) seeking to compel two distressed debt investors in Hong Kong to appear and provide oral testimony regarding certain alleged receivables owing to a foreign company.

The court stressed that the discovery was sought against persons who were not party to the judgments made by the Washington Federal Court and was for the purpose of 'plotting the course' of unspecified, possible future proceedings; hence, the proposed examination was found to be a pretrial discovery, which was essentially a fishing expedition that ought to be prohibited under section 76(3) of the Evidence Ordinance (Cap 8).

Recognition of foreign provisional liquidator appointed on soft-touch basis

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

Re Joint Provisional Liquidators of Moody Technology Holdings Ltd

In *Re Joint Provisional Liquidators of Moody Technology Holdings Ltd*,[22] the Hong Kong Court granted a recognition order to foreign provisional liquidators, who were appointed on a soft-touch basis, to explore and facilitate the restructuring of a company. This order was made despite soft-touch provisional liquidation being impermissible in Hong Kong.

21 [2019] HKCFI 1738.
22 [2020] HKCFI 416.

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

Moody's JPLs were appointed on a soft-touch basis to restructure Moody and its debts in Bermuda. The key question before the Hong Kong Court was whether it should give recognition to Moody's JPLs while under current Hong Kong law, according to the Court of Appeal decision in *Re Legend International Resorts Ltd*,[23] soft-touch provisional liquidation is impermissible.

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

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

In *Re the Joint and Several Provisional Liquidators of China Oil Gangran Energy Group Holdings Limited*,[24] the Hong Kong Court continued the trend of recognising foreign soft-touch provisional liquidators.

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

The court considered the general principles of recognising foreign insolvency proceedings in *Re CEFC Shanghai International Group Ltd*, and its past practice of recognising foreign soft-touch provisional liquidation,[25] and accordingly granted the recognition order.

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

23 [2006] 2 HKLRD 192.
24 [2020] HKCFI 825.
25 For example, see footnote 19.

Problematic use of soft-touch provisional liquidation

In *Re Lamtex Holdings Ltd*,[26] the court refused to grant the adjournment of the winding-up petition sought by the joint provisional liquidators appointed in Bermuda and made an immediate winding-up order. The court was of the view that Lamtex did not have a credible plan to restructure its debt and was likely using the application in Bermuda as an attempt to engineer a de facto moratorium, which could not be obtained under Hong Kong law. The soft-touch provisional liquidation was described by the court as 'questionable'.

In *Re Ping An Securities Group (Holdings) Ltd*,[27] there were two proceedings concerning Ping An Securities. In the earlier proceedings, the court decided to adjourn the winding-up petition presented by the creditor for two months and made an order for recognition and assistance for the soft-touch provisional liquidation of the debtor in Bermuda. Notwithstanding the creditor's opposition, the court was of the view that since the debtor satisfied the relevant criteria, as explained in *Re China Huiyuan Juice Group Limited*, including the feasibility of restructuring, the petition should be adjourned.

However, in the later proceedings, as the provisional liquidators made no effort to contact the creditor and did not provide the creditor with any information about the progress of the restructuring, the court was of the view that the progress of the matter was entirely unsatisfactory and expressed concerns about the way soft-touch provisional liquidation, generally referred to as the *Z-Obee* technique,[28] was being used. The court eventually exercised its discretion to order a normal winding-up order.

In both *Re Joint Provisional Liquidators of China Bozza Development Holdings Ltd*[29] and *Re Joint and Several Provisional Liquidators of Victory City International Holdings Ltd*,[30] the court was sceptical towards similar uses of soft-touch provisional liquidation. More pertinently, in *Re China Bozza*, the court only granted an order for recognition as a matter of private international law and, for the first time ever, refused to grant the general assistance that was granted on previous occasions, because the way the joint provisional liquidators had approached the matter had failed to satisfy the court that they were protecting the creditors' interests.

26 [2021] HKCFI 622.
27 [2021] HKCFI 651, [2021] HKCFI 1394.
28 [2018] 1 HKLRD 165.
29 [2021] HKCFI 1235.
30 [2021] HKCFI 1370.

Scheme of arrangement

A scheme of arrangement in Hong Kong is an effective tool to compromise debts, even those governed by non-Hong Kong law, despite the old common law *Gibbs* rule.[31]

In *Re China Singyes Solar Technologies Holdings Ltd*,[32] the Hong Kong Court considered an exception to the *Gibbs* rule and, more generally, the principles of sanctioning a scheme.

China Singyes Solar Technologies Holdings Limited (Singyes) is incorporated in Bermuda and listed in Hong Kong.

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

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

It reasoned that although the convertible bonds were governed by English law, there was no need to seek recognition of the Scheme in England. This is because 100 per cent of the holders of the convertible bonds voted in favour of the Scheme, which constituted an exception to the *Gibbs* rule. In reaching this decision, the court considered the observation in *Re OJSC International Bank of Azerbaijan*:[33]

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

Therefore, the Scheme would be effective in England.

The court also accepted that there was no need to seek recognition of the Scheme under US law as more than 99 per cent of the noteholders had acceded to the restructuring support agreement and voted in favour of the Scheme. The court accepted that the risk of adverse enforcement by a dissenting scheme creditor in the United States was de minimis.

31 According to this well-established English principle laid down in *Antony Gibbs & Sons v La Société Industrielle et Commerciale des Métaux* [1890] 25 QBD 399, a foreign composition does not discharge a debt unless it is discharged under the law governing the debt.
32 [2020] HKCFI 467.
33 [2018] EWCA Civ 2802; [2019] Bus LR 1130 at [28] (Henderson LJ).

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

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

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

On 14 May 2021, the Record of Meeting was signed. The arrangement highlights the unique role played by Hong Kong under 'one country, two systems' and fosters further legal cooperation in civil and commercial matters between the two jurisdictions.

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

A set of opinions[34] (the Opinion) and a practical guide[35] have been issued by the Supreme People's Court and the Hong Kong government, respectively. In particular, article 4 of the Opinion is an important piece of guidance that has been frequently referred to by both Hong Kong and mainland China courts, and is fully cited below:

> *This Opinion applies to Hong Kong Insolvency Proceedings where the HKSAR is the centre of main interests of the debtor.*
>
> *'Centre of main interests' referred to in this Opinion generally means the place of incorporation of the debtor. At the same time, the People's Court shall take into account other factors including the place of*

34 'Record of Meeting of the Supreme People's Court and the Government of the Hong Kong Special Administrative Region on Mutual Recognition of and Assistance to Bankruptcy (Insolvency) Proceedings between the Courts of the Mainland and of the Hong Kong Special Administrative Region', signed on 14 May 2021, available at http://www.doj.gov.hk/en/mainland_and_macao/pdf/RRECCJ_RoM_en.pdf.

35 'Procedures for a Mainland Administrator's Application to the Hong Kong SAR Court for Recognition and Assistance Practical Guide', available at http://www.doj.gov.hk/en/mainland_and_macao/pdf/RRECCJ_practical_guide_en.pdf.

principal office, the principal place of business, the place of principal assets etc. of the debtor.

When a Hong Kong administrator applies for recognition and assistance, the centre of main interests of the debtor shall have been in the HKSAR continuously for at least 6 months.

Besides this, article 6 of the Opinion further sets out the procedures to be followed for an application by a Hong Kong liquidator.

Application by Hong Kong liquidators for recognition and assistance in mainland China

In *Re Samson Paper Co Ltd*,[36] the Hong Kong Court has, for the very first time, approved the application made by the liquidator of a Hong Kong-incorporated company to issue the letter of request to a mainland China court for recognition and assistance pursuant to the cooperation mechanism. Upon receiving the letter of request from the Hong Kong Court, the Shenzhen Intermediate People's Court approved the first-ever application for recognition of and assistance to Hong Kong insolvency proceedings in *Yue 03 Ren Gang Po No.1* (Shenzhen Intermediate People's Court).[37] The Shenzhen Court agreed with the Hong Kong Court's findings that the company in liquidation's 'centre of main interests' was in Hong Kong on the ground that the company is incorporated in Hong Kong and has 40 years in the paper manufacturing business, and the company holds most of its assets in Hong Kong (a few industrial flats in Kwun Tong, Hong Kong). Having met the criteria as suggested in article 4 of the Opinion and having complied with the procedures pursuant to article 6 of the Opinion, the Shenzhen Court approved this letter of request from the Hong Kong Court. This is the first-ever case of a mainland China court formally recognising Hong Kong insolvency proceedings since the signing of the Record of Meeting.

Recently, in *Re Ozner Water International Holding Ltd*,[38] the Hong Kong Court granted an application to issue the letter of request to the Shenzhen Court despite the company's place of incorporation being in the Cayman Islands. In approving the application, the Hong Kong Court found that the company's 'centre of main interests' under article 4 of the Opinion remains Hong Kong. The letter of request is now pending approval from the Shenzhen Court. We await further development as to whether the Shenzhen Court would recognise the Hong Kong Court's criteria for determining the location of centre of main interests under article 4 of the Opinion, and whether the Shenzhen Court will recognise and assist the insolvency proceedings of a non-Hong Kong incorporated company.

36 [2021] HKCFI 2151.
37 粤03认港破1号 (2021), judgement of 5 January 2022, available at https://www.szcourt.gov.cn/article/906503549358080.
38 [2022] HKCFI 363.

At the time of writing, there are no reported cases where courts from Shanghai, Xiamen and Shenzhen have sent a letter of request to the Hong Kong Court asking for recognition of and assistance to insolvency proceedings.

In view of the increasing need for cross-border insolvency assistance between mainland China and Hong Kong, it is expected that more case law will arise under this cooperation mechanism, and further clarifications on article 4 of the Opinion will be provided. Given the closer business ties between Hong Kong and mainland China cities, it remains to be seen whether the cooperation mechanism will serve as a useful and practical solution to facilitate more efficient cross-border corporate restructuring actions, and expand beyond the three pilot cities to other major cities in mainland China.

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Overview of India's Insolvency and Bankruptcy Code

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In summary

This article contains a summary of the most significant developments in Indian insolvency and bankruptcy law since August 2021. Where possible, the legislative changes and relevant case law are discussed simultaneously to give the reader an understanding of the letter of the law and its interpretation. Some trendsetting judgments are also discussed in this article. The article also includes a brief summary of legislative changes in the pipeline.

Discussion points

- Insolvency and Bankruptcy Code amendments and subordinate regulations
- Whether the commercial wisdom of the committee of creditors is unassailable
- Withdrawal or modification of resolution plans
- Jurisdiction of NCLT with respect to proceedings against personal guarantors
- Changes to Indian insolvency law expected in the coming year

Referenced in this article

- Insolvency and Bankruptcy Code 2016
- *Bank of Maharashtra v Videocon Industries Ltd*
- *Committee of Creditors of Essar Steel India Ltd v Satish Kumar Gupta*
- *Consolidated Construction Consortium v Hitro Energy Solutions Pvt Ltd*
- *Dena Bank (now Bank of Baroda) v C Shivakumar Reddy and Anr*
- *Ebix Singapore Pvt Ltd v Committee of Creditors Educomp Solutions Limited*
- *Gujrat Urja Vikas Nigam Limited v Amit Gupta*
- *Gurmeet Sodhi v Union of India*
- *Lalit Kumar Jain v Union of India*
- *Mahendra Kumar Jajodia v State Bank of India Stressed Asset Management Branch*
- *New Okhla Industrial Development Authority v Anand Sonbhadra*
- *State Bank of India v Mahendra Kumar Jajodia*
- *TATA Consultancy Services Ltd v Vishal Ghisulal Jain, Resolution Professional, SK Wheels Pvt Ltd*
- *Union of India v Kapil Wadhwan*
- *Vallal RCK v Siva Industries and Holdings Limited and Ors*
- *Vidarbha Industries Power Limited v Axis Bank Limited*

Introduction

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

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

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

The National Companies Law Tribunal (NCLT), which existed as a forum for adjudication of disputes for companies, became the AA for corporate insolvency resolution and liquidation. Since the IBC came into force, the NCLT has become pre-eminently a forum for insolvency resolution and liquidation, with its caseload predominantly comprising insolvency cases. According to the annual report of the Ministry of Corporate Affairs for 2021–2022,[1] a total of 9,653 fresh cases were filed at various benches of the NCLT, of which 4,640 were filed under the IBC. Similarly, of the total 9,362 cases disposed of by various NCLT benches, 4,142 were under the IBC.

A large caseload, particularly at the NCLT benches in Delhi and Mumbai, has often led to delays in the adjudication of disputes. While the setting-up of regional benches across various states and an increase in bench strength at the

1 https://www.mca.gov.in/bin/dms/getdocument?mds=OoAPyiJse9QRULR80SKCTw%253D%253D&type=open (last accessed: 16 June 2022).

Delhi and Mumbai benches were intended to improve the pendency issues, the reality is different. At present, against the sanctioned strength of 63 members, there are 22 judicial members and 25 technical members.[2] This implies that about one-fourth of the bench strength is yet to be filled. Out of the current members, 10 judicial members and 16 technical members are going to retire in 2022,[3] which raises concerns about whether the appointments made during 2021 would be sufficient to deal with the exploding docket. Further, through a notification dated 12 May 2022, the bench strength in the National Company Law Appellate Tribunal (NCLAT) has been increased from seven to 12 with the addition of three judicial members and two technical members. Despite some appointments in September 2021, many regional benches of the NCLT are not fully functional, leading to the diversion of the resources of other benches. Unless such structural issues are resolved, the number of pending cases under the IBC will only rise, leading to delays in resolutions.

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

According to the data released by the IBBI, the average time taken for CIRPs that resulted in resolution plans is 581 days (after excluding time permitted by AAs). Further, the CIRPs that ended up in liquidation took an average of 654 days for conclusion.[4] Many cases take much longer (Essar Steel's CIRP took as long as 866 days to complete).

The delays have resulted in eroding value for creditors, and they may arguably have contributed to larger haircuts by all stakeholders. The number of days taken for the CIRPs has also swelled owing to the disruptions caused by the covid-19 pandemic and the resultant circuit breaker measures adopted by the Indian government. Further, as per the data released by the IBBI, a total of 5,258 CIRPs commenced under the IBC until 31 March 2022. Of those, 1,852 are ongoing.

The trend of more corporate debtors choosing liquidation instead of resolution plans continues. According to available data, of the 3,406 CIRPs closed, AAs passed orders for liquidation in 47 per cent of the CIRPs. The number of corporate debtors going forward with a resolution plan was a low 14 per cent.[5]

2 https://www.financialexpress.com/industry/large-number-of-vacancies-may-hit-nclt-functioning/2495848/ (last accessed: 16 June 2022).
3 ibid.
4 Insolvency and Bankruptcy Board of India, Insolvency and Bankruptcy News, Vol. 22, January–March 2022.
5 ibid.

In most cases, the disruption of timelines is attributable to judicial intervention. The courts have been liberal in interpreting the boundaries set by the timelines, which has led to the timelines being construed as merely advisory in nature. The government and Parliament's attempts to fix the timelines have been repeatedly thwarted by the courts. The Supreme Court, in the case of *Committee of Creditors of Essar Steel India Ltd v Satish Kumar Gupta*,[6] has held the timeline of 330 days (inserted by way of an amendment in 2019) to be advisory and not mandatory, holding that the word 'mandatorily' is unconstitutional.

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

Recent legislative amendments

The IBC is perhaps the most frequently amended legislation in recent years, and some of the changes were necessary to avoid unintended consequences. In the past year, the legislative changes to the IBC have focused on the timely conclusion of the CIRPs.

The 2021 Amendment

On 12 August 2021, the government enacted the Insolvency and Bankruptcy Code (Amendment) Act 2021, after it had promulgated the Insolvency and Bankruptcy Code (Amendment) Ordinance 2021 in April 2021 for introducing the pre-packaged insolvency resolution process (PPIRP) for micro, small and medium-sized enterprises (MSMEs) as defined under the Micro, Small and Medium Enterprises Development Act 2006. This amendment was felt to be necessary to help MSMEs tide over widespread distress induced or exacerbated by the pandemic.

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

6 2019 SCC OnLine SC 1478.

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

The amended IBC also provides a shorter timeline of 120 days for completion of the PPIRP. The PPIRP enables an MSME to work on a resolution plan while the corporate debtor and its management stays in possession of the company (ie, debtor-in-possession model as opposed to the creditor-in-control model for the CIRP). As per the latest data available, two applications were admitted up to 31 March 2022 for pre-pack insolvency.[7] It is still early days to decide whether the amendments work or some changes are necessary.

Key regulatory changes

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

The notification of those provisions was challenged as being unconstitutional on the basis that there was no intelligible basis to the difference between individuals per se and individuals who had issued guarantees in respect of the debt of corporate entities. The Supreme Court of India in *Lalit Kumar Jain v Union of India*[8] dismissed the challenge and upheld the notification. It also held that if a resolution plan is approved in respect of a corporate debtor, it does not absolve the personal guarantor of his or her liability that arises out of a separate contract.

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

7 Supra at 4.
8 2021 SCC OnLine SC 396.

As anticipated, there has been an increase in insolvency proceedings against personal guarantors with a view to improving recovery for banks and financial institutions. Until 31 March 2022, 926 applications were filed against personal guarantors. Out of these 926 applications, 908 have been before the NCLT and 18 before the Debt Recovery Tribunal (DRT). Further, 844 applications out of these 926 were filed by creditors and the rest by debtors under sections 94 and 95 of the IBC.[9]

Other changes to deal with stressed assets

The Finance Minister during her budget speech in 2021 had announced the government's plan to set up a 'bad' bank for taking over the stressed assets of banks. Accordingly, the National Asset Reconstruction Company (NARCL) was established to take over the non-performing accounts of more than 50 million Indian rupees from banks. The NARCL is expected to take over the first set of non-performing accounts of banks soon. Similarly, the government set up the India Debt Resolution Company Ltd (IDRCL) for handling the debt resolution process for such non-performing assets. The NARCL and the IDRCL will help banks clean up their balance sheets by transferring their bad loans so that the banks can focus on their core business of taking deposits and lending money.

IBBI (Insolvency Resolution Process of Corporate Person) (Third Amendment) Regulations 2016

Recently, there has been a lot of confusion regarding the powers of the COC to run the affairs of the corporate debtor and its discretion to allow the resolution applicants to make changes in their plan multiple times. The recent amendment, IBBI (Insolvency Resolution Process of Corporate Person) (Third Amendment) Regulations 2016 vide notification dated 30 September 2021, tries to bring some clarity to these issues. Following the amendment, revisions can only be made once to the request for resolution plans, the evaluation matrix and the resolution plan. It is plausible that this amendment has been brought to mitigate delays owing to the COC and the resolution applicants engaging in multiple revisions of the plans. The amendment also prohibits the COC from considering plans: (i) received after the timeline decided by it; (ii) received from a person who does not appear in the final list of prospective resolution applicants; or (iii) not complying with the provisions of section 30 of the IBC.

To maximise the assets of the corporate debtor, the amendment also provides that the resolution professional can use a 'challenge mechanism' to enable resolution applicants to improve their plans. This challenge mechanism would

9 Supra at 4.

allow other parties to provide a plan with better recoveries for the creditors, and the original applicant would have to match or improve its plan accordingly. The amendment does not specify any particular method by which the plan may be improved; but, perhaps, this will result in greater adoption of the Swiss challenge method in the future.

IBBI (Voluntary Liquidation Process) Amendment Regulations 2022

There have been multiple instances of substantial delay in the completion of the voluntary liquidation process. To avoid such delays, the government shortened the timelines for various steps in a voluntary liquidation process in the IBBI (Voluntary Liquidation Process) Amendment Regulations 2022 as amended on 5 April 2022. The time period for distribution of the proceeds from realisation has been reduced from six months to 30 days. Further, the time period for submission of the final report has been reduced from one year to: (i) 270 days from the date of the initiation of the process in cases where claims have been received from creditors; and (ii) 90 days from the date of the initiation of the process in cases where no claims have been received from any creditor.

Trendsetting judicial developments

The Supreme Court passed certain landmark judgments recently, thereby adding to the rapidly evolving jurisprudence of the IBC.

Withdrawal or modification of Resolution Plans

In *Ebix Singapore Pvt Ltd v Committee of Creditors Educomp Solutions Limited,*[10] the Supreme Court held that under the IBC, a resolution applicant is not entitled to withdraw or modify its resolution plan once it has been approved by the COC, even while it is pending for approval before the NCLT. Keeping in view the significant delays and time limitations in the Code, the Apex Court held that in the absence of a clear provision, the AA could not allow such withdrawals.

The principle laid down in *Ebix Singapore* was followed by the NCLAT in *Union of India v Kapil Wadhwan*[11] to overturn the AA's direction to the COC to consider the resolution plan submitted by the erstwhile promoter, while another resolution plan was pending approval before the AA. The NCLAT held that there was no scope for negotiations between the parties once the COC approved a resolution plan.

10 2021 SCC OnLine SC 707.
11 2021 SCC OnLine NCLAT 190.

NCLT's discretionary power to admit application under section 7 of IBC

In *Vidarbha Industries Power Limited v Axis Bank Limited (Vidarbha)*, the Supreme Court held that the NCLT has the discretion to reject an application filed by a financial creditor under section 7 of the IBC for initiation of CIRP against a corporate debtor. Prior to the judgment, if the debt and default were established, the NCLT admitted such applications mandatorily except where there were defects in the application. However, in *Vidarbha*, the Court held that the NCLT may examine the overall financial health and viability of the corporate debtor and then apply its mind to examining the relevant circumstances behind such default. Further, use of the word 'may' instead of 'shall' (which has been used in section 9 for operational creditors) shows that the NCLT's power regarding admission under section 7 of IBC is discretionary. The Supreme Court also held that initiation of insolvency proceedings when the corporate debtor has good overall financial health amounts to penalising the solvent companies temporarily defaulting in repayment of their financial debts. The implications of this case are very wide, but it is hoped that this judgment will be read narrowly given the peculiar facts of this particular case.

Termination of contract

In *Gujrat Urja Vikas Nigam Limited v Amit Gupta*,[12] the SC analysed the law on the validity of ipso facto clauses globally and concluded that if the corporate debtor is continuing to perform its obligation (in this case, power supply), then the power purchaser could not have terminated the power purchase agreement. The first 2020 amendment also extended the scope of the moratorium under section 14 of the IBC to provide that licences, permits, concessions and clearances, etc, issued by a government authority must not be suspended or terminated on the ground of insolvency during the moratorium period if current dues are being paid. Furthermore, the supply of goods or services critical to maintaining the corporate debtor's going concern status must not be suspended if the current dues are being paid during the moratorium period.

The Supreme Court in *TATA Consultancy Services Ltd v Vishal Ghisulal Jain, Resolution Professional, SK Wheels Pvt Ltd*,[13] following the precedent set in *Gujarat Urja*, clarified that the jurisdiction of the AA under the IBC cannot be invoked by the corporate debtor if the termination of a contract by a third party takes place on grounds unrelated to the insolvency of the corporate debtor. The appellant had terminated the contract on the grounds that the corporate debtor had failed to perform its obligations, and this was evident from the communications between the appellant and the corporate debtor prior to initiation of the CIRP.

12 2021 SCC OnLine SC 194.
13 2020 SCC OnLine SC 1254.

Jurisdiction of NCLT with respect to proceedings against personal guarantors

The Supreme Court and NCLAT have provided much need clarity with respect to the jurisdiction of NCLT for proceedings against personal guarantors. The Madras High Court[14] and the NCLT, Mumbai,[15] had laid down that insolvency proceedings against personal guarantors to corporate debtors (which are not undergoing CIRP) can be initiated only before debt recovery tribunals. The NCLT, Delhi,[16] had held that in cases where the application in relation to the corporate debtor for initiation of CIRP is pending at the NCLT, initiation of CIRP of the corporate debtor is not a prerequisite for the maintainability of an application for initiating insolvency proceedings against personal guarantors before the NCLT.

Ultimately, the NCLAT in *State Bank of India v Mahendra Kumar Jajodia*[17] held that an application filed for the initiation of insolvency proceedings against personal guarantors before the NCLT cannot be rejected solely because no liquidation or CIRP is pending before the NCLT. This decision of the NCLAT was upheld by the Supreme Court in *Mahendra Kumar Jajodia v State Bank of India Stressed Asset Management Branch.*[18]

Further, in *Gurmeet Sodhi v Union of India,*[19] which is a plea challenging the constitutional validity of provisions relating to insolvency of individual, the Supreme Court issued a notice in the matter. Therefore, the law on personal insolvency is evolving, and much is contingent on the outcome of this case.

Treatment of advance money given for goods or services as operational debt

The Supreme Court, in *Consolidated Construction Consortium v Hitro Energy Solutions Pvt Ltd*,[20] held that any advance payment given to the provider of goods or services would come under the definition of 'operational debt' under the IBC, as operational debt includes a debt arising from a contract in relation to the supply of goods or services from the corporate debtor. It elaborated its reasoning by stating that section 5(21) defines 'operational debt' as a 'claim in respect of the provision of goods or services'. The judgment clearly mentions that the claim must bear some nexus with a provision of goods or services, without specifying who is to be the supplier or receiver.

14 *Rohit Nath v KEB Hana Bank*, 2021 SCC OnLine Mad 2734.
15 *Insta Capital Pvt Ltd v Ketan Vinod Kumar Shah*, 2021 SCC OnLine NCLT 158.
16 *PNB Housing Finance Ltd v Mohit Arora and Ors*, 2021 SCC OnLine NCLT 488.
17 2022 SCC OnLine NCLAT 58.
18 Civil Appeal No. 1871-1872 of 2022.
19 W.P.(C) No. 307/2022.
20 2022 SCC OnLine SC 142.

This judgment has created new jurisprudence in the IBC by including the advance money given for goods or services in the definition of operational debt.

Status of governmental land owner clarified

The Supreme Court in *New Okhla Industrial Development Authority v Anand Sonbhadra*,[21] has held that a lease is considered a financial lease if the lease term is for the major part of the economic life of the underlying asset. The Supreme Court stated that the economic life of land (underlying asset) is not limited and, as the lease deed was for 90 years, this lease deed cannot be considered a financial lease. Accordingly, such a lessor would be an operational creditor and not a financial creditor. This issue was required to be resolved as NOIDA – a government land-owning authority – was claiming the status of financial creditor in the insolvency of a number of real estate companies.

Applicability of limitation law on IBC proceedings

The Supreme Court, in *Dena Bank (now Bank of Baroda) v C Shivakumar Reddy and Anr*,[22] while referring to its multiple earlier judgments with respect to the applicability of limitation law on IBC proceedings, held that an application under the IBC would not be barred by limitation, on the ground that it had been filed beyond a period of three years from the date of declaration of the loan account of the corporate debtor as a non-performing asset, if there was an acknowledgement of the debt by the corporate debtor before expiry of the period of limitation of three years, in which case the period of limitation would get extended by a further period of three years.

Commercial wisdom of the COC

The Supreme Court reiterated that the principle of non-interference by the NCLT in the commercial wisdom of the COC in *Vallal RCK v M/s Siva Industries and Holdings Limited and Ors*,[23] stating that in a case where 90 per cent of COC members permit settlement and withdrawal of CIRP, NCLT and NCLAT cannot sit in an appeal over the commercial wisdom of the COC. This may settle the debate with respect to the approval of resolution plans by the COC in which the creditors take large haircuts. The NCLT, in the *Videocon Industries* matter, had raised concerns with regard to the approval of the resolution plan in which the creditors were taking a 96 per cent haircut. The concern raised by NCLT

21 2022 SCC OnLine SC 631.
22 2021 SCC OnLine SC 543.
23 2022 SCC OnLine SC 717.

had made creditors apprehensive of approving the plan that provided for large haircut. However, the reiteration of the principle of commercial wisdom of the COC by the Supreme Court ruling in *Siva Industries* provided much needed clarification regarding the powers of the COC.

The NCLAT in *Bank of Maharastra v Videocon Industries Ltd*[24] reiterated the principle of non-justifiability of the commercial wisdom of the COC and held that the NCLT and the NCLAT can send back the resolution plan to the COC for reconsideration even in cases where the creditors are taking a large haircut.

Cross-border insolvency

The Report of the Working Group on Cross-Border Insolvency noted that the existing provisions in the IBC (sections 234 and 235) do not provide a comprehensive framework for cross-border insolvency matters.[25] The proposal to provide a comprehensive framework for this purpose based on the UNCITRAL Model Law on Cross-Border Insolvency 1997 has been pending for some time. As per some reports, the government is expected to introduce the bill for cross-border parliament during the upcoming monsoon session.[26]

While amendments to the IBC are awaited, the NCLAT advised a framework of cooperation between the administrator appointed by a Dutch court in respect of Jet Airways (having its regional hub in Amsterdam) and the resolution professional appointed by the AA in a petition filed by a financial creditor.[27] The protocol was designed on the principles of the UNCITRAL Model Law and provides a robust framework for cross-border coordination, maintaining respect for independent jurisdictions of the Dutch court and the NCLAT. As Jet Airways was an Indian company with its centre of main interest in India, the IBC proceedings in India were the main insolvency proceedings, and the Dutch proceedings were non-main proceedings.[28]

In the case of *Videocon Industries*, the AA in India permitted the inclusion of the foreign assets held through other companies to be included in the resolution process. Further, the AA also declared that the moratorium under section 14 of the IBC is applicable to those foreign assets.[29] However, in the absence of a clear framework, these matters have to be dealt with on a case-by-case basis.

24 2021 SCC OnLine NCLAT 245.
25 Report of Insolvency Law Committee on Cross-Border Insolvency (October 2018).
26 https://economictimes.indiatimes.com/industry/banking/finance/banking/govt-preparing-cabinet-note-on-cross-border-insolvency/articleshow/92126107.cms (last accessed: 16 June 2022).
27 Jet Airways (India) Limited v State Bank of India and Another, 2019 SCC OnLine NCLAT 385.
28 ibid.
29 *Venugopal Dhoot v State Bank of India*, MA 2385/2019 in C.P.(IB)-02/MB/2018.

Conclusion

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

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

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

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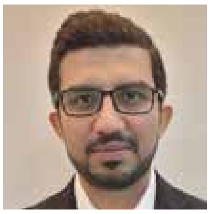

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Business turnaround following the covid-19 pandemic in Japan

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In summary

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

Discussion points

- Overview of the current situation in Japan (2021 to 2022)
- Outlook on restructuring and insolvency following the pandemic

Referenced in this article

- SME Vitalisation Council
- Guidelines for business turnaround of SMEs
- Guidelines for debt workouts of company managers' guarantee obligations
- Turnaround ADR
- Special conciliation

Following the covid-19 pandemic

It remains uncertain when the covid-19 pandemic will come to an end in the true sense, but with fatality rates gradually falling and vaccination programmes progressing, Japan is trying to find its way back to normality – although what 'normal' means has gone through changes in people's minds over the past few years. In contrast to Europe and the United States, where the restrictions on behaviour and border measures were eased some time ago, in Japan, restrictions and other preventive measures on travel, movement, face masks and other behaviours and actions based on a declaration of a state of emergency largely remained in place until March 2022. With respect to its borders, from March 2022, Japan again started to accept international students and foreign technical intern trainees, as well as business travellers, but to a limited extent. And at the time of writing, only foreign tourists from limited areas, such as Europe and North America, where covid-19 infections are considered settled, are permitted to enter Japan in the form of participation in tours hosted by registered travel agencies under the Travel Services Act. Foreign tourists are not allowed to freely travel to tourist sites or enjoy shopping, and are asked to travel with attendants and to always wear masks in public. It has been hard for the tourism industry, the aviation industry, and the restaurant and hotel industry, which largely relied on revenue generated from certain numbers of foreign tourists coming in.

Overview of the state of the Japanese economy

With respect to the external environment in which the Japanese economy operates, owing to the sharp rise in energy prices due to Russia's invasion of Ukraine and the plummeting value of the Japanese yen, which is believed to have mostly arisen from the continuing relative deflation and ultra-low interest rates in Japan, contrasting sharply with the recent inflation and higher interest rates in the United States, Japan is beginning to face a more severe economic environment.

In the past, the depreciation of the Japanese yen was generally regarded as an advantage for Japanese companies, as it allowed companies to easily enjoy a trade surplus. However, in recent years, many, if not most, Japanese companies have been shifting to overseas production and manufacturing; therefore, it is more challenging to enjoy the benefits of Japanese yen depreciation. Instead, the rise in procurement costs, which more or less correlate with import costs for many Japanese companies, has resulted in negative consequences for enterprises as a result of the Japanese yen being weaker. Although Japanese companies seem to have delayed passing procurement costs on through sales prices, they can only do so for so long, and in the past months, for example, food prices have risen rapidly to the highest in 10 years. The rising prices of commodities has not only started to squeeze companies but also consumer household budgets.

While Russia's invasion of Ukraine has yet to end, because Japan lacks fossil fuel resources, it must depend on imports of energy resources or on non-carbon energy or nuclear energy for electricity power generation. However, after the Fukushima nuclear power plant accident, there is a strong sense of caution about restarting nuclear power plants. Further, as a backdrop, some new power companies that emerged following the deregulation as an indirect fallout of the Fukushima accident, as well as emerging renewable energy companies, have recently been experiencing financial difficulties, with some even seeking insolvency protections, as a result of certain pricing mechanisms based on market and business regulations that resulted in their failure to recoup their initial capital expenditures through electricity sales while experiencing challenges in rising procurement and other operating costs. To date, no effective solution has been found for the energy cost issue.

In terms of monetary policy, the United States has increased interest rates to stop inflation, while Japan continues a policy of monetary easing to support Japan's economic downturn, so it is possible that the Japanese yen will continue to depreciate. Thus, the Japanese economy is now in an uncertain situation, on top of uncertainties arising from the financial challenges that many enterprises and businesses are expected to face in the course of their post-covid-19 recovery.

Insolvency and restructurings

With regard to insolvencies – including bankruptcies – and restructurings, contrary to initial expectations, Japan has not seen a rapid spike in the number of insolvency and restructuring cases; rather, there has been a decrease in the number of insolvencies and restructurings.

According to Teikoku Data Bank, 2021 had the lowest level of recorded bankruptcies (6,015 cases) for any year since 1966. This is believed to be, at least in part, because of government efforts to actively promote measures to aid and support ailing businesses since the start of the pandemic. It is fair to say that those measures have been somewhat successful in allowing enterprises to avoid immediate bankruptcy or insolvency, and that they have prolonged the lives of impacted enterprises. This is especially notable considering that, in Japan, contrasted with other foreign countries and jurisdictions where courts were shut down for extended periods, the bankruptcy courts in Japan did not close for any significant period.

However, the existing measures mostly comprise emergency loans and guarantees, as well as extensions on taxes and other public payments, with only small amounts of grants and subsidies, and such extensions and benefits came to an end in 2021. Hence, it is expected that an increasing number of enterprises are or will be carrying more debt than they can repay, and that those businesses are, or soon will be, facing financial difficulties, despite the small breathing room the government measures have provided. In other words, there is no guarantee that those well-intended measures will be enough to allow troubled enterprises to sustain their business endeavours or maintain manageable debt service levels. If this proves to be true, more likely than not, banks and other financial institutions will accelerate their disposition of non-performing loans, especially once the economy returns to a more normal state. Recently, fraudulent receipts of grants and subsidies have emerged. If distressed businesses have similar issues, it could be a hurdle for future business revitalisation.

Outlook: once the dust settles?

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

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

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

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

We are already starting to see large and medium-sized enterprises responding to these long-awaited changes by withdrawing from unprofitable businesses, returning their focus to core businesses via selection and concentration, and funding these efforts through the use of preferred stock and subordinated loans from financial institutions. Financing to companies in industries affected by the pandemic, such as Japan Airlines (aviation), AIRDO (aviation), Solaseed Air (aviation), JTB (travel), Fujita Kanko (hotel and bridal) and TAKE and GIVE NEEDS (bridal), has been catching the eye of market participants; these companies have been able to avoid in-court insolvency and restructuring procedures through tapping early-stage out-of-court workouts.

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

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

In Japan, the low interest rate environment and the prevalence of deflationary markets resulted in the adoption of a number of rule-based workout initiatives. Among them are two rule-based out-of-court workouts initiatives that can be used by SMEs: guidelines for business turnarounds of SMEs, which was newly introduced in March 2022, and turnaround alternative dispute resolution (ADR). These workouts are designed to be easy to use and provide a moratorium (or stay), and both call for financial institutions to sit at the bargaining table (and government agencies have been asking that financial institutions do so). From the perspective of financial institutions, in addition to the predictability of those procedures, they are easier to accept because they contain explicit statutory grounds for non-taxed write-offs being permitted when financial debts are waived through those procedures.

Turnaround programmes for SME vitalisation

In March 2022, the Ministry of Economy, Trade and Industry, in collaboration with the Financial Services Agency and the Ministry of Finance, formulated the SME Vitalisation Package to develop comprehensive support measures to improve profitability, revitalise and allow rechallenges by SMEs suffering from increasing debt and continue liquidity support for SMEs.

This includes (i) the continued provision of emergency loans and subordinated loans by government-affiliated financial institutions, the flexible operation of the deferral system of tax and social insurance premiums (including reducing delinquent taxes), and (ii) comprehensive support for SME profitability improvement and business revitalisation by the SME Vitalisation Council, expansion of the business revitalisation fund funded by government-affiliated funds, as well as the formulation of new guidelines for SME business turnarounds and guidelines for debt workouts of company managers' guarantee obligations as another rules-based out-of-court workout process.

Out-of-court workouts based on guidelines for business turnarounds of SMEs are procedures aimed at facilitating the smooth business rehabilitation of SMEs by granting grace periods to repay debts (mainly financial debts) and debt reductions and exemptions, etc, for SME debtors experiencing difficult business conditions, based on agreements between SMEs that are debtors and financial creditors (non-financial creditors such as bondholders or trade creditors can also be included, but that is not the anticipated norm), not through in-court insolvency proceedings, namely bankruptcy proceedings, civil rehabilitation proceedings, corporate reorganisation proceedings or special liquidation proceedings.

In considering the availability of this procedure, SMEs will select candidates for 'support experts' (experts such as lawyers and certified public accountants who have obtained qualified accreditation) who are third-party experts, and notify major creditors that they are considering an out-of-court workout based on guidelines for business turnarounds of SMEs; at the same time, SMEs will obtain consent from all major creditors, initially only for the appointment of third-party support experts. After requesting a temporary suspension of loan repayments to the target creditors, SMEs, with the support of a third-party support expert, will formulate a business revitalisation plan that must address the following items:

- ways or measures by which to resolve substantial excess debt within five years;
- ways or measuress by which to ensure ordinary income will be converted into a surplus within three years;
- the business revitalisation plan must result in the cash flow ratio of interest-bearing debt in the final year of the plan being 10 times or less; and
- shareholder responsibilities (but only if the debtor SME is to call for a debt reduction and exemptions), management responsibilities and a policy for liquidating warranty liabilities when guaranteed by management.

When all target creditors agree to a proposed plan and a third-party support expert confirms this in writing, a business revitalisation plan is confirmed. In addition, third-party experts and major creditors will regularly conduct monitoring in the three fiscal years following the enactment of the confirmed plan.

Interestingly, in addition to restructuring-type out-of-court workouts, these guidelines also stipulate an out-of-court workout processes for business discontinuation, namely discontinuance-type procedures. In the process described above, if a third-party support expert or major creditors determine that the business is unlikely to continue, and if the debtor SME submits an application for business discontinuance, the debtor SME may draft the necessary measures such as the liquidation of assets for business discontinuance and formulate a repayment plan. In this case, the draft plan must also be economically rational for the target creditors, such as the prospect of obtaining a better recovery than the liquidation value to be distributed in the bankruptcy proceedings.

When implementing discontinuance-type procedures for SME debts, and the guarantor intends to arrange warranty obligations for such debts, the guarantor must disclose assets in good faith and utilise guidelines for debt workouts of guarantee obligations of the debtor company's management in an effort to integrate the principal obligations and guarantee obligations.

Until now, the SME Revitalisation Support Council (renamed the SME Vitalisation Council), a neutral third-party organisation, had established separate procedures and supported drafting plans and organised out-of-court workout procedures. From now on, however, even SMEs that are unable to formulate plan proposals required by the SME Vitalisation Council procedures because of the impact of covid-19 or other factors can select third-party support experts and proceed with business revitalisation on their own with the consent of the target creditors. It is hoped that SMEs working to improve their businesses in post-covid-19 climates will accelerate their efforts to revitalise their businesses based on a shared understanding with financial institutions that are eligible target creditors to take steps toward sustainable growth.

Turnaround ADR

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

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

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

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

If any creditors disagree with the plan, it is assumed that special conciliation, as described below, will be used or a transition to in-court insolvency procedures will occur. In the case of a transition to in-court procedures, to allow for a smooth transition (which, in turn, incentivises relevant parties to do as much as possible within the ADR procedure), the following support measures, which respect the results and actions taken during the course of the turnaround ADR, have been institutionalised and codified:

- facilitation of priority payment of commercial claims in in-court procedures;
- facilitation of priority payment of bridging loans (pre-DIP finance); and
- simplified procedures relating to the expedition of special conciliation procedures, etc.

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

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

However, the amendment did not function effectively enough in one recent ADR case. Media outlets have been reporting that MARELLI Holdings obtained consent from most of the financial creditors through its turnaround ADR process, but it had to abandon the process because it was not able to obtain consent from a minority of financial institutions, and it filed a petition for a simplified civil rehabilitation procedure with the Tokyo District Court. As mentioned above, the amendment was originally aimed at promoting unanimous consent at the turnaround ADR stage by preventing minority financial creditors holding out and effectively gaining a veto right in an unreasonable fashion, backed up by the transition to a simplified civil rehabilitation procedure. However, the *MARELLI* case apparently did not go as the amendment intended.

To avert such scenario, one additional amendment to possibly address the issue is to allow a cramdown through votes by the relevant creditors, effectively allowing the majority vote to cause the proposed restructuring plan to become effective. In the New Capitalism Grand Design and Implementation Plan approved by the Cabinet of Japan in June 2022, the government clearly stipulated 'the establishment of legislation for out-of-court workouts for business restructuring' while indicating that 'in other countries, there is a system to change creditor's rights (eg, reduction of financial debts) by majority vote with the approval of the court.' So there is a possibility that there will be additional amendments to turnaround ADR processes allowing a cramdown in the course of the process to further facilitate the use of, and in turn the resultant business restructuring through, the out-of-court turnaround ADR processes.

Special conciliation

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

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

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

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

Closing remarks

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

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

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

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

In addition to responding to post-pandemic ways of life and changes in how our societies function, changes in the business environment, such as digital transformations and responses to sustainable development goals, will be constant and will continue to grow in importance. Recent economic challenges arising from the spikes in commodity prices, energy costs, import procurement costs and the weaker Japanese yen will all compound the importance of, as well as the difficulties in achieving, the goals. In that respect, we expect that insolvencies and restructuring will place more importance on facilitating and accelerating each enterprise's business metabolism, as well as that of the industries and the economy overall, as we move into an ever- and faster-changing business and commercial landscape.

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Among the notable restructuring cases, he was involved as a core member in the reorganisation of Japan Airlines; the financial and operational restructuring, as well as the subsequent reorganisation, of Tokyo Electric Power Company; the financial restructuring and sale of Sharp Co, Ltd; the global restructuring of Takata group; and various restructuring cases involving low-cost carrier airlines in Japan.

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He is currently dealing with covid-19-related cases and matters, specifically in the food and beverage industries, and rural transportation infrastructure that is severely damaged. He is also involved in cases and matters relating to debt and equity transactions.

He has been involved in various litigation matters ranging from commercial disputes, financial disputes and IP disputes to corporate disputes, including managerial disputes over corporate control. In business revitalisation cases, he has dealt with not only in-court liquidation (both civil rehabilitation and corporate reorganisation) but also out-of-court workouts.

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

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Developments in judicial management in Malaysia

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In summary

March 2018 saw the arrival of a corporate rescue mechanism in Malaysia termed 'judicial management'. Over the years, the law on judicial management has seen much development of juridical and commercial significance since its introduction. The proposed and much-needed Companies (Amendment) Bill 2020 remains in legislative limbo and has yet to become law. This article focuses on significant developments in the Malaysian courts regarding judicial management in the past two years.

Discussion points

- The judicial management process under Malaysian law
- Recent developments in the law concerning judicial management
- Discussion of the proposed reforms

Referenced in this article

- Capital Markets and Services Act 2007
- Companies Act 2016
- Companies (Corporate Rescue Mechanism) Rules 2018
- Consultative Document on the Proposed Companies (Amendment) Bill 2020
- Insolvency, Restructuring and Dissolution Act 2018 (Singapore)
- Insolvency Act 1986 (UK)
- *Re Scomi Group Bhd*
- *Syed Ibrahim & Co (applying as a legal firm) v Trans Fame Offshore Sdn Bhd (under judicial management) (formerly known as Transfame Sdn Bhd) (BAP Resources Sdn Bhd & Ors, interveners)*
- *Jepak Holdings Sdn Bhd v TNB Repair and Maintenance Sdn Bhd & Ors*

Introduction

Judicial management is a corporate rescue mechanism that was introduced in the Companies Act 2016. The Companies Act 2016 is the statute that replaced the outdated Companies Act 1965. Although most parts of the Companies Act 2016 came into force on 31 January 2017, the judicial management provisions did not come into force until 1 March 2018. The provisions have thus only been in use for slightly over four years. However, in that time, the Malaysian courts, especially the first instance courts, have had the opportunity to interpret and apply the new provisions on a case-by-case basis.

The development of the law by the Malaysian courts has helped guide practitioners and Malaysian corporates in how the law is to be used and applied. Although this guidance has been useful, there is room for improvement. Major reforms were proposed by the Companies Commission of Malaysia in 2020. These reforms were supposed to have been introduced through an amendment to the Companies Act 2016 in 2021[1] but have not yet materialised owing to various factors that have nothing to do with the regulator. Without these reforms, there are still difficulties that Malaysian corporates face in the judicial management space. This article focuses on significant developments in the Malaysian courts in judicial management in the past two years.

The judicial management process

Judicial management is a corporate rescue mechanism that allows a Malaysian company that is or will be unable to pay its debts, or its directors or its creditors, to apply to the High Court for a judicial management order to be made and for a judicial manager to be appointed over the company. There are several conditions that must be satisfied before a company is eligible for judicial management:

- the company is or is likely to be unable to pay its debts; and
- making a judicial management order will be likely to achieve one or more of the following purposes:
  - the survival of the company or its undertaking (whether in whole or part), as a going concern;
  - the company will obtain the approval of a scheme of compromise or arrangement under section 366 of the Companies Act 2016; or
  - a more advantageous realisation of the company's assets would be achieved compared to through a winding up.

1 The proposed reforms, and the gaps in the judicial management framework that the reforms were intended to address, were described in 'The Path to Corporate Rescue Reform in Malaysia' by Rabindra S Nathan published in the *Asia-Pacific Restructuring Review 2022* in 2021.

A judicial management order will be in effect for six months unless it is otherwise discharged before that period ends. The court-appointed judicial manager can seek an extension of the judicial management order for a further period of six months. The making of a judicial management order has several mandatory consequences:

- any existing receiver or receiver and manager will have to vacate office and no new appointment may be made;
- any pending winding up application must be dismissed;
- no resolution for voluntary winding up of the company can be made;
- no legal proceedings of any kind or execution process of any kind can be commenced or continued unless the judicial manager consents or the court permits;
- no enforcement of any form of security over the company's property can proceed unless the judicial manager consents or the court permits; and
- no goods, equipment or chattels under hire purchase, leasing arrangements or retention of title arrangements can be repossessed unless the judicial manager consents or the court permits.

During the time the judicial management order is in place, the judicial manager will normally consult with key creditors and devise a plan for the rehabilitation of the company. The judicial manager's plan, which is formally known as the proposal, must be developed, and issued within 60 days of the judicial manager's appointment, unless the High Court allows a longer time. This proposal is then issued to all creditors and placed before a creditors' meeting summoned for this purpose. If the proposal is approved by 75 per cent in value of the creditors (present and voting) whose claims have been accepted by the judicial manager, it becomes legally binding on all creditors, regardless of whether they voted in favour of the proposal or not.

After the proposal is put to the creditors and voted upon, the judicial management order must be discharged either because:

- the proposal was accepted by the statutory majority and has become binding in law and the process has been successful; or
- the creditors rejected the proposal that failed to achieve the statutory voting threshold and, therefore, the judicial management process has come to its logical end.

The judicial manager will vacate office and leave the company proceeds under the control of its board of directors, either as a rehabilitated going concern if the judicial management was a success, or as a company that is potentially headed for formal insolvency if the judicial management was unsuccessful.

Recent developments in the law of judicial management

Public listed companies and judicial management

The first recent development relates to clarification by the Malaysian courts that public listed companies in Malaysia are ineligible to apply for judicial management.

It is provided under section 403 of the Companies Act 2016 that public listed companies regulated by the Malaysian Securities Commission (SC) under the Capital Markets and Services Act 2007 (CMSA) or by the Central Bank of Malaysia, also known as Bank Negara Malaysia (BNM), are ineligible to apply for judicial management under various statutes.

In *Re Scomi Group Bhd* [2022] 7 MLJ 620, the High Court held at [23] and [29] that the applicant, as a listed company under the CMSA, is caught by section 403(b) of the Companies Act 2016. Thus, it cannot avail itself of judicial management. On 23 May 2022, the Court of Appeal orally affirmed the findings of the High Court.

Under section 405(1) of the Companies Act 2016, the directors of an eligible company and any creditor or contingent creditor of such a company have standing to apply for a judicial management order. The effect of the Malaysian Court of Appeal's confirmation in *Re Scomi Group Berhad* means that directors, creditors, and contingent creditors of a listed company equally cannot make the application if it concerns a listed company.

There is a significant difference between the more restrictive approach in Malaysia with respect to public listed companies and judicial management, and the more liberal position under Singapore law. In Singapore, a company listed on the Singapore Exchange (SGX) placed in judicial management must comply with several obligations under the Listing Rules that are tailored to address the impact of judicial management applications and orders. When an application is filed with a court to place the listed company or its significant subsidiary under judicial management, trading in the shares of the listed company is suspended.[2]

One of the proposed reforms[3] was to enable public listed companies to apply for judicial management similar to the equivalent Singapore provisions, but that is still some way off owing to the uncertainty over when the amending legislation will complete the parliamentary process and become law.

In the course of the hearing in the *Re Scomi Group* case, the High Court was referred to the Companies Commission of Malaysia's Consultative Document on the Proposed Companies (Amendment) Bill 2020, which noted that:

2 SGX Listing Rules, Rule 1303(3).
3 See footnote 1, supra.

> *...the benefit of judicial management is not available to companies which are regulated under [the CMSA] including listed companies. The proposed amendment would assist all companies facing financial difficulties including listed companies an avenue to rehabilitate their situations through judicial management.*[4]

Thus, until the Companies (Amendment) Bill 2020 is passed by the Malaysian parliament, public listed companies will remain ineligible to apply for judicial management. In the meantime, a vital corporate rescue mechanism will be unavailable to such companies. It is likely that for as long as the law remains unamended, schemes of arrangement will continue to be the only corporate insolvency restructuring process that public listed companies will be able to utilise.

Eligiblility of subsidiaries of public listed companies for judicial management

While listed companies are themselves ineligible for judicial management, there is no restriction on subsidiaries of a public listed company from having recourse to judicial management as a corporate rescue tool. A recent example is the attempt in February 2022 by four subsidiaries of a listed company called Serba Dinamik Holdings Berhad to seek the appointment of a judicial manager over each applicant company. Those applications were eventually withdrawn in late March 2022 owing to strong opposition from creditors of those four subsidiaries.

Possibility for a second judicial management order application

In the case of *Syed Ibrahim & Co (applying as a legal firm) v Trans Fame Offshore Sdn Bhd (under judicial management) (formerly known as Transfame Sdn Bhd) (BAP Resources Sdn Bhd & Ors, interveners)* [2022] MLJU 1380, the High Court had to consider whether a second application for a judicial management order could be made.

The High Court observed that on a reading of sections 404 and 405 (1) and (2) of the Companies Act 2016, those provisions do not contain any indication whether Parliament had intended the Companies Act 2016 to restrict any applications for a judicial management order to a one-time application only. The court noted that had Parliament intended that a second judicial management order application was not possible, it would have surely made that clear by including a provision to that effect.

4 See the Companies Commission of Malaysia's Consultative Document on the Proposed Companies (Amendment) Bill 2020.

Adopting a purposive approach to the judicial management framework in Division 8, subdivision 2 of the Companies Act 2016, the court held that if a judicial management order is discharged or comes to an end after its initial six-month lifespan, the court still retains the ability to make a fresh judicial management order based on a second application, provided all the conditions laid down in sections 404 and 405 of the Companies Act 2016 are met.

While the court held that a second application for a judicial management order can be made, the court also went on to hold that the applicant must necessarily comply with all the statutory prerequisites when making the second application. The court also held that any subsequent judicial management application must be made bona fide and with full and frank disclosure of all the material facts.

Creditors seeking a judicial management order

As mentioned earlier, section 405(1) of the Companies Act 2016 enables a creditor of an eligible company to apply for a judicial management order. However, reported examples of judicial management order applications by creditors have been rare. Recently, the position has been clarified.

In *Spacious Glory Sdn Bhd v Coconut Three Sdn Bhd (previously known as Nexgram Land Sdn Bhd)* [2022] 7 MLJ 76 at [25], the High Court held that section 405 of the Companies Act 2016 clothes creditors with locus standi to apply under section 404 of the Companies Act 2016 for a judicial management order. Here, the applicant was an unsecured creditor. This decision was subsequently applied and followed by the same court in *Loh Teck Wah v Fintree Capital Sdn Bhd* [2021] 1 LNS 782; [2021] MLJU 995 at [61].

In Singapore, the case of *Re Bintan Lagoon Resort Ltd* [2005] SGHC 151; [2005] 4 SLR 336 is an example of an application for judicial management being filed by creditors.

When interested parties put forward different nominees for judicial manager

A starting point is the general position under the judicial management framework. It is expressly provided that the applicant may appoint an insolvency practitioner to be the judicial manager under section 407 of the Companies Act 2016. However, by virtue of subsection (2) thereof, the court may refuse the nomination of the applicant's nominee under subsection (1). In such circumstances, the court may appoint another person who is an insolvency practitioner as the judicial manager.

In *Jepak Holdings Sdn Bhd v TNB Repair and Maintenance Sdn Bhd & Ors* [2021] 11 MLJ 625, the High Court recognised that the court's power to refuse the nomination of the applicant stems from the express words of section 407(2). The court also held that from a natural and ordinary meaning of the words in section 407(2), the discretion of the court is unfettered and may be exercised by the court when, for example, there are obvious issues of conflict of interest or bias or the fact that the nominee proposed is not qualified to act is sufficiently demonstrated to the satisfaction of the court. The court also observed that it would ultimately have to decide each matter on a case-by-case basis.

The next issue is dealing with multiple nominations by different interested parties. Section 407 of the Companies Act 2016 deals with the ability to nominate the judicial manager. The initial nomination is always made by the applicant – that can be the company itself, or the directors of the company or a creditor or a contingent creditor. One possibility is provided under section 407(2) where the High Court can reject the applicant's nominee and appoint another qualified insolvency practitioner as the judicial manager. Another possibility is that under section 407(3), the creditors who collectively comprise a majority in value of all creditors of the subject company are entitled to persuade the judge to accept the nomination of an alternate insolvency practitioner that they propose.

The words of section 407(3) of the Companies Act 2016 refer to 'a majority in value of the creditors'. The issue arose recently in the *Jepak* case as to whether a minority creditor can invite the court to consider its nomination of an insolvency practitioner as the judicial manager and, if so, whether the court is bound to accept it.

In *Jepak* the High Court held at [33] that subsections 407(2) and (3) should be read disjunctively. In other words, the power of the court to refuse the applicant's nomination and to appoint an insolvency practitioner as judicial manager under subsection (2) and the power to invite majority creditors to nominate their judicial manager candidate under subsection (3) are mutually exclusive. Therefore, there is no place for a minority creditor to invite the creditors pursuant to subsection (3) to appoint a judicial manager other than the applicant's choice. A minority creditor can, by all means, rely on subsection (2) alone to oppose the nomination, but it must make way for majority creditors as subsection (3) is to be given primacy over subsection (2).

A comparison can be made to the position in the United Kingdom under the Insolvency Act 1986. The main concern in the United Kingdom is to ensure that the appointment of an administrator is conducive to the proper operation of the process of the administration and the court is not bound by the view of any creditors. In *Healthcare Management Services Ltd v Caremark Properties Ltd* [2012] EWHC 1693 (Ch), the English High Court held at [24] that the majority view does not bind a court that has the final say. In that way, the majority of the creditors do not have an absolute right to choose the identity of the liquidator or the administrator (this being an administration case). There are also contrary views in, for example, *Med-Gourmet Restaurants Ltd v Ostuni Investments Ltd* [2010] EWHC 2834 (Ch) where Lewison J held that the court would normally be guided by the wishes of the majority of creditors.

In Malaysia, it seems quite clear now that the court must give priority to the nomination by the majority of the creditors in value.

Independence and impartiality of the proposed judicial manager

In the *Jepak* case, the High Court had to deal with the issue of the independence of the nominated candidate for the role of judicial manager. There are no specific independence rules or requirements laid down in the statutory framework under the Companies Act 2016; however, the same rules that would disqualify a liquidator are likely to apply in relation to a potential judicial manager.

This issue arose squarely in the *Jepak* case. There, none of the creditors of the company were objecting to the making of a judicial management order itself. The only issue was whether the person nominated by the applicant to be the judicial manager was impartial and free of bias. The High Court recognised the possibility that the nominee for judicial manager might not be independent of the company or its controlling shareholder and would not, in those circumstances, be sufficiently independent. The court referred to the Australian case of *Aboriginal & Torres Strait Island Commission v Jurnkurakurr Aboriginal Resource Centre Aboriginal Corp (in liq)* (1992) 10 ACSR 121, where the Supreme Court of the Northern Territory examined multiple grounds to remove a liquidator; among the grounds was 'some unfitness of person' that included the lack of probity or impartiality.

In *Jepak*, the High Court also considered the Singapore case of *Cendekia Candranegara Tjiang v Yin Kum Choy & Ors* [2002] 4 SLR 48. There the judicial manager was also the special accountant to a related company, as well as a personal adviser to and nominee for the company's directors, the Kwan brothers. The Singapore High Court found that the judicial manager was wearing multiple hats and was thus held to be in a position of conflict.

On the facts, the High Court in the *Jepak* case found that the proposed judicial manager was sufficiently independent. The fact that prior to the filing of the judicial management order application, the nominated judicial manager had advised the company in relation to its judicial management application was held to be not a bar to his appointment or a matter that compromised his independence. The court also dealt with an additional ground that had been advanced as part of the challenge to the independence of the proposed judicial manager, namely, the fact that the nominee had been provided with an indemnity for his fees by a related party to the applicant company that also happened to be a supporting creditor. The court held this was perfectly proper given that section

407 of the Companies Act 2016 allowed the judicial manager's fees to be agreed upon with the creditors.

It is useful to make a comparison to the position in England. In *Re Ve Interactive Ltd (in administration)*; *Ve Vegas Investors IV LLC and others v Shinners and others* [2018] EWHC 186 (Ch), the applicants were creditors of a company. The company encountered financial difficulties and its directors appointed insolvency practitioners to advise on and effect a pre-pack sale of the company's business and assets. The insolvency practitioners could not obtain financial information and clarity over the extent of the sale of assets from the company. As a result, only one external purchaser was identified. Insolvency practitioners were appointed administrators of the company by the court but they did not report the difficulty that they had in obtaining sufficient information from the company directors. The day after their appointment, the administrators then sold the business and assets to a new company set up by the company directors.

The company's creditors then applied to appoint new administrators to investigate claims against the company's directors and the insolvency practitioners relating to the pre-pack sale that either prevented other options from being pursued or caused the undervalued transaction. The application also sought the removal of the existing administrators from office.

The English High Court held that an application to remove administrators on grounds of conflict of interest required the court to decide whether there was a serious issue for investigation, but not whether the claims identified for investigation had merit. The court did not have to decide whether any claims existed, but whether the respondents should be removed from office, because of the need to investigate the existence of a conflict of interest.

In *Re One Blackfriars Ltd (in liquidation) Hyde and another (as joint liquidators of One Blackfriars Ltd) v Nygate (in his capacity as representative of the estate of James Joseph Bannon, former joint administrator of One Blackfriars Ltd appointed under CPR R 19.8(1)) and another* [2021] EWHC 684 (Ch), the applicants who were joint liquidators of One Blackfriars Ltd (the company) claimed that the latter was mishandled by its former administrators who allegedly failed to act independently. The applicants alleged that the former administrators were in a conflict of interest when they appointed CB Richard Ellis Ltd as their adviser, which was also acting for a syndicate of banks that foreclosed on the company's plot of land in Central London owing to the company's default in repayment to the syndicate of banks. The English High Court found that the facts did not give rise to a conflict of interest.

In Singapore, section 91(3)(b) of the Insolvency, Restructuring and Dissolution Act 2018 requires the nominated judicial manager to statutorily declare that they are not in a position of conflict. There is no Malaysian equivalent. The Companies Commission of Malaysia should consider whether this is sufficiently important to be included in the judicial management statutory framework in subdivision 2 of Division 8 of the Companies Act 2016.

Submitting an affidavit or an expert report supporting the application

There is strictly no requirement under the judicial management framework in subdivision 2 of Division 8 of the Companies Act 2016 for the proposed judicial manager to submit an affidavit or report to give an indication to the court of whether the statutory objectives of judicial management will be satisfied if a judicial management order is made. The question has arisen in Malaysian courts as to whether it is necessary for the proposed judicial manager to make an affidavit or report containing such an assessment.

In *Re Biaxis (M) Sdn Bhd* [2022] 7 MLJ 443, the High Court held that the nominated judicial manager had not affirmed an affidavit to support the application; consequently, there was no satisfactory explanation as to the rationale of the proposal for the fulfilment of the statutory objectives and how the intended judicial management, if ordered, would achieve those objectives.[5] The High Court went on to hold that without the proposed judicial manager's expert opinion and verification of the material facts relating to the status of the company and its prospects for survival, there was nothing credible before the court for it to even consider that the proposal would be likely to achieve the statutory objectives.

In *Re Sin Soon Hock Sdn Bhd* [2020] 1 LNS 976; [2020] MLJU 1242, the same judicial commissioner reaffirmed the need for such an affidavit or report.[6] Because a judicial manager will eventually be the one responsible for the statutory proposal, there should be some statement in their impartial and professional wisdom that such a proposal can achieve the intended statutory purpose.

However, after considering this point, a recent High Court decision in the case of *Federal Power Sdn Bhd v Dara Consultant Sdn Bhd* [2022] 7 MLJ 563 went in the opposite direction. The High Court stressed that such burden on the prospective judicial manager does not exist under the Companies Act 2016 or the Companies (Corporate Rescue Mechanism) Rules 2018. The High Court did not disagree with the earlier decision in *Re Biaxis*, noting that it cannot be denied that such an affidavit would assist the court in assessing whether any proposals put forth are viable. Nonetheless, the High Court ultimately did not find that a supporting affidavit was necessary when faced with an application to appoint a judicial manager.

5 [2022] 7 MLJ 443 at [47].
6 [2020] 1 LNS 976; [2020] MLJU 1242 at [15].

It is useful to compare this with the position in the United Kingdom. As far back as 1991, in the case of *Re Land and Property Trust Co plc* [1991] BCLC 849, a petition for an administration order under section 8(1) of the Insolvency Act 1986 was supported by a substantial report prepared by the proposed administrators, who were insolvency practitioners, and an addendum that addressed the issue of whether the statutory purpose of administration was achieved. In *Re Arrows Ltd (No. 3)* [1992] BCLC 555, a report was also prepared by two insolvency practitioners nominated by the applicant, although their independence was in some doubt. Reports feature in a long line of administration application cases to date.[7]

The reports prepared by the insolvency practitioners were actually mandated by the applicable rules under the Insolvency Act 1986. Rule 2.2 of the Insolvency Rules 1986, which applied at the time the Insolvency Act 1986 was first enacted, required an independent report to be prepared by the person proposed as administrator.[8] The report had to specify the purposes consistent with the statutory objectives of administration, which in the opinion of the person preparing it, might be achieved. The Insolvency Rules 2016 are differently worded but contain similar requirements.

The Companies Commission of Malaysia should consider whether to enshrine similar requirements in the Companies (Corporate Rescue Mechanism) Rules 2018. Incorporating the need for a report to be made by the proposed judicial manager specifically addressing whether the statutory purposes specified in sections 405(1)(b)(i) to (iii) will be capable of being satisfied and why will significantly contribute to the material information and evidence placed before the court for its consideration during the application.

* *With the assistance and contribution of Wong Yong Jim, a pupil-in-chambers in the Dispute Resolution department of Shearn Delamore & Co.*

7 A snapshot of some of the cases would include the following: *Re Harris Simons Construction Ltd* [1989] BCLC 202; *Re MTI Trading Systems Ltd (In Administration)* [1998] 2 BCLC 246; *Re Professional Computer Group Ltd* [2009] 1 BCLC 88; *Re Capital Films Ltd* [2011] 2 BCLC 359; *Re Moss Groundworks Limited* [2019] EWHC 2825 (Ch); and *Re ARL 009 Ltd* [2020] EWHC 3350.

8 Or any other person who is not a company insider such as a director, secretary, manager, member or employee of the company, who has adequate knowledge of the company's affairs (see Rule 2.2(2) of the Insolvency Rules 1986).

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