

**A GLOBAL PERSPECTIVE TO BANKRUPTCY RISKS
AND CHALLENGES WHEN DEALING WITH
FINANCIALLY DISTRESSED CUSTOMERS IN
FOREIGN JURISDICTIONS: THE ASIAN
PERSPECTIVE**

**FCIB INTERNATIONAL CREDIT EXECUTIVES
(I.C.E.) CONFERENCE**

Drake Hotel

Chicago, IL

April 19-21, 2009

INTRODUCTORY COMMENTS AND TIPS

- Know before you go-find out as much as you can about your customers and the countries in Asia in which you will be doing business before you establish the business relationship (become culturally acclimated)
 - Some useful public sources: www.worldbank.org (country pages); www.state.gov (country pages); www.export.gov ; www.iccwbo.org
- Keep your friends close and your customers closer-maintain good communication with your customers so that early warning signs may be spotted and resolved-preferably through non-judicial means (ADR)
- Identify and line up your team up with competent and “connected” (*guanxi*) professionals in the countries where your are doing business-before there is a problem

INTRODUCTORY COMMENTS AND TIPS (CONT.)

- **As judicial processes and legal regimes in many countries in Asia do not provide quick and effective remedies for foreign creditors, the uncertainty of legal systems and redress, most commercial disputes in many Asian countries are often resolved through non-judicial “informal” (negotiation/conciliation) and “formal” (mediation/arbitration) ADR Processes; the “informal” processes, in particular, are often not “lawyer-driven”**
- **Since the legal regimes/practices vary widely throughout Asia, these materials will focus primarily on the laws, practices and culture in the PRC and the Kingdom of Thailand**

IS YOUR CUSTOMER IN FINANCIAL DISTRESS? WARNINGS AND RED FLAGS

- In addition to the “usual” warning signals (slow pay, no pay, announcement of a payment moratorium, resignation/loss of key officers, industry downturn, news or rumors of an impending bankruptcy or of the restructuring/insolvency professionals), tap into your professional and “on the ground” contacts to look for the following:
 - In the past, PRC companies, in a last-ditch effort to secure additional financing, turned to the HK equity market (less likely in this economic climate); your professional contacts in HKG would be able to tap into that news
 - News from your sources on the ground that key parties and their family members may be planning to flee the jurisdiction (e.g.: Thai business and their families taking an extended trip to Singapore or Hong Kong)

IS YOUR CUSTOMER IN FINANCIAL DISTRESS? WARNINGS AND RED FLAGS (CONT.)

- While the “usual” sources (D & B, S & P, Moody’s and e-sources such as Debtwire, etc.) may not be helpful-particularly when dealing with primarily family-owned SMEs in, for example, the PRC and Thailand, on-the-ground resources such as contacts at the local International Chambers of Commerce or the local American Chamber of Commerce group (such as AmCham Thailand) may be good sources to consult-particularly when dealing with local entities.
- Sometimes, articles that relate to the financial difficulties of your customers will appear in local newspapers, business publications and even e-sources-before they appear in English publications or on websites-your local professional team might keep an eye out for any such articles or comments that signal that your customers may be in financial distress



NEXT STEPS AFTER CONFIRMATION THAT CUSTOMER IS IN FINANCIAL DISTRESS (CONT.)

- **Direct communication may be hampered by cultural barriers**
 - **For example, in Thailand, inability to pay one's debts can result in "broken face" (sia na); if the indirect approach does not work, reach out to your client through an intermediary**
 - **"Soft" approaches to breach communication barriers generally work better in Asia than aggressive approaches (aggressive techniques early on may impede your ability to achieve an out-of-court resolution of the dispute)**

NEXT STEPS AFTER CONFIRMATION THAT CUSTOMER IS IN FINANCIAL DISTRESS (CONT.)

- **Availability (and efficacy) of common tools that might be used to improve creditor's position w/re: the prior debt and future extensions of credit (assuming that LCs and/or CI put products are unavailable):**
 - **No PRC or Thai equivalent of a PMSI**
 - Under PRC law, while foreign creditors are able to obtain an SI on certain items of personal property, including M & E and inventory, a SI vs. a Chinese company requires approval by the State Administration of Foreign Exchange (SAFE)-would also be junior to any prior liens (and subject to an avoidance action in the event the Chinese company enters into BK proceedings-see below)
 - Thai law does not provide for UCC Art. 9-type liens on personal property (with the exception for properly-registered liens vs. certain M & E).
 - Other issues where SOEs are involved (is customer really a "private" entity?)

NEXT STEPS AFTER CONFIRMATION THAT CUSTOMER IS IN FINANCIAL DISTRESS (CONT.)

- **Consignment of goods-often used in Asia in because of the lack of available creditor remedies (title is retained by consignor)**
 - **Practice tip: Ensure that your agreements with the customer include ADR clauses (arbitration in a favorable venue; mediation) to avoid being “home towned” in local courts**

NEXT STEPS AFTER CONFIRMATION THAT CUSTOMER IS IN FINANCIAL DISTRESS (CONT.)

➤ Third-Party Guaranty

- Very common in Asia-particularly useful if guarantors are off-shore “asset-rich” affiliates located in creditor-friendly jurisdictions (e.g.: HK affiliates of PRC companies)-
 - Practice tip: Seek Guaranty of payment so that Creditor may look to guarantor w/o exhausting collection efforts vs. customer
 - Practice tip: Again, make sure that the docs contain favorable ADR clauses

NEXT STEPS AFTER CONFIRMATION THAT CUSTOMER IS IN FINANCIAL DISTRESS (CONT.)

- **“Prejudgment attachment”/asset seizure orders**
 - **Can be obtained, for example, in certain circumstances in the PRC and Thailand.**
 - **Would require seeking relief in local courts (People’s Court in the PRC, Dika (civil court) in Thailand or IP/IT specialized court in Thailand)**
 - **Proceed with caution (e.g.: watch out for “criminal” counterclaim in Thailand-other parts of Asia-for example)**

COMPARISON OF BANKRUPTCY SYSTEMS-THAILAND

- **Following the '97 Crash, in response to international pressure., Thailand pursued a multi-tiered approach to tackle its financial crisis:**
 - **Amended its Bankruptcy Act (principal amendments in 1998 and 1999 with additional technical amendments in 2004) to incorporate, among other things, a new reorganization chapter modeled on US Chapter 11 and Singaporean law (“Planner” vs. DIP)**
 - **Established a specialized bankruptcy court (Central Bankruptcy Court) in 1999**
 - **Established the Business Reorganization Office (a branch of the Thai Legal Execution Department) to supervise formal bankruptcy reorganization cases in 1999**
 - **Adopted its version of the “London Approach” to to “formalize” out-of-court workouts (CDRAC) in 1998**
 - **Established a national AMC and pursued ADR initiatives to tackle cases involving financial disputes (see below)**

COMPARISON OF BANKRUPTCY SYSTEMS-THAILAND (CONT.)

- Chapter 3 (the reorganization chapter) of Thailand's BK law incorporates many provisions familiar to US practitioners (such as classification of creditors/parties in interest, avoidance provisions, rejection of "burdensome" contracts, concepts of "adequate protection" and "cash collateral") as well as concepts familiar to practitioners in Singapore and under U.K. law (the independent "planner" concept was modeled after the JM concept in Singapore's insolvency regime)
- BK cases are initiated through an involuntary petition using a "modified balance sheet" test to determine insolvency-a prerequisite to the entry of the order for relief

COMPARISON OF BANKRUPTCY SYSTEMS-THAILAND (CONT.)

- Early high-profile cases following the '97 Crash (*TPI*) demonstrated that gaps in the law and procedures (as well as other gaps in Thai commercial, civil and criminal law) could be exploited to the disadvantage of creditors. For example:
 - While the intent was to put companies reorganizing under new Chapter 3 of the Thai BK Act under the leadership of independent “planner” entities, in practice, many debtors were able to establish “planner” entities under the indirect control of the former management/owners
 - Some foreign planners found out the hard way that labor/immigration/criminal laws could be exploited by adversaries to “run them out of town”

CHALLENGES PRESENTED UNDER THAI BANKRUPTCY REGIME

- While the Thai BK law tries to address enforcement and asset recovery (such as preference/fraudulent conveyance provisions), the lack of enforcement mechanisms and procedures hamper the location and recovery of estate assets
- Despite that the Thai Central Bankruptcy Court is approaching its 10 year anniversary (June 2009), Thai judges and attorneys are still relatively inexperienced (restructurings have been at a standstill since '01 and many of the experienced judges and practitioners have moved on since the last financial crisis) ; moreover, as is the case with other countries in the region, rumblings of judicial corruption, “gaps” in the present system and political interference w/court processes have shaken the confidence of foreign creditors and investors in the Thai legal and judicial system
- These issues and similar issues in other Thai courts (such as the Thai civil courts and the specialized IP/IT Court have led to the increase in use of ADR to resolve commercial and financial disputes in Thailand.

CHALLENGES PRESENTED UNDER THAI BANKRUPTCY REGIME-CONT.

- No “super-priority” status given for post-reorganization loans/extensions of credit; existing lender/creditors often end up providing the exit financing (debt for equity swaps)
- Since Committee formation occurs at a later stage of the case under the Thai system, many creditors do not have the opportunity to air their concerns until the plan voting stage (Committee is not an effective “watchdog”)
- Current law does not include provisions for the sale of substantially all the assets of a debtor outside of a plan
- The business reorganization provisions of the Act do not apply to natural persons (e.g.: guarantors)
- No recognition of US judgments in Thai courts; no “Model Law” or Chapter 15 equivalent.

THAI ADR

- **Thais have a propensity to seek to resolve disputes through ADR processes (such as conciliation). The preference for the “softer” approach was demonstrated time and time again in both out-of-court and formal business reorganization cases and by the willingness of the of the Thai government to intercede as a “neutral” in large and complex cases (TPI)**
- **Arbitration is a very common dispute resolution tool- often, arbitrations are conducted under the rules/guidelines of the International Chamber of Commerce**

THAI ADR (CONT.)

- **The Mediation Center of Financial Disputes (MCFD) was established in April 2001 under the umbrella of the Thai Office of the Judiciary to promote/administer the use of mediation as a means of resolving the thousands of NPL cases then clogging the Thai civil courts**
- **ADRO established detailed rules and guidelines relating to the use and conduct of mediations proceedings to resolve financial disputes.**

THAI ADR (CONT.)

- **With international financial support and with the assistance of Western trainers, the Thais initiated a series of training programs which resulted in the training of a core group of mediators and trainers in Thailand in Western mediation procedures and techniques; the training programs also resulted in the development and adoption of a standardized mediation guide (which contained tips, forms and procedures) conforming to international standards and best practices**
- **The Thais also undertook as series of programs to increase public and judicial awareness of the availability and benefits of ADR**

COMPARISON OF BANKRUPTCY SYSTEMS-PRC

- In 2006, the PRC enacted its new Enterprise Bankruptcy Law (in effect as of June 1, 2007) which, on its face, appeared to incorporate many concepts and provisions found in US Bankruptcy law and practice:
 - Applicable to both private entities and SOEs, the law contains reorganization provisions modeled after Chapter 11, including provisions for the imposition of an “automatic stay” on the entry of an order for relief, appointment of independent “administrators” who would supervise and administer the reorganization process, provisions for post-petition lending and treatment of administrative claims, avoidance actions, committee formation, plan of reorganization, classification of claims, voting by class, and “cram down”

COMPARISON OF BANKRUPTCY SYSTEMS-PRC (CONT.)

- Cases may be initiated either by a voluntary filing or an involuntary filing-test of “insolvency” is determined either via the balance sheet or inability to pay debts as they become due
- Numerous cases have been filed under the new Enterprise Bankruptcy Law throughout China
- In keeping with the Chinese custom and practice of resolving disputes through non-judicial means, the new law included provisions for the resolution of disputes through a “conciliation” process
- The Enterprise Bankruptcy Law also contains provisions that acknowledge reclamation and setoff rights-some differences from US practice and law

COMPARISON OF BANKRUPTCY SYSTEMS-PRC (CONT.)

- **With respect to cross-border recognition, while the PRC has not adopted the UNCITRAL Model Law (or a version of the Model Law), the law does provide that parties may apply to the People's Court for recognition of a judgment or ruling with respect to a PRC debtor/estate which the court may consider essentially under general principles of comity**

CHALLENGES PRESENTED UNDER PRC BANKRUPTCY REGIME

- **As the Chinese have historically resorted to non-judicial means to resolve conflict (conciliation), the rule of law/resort to seeking redress through formal court processes is a relatively new concept for PRC culture and society**
- **There is no specialized BK court in the PRC-cases are heard by judges of the local People's Court**
 - **While some of the judges/courts are used to handling sophisticated matters (Beijing, Shanghai and Shenzhen, for example), there is a dearth of expertise in the field and most PRC judges and attorneys have little or no expertise in dealing with BK or reorganization matters/cases**
 - **The more one strays away from major commercial centers in the PRC, the higher the likelihood of getting “home towned” in the local People's Courts**
 - **Practice tip: Make sure that your legal team includes “local” lawyers (with connections to the court, the parties, the local governmental and party officials)**

CHALLENGES PRESENTED UNDER PRC BANKRUPTCY REGIME (CONT.)

- While the new Enterprise Bankruptcy Law appears to be “Chapter 11-like”, some of the “gaps” in the law and practice are as follows:
 - Appointment of administrators-varies by court, by province; must be a PRC entity/firm
 - The standards for determining whether an order for relief should be entered when there is an involuntary filing are unclear-potential for abuse
 - The “automatic stay” is not all-encompassing; pending pre-petition litigation vs. the debtor may continue after the appointment of the administrator
 - Judges, attorneys and other professionals will need specialized training to deal with sophisticated and complex BK/reorganization cases
 - The new law exempted a host of large SOEs that would be administered under the “Policy Bankruptcy” program (geared to the protection of labor interests and rights; while the program was to have phased out at the end of 2008, it is still ongoing, with the result that the wind-down and dissolution of many of the larger SOE entities will be treated under the “old law”).
 - The new law does not apply to individuals (such as guarantors)
 - While there is conflicting data on the cases that have been resolved under the new law so far, there is a great disparity in China between the law as written and the law as practiced

PRC ADR

- **Given the Chinese cultural and social propensity to resolve conflict through non-judicial means, ADR processes (arbitration and conciliation) are often used to resolve conflict in China (particularly in view of the perception of the weaknesses in the PRC judicial processes and legal system and procedures)**
 - **Practice tip: Contracts with PRC customers should include ADR/arbitration clauses; most foreign parties prefer to conduct mediations/arbitrations off-shore (Hong Kong/Singapore, for example)**

PRC ADR-(CONT.)

- **Given the historical foundation for the resolution of conflict through “conciliators”, some Western concepts (such as “facilitative mediation”) have not taken root in China, despite joint PRC and Western initiatives (such as the efforts by the CPR Institute and the PRC government to introduce “Western-styled” mediation to PRC judges, lawyers, government officials and representatives of SOEs and private businesses)**

WRAP UP/Q AND A

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