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IPBA NEWS AND LEGAL UPDATE



Bankruptcy and Insolvency in the Asia-Pacific Region

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The European Union in 2008 refused to recognize China's status as a "full market economy" because, in their opinion, shortcomings remain in certain areas of governance. One such shortcoming was the lack of sound insolvency laws appropriate to a market economy and also general international practice. The Enterprise Insolvency Law of the PRC, which took effect on June 1st, 2007, introduced some changes, most notably in relation to greater transparency and creditor involvement in insolvency proceedings. In practice, few Chinese enterprises have officially declared bankruptcy in accordance with the new law. This article aims to provide you with an overview of the Chinese insolvency and bankruptcy system



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The President's Message – A Difficult Year



Dear Colleagues,

This IPBA year, our 18th, has been a difficult one, as we, along with countless other organizations around the world, have been seriously affected by events beyond our control. The almost

unprecedented flooding in Hanoi last November made it necessary to cancel our Mid-Year Meeting, the first time that has ever occurred with a major IPBA event. For an organization that thrives on collegiality and friendship, this was a major setback. And of course overshadowing all of us for many months has been the global economic meltdown, the worst in the lifetimes of most of us, making it extraordinarily difficult for many of us to devote time to IPBA matters or to travel to IPBA conferences and other events.

Still, there have been successes. The IPBA Council meeting held by conference call following cancellation of the Mid-Year Meeting, with more than 40 participants, suggests that ever-improving technology will enhance our ability to communicate with each other and act other than at actual in-person meetings. And a number of other important steps have been taken to improve our organization. The wholesale revision of the IPBA Manual, our “bible” regarding many IPBA policies, has been greatly revised and upgraded, under the leadership of Jerry Sumida, soon to become our Secretary-General. Our new Competition Law Committee expands the range of opportunities available to our members, and promises to enable us to participate in the education of the bar in this important field. The organization of our Leadership Committees, a number of which have already been formed, should strengthen our “infrastructure”, and hence our ability to expand our membership and augment the range of our activities in the major jurisdictions in the Asia-Pacific region. And there is new energy

and enhanced coordination within our committee structure overall under the leadership of Cedric Chao, our Committee Coordinator, a promising sign for the continued vitality of the IPBA.

Through the efforts of many officers and other members we have succeeded in developing or collaborating with other organizations in presenting an array of high quality, instructive programs, including, in the last two months alone, a Women’s Lawyers Conference in New Delhi, organized by our Women’s Business Lawyers Committee; a Middle East Financial Law Congress held in Qatar, organized by the Qatar MICE Development Institute and supported by the IPBA; and the First Asian Legal Information Institute Conference, organized by the University of Technology in Sydney and the University of New South Wales, also supported by the IPBA. By the time you read this message one of our showcase events, our annual joint Asia M&A Forum, will have been held in Hong Kong in collaboration with the International Financial Law Review. And in June we offer in Hong Kong, in conjunction with the American Bar Association Section of Business Law, the Global Business Law Forum, a major undertaking organized by the ABA Section of Business Law with important contributions by the IPBA. These events, and the expanding relationships we have with bar and other organizations in the Asia-Pacific region, bode well for our continued growth and development.

Many IPBA officers, council members, committee chairs and vice chairs, and others, far too many to name, have contributed to these worthy and successful endeavors. As this current IPBA year draws to a close, I thank all of them for their dedication. The opportunity to serve as your President has been a privilege, for which I thank you. And I hope to see you at our 2009 Annual Conference in Manila in April.

Gerold W Libby
President

The Secretary-General's Message



Dear IPBA Members,

I am sure all IPBA members are affected by the global financial and economic problems; some for better and some for worse. Those of us who are busy at this time may be stretched by

clients to find quick solutions for their exigencies. Those experiencing a slack in legal work are probably thinking up more creative means of keeping busy and profitable. At times like this we are all anxious and busy, either for our clients or for ourselves.

The initial response in most law firms in such times is to cut back on travel and attending conferences, pare down on non-essential advertising and training programs and generally tighten up on costs. The rational approach to such expenditures must be to attend selective conferences having the quality of a "one-stop" facility, where meeting with new people and renewing old friendships will yield the best returns for improved work prospects. Even better, a good conference like the one we will have in Manila will give the participant a quick update on the essentials of his or her own practice areas through well-structured educational programs.

It is with this in mind that I write, hoping to reach out to those who are uncertain about coming to the Annual Conference in Manila, to prod them to firm up their plans to come. This is the time for making friendships with the new and the young, with those who are established and in the position to refer work. This is the time to listen and to encourage, and put yourself in the way of opportunities which you will not otherwise hear about. The right antidote for times like now must be to drink deep from the IPBA well of friendship, which yields generously. At times like this IPBA shines for its reliability in meeting the expectations of those who are looking to network with good, well-meaning fellow professionals. I will say that it is a feeling not unlike that of making plans to go home for the holidays.

I hope to see all of you in Manila, particularly those who have come because they had been encouraged by what I have said to her.

Arthur Loke
Secretary-General

A Day of Excellence: The IPBA Women Lawyers Conference in India



Varya Simpson
Sonnenschein Nath & Rosenthal LLC
Chair, IPBA Women Business Lawyers
Committee

February 10, 2009, truly was a day of excellence for all of us attending the *Women Business Lawyers Conference in India: Encouraging Success and Maintaining Balance*, in New Delhi, India, presented by the IPBA Women Business Lawyers Committee. Excellent weather, excellent venue, excellent presentations, excellent dialogue,

and, most important of all, excellent participants, fully and actively engaged in discussion throughout the day.

The concept of the conference was generated from the enthusiastic response of the attendees at the presentation on Work-Life Balance by the Women Business Lawyers Committee at the IPBA Annual Conference in Los Angeles in 2008, a very interactive session led by legal consultant Susan Manch of Shannon and Manch in Washington, DC. The impetus of the conference was fueled by my desire, as Chair of the Women Business Lawyers



Committee, to provide greater outreach for our committee and by my personal commitment from living for several years in Hyderabad and Chennai to provide a forum for women lawyers in India to meet together and discuss issues and topics of importance to the development of their careers. The stars were correctly aligned for this event when I found in one of my committee Vice Chairs, Priti Suri of PSA, Legal Counsellors, in New Delhi, a like-minded enthusiastic supporter who was willing to put in the great effort and resources necessary to organize an ambitious conference with little outside support.

Over 70 women, and a few men, attended the all-day event, held at the India Habitat Centre in New Delhi, ranging from new associates to managing partners of major Indian law firms to seasoned litigators at the High Court, coming from Delhi, Mumbai, Bangalore and Hyderabad. Susan Manch was willing to assist us again and led the initial panel discussion with IPBA members Priti Suri of PSA in New Delhi, Varya Simpson of Sonnenschein Nath & Rosenthal in San Francisco and Noor Meurling of Soebagjo, Jatim, Djarot in Jakarta, each providing their global perspective on the issue of gender diversity. After the panel presentation, all attendees participated in interactive small group discussions on three topics: increasing and exercising influence, building and strengthening client relationships and achieving and maintaining work-life balance. Each

discussion was led at ten individual tables by pre-trained facilitators, who included IPBA members Kumkum Sen of Rajinder Narain & Co in Delhi, Helen Zhang of McDermott Will & Emery in Shanghai, and Caroline Berube of HJM Asia Law & Co in Guangzhou, China, and concluded with Susan Manch leading the entire group to create a synthesized joint list of action steps to consider on each of the topics under discussion.

The true benefit and pleasure for all of us attending the conference was to hear the energy, passion and perspectives provided by all the participants and their willingness to share the experiences and challenges they have faced in developing and maintaining their legal careers. The ability and dedication to the practice of law displayed by this group was inspiring. It was the consensus of those present that an effort should be made to create a forum in New Delhi for ongoing discussion on topics of specific interest to women practicing law in India.

The conference was made possible by the very generous support and financial contribution of PSA, as well as sponsorship by HJM Asia Law & Co, Sonnenschein Nath & Rosenthal, Manupatra, Mary Kay Cosmetics Private Limited, Udadia Udeshi & Co, J Sagar Associates, Rajinder Narain & Co, Krishnamurthy & Co, and Agarwal Jetley & Company. If you are interested in finding out more information about organizing a similar conference in your jurisdiction, please contact the IPBA office.



Publications Committee Guidelines for Publication of Articles in the IPBA Journal

The IPBA Publications Committee is soliciting quality articles for the Legal Update section of the June and September 2009 issues of the IPBA Journal. If you are interested in contributing an article, please contact **Mr Kap-You (Kevin) Kim**, Publications Committee Chair, at kyk@bkl.co.kr or **Mr Hideki Kojima**, Publications Committee Vice-Chair, at kojima@kojimalaw.jp and/or submit articles by email to Mr Kim or Mr Kojima at the foregoing addresses.

Proposed themes for upcoming editions:

- Law and Technology
(June 2009)
Deadline for submissions: June 1, 2009
- Project Finance
(September 2009)
Deadline for submissions: September 1, 2009

The requirements for publication of an article in the IPBA Journal are as follows:

1. The article has not been previously published in any journal or publication;
2. The article is of good quality both in terms of technical input and topical interest for IPBA members;
3. The article is not written to publicize the expertise, specialization, or network offices of the writer or the firm at which the writer is based;
4. The article is concise (2,500 to 3,000 words) and, in any event, does not exceed 3,000 words; and
5. The article is written by an IPBA member.

Bankruptcy of Participants in Real Estate Securitization – A Japanese Aspect of the Global Credit Crisis



Ryosuke Ito



Koji Hayashi

In Japan, the real-estate business has been most immediately and seriously impacted by the shock waves of the current financial crisis. Since modern financial techniques were used for real-estate financing in the “mini-bubble” economy in Japan,

many unprecedented legal issues have been suddenly created endangering those “sophisticated” financial schemes – particularly the unexpected bankruptcy of a participant in such schemes.

Ryosuke Ito

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Introduction

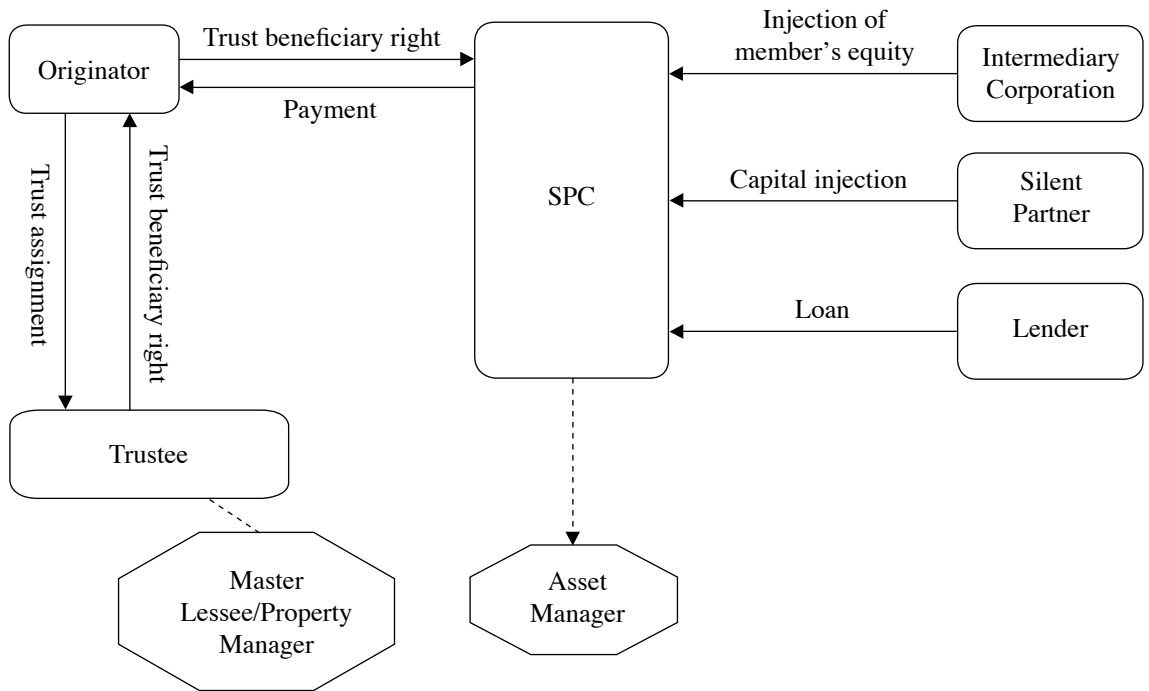
When the sub-prime loan crisis emerged in the United States in 2007, a tendency towards a credit crunch in Japanese financial institutions also began to be seen, and grew steadily stronger. Then, in September 2008, as typified by the “Lehman Shock,” the credit crisis suddenly took hold in the United States, and the credit crunch at once spread to financial institutions around the globe. In Japan, the period of brisk real estate investment called the “real estate mini-bubble” continued until around the middle of 2007, but was then greatly influenced

by the credit crunch. Real estate investment funds, which used real estate securitization techniques extensively, played an important role in the “real estate mini-bubble.” As the effects of the credit crunch brought about by the credit crisis in America spread, loans for property acquired by realtors and participants in real estate securitization were called in, refinancing plans for existing loans went into disarray, and as a result bankruptcy became common. The basic premise of the Special Purpose Companies (SPCs) which formed the core of real estate securitization was bankruptcy remoteness, but the bankruptcy of participants who were not SPC’s or originators made it difficult for the schemes to meet their intended goals. As a result, asset securitization schemes have been placed in an unstable position.

Basic Real Estate Securitization Scheme

A typical real estate securitization scheme using a trust is illustrated below:

An Example of a Real Estate Securitization Scheme



The following is a general outline of the structure, types of contracts and cash flow:

(1) Structure

- 1) The original holder of the property, called the “originator,” becomes the initial assignor/beneficiary and entrusts the property to a trustee (a trust bank or trust company).
- 2) The trustee accepts the assignment, and grants the originator trust beneficiary rights.
- 3) The originator assigns the trust beneficiary rights to an SPC (a type of limited liability company), and the SPC in return makes a payment to the originator.
- 4) The funds for the trust beneficiary payment that the SPC makes come from sources such as contract-based capital injections from silent partners and non-recourse loans from master lenders (banks).
- 5) For the purpose of bankruptcy remoteness, the injection of member equity typically comes from limited liability intermediary entities. (After the law that applies to ordinary corporations and ordinary incorporated foundations goes into effect, it is thought that ordinary corporations will be used. Under that law, limited liability intermediary entities will be considered to be ordinary corporations.)

(2) Contracts under a Basic Real Estate Securitization Scheme

The profits realized from the proper oversight of the real estate are used to pay various expenses,

and must be managed. Generally, besides the trust agreement, the following kinds of contracts are entered into:

1) Asset Management Contracts

In these types of contracts, which are used to ensure that the project as a whole goes smoothly, the SPC entrusts its asset management duties to an asset manager. The asset manager’s duties include producing all necessary documents to be filed with the SPC’s lenders, the safekeeping of the SPC’s necessary documents, negotiation with the owner of the real estate and neighbouring property owners, giving general advice on the management of the real estate, giving advice on trust beneficiary rights and the real estate in the event of a sale, and managing the overall governance of the scheme.

2) Master Lease Contracts/Property Management Contracts

In these types of contracts, the trustee leases out all of their properties in one bundle, and has property management conducted for them. “Property management” includes the implementation of real estate investment plans made by asset managers and the like; taking care of day-to-day real estate oversight duties such as tenant, building, and facility management; maximization of profits from the real estate properties; and the maximization of the value of real estate properties themselves. In theory, property management contracts

do not need to be linked to master lease contracts, but many originators have their properties managed under a unified master lease/property management contract.

3) Building Management Contracts

In these contracts, the property manager subcontracts building and facility management, repair, cleaning, and similar duties.

4) Contracts with Creditors

The project's overall cash flow is called the "waterfall". In securitization schemes, with their numerous participants, it is necessary to clarify who the senior and junior debt holders are. Therefore, the SPC (borrower), lender, and asset manager each becomes a party to the scheme, and in each contract separately agree on the important matters concerning the "waterfall" and the project as a whole.

(3) Cash Flow of a Basic Real Estate Securitization Scheme

An example of a typical "waterfall" (cash flow) is outlined below:

- 1) A payment is made by the end tenant to the bank account of the trustee or the master lease holder. After reserving the funds necessary to pay entrustment fees and operating expenses, the trustee pays the beneficiary dividends in accordance with the trust beneficiary rights.
- 2) After funds for payments to the bank accounts of the lender and SPC have been reserved from the dividends paid to the beneficiary's account, loan and expense payments are made. In addition, an appropriate amount of funds are withheld to guarantee payment for various expenses, including interest payments, emergency maintenance, taxes, insurance premiums, end tenant security deposits, and the like.
- 3) After payments are made and funds reserved, the remainder is deposited in the SPC's release account. Asset management fees and dividends to silent partners are paid, and what remains is pooled in the release account.

The Bankruptcy of Participants in Securitization Schemes

(1) The Effect of Participants' Bankruptcy

As stated above, a great number of participants took part in real estate securitization schemes. Because these projects' viability depends on each individual part functioning smoothly, the bankruptcy of one participant creates worries

about the dysfunction of the entire project.

Until recently, the central topic of conversation concerning asset securitization was the collapse of the creditworthiness of originators, who are the titleholders of the concerned properties (the problem of bankruptcy remoteness in a narrow sense). However, not a few projects have suffered from dysfunction because of the bankruptcy of participants who are neither originators nor SPCs. This is the broader problem of bankruptcy remoteness, and there is a need to investigate exactly what kinds of problems occur when each kind of participant goes into bankruptcy, and to find out how to deal with those problems. As already explained, the cause of many recent realtor bankruptcies has been financial plans for costs for new acquisitions and refinancing existing loans going awry, combined with financial institutions imprudently calling debts due. Because of this, by the time most realtors file for bankruptcy, the funds in their accounts have already been drained. Looking at the facts of actual cases, it is presumed that if there are enough funds that if debt payments were suspended a company could continue operations, the company will choose to enter civil rehabilitation rather than bankruptcy proceedings. In the case of insolvency, it will be thought of as mainly a civil rehabilitation case, but will be basically similar to a bankruptcy case. As stated above, securitization schemes can be called a collection of various contracts, and if a participant in the scheme who is a party to the contracts goes into bankruptcy, there is a need to pay special attention to the operations of bankruptcy law (Civil Rehabilitation Act Art 49 and Bankruptcy Act Art 53), such as suspension of debts, creditor claims, and special bankruptcy termination provisions, as well as the right of termination or performance in relation to bilateral contracts.

(2) The Bankruptcy of Asset Managers

Asset managers play an extremely important role in real estate securitization. If an asset manager goes bankrupt, the SPC cannot fulfil its duty to submit required documents to its lender and cannot properly control real estate sales projects and the like. Having lost the manager of its present and future contract documents, an SPC in such circumstances faces great contractual and practical difficulties. In actual cases, the specific duties of asset managers differ, but from the point of view of interested lenders and investors, the first activities that must be done if an asset manager goes bankrupt are to obtain delivery of important documents and find a replacement for the asset manager, or if the project is nearing completion, to develop tactics for finishing the project without an asset manager.

1) Delivery of Important Documents

When an asset manager falls into dysfunction as a result of bankruptcy, the delivery of documents, such as documents entrusted by the lender to the asset manager (such as titles to the properties and survey maps), is extremely important. Under contract, a lender can secure the right to obtain the documents, but in some cases, a lender can, under its rights as a creditor (Civil Code Art 423), subrogate that right to an SPC, which then entrusts those documents to an asset manager, from whom the documents can be requested.

2) Changing Asset Managers

When an asset manager goes bankrupt, it is typical for this to be a reason for termination of the asset management contract, which assumes the asset manager will be changed. The asset management contract is between the asset manager and the SPC. If the asset manager goes bankrupt, it is common for there to be a provision so that the SPC can get approval from the associated lenders to dissolve the relevant contracts. However, as a practical matter, substantial decision making is difficult for SPCs, and getting SPCs to engage in a speedy termination of asset management contracts is no exception. While it is preferable that the contracts between creditors include provisions as to who is to give instructions in the case of an asset manager's bankruptcy, most plans to date have not included these types of terms. For this reason, in order to ensure that the SPC terminates its contract with the current asset manager and executes a new contract with a new asset manager, the only options seem to be having the bankrupt asset manager and the SPC voluntarily terminate their asset management contract, or instructing the SPC's directors to agree to change asset managers.

One problem that arises when changing asset managers is the choice of a new asset manager. Asset managers must be registered either as an Investment Management Business Operator ("IMBO") or an Investment Advisory Business Operator ("IABO") in accordance with the Financial Instruments and Exchange Act of Japan. If the asset managers are both respectively registered as the same type of Operator, *ie*, an IABO or an IMBO, then no special issues arise. If, however, there is a change from an IMBO to an IABO, or from an IABO to an IMBO, then the decision-making methods for the SPC are

different, and it therefore becomes necessary to confirm appropriate revisions for all past contracts.

3) Exit Strategy Provisions

As the project nears completion, selling and the exercise of trust beneficiary rights occur. If the asset manager goes bankrupt at this time, the opportunity for a timely sale may be lost. If appropriate sales activities are not conducted at the right time, the previously expected sales price may not be obtained and not only SPCs, but also lenders and investors may lose out on expected profits. In these types of cases, it is necessary to recognize some form of right to intervene so that lenders and/or investors can, in dealing with the SPC, preserve their claims. On this point, it is advisable that contracts between creditors regarding methods of exit include settled provisions. If no such provisions exist, an agreement wherein the asset manager is changed and the SPC initiates sales in accordance with instructions from the lenders can most likely be reached.

(3) Bankruptcy of the Master Lessee

The party that executes the overall master lease contract (as mentioned in section 2 above), buys



all the related property, and then sublets to the various tenants, is called the master lessee. It is a basic rule in Japanese bankruptcy law that if the master lessee goes bankrupt (because the master lease contract itself is considered a typical lease agreement) the debt obligations on both parties, who have both failed to meet them, can be set aside. However, even if the master lease is broken, the master lessee cannot exercise its duty as the leaseholder to restore circumstances to their original state and take back the building, because the building itself is actually in the possession of the tenant-sublessee. When the master lessee goes bankrupt, the question is whether to transfer the master lessee's status to a third party, or if the owner should sign a lease directly with the end tenant in question. Additionally, in cases where, like above, the master lease includes a contract with a property manager, it may be necessary to change property managers.

(4) Lender and Investor Bankruptcies

Only infrequently are asset securitization plans affected by the bankruptcies of lenders or other investors. However, in recent years when we have seen increasing numbers of development-style real estate asset securitization plans, when buying land, or demolishing or constructing buildings, new investment at the beginning of every stage

is governed by regulations. In cases where these types of lenders have obligations to make additional loans, and investors have obligations to make additional disbursements, if the lenders and investors go bankrupt, they will be unable to meet their respective obligations and delays to the entire plan will result. In these cases, where the successors to the bankrupt parties are required to succeed such bankrupted parties in the securitization plan in question, it is necessary to require the succeeding third parties, who are obligated successor parties to the contracts, to assume the assets and liabilities.

Conclusion

Once participants in an asset securitization plan have gone bankrupt, no matter how the plan is constructed it is impossible for the asset securitization plan to completely avoid being affected.

The expected governance of the scheme (for example, systems for decision-making and process implementation) as well as the "waterfall" will be greatly affected by the bankruptcies of participants in the real estate securitization scheme. While it is possible that things will go according to the agreed-upon contracts, there will certainly be deviations. In the final analysis, the only option is to cooperate with the administrators/receivers and managers of the bankrupt company in order to agree together on the path towards a resolution. During that process, with the aim of preserving fairness, it is necessary for the interested parties to the asset securitization scheme to agree on the framework and structure, and, in compliance with the bankruptcy laws and regulations, look for expected points of agreement at the time of bankruptcy.

Since the value of business activities rapidly deteriorates in a worsening business environment, there is a requirement to expedite processing, and even though it may be necessary to study more broadly the effects on related markets, the affected parties should look to actual examples for guidance in order to reach a balanced solution.



Photo: Andreas Kaspar

Insolvency and Corporate Rehabilitation in the Philippines



This article discusses possible relief of distressed or otherwise insolvent juridical debtors in the Philippines.

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Preface

Corporate Rehabilitation is distinct from insolvency. Rehabilitation contemplates the revival of a distressed corporation enabling it to continue doing business. An insolvency proceeding, on the other hand, contemplates the inability of a corporation to continue doing business thereby requiring its liquidation and eventual closure.

Corporate Rehabilitation is a creation of Presidential Decree 902-A (“PD 902-A”), however the procedures on how to avail of it are found in the rules issued by the Supreme Court (the “Rules on Corporate Rehabilitation”). Prior to the promulgation of PD 902-A, the prevailing law in this area was Act No 1956, otherwise known as the “Insolvency Law.”

This essay will briefly discuss the various remedies under the Insolvency Law and the Rules on Corporate Rehabilitation insofar as they affect juridical entities.

Remedies under PD 902-A

Suspension of Payments (“SOP”) – A corporation possessing sufficient property to cover

all its debts but foreseeing the impossibility of meeting them when they respectively fall due, may petition the court that it be declared in the state of SOP. This remedy allows the corporation to avail of a moratorium on the payment of its debts while the corporation is undergoing rehabilitation.

Generally, SOP under PD 902-A is available as a remedy to solvent corporations. PD 902-A does not mandatorily require the favorable vote of the creditors to be effective. The remedy being regulator-driven, the decision on whether or not the corporation will be granted a reprieve lies ultimately within the sound discretion of the appointed rehabilitation receiver.

New Rules on Rehabilitation – The Supreme Court recently revised the rules governing actions for corporate rehabilitation in order to clarify certain aspects of the proceedings and to address the claims of foreigners. The new rules became effective on January 16, 2009, just in time for the effects of the global economic crisis.

Salient Features – A petition for suspension of payment has the following salient features:

1. Proceedings are considered *in rem*, summary and non-adversarial in nature.
2. Any pleading filed, which may be thru facsimile transmission (fax) or electronic mail (e-mail),

must be supported by verified statements based on authentic records, and must contain documentary annexes supportive of the pleading.

3. If the petition for rehabilitation is sufficient in form and substance, an order, effective upon issuance until the final rehabilitation of the debtor or the dismissal of the action, is issued, *inter alia*: (a) appointing a rehabilitation receiver; (b) suspending enforcement of all claims against the debtor, its guarantors and persons not jointly liable with the debtor, excluding claims against letters of credit and similar security arrangements issued by a third party; (c) allowing the debtor to continue operating under the supervision of the court; (d) prohibiting the debtor from disposing its properties, except in the ordinary course of business; and (e) setting a creditors' meeting to discuss and consider the rehabilitation of the debtor.
4. The court may issue an order, upon application, to protect trade secrets or other confidential research, development or commercial information belonging to the debtor.
5. The receiver is an officer of the court and possesses certain qualifications, disqualifications, powers and functions. He is primarily tasked with rehabilitating the debtor, ensuring that the debtor's property is reasonably maintained, and implementing the rehabilitation plan after its approval. He is not a substitute for the corporate officers and the Board of Directors of the debtor, but can ask the court to nullify the latter's action or resolution if warranted.
6. The proposed rehabilitation plan must be approved within 180 days from initial hearing and favorably endorsed by creditors holding at least two-thirds (2/3) of the total liabilities of the debtor, including secured creditors holding more than fifty percent (50%) of the total secured claims of the debtor and unsecured creditors holding more than fifty percent (50%) of the total unsecured claims of the debtor. The plan must include (a) the desired business targets or goals and the duration and scope of the rehabilitation; (b) the terms and conditions of such rehabilitation, including terms addressing the manner of its implementation; (c) the material financial commitments of the stockholders of the debtor or the existence of a "white knight" to support the rehabilitation plan; (d) the means for the execution of the rehabilitation plan, which may include debt to equity conversion, restructuring of the debts, how the debtor could concentrate on its core business, *dacion en pago* or sale or exchange or any disposition of assets or of the interest of shareholders, partners or members; and (e) a liquidation analysis setting out for each creditor that the present value of payments it would receive under the plan is more than what it would receive if the assets of the debtor were sold by a liquidator within a six-month period from the estimated date of filing of the petition.
7. If the plan extends the period to pay debts under existing contracts, the new period should not extend beyond fifteen (15) years from the expiration of the stipulated term existing at the time of filing of the petition.
8. The approval of the plan by the court results in: (a) the plan becoming binding on the debtor and all persons who may be affected thereby, including the creditors, whether or not such persons have participated in the proceedings or have opposed the plan or whether or not their claims have been scheduled or listed in the application; (b) a requirement that the debtor must comply with the plan and take all actions necessary to carry out the plan; (c) schedule of payments to the creditors in accordance with the plan; and (d) any compromises on amounts or rescheduling of payments by the debtor becoming binding on creditors regardless of whether or not the plan is successfully implemented.
9. The court may approve, alter, modify or dismiss a rehabilitation plan even over the opposition or objection of creditors of the debtor. Even without a creditors' endorsement, the court may still rehabilitate the debtor if the rehabilitation plan provides the objecting creditors with payments whose present value would be greater than what they would have received if the assets of the debtor were sold by a liquidator within a six (6)-month period from the date of filing of the petition.

Who may apply – Generally, a corporate-debtor, either alone or together with its affected affiliates or subsidiaries, can initiate the action in court. The action may also be initiated by creditors holding at least twenty percent (20%) of the debtor's total liabilities if they find the business of the debtor feasible to continue. In the latter case, requirements are less stringent.

Pre-negotiated Rehabilitation – It is also

possible to file a petition for a pre-negotiated rehabilitation. In that case the petition must be supported by an affidavit showing the written favorable endorsement of creditors holding at least two-thirds (2/3) of the total liabilities of the corporate-debtor, including secured creditors holding more than fifty percent (50%) of the total secured claims and unsecured creditors holding more than fifty percent (50%) of the total unsecured claims. The court proceedings are simpler and shorter in this instance but the effect is the same.

Recognition of a Foreign Proceeding – A foreign representative may apply with the local court where the debtor resides for recognition of the foreign proceeding in which the foreign representative has been appointed. This procedure applies when (a) assistance is sought in a Philippine court by a foreign court or a foreign representative in connection with an existing foreign rehabilitation proceeding; (b) assistance is sought in a foreign state in connection with a domestic proceeding; or (c) a foreign proceeding and a domestic proceeding are taking place concurrently. The sole fact that a petition for rehabilitation is filed does not subject the foreign representative or the foreign assets and affairs of the debtor to the jurisdiction of the local courts for any purpose other than the petition. But the court may reject the application if (a) the action would be manifestly contrary to the public policy of the Philippines; or (b) if the court finds that the country of which the petitioner is a national does not grant recognition to a Philippine rehabilitation proceeding.

Effects of Recognition of Foreign Proceeding – Upon recognition of a foreign proceeding: (a) commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities is stayed; provided, that such stay does not affect the right to commence individual actions or proceedings to the extent necessary to preserve a claim against the debtor; (b) execution against the debtor's assets is stayed; and (c) the right to transfer, encumber or otherwise dispose of any assets of the debtor is suspended.

Relief after Recognition of Foreign Proceeding – When necessary to protect the assets of the debtor or the interests of the creditors, the court may grant any appropriate relief including: (1) staying the commencement or continuation of individual actions or proceedings concerning the debtor's assets, rights, obligations or liabilities to the extent they have not been stayed; (2) staying execution against the debtor's assets to the extent it has not been stayed; (3) suspending the right



to transfer, encumber or dispose of any assets of the debtor to the extent this right has not been suspended; (4) providing for the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, rights, obligations or liabilities; (5) entrusting the administration or realization of all or part of the debtor's assets located in the Philippines to the foreign representative or another person designated by the court; and (6) extending the relief granted under the rules. Upon request, the court may entrust the distribution of all or part of the debtor's assets located in the Philippines to the foreign representative or another person designated by the court.

Protection of Creditors and Other Interested Persons – In granting or denying relief under the recognition of foreign proceedings or in modifying or terminating the relief granted thereunder, the court must be satisfied that the interests of the creditors and other interested persons, including the debtor, are adequately protected. The court may subject the relief granted to conditions it considers appropriate and may even modify or terminate such relief on its own.

Intervention by Foreign Representative – Upon recognition of a foreign proceeding, the foreign representative may intervene in any action



or proceeding in the Philippines in which the debtor is a party.

Cooperation and Direct Communication with Foreign Courts and Foreign

Representatives – In matters covered by the subject law, the court is mandated to cooperate to the maximum extent possible with foreign courts or foreign representatives. The court is entitled to communicate directly with, or request information or assistance directly from, foreign courts or foreign representatives. Cooperation may be through (a) appointment of a person or body to act at the discretion of the court; (b) communication of information by any means considered appropriate by the court; (c) coordination of the administration and supervision of the debtor's assets and affairs; (d) approval or implementation by courts of agreements or contracts; (e) coordination of concurrent proceedings regarding the same debtor; (f) suspension of proceedings against the debtor; (g) limiting the relief to assets that should be administered in a foreign proceeding pending in a jurisdiction other than the place where the debtor has its principal place of business or information required in that proceeding; and (h) implementation of rehabilitation or re-organization plan for the debtor.

Commencement of Local Proceeding – After the recognition of a foreign proceeding, a local proceeding may be commenced only if the debtor is doing business in the Philippines. The effects of the proceedings shall be restricted to the assets of the debtor located in the country and, to the extent necessary to implement cooperation and coordination under the rules, to the other assets of the debtor that, under local laws, must be administered in that proceeding.

Remedies under Act No 1956

Suspension of Payments – This remedy is a creditor-controlled proceeding even as only debtors could apply under this law. It is dependent on the court's approval of the application and the acceptance of the creditors, in that, should the creditors reject the proposal of the corporation, they are free to enforce their claims through foreclosure or otherwise.

Unlike PD 902-A, SOP under Act 1956 does not cover secured creditors and in the absence of any agreement among the creditors, the automatic stay would expire after three months. Under PD 902-A, both secured, to a limited extent, and unsecured creditors are covered and the automatic stay prevails for as long as the debtor is under a management committee.

Requirements are more rigorous under this law than that of PD 902-A. Thus, most of the latest applications are under the later law.

State of Insolvency – An insolvent corporation may petition the court to be declared in a state of insolvency. In its petition, the corporation sets forth its inability to pay all its debts in full, its willingness to surrender all its property to an assignee for the benefit of its creditors, and an acceptance of the consequences of being adjudged an insolvent.

How to Apply – A petition for declaration of insolvency may either be voluntary or involuntary. If the petitioner is the insolvent debtor itself, it is called voluntary, which means that the action should have the appropriate imprimatur of its board of directors and stockholders. If the petitioner is a group of creditors, then it is involuntary. In such a case, three or more creditors must join the initiation of the proceedings. In both cases, the court has to determine by conducting hearings if the debtor is really insolvent before making such a declaration. Thereafter, the court's declaration is published and a creditors' meeting is called to elect an assignee in insolvency, who shall take possession of the debtor's property for the benefit of the creditors of the debtor. The last step is the conveyance or liquidation of the debtor's properties, payment of debts and composition if agreed.

Voluntary Insolvency – In voluntary insolvency, the petitioner must submit to the court a complete list of all its assets and creditors showing the amount and nature of indebtedness, their address and the security involved. Petitioner is required to include a verified statement that the lists are complete and nothing else remains to be disclosed. If application is sufficient in form and substance, an order is issued with the effect of staying all civil proceedings pending against the insolvent entity.

Involuntary Insolvency – In involuntary proceedings, to be considered an act of insolvency, an applicant must set forth at least one of the following: a) debtor's principal officer is about to depart from the Philippines, b) concealment to avoid service of legal processes, c) offering judgment for purposes of defrauding creditors, d) allowing judgment by default for purposes of hindering or defrauding creditors, e) assignment or transfer of property with intent to defraud creditors, f) default of payment under contracted obligations, or g) in contemplation of insolvency, made payment, donation or transfer of assets. To be effective, the petitioning creditors must post sufficient bond to answer for damages if the petition would be dismissed or withdrawn.

Powers of the Assignee – The assignee in insolvency has the power to sue, recover into its possession all assets of the insolvent debtor, sell at public auction any and all personal or real properties of the debtor, redeem all valid mortgages and pledges, settle all accounts of the debtor or satisfy judgment of claims subject to the approval of the court, and recover conveyance or payments from other parties made in violation of the law. The assignee is allowed necessary expenses in the care, management and settlement of property of the debtor and is also entitled to reasonable charges for services rendered.

Effect of Declaration – After three months but not later than one year from the declaration of

insolvency, the insolvent debtor may apply to the court for discharge from its debts. The court would then send notices to all creditors asking them to show cause why such application should not be granted. Such notice is made through mail and publication in a newspaper. Among the grounds for denying the application are: a) false statement in the petition, b) concealment of property, c) fraud or willful neglect in the care or custody or delivery to the assignee of its assets or properties, d) absence of records, or destruction, alteration or falsification of relevant documents, e) fraudulent payment or transfer of any part of its property, f) debtor has been convicted of a misdemeanor or is guilty of fraud contrary to the true intent of Act 1956, g) debtor has already enjoyed the benefit of Act 1956 within the six-years period immediately preceding the application for discharge, or h) other pending insolvency proceedings in another court.

A defrauded creditor may, however, contest such order within one year from the date thereof.

Conclusion

The application for rehabilitation is the approximate equivalent of Chapter 11 of the United States Bankruptcy Code. It shares the same objective of giving a technically insolvent creditor a chance to survive rather than allowing its creditors to grab its assets in a disorderly manner. The rehabilitation procedure has already been successfully implemented for a number of distressed companies in the Philippines, including the Philippine flag carrier, Philippine Airlines.

If a debtor has no chance to be rehabilitated, it can ask the court to be declared insolvent so that all its assets would be liquidated and distributed to its creditors in an orderly manner. This remedy stays all actions against the corporation. Unlike the case of individual debtors, however, the law expressly declares that the insolvent corporation is not discharged from its liabilities despite having paid or conveyed all its property to its creditors.

Winding Up of Companies for Non-Payment of Debts



In India, a company can be wound-up for non-payment of debts. However, courts have classified this as a remedy of last resort and not a means to assist creditors in recovering their debts. This article sheds some light on this concept in the background of the recession.

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Introduction

In this recent recession, defaults in debt payments are fairly common. In such an event, creditors have no options but to sue the debtors for recovery of the money. In India, one common, but often time-consuming approach of doing that is by suing the company and petitioning for its winding up. This article will discuss some interesting Indian court judgments issued in 2008 on the subject of winding up for non-payment of debts.

Winding Up under The Companies Act of 1956

An Indian company can be wound up by the court if, among other things, it is unable to pay its debts.¹ A company is said to be unable to pay its debts when:

- (a) A creditor to whom the company owes more than Rs.500 (US\$9.8) has served a demand on the company for the payment and the company neglects to satisfy the demand for three (3) weeks thereafter; or
- (b) If a decree or judgment received from a creditor is returned back unsatisfied, in whole, or in part, by the company; or
- (c) Where the court rules that the company is unable to pay its debts taking into account its contingent and prospective liabilities.²

The process for this is as follows:

- (a) A three (3) weeks' notice is to be provided by the lender in which it has to list the unpaid debt and other statutory provisions;
- (b) The creditor can apply before the jurisdictional High Court, praying for the winding up of the company. Such a petition is thereafter published in the newspaper and each and every creditor is also sent a copy of the petition;
- (c) The petition comes up for acceptance. This process can take up to three (3) months.

If the petition is accepted, there is a service of process on the company and the petition is then taken up for admission – the process post-acceptance and up to admission can take another six (6) months.

Post admission, the court hears arguments from both sides and decides on whether the company should be wound up. If the court decides to issue an order to wind up the company, a liquidator is appointed for the company and the company is liquidated. The proceeds of liquidation are distributed between the creditors and the shareholders as per the statutory distribution waterfall.

However, there are various interesting questions which arise from the perspective of determining when a company is unable to pay its debts, *etc.* In 2008, Indian courts addressed a number of these issues, as described briefly below.

Indian Case Law Developments in 2008

*Nachmo Knitex v Abhiyog Holdings*³ (Inability to repay debts due to recession)

The creditors had extended certain loans to the

company, which was allegedly unable to pay these dues in a timely manner. In response, the company representative argued that the company provides normal trade credit to its customers and that the recovery process had slowed down considerably on account of the market recession. The company contended that it should not be reckoned as unable to pay its debts because the delay in payments was attributable to a recession in the global markets.

The court, however, took a different view.

After reviewing the past few years' balance sheets, the court concluded that the company was, in fact, not in a position to repay its debts as there were no profits in the company's books. Hence, the court allowed the winding up petition.

*Narsey Brothers v Nithyalakshmi*⁴ (Bona fide dispute)

The creditor was providing shipments of cotton to the company and the company was in turn required to make appropriate payments as agreed. However, the customer contended that most of the cotton which was provided was of an inferior quality.

After considering arguments from both sides, the court held that a winding up petition would not lie in this case as the company had a *bona fide* case. The court also observed that the plaintiff's petition for an order of winding up was meant to intimidate the company and pressurize it to make a payment of the entire amount.

*Binayak Sarkar v Shuvam*⁵ (Disputed debt cannot be subject matter of winding up)

The debtor company had engaged the services of an advertisement agency. The agency had provided services and claimed in its winding up petition that the company had failed to pay the debts arising out of services performed by the firm including booking of slots on various television channels, both public and private, for telecasting advertisements of various products manufactured and/or marketed by the company.

The creditor alleged that bills had been raised from time to time and that the company had duly accepted service of these bills. However, the company contended during the admission proceedings that many of the bills had never been received by the company. Further, many bills were under dispute as the company contended that the television slots had been booked without the company's approval.

The court noted that for such a winding up application to be admitted, there must be either a clear admission of debt by the debtor or the absence of a *bona fide* defense on the part of the debtor. In this case, the court held that there was a *bona fide* defense which would require the court to examine the evidence provided by both parties. Therefore, the court declined to entertain the winding up petition.

*Vijay Industries v NATL Technologies Limited*⁶ (Interest on loans)

The petitioners had lent some money to the respondent company. After the last round of payments had been made, there was an interest component which was still outstanding. The respondent company contended that the interest payment could not be a part of the debt as it was not fixed. The Supreme Court held that interest payments could also be a part of the debt and it reviewed various cases in this regard.

In rendering this decision, the Supreme Court set aside the judgment of the High Court whereby it was held that interest could not form a part of the debt. In fact, in order to forestall further litigation, the Supreme Court also specified the percentage interest which the company would be required to pay on the outstanding balance.

*G Siva Ramakrishna v Rusni Distilleries*⁷ (Whether share application money amounts to a loan)

The petitioners contended that they had forwarded an unsecured loan to the company and that, pursuant to an understanding with the company, they would have the option to convert this loan into shares. However, despite repeated reminders, the company did not repay the amount, nor did it allow the petitioners to convert the loans into shares.



Photo: Paul Hart

For these reasons, the petitioners filed the winding up petition before the court. The company raised preliminary defenses regarding the requirement of a notice, *etc.* However, the important point in this case was that the company disputed the petitioners' status as creditors. The company contended that the money paid by them was toward share application money and not as a loan. Dismissing the winding up petition, the court held that the company had a *bona fide* defense and that the petitioners had not been able to *prima facie* prove that they were creditors' *vis-à-vis* the company.

*Gujarat Industrial Investment Corporation v Sterling*⁸ (Disputed interest liability)

The petitioner had provided a loan to the respondent company for improvement of facilities at its hotel. The petitioner claims to have sent periodic reminders to the company seeking payment of the loan. Eventually, the creditor decided to file a winding up petition.

The company argued that it had admitted the principal liability but that it disputed the interest liability. The company also contended that on the issue of interest liability, a suit was already pending in the trial court. The High Court held that there was a *bona fide* dispute regarding the interest liability. Hence, it dismissed the winding up petition.

*Andhra Cements v Bhatia International*⁹ (Statutory Notice to registered office of company)

As mentioned above, it is imperative that a creditor must send a three (3) weeks' notice to the debtor setting out the details of the debts. In this case, the creditors were dealing with a particular office of the debtor company and sent repeated reminders to the concerned office with which they had been corresponding. On not receiving any satisfactory solution, they sent winding-up notices to the same

office. The debtor contended that the notices ought to have been sent to the registered office as is required under the Act.

The creditors contended that since they had been corresponding and working with only the branch office of the debtor, they sent the notice to that address. The court concluded that the Act requires that the notice be sent to the registered office of the debtor company. Hence, it was not sufficient that the notices were sent to the concerned branch office with which the creditors had been conducting business.

*Rajarajeswari Packaging v Dev*¹⁰ (Importance of pleadings in a winding up matter)

In this case, the creditor was supplying nuts and bolts to the debtor company. The debtor company refuted the debt, stating that most of the goods were sub-standard and hence the company would not bear their cost. The court held that this amounted to a *bona fide* defense and hence the company could not be wound up.

More importantly, the court took notice of the pleadings and written submissions and held that they were grossly inadequate to return a finding in the favor of the petitioner.

Conclusion

Based on the cases reviewed and discussed above, it is clear that Indian courts are taking a liberal approach on the issue of *bona fide* defenses available to a debtor company. If the company can show a *prima facie* tenable defense, then it cannot be wound up under this provision. That being said, the courts have not been willing to accept the recession and the credit crunch as valid *bona fide* defenses. Further, it is important for creditors to scrupulously adhere to the procedure provided in the Act with respect to service of notice, *etc.*, lest their petitions be dismissed on procedural grounds.

Notes:

¹ Section 425 and Section 433(e) of the Companies Act, 1956 (the "Act").

² Section 433 and 434 of the Act.

³ *Nachmo Knitex Limited v Abhiyog Holdings Private Limited*, [2008] 172 Comp Cas 512 (Guj).

⁴ *Narsey Brothers v Nithyalakshmi*, [2008] 144 Comp Cas 446 (Mad).

⁵ *Binayak Sarkar v Shuvam Watch Straps Pvt Ltd*, [2008] 144 Comp Cas 384 (Cal).

⁶ *Vijay Industries v NATL Technologies Limited*, [2009] 89 SCL 205 (SC).

⁷ *G Siva Ramakrishna v Rusni Distilleries Pvt Ltd*, [2008] 143 Comp Cas 289 (AP).

⁸ *Gujarat Industrial Investment Corporation v Sterling Holiday Resorts*, [2008] 143 Comp Cas 39 (Mad).

⁹ *Andhra Cements v Bhatia International*, [2008] 145 Comp Cas 681 (AP).

¹⁰ *Rajarajeswari Packaging Products v Dev Fasteners Ltd*, [2008] 144 Comp Cas 351 (Mad).

Bankruptcy and Insolvency in the PRC: A Myth?



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The European Union in 2008 refused to recognize China's status as a "full market economy" because, in their opinion, shortcomings remain in certain areas of governance. One such shortcoming was the lack of sound insolvency laws appropriate to a market

economy and also general international practice. The Enterprise Insolvency Law of the PRC, which took effect on June 1st, 2007, introduced some changes, most notably in relation to greater transparency and creditor involvement in insolvency proceedings. In practice, few Chinese enterprises have officially declared bankruptcy in accordance with the new law. This article aims to provide you with an overview of the Chinese insolvency and bankruptcy system.

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Definitions

In this article, the term "insolvency" will refer to a situation where a business enterprise is unable to pay its debts as and when they come due, whilst "bankruptcy" will refer to a similar situation in relation to any entity (including an individual person). In western jurisdictions, the term "bankruptcy" usually refers to a situation where the insolvency of an entity (including an individual) has been legally declared in some form; thus, where we discuss the declaration of insolvency we will also use this term and note whether the reference is restricted to business enterprises or not.

Many Enterprises Close, but Few Declare Bankruptcy

Since the entry by the People's Republic of China (the "PRC" or "China") into the World Trade Organization in 2001, China has played an increasingly important role in the global economy. With the increase of foreign direct investment into China, legal issues relating to corporate insolvency in the PRC have assumed greater significance and importance to such foreign investors, as well as foreign countries in general and organizations such as the World Bank, IMF, OECD, and INSOL.

The following statistical chart was issued by the Beijing Siyuan Merger and Bankruptcy Consulting Company which is a well-known local firm that deals with mergers and bankruptcies. According to the chart, there were a total of 2,955 bankruptcy cases accepted by the Chinese courts by the end of 2008. Of these 2,955 bankruptcy cases, 153 occurred in Guangdong province. However,

Statistical Chart of Enterprises Bankruptcy Cases in China from 1989 to 2008



北京思源兼併與破產諮詢事務所·破產數據庫製作
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according to a government website (<http://www.gxdy.gov.cn/news/shownews.asp?newsid=6729>), an official of the Administration Bureau of Small and Medium-Sized Enterprises in Guangdong told a reporter that a total of 15,661 businesses had closed down from January 1, 2008 to the end of October 2008. In other words, in Guangdong only 153 businesses declared bankruptcy in accordance with the related laws and regulations; presumably, the rest just closed their doors with their related debts and liabilities remaining. The question that must be asked is why Chinese enterprises are so reluctant to declare bankruptcy, and whether such reluctance relates in some way to the Chinese insolvency procedures.

Insolvency Laws in China (and the lack thereof)

The first insolvency-related law of the PRC (titled the *Provisional Insolvency Act on State-owned Enterprises* was enacted in 1986 and applies to state-owned enterprises only. The *Civil Procedural Law of the PRC* and *The Company Law of the PRC* were enacted in 1991 and 1993 respectively. Corporate insolvency legal issues were initially covered by the above three laws. However, as of 2007, the *Provisional Insolvency Act on State-owned Enterprises* was removed, and the elements directly relating to insolvency and bankruptcy contained in the Civil Procedure Law of the PRC were removed and placed into the *Enterprise Insolvency Law of the PRC* (hereinafter the “**Insolvency Law**”).

The Insolvency Law came into effect on June 1, 2007. The Insolvency Law applies to all enterprises and bodies with some notable exceptions, such as those otherwise provided for under different laws and regulations (such as for partnership enterprises and household enterprises).

Another exception is regarding personal bankruptcy – there are still no personal bankruptcy laws in China, and there are a number of reasons for this. Firstly, consumption on credit amongst Chinese people is becoming more common but still remains at levels much lower than those found in the West; secondly, credit checking facilities (in relation to personal credit ratings) remain limited in China; and thirdly, the lack of a unified network amongst the Chinese commercial banks that would allow them to share the relevant credit information. However, personal bankruptcy has recently become a contentious issue in China, and even more so after the 2008 Sichuan Wenchuan Earthquake. This is because many people’s houses collapsed during the earthquake but the house owners remain theoretically liable for the balance of their mortgages. This is still a pending matter for the Chinese government and one which has attracted attention of both the Chinese government and the Chinese people to the issue of personal bankruptcy in general.

The Bankruptcy Process under Current Insolvency Laws

The general steps for filing for bankruptcy are as follows:

1. The bankruptcy application is filed with the relevant Chinese court (both the insolvent party (debtor), and the creditors of the insolvent party (creditors), can file an action on the insolvent party's behalf);
2. The court makes the decision on whether to accept the bankruptcy case. Where the application is for voluntary bankruptcy (*ie* the debtor makes the application) the court takes 15 days to decide; for passive bankruptcy applications (*ie* the creditor makes the application) the court takes 22 days;
3. Within 25 days upon its acceptance of the insolvency matter, the court will publish an announcement of its acceptance, and will also inform the known creditors;
4. The creditors shall file a claims report with the court within the relevant time restriction (which is between 30 days and three months of the court's acceptance date as per point 3 above);
5. The court holds the first meeting between the insolvent party's creditors;
6. A bankruptcy trustee is appointed by the court;
7. The insolvent party is declared bankrupt by the court;
8. The bankrupt party's assets are liquidated by the bankruptcy trustee;
9. The bankrupt party's assets are distributed by the bankruptcy trustee; and
10. The insolvency assets distribution report is submitted to the court by the bankruptcy trustee.

After the asset distribution, the bankruptcy procedure is officially terminated by the court via a judgment. The bankrupt party then files for dissolution.

Not every insolvency case will end with liquidation. Under the current Insolvency Law, there are two alternatives to liquidation, namely, insolvency restructuring/reorganization and insolvency reconciliation arrangements. These two procedures provide the creditors more protection because the debtor is able to keep its business operation going and the creditors may also get a much higher percentage of their debts repaid.

Insolvency restructuring/reorganization can be thought of as a middling approach between the interests of the creditor(s) and the debtor. The creditors agree to the debtor continuing its business and the debtor will pay its debts according to the new payment arrangements as provided in the new restructuring plan (such plan is provided

by the debtor). This whole process is under the supervision of the Chinese courts. Whenever the debtor is incapable of fulfilling (or fails to fulfill) its obligations under the restructuring plan, the entire process will be terminated by the Chinese courts, who will then declare the debtor bankrupt in accordance with the Insolvency Law.

Insolvency reconciliation is also introduced by the Insolvency Law, and allows the creditors and debtors to reach an agreement on the issue without the direct involvement of a court. However, when such agreement is reached, it must be submitted to the court for its review and approval. The court will confirm that the terms of the agreement are in compliance with any relevant rules and regulations, and will issue a bulletin to the public in relation to the agreement.

A bankruptcy declaration is made by the courts to legally confirm that the debtor has been declared bankrupt. Such declaration of bankruptcy occurs after the avenues of insolvency restructuring/reorganization and insolvency reconciliation have either been exhausted or considered inappropriate. Once this has occurred, and all of the assets have been liquidated and then distributed by the



bankruptcy trustee, and the insolvency assets distribution report has been submitted to the Chinese court, the court shall make final judgment whether to finalize bankruptcy proceedings within fifteen (15) days upon its receipt of the bankruptcy trustee's application for finalizing the bankruptcy proceedings.

The Bankruptcy Trustee

Pre-2007, there was a similar system under the *Provisional Insolvency Act on State-owned Enterprises* which employed a "liquidation committee." However, the liquidation committee consisted of people appointed by the Chinese courts from various government departments, such as administrative departments and finance departments. Such law applied to state-owned enterprises only. However, such system obviously could not adapt to the current insolvency practices and was not in accordance with international practice.

The Insolvency Law prescribes that if a Chinese court hears the matter it will appoint a bankruptcy trustee as stated in item 6 of the above list. A bankruptcy trustee is usually a law firm or

an accounting firm (but can be an individual) and is selected by the list system created by the courts. The bankruptcy trustee is useful as an independent party that can act as a "buffer" between the interests of the creditors and the debtor as well as among the interests of individual creditors.

Priority of Distribution for the Insolvency Assets

The secured debts are regarded as part of the insolvency assets, and a creditor with secured debts will of course enjoy priority in getting his or her secured debts repaid. As a result, creditors with secured debts have no voting rights on issues such as the distribution plan of insolvency assets and in the insolvency reconciliation negotiations. This is because such decisions will not influence secured debts. The right of the secured debtor to 'bypass' the asset division rules and processes is referred to as the "exemption right" under the Insolvency Law.

After the secured debts are repaid, the insolvency expenses (which largely consists of court expenses) will be deducted and then (providing there is money remaining), the communal liabilities (which consist of, for example, unjustified benefits, as well as more 'petty' expenses, such as the employment of a guard at the insolvent company's office or factory) will be deducted, and the remaining priority order of distribution will be as follows:

1. Employee expenses (salary, social insurance, severance pay, *etc*);
2. Payable taxes; and then
3. General debts (*ie*, unsecured debts).

Pros and Cons of the PRC's Insolvency Practice

As mentioned above, the Insolvency Law absorbed some key concepts for the first time which are in accordance with international practice such as, for example, the "bankruptcy trustee," "insolvency restructuring" and "extraterritorial insolvency" (which permitted Chinese courts to recognize foreign bankruptcy orders and vice versa, as explained further below). This update to the Chinese law was regarded as a big leap for the area of Chinese insolvency law because such concepts are more focused on the protection of the creditor's interests. However, insolvency law in China cannot be regarded as a complete bankruptcy law because as mentioned above, there are no laws relating to personal bankruptcy.

There were two judicial interpretations issued



by the Supreme Court of the PRC in 2007 regarding the appointment and remuneration of the bankruptcy trustee. These judicial interpretations (judicial interpretations of the Supreme Court of the PRC are regarded as mandatory instructions for all Chinese courts) provide that the bankruptcy trustee shall be selected from the lists created by the relevant Chinese primary and secondary courts.

There are three different selection methods for choosing the bankruptcy trustee for each bankruptcy case (note that all potential trustees are already listed on the list):

1. Random (the potential trustees are selected in a form of lottery);
2. Through invitation bidding (only where more than three potential trustees apply); and
3. Through appointment (this selection method applies to certain specific types of cases such as bankruptcy of financial institutions).

A method of choosing bankruptcy trustees whereby the initial ‘shortlist’ is not created by the court may ensure the efficiency and equity of the insolvency process. Many Chinese lawyers have argued that the Chinese courts hold too much power over the selection process of the bankruptcy trustee—from compiling the list of bankruptcy trustees to determining their remuneration—a fact which, in the opinion of many, will inevitably bring opportunities for judges to act in their own best interests. Owing to the sensitive relationship between bankruptcy trustees and judges (in insolvency cases), many argue that selection of bankruptcy trustees should be handled by an independent third party.

The Insolvency Law, for the first time in China, provides rules for the “extraterritorial jurisdiction” of bankruptcy judgments made by the Chinese courts. Regarding judgments made by the courts of foreign countries which involve assets contained inside the territory of the PRC, a creditor may file

for the recognition and enforcement of the above judgments in the PRC, and the Chinese courts will review the judgments in accordance with the related international treaties and then decide whether to enforce such judgments. In practice, it is a lengthy and complicated process for Chinese courts to recognize and enforce judgments and decrees made by foreign courts, and such recognition depends on the bilateral treaties between countries, international private laws, notarization and admissibility of evidence, and even Chinese public interests or national security elements. Many local secondary courts in China have not even dealt with such cases yet.

Conclusion

Effective company laws of a jurisdiction should include effective incorporation laws, operation laws, and also ‘exit laws.’ Effective ‘exit laws’ should include appropriate insolvency and bankruptcy laws that can enable those enterprises which have ‘crashed’ the ability to exit from the market in a manner which is both legal and equitable for all concerned.

The promulgation of the 2007 Insolvency Law is regarded as a major turning point in the Chinese business law sphere, which can possibly bring a heightened sense of confidence to both domestic and foreign investors through the regulation and clarification of how an enterprise can exit from the market legally in China, and what liabilities and obligations it must incur and fulfill. However, as there has been, until recently, a lack of related laws and regulations regarding the winding up of (non state-owned) enterprises, most Chinese enterprises (especially small and medium-sized enterprises) prefer to choose effective abandonment as the solution to their financial woes. While this might be a cost-effective and easy solution for particular enterprise owners, such activities impact negatively on the economy and the business reputation of Chinese enterprises as a whole.



An Invitation to Join the Inter-Pacific Bar Association

The IPBA is an international association of business and commercial lawyers who reside or have an interest in the Asian and Pacific region. The IPBA has its roots in the region, having been established in April 1991 at an organizing conference in Tokyo attended by more than 500 lawyers from throughout Asia and the Pacific. Since then it has grown to over 1,700 members from 68 jurisdictions, and it is now the pre-eminent organization in the region for business and commercial lawyers.

The growth of the IPBA has been spurred by the tremendous growth of the Asian economies. As companies throughout the region become part of the global economy they require additional assistance from lawyers in their home country and from lawyers throughout the region. One goal of the IPBA is to help lawyers stay abreast of developments that affect their clients. Another is to provide an opportunity for business and commercial lawyers throughout the region to network with other lawyers of similar interests and fields of practice.

Supported by major bar associations, law societies and other organizations throughout Asia and the Pacific, the IPBA is playing a significant role in fostering ties among members of the legal profession with an interest in the region.

IPBA Activities

The breadth of the IPBA's activities is demonstrated by the number of specialist committees overleaf. All of these committees are active and have not only the chairs named, but a significant number of vice-chairs to assist in the planning and implementation of the various committee activities. The highlight of the year for the IPBA is its annual multi-topic 4-day conference, usually held in the first week of May each year. Previous annual conferences have been held in Tokyo (twice), Sydney (twice), Taipei, Singapore, San Francisco, Manila, Kuala Lumpur, Auckland, Bangkok, Vancouver, Hong Kong, New Delhi, Seoul, Bali, and Los Angeles attracting as many as 700 lawyers plus accompanying guests.

The IPBA has organized regional conferences and seminars on subjects such as Practical Aspects of Intellectual Property Protection in Asia (in five cities in Europe and North America respectively) and Asian Infrastructure Development and Finance (in Singapore). The IPBA has also cooperated with other legal organizations in presenting conferences—for example on Trading in Securities on the Internet, held jointly with the Capital Market Forum.

The IPBA also publishes a membership directory and a quarterly *IPBA Journal*.

Membership

Membership in the Association is open to all qualified lawyers who are in good standing and who live in, or who are interested in, the Asia-Pacific region.

• Standard Membership	US\$195 / ¥23,000
• Three-Year Term Membership	US\$535 / ¥63,000
• Lawyers in developing countries with low income levels	US\$100 / ¥11,800
• Young Lawyers (under 30 years old)	US\$50 / ¥6,000

Annual dues will cover the period of one year starting from January 1 and ending on December 31. Those who join the Association before August 31 will be registered as a member for the current year. Those who join the Association after September 1 will be registered as a member for the rest of the current year and for the following year.

Membership renewals will be accepted until July 31.

Selection of membership category is entirely up to each individual. If the membership category is not specified in the registration form, standard annual dues will be charged by the Secretariat.

Further, in order to encourage young lawyers to join the IPBA, a Young Lawyers Membership category (age under 30 years old) with special membership dues has been established.

IPBA has established a new 3-Year Term Membership category which will come into effect from the 2001 membership year.

There will be no refund of dues for cancellation of all membership categories during the effective term, nor will other persons be allowed to take over the membership for the remaining period.

Corporate Associate

Any corporation may become a Corporate Associate of the Association by submitting an application form accompanied by payment of the annual subscription of (¥50,000/US\$500) for the then current year.

The name of the Corporate Associate shall be listed in the membership directory.

A Corporate Associate may designate one employee ("Associate Member"), who may take part in any Annual Conference, committee or other programmes with the same rights and privileges as a Member, except that the Associate Member has no voting rights at Annual or Special Meetings, and may not assume the position of Council Member or Chairperson of a Committee.

A Corporate Associate may have any number of its employees attend any activities of the Association at the member rates.

- Annual Dues for Corporate Associates US\$500 / ¥50,000

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Payment of dues can be made either in US dollars or Japanese yen. However, the following restrictions shall apply to payments in each currency. Your cooperation is appreciated in meeting the following conditions.

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See overleaf for membership
registration form



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