

# Casting a spotlight over insolvency



*KPMG partners share their experiences of the widely diverging insolvency regimes across the region.*  
*By Edward Middleton and Nina Mehra.*

**T**he global economic crisis has produced a swathe of spectacular corporate collapses with gigantic icons of Wall Street, such as Lehman Brothers, and of industry, such as General Motors, adding a new – and unimagined – chapter to their corporate histories: bankruptcy. Reaction to these massive and complex failures includes, if only at the fringes, a re-examination of how economies around the world deal with insolvent or struggling businesses.

Historically, bankruptcy law has developed on a country-by-country basis, reflecting the different economic, cultural and social traditions. Attempts at international harmonisation or standardisation remain rare.

Insolvency practitioners face challenges when working on cases involving multi-national companies, with assets and liabilities spread over several jurisdictions, and subject to widely different insolvency regimes. In order to be effective across borders, office holders in an insolvency need to have their authority recognised in jurisdictions other than their home. That is by no means straightforward.

The failure of global investment bank Lehman Brothers is one such example, as its collapse led to what looks like being the most complex international bankruptcy in history. After the bank's demise Lehman's regional management in Asia Pacific sought the appointment of KPMG partners as provisional liquidators to the Hong Kong entities and substantially all of Lehman's operations in the region outside of Japan. They also asked the firm to conduct an Asia-wide solvency review covering 120-odd operating entities. That review saw KPMG firms take control of Lehman's busi-

nesses in Hong Kong and Singapore, a brief that covered 14 of the group's regional entities.

The insolvency of Lehman's in Hong Kong highlights one quirk of Hong Kong's insolvency regime – the lack of a statutory corporate rescue regime for dealing with distressed corporates. Rescue regimes around the world are designed to buy time for a distressed corporate to pursue a rescue, for instance, by allowing emergency funding and by making it easier for critical supply contracts to be maintained. In Hong Kong however, corporates do not have that option, with the result that many distressed businesses fall all too quickly into liquidation.

Edward Middleton, Deputy Chairman, Asia Pacific Restructuring Services, KPMG and one of the Liquidators of Lehman's eight Hong Kong incorporated entities, says: "If you take the Lehman Brothers' collapse as a case in point, certainly of the major centres of that particular empire, Hong Kong was pretty much alone in having as the starting point for dealing with the collapse, the immediate commencement of liquidation proceedings; there was no choice. By contrast, in the USA, the UK and Japan, the entry point was a process predicated on giving the corporate entity at least the choice of rescue. One practical effect of the lack of a single, group-wide insolvency or restructuring process is that each office holder in each jurisdiction is duty-bound to take care only of the assets and liabilities of his or her particular estate. There is little or no scope to look at things on a group-wide basis, which limits options."

Differences exist across Asia Pacific, as creditors are crucial in countries with legal systems based on English law such as Australia, Singapore and Hong Kong, whereas the



emphasis tends to be more on rescuing the debtor in countries such as Japan, Korea and the Philippines. Even where legal systems are based on the English model, customs and practices can vary. This can make restructuring complex, particularly when working with a group that has interests spanning several countries.

### **A model law**

In order to address cross-border insolvency issues, the United Nations Commission on International Trade Law (UNCITRAL) has developed a ‘model law’ which can be incorporated into countries’ existing insolvency systems. Its aim is to facilitate recognition of, and give powers to, an office holder in a foreign insolvency proceeding. Although some major countries such as the USA, the UK, Japan and Australia have now adopted the model law, it is not yet universal. Even where it is adopted, recognition may be dependent on court rulings. For example if a company based in Europe has US assets, insolvency practitioners will have to seek recognition from the US Courts under Chapter 15 of the United States bankruptcy code, which introduces into the US system the UNCITRAL Model Law.

The KPMG practice located in New Zealand is a case in point as it is currently seeking Chapter 15 recognition in New York in relation to an undisclosed New Zealand registered entity that trades in the US, a first for New Zealand.

Shaun Adams, Director, Restructuring & Insolvency, KPMG New Zealand, explains: “We are currently applying to the New Jersey Court in the US for cross border recognition under UNCITRAL rules and Chapter 15 of the bankruptcy code, in order to enable me to administer the NZ entity from New Zealand. I will also be able to take control of the assets in the US and proceed with the sale of the assets, repatriate the funds and distribute them under New Zealand law, rather than applying Chapter 7 or 11 proceedings in the US, which is expensive. I believe this move will set a precedent in New Zealand in terms of applying to the US for recognition.”

New Zealand insolvency law is based on UK law principally, although it is less regulatory in nature. Receiverships and liquidations are the most common forms of insolvency, while Voluntary Administrations were imported from Australia in November 2007. The banks tend to take the lead in restructuring cases, with only the worst performers coming into the hands of restructuring and insolvency experts.

Shaun Adams was also appointed receiver and liquida-

tor of two companies in the Canterbury Group of Companies in August 2009, a brand that sells rugby sporting apparel worldwide. Working in conjunction with KPMG Manchester, his team dealt with a complex legal and multi-jurisdictional insolvency process in the UK and NZ to enable a sale of the worldwide brand to a UK purchaser. They also joined forces with their Australian counterparts who were advising on some domestic issues, which were ultimately resolved without recourse to an insolvency process in Australia.

“In the case of Canterbury, we were able to dovetail the different procedures to fit the circumstances and come up with a workable solution. The biggest problem we faced was the issues of how the statutes and case law relating to pre-packaged sales of business are so fundamentally different in the UK, Australia and to a lesser extent NZ. This created a significant amount of consternation, particularly when we were debating the use of formal insolvency options in the different jurisdictions,” Adams adds.

In Australia, insolvency laws are legislated by the *Corporations Act*, with the Australian Securities and Investments Commissions (ASIC) providing regulatory oversight. Formal insolvency appointments require the appointment of a Registered Liquidator. The laws provide for various forms of external administration including Voluntary Administration, Deeds of Company Arrangement, Creditors’ Voluntary Liquidations, Receiverships, Court-Appointed Liquidations and Members’ Voluntary Liquidations. The most common forms of external administrations in Australia are Voluntary Administrations and Receiverships.

The Voluntary Administration regime was enacted to enable companies to maximise the chance of a whole or part of a company continuing in existence and provide a greater return to creditors and members than would result from an immediate winding up. This occurs through creditors voting to either hand the company back to the directors or placing the company into liquidation, or agreeing to execute a deed of company arrangement (DOCA). A DOCA is a contract between a company and its creditors to provide a return to creditors on stated terms and conditions.

Australia still maintains a receivership regime whereby secured creditors can appoint receivers to realise the assets subject to the securities they hold. Australian financiers will generally use receivership as a last resort and will ordinarily seek to work out an arrangement with its customer prior to enforcing its securities.

Appointment of receivers generally results in a sale or closure of the business. Liquidations operate to wind up a company's affairs and generally results in a closure or sale of the business.

Paul Thomson, Partner-In-Charge, Restructuring Services, KPMG Australia, says: "In approaching a restructuring process, a key issue to be addressed very early in the process is the solvency of the company. The consequences for directors of companies who are trading whilst insolvent are severe in Australia in that they can be held personally liable for any debts incurred. This places an onerous obligation on directors and can often impact the ability of directors to work through issues their company may be facing in order to avoid taking any risk that they may be held liable for trading whilst insolvent. Therefore, establishing solvency is critical in allowing the time necessary to work through a restructuring process."

The key challenges in restructuring and insolvency engagements have been the ability to "hit the ground running" and obtain a sound understanding of complex issues that are as a result of the nature of market and corporate structures, as well as managing the expectations and requirements of all key stakeholders.

In the case of Mainland China, where KPMG has offices in 12 locations and over 100 restructuring professionals, the Government has been commended for its relatively new yet effective *Enterprise Bankruptcy Law*. The law, which came into effect in June 2007, provides for a more orderly and structured approach for dealing with failing companies and seeks to provide better protection for creditors. It applies to all types of enterprises including state owned, foreign invested and privately owned enterprises. Although China's banks tend to pursue legal processes rather than negotiate compromise agreements with debtors, the new law helps distressed companies to work out a reorganisation plan.

Middleton says: "The legal framework around restructuring in China is better, in my opinion, than it is in Hong Kong. There is favourable comparison with other major economies around the world, particularly the US. The law as it is written is robust however there are still some issues around implementation. China does not for example have a specialist and dedicated bench of companies' judges, so there is an education process in the courts as to how these processes could work. On the flip-side, sanctions against directors can be quite stringent in China, which is not the case in Hong Kong legislation and that is a point of contrast."

In the case of Japan, its insolvency procedures and practices are considerably advanced as a result of a series of changes in laws and measures designed to cope with a long adjustment period after the 1990 economic crisis. In 2000, the *Civil Rehabilitation Law* was introduced in Japan, which was heavily influenced by the Chapter 11, Federal Bankruptcy Code of the US. For example, the process can be led by the existing management (Debtor-in-Possession (DIP)), while an alternative reorganisation type of insolvency procedure, the *Corporate Reorganisation Law*, requires an appointment of an administrator by the court and the mem-

**"The legal framework around restructuring in China is better, in my opinion, than it is in Hong Kong. There is favourable comparison with other major economies around the world, particularly the US"**



**Edward Middleton**

bers of existing management usually resign upon filing and lose control over the following process.

Masahiko Chino, Chairman, Asia-Pacific Restructuring Services, KPMG, says: "Right after the introduction of the *Civil Rehabilitation Law*, we saw a significant increase in the number of cases of reorganisation-type insolvency procedures in Japan and since then, the procedure has become one of the most established in the region. Given the current economic condition, however, we are likely to see more large scale restructuring and reorganisation cases. Japan Airlines is one recent such example, which may require a whole range of procedures from *Corporate Reorganisation Law*, *Bankruptcy Law* and special liquidation procedures stipulated in Japan's *Corporate Law*, all of which have been reformed since 2000 in 2003, 2005 and 2006. These procedures, together with the *Civil Rehabilitation Law*, make up Japan's sound legal systems which help ensure equal treatment of domestic and foreign creditors."

Insolvency laws are well-established in the City State



of Singapore. The legislation applicable to insolvency of companies is the *Companies Act* which contains regulatory framework for the judicial and statutory corporate insolvency regimes of liquidation, judicial management, receivership and schemes of arrangement.

Insolvency regimes are primarily served by liquidation and receivership regimes although the latter does not necessarily automatically lead to the demise of a company, although unfortunately more often than not liquidation is the next step after receivership.

Bob Yap, Head of Restructuring in KPMG Singapore, explains: “Apart from the traditional impediments (e.g. inter-creditor issues, erosion of confidence in management etc) that have long plagued restructuring engagements, new challenges have emerged over time. As debt markets grow in breadth and complexity the profile of lenders has changed significantly. The pervasiveness of CDS and other similar financial instruments has made the task of managing insolvency that much more challenging. Creditors armed with these credit default protection instruments may be less reluctant to avoid insolvencies.”

### **Consensual restructuring**

It is a different picture however in some of the other jurisdictions across the Asia Pacific. In Indonesia, for example, the debt restructuring market petered out from 2005. This is expected to change in 2009 with restructurings of mostly foreign lender debt following the fallout of the global financial crisis already starting to appear. The *Law on Bankruptcy* of June 1905 was amended in 1998 during Indonesia’s economic crisis, as a World Bank/IMF requirement, and was fully replaced in 2004 with the *Law on Bankruptcy and Suspension of Payments*.

For a few years the new law seemed to operate effectively with a reasonable number of bankruptcy proceedings successfully brought, however this seems to have ceased in recent years with little use being made of the law.

David East, Head of Transactions & Restructuring, KPMG Siddharta Consulting, says: “Part of the reason might be improvements in the economic climate, but also fundamental problems in the judiciary itself – a general risk that those using the bankruptcy legislation face are both a lack of experience and lack of knowledge on the part of those with the responsibility to administer the law. Efforts to stamp out corruption in the judiciary have also been a major focus of the Indonesian Government.”

Consensual restructuring is the name of the game here, for both lender and debtor – depending on the circumstances this might be a simple rescheduling with ratcheted interest rates or a plan that comprises a mix of rescheduling, debt haircut and debt to equity conversions with additional security taken.

Insolvency practitioners in Malaysia are regulated within a statutory framework created by the *Companies Act* 1965, the *Companies Regulations* 1966 and the *Companies (Winding up) Rules* 1972. Hock An Ong, Partner, KPMG Malaysia, says: “In the case of formal insolvency appointments, given the current uncertain global financial economy, and the Malaysian economy and political environment, investors are still very selective and careful in their investments which to some extent affects insolvency practitioners’ efforts in realising the assets/business of companies in receivership or liquidation.”

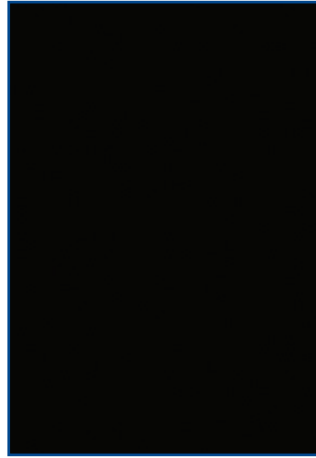
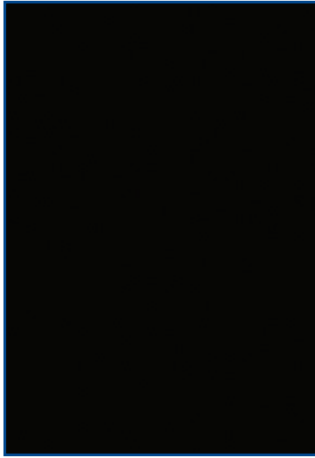
“Harmonisation of insolvency laws between jurisdictions has been discussed but we do not see much headway made in this area. However, the Malaysian government has initiated a review of companies’ law (including insolvency aspects of it). KPMG Restructuring in Malaysia actively participated in the law reform and also chaired one of the sub-committees relating to a restructuring chapter,” he adds.

Taiwan, on the other hand, does not have an up-to-date insolvency legal framework. Steven Peng, Director, KPMG Corporate Finance Co Ltd, Taiwan, explains: “*The Bankruptcy Law* in Taiwan is not effective enough to facilitate corporate exit by which stakeholders are able to maximise recovery in a timely manner. There are very few bankruptcy and liquidation filings, as the process takes a long time to complete. However, in practice we do have restructuring procedures that help distressed companies stay in and turnaround the business. The dominant procedure is voluntary debt negotiation without the court’s involvement.”

There is also a formal restructuring procedure called “Reorganisation” which is similar to Chapter 11 in the US. Unfortunately this procedure generally takes at least three years to complete, making it an undesirable resolution for creditors. Currently a new code of law consolidating reorganisation and bankruptcy is under final review. If the new law becomes effective, we will have more bankruptcy, liquidation, and reorganisation cases.”

[www.kpmg.com](http://www.kpmg.com)

# It's a new world. Are you feeling brave?



When the world is suddenly a very different place, how are you managing? Are you ready for a world where cash is scarce, but risk is not? Ready for a world that's connected, but in ways you can't connect with? That demands performance, but is merciless on costs?

KPMG firms are here to help you make this new place intelligible. We've tools that can allow you to unlock cash, improve efficiency, reduce risk, increase control – and prepare you for growth when the world turns again. So plant your feet firmly on this new ground. Visit [kpmg.com](http://kpmg.com)

**Masahiko Chino**  
Chairman – Asia Pacific  
Restructuring Services  
+81 (3) 5218 6700  
[masahiko.chino@jp.kpmg.com](mailto:masahiko.chino@jp.kpmg.com)

**Eddie Middleton**  
Deputy Chairman – Asia Pacific  
Restructuring Services  
+852 3121 9833  
[edward.middleton@kpmg.com.hk](mailto:edward.middleton@kpmg.com.hk)

**Australia**  
**Paul Thomson**  
+61 (3) 9288 5342  
[paul.thomson@kpmg.com.au](mailto:paul.thomson@kpmg.com.au)

**China**  
**Jannie Wong**  
+852 3121 9305  
[jannie.wong@kpmg.com.hk](mailto:jannie.wong@kpmg.com.hk)

**Indonesia**  
**David East**  
+62 (21) 574 0877  
[deast@siddharta.co.id](mailto:deast@siddharta.co.id)

**Japan**  
**Masahiko Chino**  
+81 (3) 5218 6700  
[masahiko.chino@jp.kpmg.com](mailto:masahiko.chino@jp.kpmg.com)

**Korea**  
**Chan Yong Park**  
+82 (2) 2112 0705  
[chanyongpark@kr.kpmg.com](mailto:chanyongpark@kr.kpmg.com)

**Malaysia**  
**Hock An Ong**  
+60 (3) 7721 3388  
[hong@kpmg.com.my](mailto:hong@kpmg.com.my)

**New Zealand**  
**Shaun Adams**  
+64 (9) 367 5953  
[shaunadams@kpmg.co.nz](mailto:shaunadams@kpmg.co.nz)

**Philippines**  
**Henry D. Antonio**  
+63 (2) 885 7000  
[hantonio@kpmg.com.ph](mailto:hantonio@kpmg.com.ph)

**Singapore**  
**Bob Yap**  
+65 6213 2677  
[byap@kpmg.com.sg](mailto:byap@kpmg.com.sg)

**Taiwan**  
**Janice Lai**  
+886 (2) 8101 6666  
[janicelai@kpmg.com.tw](mailto:janicelai@kpmg.com.tw)

**Thailand**  
**Bob Ellis**  
+662 677 2118  
[bellis1@kpmg.co.th](mailto:bellis1@kpmg.co.th)

**Vietnam**  
**John Ditty**  
+84 8 3821 9266 ext 8100  
[jditty@kpmg.com.vn](mailto:jditty@kpmg.com.vn)