APPENDIX II:
PAPERS OF THE SESSIONS

RECENT DEVELOPMENTS IN INSOLVENCY REFORM IN ASIA

BY
RONALD HARMER, CONSULTANT, ASIAN DEVELOPMENT BANK AND
BLAKE DAWSON WALDRON, AUSTRALIAN LAWYERS
AND
CLARE WEE, SENIOR COUNSEL, ASIAN DEVELOPMENT BANK

INTRODUCTION

This paper surveys recent developments in insolvency law and related areas in the Asian region.

Much of the development in the region occurred as a result of the Asian financial crisis. Enough has been written of that event, its causes and effects. It should not be necessary to repeat or add to that here. It is commonly agreed that the crisis dictated that urgent measures be taken to deal with the critical problem of systemic banking and financial sector failure. That failure was traced into corporate failure and that, in turn, resulted in a consideration of and attempts to deal with basic issues concerning corporate debt, its recovery and enforcement and corporate insolvency.

It is also commonly agreed that but for the crisis none of this development would have occurred. To that extent the crisis has produced positive results. Indeed, the claim could be made that the results have been outstanding. The evidence may be found in the number of countries that have reformed or are in the process of reforming their insolvency law systems and the extent to which many countries have developed and encouraged the adoption of informal, out of court, insolvency related processes.

But questions have been and will continue to be asked whether some of the developments and reforms are superficial and nothing much more than a masquerade, covering and hiding the fact that there has been no real application and no real progress. An analysis that goes beyond a bare recitation of the developments is therefore desirable.

Care must be taken in such an analysis. The Asian region is considerably diverse. As the note to the agenda for this forum comments:

> "…reflecting different legal, economical, cultural and historical backgrounds, the current strategy varies among the countries in

the region and the achievement to date differs significantly."

Rather than pursue a course of examining and analysing the developments on a country by country dissection, it is preferred to examine the overall developments by reference to some important areas of insolvency law and practice. Accordingly the paper is divided into five parts and covers the following:

1. The fundamental aspects of a formal insolvency law regime, namely the liquidation process and the rescue process;
2. The application and administration of those processes;
3. Informal insolvency processes, such as private informal work outs and the more public and structured work out techniques;
4. The treatment of secured transactions in insolvency laws; and
5. Cross-border insolvency issues.

DEVELOPMENTS IN FORMAL INSOLVENCY LAW REGIMES

THE LIQUIDATION PROCESS

Most attention in the region has been given to the reform or, in some cases, the creation of a rescue or reorganisation process in formal insolvency law regimes. But it should never be overlooked that it is the less fashionable and more traditional and conservative process of liquidation (or bankruptcy) that is at the heart of any corporate insolvency law system. Liquidation effectively underpins both a formal rescue process and an informal rescue process. It also provides unsecured creditors with a critical ultimate right of enforcement, albeit within the framework of a collective procedure.

When it is claimed that the formal rescue process of a country is not working, often the fault will not be found in that process. Rather the fault may be traced to the fact that the rescue process cannot be encouraged, facilitated or imposed because it is difficult, if not impossible, to initiate the liquidation process. There is no persuasive force to encourage a debtor to initiate the process. Likewise, if it is complained that there is considerable difficulty in encouraging the development of private informal work out processes, the reason may often be traced to the fact that there are considerable difficulties in initiating the liquidation process. If another complaint is that unsecured creditors have no real means of enforcing their claims it will often be the fact that there is no effective liquidation regime to which unsecured creditors may turn to exercise an ultimate and fundamental right of enforcement. Again, the debtor remains relatively free of any real threat of enforcement.

Viewed in this way, it may be seen that it is the liquidation process that drives, encourages and, in some cases, dictates resort to rescue processes, formal or informal. However, given the extent of recent insolvency law reform in the region, it is somewhat surprising that so little attention has been given to the liquidation process and its application. Some examples may illustrate the point.

In those countries of the region that largely inherited their insolvency law from English based legal systems (most notably Singapore, Malaysia, India, Pakistan, and Hong Kong, China), the liquidation law (as distinct from its application) is basically sound and capable of efficient application. None of those countries had to be concerned to reform that aspect of their law as a result of the crisis. In terms of application, the liquidation processes work efficiently and well in Singapore, Malaysia and Hong Kong, China. It is relevant to observe that in each of those jurisdictions there are strong, functional and well-regarded rescue processes, both formal (although not in the case of Hong Kong, China) and informal. It suggests that there is a strong correlation between an efficient liquidation law and an effective rescue process.

On the other hand the application of the liquidation process is not effective in India and Pakistan. This does not appear to be the fault of the law itself. Commentators in those countries level their criticism at the court systems (delays and impediments) and at other factors (such as corruption and political manipulation). It is therefore likely that the fault lies in either or both of insufficient resources at infrastructure level, most notably in the courts and public sector administration of insolvency cases, and the endemic problem of corruption and political intervention. But, importantly, in neither of those countries is there anything approaching a flourishing rescue process, whether formal or informal. It may be concluded that reform to the liquidation process and its application is urgently required in those countries before a rescue culture may be developed.

Thailand provides another example. It reformed its Bankruptcy Act in 1998 by adding a new rescue process. Many commentators properly commended that reform. However a problem relating to the commencement criteria under the existing liquidation or bankruptcy law subsequently emerged that was to affect the application of the new business reorganisation process. This problem concerned the definition or meaning of 'insolvency' under the law in Thailand.

Not long after the new rescue process commenced operation, both debtors

and, in particular, creditors, discovered that it was necessary to establish that a corporation was insolvent by the use of a 'balance sheet' test to promote a rescue. A balance sheet test requires proof that the liabilities of the corporation exceed its assets. Proof that such a condition exists is particularly difficult to establish by a creditor. Criticisms and complaints quickly surfaced that the new rescue process was ineffective, difficult to apply and, even, useless.

But, again, the criticisms were misdirected. The fault (if it be such) lay in the fact that proceedings under the Bankruptcy Act of Thailand could only be commenced and given effect if the debtor was insolvent on a balance sheet test. That test had been specified (albeit, not altogether clearly) in the Act since its enactment in 1940 and had been long applied to proceedings for liquidation as a result of a number of decisions by superior courts in Thailand. In the drafting of the amending legislation for the new rescue process that process was made subject to the same commencement criteria as existed for liquidation proceedings.

It would have been desirable if the new rescue process had been given different commencement criteria, to encourage attempts at rescue when there appears a possibility that a corporation may become or is insolvent, based on a cash flow test (inability to pay a due debt). But, whatever, not only was the new rescue process put under a cloud of considerable doubt, the shortcomings of the liquidation or bankruptcy process were also exposed. No revision has yet been made although the whole of the bankruptcy law regime of Thailand is now under review.

Again, this reveals the importance of examining the whole of an existing insolvency law regime and its application to ensure that both any newly introduced rescue process can operate successfully and that both it and the liquidation process may compliment one another.

Japan, Korea and Taipei, China provide some further examples of problems in the commencement criteria for liquidation proceedings. The relevant legislation in all of those jurisdictions contains only a general statement of the criteria for commencement. They do not provide specific procedural rules by which the criteria may be established. In Japan, for example, the relevant legislation provides that when a debtor is '*unable to pay*' the debtor may be adjudged bankrupt and that a debtor shall be deemed unable to pay when the debtor has '*suspended payment*'. There are no definitions or meanings of these terms in the law. The criteria are vague and could be difficult for a creditor to establish. Although this is not carried into the rescue processes in those juris-

dictions, the vague criteria for the commencement of liquidation proceedings may mean that a creditor is denied the opportunity of, in effect, forcing or inducing an insolvent debtor into the rescue process.

Korea is, of course, undertaking a full reform of its insolvency law regime. It will be interesting to see the result of that exercise, particularly as much of the present Korean regime has extended from Japanese models.

In the Philippines, although the commencement criteria are acceptable, it is necessary that three creditors join together to prosecute a liquidation case. It is difficult to understand why one unpaid creditor should not be enough to enable a proceeding to be commenced.

The existing insolvency laws in both the People's Republic of China and Vietnam are also problematical regarding the opening of insolvency proceedings. In Vietnam, for example, one of the necessary criteria is that an enterprise has made losses for at least two years. Such a criterion for commencement is far from conducive to encouraging the application of a rescue culture. In the PRC it is necessary for some government sanction before insolvency proceedings may be commenced in relation to a state enterprise. The process becomes, therefore, much more of an administrative and controlled exercise rather than one that is consistent with the development of a market economy. However, in both these countries insolvency law reform projects have commenced or are proposed and the probability is that there will be some significant and appropriate changes to commencement criteria.

Another way of assessing the effectiveness of liquidation processes is by reference to the statistics of the number of liquidation cases. In many countries in the region the numbers are astonishingly low and bear no resemblance to the known fact that there are many insolvent corporations incapable of rescue but which appear to be either immune or protected from liquidation proceedings. In the Philippines and Indonesia, for example, cases of corporate liquidation or bankruptcy were virtually unknown.

The above brief analysis suggests that, in a number of countries in the region, the reform process has not paid any or any sufficient attention to the vital, but unfashionable, liquidation or bankruptcy processes. In consequence those countries may experience little benefit from their respective reforms in the more fashionable area of rescue. The analysis should not, however, be interpreted as a call for radical and draconian measures to ensure that enterprises may be liquidated at the first sign of financial difficulty. That is not the thrust of the analysis. Rather, the point is that unless the insolvency law sys-

tem carries with it a real prospect of a significant sanction directed at financially troubled corporations (which can only be done through a real threat of possible liquidation) the following consequences will result:

- first, endeavours to promote both formal and informal rescue processes will have no or limited effect;
- secondly, the rights of unsecured creditors will be significantly reduced and become almost meaningless; and
- thirdly, insolvent enterprises will be permitted to continue to conduct business to the prejudice of all that may deal with them.

Some of those consequences can be identified in a number of countries in the region. The cure lies in a careful examination and reform of the liquidation side of an insolvency law regime.

Rescue

By comparison with liquidation, rescue has been the centre of the insolvency law reform movement. Three countries in the region have made substantial reforms in this area – Thailand, Indonesia and Japan. Another five countries have substantial reform projects in hand to create or reform formal rescue processes – the PRC, Vietnam, Korea, Hong Kong, China, Indonesia and the Philippines. There is also a prospect of reform in this area in India, Malaysia and Taipei, China. In short, creating and/or improving formal rescue regimes has become the flavour of the times.

This endeavour is, of course, to be commended. There can be little doubt that a process that encourages and facilitates commercial negotiation under appropriate safeguards and non-intrusive regulation is more likely to produce a better and more satisfactory outcome than anything approaching a forced liquidation approach. Indeed, although it may be the case that in a liquidation environment the law has a significant regulatory role to perform, in the rescue process the principal aim of the law should not be to regulate but to facilitate and provide the system, the mechanism and the forum for the negotiation of a plan of reorganisation.

It would be unfair to attempt some comparative critical analysis of the rescue regimes of the different countries in the region. That is because they will have been constructed to take account of local commercial and other customs and practices. There is, however, some worth in examining the rescue regimes by reference to some key legal and commercial standards that would be applied by most rescue legislation. They are standards that appear to be the

subject of common and, in some cases, universal acceptance. They may be conveniently listed in the form of the following propositions or questions as follows:

- Does the law enable the reorganisation process to be easily and inexpensively commenced?
- Does the law provide for an immediate automatic stay and suspension of all actions against the property of the enterprise for a limited period of time to enable a reorganisation plan to be formulated, negotiated and approved?
- Does the law adequately provide for the ongoing management and control of an enterprise that seeks to be reorganised?
- Does the law provide for a commercially sound form of priority for the ongoing finance funding that may be required to keep the enterprise liquid?
- Does the law provide for a speedy but sensible time frame for the progress of a case of reorganisation?
- Does the law provide for creditors to receive sufficient and reliable information concerning the enterprise and the reorganisation proposal or plan?
- Does the law adequately provide for creditor voting rights and their exercise?
- Does the law ensure that a plan of reorganisation meets some fundamental basic requirements, (for example, that a reorganisation should provide a better benefit to creditors than might be expected from a hypothetical liquidation of the enterprise; and that a reorganisation must ensure that the enterprise is returned to the commercial world in a solvent financial state)?
- Does the law provide for adequate overall supervision of the reorganisation process?
- Does the law provide for conversion to liquidation if creditors do not accept a reorganisation plan or if the plan is not implemented?

The work of the Asian Development Bank on its comparative study of the insolvency laws of eleven Asian economies (see Report on RETA 5795: '*Insolvency Law Reforms in the Asian and Pacific Region*' in Law and Policy Reform at the Asian Development Bank, 2000 Edition, Vol.1) identified a reasonably high degree of application of these standards in the formal rescue legislation of the region. The following are illustrative:

- *Access.* Access to rescue processes was relatively easy in most of the jurisdictions, but sometimes problematical in Thailand (as mentioned above) and somewhat constrained with procedural requirements in Japan, Korea

and Taipei,China. Since then, however, Japan has introduced an improved rescue process (the Civil Rehabilitation Law, December 1999) in which the access criteria is framed as a possibility of facing facts out of which a bankruptcy may arise. As mentioned earlier the Korean system is undergoing reform.

- *Automatic stay.* The vital 'automatic' stay requirement was, surprisingly, less common. The 'English' based law jurisdictions are the greatest offenders (Malaysia, India, Pakistan and Hong Kong, China). The judicial management process of Singapore, by comparison, featured an excellent stay provision. That is no doubt due to the fact that it is a relatively new (1987) process. The problem in the other English law jurisdictions is that their 'rescue' processes (they all take the form of a 'scheme of compromise or arrangement' process) are old, outdated, expensive and inefficient. They are all in urgent need of modernisation. In some of the other jurisdictions there is some concern at the length of the automatic stay (for example, in Japan, Korea and Taipei, China), but this appears to be largely associated with procedural requirements that greatly increases the length of time that it takes for the negotiation and approval of a plan of reorganisation. The recent introduction of the new Civil Rehabilitation Law in Japan has already alleviated much of this delay (although, interestingly, it does not impose an automatic stay upon secured property enforcement rights).
- *Continued management.* The issue of the continued management of a corporation that seeks reorganisation has produced a variety of solutions that provides some comparative interest. In Japan and Korea, for example, the reorganisation law provides for exclusive management through the appointment of an independent receiver (in Japan this position has been maintained under the civil rehabilitation law). Under the legislation of both Singapore and Thailand the law actually suspends the powers of management in favour of an independently appointed manager. That has created some tension in Thailand because of a strong cultural aversion, mainly from owners and managers of corporations, to surrendering complete control. In most of the other jurisdictions there is something of a halfway house, with existing management continuing under supervision by a court or administrative appointee. In Vietnam, for example, existing management is expected to continue but subject to supervision by a court and an 'asset management team'.
- *Provision of 'new money'.* The appropriate means by which to encourage

and facilitate continued funding of an insolvent corporation continues to cause problems. It is an issue that is not confined to the Asian region – it creates problems throughout the world. In only three jurisdictions in the region do the rescue laws expressly provide for the possibility of sanctioning the provision of 'new money' – those of Singapore, Korea and Thailand. However, of these, only Singapore, under the judicial management law, provides protection by way of priority repayment of that funding. This is an area in which considerably more study and assistance is required. The main issue concerns the effect of 'new money' funding on existing creditors, both secured and unsecured. Considerable attention must be paid to the position of secured creditors.

- *Time frame.* The time frame for the progress of an attempt at reorganisation is, in general, well structured. The respective rescue laws of Indonesia, Singapore, and Thailand prescribe strict, but commercially sensible, time limits for all stages of the procedure. They provide very good models. However, in other countries the process can be very slow and considerably delayed (in Japan and Korea, for example, the legislation permits a period of 12 months for a plan to be prepared and that can be extended by order of the court to as long as 18 months). In some other jurisdictions the process is subject to considerable delay because of problems and inefficiencies in the court system, an area that is the subject of comment later in this paper.
- *Information to creditors.* The provision of information to creditors is another vital component of a rescue regime. In most cases creditors are the decision-makers. They cannot be expected to participate in that process without reliable and independently assessed information. Although most countries in the region endeavour to apply this standard, there is some considerable variation in the degree of effective delivery. For example, the rescue laws of both Indonesia and Thailand require the delivery of relevant information but in both jurisdictions there is a problem associated with the appointment of an independent expert or advisor to ensure that the provision of information is handled professionally and objectively. Again, this is an area that concerns institutional capacity and is the subject of further comment late in this paper.
- *Voting rights and requirements.* Creditor involvement in the rescue process is achieved through meetings, voting rights and their exercise at meetings. In general, all the rescue laws of the region provide for a high extent of creditor involvement in the process. One exception, for a time, was in

the Philippines where there was no provision for meetings or voting powers. That has since been remedied by procedural rules and it may be expected that this will be maintained in that country when the new insolvency law reforms are finally settled. The exercise of voting rights and requirements provide some interesting comparisons. They vary considerably – as low as a simple majority vote for the approval of a plan, to a requirement for a majority as high as 75% of value (for example in Japan under the Corporate Reorganisation Law there is a requirement for a 75% majority of secured creditors in favour of a plan) and in some jurisdictions there is a requirement for a dual standard of majority both in number and in aggregate debt of creditors (for example, Singapore). In Vietnam a plan of reorganisation must be approved by two thirds in value of all creditors, whether they are present at the meeting or not.

- *Basic requirements of reorganisation plans.* Although it is generally accepted that the law should not intervene into the ultimate compact that is negotiated between the creditors, the enterprise and other interested parties, it is generally accepted that the law should impose at least two basic requirements. One is that the result of a plan should ensure that the benefit to creditors is not less than they would be likely to receive if the enterprise was, hypothetically, liquidated. Although this might be considered axiomatic and a 'given' (where is the commercial benefit for creditors in a reorganisation?), very few formal reorganisation regimes actually spell it out. Unless a standard such as that is required (and enforced) a reorganisation process can be much abused to the prejudice of creditors. The other very important standard is that the enterprise should not remain insolvent at the end of a reorganisation. The aim of any insolvency law regime must be to remove insolvent enterprises from the market place, not to restore them to the market place in that same condition. Thus, it must be shown that the end effect of a reorganisation is that the enterprise has ceased to be insolvent. This may appear very basic and, again, taken as a given, but so few insolvency law regimes actually spell out that fundamental policy point. In the region, somewhat surprisingly, only Singapore and Thailand provide for these basic safeguards.
- *Supervision of the process.* Consistent with the view that the law should not unnecessarily intrude into the rescue process but there should be some overall judicial or other supervision of the process, that also should not be over intrusive. The rescue laws of Japan (before the Civil Rehabilitation

Law), Korea and Taipei, China place heavy emphasis on judicial involvement. That undoubtedly contributes greatly to delays in the process. It is legitimate to enquire whether this is the best use of valuable judicial time and energy. In the Philippines, until just recently, the SEC had an extraordinary power to set aside a majority 'non-approval' of a plan vote of the creditors if the SEC was of the opinion that the majority view was 'manifestly unreasonable'. There is a similar provision in the present draft of a proposed reformed insolvency law of the PRC. It may be argued that to vest such a power in a court or other tribunal runs contrary to a strong view that creditors should have freedom to contract and that they are the best judges of the commercial effect of a reorganisation plan. To empower or require a judge to, in effect, 'second guess' the commercial wisdom of people of commerce may be unnecessarily intrusive.

- *Conversion to liquidation.* Finally, there is the requirement that a rescue law should provide for the possible conversion from a failed attempt at rescue to liquidation. This standard is subject to considerable variation in the region. None of the common law jurisdictions provide for conversion (which is surprising in the case of Singapore since its rescue law is of relatively recent origin). Thailand has a provision for conversion, but it is of limited scope. Only Indonesia, Japan, Korea, Philippines and Taipei, China have an express provision for conversion. Absent such a provision if a proposed reorganisation is not approved or fails and the proceedings are terminated the enterprise remains insolvent and at large in the commercial community. In addition there is the consequent delay and the waste of costs of re-initiating the insolvency process.

In summary, the areas in which there appears to be a need for the greatest reform are:

- All of the 'English' law based countries, with the exception of Singapore, require the introduction of a modern rescue law into their respective insolvency law regimes.
- Some countries should further review the effect and operation of their automatic stay provisions.
- All countries, with the possible exception of Singapore and Thailand, require legislation to sanction and protect 'new money' that is necessary for an enterprise that seeks a genuine reorganisation.
- The degree of practice and procedure that requires consequent judicial

involvement in the rescue process should be reduced as much as possible.
- The involvement of, the provision of information to and the voting powers of creditors is another area that might be usefully reviewed, particularly if a principal aim of a rescue process is to provide the forum for negotiation and resolution of a reorganisation.
- The basic safeguards or standards of the effect of a reorganisation should be expressly provided for in all formal rescue legislation.
- Automatic conversion from a failed reorganisation to liquidation should be considered in a number of countries.

APPLICATION AND ADMINISTRATION OF LIQUIDATION AND RESCUE PROCESSES

It is in this area that the good intentions of insolvency law reform in the region may appear decidedly fragile and ineffective. It is the failure or the inability to properly apply the law that leads to criticisms that much of the recent insolvency law reform in the region is not much more than a widow dressing and of little practical substance.

There are three areas of infrastructure development that are required in most countries in the region:

- The first is in the *courts and other tribunals* that have jurisdiction under the insolvency law regime. Problems in this area may be identified as one or more of the following: no or not enough sufficiently educated, trained and knowledgeable judges to exercise jurisdiction; not enough courts and not enough resources to ensure that the court system may deal with insolvency cases efficiently and quickly; and elements of corruption of and/or political or other interference with judges. This is a problem that seems to have become particularly evident in Indonesia, despite the establishment of a new commercial court. No doubt this is an area that will be more fully addressed in the following parts of this forum, since it is primarily devoted to a review of the role of courts and judges in the insolvency process.
- The second concerns the *administration of liquidation cases.* Very few countries have established or provided sufficient resources to a public office to handle cases of enterprise liquidation. It should be recalled that regardless of the emphasis in many countries that is placed on and the encouragement given toward reorganisation processes, most enterprises that fail will be hopelessly insolvent and will be suited only to liquidation. That very large bulk requires a public office to administer them. The best ex-

amples in the region of this type of facility are in Singapore, Malaysia and Hong Kong, China. In other jurisdictions there are public offices but they have a considerable range of functions (such as execution of judgements and enforcement of orders for the sale of secured property). They are also staffed by officials who have very little experience or knowledge in the conduct of a liquidation of, for example, a corporation.

- The third involves *management of reorganisation cases.* Here the biggest problem is the lack (sometimes the complete absence) of trained and experienced private sector professionals to take a prominent role in various aspects of a reorganisation. These aspects include the financial and other analysis of a corporation that is in financial difficulty; the ongoing management of a corporation while it seeks to reorganise; the devising of a reorganisation plan; advising various stakeholder groups (particularly unsecured creditors) in a reorganisation; and being responsible for the implementation of a reorganisation plan. Most of these functions are important in a reorganisation. The chief problem in the region is the absence of qualified people to perform them.

No amount of revision and reform of the law will count for much in the face of an inability to apply the law through weaknesses in one or more of the above three vital areas. The reform of insolvency law creates change. It may result in an area that has been dormant and unused suddenly being revitalised and in demand. It may result in the introduction of new practices and processes. That requires knowledge, training and experience.

A symposium was recently convened in Vienna jointly by UNCITRAL, INSOL International and the International Bar Association. The principal purpose of the symposium was to assist UNCITRAL to frame the areas of insolvency law upon which it might be able to produce model legislative guidelines. Many of the delegates and representatives from developed, developing and transitional countries at the symposium applauded that endeavour but continually spoke of the need for training and experience to enable insolvency law regimes to work.

That is a message that cannot be ignored. International aid agencies, legislators and regulators must bear in mind the long term continual education and training needs of many countries in the Asian region in the area of insolvency law and practice.

DEVELOPMENTS IN INFORMAL INSOLVENCY PROCESSES

This appears to be the area in which there has been considerable positive and beneficial development. The ADB Insolvency Report regarded this area as possibly more encouraging than the attempts at insolvency law reform and the application of those reforms. It may be deserving of more encouragement because it avoids the use of courts and formal legal processes, it encourages the use of mediation and conciliation techniques and it may, overall, be more suited to the commercial and other culture of the region because it is principally non-confrontational.

Many of the informal processes were introduced into countries in the region through semi-official structured processes. These include the process known as the 'Jakarta Initiative' in Indonesia, the Corporate Debt Restructuring Advisory Committee (CDRAC) in Thailand, the Financial Institution Agreement for the promotion of Company Restructuring in Korea and the Corporate Debt Restructuring Committee (together with he more formal and powerful organisation known as Danaharta) in Malaysia.

Those initiatives have had varied success and it is sometimes difficult to measure their real effect because of the degree of imposition (as distinct from purely voluntary submission) that might have been imposed and issues regarding the 'quality' of some of the cases of 'reorganisation' (many would appear to be cases of debt rescheduling or postponement rather than cases of reorganisation or restructuring). However, they certainly appear to have achieved more positive results than anything under formal legal insolvency processes.

However, the importance of these informal processes for the region may not necessarily be found in the numbers they have produced and processed or in the quality of the results. Their real significance may lie in the fact that they introduced into the region the basis of, the elements to apply and the skills that are necessary to conduct informal workouts. It is also relevant that the banking sectors of both Singapore and Hong Kong, China have recently promoted guidelines for the conduct of corporate workouts, unaffected by any semi-governmental organisation to give them effect.

This is an area that is likely to receive a considerable amount of attention and promotion from the private sector in the immediate future. INSOL International, through its Lenders Group, has recently published a 'Statement of Principles for A Global Approach to Mulit-Creditor Workouts'. The principles are a statement of best practices in informal workouts. Also, the Asian Devel-

opment Bank will soon commence a regional technical assistance that, amongst other important goals, will endeavour to capture the benefit of the recent and continuing experiences of countries in the region in this area. This may be most vital if the experiences are to be preserved as a legacy upon which to further develop the informal technique. Already, for example, CRDAC in Thailand has been disbanded and others of the structured initiatives may soon complete their work. What is necessary in the immediate future is for the work and experiences of those agencies to be gathered together, assessed and supplemented by training and education from the private sector interests.

A final important point that should be observed in relation to informal workout processes is that they depend very much on the strength of the formal insolvency law regime, particularly the liquidation process. That may not be quite so apparent in the Asian region since the structured informal processes of the region exhibited some element of quasi-official encouragement or persuasion that required both creditors and debtors to at least consider or contemplate the prospect of an informal work out. However, the success of a purely informal work out environment, such as those sponsored or encouraged by banking sectors, relies almost entirely on commercial good sense or on the fact that the debtor will be faced with the distinct prospect of liquidation unless the informal process is initiated and progressed. Once the structured informal processes disappear the region will be left with banking sector inspired informal processes. If they are to succeed a number of countries in the region will need to strengthen their respective insolvency laws.

THE RELATIONSHIP BETWEEN SECURED TRANSACTIONS AND INSOLVENCY LAW REGIMES

There are a number of issues in this area that present themselves for discussion. The main two issues concern the importance of a strong and effective secured transaction enforcement regime for insolvency law purposes and the interrelationship between secured transactions and insolvency in a formal rescue regime process.

Relevance of strong secured transactions enforcement regimes. In the same way that the availability of the remedy of liquidation can promote resort to rescue processes, so too can an effective secured transaction enforcement regime, for very much the same reasons. In the case of a threat of liquidation, a debtor corporation can initiate a formal rescue process. This will normally protect the creditor from liquidation proceeding because, upon the commence-

ment of the rescue process, actions against a debtor will be stayed or suspended by application of the automatic stay provision. This would include a stay on the commencement or continuation of liquidation proceedings. In the case of the threat of security enforcement, a debtor corporation may, again, initiate a formal rescue process because it is likely that an automatic stay provision will normally have the effect of suspending security enforcement action against a debtor.

In both cases the result is the same – the debtor may be compelled to take steps to implement the formal rescue process or suffer the consequences. Both follow as a result of the effectiveness of, respectively, the insolvency law and the secured transaction enforcement law.

Another benefit of a strong and effective secured transaction enforcement regime concerns corporate governance standards. A corporation will only take a responsible attitude toward the debts that it incurs and their discharge if there are sanctions against irresponsible treatment of or a cavalier attitude to creditors. The certain prospect of enforcement action being taken in relation to secured debts provides a powerful incentive to act responsibly.

Interrelationship between secured transactions and rescue regimes. The use of a rescue process to shield an enterprise from security enforcement action raises, of course, a major area of tension between secured transactions law and insolvency law. Proponents of secured transaction regimes would prefer that there was no interference or delay in the right to enforce security rights. On the other hand, proponents of formal rescue laws would maintain that a rescue regime might be fatally flawed unless secured transactions enforcement processes are stayed and suspended under the automatic stay provisions of the rescue regime.

There is a clear need to frame an acceptable balance between these two extremes. In a large number of jurisdictions the balance is achieved by applying the stay to the enforcement of secured transactions, but:

- limiting the time period of the stay;
- affording a secured creditor the right to apply to a court for the lifting of the stay; and
- requiring, in some cases, that continuing obligations under the security contract (for example, the payment or accrual of interest charges) must be maintained.

In relation to issues concerning the involvement of secured creditors in a reorganisation plan and its approval, these regimes also endeavour to provide some protection to secured creditors. Generally speaking, a secured creditor

cannot be bound or adversely affected by a plan unless the creditor has consented or agreed to be bound.

Secured transaction and insolvency law regimes in the Asian region are, generally, weak regarding these types of issues. Some examples may illustrate this:

- *First,* secured transactions legal regimes are inadequate in many of the jurisdictions in the region. In a number of jurisdictions enforcement of secured transactions must be conducted through court and related judicial enforcement procedures (for example, India, Pakistan. Indonesia and Thailand). There is usually considerable delay. In some jurisdictions enforcement may prove to be impossible. As a result there is little threat to an insolvent debtor enterprise and a consequent disregard of corporate governance standards. Coupled to a weak or ineffective liquidation remedy there is very little creditor pressure that may be applied to encourage the initiation of a rescue process.
- *Secondly,* although a stay or suspension of secured transaction enforcement rights may be justified under a formal rescue process, there is very little reason to apply any such stay if the debtor is being liquidated. Yet, in some Asian jurisdictions, a stay applies to the enforcement rights of secured creditors and, in some cases, the powers of enforcement are given to the official/s that conduct the liquidation. In Indonesia there is a somewhat puzzling requirement that unless a secured creditor realises the security within 2 months of the commencement of a liquidation, the secured creditor becomes responsible for part of the costs of the liquidation. It is difficult to justify why some of the above requirements are necessary.
- *Thirdly,* in some jurisdictions, the effect of the commencement of insolvency proceedings on secured creditors is left vague or, even, not stated at all. This results in uncertainty. An insolvency law regime should contain a positive and clear statement of the effect of the commencement of the various insolvency processes upon secured creditors.

The need for integration between secured transaction and insolvency law regimes has been the subject of a special report by the Asian Development Bank ('*The Need for an Integrated Approach to Secured Transactions and Insolvency Law Reforms*' in Law and Policy Reform at the Asian Development Bank, 2000 Edition, Vol.1). Also relevant is the recently published report of the ADB, entitled '*Secured Transactions Law Reform in Asia: Unleashing the potential of Collateral*' in Law and Policy Reform at the Asian Development Bank,

2000 Edition, Vol. II.

THE TREATMENT OF CROSS-BORDER INSOLVENCY ISSUES

The region is an obvious target for cross-border insolvency co-operation. Slowly it is emerging from an attitude that largely dictated territoriality toward neighbouring states on such issues. It is refreshing that the new Civil Rehabilitation Law of Japan provides that a rehabilitation proceeding commenced in a foreign country shall be effective with respect to property situated in Japan and rehabilitation proceedings commenced in Japan (Article 4). In earlier laws an insolvency proceeding commenced abroad had no effect upon property situated in Japan. Chapter X of the new law also contains special provisions for dealing with corporate insolvency cases that are infected by cross-border issues. The measures that may be employed include co-operation, provision of information and mutual participation in proceedings.

A development such as that might provide the initiative for other countries in the region to rethink and reconsider their attitudes toward cross-border insolvency issues.

This year the Asian Development Bank will commence a regional technical assistance on '*Promoting Regional Co-operation in the Development of Insolvency Law Reforms*'. One of its aims is the development of co-operation and assistance in relation to cross-border insolvency. This part of the technical assistance will benefit from the assistance of UNCITRAL and INSOL International. A purpose of that initiative will be to promote and encourage the adoption of the UNCITRAL Model Law on cross-border insolvency in the region.

Finally another consequence of the Asian financial crisis should be considered in this context. This concerns the flight of funds and property of insolvent corporations out of jurisdictions and, consequently, out of the reach of creditors. This became evident in a number of countries when creditors commenced debt recovery and insolvency proceedings. Creditors looked on with dismay at the apparent inability and/or unwillingness to follow and retrieve property and prosecute those responsible for such a blatant misuse of the privilege of incorporation. Laws relating to co-operation, recognition, assistance and relief in the context of insolvency may be effectively used to pursue and recover funds and property improperly removed from the jurisdiction. At present they do not really exist in the region.

RECENT DEVELOPMENTS IN INSOLVENCY REFORM IN ASIA SUMMARY OF RECENT DEVELOPMENTS IN INSOLVENCY REFORM IN JAPAN*

BY
MANABU WAGATSUMA
ASSOCIATE PROFESSOR
TOKYO METROPOLITAN UNIVERSITY
TOKYO, JAPAN

INTRODUCTION

There has been considerable legislative activity in the field of insolvency law reform in Japan since 1996. The need for a fair, effective and efficient legal system is critical as the Japanese economy has been mired in recession, private work and composition can no longer be a panacea for corporate rescue regime. The practice of insolvency proceedings has also been gradually changing. As the courts were used to screen cases for eligibility when a filing for insolvency proceedings was made and to supervise debtor, the formal insolvency proceedings were time-consuming and expensive. For the sake of efficiency, the key player of the screening process and assessment of a prospect of a case for reorganization is shifting gradually from the court to the petitioner on behalf of the debtor or supervisor.

This article will first give a general explanation of Japanese insolvency law for a preliminary study. Secondly, it will describe the recent developments in insolvency reforms from 1996 in Japan. Finally, it will conclude with a discussion of the implications of the new corporate rescue regime.

INSOLVENCY LAW IN JAPAN

There are five types of judicial insolvency proceedings in Japan, two of which can be categorized as liquidation proceedings and the other three as rehabilitation .

In1922, the Bankruptcy Law (*Hasanho*)[1] was enacted modeled after the German Bankruptcy Law of 1877. That following year, the Composition Law

---

* The former title of the paper is "Recent Developments in Insolvency Reform in Japan" (see Summary Session I page 4)

[1] Law No.71 of1922

(*Wagiho*)[2] was enacted, which was basically modeled after the Austrian Composition Law of 1914. This proceeding can be filed only by the debtor. These two proceeding are applicable to natural persons and judicial persons such as business corporations.

Corporate Arrangement (*Kaishaseiri*) was introduced in 1938 in order to help the private workout to rescue corporations under the supervision of the court. Special liquidation was also introduced at the same time with corporate arrangement. It is a liquidation procedure under the supervision of the courts. These two are regulated by the corporate section of the Commercial Code[3].

After the World War II, the Corporate Reorganization Law (Kaishakoseiho)[4] was enacted in 1952 based under on the Bankruptcy Act in the United States. That same year, a discharge system for individual debtors was introduced in the Bankruptcy Law, which was also under the influence of the Bankruptcy Act in the United States. The Corporate Reorganization Law is applied only for the stock corporations. Those five systems above ware not necessarily harmonious with each other.

The numbers of the filings of insolvency procedure from 1997 to 1999 are in table1 shown below.

Table 1. National Totals Insolvency case Filing for Calendar Years 1997-1999

Bankruptcy			Composition	Coorporate	Special	Corporate
	Total	Individual		Arrangement	Liquidation	Reorganisation
1997	76,032	71,683	263	18	172	23
1998	111,067	105,468	306	24	249	51
1999	128,488	123,915	121	12	343	9

source:Annual Judicial Statistics:Civil Matters 1997-1999

Most of the bankruptcy cases of individuals are consumer bankruptcy. The number of business bankruptcies is between 3,000 and 4,000 a year. Almost all composition cases are corporate cases. As the Corporate Reorganization Law is

[2] Law No.72 of1922
[3] Law No.48 of1899
[4] Law No.172 of1952

tailored for the large corporation, the number of cases is less than 100 a year.

There are approximately 14,000 to 18,000 business failures a year. If a company runs into trouble, its main bank would rescue it. As the formal procedures are time-consuming and expensive for the insolvent debtor, most of them are handled outside the court.

THE IMPLEMENTATION OF RESCUE SCHEMES FOR FINANCIAL INSTITUTIONS

The Rescue Package for Financial Institutions[5]

The Japanese financial institutions have been protected under the tight regulations. Until the failure of the Hanwa Bank, a middling regional bank in 1996, no Japanese bank had undergone liquidation after the World War II. If a financial institution was in trouble, a rescue plan, such as merger and acquisition was carried out under the guidance of the Ministry of Finance.

Most of the banks, hugely unprofitable and burdened with nonperforming loans since the early 1990s, no longer have enough funds to come to the rescue of failing firms of all types. The life insurance companies are also struggling to pay the fixed rates they had committed for annuities in the late1980s because of falling premium income and large underwriting losses.

The government pushed through an unpopular and expensive scheme to liquidate seven home mortgage lending companies (*jusen)* under Ministry of Finance guidance in order to save agricultural cooperatives in1996. Land values did not improve to bail out of troubled companies. As it became difficult to negotiate and reach an agreement of a rescue package for banks or life insurance companies under the leadership of the relevant authorities, the need of various efficient rescue proceedings is highlighted.

Firstly the special law with regards to the reorganization proceedings of the financial institutions[6] was enacted in1996. Under the special law , the corporate reorganization proceedings are applied not only to banks all of which are stock corporation but also to the corporative financial institutions such as credit unions. The Minister of Finance is entitled to file a reorganization proceeding or bankruptcy proceeding with respect to any financial institution in a more formal and timely manner. The Deposit Insurance Cooperation can file depositors' claims on behalf of depositors in a reorganization proceeding. Al-

[5] See Milhaupt, *Japan's Experience with Deposit Insurance and Failing Banks: Implications for Financial Regulatory Design?*, 77Washington University Law Quartely,399,408(1999)

[6] Kin'yu kikan no kosei tetsuzuki no tokureito ni kansuru horitsu,Law No.95 of 1996

though the Hokkaido Takushoku Bank collapsed in 1997, the Hokuyo Bank took over the operations with infusions by Bank of Japan. The reorganization plan under the special law was not applied.

Secondly the special law on emergency measures to revitalize the functions of the financial system[7] was enacted in 1998. Under the special law, The Financial Revitalization Commission[8] will identify insolvent financial institutions based on the Financial Supervisory Agency examination and this Commission is entitled to appoint a financial trustee(*kinyuseirikanzainin*) to removed the director and take over the management of insolvent financial institution. The Deposit Insurance Corporation can be appointed as a financial trustee. The financial trustee must investigate and take action against the delinquent director. The Financial Revitalization Commission is entitled to select an appropriate resolution specified in the special law. The insolvent banks must either be (1) operated by a financial trustee as a bridge bank to assume business until a private successor institution emerges, or be (2) temporarily nationalized by placement under special public management. Where the Financial Revitalization Commission determines that systemic risk is posed by a bank's failure, insolvent or nearly insolvent institutions will be temporarily nationalized through The Deposit Insurance Corporation's compulsory acquisition of their shares, set a price determined by the Commission. Public management of the bank will terminate when the bank has been rehabilitated, a private successor emerges, or its shares are reprivatized.

The Long-Term Credit Bank and Nippon Credit Bank were temporally nationalized in 1998. Under both resolution mechanisms, nonperforming loans will be transferred to a new Resolution and Collection Organization, sound borrowers of the failed bank will continue to receive funding to prevent a chain reaction of bankruptcies in the real economy. The special law will cease to be effective on March 31, 2001.

The Rescue Package for Insurance Companies

Nissan Mutual in 1997 and Toho Life in 1999 were ordered to suspend operations. As the special law with regards to the reorganization proceedings of the financial institutions did not apply to insurance companies, they were handled under the Insurance Company Law.

[7] Kin'yu kino no saisei no tame no kinkyu sochi ni kansuru horitsu, Law No.132 of 1998

[8] The Financial Supervisory Agency assumed supervisory responsibility over banking, securities, and insurance industries from the Ministry of Finance on June22,1998.

When an insurance company fails, the insurance administrator is appointed to make a necessary plan to transfer the whole insurance policy package or merger with stronger financial institution. The Insurance Policyholder Protection Institute is entitled to extend financial assistance for the successor in order to cover the loss of the policyholder. The right of the policyholder can be altered in order to avoid paying the high, fixed returns on old policies without control of the court.

The rescue plan under the Insurance Company has the following shortfalls. While the general creditor is protected under the Insurance Company Law, the right of the policyholder can be diminished. The compensation fund is undercapitalized in order to clean up Toho Life in 1999, the need of various efficient rescue proceedings has become critical.

THE RECENT DEVELOPMENTS IN INSOLVENCY REFORM IN JAPAN DURING LAST 12 MONTHS

The Civil Rehabilitation Law of 1999 (Minjisaisei-hou): Background

In 1996 on December, the Legislative Advisory Council announced it was to embark on a whole reform of the Insolvency Procedure within five years to update insolvency proceedings to meet the demand of the modern international business world.

The debtor can rehabilitate business without necessarily getting rid of ownership under the composition proceeding. As the Composition Law has the following shortfalls, most of the business failures handled by private workout although the number of middle and small companies facing liquidity and cashflow problems has been increased. The composition proceedings will commence when the causes of a bankruptcy such as the value of the company's assets is less than its liabilities (balance sheet test) or inability to pay one's debts exists (Art.12). On the filing of petition the proposal of rescue plan should be submitted (Ar.13). These requirements pushed the filing of petition by debtor for rehabilitation too late. The supervision of the debtor after plan of payments agreed by creditors is also weak.

In order to cope with urgent demand to rescue small business suffering from cashflow problems from the long recession after the bubble economy collapsed in 1991, the reform schedule was advanced in 1998 to introduce more simple and efficient reorganization proceedings for small business within one year.

The government offered emergency loan-guarantees to rescue imperilled small businesses in October 1998.

The feature of the Civil Rescue Law

The Bill of Civil Rescue Law was enacted on 14 December 1999 and enforced on April 2000. The Civil Rescue Law[9] modeled on the United States' Chapter 11 regime. The Civil Rescue Law has the following scheme to provide a more efficient mechanism for a rehabilitation of a business and financial difficulties. The Composition Law was repealed.

The causes of a bankruptcy is not required when the debtor is in financial difficulties (Art.21). The Limit of proposal of the rescue plan is extended within the fixed period set by the court (Art.163), it is not necessary to submitted on the filing. These requirements are implemented to encourage debtor to file for rehabilitation earlier.

On presentation of a petition for a civil rescue proceeding, the court may suspend not only provisional attachment and provisional disposition(Art.30) but also execution against debtor's assets (Art.26). The court may order a comprehensive protection with regards to debtor's assets (Art.27). The debtor is unable to withdraw the petition without permission of court (Art.32) in order to prevent the abuse of moratorium. The court may appoint an provisional administrator (*hozenkanrinin)* to take over the business and administrate the debtor's assets (Art.79).

Neither the petition nor any resulting civil rescue proceedings affects substantive rights of secured creditors (Art.51) The court may order a stay of the foreclosure of security interest or mortgage within a fixed period if it will not cause great harm to the security creditor (Art.31). On application of the debtor, the court may order redeem the security if the security is necessary to continue business (Art.148).

The debtor can retain ownership and continue business in general (a kind of debtor in position) but the court may appoint a supervisor *(kantokuin*)to supervise the debtor (Art.54) or appoint a trustee to take over the business (Art.64). The supervisor will also supervise the debtor to carry out the plan of payments (*saiseikeikaku*)for three years. The trustee will supervise the debtor until the plan is complete (Art.188,s.2,s.3). The period of the plan is generally within ten years (Art.155,s.2). The supervision of the debtor after plan of payments is strengthened.

[9] Law of No.225 of 1999

The failing corporation will either (1) operate business holding the ownership (a kind of debtor in position), (2) transfer whole or a part of the business, (3)eventually liquidate the business. The court may give permission to transfer whole or a part of the business on application of debtor after commencing civil rescue proceeding if the stock company is unable to pay the whole debts and if it is necessary to continue business (Art.42, Art.43). In order to promote an efficient merger, neither the proposal of rescue plan nor the confirmation of special resolution of general meeting (The Commercial Law,Art.245,s.2) is required.

The debtor does not have the exclusive right to propose a reorganization plan. The general contents of the rescue plan will be to write off debt and reschedule the payments. It is also possible to reduce capital to restructure the insolvent company with a confirmation by the court in advance (Art.154,s.3, Art.161, Art.183). In order to provide a more simple and efficient restructure proceeding, the confirmation of special resolution of general meeting (The Commercial Law, Art.375, Art.343) is not required. It is necessary to be confirmed by the board of directors to increase capital (The Commercial Law, Art.280-2,s.1).

The rescue plan should be confirmed by over half of the holding shares having a right to vote on which a sum as been paid up equal to not less than half of the total sum paid up on all the shares conferring that right (Art.171,s.4) As the requirement of confirmation of the composition was a three-fourths majority of the total sum paid up on all the shares, it becomes much easier to reach the agreement if the main bank will accept the rescue plan.

Some feature of current practice in Tokyo District Court[10]

The number civil rescue cases filed from April 2000 to November 2000 is 160, 151 are judicial persons and 9 are natural persons. 80 per cent of judicial persons are medium and small- scale enterprises, the remaining 20 per cent are large company (the capital is over one hundred million yen and the debt is over 10 billion yen) such as Sogo, a department store. The number of civil rescue cases in 2000 is estimated to be six times as much as the number of former composition in 1999.

[10] See Sono, "The current practice and issues of the Civil Rescue Law at Tokyo District Court",91 saikenkanri,94(2001);"The practice direction and time schedule of the Civil Rescue cases at Tokyo District Court",1594 kinyuhomujijyo,6(2000)

The standard timetable from filing is set in advance. On presentation of a filing for a civil rescue proceeding, the court will give an order on the same day to a prohibition of the payments of debts and appoint a supervisor. The commence order will be made within 15 days from the filing since 10 July, 2000. The supervisor will submit a report asking for major creditors. The supervisor will appoint an accountant as an assistant to conduct inquiry of the cause of financial difficulties, accuracy of books and records and existence of fraud. The accurate prospects of payment is not necessary to conduct as the supervisor will supervise the debtor to follow the rescue plan for three years after the confirmation of the rescue plan.

The proposal of the rescue plan must be submitted within two months from the filing and the rescue plan must be submitted within three months from the filing.

The creditors' meetings are generally held within 6 months from the filing (actual termination of the rescue proceeding). Compared with the former composition, the civil rescue proceeding is much swifter.

32 cases are held the creditors' meeting, 26 cases are confirmed the rescue plan , 6 cases are denied the plan at the creditors' meeting.

At the Tokyo District Court, the judge used to screen cases for eligibility whether to make moratorium and to supervise debtor. Under the civil rescue proceedings the judge set a timetable and conducts case management but does not involve itself directly with the screening of a prospect of a case or supervise the debtor. The petitioner on behalf of the debtor is now in charge of the function.

THE REFORM OF RESCUE PACKAGE FOR FINANCIAL INSTITUTIONS AND INSURANCE COMPANIES:

The Reform of Rescue Package for Financial Institutions[11]

The Bill of Reform of Deposit Insurance Corporation Law was enacted on May 24 in 2000 in order to structure the temporary legislation[12] to permanent rescue scheme for financial institutions from April 2001. The Deposit Insurance Cooperation is entitled to extend financial assistance for promotion of efficient mergers of insolvent depository institutions with stronger financial

[11] See Matsushita, "The New Deposit Insurance Corporation System and the Rescue Scheme for Financial Institutions", in *new financial system and law* (eds.Egashira and Iwahara, 2000),164

[12] supra note 7

institution or promotion of purchasing of assets and assuming liabilities of insolvent institution by healthier institutions (Art.59,s2,Art2).

Until 31 March, 2002, financial assistance for mergers of weak institutions may exceed the payoff cost limit(including those above statutory payoff limit of ten million yen until March, 2003) (Supplementary Provisions, Art.17).

The private successor institution may provide funds for the insolvent institution to ensure the *pari passu* principles of distribution of the insolvent institution (Art.59-2). The Deposit Insurance Cooperation is authorized to make an agreement in advance with the private successor institution to compensate a part of losses when the claims transferred to the private successor institution become unable to collect (Art.2,s.10, Art59,s.1,s.5).

The special law was amended to appoint a financial trustee (*kinyuseirikanzainin*) by the Prime Minister to remove the director and take over the management of insolvent financial institution (Art.74,s.2, Art.77). The court may give permission to transfer the business and reductions of capital on application of the financial trustee if the financial institution is insolvent (Art.87). In order to provide a simpler and more efficient, a shareholder's meetings is not required Creditors are not allowed to oppose the reductions of capital (Art.89).

The insolvent banks must either be (1)operated by a financial trustee to assume business until a private successor institution emerges for one year, or (2)to create a affiliate of Deposit Insurance Corporation as a bridge bank to assume business until a private successor institution emerges (Art.81), (3)temporarily nationalized by placement under special public management (Art.102). Where the Prime Minister after holding a financial risk management conference determines that systemic risk is posed by a bank's failure, insolvent institutions will temporarily nationalized through The Deposit Insurance Corporation's compulsory acquisition of their shares (Art.102., Art.111, Art.112). Public management of the bank should terminate as soon as a private successor emerges, or its shares are reprivatized (Art.119).

The Reform of special law with regards to the reorganization proceedings of financial institutions also enacted in 2000. The Financial Agency[13] is entitled to file reorganization proceedings and civil rehabilitation against any financial institution (Art.178). The Deposit Insurance Corporation can file depositors claims on behalf of depositors in reorganization proceedings (Art.178-

[13] The Financial Supervisory Agency was reorganized to The Financial Agency on July, 1999

8-'178-15). When the reorganization proceedings or the civil rescue proceedings commences and the trustee is appointed, the Deposit Insurance Corporation is entitled to provide financial assistance to cover the payments limited to the statutory payoff limit (ten million yen until March,2003)(Art. 127). On the petition of the trustee, the court may make a compensation payments order to eligible depositors. The Deposit Insurance Corporation can file the fund as reorganization claims or civil rescue claims. When the protection order is made or the reorganization proceedings starts, the depositors will be protected while the financial institution continues business.

The Reform of Rescue Package for Insurance Companies[14]

The Reform of the Insurance Company Law and the Reform of special law with regards to the reorganization proceedings of financial institutions also enacted in 2000. Under the special law with regards to the reorganization proceedings of the financial institutions, the cooperate reorganization proceedings are applied not only for the insurance company but also to the mutual insurance company. The Financial Agency is entitled to file reorganization proceedings against an insurance company when the insurance company is deemed to be insolvent (Art.161). The Insurance Policyholder Protection Institute can file depositors claims on behalf of depositors in a reorganization proceeding (Art.177-22). The provision of executory contract is not applied in order to protect the right of policyholders. The right of policyholders is entitled as a statutory lien(*sakidoritoken*)(Insurance Company Law,Art.117-2). A statutory lien is recognized as a priority reorganization claim (the Cooperate Reorganization Law, Art.228,s.1) As a statutory lien is handled outside the civil rescue proceedings, the civil rescue proceedings is not applicable to the insurance company. When the reorganization proceedings commenced, The Insurance Policyholder Protection Institute is entitled to acquire the claims of policy holders (Art.177-20) and to provide financial assistance to the successor in order to cover the loss of policyholder (Art.177-29, 177-30, Insurance Company Law,Art.270-6-6, Art.270-6-7). When the protection order is made or the reorganization starts, the right of policyholders will be protected.

The right of the policyholder can be altered according to the reserve fund.

---

[14] Yamashita,"Incooperation of Mutual Insurance Company and the Rescue Scheme for the Insurance Company", supra note11at107

The right of the policyholder who canceled in advance after the protection order is ordered or the reorganization proceedings is commenced, can be subordinated (Art.177-34,s.2). These are the special provision of the *pari passu* principles of distribution.

Chiyoda Mutual Life and Kyoei Life Company applied for the reorganization proceedings on October 2000. The reorganization proceeding of Kyoei was extremely swift; the case was filed on 20 October, 2000 and the Protection Order was made on the same day and Reorganization proceeding was commenced on 23 October, 2000.

CROSS BORDER INSOLVENCY[15]

Japan is sometimes referred to as a country which has adopted the territorial principle (The Bankruptcy Law, Art.3(1), The former Composition Law, Art.11, The Corporate Reorganization Law, Art.4, (1)[15]. The principle of territoriality can cause inequality among creditors between Japan and foreign countries and also causes great inconvenience in the reorganization of an international company. With ever increasing amount of trade and investment between Japan and other countries, it is necessary to harmonize the international insolvency proceedings.

The Bill of Recognition and Co-operation of Foreign Insolvency Proceedings was enacted on 21 November 2000 and will be enforced from April 2001. The Bill was under the great influence of UNCITRAL Model Law. The Law of Recognition and Co-operation of Foreign Insolvency Proceedings[16] contains of recognition proceedings and requirements of recognition of foreign insolvency proceedings (Chapter 2), co-operative measures to be extended to foreign insolvency (Chapter 3), relations between concurrent domestic and foreign insolvency proceedings (Chapter 4). The Law repeals infamous provisions setting forth strict territorialism and adopts the principle of moderate universality.

On the petition of the trustee, the court makes an order of the recognition of foreign insolvency proceedings (Art.22). The order of recognition itself will not bring any effect automatically, but the court may suspend execution, provisional attachment and provisional disposition against an assets of debtor, law

[15] Recent Articles with regards to Japanese international insolvency are Kashiwagi "The Cross Border Insolvency Situation in Japan", Int.Insol.Rev.,Vol.9:205, 2000,Matsushita, "On Current International Insolvency Law in Japan", Int. Insol. Rev., Vol.6:210, 1997

[16] Law No.129 of 2000

suits or administrative proceedings with regards to an asset of debtor (Art.25). The court may order a prohibition of the disposition of assets or business of debtor, a prohibition of the payments of debt (Art.26), and stay of the foreclosure of security interest or mortgage (Art.27).

Insolvency proceedings filed under Japanese insolvency laws before or after the recognition of foreign proceedings will prevail over insolvency proceedings in foreign countries (Art.57,s.1). However, foreign insolvency proceeding filed in a country where the principal place of business of the debtor exists may at the discretion of the court prevail over Japanese concurrent proceeding , provided that the interest of the creditors in Japan will not be unduely prejudiced and the recognition of such foreign proceeding will promote the benefit of the creditor as a whole. In such case, concurrent Japanese insolvency proceedings will be discontinued.

CONSUMER BANKRUPTCY

The number of consumer bankruptcies has increased radically since 1995 because of unemployment or income interruption. Under the discharge proceedings of Bankruptcy Law, the individual debtor may not keep a home, it is necessary to draft the special provision to allow the debtor to keep the home if the debtor can pay the arrearage in the home mortgage with future earnings through rescheduling the payment plan. As the civil rescue Law is tailored for the middle and small company, it is necessary to introduce much more simple and efficient rehabilitation proceedings for the regular income debtor and small private business. The Bill of reform of Civil Rehabilitation Law enacted on 21 November 2000 and will be enforced April 2001.[17]

CONCLUSION

The overhaul of the insolvency system has not yet been completed in Japan. The Bankruptcy Law and The Corporate Reorganization Law is now under revision.

We are now at the start of economic restructuring, it is too early to assess the effect of the reform but these new developments to shift the corporate rescue regime from the private workout or compromise to more formal and fair proceedings in recent legislation are undoubtedly welcome. The rescue scheme for the financial institution conducted under the leadership of the relevant

[17] Law No.128 of 2000

authorities is amended to provide more efficient and fair options to rescue financial institutions with the assistance of The Deposit Insurance Cooperation as a safety net. The judicial rescue scheme to reorganize financial institutions and insurance companies was also implemented to assure fair proceeding.

Under the civil rescue proceeding the practice of formal insolvency is also gradually changing to become more efficient in order to keep with the needs of modern business life for reorganization. The former practice which relied heavily on the court for control and supervision of the rescue process is gradually changing. The petitioner now plays a key role of screening the prospect of reorganization and supporting and supervising the business in co-operation with a financial advisor and a merger and acquisition advisory service.

Although, the Civil Rescue Law provides an efficient scheme for reorganization, most of the debtors still regard filing a civil rescue as a last resort because the social stigma of insolvency is strong. The number of lawyers who specialized in insolvency proceeding is limited and the special division for insolvency proceeding at court is also limited in large cities such as Tokyo, Osaka and Nagoya, it will take more time and effort to establish and maintain a fair and efficient practice.

It is necessary to establish a system to provide financial assistance for promotion of efficient rescue of insolvent and distressed companies.

It is also necessary to provide an efficient mechanism to restructure the insolvent company to reduce the capital and increase the capital with debt equity swap to enhance the return for creditor.

ROLE AND ACCOUNTABILITY OF JUDGES

BY
JOHN LOCKHART, DIRECTOR OF THE BOARD,
ASIAN DEVELOPMENT BANK

INTRODUCTION

- Much of the substance of insolvency law is common to many countries, both common law and civil. Insolvency law to be discussed here applies to both corporations and individuals.
- Insolvency law is complex. You either know a little or a lot about it. As Alexander Pope, the great British poet said, "A little learning is a dangerous thing, drink deep or taste not the Pyrrhean spring." A judge sitting in insolvency matters must have a sound knowledge of the law and practice in this field. Ideally, this is developed over years before the Judge is appointed to the Bench, both in legal education courses and in practice; but this is not always available, especially in developing countries.
- It is important that judges acquire knowledge of insolvency law and practice before they hear insolvency cases. This emphasizes the importance of judicial education and training of judges before appointment or shortly after appointment. Ongoing judicial education is also important to all judges because the law moves and changes so fast.
- In some countries when insolvency law has existed and operated for many years, a cadre of insolvency legal practitioners and judges grows up and the choice of suitable persons as insolvency judges is fairly easy. This is not so in the case of countries where insolvency law is comparatively new. In some countries there is no tradition of insolvency law for a variety of reasons including in many countries the inconsistencies between insolvency law and local cultures.

ROLE OF JUDGES

- Applications of many different kinds come before judges hearing insolvency matters. Classically, the insolvency petition or application to make an individual bankrupt or to wind up a company or organization is the most frequent and significant matter to be dealt with by the judge. This may be

preceded, accompanied or followed by a large variety of interim or interlocutory applications including injunctions, appointment of receivers, pretrial procedures to prepare contested and complex cases for hearing, applications for discharge from bankruptcy or to stay windings up, applications to approve schemes of arrangement, assignments of property, reconstructions and amalgamations of companies, etc.

- Much of this requires the judge to act as an overseer, even though he may delegate these matters to court officers or senior court officials, or in some cases, to trustees in insolvency.
- In some countries there is a supervisory judge who directs or controls the insolvency proceeding from beginning to end and has close contact with the relevant court officers and trustees. This is particularly so in civil code countries.
- Often, undefended petitions or applications to wind up companies or organizations or to sequestrate the estates of individuals may be heard by persons subordinate to the judge by delegation from the judge.
- In some countries, particularly those that have written constitutions, questions of constitutional power of the officer hearing insolvency matters can be raised. This is so in countries where only judges can exercise judicial power. The position is complicated further in countries that not only have written constitutions, but have federal systems of government. So the further and more refined question arises of whether only judges exercising federal or state or provincial power, can hear insolvency matters.
- Arrangements, assignments of property, reorganizations and amalgamations are becoming increasingly popular. It reflects the desire of persons and corporations in financial difficulties and their creditors to keep outside the formal procedures of insolvency. Some are private insolvent administrations, others are administrations under the control of the court, not necessarily involving the status of bankruptcy or winding up. The role of the judge in these matters varies considerably from country to country. In some countries, very tight control is exercised by the judge and in others, the judge only hears applications that are brought to the court by interested parties.
- Whatever the system may be, judges are frequently involved in legal proceedings after sequestration or winding up. Examples are applications for declaration of preferences, unauthorized or fraudulent dispositions of property, setting aside of voluntary settlements, determining questions of pri-

orities of debts, dealing with public examination of bankrupts or persons associated with the insolvency, etc.

- Control of court processes, including pre-trial directions, is an ever increasing part of the life of a judge. Some judges do this competently, others do not. The conduct of pre-trial litigation is a large discipline itself with many sophisticated training courses being conducted throughout the world. If judges are to handle these matters themselves, they must be trained to do so. Hence, the necessity for the availability of courses for pre-trial administration. This generally should be ongoing for judges and others associated with insolvency work.
- A problem constantly confronting judges is the extent to which they should control the conduct of a case. This depends to a large degree on the personality of the judge concerned. But the days have gone when judges sit back and let the lawyers have a free hand in conducting the case, merely ruling on points of evidence. Communities today demand efficient, quick and cheap administration of justice. This is of course a relative concept. Judges should not hesitate to take a hands-on approach to the conduct of cases provided they do not enter the arena and become partisan. Of course, in legal systems where a judge legitimately assumes an interrogating role, the duties of the judge are different.
- Settlement discussions are difficult matters for a judge to engage in, especially if he/she is the judge of fact. The judge may be perceived as showing bias and therefore may be disqualified from hearing the matter further. Officers of the Court or experts outside the Court often conduct such discussions on the direction of the judge.
- The supervisory judge. The supervisory judge in some countries, generally civil code societies, plays a day to day hands on role in the administration of insolvencies. This has a number of advantages that include close relationship between the judge and the trustee administering the estate, so that each can speak frankly to the other and deal with problems on the spot with minimum of delay.

ALTERNATIVE DISPUTE RESOLUTION (ADR)

- ADR is alive and well. It is being used increasingly in modern commercial societies. It is also being used in developing countries, sometimes as an alternative to an inefficient judiciary. In some countries, people feel that

judges are appointed with scant knowledge of the law and little understanding of judicial independence and may be ill equipped to handle litigation particularly litigation that inevitably arises in a modern market economy. Reforming the courts and the judiciary is an important step forward; but that is a slow process and court business must go on in the meantime.

- ADR can be a useful aid to solve this problem. This involves setting up an appropriate mechanism with or without government assistance. Generally, it would need government assistance which involves meetings with government officials, members of the private legal professions and others to establish it. Sometimes it is necessary to retain an outside expert to undertake a diagnostic survey of the country concerned with respect to ADR and its mechanisms.
- If an ADR center is established in a particular country then the following are some key matters to be considered concerning the establishment and operation of that center:
  a. It should be a free standing, independent service, not related to any existing institution in the country, to avoid perception of bias for or against any party;
  b. It should consider providing both mediation and arbitration services.
  c. There should be a legislative base for ADR, although it may not be strictly necessary. Legislation may give ADR added weight and force;
  d. The ADR program may be focused solely on commercial disputes (not necessarily so) and staffed by people with experience in the business world;
  e. A panel of people who are highly respected in the community should be trained as mediators and arbitrators;
  f. The ADR center should be headed by a director with responsibility for promoting the ADR services and administering it;
  g. First class training must be provided to the staff of the ADR center and to the mediators and arbitrators.
- The ADR center should be provided with its own office, with sufficient space for the director and administrative assistant, a large room for conducting mediations and arbitrations, a smaller conference room and a reception area. The office will need basic office equipment, telephones, faxes, computer, printer and office furniture.

CONDITIONS OF SERVICE

- There is little use in a country saying that it should have competent and corruption free judges unless they are treated properly by Government. This means proper salary and working conditions.
- Broadly speaking, developing countries have a number of problems in common which include:
  a. Corruption is said to exist at many levels of society including the judiciary;
  b. Judges of the courts of first instance (trial courts) work in difficult conditions. The courtrooms and offices (CES) in the court buildings are often in poor condition. There is a need for proper facilities including computers, copying machines, etc. Judges' staff are not given adequate training. Security measures to protect the judges are insufficient;
  c. Judges are poorly paid and understaffed;
  d. The public has insufficient access to the written records of the laws of the countries and to the principal judicial decisions;
  e. There are no, or very limited, facilities for judicial training;
  f. Appellate courts sometimes have not been established on a proper basis;
  g. There is an absence of proper mechanisms to enforce the decisions of courts in civil cases;
  h. Practicing lawyers may not be licensed;
  i. Law schools frequently have poor facilities.

Unless these matters are addressed, the quality of the judiciary and therefore society itself will not improve.

SPECIALIST COURTS

- Some countries have specialist courts dealing with insolvency matters. For example, in Indonesia the Commercial Court was established in the wake of the Asian financial crisis, and in Thailand a new bankruptcy court was established and commenced operation in June 1999. Other countries prefer judges to have general jurisdiction including insolvency. The main problem in some countries is that there are insufficient judges with expertise in cases of insolvency and reorganization.

- A problem that arises in some developing countries is the fact that there is an absence of consistency in the decisions of the courts. Sometimes this is explained by the absence of precedent in the country's judicial system. But at other times, it is simply compounded by an absence of published material on decisions of the courts that might otherwise assist in establishing a base for decisions.
- There is a strong body of opinion to the effect that there is a need for specialized courts and judges with experience and knowledge especially in commercial matters. A specialized court need not devote itself solely to questions of insolvency. It may be a court with board commercial jurisdiction of which insolvency is a part.

JUDICIAL INDEPENDENCE

- Judicial independence is sometimes defined as "the freedom of judges from influences brought to bear by other organs of government, in particular, the executive." I think this is as good a definition as any other; but it needs explanation and a degree of qualification.
- The concept of an independent judiciary is not in theory confined to democracies; but in practice it generally is. Also, in modern democracies, large power is wielded, not only by the executive and parliamentary branches of government, also by large corporations, in particular multinationals, and by other organizations including those who control the media.
- Judges are not totally free from outside influences. They are human beings with families and friends, and often belong to public organizations. In my view, membership of outside bodies is permissible provided it is not inconsistent with judicial office. But where other organs of government and other organizations and people seek to bring pressure to bear on judges in the execution of their public duties, they encroach on judicial independence, which is the principal watchdog of a civilized society. It guarantees the rights of citizens and adjusts the balance, often delicate, of the relations between citizen and State, citizen and citizen, thus ensuring a strong and efficient society on the one hand and the advancement of individual rights and freedoms on the other. Judicial independence is thus the freedom of judges from interference exerted from external sources.
- It is important to remember the aim of judicial independence. It is not to confer a benefit or privilege upon judges. It is to enhance and safeguard a modern society in the interests of the society itself.

- Judicial independence is one of the most important rights in a democratic society, together with freedom of speech and association. Without it, other rights would be seriously diminished or lost.
- Judicial independence is vital to the preservation of every system of truth and justice and also to the preservation of a democratic system of government. Judicial independence means that judges are free to determine cases according to their view of the law, not without pressure from government or extremes of public opinion.
- A related question concerns a practice followed in some countries of promoting or translating judges from lower courts to higher courts, or from trial courts to appellate courts. In my opinion, this is a permissible practice; but should be watched with care. However, there should never be a perception amongst judges that they will be "promoted" if they perform well. Obviously, this could lead to judges discharging their duties with an eye to making decisions convenient to the Executive.

THE DISMISSAL OF JUDGES

- It is imperative that the power of removal from office is not vested in the Executive.
- The preferable method of removing judges from office is by clear provision in the Constitution. The classic formula is still the best; namely, by vote of the House or Houses of Parliament for proved unfitness for judicial office or incapacity. However, in some countries, it is felt by the Parliaments and Executives that Parliament has no effective mechanism available to it to determine in a particular case the unfitness or incapacity of a judge. The measure is adopted of interposing some agency, independent of the Parliament and the Executive (a judicial commission), to act, either of its own motion or upon complaint being made, by examining the relevant material; hearing witnesses, including the judge; acting fairly and reporting to Parliament. It is then for Parliament to act as it wishes. Great care must be exercised in defining by statute the qualifications of members of such a commission and its powers.

THE REMUNERATION OF JUDGES

- The mechanism for determining the remuneration of judges should be independent of the Executive. My own country (Australia) has a reasonably effective mechanism; namely, the Parliament (federal or state, as the case

may be) has enacted legislation to establish a remuneration tribunal, the members of which are appointed by the Executive, who must have certain prescribed qualifications and who are required to report on a periodic basis to the Parliament and recommend increases or decreases in levels of remuneration to the Judiciary. Once the report is tabled in Parliament, it becomes law of its own force, provided it lies on the table of the Houses of Parliament for a fixed number of days during Parliamentary sittings and is not disallowed by the Parliament, which intervenes only occasionally. When I use the expression "remuneration", I include pensions payable upon retirement, and other benefits. As pointed out by Mr. I. F. I. Shihata in his work "Judicial Reform in Developing Countries and the Role of the World Bank" at 376, post retirement pensions "provide judges with the insurance needed for the carrying-out of their function without the fear associated with an early or abrupt retirement without a secure income."[7] This raises an interesting question in countries which, by their constitutions, provide that the remuneration of judges shall not be diminished during their tenure of office. Does the protection extend to retirement pensions and other benefits of office?

PERSONAL SECURITY OF JUDGES

- This is an important element in preserving judicial independence. In some countries judges are not protected from actual threats of death or physical violence, especially from organized crime. It seriously undermines the capacity of judges to perform their duties conscientiously when the security of themselves and their families is a matter of personal anguish. Governments must provide adequate resources to ensure the protection of the judges.

THE ADMINISTRATION OF COURTS

- It is only in comparatively recent times that some courts have been given control over their own budgets, with power to prepare and submit them to Parliament and expend the monies authorized by Parliament. Traditionally, courts have depended on the Executive arm of government for budget allocation and authorized expenditure. The most advanced country in this respect is the USA. The Judicial Conference of the USA came into existence in 1922. The Administrative Office of the United States Courts and the Circuit Judicial Council trace their origins to 1939 when the Judi-

cial Branch achieved budgetary and administrative independence from the US Department of Justice.

ACCOUNTABILITY OF JUDGES

- There is constant reference today to the need for judges to be accountable. It is said that judges have greater security of tenure than most people, yet are the least accountable. I disagree. In my opinion, judges are more accountable than most holders of public office. Everything they do is open to public scrutiny. They sit in court, hear cases, and deliver oral or written judgments – all in public. Unsuccessful litigants may appeal from judgments which are not to their liking, frequently within a two (sometimes a three) tier appellate structure. Their judgments are poured over, dissected and scrutinized in minute detail.
- If judges are proved to be unfit for office, they are liable to removal. The removal process should not be invoked lightly. In particular, it should not be invoked because the community or some section of it regards a decision as unpopular. The appellate process should take care of this. In the United States during the 1980's, there were considerable numbers of attempts proposing constitutional amendments to contest judicial tenure. Very little came of them.
- There should be an appropriate judicial disciplinary mechanism and a system for handling complaints against judges to safeguard both the judges from undue interference with their independence, and the public from abuse of their right to a free, prompt and efficient hearing of their cases.
- There is a growing body of opinion that there should be canons of judicial conduct enunciated either by the Parliament or by the judges themselves to ensure that judges remain free from improper influences, handle their cases expeditiously and efficiently, are fair and impartial to litigants, and that they keep abreast of current developments in the law. There can be benefit in these published codes of judicial behaviour, subject to the qualification that they are sometimes an exercise in public relations rather than of substance. Fine judges do not need them and poor judges (mercifully few, one hopes) may not heed them.

THE ROLE OF JUDGES IN INSOLVENCY PROCEDURE: THE INDEPENDENCE AND ACCOUNTABILITY OF JUDGES

BY
ELIYANA TANZAH
INDONESIA

INTRODUCTION

On August 20, 1998 in Indonesia, a Commercial Court was established in the District Court of Central Jakarta based on Article 281 paragraph 1 of Perpu (Government Regulation substituting Law) No. 1 of 1998 vide Law No. 4 of 1998. Since May 8, 2000, based on Presidential Decree No. 97 of 1999 vide Article 281 paragraph 2 of Perpu No. 1 of 1998 vide Law No. 4 of 1998 a Commercial Court has also been established in the District Courts of Surabaya, Makasar/Ujung Pandang, Medan and Semarang.

Since the establishment of Commercial Courts in Indonesia on August 20, 1998 all the cases on insolvency and Deferment of Obligation to Pay Debts and all other related matters have come under the absolute competence of the Commercial Court (Article 2 of Perpu No. 1 of 1998 vide Law No. 4 of 1998).

Based on the above-mentioned description it becomes obvious that since August 20, 1998 the Judge who has a role in an insolvency or its process is the Commercial Judge. Before the establishment of Commercial Courts or, in another word, before the enforcement of Perpu No. 1 of 1998 vide Law No. 4 of 1998, all the cases on Insolvency and Deferment of Obligation to Pay Debts and the related matters lie within the competence of the District Court, so it was the Judge of District Court who had a role in such cases in the past.

To comply with Article 283 paragraph 1 of Perpu No. 1 of 1998 which sets out: Commercial judges shall be appointed by decision of the Chief Justice of the Supreme Court. Therefore, on August 20, 1998, the Chief Justice of the Indonesian Supreme Court appointed a number of Commercial Judges from the District Court Judges who met the requirements prescribed in Article 283 paragraph 2 of Perpu No. 1 of 1998 to carry out the duties assigned to the Commercial Courts.

In addition, based on Article 283 paragraph 3 of Perpu No. 1 of 1998, President of the Republic of Indonesia on February 27, 1999 as proposed by the

Chief Justice of the Supreme Court appointed several Ad Hoc Judges in the Commercial Courts of First Instance by Presidential Decree (Keppres) No. 71 of 1999.

Conformed to its title, this working paper will describe:

- The role of judges in insolvency procedure;
- The independence and accountability of judges;
- The role of judges in insolvency procedure.

THE ROLE OF JUDGES IN INSOLVENCY PROCEDURE

The term 'Judge' means the Commercial Judge in a Commercial Court. The role of a Commercial Judge in Insolvency Procedure is two fold:

1. As the Chief Justice or the Member Judge in a tribunal which tries and adjudicates a case of Petition for Insolvency Declaration (Article 282 paragraph 1 of Perpu No. 1 of 1998), further called Judge Tribunal;
2. As the appointed/designated Supervisory Judge in a Judgement on Insolvency Declaration.

ITEM 1

The role of the Tribunal (consisting of one Chief and 2 Members) which is appointed as the Judge Tribunal to try and adjudicate a case of Insolvency Petition from a Debtor or against a Debtor is conclusive, because it is this Judge Tribunal that will independently decide to declare whether a Debtor is insolvent or not as defined in Article 6 paragraph 3. More readily, under the currently applicable Indonesian Insolvency Law, Perpu No. 1 of 1998 vide Law No. 4 of 1998, the Judgement on Insolvency Declaration of the Commercial Court is instantaneous.

The duty and authority of the Judge Tribunal who tries and adjudicates a case of Petition for Insolvency Declaration also include:

- The authority to impose an Attachment on Debtor's property partly or wholly before the Debtor being declared insolvent and appoint a temporary Curator/Receiver to supervise the management of Debtor's business and to supervise payments to the Creditor, the transfer or use of Debtor's property which, as part of Solvency, requires the approval of the Curator (Article 7 of Perpu No. 1 of 1998);
- The obligation to *settle (try and adjudicate)* the matters/cases related to the Judgement on Insolvency Declaration such as in the event of a counter

claim against the imposition of Attachment referred to in Article 7 of Perpu No. 1 of 1998, in the case of an Actio Paulina claim, the Petition/Proposal for the Revocation of Judgement on Insolvency Declaration (Article 15), the Petition for Endorsement to a Compromise (or a Planned Compromise which has reached the quorum) and so on. The duty and authority of the Commercial Judge Tribunal in an insolvency process also include the duty and authority after the Judgement on Insolvency Declaration has been handed down, i.e., determining the amount of the Curator's (Receiver's) fee, fulfilling or dismissing the request for rehabilitation from the Insolvent Debtor or his heir. The duty and authority of the Judge Tribunal in the insolvency process are scattered in the Articles under First CHAPTER on insolvency declaration. The duty and authority of the Judge Tribunal subsequent to the Judgement on Insolvency Declaration may be performed by the Judge Tribunal which is different from the one adjudicating the case of Insolvency Petition. Generally, however, this Judge Tribunal is still assigned at the Commercial Court.

From the above-mentioned description it becomes obvious that the role of the Commercial Judge Tribunal in Insolvency Procedure is very conclusive. The fate of Creditors, who expect the settlement of their non-performing loans through their Debtors' insolvency, lies in the hand of the Commercial Judge Tribunal since it is only the appointed Commercial Judge Tribunal that is authorized to declare whether a Debtor is insolvent or not.

ITEM 2

In the Judgement on Insolvency Declaration a Supervisory Judge must be appointed who is nominated from the Judges of Commercial Court, thus it is clear that the role (duty and authority) of the Supervisory Judge is commenced only from the time the Debtor is declared insolvent. The duty of the Supervisory Judge is to perform control over the implementation of the Curator's (Receiver's) duty. On the other hand, the Curator's duty is to make arrangement and settlement of the insolvent assets. The Supervisory Judge is the Chairman of all Creditor meetings and also the Chairman of Verification Meetings. In the event that the Curator/Receiver encounters any difficulty in performing his duty, the Supervisory Judge is the place for him to consult. In addition, in taking certain actions such as selling the insolvent assets personally, the Curator also requires the approval of the Supervisory Judge.

The Supervisory Judge is authorized to inquire about anything concerning insolvency, hear the witnesses or order an investigation by experts.

Unless specified otherwise, all rulings on matters concerning the arrangement or settlement of insolvent assets, including those made by the Supervisory Judge, may be executed first, and similarly for the original Decree.

Moreover, before making any ruling/JUDGEMENT on something concerning the ARRANGEMENT or settlement of insolvent assets the Commercial Court must hear the Supervisory Judge first.

From the duty and authority description of the Commercial Judge Tribunal appointed to try and adjudicate a case of Insolvency Petition as well as the one of the Supervisory Judge, it could be concluded that the Commercial Court Judge has an extremely great role and is even conclusive in the insolvency process since it is in their hands (the Judge Tribunal's) that the fate of Creditors, who expect the settlement of their non-performing loans through an insolvency procedure/process, lies. It is this Judge Tribunal that is absolutely competent in declaring a Debtor is insolvent or not. More readily, under the currently applicable Indonesian Insolvency Law, Perpu No. 1 of 1998 vide Law No. 4 of 1998, the Judgement on Insolvency Declaration is instantaneous.

In order that the duties and authority of the Judge Tribunal and the Supervisory Judge can be performed properly, in that the Judge Tribunal's ruling as well as the arrangement and settlement measures taken by the Supervisory Judge will not disappoint the community who seek justice, a line-up of Indonesian Commercial Judges is needed who meet the requirements, at least:

- Having a good command of not only the prevailing Insolvency Law (Perpu No. 1 of 1998 vide Law No. 4 of 1998) and the Civil Law Procedure/HIR (since the Article 284 paragraph 1 even prescribes: unless specified otherwise the prevailing Civil Law Procedure saall also apply to the Commercial Court), but also the Indonesian Civil Law as prescribed in the Code of Civil Law (KUHP) and the Indonesian Commercial Law (KUHD) and all statutory regulations related to an insolvency process;
- Having a high morality standard in that a Commercial Judge must be sincere in performing his duties by holding onto the prevailing law and sense of justice and will in no way base his judgement or action on matters other than the prevailing law.

THE INDEPENDENCE AND ACCOUNTABILITY OF JUDGES

The Indonesian Judge, including Commercial Judge, is independent in performing his duty, i.e., in trying and adjudicating any case submitted to him and in making the rulings as the Supervisory Judge in insolvency. 'Independent' means free from any interference of other State's authorities, in terms of the one coming either from the executive or the legislative power, and free from any coercion, directive or recommendation coming from extra-judicial parties. The independence given to the Judge is not absolute because a Judge is to uphold the law and justice through the cases referred to him to be tried and adjudged by rendering a judgement based on the true interpretation of law, the legal findings in the issues not yet governed by the existing law, by finding out the grounds and the underlying principles. The independence of the Indonesian Judge as outlined above can be concluded from Article 1 of Law No. 14 of 1970 concerning the Principal Provisions on Judiciary Power and Elucidation of this Article 1 and substantiated by Article 4 paragraph 3 which provides:

> "Any interference in judicial affairs by other parties beyond the Judiciary Power is prohibited except in such matters as prescribed in the Constitution."

And also Article 32 paragraph 5 of Indonesian Law No. 14 of 1985 on the Supreme Court which provides:

> "The supervision and authority referred to in paragraphs (1) through (4) may not mitigate the independence of the Judge in trying and adjudicating a case."

From the above-mentioned description it could be stated that the independence of Indonesian Judges in trying and adjudicating a case is only limited by the mastery of the prevailing relevant laws, the subject matter of the case and his own conscience. A question comes out: How would it be if the Judge in performing his duty, trying and adjudicating a case, had violated his independence leading to an abuse of power or any other disgraceful deeds? Can the Judge concerned be called to account and to whom the Judge should account for his conduct/deed?

With regard to the Judge's account it could be stated that this matter is

not much addressed in Indonesian laws. It could be stated that Law No. 14 of 1970 on Principal Provisions on Judiciary Power, Indonesian Law No. 14 of 1985 on the Supreme Court as well as Indonesian Law No. 2 of 1986 on Ordinary Courts do not explicitly provide for the accountability of judges because although Article 23 paragraphs 1, 2, 3, 4 of Law No. 14 of 1985 provides that the Supreme Court:

- performs the highest supervision over the judicial administration in all judicial circles in exercising the judiciary power;
- supervises the conduct and deeds of Judges in all judicial circles in performing their duties;
- is authorized to inquire about anything related to the techniques of judicial administration in all judicial circles;
- is authorized to provide the necessary directives, reprimands or warnings to the courts in all judicial circles;

but no sanction has been defined in the event that the Judge is found to have violated his independence in performing his duty which leads to an abuse of power/ independence or committed any other disgraceful deeds, even in paragraph 5 of Article 32, Law No. 14 of 1985 above it is provided that:

> "The supervision and authority referred to in paragraphs (1) through (4) may not mitigate the independence of the Judge in trying and adjudicating a case."

From the provisions of Law governing the independence of Judges above, being associated with the wording of Article 4 paragraphs 1 and 3 of Law No. 14 of 1970 as follows:

Paragraph 1 The judicial administration shall be performed "For Justice Based on the One and Only God".

Paragraph 3 Any interference in judicial affairs by other parties beyond the judiciary power is prohibited except in the matters set forth in the Constitution.

It could be concluded that the original intention is that the Indonesian Judges are only responsible for the performance of their duties to the One and Only God.

With the spreading opinion in the community that many judgements of Indonesian Judge Tribunal are allegedly passed on the basis of an abuse of power/independence/freedom of the Judge or other disgraceful deeds, the Government has proactively prepared the Bill concerning the Revision of Law No. 14 of 1985 on the Supreme Court which in its CHAPTER V sets out the Judge Honorary Council as an independent External Institution having a function to receive complaints/reports from the community on judicial performance which constitute the abuse of power/independence or other disgraceful deeds. the organization structure, competence, procedure and honorarium of the Judge Honorary Council will be governed further by a Presidential Decree.

May in the near future the Bill on the Revision of Law No. 14 of 1985 which in its CHAPTER V sets out the Judge Honorary Council serving as an independent External Supervisory Institution soon become a Law. Similarly for the Presidential Decree which governs the organization and competence, so there will be an independent institution that controls the performance of the Judge's freedom/independence in performing his duties.