

Global Navigation Through the Uncertainties of Insolvency and Restructuring: Banking and Secured Lending Issues

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Question 1: Can you briefly summarize the role that a secured lender, including a pre-insolvency lender, plays in the insolvency proceeding?

U.S.

The secured lender(s) in a U.S. bankruptcy plays an important and influential role in the bankruptcy proceeding. In many instances, it has the power or ability to block a possible reorganization through the Chapter 11 plan confirmation/voting process. Conversely, the pre-bankruptcy secured lender will many times have the power or ability to aid the debtor in its successful reorganization and emergence from bankruptcy.

During the course of the bankruptcy proceeding, the secured lender may exert its influence over the debtor due to its role as a major creditor in the case, and in many instances will be heavily involved in the debtor's decision-making process and the ultimate formulation of a Chapter 11 plan.

The secured lender can consent to or fight the debtor's use of the lenders' cash collateral during the bankruptcy proceeding and, thus, influence the direction of a bankruptcy proceeding from the date the bankruptcy is initiated.

A post-petition secured lender, which provides secured financing to a debtor during the reorganization process, can also influence the direction of the bankruptcy proceeding by placing strict requirements and conditions on the debtor to obtain post-petition financing.

Switzerland

A secured lender has in certain matters a special position in a Swiss bankruptcy procedure. The secured lender holding some chattel as a pledge has to hand out the pledged object to the bankruptcy administrator. Pledged assets (except money) may only be realized in a public auction unless all of the secured creditors agree to a different procedure.

Germany

The secured lender is part of the creditors' committee and the creditors' assembly, the decision making bodies in which the creditors are represented. Each group of creditors forms its own segment within those bodies. Any deal that the insolvency Trustee may enter into with respect to the estate requires approval of a simple majority of the creditors. The votes are allocated depending on the size of the debt. The position of the secured lender(s) is generally the strongest within the group of creditors.

Depending on the type of security, the secured lender will receive either (i) preferential payment from the proceeds from a sale of the collateral or (ii) delivery of the collateral. The latter is the case where title in certain items of collateral has been transferred to the secured lender.

The secured lender will normally take an active role in the insolvency proceeding, in some cases also providing additional credit to the estate, which will then be super senior priority.

<u>China</u>	<u>Hong Kong</u>	<u>Singapore</u>
<p>Qualified to attend creditors meeting and can vote to make a decision on most of the issues in the meeting.</p> <p>In case the secured lender refuse to waive the right of priority, he has no right to vote for a decision on settlement or on the plan for distribution of the distressed assets</p> <p>If the secured claiming amount is higher than the distressed assets, for the exceeding part of the claim, the secured lender has the same legal status with other ordinary creditors, and he has the right to vote on the plan for distribution of the distressed assets.</p>	<p>Hold the secured assets only and rely on their security.</p> <p>In an insolvency proceeding, secured lenders aim to realize and capitalize the company's assets for repayment of the debt due to them from the company.</p>	<p>The secured lender may appoint a receiver under a statutory power or power contained in the debenture. Where the security is a mortgage over land, the mortgagee has a statutory power to appoint a receiver to collect rent. §24(1)(c), Conveyancing and Law of Property Act. The secured lender may also apply to the court to appoint a receiver over property constituting security for the debenture. §266(5)(d), Securities and Futures Act.</p> <p>The court will not make a judicial management order against a debtor if a receiver and manager over the whole or substantially the whole of its assets has been or will be appointed, unless public interest so requires. §227(B)(5), 227(B)(10)(a), Companies Act. If judicial management is already in place, lenders secured by a floating charge cannot appoint a receiver and manager. But there is no prohibition on the appointment of a receiver subject to the consent of the judicial manager or with the leave of court (§227(D)(4)(b), Companies Act. In such a case, the receiver can gather the assets subject to a specific charge while the judicial manager manages the debtor's business.</p> <p>Generally on liquidation, the receiver and manager cease to be an agent of the Company, but retain the power to realize and convey the debtor's assets. The receiver can also continue litigation in the name of the debtor but may be exposed to costs.</p> <p>The secured creditor can exercise the power to appoint a receiver, if none has yet been appointed, even after the debtor has gone into liquidation. In certain circumstances, the secured creditor may authorize the liquidator to sell the property charged.</p>

Question 2: Does insolvency law in your country comprehensively govern a secured lenders' rights in an insolvency proceeding, or does it incorporate other statutory or common law?

<u>U.S.</u>	<u>Switzerland</u>	<u>Germany</u>
<p>Non-bankruptcy law establishes the validity, amount and priority of claims and scope and perfection of security interests. Some exceptions apply where claims are capped (e.g. unmatured interest, lease rejection damages and punitive damages and penalties). 11 U.S.C. § 502.</p> <p>Bankruptcy law generally enforces subordination agreements and liquidation priorities under non-bankruptcy, but temporarily stays the enforcement by creditors so that a plan of reorganization to compromise claims may be proposed and voted upon to allocate value under the "new reality" of a less valuable or less liquid debtor. 11 U.S.C. §§ 362, 510, 1121, 1123, 1129. Even if some creditors reject the plan, bankruptcy law can grant a discharge to the debtor that generates cash by asset sales or litigation and settles claims and equity interests with payments or new debt and equity that substitute obligations under a plan for the original claims and interests. 11 U.S.C. § 1141.</p>	<p>The Swiss Debt Enforcement and Bankruptcy Act governs comprehensively a secured creditor's rights in an insolvency proceeding.</p>	<p>The existence of the debt and the validity of the collateral is governed by the general provisions of German civil law, the Civil Code (<i>Bürgerliches Gesetzbuch</i>). German law relies on the principle of priority in terms of perfection of a security. There is no registration process, other than with respect to security rights granted in real property.</p> <p>The rights of the secured creditor within the insolvency proceeding are governed by the Insolvency Ordinance (<i>Insolvenzordnung</i>). The creditors' meeting will decide on specific transactions as well as whether the insolvent company will be sold, the assets liquidated or whether the company will continue to operate under an insolvency plan.</p> <p>During the insolvency proceedings, any pending court actions are automatically stayed.</p>

<u>China</u>	<u>Hong Kong</u>	<u>Singapore</u>
<p>No, but the majority of it is in the bankruptcy law of PRC.</p> <p>The rights from security are also spread in some other law, such as Property Law or Law on Security, but such law does not specially deal with insolvency.</p> <p>Note that China is not a common law country.</p>	<p>Yes, where a creditor is secured, assuming that his charge is valid, it does not need to prove its debt in the liquidation if it is looking only to the security for satisfaction of the debt.</p> <p>If the proceeds of realization exceed the debt, the secured creditor must account to the liquidator for the excess.</p> <p>If the proceeds are insufficient to satisfy the secured debt, the secured creditor must prove the balance of the debt not satisfied by the sale proceeds of the security and is a general creditor as to such unsatisfied amount.</p>	<p>Some of the secured creditors' rights in an insolvency proceeding are governed by the Companies Act, e.g. §227(B)(4)(b)(ii) on the right of lenders secured by floating charges to oppose a petition for judicial management; §227(B)(5)(a) on the right to appoint a receiver and manager; §227(C), §227(D)(4), §258, §260, §262(3), §299(2) on moratorium on enforcement of security; §328(5) on the priority of preferred debts over floating charges</p> <p>Apart from the Companies Act, the secured creditors' rights are governed by other statutory laws (e.g. §41(1) of the Employment Act which adds a further class of preferred creditor in respect of gratuity and retrenchment benefits; §24(1)(c) of the Conveyancing and Law of Property Act on the power to appoint a receiver over a mortgage; §266(5)(d) of the Securities and Futures Act on the right of the secured creditor to apply to court to appoint a receiver over the security) as well as common law (e.g. a secured creditor is not obliged to submit a proof of debt if he relies upon his security for payment – <u>K Balasubramaniam v MBF Finance Bhd</u> [2005] 2 MLJ 201)</p>

Question 3: How does the commencement of an insolvency proceeding under your country's insolvency law affect the procedural and substantive aspects of a secured lenders' right to enforcement?

<u>U.S.</u>	<u>Switzerland</u>	<u>Germany</u>
<p>As a general principle, the filing of a voluntary or involuntary petition under the United States Bankruptcy Code acts as an "automatic stay" of the continuation or initiation of all enforcement actions by all creditors, including secured lenders. 11 U.S.C. § 362. It is important to note that the automatic stay does not generally apply to acts taken by the debtor in a Chapter 11 or Chapter 13 proceeding, and the automatic stay only applies to the debtor and its assets; i.e., the stay does not extend to the debtor's subsidiaries or affiliates, or the subsidiaries' and affiliates' assets unless so ordered by the Bankruptcy Court.</p> <p>Once the automatic stay comes into effect, the continuation or initiation of most enforcement actions, as well as other acts by a creditor that are intended to collect a pre-petition debt owed by the debtor, will either be void <i>ab initio</i> or voidable by the debtor (depending on the jurisdiction), and could subject the offending creditor to fines and penalties.</p> <p>Additionally, certain enforcement actions taken by the secured creditor within the ninety (90) days prior to the bankruptcy filing may be avoided by the debtor if found to be preferential. 11 U.S.C. § 547. For example, the debtor may be entitled to avoid the perfection of a judgment lien that was obtained against property of the debtor within the ninety (90) days prior to the bankruptcy filing.</p> <p>The U.S. Bankruptcy Code contains certain exceptions to the automatic stay, including the secured lender's ability to place an administrative freeze on the debtor's accounts, criminal proceedings against the debtor, government proceedings to enforce its police or regulatory powers, actions by a lessor to obtain possession of nonresidential real property leased to a debtor under a terminated lease, tax demands and audits, and acts to perfect, maintain or continue the perfection of certain interests in property.</p>	<p>The commencement of an insolvency proceeding has no direct consequences. If, however, a bankruptcy has been declared against a debtor all the debts of the debtors will be due and payable except the claims of the creditors secured by mortgages. The bankruptcy administrator orders the secured creditors to hand over any chattel pledged within a month. Otherwise the pledge will become void.</p>	<p>The commencement of the insolvency proceedings leads to a stay of any pending court actions. The Insolvency Trustee will first assess the economic situation of the insolvent company. If the Trustee determines that the insolvent company does not have sufficient free assets to cover the costs of the insolvency proceedings, then he will recommend to the court that formal proceedings are not opened. In this case, the individual secured creditors are free to enforce their respective collateral.</p> <p>If the Insolvency Trustee comes to the conclusion that there are sufficient assets available, then the enforcement of the collateral is generally done through the Trustee in the course of the insolvency proceeding. If the secured creditor merely has a right to receive preferential payment, the Trustee will sell the collateral and pay out the proceeds to the secured lender, less a lump sum commission to the insolvency mass of about 9% of the proceeds, up to the amount of the debt. Any remaining amounts will go to the insolvency mass.</p> <p>In those cases where the secured lender has received title to the collateral, the Trustee will hand over the specific item of collateral. In those cases the secured lender will then be free to liquidate the asset and to retain any proceeds therefrom, up to the amount of the debt. Any additional amounts will have to be paid to the Trustee/the estate.</p>

<p>If cause exists to do so, upon motion by the secured creditor the Bankruptcy Court may grant the secured creditor relief from the automatic stay to enforce its non-bankruptcy rights and remedies against the debtor and the secured creditor's collateral. A secured creditor's request for relief from the automatic stay will be granted when: (a) the debtor cannot adequately protect the secured lender's interests in the collateral; or (b) the debtor does not have any equity in the collateral and the collateral is not necessary for a reorganization (or the debtor does not have a reasonable prospect of confirming a plan within a reasonable time).</p>		
<p style="text-align: center;"><u>China</u></p> <p>Limitation of the priority right. Creditors with secured rights may need to negotiate and discuss with the receivers. They may be granted secured claims on condition that this shall not affect the insolvency proceedings.</p> <p>Exercise of secured creditors' right should be subject to satisfaction of unpaid salary, social security funds and compensation to the employees of the insolvent company.</p> <p>In the course of reconstruction of the insolvent company, exercise of secured creditors' rights will be suspended, however the law also give secured creditors right to go to the court for protection of the secured rights if they believe the rights are to be damaged.</p> <p>If the secured claim is more than the value of the distressed assets, after satisfaction by the distressed assets, the exceeding part of the claim not paid will be treated as ordinary claim and will be satisfied together with other ordinary claims equally.</p>	<p style="text-align: center;"><u>Hong Kong</u></p> <p>Avoidance of dispositions of property, etc after commencement of winding up (S182, Companies Ordinance).</p> <p>Avoidance of attachments, etc (S183, Companies Ordinance).</p> <p>Power to stay or restrain proceedings against company (S181, Companies Ordinance) from the commencement of the winding up until a winding-up order is made.</p> <p>Stay of proceedings (S186, Companies Ordinance) when a winding-up order has been made.</p>	<p style="text-align: center;"><u>Singapore</u></p> <p>Upon presentation of a petition for judicial management, the secured creditor can neither commence nor continue enforcement proceedings, nor execute judgment nor levy against the debtor's property without leave of court. §227(C)(b) & (c), Companies Act The court may grant leave if the creditor would suffer a significant loss or is able to show a seriously arguable case that it has a proprietary right and is not just a creditor.</p> <p>Upon presentation of a petition for winding up, the secured creditor cannot commence or continue enforcement proceedings, execute judgment or levy against the debtor's assets without leave of court. Leave may be granted if the claim cannot be adequately dealt within the winding up or the remedy sought cannot be given in the winding up.</p> <p>Further, any execution against the debtor that is not fully satisfied may be avoided. If execution is already levied but the process has not been completed prior to the petition, the secured creditor may not be able to retain the benefits of the execution if this would defeat the <i>pari passu</i> distribution and the secured creditor may be forced to prove its debt as an unsecured creditor. §258, 260, 262(3), 299, Companies Act</p>

		<p>Notwithstanding the presentation of a petition for judicial management or winding up, the secured creditor can employ self-help remedies such as contractual set-off or non-judicial actions such as the service of contractual notice to terminate rights or crystallize liabilities. Mortgagees or floating charges may enforce their security extra-judicially. In the latter case, if the debtor disputes the validity of the security and refuses possession of the assets, the secured creditor may be forced to prove its debt as an unsecured creditor.</p> <p>A floating charge created within 6 months of the commencement of the winding up is invalid except to the extent of any cash consideration and interest thereon at the rate of 5% p.a. given at the time of or subsequent to the creation of the charge. §330, Companies Act</p> <p>The preferred debts consisting of costs and expenses of winding up, wages, retrenchment benefits and ex-gratia payments, contribution to provident funds, and remuneration in respect of vacation leave are to be paid out of the assets subject to the floating charge if the assets available to the general creditors are insufficient. The fact that the charge has crystallized does not deprive the preferential debts of priority. §328(5), Companies Act</p>
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Question 4: How does your country's insolvency law accommodate new financing for ongoing operations and exit from an insolvency case with the rights of existing secured lenders?

<u>U.S.</u>	<u>Switzerland</u>	<u>Germany</u>
<p>Bankruptcy law allows a debtor to use cash collateral and to incur new secured loans so long as existing secured lenders receive “adequate protection” of their interests, usually in the form of payments or replacement liens on other collateral. 11 U.S.C. §§ 363, 364. Financing is facilitated because pre-bankruptcy security interests do not carry over into new post-bankruptcy assets like tax refunds, accounts, inventory and claims arising under the bankruptcy code (other than proceeds of existing collateral). 11 U.S.C. § 552. Post-petition trade credit and borrowings have administrative priority over unsecured claims. 11 U.S.C. § 364(c). Prohibitions on new indebtedness and security interests on common collateral can be overridden.</p> <p>The discharge of claims allows lenders providing “exit” financing for emergence from bankruptcy to lend to a reorganized debtor with a cleaned up balance sheet, except for plan obligations. Indeed, equity can be issued to creditors pursuant to the plan without complying with state and federal securities laws. 11 U.S.C. § 1145.</p>	<p>In a bankruptcy proceeding, the debts entered into after the issuance of the bankruptcy order will be paid first. The same applies in a chapter 11 like procedure. Consequently, any new financing for ongoing operations entered into after the court order commencing the procedure will be paid first.</p>	<p>New financing provided during the insolvency proceeding will be treated as so-called “mass credit”, meaning that this loan will be repaid from the first proceeds of any sale of estate assets. This new financing is therefore senior to any other repayment claim. The “mass credit” is normally secured by any free assets that the insolvent company may still have. The factual problem is that many companies do not have sufficient free assets to secure new financing.</p> <p>The above principles also apply to “exit” financing. Debt for equity swaps have not been commonly used in Germany so far, but recently there has been some interest for those type of structures.</p>

<u>China</u>	<u>Hong Kong</u>	<u>Singapore</u>
<p>Reconstruction of the distressed company will be the priority to be considered. Under this condition, to maximize satisfaction of the credits.</p> <p>Limitation to the secured creditors rights, see the above.</p>	<p>Hong Kong Monetary Authority and the Hong Kong Association of Bankers have jointly issued the Hong Kong Monetary Authority Guidelines on Standstill and Workouts.</p> <p>The Trade and Industry Department (TID) introduced various enhancement measures to the "SME Funding Schemes" in March and November 2008.</p> <p>TID further introduced a "Special Loan Guarantee Scheme" in December 2008, providing up to \$100 billion loan guarantee.</p> <p>"Support and Consultation Centre for SMEs" (SUCCESS) of TID provides SMEs with free business information and practical consultation services, including advice on dealing with business operation problems.</p>	<p>If the judicial manager obtains new financing, the new creditors get a statutory right of action against the judicial manager (unless the credit is disclaimed for being onerous under §332). In effect, the judicial manager may pay the new creditors out of an earlier floating security although this scenario only arises where an order has been made on the public interest exception, or where there is a floating charge not of substantially the whole of the company's property. §227(I), 227(B)(10)(a), 227(B)(4)(b)(ii), Companies Act</p> <p>The new creditors are also paid ahead of pre-judicial management order credit. §227(G)(6), Companies Act</p> <p>The liquidator may borrow as against the security of the debtor's assets, but the security granted is subject to the rights of the existing secured creditors whose rights are fixed. §272(2)(g)</p> <p>In any case, the secured creditor can rely on his security and prove for the balance, if any, to be paid <i>pari passu</i> with other unsecured creditors.</p>

Question 5: How does your country's insolvency govern the relative priority of a secured or unsecured lender's claims to distributions in an insolvency proceeding?

<u>U.S.</u>	<u>Switzerland</u>	<u>Germany</u>
<p>The secured lender in a U.S. bankruptcy holds a first priority lien position against all of the assets composing its collateral/security, and the secured lender must be the first claim to be satisfied out of the sale proceeds resulting from the disposition of its collateral.</p> <p>There are exceptions to the secured lender's first priority lien position as to its collateral, including the equitable subordination of the secured lender's claim based on its inequitable conduct in dealings with the bankrupt debtor. The secured lender's first priority lien may also be "primed" by a post-bankruptcy lender under certain circumstances. Additionally, the debtor or a bankruptcy trustee may seek to "surcharge" the secured lender's collateral in order to pay expenses incurred by the debtor or trustee in preserving the lenders' collateral. Further, there are certain other types of claims that will prime the secured lender's lien, including unpaid real property taxes that will "prime" the secured lenders' lien as to the specific piece of real property for which the taxes are due.</p> <p>In instances where the value of the secured lender's collateral is insufficient to pay the secured obligations in full, the debtor may "cram-down" the lender's lien to the actual value of the collateral. Any amount owed that is in excess of the collateral value becomes an unsecured claim (i.e., the lender's claim is bifurcated into secured and unsecured portions).</p> <p>Generally speaking, the priority/distribution scheme for creditors under the U.S. Bankruptcy Code is as follows:</p> <ul style="list-style-type: none"> -Secured creditors (to the extent of their collateral) -Priority claims: 	<p>All the pledged assets fall into the bankruptcy mass. The secured creditor, however, will be satisfied out of the proceeds of the sale of the pledged asset first. The creditors belonging to a preferential creditor's class will not be paid out of the proceeds of the sale of a pledged asset as long as the secured creditor is not paid in full by such proceeds.</p>	<p>The distribution will be, first, to those creditors that receive preferential payment. As noted, the Trustee will retain a fee of about 9% of the proceeds to be used for payment of the costs of the proceedings as well as for distribution to unsecured creditors.</p> <p>Any remaining proceeds will be paid, secondly to the unsecured creditors. The unsecured creditors will receive a quota on their amounts owed. The size of the quota varies from case to case, but a return of more than 20% of the amounts owed to the unsecured lenders is rarely achieved.</p> <p>In the rare cases where all secured and unsecured creditors are repaid in full, any remaining proceeds will be distributed to the shareholders.</p> <p>The creditors can, within the framework of a so-called insolvency plan, agree on a negotiated distribution of proceeds that varies from the distribution mechanism provided for under the Insolvency Ordinance.</p>

<ul style="list-style-type: none"> --Administrative expenses of the bankruptcy proceeding; --certain pre-bankruptcy employee wages/benefits --certain unsecured tax claims -Pre-petition general unsecured creditors -Equity holders 		
<p style="text-align: center;"><u>China</u></p> <p><u>Priorities:</u></p> <ul style="list-style-type: none"> -Secured claims -Expenses incurred for insolvency, or expenses incurred for the benefit of the creditors in the insolvency -Employees' salary, allowance, social security funds, and compensation that should be paid to the employees as per law and regulations -Other social insurance and tax due -Ordinary claims(unsecured claims) <p>Note: However it is still not very clear whether the secured claims can be put in the first place, due to absence of clear legal provisions.</p>	<p style="text-align: center;"><u>Hong Kong</u></p> <p><u>Priorities:</u></p> <ul style="list-style-type: none"> -Secured creditors -Liquidation costs -Preferential creditors -Floating charge holders -Unsecured creditors -Shareholders 	<p style="text-align: center;"><u>Singapore</u></p> <p>Secured creditors need not prove for their debts but can realise their security and obtain full satisfaction. If the security is inadequate, they may prove as unsecured creditors for the balance. The unsecured credit will be paid only after all the preferred debts are paid.</p> <p>Alternatively, secured creditors can voluntarily surrender their security and prove for the whole debt, as if it were unsecured.</p>

Question 6: What current trends and strategies affect secured lenders' claims in insolvency proceedings under your country's insolvency laws in the current economic crisis?

<u>U.S.</u>	<u>Switzerland</u>	<u>Germany</u>
<p>Distressed secured and unsecured debt is being traded to investors at a discount that allows the new holders to acquire the debtor or its assets or to gain leverage in the process of voting for plans.</p> <p>Investors are following a "loan to own" strategy in making new secured loans to distressed and highly leveraged companies with a willingness to convert the debt to equity in restructuring transactions, bankruptcy sales or secured creditor sales.</p>	<p>There are no new trends and strategies affecting secured lenders' claims in insolvency proceedings under Swiss insolvency laws.</p>	<p>German insolvency law is focused on the repayment of creditors more than on the ongoing operability of the insolvent company. Therefore most cases are still handled in the traditional way described above, i.e., the sale of the company or of specific assets and pay-out to the creditors.</p> <p>As a result of the crisis, "loan to own" strategies or fire sale acquisitions have been used in some cases, but the large majority of the insolvency proceedings, including recent high profile cases such as <i>Quimonda</i> and <i>Quelle</i>, continue to follow the established route.</p> <p>The government has in some high profile cases provided state financing to avoid bankruptcies, either for political reasons (e.g., Opel AG, the German subsidiary of General Motors) or in order to avoid a system crash. The most prominent example of the latter was the nationalization of the, formerly publicly held, Hypo Real Estate bank, a mortgage lender.</p>

<u>China</u>	<u>Hong Kong</u>	<u>Singapore</u>
<p>As per the recent interpretation of the Supreme Court of PRC, reconstruction of the insolvent and settlement proceedings is reiterated in an attempt to save the company in distress.</p> <p>PRC law does not provide the mechanism of converting secured credits into equity rights of the reconstructed company</p>	<p>Hong Kong does not presently have a voluntary administration or Chapter 11 type process to rehabilitate companies in distress.</p> <p>The Companies (Corporate Rescue) Bill is under review but is not yet law.</p> <p>Hong Kong Monetary Authority has adopted a series of measures to help alleviate the difficulties facing enterprises amid the global financial crisis.</p>	<p>At present, secured lenders, like banks, have taken the government's lead to support financially-strapped companies and to allow them to rehabilitate. For this year, there has only been a very modest 10% increase in the number of winding up orders as compared to last year. (graphs will be provided)</p> <p>A number of companies have successfully entered into schemes of arrangement with their creditors.</p> <p>One listed company did not obtain the backing of the banks because of improper dealings on the part of its Directors.</p>