

# LESSONS LEARNED: BANKRUPTCY REFORM IN THAILAND

*by*  
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The objective of this paper is to explain how Thailand, after being hit by the economic crisis in 1997, reformed the bankruptcy system in order to deal with the subsequent growth of non-performing loans. This paper shows how the changes were made and the reasons behind the changes. It is now possible to see if they were beneficial and, most important, if they contributed to an appropriate and sustainable bankruptcy system. The paper also identifies the advantages and disadvantages of the system and suggests ways forward both for Thailand and other countries in the region. Finally, it illustrates the ongoing process of change in Thailand.

## 1) How to swiftly change a bankruptcy system

After the crisis hit Thailand, bankruptcy law was seen as a mechanism to deal with bad debts. It was clear at the time, that during the systemic bankruptcy of a country, that no law in general is capable of dealing with such a situation. In spite of this, attempts were made to reform the debt collection laws (such as the Civil Procedure Code and the Bankruptcy Act) on the grounds that they, at least, should be able to help clear up debts more swiftly than agencies set up to deal with the assets and liabilities of financial companies.

The Thai Ministry of Justice was given the task of reforming the bankruptcy law and the Civil Procedure Code. This task was neither innovative nor difficult since both society and the ministry had already attempted to initiate change. The Ministry of Justice took the opportunity to push for its own draft legislation on the amendment of the Thai bankruptcy law and the Civil Procedure Code. These were then given priority to be submitted to parliament.

It was accepted at the time that had there been no such drafts, it would have taken the government longer to react to the problem and that there would have, perhaps, been greater overseas influence on the drafting process. Although foreign influence is not necessarily detrimental, internally-based changes implemented with a true understanding of a country are more likely to meet with acceptance.

## 2) An existing system is a crucial support of change

It should be understood that prior to the reform of the country's bankruptcy system, Thailand already had a long history of bankruptcy law. It had both relevant laws and institutions. The existing law was the Bankruptcy Act of 1940, with bankruptcy issues being heard by courts with civil jurisdiction throughout the country. In terms of the management of the estate of bankrupts, the official receiver's office (or the Legal Execution

Department as it is called in Thailand) was active. This existing system eased the task of reform substantially, since the only crucial matter was to modify rather than to build anew.

With respect to changes in the law, since Thai law already allowed for liquidation procedures, the challenge was to modify the law so as to allow reorganisation procedures. It was agreed that the draft legislation on the matter was almost adequate. After some minor changes were made, the draft was submitted to parliament and subsequently became the Bankruptcy Act (4th Issue) of 1998. The law allowed companies to undergo reorganisation with the protection of stay and subject to the process of the court's supervision. This could either be done voluntarily (with the debtor's application), or involuntarily (with the creditor's application). In short, if the plan was approved by the creditors' meeting and confirmed by the civil court, it would then bind all the parties involved.

### **3) The reality of legal and institutional reform**

Given the fact that the existing system helped to ease the task of legal reform considerably, genuine reform was still the predominant issue. Changing the law might be seen as adequate in itself, but the Ministry of Justice was well aware that such an approach without genuine changes to support the implementation of the system would lead to failure.

The reorganisation procedure was regarded as a new mechanism, the most difficult part being to allow judges and official receivers to play a role in dealing with the survival of business units. Some court decisions might therefore involve the sphere of day-to-day management. They could include decisions taken in the ordinary course of business or on transactions outside the ordinary course of business.

The level of control by official receivers over the transparency of companies necessitated a highly competent group of receivers. Initially, many people considered shifting this responsibility to a new agency consisting of persons with a strong commercial background, though it ultimately became the challenge of the judiciary system.

### **4) Courts versus tribunals**

Critics did not really believe that the judiciary and official receivers would be able to adapt to the changes in the bankruptcy system. It was widely accepted that, without changes in the judiciary itself, the burden would be too great to bear. Although many people suggested that a somewhat neutral organisation set up by law might be able to tackle the problem more quickly and easily, it was agreed that such a move would not be sustainable and that it might damage the country in the long run if the judiciary were given the task.

It was, instead considered wiser to improve the existing system rather than create a new one simply for a particular purpose. Another prime reason was that even if a new agency was established, under the constitution, disputes appertaining to its management could still go to the court. It was also agreed that the trust of the people in the integrity of the judiciary was instrumental in the decision to give it the task. Ultimately, the Ministry of Justice insisted that the court be assigned the task and matters were implemented accordingly.

### **5) How to strengthen the court and its supporting agencies**

In order to help the court prepare itself for the task, it was accepted that the extant court system for dealing with bankruptcy cases would be unsuitable since reorganisation cases could involve large numbers of both companies and debts. In addition, bankruptcy

cases were treated as civil matters and had to be filed with courts with civil jurisdiction, including provincial courts throughout the country. It would have required an enormous effort by the judiciary to prepare judges all over the country to react quickly and appropriately in every case. Judges would also have needed training in the new law in addition to the understanding of business.

It was accepted also that due to the urgency of the issue, these reorganisation cases had to be dealt with swiftly. If they were to be heard in these courts, the backlog of other cases would cause considerable delay. Furthermore, to have implemented training for all judges in a short period of time would have been neither easy nor economical, while lack of expertise could have undermined the system as a whole.

One solution to the problem was to establish a specialised court for bankruptcy cases, an approach that had already been implemented in Thailand with a number of other specialised courts (such as Labour, Tax, Intellectual Property and International Trade courts). Such a system allows a specialised court of first instance to be set up for a particular type of case, benefiting the recruitment of judges and being a more economical way to arrange training for them. Appeals against decisions made in these specialised courts go directly to the Supreme Court.

Specialised courts are not suited for all countries. Even in Thailand, the attempt to set up the first such court was not without criticism. Opponents generally raised the issue of the principle of equality before the law and the effectiveness of the system in addition to arguing that these types of specialised court cases could just as well be heard in civil courts. It was also argued that if there were relatively few cases, it would not be cost-efficient to set up a specialised court. In some countries, judges would be regularly transferred to other courts and it would be difficult to keep judges in one place since the reason behind the move was the need for judges to gain experience in different types of cases.

Since the specialised court system was already in existence in Thailand, it was not difficult to convince the parliament to pass a law on the establishment of the bankruptcy court. The act was passed in 1999. After that, it was not permitted to hear bankruptcy cases involving either liquidation or reorganisation in other courts. Judges with bankruptcy experience were recruited and placed on the court. Training sessions in the required areas were held specifically for them.

With respect to the official receiver, the Legal Execution Department set up the Business Reorganisation Office to take responsibility for the new law regarding reorganisation cases. All the officers involved had to undergo special training. The Ministry of Justice worked in co-ordination with lawyers to ensure that those concerned were given adequate training.

## 6) Outcomes

After the changes were introduced, no doubts remained that the system could carry out its task as intended. Reorganisation cases reached a peak in 2000, when more than 100 cases were filed with the bankruptcy court and the amount of debts being restructured went up to around THB 4 billion (Thai baht). The judiciary ensured that all cases were heard in a speedy manner and most of the major cases were dealt with successfully in due course.

Inevitably, some problems emerged during implementation, leading to calls for additional changes. The bankruptcy court was entrusted by parliament to have jurisdiction

over criminal matters arising out of bankruptcy practice, this being envisaged as an efficient way to prevent fraud within the system.

When the system is evaluated, there is always the question of whether or not it is sustainable. The figures in Table 1 show that although there was a reduction in the number of reorganisation cases after the crisis in 2001, a steady number of such cases still enters the bankruptcy court.

**Table 1. Number of new reorganisation cases**

	2001	2002	2003	2004	2005
<b>Number of new reorganisation cases filed with the court</b>	79	61	52	50	30

Table 2 shows the numbers of filings for bankruptcy with the court. The increase in 2003 was caused by a change in the bankruptcy law to allow an easier method of discharge.

**Table 2. Number of bankruptcy filings**

	1999	2000	2001	2002	2003	2004
Individual bankruptcy	1 118	835	968	1 591	2 209	4 778
Juristic persons' liquidation	549	604	746	922	657	965

The regular use of bankruptcy was not possible in the past, when the associated stigma was regarded as a big issue. However, the recent increase in the number of cases can be seen as an indicator that bankruptcy is now more socially acceptable and is also an indicator of the need to improve the system to help steer the management of bad debts in the proper direction.

## 7) The ongoing business of reform

Bankruptcy reform is not an easy matter. After the economic crisis in Asia, a number of international institutions (like the IMF, the World Bank, UNCITRAL, the OECD and development banks in the various regions) decided to pursue the same goal, which is to say, the installation of a proper bankruptcy system in each country.

In Thailand, there are many issues which are now pending consideration. Many proposals have been made to the Ministry of Justice to change or even overhaul the whole system for bankruptcy. Such a task is for long-term development, and the government has assigned it to the Bankruptcy Law Amendment Commission, in co-ordination with the Ministry of Justice. It is envisaged that the whole law will be replaced by a new one. Even though no deadline has been set, the Ministry of Justice hopes that draft legislation will be presented to the government in 2006.

It has been suggested that the UN Legislative Guide on Bankruptcy Law and the work of the World Bank should be used as the basis for considering proposed changes.

Interestingly, none of the recommendations put to the commission so far involve changing the role of judges in bankruptcy cases. This could be an indicator of the effectiveness of judges in their handling of bankruptcy cases after the crisis.

The new issue to emerge in Thailand is consumer bankruptcy. Some institutions suggest the abolishment of consumer bankruptcy. This issue is still under discussion.

## 8) Lessons to be learned

Even though Thailand has opted for the use of a specialised bench to react quickly to problems, the same approach may not work for other countries. As was previously stated, the success of the Thai approach was based on an existing infrastructure that supported changes. It was also regarded as a change from within, since most of the draft legislation already existed at the time of crisis.

However, the stance on letting the judiciary have jurisdiction over bankruptcy cases was admirable. It was in line with the constitution and was supported by the people who believed that the courts could handle the cases. Obviously, the task would be easier if there were no need for swift change; for those who have time to reform, more investment should be made in the judiciary. Integrity is also essential. A profound knowledge of business affairs among judges is another prerequisite for a reliable system. A key lesson is that changing the law is only the first step, and that without genuine change in implementation, the reform will not work.

Another lesson to be learned is that a bankruptcy system is one of debt collection laws. Enforcement of security and civil judgments is another important factor. Each country needs to have all the systems working efficiently in order to ensure proper functioning of the whole. It is advisable to lay the fundamental groundwork by ensuring that a proper system of civil procedural law exists. An overall legal and institutional framework is likewise needed.

To strengthen a country's bankruptcy system, transnational aspects of trade need to be taken into consideration. Cross-border insolvency issues are becoming important. Some advances are being made within the ASEAN community. During the last Law Ministers' Meeting in Ha Noi, Viet Nam, ASEAN member countries expressed both the need and willingness to expand their co-operation on civil law matters.

This was followed by a seminar held jointly between Thailand and UNCITRAL on bankruptcy and secured transaction laws. It is noteworthy that participating countries were interested in the improvement of their legal infrastructure (especially secured transaction law), with Viet Nam having already established a legal framework and Cambodia in the process of drafting one. This has resulted in further co-operation between Thailand and the Lao PDR on training programmes.

In conclusion, those countries that form a group or region tend to find it easier to co-operate. It is a great deal easier to do this than having to rely excessively on the programmes of international organisations. However, a synergy of global and regional approaches can be created with international organisations finding a role through which they can support regional approaches.

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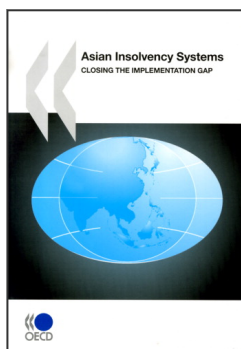
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