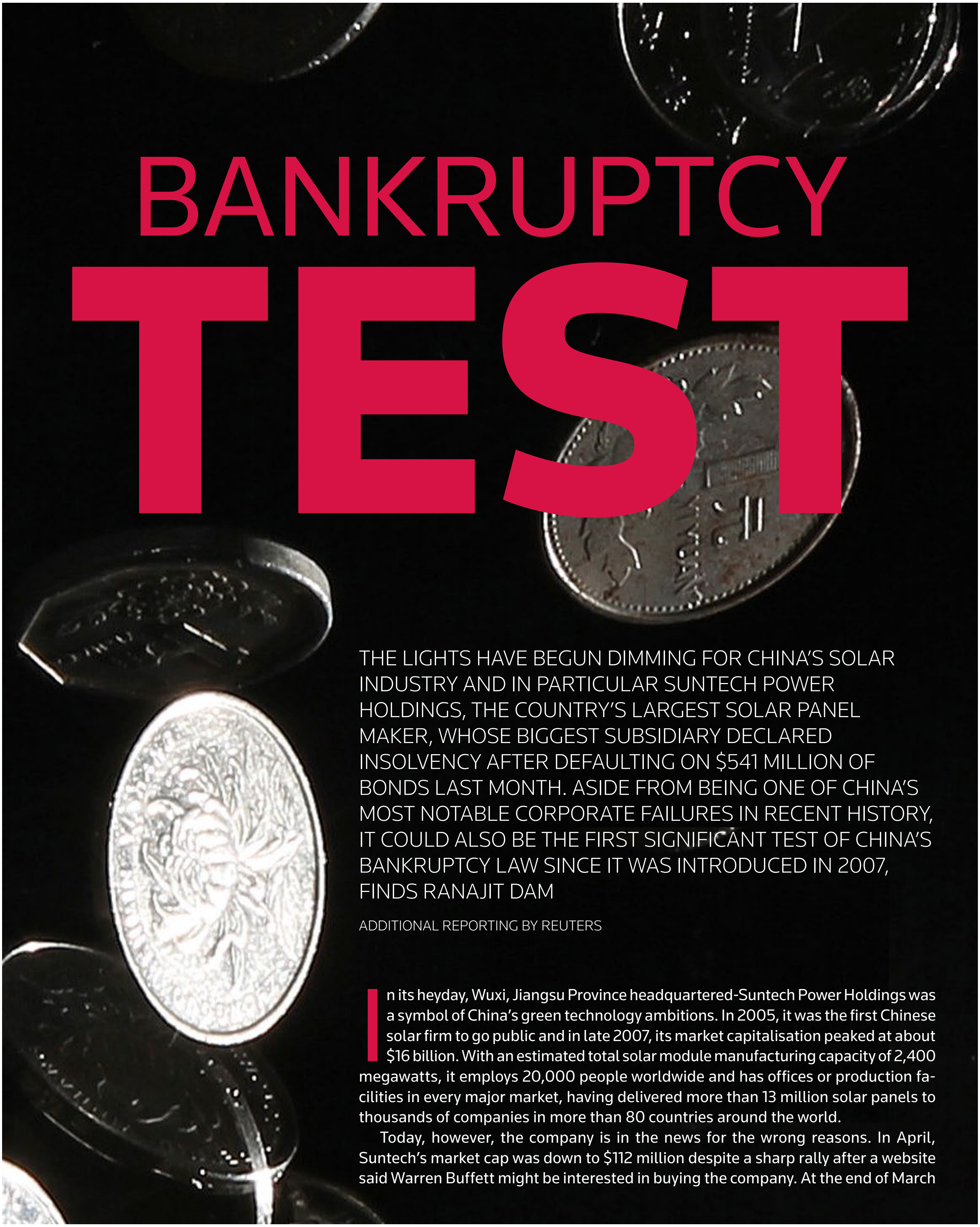

BANKRUPTCY TEST

THE LIGHTS HAVE BEGUN DIMMING FOR CHINA'S SOLAR INDUSTRY AND IN PARTICULAR SUNTECH POWER HOLDINGS, THE COUNTRY'S LARGEST SOLAR PANEL MAKER, WHOSE BIGGEST SUBSIDIARY DECLARED INSOLVENCY AFTER DEFAULTING ON $541 MILLION OF BONDS LAST MONTH. ASIDE FROM BEING ONE OF CHINA'S MOST NOTABLE CORPORATE FAILURES IN RECENT HISTORY, IT COULD ALSO BE THE FIRST SIGNIFICANT TEST OF CHINA'S BANKRUPTCY LAW SINCE IT WAS INTRODUCED IN 2007, FINDS RANAJIT DAM

ADDITIONAL REPORTING BY REUTERS

In its heyday, Wuxi, Jiangsu Province headquartered-Suntech Power Holdings was a symbol of China's green technology ambitions. In 2005, it was the first Chinese solar firm to go public and in late 2007, its market capitalisation peaked at about $16 billion. With an estimated total solar module manufacturing capacity of 2,400 megawatts, it employs 20,000 people worldwide and has offices or production facilities in every major market, having delivered more than 13 million solar panels to thousands of companies in more than 80 countries around the world.

Today, however, the company is in the news for the wrong reasons. In April, Suntech's market cap was down to $112 million despite a sharp rally after a website said Warren Buffett might be interested in buying the company. At the end of March

A man walks past Suntech Power Holdings headquarters in Wuxi, Jiangsu province. REUTERS/Stringer

2012, Suntech had total debt of $2.2 billion - including a $50 million convertible loan from the IFC, the private sector arm of the World Bank. Domestically, nine banks, including Industrial and Commercial Bank of China, Agricultural Bank of China and Bank of China had outstanding loans of 7.1 billion yuan ($1.1 billion) to Suntech at the end of February this year, according to state news agency Xinhua. And it became the first company from mainland China to default on its bonds after failing to repay $541 million of notes due March 15, breaching terms of other outstanding loans.

The fact that China's solar power sector is mired in a deep crisis has been apparent for some time now. Companies have been badly hit by an estimated 66 percent fall in solar panel prices in the last two years as the euro zone debt crisis has led to countries like Germany slashing subsidies for renewable power. Now, they are struggling after taking on debt to expand supply that led to the glut that forced down prices and squeezed profits and, most notably, are fighting to renegotiate their liabilities and obtain flexibility over payments to creditors. Indeed, just a month after Suntech's default, another Chinese solar panel maker, LDK Solar, reported its seventh straight quarterly loss and partially defaulted on a $24 million bond. Suntech's case is, however, shaping up to be a landmark one. As the Wuxi Municipal Intermediate People's Court accepted the petition of eight banks to push Suntech's main operating subsidiary, Wuxi Suntech, into insolvency, it set into motion a chain of events that is likely to lead to the first big test of China's bankruptcy law since it was introduced in 2007. The Suntech case could also have a say in the way Chinese governments at various levels deal with failing firms, and change the attitudes of bondholders, both offshore and onshore, for good.

UNTESTED LAW

In 2007, China passed a new bankruptcy law that is rarely tested because local officials generally mediate between creditors behind closed doors. Beijing has used the law cautiously, fearing the failure of large companies and widespread layoffs could lead to social unrest. Mark Hyde, head of finance for Asia-Pacific and global head of the restructuring and insolvency practice at Clifford Chance, says that this untested process will lead to a number of questions. "Ultimately, whether an insolvency law is effective or not depends on how the judges actually interpret and apply the law as they go through the process," he says. "Most insolvencies throw up new issues, but some jurisdictions like the U.S. have dedicated and very experienced insolvency judges. In other jurisdictions, such as Hong Kong and England, while you don't have judges who only hear insolvency cases, you certainly have judges who've often practiced insolvency law whilst at the bar, and understand the issues."

He adds that one of the key issues in relation to the development of China's bankruptcy law is therefore whether the relevant judges, and who have had appropriate training will apply the laws in a consistent and coherent manner. "I think to my mind that's what people will be looking at closely: How effective will the courts be, and by effective, I don't just mean consistent and clear interpretations of the law which don't, for example, distinguish or make life more difficult for foreign creditors, but also other aspects which are necessary for a clear rule of law," Hyde says. "For example, will they issue their judgments in a timely fashion? There's no point people piling into court making representations only for the court to take years to deliberate on its rulings. So for me, and I'm sure for other commentators, that's really the key issue. How will the laws be interpreted? Will everybody who wishes to be heard be given a fair hearing? And will the process be effective and conclude in a timely manner?"

A man walks through solar panels at a solar power plant under construction in Aksu, Xinjiang Uyghur Autonomous Region April 5, 2012. REUTERS/Stringer

REUTERS

CHINA'S BAILOUTS DARKEN HORIZON FOR SOLAR PANEL SECTOR

China's rush to bail out Suntech Power Holdings and other solar panel makers is condemning its solar sector to a worsening glut, as demand remains stubbornly stagnant, both at home and abroad.

As prices crumble in the once high-flying solar panel industry, Chinese authorities fear that letting uneconomic manufacturers collapse will destroy tens of thousands of jobs and increase the potential for unrest.

On the other hand, throwing these firms a lifeline is a drain on public finances and just adds to over-supply. Against global demand for 30 to 35 gigawatts (GW) of solar power this year, supply is 50 to 60 GW, most of which is in China, according to some industry estimates.

While local authorities in China continue to bail out solar panel makers to preserve social stability, governments suffering from strained finances are withdrawing the incentives that could spark increased demand.

"China's solar industry is becoming like a prison," said Samuel Yang, chief executive officer of Shanghai-listed solar panel maker Hareon Solar.

"None of us is doing well. We are all locked in the prison," said Yang, whose firm is developing a solar farm in Bulgaria and is seeking financing to launch more overseas projects as one way to escape the glut. However, even China's state banks are wary of lending to the sector - solar panel prices have fallen about 66 percent in the last two years.

Both at home and abroad, the incentives offered by governments wanting to shift to cleaner energy are drying up. The euro zone debt crisis has led to countries like Germany slashing subsidies for renewable power.

The United States has slapped anti-dumping duties on Chinese solar panels and the European Union, China's biggest market for the product, could be on the verge of following suit.

Some Chinese panel makers have been shifting focus to the home market, hoping Beijing's moves to stimulate domestic solar consumption would come to the rescue.

But the measures are unlikely to have any major impact due to the sheer size of China's solar panel making capacity, a lack of funding for solar subsidies, China's geographical energy imbalance and the absence of infrastructure required to harness intermittent renewable energy.

CAUGHT BY SURPRISE

China has a history of bailing out companies on the brink of failure, and investors had assumed Suntech would be no exception. But the move by domestic creditors to petition for Suntech's bankruptcy has now introduced some doubt into the minds of investors. "Creditors may thus far have assumed that when they pushed a Chinese company very hard, they did so in the knowledge that it was unlikely that the management would carry out a threat to file the company; in other words, the threat may hitherto been seen as a slightly empty one," says Hyde. "This changes that situation, and anyone trying to negotiate the financial restructuring of a substantial Chinese company has to be cognizant of the fact that if the negotiations don't go the right way for the company, there is clearly a risk the company will file, as demonstrated by what's happened at Suntech."

One of the issues complicating the Suntech case is its multijurisdictional reach: The company's shares listed on the New York Stock Exchange, but it is registered in the Cayman Islands and its assets are in China. According to Hyde, there may have been a significant concern on the part of the company and those behind it that there could well have been a risk of a process commencing in another jurisdiction and most obviously the U.S.," he says. "In this particular instance, I think that people were caught by surprise. I don't think anyone close to the situation really thought the company would file in China precisely because the laws are untested for an insolvency of this size. However, China now has control of the process and there hasn't been an intervening process in another jurisdiction as could conceivably have been the case."

PULLING THE PLUG?

Generally, Chinese governments at various levels have been loath to let firms fail, instead choosing to negotiate with creditors behind closed doors. According to Ivo Naumann, managing director of advisory firm AlixPartners, this is happening as the Chinese government seeks to continue economic growth, both at the national and the provincial level. "One strategic direction is to shift away from the high dependency on export towards boosting domestic demand and consumption," he says. "It is foreseeable that Chinese governments will keep inclining towards sectors with good domestic potential, including supporting low performing players with government resources, with the intention to speeding up the capability growth of those companies, hoping that those companies will

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leap forward faster than their global peers."

Currently in Wuxi, home to Suntech, the local government is seeking to bail out the company to stave off its collapse, Reuters reported. One proposal under consideration is allowing Wuxi Guolian, the local government's investment arm, to take over Suntech's Wuxi business through a restructuring. "Production has to continue," Reuters cited an unnamed source as saying. "The Wuxi government is still seeking to bail out Suntech in one form or another. It has no intention to let it collapse as, if that happens, it would damage its reputation." The *Yangtze Evening News*, a local official newspaper, said authorities will try their best "to maintain normal production of the company, social stability, safeguard the security of company assets and protect the interest of creditors." Such a move would also test the notion - widespread in Chinese bond markets - that local governments will always bail out important companies without inflicting pain on domestic creditors.

NO GUARANTEES

However, what happens to the offshore holders of Suntech's bonds will have wide implications for investors who have flocked to Chinese dollar-denominated debt in search of yield. Naumann points out that in the Suntech case, the bankruptcy law has not been applied to the overseas-listed entity, but only to Wuxi Suntech, the entity inside China that holds the majority of the assets. International investors in the bonds were never secured by this entity but only by the offshore entity, Suntech Power in the Cayman Islands, and thus foreign creditors will only play a minor role, if any, in the bankruptcy proceedings. "While the offshore bondholders could sue Suntech Power for default in a jurisdiction outside of China, they would probably end up recovering little, if anything, in respect of Wuxi Suntech which holds the majority of assets," he says. "Offshore creditors will be subordinated to the onshore creditors as these are fully secured. The key for any outcome will be the role the government will play and whether any 'white knight' rescue can be arranged."

An employee examines newly made solar panels at a factory of Suntech in Wuxi, Jiangsu province. REUTERS/Stringer

Reuters quotes Paul Boltz, a Hong Kong-based partner with law firm Ropes & Gray, as saying that the Suntech situation is a good reminder that offshore investors can have difficulties in enforcing their rights. "The offshore holding companies which are used to list overseas often have fewer assets than the onshore entities. In that case, they face a disadvantage compared with onshore lenders like Chinese banks which can have direct recourse against the assets," he says. While China's domestic bond market has not been much affected by the news, with most investors thinking of it as an offshore bond, foreign debt holders are, however, in a more difficult situation. "Offshore debt holders are on shaky legal ground (their claims are to a piece of paper in the Caymans, whereas STP's operating assets are effectively all in China)," says Charles Yonts at CLSA in Hong Kong, "and even if not, they would have the rather daunting task of fighting to the front of the queue of Chinese creditors in China. Good luck with that."

Nevertheless, Hyde believes the Suntech bankruptcy will be closely followed by a number of people around the world. "It's going to be key for all the various constituents, and key for the integrity of the Chinese insolvency laws as how they play out in practice," he says. "Equally, it will be key for people doing business with and lending money to Chinese companies because as is the case anywhere else in the world, where a company fails, people who have exposure want to know that the process for unraveling the mess is a fair and transparent one and will give them whatever return they're entitled to, whether that's 10 cents in the dollar or 90 cents in the dollar."