

# Taipei,China

Eric Tsai, Partner  
**Puhua & Associates**

Hui-Erh Yuan, Partner  
Jason Liu, Director  
**PricewaterhouseCoopers**

The insolvency regime in Taipei,China appears to be heading towards a period of transition. The primary vehicles available – corporate reorganisation under the Company Law and bankruptcy – have often proved problematic, for reasons outlined below. However, thanks to a number of recent developments, creditors may now enjoy improved prospects of recovery. These developments include:

- the 2001 overhaul of the Company Law, which streamlined the reorganisation procedures;
- the enactment of the Law on Mergers of Financial Institutions, which paved the way for the introduction of asset management companies; and
- the recent enactment of the Regulations on Securitisation of Real Property, which should improve the market value of real property collateral, and the Regulations on Securitisation of Financial Assets, which should enhance the liquidity of banks' financial assets.

The Ministry of Justice has also begun to contemplate possible revisions to the Bankruptcy Law, which up to now has not been widely used by debtors or creditors in Taipei,China.

## **1. Legal framework and the effectiveness of court processes/legal remedies**

### **1.1 Describe the nature and effectiveness of the following:**

#### **(a) Debt recovery remedies where the creditor has no security**

In general, unsecured creditors seek to collect on their debts by obtaining a judgment through the courts. Simplified proceedings are available depending on the amount of the claim, subject to prior compulsory reconciliation procedures before the court. Prior or simultaneous to filing the action, a creditor may pursue the following remedies to safeguard the integrity of the debtor's assets:

- Petition for a ruling authorising the provisional attachment of the debtor's assets. In practice, the courts usually require the posting of a bond in an amount equivalent to one-third of the attached asset value.
- If the debtor engages in a fraudulent gratuitous transfer which is likely to be prejudicial to the rights of creditors, petition for cancellation of the transfer and restoration of the pre-transfer status quo.
- If the debtor engages in a fraudulent transfer for consideration and the counterparty has knowledge of the debtor's financial situation at the time of the transfer, petition for cancellation of the transfer and restoration of the pre-transfer status quo.
- Upon the debtor's default, exercise in its name any rights of the debtor which the debtor has neglected to exercise, other than those which are strictly personal to the debtor.

Once the unsecured creditor has obtained a final, irrevocable judgment on the debt, it can petition an enforcement court to enforce the judgment in accordance with the Compulsory Execution Law.

After the commencement of a court action, the debtor and creditor may seek to settle their differences through a court-mediated reconciliation or settlement, which has the same effect as a final judgment. In practice, however, the parties usually engage in extensive negotiations prior to any court action and it is thus unusual for parties to settle afterwards.

If the creditor's claim is for the payment or delivery of a definite amount of money or other fungibles, or for securities, the creditor may, upon the debtor's default, alternatively make an application to court for the issue of a payment order to the debtor. Subject to the debtor's objection, a payment order has the same effect as a final, irrevocable judgment and may thus be the object of a compulsory execution proceeding. If the debtor makes a timely objection to the order, the order will lose its effect and the application for a payment order will be regarded as the institution of a court action on the debt or an application for reconciliation.

If the contract between debtor and creditor meets specific criteria set out in the Public Notarisation Law (eg, a contract for payment or delivery of money, other fungibles or securities) and was notarised at the time of signing, the creditor may, upon the debtor's default, immediately petition for compulsory execution without first obtaining a judgment on the underlying debt.

#### **(b) The enforcement of security**

Foreclosure on a real property mortgage commences by application to the court for a compulsory execution ruling, followed by application for an execution order to auction the property. The proceeds are distributed to the mortgagees according to their rank of priority in registration.

If the auction does not yield an offer, or if the highest offer price is below the floor price set by the court, the auction can be continually repeated. In practice, if the property is not eventually successfully auctioned, the creditors will usually accept title to the real estate at the floor price. The creditor and debtor may privately agree to a transfer of title to satisfy the debt, but such agreements are valid only when made after the debtor has defaulted.

While the auction is generally carried out by the execution court, the Law on Mergers of Financial Institutions does allow asset management companies that have obtained an execution order on a first-priority mortgage to engage an impartial third party approved by the competent authority to conduct the auction.

Where the collateral is movable property or instruments pledged to the creditor, the creditor can directly sell the collateral upon default and retain the proceeds, or alternatively seek enforcement through the execution court. As with real property, any agreements to take title to the collateral which are concluded before default are void.

Certain movable collateral in the debtor's possession can be made subject to a registered chattel mortgage contract. Upon default, the creditor can directly take possession of and auction the collateral. If the contract specifies compulsory execution, the creditor may directly seek enforcement upon default, or directly seek provisional attachment if the debtor engages in activities that endanger the creditor's interest in the collateral.

#### **(c) Corporate bankruptcy/liquidation processes**

If a debtor's assets are insufficient to meet its liabilities, the creditors may petition the court to commence bankruptcy proceedings. They may also seek to have the debtor detained and to take preservation measures such as attachment of the debtor's assets.

In practice, bankruptcy proceedings are seldom pursued by creditors. There are several reasons for this. First, bankruptcy proceedings are often prolonged and lengthy. Further, secured creditors usually do not participate, since assets subject to security interests may be enforced despite the commencement of bankruptcy proceedings; this greatly reduces the size of the bankruptcy estate to begin with. Given these factors, it is often difficult to justify the time and expense of bankruptcy proceedings.

#### **(d) Formal corporate rescue processes**

The following parties may petition a court to rule for corporate reorganisation:

- creditors of a distressed company with publicly issued shares or bonds whose claims together represent at least 10 per cent of the company's capital;
- shareholders that have continuously owned 10 per cent of the shares in the company for a

- period of six months; or
- the company itself.

The court will reject the petition if, among other things, it believes that the company cannot be revived through reorganisation.

In practice, petitions for corporate reorganisation are usually submitted by debtors, as the law requires that all enforcement actions be stayed once the court has authorised reorganisation. In the past, some debtors filed for reorganisation as soon as informal rescue processes failed, to avoid immediate enforcement on their assets.

Before a reorganisation ruling has been issued, the creditors may petition the court to issue a ruling ordering, among other things:

- preservation of company assets;
- restriction of the company's business;
- suspension of bankruptcy, composition or enforcement proceedings; and/or
- restriction of performance of company obligations or the exercise of claims against the company.

During reorganisation, creditors which have declared their claims are divided, along with the shareholders, into groups of preferential creditors, secured creditors and unsecured creditors. Each group separately exercises voting rights at meetings of the interested parties. A primary objective of these meetings is the review and approval of the reorganisation plan. If the plan is approved and implemented, unpaid portions of declared claims will expire, unless assumed by the company thereafter, and all prior bankruptcy, composition and enforcement proceedings become ineffective. If the plan is not approved, the court may declare the company bankrupt.

In the past, the effectiveness of corporate reorganisation was inconsistent, due in part to a lack of commercial viability on the part of the companies undergoing reorganisation. However, its viability as a restructuring tool has been considerably enhanced by the 2001 amendments to the Company Law, which require that the debtor be capable of being revived through reorganisation and reduce the length of time it takes to obtain a reorganisation ruling. These changes have also reduced the risk of debtors abusing the reorganisation procedure to avoid bankruptcy. Several successful reorganisations were carried out last year.

### **(e) Informal corporate rescue processes**

When a debtor becomes insolvent, it may seek to negotiate with its creditors to agree contractually on a debt workout plan, which effectively serves as a private settlement to avoid prolonged reorganisation. However, such meetings are of limited effect as secured creditors do not usually participate.

#### **1.2 What are the formal processes to effect a liquidation of the company's assets?**

As discussed, creditors may petition the court to commence bankruptcy proceedings and to take preservation measures against the debtor and its property. Where the court rules for bankruptcy, it will give public notice of the particulars and select a bankruptcy manager. In general, creditors whose claims are not reported to the manager within three months of the notice are not eligible to receive payment from the estate. In practice, the manager will call a creditors' meeting to determine how to administer the estate, such as whether to continue business operations. The manager will then prepare a claims list and distribution list showing the proportion and method of distribution. Once the assets have been distributed, the manager will submit a final report to the court, which will issue a ruling to close the proceedings. However, if the estate is insufficient to cover its expenses and debts, the court will order the termination of bankruptcy proceedings at the petition of the manager.

#### **1.3 What is the effect on debt collection and the enforcement of security of:**

##### **(a) An adjudication of corporate bankruptcy/liquidation?**

In general, upon an adjudication of bankruptcy, all parties with an interest in the estate must seek repayment through the bankruptcy proceedings, as enforcement actions are stayed. However, the following exceptions to this stay apply:

- Secured creditors may continue to enforce the collateral independently of the bankruptcy proceedings.
- If property in the estate is owned by a third party, that third party may reclaim the property from the estate.
- Sellers of real or movable property to the debtor may rescind the sale and reclaim the property if the property has not yet been received by the debtor or the purchase price paid.

Notwithstanding these exceptions, the manager may still exercise avoidance powers to annul:

- new security interests created within six months of the bankruptcy ruling; and
- transfers effected during those six months to satisfy debts that have not yet fallen due.

Gratuitous transfers and non-gratuitous transfers to bad-faith third parties that prejudice the rights of creditors can also be avoided by the manager.

**(b) The commencement of a formal corporate rescue process?**

All bankruptcy, composition and enforcement proceedings are suspended upon a reorganisation ruling. Prior to this, the court may rule that enforcement proceedings be restricted.

**(c) The initiation of an informal corporate rescue process?**

Creditors which are not contractually bound by privately negotiated debt workout plans with the debtor may still pursue enforcement, in addition to asserting other defences available at law, such as withholding performance pending payment or the provision of security by the debtor.

**(d) The initiation of an insolvency or insolvency-related process under any special legislation?**

Current laws do not provide for insolvency-related processes which affect enforcement procedures. However, there is special legislation on insolvent banks.

**1.4 Are insolvency procedures involving a corporation incorporated in your jurisdiction recognised if they are started in another jurisdiction?**

Taipei, China adopts a territorial approach. The Bankruptcy Law states that a composition or bankruptcy adjudicated outside Taipei, China will not have legal effect *per se* with respect to properties which the debtor possesses in Taipei, China. Thus, to enforce a debt the creditor must initiate a separate compulsory execution process in Taipei, China.

**1.5 In what circumstances would the directors or officers of a company in financial difficulties face potential personal liability for continuing to trade? In practice, are any such provisions actually enforced?**

Directors and high-level officers owe duties of care and loyalty to the company as fiduciaries. If a director breaches these duties he may be held liable to the company and incur penalties ranging from administrative fines to civil damages and criminal liability. As regards third parties, the Company Law expressly states that directors and high-level officers can be held jointly and severally liable together with the company if they cause the company to engage in a violation of the law.

The relevant laws specify that certain actions must be taken when a company is in financial distress. For instance, where a company has incurred losses that amount to half its paid-up capital, the Company Law requires the directors to convene a shareholders' meeting. Also, where a company's assets are clearly insufficient to meet its liabilities, both the Company Law and Civil Law require the directors to ensure that the company files for bankruptcy or reorganisation. Directors who negligently fail to comply with this obligation may be held personally liable to creditors and shareholders for civil damages, in addition to criminal penalties.

In practice, creditors and shareholders rarely seek to hold directors personally liable, in part because the directors are often in dire financial straits themselves or have already disposed of their assets in order to frustrate enforcement.

**2. What are the advantages and disadvantages of triggering a formal procedure?**

One advantage of commencing formal bankruptcy proceedings is that it triggers a stay on enforcement actions and allows the company to continue in the normal course of business operations. The disadvantages are discussed in section 1.1(c).

**3. What are the practical options for out-of-court restructuring?**

In practice, if the company can propose a feasible business plan that would ensure the part-payment of interest and prevent the creditors from incurring bad debts, institutional creditors will usually agree to defer enforcement. However, if some of the creditors do not agree to be bound by the plan and

independently seek enforcement, the debtor may be tempted to pursue reorganisation instead.

#### **4. What is the effect on the management of a company of:**

##### **4.1 An adjudication of corporate bankruptcy/liquidation?**

The bankruptcy manager appointed by the court upon the commencement of bankruptcy proceedings takes over the management of the company in lieu of the board of directors and shareholders.

##### **4.2 The commencement of a formal corporate rescue process?**

Upon the commencement of reorganisation, the court will appoint a reorganisation manager to assume the management of the company in lieu of the board of directors, and a reorganisation supervisor to assume certain administrative duties as well as governance powers previously held by the shareholders and supervisor, such as the right to approve extraordinary transfers or *ultra vires* acts, transfers or waivers of company rights, as well as key personnel decisions.

##### **4.3 The initiation of an informal corporate rescue process?**

Unless the debtor has contractually agreed to cede oversight powers to certain creditors, informal out-of-court negotiations generally have no impact on management.

##### **4.4 The initiation of an insolvency or insolvency-related process under any special legislation?**

Current law does not provide for insolvency-related processes to affect management, except for certain legislation applicable to insolvent banks.

#### **5. Roles of key players involved in the restructuring and insolvency process**

##### **5.1 Who is responsible for the ‘case management’ control and administration of a corporate bankruptcy/liquidation, a formal rescue or an informal rescue?**

The bankruptcy manager is responsible for case management control and administration, subject to court oversight and resolutions of the creditors’

meeting on the administration of the estate, as described in section 1.2. The creditors may also select a bankruptcy supervisor who has the right, among other things, to request reports from the manager and investigate the estate.

##### **5.2 Who is responsible for the ‘case management’ control and administration of an insolvency or insolvency-related process under any special legislation?**

The reorganisation manager is responsible for the general administration of the reorganisation, under the oversight of the reorganisation supervisor and the court. As discussed, certain decisions require the prior approval of the reorganisation supervisor and the creditors’ meeting.

##### **5.3 Who is responsible for preparing the restructuring plan in a formal or informal rescue?**

The reorganisation manager is responsible for preparing the restructuring plan for review and approval by the creditors and the court. When deciding whether to approve the plan, the court will take into account the opinions of related government authorities. If the creditors do not approve the plan but the company is a viable candidate for revival, the court has discretion unilaterally to alter the disputed portions of the plan and rule on the revised plan.

In an informal rescue, the debtor is usually responsible for submitting a workout plan for negotiation with the creditors.

##### **5.4 Who is responsible for preparing the restructuring plan in an insolvency or insolvency-related process under any special legislation?**

Apart from the laws on bankruptcy and reorganisation, there is no special insolvency legislation other than that regarding banks.

#### **6. What financial information is available to creditors in a corporate bankruptcy/ liquidation, a formal rescue and an informal rescue?**

In bankruptcy and reorganisation proceedings, information about the debtor which is usually available includes financial statements, lists of properties, a schedule of outstanding debts and other public information. The information available in informal rescues depends on the circumstances, such as the type of debtor involved.

## 7. Financial issues

### 7.1 What are the main areas from which funding is generally utilised by companies undertaking either formal or informal restructuring?

Generally, the funding package for a company undergoing restructuring usually includes bank loans, equity injections by new shareholders and proceeds from the disposal of valuable assets.

### 7.2 In what order are creditors paid in a corporate bankruptcy/liquidation?

Secured creditors need not seek payment through the bankruptcy proceedings, except to the extent that the security is insufficient to satisfy their claims in full, in which case the outstanding portion is treated as a general unsecured claim. Likewise, the employee retirement reserve created pursuant to the Labour Standard Law is not included in the estate. Thus, retirement pay and severance pay may be paid from the reserve independently of the bankruptcy proceedings.

Unsecured claims rank in the following order of priority:

- administrative expenses (eg, costs of administering and liquidating the estate, manager's remuneration, taxes) and debts of the estate (eg, arising from acts performed by the manager in connection with the estate, or from the estate's contractual performance);
- unpaid employee wages for up to six months; and
- general unsecured claims.

In general, each category is entitled to full satisfaction before the next category is paid. Within each category, claims are paid *pro rata*.

### 7.3 Are there any legal provisions that might operate to invalidate the creation of security, the disposal of an asset or the payment of a creditor by a company in financial difficulties?

As noted in section 1.1(a), where such actions prejudice the rights of creditors, the creditors may, depending on the status of the counterparty, petition the court for cancellation of the action and restoration of the status quo. After a bankruptcy ruling has been issued, the manager may exercise avoidance powers as noted in section 1.3(a).

### 7.4 What is the position of both unsecured and secured creditors that vote against, do not agree with or do not consent to either a formal or an informal rescue plan?

The reorganisation plan must be approved by a two-thirds majority in each creditor group. Thus, creditors with sizeable claims may be able to prevent its approval.

If the plan is twice rejected by the creditors, the court will terminate the reorganisation unless it deems the company worthy of revival, in which case it may bypass creditor approval to make certain amendments and directly enter a ruling to accept the plan. In practice, however, the courts usually accept the creditors' decision.

Once the reorganisation plan has been approved by the requisite majorities and confirmed by the court, it becomes binding on both unsecured and secured creditors alike. Upon the completion of reorganisation, all compulsory execution proceedings commenced before the reorganisation ruling cease to be effective. If circumstances arise during the plan's execution which render execution unfeasible, the creditors may petition the court to allow them to review and/or terminate the plan.

In an informal rescue, creditors that have not approved the debt workout plan will usually initiate independent collection procedures.

### 7.5 What actions can creditors take if they are not satisfied with the conduct of either a formal rescue procedure or a corporate bankruptcy/liquidation?

If creditors in reorganisation are not satisfied with the actions of the reorganisation manager, they may vote to replace him, subject to court approval.

The reorganisation manager and supervisor owe duties of care and loyalty to the company as fiduciaries. If their negligent or wilful actions amount to a breach of such duties, the creditors may sue to hold them jointly and severally liable to the company for civil damages, or may petition the relevant authorities and courts for administrative or criminal sanctions.

Some remedies are also available to creditors in bankruptcy proceedings. The creditors can elect a bankruptcy supervisor to supervise the bankruptcy manager and vote on how to manage the estate. If a creditor disputes the claims list or distribution list proposed by the manager, it may file an objection with the court for the list to be redrawn. If a creditor objects to resolutions of the creditors' meeting, it can petition the court to prohibit their execution.

Creditors can generally appeal rulings made in reorganisation or bankruptcy proceedings on the basis of substantive or procedural defects.

## 8. General

### 8.1 Can the insolvency regime be described as systematic and efficient for:

#### (a) The liquidation of businesses incapable of being restructured?

#### (b) The restructuring of debt?

As described above, bankruptcy proceedings are usually prolonged and are not widely used. Restructuring, on the other hand, may be successful if there is some prospect of revival. Access to funding, rather than the legal system, is the key factor to the success of a restructuring.

### 8.2 What are the biggest legal and non-legal impediments to the systematic and efficient liquidation of businesses and restructuring of debt?

There is no concept of 'piercing the corporate veil' in Taipei,China. This makes it easy for shareholders of small to medium-sized enterprises (the driving force of the domestic economy) to wash their hands of a distressed business and start up a new one, instead of going through protracted bankruptcy proceedings. Moreover, if secured creditors do not favour reorganisation they will vote against the plan in the group meeting, often scuppering the chances of restructuring.

### 8.3 Has the insolvency regime been reformed in the last two years? If so:

#### (a) What are the reforms?

#### (b) Are the reforms being implemented so as to facilitate the systematic and efficient handling of corporate insolvency cases?

The insolvency legislation has not been reformed in the last two years.

### 8.4 Are there any other legal or non-legal changes in the last two years that have impacted on the operation of the insolvency law regime?

No.

### 8.5 Is statistical information on insolvency cases and corporate insolvency published? If so, how? Is it easily and freely accessible?

Statistical information on relevant cases is published in the *Judicial Statistics Yearbook* and the *Monthly Bulletin of Judicial Statistics*, and is easily and freely accessible on the website of the Judicial Yuan ([www.judicial.gov.tw/b4/](http://www.judicial.gov.tw/b4/)).

### 8.6 What is the most urgent reform required to facilitate the systematic and efficient handling of corporate insolvency cases (formal and informal)?

The Ministry of Justice is contemplating revisions to the legal system which would combine the Bankruptcy Law and the reorganisation sections set out in the Company Law into a single code, in observance of the 'single entry' principle advocated by the World Bank and the United Nations Commission on International Trade Law. The new code will focus on issues such as:

- the transition between bankruptcy and reorganisation procedures;
- how to encourage injections of new capital; and
- the retention of judges with expertise to preside over bankruptcy and restructuring cases.