

Taipei, China is a civil law jurisdiction. Creditors' rights are governed by the Civil Code, the Bankruptcy Law, the Company Law and specific laws governing various types of security interests such as the Chattel Secured Transactions Act, or the insolvency of specific types of entities such as the Central Deposit Insurance Act ("CDIA"), which governs the insolvency of banks.

Taipei, China law recognizes and facilitates the creation and enforcement of security interests over fixed assets (land, building and equipment) and over rights (accounts receivables, bank accounts, shares, bonds, etc.), but does not provide for floating charges.

Creditor rights are enforced through a court system which is comparatively mature and independent.

In theory, various types of insolvency proceedings are available. However, for the restructuring of corporations engaged in ongoing businesses of a size and type relevant to institutional creditors, the three proceedings that are relevant are as follows:

- ▲ Liquidation bankruptcy under the Bankruptcy Law (the "Bankruptcy Law").
- ▲ Corporate reorganization under the reorganization provisions of the Company Law ("Court Reorganization").
- ▲ Reorganizations by contract negotiated among the debtor and its creditors outside the judicial system ("Contractual Reorganization").

The primary concerns/difficulties in restructuring in Taipei, China relate to (i) the inability/unwillingness of the courts to take an active role in the selection of bankruptcy trustees/reorganization managers and/or in enforcing compliance with insolvency procedures; and (ii) a mind set among local (particularly government-owned) banks which is inclined not to recognize the depth of problems or the need, for example, to write off debt in a Contractual Reorganization.

Such concerns/difficulties often result in courts (i) permitting Court Reorganization of companies which clearly have no hope of survival; and/or (ii) allowing the debtor's management to remain in control of the process which, in turn, creates a lack of discipline and facilitates extra-legal self-help and other actions that are detrimental to both domestic and foreign institutional creditors. To combat such risks, it is critical that creditors involved in Taipei, China insolvencies pursue an aggressive "hands-on" role in the restructuring.

1 Describe the nature and the effectiveness of the following processes:

a) Civil unsecured debt collection remedies.

An unsecured creditor would normally pursue debt collection in Taipei, China through commencement of an action on the debt in the Taipei, China courts. Actions are commenced by filing a complaint and payment of a court fee of 1 percent of the claim amount. The fee is non-refundable but becomes a part of the claim against the debtor. Provisional attachment of assets prior to commencing court action is available and highly recommended as a means of preserving assets. Provisional attachments, however, do not create a priority. Thus, other attaching creditors would share in any proceeds.

Provisional attachment may be requested *ex parte* upon the following:

- ▲ Submission of nominal evidence of the debt.
- ▲ Providing the court with the identity and location of the specific assets to be provisionally attached (and evidence that such assets are owned by the debtor).
- ▲ Posting of a cash or cash-equivalent bond of from one third to 100 percent of the debt amount at the discretion of the court.
- ▲ Paying a court fee of 0.7 percent of the claim amount.

Upon the obtaining of a final judgment and exhaustion of appeals, the creditor may use that judgment to execute against provisionally attached or other locatable assets of the debtor through court seizure and auction.

Provisional attachments can generally be obtained within 1 to 2 weeks. The time required to obtain judgment on the debt (and exhaust appeals) will vary significantly case by case. However, in the absence of special circumstances or appeals, time frames of 6 to 12 months would be normal. Post-judgment execution against assets, once located and seized, normally requires 3 to 6 months. However, substantial delays are always possible in any given case.

Assuming assets can be located, debt actions in Taipei, China courts are viable.

b) Secured property enforcement remedies.

Security over land and chattels is generally created by registration. Security over rights is created by contract, delivery of the instrument evidencing the right and notice to the underlying obligor.

Realization on security in most cases requires foreclosure and auction through the courts. Auction sales are conducted by sealed bid. Foreclosure is commenced by application to the court and a showing that the debt is past due. Judgment on the underlying debt is not required. Upon foreclosure, the court will cause the asset to be appraised, use such appraisal as a "floor price", schedule an auction date, and accept sealed bids. The highest bid over the floor price is the winning bid. If no bid exceeds the floor price, the auction will be cancelled, the floor price will be reduced (normally, by 20 percent), and the process repeated. Such repetition, with limited exceptions, will continue until a bid over the floor price is received.

There are variations for certain types of assets. For example, if the security is shares of stock listed on an exchange, the auction is replaced by a sale through the normal exchange trading mechanism handled by a court-designated broker or by the Central Depository, and if the asset is cash (e.g. a bank deposit), auction is not required.

Private sales generally are available only if the owner of the asset agrees thereto after default (agreements permitting private sale that are entered into prior to default are null and void).

Security holders may bid at auction to the same extent as if they were not the security holder. However, foreigners may be subject to foreign ownership restrictions and/or approval requirements related to purchase of land and shares of stock of companies in certain industries (e.g. telecommunications, airlines, shipping, etc.).

Taipei, China's security foreclosure system is mature and quite viable assuming that the assets have marketable value.

c) Any special debt collection or secured property remedies that are available to banking sector creditors.

There are no special debt collection or secured property remedies available to creditors that are banks but are not available to non-bank creditors.

d) Corporate bankruptcy/liquidation processes that are available to corporate debtors and creditors.

The primary action available for liquidation is bankruptcy. A petition for bankruptcy may be filed by the debtor or by any one or more creditors, and is filed with the court. The court must either accept or reject the petition within seven days. If accepted, the court will appoint a trustee, fix a time within which claims are to be filed and fix a date for the first creditors' meeting.

Bankruptcy proceedings are rare and generally not viable because of the following:

- ▲ Land, building and rights tend to be the subject to security interests and holders of security interests may auction the relevant assets independent from the bankruptcy.
- ▲ Assets not subject to security interests (e.g. inventory etc.) tend to disappear through extra-legal self-help measures leaving few, if any, assets to be divided among general creditors.

Bankruptcy proceedings can be very protracted.

e) Formal corporate rescue processes that are available to corporate debtors and creditors.

The formal rescue mechanism available for entities other than banks in Taipei, China is Court Reorganization. Court Reorganization, however, is available only to so-called “public companies” (companies are considered public if, among other criteria, they have paid-in capital of NT\$500 million or more).

Court Reorganization may be applied for by the following:

- ▲ The debtor’s board of directors.
- ▲ Shareholders which hold 10 percent or more of the debtor’s shares and have held such shares for at least six months.
- ▲ Creditors whose claims in amount equal 10 percent or more of the debtor’s paid in capital.

Upon filing the petition, the court will issue interim orders which typically bar disposal of assets, payment of debts and transfer of shares. Such orders are valid for 90 days and may be extended twice.

If the court approves reorganization it will appoint a reorganization manager(s) who have powers similar to a receiver/trustee in other jurisdictions and a reorganization supervisor(s) who have certain over-sight powers/responsibilities with respect to the activities of the manager.

The reorganization manager is mandated to continue the business of the debtor, register debts, formulate a plan and obtain approval thereof.

Interested parties are divided into three groups: secured creditors, unsecured creditors and shareholders. The plan must be approved by simple majority vote within each group with the qualification that if the debtor has negative net worth, the shareholders lose their right to vote on the plan. The areas of concern are:

- ▲ The fact that reorganization manager(s)/supervisor(s) often are not sufficiently independent from pre-filing managers/owners.
- ▲ The fact that interested party groups (secured creditors, unsecured creditors and shareholders) often cannot agree to a plan.
- ▲ The lack of court enforcement to prevent extra-legal activities.
- ▲ Long delays.

Timing is uncertain at best because long delays in obtaining approval of a plan are not unusual. Based on past experience, the success rate (i.e. the number of cases which result in a company which survives and provides its creditors a reasonable pay back on debt) is very low both because the companies permitted to reorganize are, in fact, often not commercially viable and because the process is not sufficiently disciplined to facilitate fairness.

f) Informal corporate rescue processes.

Informal rescues are solely a matter of contract. To a limited extent the authorities may take steps to “encourage” participation, but to date this author is not aware of legally mandatory participation being imposed.

g) Any other corporate insolvency, or insolvency-related, processes that are available under special legislation.

To date the only special legislation which would likely be relevant is the CDIA, which governs the insolvency of banks.

2 What is the effect upon debt enforcement and secured property enforcement processes of:

a) An adjudication of corporate bankruptcy/liquidation?

If a debtor becomes subject to bankruptcy proceedings, such proceedings would supplant enforcement of general creditor claims, which would be stayed. Secured creditors generally may continue to pursue foreclosure on the assets they hold as security outside the bankruptcy proceedings.

b) The commencement of a formal corporate rescue process?

Upon application for court reorganization, as discussed above, the court will issue an interim stay order pending the court's decision on whether or not to permit the reorganization. Interim stay orders normally stay all collection actions by both secured or unsecured creditors. Although, set-offs generally are not barred.

c) The initiation of an informal corporate rescue process?

Informal rescues (i.e. Contractual Reorganizations) are governed solely by contract and, thus, do not preclude enforcement actions by parties other than those who contractually agree to be bound by the relevant agreements.

d) The initiation of an insolvency proceeding under special legislation?

Initiation of a bank bail-out under the CDIA would result in a stay of all debt enforcement actions against the bank.

3 What is the effect on the management of a corporation of:

a) An adjudication of corporate bankruptcy/liquidation?

Upon commencement of bankruptcy proceedings, the court will appoint a trustee who effectively takes over the role of the board of directors. The prior board of directors loses its authority to act upon appointment of the trustee. Shareholders also lose their powers of governance.

b) The commencement of a formal corporate rescue process?

Upon court approval of Corporate Reorganization and appointment of the reorganization manager(s) and supervisor(s), the reorganization manager(s) effectively acquire the powers of the pre-filing board of directors and the reorganization supervisor(s) effectively acquire a role similar to that of a corporate supervisor. The board of directors, the corporate supervisor(s) and the shareholders all lose their powers to govern the debtor upon such appointments.

c) The initiation of an informal corporate rescue process?

The initiation of negotiations of, or execution of an agreement for, Contractual Reorganization has no impact on the management of and corporate governance powers of the debtor except to the extent the debtor or its shareholders agree to be bound by contract.

d) the initiation of an insolvency, or insolvency-related, process under any special legislation?

In the insolvency of a bank, the Ministry of Finance ("MOF") may appoint the Central Deposit Insurance Corporation ("CDIC") to take over control of the debtor bank in which case the bank's management, board of directors and shareholders lose their power to govern.

4 Who is responsible for "case management" control and administration:

a) A corporate bankruptcy/liquidation?

The trustee has the power to administer a bankruptcy under the general oversight of the court.

b) A formal rescue?

The reorganization manager has the general management/administrative functions in a Court Reorganization. Certain specified actions, however, require approval/agreement of the reorganization supervisor(s) and/or the court.

c) An informal rescue?

Which party(ies) would be responsible is solely a matter of contract. In practice, creditors tend to include in the relevant agreements a concept of a steering committee (normally made up of the largest creditors) who are given authority to make decisions based on a majority vote among themselves. One creditor may then act as the lead bank or chairman of the steering committee.

d) A case of corporate insolvency under any special legislation?

In a bank insolvency, the CDIC takes over this responsibility under the supervision of the MOF.

5 Who has the responsibility for the preparation of the plan of rescue under:

a) A formal rescue?

The reorganization manager is obligated to prepare the plan.

b) An informal rescue?

Who is to prepare the plan is a matter of contract. Generally, the debtor's management (often with the assistance of a designated accounting firm) is required to produce a plan within general parameters outlined in the agreement and to submit such plan for steering committee or creditor approval within some specific period failing which the agreement (and the rescue) terminates.

c) A case of corporate insolvency under any special legislation?

The CDIC and the MOF would develop a plan for a bank.

6 How are the different classes of creditors treated in relation to:

a) A corporate bankruptcy/liquidation?

Secured creditors generally may remove the relevant secured assets and auction such assets outside the bankruptcy proceedings. Any residual proceeds after payment of the secured debt are then returned to the bankruptcy pool.

There are various statutory preferences depending on the nature of the debtor's business or the assets involved. The more significant of these include (the following list is not necessarily exhaustive):

- ▲ In an auction or bankruptcy sale of assets, sale related costs have a priority.
- ▲ Land value increment tax (a type of capital gains tax on sale of land), customs duties (in the case of duty-deferred, imported chattels) and various other taxes and government charges (but not general income or revenue taxes) have priorities.
- ▲ Unpaid employee wages for up to six months rank in priority to general creditors.
- ▲ Builders', mechanics' and possessory liens may have priority over general creditors.
- ▲ In the sale of a vessel, claims reorganized as maritime liens under the Maritime Law, take preference over unsecured creditors.

b) A formal rescue?

In a Court Reorganization, pre-filing debt is defined as secured debt or unsecured debt. When the plan is developed the plan must be approved by a majority (one dollar/one vote) of the secured creditors and the unsecured creditors. If the debtor has positive net worth, the plan must also be approved by a majority of the shareholders (one share/one vote). If the debtor has negative net worth, shareholders lose their right to vote. In concept, there are no priorities except for those as provided for in the plan. However, it is unlikely that secured creditors will approve a plan that deprives them of the priority provided by their security interests.

Administrative costs and permitted debts incurred in the post-filing conduct of the debtor's business take priority over pre-filing debt.

c) An informal rescue?

In a Contractual Reorganization, each creditor retains its underlying claims and priorities unless such creditor expressly waives or agrees to modify such rights by contract.

d) A case of corporate insolvency under any special legislation?

Priority in the winding-up of a bank is the same as priority in the winding-up of a non-bank. Depositors are treated (in the insolvency) as general creditors. However, because deposits are insured by CDIC, it is likely CDIC would pay out insured depositors and acquire their claims as subrogee.

7 What is the position of both unsecured and secured creditors who vote against, do not agree with, or do not consent to, a plan of rescue in relation to:

a) A formal rescue?

As discussed above, in Court Reorganizations, each interested party group (secured creditors, unsecured creditors and, if there is positive net worth, shareholders) must approve the plan by majority vote. A creditor/shareholder that is out-voted by the majority is bound by the result.

b) An informal rescue?

A creditor which does not agree to sign the agreement is not bound thereby, and is free to pursue its legal and contractual remedies independently.

Once a creditor signs the agreement, it would be contractually bound by whatever voting mechanisms (e.g. delegation of authority to a steering committee) set out therein.

c) A case of corporate insolvency under any special legislation?

All creditors of a bank would be bound by CDIC's and/or the MOF's decisions.

8 In relation to the need for an insolvent corporation to have urgent working capital funding, what difficulties are encountered in the provision of such funding in relation to:

a) A formal rescue?

In a Corporate Reorganization, new (post-filing) extensions of credit have priority over pre-filing debt. The primary difficulty is the willingness of banks to extend credit notwithstanding such priority.

b) An informal rescue?

In an informal rescue, unless security is provided, the new debt has no special priority over prior debt. Thus, the primary difficulty is arriving at a financing plan with which all creditors can agree.

c) A case of corporate insolvency under any special legislation?

In a bank insolvency, the supplier of emergency funding is the CDIC or the government.

9 Briefly describe the relevant provisions relating to the setting aside of antecedent and fraudulent transactions in relation to:

a) A corporate bankruptcy/liquidation?

In a bankruptcy, the trustee may do the following:

- ▲ Apply to the court to set aside any "gratuitous or onerous" acts done by the debtor at any time prior to the adjudication of bankruptcy if such acts are prejudicial to creditors rights and which may be set aside "under general law". General law provides that if a debtor engages in a gratuitous act (e.g. issues a guarantee of third party debt without compensation) and such act jeopardizes a prior creditor, the prior creditor may petition a court to invalidate the act (e.g. invalidate the guarantee).
- ▲ Set aside any security for pre-existing debt created within six months prior to the adjudication of bankruptcy unless there was a pre-existing contractual obligation to provide such security and any prepayment of unmaturing debts.

b) A formal rescue?

There are no specific set aside provisions in the Reorganization Law. However, the above gratuitous act concept would apply.

c) A case of corporate insolvency under any special legislation?

In a bank insolvency, the above gratuitous act concept would apply.

10 Are there any provisions of law that might operate to invalidate a secured property transaction in relation to:

a) A corporate bankruptcy/liquidation?

Please refer to Section 9a above.

b) A formal rescue?

There are no provisions that would invalidate a security interest.

c) A case of corporate insolvency under any special legislation?

Because of underlying banking regulations, security interests generally do not exist over bank assets.

11 Describe the difficulties that are encountered in endeavoring to administer cases of corporate bankruptcy/liquidation and formal corporate rescue that involve property and business interests located in more than one jurisdiction.

As a general concept, Taipei, China courts most likely do not have jurisdiction over assets located outside Taipei, China and vice versa. The Bankruptcy Law, for example, expressly states that a bankruptcy adjudication outside Taipei, China shall be ineffective as regards the debtors assets located in Taipei, China. Thus, in practice, parallel proceedings may be needed.

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1 Is the restructuring/insolvency legislation generally:

- a) Understood?
- b) Being followed and/or available opportunities being taken up?
- c) Being enforced by relevant authorities?

Under the insolvency laws of Taipei, China a distinction is made between companies that have prospects of survival and those that do not. The Company Law provides for restructuring companies that may be salvaged, while the Bankruptcy Law regulates the winding-up or insolvency procedures for those companies with no real prospect of restructuring.

Prior to the Asian financial crisis, the restructuring legislation was not generally understood or followed and very few cases had been seen in Taipei, China. The financial crisis has, however, seen over 30 public companies face financial difficulty since the second half of 1998, leaving the total corporate bad debt estimated at nearly NTS\$200 billion (approximately US\$6.3 billion). Most of these companies have turned to the restructuring legislation to help solve their debt problems, although many are still under the court's rule. Their final outcomes have yet to be determined. This delay illustrates a slow and unwieldy process that is generally not sufficiently responsive in today's economic circumstances.

According to Article 282 in the Company Law, the board of directors, major shareholders and major creditors of the company may apply for restructuring. The company's property is preserved and creditors cannot make claims during the period of restructuring. Consequently, most restructuring cases have been applied for by the board of directors and major shareholders as a means of obtaining immunity from creditors' claims. The use of the restructuring process for this purpose has caused concern in the banking and financial sector and, as a result, the relevant authorities plan to update the restructuring protection for all interested parties, which will likely lead to stricter conditions and requirements on restructuring applicants.

According to Article 58 in the Bankruptcy Law, the court may declare a company bankrupt on the application of the debtor or the creditors. The court can force the company into bankruptcy under certain circumstances, i.e. if the debtor and its creditors can not reach a settlement. However, cases of forced bankruptcy have been very rare in recent years.

2 Broadly speaking, in practice, does the insolvency/restructuring legislation tend to lead to:

- a) Early recognition and action on financial difficulties experienced by a corporation?
- b) Restructuring alternatives as opposed to liquidation, and if not, why not?

The restructuring and insolvency laws do not generally lead to early recognition and action by corporates facing financial difficulties. Article 282 of the Company Law states that a public company can apply under the insolvency/restructuring legislation when its financial difficulties are likely to cause its business to cease or be suspended. In practice, the restructuring procedure is treated as an alternative to liquidation and most of Taipei, China's troubled corporations only apply for insolvency/restructuring protection when their financial difficulties worsen. Major shareholders of these companies generally use their shares as collateral to acquire funding from financial institutions. Shareholders typically fear that if they disclose the company's financial problems share prices would collapse, causing lenders to squeeze their credit and create a sequential impact on the company's finances.

3 What are the main practical difficulties being encountered in:

- a) The preparation of restructuring plans?
b) The implementation of restructuring plans?

Article 303 of the Company Law sets out the schedule for preparation of the restructuring plan and Article 304 regulates the scope and content of the plan. Providing a practical and workable financial plan is extremely difficult because of the following reasons:

- ▲ The company will lack the resources to implement its recovery plan.
- ▲ Experienced employees will likely resign.
- ▲ Credit lines will remain restricted.

The legislation does not provide for flexible arrangements to be made with creditors nor does the process proceed quickly enough to deal with a deteriorating financial situation. Consequently, there are very few successful examples of corporate restructuring in Taipei, China.

4 To what extent are companies that are going through any formal or informal restructuring merely adjusting their debt/equity structure, rather than genuinely restructuring their business operations?

The companies that apply for restructuring are usually companies with high debt/equity ratios. The financial problems of numerous companies are derived from over-investment and over-expansion into non-core businesses. Therefore, most restructuring plans focus on the debt-payback schedule and adjusting their debt/equity structure and include the disposal of non-operating assets, organization restructuring and strategic moves into high-growth sectors.

5 What are the main areas from which funding is generally being utilized by companies which undertake either formal or informal restructuring?

In Taipei, China, companies undertaking restructuring find it extremely difficult to acquire funding from formal channels such as capital markets or financial institutions. Few financial institutions will lend money to companies in the process of recovery due to their bad credit rating. Furthermore, public companies in financial difficulty are not allowed by the Securities Exchange Committee to issue new shares to raise money from the public.

Companies facing financial difficulty must search for potential acquirers or investors. However, most of these companies conduct business in traditional sectors, such as food, textile, metal and construction. These are sectors in which few investors are interested.

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