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Cross-Border Insolvency and Informal Workouts: A look at Chinese Taipei
Mr Lawrence S. Lui, Partner, Lee and Li

Border Insolvency and Informal Workouts: A look at Chinese Taipei

I. Introduction

For good reasons, Chinese Taipei has an archaic insolvency regime, which is being revamped. A short explanation for this phenomenon is that insolvency system was not necessary during high economic growth period, when the policy pattern was encouraging export by small and medium-sized enterprises. But Chinese Taipei has to globalize, it has opened up and diversified the domestic market, and both industrial upgrading and financial reform policies demand more national investment in insolvency reform.

Antiquity and Rigidity

Antiquity and rigidity of the insolvency regime in Chinese Taipei come in several forms. First, insolvency matters are treated as “non-litigious matters”, that is, matters that would not involve lawsuits and disputes. This cannot be farther from truth and reality: all practitioners and economists understand the high stakes involved in insolvency proceedings, and the human instinct to dodge and play mischief. But this is not how Chinese Taipei received its insolvency law as part of the Civil Law transplant that began at the turn of the last century in China proper.

Second, the system has suffered from “code fragmentation”. There has not been a unified code of insolvency laws. For example, the Company Law enforced and maintained by the Ministry of Economic Affairs contains a chapter on corporate reorganizations. But only public reporting companies (including listed companies) are entitled and subject to its application. Not even their subsidiaries can be included (although in informal workouts, practitioners can deal with this constraint through private negotiations).

The Bankruptcy Code, on the other hand, is a separate code in Chinese Taipei, and is maintained by the Judicial Yuan, its judiciary. In other words, liquidation and composition proceedings are governed by a statute separate from the corporate reorganization proceedings.

Third, the government has heavily controlled the banking sector until the early 1990s. Conservatism had led to asset-based lending without much emphasis on understanding the firm value and risks (including insolvency risks and costs).

Fourth, there is no special bankruptcy court. Judges are not well trained. Nor were they expected under the “non-litigious matter” mode to be fully educated in matters involving industry and finance so as to intelligently rule on important bankruptcy cases. In addition, courts in Chinese Taipei are usually congested. Therefore, often the proceedings in major corporate reorganization cases and outright bankruptcy (that is, liquidation) cases are long drawn out. Judges also often move on to their next rotational assignment without closing the pending insolvency docket.

Fifth, like many other Asian or emerging markets, Chinese Taipei has not developed the necessary institutional arrangements for a credit industry. Fraudulent conveyance is always a concern in all foreclosure-type proceedings and workout situations. Collection, retrieval and processing of credit information is underdeveloped and fragmented, in part because article 48 of the Banking Law prohibits banks from sharing information with non-bank institutions.

Pressure for Reform and Progress Thus Far

This archaic insolvency system has persisted, frankly speaking, because the high-growth economy has not felt the need for massive national investment to improve it until recent years. Other than business cycles and global oil crises, Chinese Taipei has not experienced major bankruptcies.

Of course, this all changed by the late 1990s. Industries began to experience the pains of global economic downturn. Banks started to accumulate nonperforming loans. The government had to rush through receivership and debt resolution legislation (like the 2000 Banking Law amendment and 2001 Financial Restructuring Fund Law) and take over community financial institutions (like credit departments of fishery associations and farmers associations).

Despite some earlier, ill-conceived efforts to apply administrative guidance on banks to grant moratoriums to big borrowers, since 2001 the government has demanded NPL cleanup under a “2-5-8” plan. Financial institutions on the whole are to reduce their NPL levels to below 5% and increase their capital adequacy levels to the BIS-mandated 8%. These results are to occur within two years after passage of a pending amendment to the FRF fund law that would authorize more than NT\$1 trillion of tax dollars for debt resolution.

In addition, the 2000 Financial Institutions Merger Act authorizes the formation of asset management companies to buy NPLs from banks. The Securitization Law enacted in mid 2002 permits and encourages banks to securitize performing loans. In November 2001 the Company Law underwent a major amendment including improvement of the corporate reorganization provisions. Since 2000, the Judicial Yuan of Chinese Taipei has embarked on an overhaul of the Bankruptcy Law, and currently there is already a discussion draft.

Unfortunately, the draft amendment to the Bankruptcy Law still follows the mode of separate codes before. In its effort to reform the bank sector, the FIMA law sponsored by the Ministry of Finance allows AMC's to enjoy foreclosure powers that are at odds with general bankruptcy law principles.

Warts and all, Chinese Taipei has begun to reform its outdated insolvency system. It is still too early to see the directions and impact of this reform effort. However, this effort will definitely affect cross-border insolvency proceedings and informal workouts in Chinese Taipei.

II. Cross-Border Insolvency Rules

Proper Context for Analysis

In discussing cross-border insolvency rules in Chinese Taipei, it is important to note that there are very few cases, formal or informal. In addition, most foreign investors in Chinese Taipei and most Chinese Taipei investors investing abroad set up local subsidiaries, which are separate legal entities.

Where a Chinese Taipei company (albeit a wholly-foreign owned subsidiary) is involved, one can say that technically there is no “cross-border” insolvency, because no foreign companies are involved. Similarly, when a foreign subsidiary of a Chinese Taipei company files for insolvency proceedings abroad, there is technically no “cross-border” insolvency concerns.

The exceptions are trading companies, banks, insurance companies, securities firms, air lines, shipping companies, and other businesses which for business or regulatory reasons (like landing rights) have to use the “branch” model for their investment in Chinese Taipei.

What this means is that, technically speaking, cross-border insolvency matters in Chinese Taipei can only involve Taiwan branches of foreign companies. This is a very limited scenario, but there is still likelihood of its occurrence. For example, if United Air Lines were to seek Chapter XI protection in the U.S., its Taiwan branch would need to deal with cross-border insolvency issues arising from Chinese Taipei's bankruptcy laws.

Bankruptcy Law and Related Rules Currently in Force

Under the Bankruptcy Law, the concept of bankruptcy means liquidation and dissolution of the bankrupt firm. In addition, article 4 of Chinese Taipei's Bankruptcy Law does NOT accord any binding effect on the bankrupts' assets in Taiwan. As a result, for example, a stay order arising from Chapter XI of the U.S. Bankruptcy Code will not be applicable with respect to assets of a Chinese Taipei branch of the American company seeking protection under Chapter XI. No courts in Chinese Taipei has opined on the issue of whether

such a Chapter XI proceeding would constitute a bankruptcy within the meaning of article 4 of Chinese Taipei's Bankruptcy Law. In light of the vintage of this legislation and the pattern of narrow interpretations, courts most likely would not draw such a conclusion.

In addition, a stay arising from a foreign insolvency proceeding is not a foreign JUDGMENT within the meaning of article 402 of Chinese Taipei's Code of Civil Procedure. Under this rule, Chinese Taipei courts would not review a judgement *de novo* if:

- (1) the foreign court has competent jurisdiction (as viewed under Chinese Taipei laws);
- (2) in proceedings leading to the foreign judgment against a defendant in Chinese Taipei, it has been properly served (personally or through Chinese Taipei's "letter rogatory" judicial assistance procedures);
- (3) the foreign judgment does not contravene Chinese Taipei's public order or good morals; and
- (4) the foreign court accords reciprocity over judgments made by Chinese Taipei courts.

Most importantly, such a judgement has to be final and non-appealable. By contrast, a stay order is only interim in nature and are not final judgments. In other words, under Chinese Taipei laws, creditors of a foreign company may still seek relief over assets of the foreign company located in Chinese Taipei.

The foreign company then would have to consider petitioning, through its Chinese Taipei branch, for protection under Chinese Taipei's insolvency laws. There are several problems. First, a branch is not a full legal entity. Secondly, the Company Law's corporate reorganization rules only apply to public reporting companies. As such, they cannot be invoked. Third, the Bankruptcy Law of Chinese Taipei only contemplates outright liquidation and dissolution. This could create a problem when the proceedings in the home state are, instead, reorganization in nature.

In addition, a Chinese Taipei or foreign creditor may seek enforcement against the local assets of that foreign company. Such enforcement actions include attachment from final judgment, pre-trial provisional attachment (requiring a bond of usually one-third of the claim and a lodging a definitive complaint within seven days of such levy).

In sum, the current state of cross-border insolvency law is a case of straightforward irrelevance. The current insolvency laws in Chinese Taipei do not contemplate cross-border insolvency situations at all. They do not reach over assets located outside Taiwan. For assets of a foreign company that are located in Taiwan, Chinese Taipei's insolvency laws would give effect to only local legal proceedings.

III. New Proposal under the Preliminary Bankruptcy Law Amendment Bill

Chinese Taipei's Judicial Yuan has publicized for discussions and comments a preliminary Bankruptcy Law amendment bill in 2002. This draft contains rules which are a significant from both the current law and the 1999-2000 draft, in which cross-border rules were short and ill-conceived. Indeed, I had to occasion to comment on the 1999-2000 version and suggested that the Judicial Yuan look into the work of the UNCITRAL, that is, Model Law on Cross-Border Insolvency.

Allowing Recognition of Foreign Proceedings

The 2002 preliminary bill allows a procedure to recognize a foreign court order permitting composition or declaring bankruptcy through an application filed by the representative of the composition or bankruptcy proceedings. (art. 208) Once recognized, the law of the foreign proceedings will determine the procedure and effect of the disposition of assets of the foreign debtor that are located in Chinese Taipei. (art. 213) The recognition will be binding upon the debtor, bankrupt and affiliates with respect their assets in Chinese Taipei. As a result of the recognition order, the representative of the foreign composition or liquidation proceedings will have power over the assets of the foreign debtor located in Chinese Taipei in accordance with Chinese Taipei's Bankruptcy Law. (art. 214)

Parallel Proceedings

Cryptically, the 2002 preliminary bill contains extensive provisions dealing with parallel proceedings. They cover foreign proceedings and are the subject of a recognition order, and proceedings in Chinese Taipei that arise under the Bankruptcy Law. This can be very confusing.

For example, the 2002 preliminary bill contains a rule that, despite a recognition order by a Chinese Taipei court, the same composition, liquidation or bankruptcy proceedings in Chinese Taipei would not be affected. Representatives of the foreign proceedings covered by the recognition order, however, would be entitled to participate in the parallel Bankruptcy Law proceedings in Chinese Taipei. (art. 217) If the text means what it says, a recognition order does not mean much.

Where a Chinese Taipei court has pending before it an application for permitting composition or declaring bankruptcy in the parallel Bankruptcy Law proceeding in Chinese Taipei, the 2002 preliminary bill requires it to stop and think. In other words, before it makes a non-appealable decision in the parallel proceeding under the Bankruptcy Law, it shall discontinue the review of the application for the recognition order, except when recognition would be more advantageous to creditors in Chinese Taipei. (art. 218) Again, this rule could create problems in actual cases.

Because the 2002 preliminary bill essentially allows parallel proceedings to co-exist, it also contains rules governing the distribution of the estate where a creditor has been paid or will be paid out of the foreign proceeding. In such a situation, that creditor will not be entitled to participate in distributions under the Chinese Taipei parallel proceedings unless other creditors enjoying the same seniority have been paid proportionately. (art. 219, 220).

The 2002 preliminary bill further provides that local representatives in the parallel Chinese Taipei proceedings may participate in the foreign proceedings. In addition, They may provide assistance and information to the foreign representatives and demand the same from foreign representatives. (art. 221, 222).

In sum, the parallel proceedings rule of the 2002 preliminary bill gives some, but not priority or exclusive effect to foreign proceedings. It then essentially weakens the recognition mechanism.

Foreign Reorganization Proceedings Not Covered

One of the major problems with this recognition procedure is that it does not apply to recognition of foreign orders in a reorganization proceeding. This seems to be a ill-conceived corollary of the premise that the Bankruptcy Law can only deal with liquidation proceedings. Therefore, it would not be appropriate to include foreign reorganization proceedings when the Bankruptcy Law does not contemplate (local) reorganization proceedings.

Time Gap

In addition, there always will be a time gap between (at least) the foreign court permitting composition or declaring bankruptcy and the Chinese Taipei court's recognition order. The 2002 preliminary bill allows good faith (meaning unknowing) counter parties dealing with the debtor and providing consideration for transactions with the debtor involving assets located in Chinese Taipei to assert the validity of the transaction against the estate. Where the counter party knowing engages in such a transaction, it may still assert the validity of such transaction to the extent the estate has benefited from it. (art. 215) This rule could create problems in actual cases.

Requirements for Recognition Order

The 2002 preliminary bill also requires certain documents for such a recognition procedure. (art. 209) The more important documents are:

- (1) translations and originals or authenticated photocopies of the foreign court orders permitting composition or declaring bankruptcy;
- (2) credentials of the representative in the composition or bankruptcy proceedings and translation thereof;
- (3) a full description of the financial status of the foreign debtor, including its assets, creditors and debtors, and translation thereof; and
- (4) the original full statutory text of the foreign insolvency law on whose basis the foreign court order was rendered, or a translation of the relevant statutory text.

While this rule is clear, it seems slightly more demanding than the requirement of the Model Law. (art. 15-18) Once recognized, the foreign court order and the recognition order as well as relevant documents shall be publicized. (art. 211)

Decision With Respect To Application for Recognition

The 2002 preliminary bill contains an important provision on the criteria to determine whether to recognize a foreign court order permitting composition or declaring bankruptcy. The Chinese Taipei court shall deny recognition if:

- (1) under Chinese Taipei laws, the foreign court does not have jurisdiction;
- (2) recognition would unjustifiably harm the interest of creditors in Chinese Taipei; or
- (3) if the foreign order contravenes Chinese Taipei's public order or good morals.

In addition, where the foreign court does not grant reciprocity to comparable orders of Chinese Taipei courts, the Chinese Taipei court may refuse recognition.

This rule follows article 402 of the Code of Civil Procedure governing the recognition of foreign judgments in general. A slight improvement is relaxing the reciprocity requirement (which has been the rule under Chinese Taipei's Arbitration Law for recognizing foreign arbitration awards). However, the test of "unjustifiably harm the interest of creditors in Chinese Taipei" is potentially a Pandora's box well liked by creative practitioners to forestall recognition attempts.

Provisional Relief

Before a Chinese Taipei court renders a recognition order and an application is already pending, the court may in its own discretion or upon the application of the representative of the foreign composition or bankruptcy proceeding grant the following provisional relief:

- (1) prohibit or discontinue foreclosure proceedings against the debtor;
- (2) prohibit any transfer, mortgage or other dispositions of assets by the debtor; and
- (3) other necessary provisional relief.

Unless otherwise stated in the definitive recognition order, such provisional reliefs will not be effective on rendering such an order. (art. 212)

Rescission of Recognition Order

Where justified, a Chinese Taipei court may rescind a previously rendered recognition order. Such justifications are:

- (1) where conditions under article 210 for denying recognition existed;
- (2) where the foreign proceeding has been terminated or rescinded;
- (3) where the representative provided false documents or representations; or
- (4) where the representative has materially breached its duty under the Bankruptcy Law. (art. 216)

IV. Informal Workout: The Wang Laboratory Case

As mentioned above, there have been only a few cross-border insolvency cases of note in Chinese Taipei. The context of such cases is also instructive: Chinese Taipei branches of foreign companies do not play any central role in such debt resolution.

However, an interesting cross-border insolvency case in the late 1980s is noteworthy. This matter involves Wang Laboratory Taiwan (WLT), a subsidiary of Wang Laboratory, Inc. (WLI) founded by Chinese American Dr. An Wang. WLI had owed significant amounts of trade payables to WLT, which had been its dominant oversea manufacturing plant. In an attempt to restructure and strengthen the business, WLI then invited President Enterprise Company (PEC), a leading food processing company from Chinese Taipei, to be a minority shareholder in WLT. But WLI soon experienced significant losses resulting from competition from personal computers and sought Chapter XI protection in America. How to deal with WLT and PEC in the WLI reorganization proceeding thus became an issue.

The Company Law of Chinese Taipei at that time prohibited share buyback, with one major exception. A company incorporated in Chinese Taipei may buy back its shares from a shareholder who is bankrupt, if that shareholder owes debt to the company. This is a very unique rule that allows debt-equity cancellation. Indeed, it may not be consistent with insolvency law principles. But it has been in the Company Law, and was invoked in the WLT case.

In this case, WLT applied with the MOEA for a ruling and was assured that it could repurchase shares held by WLI so as to cancel the debt owed by WLI to it. As a result of this buyback, WLT would be essentially taken over by PEC. Bank of Boston acted as financial adviser in this informal workout, which proceeded smoothly. Importantly, even though the relevant Company Law rule (art. 167) only mentions bankruptcies (which usually mean liquidations) as the triggering condition, the MOEA had no problem including reorganization (and indeed a foreign reorganization) proceedings in the ambit of this unique rule.

Technically, this is not a cross-border insolvency case because WLT is a Chinese Taipei company, and WLI itself has no other assets in Chinese Taipei. However, the importance of this case is that WLT had been run as if it was a branch. Also, although one can quibble about the policy of having a debt-equity cancellation rule like article 167, the fact of the matter is that the parties were able to efficiently and speedily resolve their financial claims and consummated a workout/buyout to everyone's satisfaction.

The 2002 preliminary bill of the Bankruptcy Law, however, does not show this much flexibility. Therein lie the opportunities to further improve the bill.

V. Conclusion

Chinese Taipei will continue its insolvency reform in earnest. The reason is obvious: the administration realizes that it has to engage in financial reform for Chinese Taipei to stay competitive globally. Increasingly, the insolvency system is viewed as part and parcel of the financial system. Therefore, insolvency reform has to be a part of the financial reform.

The key to this reform is judges in the Judicial Yuan. They have the responsibility in Chinese Taipei for both administering bankruptcy and reorganization cases and updating the Bankruptcy Law by sponsoring amendments. In this regard, problems in the cross-border insolvency chapter of the 2002 preliminary bill mentioned above need to be addressed in line with the Model Law on Cross-Border Insolvency as soon as possible. Indeed, there should be a more ambitious attempt to explore, for example, the work emerging from the UNCITRAL process on the draft Legislative Guide for Insolvency Law.

The executive branch in Chinese Taipei also has a large role to play. It needs to somehow design a model for a unitary insolvency legislation that includes all kinds of insolvency proceedings. This is important because the MOEA is charged with updating the corporate reorganization rules of the Company Law. But this fragmentation approach is not desirable. Again, the executive branch could monitor and explore the current

work of the UNCITRAL on a unitary, modern insolvency regime. It also needs to be patient with insolvency reform initiatives of the judiciary, and meanwhile not seek “quick fixes.” One of such quick fixes is to write hastily crafted special insolvency rules into banking legislation like FIMA so as to favor banks or privately held AMCs in usual corporate insolvency cases.

The private bar and the financial service community in Chinese Taipei have demonstrated much maturity in recent years where local reorganization cases are concerned. Since they operate in the private sector and have to react to market forces, they have been very responsive and adaptive to foreign practices and new concepts. For this reason, one would not be surprised if the private sector comes to lead the effort in meaningful insolvency reform in Chinese Taipei.