

Restructuring and insolvency in Taiwan: overview

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Forms of security

1. What are the most common forms of security granted over immovable and movable property? What formalities must the security documents, the secured creditor or the debtor comply with? What is the effect of non-compliance with these formalities?

Immovable property

Common forms of security and formalities. The most common form in setting up security over immovable property, such as land and buildings, is through the creation of either a:

- General mortgage.
- Maximum amount mortgage on the immovable property.

None of the above mortgages requires the transfer of ownership of the mortgaged property. The mortgage will be registered as a right owned by the mortgagee, who thereby is entitled to receive a prioritised and preferential payment from the proceeds of the mortgaged property. This will be according to a final court judgment in favour of the mortgagee in judicial enforcement proceedings when the debtor defaults, or in bankruptcy/insolvency proceedings.

The creation of a mortgage over immovable property involves certain formalities:

- A written agreement between the mortgagor and mortgagee, clearly stipulating the underlying indebtedness the mortgagee is securing.
- Registration with the competent land office.

Effects of non-compliance. The mortgage is void if the parties fail to enter into a written agreement and complete the registration.

Movable property

Common forms of security and formalities. The most common forms of security over movable property (for example, stocks, bank deposit, machinery, inventories, and cars) are as follows:

- **Pledge.** This is created by an agreement and physical delivery of the secured property to the pledgee, by which such security is perfected through the pledgee's possession of the pledged property. Generally, a pledge does not require a registration as the appearance of possession by the pledgee should be comparable to that of the mortgage registration of immovable property. However, for shares in scripless form (a trading system where settlement is carried out via book-entries rather than by the movement of physical securities) and kept in the book-entry system operated by the Taiwan Depository and Clearing Corporation (TDCC), they should be pledged by registration of such pledge in TDCC's book entry system in accordance with TDCC's regulations.
- **Mortgage.** Where the movable properties are cars, machinery, equipment, and other registerable properties under the Personal Property Secured Transactions Act, a mortgage can be created over such properties by a written agreement between the mortgagor and mortgagee, and the registration with the competent authority.
- **Lien.** Generally, when a creditor possesses a movable property of a debtor, the creditor may hold the property as security until the debtor has paid in full or performed their obligations, as long as there is a nexus between the occurrence of the creditor's claim and that property. Namely, the possession of the property by the creditor, and the fact that there is some connection between the creditor's claim and the property are two mandatory requirements for the creation of this type of

security; no written agreement or registration is required.

Effects of non-compliance. Non-compliance with the relevant formalities would make the security void.

Creditor and contributory ranking

2. Where do creditors and contributories rank on a debtor's insolvency?

When a debtor is in insolvency proceedings, the priority of payments is as follows:

- Liquidators: the costs and expenses incurred by the liquidators in the liquidation proceedings.
- Tax authorities: overdue taxes.
- Secured creditors: for example, a pledgee and mortgagee who may claim a preferential payment on the amount of proceeds derived from the pledged/mortgaged property.
- Unsecured creditors.
- Shareholders: the residual or surplus will be distributed among the shareholders or contributors in accordance with the rights attached to their shares/contributions.

Unpaid debts and recovery

3. Can trade creditors use any mechanisms to secure unpaid debts? Are there any legal or practical limits on the operation of these mechanisms?

Trade creditors are generally entitled to the right of retention to secure the unpaid debts in situations where the trade creditor is in possession of the debtor's certain property which is related to the claim the trade creditor asserts against the debtor, and the creditor may retain such property to secure the unpaid debts.

The limitation of the right of retention is that the retention of property must not be contrary to public interests or good morals, and cannot be in conflict with either a duty that must be borne by the creditor or an agreement between creditor and debtor.

Additionally, the possession by the creditor cannot be obtained or derived from an act of tort or other unlawful cause, or if at the time the creditor took possession the creditor knew, or due to gross negligence failed to know, that the property is not owned by the debtor.

4. Can creditors invoke any procedures (other than the formal rescue or insolvency procedures described in Questions 6 and 7) to recover their debt? Is there a mandatory set-off of mutual debts on insolvency?

Creditors have the right to file a lawsuit against debtors, and after obtaining a favourable final court judgment, may enforce such judgment against the debtor, either by demanding the debtor to do or not to do certain action(s), or requesting for payment at the amount as stated in the court judgment.

There is no mandatory set-off of mutual debts on insolvency. In practice, creditors may choose to set off mutual debts with the debtor if both mutual debts are due and payable.

State support

5. Is state support for distressed businesses available?

Under the Company Act of Taiwan, a company may, for improving its financial structure or resuming its normal operation, apply for a special bailout programme with the competent authorities. The company may also issue and transfer new shares to the government as the consideration for receiving

governmental financial help. If the bailout programme reaches TWD1 billion, the competent authority of the special approval and the company receiving such bailout must report its self-help plan to the Legislative Yuan of Taiwan.

Rescue and insolvency procedures

6. What are the main rescue/reorganisation procedures in your jurisdiction?

Administration

Objective. Reorganisation proceedings are intended to enable a public company to rehabilitate its business operations in accordance with a reorganisation plan approved by the interested parties and recognised by the court.

Initiation. The following qualified petitioners can file a petition for reorganisation with the court:

- The company.
- Shareholders holding at least 10% of the total issued shares of the company for at least six consecutive months.
- Creditors whose claims against the company are equivalent to the value of at least 10% of the total issued shares of the company.

Substantive tests. Provided the company's business can be revived through reorganisation, proceedings can be commenced in respect of a public company that:

- Encounters financial difficulty.
- Suspends operations.
- May need to cease its operation to rehabilitate its business operations.

Consent and approvals. A majority of the aggregate votes for each of the interested parties at an interested parties' meeting are required for a proposed reorganisation plan to be approved. The interested parties are as follows:

- Preferred creditors (whose rights are given priority over others by law).
- Secured creditors.
- Unsecured creditors.
- Shareholders.

In the event that the net asset value of the company is negative, the shareholders must abstain from voting. The reorganisation plan adopted at an interested parties' meeting will become binding on the company and the interested parties on the court's further approval.

Supervision and control. The power and authority of the directors and supervisor(s) as well as those of the shareholders' meetings to manage the company's business operation and financial affairs will be assumed by the reorganiser(s) appointed by the court. The court will also appoint an inspector to supervise the reorganisation proceedings. The court will prohibit the company from engaging in certain activities without the inspector's consent (such as disposing of its property outside the ordinary course of business, incurring borrowings, and entering into material or long-term contracts).

Protection from creditors. When a petition for the commencement of reorganisation proceedings is filed, the court may issue a stay order to preserve the assets of the company in order for the company to remain solvent for the reorganisation. The court may issue a stay order for any of the following purposes:

- Freeze the company's assets.
- Restrict the company's business activities.

- Restrict the company's performance of its obligations, and the exercise of rights of claim against the company.
- Impose a stay on the company's bankruptcy, settlement, or compulsory execution proceeding.
- Prohibit the transfer of the company's registered shares.
- Make an assessment of the liabilities of the company's responsible persons for any loss or damage caused, and freeze their assets.

Length of procedure. Reorganisation proceedings can last for 18 to 30 months depending on whether the creditors can reach a consensus on the reorganisation plan.

Conclusion. The execution of the reorganisation plan should be completed within one year after the date of the court's approval. The court may extend the one-year period on an application by the reorganisation supervisor(s). Failure to timely execute the entire reorganisation plan may result in the termination of the company's reorganisation proceedings.

7. What are the main insolvency procedures in your jurisdiction?

Liquidation

Objective. The principal purpose of a liquidation bankruptcy proceeding is to equally distribute the bankruptcy estate of an insolvent debtor to all its creditors.

Initiation. A bankruptcy petition may be filed by either:

- The insolvent debtor as a voluntary bankruptcy petition.
- One or more of its creditors as an involuntary bankruptcy petition.

However, in the event a company's assets are not sufficient to pay off its debt, the company's board of directors must file a bankruptcy petition immediately, unless the company is a public company but still has chance for turnaround and has petitioned for reorganisation (*see Question 6*).

Substantive tests. Bankruptcy proceedings can be commenced in respect of a debtor when its assets are not sufficient to pay off its debt. The petitioner should prove to the court that the:

- Debtor's liabilities exceed its assets.
- Debtor has more than one creditor.

Consent and approvals. No consent is required from creditors for the commencement of bankruptcy proceedings provided the bankruptcy petition will be approved by the court.

Supervision and control. On adjudication of bankruptcy, the debtor is deprived of its power to manage and dispose of its property that should be classified as the bankruptcy estate. The court will appoint a trustee to administer and dispose of the debtor's property.

Protection from creditors. All of the creditors' efforts to enforce their claims against the debtor must stop. This is except for the claims that have been secured by means of a pledge, mortgage or lien before the adjudication of bankruptcy. Such secured creditors are entitled to enforce their rights over the collateral without going through the bankruptcy proceeding. If the sale proceeds available from the enforcement are insufficient to repay the debt in full, the secured creditors may then participate in the bankruptcy proceeding for the recovery of any unpaid portion of the debt as unsecured creditors.

Length of procedure. The length of proceedings will differ on a case-by-case basis, depending on the debtor's specific circumstances.

Conclusion. The assets of a company under a bankruptcy proceeding would normally be disposed of by the trustee and the sale proceeds would be parcelled out to the creditors according to their priority of rights. The debts and administrative expenses in connection with the estate must always be first paid out of the estate. The court will terminate the bankruptcy proceeding on the trustee's application when the debts and expenses incurred in the bankruptcy proceeding exceed the value of the estate.

Stakeholders' roles

8. Which stakeholders have the most significant role in the outcome of a restructuring or insolvency procedure? Can stakeholders or commercial/policy issues influence the outcome of the procedure?

Stakeholders

The creditors play the most significant role in reorganisation proceedings while the trustee plays the most significant role in bankruptcy proceedings.

Influence on outcome of procedure

Reorganisation proceedings. The reorganisation proceedings involve negotiations between a company and its key creditors. The reorganisation will fail if the creditors cannot reach a consensus on the reorganisation plan.

Bankruptcy proceedings. Bankruptcy proceedings are usually governed by the trustee. The court is competent to decide who will become the trustee. In practice, the court usually appoints a professional such as a certified public accountant, a lawyer or a reputable person in the field of the debtor's business as the trustee. Creditors also have the right to elect a new trustee in the creditors' meeting.

Liability

9. Can a director, partner, parent entity (domestic or foreign) or other party be held liable for an insolvent debtor's debts?

Director

The director assumes a fiduciary duty and duty of care in respect of the sound administration and management of an insolvent debtor's affairs. The director will be held responsible for any damages suffered by the insolvent debtor due to their breach of their fiduciary duty and duty of care.

Partner

The liability of a partner is limited to the extent of their capital contribution. The general partner of the limited partnership assumes a fiduciary duty and duty of care in respect of the sound administration and management of an insolvent limited partnership's affairs. The general partner will be held responsible for any damages suffered by the insolvent limited partnership due to their breach of their fiduciary duty and duty of care.

Parent entity (domestic or foreign)

The liability of a shareholder is basically limited to the extent of its capital contribution. However, if a shareholder abuses the company's status as a legal entity thereby causing the company to bear specific debts which are apparently difficult for the company to repay, and if such abuse is of a severe nature, the shareholder will, if necessary, be liable for such debts.

If the parent entity is a controlling company and has caused its subordinate company to conduct any business which is contrary to normal business practice or not profitable, but fails to pay an appropriate compensation at the end of the relevant fiscal year, causing the subordinate company to suffer damages, the controlling company will be liable for such damages.

Other party

A non-director of a public company will be deemed a shadow director and will be subject to a director's liabilities if they:

- De facto perform a director's duties.
- Have de facto control over a company's personnel, financial or business operations and can instruct a director to perform their duties.

Setting aside transactions

10. Can an insolvent debtor's pre-insolvency transactions be set aside? If so, who can challenge these transactions, when and in what circumstances? Are third parties' rights affected?

Reorganisation proceedings

A transaction without remuneration entered into by a debtor is revocable by the debtor's creditors if the transaction is detrimental to them. Revocation of a transaction with remuneration requires further evidence that the parties to such transaction are both aware that the transaction is detrimental to the rights of the debtor's creditors when conducting such transaction.

To determine whether a transaction is detrimental to the rights of the debtor's creditors, the court precedent holds the view that a transaction would not be considered detrimental to the rights of the debtor's creditors if the debtor still has sufficient assets to repay the debts owed to its creditors after the transaction is completed. In other words, the creditors of a debtor cannot revoke a transaction if the debtor becomes insolvent after the transaction.

To determine whether the parties to the transactions are both aware that the transaction is detrimental to the rights of the debtor's creditors, in addition to actual knowledge, the court once held the view that the relevant parties would be assumed to have such knowledge if the remuneration paid under a transaction concerned is obviously more favourable to the counterparty than would be the case for an arm's-length transaction.

Bankruptcy proceedings

The trustee can request the court to revoke a transaction conducted by the debtor prior to its declaration of bankruptcy (*see Question 7*).

Further, the trustee is also entitled to revoke the following transactions conducted by the debtor:

- Provision of security interest over existing debts within six months prior to the debtor's declaration of bankruptcy, unless such provision of security interest is based on a promise made prior to the six-month period before entering into the bankruptcy.
- Prepayment of debt prior to its maturity within six months prior to the debtor's declaration of bankruptcy.

Carrying on business during insolvency

11. In what circumstances can a debtor continue to carry on business during rescue or insolvency proceedings? In particular, who has the authority to supervise or carry on the debtor's business during the process and what restrictions apply?

Corporate reorganisation proceedings

For corporate reorganisation proceedings under the Company Act (applicable to public companies) the court will appoint reorganisers and reorganisation supervisors for the debtor.

During the reorganisation process, the debtor's business will be carried out by the reorganisers as usual, subject to the court's orders and the prior consents of the supervisors for certain material matters. In most cases, the court will appoint the directors of the debtor to act as the reorganisers, and the reorganisation supervisors are normally professionals.

The material matters that require the reorganisation supervisors' consent include:

- Disposal of property of the debtor outside its ordinary course of business.
- Change of the debtor's business or the ways of its operation.
- Obtaining a loan.
- Conclusion or rescission of important or long-term contracts (the scope of which will be determined

by the reorganisation supervisor).

- Proceeding in litigation or arbitration.
- Waiver or assignment of the debtor's rights.
- Dealing in cases where others exercise rights of retrieval, rescission or set-off.
- Appointment and removal of the debtor's important officers.
- Other matters restricted by the court.

Bankruptcy proceeding

For bankruptcy proceedings under the Bankruptcy Act, once the debtor's bankruptcy is approved by the court, the debtor will no longer have any right to manage or dispose of its assets. The court will appoint a trustee to handle the relevant matters. Before the first creditors' meeting, the trustee may keep conducting the debtor's business, to the extent necessary for completing disposition of the debtor's assets and repayment of its debts and subject to the court's consent. The creditors' meeting may appoint one or more supervisors to supervise the bankruptcy proceeding and determine whether the debtor should cease or keep carrying out its business operation.

The trustee should obtain the supervisor's consent before proceeding with the following matters:

- Transfer of real estate.
- Transfer of copyright, patent, mining rights and fishing rights.
- Transfer of business or all inventories.
- Obtaining a loan.
- Transfer of movable properties (other than transfer under permitted business operations).
- Transfer of claims or securities.
- Asking for return of funds, securities or other valuable assets under a trust.
- Performance of a bilateral contract under which the parties have payment obligations to each other.
- Settlement and arbitration regarding the debtor's assets.
- Waiver of rights.
- Acknowledgement of others' rights to take back their properties, others' security interest over the debtor's assets, and the debts and expenses arising from the bankruptcy process.
- Asking for return of assets that are subject to other's security interests.
- Instituting litigation or other legal proceedings regarding assets that should be subject to the bankruptcy proceeding.

Additional finance

12. Can a debtor that is subject to insolvency proceedings obtain additional finance both as a legal and as a practical matter (for example, debtor-in-possession financing or equivalent)? Is special priority given to the repayment of this finance?

Reorganisation proceedings

During the reorganisation proceeding, the reorganisers can represent the debtor to obtain a loan with the reorganisation supervisors' consent.

The debtor's debts arising from its continuous business operations will have a priority over other creditors' claims.

Bankruptcy proceedings

During the bankruptcy proceeding, the trustee can represent the debtor to obtain a loan with the supervisors' consent.

The debtor's debts arising from the trustee's act regarding the assets under the bankruptcy proceeding will have a priority over other creditors' claims.

Multinational cases

13. What are the rules that govern a local court's recognition of concurrent foreign restructuring or insolvency procedures for a local debtor? Are there any international treaties or EU legislation governing this situation? What are the procedures for foreign creditors to submit claims in a local restructuring or insolvency process

Recognition

Under current Taiwan law, recognition of foreign legal proceedings (including foreign restructuring or insolvency procedures) can only be made through the recognition and enforcement of a foreign final court judgment/order on a reciprocal basis. There is no special procedure for a general recognition of foreign restructuring or insolvency procedures.

However, the Bankruptcy Act of Taiwan expressly provides that Taiwan courts will have exclusive jurisdiction for a local debtor's bankruptcy processes, and a debtor's assets in Taiwan will not be subject to a foreign settlement or bankruptcy process. As such, it is likely that Taiwan courts will not recognise or enforce a foreign court's judgment or order in respect of a foreign bankruptcy process. The Company Act of Taiwan is silent as to whether a local debtor and its assets in Taiwan can be subject to a foreign procedure similar to the reorganisation proceeding under the Act. However, it is likely that local courts will follow the Bankruptcy Act and hold the same position regarding the recognition and enforcement of the relevant foreign court judgment or order.

Concurrent proceedings

There is no special procedure under Taiwan law for a general recognition of foreign restructuring or insolvency procedures. As the Bankruptcy Act of Taiwan expressly provides that Taiwan courts will have exclusive jurisdiction for a local debtor's bankruptcy proceeding and a debtor's assets in Taiwan will not be subject to a foreign bankruptcy proceeding, it is likely that Taiwan courts will not recognise or enforce a foreign court's judgment or order in respect of a foreign bankruptcy proceeding.

Other than the above, Taiwan laws are silent on how to deal with concurrent foreign restructuring or insolvency procedures for a local debtor.

International treaties

Taiwan is not a party to any international insolvency treaty.

Procedures for foreign creditors

Foreign creditors are treated in the same manner as local creditors.

Reform

14. Are there any proposals for reform?

In April 2016, a proposed amendment to the Bankruptcy Act of Taiwan was jointly submitted by the Executive Yuan and Judicial Yuan to the Legislation Yuan. Under the proposed amendment, the Bankruptcy Act of Taiwan will be renamed the Debt Clearance Act. It will (among other things):

- Combine the reorganisation and bankruptcy processes under the same Act.
- Introduce a procedure for the recognition of foreign restructuring or insolvency procedures.

The amendment is still under Legislation Yuan's review.

Online resources

Ministry of Justice

W <http://law.moj.gov.tw/Eng/>

Description. The website is maintained by the Ministry of Justice, and provides access to Taiwanese laws.

Legislative Yuan of Taiwan

W www.ly.gov.tw/Engpages/index.aspx

Description. The website is maintained by the Legislative Yuan of Taiwan, and provides links to Taiwanese legislation.