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# Creditors' Rights in Taiwan: A Comparison of Corporate Reorganization Law in the United States and the Republic of China

Jane Kaufman Winn

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# Creditors' Rights in Taiwan: A Comparison of Corporate Reorganization Law in the United States and the Republic of China

*Jane Kaufman Winn\**

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## I. Introduction

This article is based on a study of the company reorganization law of the Republic of China on Taiwan (ROC) undertaken in 1986 for the Banking Committee of the American Chamber of Commerce in Taipei.<sup>1</sup> The study was designed to compare the ROC reorganization statute with the U.S. company reorganization statute in order to produce proposals for reform of the ROC statute. An examination of the experiences of creditors who participated in court-ordered reorganizations in the ROC from 1983 to 1986 reveals several major sources of creditor dissatisfaction.<sup>2</sup>

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<sup>1</sup> Many facts and statutory interpretations given in this article were provided to the author in interviews. Some interviewees agreed to speak freely concerning their experiences and opinions in exchange for assurances that there would not be attributions of comments likely to disturb long-standing business relationships. Not all assertions, therefore, can be substantiated in conventional footnote form.

<sup>2</sup> In the late 1970s and early 1980s, a large number of foreign banks set up branches in Taipei. Two major factors contributed to this unprecedented flood of foreign banks into the local ROC banking market. The official ROC policy at that time was to encourage foreign banks to establish operations in Taiwan. Also, many banks from major financial centers around the world were flush with petrodollars from the second major round of oil price increases and were looking for new markets in which to place those funds.

In the early 1980s, the economy of Taiwan moved into its first serious and prolonged recession in over a decade, causing many companies to become insolvent. Those compa-

One essential prerequisite to any successful form of court supervised debtor relief is the ability of the courts actually to assert jurisdiction over the debtor and prevent fraud. Experience in both the United States and the ROC shows that any legal procedure aimed at debtor relief that is not combined with adequate court control of the proceedings acts as an open invitation to debtor misconduct. The prospects for a workable court-ordered reorganization process in Taiwan, therefore, depend in part on the ability and willingness of the ROC courts to take control of the proceedings.

The reorganization process in Taiwan is initiated after a petitioner files with the court and the petition is reviewed by government agencies such as the Industrial Development Board of the Ministry of Economic Affairs and the Taiwan Securities and Exchange Commission (Taiwan SEC).

Once a reorganization has officially commenced, ROC law provides inadequate constraints on the conduct of the "reorganization manager" (similar to the "debtor in possession" under U.S. law). The provisions under ROC law for a "reorganization supervisor" to oversee the activities of the reorganization manager and to represent the creditors' interests have proven ineffective. Some tougher mechanism is needed to prevent or discipline self-interested conduct by company management and to maximize the value of the estate for the benefit of creditors.

Local and foreign bankers have been unable to set common objectives within creditors' committee meetings in part because of the different management philosophies of the two groups of bankers. Local banks in the ROC are often government-owned. Local bank employees, therefore, are subject to civil service regulations that severely limit the exercise of any independent business judgment. Bureaucratic constraints on local bankers have made it more difficult to reach a consensus with foreign bankers who place greater emphasis on financial analysis in making decisions.

Plans submitted by reorganization managers have often been so unrealistic in projections of future earnings and other variables as to call into question whether the managers prepared the plans in good faith. Current ROC laws and court inaction have allowed management to use delay in submitting plans to improve their bargaining power in negotiations with creditors. Needless formality and rigidity in ROC company law has stifled attempts at innovative solutions within reorganization plans.

This article examines some possible reforms of the ROC com-

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nies invoked the reorganization provisions of the ROC Company Law for the first time. Foreign banks were forced not only to contend with ROC reorganization procedures, but also with substantial losses to local businesses. Interview with Tracy Cheng, Senior Vice President, Taiwan Stock Exchange, in Taipei (Apr. 1986).

pany reorganization statute in detail. The source of most proposals is the U.S. Bankruptcy Code. Significant differences between the legal and economic environments of the United States and the ROC, however, make the wholesale transplant of current U.S. law inadequate to deal with many issues raised in the ROC context.

## II. Economic Regulation and Company Law

Important differences exist between the legal systems of the United States and the ROC. The U.S. legal system is part of the Anglo-American legal tradition, while the ROC system is part of the civil law tradition. More important than any structural difference between the U.S. and ROC legal systems, however, is the relative importance of the legal system within the larger context of the national economic, political, and social systems. The formal legal system of the ROC today does not enjoy the same prominent position within Taiwanese society that the legal system enjoys in the United States. Laws and regulations often are of marginal relevance to most developments in Taiwan because actual conduct and events refer to social norms and political power rather than to the formal legal system.

The interpretation of any statute, including the Company Law reorganization provisions, is subject to qualification because of the diminished authority of the ROC legal system in general. This section of this article looks at the legal system of the ROC and the development of company law to determine to what extent ideas borrowed from the U.S. system of regulating economic and financial markets have any chance of success in dealing with challenges faced by ROC policymakers.

### *A. Economic Regulation in the Republic of China*

The legal system plays a central role in economic regulation and business decision making in the United States. Court-ordered reorganizations are only one small element of that very legalistic business and economic environment. Businessmen and government officials in the ROC today rely much less on their legal system in meeting individual and national economic objectives. This difference results from traditional Chinese ideas about law and from the recent history of the ROC.

#### *1. Law and Authority in Chinese Culture*

The Confucian tradition in China remains important in understanding the social and political systems of the ROC. ROC schools actively promote Confucian classics and the thought of Dr. Sun Yat-Sen, the father of the Chinese republic.<sup>3</sup> The Confucian tradition

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<sup>3</sup> Goldstein, *Rich Heritage Faces Obstacles*, FAR E. ECON. REV., Aug. 8, 1985, at 33.

emphasizes respect for authority and personal relationships and denigrates formal legal rights and obligations.<sup>4</sup> Confucian classics emphasize the authority of parents, teachers, and the national leader as well as the duty of subordinates such as wives, children, or subjects to obey.<sup>5</sup> Confucianism expects those in positions of authority to rule by virtuous example and to dedicate themselves to the paternalistic care of their subordinates.<sup>6</sup> Dr. Sun reinforced that paternalistic tradition with his theory that the Chinese people required a period of tutelage before they would be ready to participate in a modern democracy with constitutional government.<sup>7</sup>

Confucian thought also emphasizes the importance of family and personal relationships. Maintenance of harmonious family and social relationships is considered the greatest virtue, while resort to formal laws to maintain the social order is considered decadent and vulgar.<sup>8</sup> Persons in subordinate positions should be guided by their sense of shame while persons in positions of authority should be guided by their education and highly developed sense of personal virtue.<sup>9</sup> Even the Legalist school of philosophy, which scholars considered to be in radical opposition to the Confucian school of philosophy, emphasized law as a mechanism of social control that could be used to increase the power of the state and to weaken feudal opposition to a centralized monarchy.<sup>10</sup> Little or nothing in the Chinese tradition corresponds to the modern Western preoccupation with individual rights and the idea that law can be used to safeguard the liberty of citizens against the tyranny of rulers. Even Dr. Sun believed that in a Chinese form of democracy the Chinese ideas of obligation and duty should be substituted for the Western liberal idea of individual rights.<sup>11</sup>

Although legal codes have existed in China for hundreds of years, codified law contained, until recently, little more than a summary of criminal penalties for highly antisocial acts.<sup>12</sup> Local custom-

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<sup>4</sup> See Schwartz, *On Attitudes Toward Law in China*, in *GOVERNMENT UNDER LAW AND THE INDIVIDUAL* (M. Katz ed. 1957).

<sup>5</sup> Ma Han-Bao, *Law and Morality: Some Reflections on the Chinese Experience Past and Present*, 21 *PHILOSOPHY EAST AND WEST* 443, 444 (1971):

<sup>6</sup> L. THOMPSON, *CHINESE RELIGION* 14 (1979).

The Master said, "If the people be led by laws and uniformity sought to be given them by punishments, they will try to avoid the punishments, but have no sense of shame. If they be led by virtue and uniformity sought to be given them by the rules of propriety, they will have the sense of shame and moreover will become good."

CONFUCIAN ANALECTS: THE GREAT LEARNING AND THE DOCTRINE OF THE MEAN, Book II, ch. 3 reprinted in *THE CHINESE CLASSICS*, Vol. 1, at 146 (J. Legge trans. 1893/1983).

<sup>7</sup> SUN YAT-SEN, *FUNDAMENTALS OF NATIONAL RECONSTRUCTION* 1-7 (1953).

<sup>8</sup> See Ma, *supra* note 5.

<sup>9</sup> CH'Ü T'UNG-TSU, *LAW AND SOCIETY IN TRADITIONAL CHINA* 226 (1961).

<sup>10</sup> *Id.* at 241-43.

<sup>11</sup> SUN YAT-SEN, *THREE PRINCIPLES OF THE PEOPLE* 46-52 (1981 ed.).

<sup>12</sup> See S. VAN DER SPENKEL, *LEGAL INSTITUTIONS IN MANCHU CHINA* 56 (1962/1977).

ary law provided the substance of what might be considered civil law.<sup>13</sup> The family and personal relations embodied in customary law formed the primary basis for the social order.<sup>14</sup> The formal legal system was reserved primarily for punishing the common people to supplement and reinforce their sense of shame and their desire to follow the virtuous example of their leaders.<sup>15</sup>

The idea that legal regulations are vulgar, punitive, and applicable only to the common people still has influence in Taiwan today. Drawing an analogy between regulations and a sports playing field illustrates the difference between U.S. and Chinese attitudes on law and economic regulation.<sup>16</sup> The U.S. style of regulation allows anyone interested to come onto the field and play in any game, provided that all players obey the rules and the instructions of the referees. The Chinese style of regulation shuts off the entire playing field and allows only those individuals whose character has been carefully screened to enter. Once in the field, however, the regulations allow those individuals to do whatever they want without any interference from the referees.<sup>17</sup> The analogy captures some of the traditional Chinese disrespect for formal law and the emphasis placed on moral character and hierarchy.

The traditional Chinese contempt for legalism and preference for informal personal relations is a factor that contributes to the underdeveloped state of the ROC legal system today.<sup>18</sup> When a Western-style legal system was first introduced in Ch'ing China, the leadership discouraged litigation by a variety of formal and informal means. Local leaders discouraged litigation in their communities because it reflected poorly on their leadership.<sup>19</sup> Corruption among the staff of law courts was notorious.<sup>20</sup> The Chinese feared the arbitrariness and oppression of the magistrates who, in turn, actively encouraged the resolution of disputes through mediation within communities and limited the jurisdiction of their courts.<sup>21</sup> Common people feared any entanglement with formal legal processes.<sup>22</sup> They often ignored obvious violations of the law in order to avoid being drawn into a criminal investigation and receiving possible punishment.<sup>23</sup>

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<sup>13</sup> *Id.* at 102-03.

<sup>14</sup> *Id.*

<sup>15</sup> CH'Ü, *supra* note 9, at 177.

<sup>16</sup> Interview with Paul Hsu, managing partner, Lee & Li, Attorneys at Law, in Taipei (June 1986).

<sup>17</sup> *Id.*

<sup>18</sup> See Ma, *supra* note 5, at 455-57; M. MOSER, LAW AND SOCIAL CHANGE IN A CHINESE COMMUNITY 60-65 (1982).

<sup>19</sup> S. VAN DER SPRENKEL, *supra* note 12, at 72.

<sup>20</sup> *Id.* at 77.

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> See generally M. MOSER, *supra* note 18; S. VAN DER SPRENKEL, *supra* note 12; Brock-

Some Chinese defend the traditional Chinese aversion to litigation and preference for informal mediation in terms of Confucian moral theories.<sup>24</sup> Confucianists regard litigation as anti-social and disreputable behavior because it involves public expressions of hostility which are damaging to the community. A virtuous person should be willing to compromise self-interest in the interest of the harmony of the community and so submit to mediation.<sup>25</sup>

The aversion to litigation is also a result of the lack of an effective and responsive forum in which to litigate.<sup>26</sup> Michael Moser, an American anthropologist and lawyer, discovered that when a judicial forum which Chinese perceive as fair and impartial is made available, they are quite willing to litigate their problems.<sup>27</sup>

## 2. *The Legal System of the ROC on Taiwan*

The first attempts to create a Western-style legal system for China were made during the final years of the Ch'ing dynasty. These efforts were ineffective and the successful republican revolution of 1911 swept them aside.<sup>28</sup> Following the 1911 revolution, political power in China passed through the hands of various warlords. Dr. Sun Yat-Sen founded the Nationalist Party (Kuomintang or KMT) in 1919 to take control of the government from the warlords. Although Dr. Sun died in 1925, the KMT under the leadership of Chiang Kai-Shek officially gained control of the government in 1927.

Once in control, the KMT began a wide ranging program of legal reform. The KMT created the modern Chinese legal system, drawing heavily on the German Civil Code.<sup>29</sup> Political and economic realities, however, prevented the legal reforms from having a significant impact on society. Warlords remained an active political force even after 1927. The KMT was preoccupied with suppressing the

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man, *Commercial Contract Law in Late 19th Century Taiwan*, in *ESSAYS ON CHINA'S LEGAL TRADITION* 76 (J. Cohen, R. Edwards & Fu-Mei Chang Chen, eds. 1980).

<sup>24</sup> Cf. Ma, *supra* note 5 (discussion of the renewed emphasis on traditional Confucian morality).

<sup>25</sup> See M. MOSER, *supra* note 18, at 61-67.

<sup>26</sup> *Id.* at 72-73, 174-85.

<sup>27</sup> *Id.*

<sup>28</sup> For example, in 1907 a bankruptcy law was drafted and promulgated. Chambers of Commerce, modern successors to the guilds, were to play a major role in administering cases. The law contained many new expressions in Chinese in an attempt to combine traditional practices and imported modern innovations, but the result was just ambiguity. Due to resistance which emerged within the bureaucracy, the law was repealed before it was ever used. One provision gave government debt the same priority as private obligations, reversing the pre-existing rule. Since there was no public support or understanding of the law, bureaucrats were able to have the whole statute repealed rather than simply revise the offending provision. Mitrano, *The Chinese Bankruptcy Law of 1906-1907: A Legislative Case History*, 25 *HARV. L. SCH. STUD. E. ASIAN L. (CHINA)* 278 (1973).

<sup>29</sup> The German Civil Code was considered the most modern legal system in the world at that time. The Japanese had borrowed extensively from the German system in modernizing their legal system in the late nineteenth century.



Communist insurrection until forced to confront the Japanese invasion in 1937. Following World War II China again lapsed into Civil War until the Communist victory in 1949.

China had ceded the island of Taiwan to Japan under the Treaty of Shimonoseki in 1895.<sup>30</sup> Japan developed Taiwan as an agricultural colony and thus, spared Taiwan much of the upheaval mainland China suffered during the 1920s and 1930s. After Taiwan was returned to Chinese control in 1945, the situation rapidly deteriorated. Hyperinflation spread from mainland China and food shortages developed on Taiwan. The KMT violently suppressed an uprising by the Taiwanese against KMT rule in March 1947.<sup>31</sup>

The government of the ROC moved to Taiwan in 1949. The Nationalist government in Taiwan adopted a constitution in 1946, but suspended substantial portions of it in 1948 due to the civil war.<sup>32</sup> In 1948, the legislature adopted emergency measures allowing President Chiang Kai-Shek to rule by executive order "during the period of the temporary emergency arising from the Communist insurgency."<sup>33</sup> Martial law had been instituted in 1934. The government of the ROC strengthened martial law in 1949 and did not repeal it until July 1987.<sup>34</sup>

By 1985, the system of government of the ROC on Taiwan was still only nominally democratic. The Soviet support given to the KMT in the 1920s was still visible in the authoritarian, one-party state in power on Taiwan. The legitimacy of the KMT regime on Taiwan formally rests on its claim to be the sole legitimate government of all China and its stated intention to retake the mainland. With the passing decades of exile on Taiwan, the continued authority and legitimacy of KMT rule has come to depend more on providing the people of Taiwan with a rising standard of living and less on repression.<sup>35</sup> Edwin Winckler, an American political scientist specializing in ROC politics, characterized the regime in Taiwan as "gerontocratic-authoritarian" because for almost forty years the reins of power remained firmly in the hands of the aging technocratic and military elite of KMT members who fled mainland China in 1949.<sup>36</sup> Nevertheless, Winckler believes that the 1980s are a period

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<sup>30</sup> M. HANE, *JAPAN: A HISTORICAL SURVEY* 355 (1972).

<sup>31</sup> See G. KERR, *FORMOSA BETRAYED* 254-310 (1965); Shin, *Haunted by the Past*, *FAR E. ECON. REV.*, Mar. 10, 1988, at 36. "Formosan leaders in exile charge that more than 10,000 were slaughtered in the month of March. I must assume that there could not have been less than 5,000 and I am inclined to accept the higher figure." G. KERR, *supra* at 310.

<sup>32</sup> U.S. ARMY JUDGE ADVOCATE GENERAL, *COUNTRY LAW STUDY FOR THE ROC* 19 (July 1959).

<sup>33</sup> *Temporary Provisions Effective During the Period of Communist Rebellion*, 1 A *COMPILATION OF THE LAWS OF THE ROC* 43-44 (1971).

<sup>34</sup> Goldstein, *Retaining the Edge*, *FAR E. ECON. REV.*, July 9, 1987, at 24.

<sup>35</sup> See T. GOLD, *THE STATE AND SOCIETY IN THE TAIWAN MIRACLE* 125 (1986).

<sup>36</sup> Winckler, *Institutionalization and Participation on Taiwan: From Hard to Soft Authoritarianism?*, 99 *THE CHINA Q.* 481, 482 (1984).

of generational succession in which a younger, less dogmatic elite is coming to power within the KMT.<sup>37</sup> During this period of succession, Winckler predicts a general trend towards liberalization of the political system, punctuated by periods of inconsistency and uncertainty while control over policy slowly shifts.<sup>38</sup>

The executive branch of government, the KMT, the armed forces, and the security forces which administered martial law are effectively in control of political power in the ROC today. The one-party form of government and martial law have diminished the importance of the legislative and judicial branches of government.<sup>39</sup> In addition, under the ROC Constitution the legislature has no power to propose legislation, but can only review and amend bills proposed by the executive branch.<sup>40</sup>

The judicial branch is patterned on the civil law model, with a very narrowly defined power to make law or exercise constitutional review.<sup>41</sup> A shortage of lawyers and government personnel assigned to policing frustrates the enforcement of existing laws and economic regulations. The shortage of legal and administrative agency personnel is compounded by a lack of effective tools for enforcing regulations. Nothing in ROC law corresponds to the U.S. administrative law cease and desist order, which allows agency personnel to identify violations of regulations, issue warnings, and proceed with criminal prosecutions for further violations once a warning has been issued.<sup>42</sup>

The lack of a system for reporting cases further limits judicial law making in the ROC. Court records of litigation are accessible only to parties and their counsel. Although appellate and Supreme Court cases are reported, they are not binding precedent unless a special committee of the Supreme Court designates them as such. This committee convenes only about every five years.<sup>43</sup>

### 3. *Economic Development and Business Practices*

The economic miracle the ROC has enjoyed since the 1960s is due at least in part to economic planning and incentives for development which the central government initiated. The administration of

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<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> Since the late 1970s, the opposition to the KMT has been increasingly active in Taiwan and even formed an unofficial opposition party. There were indications that, in 1987, the opposition to the KMT would be allowed to form an officially recognized opposition party. Although martial law was repealed in 1987, it was replaced by a National Security Law that reimposed some of the features of martial law.

<sup>40</sup> ROC CONST. arts. LVII(1) & LXIII.

<sup>41</sup> A. VON MEHREN & J. GORDLEY, *THE CIVIL LAW SYSTEM: AN INTRODUCTION TO THE COMPARATIVE STUDY OF LAW* 1142-45 (2d ed. 1977).

<sup>42</sup> For example, in the U.S. bankruptcy context, "[t]he Court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [Title 11]." 11 U.S.C. § 105(a) (1982 & Supp. IV 1986).

<sup>43</sup> Baker & McKenzie, *Taiwan Newsletter*, April-June 1987, at 11.

U.S. aid by the Joint Commission on Rural Reconstruction in the early 1950s began the economic planning process in Taiwan.<sup>44</sup> By the late 1950s, the aid had helped the government establish a formal economic plan. In the late 1950s and early 1960s, the ROC made a series of farsighted and highly successful reforms in the tax code and regulation of foreign investment to encourage the growth of Taiwan's export industries.<sup>45</sup>

Officials describe economic planning in Taiwan as "indicative," designed to provide support for a free enterprise economy and not in any sense compulsory. Direct central government involvement in the economy of Taiwan, particularly in the form of government-owned enterprises, however, is fairly substantial. This direct government intervention may be justified by referring to the economic philosophy of Dr. Sun.<sup>46</sup> Dr. Sun's philosophy, which he expressed in "Three Principles of the People," includes the principle of "peoples' livelihood" or the obligation of the government to provide for the material well being of the people of China.<sup>47</sup>

The ROC Constitution affirms that the "Three Principles of the People" are the basis of the government of the ROC.<sup>48</sup> The central government, therefore, has a constitutional mandate to take positive steps to manage the economy and control economic development for the benefit of all the citizens of the ROC. Government ownership of almost all major banks is an example of where the "Three Principles of the People" guide and legitimate government economic intervention.

Although central government intervention in the economy of Taiwan is substantial, many government-owned companies are in effect public utilities.<sup>49</sup> Since the 1950s, the private sector of the economy of Taiwan has grown relative to the public sectors and now accounts for more than eighty-seven percent of industrial production.<sup>50</sup> As much as ninety percent of the private sector of the ROC consists of small and medium businesses which are often family owned.<sup>51</sup> A very free-wheeling laissez-faire capitalism prevails, especially in the part of the private sector dominated by small and medium businesses. Firms face intensely competitive conditions.

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<sup>44</sup> See N. JACOBY, U.S. AID TO TAIWAN 32 (1966).

<sup>45</sup> S. KUO, G. RANIS & J. FEI, THE TAIWAN SUCCESS STORY: RAPID GROWTH WITH IMPROVED DISTRIBUTION IN THE REPUBLIC OF CHINA, 1952-1979, at 73-78 (1981).

<sup>46</sup> HSIEH KWAN-SHENG, A BRIEF SURVEY OF THE CHINESE CONSTITUTION 22-30 (1957).

<sup>47</sup> *Id.*

<sup>48</sup> ROC CONST. art. I.

<sup>49</sup> State-owned companies in the ROC include Taipower, China Petroleum, Taiwan Sugar, Taiwan Fertilizer, China Steel, China Shipbuilding, Taiwan Metal Mining, and China Petrochemical Development. The trains, phone system, and post office are controlled directly by the Ministry of Communications.

<sup>50</sup> ROC 1986: A REFERENCE BOOK 209. In the 1950s, the private sector accounted for less than half of industrial production.

<sup>51</sup> *Taiwan Survey*, THE ECONOMIST, Mar. 5, 1988, at 11.

In addition to the dozen or so nationalized industries, there are also several major private companies in Taiwan today. Companies commonly combine informally to form enterprise groups, although ROC company law does not recognize conglomerates.<sup>52</sup> Some of the leading enterprise groups in Taiwan rose to prominence by cooperating with government officials to invest in industries targeted as strategic under economic plans.<sup>53</sup> The largest enterprise group in Taiwan, the Formosa Plastics group, achieved success by responding to government calls for investment in the manufacture of certain types of raw materials the plastics industry needed for development in the early 1970s.<sup>54</sup>

This cooperation between major local entrepreneurs and central government planning officials has clearly been important in the economic development of Taiwan.<sup>55</sup> Until recently, central government bureaucrats undertook the central economic planning in the ROC with a minimum of discussion and cooperation with business representatives.<sup>56</sup>

The government supported this system of indicative economic planning indirectly through encouragement in the form of tax incentives. Indicative economic planning combined with limited direct government ownership of industry and an unruly, effectively unregulated private sector has complemented the political divisions of power in Taiwan. The ROC gave many mainlanders who arrived in Taiwan in 1949 positions in government or government-owned industries.<sup>57</sup> For many years, Taiwanese participation in central government was very limited.<sup>58</sup> The grant of economic freedom, however, compensated the local population in some sense for the denial of political rights.

The failure of central government economic planning to reach

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<sup>52</sup> Chuang, *Legal Aspects of Relationships of Enterprise Groups in Taiwan* 7 (1986) (S.J.D. thesis, U.C.-Berkeley). See also *infra* text accompanying notes 95-96.

<sup>53</sup> T. GOLD, *supra* note 35, at 83.

<sup>54</sup> Two of the corporate reorganization case studies at the end of this article, Delta Petrochemical and Ta Nun, involved companies which received government monopoly licenses in the 1970s as part of a program to foster the development of domestic industries in Taiwan. See the Delta Petrochemical and Ta Nun case studies at the end of this article.

<sup>55</sup> This cooperation, however, does not approach the degree of cooperation between government and industry found in Japan and Korea. The ROC has no conglomerates which approach the magnitude or importance of the Japanese or Korean trading conglomerates which combine international marketing, production, and financial operations.

<sup>56</sup> Interview with Su Han-Ming, Senior Vice President and Chief Economist, International Commercial Bank of China, in Taipei (Apr. 1986).

<sup>57</sup> J. FAIRBANK, E. REISCHAUER & A. CRAIG, *EAST ASIA: TRADITION & TRANSFORMATION* 937 (1973).

<sup>58</sup> This began to change in the 1970s. The process of greater Taiwanese participation in a government controlled by the KMT and mainlanders has been further accelerated with the formation of an opposition party in 1986, the Democratic Progress Party (DPP). Although the formation of an opposition party is still officially banned, the DPP has been tolerated by the authorities and allowed to take seats in the legislature.

very deeply into many aspects of private sector economic activity has contributed to the development of a large unregulated money market in the ROC.<sup>59</sup> Another contributing factor was the tight money conditions prevailing throughout the 1960s and 1970s in Taiwan, which caused the demand for credit to exceed the amount regulated banks and financial institutions could provide. Many forms of financial transactions in the unregulated money market take place between friends and relatives based upon mutual trust.<sup>60</sup>

Many businesses in Taiwan fail to maintain accurate financial records.<sup>61</sup> While relaxed bookkeeping practices may be due in part to a lack of financial sophistication among small and medium businesses, the practices are also due to efforts to evade business taxes.<sup>62</sup> The tax code indirectly condones the failure to keep accurate financial records. It provides that where a business' records are so incomplete that the tax inspectors cannot accurately assess the tax liability, the tax inspectors may simply levy taxes based on the average rate of profit for that industry.<sup>63</sup> The unfortunate result has been that many local businesses have failed to develop and maintain reliable accounting systems.<sup>64</sup> According to a U.S. businessman in Taiwan, during the years of Taiwan's tremendous economic success, many businesses were happy to pay taxes at an artificially low average rate of profit because their actual profits were usually well in excess of that rate.<sup>65</sup>

The lack of an efficient credit reporting system as well as irregular accounting practices within firms and ready access to working capital through informal and unregulated sources, which are often not reported in full company accounts, have hindered the development of a sound financial market in Taiwan. Until very recently, information about borrowers was very difficult or impossible to obtain. For example, even though the MOEA requires companies to file cer-

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<sup>59</sup> Kaufman-Winn, *Decriminalizing Bad Checks Should Help to Rationalize Taiwan's Financial System*, 8 E. ASIAN EXEC. REP. 9, 20 (Aug. 15, 1986).

<sup>60</sup> CHINA ECON. NEWS, Jan. 28, 1985, at 6. Commonly, a credit lottery (or *piao hui* in Chinese) is set up between neighbors or people who work together. For example, each of twenty members will contribute the equivalent of U.S. \$100 every month. In return, each member will receive the collected sum once during the life of the *hui*. Surveys indicate that up to 85% of the public in Taiwan participates in *piao hui* and most participants never request any written evidence of obligation or collateral. Members may participate in the *hui* as a form of saving, or may initiate a *hui* to raise money for business or personal use. *Id.*

<sup>61</sup> S. Champion, American Bankers' Comments on Accounting and Auditing Standards in Taiwan (undated, unpublished report on file with the N.C.J. Int'l L. & Com. Reg.).

<sup>62</sup> This problem is by no means unique to Taiwan, but is probably endemic in developing countries. See generally Wilson and McBride, *The Fictions and Figures in the Company Books*, FAR E. ECON. REV., Dec. 8, 1978, at 43.

<sup>63</sup> ROC Income Tax Law art. 83.

<sup>64</sup> Interview with William M. Foley, partner, Peat, Marwick, Mitchell & Co., in Taipei (Mar. 1986).

<sup>65</sup> See, *supra* note 1 regarding confidential sources.

tain information concerning promoters and capitalization when seeking permission to incorporate, this most minimal information is not available to interested parties without a court order.<sup>66</sup> Because court records are not a matter of public record, even information about prior judgments against a prospective borrower might be difficult to obtain.

Since the 1970s, the authorities have taken several steps to reduce the importance of the unregulated money market and to promote sound credit practices. In the late 1970s, the ROC established "bills finance houses" to create a regulated commercial paper market and to get major companies out of the unregulated money market.<sup>67</sup> In 1986, in an effort to diminish reliance on postdated checks as a credit instrument, the ROC government eliminated criminal penalties for bouncing checks.<sup>68</sup> Postdated checks have been enormously important in the unregulated money market.<sup>69</sup> The business community viewed the removal of criminal penalties as a dramatic official step to undermine the security of transactions in that market and to pressure businessmen to turn to regulated sources of finance.<sup>70</sup>

The ROC authorities have not yet effectively addressed one major factor contributing to the growth of the unregulated money market: the inability of overregulated, bureaucratic government-owned banks to meet the legitimate demand for credit in Taiwan. The Economic Reform Committee (ERC)<sup>71</sup> recommended more consistent enforcement of existing regulations, less central government interference in the day-to-day management of the government-owned banks, and the licensing of additional privately owned banks.<sup>72</sup> As of 1987, no positive steps had been taken since the ERC report to implement any of these reforms.

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<sup>66</sup> Shen, *Bad Check Decriminalization Boosts Credit Information Business*, in FINANCIAL AND INVESTMENT YEARBOOK ROC 1987, at 43.

<sup>67</sup> R. Ho, *The Financial System in Taiwan, ROC, Its Function and Operation* 22-25 (Oct. 1981) (unpublished report on file with the N.C.J. Int'l L. & Com. Reg.).

<sup>68</sup> Kaufman-Winn, *supra* note 59, at 9.

<sup>69</sup> Many transactions in the unregulated money market are not documented at all and are supported by the existence of family or close social connections between the parties. With the growth of the unregulated money market since the 1960s, however, not all transactions can depend on personal relationships for security. By requiring postdated checks as security for credit in the unregulated money market, unregulated lenders could use the criminal penalties as a cheap, efficient method of securing and enforcing their credits. When the authorities administered the criminal penalties, they were in effect intervening in the unregulated money market on behalf of unregulated lenders.

<sup>70</sup> Kaufman-Winn, *supra* note 59, at 19.

<sup>71</sup> The Economic Reform Committee was established in 1985 to look into the causes of the Cathay scandal and make suggestions on what improvements were needed in the ROC's current economic and financial system. Goldstein, *In Exchange for What?: Taiwan Debates Benefits of Freer Currency Movements*, FAR E. ECON. REV., Oct. 3, 1985, at 67; Goldstein, *The Never-Ending Story: More Nasty Surprises in Taiwan's Cathay Banking Scandal*, FAR E. ECON. REV., Sept. 12, 1985, at 93.

<sup>72</sup> Liang Kuo-Shu, *Financial Reforms Recommended by the Economic Reform Committee, ROC, INDUSTRY OF FREE CHINA*, Mar. 1986, at 7.

The government considers employees of government-owned banks in the ROC to be civil servants and consequently subjects them to a draconian system of bureaucratic regulation.<sup>73</sup> In addition to regulations administered by the Ministry of Finance and the Central Bank of China, individual bank employees are subject to a special investigatory branch of government, the Control Yuan. The Control Yuan investigates losses of public property.<sup>74</sup> The Control Yuan defines all public deposits with state-owned banks as "public property" so that any loss of principal of a loan becomes a matter for investigation and assignment of fault.<sup>75</sup> Individual bank officers face administrative sanctions for any loans they make which later become nonperforming.<sup>76</sup> This concern over possible personal liability is a powerful disincentive inhibiting the exercise of business judgment within the government-owned banks. Bankers focus instead on the value of collateral and try to avoid any unsecured lending. The lack of accurate financial records further encourages the conservatism of lending officers, who prefer to lend only when real property or fixed assets can be offered as collateral. This pawn shop mentality is perfectly rational given the system of bank regulation and general standard of financial accounting, but the resulting restriction of bank credit forces many businessmen into the unregulated money market for working capital. The elimination of the unregulated market is only possible when the government allows regulated financial institutions the freedom to set their own interest rates and lending policies and to meet a greater proportion of existing demand for credit.

### *B. A Comparison of U.S. and ROC Company Law*

Judges in the Anglo-American tradition have considerable discretion to make new common law and to overrule or significantly reinterpret statutes. Civilian judges in the ROC, by contrast, are confined to applying the law as the legislature has written it. While courts in the United States can remedy statutory deficiencies by creating new common law, ROC judges are relatively powerless to do the same. Judges in the Anglo-American tradition not only have the power to create new common law, they also enjoy the power to decide cases on general principles of equity or fairness.<sup>77</sup> The equitable powers of U.S. courts have been very important in the historical

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<sup>73</sup> *Id.* at 9.

<sup>74</sup> Interview with Keng Ping, Executive Vice-President of the Bank of Communications, in Taipei (July 1986).

<sup>75</sup> If the Control Yuan defined "public property" in the government-owned banking context as the capital of the bank, individual bank officers would have no problems with investigations from losses of public property. *Id.*

<sup>76</sup> *Id.*

<sup>77</sup> A. VON MEHREN & J. GORDLEY, *supra* note 41, at 1129-45.

development of U.S. company law. Nothing in the ROC corresponds to the Anglo-American tradition of equity jurisdiction.

The court-ordered reorganization of financially distressed companies is one aspect of the regulation of corporate financial transactions. Differences between the conduct of court-ordered reorganizations in the United States and ROC stem not only from different systems for handling creditors' rights and business insolvencies, but also from different systems of company law and economic regulation.<sup>78</sup>

### 1. U.S. Company Law

In the nineteenth century in the United States, each state attempted to regulate closely the granting of corporate charters.<sup>79</sup> Corporations could be formed only by a special act of the state legislature and were granted limited powers. Courts could severely limit activities outside that grant of powers ("ultra vires" acts). This former system of court limitation of the scope of corporate charters is similar to the present system in the ROC as administered by MOEA. MOEA grants company licenses only for specifically authorized business activities.<sup>80</sup>

Following the Civil War in the United States in 1865, corporate economic activity exploded. By 1900 most states had given up trying to limit the activities of corporations. The existence of many different state governments in competition with each other for tax revenues made this revolution in U.S. company law possible. Many states offered companies low tax rates and lax legal regulations in an attempt to bring corporate investment and tax revenue into their states from other states.<sup>81</sup> This "race to the bottom" of deregulation by state governments gave company management wide powers at the expense of protections for shareholders and creditors of companies.<sup>82</sup>

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<sup>78</sup> An important feature necessary for understanding the regulation of corporate finance in the United States is the division of the U.S. legal system into a federal system which applies to the whole nation, and individual state systems which apply only to residents of each state. The ROC does not have any such division into national and local legal systems.

<sup>79</sup> See generally L. FRIEDMAN, *A HISTORY OF AMERICAN LAW* 511-12 (2d ed. 1985).

<sup>80</sup> Correspondence with David Chang to Jane Kaufman Winn (Dec. 7, 1988); See generally *infra* p. 000.

Art. 16 of the Company Law provides that:

Unless guarantee services are rendered in accordance with other applicable laws or its articles of incorporation, a company shall not act as a surety or guarantor in any manner whatsoever. The responsible person(s) of the company who violates [this] provision . . . shall not only be personally responsible for such surety or guaranty obligation, but also (severally) fined not more than twenty thousand *yuan* and liable to the company for any damage so incurred.

<sup>81</sup> L. FRIEDMAN, *supra* note 79, at 524.

<sup>82</sup> But see Romano, *Metapolitics and Corporate Law Reform*, 36 *STAN. L. REV.* 923 (1984)



The equity powers of U.S. courts also played a role in the development of company law. Anglo-American company law has many roots in trust law.<sup>83</sup> During much of the nineteenth century, courts used their equitable powers to treat management of companies like trustees for the interests of minority shareholders and creditors.<sup>84</sup> With the collapse of state statutory regulations, however, the courts also abandoned efforts to control many abuses by management.<sup>85</sup> At this time states eliminated many provisions similar to current ROC provisions concerning legal capital requirements, limitations on holding stock in other companies, and the payment of dividends.

Following the stock market crash of 1929 and during the Great Depression of the 1930s, the federal government stepped in to take responsibility for regulating U.S. securities markets. A regulatory philosophy of full and fair disclosure combined with decentralized decision making lay behind many major reforms of the 1930s. This emphasis on governmental supervision of disclosure while allowing the parties, such as creditors and shareholders, to police the actual conduct of company management makes the free flow of reliable information an essential factor in the U.S. system of economic regulation.

States never returned to the attempt to regulate directly the conduct of management through such means as limiting the use of holding companies, the scope of authorized business activities, or the setting of minimum capital requirements. Because many state governments do not actively regulate the conduct of company management, the powers of U.S. courts to protect minority shareholders and creditors based on equitable principles of fairness remain important.

## 2. ROC Company Law

The Company Law of the ROC was first promulgated under the Ch'ing dynasty in 1904 and was based on German company law.<sup>86</sup> The ROC government added a chapter dealing with court-ordered company reorganizations in 1966, which it modeled on both U.S. and Japanese company reorganization laws.<sup>87</sup>

Many provisions of the current ROC Company Law seem to in-

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(discussing the underlying political vision that states demonstrated by repealing limitations on corporate activities).

<sup>83</sup> Civil law has no equivalent of trust law. The common law idea of a trust was borrowed from Anglo-American law in the early 1970s to create "trust and investment companies," companies invented by Taiwanese financial authorities in an effort to increase the volume of long-term investment.

<sup>84</sup> See Horwitz, *Santa Clara Revisited: The Development of Corporate Theory*, 88 W. VA. L. REV. 173, 207 (1986).

<sup>85</sup> *Id.* at 214-16.

<sup>86</sup> Lai In-Jaw, *Legal Problems of Parent-Subsidiary Corporations*, in TRADE AND INVESTMENT IN TAIWAN 745, 753-54 (2d ed. 1985).

<sup>87</sup> LIN MING-HUA, TREATISE ON COMPANY REORGANIZATION LAW i (1984) (in Chinese).

dicare policies favoring sound financial management of incorporated businesses with limited liabilities.<sup>88</sup> The actual provisions of the ROC Company Law are generally more conservative than the similar provisions of company law in most states in the United States. The formal provisions of the law, however, are often undermined by erratic enforcement or restrictive judicial interpretations.<sup>89</sup> Company management is too often not accountable to minority shareholders or creditors. Existing company law, therefore, offers little relief. This potential abuse of control by management of viable companies corresponds to the inability of creditors to effectively control management during court-ordered reorganizations.

Many provisions of the ROC Company Law strictly regulate the financial structure of companies. For example, companies are required to retain ten percent of any net profits in a legal reserve until the accumulated legal reserve equals the stated capital of the firm.<sup>90</sup> Companies are forbidden to lend money to shareholders or to purchase their own shares.<sup>91</sup> The enforcement of these requirements, however, is so lax that the protections they offer creditors or minority shareholders are not meaningful.<sup>92</sup> Even sophisticated creditors may be at a loss to obtain accurate information concerning the financial structure of a company. Without such information the enforcement of particular legal obligations is impossible.

The ROC Company Law includes provisions for a "supervisor," a position which does not exist within Anglo-American company law.<sup>93</sup> The supervisor, like the board and officers of a company, is a "responsible person" under the ROC Company Law and may be liable for breach of duties of care and loyalty to the company.<sup>94</sup> As has happened in Germany, the company supervisor in the ROC is often captured by the board and does not effectively supervise management. This problem is mirrored in the inability of reorganization su-

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<sup>88</sup> *E.g.*, ROC Company Law arts. 131 (initial issues of shares must be fully paid), 156 (regulatory authority may set minimum capital requirement), 218 (supervisor authorized to examine books), 237 (10% of net profits must be set aside as legal reserve prior to declaring dividend), 15 (company prohibited from lending to shareholders), 167 (company prohibited from purchasing its own shares except in very limited circumstances), and 247 (limitations on the amount of debt the corporation can incur) [hereinafter Company Law].

<sup>89</sup> See Chuang, *supra* note 52; Lai *supra* note 86, at 761.

<sup>90</sup> Company Law arts. 232, 237.

<sup>91</sup> *Id.* at arts. 15, 167.

<sup>92</sup> Chuang, *supra* note 52, at 236; see generally *infra* p. 420.

<sup>93</sup> Wang, *Company Law of the ROC*, in TRADE AND INVESTMENT IN TAIWAN 511, 542-43 (2d ed. 1985).

<sup>94</sup> Company Law art. 216 provides for the election of a supervisor by shareholders. The supervisor reviews the financial statements and business operation of the company and generally supervises management for the benefit of shareholders. Article 23 of the Company Law provides that any "responsible person" (defined in Article 8) may be jointly liable with the company for any harm done to third parties.

pervisors to exercise any control over the conduct of reorganization managers.

ROC Company Law has no provisions to effectively regulate conglomerates or enterprise groups.<sup>95</sup> Article 13 of the Company Law limits the direct investment by one company in the shares of another to forty percent of the stated capital of the investing company. While this restriction is based on a desire to limit, if not actually prohibit, the formation of holding companies, groups of informally affiliated companies doing business are increasingly the norm in the ROC today.<sup>96</sup>

The narrow formalism of ROC courts in interpreting existing law had compounded the failure to make any statutory provision to protect creditors or minority shareholders of companies affiliated with enterprise groups. In *China Credit Information Service v. Taipei Bureau of National Taxation*,<sup>97</sup> the Taipei Tax Collection Office held that two separate companies were in substance one company. The tax collection office found that the two companies in question used the same office and the same bank account.<sup>98</sup> It also found that the companies recorded transactions with third parties in the same books. Both companies were run by the same person and had almost identical shareholders. Based on these facts, the tax collection office held that the two companies were one enterprise for tax purposes. The Administrative Court heard the case on appeal and overruled the Tax Collection Office decision because the two companies were separately incorporated at the MOEA.<sup>99</sup> It held that the interlocking boards and shareholders, and commingling of funds, were not sufficient to establish that the two companies were a single enterprise.<sup>100</sup>

Until recently the MOEA granted companies a limited scope of authorized business activities at the time of incorporation. Any significant expansion of business operations required application to the MOEA to amend the authorized scope of business activities. The MOEA generally prohibited companies from giving corporate guarantees because the MOEA refused to include the power to give guarantees in the activities authorized in a company license. Businesses devised many creative legal maneuvers to circumvent this prohibition, such as joining the would-be guarantor to a negotiable instrument as a co-maker or as maker while the recipient of the proceeds

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<sup>95</sup> Chuang, *supra* note 52. Chuang coined the term "enterprise group" based on his translation of the Chinese expression *kuan-hsi chi-yeh*, which is literally "related companies." See also Lai In-Jaw, *Legal Problems of Parent-Subsidiary Corporations in Taiwan* (S.J.D. thesis, Harvard Law School) (1981).

<sup>96</sup> Chuang, *supra* note 52, at 11; Lai, *supra* note 86, at 755.

<sup>97</sup> *China Credit Information Serv. v. Taipei Bureau of Nat'l Taxation*, 62 P'au Tzu 252 (1973), cited in Lai, *supra* note 86, at 757.

<sup>98</sup> *Id.* at 758.

<sup>99</sup> *Id.* at 759.

<sup>100</sup> *Id.* at 760.

of the loan was joined as endorser. In 1983, the MOEA changed its policy so that companies no longer needed authorization in their company license to give guarantees if they were authorized to do so by their charter and not otherwise prohibited by law. The procedures used before 1984 to circumvent the prohibition, however, caused many problems concerning primary and secondary liability for obligations between parent and subsidiary corporations in the context of corporate reorganizations, such as irregular transfers of assets between corporations.

The lack of adequate protection for creditors under the Company Law or other regulations gave rise to a common practice among creditors of requiring all principals of a company to personally guarantee major corporate obligations.<sup>101</sup> The ROC Company Law does not provide for piercing the corporate veil or holding majority shareholders liable for company obligations under any circumstances. Therefore, many creditors request the personal guarantees of directors, officers, and major shareholders at the time credit is extended.<sup>102</sup>

The picture which emerges of the ROC Company Law is a formal body of law which strictly regulates corporate affairs in some areas while leaving others totally unregulated. Narrow judicial interpretations of existing statutes combined with lax enforcement have reduced many laws to empty formalities. The lack of effective controls on the conduct of management in company law generally is further reflected in the inability of courts and creditors to adequately control the conduct of reorganization managers in company reorganizations.

### III. Policies Underlying Corporate Reorganization<sup>103</sup>

Bankruptcy, or straight liquidation, is a procedure for the orderly distribution of an insolvent debtor's assets among creditors.<sup>104</sup> Corporate reorganization is more than a debt collection technique. An additional objective of reorganization is the re-emergence of the financially distressed company as a viable enterprise.<sup>105</sup> The insolvency of a company raises issues concerning the rights of individuals such as the creditors, shareholders, management, and employees of the company. In the aggregate, rules for distributing the costs of corporate failures and reorganizations are an important dimension

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<sup>101</sup> Chuang, *supra* note 52, at 262.

<sup>102</sup> *Id.*

<sup>103</sup> Much of the information in this section was obtained from confidential sources. See *supra* note 1.

<sup>104</sup> Jackson, *Bankruptcy, Non-Bankruptcy Entitlements and the Creditors' Bargain*, 91 YALE L.J. 857, 893-95 (1982).

<sup>105</sup> Gerdes, *General Principles of Plans of Corporate Reorganization*, 89 U. PA. L. REV. 39, 41-42 (1940).

of national economic policy. A look at the historical development of company reorganization law in the United States shows how U.S. courts and creditors have tried to resolve problems similar to those faced in the ROC today.

*A. Historical Background of U.S. Bankruptcy and Reorganization Law*

The equity powers of U.S. courts were important in the invention of the procedure for corporate reorganization. Bankruptcy, as a procedure for dealing with insolvent debtors, existed as long ago as 1285 in England.<sup>106</sup> Several U.S. colonial bankruptcy statutes were in effect when the United States achieved independence from England. Unlike the involuntary bankruptcy relief statutes in England at that time, the colonial statutes were typically voluntary and provided debtor, not creditor, relief. The U.S. Constitution gives bankruptcy jurisdiction to the federal courts, not the state courts.<sup>107</sup> For several years following the adoption of the Constitution, however, Congress failed to enact any bankruptcy law for the federal courts to apply.

Each year from 1789 to 1800 saw attempts to enact a U.S. bankruptcy law.<sup>108</sup> Congress adopted the first national bankruptcy law in 1800 following the financial panics of 1792 and 1797.<sup>109</sup> Although this law was intended to be a temporary five year measure, it survived only three years before its repeal in 1803. Congress passed the next bankruptcy law in 1841, but similarly repealed it less than two years later due to increased opposition to discharging debtors through bankruptcy.<sup>110</sup> A third attempt lasted from 1867 to 1878.<sup>111</sup>

The U.S. economic boom and bust cycles in the late nineteenth century forced courts to deal with the problems of insolvent railroads. Public policy demanded that the railroads continue in operation for the benefit of the public, regardless of the interests of shareholders and creditors. Railroads, however, had the most complex financial structure of any corporate enterprises in the United States at that time, often having many classes of bondholders holding first, second, third, and even fourth mortgages on assets.<sup>112</sup> Usually in the absence of any federal bankruptcy statute and without any common law precedent, the courts used their equity jurisdiction

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<sup>106</sup> Dalhuisen, *Historical Development of Bankruptcy Remedies*, in EUROPEAN BANKRUPTCY LAW 1, 21 (1974).

<sup>107</sup> U.S. CONST. art. I, § 8, cl. 4.

<sup>108</sup> 9 *Annals of Cong.* 2649-77 (1799).

<sup>109</sup> Bankrupt Act of April 4, 1800, 2 Stat. 19-36, *repealed by* Act of December 19, 1803, ch. 6, 2 Stat. 248.

<sup>110</sup> Bankrupt Act of August 19, 1841, ch. 9, 5 Stat. 440-49, *repealed by* Act of March 3, 1843, ch. 82, 5 Stat. 614.

<sup>111</sup> 14 Stat. 517 (1867), *repealed by* 20 Stat. 99 (1878); *see also* P. COLEMAN, DEBTORS AND CREDITORS IN AMERICA 18-28 (1974).

<sup>112</sup> Gerdes, *supra* note 105, at 40.

to create the equity receivership procedure.<sup>113</sup>

Under this procedure, the courts turned over the assets of the company to a receiver, who was similar to a bankruptcy trustee.<sup>114</sup> Different groups of creditors formed different protective committees.<sup>115</sup> The receiver organized a sale of all the productive assets of the railroad in order to pay off the creditors. The court set an upset price below which the parties could not conclude the sale.<sup>116</sup> In reality, the only buyers for the railroad's assets were those among the creditors themselves who incorporated a new company to receive the assets.<sup>117</sup> The protective committees negotiated the terms of the reorganization plan.<sup>118</sup> Under the plan, the court allowed creditors who stood to recover something from the old company to convert their claims against the old company into stock or bonds in the new company.<sup>119</sup> Preferred stock was an invention of these early equitable reorganizations, given in exchange for bonds in the insolvent company. The essence of this reorganization process was the sale of the company's assets to its creditors.

Court supervision of the process was minimal. Beyond setting the minimum upset price, courts deferred to the principle of creditor control. This deference opened the door for existing management and their investment bankers to usurp the process at the expense of the investing public and small creditors.<sup>120</sup> Management and their investment bankers could manipulate the protective committees for their own benefit.<sup>121</sup> Small creditors were denied any hearing for their grievances and generally were denied any recovery as well.<sup>122</sup> Courts often set the upset price at a low amount which did not protect unsecured creditors from overreaching by shareholders.<sup>123</sup> The reorganization process was characterized by exorbitant costs due to complex legal procedures and fees charged by various participants,

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<sup>113</sup> The following discussion is based on Fuller, *The Background and Techniques of Equity and Bankruptcy Railroad Reorganizations—A Survey*, 7 *LAW & CONTEMP. PROBS.* 377 (1940).

<sup>114</sup> *Id.* at 378.

<sup>115</sup> *Id.*

<sup>116</sup> *Id.* at 382.

<sup>117</sup> *Id.* at 382, n.15.

<sup>118</sup> *Id.* at 381-82.

<sup>119</sup> *Id.* at 382.

<sup>120</sup> A national securities market had begun to emerge by the late nineteenth century in the United States. As a result, many small creditors were bondholders. This contrasts sharply with the recent experience in the ROC where the corporate bond market is very underdeveloped and bond holders are not a significant class of creditors in any major reorganizations. Corporations in the ROC tend to rely for capital on a combination of bank credit, the organized commercial paper market, and the unregulated money market, instead of an organized securities market. Interview with Tracy Cheng, *supra* note 2.

<sup>121</sup> SECURITIES AND EXCHANGE COMMISSION, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES, Part I, 863 *et seq.* (1937) [hereinafter SEC REPORT]. This monumental 8-part study was 4,000 pages long.

<sup>122</sup> See generally Fuller, *supra* note 113.

<sup>123</sup> *Id.* at 383-84.

including legal counsel to the protective committees, reorganization managers, and mortgage trustees.

In *Northern Pacific Railway Co. v. Boyd*,<sup>124</sup> a railroad that had cost \$241,000,000 to build and was mortgaged for \$157,000,000, was sold for \$61,000,000 in reorganization. The low sale price effectively denied unsecured creditors any recovery.<sup>125</sup> Secured creditors and the management of the insolvent company, acting through the creditors' committee, then issued stock and bonds in the new company worth \$345,000,000 which the management recorded as fully paid.<sup>126</sup> An unsecured creditor tried to assert his claim against the reorganized company.<sup>127</sup> The Supreme Court held that the unsecured creditor could collect his claim from the reorganized company where the reorganization plan had allowed the stockholders from the old company to participate, but had not allowed unsecured creditors of the old company to recover.<sup>128</sup>

Following the *Boyd* case, judicial inquiry into the fairness of reorganization plans grew slowly.<sup>129</sup> The fairness of proposed reorganization plans could be litigated in the foreclosure proceedings.<sup>130</sup> The *Boyd* fairness doctrine allowed courts to prevent the most obvious fraudulent excesses by management and investment bankers. Many abuses of equity receiverships, however, were not effectively stopped until the 1930s when Congress reformed the U.S. securities and banking law.<sup>131</sup> As part of the reforms, Congress established the Securities and Exchange Commission (SEC) and enacted federal securities market regulations.<sup>132</sup> The reforms broke investment bank control of industrial companies through interlocking directorships.

One of the major initiatives the newly founded SEC undertook was an investigation into the abuses of creditors' committees during the court supervised reorganization process.<sup>133</sup> This investigation culminated in the company reorganization provisions of the Chandler Act of 1938.<sup>134</sup>

The Chandler Act added two new procedures for company reor-

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<sup>124</sup> 228 U.S. 482 (1913).

<sup>125</sup> *Id.* at 507.

<sup>126</sup> *Id.*

<sup>127</sup> *Id.* at 498. The claims of most unsecured creditors had been purchased by management during the reorganization process.

<sup>128</sup> *Id.* at 508.

<sup>129</sup> See Swaine, *Reorganization of Corporations: Certain Developments of the Last Decade*, in SOME LEGAL PHASES OF CORPORATE FINANCING, REORGANIZATION AND REGULATION 133, 142 *et seq.* (1931).

<sup>130</sup> Fuller, *supra* note 113, at 383.

<sup>131</sup> Securities Act of 1933, 15 U.S.C. § 77a-77aa (1982 & Supp. IV 1986); Securities Exchange Act of 1934, 15 U.S.C. § 78a-78kk (1982 & Supp. IV 1986).

<sup>132</sup> Securities Exchange Act of 1934, *supra* note 131, at § 78-78kk.

<sup>133</sup> SEC REPORT, *supra* note 121, Parts I-VIII.

<sup>134</sup> Chandler Act, Bankruptcy Revision of 1938, ch. 575, 52 Stat. 840 (Title 11) (1938). William O. Douglas led the investigation.

ganization to the Bankruptcy Act of 1898.<sup>135</sup> One simple, informal procedure, Chapter XI, applied to companies which did not have many shareholders or bondholders.<sup>136</sup> The act created a more complex procedure, Chapter X, for major publicly held companies.<sup>137</sup> In the more complex form of reorganization, the act required the SEC to make an independent study of the reorganization plan and report to the court on whether or not it was fair to small investors and creditors.<sup>138</sup>

Another reform inspired by the abuses of creditors' committees was the establishment of clear rules of priorities to protect secured and unsecured creditors from overreaching by management and shareholders.<sup>139</sup> Doctrines like the absolute priority rule defined and protected the property interests of secured creditors.<sup>140</sup> Under the absolute priority rule,<sup>141</sup> no junior creditors or shareholders could recover anything until all senior classes had recovered in full. When Congress passed the Chandler Act, the investment banking community and its lawyers complained that judicial absolutism was being substituted for the democratic principle of creditor control.<sup>142</sup> An exhaustive study by the SEC, however, clearly showed that the former system allowing parties freedom to negotiate had been anything but democratic.<sup>143</sup>

The Chandler Act reforms provided for the enforcement of these and other rules by greater court involvement in all phases of the reorganization process.<sup>144</sup> In addition, SEC intervention was mandatory in those cases involving major publicly held companies.<sup>145</sup>

While the Chandler Act represented a great step forward in curbing the abuses of the system prevailing before the 1930s, many of the reforms ultimately proved too rigid to work in a variety of cases. For example, cases became bogged down in litigation to determine whether the company could proceed with the simpler Chapter XI process, or would have to submit to Chapter X. SEC supervision

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<sup>135</sup> *Id.*; Bankruptcy Act of 1898, ch. 541, 30 Stat. 544.

<sup>136</sup> 11 U.S.C. §§ 707-799 (repealed in 1978).

<sup>137</sup> 11 U.S.C. §§ 501-576 (repealed in 1978).

<sup>138</sup> 11 U.S.C. § 572 (repealed in 1978).

<sup>139</sup> 11 U.S.C. § 597 (repealed in 1978).

<sup>140</sup> *Id.*

<sup>141</sup> The absolute priority rule applied only to Chapter X proceedings. In Chapter XI proceedings the court could not affect the rights of secured creditors. S. DONNELLY, *BANKRUPTCY, ARRANGEMENTS AND REORGANIZATIONS* 114 (1972). In this respect, Chapter XI resembles the ROC Bankruptcy Law, under which security interests are exempt from bankruptcy administration. ROC Bankruptcy Law art. 108 [hereinafter Bankruptcy Law].

<sup>142</sup> See, e.g., Blum, *The Chandler Act and the Courts*, 27 A.B.A.J. 232 (1941).

<sup>143</sup> See, e.g., Burke, *The Chandler Act and the Courts: A Reply*, 27 A.B.A.J. 237 (1941).

<sup>144</sup> *Id.* at 239.

<sup>145</sup> 11 U.S.C. §§ 501-676 (repealed in 1978).



proved expensive and cumbersome. The Chandler Act did not eliminate all abuses by powerful creditors and insiders.

In 1978, Congress extensively revised the Bankruptcy Act.<sup>146</sup> Chapter 11 of the Bankruptcy Code now has only one form of company reorganization, which combines features of both forms of reorganization available under the Chandler Act, and eliminates all mandatory supervision of reorganizations by the SEC.<sup>147</sup>

Some of the 1978 reforms dealt with balancing the interests of dissenting creditors and the interests of parties who were willing to adopt a plan of reorganization. The reforms introduced complex "cram down" provisions, which allowed debtors to force creditors to accept a plan if certain conditions were met.<sup>148</sup> These provisions were an attempt to replace the veto power given in 1938 to small creditors with objective standards which when met allow the reorganization to proceed over their objection. In addition, the reforms abandoned the rigid form of the "absolute priority" rule which had been applied in Chapter X cases.<sup>149</sup>

Under the Chandler Act shareholders could not participate in the reorganization plan unless the debtor company fully compensated "creditors' prior rights."<sup>150</sup> This rule applied even in cases where most creditors felt existing management might perform better if given some equity participation in the reorganized company.<sup>151</sup> Under the 1978 Act, however, creditors can now waive the absolute priority rule by requisite vote and allow shareholder participation, if they find it to their own advantage to do so, provided that the parties fully disclose the details of the transaction prior to acceptance of the plan. The absolute priority rule continues to apply only where the proponents of a plan seek to get court approval of it over the objection of a class of creditors.<sup>152</sup>

### *B. Policies of ROC Bankruptcy and Reorganization Law*

During a period of rapid economic change and development like that which the ROC has enjoyed for the last thirty years, formal statutory law often cannot keep up with the changing social and eco-

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<sup>146</sup> 11 U.S.C. §§ 101-109, 326 (1982 & Supp. IV 1986).

<sup>147</sup> 11 U.S.C. § 1109(a) (1982). The SEC, however, still retains the right to raise and be heard on any issue in a reorganization case. B. WEINTRAUB, *BANKRUPTCY LAW MANUAL* § 8.15 (1986).

<sup>148</sup> 11 U.S.C. § 1129(b) (1982 & Supp. IV 1986); E. WARREN & J. WESTBROOK, *THE LAW OF DEBTORS & CREDITORS* 608 (1986).

<sup>149</sup> 11 U.S.C. § 1129(a)(8) (1982 & Supp. IV 1986).

<sup>150</sup> 6A *COLLIER ON BANKRUPTCY* § 10.03 (14th ed.).

<sup>151</sup> See *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939); *Metropolitan Holding Co. v. Weadock*, 113 F.2d 207 (1940); *Swanson v. Barclay Park Corp.*, 90 F.2d 595 (1937).

<sup>152</sup> This is by the cram down provisions of 11 U.S.C. § 1129(b). D. COWANS, *COWANS BANKRUPTCY LAW AND PRACTICE* § 20.26, p. 334-39 (1986).

conomic realities. Consideration of the general policies underlying any statutory debtor relief such as a corporate reorganization law helps clarify the weaknesses of the existing ROC reorganization statute and identify the directions any reform should take. It also highlights areas in which lawmakers in the United States and ROC are pursuing different policy objectives.

### 1. *Fraudulent and Nonfraudulent Insolvency*

Any statutory grant of debtor relief requires concessions from creditors to be effective. Therefore, any such statute must also provide for enough supervision of the debtor to prevent abuse of benefits conferred by the statute. Any statute that fails to distinguish between fraudulent and nonfraudulent conduct by the debtor seeking relief acts as an open invitation to debtor misconduct.<sup>153</sup>

U.S. company reorganization law provides a variety of legal doctrines to prevent fraudulent misconduct by debtors seeking relief. Fraudulent conveyance law prohibits debtors from making gratuitous transfers to the detriment of creditors.<sup>154</sup> The law of voidable preferences prohibits debtors from unfairly discriminating on the eve of bankruptcy between creditors with similar legal entitlements.<sup>155</sup> Shareholders who use the legal fiction of incorporation in a manner contrary to public policy may be found personally liable for corporation debts under the doctrine of piercing the corporate veil.<sup>156</sup> Where creditors have taken advantage of their position as insiders to secure advantages over other creditors, a court might subordinate their claims to those of similar creditors under the doc-

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<sup>153</sup> In *Essentials of Bankruptcy: Prevention of Fraud and Control of Debtor*, 23 VA. L. REV. 373 (1937), Professor Garrard Glenn observed that:

There is always the fraudulent debtor, and, to meet his case, bankruptcy requires a controllable debtor. Hence the bankrupt must do two things. He must give full discovery, that is, he must tell the truth about his estate and doings; and, in order to insure this, the debtor must surrender to the court, not only his estate if he has any, but also himself. Such is the method by which fraud can be detected and creditors will get their due.

*Id.* at 378.

Glenn was criticizing an attempt at a corporate reorganization statute in effect from 1933 to 1938 which allowed "corporate officers and directors to help themselves from the chest before the ship goes on the rocks." *Id.* at 375.

Professor Glenn, a legal historian, was disturbed by the fact that "[i]t never seemed to have occurred to the [drafters of that corporate reorganization statute] . . . that it is quite possible for a corporation to be dishonest as well as poor" and observed that the illusion that "an insolvent corporation always loves its creditors as itself" had resulted in egregious fraud by the principals of corporations seeking reorganization. *Id.* at 374. He argued that while most debtors may be fair in their dealings with creditors, the problem of dealing with the minority of debtors who try to defraud their creditors must always be addressed in any form of statutory debtor relief.

<sup>154</sup> 11 U.S.C. § 548(a) (1982 & Supp. IV 1986).

<sup>155</sup> 11 U.S.C. § 547 (1982 & Supp. IV 1986).

<sup>156</sup> See, e.g., *Alman v. Danin*, 801 F.2d 1 (1st Cir. 1986).

trine of equitable subordination.<sup>157</sup> Where the business of affiliated companies has been conducted to the unreasonable detriment of some affiliates and the benefit of others, a court may consolidate the separate corporate entities to protect creditors in the reorganization of one of the affiliates under the doctrine of substantive consolidation.<sup>158</sup>

Some statutory provisions similar to these U.S. doctrines exist in the ROC.<sup>159</sup> The ROC could increase protection for creditors from fraudulent misconduct on the part of debtors by adding statutory provisions which do not currently exist under ROC law. Courts have been either unwilling or unable to enforce the rights which, in theory, creditors currently enjoy under the existing law. One problem is the often unresponsive and formalistic interpretations courts give statutes.<sup>160</sup> Another problem is lack of discovery procedures<sup>161</sup> in ROC courts which, when combined in many cases with the lack of reliable company accounts or financial statements, presents creditors with formidable problems in establishing the factual basis for recovery.

## 2. Access to Reorganization Proceedings

While policymakers in both the United States and the ROC may agree on the desirability of controlling fraudulent debtors, the different national policies concerning economic planning and development have produced different standards for allowing corporate reorganizations in each country.

In the United States the consensus is that corporate reorganization should proceed if it is expected to increase the total return to creditors and shareholders by preserving the going concern value of the company.<sup>162</sup> A court values a company by looking at a projected return on investment and comparing that return with returns available in the capital markets for similar investments.<sup>163</sup> No reorgani-

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<sup>157</sup> See, e.g., *Wilson v. Huffman (In re Missionary Baptist Found.)*, 712 F.2d 206 (5th Cir. 1983).

<sup>158</sup> See, e.g., *Evans Temple Church of God in Christ & Community Center, Inc. v. Carnegie Body Co. (In re Evans Temple Church of God in Christ & Community Center, Inc.)*, 55 Bankr. 976 (N.D. Ohio 1986).

<sup>159</sup> See, e.g., Company Law arts. 15 (prohibition on corporate lending to shareholders), 131 (initial issues of shares must be fully paid), 244 (fraudulent conveyance prohibition), 247 (limitations on amounts of corporate debt) and 267 (prohibition of purchases of certain outstanding shares).

<sup>160</sup> See *supra* text accompanying notes 41-43 for a discussion of why this formalism occurs.

<sup>161</sup> A civil law system, such as exists in the ROC, gives the judge, not the parties, the primary responsibility for collecting evidence. As a result, the ability of one party to compel another party to a lawsuit to surrender relevant information is not very great in a civil law system.

<sup>162</sup> See T. EISENBERG, *DEBTOR-CREDITOR LAW* 779 (1984).

<sup>163</sup> *Id.*

zation can continue without the debtor producing a plan which meets the "feasibility" standard imposed by the U.S. Bankruptcy Code.<sup>164</sup> The debtor has the absolute right to convert the reorganization to a liquidation.<sup>165</sup> Creditors retain the right to convert the proceeding into a straight liquidation if it becomes apparent that more value is being lost by continuing the reorganization than could be realized by an immediate sale of assets.<sup>166</sup> If the majorities specified in section 1126(c) do not approve the debtor's reorganization plan, conversion of the case to a liquidation is required.<sup>167</sup>

Within the system of indicative economic planning and limited direct government involvement in the economy in the ROC, the standards for allowing a major, publicly held company to proceed to reorganization are unclear. Under existing procedures the courts tend to defer to the judgment of the MOEA. The MOEA takes a wide variety of economic and social variables into account, such as export objectives, employment goals, and domestic production of strategic materials, to name a few. Just as the standards for allowing a reorganization to begin are not clearly defined, no clear basis exists for making the decision to terminate a reorganization. The courts have allowed many companies with no hope of regaining solvency to linger on for years in reorganization proceedings.

While the emphasis by ROC officials on "soft" variables may produce inefficient results, it is not unlike the Japanese style of economic regulation which emphasizes social and cultural values more than the reliance on financial valuation techniques used by creditors in the United States.<sup>168</sup> Unlike Japanese company reorganizations, Chinese official intervention in reorganization proceedings has been ad hoc and based on no clearly defined standards. The lack of coherent policy objectives at the MOEA is further reflected in the lack of government financial support for reorganizations once initiated. This contrasts sharply with the Japanese system where the central government strongly supports the banking system.<sup>169</sup> Private banks in Japan act as intermediaries between government agencies like the Ministry of International Trade and Industry (MITI) and major corporations. Once a commitment to a project has been made, adequate resources to see the project to completion are made available

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<sup>164</sup> 11 U.S.C. § 1129(b)(1) (1982). See *infra* text accompanying note 320.

<sup>165</sup> 11 U.S.C. § 1112(a) (1982 & Supp. IV 1986); E. WARREN & J. WESTBROOK, *supra* note 148, at 401.

<sup>166</sup> 11 U.S.C. § 1112(b) (1982 & Supp. IV 1986). See *infra* text accompanying notes 315-18.

<sup>167</sup> E. WARREN & J. WESTBROOK, *supra* note 148, at 401.

<sup>168</sup> See C. JOHNSON, *MITI AND THE JAPANESE MIRACLE: THE GROWTH OF INDUSTRIAL POLICY, 1925-1975* (1982).

<sup>169</sup> See Pascale and Rohlen, *The Mazda Turnaround*, 9 J. JAPANESE STUD. 219 (1983). The responsibility for salvaging a failing company may still fall primarily on a private bank. *Id.* at 231-33.

from private or official sources.<sup>170</sup>

### 3. *Equal Treatment for Creditors*

"Equality is equity" is a fundamental and overriding policy in U.S. bankruptcy law.<sup>171</sup> This principle refers to relations between creditors and between classes of creditors. While creditors who act in concert are able to maximize the recovery of all creditors, any individual creditor has an incentive to try to increase his return by securing preferential treatment. In reorganizations in the ROC, this principle of equal treatment of creditors based on similar legal entitlements is hardly seen as an issue except among foreign bankers.

The relative indifference to principles like "treat like cases alike" may derive in part from traditional Chinese ideas about law and custom.<sup>172</sup> Westerners living in Taiwan believe that Chinese tend to view the individuals involved in a dispute as more important than abstract rights and principles. Cases which Americans view as similar because they call for the application of similar legal doctrines, Chinese participants may see as very different because of greater emphasis on the different facts of each case.

Creditors of an insolvent Taiwanese company may include employees, private lenders, trade creditors, local banks, and foreign banks. The real problems come from private lenders<sup>173</sup> who do not hesitate to use extralegal enforcement methods to the detriment of regulated institutional lenders like banks.<sup>174</sup> In their ability to take advantage of their position as insiders, unregulated lenders in Taiwan enjoy an unfair advantage over regulated lenders.<sup>175</sup> Any consideration of reforms of the ROC law should include proposals to prevent manipulation by insiders like unregulated lenders.<sup>176</sup>

Foreign lenders are the group most at a disadvantage if a debtor does not adequately respect legal entitlements. Foreign banks are often outside the Chinese system of informal relationships and obli-

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<sup>170</sup> *Id.*

<sup>171</sup> "[T]he principle that equality is equity . . . is the spirit of the bankrupt law." *Cunningham v. Brown*, 265 U.S. 1, 13 (1923), *quoted in Heyman v. Kemp (In re Teletronics, Ltd.)*, 649 F.2d 1236, 1241 (7th Cir. 1981).

<sup>172</sup> See *supra* text accompanying notes 3-11 for a discussion of Confucian attitudes toward hierarchy and law.

<sup>173</sup> See *supra* text accompanying notes 59-72 for a discussion of the unregulated money market within which private lenders operate.

<sup>174</sup> Winn, *Security Interests Under the Laws of the ROC on Taiwan*, 23 TEXAS INT'L L.J. 395, 398 (1988).

<sup>175</sup> This situation parallels nineteenth century railroad reorganizations in the United States in which investment bankers as insiders enjoyed an unfair advantage over the investing public and small creditors. Reforms of the U.S. company reorganization procedures in the 1930s focused on preventing manipulation by insiders like investment bankers. The reforms included mandatory SEC participation in Chapter X proceedings, appointment of an independent trustee in most cases, and court approval of the reorganization plan.

<sup>176</sup> See *supra* text accompanying notes 59-72 & 72-76 for a discussion of the unregulated money market and investment bankers, respectively.

gations which helps private lenders supplement their legal rights. Foreign banks have also experienced difficulties articulating and lobbying for their interests as a group, which has increased their frustration with the court-ordered reorganization process in general. The loudest calls for reform of the reorganization procedure and greater equality in treatment for creditors with similar legal rights, therefore, have come from the foreign banking community.

#### 4. *Maximize the Debtor's Estate*

In the absence of any provision for the discharge or rehabilitation of the debtor, the fundamental purpose of a bankruptcy procedure is to maximize the recovery by creditors. The collection of all the debtor's assets is an essential element in that procedure. A further purpose in corporate reorganization is the rehabilitation of the corporate debtor. Under U.S. law, however, that further purpose is secondary to the fundamental purpose of helping creditors recover.<sup>177</sup> In a corporate reorganization the business is rehabilitated because it is worth more to interested parties as a going concern than the assets would bring in a liquidation sale.<sup>178</sup>

Preserving the value of the company includes taking prompt steps if necessary to protect inventory, cash, and other assets from dissipation.<sup>179</sup> The debtor in possession or the reorganization manager has a duty to maximize the value of the estate for the benefit of creditors while managing the business of the company undergoing reorganization.<sup>180</sup> To maximize the benefit to creditors, corporate assets not essential to the current operations of the company in reorganization may be sold.<sup>181</sup>

Current ROC law does not clearly recognize the principle of maximizing the value of the company for the benefit of creditors. While courts consider petitions for reorganization, lengthy delays may occur allowing unnecessary dissipation of company assets. These assets are difficult to recover if the reorganization manager and the supervisor do not act forcefully to recover assets fraudulently or preferentially transferred to insiders prior to commencement of the reorganization of the case. The ROC statute covering company reorganizations does not distinguish between assets essential to the reorganization and nonessential assets which could be sold during the reorganization. In Taiwan statutory reforms might im-

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<sup>177</sup> Jackson, *supra* note 104, at 857.

<sup>178</sup> Gerdes, *supra* note 105, at 40.

<sup>179</sup> This is achieved under U.S. bankruptcy law by the appointment of interim trustees and examiners if necessary. See *infra* text accompanying notes 232-34.

<sup>180</sup> Under U.S. bankruptcy law this is done by holding the debtor in possession to the standards imposed on a trustee. See *infra* notes 241-43 and accompanying text.

<sup>181</sup> 11 U.S.C. § 362(d)(2) (1982 & Supp. IV 1986).

prove the conduct of court-ordered reorganizations by providing for the release of nonessential assets at the request of creditors.

##### 5. *Harmonize Bankruptcy with Other Creditors' Remedies*

The legal procedure used to enforce a right should not affect the substance of the right enforced. If the substance of a right changes depending on what enforcement procedure is used, then some parties are given an incentive to choose one procedure, such as corporate reorganization, over another, such as bankruptcy, in order to improve their personal position even though the choice of procedure is otherwise inappropriate.

The failure to adequately protect creditors has given management an incentive to seek reorganization simply to gain an advantage over creditors without making a good faith effort to cooperate in the reorganization. The rights of both secured and unsecured creditors have not received the same protection within corporate reorganizations as they receive in other legal procedures, such as compulsory execution.<sup>182</sup> This practice undermines the public policy underlying company reorganizations of helping major public companies overcome temporary financial distress and returning them to profitability.

The enforcement procedures available to creditors outside company reorganization differ significantly in the United States and the ROC. A single unsecured creditor seeking judgment against a debtor in the United States enjoys the benefit of some sort of supplementary proceedings if the first attempt to execute on a judgment is not successful. "Supplementary proceedings" are defined by the law of each state, but generally provide creditors with an extra procedure after the trial is over to compel the debtor to provide the court with information about the debtor's assets.<sup>183</sup> A debtor who fails to cooperate in supplementary proceedings can be held in contempt and jailed.<sup>184</sup>

No special procedure like this exists in the ROC. As a result, unsecured creditors who fail to identify assets when credit is extended may find it difficult to locate them after a debtor has defaulted.

If a debtor has defaulted on more than one unsecured obligation, the result under Anglo-American law is the "race to the courthouse." This race occurs because the first unsecured creditor to obtain a judgment against the debtor is given a "judgment lien" on

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<sup>182</sup> This corresponds to the U.S. experience prior to *Boyd*. See *supra* text accompanying notes 113-23.

<sup>183</sup> See, e.g., N.C. GEN. STAT. § 1-352 (1983).

<sup>184</sup> See, e.g., N.C. GEN. STAT. § 1-352.1 (1983).

the debtor's property and thus has priority over other unsecured creditors in the amount of the judgment.

Under the ROC Compulsory Execution Law, any unsecured creditor who can demonstrate that a debtor will not have sufficient assets left after judgment to satisfy that creditor's claim is allowed to join an execution proceeding already begun by another unsecured creditor. Allowing all other unsecured creditors to "piggyback" on the execution by the first unsecured creditor prevents any "race to the courthouse" by unsecured creditors in the ROC. On the contrary, unsecured creditors have a strong incentive to pursue composition or other informal solutions.

U.S. bankruptcy law also frustrates the race to the courthouse by unsecured creditors by voiding transfers made during the ninety days preceding bankruptcy.<sup>185</sup> Both the debtor and any unsecured creditors have the right to initiate bankruptcy and then to recover assets taken by the first unsecured creditor to execute.<sup>186</sup> Therefore, even in the United States, the bankruptcy law actually encourages any unsecured creditor who considers executing against the debtor's property to enter into informal negotiations with the debtor and other creditors.

Composition, a settlement between creditors, is one of the most common forms of debtor relief in the ROC today. If the company reorganization statute were simply repealed instead of being reformed, creditors of financially distressed corporations would probably rely on composition as a substitute for reorganization.<sup>187</sup> Unlike U.S. bankruptcy, composition under ROC law does not give the debtor discharge as a matter of right. Creditors holding claims equal to two-thirds of total claims must approve the debtor's proposed plan for relief from his obligations.<sup>188</sup> Secured creditors are exempt from composition proceedings and never lose their right to enforce their mortgage interest by execution.<sup>189</sup>

The ROC Bankruptcy Law provides that secured creditors are exempt from bankruptcy proceedings. The pawn shop mentality of many lenders<sup>190</sup> has led to the practice among borrowers of granting security interests in all fixed assets of a company. Consequently, very few insolvent companies have unencumbered assets for distribution to unsecured creditors. As a result, unsecured creditors

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<sup>185</sup> 11 U.S.C. § 547(b) (1982 & Supp. IV 1986).

<sup>186</sup> The trustee can only recover such assets if the company was insolvent when the assets were taken. Recovery is aided by the presumption that the company was insolvent for the ninety days before the bankruptcy proceeding commenced.

<sup>187</sup> Interview with C.C. Chen, Senior Vice President, International Commercial Bank of China, in Taipei (May 1986).

<sup>188</sup> Bankruptcy Law art. 27.

<sup>189</sup> *Id.* at art. 108. This is similar to the former U.S. Chapter XI proceeding. *See supra* text accompanying notes 135-36.

<sup>190</sup> *See supra* p. 422.



rarely use the Bankruptcy Law.<sup>191</sup>

The U.S. Bankruptcy Code provides for both a liquidation bankruptcy under Chapter 7<sup>192</sup> and corporate reorganization under Chapter 11.<sup>193</sup> Many of the provisions in Chapter 7 and Chapter 11 are identical. The bankruptcy bar in the United States is large and there is no shortage of professional managers to step in to help turn around companies undergoing reorganization.

Under ROC law the reorganization provisions are included in the Company Law rather than the Bankruptcy Law.<sup>194</sup> The practical absence of legal remedies in both the largely informal compositions and the quite complex reorganization procedures creates a shortage of qualified legal and other personnel to assist in the conduct of reorganizations. In addition to the shortage of qualified personnel, the corporate reorganization statute is woefully incomplete in many areas.

#### IV. ROC Reorganization Proceedings in Detail

This section discusses statutory provisions of ROC company reorganization law in the light of actual practices. Where the existing ROC statute appears inadequate, a comparison with the U.S. Bankruptcy Code and U.S. reorganization practice is provided.

##### *A. Commencement of the Case*

The current statute governing commencement of company reorganizations in the ROC has four major weaknesses. First, no clear standard exists for deciding which companies should be allowed to reorganize. Second, the ROC law fails to provide for adequate notice of the commencement of the proceedings or a real opportunity for parties whose interests are affected to contest. Third, the time the law allows for accepting or rejecting a petition is too long, creating opportunities for officers of the debtor business to deplete the assets of the corporation while the court considers the application. Finally, even though many major public companies which have sought reorganization have been part of enterprise groups, no procedure exists for consolidating proceedings against affiliated companies which have done business as a single entity.

##### *1. Access to Court-Ordered Reorganization*

A petition for reorganization can be filed by a "party in inter-

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<sup>191</sup> Interview with C.C. Chen, *supra* note 187. Mr. Chen, a Chinese banker with experience in corporate reorganizations, knew of only one bankruptcy case ever brought by a publicly held company listed on a stock exchange.

<sup>192</sup> 11 U.S.C. §§ 701-766 (1982 & Supp. IV 1986).

<sup>193</sup> 11 U.S.C. §§ 1110-1172 (1982 & Supp. IV 1986).

<sup>194</sup> Company Law art. 282.

est," which the statute defines to include members of the board acting pursuant to a resolution, shareholders who have held stock for at least six months, and creditors holding claims equal to or greater than ten percent of the company's capital.<sup>195</sup> The statute does not require that the court make any particular finding in order to accept a petition for reorganization. If the court rejects the petition, it must be for one of the reasons listed in the statute. These grounds for dismissal include procedural mistakes, prior bankruptcy, misrepresentation of material facts in the petition, or a determination that the company cannot be expected to become viable after reorganization.<sup>196</sup>

Very few companies are actually eligible to be considered for reorganization at all. Only companies limited by shares<sup>197</sup> which are also "publicly held" are eligible for reorganization.<sup>198</sup> Article 156 of the Company Law requires that "a company shall apply to have its shares offered to the public if its authorized capital exceeds a certain amount as prescribed by order [of] the competent authority."<sup>199</sup> In 1981 the MOEA ruled that a company whose capital exceeds NT\$200 million (New Taiwan dollars) must offer its stock to the public.<sup>200</sup> Publicly held companies are not limited to Taiwan Stock Exchange listed companies. Because "publicly held" companies are required to make extensive disclosure of their financial condition, many companies limit their paid-in capital to one dollar less than the minimum required for being "publicly held."<sup>201</sup> As a result, the proportion of "publicly held" companies to all "companies limited by shares" is relatively small.

Before it can act on the petition the court must forward a copy of the petition for comments to the Taiwan SEC, the MOEA and the "central competent authority" with jurisdiction over the business of the company (usually the Industrial Development Board). Because financially troubled businesses had never used reorganization proceedings prior to the 1980s, many judges were extremely reluctant

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<sup>195</sup> *Id.*

<sup>196</sup> *Id.* at arts. 282, 288.

<sup>197</sup> The Company Law recognizes four types of legal entities: (1) unlimited companies, *i.e.*, partnerships (Chapter II); (2) limited companies, *i.e.*, close corporations (Chapter III); (3) unlimited companies with limited liability shareholders, *i.e.*, limited partnerships (Chapter IV); and (4) companies limited by shares, *i.e.*, corporations (Chapter V).

<sup>198</sup> Company Law art. 282.

<sup>199</sup> Exceptions are granted for government-approved private enterprise or where a company has obtained "approval on a case-by-case basis from the competent authority having jurisdiction of its line of business." Company Law art. 156. Any foreign company which holds more than 45% of the shares is also exempted from this rule. Correspondence with Chang, *supra* note 80; see Overseas Chinese Investment Act art. 18; ROC Foreign Investment Act art. 18.

<sup>200</sup> (70) shangtze 05324 (1981), *cited in* Correspondence with Chang, *supra* note 80.

<sup>201</sup> Interview with Tracy Cheng, *supra* note 2.

to take any initiative in acting on petitions. The government officials in effect made the decision to permit reorganization, not courts.

Officers of troubled companies recognized the relative impotence and detachment of the courts in these proceedings. As a result, companies usually did not present petitions to a court before the principals of the company had discussed the situation with the MOEA and received tentative approval to proceed.<sup>202</sup>

Chinese and American bankers are united in their agreement that the ROC needs more rigorous standards to decide what companies should be granted court-supervised reorganization.<sup>203</sup> Bankers have not reached a consensus, however, on what these new, more stringent standards should be. In 1986, the MOEA considered proposals to reduce the discretion of judges still further by retaining more control over the decision to allow reorganization within the MOEA.<sup>204</sup>

If the MOEA were able to assume a position similar to that of the Ministry of International Trade and Industry (MITI) in Japan, this might be a beneficial change in ROC reorganization procedure. In Japan, MITI makes decisions to save companies in order to further existing plans for industrial development and export promotion.<sup>205</sup> The decisions involve a review and evaluation by the lending banks of the financial and operational health of the company, including close scrutiny of the conduct of existing management if necessary.<sup>206</sup> MOEA involvement along these lines could bring positive results in the ROC.

In U.S. bankruptcy practice, the decision to allow reorganization is in the hands of the parties, not the court or the government.<sup>207</sup> Cases are commenced voluntarily by the company or involuntarily by creditors.<sup>208</sup> Creditors retain the power to request that a reorganization be converted into a liquidating bankruptcy.<sup>209</sup> The court may convert the case only upon request of a party in interest and after notice and opportunity for a hearing has been granted to all parties in interest.<sup>210</sup> Grounds upon which creditors can seek to convert a reorganization to a bankruptcy include: continuing erosion of the value of the company's assets, inability to effectuate a plan, unreasonable delay by the debtor, inability to get the necessary approval for any plans which the debtor has proposed, and inability to effectu-

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<sup>202</sup> See *supra* note 1 regarding confidential sources.

<sup>203</sup> Interview with C.C. Chen, *supra* note 187.

<sup>204</sup> *Id.*

<sup>205</sup> See C. JOHNSON, *supra* note 168.

<sup>206</sup> Pascale and Rohlen, *supra* note 169.

<sup>207</sup> 11 U.S.C. §§ 301-303 (1982 & Supp. IV 1986).

<sup>208</sup> 11 U.S.C. §§ 301, 303 (1982 & Supp. IV 1986).

<sup>209</sup> 11 U.S.C. § 1112(b) (1982).

<sup>210</sup> *Id.*

ate a plan which has been approved.<sup>211</sup>

Prior to the 1978 reform of U.S. bankruptcy law, the SEC often assisted bankruptcy judges by reviewing reorganization plans which publicly held companies proposed. This was done to determine whether they were fair to creditors and stockholders.<sup>212</sup> The SEC applied strict financial standards and recommended liquidation whenever it appeared that the liquidation value of the company was higher than the expected value of future earnings of the reorganized company.<sup>213</sup> In theory, the financial standards the SEC applied did not differ significantly from the standards other creditors applied, although the SEC might be more rigorous in its application than a group of creditors closely allied with management.<sup>214</sup>

The foreign bankers in Taiwan have expressed concern that neither MOEA officials nor local bankers are particularly interested in the financial condition of firms seeking reorganization. MOEA analysis includes a wide variety of factors such as ability to export, strategic importance, and employment rather than focusing on financial variables such as present value of expected future earnings.<sup>215</sup>

In 1985 American bankers were encouraged when a judge rejected the E An company's petition for reorganization based on the hopeless financial condition of the company. The E An company was an affiliate of the Ta Nun company.<sup>216</sup> Some American banks took the unusual step of inviting the court and representative from the Taiwan SEC and the Industrial Development Board to a tour of E An's facilities. The banks also introduced evidence to show that the company had grossly overstated the value of assets in the company's financial records. On the basis of financial information which the banks presented and the guided tour, the judge rejected the petition independent of MOEA comments because the company clearly had no prospects for recovery.<sup>217</sup>

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<sup>211</sup> *Id.*

<sup>212</sup> 6 COLLIER ON BANKRUPTCY, *supra* note 150, § 7.36.

<sup>213</sup> See, e.g., *In re Atlas Pipeline Corp.*, 9 S.E.C. 416 (1941).

<sup>214</sup> The Taiwan SEC has not been able to provide the same critical review. Although the Taiwan SEC formally participates in the MOEA decision whether or not to allow reorganization to proceed, its input has been based on outdated or inaccurate financial information which the companies had previously filed with them. (The shortage of qualified auditors on the Taiwan SEC staff has hampered its ability to critically review the financial statements public companies file with the Taiwan SEC.) See Kaplan, Russin, Vecchi, and Parker, *Creditors' Rights and Corporate Reorganizations in the ROC—Some Recommendations* 4 (paper presented at 9th Annual Joint U.S.A.-ROC/ROC-U.S.A. Economic Council, Nov. 18, 1985).

<sup>215</sup> Interview with Hank Peng, Vice President, Chemical Bank, in Taipei (May 1986).

<sup>216</sup> The Ta Nun company also sought reorganization. See *infra*, Section V, p. 467 for a case study on Ta Nun.

<sup>217</sup> Peng, *supra* note 215.

2. *Inadequate Notice of Opportunity to Contest  
for Interested Parties*

After the petition is filed but before it has been approved, the court may issue "protective orders" to stay actions against the company while the court considers a petition.<sup>218</sup> The protective orders are valid for up to three months and can be renewed at the request of a party in interest or *ex officio* by the court for two successive three month terms.<sup>219</sup> ROC law does not require that the court provide notice or an opportunity to contest the issuance of protective orders to parties whose interests are affected. In practice, courts have granted the protective orders automatically upon request of the management of the company and without any notice to creditors or opportunity for them to contest.

Court action of this sort would normally be impossible under U.S. law. U.S. Bankruptcy Code, section 362 provides that a petition filed to commence bankruptcy or reorganization proceedings shall operate as an automatic stay similar to the protective orders just described.<sup>220</sup> Section 362, however, also provides a procedure where creditors can seek relief from the automatic stay.<sup>221</sup> The grounds upon which a secured creditor may seek relief include lack of adequate protection of the creditor's property interest or that the debtor has no equity in the property and the property is not necessary to an effective reorganization.<sup>222</sup>

A well respected Chinese banker with extensive personal experience in many reorganizations, both those limited to local creditors and those involving foreign creditors, believed that the ROC authorities were not likely to improve substantially the notice and opportunity to contest provisions.<sup>223</sup> He observed that foreign banks were very effective at asserting their legal rights and very willing to do so whenever given the opportunity.<sup>224</sup> The simplest way for the Chinese authorities to retain control of the decision whether or not to allow reorganization was to prevent foreign bank participation by not informing them of the proceedings.

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<sup>218</sup> Company Law art. 287.

<sup>219</sup> *Id.* Two cases are of interest in this respect. In the New East reorganization, the court actually granted a third extension. An American bank creditor appealed the decision as violating the plain language of the statute, but by the time the appeal was heard, the court had approved the petition and rendered the appeal moot. In the Fu Mu reorganization, no decision had been made two years after the petition had been lodged, but no foreign banks were involved and none of the local creditors appealed.

<sup>220</sup> 11 U.S.C. § 362(a) (1982 & Supp. IV 1986).

<sup>221</sup> 11 U.S.C. § 362(d).

<sup>222</sup> 11 U.S.C. § 362(d)(1)-(d)(2) (1982 & Supp. IV 1986).

<sup>223</sup> See *supra* note 1 regarding confidential sources.

<sup>224</sup> *Id.*

### 3. *Dissipation of Company Assets While the Petition Is Being Considered*

Under Article 287 of the ROC Company Law, the court has the power to institute various protective measures to preserve the assets of the company while it considers the petition for reorganization. Interested parties can petition the court to stay proceedings in bankruptcy, compulsory execution, or composition proceedings, or to limit the company in its conduct of its business or in the fulfillment of its obligations. In practice, however, management has been able to stay creditors' actions before becoming subject to effective court scrutiny. Rapid dissipation of liquid assets and movable property while the court considers interim protective orders has been particularly detrimental to the unsecured creditors whom the court-ordered reorganization is supposed to protect.

ROC courts also have the power to freeze assets belonging to managers or directors of the company who may be liable for corporate debts, although courts have not used this power extensively.<sup>225</sup> In the Delta Petrochemical case, the attempt to freeze the assets of personal guarantors of company obligations proved ineffective because, prior to petitioning for reorganization, the individuals involved transferred all their assets beyond the reach of their creditors. Creditors were unable to avoid the transfers under Article 244 of the Civil Code<sup>226</sup> because they could not establish the necessary factual basis for recovery.<sup>227</sup>

U.S. law now provides more effective procedures for preventing dissipation of the company's assets during the early months of the reorganization procedure. Before the 1978 reforms, U.S. bankruptcy law required creditors filing an involuntary bankruptcy petition to prove an act of bankruptcy before filing a petition.<sup>228</sup> The bankruptcy law reforms eliminated these obstacles.<sup>229</sup> The creditors' petition is expeditiously approved unless the debtor chooses to contest.<sup>230</sup> A voluntary petition for relief is automatically granted.<sup>231</sup>

U.S. bankruptcy law provides for the appointment of an interim

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<sup>225</sup> See generally Company Law art. 287.

<sup>226</sup> See *infra* text accompanying notes 280-81 for a discussion of Article 244 of the ROC CIVIL CODE [hereinafter CIVIL CODE].

<sup>227</sup> Peng, *supra* note 215.

<sup>228</sup> E. WARREN & J. WESTBROOK, *supra* note 148, at 288-89.

<sup>229</sup> *Id.* at 288.

<sup>230</sup> 11 U.S.C. § 303(d), (h) (1982). Creditors are further safeguarded by the automatic stay protection, which becomes effective with *filing* a petition. See *supra* text accompanying notes 221-22 for a discussion of the automatic stay under U.S. law.

<sup>231</sup> 11 U.S.C. § 301 (1982). If creditors feel that a voluntary application for reorganization relief should not be granted, they can argue that the case should be converted to straight bankruptcy. 11 U.S.C. § 1112(b).

trustee in liquidation bankruptcies.<sup>232</sup> The court can appoint an interim trustee promptly after it has received a petition seeking bankruptcy relief.<sup>233</sup> The interim trustee has all the powers of a trustee to protect the assets of the debtor.<sup>234</sup>

The role of a supervisor in ROC bankruptcy law differs from an interim trustee in that the supervisor has no power to take positive steps to protect company assets from improper dissipation by insiders.<sup>235</sup>

In addition to lacking any statutory provision for a representative of creditors' interests with concrete powers to protect a company's assets while interim orders are in effect, Taiwan suffers from a shortage of qualified personnel to handle the task. The absence of any real bankruptcy practice results in the lack of an organized bankruptcy bar. Few business people are trained in professional management techniques and able to take over the management of a financially troubled company. Some well respected academics with a lack of practical management experience have assisted in reorganizations, but have been unable to control management abuses.

#### 4. *Substantive Consolidation of Cases Involving Companies with Affiliates*

Under U.S. company reorganization law the court may require that affiliated companies be consolidated and treated as one entity in order to protect the rights of creditors of the individual companies.<sup>236</sup> This power of the courts to consolidate companies which are separately incorporated is not based on any express statutory provisions of the U.S. Bankruptcy Code, but rather on the general equitable powers of U.S. courts to prevent fraud.<sup>237</sup> Courts have disagreed on when a court is justified in consolidating cases, but some jurisdictions have found consolidation appropriate when the interrelationships of the affiliates are so "hopelessly obscured" that the affairs of the affiliates cannot be disentangled by the court.<sup>238</sup> Others have suggested that consolidation is appropriate when failure to consolidate would unjustly affect the claim of a creditor who had reasonably relied on the credit of an affiliate.<sup>239</sup>

Substantive consolidation is an area of U.S. law which is currently developing and does not yet present a clear model from which

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<sup>232</sup> 11 U.S.C. §§ 701, 702(d) (1982 & Supp. IV 1986).

<sup>233</sup> 11 U.S.C. § 701(a) (1982 & Supp. IV 1986).

<sup>234</sup> 11 U.S.C. §§ 701, 702(d), 704 (1982 & Supp. IV 1986).

<sup>235</sup> Company Law art. 285. See *supra* notes 93-94 and accompanying text for a discussion of the role of the supervisor in German and ROC company law.

<sup>236</sup> See, e.g., Note, *Substantive Consolidations in Bankruptcy: A Flow-of-Assets Approach*, 65 CALIF. L. REV. 720 (1977).

<sup>237</sup> *Id.*

<sup>238</sup> *Chemical Bank New York Trust Co. v. Kheel*, 369 F.2d 845, 847 (2nd Cir. 1966).

<sup>239</sup> *Id.* at 848 (Friendly, J., concurring).

the ROC could draw suggestions for the reform of its corporate reorganization law. Given the prevalence with which major publicly held companies use affiliated companies to frustrate corporate creditors, some form of substantive consolidation is desirable under ROC law. The ability of creditors to demand the consolidation of affiliated companies within a reorganization reduces the incentive for management to use affiliates to transfer assets out of the company prior to filing.<sup>240</sup>

### *B. Management of the Estate*

After the court approves the petition and the reorganization process begins, several major problems emerge. One such problem is the inadequacy of mechanisms for controlling the conduct of existing company management acting as the reorganization manager. The outside professionals who act as reorganization supervisors and who are supposed to supervise the conduct of the reorganization managers have been unwilling or unable to significantly affect the conduct of the reorganization. The courts have allowed suspect claims by creditors with inadequate critical review. Powers to avoid fraudulent or preferential transfers in order to draw assets back into the company are inadequate.

#### *1. Conduct of the Reorganization Manager*

Both ROC and U.S. company reorganization law favor keeping existing management in possession of the company during reorganization.<sup>241</sup> Most parties to a reorganization agree that this solution is the most efficient, inexpensive way to run a company during reorganization. A debtor in possession under U.S. law is held to the same standard as a trustee in managing the company affairs.<sup>242</sup> U.S. bankruptcy law requires the trustee or debtor in possession to collect the assets of the estate and manage those assets for the benefit of parties in interest, usually the creditors.<sup>243</sup>

Article 290 of the ROC Company Law authorizes the court to appoint one of the current directors as the reorganization manager unless the court finds that none of the directors are appropriate for the position. In such a case the court can choose the reorganization manager from among the shareholders or creditors. The ROC Company Law also imposes a fiduciary duty on the reorganization manager and supervisor; they must perform their duties with the "care of a good administrator."<sup>244</sup>

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<sup>240</sup> Chuang, *supra* note 52, at 290-95.

<sup>241</sup> See 11 U.S.C. § 1104 (1982 & Supp. IV 1986); Company Law art. 290.

<sup>242</sup> See 11 U.S.C. §§ 704, 1107 (1982 & Supp. IV 1986).

<sup>243</sup> See 11 U.S.C. § 704(1) (1982 & Supp. IV 1986).

<sup>244</sup> Company Law art. 313.



In theory, interested parties have the power to remove an unacceptable reorganization manager.<sup>245</sup> The reorganization supervisor, who is supposed to supervise the manager, may petition the court to have the manager removed for illegal or improper conduct.<sup>246</sup>

In practice, regardless of any statutory power to replace the reorganization manager, the ROC courts often have allowed existing management to stay on despite apparent misconduct. This practice is due in large part to the shortage in Taiwan today of professional managers willing or able to take control of a troubled company. It is also due in some cases to the unwillingness of courts and local authorities to critically review the competence and integrity of existing management.

Article 293 of the Company Law provides sanctions for failure of existing management to cooperate with the transfer of power to a reorganization manager. Any responsible person who conceals or destroys accounting records, conceals or destroys assets, or forges or promotes fraudulent claims may be imprisoned for up to a year and fined. In practice, this provision has not protected creditors from the above abuses by reorganization managers. This failure may be due to evidentiary difficulties, lack of cooperation between creditors, or unwillingness of the court to act contrary to implicit or explicit indications from government officials on the appropriate conduct of the reorganization.

## 2. *Reorganization Supervisors Are Ineffective in Protecting Creditors' Interests.*

Article 289 of the Company Law requires the court to appoint an individual or financial institution with professional knowledge and experience in operating the business of the company in reorganization to act as reorganization supervisor.<sup>247</sup> In practice, reorganization supervisors have been drawn from a variety of sources. Some have been well respected local CPAs or academics from business or law faculties.<sup>248</sup> In the Pao Lung case, one of the first major reorga-

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<sup>245</sup> *Id.* at art. 290.

<sup>246</sup> U.S. reorganization law provides a different kind of standard for creditors to meet in seeking the removal of the debtor in possession. Upon request of a party in interest and after notice and opportunity for hearing for all interested parties, the court may order the debtor in possession replaced with a trustee for two reasons. One is for fraud, dishonesty, incompetence, or gross mismanagement before or after commencement of the reorganization. The court must find not merely mismanagement but gross mismanagement, so creditors must introduce compelling evidence to prevail. *See* 11 U.S.C. § 1104(a)(1) (1982 & Supp. IV 1986).

The second reason for replacing the debtor in possession, however, is that it is simply in the interest of the creditors or shareholders. This second standard is very flexible and gives the court the discretion to evaluate the equities of each case. *See* 11 U.S.C. § 1104(a)(2).

<sup>247</sup> *See supra* text accompanying notes 93-94.

<sup>248</sup> For example, in the Hsin Chu Glass reorganization, the following people were ap-

nizations involving many foreign banks, the Bank of America acted as one of three supervisors. The Bank of America found that its limited role in the proceedings was inadequate to protect creditors' interests. The overall experience was one of frustration and impotence.

The supervisor has a wide variety of administrative functions. The supervisor oversees conduct of the reorganization managers and must be given prior notice of certain actions by the manager.<sup>249</sup> The supervisor has the right to obtain business and financial information from the company's directors and managers.<sup>250</sup> Creditors must file claims with the supervisor who then prepares the definitive list of creditors and claims.<sup>251</sup> The supervisor also chairs all creditors' and shareholders' meetings. Both the supervisor and manager must perform their duties with the care of a "good administrator."<sup>252</sup> The standard of care required of a good administrator is the highest standard under ROC law.<sup>253</sup> Compensation for a supervisor or manager is set by the court after considering the nature of the duties performed.<sup>254</sup>

The statutory framework puts the supervisor in the position of an examiner in U.S. bankruptcy law.<sup>255</sup> Consequently, the supervisor has little statutory authority to act decisively to protect company assets. The committee structure of many reorganization supervisors compounds the absence of clear statutory authority. While foreign bank creditors might desire a supervisor to be installed within the company to take control of cash flow and prevent depletion of assets, local creditors might not favor such a heavy handed approach to supervising the reorganization manager.<sup>256</sup>

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pointed to serve as reorganization supervisors: Lin Lee-Hsin, the general manager of the Overseas Chinese Commercial Bank, Bao Er-Yi, supervisor of Central Bank, CPA and Professor in Accountancy at Soochow University, and Lai Yen-Ho, law professor at Cheng Chi University.

<sup>249</sup> Company Law art. 290.

<sup>250</sup> *Id.* at art. 293.

<sup>251</sup> *Id.* at arts. 297-298.

<sup>252</sup> *Id.* at art. 313.

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The concept of a good administrator should be considered in relation with three degrees of attention or negligence. The concept of negligence originates from the Criminal Law, but has been used also in the context of the Civil Law. The highest degree of attention is required from a good administrator. The three degrees, in decreasing degrees of absence of attention, are as follows: gross negligence, substantial slight negligence (the failure to take care as though it were one's own business), [and] abstract slight negligence (the failure to take care as a good adviser to the company. A good adviser should pay more attention than someone who runs his own business, because an adviser is specifically trained and professionally appointed for his task.) [sic]

Correspondence with Chang, *supra* note 80.

<sup>254</sup> *Id.*

<sup>255</sup> See 11 U.S.C. § 1104.

<sup>256</sup> The apparent passivity of some creditors in company reorganizations in the ROC may be due to the excessive regulation of local banks, which stifles initiative in many bank

A foreign banker suggested that the inability of supervisors to significantly affect the conduct of the reorganization stems from a perceived lack of financial support.<sup>257</sup> Although courts award compensation for services, some bankers believe that a court award is unlikely to reflect accurately the commitment of resources necessary to see any results. Given the limits of the supervisor's official role, only an individual of outstanding competence and initiative could hope to enter the company and help turn the situation around. No individual creditor would be willing to commit an outstanding bank officer for an extended full time assignment with the company if no mechanism existed for sharing the costs involved.<sup>258</sup>

### 3. *No Critical Review of Some Creditors' Claims*

A reorganization supervisor is responsible for preparing lists of preferred, secured, and unsecured creditors and shareholders together with their respective claims and making the lists public.<sup>259</sup> Court hearings are held to review the claims and contested claims are designated by court decree.<sup>260</sup> Substantive disputes must be decided in a separate court action within twenty days of the court decree.<sup>261</sup> Failure to contest before the end of the readjustment hearings makes the finding of the supervisor final and binding on all parties.<sup>262</sup>

U.S. company reorganization law explicitly provides that parties in interest may object to the allowance of any claim.<sup>263</sup> After notice and hearing, the court may disallow any claim for any one of several grounds.<sup>264</sup> These grounds include that the claim or interest has not matured, that the claim is by an insider for services rendered and the claim exceeds the reasonable value of the services, and that the claim exceeds the limits for allowed claims by landlords or employees.<sup>265</sup>

One common problem with questionable claims allowed in ROC reorganizations is the ease with which the principals of a company

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officers. It may also be due to a reluctance to pursue legal remedies to extremes, either because legal remedies are presumptively not very effective or because they are considered inappropriate. If the principal of a company is a person of substance and reputation within the ROC, a variety of social norms may inhibit creditors from vigorously pursuing their legal rights. See *supra* text accompanying notes 18-27, 73-76.

<sup>257</sup> See *supra* note 1 regarding confidential sources.

<sup>258</sup> This concern is realistic, considering that the Sumitomo Bank in Japan assigned one of its top managers to the Mazda company reorganization for over four years. See Pascale and Rohlen, *supra* note 169, at 228-30.

<sup>259</sup> Company Law art. 298.

<sup>260</sup> *Id.* at art. 299.

<sup>261</sup> *Id.*

<sup>262</sup> Company Law arts. 297-299.

<sup>263</sup> 11 U.S.C. § 502 (1982 & Supp. IV 1986).

<sup>264</sup> *Id.*

<sup>265</sup> See *id.*

can fabricate phony claims.<sup>266</sup> Postdated checks and promissory notes are the most common forms of payment for transactions in the unregulated money market. Article 202 of the Company Law requires a board resolution to authorize any obligation of a company, unless the articles of incorporation provide otherwise.<sup>267</sup> Many companies in Taiwan have charter provisions authorizing principals of the company to obligate the company without a board resolution. Generally poor financial records in combination with great authority enable the principal of a company to create without much difficulty enormous quantities of phony obligations evidenced only by a check or promissory note.<sup>268</sup>

A new, more stringent standard should be drawn up for review of creditors' claims in order to reduce the possibility of collusion between management and inside creditors on the eve of reorganization. If creditors were required to furnish more substantial evidence of a claim than a check or promissory note, which can easily be predated just prior to petitioning for reorganization, both management facing a cash flow crisis and unregulated lenders would have less incentive to engage in unrecorded financial transactions.

#### 4. *Inadequate Mechanisms for Voiding Fraudulent or Preferential Transfers*

The powerlessness of reorganization managers and supervisors to challenge improper transactions entered into on the eve of filing the petition for reorganization has been one of the most acute problems in ROC company reorganization law. U.S. bankruptcy law provides several techniques for recovering property for the benefit of creditors: fraudulent conveyance law, the power to void preferential transfers on the eve of bankruptcy, equitable subordination of the claims of insiders who have breached their fiduciary duties,<sup>269</sup> substantive consolidations of affiliated companies,<sup>270</sup> and the power of the trustee to assume or reject unexpired leases or executory contracts.<sup>271</sup>

The Bankruptcy Code of 1978 provides several tools for the

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<sup>266</sup> This problem is not unique to the ROC. A bankruptcy statute enacted in England in 1697 was repealed within a year because "many fraudulent practices [had] been committed by making pretended agreements with persons who were not real creditors." 9 & 10 Will. 3, ch. 19, preamble, *cited in* Glenn, *supra* note 153, at 379.

<sup>267</sup> Company Law art. 202.

<sup>268</sup> Perhaps the most remarkable example of obligations appearing for the first time in the reorganization process was the Ta Nun case. *See infra* p. 467. One banker estimated 30-40% of all allowed claims were evidenced by only checks or promissory notes and did not appear on the books of the corporation.

<sup>269</sup> 11 U.S.C. § 747(1) (1982).

<sup>270</sup> *See supra* text accompanying notes 236-40.

<sup>271</sup> 11 U.S.C. § 365(a) (1982 & Supp. IV 1986); *see supra* text accompanying notes 290-93.

trustee in recovering assets for the estate.<sup>272</sup> The trustee may avoid transfers of the debtor's property for the benefit of a creditor on account of an antecedent debt which is made within ninety days prior to filing for court protection and which gives that creditor more than he would recover in bankruptcy if the transfer had not been made.<sup>273</sup> This standard roughly corresponds to Article 79 of the ROC Bankruptcy Law.<sup>274</sup> The reorganization chapter of the Company Law, however, has no such provision.

The power of the trustee to avoid preferential transfers includes special provisions which allow a floating lien on inventory or accounts receivable to float without being voidable, so long as the secured party's position does not improve as a result.<sup>275</sup> This exception is very important in the United States where inventory and accounts receivable financing are very common. It would be less significant in Taiwan where accounts receivable financing is generally done by discounting postdated checks, and inventory financing is not very popular with regulated lenders who prefer fixed assets as collateral.<sup>276</sup>

In U.S. bankruptcy law the trustee can avoid unperfected security interests for the benefit of the debtor's estate.<sup>277</sup> ROC reorganization law has no similar express provision. A real property mortgage, however, is not effective until registered.<sup>278</sup> A chattel mortgage is not effective against bona fide third parties until it has been registered.<sup>279</sup> The application of these provisions in reorganizations is unclear.

The Civil Code of the ROC provides creditors with some protection against fraudulent conveyances by debtors. The first provision of Article 244 of the Civil Code permits a creditor to apply to the court to void a gratuitous act done by the debtor which is likely to be prejudicial to the creditor's interest.<sup>280</sup> In a 1962 case, the ROC Supreme Court added the requirement that the creditor must prove

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<sup>272</sup> See 11 U.S.C. §§ 365, 548, 549 (1982 & Supp. IV 1986); see also H. LEBOWITZ, BANKRUPTCY DESKBOOK 428 (1986).

<sup>273</sup> See 11 U.S.C. § 547(b) (1982 & Supp. IV 1986).

<sup>274</sup> See Bankruptcy Law art. 79.

<sup>275</sup> See 11 U.S.C. § 547(c)(5) (1982 & Supp. IV 1986).

<sup>276</sup> See *supra* notes 68-69, 76, and accompanying text. The practice of requiring offsetting balances, however, is common among bankers in the ROC. The right of setoff in U.S. bankruptcy law is governed by a standard similar to the one for floating liens. A U.S. bank may setoff a claim against a cash balance immediately prior to bankruptcy, provided that the bank's claim was not acquired from a third party or that the claim did not arise within ninety days of commencement of the case. The bank may also be required to disgorge assets of the debtor taken by exercise of its right of setoff if, after application of a complex test, the trustee determines that the bank managed to reduce an insufficiency in its cash collateral within ninety days of bankruptcy. See 11 U.S.C. § 553 (1982 & Supp. IV 1986).

<sup>277</sup> See 11 U.S.C. § 544(b) (1982).

<sup>278</sup> CIVIL CODE art. 758.

<sup>279</sup> ROC Chattel Secured Transaction Act, art. 5.

<sup>280</sup> CIVIL CODE art. 244.

that the transfer rendered the debtor insolvent.<sup>281</sup> The second provision of Article 244 provides that a creditor may avoid a nongratuitous transfer by the debtor if the creditor can show that the debtor knew it was prejudicial to the creditor's interests and that the third party knew of the prejudice at the time the transfer was made. These standards are very difficult to meet, especially in a court system in which litigants have few powers to discover information held by the opposing side.

The U.S. Uniform Fraudulent Conveyance Act (UFCA), by contrast, provides several tests for voiding fraudulent transfers. The first test allows creditors to void conveyances made with the actual intent to defraud present creditors. For this test the creditor must show actual fraud by the debtor, but need not show insolvency.<sup>282</sup> The second test allows creditors to avoid transfers made for less than fair consideration which render the debtor insolvent.<sup>283</sup> The third test protects creditors from debtors who engage in or are about to engage in business and after a transfer for less than fair consideration, have inadequate capital with which to conduct business.<sup>284</sup> The fourth test protects creditors from debtors who make conveyances or incur debts without fair consideration and thus incur debt beyond their ability to pay.<sup>285</sup> Like Article 244 the UFCA puts a heavy burden on the creditor to establish a case for voiding a transfer.<sup>286</sup> The variety of standards available under the UFCA, however, allows creditors substantially more protection under U.S. law than ROC law. Section 544(b) of the Bankruptcy Code indirectly incorporates the UFCA into bankruptcy law.<sup>287</sup>

The lack of any effective statutory mechanism to prevent preferential or fraudulent transfers on the eve of a petition allows grossly inequitable practices to continue unchecked in many reorganizations. Many unregulated lenders are friends or relatives of the principals of a company. Their investments in the form of unrecorded loans receive the equivalent of high dividend distributions in the form of interest payments. Their credit risk is lower than that earned by regulated lenders who are not allowed to earn the same high returns. These creditors, as insiders, are well situated to recover their investment immediately prior to commencement of reorganization.

Another abuse has been the management practice of leasing all the productive facilities of the company to friends in affiliated com-

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<sup>281</sup> Supreme Court judgment, Ref. No. 51 Tai Shang Tze 3528.

<sup>282</sup> Unif. Fraudulent Conveyance Act § 7, 9B U.L.A. 138 (1918). This paper does not deal with the new Uniform Fraudulent Transfer Act.

<sup>283</sup> *Id.* at § 2(1), 9B U.L.A. 82 (1918).

<sup>284</sup> *Id.* at § 5, 9B U.L.A. 135 (1918).

<sup>285</sup> *Id.* at § 6, 9B U.L.A. 137 (1918).

<sup>286</sup> Landers, *A Unified Approach to Parent, Subsidiary, and Affiliate Questions in Bankruptcy*, 42 U. CHI. L. REV. 589, 595 (1975).

<sup>287</sup> 11 U.S.C. § 544(b) (1982).

panies at nominal rents. The lease is predated to give it some appearance of legitimacy.<sup>288</sup> As a result, for the duration of the reorganization friends of management are allowed to run the company and extract all revenues in excess of a purely nominal rent. Secured creditors are forced to watch the value of their equipment collateral depreciate while protective orders prevent enforcement of their rights. No effective mechanism exists for creditors to avoid such leases. An American banker has estimated that these lease arrangements exist in as many as fifty percent of company reorganizations.

In theory, the reorganization manager could choose to accept or reject these lease obligations. Article 290, paragraph 5(4) provides that, subject to prior approval by the reorganization supervisor, the reorganization manager may execute or cancel an important, long-term obligation of the company. Paragraph 5(6) allows the reorganization manager to relinquish or transfer any rights of the company. Reorganization managers have not, in fact, used these powers to avoid questionable obligations.<sup>289</sup>

U.S. bankruptcy law formerly required the trustee to demonstrate that an executory contract or lease was a burden to the estate in order to avoid the obligation.<sup>290</sup> Under Chapter 11, section 365 of the new Bankruptcy Code, the decision is now within the business judgment of the trustee subject only to court approval.<sup>291</sup> Damages arising from the rejection of an unperformed obligation become an unsecured claim, assuming no security was taken originally.<sup>292</sup> Where the contract is a lease, the U.S. Bankruptcy Code further limits the amount the lessor can recover for the rejection of a long-term lease.<sup>293</sup> Although the U.S. provisions are intended to apply in a situation where the debtor is a lessee, not the lessor, the ROC law could incorporate an analogous provision. By expressly requiring the reorganization manager to reject leases which burden the estate and by limiting the lessee's recovery for rejection of long-term leases, the abuses of leasing productive facilities might be controlled. A legal standard alone would not be effective in controlling collusive or fraudulent practices by company management on the eve of reorganization, but it might encourage greater judicial intervention on behalf of creditors.

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<sup>288</sup> In the *Yi Hing Hang* case, the principals were so inept that the predated lease was dated prior to the date when title to the property was acquired, thus exposing the fraud.

<sup>289</sup> Without access to court records of the proceedings it is difficult to be sure why this has been so. See *infra* text accompanying note 341.

<sup>290</sup> 11 U.S.C. § 602 (1976).

<sup>291</sup> See 11 U.S.C. § 365 (1982 & Supp. IV 1986).

<sup>292</sup> 11 U.S.C. § 502(g).

<sup>293</sup> The lessor is limited to the greater of one year's rent or 15% of the remaining rent, but not more than three years rent. See 11 U.S.C. § 502(b)(6) (1982 & Supp. IV 1986).

C. *Conduct of Creditors' Meetings*

Some of the major reforms in U.S. company reorganization law in the 1930s came in the area of "protective committees" or creditors' meetings.<sup>294</sup> The problem of creditors' committees' abuse of fiduciary duties and oppression of small investors has not arisen in Taiwan, where conflicts between different groups of creditors have instead stalemated attempts to draw up reorganization plans.

1. *Existing Class Divisions Are Too Broad*

Under ROC law claimants are divided into the following groups: preferred, secured, and unsecured creditors, and shareholders.<sup>295</sup> At creditors' meetings, creditors hear reports and comments on the financial condition of the company and the proposed reorganization, discuss and vote on the reorganization plan, and attend to any other matters relating to the reorganization.<sup>296</sup> Voting at meetings is by a majority based on amount of claims. A reorganization plan, however, can only be approved by a two-thirds majority.<sup>297</sup>

ROC law has no provision corresponding to the U.S. bankruptcy rule that secured creditors are secured only to the extent of the value of their collateral and are unsecured for any claim in excess of the value of the collateral.<sup>298</sup> As a result, secured creditors' groups are crowded with creditors holding worthless mortgage rights.

U.S. reorganization law provides the court and parties in interest with more freedom in creating groups of creditors. The only committee which must be created is the unsecured creditors' committee.<sup>299</sup> A party in interest may request the court to create additional committees of creditors or shareholders.<sup>300</sup> The creation of special committees historically gave some creditors disproportionate power over other creditors.<sup>301</sup> The Bankruptcy Code now provides that classification of creditors be based on the nature of their claims and not unfairly discriminate against small creditors.<sup>302</sup>

The common practice of requiring guarantees from principals and affiliated companies in Taiwan has resulted in many claims against companies in reorganization arising from obligations which the company co-made, but for which the company never received any value.<sup>303</sup> This practice has led some creditors to suggest that credi-

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<sup>294</sup> See *supra* text accompanying notes 133-34.

<sup>295</sup> Company Law art. 298.

<sup>296</sup> *Id.* at art. 301.

<sup>297</sup> *Id.* at arts. 298, 302.

<sup>298</sup> 11 U.S.C. § 506 (1982 & Supp. IV 1986).

<sup>299</sup> *Id.* at § 1102(a)(1) (1982 & Supp. IV 1986).

<sup>300</sup> *Id.* at § 1102.

<sup>301</sup> SEC REPORT, *supra* note 121, at 863, *et seq.*

<sup>302</sup> 11 U.S.C. § 1122 (1982).

<sup>303</sup> See *supra* text accompanying notes 266-68.



tors with claims arising from value given to the company in reorganization should be given priority over claims for apparently co-made obligations for which the company in substance was only a guarantor. In the Ta Nun case the court rejected this suggestion because "direct" and "contingent" liabilities are not recognized concepts in ROC reorganization law. The power to subdivide classes of creditors would allow these types of claims to be distinguished in reorganization.

Another important power U.S. courts have to insure fair treatment between creditors is the power to subordinate insiders' claims.<sup>304</sup> Under the doctrine of equitable subordination, if inside creditors have mismanaged the affairs of the company to their own benefit or to the detriment of creditors, the courts may subordinate the inside creditors' claims to those of outside creditors. The doctrine of equitable subordination is most likely to be applied in the United States where the apparent wrongdoer is an insider.<sup>305</sup> Regulated creditors in Taiwan should be allowed to seek subordination of insiders' unsecured claims evidenced only by a note or check, if evidence indicates bad faith or collusion, but is not strong enough to disallow these claims altogether.

## 2. *Conflicting Perspectives Make Agreement on a Plan Difficult*

In many reorganization proceedings local government-owned or supervised banks, foreign banks, trade creditors, employees, and unregulated lenders are involved as claimants. Some major conflicts of interest have arisen between foreign banks and local banks, foreign banks and unregulated lenders, and between the foreign banks themselves. These tensions originate outside company reorganization law.

Foreign banks opened branches in Taiwan in large numbers beginning in 1979.<sup>306</sup> In 1979, only twelve foreign bank branches were located in Taipei. These banks focused on export financing and sovereign lending. By 1982, twenty-nine foreign bank branches were located in Taipei. Since most foreign banks were recent arrivals to the lending market in Taiwan, they were forced to lend unsecured. Local banks had long established relationships with most companies approached by the lending officers of the new foreign bank branches and had long since taken security interests in all fixed assets of their borrowers. Foreign banks had lent unsecured or against security that on closer examination proved to be worthless.

U.S. banks announced their intention to follow modern banking practices, such as cash flow lending based on analysis of financial

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<sup>304</sup> 11 U.S.C. § 510(c) (1982).

<sup>305</sup> E. WARREN & J. WESTBROOK, *supra* note 148, at 546.

<sup>306</sup> *See supra* note 2.

statements. Newly arrived bankers aggressively pursued local borrowers and were often unaware or unconcerned that a borrower might be accepting funds from several foreign banks simultaneously. Foreign bankers did not initially question the ability of local businessmen to use the funds in profitable investments and so did not closely monitor their use of bank credits.

As Taiwan's economy moved into a severe recession in 1983, many problems with financial statements prepared by local businesses and endorsed by local CPAs became apparent. Once foreign banks learned that the financial statements they had relied upon in granting credits were often inaccurate and in some cases complete fabrications, they began to rely more heavily on rumors of problems with borrowers in making decisions to withdraw credits.<sup>307</sup> Once companies were faced with insolvency, foreign bankers tended to emphasize the bad faith of management in preparing financial statements and in failing to disclose unregulated borrowing. Local bankers and borrowers emphasized instead the lack of a long-term commitment among foreign bankers to the local economy, and the ability of foreign banks to cause the collapse of a company by suddenly withdrawing lines of credit based on rumors that other banks were doing the same.

In U.S. company reorganizations secured creditors are often the most critical parties in interest in evaluating a company's chance of success in reorganization. Secured creditors are generally critical observers of the reorganization process because, if the reorganization is converted into a straight liquidation, they will be able to recover the value of their collateral more promptly. In company reorganizations in the ROC, secured creditors are often local banks. Employees of local banks in the ROC do not have the same incentives as secured creditors in the United States to convert a reorganization into a liquidation. Local bankers are effectively civil servants rather than businessmen. As a civil servant, the bank officer in charge of lending to the company in reorganization is held personally responsible if it becomes necessary to write off any loans to that company.<sup>308</sup>

Ministry of Finance (MOF) regulations provide that nonperforming loans to companies in court-ordered reorganizations need not be recorded as nonperforming for the duration of the reor-

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<sup>307</sup> Cf. text accompanying notes 76 and 161. The development of the accounting profession in Taiwan has not kept pace with the economy's rapid development. Expertise and professional integrity are often lacking among local CPAs. R. Chen, *An Evaluation of Some Aspects of the Public Accounting Profession in Taiwan* 181 (1973) (unpublished Ph.D. thesis, U. Missouri-Columbia). American bankers were unaware of the nature of Taiwan's accounting profession when they began their aggressive lending programs in the early 1980s.

<sup>308</sup> Liang, *supra* note 72, at 9.

ganization. The responsible lending officer, therefore, has an interest in preventing the termination of the reorganization if to do so would force recognition of a loss and possibly result in the imposition of administrative penalties against him personally for the loss.<sup>309</sup> Any bad faith delay by management in the conduct of a reorganization in the ROC is compounded by the fact that the employees of local banks also have an interest in delay. Foreign bankers have often complained that this situation leads to a disregard of the actual financial condition of the company in reorganization.

The bureaucratic inflexibility of local bankers not only makes negotiations with foreign bankers difficult, it prevents government-owned banks in the ROC from playing the same supportive role in economic development which banks in Japan have played.<sup>310</sup> Banks in Japan are given incentives from the central government to encourage their borrowers to adopt professional management techniques. By stifling any entrepreneurial initiative within local banks, ROC authorities make it difficult for government-owned banks to provide the same encouragement to ROC companies.

#### *D. Quality of Plans Submitted*

Very few workable plans have been produced in reorganization proceedings. Many companies sought reorganization to delay performance on their obligations to creditors. Although the Company Law gives the court authority to "cram down" a reasonable plan,<sup>311</sup> in practice courts have put very little pressure on management to produce plans and end the reorganization proceedings. If the court has made the decision to allow reorganization by taking into account a large number of general economic variables, the court should distribute the costs of reorganization among all the parties expected to benefit. The failure to require management to cooperate in good faith in the reorganization effort makes attainment of the general economic objectives unlikely and puts the costs of the reorganization on the unsecured creditors.

##### *1. ROC Company Law Has No Workable "Feasibility" Standard*

The reorganization manager is responsible for drawing up a

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<sup>309</sup> For a discussion of Control Yuan punishment of any individual bank officer held responsible for a bad loan, see *supra* text accompanying notes 73-76.

Bad loans in Taiwan cannot be written off without review of the case by the Control Yuan. While Ministry of Finance and Central Bank of China bank examination standards tend to support modern banking practices, Control Yuan investigations focus on finding guilt and punishing responsible parties.

<sup>310</sup> Pascale and Rohlen, *supra* note 169, at 228-33.

<sup>311</sup> Company Law art. 306.

plan and submitting it to the meetings of interested parties.<sup>312</sup> If the interested parties approve the plan, the court must review the plan. Court review includes submission of the plan to the MOEA and Taiwan SEC for comment.<sup>313</sup> If the interested parties reject the plan, the court may still submit the plan to the MOEA and Taiwan SEC for review and amendment.<sup>314</sup> The amended plan is resubmitted to the interested parties. If the interested parties still do not approve the amended plan, the court has the power to terminate the reorganization proceedings or to enter a decree implementing the amended plan.<sup>315</sup> None of the provisions relating to court-ordered amendments to a plan and court approval in the absence of approval by interested parties have ever been used in any reorganizations to date.

The confirmation standards of the U.S. Bankruptcy Code are very complex. Confirmation standards are meant to insure that no interested party is forced to accept any reorganization plan which does not offer at least as much as that party would receive in a straight liquidating bankruptcy.<sup>316</sup> Any creditor who is to receive full satisfaction of its claim is conclusively presumed to have assented to the plan.<sup>317</sup> Very complex cram down provisions guarantee that secured creditors are able to either retain their mortgage interest, or receive cash payments equal to their allowed secured claims plus interest at market rates.<sup>318</sup> Unsecured creditors receive payment of their claims in full, or at least a guarantee that no junior classes are to receive any benefit without the unsecured creditors' consent.<sup>319</sup>

Independent of any safeguards for creditors or voting requirements, a U.S. court cannot approve a plan unless the court finds that the plan is likely to succeed.<sup>320</sup> This feasibility standard might be implied in the ROC Company Law requirement that the court seek the recommendations of the MOEA. The ROC statute contains no express feasibility standard and in practice the courts have applied no such standard.

MOEA proposals for reform of reorganization law suggested a fixed time limit, such as two years from approval of a petition, to deal with the problem of companies using reorganization to delay per-

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<sup>312</sup> *Id.* at 303.

<sup>313</sup> *Id.* at arts. 305, 307.

<sup>314</sup> *Id.*

<sup>315</sup> *Id.* at arts. 306-307. The amendments the court may make include: transferring all encumbered property and claims to the new company, releasing encumbered property to secured creditors in satisfaction of their claims, or any other fair and reasonable means to continue the company's business and protect the rights of creditors.

<sup>316</sup> 11 U.S.C. § 1129(a)(7) (1982 & Supp. IV 1986).

<sup>317</sup> 11 U.S.C. §§ 1126(f), 1124 (1982 & Supp. IV 1986).

<sup>318</sup> 11 U.S.C. § 1129(b)(2)(A) (1982 & Supp. IV 1986).

<sup>319</sup> 11 U.S.C. § 1129(b)(2)(B) (1982 & Supp. IV 1986).

<sup>320</sup> 11 U.S.C. § 1129(b)(1).

formance of obligations indefinitely.<sup>321</sup> A feasibility standard and granting creditors the power to convert a reorganization to a liquidation would allow creditors rather than bureaucrats more control over the conduct of the proceedings and allow greater flexibility in dealing with individual cases.

The U.S. feasibility standard is workable in part because bankruptcy judges are willing to receive evidence of the financial condition of the company and to form an independent evaluation of the evidence presented. In order to prevent an end-run by management around any attempt to impose a feasibility standard, ROC courts must scrutinize more closely the financial statements which reorganization managers offer in proposed plans. Some reorganization plans have contained projections of increasing earnings and profits with no factual basis whatsoever. Many plans also include repayment schedules of ten years or more. The plans offer creditors repayment guaranteed by fabricated projections of future profitability and virtually indefinite repayment periods. Under such circumstances creditors are willing to sell such obligations at deep discounts following acceptance of such plans.

2. *Creditors' Claims Cannot Be Converted to Equity in the Reorganized Company.*

Article 272 of the Company Law provides that the company may issue new shares only for cash. In several reorganizations courts have interpreted this requirement to mean that debtors cannot convert unsecured creditors' claims to equity in the reorganized company. This interpretation is diametrically opposed to the U.S. concept of the reorganization process. According to that view, "reorganization proceedings provide nothing more than a method by which the sale of an enterprise as a going concern may be made to the creditors themselves."<sup>322</sup>

By strictly upholding the Company Law provision disallowing the conversion of claims against a company into shares, ROC courts have created an enormous obstacle to successful reorganizations. Once a company's problems become known, very few creditors are willing to extend new credit. Mistrust between local and foreign bankers has exacerbated the problem of securing existing credits and finding infusions of capital.<sup>323</sup> When new capital is very difficult to obtain, the assets already in the company in the form of unsecured claims are an obvious and important source of capital.

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<sup>321</sup> Interview with C.C. Chen, *supra* note 187.

<sup>322</sup> Jackson, *supra* note 104, at 893. *See supra* p. 428 for the historical development of U.S. company reorganization law.

<sup>323</sup> *See supra* p. 456-58.

## V. Case Studies<sup>324</sup>

### A. *Delta Petrochemical/Grand Pacific*

Delta Petrochemical is the only major company in Taiwan to have emerged from court-ordered reorganization procedures as a viable company. Changes in world commodity prices for its major products forced the company to seek reorganization in 1983. The company replaced prior management and shareholders in the course of the reorganization. The forceful leadership of Ronald Ho and C.C. Chen of the International Commerce Bank of China (ICBC), Delta's largest single creditor, was instrumental in obtaining capital infusions from official sources as well as assuring cooperation among bank creditors—both foreign and local.

Delta Petrochemical was founded in 1974 by overseas Chinese<sup>325</sup> entrepreneurs to whom the ROC authorities had given a variety of incentives to set up a business in Taiwan. Under the one company, one product policy in effect at the time, the company was given an exclusive license for the production of styrene monomer, which insured its profitability.<sup>326</sup> This venture was one of a group of highly publicized central government infrastructure projects launched during the 1970s.<sup>327</sup>

Because Delta was a government licensed monopoly, its management was able to dictate prices and exercise considerable discretion in allocation of output in the local ROC market. Business relations between Delta and its three main customers became increasingly strained. In the late 1970s the customers successfully lobbied the authorities to give them their own license to produce styrene monomer. A move by the government to open the local market to imports in 1980 coincided with a steep drop in the world price of styrene monomer.

At the same time, however, Delta began building a second, more modern styrene plant as well as two plants which used styrene in production of other plastics products. By 1981, Delta was borrowing heavily to cover operating losses. According to Chen at ICBC,<sup>328</sup>

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<sup>324</sup> See *supra* note 1 regarding confidential sources.

<sup>325</sup> The ROC Government distinguishes non-ROC citizens of Chinese descent, known as overseas Chinese, and all other foreigners. Non-ROC citizens of Chinese descent are often given preferential treatment by the ROC Government compared with other foreigners.

<sup>326</sup> The policy objectives behind granting these licenses were to reduce Taiwan's reliance on imports of essential raw materials and to protect infant industries from the full force of international price competition. Monopoly licenses combined with import barriers were granted to local companies to produce raw materials needed in Taiwan's manufacturing industries at prices which did not exceed the cost of importing the same materials.

<sup>327</sup> These were known as the "Ten Major Construction Projects." REPUBLIC OF CHINA: A REFERENCE BOOK 256 (1987).

<sup>328</sup> Interview with C.C. Chen, *supra* note 187.

Delta's debt/equity ratio declined from 69/1 in 1979 to 593/1 in 1982.

The principals of the company turned to the authorities for financial support, relying on their long standing relationship and the importance of the petrochemical industry in official economic plans. The authorities conducted an appraisal of the company's financial situation and prospects for future profitability and determined that the company was worth bailing out. The chairman, who had contributed to the breakdown in relations with Delta's main customers, became little more than a figurehead. The president took effective control of Delta during the conduct of the reorganization and continues to lead the company.

Delta began the reorganization in August 1983 and appeared to have completed it by August 1984. Bankers at ICBC provided the greatest leadership in the conduct of the reorganization. The forceful leadership provided by these bankers was an important element contributing to the ultimate success of the Delta reorganization—leadership which was apparently not forthcoming from the ranks of creditors in most other reorganizations. ICBC, along with the Bank of Communications (the ROC development bank), and the Bank of Taiwan (the largest commercial bank in the ROC), acted as reorganization supervisor. As the largest unsecured creditor, ICBC had good reason to exert considerable efforts to insure that recalcitrant foreign banks as well as local banks cooperated during the reorganization and approved the plan. The foreign banks, however, managed to condition their participation on a substantial capital contribution by local financial institutions and shareholders.

Unlike other companies, Delta Petrochemical was able to obtain major infusions of capital. Many attempted reorganizations in the ROC failed because creditors could not convert their claims into equity in the reorganized company and were also unwilling to contribute new funds. Two trust companies and a government controlled development fund contributed the equivalent of forty million U.S. dollars in new capital to Delta. These contributions from official sources were due in part to the economic fundamentals of the case, but also were a reflection of the effectiveness of bankers at ICBC in lobbying on behalf of Delta. Two new shareholders also contributed equity.

In 1985, the viability of what was otherwise the only successful reorganization in Taiwan came into question. The world prices of styrene monomer remained low and Delta, now renamed Grand Pacific, was forced to seek additional concessions from creditors. Interested parties consented to amendments to the plan delaying principal repayments and reducing interest payments from 6 percent to 3 percent until 1987.

By the second half of 1986, Grand Pacific was again profitable. The local economy had recovered from recession, the new facilities which had been brought on line in the early eighties were producing at prices which were competitive on world markets, and the world market price had risen substantially. According to Chen, Grand Pacific anticipated being able to complete payments by the end of 1987, ahead of schedule under the plan.<sup>329</sup>

*B. Pao Lung Pulp and Paper Company*

Before major problems surfaced in late 1982, Pao Lung ("precious and prosperous" in Chinese) was considered one of the best run and most progressive companies in Taiwan. Pao Lung was listed on the Taiwan Stock Exchange and had had numerous successful public offerings. Even the largest public companies in Taiwan are unwilling to allow large public issues for fear of losing control and because of resistance to disclosure requirements. Pao Lung appeared to be an unusual example of enlightened modern management.

The ROC strictly regulates the paper industry in Taiwan for what were originally national security reasons. Wood pulp must be imported to Taiwan. The ROC import substitution policies of the 1950s placed severe restrictions on the use of paper products.<sup>330</sup> A major market for Pao Lung products is packaging for the export industries. As a result, the company's fortunes are closely tied to the fortunes of Taiwan's exporters. When the U.S. economy, Taiwan's largest single export market, moved into recession in 1982, the economy of Taiwan also slipped into recession. Pao Lung Paper suffered just as badly as its exporter clients with the slowdown of sales to America. With a significant drop in revenues, many irregularities in the management and finances of the company came to light for the first time.

In early 1983, Pao Lung became unable to make principal repayments on its short term debt. Out of a total of two and a half billion New Taiwan dollars in obligations, Pao Lung owed about one-half to foreign banks. Pao Lung also had made major investments in new equipment, but was experiencing difficulties in bringing the new machinery on line.<sup>331</sup> The different perspectives between foreign and local creditors quickly emerged as a major issue as creditors attempted to organize a collective response to the company's problems.<sup>332</sup>

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<sup>329</sup> *Id.*

<sup>330</sup> Until January 1, 1988, daily newspapers in Taiwan were limited to twelve pages under the paper conservation policy implemented in the 1950s. *Asian Wall St. J. Weekly Edition*, Jan. 11, 1988, at 2, col. 1.

<sup>331</sup> *Asian Wall St. J.*, June 7, 1983, at 1, col. 3.

<sup>332</sup> See *supra* text accompanying note 307.



Pao Lung was closely affiliated with two other companies, Great Wall Enterprises (GW) and Lien Hwa Industrial Co. (LH).<sup>333</sup> The principals of GW and LH had given personal and corporate guarantees for many of Pao Lung's obligations in exchange for guarantees from Pao Lung's principals. Some foreign banks had not effectively supported their loans with corporate guarantees, relying only on the personal guarantees of the principals.<sup>334</sup> In the Pao Lung case bankers who had relied on personal guarantees alone ultimately recovered nothing on those guarantees.<sup>335</sup>

In early 1983, the principals sought government assistance. The Bank of Communications (BOC), a state-owned bank that focuses on development finance, was appointed to coordinate government support efforts, a role BOC assumed in many subsequent reorganizations and workouts. In the early days of the Pao Lung case, BOC was unwilling to provide extensive assistance and insisted that Pao Lung management arrange new loans with banks without concrete government assistance.<sup>336</sup> Local banks and foreign banks attempted to work out an informal rescue package without success.

In late May, the chairman and president of Pao Lung agreed to step down if necessary to the success of a rescue plan. About this time Pao Lung mortgaged a substantial quantity of real estate to GW and LH in return for corporate guarantees on its borrowing with local banks. Shortly thereafter the principals, Yang and Chiao, skipped the country.<sup>337</sup>

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<sup>333</sup> The informal affiliation between Pao Lung, Great Wall, and Lien Hwa is a good example of the informal yet close ties which create what Chuang calls "enterprise groups." See *supra* note 95 and accompanying text.

<sup>334</sup> Foreign banks had often been satisfied with the personal guarantees of a company's chairman and president, who were often prominent local citizens. Local banks generally require not only the personal guarantees of the principals on all corporate obligations, regardless of the size of the company, but also corporate guarantees of all related companies. One reason for this practice is that ROC company law has no doctrine like "piercing the corporate veil." For a discussion of the use of the personal guarantees of a company's principals, see *supra* text accompanying notes 101-02.

<sup>335</sup> The Pao Lung case was frustrating for foreign bankers inexperienced with local business practices. Many bankers learned to their chagrin that the principals of major, publicly held companies could be judgment proof because of inadequate legal tools for dealing with fraudulent conveyances.

<sup>336</sup> Asian Wall St. J., *supra* note 331, at 3, col. 2.

<sup>337</sup> Until July 1987, the ROC had strict exchange controls to prevent capital outflows, but businessmen had a variety of techniques to evade them and shelter very large sums offshore. These techniques included understating invoice prices, receiving part payment in foreign countries, and setting up Hong Kong subsidiaries which were not subject to any exchange controls. While these practices had gone on for some time to evade taxes and because of anxiety over the future sovereignty of Taiwan, they assumed a new importance when many enterprises in the ROC unexpectedly faced bankruptcy. The principals of the failing companies were largely unfazed by their companies' slide into bankruptcy; they themselves had capital in foreign countries with which to start over. As a result, for a brief period in 1983 and 1984, the principals of failing businesses skipped the country in record numbers.

Eventually creditors discovered a technique to deal with this particular problem. By

A variety of problems began to surface in the summer of 1983 which called the integrity of the Pao Lung management into question. Pao Lung management had grossly overstated the value of the new equipment, presumably to siphon funds out of the country. Creditors who had taken security interests in the equipment based on the value stated for customs duty purposes discovered that they were effectively unsecured.

Securities market manipulations also came to light. The principals had apparently set up subsidiary companies to buy stock in Pao Lung prior to new share issues to drive up the market price. Although this practice had been successful several times in the past, the most recent attempt was frustrated by the general economic recession and decline in stock market prices.<sup>338</sup> The principals had borrowed heavily from foreign banks to finance the manipulation, although lenders were not aware of how the funds were being used. Sidestreaming, or diverting funds borrowed for one purpose to another use, is a common practice in Taiwan which is facilitated by inadequate financial records. When the Pao Lung manipulation failed, the loan proceeds and the stock certificates involved all disappeared without a trace.<sup>339</sup> Although Pao Lung stock remained listed on the Taiwan Stock Exchange, the stock soon became worthless.

The Taiwan SEC investigation found that financial statements had been falsified and prosecuted the principals. In May 1984 in spite of very strong evidence against the principals, they were acquitted by the trial court at Taipei. The Taiwan SEC appealed the judgment, but after three years no hearing of the case on appeal had been scheduled.<sup>340</sup>

Foreign banks who had lost millions of dollars in loans to Pao

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reporting an "economic criminal" to the Investigation Bureau and Exit & Entry Control divisions of the Ministry of the Interior, creditors could prevent defaulting debtors from leaving the country by legitimate means. Of course, it remained possible to leave by private ship or forged passport. The economic recovery which began in 1985 has now largely eliminated the problem.

<sup>338</sup> Interview with Lu Daung-Yen, Commissioner of Taiwan SEC, in Taipei (May 1986).

<sup>339</sup> As egregious as this fraud was, it pales in comparison with the activities of the principals of the Hsin Chu Glass Company, another major, publicly held company that had to seek reorganization relief in 1985. The principals of Hsin Chu approached a foreign bank lender for an additional line of credit secured by a pledge of stock. As soon as the credit was made available, it was withdrawn and the principals skipped the country. The certificates were then discovered to be forgeries.

Shortly thereafter, more forged certificates turned up in the hands of members of the investing public. These additional forged shares had apparently been pledged to unregulated lenders who then sold them on the stock exchange as soon as they learned that the principals had skipped. There was some suggestion of complicity between the brokerage firms who handled the trades and the original pledgees because the Taiwan SEC managed to pressure the brokers into compensating the individual investors for their losses in an informal settlement. Chen, *Financial Scandals Lend Impetus to Stock [Market] Improvement*, in FINANCIAL AND INVESTMENT YEARBOOK ROC 1986, at 74.

<sup>340</sup> Interview with Lu, *supra* note 338.

Lung requested a copy of the trial transcript to learn the grounds for the decision. The court denied the request. Court records are generally not open to the public in the ROC.<sup>341</sup> The court determined that foreign bank lenders to Pao Lung were not "parties in interest" to the criminal prosecution of the principals for securities fraud and therefore were not entitled to see the transcript.

In September 1983, the Bank of America petitioned to place Pao Lung in reorganization. The Bank of America's reasons for the petition included severe cash flow problems and failure of management to deal effectively with the crisis, as well as the securities fraud and other mismanagement by Pao Lung's senior management. Bank of America sought and obtained protective orders for the period while the petition was considered. The company shut down its productive facilities in June 1983 and remained closed until 1986.

In March 1984 the court approved the petition for reorganization. Han and Miao, directors of GW and LH, were appointed reorganization managers. Larry Greenberg, head of Bank of America's branch in Taipei, along with Mr. H.P. Chia, president of BOC, and Mr. Ni, president of United World Chinese Commercial Bank, were appointed reorganization supervisors.

Management submitted the first of two plans in May 1985. The plan's main features were writing off existing equity, extending the maturity and reducing the interest on existing obligations, and converting a portion of unsecured claims into new equity.<sup>342</sup>

Foreign bank creditors continued to pressure Miao and Han to make good on their personal guarantees without any success. Credit investigation in Taiwan is rudimentary at best and no effective mechanisms exist for recovering fraudulent conveyances.<sup>343</sup> Some foreign banks which had required GW and LH to co-make several obligations with Pao Lung had more success in recovering.<sup>344</sup>

The court reviewed the May 1985 plan at length and ultimately refused to approve it. The court found that the provision to convert unsecured claims into equity violated article 272 of the Company Law, which requires companies to pay for all subscriptions in cash. The plan actually provided that the court could sever the offending

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<sup>341</sup> Digests of specially selected Supreme Court judgments that are considered precedent are published, however.

<sup>342</sup> See *supra* p. 433-40 for a general discussion of reorganization plans.

<sup>343</sup> See *supra* text accompanying notes 159-61 & 280-81.

<sup>344</sup> GW and LH tried to effect a discharge of their surety obligations through a composition. Article 27 of the ROC Bankruptcy Code provides: "A resolution for composition at the creditors' meeting shall be adopted by a majority vote of the creditors present at the meeting, who together represent more than two-thirds of the aggregate amount of unsecured obligatory claims." Miao and Han initiated the composition proceedings near their home in the south of Taiwan and tried to pack the creditors' meeting with their allies. However, two U.S. banks held more than one-third in total claims and were able to veto the composition settlement. Chen, *supra* note 339, at 72, 74.

provision from the plan and disregard it in the event the court held it to be unlawful. The reorganization manager's lawyer also offered to withdraw the provision in order to get approval. The court nevertheless rejected the plan, delaying the reorganization further.

A second plan was drawn up but never approved. In the summer of 1986, the economy of Taiwan had recovered to such a point that the Pao Lung facilities could again be profitable. Miao and Han approached creditors individually and bought up their outstanding claims for a fraction of face value.<sup>345</sup>

### C. *Ta Nun*

The Ta Nun ("Great Ability" in Chinese) case is interesting because the perceptions of local and foreign bankers diverged profoundly in their evaluations of this case. Some local bankers believed that the Ta Nun group of companies was highly profitable, if somewhat unorthodox in its internal accounting practices, and that its failure was largely precipitated by the sudden cancellation of lines of credit by foreign bankers acting in concert. Foreign bankers, however, believed that the problems of the company were due to fraudulent mismanagement of parent and subsidiary affairs and the failure of many highly speculative investments with the recession in Taiwan. Foreign bankers also believed that the principals of Ta Nun made no secret of their alleged connections with the Military Intelligence Bureau and failed to participate in good faith in the reorganization proceedings.<sup>346</sup>

The Ta Nun group included about a dozen different companies, but the Ta Nun company was the heart of the group. The Ta Nun company had been granted a monopoly license for the production of sodium cyanide in Taiwan and was highly profitable as a result. The Ta Nun group invested profits from the monopoly in a wide variety of businesses. Other members of the group included companies producing cement, paper, nickel sulphate, porcelain, as well as a construction company and a semiconductor assembly plant.

Financial control for the group remained concentrated in the Ta Nun parent company without regard to the separate parent-subsidiary corporate entities. Ta Nun management structured cash flow to

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<sup>345</sup> By 1987, following the adoption of reorganization plans, offers were made by management in several cases to purchase company obligations at a small fraction of their face value. Foreign bankers speculated that reorganization proceedings had been used to wear down creditor resistance to management settlement offers. Management secured extensive delay through reorganization. By buying up obligations under the plan at a deep discount, they also secured the equivalent of a dividend payout, taxable only as capital gain if the company returned to profitability.

<sup>346</sup> Foreign bankers also believed that some important people in the ROC establishment were included among Ta Nun's major shareholders and that this affected the handling of the case. The speculation focused on one of President Chiang's sons.

pass through the parent.<sup>347</sup> Such a system works well enough, so long as no one subsidiary experiences more serious problems than any other.<sup>348</sup>

The foreign banks lent heavily to the Ta Nun group, unaware that Ta Nun was also borrowing heavily from private lenders. When problems emerged in Ta Nun and some other companies in the group, foreign bankers insisted on treating each company as a separate entity, which aggravated cash flow problems for the group as a whole.<sup>349</sup> The Ta Nun case clearly pointed to the need for some mechanism for consolidating the finances and administration of affiliated companies, both within the context of a court-ordered reorganization and in ROC company law generally.

One of the companies in the group was the E An company. Ta Nun had purchased the E An company and had made a public offering of the company's stock to raise cash for the group as a whole. After the initial public offering the stock price dropped sharply when investors reappraised the value of the company.<sup>350</sup> E An filed separately for reorganization, but the court denied the petition and liquidated the company, largely at the insistence of foreign bank creditors.

Following the petition for reorganization by Ta Nun, foreign and local bank opinions remained sharply divided on the correct manner of handling the company's problems. Local banks believed that foreign banks had precipitated the problem by first extending substantial credits to the group without adequate investigation, and then suddenly withdrawing credits as a group based largely on rumors of problems with the company. Foreign bankers believed that the principal of Ta Nun was using reorganization solely to delay meeting any obligations to banks and that no genuine effort was being made to draw up a reorganization plan.

Foreign bankers were also uncomfortable with the record numbers of unrecorded lenders who surfaced to file claims in the reorganization. As many as one-third of the claims allowed in the reorganization were not recorded in the company accounts.

In November 1985, the reorganization manager submitted a plan which was unacceptable to foreign bankers. The foreign bankers successfully lobbied to have someone from the Taiwan office of the Peat Marwick accounting firm called in as a consultant and independent auditor.

Ta Nun drew up another plan which creditors expected would

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<sup>347</sup> For a discussion of the failure of ROC Company Law to effectively protect creditors of companies which belong to "enterprise groups," see *supra* text accompanying notes 95-100.

<sup>348</sup> See *supra* note 1 regarding confidential sources.

<sup>349</sup> *Id.*

<sup>350</sup> See *supra* text accompanying notes 61-66.

be adopted sometime in 1987. Ta Nun's primary financial resource remains the license for the production of sodium cyanide, which is expected to generate enough profits in the long term to meet most of the group's existing obligations. Although management was able to retain the profitable monopoly license, they were unable to secure any new capital contributions. Shareholders were forced to accept a fifty percent reduction in equity, while creditors agreed to a payment schedule which extended to more than ten years for some claims.

## VI. Conclusion

ROC courts and government policymakers today stand at a threshold similar to the one crossed when the U.S. Supreme Court decided *Boyd* in 1913. In the United States in the late nineteenth century, industrialization and the increased importance of the corporate form of doing business had created problems which the U.S. legal system had difficulty solving. *Boyd* effectively amended the existing law by requiring lower courts to scrutinize the substantive fairness of company reorganizations. Although *Boyd* required courts to provide some supervision of the equity receivership procedure and to control the worst abuses, it gave little concrete guidance on how courts should carry out these new responsibilities. In the 1930s, Congress drafted a statute based on the experiences of company reorganizations in the 1920s and 1930s which provided a comprehensive, workable system for reorganizations.

In the ROC today, the inadequacies of the existing reorganization law have forced courts to deal with novel and complex problems in attempting to administer the company reorganization law. The results have been discouraging. Most reorganizations have ended in failure. Misconduct by interested parties has marred many reorganization attempts. The situation is unlikely to improve without more forceful judicial intervention and supervision of the process. ROC courts, as creations of the civil law system, do not have the freedom U.S. courts enjoy to create new law to address new problems. Without legislative reform of the existing statute, the courts are not likely to resolve existing problems.

Does the ROC need a company reorganization statute at all? The argument can be made that it does not. The undeveloped system of ROC bankruptcy law has resulted in a dearth of legal practitioners and court personnel with bankruptcy experience. Court-ordered company reorganization is a complex and labor intensive process. It will be difficult to administer effectively in the short to medium term without any bankruptcy experience to draw upon.

The development of a very complex U.S.-style reorganization statute might also be undesirable to ROC authorities because it would put the resolution of important economic questions in the

hands of the parties and the courts and reduce the discretion of government officials responsible for economic policy. The failure of a major business involves powerful people and important economic issues. The authoritarian style of government that prevails in Taiwan results in such important decisions being made by an elite within the KMT and the government.

While company reorganization is an essential element of the present system of corporate finance in the United States, the need for such a system may not be so great in the ROC. Businesses and government officials in the ROC rely less on their legal system than do their counterparts in the United States. The financial structure of major, publicly held companies in Taiwan is not as complex as those of companies in similar positions in the United States. Some of the abuses of existing ROC reorganization law would not arise under composition procedures which exempt secured creditors altogether and require consent of two-thirds of unsecured creditors. Reliance on creditor self-help and informal cooperation, however, might simply allow the same abuses to take place outside of a formal legal proceeding. Furthermore, official ROC policies on the further economic development of Taiwan are based on a transition from labor intensive, low technology industry to capital intensive, high technology industry. In the event of another serious and prolonged recession in the ROC, or in the event that the transition to capital intensive, high technology industry is successful, the ROC will need a sophisticated procedure to sort out the claims of parties in interest against financially distressed companies.

If the ROC authorities make an official commitment to provide a court-ordered reorganization procedure for dealing with company failures, substantial changes need to be made to the current statute in order for the ROC system to operate effectively. If authorities at the MOEA retain the authority to decide which companies are entitled to rescue efforts, then the MOEA must make some attempt to insure that the parties who benefit from the rescue efforts also shoulder the costs. The current lack of clear standards for initiating and continuing reorganizations not only encourages misconduct by the reorganization manager, it also prevents any clear assessment of the costs and benefits of the rescue. If the authorities believe a company is worth bailing out and choose to disregard the financial condition of the company, then they should underwrite their decision with commitment of funds for the rescue effort. Allowing the MOEA to approve a reorganization without requiring a commitment of government resources to make the reorganization work, unfairly leaves creditors of the failing company to pay the cost.

The implementation of more stringent financial and accounting standards is an essential step in the internationalization of the econ-

omy of the ROC. The system for enforcing legal entitlements also needs to be strengthened. Any new legislation must clarify and enforce the duty of the reorganization managers to maximize the estate for the benefit of creditors. The ROC must also reinforce the legal mechanisms for drawing assets into the estate, and the courts must assert their authority over the proceedings more forcefully.

The ROC will require more than statutory reforms in bankruptcy and corporate reorganization to solve the problems which plagued the first attempts at court-ordered reorganizations in the ROC. The ROC also needs reforms in other areas like accounting standards and the regulation of government owned banks. The government must address the conditions in financial markets and the private economic sector which encouraged the rise of the unregulated money market. Finally, the formalistic and impotent ROC courts must be able to take control of the procedure. Even with major statutory reform, creditors cannot easily bring company insiders who make loans which are not disclosed in company financial statements within the jurisdiction of the courts. Likewise, the courts are not likely to assert their authority in a contest with policymakers in the executive branch of government. Statutory reforms would only be a first step in dealing with these issues.



