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**INSOLVENCY SYSTEMS IN ASIA: AN
EFFICIENCY PERSPECTIVE**

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Insolvency Institutions in Korea

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INSOLVENCY INSTITUTIONS IN KOREA

1. Overview

Korea does not have a unified bankruptcy code. Instead, the following three legislations govern the insolvency proceedings in Korea:

- The Bankruptcy Act (the "B.A.") which is equivalent to Chapter of 7 of the U.S. Bankruptcy Code;
- The Corporate Reorganization Act (the "C.R.A.") which is very similar to the old Chapter X (Corporate Reorganization) of the U.S. Bankruptcy Act prior to 1978; and
- The Composition Act (the "C.A.") which is comparable to Chapter XI (Arrangement) of Bankruptcy Act.¹

The primary focus of this paper is the C. R. A. The Appendix attached hereto summarizes the main features of three insolvency proceedings in Korea.

Table 1 shows the number of filing of insolvency cases. From Table 1, it is noted that before 1995 there are very few composition cases and only corporate reorganization cases exceeded liquidation cases and the composition cases.²

<Table 1> The number of Filing of Insolvency Cases.

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999 ³
C. R..A.	27	15	64	89	45	68	79	52	132	26	31
C.A	2	0	0	0	0	0	13	9	322	295	107
B.A.	37	27	16	14	26	18	12	18	38	86	592

2. Amendments to Three Insolvency Acts in 1998

Amendments to the three insolvency acts were instigated by the I.M.F. and the I.B.R.D in 1998. After Seoul was forced to receive a bailout from I.M.F., amendments to the three acts were made on February 24th, 1998. The main purpose of these amendments was to make all bankruptcy proceedings speedy and efficient by lessening the burden on the courts and shortening the time required for complementary procedures.

The first amendment involved changing the venue of the liquidation or composition proceedings for merchant debtors. The venue for these proceedings was specified to be the District Courts only, whereas prior to the amendment, the venue could have been either the Branches of the District Courts or the District Courts.

The second amendment established a creditor's conference under the composition proceeding under the C.A.⁴ and the reorganization proceeding under C.R.A.⁵ Further, the amendment established a management committee under the corporate reorganization

¹ The intensity of supervision by the court under the C.A. is much looser than that provided for under the Bankruptcy Code, as revised in 1978.

² While only joint stock company has eligibility for corporate reorganization procedure, under the Composition Act all legal entities including individual debtor as well as any type of corporation have eligibility for the procedure. See the Appendix for the difference among three insolvency proceedings.

³ The number of case in 1999 includes cases filed only by the ending of September.

⁴ §§ 49-2 to 49-4.

⁵ § 173-2 to 173-4.

proceeding under C.R.A.⁶ Both committees were modeled after the creditors committee of the U.S. Bankruptcy Code. The management committee was established to manage the three insolvency proceedings fairly and speedily. Its role is to present to the court its opinion on the appointment of an interim trustee, trustee, inspection commissioner; supervise the discharge of operations by the trustee; examine the reorganization plans; oversee transmission of information to creditors; and evaluate the progress of reorganization proceedings.⁷ It should be noted that there is no interim trustee in proceedings under the B.A.

The third amendment involved §19-2 of the C.A., which provides for special cases where application by a large joint stock company for composition can be rejected. These are cases where it would be inappropriate to go through composition proceedings in light of various factors, such as the magnitude of the debtor's assets and liabilities or the number of interested persons, such as creditors. In light of such factors, the court may reject an application for commencement of composition by a large joint stock company. The purpose of this clause was to restrict a large joint stock company from entering into composition proceedings, rather than filing for corporate reorganization. In a recent case, the Supreme Court confirmed the decision of the lower court, which rejected the filing of a petition for composition by a joint stock company whose assets were worth approximately \$50,000,000 (USD) with liabilities of \$100,000,000 (USD) on the ground that the case fell under the C.A. §18(5). In its decision, the Court stated that the condition of composition was contrary to the general interests of composition

The fourth amendment instituted mandatory transfer to bankruptcy proceedings from composition proceedings. The C.A. §9 now states that if rescission of composition has been decided and the decision to deny or cancel the composition proceeding has become final and binding, the court should make an adjudication of bankruptcy at its own discretion.

Finally, the fifth amendment was to shorten the time limit of the plan from twenty years to ten years. The period of twenty years is to be measured from the day of confirmation of the plan.

3. Court

The Korean judiciary does not have special bankruptcy courts or federal court system. All Korean judges have power to hear bankruptcy matters as well as cases relating to bankruptcy.⁸ Therefore, unlike the U.S. system, there is no grounds for jurisdictional challenge to proceedings in the courts in Korea. Furthermore, until now, there has not been enough insolvency cases to establish a specialized bankruptcy court.

However, after the number of insolvency cases increased since 1978, two bankruptcy panels have been established in the Seoul District Court since March 1st, 1999. The first panel hears the corporate reorganization cases and the second panel handles the cases arising under the Bankruptcy Act and the Composition Act. One of the chief judges of the Seoul Appellate Court is acting as a chief judge of the first panel, which indicates the court's recognition of the importance of the reorganization cases which eventually have a significant impact on the national economy. The government may consider establishing bankruptcy courts if the number of insolvency cases keeps increasing in the future.

4. Trustee

⁶ §§ 93-2 to 93-4

⁷ C.R.A. §93-2

⁸ The cases relating to bankruptcy includes avoidance of preference, the contestant matters if the trustee objects the allowance of the claim in the procedure of filing the proof of claims, and suit against the guarantor or codebtor.

In Korea, the court -- not the creditors -- appoints either the interim trustee, and trustee of composition or corporate reorganization⁹ as well as trustee of liquidation,¹⁰ in contrast to the Chapter 7 of the U.S. Bankruptcy Code.¹¹ In liquidation, the court appoints the trustee after seeking the opinion of an administrative committee.¹² Under the C.R.A. the court seeks the creditors conference's opinion as well as the administrative committee's opinion.¹³

There is usually only one trustee, but if necessary, the court may appoint more than one trustee.¹⁴ Corporation may serve as a trustee in bankruptcy cases if the corporation is authorized by its bylaws.¹⁵ Neither the B.A nor the C.A. provides any special clauses about whether a corporation may serve as trustee. Practically, all trustees of liquidation and composition are individual lawyers in Korea, but under the corporate reorganization proceedings, only a bank, trust company or merchant bank may become a trustee.¹⁶ Prior to the Amendment of December 12, 1996, the trustee of reorganization had to be a disinterested party; however, under the current Act, any individual or bank with some connections to the corporation or shareholders of the debtor may serve as the trustee. It is not necessary for the trustee to post a bond with the court.

The right to the administration and disposal of the bankrupt estate belong to the bankruptcy trustee.¹⁷ The trustee in corporate reorganization also hold such right, but under the composition proceeding, the trustee has no right to the administration and disposal of the bankrupt estate. The trustee in the latter has only a right of supervision. A commencement of composition does not affect the rights of a debtor on administration and disposition of debtor's own assets.¹⁸ Reasoning being, why many joint stock corporations have preferred filing for composition proceedings since 1997.

Immediately after the court order, the trustee must collect, preserve, protect and control the debtor's assets to incorporate the debtor's estate. The right of avoidance is exclusive to the trustee. One of the essential duties of the trustee in liquidation is to investigate the claims and to distribute the dividends to the creditors as an immediate distribution at any time, with the consent of the court or the inspection commissioners.¹⁹

The trustee must carry out his or her duties with the care of a good manager. If the trustee fails to exercise due care and if any loss is caused by the trustee's failure to do so, the trustee may be jointly and severally liable to the interested parties.²⁰ The Supreme Court has held that the trustee of corporate reorganization proceedings has no duty to pay for "claims which have been given priority upon the estate" from its own property even though the C.R.A. Section 281 provides that if a court decision to dismiss the case due to failure of implementing the plan becomes final and binding, the trustee shall satisfy the "claims which

9 B.A. § 147, C.A. §§ 20, 27 and C.R.A. §94.

10 Presently, there is no interim trustee in liquidation proceedings.

11 Bankruptcy Code §702.

12 B.A. §147.

13 C.R.A. §94.

14 B.A. §148.

15 Bankruptcy Code §321(a)(2).

16 C.R.A. §95.

17 B.A. §7.

18 C.A. §32(1).

19 B.A. §228.

20 B.A. §154.

have been given priority upon estate," and make a deposit with respect to the claims subject to objection, in the interests of the creditors thereof.²¹

The trustee under the B.A. or the C.R.A. has the capacity to sue and be sued, as is the case in the U.S. Bankruptcy Code (per Section 323). However, this is not the case for the trustee under the C.A., where only the debtor can sue and be sued.²² Under the C.A., a suit against the debtor or filed by the debtor may not be suspended. But the filing of a suit and counterclaims to a suit or a decision not to sue must be approved by the trustee.²³ If a trustee makes a compromise in the court without the consent of inspection commissioner or the resolution of creditors' meeting, it becomes a grounds for retrial provided in Section 422(1)(•) of the Civil Procedure Code.²⁴

5. Management Committee

A management committee can be established at the district court, as determined by the Supreme Court Regulations in order to manage the three types of insolvency cases fairly and expeditiously.²⁵ By now, only the Seoul District Court has a management committee. The other courts can entrust the necessary operation to the management committee of the Seoul District Court.

A management committee carries out following operations under the court's supervision:

1. Presentation of its opinions on the appointment of interim trustee, trustee, and examiner;
2. Supervision and evaluation over the propriety of operation by the interim trustee, trustee, and examiner;
3. Review of the plans;
4. Composition of a creditor's conference and to provide information to creditors;
5. Evaluation of the progress of reorganization; and
6. Presentation of its opinions on the dismissal of cases due to the failure of implementing the plans. or on the termination of cases based on the high probability of failure of implementing the plans

A management committee is composed of no less than three (3) but no more than fifteen (15) members including a chairman. Some of the members are permanent and receive salaries from the court, while others may not. A management committee also has a power of presenting its opinions on the appointment of a trustee under the B.A. as well as under the C.A.

6. Creditors' Conference.

Once a petition for commencement for reorganization is filed, a court where a management committee is not established must compose a creditors' conference comprised of major creditors of a corporation that is not a medium and small enterprise.²⁶ A conference is to be composed of no more than ten (10) persons with majority creditors, other than security holders. If necessary, minority creditors may be members. A conference may present its opinions on

21 1974. 11. 26. 73da898 (Kong 1974, 8168).

22 The Court Administration Office, Practical Guide of Composition Cases (second edition, 1998), 96.

23 C.A. § 32.

24 The Supreme Court 1990. 11. 13. 88daka26987 (Kong 1991, 57).

25 C.R.A. §93-2.

26 It was newly established by the amendment in 1998, C.R.A. §§173-2 173-4.

reorganization proceedings to the court. The court is to provide to the conference documents, written decisions, audit reports and any other copies of important data on reorganization proceedings. The conference may request access to the corporation's books or other data on reorganization proceedings as necessary to make a decision relating to reorganization proceedings.

Appendix

Major Features of Bankruptcy, Composition and Corporate Reorganization Proceedings in Korea

Insolvency Systems in Asia : An Efficiency Perspective
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	Bankruptcy	Composition	Corporate Reorganization
Eligibility for Proceedings	Individual, corporations and other juridical persons	Individuals, corporations and other juridical persons (*certain large-size joint stock company may not be eligible)	Joint stock company
Applicant	Debtor, creditor	Debtor	Debtor, qualified creditor(s); qualified shareholder(s)
Business Operation and Disposal of Assets	Trustee (no interim trustee is recognized)	Debtor (under the supervision of interim trustee and trustee)	Interim trustee, Trustee
Qualification of Trustee	Individual	Individual	Individual or financial institute
Foreclosure of Mortgages and Other Security Interest on Debtor's Assets	Foreclosure is not stayed	Foreclosure may not be stayed	Foreclosure is stayed once the proceeding is commenced
Execution of Judgment Auction	Stayed	Stayed	Stayed
Compulsory Redemption of Shares without Compensation	Not applicable	Redemption of shares is not required	Redemption of all or part of outstanding shares without compensation is mandatory in certain cases
Filing of Proof of Claims	Mandatory	Not mandatory (if not filed, the creditor loses only voting rights)	Mandatory
Suspension of Litigation	Suspended	Not Suspended (Diversity of Opinion in Practice)	Suspended
Submission of Plan	Not applicable	Composition Plan should be submitted at the time of petition for commencement of proceedings (but the plan may be changed)	Plan is submitted after commencement of proceedings
Repayment Period	Not applicable	No restriction (usually, 4-8 years)	Up to 10 years from the confirmation of the Plan
Court's Involvement	Until the completion of distribution	Until the approval of the Plan	Until successful Implementation or dismissal of the case