

*Organisation for Economic Co-operation and Development
the World Bank
Asia Pacific Economic Cooperation
and
the Australian Treasury
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AusAID*

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

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Creditor Rights in Insolvency Procedure

***Hotel Inter-Continental
Sydney, Australia
29-30 November 1999***

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Good morning, ladies and gentlemen.

First of all, I would like to extend my sincere gratitude to OECD, World Bank, APEC, AusAID and the Australian Treasury for preparing this seminar and inviting us here. While Dr. Nam and I wrote the comparative report based on six country reports, I have realized that how difficult it is to understand correctly the legal mechanism of a foreign country and its meaning in actual social and economic context. At the same time, I have got to know that how important it is to know them for the mutual benefits. Living in the days of global standards and international best practices, I think, we need to devote more times with affection to understand different situation and different solution of each country.

This morning, I would like to share the experience of Korea regarding some issues on creditors' rights in insolvency procedure. Let me start with priority issue.

Priority between Creditors

Priority is decided by statutes and strictly observed in the individual debt collection process. Generally speaking, there are three categories according to their priority; claims with preference, secured claims and unsecured claims. In insolvency procedure, shareholders rights are placed under the unsecured creditors.

Wage claims have priority over secured claims in the Korean insolvency laws. There are not much debates on the legitimacy of priority of wage claims, which is the matter of policy choice. Wage claimants, in Korean context, are not perceived as being situated in the same categories as general creditors. It seems that there is social consensus on this issue.

Tax and government interests, however, have been considered in different way. Nobody wants to lose its interest even in the insolvency procedure. It is also true to the government. Most countries put the tax claims on the high priority over the secured claims. There are pros and cons on the high priority of tax. The comparison and evaluation between public interest and private interest is a matter of policy choice in nature. The Constitutional Court of Korea declared unconstitutional the provision of the Basic Act of Taxation stipulating the priority of tax claims over the security interests established within one year of the creation of the tax claims. The Constitutional Court could not find any reason for the tax claims to be treated favorably than secured claims. Following this decision, the National Assembly amended the provision so that tax claims are not superior to secured claims now in Korea.

In the corporate reorganization procedure, many state-owned banks are involved. Some banks which handle policy loans, like Korean Development Bank, have sometimes enjoyed special treatment in the reorganization process. Recently, the Korean Supreme Court banned such practice by revoking the corporate reorganization plan which allowed higher interest rates to KDB than other commercial banks. As far as private legal matters concerned, Government is assumed as one of creditors in Korea.

Absolute Priority Rule

Absolute priority rule is not manifested by the Korean insolvency laws, nor adopted by the

courts' precedents. Rather, it is common for the inferior creditors to be paid to some extent even though superior creditors are not fully paid in the corporate reorganization procedure. Although most of corporate reorganization plans allow a payment schedule against absolute priority rule, it is not reported yet any superior claimants contests the legitimacy of the plan.

Why is not the absolute priority rule applied to insolvency procedure while it is strictly applied to the individual debt collection process? Basically, absolute priority rule can not be applied when superior creditors agree with the payment schedule which does not treat them favorably. So in the bargaining structure, superior creditors try to maximize their interests regardless the absolute priority rule. It is the case that a creditor had unsecured credits as well as secured credit at the same time.

Foreign Creditors

It is not easy to imagine that insolvency laws have any provision explicitly discriminating foreign creditors. Insolvency laws usually do not ask the nationality of creditors. Discrimination, however, may happen in the course of court process. Judges can identify the nationality of creditors and attorney may appeal to their patriotism. They may interpret at discretion by narrowing or extending the meaning of certain provision of the insolvency laws. It is a matter of general judicial system, not that of insolvency laws.

The Supreme Court of Korea rendered a meaningful decision in this regard in 1992. A Japanese plaintiff ordered a yacht but the company breached the contract. The plaintiff got to have damage claims. After the company went through the reorganization procedure, a reorganization plan was proposed which contained the payment schedule to the plaintiff starting 6th year through 19th year of the corporate reorganization plan without any interests. Other creditors who were classified in the same category with the plaintiff, for example normal trade claimants, were scheduled to be paid within two years from the commencement of reorganization procedure. When the plan was consented at the interested parties' meeting and approved by the district court. The plaintiff appealed to the appellate court in vain. Revoking the decision of the appellate court *in re Korea Takoma*, the Supreme Court said that different treatment of similarly situated creditors was against the statutory requirements of equal and equitable treatment for the approval of the plan. Though the nationality of the plaintiff (creditor) was not the issue in this case, the decision was interpreted that the same rule should be applied to all creditor including foreign creditors.

Foreign creditors are posing the problem of adverse discrimination. in informal insolvency procedures. In a critical situation, like the crisis of 1997, foreign creditors hold a strong bargaining power in negotiation on debt rescheduling with a country. It is observed that foreign creditors has asked debtor company and the government more favorable treatment than domestic creditors. Debtors and their government are situated in a weak position because they do not want to be isolated from the international money market.

In Dawoo case recently, foreign creditors grumbled that they are discriminated against domestic creditors. But they do not want to put the Dawoo in the formal judicial procedure where they are treated absolutely equally. They are demanding government guarantee on the rescheduled loans. As the whole story in the negotiation is not covered-up yet, I am not sure whether foreign creditors are discriminated negatively or positively.

I would rather ask whether foreign creditors have been discriminated favorably or unfavorably on the whole in East Asian countries in those days?

Professor OH Soogeun has taught corporation law since 1986 at Inha University, Incheon, Korea. His recent research topics are insolvency law, corporate governance and liability imitation. He has participated in the reform project of the Korean insolvency laws as a member of the special committee for the Ministry of Justice of Korea. He is the author of *Comparative Law and Conflict of Law* and many articles on insolvency law including “An Empirical Analysis of Corporate Reorganization Cases,” “A Conceptual Analysis of Insolvency,” and “A Study on the Payment Schedule of Reorganization Plan”.