

## BANKRUPTCY DIVISION AND COMMISSIONER

Prepared by  
**Mr. Soogeun Oh,**  
Professor of Law, Ewha Womans University  
Seoul, Korea

### 1. Background

It was on the top of the list of complaints on insolvency mechanisms<sup>1</sup> that judges who handled insolvency cases were incompetent for handling the insolvency cases. Judges, critics argued, were not knowledgeable on accounting, corporate finance, business activities and management. Criticism drew the evidence from the fact that the procedures were delayed, rehabilitation rate was low, and creditors received small amount of repayment. Strengthening judicial expertise was an urgent demand.

Right after the foreign currency crisis in 1997, a specialized bankruptcy court was proposed as a solution for the necessary expertise. The Ministry of Finance made an amendment proposal to establish the bankruptcy court.<sup>2</sup> As the Korean government promised to slim-line the insolvency procedures to international institutions, IBRD and IMF strongly recommended the establishment of the bankruptcy court to strengthen judicial expertise.

Although there were controversies on the issue, the Supreme Court did not oppose itself but doubted the usefulness of the bankruptcy court. The Ministry of Justice, which was in charge of the amendment of insolvency laws, concluded that the bankruptcy court could not be the best solution to enhance the efficiency of insolvency mechanism. So the final amendment draft in 1998 did not adopt the specialized bankruptcy court.

Then the ball was in the court of the court. The Supreme Court put the highest priority on the task of strengthening judicial expertise. The Korean judiciary had had very strong pride over the intelligence of judges. The Supreme Court had thought judges were the most brilliant group in Korea. The Supreme Court could not bear the criticism that judges were incompetent.

<sup>1</sup> Korea has three types of insolvency mechanisms; corporate reorganization, composition and bankruptcy. Each has separate applicable statutes. Corporate reorganization procedure aims at rehabilitating big business corporations whereas composition procedure mainly concerns firms with less than certain amount of debts and sole proprietorships. Bankruptcy procedure is for liquidation and winding-up of individuals and corporations. Composition was seldom used before the foreign currency crisis in 1997. Composition has attracted rehabilitation cases much more than corporate reorganization because composition procedures allow existing management to hold control over firms even before and after the commencement of composition proceedings. The following table shows the number of cases in this field.

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
<i>Boodo*</i>	4,107	6,159	10,769	9,502	11,255	13,992	11,589	17,168	22,828	6,718
Bankruptcy	27	16	14	26	18	12	18	38	467	733
Composition	-	-	-	-	-	13	9	322	728	140
Reorganization	15	64	87	45	68	79	52	132	148	37

\* *Boodo* means non-payment of promissory notes, which are main method of payment in business transaction in Korea.

<sup>2</sup> The Corporation Reorganization Act and the Composition Act were enacted in 1962 and were not substantially amended until 1997. The Ministry of Finance prepared amendment proposals of those insolvency statutes from the early 1997 before the crisis. Due to its proposal, it was possible to amend insolvency statutes so early as Feb. 24, 1998.

I will look into how the Supreme Court of Korea tackled this problem and draw some lessons for further reform in insolvency mechanism. At first, I will review the pros and cons over the specialized bankruptcy court and why the Korean government chose not to adopt it. The Supreme Court has reinforced the ability of judges who handle insolvency cases in several ways including selection of brilliant judges for the insolvency cases, training of insolvency judges and operation of the Management Committee. I will explain and analyze them in two categories; Bankruptcy Division and the Management Committee. I will conclude my paper with some lessons for strengthening judicial expertise from the Korean experience.

## **2. Pros and Cons on a Specialized Bankruptcy Court**

The logic for and against a specialized court is similar regardless of its specialized fields. The first and utmost merit is specialization. As related cases are concentrated to the specialized court, it can be an arena for judges to develop their knowledge and skill on the specific subject. This merit, however, might diminish when judges move into and out of the specialized court. Specialization can be possible if the specialized court hires its own judges. But it would be another complex issue how much the specialized court had independence from the general judiciary system.

In the specialized court, it is easier to utilize non-judge experts in the structure of established institution. For example, engineers can be judges in the patent court. In normal court structure, it is impossible for non-judge expert to play a role of judges in Korea.

Specialization depends, to some degree, on the ability of quality of judges. If the specialized area is attractive to competent judges, the specialized court can easily recruit capable judges. If honest and intelligent judges do not like to work for the specialized court, the performance of the specialized court would be far below the expectation.

Another issue related with specialization is how specific the specialized court shall be. If the number of cases on a specialized issue is not big enough to run the specialized court, the court should have jurisdiction over cases in more broad categories. In that case, conflict of jurisdiction is inevitable.

We have to calculate the cost of the specialized court also. Separate courts spend additional managerial costs that are irrelevant to the quality of courts' performance. Applicants should go to the specialized court far away from neighbor courts.

Korea has 3 specialized courts; the Family Court, the Administration Court and the Patent Court. Comparing with these courts, the insolvency court could not obtain enough support for its establishment. The number of insolvency cases was far smaller than those in other specialized areas. The fluctuation of its number also did not give confidence to legislators. Under the strict rotation system of the Korean judiciary, the effect of specialization can be achieved in other ways. Bankruptcy Divisions and the Management Committee were the answer of the Supreme Court.

## **3. Bankruptcy Division**

Korea has chosen to intensify the division in charge of insolvency cases in district courts instead of creating a specialized court like a bankruptcy court. District courts have several divisions, each of which is consist of 1 senior judge of district court and 2 judges, and several sole judgeships, which is consist of single judge.<sup>3</sup> Insolvency cases are usually handled by a division in which a judge with highest seniority presides in that district court (the division is called as top division). The Seoul District Court, however, established two separate bankruptcy divisions because the number of insolvency cases filed to the court is enough to make 2 divisions exclusively specialized to insolvency cases.<sup>4</sup> The Supreme Court has selected most brilliant judges for bankruptcy divisions.

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<sup>3</sup> The Korean judiciary has the promotion system of judges; judge, senior judge of district court, senior judge of higher court, chief of district court, chief of higher court, supreme court justice and chief justice.

<sup>4</sup> Almost half of insolvency cases have been file to the Seoul District Court.

During the last 3 years, bankruptcy divisions in Seoul District Court performed great amount job in the sense of case number and quality. In that period, they handled as many cases as accumulated cases from 1962 through 1997. They also encountered many new situations arising from chaebol<sup>5</sup> companies and various industries. Many of decisions they rendered were new precedents and became leading cases.

The most important thing was that they documented their experience and made principles and published them. Those documents have become references for other judges and practicing lawyers. Judges in other courts frequently asked their colleagues in the Bankruptcy Divisions who had more experience. The Bankruptcy Divisions have played successful roles in refining the practice and spreading their experts. Recently they published *Practice Manual for Corporate Reorganization*.

Though the Supreme Court cannot directly supervises judges in lower courts as each judge is an independent institution, the Supreme Court has put various efforts to higher the standard of practice in insolvency cases. It published the manual for composition procedure and revised the Rule on Corporate Reorganization Procedure.

It has also held a workshop once a year for judges who are in charge of insolvency cases. The workshop usually consists of two sessions: discussion and lectures. Participating judges share their experience with each other during discussion session. Special lectures are delivered by experts including insolvency law professors, certified public accountants and financial specialists. Undoubtedly discrepancy among insolvency practices can be adjusted through this kind of workshop.

#### **4. Management Committee and Commissioner**

The 1998 amendment established the Management Committee in the corporate reorganization and composition mechanism to provide professional expertise in corporate restructuring and help the court in supervising trustees.<sup>6</sup> Various concern were presented in the debate over the establishment of the

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<sup>5</sup> Large conglomerate in Korea owned and controlled by a family.

<sup>6</sup> A new chapter with three articles was inserted to the Corporate Reorganization Act in 1998 amendment to establish the Management Committee.

##### Chapter 2-2 Management Committee

###### Art. 93-2 (Establishment)

The Management Committees shall be established in the district courts, according to the Supreme Court Rule, to handle corporate reorganization cases, bankruptcy cases, and composition cases in a fair and speedy manner.

###### Art. 93-3 (Affairs and Authority of the Management Committee)

- 1 The Management Committee conducts the following affairs under the direction of the court.
  1. Presentation of the opinion concerning the selection of interim trustees, trustees and examiners.
  2. Supervision and assessment on reasonableness of the execution of affairs by interim trustees, trustees and examiners.
  3. Review of reorganization plans.
  4. Formation of Creditors' Conference and provision of information to creditors.
  5. Assessment of progress of corporate procedures.
  6. Affairs assigned by statutes or the court.
- 2 The Management Committee may delegate some of its affairs stipulated in the Section to its commissioner in order to conduct its affairs efficiently.
- 3 The court may direct the Management Committee to transfer the delegated affairs to other commissioner if the court acknowledges that it is inappropriate for the former commissioner to conduct the delegated affairs under the Section α.
- 4 In case that the Management Committee is not organized, provisions on commissioners in the Art.24 Sec.γ, the Art.54-2, the Art.54-3, the Art.95-2, the Art.284 Sec. and provisions on the Management

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Management Committee. The most serious concern was that it might impair the identity of judgeship. Only judges may render court decisions in Korean judicial procedures. Korea has no magistrate or any other kinds of quasi-judgeship. There had been strong opposition against the idea to create any institution that allows to substitute non-judges or quasi-judges for regular judges because of some historical reasons. In the midst of constructing new judiciary after the independence, many positions in the court including clerks asked judgeship. The conflict left unpleasant memory and formed the tradition to strictly divide judgeship and other positions.

The second concern was that whether commissioners could maintain integrity as high as average judges. The Korean judges have pride on the relatively less corrupted and fairer in their conduct of affairs than any other public sectors. Many worried that commissioners might be biased or influenced for private purpose.

The third concern was that the institution had double functions that could not be efficiently achieved simultaneously. Professional expertise and daily monitoring cannot be compatible. If the court needs professional expertise, commissioners shall be experts in the field, who are not appropriate for monitoring daily operation.

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Committee in Art.24 Sec.χ, the Art.39 Sec. β, χ, the Art.46, the Art.94, the Art.112-2 Sec.β, the Art.179, the Art.181-2 Sec. γ, the Art.247 Sec.β, χ, the Art.274 and the Art.277 Sec. are not applicable.

Art. 93-4 (The Formation of the Management Committee)

- 1 The Management Committee is composed of more than 3 and less than 15 commissioners including 1 chief commissioner.
- 2 The tenure of commissioners is 3 years and the majority of commissioners are full-time commissioners.
- 3 The chief of the district court commissions the person with one of the following qualifications as a commissioner.
  1. The person who has the license of attorney-at-law or certified public account.
  2. The person who worked for the financial institutions as defined in the Banking Act over 15 years or who worked for the listed corporations as a board member.
  3. The person who worked over 7 years in the related field with master or higher degree in jurisprudence, business management, economics and similar disciplines.
  4. The person who has knowledge and experience with the similar level as in the case of Subsection 1, 2 and 3.
- 4 The person who is in one of the following subsections shall not be a commissioner.
  1. An incompetent person, a quasi-incompetent person, a bankrupt who is not reinstated.
  2. Any person who was sentenced to an imprisonment or heavier penalty and the execution of which has not yet terminated (including the case where it is deemed to be the termination of execution), or spent less than 5 years after the exemption of execution.
  3. Any person who was sentenced to the suspension of imprisonment or heavier penalty and spent less than 2 years after the expiration of the probation period.
  4. Any person who was sentenced to the suspension of imposition of imprisonment or heavier penalty and are in the suspension period.
  5. Any person who was imposed of deprivation or suspension of qualification by the court decision or by other statutes.
- 5 The Management Committee shall make decisions with the attendance of the majority of total members and the concurrence of present members.
- 6 The Supreme Court Rules shall determine the establishment, organization and operation of the Management Committee, and the qualification of, status protection of, and disciplinary action against commissioners, and other necessary matters.
- 7 Commissioners shall be deemed to be public servants in the case of the application of punishment under the Criminal Code and other statutes.

Though it is too early to evaluate the merits and demerits of the Management Committee because only Seoul District Court has the Management Committee, the judges of the bankruptcy division are generally satisfied with the function of commissioners.

The Management Committee of the Seoul District Court had 3 standing commissioners and 2 non-standing commissioners. At the outset, 3 standing commissioners were a certified public accountant, a former bank employee and a former court appointed trustee. The certified public accountant resigned and newly delegated commissioner is a former bank employee who worked as a trustee. Out of two non-standing commissioners, one is an economist and the other a former bank employee.

The main business of 3 standing commissioners is to review the reorganization plans and to monitor the firms under reorganization procedures by meeting trustees and analyzing reports from trustees. Standing commissioners give informal as well as formal opinion if requested by the court. The court can crosscheck the condition of firms with commissioners' opinion and decide the petitions for approval by trustees.<sup>7</sup> In addition, the court delegates commissioners to approve some routine chores including monthly wage payment and repayment of small claims.

The Corporate Reorganization Act stipulates that the court shall hear the opinion of the Management Committee in certain matters like selection of trustees and approval of reorganization plans. The Committee resolves its opinion through the plenary session which 2 non-standing commissioners attend.

The Supreme Court Rules stipulate payment for the service of commissioners. Standing commissioners are paid monthly about 1 million Korean Won (about US\$800), which is far below the average reward for professionals. The bankruptcy divisions have tried to compensate for their service by appointing them as a supervisor of composition procedures. However, the total amount is not enough for the full compensation. Adequate payment is an urgent problem to be solved in near future.

Commissioners help the court in several ways. They lessen the workload of judges significantly by monitoring and handling everyday operation of firms. They give official opinion in documents on the matters required by statutes. They also answer the questions by judges mostly concerning bank operation and loan practice.

The most important function of commissioners would be to become the practical resources of precedents. In insolvency cases, there are many situations that are very important in handling cases but cannot be found in formal court documents. Commissioners can provide judges with their experience in former cases.

This function plays a great role in the judge transfer system of Korea. Almost every judge in any ranks (except supreme court justices) shall be transferred to other positions in every 2 years. So it is impossible for judges to focus on some specific topics like insolvency, tax and patents for more than 2 years. They have to leave as soon as they get to have knowledge and insight on the topic to some degree. Commissioners can be mentors for newly coming judges in this situation.

## **5. Conclusion**

Though insolvency lawyers are tempted to argue that insolvency law and cases are of unique character comparing with other area of jurisprudence, I have to confess that insolvency is just one of subjects which lawyers handle everyday. The efficiency of insolvency mechanism is to be discussed in the overall structure of judicial system. The efficiency of insolvency mechanism depends primarily on the efficiency of the general judicial system. It cannot be better or worse.

Honest and intelligent judges are the key factor for the efficient judicial system, so the recruitment of those judges is very important. If the structure of judicial system hinders judges to be honest and intelligent, the reform of judicial system is urgent.

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<sup>7</sup> Trustees have to get the approval of the court on some important decisions including payment over certain amount, investment, and major contracts.

The best way to strengthen judicial expertise is to have honest and intelligent judges handle as many cases as possible. The very reason for the lack of competency in Korea was that insolvency cases were so rare that judges handled just one insolvency case on average in their tenure before the crisis in 1997. Though many firms went insolvent in the past, the Korean government intervened the corporate exit mechanism in the name of industrial rationalization measures, workout and big deals. The court could not have enough chances to develop and accumulate expertise and know-how on insolvency cases.

Most insolvency lawyers in Korea now agree with the opinion that insolvency practice has been much improved and incompetence of insolvency judges is not problem any more in many district courts where many applications were filed including Seoul, Daegu and Changwon. Without ample cases, no judges can be experts just like in the case of medical doctors.

In some nations where total number of insolvency cases is large, a specialized insolvency court can be a solution. But the cost in maintaining such specialized court should be analyzed thoroughly from the users' viewpoint as well as court's viewpoint. Under the insolvency court system, applicants are forced to travel to the court and the court should monitor firms far away from them.

The Supreme Court of Korea has taken the policy to enhance the ability of bankruptcy divisions of the Seoul District Court and to spread their expertise to other courts. Judges who are in charge of insolvency cases realize the importance of insolvency matters enough to put every effort available in handling the cases. They do not hesitate to share the expertise with each other. So the progress during the last two years was remarkable.

There still remain many issues on the road toward efficient corporate exit mechanisms. Governance issue in creditor banks and debtor firms is the hottest one. Revision and consolidation of 3 insolvency statutes is also urgent topic. Strengthening judicial expertise becomes relatively less serious because of prompt and adequate response by the court, which is very unusual in Korea.

We do not need to change all golf clubs at a time to be a single golfer from boggy players. Just a new putter can save a few pars.