

## Unified Insolvency Law of Korea

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### Abstract

*The draft of new insolvency law is now under review by the Legislation and Judiciary Committee within the National Assembly prior to being submitted to the main meeting of the National Assembly.*

*The draft of the new insolvency law is consisted of six (6) chapters. The first chapter provides for the general provisions such as the jurisdiction, public notice and service, registration, management committee, creditors committee, etc. The second chapter provides for the new rehabilitation proceeding, which is based on the current corporate reorganization procedure. The third chapter modifies the current procedures pursuant to the Bankruptcy Act. The individual rehabilitation proceeding and international insolvency proceeding are newly inserted in the fourth and fifth chapters. The sixth chapter provides for the penalty. As seen from these chapters, the characteristics of the draft are that: (a) all insolvency procedures are provided for under one piece of legislation; (b) the rehabilitation proceedings will become one proceeding in the second chapter; and (c) the new chapters for individual rehabilitation proceeding and international insolvency proceeding are newly established. If the draft is passed by the National Assembly, the new insolvency law is expected to be effective within one (1) year.*

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## I. Introduction

The three (3) basic insolvency laws in Korea are: (a) the Corporate reorganization Act (the “CRA”); (b) the Composition Act (the “CA”); and (c) the Bankruptcy Act (the “BA”). These laws were enacted in 1962 and have since been modified several times to reflect the reality of the Korean economy. However, these basic insolvency laws have received criticism in that: (i) the rehabilitation procedure is bifurcated into the proceedings under the CRA and the CA, resulting in unequal outcome depending on the two proceedings; (ii) the CA proceeding, in most cases, is inefficient, and (iii) the laws, in comparison to the international insolvency system, are outdated. In response, the Korean government accepted the recommendation of the International Monetary Fund (“IMF”) to modify the outdated insolvency laws during the period of economic crisis.

On December 30, 2000, the Ministry of Justice (the “MOJ”) received the final draft of a recommendation for insolvency laws from the consortium composed of Shin & Kim; Orrick, Herrington & Sutcliffe LLP; and Bingham & Dana, which consortium was selected through the MOJ’s international bidding procedure. To review such draft, the Committee for Insolvency Law Reform (the “Committee”) was formed. The Committee was comprised of law professors, judges and justices from the Supreme Court and the bankruptcy department of Seoul District Court, and the members from the Ministry of Finance and Economy, the Korea Federation of Banks, the Federation of Korean Industries, etc. After the Committee conducted thorough discussions on each issue raised in the recommendation, the new Korean insolvency law<sup>1)</sup> was drafted in November, 2002 and submitted to the National Assembly of Korea in the beginning of 2003. It is now under review by the Legislation and Judiciary Committee within the National Assembly prior to being submitted to the main meeting of the National Assembly. Thus, the discussion below is based upon the latest draft of the new insolvency law without the consideration of any modification that may occur during the review by the Legislation and Judiciary Committee and at the main meeting of the National Assembly of Korea.

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1) The official name of the new insolvency code is the “Law on Rehabilitation and Bankruptcy of Debtor.”

## **II. Synopsis of New Insolvency Law Draft**

### *A. Introduction*

The draft of new insolvency law (the “Draft”) is consisted of six (6) chapters. The first chapter provides the general provisions such as the jurisdiction, public notice and service, registration, management committee, creditors committee, etc. The second chapter provides for the new rehabilitation proceeding, which is based on the current CRA proceeding. The third chapter modifies the current procedures pursuant to the BA. The individual rehabilitation proceeding and international insolvency proceeding are newly inserted in the fourth and fifth chapters. The sixth chapter provides for the penalty. As seen from these chapters, the characteristics of the Draft are that: (a) all insolvency procedures are provided for under one piece of legislation; (b) the rehabilitation proceedings are unified into one proceeding in the second chapter; and (c) the new chapters for individual rehabilitation proceeding and international insolvency proceeding are newly established. These features are explained in more detail below.

### *B. Unification of Rehabilitation Proceedings*

The current rehabilitation system consists of the corporate reorganization procedures under the CRA and composition procedures under the CA. As a result, the two procedures result in different treatment for the interested parties. For instance, the corporate reorganization procedures apply only to stock companies while the composition procedures apply to all debtors regardless of the legal entity or type of corporation. Further, once the commencement order is issued, the management loses its authority to manage the company under the CRA procedure as such power will be vested to the court appointed receiver while under the CA procedure the management can continue to run the company. In addition, the secured creditors cannot be repaid except pursuant to the reorganization plan under the CRA procedure while the secured creditors can exercise their right of security on the collaterals under the CA procedure.

Many commentators and practitioners criticized the current system as inefficient and unfair. First, an insolvent company which would not be eligible for the composition procedure would try first to utilize the composition procedure to keep the

existing management rights. Once the composition application is rejected by the court, then such procedure can be converted into the corporate reorganization procedure. The scholars and experts have pointed out the inefficiency in this system in that such trials delay the rehabilitation of the company. Second, the CA proceeding can be unfair as it does not allow large-sized stock companies to utilize the composition procedures. Third, the composition procedures under the CA have been criticized as being inefficient solution to rehabilitate insolvent companies because: (a) such procedure does not have any device to replace the incompetent managers with new court appointed managers or the creditors; (b) there is no adequate means to enforce the implementation of the composition plan; and (c) secured creditors can ruin the composition procedure by foreclosing their security interest in the middle of the composition procedure.

In order to address the above problems, the Draft abolishes the composition proceeding and unifies the rehabilitation proceedings into one proceeding based on the current corporate reorganization proceeding. Also, in order to promote equality, the unified rehabilitation system does not discriminate the applicants according to their different sizes.

Some scholars criticize the Draft as illegitimately unified insolvency law because it does not adopt the one-track system whereby the court would decide the appropriate way of resolving insolvency once the applicant files the petition for insolvency. However, the reason that the one-track system was not adopted is because it would cause the insolvent companies to be reluctant to file the petition for rehabilitation. Under one-track system, the delay of petition would be inevitable because the insolvent company does not know its destiny when it files the petition.

### *C. Establishment of Individual Rehabilitation Proceeding*

The procedure under the BA is the only relief that the insolvent individual can utilize under the current legal system. However, the current system has been considered to be institutionally inadequate for an individual person declared for bankruptcy since such person will be severely disadvantaged under the relevant laws, such as his inability to be employed as a public servant until reinstated. In addition, it is not easy for the bankrupt individuals to benefit from being discharged of the liability because the court has operated the discharge system strictly.

Recognizing the need for improvement for insolvent individuals, the Draft provides for a new system of rehabilitation for insolvent individuals under which an insolvent individual is allowed to repay his debts, not according to the BA procedure with many disadvantages, but according to new rehabilitation proceeding. However, the future income of regular salary or small amount of business profit for five (5) years shall be included in the resource for such repayment. However, the basic living cost is excluded in the resource of repayment. This system was modeled after the current system under Chapter 13 of Bankruptcy Code of the United States, civil rehabilitation proceeding for individuals of Japan and other similar systems in Germany, etc.

#### D. Improvement of International Insolvency Proceeding

The current insolvency laws adopt the strict territorial principle by providing that insolvency procedures commenced in Korea are effective only against property located in Korea while insolvency procedures commenced in a foreign country are not effective against property located in Korea. Although the courts tried to ease the strictness by recognizing the foreign insolvency proceeding in domestic cases, such territorial principle in the insolvency laws has been criticized as outdated given the current global business environment.

With respect to the international insolvency procedures, the UN and other international organizations have offered various forms of model law based on the universal principle. The pure territorial principle is no longer embodied in the insolvency systems of the United States, Japan, and other advanced countries.

The Draft adopts the universal principle based on the model law recommended by the UN. However, the Draft has various deviations from the UN model law considering other countries' system for the international insolvency proceeding.

### **III. General Provisions (Chapter 1)**

#### *A. Consolidation of Jurisdiction*

Under the current CRA, corporate reorganization cases are handled by the court that has jurisdiction over the registered head office of the debtor, while, under the BA

and the CA, bankruptcy cases and composition cases are handled by the court that has jurisdiction over the principal business office of the debtor. Therefore, if the registered head office and the principal business office of the debtor are different, different courts have jurisdiction depending upon the type of insolvency case selected by the debtor. For example, if corporate reorganization procedures are converted into bankruptcy procedures, the competent court changes from the court that has jurisdiction over its registered head office to the court that has jurisdiction over its principal business office. Since many companies maintain their principal business offices in Seoul while maintaining their registered head office in other areas, the shift in jurisdiction occurs from time to time. To solve this problem, the Draft unifies the jurisdiction over the entire spectrum of insolvency cases into the jurisdiction over the debtor's principal business office when the debtor has such office.

The Draft also allows the representative of the debtor company to use the same jurisdiction as the debtor company. In addition, according to the Draft, those who are jointly and severally liable or those who provide guarantees for the debtor or husband and wife can use the same court for insolvency cases, respectively.

### *B. Improvement of Mandatory Adjudication of Bankruptcy System*

Under the current CRA, the court is required to adjudicate the debtor as bankrupt if the corporate reorganization procedures are canceled or if the decision of non-approval for reorganization plans becomes final and conclusive for any reason. Since the corporate reorganization procedure may be converted into the bankruptcy procedure against to the intent of the debtor and the creditors, the above provisions have been regarded as one of the main reasons why debtors delay the application for rehabilitation procedures.,

To address the above problem, the Draft allows the court to refrain from adjudicating the debtor as bankrupt although the going-concern value of the debtor is proven to be lower than the liquidation value of the debtor. In addition, the rehabilitation procedure does not necessarily have to be converted when the rehabilitation plan is not passed by the creditors at the creditors' meeting.

### *C. Unification of Appeal System*

According to the CRA, the appeal is allowed only to the extent that it is specifically provided for in the CRA. On the contrary, the BA provides that the appeal is possible unless it is specifically prohibited in the BA. The Draft unifies the appeal system such that the appeal is permitted only when it is specifically provided for in the relevant provisions.

### *D. Improvement of Registration System*

According to the current CRA, various events such as preservation order and commencement order shall be registered in the Commercial Registry of the debtor and in the registration of the debtor's properties. However, such registration has been omitted from time to time because the registration of such events in the registration of the debtor's properties has become too cumbersome. The Draft addresses such problem by not requiring the registration of the insolvency procedures in the registration of the debtor's properties.

### *E. Improvement of Public Notice and Service*

Under the Draft, the public notice shall be made in the official gazette or as provided for in the regulation of the Supreme Court. Thus, the public notice made through the Internet is possible if such method is provided for as a valid public notice in the Supreme Court's regulation.

The recommendation that the service to minority shareholders should be easily made was not accepted because such service may hurt the interest of the minority shareholders. The Draft still adopts the relative priority rule with respect to the repayment. Therefore, the shareholders of the debtor shall have some interest in the debtor although the debtor's liability is over its assets.

### *F. Disclosure of Information*

In order to promote M&A of the debtor, the Draft newly provides that any interested party has the right to request the disclosure of information regarding the



insolvency procedure of the debtor. For that purpose, an interested party may request the court: (i) to provide access to the records of a relevant case (including documents and other items), (ii) to allow such party to make copies of such records, or (iii) to issue an original copy, certified copy or abstract thereof, or a certificate of matters pertaining to the case.

### *G. Inquiry about the Debtor's Property*

At the request of the receiver, an interested party, or ex officio, the court may cause a public institution, financial institution, or any other organization that manages the computer networks with respect to the debtor's property or credit to make an inquiry into the property in the name of the debtor if deemed necessary under the court's discretion. If any interested party connected with the discharge of the debtor makes the foregoing request, such party shall specify the institution or organization to which such inquiry is to be commissioned. In this case, the court shall order prepayment of expenses necessary for such inquiry.

This provision is designed to prevent the debtor from abusing the insolvency procedures and to secure the property data regarding such debtor before the adjudication of bankruptcy or a decision of discharge for the debtor is issued.

#### 1. Avoidance, Set-off, etc.

There was a recommendation that the provisions for avoidance and set-off shall be provided in Chapter 1 because those provisions apply to all insolvency procedures. However, such recommendation was not accepted because such provisions shall be interpreted differently between the rehabilitation procedure and the bankruptcy procedure.

## **IV. Rehabilitation Procedure (Chapter 2)**

### *A. Expansion of the Scope of Application*

The current CRA applies only to stock companies while the CA and the BA apply

to all types of legal entities including individuals, corporations, and unincorporated foundations or associations, etc.

Under the Draft, the CA procedure is abolished. Therefore, the Draft grants the right to apply for all types of legal entities. However, some provisions apply only to stock corporations, such as those for spin-off, comprehensive swap or transfer of shares, etc.

### *B. Improvement of the Receiver System*

The receiver system has been a hotly contested issue during the review of the Draft since there are various opinions as to what system would most efficiently revive the insolvent company with respect to the management of the company under the rehabilitation procedure. First, the management can keep its right to run the company as provided for in the CA. Second, the management may be replaced by the receiver appointed by the court as in the CRA. Third, the supervisory manager appointed by the court as in the Civil Rehabilitation Law of Japan can supervise the management.

The receiver system under the CRA is criticized because the management has a disincentive to file the petition for the rehabilitation procedure. In addition, there is no guarantee that the receiver manages the company better than the current management. The DIP system under the CA is also criticized because the interested party may not remove the management even though the interested party distrusts them.

After much discussion, the Draft basically adopts the receiver system under the CRA. However, the receiver system is complemented by the DIP system provided for in Chapter 11 of the Bankruptcy Code of the United States. Under the Draft, the receiver appointed by the court replaces the management. However, the court is supposed to appoint the current management as receiver in order to give the management an incentive to file early and to utilize the management's know-how for the revival of the company. However, the court does not have to appoint the current management as receiver: (i) if financial distress of the debtor is ascribed to property misappropriation, concealment, or mismanagement with serious liability by the debtor or any director of the debtor company, (ii) if the Council of Creditors makes a reasonable request, or (iii) if it is necessary for rehabilitation of the debtor.

In addition, the court has the discretion not to appoint any receiver in the case of the rehabilitation procedures for individuals and small and medium-sized companies. In

this case, the representative of the debtor shall act as the receiver. This system comes from the DIP system under the Bankruptcy Code of the United States.

Furthermore, if new shares are issued after capital reduction, the shareholders who have contributed to the mismanagement of the debtor company shall not be able to subscribe for such new shares; provided, however, that stock options allowed in the Commercial Code may be granted to the said shareholders.

The corporate governance under the Draft will be discussed by the National Assembly and may be modified according to the result of such discussion.

### *C. Court's Right to Appoint Statutory Auditor*

According to the Draft, the court has the right to appoint a statutory auditor for the debtor in order to reflect the current practice and to check the DIP system.

### *D. Improvement of Economic Viability Rule*

Under the current CRA, the application for corporate reorganization procedure shall be rejected and the corporate reorganization procedure shall be closed if the liquidation value of the debtor is apparently greater than the going-concern value thereof. If the corporate reorganization procedure is closed, the court shall adjudicate the debtor as bankrupt. This mandatory conversion of the corporate reorganization procedure into bankruptcy procedure caused the insolvent companies to be reluctant in filing the petition for corporate reorganization procedure because the company can go to bankruptcy procedure against the petitioner's intent.

To reflect the above criticism, the comparison between the going-concern value and the liquidation value is reviewed when the court decides whether the petition for rehabilitation procedure shall be accepted or dismissed. Also, the court does not have to declare the debtor bankrupt when the liquidation value of the debtor is proven to be greater than the going-concern value after the rehabilitation plan is submitted. Thus, the court's mandatory adjudication of bankruptcy under the current CRA is changed to the court's discretionary adjudication of bankruptcy under the Draft when the liquidation value of the debtor is proven to be greater than the going-concern value after the rehabilitation plan is submitted.

## *E. Reinforcement of Protection of the Rehabilitation Estate*

### 1. Avoidance of Transaction involving Specially Related Persons

With regard to application of the avoidance in the Draft, if the beneficiary is a shareholder of the debtor or other specially related parties, such beneficiary shall be presumed to have had the knowledge, at the time of such act, that suspension of payment, etc. took place, and that such act was prejudicial to the interests of the creditors. Thus, the burden of proof has changed from the receiver to the specially related party when the transactions with the specially related parties are avoided. The transactions subject to the avoidance are extended from sixty (60) days to one (1) year in the case of the transactions involving the specially related persons.

### 2. Introduction of Comprehensive Restraining Order System

Under the current CRA, the foreclosure, preliminary attachment, injunction against disposition, and auction procedures for the exercise of security rights based on secured or unsecured rehabilitation claims (“Foreclosure, etc. based on Rehabilitation Claims”), that have been already undertaken in regard to the rehabilitation debtor’s property, could be suspended by the debtor’s respective application. Thus, the creditors’ Foreclosure, etc. based on Rehabilitation Claims could not be stopped comprehensively.

However, the comprehensive restraining order can be obtained by the debtor under the Draft. In the event any filing for commencement of rehabilitation procedures is made, the court may issue, at the request of an interested party or ex officio, a restraining order to all unsecured and secured rehabilitation creditors against any Foreclosure, etc. based on Rehabilitation Claims until a decision is made on such filing for commencement of rehabilitation procedures, if there exist special circumstances where it is reasonably feared that the purpose of the rehabilitation procedures will not be fully attained with the issue of such suspension order.

This comprehensive restraining order is not necessary if the Draft adopts the automatic stay system. However, the Draft does not adopt the automatic stay system because the Law on Bounced Check would be meaningless and the debtor may abuse the insolvency procedure if such automatic stay system is adopted.

### 3. Collective Bargaining Agreement

There was a strong recommendation that the collective bargaining agreement shall be treated as an executory contract which the receiver can terminate if he believes that such contract is unfavorable to the debtor. However, this recommendation was not accepted because the relationship between the debtor and the employees shall be regulated by the labor law not by the insolvency law.

#### *F. Reinforcement of Creditors' Right to Participate in Proceedings*

##### 1. Creditors' Right to File the Petition for Rehabilitation Procedures

Under the current CRA, creditors of a debtor are entitled to file the petition for the corporate reorganization procedures while, under the CA, they are not entitled.

The Draft allows the creditors of the debtor to file the petition for the rehabilitation procedures. In such case, however, the creditors must hold claims corresponding to at least 1/10 of the capital stock of the debtor company if the debtor company is a stock company or a limited liability company or must hold claims corresponding to at least 30 million Won if the debtor is neither a stock company nor a limited liability company. In addition, if the debtor is a corporation, the shareholders who have at least 1/10 of the total capital of the debtor company are eligible for filing the petition for the rehabilitation procedure under the Draft.

##### 2. Reinforcement of Council of Creditors' Role

Under the current CRA and CA, creditors can present their opinion on such procedures through the Council of Creditors, be provided with various data and information regarding such procedures, and evaluate whether the repayment schedules have been complied with. However, the current system lacks the creditors' active participation in the insolvency procedures.

The Draft reinforces the role of the Council of Creditors in the insolvency procedures. First, the Council of Creditors has the right to present their opinion on appointment of the statutory auditor. Second, the Council of Creditors can request a due diligence review on the management status of the debtor company after the

approval of rehabilitation plans at the debtor's expense. Third, the Council of Creditors can request the court to appoint a third party other than the representative of the debtor as a receiver of the debtor. All these new provisions are intended to reinforce the Council of Creditors' role in the insolvency procedures.

### 3. Improvement of Claim Reporting and Investigation System

Under the CRA, creditors are required to report their claims within a bar date set by the court. Otherwise, the creditors' claims are extinguished. The Draft requires the debtor to submit a list of creditors. Unsecured and secured claims and stocks shall be deemed reported if they are stated in the list of creditors. This is designed to reduce costs associated with the claim report.

The Draft also adopts the report review 'period' system with respect to the investigation of the reported claims while the current CRA adopts the report review 'date' system. Thus, the interested parties did not have sufficient opportunity to review the reported claims. Since the interested parties can submit their objection to the reported claims during the review 'period' under the new system, they will have more opportunities to review the reported claims than now.

In addition, under the current system, claims to which an objection is raised are determined conclusively only through normal litigation. The Draft introduces a simple procedure where the court can decide on the objected claims without litigation procedure. Those who do not agree on the court's judgment through such simple procedure can bring a formal lawsuit and get the court's formal decision.

Under the current CRA, the flows of the claim report and the review are as follows: Claim report → Claim review on the claim review date → Solution of the objected claims through normal litigation. Under the Draft, this proceeding is changed as follows: Submission of the list of creditors → Claim report (report is deemed to have been made when the claim is on the list of the creditors) → Claim review during the claim review 'period' → Court's judgment on the objected claims through simple procedure.

### 4. Permission of split voting

Under the CRA, there is no provision on split voting whereas a creditor may, for

the reason that he has acquired the claims in trust or for other reasons, split his votes in exercising his voting rights at a meeting of interested persons. In order to increase the creditor's opportunity to properly exercise the voting rights, the Draft allows the creditor to split his votes in a meeting of creditors, subject to an approval of the court, in cases where he has acquired the claims in trust or holds claims for and on behalf of some other person or has other corresponding reasons.

### 5. Extension of the Bar Date for Claim Report

Under the CRA, the claims must be reported by a creditor prior to a meeting of interested persons for the deliberation of reorganization plans. Therefore, when the receiver exercises a right of avoidance after such meeting of interested persons, the concerned creditors may not report their claims resulting from the receiver's exercise of the avoidance right since the bar date for the claim report has passed.

To solve this problem, the Draft allows such creditors to report their claims even after the meeting of interested persons for the deliberation of rehabilitation plans or after the court's permission of written resolution for the rehabilitation plans.

### *G. Guarantee of Liquidation Value for Creditors*

Under the current CRA, the corporate reorganization plans are not required to include a provision for guaranteeing liquidation value for unsecured or secured creditors. As a result, if a majority of creditors approves the reorganization plans with repayment of less than the liquidation value, the minority of creditors does not have a choice but to accept such reorganization plans.

To address the above problem, the Draft newly provides for a guarantee of liquidation value as a precondition for the court's approval of rehabilitation plans. Under the Draft, a secured creditor is paid at least the liquidation value of the collaterals and the unsecured creditor is paid at least the liquidation value of the debtor's business.

### *H. Adjustment of Tax Claims*

Under the CRA, the withholding taxes, that are not due for payment at the time of

commencement of the corporate reorganization procedure, become the claims for common benefits. Therefore, the tax claims on such bonus payments become the claims for common benefit if any liquidity shortage of the debtor company is, according to the tax laws, deemed to be the payment to the management through the tax investigation after the commencement of the corporate reorganization procedure. There have even been some cases where the amount of such tax claims was so great as to impede the rehabilitation of the debtor.

To solve this problem, the Draft excludes the tax claims on the deemed payment to the management from the claims for common benefits. Therefore, such claims will be treated as unsecured claims. In addition, the rescheduling period of the tax claims requiring the tax authority is extended from two (2) years to three (3) years under the Draft.

### *I. Suspension of Exercise of Claims for Common Benefits*

In any of the following cases, the court may, at the request of the receiver or ex officio, order suspension or cancellation of any foreclosure or preliminary attachment on the rehabilitation debtor's property based on common benefit claims, with or without collateralization: (i) if such foreclosure or preliminary attachment causes a significant impediment to rehabilitation of the rehabilitation debtor and such debtor has other sufficient properties that can be easily realized and (2) if it becomes obvious that the rehabilitation debtor's property is insufficient for satisfaction of all common benefit claims.

### *J. Promotion of M&A for Insolvent Companies*

#### 1. Current system and its problems

The composition procedures are not suitable for M&A because the undisclosed liabilities of debtor cannot be identified.

On the contrary, the corporate reorganization procedure is utilized for M&A since the undisclosed liabilities of debtor can be identified in the course of the reorganization procedure and all of the existing shares can be redeemed by the reorganization plan. However, the current reorganization procedures also have some problems for M&A:



(i) lack of a system for business transfer prior to the approval of the reorganization plan, (ii) the business transfer is not allowed under the liquidation-type plan of reorganization, and (iii) the potential purchaser does not have any right to make access to the information regarding the target company.

## 2. Business Transfer prior to Approval of Rehabilitation Plan

The current reorganization procedures acknowledge only the business transfer under the reorganization plan. However, the Draft helps the early rehabilitation of the debtor by allowing the business transfer even prior to the approval of the rehabilitation plan. For that purpose, the receiver shall obtain the court's approval.

## 3. Improvement of Liquidation-Type Plan of Rehabilitation

Under the CRA, if the court deems that the liquidation value of a debtor is larger than its going-concern value, the court may permit formulation of a liquidation-type rehabilitation plan. The business transfer was not allowed to be included in the liquidation-type plan according to the current CRA. However, the Draft allows the rehabilitation plan including the business transfer to be prepared by the receiver when the liquidation value of a debtor is larger than its going-concern value. In addition, the requirement to pass the liquidation-type plan is eased from the unanimous consent of all secured creditors to the affirmative votes of 4/5 or more of the total voting rights of secured creditors.

## 4. Access to Data of the Debtor

An interested party such as the potential purchaser may request the court to provide an access to the records of a relevant case (including documents and other items), allow such party to make copies of such records, or to issue an original copy, certified copy or abstract thereof, or a certificate of matters pertaining to the case. However, the court may not allow an access to, make copies of, or issuance or duplication of a relevant original copy, certified copy or abstract in cases where any significant problem might occur to maintenance of business or rehabilitation of the rehabilitation debtor or where any significant damage will be caused to the property

of the rehabilitation debtor.

## 5. Non-Application of the Provisions Hindering Debt-Equity Swap

Some laws, such as Bank Act, Insurance Business Act, etc., include the provisions prohibiting the debt-equity swaps in order to restrict the banks or other financial institutions from controlling the companies. These provisions have impeded the debt-equity swaps by the banks and other financial institutions. The Draft provides that these provisions shall not be applied to the companies which are restructured according to the rehabilitation plan under the Draft.

### *K. Promotion of Swift Proceeding*

#### 1. Reduction of Period for Determination of Preservation Order

If an interested party files for a preservative order, the court shall decide whether to take such preservative measure within seven (7) days from the date of filing under the Draft rather than fourteen (14) days under the CRA.

#### 2. Simplification of the Causes for Dismissal of Filing for Rehabilitation Procedure

The causes for dismissing the filing for commencement of rehabilitation procedures are restricted as follows: (i) if the expenses for rehabilitation procedures have not been paid in advance, (ii) if such filing has not been made in good faith, or (iii) if the general interest of the creditors is not served by following the pending rehabilitation procedure.

#### 3. Reduction of Period for Submitting the Rehabilitation Plan for Individuals or Small or Medium-Sized Enterprises

In the case of individuals or small or medium-sized enterprises, the period for submitting the rehabilitation plan is shortened from four (4) months under the CRA to two (2) months under the Draft. (Article 222 of the combined Insolvency Act draft).

#### 4. Introduction of Resolution in Writing

Under the CRA, the meetings of interested parties cannot be avoided. Under the Draft, however, the meetings of interest parties can be omitted if the court's permission is obtained.

### **V. Bankruptcy of Debtor (Chapter 3)**

#### *A. Introduction*

Chapter 3 of the Draft reproduces the current BA with some improvements. The improvements from the BA are shown below.

#### *B. Improvement of Time of Application for Discharge*

Under the Draft, any individual debtor may, at any time during the period from application for bankruptcy to termination of bankruptcy procedures, apply for discharge to the court. Thus, the debtor may apply for discharge simultaneously with the application for bankruptcy procedures. Under the CRA, the debtor can apply for discharge to the court only after the declaration of bankruptcy.

#### *C. Expansion of Exempted Property*

Under the Draft, the following properties are not included in the bankruptcy estate: (i) property that may not be seized, (ii) the right to the real estate used for residential purpose by the debtor or his/her dependents or the right to use the real estate, with the exempt amount not exceeding the amount set by the rules of the Supreme Court, and (iii) living expense of the debtor or his/her dependent for six (6) months not exceeding the amount set by the rules of the Supreme Court. The exact scope of exemption properties shall be decided by the court at the debtor's request.

*D. Special Provisions for Deposit Money for Residential Lease*

Tenants who satisfy the requirement for the setting up as stipulated in the Protection of House Lend-Lease Act or the Protection of Commercial Lend-Lease Act shall have the right to be repaid their lease deposits out of the proceeds of realization of the leased house (including the land) prior to the other creditors including subordinate creditors.

*E. Prevention of Abuse of Application for Bankruptcy Procedures*

Under the Draft, the court has the right to dismiss the debtor's application for bankruptcy procedures if: (i) the debtor fails to prepay the expenses of procedures, (ii) the debtor's rehabilitation procedure or his personal rehabilitation procedure is pending at the court and the continuance of such procedure is suitable for the general interests of creditors, (iii) the debtor has no cause for bankruptcy, (iv) such application is not the bona fide one, or (v) such application falls under the abuse of bankruptcy procedures even though the debtor has cause for bankruptcy.

*F. Abolishment of Compulsory Composition*

The compulsory composition provisions set forth in the BA are abolished according to the abolishment of the composition procedures under the CA.

*G. Expansion of Cases involving Small-Amount Bankruptcy Procedures*

The applicable amount for small-amount bankruptcy procedures is expanded from 200 million Won to 500 million Won.

*H. Express Provision for Partial Discharge*

Although there was an argument as to whether the partial discharge should be allowed, the Draft explicitly allows the partial discharge to be decided by the court because this system may be utilized usefully.

## **VI. Individual Rehabilitation Procedure (Chapter 4)**

### *A. Introduction*

The debts of individuals are currently one of the hottest issues in our society. However, the BA is not very helpful in solving this problem because the insolvent individuals are reluctant to use the BA procedure due to many disadvantages that arise when the bankruptcy is declared against the petitioner. The individual rehabilitation procedure (Chapter 4 of the Draft) (hereinafter “IR Procedure”) is to help insolvent individuals reschedule their heavy liability without incurring the disadvantages under the BA.

The IR Procedure is similar to the CA procedure and the BA procedure. The similarity to the CA procedure is as follows: (i) only the debtor can file for the IR Procedure, (ii) the rehabilitation plan shall be submitted at the time of filing or within fourteen (14) days after filing, (iii) the DIP system is adopted with respect to the IR estate, and (iv) the unreported claims are not extinguished.

The similarity to the BA procedure is as follows: (i) the secured creditor is not subject to the IR Procedure, (ii) the IR Procedure has the discharge system, and (iii) the exemption property system under the IR procedure is based on the same system under the BA system.

However, the IR Procedure has its own features as follows: (i) the secured creditors cannot exercise their right of security during the IR Procedure, (ii) bankruptcy trustees are not appointed, and (iii) the rehabilitation plan is not resolved at the creditors’ meeting.

### *B. Application for Commencement of IR Procedures*

#### **1. Eligible Petitioners**

Any individual debtor, who is a wage earner or a self-employed earner with the potential to earn income continuously or repeatedly in the future, may file for commencement of the individual rehabilitation procedures. A “Self-employed earner” shall refer to any person whose income derives from real estate rental, business operation, or other similar income sources and who has obligations through which the

amount of confirmed claims does not exceed the amount set forth in the regulations of the Supreme Court. However, any person who earns both wages and self-employed operating incomes shall be regarded as a self-employed earner. Spouses satisfying the above requirement may file jointly for IR Procedure.

A debtor in the course of the rehabilitation procedures or bankruptcy procedures can file for the IR Procedure. However, the creditor is not entitled to file for the IR Procedures.

## 2. Documents to be Submitted

When filing for commencement of the IR Procedures, the debtor shall attach the following documents according to the forms stipulated in the regulations of the Supreme Court: (i) list of creditors, (ii) list of property, (iii) list of exempt property, (iv) list of income and spending of the debtor, (v) documents related to any rehabilitation cases, bankruptcy cases, or individual rehabilitation cases that have been filed in the previous ten years from the date of filing, if any, and (vi) any proof attesting to the fact that the debtor is a wage earner or a self-employed earner.

The debtor shall submit the repayment plan within fourteen (14) days from the date of filing for commencement of the IR Procedures. The court may, however, extend the period if there is sufficient reason.

## 3. Reasons for Dismissal

The court may dismiss the filing for commencement of the IR Procedures in any of the following events: (i) the debtor is not qualified to file for it, (ii) the debtor fails to submit any of the documents stated above (Sub-Section (2)), submits false documents, or fails to submit documents by the deadline set by the court, (iii) the debtor fails to pay the expenses for the procedures, (iv) the debtor fails to submit the repayment plan by the deadline, (v) the debtor's filing for commencement of the IR Procedures has been dismissed or terminated during the past five (5) years since the date of filing, and (vi) the debtor has been discharged during the past ten (10) years from the date of filing. If the application for the IR Procedure is dismissed, the debtor is restricted from utilizing the IR Procedure. Therefore, the debtor should be careful so that the application is not dismissed once the application is submitted.

#### 4. Measures prior to Commencement Order

In the event of a filing for individual rehabilitation, the court may, ex officio or upon request by the interested party, suspend or prohibit any procedures or acts falling under any of the following events: (i) rehabilitation procedures or bankruptcy procedures, (ii) compulsory execution, provisional seizure, or provisional disposition against the business and/or property of the debtor based on an individual rehabilitation claim, (iii) establishment of a security right on the business and/or property of the debtor or an auction to exercise a security right, and (iv) any and all acts of receiving or demanding repayment of individual rehabilitation claims except for legal actions. However, the comprehensive restraining order is not adopted in the case of the IR Procedure because such order may complicate the IR Procedure.

##### *C. Exemption Property*

The exemption property, as previously explained above (Heading 5., Section C.), is applied to the IR Procedure.

##### *D. Commencement Order*

#### 1. Period for determination of Commencement

The court shall make a decision on the commencement of the individual rehabilitation procedures within one (1) month from the date of filing. At the same time, the following period and date shall be decided: (i) objection period against claims which shall be at least one (1) week but no more than one (1) month from the service date of the list of creditors and (ii) date of the creditors meeting which shall be at least two (2) weeks but no more than one (1) month between this date and the last date of the objection period against claims.

#### 2. Effect of Commencement Order

In the event that the commencement of the IR Procedures is decided, any procedures or acts falling under any of the following shall be suspended or prohibited:

(i) bankruptcy procedures or rehabilitation procedures, (ii) compulsory execution, provisional seizure, or provisional disposition against any property belonging to the individual rehabilitation estate in connection with an individual rehabilitation claim, (iii) establishment of a security right on the property belonging to the individual rehabilitation estate or an auction to exercise a security right, and (iv) any and all acts of receiving or demanding repayment of individual rehabilitation claims except for legal actions. The effect of the commencement order is similar to that under the BA procedure. However, unlike the BA procedure, the secured creditors are prohibited from exercising their security right under the Draft.

In addition, even after the commencement order is issued, the debtor shall have the right to manage and dispose of the individual rehabilitation estate unless otherwise stipulated in the approved repayment plan.

#### *E. Organization for IR Procedures*

If necessary, the court may appoint a member of the administrative committee or a court administrative officer as the rehabilitation administrator. The rehabilitation administrator shall perform the following duties under the supervision of the court: (i) investigation of the property and income of the debtor, (ii) the proceeding of the creditors meeting for approval or change of the repayment plan, (iii) the supporting of the implementation of the repayment plan of the debtor, and (iv) such other duties as may be designated by the court.

#### *F. Procedures for Confirmation of Claims*

The IR Procedures have no separate procedure for claim report and claim review in order to expedite the IR Procedures. However, the IR Procedures have the objection period system during which the creditors may raise an objection with respect to the claims submitted by the debtor. After the objection period has elapsed, creditors can still make an objection through normal litigation procedure and are not required to submit their objection during the objection period.



### *G. Avoidance and Executory Contract*

The IR Procedures have not adopted rules of avoidance and executory contract in order to simplify the procedure.

### *H. Repayment Plan*

#### 1. Time of Submission

The debtor shall submit the repayment plan within fourteen (14) days from the date of filing for commencement of the IR Procedures. The court may, however, extend the period if there is sufficient reason. The debtor may revise the repayment plan before it is approved. In addition, the court may order a revision of the repayment plan, ex officio or upon request by the interested party.

#### 2. Details of Repayment Plan

The repayment plan shall set forth the following: (i) the income or property shall be sufficient to carry out the repayment plan, (ii) the entire amount of the estate claims shall be repaid unless otherwise agreed upon by the estate creditors, (iii) the repayment schedule shall start within one (1) month from the court's approval of the repayment plan and shall contain the regular repayment, and (iv) the repayment period set by the repayment plan shall not exceed five (5) years beginning on the date of repayment commencement.

#### 3. Effect of Approval of Repayment Plan

The repayment plan shall take effect upon the court's decision of approval. If approval of the repayment plan is decided, all property belonging to the individual rehabilitation estate shall revert to the debtor. In addition, the suspended bankruptcy procedures or rehabilitation procedures and compulsory execution, provisional seizure, or provisional disposition based on individual rehabilitation claims shall lose its effect unless otherwise stipulated in the decision of approval of the repayment plan. If approval of the repayment plan is decided, restriction on establishment of security right

on any property belonging to the individual rehabilitation estate shall be lifted and any auction for exercise of a security right shall be continued.

#### 4. Amendment of Repayment Plan

According to the repayment plan, the repayment plan can be revised at the request of the debtor, rehabilitation administrator, or creditors before repayment is completed.

##### *I. Creditors' Meeting*

###### 1. Convening

The court shall summon the debtor, known creditors, and rehabilitation administrator at the date of the creditors meeting. In this case, the summary of the repayment plan shall be notified. The creditors meeting shall be proceeded by the court. However, if the rehabilitation administrator has been appointed, the court may allow him/her to proceed the meeting.

###### 2. Debtor's Obligation to Attend the Meeting and Explain

The debtor is obliged to attend the creditors' meeting and to provide an explanation if requested by any creditor.

###### 3. Creditor's Right to Raise Objection

The creditors may state an objection against the repayment plan at the creditors' meeting. When any creditor states an objection, the court may decide to approve the repayment plan only when the following requirements are satisfied: (i) the value of the total repayable amount that the creditor, who states an objection, will receive shall not be smaller than the total amount to be distributed if the debtor is bankrupt as of the date when the approval of the repayment plan is decided and (ii) all of the 'usable income' that the debtor will receive during the repayment period, beginning on the first repayment date, shall be used for repayment according to the repayment plan. 'Usable income' refers to the income of the debtor less the living cost necessary for the life of

the debtor and his/her dependents, which shall be as set forth in the regulation of the Supreme Court.

### *J. Discontinuation*

The court shall decide to discontinue the individual rehabilitation procedures ex officio if it cannot approve the repayment plan submitted by the debtor. In addition, the court shall decide to discontinue the individual rehabilitation procedures, ex officio or upon request by the interested party, if all of the following requirements are satisfied: (i) it is evident that the debtor is unable to carry out the approved repayment plan, and (ii) the debtor fails to be discharged according to the relevant provisions.

### *K. Discharge*

The court shall decide to grant a discharge, ex officio or upon request by the debtor, when the debtor has completed the repayment according to the repayment plan. Even when the debtor has not completed repayment according to the repayment plan, the court may decide to grant a discharge after hearing the opinions of the interested parties if all of the following requirements are satisfied: (i) the debtor failed to complete repayment due to a reason not attributable to the debtor and (ii) the amount repaid to the creditors, by the date when a discharge is decided, is not less than the amount to be distributed to the creditors from the bankruptcy procedures if the debtor files for bankruptcy procedures.

The discharged debtor shall be relieved from all of the obligations due to the individual rehabilitation creditors, except for the claims described in the following items: (i) fines, penalties, expense for criminal procedures, surcharges and fines for negligence, (ii) claims not included on the list of creditors by the debtor in bad faith, and (iii) any obligations under the repayment plan.

In the event the debtor is granted a discharge by deception or other fraudulent methods, the court may revoke it, ex officio or upon request by the interested parties. The request described in the above Paragraph 1 shall be made within one (1) year from the date when the discharge is decided.

## **VII. International Insolvency Procedure (Chapter 5)**

### *A. Introduction*

The strict territorial principle under the current CRA and BA is outdated. Chapter 5 of the Draft includes new provisions regarding international insolvency procedure based on the universalism principle.

### *B. Scope of Application*

International insolvency is applicable to the cases where: (i) the representative of the foreign insolvency procedures wants to participate in the domestic insolvency procedure, (ii) the representative of the foreign insolvency procedures seeks for an approval or support from the court of the Republic of Korea with respect to the foreign insolvency procedures, and (iii) the receiver, trustee in bankruptcy, debtor and such other persons as those permitted by the court works in a foreign country, including participating in the procedures of a foreign court or seeking for an approval or support of a foreign court, with respect to the domestic insolvency procedures.

### *C. Jurisdiction*

A case for approval and/or support of foreign insolvency procedures shall be under the jurisdiction of the Seoul District Court. However, if necessary for efficient proceeding or protection of the rights of the interested parties, the Seoul District Court may, ex officio or upon request by the interested party, transfer the case to the competent court at the same time or after the decision to approve the foreign insolvency procedures.

### *D. Decision of Approval of Foreign Insolvency Procedures*

The representative of foreign insolvency procedures may file to the court for an approval of the foreign insolvency procedures. In the event there is a filing for an approval, the court shall decide to approve it within one (1) month from the date of filing.

The court may, ex officio or upon request by the representative of the foreign insolvency procedures, order temporary measures to protect the property of the debtor or the rights of the creditors.

Once the foreign insolvency procedures are approved, the representative of foreign insolvency procedures may apply for the commencement of Korean insolvency procedures, participate in Korean insolvency procedures, or apply for the support for the foreign insolvency procedures.

#### *E. Support for Foreign Insolvency Procedures*

The court may, ex officio or upon request by the interested party, make any of the following decisions in order to protect the property and business of the debtor or the interest of the creditors upon or after approving the foreign insolvency procedures: (i) suspension of commencement, proceeding of a lawsuit, or other procedures related to property, business, rights, duties, and other liabilities, (ii) suspension of the right to transfer, to provide as a security, or to dispose of any property of the debtor, (iii) collection of evidences including examination of witnesses about property, business, rights, duties, or liabilities of the debtor and distribution of the information, (iv) realization of the property of the debtor and granting of the distribution rights, (v) granting of the administrative right for the property of the debtor, and (vi) other necessary support for preservation of the property of the debtor or protection of the interest of the creditors. However, the court may dismiss the filing if the filing for the support is against the good morals or other social orders of the Republic of Korea.

#### *F. Multiple Foreign Insolvency Procedures*

In the event several foreign insolvency procedures against the same debtor are approved, the court may choose one of them as the main foreign insolvency procedures by considering the main place of business of the debtor, the extent of the creditor protection measures, or the need to provide efficient proceeding of the approval or support procedures. In this case, the court may decide to provide relevant support or change the decision based on the main foreign insolvency procedures.

### *G. Simultaneous Proceeding of Domestic Insolvency Procedure and Foreign Insolvency Procedure*

When the domestic insolvency procedures and foreign insolvency procedures are pending at the same time, the court may decide to approve or to support the foreign insolvency procedures on the basis of the domestic insolvency procedures, or even change or cancel such decision.

### *H. Participation in Foreign Insolvency Procedures*

The receiver of the domestic rehabilitation procedures, trustee in bankruptcy, debtor, and other persons authorized by the court have the authority to file for the approval or support for the domestic insolvency procedures in foreign countries as permitted by the foreign laws.

In the event the domestic insolvency procedures, the foreign insolvency procedures, or multiple foreign insolvency procedures exist against the same debtor, the court shall decide the amount of distribution that the creditors will receive from the domestic insolvency procedures by considering the amount that the same creditors have received from the foreign insolvency procedures or the amount repaid to the same creditors from the overseas property of the debtor.

### *I. Cooperation by Courts*

To ensure efficient and fair execution of the domestic insolvency procedures, the foreign insolvency procedures, or multiple foreign insolvency procedures that are underway with respect to the same debtor or mutually related debtors, the court shall collaborate with the foreign court and the representative of the foreign insolvency procedures on the following matters: (i) exchange of opinions, (ii) administration and supervision of the property and business of the debtor(s), and (3) coordination of the process of multiple procedures.

## **VIII. Penalty (Chapter 6)**

### *A. Reform of Offense of Negligent Bankruptcy*

The elements of “extravagance” and “act bearing any obligation under a noticeably unfavorable condition” are excluded from the definition of the offense of negligent bankruptcy under the Draft because they are vague and can be interpreted discretionarily.

### *B. Overseas Offense*

Those who commit the offense of bribe offering or bribe acceptance in bankruptcy in foreign countries are criminally punished.

## **IX. Other Recommendations**

### *A. Establishment of Bankruptcy Court*

Establishment of bankruptcy court system was recommended. However, various factors shall be considered, such as the number of bankruptcy cases, the practice of shifting judges, etc.

### *B. Disqualification of Director*

If financial distress of the insolvent company is caused by the mismanagement materially attributable to a director or if a director fails to foresee the probability of the company’s bankruptcy due to bad faith, the court may issue an order disqualifying such director of the insolvent company for a certain period of time from the office of director for such insolvent company and even other companies. This system may encourage directors to file for the rehabilitation procedure as soon as possible because they otherwise would be disqualified from the office of director for companies. This system can be applied only to listed companies or to large-sized corporations.

## **X. Conclusion**

As explained above, the Draft unifies all insolvency laws into one law and combines two rehabilitation procedures into a single rehabilitation procedure. The rehabilitation procedure under the Draft adopts the DIP system substantially in the corporate governance. The Draft is designed to help individual debtors by introducing a new individual rehabilitation procedure and by improving the current bankruptcy procedure. The basic goal of the Draft is to encourage the debtor to file for the insolvency procedures as soon as possible. This early filing will help maximize repayment to the creditors.

If the Draft is passed by the National Assembly, the new insolvency law is expected to enter into force within one (1) year. Many productive criticisms and alternative solutions shall be presented in order to better perfect the law.