Journal of Korean Law | Vol. 7, 349-384, June 2008

Special Treatment of Derivatives in Korean Insolvency Proceedings: Comparison with the United States and Japan

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Abstract

In April 2005, Korea enacted the Debtor Rehabilitation and Bankruptcy Law ("DRBL") which took effect in April 2006. Article 120, Paragraph 3 and Article 336 of the DRBL contain special provisions (referred to herein as the "Korean Netting Provision") for certain "Qualified Financial Transactions" such as derivatives as well as repo and securities lending transactions. The Korean Netting Provision eliminates most of the legal uncertainty arising from the lack of express provisions under Korean insolvency and other statutes relating to close-out netting and credit support arrangements and thus, should further stimulate the expansion of domestic and cross-border derivatives transactions in Korea. This paper briefly reviews the legal issues that may arise when a party to a derivatives transaction becomes the subject of proceedings under the insolvency laws of Korea, the United States and Japan and examines the major provisions of the Korean Netting Provision and compares then with similar provisions in the United States and Japan.

I. Introduction

In April 2005, Korea enacted the Debtor Rehabilitation and Bankruptcy Law ("DRBL") which took effect in April 2006. Article 120, Paragraph 3 and Article 336 of the DRBL contain special provisions (referred to herein as the "Korean Netting Provision") for certain "Qualified Financial Transactions" such as derivatives as well as repo and securities lending transactions.[1)]

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1) Paragraphs 1 and 2 of Article 120 of DRBL contain provisions that ensure the finality of payment and the finality of settlement in the payment system and the securities/futures clearance system,

The Korean Netting Provision was enacted in response to the recommendation of many studies of derivatives transactions and the demands of the financial industry.[2] The ISDA Master Agreement that is widely used in the international markets to document derivatives transactions, contains close-out netting provisions which, upon the occurrence of an event of a default (including insolvency) with respect to one party, allow the non-defaulting party to close out all transactions and net the mark-to-market value of the closed-out transactions to produce a single net amount which may be payable by either the defaulting or the non-defaulting party.[3] The Overseas Securities Lending Agreement and the Global Securities Lending Agreement for securities lending transactions, and the Global Repurchase Agreement for repo transactions contain similar close-out netting provisions. However, there was no express provision in Korean insolvency laws or other statutes which supported the enforceability of the close-out netting provisions or protected a credit support arrangement in the event of insolvency of a party prior to the DRBL coming into effect. Prior to the Korean Netting Provision, many Korean legal commentators expressed the view that the close-out netting should be enforceable in the bankruptcy or rehabilitation proceedings of a Korean party; however, they also believed that express legislation affirming its enforceability should be incorporated in Korean insolvency laws.[4] The inclusion of the Korean Netting Provision in the DRBL

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respectively.

2) Angell Report CPSS, Report on Netting Schemes Prepared by the Group of Experts on Payment Systems of central banks of the Group of Ten Countries, CPSS Publications No. 2 (February 1989) <http://www.bis.org/publ/cpss02.pdf>; Lamfalussy Report CPSS, Report of the Committee on Interbank Netting Schemes of the central banks of the Group of Ten countries, CPSS Publications No. 4 (November 1990) <http://www.bis.org/publ/cpss04.pdf>. These reports recognize that netting effectively reduces counterparty credit risk and liquidity risk in interbank transactions, including cross-border transactions and strongly recommend netting legislation that ensures enforceability of netting provisions.

3) As to the economic implications of close-out netting, see William J. Bergman, Robert R. Bliss, Christian A. Johnson and George G. Kaufman, Netting, Financial Contracts, and Banks: The Economic Implications (Federal Reserve Bank of Chicago, Working Paper No. 2004-02, 2003) available at http://www.chicagofed.org/publications/workingpapers/wp2004-02.pdf.

4) Various articles written in Korean language such as: Konsik Kim, *Derivatives Transaction*, 23 JOURNAL OF PRIVATE CASE LAW STUDIES 636 (2001) (in Korean); Kwang Hyun Suk, *Issues on Closeout Netting in Financial Derivatives Transactions and Amendment of Insolvency Laws*, 8 KOREAN FORUM ON INTERNATIONAL TRADE AND BUSINESS LAW 37 (1999) (in Korean); SUNSEOB JUNG, CONTRACT ENFORCEABILITY AND INSOLVENCY IN FINANCIAL MARKETS – REDUCING UNCERTAINTY THROUGH LEGISLATIVE REFORM (2003) (in Korean); Soogeun Oh & Nayoung Kim, *Closeout Netting of Qualified Financial Transactions: a Legislative Proposal*, 8-2 EWHA LAW JOURNAL 35

is the Korean legislature's recognition of the urgent need for statutory support for the enforceability of close-out netting and any related credit support arrangement in Korean insolvency proceedings. The Korean Netting Provision eliminates most of the legal uncertainty arising from the lack of express provisions under Korean insolvency and other statutes relating to close-out netting and credit support arrangements and thus, should further stimulate the expansion of domestic[5)] and cross-border derivatives transactions[6)] in Korea.

Chapter II of this paper briefly reviews the legal issues that may arise when a party to a derivatives transaction becomes the subject of proceedings under the insolvency laws of Korea, the United States and Japan. Chapter III examines the major provisions of the Korean Netting Provision and compares then with similar provisions in the United States and Japan.[7)] The comparison covers (i) the scope of transactions to which the Korean Netting Provision applies, (ii) conditions for the application thereof and (iii) protections provided by the Korean Netting Provisions and the laws of the United States and Japan. Based on a comparative study, this paper concludes that the Korean Netting Provision on the whole clearly shows the legislative effort to protect derivatives transactions from the legal risks arising from the insolvency of a party, notwithstanding some remaining uncertainties.[8)] This

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(2004) (in Korean).

5) The Bank for International Settlements (BIS) reports in their "Triennial and semiannual surveys on positions in global over-the-counter (OTC) derivatives markets at end-June 2007" that at the end of June 2007, the total notional amounts outstanding of OTC derivatives was $516 trillion, 135% higher than the level recorded in the 2004 survey, and the gross market value, which is a measure of the cost of replacing all open contracts at the prevailing market prices, increased by 74% to $11 trillion. Available at http://www.bis.org/press/p071121.htm

6) The aggregate turnover amount and the aggregate outstanding amount of the OTC derivative transactions by financial institutions in Korea were 66,301 trillion Won and 4,782 trillion Won in 2007 respectively, an increase of 47.9% and 81.8% from 2006. The Financial Supervisory Service press release of March 27, 2008

7) The enforceability of close-out netting and credit support arrangement under the insolvency laws of US and Japan are discussed in detail in the memoranda of law issued to the ISDA, in the case of US, by Allen & Overy on December 31, 2006 and December 31, 2005 respectively and in the case of Japan, by Linklaters, on October 16, 2007 and on January 18, 2007, respectively. These memoranda of law offered useful guidance for the discussion of the US and Japanese insolvency laws in this paper and are available on the web site of ISDA to its members.

8) For the general overview and analysis of Article 120 of the DRBL, see Joon Park et al., *Interpretation of Article 120 of the Debtor Rehabilitation and Bankruptcy Law*, 22 BFL (March 2007) (in Korean).

paper does not discuss Korean insolvency proceedings to which the Korean Netting Provision does not apply.[9]

II. Relevant Legal Issues and Relevant Insolvency laws

1. Legal Issues

The risks associated with derivatives are many and include systemic risk, counterparty credit risk, market risk, operational risk and legal risk. Legal risks include the risk of unenforceability of a derivatives contract, particularly upon insolvency proceedings commencing against a counterparty.

Insolvency laws in general provide for various measures to preserve and protect the property of the insolvent party. For example, the disposition or transfer of the property of the insolvent party is prohibited except with the permission of the court or the consent of the receiver; the receiver has the power to assume or reject an executory contract and also the power to avoid any transfer or the insolvent party's property or payments made by the insolvent party after the commencement of the proceedings or during a certain suspect period. A master agreement for derivatives such as an ISDA Master Agreement includes a close-out netting provision which permits the non-defaulting party to terminate all outstanding derivatives transactions and calculate a single net amount payable or receivable under all such terminated transactions; in addition, parties frequently provide collateral to secure the exposure based on such net amount. Thus, the major areas of concern for enforceability of derivatives transactions in an insolvency situation include:

(i) Whether the early termination of a derivatives contract upon insolvency of the counterparty would be enforceable;
(ii) Whether the receiver would be allowed to cherry pick among the transactions;
(iii) Whether the payments made or collateral provided under a derivatives transaction during the suspect period would be avoided;
(iv) Whether the netting of any payment amounts under and across

9) *See* footnote 16 below.

derivatives transactions would be subject to an automatic stay;
(v) Whether the liquidation of or set-off against collateral would be avoided.

In order to address such issues, the U.S. Congress amended the Code and the FDIA several times,[10] providing a broad scope of protection for derivatives transactions. Various other jurisdictions around the world followed suit, including Japan. The Korean Netting Provision is another example of a legislative effort to eliminate legal risks for derivatives transactions arising in insolvency proceedings.

2. Insolvency Laws

1) Insolvency Laws in Korea

Three different set of laws apply to bankruptcy, composition, rehabilitation (e.g. administration, receivership or voluntary arrangement) proceedings in Korea: (1) the DRBL (*Chaemuja Hoesaeng mit pasang e kwanhan Bupryul*),[11] (2) the Corporate Restructuring Promotion Law (*Giup Gujo jojong chokjin Bup*) ("CRPL")[12] and (3) the Financial Industry Restructuring Law (*Gumyung Sanup eu Gujo Gaesun e kwanhan Bupryul*) ("FIRL")[13]

The DRBL applies to all persons, including natural and legal persons (including Korean branches of foreign companies) and the CRPL applies to a company which has received "credit"[14] from financial institutions[15] licensed under the relevant Korean law while the FIRL applies only to specified financial institutions which include banks, securities companies, insurance companies and asset management companies in Korea (including Korean branches of foreign financial institutions).

Chapter 2 of the DRBL provides for proceedings for rehabilitation of a

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10) The amendments include those in 1990, 2005 and 2006.

11) Law No. 7428 of 2005, as amended.

12) Law No. 8572 of 2007.

13) Law No. 5257 of 1997, as amended.

14) The term "credit" is defined to include, loans, promissory notes and claims, equipment leases, guarantees, payments of guarantee or any other transaction under which a financial institution may incur losses upon payment default of the counterparty. CRPL, Article 2, Item 6.

15) In the case of foreign financial institutions licensed in Korea, CRPL proceeding affects their license Korean branches and does not affect the head office or any offshore branches.

legal entity as well as an individual engaged in business and Chapter 3 of the DRBL provides for proceedings for bankruptcy (i.e., liquidation) of a legal entity or an individual while Chapter 4 of the DRBL provides for proceedings for rehabilitation of an individual debtor. In this memorandum, we discuss rehabilitation proceedings under Chapter 2 ("Rehabilitation Proceedings") and bankruptcy proceedings under Chapter 3 of the DRBL ("Bankruptcy Proceedings"), since Chapter 4 rehabilitation proceedings are available only to individuals.

The CRPL offers composition procedures among financial institution creditors without a court's supervision for companies that have received credit in excess of 50 billion Won from financial institutions. The CRPL affects only creditors that are financial institutions (including branches of foreign banks or securities companies) in Korea. The enforceability of the close-out netting provisions under the ISDA Master Agreement may become an issue under the CRPL.[16)]

Under the FIRL, banks and other financial institutions (including securities companies, insurance companies and investment trust companies) are subject to supervision by the Financial Services Commission of Korea ("FSC") which has the authority to issue an order with respect to a financial institution that is a "failing institution." However, the FIRL contains no provisions regarding restrictions on the exercise by creditors of their rights such as foreclosure on

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16) The CRPL contains no safe harbor provisions for derivatives transactions. The enforceability of the close-out netting under the ISDA Master Agreement may become an issue under the CRPL if the netting is considered an exercise of a set-off right. In its decision of September 15, 2005 (Case No.: 2005DA15550), the Supreme Court apparently took the view that a (non-contractual) set-off is an exercise of a creditor's right and that a creditor may exercise its rights (including set-off rights) until the Creditors' Council agrees to suspend creditors' rights at its first meeting. On the other hand, the Ministry of Finance and Economy ("MOFE", as of the date hereof, the Ministry of Strategy and Finance) of Korea issued a ruling on January 27, 2003 which appears to imply that the netting upon Early Termination of derivatives transactions should be viewed as a procedure for calculating the "claim" for purposes of the CRPL and therefore, would not constitute an exercise of a creditor's rights since the Non-defaulting Party will acquire a creditor's right only when it is owed a net Early Termination Amount as a result of the netting. According to the Supreme Court decision and the MOFE ruling, clearly the close-out netting under the ISDA Master Agreement that is completed prior to the first Creditors' Council Meeting will be valid and enforceable. It is not clear, however, whether the close-out netting made after the first Creditors' Council Meeting adopted a resolution to suspend all creditors' rights would be still valid and enforceable. It would be anomalous if the close-out netting which is enforceable under the DRBL is held to be ineffective under the CRPL since the legislative intent to protect the close-out netting of derivative transactions in insolvency proceedings is clearly manifested in the DRBL.

collateral or set-off and the FSC or any other agency has no power to assume or reject an executory contract and no power to invalidate any prior payments or transfers of assets made by the insolvent institution. Therefore, FIRL proceedings will not affect the efficacy of the close-out netting provisions for derivatives transactions and accordingly, the FIRL includes no provisions relating to their special treatment.

This article will focus on the DRBL which provides more general insolvency proceedings applicable to all types of transaction parties to derivatives transactions.

2) Insolvency Legislation in the US and Japan for Comparison

(1) U.S.

In the U.S., insolvency is subject to various federal laws[17] as well as state laws, depending on the types of debtor. This paper will review only (i) the U.S. Bankruptcy Code; (ii) the FDIA and (iii) the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"),[18] each as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005[19] ("2005 Act") and the Financial Netting Improvements Act of 2006[20] ("2006 Act").

The U.S. Bankruptcy Code provides two general forms of bankruptcy relief: (i) liquidation and (ii) reorganization. Banks are not subject to the U.S. Bankruptcy Code but to the FDIA, in the case of federally insured banks or federally chartered banks and to state laws in the case of non-insured, non-federally chartered banks. The Federal Deposit Insurance Corporation ("FDIC") is appointed as receiver or conservator in insolvency proceedings under the FDIA.

(2) Japan

The Japanese laws relating to insolvency of Japan consist of the Bankruptcy Law (*Hasanho*) ("JBL")[21] which applies to bankruptcy

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17) U.S. federal insolvency laws include the Bankruptcy Code, the Federal Deposit Insurance Act and the Securities Investor Protection Act, among others. Each state also has insolvency laws that would apply to certain entities that are not subject to the federal insolvency laws.

18) Pub. L. No. 102-242 (1991).

19) Pub. L. No. 109-8. This Act amends the US Bankruptcy Code, the FDIA, the FDICIA and other related statutes.

20) Pub. L. No. 109-390. This Act amends the US Bankruptcy Code, the FDICA, the FDICIA and other related statutes.

21) Law No. 75 of 2004.

(liquidation) of any individual or corporation, the Corporate Reorganization Law (*kaisha kosei ho*) ("*JCRL*")[22] which applies to rehabilitation and reorganization of a corporation, the Civil Rehabilitation Law (*Minji saisei ho*) ("JCIRL")[23] which provides composition proceedings to companies as well as individuals and the Law concerning the Special Provisions for the Reorganization of Financial Institutions (*Kinyu kikan no kousei tetsuzuki no tokurei ni kansuru horitsu*) ("LSP")[24] which applies to the insolvency of certain types of financial institutions.[25] The Company Law of Japan includes sections relating to "special liquidation" (*Tokubetsu seisan*); however these sections do not empower the insolvency official to assume or reject an executory transaction and therefore, would not adversely affect the enforceability of derivatives transactions. The JBL, the JCRL, the JCRL and the LSP are collectively referred to as the "Japanese Bankruptcy Laws". The Law concerning Close-out Netting of Specified Financial Transactions to be Entered into by Financial Institutions (*kin-yu-kikan-to ga Okonau tokutei torihiki no Ikkatsu Seisan ni Kansuru Horitsu*) (the "Japanese Netting Law")[26] took effect as of December 1, 1998.

Article 58 of the JBL which provides safe harbors for derivatives transactions applies *mutatis mutandis* to corporate reorganization proceedings under the JCRL[27] and civil rehabilitation proceedings under the JCIRL.[28]

III. Analysis of Korean Netting Provision

The Korean Netting Provision was included as Article 120, Paragraph 3 of the DRBL.[29] Article 336 of the DRBL provides that the above provision will

22) Law No. 154 of 2002, as amended.

23) Law No. 225 of 1999, as amended.

24) Law No. 95 of 1997, as amended.

25) The Deposit Insurance Law (*Yokin hoken ho*) of Japan (Law No. 34 of 1971 as amended) provides for administrative proceedings for resolution of insolvency of financial institutions; however, the law contains no provisions that adversely affect creditors' rights and therefore would not affect the enforceability of derivatives upon insolvency of an insured financial institution.

26) Law No. 108 of 1998.

27) Article 63 of JCRL.

28) Article 53 of JCIRL.

29) Article 120, Paragraph 3 of the DRBL provides: "In the event that rehabilitation proceeding have

also apply, *mutatis mutandis*, to Bankruptcy Proceedings under Chapter 3 of the DRBL. There is no comparable provision for proceedings under Chapter 4 (individual rehabilitation) proceedings under the DRBL.

1. Requirements for Application of Special Treatment

The special treatment under Article 120, Paragraph 3 of the DRBL applies to certain "Qualified Financial Transactions" entered into pursuant to a single agreement which provides for the basic terms of the transactions. Thus, in order to enjoy the special treatment under Article 120, Paragraph 3 of the DRBL, the transactions concerned must be (i) a Qualified Financial Transactions and (ii) entered into pursuant to a single agreement which provides for their basic terms. Article 120, Paragraph 3 does not require any qualification for the parties to the Qualified Financial Transactions. Thus, if all the other requirements are satisfied, the special treatment under Article 120, Paragraph 3 can be enjoyed by any type of transaction party under Rehabilitation Proceedings of a juridical person as well as the proprietary business of an individual and Bankruptcy Proceedings of any type of juridical natural persons.

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commenced with respect to a party to any of the following transactions (referred to in this Paragraph as a "Qualified Financial Transaction") pursuant to a single agreement which provides for the basic terms of specified financial transactions (referred to in this Paragraph as a "Master Agreement"), the termination and calculation of settlement amount of such Qualified Financial Transactions shall, notwithstanding any provision in this law, take effect in accordance with the parties' agreement in the Master Agreement and shall not be subject to rescission, termination, revocation or avoidance; the transactions under Item 4 shall not be subject to an interim stay order [*Jungji Myungryung*] or a comprehensive stay order [*Pogwaljuk Kumji Myungryung*]; provided, however, that the foregoing shall not apply to any Qualified Financial Transaction entered into by the debtor in collusion with the counterparty for the purpose of harming the other unsecured rehabilitation or secured rehabilitation creditors.

(1) Any derivative transaction, as determined in the Presidential Decree of the DRBL, such as a forward, option or swap that is based on the price of currency, securities, equity contribution, commodity, credit risk, energy, weather, freight, bandwidth, environment or interest rate, an index composed of the above or other index;

(2) Spot currency transaction, securities repurchase transaction, securities lending/borrowing transaction and secured call loan transaction;

(3) Any transaction that is a combination of any of the transactions falling under Items 1 or 2; and

(4) Provision, disposition or application of collateral in connection with the transactions falling under Items 1 through 3.

1) Qualified Financial Transactions

Qualified Financial Transactions mean (i) derivatives transactions; (ii) spot currency transactions, securities repurchase transactions, securities lending/borrowing transactions and secured call loan transactions; (iii) a transaction that is a combination of any of the transactions falling under Items (i) or (ii); and (iv) the provision, disposition or application of collateral in connection with the transactions falling under Items (i) through (iii).[30] The term "derivatives transaction" means a forward, option or swap transaction where the underlying product is any of the following or a price, interest rate, indicator or unit thereof or any index produced on the basis thereof: (i) financial investment product (securities, any product based on a derivatives transaction); (ii) currency (including foreign currency); (iii) commodity (agricultural product, livestock product, fishery product, forest product, mineral product, energy product or any product produced or manufactured therefrom or any other similar product); (iv) credit risk (changes in credit of a party or a third party due to changes in credit rating, bankruptcy or debt restructuring); and (v) any natural, environmental or economic risk where the price, interest rate, indicator or unit can be produced or evaluated in a reasonable and appropriate manner.[31]

The above definition of "derivatives" would cover almost all types of derivatives transactions with respect to which the ISDA currently seeks the close-out netting opinion.[32] However, the definition excludes any commodity (including bullion) derivatives involving physical delivery on a spot basis. As a catch-all, the definition of "derivatives" includes "forward, option or swap transaction linked to "any natural, environmental or economic risk where the price, interest rate, indicator or unit can be produced or evaluated in a

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30) We will discuss the treatment of collateral arrangement under insolvency law in Section 3.2.3 below.

31) Article 14, Paragraph 1 of the Presidential Decree under the DRBL.

32) The current ISDA close-out netting opinion for Korea covers the following transactions; basis swap, bond option, bullion option, bullion swap, cap transaction, collar transaction, commodity forward, commodity option, commodity swap, contingent credit default swap, credit default swap option, credit default swap, credit derivative transaction on asset-backed securities, credit spread transaction, cross currency rate swap, currency option, currency swap, economic statistic transaction, emissions allowance transaction, equity forward, equity index option, equity option, equity swap, floor transaction, foreign exchange transaction, forward rate transaction, freight transaction, interest rate option, interest rate swap, swap option, total return swap and weather index transaction.

reasonable and appropriate manner" and thus, most if not all derivatives products that may be newly invented would probably be covered by the definition. The catch-all clause only requires that "the price, interest rate, indicator or unit can be produced or evaluated in a reasonable and appropriate manner" and any derivatives that are linked to "any natural, environmental or economic risk" are also included. There is no requirement that there be a market for the derivatives product or that they should be widely available in the financial market. However, it is required that "the price, interest rate, indicator or unit can be produced or evaluated in a reasonable and appropriate manner." This "reasonable price" requirement does not apply to conventional types of derivatives such as currency or equity derivatives. The legislators appeared to have viewed that markets for the conventional derivatives are well developed so that such reasonable price requirement as applied to them would be redundant. Hence, the benefit of the Korean Netting Provision would be available with respect to derivatives linked to "natural, environmental or economic risk" only if the underlying values such as the price, interest rate, indicator, etc. can be calculated in an objective manner. There is no court case as yet that addresses the scope of the application of the Korean Netting Provision and there appear to be no derivatives transaction currently traded in the market that might not fall within this definition.

2) Basic/Master Agreement

The Korean Netting Provision is applicable only to Qualified Financial Transactions that are made under a master agreement. The term "master agreement" is not expressly defined in the Korean Netting Provision. However, because the legislative intent is to affirm the parties' agreement to close out all transactions and produce a single payment amount by netting, it would be reasonable to conclude that the master agreement at least must have a close-out netting provision.[33] The BIS capital adequacy rules provide capital relief only if the transactions are made under a close-out netting contract.[34] The Korean Netting Provision applies a similar requirement.

33) CHI YONG LIM, RESEARCH ON BANKRUPTCY LAW 204 (2006) (in Korean).

34) Basel Committee on Banking Supervision, The Supervisory Recognition of Netting for Capital Adequacy Purposes (April 1993) < http://www.bis.org/publ/bcbs11c.pdf, 2007. 2. 9.

The agreements that would qualify as the "master agreement" for purposes of the Korean Netting Provision would include the ISDA Master Agreement,[35] the overseas Securities Lending Agreement, the Global Master Securities Lending Agreement and the Global Master Repurchase Agreement. Where parties enter into "customized securities lending transactions" through the securities lending system of the Korea Securities Depository[36] pursuant to the Global Master Securities Lending Agreement or the Overseas Securities Lender's Agreement that is entered into between the parties, whether the transactions are entered into pursuant to a master agreement should be determined on the basis of such master agreements.

In the case of over-the-counter (OTC) derivatives transactions, the parties will negotiate the terms of the Schedule, including the governing law and jurisdiction clauses, the termination currency and the credit support arrangement and then execute the ISDA Master Agreement together with a Schedule and, at times, a Credit Support Annex. However, the negotiation of terms is generally a lengthy process which often cannot be completed before the parties enter into a derivatives transaction. Thus, it is not unusual for the first OTC derivatives transaction to be entered into before the parties have executed the ISDA Master Agreement. Generally, the transaction is documented under a long form confirmation which includes additional provisions that would not be included in a short form confirmation which would be used if the ISDA Master Agreement has already been executed. Such provisions would include the governing law and jurisdiction clauses, the termination currency and the credit support arrangement. The long form confirmation would also state that the Confirmation shall supplement, form a part of, and be subject to, the ISDA Master Agreement as if the parties had executed such an agreement and that upon execution of the ISDA Master Agreement, all provisions therein will govern the Confirmation. When the ISDA Master Agreement is subsequently executed, the agreement takes effect not on the execution date but retroactively from the date of the first derivatives transaction between the parties. For purposes of the Korean

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35) The ISDA Master Agreement is available in the 1992 version and the 2002 version both of which would qualify as a master agreement under the Korean Netting Provision.

36) Under the customized transaction, the terms of the transaction including the lending fee and the collateral ratio are agreed between the parties (Article 2, Paragraph 1, Item 3 of the Regulation on Intermediation of Securities Lending).

Netting Provision, a transaction entered into under a long form confirmation described above should be considered to fall within the scope of the protection as a transaction made under a master agreement. This should also be the case even if parties have failed to execute the ISDA Master Agreement prior to commencement of the insolvency proceedings of a party, as long as the derivatives transactions are entered into under such a long form confirmations.

3) Transaction Parties

The Korean Netting Provision does not require any qualifications for the parties to qualify as Qualified Financial Transactions. Thus, if all the other requirements are satisfied, the special treatment under the Korean Netting Provision can be enjoyed by any type of transaction parties under Rehabilitation Proceedings of a juridical person as well as the proprietary business of an individual and Bankruptcy Proceedings of any type of juridical person or a natural person.

4) U.S. and Japan

(1) U.S.

Protected Transactions

The 2005 Act and the 2006 Act amended the definition of "swap agreement" under the U.S. Bankruptcy Code to include, among other things, various types of equity, credit, commodity, weather, inflation and emission derivatives as well as spot transactions for the foregoing.[37)]

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37) As amended by the 2006 Act, Section 101(53B) of the U.S. Bankruptcy Code defines "swap agreement" as: (i) any agreement, including the terms and conditions incorporated by reference in such agreement, which is – (I) an interest rate swap, option, futures, or forward agreement, including a rate floor, rate cap, rate collar, cross-currency rate swap, and basis swap; (II) a spot, same day-tomorrow, tomorrow-next, forward, or other foreign exchange, precious metals, or other commodity agreement, (III) a currency swap, option, future, or forward agreement; (IV) an equity index or equity swap, option, future, or forward agreement; (V) a debt index or debt swap, option, future, or forward agreement; (VI) a total return, credit spread or credit swap, option, future, or forward agreement; (VII) a commodity index or a commodity swap, option, future or forward agreement; (VIII) a weather swap, option future or forward agreement; (IX) an emissions swap, option, future or forward agreement; or (X) an inflation swap, option, future or forward agreement; (ii) any agreement or transaction that is similar to any other agreement or transaction referred to in this paragraph and that – (I) is of a type that has been, is presently, or in the future becomes, the subject of recurrent dealings in the swap or other derivatives markets (including terms and conditions incorporated by reference therein); and (II) is a forward, swap, future, option, or spot

The definition of "swap agreement" including "any agreement or transaction that is similar" is so broad that it is difficult to imagine any derivatives transactions that would not be included in the definition. It is also not necessary that a swap transaction be made under a master agreement since a "master agreement" is included within the definition of 'swap agreement."

In the event that a transaction does not fall squarely in the definition of "swap agreement," there is a possibility that it falling within the scope of the terms "securities contracts"[38] or "forward contracts"[39] that are similarly

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transaction on one or more rates, currencies, commodities, equity securities, or other equity instruments, debt securities or other debt instruments, quantitative measures associated with an occurrence, extent of an occurrence, or contingency associated with a financial, commercial, or economic consequence, or economic or financial indices or measures of economic or financial risk or value; (iii) any combination of agreements or transactions referred to in this subparagraph; (iv) any option to enter into an agreement or transaction referred to in this subparagraph; (v) a master agreement that provides for an agreement or transaction referred to in clause (i), (ii), (iii), or (iv), together with all supplements to any such master agreement, and without regard to whether the master agreement contains an agreement or transaction hat is not a swap agreement under this paragraph, except that the master agreement shall be considered to be a swap agreement under this paragraph only with respect to each agreement or transaction under the master agreement that is referred to in clause (i), (ii), (iii), or (iv); or (vi) any security agreement or arrangement or other credit enhancement related to any agreements or transactions referred to in clause (i) through (v), including any guarantee or reimbursement obligation by or to a swap participant or financial participant in connection with any agreement or transaction referred to in any such clause, but not to exceed the damages in connection with any such agreement or transaction, measured in accordance with Section 562.

38) Under the U.S. Bankruptcy Code (11 U.S.C. §741(7)), "securities contract" means: (i) a contract for the purchase, sale, or loan of a security (as defined in 11 U.S.C. 101(49)), a certificate of deposit, a mortgage loan, any interest in a mortgage loan, a group or index of securities, certificates of deposit, or mortgage loans or interests therein (including an interest therein or based on the value thereof), or option on any of the foregoing, including any option to purchase or sell any such security, certificate of deposit, mortgage loan, interest, group or index, or option, and including any repurchase or reverse repurchase transaction on any such security, certificate of deposit, mortgage loan, interest, group or index, or option (whether or not such repurchase or reverse repurchase transaction is a "repurchase agreement" as defined in section 101); (ii) any option entered into on a national securities exchange relating to foreign currencies; (iii) the guarantee (including by novation) by or to any securities clearing agency of settlement of cash, securities, certificates of deposit, mortgage loans or interests therein, group or index of securities, or mortgage loan loans or interests therein (including any interest therein or based on the value thereof), or option on any of the foregoing, including an option to purchase or sell any such security, certificate of deposit, mortgage loan, interest, group or index, or option (whether or not such settlement is in connection with ant agreement or transaction referred to in clauses (i) through (xi)); (iv) any margin loan; (v) any extension of credit for the clearance or settlement of securities transactions; (vi) any loan transaction coupled with a securities collar transaction, any prepaid forward securities transaction, or any total return swap transaction coupled with a securities sale transaction; (vii) any other agreement or transaction that is similar to an agreement or transaction referred to in this subparagraph; (viii) any combination of the

protected under the U.S. Bankruptcy Code.

In addition, with respect to any derivatives transactions that are not enumerated in the definition of the swap agreement, securities contracts or forward contracts, close-out netting under a master agreement under which such non-enumerated transactions are made would be enforceable upon the insolvency of a financial institution that is subject to FDICIA. The FDICIA, as amended by the 2006 Act affirms the enforceability of the termination, liquidation, acceleration and netting of payment obligations between two "financial institutions" under a "netting contract,"[40] "notwithstanding any

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agreements or transactions referred to in this subparagraph; (ix) any option to enter into any agreement or transaction referred to in this subparagraph; (x) a master agreement that provides for an agreement or transaction referred to in clause (i), (ii), (iii), (iv), (v), (vi), (vii), (viii), or (ix); or (xi) any security agreement or arrangement or other credit enhancement related to any agreement of transaction referred to in this subparagraph, including any guarantee of reimbursement obligation by or to a stockbroker, securities clearing agency, financial institution, or financial participant in connection with any agreement or transaction referred to in this subparagraph, but not to exceed the damages in connection with any such agreement or transaction, measured in accordance with Section 562" and explicitly excludes "any purchase, sale, or repurchase obligation under a participation in a commercial mortgage loan.

39) "Forward contract" is defined under the U.S. Bankruptcy Code as amended by the 2006 Act as: "(A) a contract (other than a commodity contract as defined in section 761) for the purchase, sale or transfer of a commodity, as defined in section 761(8) of this title, or any similar good, article, service, right or interest which is presently or in the future becomes the subject of dealing in the forward contract trade, or product or byproduct thereof, with a maturity date more than two days after the date the contract is entered into, including, but not limited to, a repurchase or reverse repurchase transaction (whether or not such repurchase or reverse repurchase transaction is a repurchase agreement, as defined in this section) consignment, lease, swap, hedge transaction, deposit, loan, option, allocated transaction, unallocated transaction, or any similar agreement"; (B) any combination of the agreements or transactions referred to in subparagraphs (A) and (C); (C) any option to enter into any agreement of transaction referred to in subparagraph (A) and (B); (D) a master agreement that provides for an agreement of transaction referred to in subparagraph (A), (B) or (C), together with all supplements to any such master agreement, without regard to whether the master agreement provides for an agreement or transaction that is not a securities contract under this subparagraph, except that such master agreement shall be considered to be a forward contract under this subparagraph only with respect to each agreement or transaction under such master agreement that is referred to in subparagraph (A). (B) or (C); or (E) any security agreement of arrangement or other credit enhancement related to any agreement or transaction referred to in subparagraph (A), (B), (C) or (D), including any guarantee or reimbursement obligation by or to a forward contract merchant or financial participant in connection with any agreement or transaction referred to in any such subparagraph, but not to exceed the damages in connection with any such agreement or transaction, measured in accordance with section 562."

40) "Netting contract" is defined as "a contract or agreement between 2 or more financial institutions, clearing organizations, or members that provides for netting present or future payment obligations or payment entitlements (including liquidation or close out values relating to such obligations or entitlements) among the parties to the agreement" but does not include any contract or agreement that is

other provision of law" and notwithstanding any "stay, injunction, avoidance, moratorium or similar proceeding or order, whether issued or granted by a court, administrative agency, or otherwise."[41]

The term "Qualified Financial contract" is also defined under the FDIA to include securities contracts, commodity contracts, forward contracts, repurchase agreements and swap agreements.[42] The definition of "swap agreement" under the FDIA is substantially identical to the U.S. Bankruptcy Code definition.

Protected Parties

The protection for derivatives transactions under the U.S. Bankruptcy Code is provided to a "swap participant" i.e., "an entity that, at any time before the filing of the petition, has an outstanding swap agreement with the debtor"[43] or a "financial participant." i.e., "(i) an entity that, at the time it enters into a securities contract, commodity contract, swap agreement, repurchase agreement, or forward contract, or at the time of the date of the filing of the petition, has one or more agreements or transactions of the foregoing type or one or more master netting agreements with the debtor or any other entity (other than an affiliate) of a notional value of at least U.S.$1 billion outstanding (aggregated across counterparties) or a mark-to-market value of at least U.S.$100 million (aggregated across counterparties) at such time or on any day during the 15-month period preceding the date of filing the petition; or (ii) a clearing organization."[44]

The protection for derivatives transactions under the FDIA is provided to a party to Qualified Financial Contracts with an insured bank.

(2) Japan

Japanese Netting Law

Even prior to the enactment of the Japanese Netting Law, a prominent legal scholar of Japan strongly argued that the netting provisions in the ISDA

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invalid under or precluded by Federal law. 12 U.S.C. §4402(14).

41) 12 U.S.C. §4405.

42) 12 U.S.C. §1821(e)(8)(D).

43) 11 U.S.C. §101(53C).

44) 11 U.S.C. §101(22A). According to Edward R. Morrison & Joerg Riegel, *Beneath the Surface of BAPCPA*, 13 AM. BANKR. INST. L. REV. 641, 651, the 2005 amendment to the definition of "swap agreement" expanded the definition to include virtually every contract traded in derivatives markets and effectively eliminated the concept of protected parties with respect to forwards and commodity contracts.

Master Agreement should be enforceable under then in force Japanese insolvency laws.[45] However, the Japanese legislature determined that relying on the interpretation of existing laws was not sufficient to support further development of the derivatives market and therefore enacted the Japanese Netting Law to ensure the enforceability of the close-out netting where at least one party is a financial institution.[46] The Japanese Netting Law provides for special treatment of (i) certain "Specified Financial Transactions" (ii) entered into by a certain financial institution (iii) pursuant to a master agreement which contains close-out netting provisions.

Specified Financial Transactions protected under the Japanese Netting Law are:[47] (i) OTC derivatives transactions (*tento derivatibu torihiki*) as defined in Article 2, paragraph 22 of the Financial Instruments and Exchange Law (*kinyu shohin torihiki ho*) ("FIEL");[48] (ii) financial derivatives transactions (*kinnyu tou derivatibu torihiki*) as defined in Article 10, paragraph 2, item 14 of the Banking Law;[49] (iii) repurchase and reverse repurchase transactions, (iv)

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45) Shindo Goji, *A study of the Legal Nature of Swap Transaction*, NBL Nos. 523 and 524 (1993) (in Japanese).

46) Yanama Norio, *An Overview of Close-out Netting Law*, 1520 KINYU HOUMU ZIZOU (July 15,1998) (in Japanese).

47) "Specified Transactions" is defined in Article 2, paragraph 1 of the Japanese Netting Law and a subordinate Joint Ministerial Ordinance of the Prime Minister's Office and the Ministry of Finance No. 48 of 1998.

48) "OTC derivative transactions" are defined in the FIEL in the relevant part as "the following transactions that are conducted outside the financial product exchange or overseas financial product exchange: (1) a transaction where parties agree to sell or purchase a certain financial product on a future date and the payment is settled by netting at the time of repurchase; (2) a transaction where parties agree to pay and receive money calculated on the difference between the agreed value and the actual value; (3) an option with respect to (a) sale and purchase of financial product (excluding item (1)); or (a transaction under item (2) and (5) through (7)); (4) an option transaction where the option issuer and the option buyer will pay or receive money based on the agreed value of a financial index and the actual value at the time of exercise of the option; (5) a transaction where parties agree to pay or receive money based on the ratio of change in the interest rate or other financial index during an agreed period of time with respect to a notional amount(including transactions where the notional amount or its equivalent of financial product is exchanged); (6) a transaction where one party pays fees and the other party agrees to pay an agreed amount (or physical delivery of financial product or rights thereto) upon occurrence of (a) a credit event of a company or (b) events that are material for the business of the parties but which the parties cannot control (such as moratorium); and (7) any transaction that have characteristics similar to the transactions set forth under (1) through (6) and are determined to require investor protection.

"Financial index" includes index pertaining to price or interest rate of financial products, weather, observational data published by Japanese governmental agency or foreign equivalent.

49) "Financial derivative transactions" are defined in the Banking Law as "a transaction where parties

securities lending transactions, (v) certain bond purchase transactions where a party has the right to designate the delivery date and which will be terminated if such right is not exercised during a certain period of time, (vi) forward foreign exchange transactions, and (iv) certain security transactions, i.e., lending or deposit of money or securities effected for the purpose of securing the aforementioned transactions ("Security Transactions"). Given the definitions, it appears that most types of derivatives transactions that are currently available in the financial market are included in the term "Specified Transactions" as defined under the Japanese Netting Law except for certain limited types of transactions.[50] The index referred to in the definition of OTC derivatives transactions include weather index and various economic indices published by governments and the term 'credit" includes not only credit of the parties but also the government acts that impose moratorium on foreign exchange business or payment of debts so that new products to be developed in these areas can be captured by the definition.

The Japanese Netting Law applies to Specified Financial Transactions under a master agreement that is entered into between a financial institution and a counterparty for the purpose of entering into two or more Specified Financial Transactions on a continuing basis and contains a close-out netting provision.[51]

However, the protection under the Japanese Netting Law is available only if at least one of the parties to the netting arrangement falls within the

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agree to exchange money the amount of which is calculated on the basis of the difference between the agreed value the index of interest rate, price of currency or price of commodity, etc. and the value of such index on a certain future date or a similar transaction as is further determined by the ministerial ordinance." The ministerial ordinance of the Banking law further determines the following as "financial derivative transactions": (1) a transaction where parties agree to make payments based on the market price with respect to the agreed quantity of commodity (provided that transactions are settled by netting) or a similar transaction; (2) a transaction where parties agree to make payments based on the market price with respect to the agreed quantity of allocated amount (that is determined under Article 2, Paragraph 6 of the Law on Promotion for Measures for Global Warming) provided transactions are settled by netting) or a similar transaction; (3) an option transaction with respect to transactions under (1) or (2) or similar transaction.

50) However, it appears that physically-settled commodity swaps, commodity options, equity forwards, commodity forwards, derivative transactions, physically settled emissions allowance transaction and property index derivative transaction would not be included within the scope of protected transactions.

51) Article 2, Paragraph 6 of the Japanese Netting Law.

category of Qualified Financial Institutions. Qualified Financial Institutions include Japanese banks (as well as Japanese banking branches of non-Japanese banks), financial instruments dealers which are engaged in the First-Class Financial Instruments Dealing Business,[52] Japanese insurance companies (as well as foreign insurance companies)[53] and certain other financial institutions.[54] Thus, the special treatment under the Japanese Netting Law is not applicable to derivatives transactions between a non-Japan financial institutions which are not based in Japan or acting through its presence in Japan and a Japanese party (e.g., general corporations) which does not fall under Qualified Financial Institutions.

JBL

The Japanese Netting Law would apply only to derivatives transactions where one party is a financial institution licensed in Japan and therefore, would not apply to transactions where neither party is a financial institution; for example, the Japanese Netting Law would not apply to derivatives transactions between a foreign financial institution that is not licensed in Japan and a Japanese corporation. In order to cover this gap, Article 58 of the JBL was amended to provide similar protections. The protection under Article 58 of JBL applies to "a contract relating to a transaction in a product which has a price quoted on an exchange or otherwise has a price in the market, where, because of the nature of such contract, the purpose of the contract would be negated unless the contract is performed on a specified date and time or within a specified time period." Japanese commentators state that a derivatives transaction where the underlying has a price quoted on an exchange or has a market price would be accorded the protection.[55] The court

52) As defined under Article 28 Paragraph 1 of the FIEL. The First-Class Financial Instruments Dealing Businesses are substantially the same as the businesses which the "securities companies" registered under the Securities and Exchange Law of Japan were allowed to conduct thereunder. The Law on Foreign Securities Firms has been abolished since 30 September 2007 when the FIEL was enacted. A foreign securities firm is now regulated under the FIEL in the same way as the Japanese financial instruments dealers.

53) As defined in Article 2, Paragraph 7 of the Insurance Business Law and foreign insurers having a Japanese branch and having obtained a license pursuant to Article 185, Paragraph 4 of the Insurance Business law.

54) The other types of financial institutions are: any of Shinkin Central Bank, Norinchukin Bank and Shokochukin Bank Securities Finance Companies and Money market brokers designated by the Financial Services Agency.

55) Momoo Shigeaki, *Prohibited Setoff II, in* SHINPAN HASANHO 310 (Sonoo Takashi eds., 2006) (in

have yet to determine what types of derivatives transactions would fall within the scope of "a contract that is to be performed on a specified date and time or within a specified time period." Unlike the Japanese Netting Law, Article 58 of the JBL does not limit the applicability to certain particular type of transaction parties. Thus, any entity that has outstanding derivatives contracts with the debtor would enjoy the protection.

5) Comment

The products that are specially protected in the insolvency proceedings are so broadly defined in all three jurisdictions that most if not all types of derivatives transactions would be protected. However, U.S. and the Japanese laws contain certain limitations. For example, in the U.S., while there are no restrictions on the protected parties with respect to swap agreements, the protection is available only to "certain sophisticated financial institutions" for forward, commodities and securities contracts. In Japan, the protection for a wide scope of derivatives transactions under the Japanese Netting Law is available only if one party is a financial institution while under Article 58 of the JBL, there is no restriction on the protected parties but the scope of the protected transactions appears to be limited to the cases that are based on market price and are performed on a specified date and place. Compared to the U.S. and Japan, the Korean Netting Provision applies to a wide range of derivatives products regardless of the status of the parties and there is no requirement of a market or a market price of the underlying of the transactions. In light of the scope of the application, the Korean Netting provision was apparently intended to provide a broadest protection to derivatives transactions and it is hoped that the courts would fully honor such intent and not attempt to narrow the protection in an effort to benefit the debtor's estate in insolvency.

2. Types of Protection

1) Protections under Korean Netting Provision

The Korean Netting Provision concerns the finality of contractual netting arrangements under Qualified Financial Transactions and basically provides,

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Japanese).

in the Rehabilitation Proceedings under Chapter 2 thereof and the Bankruptcy Proceedings under Chapter 3 thereof, the following protections: (i) enforceability close-out netting; and (ii) enforceability of collateral arrangement including provision and liquidation of collateral. More specifically, according to the Korean Netting Provision, derivatives transactions that are entered into under a master agreement and fall within the scope of the Qualified Financial Transaction would be exempt from:

(i) any restrictions under the DRBL that, but for the special provisions, may have applied to the termination and settlement of the transactions which termination and settlement will become effective pursuant to the terms of the basic/master agreement entered into by the parties;
(ii) rescission, termination or revocation as a result of the receiver's power to reject an executory contract and to avoid certain acts of the insolvent party;[56)]
(iii) an interim stay order [*Jungji Myungryung*] or a comprehensive stay order [*Pogwaljuk Kumji Myungryung*] with respect to security.

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56) Under the DRBL, the receiver is authorized to set aside, subject to certain conditions, the following types of actions taken by the insolvent party:

(i) any act (e.g., payment or transfer of property) taken by the insolvent party with intent to harm other creditors if the payee/transferee also knows that such payment or transfer would harm other creditors;
(ii) any act that would harm other creditors or any repayment of debt or provision of collateral made after a suspension of payment or the filing of insolvency proceedings ("Insolvency Event") if the payee or the secured party knows that the Insolvency Event has occurred or that such act will harm other creditors;
(iii) repayment of debt or provision of collateral made after or within 60 days prior to an Insolvency Event when the insolvent party had no antecedent obligation to do so at such time if (a) the payee/secured party knows the Insolvency Event has occurred or (b) such act will prejudice equal treatment of creditors; and
(iv) any gratuitous act or act that can be deemed gratuitous which occurs after or within six months prior to an Insolvency Event. If the party that benefited from the insolvent company's action is specially related to the insolvent company, then under (ii), the payee or the Secured Party is presumed to have the knowledge, under (iii), the 60 day period is extended to 1 year and under (iv) the 6 month period is extended to 1 year. "Specially related parties" include any company that holds 30% or more of interest in the insolvent company or any company in which the insolvent company holds 30% or more interest or any company that controls or is controlled by, the insolvent company.

Unfortunately, the Korean Netting Provision is not drafted with the utmost grammatical exactness; if literally read, the subject of the clause "shall not be subject to rescission, termination, revocation or avoidance" could be "termination and calculation of settlement amount." The words "rescission, termination, revocation" refer to the receiver's right to assume or terminate/ rescind an executory contract. The termination and calculation of settlement amount, i.e., the close-out netting would not be subject to such receiver's power with respect to an executory contract. In addition, the close-out netting cannot be subject to the receiver's avoidance power. Therefore, the correct reading of the clause would be that each Qualified Financial Transaction "shall not be subject to rescission, termination, revocation or avoidance."

If the transactions are not entered into by the debtor in collusion with the counterparty for the purpose of harming other creditors, however, the above exemptions will not apply.

2) Enforceability of Close-out Netting

Close-out netting upon insolvency of a party involves (i) termination of transactions and (ii) calculation of the settlement amount by netting.

(1) Enforceability of Ipso Facto termination provision

Prior to the enactment of the DRBL, there was some uncertainty as to whether an *ipso facto* termination provision which permits termination of the contract upon insolvency of one party would be enforceable with respect to an executory contract in insolvency proceedings. The Supreme Court of Korea held that the *ipso facto* provision is effective for a joint investment agreement which is, however, held not to be an executory contract.[57] Some Korean legal commentators[58] argued that an *ipso facto* termination provision should not be enforced with respect to an executory contract, because the enforcement would deprive the receiver from its power to reject or assume an executory contract. The Korean Netting Provision eliminated the uncertainty on this issue by providing that the termination and settlement of derivatives transactions under a master agreement would be enforceable in accordance with the parties' agreement. Therefore, the *ipso facto* termination provision in

57) Korean Supreme Court Decision of September 6, 2007 (Case No.: 2005DA38263).

58) *E.g.*, Chang-Hoon Baik & Chae-Hong Im, CORPORATE REORGANIZATION LAW I, 361 (2nd ed. 2002) (in Korean).

the ISDA Master Agreement would be enforceable in DRBL proceedings.

(2) Enforceability of Netting

The Korean Netting Provision, which provides that termination and settlement of Qualified Financial Transactions made under a master agreement would be enforceable in accordance with the terms of the master agreement, eliminated the uncertainty under previous Korean insolvency-related laws as to whether netting would be allowed after the commencement of Rehabilitation Proceedings where the transactions are terminated on the ground of insolvency of a party. The uncertainty arose because some commentators argued that the setoff right is similar to a security interest and in view of the fact that the exercise of security right is stayed upon commencement of Rehabilitation Proceedings, setoff should be permitted only when the relevant claim and cross claim matured prior to the commencement by its terms.[59)]

(3) Exemption from Automatic Stay

In DRBL Rehabilitation Proceedings, all creditors' actions (including the exercise of security rights) are stayed at the time of the commencement of the proceedings[60)] while in Bankruptcy Proceedings creditors' exercise of security rights is not stayed.[61)] There is no court precedent as to whether the termination of an agreement is subject to the automatic stay in Rehabilitation Proceedings. In the Bankruptcy Proceedings, certain contracts including the current account contracts (*Sangho Kyesan*) and the Fixed-Term Contracts are automatically terminated by law upon declaration of bankruptcy. However, pursuant to Articles 120 and 336 of the DRBL, the termination and settlement of the Qualified Financial Transactions would be enforceable in accordance with the terms of the master agreement. Hence, close-out netting should be viewed exempt from the automatic stay in the Rehabilitation Proceedings.

3) Enforceability of Collateral Arrangement

Under the Korean Netting Provision, the provision, disposal or appropriation of collateral (*Dambo*) securing a Qualified Financial Transaction (including a derivatives transaction) is exempt from the interim stay order or

59) *Id*., at 543.

60) Article 131 of the DRBL.

61) Article 412 of the DRBL.

the comprehensive stay order.[62] As discussed above under 3.2.1, under a reasonable reading of the Korean Netting Provision, the "provision, disposition and application of collateral" "shall not be subject to rescission, termination, revocation or avoidance" subject to a proviso.[63]

(1) Nature of Collateral

In the derivatives industry, collateral is provided generally either in the form of pledge or title transfer.[64] "*Dambo*" is a Korean term meaning security or collateral. There is no doubt that typical security interest recognized as a property right (*Mul-kwon*) such as pledge, mortgage or *yangdodambo* falls under "*dambo*" under the Korean Netting Provision. *Yangdodambo* is a security interest in the form of transfer of title for the purpose of security interest, the validity of which has been recognized by the court precedents. *Yangdodambo* is different from title transfer under the English CSA in that *yangdodambo* holder is not permitted to dispose of the collateral unless and until the secured obligations are due and payable and that *yangdodambo* holder must return the collateral (not the equivalent of the same kind) to the *yangdodambo* provider once the secured obligations are fully paid. The DRBL is silent on the scope of the term "*dambo*" used in Article 120, Paragraph 3. Thus, there may be split of views on the issue of whether that should be interpreted narrowly to mean

62) Under the Korean Netting Provision, the provision, disposition and application of collateral in connection with other Qualified Financial Transactions fall within the scope of the Qualified Financial Transaction. In general, a transaction refers to the entry into a contractual relationship between two or more parties and does not include a unilateral action taken by one party. The disposition of collateral is an exercise of the security right but cannot constitute a transaction between the collateral provider and the secured party. For the same reason, the application of the proceeds of sale of collateral cannot qualify as a transaction. It is not clear why "the provision, disposition, application of collateral" is classified as a Qualified Financial Transaction.

63) The proviso of Article 120, Paragraph 3 of the DRBL states that this exemption would not apply if there is collusion between the secured party and the insolvent company to harm other creditors of the insolvent company, these exemptions would not apply. Unless the proviso applies, pursuant to Article 120 (3) of the DRBL, disposition of collateral provided in connection with derivative transactions would be exempt from avoidance. To the extent that secured obligations arise under derivative transactions, this provision would have the effect of reversing the Korean Supreme Court decision of February 28, 2003 (Case No.: 2000DA50275) that avoided in the corporate reorganization proceedings a secured creditor's liquidation of collateral after the debtor's suspension of payment.

64) OTC derivative transactions are predominantly documented by the master agreements and annexes thereto published by the ISDA. Several different versions of credit support annex are available; most notably the New York law-governed CSA (which adopts the pledge method) and the English law-governed CSA (which adopts the title transfer method).

"collateral that is subject to a security interest recognized as a property right (*Mul-kwon*)" or more widely to refer to arrangement that functions as collateral. As title transfer does not fall under the narrow meaning of collateral under Korean law, a question may arise as to whether collateral provided in the form of title transfer could be treated in the same manner as other types of traditional security interest for purposes of the Korean Netting Provision in light of the function of the transfer of title as collateral and the legislative intent for this article including the protection of the secured party in Qualified Financial Transactions. There is no court precedent on this issue. For the reasons set out below, however, the more reasonable view appears to be that the term "*dambo*" for purposes of the Korean Netting Provision should be considered as including collateral in the form of title transfer.[65] Firstly, the term "*dambo*" appears also in Paragraphs 1 and 2 of Article 120 which address the finality of payment and settlement for a payment and settlement system and the finality of clearing and settlement on the Korea Exchange, respectively. Paragraphs 1 and 2 expressly state that "*dambo*" includes "cash margin" (*Jung-geo-kum*). Korean law does not recognize a security interest in cash. "Cash margin" can mean either "security deposit" (*Bo-jung-kum*) or a loan (*so-bi-dae-cha*). Under the former, the obligation of the secured party/ transferee to return the same amount of cash arises only upon the full discharge of the secured obligation; thus, upon default, the secured party/ transferee has no obligation to return the cash collateral, except that it will be required to return any excess cash collateral after enforcement. The other possible characterization of "cash margin" is a loan (*so-bi-dae-cha*) of cash coupled with a set-off right so that upon default the secured party/transferee can set off its obligation to repay the loan against the secured obligation. Regardless of the characterization, "cash margin" is not collateral subject to a security interest and therefore, the term "*Dambo*" used in Paragraphs 1 and 2 of Article 120 appears to be a concept broader than a Korean security interest.

(2) Provision of collateral

As discussed above under 3.2.1, above, under a reasonable reading of the

65) RESEARCH GROUP OF THE BANKRUPTCY DEPARTMENT OF SEOUL DISTRICT COURT, REHABILITATION CASE PRACTICES (*Hoesaeng Sakun Silmu*) 160 (2nd ed. 2007) (written in Korean language) also takes the view that the term "*dambo*" as used in Article 120, Paragraph 3 and Article 336 should be interpreted to include a title transfer arrangement.

Korean Netting Provision, the "provision, disposition and application of collateral" "shall not be subject to rescission, termination, revocation or avoidance." "Qualified Financial Transactions" include "provision, disposition or application of collateral" in connection with other Qualified Financial Transactions. Therefore, any provision of collateral in connection with derivatives transactions would be protected from avoidance.[66)]

(3) Liquidation of collateral

Under the Korean Netting Provision, in connection with derivatives transactions, the secured party's right to liquidate collateral would not be subject to an interim stay order [*Jungji Myungryung*][67)] or comprehensive stay order [*Pogwaljuk Kumji Myungryung*].[68)] However, the Korean Netting Provision is silent on the treatment of such collateral under the general automatic stay in the Rehabilitation Proceedings.

All creditors' collection actions, whether through administrative or judicial procedures will be automatically (i.e., without relying on an interim stay order or comprehensive stay order) stayed upon commencement of Rehabilitation Proceedings while a secured creditor is free to liquidate collateral at any time in Bankruptcy Proceedings. Thus, the secured party would be stayed from liquidating the collateral upon commencement of Rehabilitation Proceedings while the secured party is not subject to such stay upon commencement of the Bankruptcy Proceedings. The court is required to decide whether to commence Rehabilitation Proceedings within one month after the petition is filed.

It is not entirely clear whether the liquidation of collateral that secures obligations under derivatives transactions would be also stayed upon commencement of Rehabilitation Proceedings. An argument may be made that the liquidation of collateral should be considered part of the "termination and settlement" of derivatives transactions and hence, should be enforceable in accordance with the parties' agreement in the master agreement. On the

66) *See id*.

67) Once the petition is filed for Rehabilitation Proceedings, a court may issue an interim stay order to stay certain specific administrative or judicial procedures (such as provisional attachment, execution of judgment) against the insolent company or its assets.

68) After a petition is filed for Rehabilitation Proceedings, a court may also issue a comprehensive stay order which will stay all administrative or judicial procedures (such as provisional attachment, execution of judgment) against the insolvent company or its assets.

other hand, however, some Korean legal commentators expressed the view that the liquidation of collateral securing derivatives transactions should not be exempt from the automatic stay that takes effect upon commencement of Rehabilitation Proceedings.[69] This issue is a question as to whether the limitations on the general secured creditors should apply to secured creditors for transactions falling under the definition of Qualified Financial Transaction should be further examined in greater depth.[70]

Regardless of the method by which collateral is provided, the claim for the close-out net amount under the derivatives transactions against the party subjected to Rehabilitation Proceedings will constitute a rehabilitation claim and hence, further provision to secure such a claim would not be permissible.

4) Exclusion from Protection

The Korean Netting Legislation includes a proviso ("Exclusion Proviso") to the effect that it would not apply to any Qualified Financial Transaction if it is entered into by the debtor in collusion with the counterparty for the purpose of harming the other creditors. The Exclusion Proviso is not included in Paragraph 1 or 2 of Article 120 of the DRBL because the settlement and the clearance systems to which Paragraphs 1 and 2 apply are not susceptible to abuse of the special protection whereas Qualified Financial Transactions offer opportunities for abuse. For example, financing could be offered through a derivatives contract rather than an ordinary debt contract. If the benefits of the Korean Netting Legislation are available for such lenders, it would not be fair to other *bona fide* lenders who would not enjoy such benefits. Courts may decide that such disguised loans do not fall under the "derivatives." "Swap,

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69) Rehabilitation Case Practices *supra* note 55, at 160; Lim, *supra* note 33 at 207 (2006).

70) A transfer of title to collateral under the English law Credit Support Annex would fall under "Qualified Financial Transaction" under the Korean Netting Provision and under the ISDA Master Agreement the title transfer transactions are also included in the close-out netting upon occurrence of an event of default. Therefore, such setoff or netting against the collateral value would fall under "the termination and calculation of settlement amount" which is enforceable in accordance with the parties' agreement under a master agreement. It should be noted that each of the Global Securities Lending Agreement, the Overseas Securities Lender's Agreement and the Global Repurchase Agreement includes close-out netting provisions which expressly include in the netting the margin that is provided in the form of title transfer. Thus, under the title transfer method, the secured obligation is discharged not through disposition or realization of a security interest but through the close-out netting which is enforceable under the Korean Netting Provision.

forward and option" are not defined in the DRBL and a court may impose its own definition of such terms in order to exclude the disguised loans from the protection or alternatively may adopt the market's definition of such terms. On the other hand, "secured call loans" are included in the Qualified Financial Transaction and therefore, the fairness argument may be raised by other lender.

5) U.S. and Japan

(1) U.S.

The U.S. Bankruptcy Code provides special protections in the following general areas: (i) an exemption from the automatic stay with respect to close-outs, set-offs and foreclosure on collateral;[71] (ii) recognition of enforceability of bankruptcy termination or *ipso facto* clauses;[72] and (iii) an exemption of payments made under the derivatives from preference and constructive (but not actual) fraudulent transfer.[73]

The FDIA distinguishes between a receivership and a conservatorship. In a receivership, a party to a "qualified financial contract" is entitled to: (i) exercise any contractual right to terminate, liquidate or accelerate a qualified financial contract which arises upon the appointment of the FDIC as receiver; (ii) exercise any rights under any security arrangement related to the qualified financial contracts; and (iii) exercise any right to "offset or net out any termination value, payment amount or other transfer obligation arising under or in connection with [one] or more qualified financial contracts."[74] In a conservatorship, the above applies except that a party to a qualified financial contract will not be permitted to exercise any contractual right to terminate based solely on the appointment of a conservator or by reason of insolvency (i.e., *ipso facto* clauses).[75]

(a) Enforceability of Ipso Facto termination and netting

U.S. Bankruptcy Code

The U.S. Bankruptcy Code generally prevents a non-bankrupt party from using the bankruptcy filing as a ground for terminating an executory

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71) 11 U.S.C. §362(b)(17) as amended by the 2006 Act.

72) 11 U.S.C. §560.

73) 11 U.S.C. §§546(g), 548(c), 548(d)(2).

74) 12 U.S.C. §1821(e)(8)(A).

75) 12 U.S.C. §1821(e)(8)(E), 1821(e)(12).

contract[76] and the automatic stay takes effect upon filing of the insolvency petition.[77] However, such provisions are overridden by Section 560 of the U.S. Bankruptcy Code, which expressly recognizes the contractual right to liquidate, terminate, or accelerate one or more swap agreements.[78]

FDIA and FDICIA

The *ipso facto* provisions in a master agreement for derivatives transactions are enforceable in receivership but would not be enforceable in a conservatorship. Therefore, a party to a qualified financial contract will not be able to terminate the contract as a result of the appointment of the FDIC as conservator.

After the appointment of a conservator or receiver, the FDIC is authorized to request a stay in any judicial action or proceeding to which the insolvent institution is a party for a specified period.[79] However, FDIA expressly provides that no person shall be stayed or prohibited from exercising any right to cause the termination or exercising any right to offset or net out any termination value, payment amount or other transfer obligation arising under any Qualified Financial Contracts.[80]

FDICIA recognizes the enforceability of the netting of payment obligations between two "financial institutions" under a "netting contract", "notwithstanding any other provision of law"[81] and notwithstanding any "stay, injunction, avoidance, moratorium or similar proceeding or order, whether issued or granted by a court, administrative agency or otherwise."[82] The term "netting contract" is defined as a contract or agreement between two or more financial institutions that "provides for netting present or future

76) 11 U.S.C. §365(e)(1).

77) 11 U.S.C. §362(a).

78) Section 560 provides: "The exercise of any contractual right of any swap participant or financial participant to cause the liquidation, termination, or acceleration of one or more swap agreements because of a condition of the kind specified in section 365(e)(1) of this title or to offset or net out any termination values or payments amounts arising under or in connection with the termination, liquidation, or acceleration of one or more swap agreements shall not be stayed, avoided, or otherwise limited by operation of any provision of this title or by order of a court or administrative agency in any proceeding under this title 11."

79) 12 U.S.C. §1821(d)(12).

80) 12 U.S.C. §1821(e)(8)(i) and 12 U.S.C. §1821(e)(8)(iii).

81) 12 U.S.C. §4403(a).

82) 12 U.S.C. §4405.

payment obligations or payment entitlements (including liquidation or close-out values relating to the obligations or entitlements) among the parties to the agreement.[83)]

(b) Collateral

U.S. Bankruptcy Code

Under the U.S. Bankruptcy Code, a trustee can ordinarily avoid a transfer of property made within the 90 days, if the transfer enabled a creditor to receive more than it would have been entitled to receive in a liquidation proceeding.[84)] However, Section 546(g) expressly provides that the trustee may not avoid a transfer made under or in connection with any swap agreement, unless such transfer is made with actual intent to hinder or defraud creditors. Moreover, Section 548(d)(2) of the U.S. Bankruptcy Code protects transfers of property made in connection with a swap agreement from avoidance as fraudulent transfers by providing that such transfers are deemed to be transfers "for value."[85)] Such transfers made "in good faith" will be exempt from the trustee's power to reclaim fraudulent transfers.

The U.S. Bankruptcy Code expressly provides that the exercise of any contractual right to liquidate, terminate or accelerate a swap agreement shall not be stayed, avoided or otherwise limited by any provision of the U.S. Bankruptcy Code.[86)] "Swap Agreement" includes "any security agreement or arrangement or other credit enhancement related to any agreements or transactions referred to in [other parts of the definition of the Swap Agreement]."[87)] In addition, Section 362(b)(17) of the U.S. Bankruptcy Code includes an exception to the scope of automatic stay under Section 362(a). This exception would allow a swap participant or a financial participant to apply to the satisfaction of obligations under the protected contracts any cash, securities or other property held, pledged or controlled as collateral or margin free from automatic stay. Therefore, not only the close-out netting but also liquidation of the collateral would be exempt from the automatic stay.

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83) 12 U.S.C. §4402(14)(A)(i).

84) 11 U.S.C. §547(b).

85) A transfer of property "for value" and in good faith is not subject to avoidance of fraudulent conveyance. 11 U.S.C. §548(c).

86) 11 U.S.C. §560.

87) 11 U.S.C. §101(53B)(vi).

FDIA and FDICIA

If the collateral provider is a federally insured bank or federally chartered bank, then the FDIA would apply Under the FDIA, the FDIC acting as conservator or receiver may not avoid any transfer of money or other property in connection with any qualified financial contract with an insured depository institution, unless the transferee had actual intent to hinder, delay or defraud the conservator or receiver.[88] Both in the receivership and conservatorship, a party to a "qualified financial contract" will be entitled to "exercise any rights under any security agreement or arrangement or other credit enhancement related to one or more qualified financial contracts."[89]

FDICIA recognizes the enforceability of "any security agreement or arrangement or other credit enhancement related to one or more netting contracts between any two financial institutions" which "shall not be stayed, avoided or otherwise limited by any State or Federal law."[90]

(c) Exclusion from Protection

Under the U.S. Bankruptcy Code, a transfer of a margin payment or settlement payment under any swap agreement is not avoidable except for the case where the transfer is made with actual intent to hinder, delay, or defraud any creditor of the insolvent party.[91] It may be difficult to attribute "actual intent to defraud" creditors, however, in cases where the parties entered into the transactions for valid business reasons other than fraudulent purposes although the economic substance of the transactions may not fall within the scope of protected derivatives transactions.

It appears that the U.S. Bankruptcy Code as amended by the 2005 Act and the 2006 Act does not deny the special protection to transactions whose economic substance falls outside the Specified Transactions in the economic substance. For example, a margin loan – loans secured by the borrower's securities portfolio – is expressly included in the definition of "securities contract" which is protected.[92] Some commentators note that the U.S. Bankruptcy Code "places form over substance in characterizing protected transactions."[93]

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88) 12 U.S.C. §1821(e)(8)(C).

89) 12 U.S.C. §1821(e)(8)(A)(ii).

90) 12 U.S.C. §4403(f).

91) 11 U.S.C. §546(e).

92) 11 U.S.C. §741(7)(A)(iv).

(2) Japan

The Japanese Netting Law expressly protects close-out netting (*ikkatsu seisan*) in the proceedings under the Bankruptcy Laws. Article 3 of the Japanese Netting Law expressly provides that Close-out Netting will not be invalidated under (a) bankruptcy proceedings under the JBL, (b) civil rehabilitation proceedings under the JCIRL and (iii) corporate reorganization proceedings under the JCRL.[94] As mentioned above, the Japanese Netting Law applies only if at least one of the parties to the transaction is a Qualified Financial Institution.[95]

In addition, Article 58 of the JBL provides for early termination of transactions involving a product which has a price quoted on an exchange or otherwise has a market price and recognizes netting of claims and obligations with respect to damages arising out of such transactions as calculated in accordance with the terms of the master agreement under which such transactions are entered into.[96]

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93) Morrison & Riegel, *supra* note 44.

94) "Close-out netting" is defined under Article 2, paragraph 6 of the Japanese Netting Law as follows:"In this law, the term 'close-out netting ' means a procedure by which, upon occurrence of a Close-out Event with respect to a party to the specified Financial Transactions entered into under a Master Agreement and regardless of both parties' intentions, the value at such occurrence of each of the specified Financial Transactions under the Master Agreement shall be computed in accordance with the provisions of Ministerial Ordinance of the Prime Minister's Office, and the aggregate net balance shall become a single claim or obligation arising between the parties." A Close-out Event (*Ikkatsu seisan jiyu*) is defined in Article 2, paragraph 4 of the Japanese Netting Law to mean: commencement of bankruptcy proceedings, civil rehabilitation proceedings or corporate reorganization proceedings.

95) *See supra* notes 52 through 54 and accompanying text.

96) Article 58 of the JBL provides as follows:

1. If with respect to a contract relating to a transaction in a product which has a price quoted on an exchange or otherwise has a price in the market, where, because of the nature of such contract, the purpose of the contract would be negated unless the contract is performed on a specified date and time or within a specified time period, and such specified time or time period is to fall after the commencement of bankruptcy proceedings, then the contract shall be deemed to have been terminated.
2. For the purpose of the preceding paragraph, damages shall be determined by the difference between (i) the market quotation for a transaction of the same kind which is to be performed at the same time as the product specified in such contract and in the same place or in such other place as is standard for the market quotation and (ii) the price of the product specified in that contract.
3. Article 54, paragraph 1 shall apply *mutatis mutandis* to the claim for damages set out in the preceding paragraph.
4. For the matters provided for in paragraphs 1 and 2 above, if such exchange or market provides

Article 58 of the JBL applies *mutatis mutandis* to corporate reorganization proceedings under the JCRL and civil rehabilitation proceedings under the JCIRL.[97)]

(a) Enforceability of Ipso Facto termination provision and netting

Japanese Netting Law

Under the Japanese Netting Law, upon occurrence of a Close-out Event, i.e., the filing of a petition for commencement of bankruptcy proceedings, civil rehabilitation proceedings or corporate reorganization proceedings,[98)] the Specified Financial Transactions are terminated and a net amount is computed and becomes a single claim or obligation, regardless of the parties' intention. Therefore, it appears that the *ipso facto* clause where the transactions will be terminated automatically upon occurrence of a Close-out Event will be enforceable and close-out netting is enforceable in the proceedings under the JBL, the JCRL and the JCIRL. The close-out amount should be "an amount fairly calculated by reference to the actual conditions of interest rates, currency rates, quotations on financial instruments markets and other indexes."[99)] It is not clear, however, whether an *ipso facto* clause where the early termination is an option would be also enforceable.

There is no express exemption from the automatic stay that takes effect upon commencement of the rehabilitation proceedings under the JCRL. However, since Specified Transactions will be terminated automatically upon occurrence of a Close-out Netting event, it appears that the automatic stay in the rehabilitation proceedings would not apply.

Japanese Bankruptcy Laws

Under Article 58 of JBL, a derivatives contract that falls within the definition of the protected transaction will be terminated by law upon commencement of the bankruptcy proceedings regardless of the parties'

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otherwise, such other provision shall prevail.

5. If a master agreement has been entered into between the parties for the purpose of continued trading in the type of transactions described in paragraph 1 above and that master agreement provides that the claims or obligations for damages described in paragraph 2 arising from the transactions governed by such agreement would be settled by netting, then the calculation of the amount of damages shall be made in accordance with such netting provision."

97) *See supra* notes 27 and 28 and accompanying text.

98) Article 2, Paragraph 3 of the Japanese Netting Law.

99) Article 2 of the Joint Ministerial Ordinance of the Prime Minister's Office and the Ministry of Finance.

intention. Therefore, an *ipso facto* clause with an automatic termination will be enforceable. It is not clear whether an optional *ipso facto* clause will be enforceable. The netting provision in a master agreement would be enforceable. There is no express exemption from the automatic stay that takes effect upon commencement of the proceedings under JBL. However, since a derivatives transaction that falls within the scope of the protected transaction will be terminated automatically upon commencement of the proceedings under the JBL, it appears that the automatic stay thereunder would not apply.

(b) Collateral

Under the Japanese Netting Law and the Ministerial Ordinance therefor, the definition of "Specified Financial Transaction" includes "OTC derivatives transactions and lending (*taishaku*) or deposit (*kitaku*) of money or securities effected for the purpose securing such transactions." Therefore, to the extent that derivatives transactions and the provision of collateral by way of lending or deposit are made under a master agreement, the netting of the collateral amount would be enforceable. In addition, since securities lending transactions also fall within the scope of Specified Financial Transaction, the provision of collateral by loan or deposit would be protected from avoidance.

However, neither the Japanese Netting Law nor Article 58 of the JBL provides any special treatments for collateral provided in the form of pledge in connection with derivatives transactions. Therefore, it appears that the provision and liquidation of collateral that is pledged to secure derivatives transactions would be subject to all restrictions such as automatic stay or avoidance that would be applicable to secured creditors under the JBL.

(c) Exclusion from Protection

Unlike the US and Korea, the protected products in Japan do not include margin loan or secured call loan. In addition, unlike the US and Korea, "derivatives" are not defined by enumerating the types of derivatives, such as swap, forward or option,[100] but are defined by referring to the basic concepts of each type of derivative transactions. Accordingly, it appears that it would be easier for courts to focus on substance over form and recharacterize "disguised transactions" as not falling within the scope of the protected

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100) *See supra* notes 30 and 31 and accompanying text for the definition under the DRBL, note 37 for the definition under the US Bankruptcy Code and notes 48 and 49 for the definition under the Japanese Netting Law (which refers to the definition under the Banking Law).

products.

6) Comment

The Korean Netting Provision addresses the finality of contractual netting arrangements under the Qualified Financial Transactions and basically provides, in the Rehabilitation Proceedings under Chapter 2 thereof and the Bankruptcy Proceedings under Chapter 3 thereof, the following protections: (i) enforceability close-out netting; and (ii) enforceability of collateral arrangement including provision and liquidation of collateral. When compared to the Japanese Netting Law, the Korean Netting Provision protects collateral that is provided in the conventional form of pledge and appears to protect collateral that is provided by way of title transfer as well.

Unlike the 2005 Act and the 2006 Act of the United States amending the US Bankruptcy Code and placing form over substance rule, the Korean Netting Legislation is silent on the priority between form and substance. As discussed above, the Korean Netting Legislation has an exclusion proviso to the effect that it would not apply to any Qualified Financial Transaction if it is entered into by the debtor in collusion with the counterparty for the purpose of harming the other creditors. It would be one of controversial issues to determine what kind of transactions are "harming other creditors." Korean courts may apply the substance over form rule based on such exclusion proviso.

The DRBL contains provisions applicable in Bankruptcy Proceedings similar to Article 58 of the JBL of Japan. Article 338[101)] of the DRBL provides that outstanding fixed-term contracts that will mature after declaration of bankruptcy will be automatically terminated upon a declaration bankruptcy and the damages will be the difference between the contractual settlement amount and the market price of the same type of contract at the same place and time of performance. The fixed-term contract is an agreement to deliver at a fixed time or within a fixed period of time certain goods which have a market or an exchange price. The Korean Netting Provision was adopted as a separate provision (i.e., Articles 120 and 336 of the DRBL) rather than amending the provision applicable to fixed-term contracts.

101) Article 338 of the DRBL is taken from Article 52 of the repealed Bankruptcy Law and applies only to Bankruptcy Proceedings but has no effect in Rehabilitation Proceedings.

IV. Conclusion

The Korean Netting Provision of Korea embodies the legislative effort to provide express protections for a wide range of derivatives transactions. The protections that are provided for derivatives transactions include (a) a clear confirmation of the enforceability of close-out netting provisions and (b) an express exemption from the receiver's power to cherry-pick executory contracts, the receiver's avoidance power, and from the interim stay order and comprehensive stay order prior to the commencement of the Rehabilitation Proceedings. The US enacted the special provisions for derivatives by stages over a number of years through several legislations and Japan enacted a separate special netting law and amended the existing relevant clause of its insolvency-related laws. In comparison, Korea appears to have benefited from the precedents in other jurisdictions and enacted a fairly comprehensive and balanced netting law in the form of the Korean Netting Provision. It is hoped that the remaining uncertainties will be clarified by courts in specific cases and also legal scholars who are active in this area of law.

KEY WORDS: Insolvency, Derivatives, Debtor Rehabilitation and Bankruptcy Law, US Bankruptcy Code, Japanese insolvency laws, close-out netting, collateral