

Korea

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Introduction

There are two categories of insolvency proceedings in Korea, namely court-administered proceedings and out-of-court proceedings. The former category relates to bankruptcy proceedings, rehabilitation proceedings and personal rehabilitation proceedings under the Debtor Rehabilitation and Bankruptcy Act of Korea (DRBA). As regards consensual out-of-court restructurings, there are two types: (i) voluntary restructuring through a workout process (workout), provided for under the Corporate Restructuring Promotion Act (CRPA); and (ii) a voluntary workout accord between the debtor and creditors to which the CRPA is not applied (voluntary workout accord). Such out-of-court restructurings are often preferred by restructuring market participants, particularly debtor companies, because they afford more flexibility and generally cause less disruption to the debtor.

A rehabilitation proceeding is a reconstructive insolvency proceeding that seeks to rehabilitate debtors in financial distress via such means as debt rescheduling. A personal rehabilitation proceeding, another type of reconstructive insolvency proceeding, is directed towards individual debtors who earn regular income and bear small amount of debts; it repays part of the liabilities with the debtor's income and excludes the rest. In contrast to these two procedures, a bankruptcy proceeding is a liquidating insolvency proceeding that takes into custody and realises the entire property of a debtor deemed to have no possibility of rehabilitation, which is then distributed fairly to the creditors. Workouts and voluntary workout accords are reconstructive insolvency proceedings distinguished from their rehabilitation counterparts in the sense that the creditors administer the procedures rather than a court.

This chapter will elaborate on insolvency proceedings to which corporate entities may be subjected. It will first explain the rehabilitation proceeding, and the bankruptcy proceeding and the workout will be discussed briefly by comparing them to the rehabilitation proceeding. Given the nature of this report, the explanation of a personal rehabilitation proceeding will be omitted. It will, however, explain voluntary workout accords, and examine Korean cross-border insolvency policies.

Rehabilitation proceedings

Persons entitled to file for commencement of rehabilitation proceeding and cause of commencement

The following persons may file for the commencement of a rehabilitation proceeding: the debtor, the creditors whose total amount of claims equal or exceed one-tenth of the debtor's capital, and shareholders who own more than one-tenth of the debtor's capital.

In order for a rehabilitation proceeding to commence, either the debtor is unable repay a matured debt without causing significant encumbrance to the continuation of its business, or there is a concern that a cause for bankruptcy may arise with the debtor. Here the cause for bankruptcy refers to (i) the debtor's inability to repay the debt in an ordinary, continuous manner due to the lack of the capacity to effect

performance; or (ii) the amount of the debtor's liabilities exceeds the value of the assets.

Asset preservation order and a comprehensive stay order

In a Chapter 11 proceeding in the United States, an automatic stay takes effect immediately when a petition is filed, thereby preserving the debtor's assets and preventing creditors from exercising their rights. In a rehabilitation proceeding in Korea, however, such a stay is not automatic and, after filing a petition for commencement, the court will issue a preservation order to preserve the debtor's assets, as well as a comprehensive order to prevent creditors from exercising their rights against the debtor.

Effect of commencement of rehabilitation proceedings

A rehabilitation proceeding formally commences when the court issues a decision to commence a rehabilitation proceeding in respect of a debtor.

When there is a decision to commence a rehabilitation proceeding, all compulsory enforcements are automatically stayed, and assets provided as security cannot be sold by a secured creditor without a court order. Further, rehabilitation claims and rehabilitation-secured claims can only be repaid as set out in the rehabilitation plan.

The court must appoint a receiver at the same time the court issues a decision to commence a rehabilitation proceeding. A receiver is authorised to take charge of the management and disposition of the debtor's assets. The Korean government implemented a debtor-in-possession (DIP) policy in 2006. However, in exceptional circumstances, when the cause of the debtor's financial deterioration can be attributed to existing management of the debtor, as a matter of legal principle, the court must appoint a third-party receiver.

Differences between rehabilitation claims and public-interest claims

In a rehabilitation proceeding, a creditor's claims are divided into three categories: (i) a rehabilitation claim; (ii) a secured rehabilitation claim; and (iii) a public-interest claim. A rehabilitation claim is one that arises from grounds that existed before commencement of a rehabilitation proceeding, and a secured rehabilitation claim is a rehabilitation claim secured on any assets of the debtor. These can be repaid only in accordance with the rehabilitation plan. A public-interest claim, however, is paid on a rolling basis, regardless of the rehabilitation plan. A good example of a public-interest claim is one incurred by the receiver with approval of the court after commencement of the rehabilitation proceeding.

Unless specified otherwise, the explanation below about claims is relevant to rehabilitation claims and secured rehabilitation claims.

Executory contract

An executory contract refers to an agreement wherein obligations relevant to both parties have not been performed in their entirety at the time of the commencement of the rehabilitation proceeding. This

type of contract receives special treatment from the said proceeding; the receiver may choose to assume or cancel (terminate) an executory contract. The receiver may exercise the cancellation right only until the closing of the meeting of interested parties that is convened for reviewing the rehabilitation plan proposal (normally the second meeting).

The counterparty may issue a notice to the receiver urging for a decision on whether to cancel or terminate the contract. Should the receiver fail to provide confirmation within 30 days of said notice, the receiver will lose the cancellation right.

In the case of performance, the other party may enforce the contract as a public-interest creditor. By contrast, if the receiver chooses to cancel the contract, the other party's damages claims arising from such cancellation are rehabilitation claims.

In order to protect the receiver's right to choose, numerous scholars have argued that an ipso facto clause, which states that filing a petition for the commencement is an event of termination of the contract, should be deemed invalid. Although Korean courts have judged ipso facto clauses to be invalid in the past, there have been cases wherein it was ruled that said clause was valid in relation to contracts that require mutual trust.

Investigation and confirmation of claims

When a rehabilitation proceeding is commenced, the receiver prepares a list of creditors. Separately, each creditor may file his or her respective (secured) rehabilitation claims with the court within the reporting period designated by the court. Even if the reporting period had lapsed, however, there are exceptions whereby the claim report can be filed afterwards. In any event, the latest point in time when a claim report can be filed is before the creditors' meeting for reviewing the proposal for the rehabilitation plan. If any (secured) rehabilitation claims are not included in the list of creditors and reported by the creditor, such rehabilitation claims are discharged upon approval of the rehabilitation plan.

As for the claims that have been filed, the receiver or other interested parties (ie, other rehabilitation creditors) may file an objection to claims included in the creditor list or filed with the court. In such an event, the creditor whose claims are contested should file with the bankruptcy court an application for confirmation of the claim.

Limitation on set-off

Once a rehabilitation proceeding commences, creditors may offset claims (receivables) with debts (payables) if their claims are due before expiry of the claim reporting period. The exercise of the set-off right must take place towards the receiver within the aforesaid term.

The creditors may not offset receivables or payables acquired before a certain point in time. (Depending on the type of claims or obligations, this may be the time of the petition requesting the commencement of a rehabilitation proceeding or the commencement said proceeding.)

Restructuring through a rehabilitation plan

A rehabilitation plan typically includes the basics of the debtor's rehabilitation, such as adjustment of claims, repayment methods, adjustment of shareholder rights, matters regarding mergers and acquisitions, and revisions to the articles of incorporation of a debtor.

After commencement of a rehabilitation proceeding, the court generally appoints an investigator to review the overall status of the debtor's assets, liquidation value and value as a going concern. In practice, the receiver prepares and proposes a rehabilitation plan based on the report prepared by said investigator. A rehabilitation plan is proposed and reviewed at the meeting of the interested parties, and

may be accepted by a quorum of (i) three-quarters or more of the total amount of secured rehabilitation claims; (ii) two-thirds or more of the total amount of rehabilitation claims; and (iii) one-half or more of the total number of shares present at the meeting (provided that if the total amount of debt exceeds the total amount of assets on the date of commencement, the shareholders do not have a right to vote).

When the proposed rehabilitation plan is accepted by a resolution passed at a meeting of the interested parties, the court may approve such rehabilitation plan. Exceptionally the court may also approve a rehabilitation plan that was not passed in the meeting; in this case the rehabilitation plan may reinforce the terms pertaining to the protection of creditors.

Restructuring that takes place as per a rehabilitation plan may be divided into three categories: unsecured claims; secured claims; and shares. The debt rescheduling for unsecured claims includes partial discharge, partial debt-equity swap and repayment in instalments after deferment. Secured claims, on the other hand, do not allow partial discharge or partial debt-equity swap; only repayment in instalments is permitted. In the case of disposing of collateral securities, it is common to have the rehabilitation plan include terms that provide that the concerned secured claims shall have priority in repayment at the disposed value. A considerable portion of shares ordinarily go through capital reduction via retirement or consolidation.

Implementation of plan and closing of rehabilitation proceeding

When a rehabilitation plan is approved, the rights of creditors and shareholders are adjusted according to the rehabilitation plan. Rehabilitation claims and secured rehabilitation claims not included in the approved plan shall be discharged.

If a rehabilitation plan is already carried out, or if there is no hindrance to carrying out the rehabilitation plan and its purpose is considered achievable, then the court may graduate the debtor from the rehabilitation proceeding. In that event, the debtor regains its authority over its assets and business.

Termination of rehabilitation proceeding

The court may terminate the rehabilitation proceeding even before the approval of the rehabilitation plan:

- if the court finds that the liquidation value of the debtor clearly exceeds the value as a going concern;
- if a rehabilitation plan proposal is not submitted; or
- if the rehabilitation plan proposal is not accepted.

The court may also terminate the proceeding if, after approval of the rehabilitation plan, it is clearly determined by the court that the rehabilitation plan is incapable of being carried out. In such an event, if the debtor has cause for bankruptcy, the court must declare the debtor in bankruptcy.

Bankruptcy proceedings (comparison to rehabilitation proceedings)

Since the provisions on bankruptcy proceedings are stipulated by the DRBA as with their rehabilitation counterpart, most of the detail explained above in relation to rehabilitation proceedings is applicable to bankruptcy proceedings as well. However, given the difference between the purposes of the two insolvency procedures, it is worth highlighting notable disparities.

The following table summarises the comparison between rehabilitation and bankruptcy proceedings:

	Rehabilitation proceeding	Bankruptcy proceeding
Creditors entitled to file a petition	May be filed by a creditor whose claim amounts to at least one-tenth of the debtor's capital	Creditors may file for the debtor's bankruptcy regardless of the pecuniary amount of their claims
Effect on the secured creditors	A secured creditor is unable to execute the security right; he or she receives repayment as per the rehabilitation plan	A secured creditor may execute the security right regardless of the bankruptcy proceeding
Right to manage and dispose of the debtor's property	The existing representative head of the debtor is usually appointed to be the custodian	An attorney is usually appointed as the bankruptcy trustee
Failure to declare claims	Undeclared claims are discharged after the rehabilitation plan is finalised	Although undeclared claims are not discharged, no dividend is paid to such claims
Set-off right	Limited	Unlimited
Restructuring	Restructuring occurs in accordance with the rehabilitation plan	There is no restructuring for the number of claims
Cessation of the juristic personality	The debtor's juristic personality continues to exist after the completion of the rehabilitation proceeding	The debtor ceases to exist as a company once the bankruptcy proceeding is completed

Workout procedure (comparison to rehabilitation proceedings)

Workouts differ from rehabilitation proceedings in the sense that they are directed and conducted by a person owing financial claims to the debtor, whereas rehabilitation proceedings are administered by the court. The DRBA defines 'financial claims' as claims that arise from a credit offering such as loans, promissory notes and sureties.

Debtors tend to prefer workouts to rehabilitation proceedings since they have less impact on the debtor's managerial rights in comparison to rehabilitation proceedings. Workouts can be a better means of restructuring than rehabilitation proceedings for debtors that must maintain the relationship of trust with their clients because the procedures do not affect business claims. Many shipbuilding and construction companies in financial difficulty have undergone workouts for this reason.

The comparison between workouts and rehabilitation proceedings (a restructuring insolvency procedure under the DRBA) is as follows:

	Rehabilitation proceeding	Workout
Supervising entity	The court	A council composed of financial creditors. The principal creditor bank represents the council and performs the actual supervisory work
Debtor subject to the proceeding	For both corporate and personal debtors	For both corporate and personal debtors
Person entitled to file a petition	The debtor, the creditors with a certain volume of claims, or shareholders with a certain shareholding ratio	The debtor
Right to manage the debtor's property	The court-appointed receiver has the right to manage and dispose of the debtor's property	The existing management continues to manage the debtor company. However, the debtor ordinarily enters into an agreement with the council of financial creditors, under which the council or the principal creditor bank may control the management of the debtor

	Rehabilitation proceeding	Workout
Scope of affected creditors	Business claims as well as financial claims	Financial claims only
Failure to declare claims	Undeclared claims are discharged after the rehabilitation plan is finalised	Undeclared claims are not discharged
Set-off right	Limited	Offsetting with financial claims is prohibited
Restructuring	Restructuring is decided by the meeting of interested parties and occurs as per the court-approved rehabilitation plan. The following conditions are the requirements for the approval of the meeting of interested parties: by a quorum of (i) three-quarters or more of the total amount of secured rehabilitation claims; (ii) two-thirds or more of the total amount of rehabilitation claims; and (iii) one-half or more of the total number of shares present at the meeting	Restructuring occurs in accordance with the decision of the council of financial creditors. The approval of the council of financial creditors require (i) the consent of financial creditors that own at least three-quarters of the total value of the financial claims, and (ii) the consent of financial creditors that own at least three-quarters of the secured claims

Restructuring under a voluntary workout accord

Restructuring that occurs in accordance with a voluntary workout accord is not governed by a specific law but by an agreement executed voluntarily by the debtor and the creditor.

In the past, restructuring based on a voluntary workout accord was not widely used when compared with insolvency proceedings under the DRBA or the CRPA. However, voluntary workout accords can virtually be the only means of restructuring for companies that expect to suffer a significant business loss when they enter the insolvency proceedings that operate under the DRBA or the CRPA. For instance, a container merchant ship corporation may not be fully protected by an insolvency proceeding that takes place in a particular country because of its worldwide business network. A notable example can be found in the case of *Hanjin Shipping*; the rehabilitation proceeding, which took place only recently, failed and the company was declared bankrupt.

There have been cases in Korea recently, wherein a company has successfully restructured debt through a voluntary accord. In the case of *Hyundai Merchant Marine*, the company undertook extensive negotiation with the creditors in July 2016 and resolved the urgent problem in management. *Hyundai Merchant Marine* stands out as a case in which the successful agreement of debt rescheduling with various types of creditors was the prerequisite for agreement with financial institution creditors. The debtor company agreed on individual debt rescheduling with charterage creditors and bondholders respectively, and thereafter successfully induced debt rescheduling for financial obligations. The *Hyundai Merchant Marine* case serves as an excellent precedent for other companies that seek to reschedule debt through voluntary accords. Daewoo Shipbuilding & Marine Engineering recently engaged in a similar type of debt rescheduling.

Cross-border insolvency

The DRBA has incorporated the UNCITRAL Model Law on Cross-border Insolvency.

A rehabilitation proceeding has universal effect, reaching beyond the borders of Korea. In order for a Korean rehabilitation proceeding to be effective in a foreign country, the receiver (as a representative of the Korean rehabilitation proceeding) may apply for recognition of the rehabilitation proceeding, as well as other necessary support. In practice, when rehabilitation proceedings have been commenced for shipping companies in Korea, many foreign countries have recognised

the Korean rehabilitation proceeding in order to preserve the debtor company's vessels and other assets.

Likewise, the representative of a foreign insolvency proceeding may file an application for recognition of the foreign insolvency proceeding with the Korean court, and ask the Korean court for relevant relief in order to preserve the debtor's assets in Korea.



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Chul Man Kim mainly practises in the areas of financial disputes and bankruptcy. Before joining Yulchon, he served as a judge at Seoul Southern District Court and Seoul District Court. He acquired extensive expertise in the area of bankruptcy as an adviser in bankruptcy proceedings of major conglomerates (Kia, Haitai, Halla, Jinro, Daewoo, etc) during the Asian financial crisis of 1997, and has since acted on a wide range of restructuring and insolvency works as a litigator. Recently, he has advised on a number of bankruptcy and rehabilitation proceedings, including the rehabilitation proceeding of country club operators such as Shilla, Castle Pine and Pine Creek.



Su Yeon Lee
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Su Yeon Lee mainly practises in the areas of bankruptcy, corporate, finance, and mergers and acquisitions. As a renowned adviser in the field of mergers and acquisitions, she has advised on the sale of a rehabilitation company, Pine Resort, and on the acquisition of a rehabilitation of Pan Ocean by Harim Consortium. She also advised on the voluntary agreement of *Hyundai Merchant Marine*.



Ki Young Kim
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Ki Young Kim mainly practises in the areas of bankruptcy, corporate, finance, and mergers and acquisitions. Since joining Yulchon in 1998, he has successfully advised on a wide range of restructuring and insolvency cases. As he is especially renowned for his extensive expertise in the area of out-of-court restructuring, he has advised on the voluntary agreement of *Hyundai Merchant Marine*, the workout of POSCO Plantec and the voluntary agreement of STX Corporation.



Sun Kyoung Kim
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Sun Kyoung Kim mainly practises in the areas of financial disputes and bankruptcy. Recently, he has performed the authorisation process for the resolution of the debenture holders' meeting for the voluntary agreement of *Hyundai Merchant Marine*, and advised Keangnam Enterprises and its subsidiaries on the rehabilitation proceeding and provided representation therein. Most notably, he also advised STX Pan Ocean on the rehabilitation proceeding and provided representation therein.



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Jin Seok Choi mainly practises in the areas of financial disputes and bankruptcy. With a remarkable breadth of practice, he has advised GS Caltex as a creditor in relation to the bankruptcy of Danish bunker supplier OW Bunker, and Hana Financial Investment on the dispute regarding the settlement of the liquidated over-the-counter derivatives with the bankruptcy administrator of Lehman Brothers.



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Yulchon's insolvency team comprises a number of attorneys specialising in bankruptcy, who have in-depth understanding of bankruptcy proceedings in general, which allows careful management and risk analyses, as well as experience accumulated over the years and by undertaking numerous cases. Knowledgeable in court customs, the direction of government policies, and the ways of various industries, the attorneys are capable of making decisions in multi-faceted situations to the satisfaction of creditors and debtors located in and outside Korea. The team includes attorneys with expertise in tax, finance and corporate laws, mergers and acquisitions, and real property, as well as accountants, attorneys licensed to practise in the US, and international arbitration specialists, providing clients with legal consultation that is meticulously custom-made for their needs. The team also has at its disposal bankruptcy experts who speak several languages, including English and Japanese, in order to accommodate foreign clients in bankruptcy cases that involve international issues.