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# KOREAN BANKRUPTCY LAW: THE HEAVY DUTY HYPOTHETICAL APPLIED\*

James L. Garrity, Jr.\*\* & Karen P. Ramdhanie\*\*\*

## I. INTRODUCTION

In Korea, a domestic company facing financial difficulties that cannot negotiate an agreement with its creditors has two options. Either it can file for bankruptcy under the Korean Bankruptcy Act ("BA") and thereby place its assets in the control of a court appointed receiver who will liquidate them, or it can file for reorganization under the Corporate Reorganization Act ("CRA").<sup>1</sup> A company is not assured relief under the CRA and that option is not particularly attractive to management because it is divested of control of the company in favor of a court appointed receiver who must promptly propose a reorganization plan. The reorganization process may also be expensive<sup>2</sup> and the viability of a given case is largely dependant upon secured and priority creditors cooperation.<sup>3</sup> Moreover, there is a stigma associated with filing a case under the BA or CRA. Nonetheless, we find that Heavy Duty likely would opt for relief under the CRA.

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1. Korean Corporate Reorganization Act, Law No. 1214, (1962), *amended by* Law No. 5380 (1981) & Law No. 3724, art. 23 (1984) [hereinafter CRA]; Ihpyo Hong, *A Comparative Study of American and Korean Corporate Reorganization Laws*, BUSINESS LAWS IN KOREA, 376, at 381 (Chan-Jin Kim ed., 1988).

2. For a discussion on the costs incurred during reorganization, see generally *infra* Parts III.B, Part IV.A.

3. *Id.*

## II. RELIEF FROM INDEBTEDNESS

### A. Bankruptcy

A company that is unable to pay its debts qualifies for relief under the BA.<sup>4</sup> The BA is effective only as to property.<sup>5</sup> Cases under the BA are commenced voluntarily by the debtor or involuntarily by creditors.<sup>6</sup> A director of the company or a liquidator may commence a voluntary case on the debtor's behalf under the BA.<sup>7</sup> Creditors may commence involuntary cases.<sup>8</sup> A petitioning creditor is not required to hold a particular amount of debt, however, it must provide prima facie proof of its claim and cause for commencing the case.<sup>9</sup> A company's failure to pay its debts is prima facie evidence of cause for relief under the BA.<sup>10</sup> Involuntary bankruptcy cases are rare.<sup>11</sup>

Upon the commencement of a case under the BA, management is divested of possession and control of the debtor's assets, the debtor ceases to operate and a court appointed receiver charged with the responsibility of liquidating the debtor's assets takes control of the debtor's property.<sup>12</sup> A case under the BA ends when the debtor's assets have been liquidated and the proceeds distributed to creditors,<sup>13</sup> the creditors unanimously agree to end the case,<sup>14</sup> or when the cost of the bankruptcy have exceeded the value of the estate.<sup>15</sup> Distributions to creditors are governed by statutory priorities. The receiver's expenses are paid up front.

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4. Bankruptcy Act, Law No. 998, art. 116 (1962), *amended by* Law No. 4472 (1991) [hereinafter BA].

5. *Id.* art. 3.

6. *Id.* art. 122(1).

7. *Id.* art.123.

8. *Id.* art.122(1).

9. *Id.* art.122(2).

10. *Id.* art.116(2); *See also* KLYNVELD PEAT MARWICK GOERDELER, INTERNATIONAL INSOLVENCY PROCEDURES 189 (1988) [hereinafter KPMG].

11. KPMG at 190 (stating that only the directors of a company may apply for bankruptcy proceedings).

12. CRA art. 23.

13. MARTINDALE-HUBBELL LAW DIGEST, Republic of Korea, Kor-2 (1996) [hearinafter MHL].

14. BA art. 319(1).

15. *Id.* arts. 135(1) & 325(1); MHL *supra* note 13, at Kor-2 (1996).

### B. Reorganization

Relief under the CRA is available only to stock companies. A debtor is eligible for relief under the CRA if it is unable to pay its debts yet is able to continue in business, or if the conditions of bankruptcy exist.<sup>16</sup> The latter includes the debtor's inability to pay its debts.<sup>17</sup> "Conditions of bankruptcy" are present where the debtor either has ceased to pay its debts in the ordinary course of business,<sup>18</sup> or it is unable to pay debts when they become due.<sup>19</sup>

A shareholder holding at least 10% of the company's total shares may commence a case under the CRA on behalf of the company, provided the company is otherwise eligible for relief under the statute.<sup>20</sup> Similarly, creditor(s) with claims equal to at least 10% of the company's capital may file an involuntary case against a debtor under the CRA, provided the company is otherwise eligible for relief under the statute.<sup>21</sup> A petitioning creditor must make a prima facie showing that it is eligible to file the petition and that the requisite condition of bankruptcy exists.<sup>22</sup> Large creditors have standing to object to involuntary petitions.<sup>23</sup> The court will seriously consider the creditor's objections, but may not reject the petition.<sup>24</sup> Instead, the court<sup>25</sup> can limit the injunction against creditors seeking to satisfy their rights to assets.<sup>26</sup> A petitioning creditor may appeal any unfavorable court decision concerning the reorganization proceeding.<sup>27</sup>

Before relief under the CRA is granted, a debtor must show that it can reorganize its business and that the creditors and shareholders will probably consent.<sup>28</sup> If the court is not persuaded it will order the debtor liquidated

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16. CRA art. 30(1); Hong, *supra* note 1, at 381; KPMG, *supra* note 10, at 189.

17. BA arts. 116 & 117.

18. KPMG, *supra* note 10, at 189.

19. *Id.* at 190.

20. CRA arts. 30(1) & 30(2).

21. *Id.*

22. *Id.* art. 33(1).

23. Hong, *supra* note 1, at 382.

24. *Id.*

25. There is no specialized bankruptcy court in Korea. Cases under the CRA are commenced in Korea's District Court. See *infra* part III, sec. A.

26. *Id.*

27. CRA art. 50(1).

28. Hong, *supra* note 1, at 382.

under the BA or convert the case to a composition proceeding.<sup>29</sup> Thus, the court, not the petitioner, determines the proper relief for the debtor company.<sup>30</sup> Among other factors, the court will consider the size and type of business conducted by the debtor,<sup>31</sup> and whether there is a public demand for the debtor's products.<sup>32</sup> The court can appoint one or more Investigation Commissioners to assist in determining whether a company is entitled to relief under the CRA.<sup>33</sup> If the court grants the petition, it issues a number of administrative orders<sup>34</sup> and appoints a receiver who must propose a reorganization plan within two months.<sup>35</sup> The reorganization proceeding is terminated if the draft reorganization plan is not timely submitted to creditors.<sup>36</sup> The court may discontinue the proceedings if the Receiver or the debtor company applies for a discontinuation of the proceedings because it is clear that the company is able to make complete payment to all reorganization creditors,<sup>37</sup> or if the court or the Receiver applies for a discontinuation of the proceedings because it is clear that the approved plan will fail.<sup>38</sup>

### C. Heavy Duty

A family owned company such as Heavy Duty would first approach its creditors in an attempt to negotiate more favorable terms of credit. Failing this attempt at easing its financial burdens, Heavy Duty would then consider a reorganization of its business practices. The directors of Heavy Duty would wish to avoid filing for bankruptcy because the economic and social repercussions to the company and its directors are severe under the BA. As a consequence of filing for bankruptcy, a Korean company can be labelled bankrupt for ten years before it is reinstated as a viable enterprise. Finally, the family members, directors and managers of Heavy Duty may

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29. See *infra* Part III, sec. A.

30. Hong, *supra* note 1, at 382.

31. *Id.* at 382.

32. *Id.* at 382 (operating statements and other evidence of company's fundamental worth must be presented).

33. See *infra* Part III, sec. B.

34. Those include without limitation, a bar date order and a date for the first meeting of interested persons.

35. See *infra* Part III, sec. C.

36. CRA art. 272(1).

37. *Id.* art. 273(1).

38. *Id.* art. 276.

want to avoid the stigma of having a family owned business being adjudicated bankrupt.<sup>39</sup> Therefore, Heavy Duty will likely opt for relief under the CRA.

### III. THE PLAYERS IN A KOREAN REORGANIZATION PROCEEDING

The following parties commonly appear in the reorganization process: the Court, the Investigation Commissioner(s),<sup>40</sup> the Receiver(s),<sup>41</sup> and the Creditors' committee/Inspection Commissioners. The debtor, however, does not play a part in the process once a Receiver is appointed.<sup>42</sup>

#### A. *The Court*

Petitions commencing cases under the CRA are filed in the District Court. It is not a specialized court. Upon receipt of a CRA petition, the court will preserve the assets of the company by issuing an order similar in scope to the automatic stay of § 362 of the United States Bankruptcy Code,<sup>43</sup> and/or it may appoint one or more Investigation Commissioners to investigate the cause for reorganization.<sup>44</sup> The District Court where the principal office of the company is located or, if the principal office is located abroad, where the company's principal place of business in Korea is located, has jurisdiction over the reorganization case.<sup>45</sup>

If the court approves the reorganization petition, it will simultaneously appoint a Receiver,<sup>46</sup> order a report of claims,<sup>47</sup> set the timeframe for filing claims,<sup>48</sup> set the date for the first meeting of interested persons,<sup>49</sup> and set

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39. See *BA supra* note 4 & accompanying text.

40. CRA art. 40.

41. *Id.* art. 94.

42. *Id.* art. 53(1) (providing that receiver has exclusive control over assets of company).

43. CRA arts. 37, 39, 67; KPMG, *supra* note 10, at 190 (Preserving the assets of the company is similar to the US automatic stay: no payment; no compulsory executions; no auction sales of assets; and no provisional attachments, unless authorized by the court).

44. CRA art. 40.

45. *Id.* art. 6(1).

46. *Id.* arts. 46 & 94; Hong, *supra* note 1, at 383; KPMG *supra* note 10 at 190.

47. CRA art. 46(1); Hong, *supra* note 1, at 382.

48. CRA art. 273(1).

49. *Id.*

the date on which to investigate all claims.<sup>50</sup> The Court also will authorize the Receiver to draft the reorganization plan.<sup>51</sup> The reorganization plan should show the names of creditors, the amount owed to each creditor, the repayment period for each debt, other details of obligations, and the interest rates.<sup>52</sup>

Even if the court allows a reorganization proceeding to begin, it may dismiss the proceeding or disapprove of the reorganization plan if it believes that there is no chance of rehabilitation or that the petition was not filed in good faith.<sup>53</sup> If the court dismisses the reorganization proceeding, the debtor may be declared bankrupt.<sup>54</sup> The court may also convert a reorganization proceeding into a composition proceeding.<sup>55</sup>

### *B. Investigation Commissioner*

The Investigation Commissioner investigates the reasons for reorganization, the existence or non-existence of the causes as outlined in the CRA, art 38, sections 2-7; the state of the business and the assets of the company; the necessity for preservative measures; and other matters related to the reorganization.<sup>56</sup> He is appointed by the court and necessarily performs his duties before the court authorizes a reorganization case to go forward.<sup>57</sup> The Investigation Commissioner may demand reports from the debtors' directors, auditors, managers and employees, and has broad authority to examine the debtor's books, financial records and other documents.<sup>58</sup> The Investigation Commissioner may appoint appraisers,<sup>59</sup> or receive assistance from bailiff(s), if necessary.<sup>60</sup> The Investigation Commissioner will report to the court on the feasibility of the proposed

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50. *Id.*

51. KPMG, *supra* note 10, at 190.

52. *Id.* at 191.

53. CRA art. 38; Hong, *supra* note 1, at 382.

54. CRA art. 23(1).

55. *Id.* art. 27.

56. *Id.* art. 40.

57. *Id.* arts. 40-44.

58. *Id.* art. 41(1).

59. *Id.* art. 41(2).

60. *Id.* art. 41(3).

reorganization.<sup>61</sup> The duties of the Investigation Commissioner end with the commencement of the reorganization proceedings.<sup>62</sup>

An Investigation Commissioner is a disinterested person possessing knowledge and experience relevant to the business of the company that is the subject of the CRA case.<sup>63</sup> The court fixes his compensation based on the duties and responsibilities involved.<sup>64</sup> His expenses are paid in advance.<sup>65</sup> Investigation Commissioners can be held jointly and severally liable for losses if they fail to exercise care in performing their duty.<sup>66</sup>

It is very likely that because Heavy Duty is a family-owned business that the court will appoint one or more Investigation Commissioner(s) to review its causes for reorganization. After receiving the Investigation Commissioner's opinion, the court will decide whether to approve the commencement of the reorganization proceeding. Assuming it does, the court will appoint one or more Receiver(s). Where there are more than one Receiver, one of the Receivers may be a member of Heavy Duty.

### C. Receiver

A Receiver is appointed after the court approves the commencement of the reorganization proceeding.<sup>67</sup> The Receiver prepares the reorganization plan<sup>68</sup> and must submit it to court within two months of his appointment.<sup>69</sup> To do so, the Receiver may obtain reports of creditors' claims and obligations from the Investigation Commissioner(s).<sup>70</sup> The Receiver may also demand reports from the debtor's directors, auditors, managers and employees, and may examine the books, documents, monies and other things of the company.<sup>71</sup> With court permission, the Receiver may dispose of assets, take transfer of property, obtain loans,<sup>72</sup> take legal action, settle, relinquish rights, approve claims of common benefits and

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61. Hong, *supra* note 1, at 383.

62. *Id.*

63. CRA art. 40(2).

64. *Id.* arts. 284(1) & (2).

65. *Id.* art. 284(1).

66. *Id.* art. 43(2).

67. *Id.* arts. 41-44, 101 (articles 41 through 44 apply to receivers).

68. *Id.* art. 189.

69. KPMG, *supra* note 10, at 190.

70. CRA art. 189.

71. *Id.* art. 41.

72. *Id.* art. 103.



rights to redeem,<sup>73</sup> recover property, and rescind contracts.<sup>74</sup> The Receiver, however, may not reduce capital, issue new shares or debentures, merge or consolidate company, distribute profits or revise the articles of incorporation.<sup>75</sup>

The court will select the Receiver<sup>76</sup> and will determine the Receiver's remuneration,<sup>77</sup> based on the duties and responsibilities involved.<sup>78</sup> Furthermore, the Receiver's expenses are paid in advance.<sup>79</sup> Where there are several Receivers, one may be an interested party, even a director of the debtor.<sup>80</sup> The Receivers may either perform their duties conjointly, or they may be assigned specific responsibilities.<sup>81</sup> Trust Companies and Banks may be appointed as Receivers.<sup>82</sup>

Once a Receiver is appointed, the family members of Heavy Duty will no longer be in control of the company.<sup>83</sup> The Receiver will have exclusive control over the assets of and claims against Heavy Duty.<sup>84</sup> In Korea, however, there are no provisions for tort claims in either bankruptcy proceeding or reorganization proceeding.<sup>85</sup> Therefore, while the Receiver in this case may rescind the lease with City of Hope,<sup>86</sup> it may prefer not to do so because it would have to incur the cost of building a new manufacturing plant.

#### *D. Creditors' Committee*

The Creditors' Committee must first approve the reorganization plan.<sup>87</sup> The reorganization creditors, reorganization security holders, shareholders,

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73. *Id.* art. 54.

74. *Id.* art. 78; Hong, *supra* note 1, at 385.

75. CRA art. 52(1).

76. *Id.* art. 94.

77. *Id.* art. 284(1).

78. *Id.* art. 284(2)

79. *Id.* art. 284(1).

80. Hong, *supra* note 1, at 385.

81. CRA art. 97.

82. *Id.* art. 95; Hong, *supra* note 1, at 385.

83. CRA art. 53(1).

84. *Id.*

85. SANG HYUN SONG, INTRODUCTION TO THE LAW AND LEGAL SYSTEM OF KOREA 925 (1984).

86. CRA art. 103.

87. KPMG, *supra* note 10, at 190.

and agent commissioners who have contributed to the reorganization may be compensated for expenses out of the assets of the company.<sup>88</sup>

#### IV. PRIORITY AMONG CREDITORS

The CRA gives priority to claims in the following order: (a) claims of common benefits,<sup>89</sup> (b) reorganization security rights, (c) reorganization claims with general preferential rights, (d) other reorganization claims,<sup>90</sup> (e) deferred reorganization claims,<sup>91</sup> and (f) shareholders' residual claims.<sup>92</sup>

##### A. *Claims of Common Benefits*

Claims of common benefits generally are paid prior to all other claims<sup>93</sup> and outside the reorganization process. They include the cost of the judicial proceedings, the management cost after the commencement of the reorganization proceeding, the cost of executing the reorganization plan, all employees compensation and retirement allowances, all monies owed to financial institutions lending after commencement of reorganization, all payments for the services of the Investigating Commissioner(s), the Receiver(s) and other court appointed persons,<sup>94</sup> and all current tax claims.<sup>95</sup> The \$2.5m claim of Heavy Duty's retired employees is a claim of common benefits.<sup>96</sup> Heavy Duty must pay that expense and other costs of the reorganization proceeding in advance.<sup>97</sup> If it cannot do so, the court can dismiss the case.<sup>98</sup>

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88. CRA arts. 284 & 286.

89. *Id.* arts. 208 & 209; Hong, *supra* note 1, at 385; KPMG, *supra* note 10, at 191.

90. CRA arts. 159 & 228.

91. *Id.* art. 121.

92. *Id.* arts. 159 & 228.

93. *Id.* art. 209(1),(2).

94. *Id.* arts. 208, 284, 286.

95. *Id.* arts. 208, 209; Hong, *supra* note 1, at 386; KPMG at 191.

96. *Id.* art. 208.

97. *Id.* art. 34(1).

98. *Id.* art. 38.

### *B. Reorganization Security Rights*

Reorganization security holders entitled to second priority status,<sup>99</sup> include those with security interests in the building and equipment of the debtor.<sup>100</sup> In this case, the bankers have security rights in the office building, physical plant and the equipment. They are secured only to the value of the collateral and unsecured for amounts exceeding the value of the collateral.<sup>101</sup>

### *C. Reorganization Claims With General Preferential Right*

Reorganization claimants with general preference rights or other general priority rights are<sup>102</sup> secured up to the value of their collateral and are unsecured creditors for any deficiency.<sup>103</sup>

### *D. Other Reorganization Claims*

Other reorganization claims<sup>104</sup> include reorganization creditors without prior claims or without deferred claims (unsecured creditors),<sup>105</sup> and tax claims.<sup>106</sup> Unsecured creditors' claims are subject to the reorganization plan.<sup>107</sup> However, if Heavy Duty's reorganization threatens small or medium sized creditors with financial ruin of their own, the court may direct that Heavy Duty pay their claims outside of the reorganization plan.<sup>108</sup> In deciding whether that relief is appropriate, the court will consider the transaction between Heavy Duty and the creditor, the financial condition of the creditor, the interest of others, and all other relevant circumstances.<sup>109</sup>

Tax claims are given special protection in a reorganization plan.<sup>110</sup>

99. *Id.* arts. 159, 228.

100. *See generally Id.* art. 106; Hong, *supra* note 1, at 386.

101. *Id.* art. 124(2).

102. *Id.* art. 159 [the CRA does not define reorganization claimants with general preference rights.]

103. *Id.* art. 124.

104. *Id.* art. 228.

105. *Id.* arts. 121, 159; Hong, *supra* note 1, at 386.

106. *Id.* art. 122.

107. *Id.* arts. 21, 124, 125, 159, 228.

108. *Id.* art. 112-2(1).

109. *Id.* art. 112-2(2).

110. *Id.* art. 122; Hong, *supra* note 1 at 386-87. In contrast, under the Bankruptcy Act,

The Receiver must consult the tax collector if the reorganization plan proposes a postponement of tax payments for less than one year, and the Receiver must get the tax collector's consent to postpone tax payments for more than one year, or to reduce or exempt payments.<sup>111</sup>

Therefore, Heavy Duty's \$1m tax liability will not be given preferential treatment in the reorganization procedure.<sup>112</sup> The Receiver may suspend the collection of Heavy Duty's tax for one year, once the tax collector is consulted.<sup>113</sup> The Receiver may petition the court to suspend the collection of Heavy Duty's taxes for more than one year, but the tax collector must consent.<sup>114</sup> Also, the court may, on its own accord or on the Receiver's petition, make the tax claim an unsecured reorganization claim subject to the reorganization plan.<sup>115</sup>

### *E. Deferred Reorganization Claims*

Reorganization creditors with deferred claims<sup>116</sup> are mainly those with claims from interest accrued after commencement of the reorganization proceeding, damages, or penalties for the debtor's failure to perform contracts, expenses for participating in the reorganization procedure, claims arising after commencement of the reorganization proceeding that are not claims of common benefits and fines.<sup>117</sup>

Heavy Duty's reorganization creditors with deferred claims will be the City of Hope for damages due to Heavy Duty's rescission of the lease, the creditors for the expenses incurred from participating in the reorganization procedure, and the bankers and creditors for interest accrued after the commencement of the reorganization procedure.

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tax claims enjoy preferential status. *Id.* at 386.

111. CRA art. 122; Hong, *supra* note 1, at 386-87.

112. CRA art 122; Young-Moo Kim & Chang-Rok Woo, *A Brief Survey of Korean Corporate Liquidation & Bankruptcy Law*, in BUSINESS LAWS IN KOREA 418 (Chan-Jin Kim ed., 1990).

113. CRA arts. 122.

114. *Id.* arts. 67(3), (4), 122.

115. *Id.* art. 67(3).

116. *Id.* art. 121.

117. *Id.*

### *F. Shareholders*

Shareholders are the residual claimants of the debtor's assets.<sup>118</sup> Heavy Duty's shareholders, however, are unlikely to receive anything after the distribution of assets to the secured and unsecured creditors.

The priority of claims system may be considered fair because it treats all creditors equally, according to their class. It is also designed to satisfy the claims of creditors before the claims of shareholders. The priority of claims system, however, may not be efficient because it requires the consent of all security holders before the debtor could reduce its obligations in the reorganization plan. Therefore, Heavy Duty must obtain the consent of all its security holders before the reorganization plan could be approved. Since, there is no distinction made between large and small security holders, even a small security holder may be able to thwart Heavy Duty's reorganization plan.<sup>119</sup>

## V. TREATMENT OF SECURED CREDITORS IN REORGANIZATION AND BANKRUPTCY

Secured creditors may participate in the reorganization procedure.<sup>120</sup> The secured creditor remains secured up to the value of the asset, and is given an unsecured deficiency claim for amounts exceeding the value of the asset.<sup>121</sup> Secured creditors must file claims with the Court within a specified timeframe.<sup>122</sup> In some instances, the secured creditor may request a one month extension,<sup>123</sup> but its claims must be filed before creditors meet to examine the draft reorganization plan.<sup>124</sup> In filing its claims, the secured creditor must submit evidence of the claim.<sup>125</sup>

Secured creditors may form a group for preparing and adopting the resolutions of the draft reorganization plan.<sup>126</sup> This group of secured creditors, however, cannot include reorganization creditors (unsecured

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118. *Id.* arts. 159, 228.

119. Hong, *supra* note 1, at 387 (noting that shareholder has the right to participate in reorganization proceeding).

120. CRA art. 124(1); Hong, *supra* note 1, at 386.

121. CRA art. 124(2).

122. CRA art. 126.

123. CRA art. 127(1).

124. CRA art. 127(3).

125. CRA art. 126.

126. CRA art. 159(1).

creditors) or shareholders.<sup>127</sup> Additionally, secured creditors may appoint one or several Agent Commissioner(s) to act on their behalf.<sup>128</sup>

A secured creditor has voting rights in proportion to the amount of the value of the underlying assets to which its security interest is attached.<sup>129</sup> In the case where the secured right is less than value of the assets, the secured creditor's voting right is in proportion to amount of the secured claim.<sup>130</sup> An additional protection given to the secured creditor is that three-fourths or more of the secured creditors have to vote on any reorganization plan which proposes the postponement of payment of their security rights.<sup>131</sup> Furthermore, in Korea, unlike in the United States, all security holders must vote on a reorganization plan which proposes to reduce or exempt their security rights.<sup>132</sup>

Thus, in reorganization, Heavy Duty's secured creditors would remain secured up to the value of the office, the plant and the equipment, but they may be undersecured. Heavy Duty's banks and suppliers are owed \$5m and \$3m respectively. Heavy Duty's equipment, however, has a book value of \$2m, but its market value would be less because of its age. Also, Heavy Duty's plant has a book value of \$3m, but is worth less because of its decaying condition. Therefore, Heavy Duty's main secured creditors may be undersecured.

In a bankruptcy proceedings, however, Heavy Duty's secured creditors would be treated differently. In Korea, there are six categories of claims in a bankruptcy proceeding, namely, preference claims, secured claims, fund claims, claims given preference under other statutes, general creditors obligations and less preferred claims.<sup>133</sup> First, preference claim status would be given to any tax claim if the mortgage on the company's plant and building was established less than one year prior to the due date of the tax.<sup>134</sup> If the mortgage were established more than one year prior to the due date of the tax liability then the mortgage claim will be given preference over the tax claim.<sup>135</sup> Therefore, unlike in a reorganization

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127. CRA art. 159(2).

128. CRA art. 160.

129. *See Id.* art. 124(1), (3); Hong, *supra* note 1, at 388.

130. CRA art. 124(3).

131. *Id.* art. 205.

132. *Id.*

133. *See* BA art. 35; Kim & Woo, *supra* note 112, at 426-27.

134. Kim & Woo, *supra* note 112, at 426-27.

135. *Id.*

proceeding, Heavy duty's tax claim of \$1m will be a preferential claim in a bankruptcy proceeding.

Second, a creditor's secured claims which is secured by a pledge or by a mortgage is given a right of separation that is exercisable outside of the bankruptcy proceedings.<sup>136</sup> If the debt exceeds the asset, the balance owed becomes a general obligation of the debtor.<sup>137</sup> Therefore, Heavy Duty's mortgagee of the office may exercise its rights outside of bankruptcy proceedings. Third, fund claims will include the costs of the judicial proceedings, the tax claims, the expenses in managing bankrupt estate, the claims arising from acts of the Receiver in managing the estate, and the claims for the performance of contracts.<sup>138</sup> Fourth, claims given preference under other statutes would be claims such as wages.<sup>139</sup> Fifth, claims of general creditors obligations are claims where creditors may offset amounts owed to the bankrupt,<sup>140</sup> or the shareholders may share equally with the other general creditors.<sup>141</sup> Finally, less preferred claims are claims such as the interest accrued after adjudication of bankruptcy, the damages and penalties for non-performance of contracts, the costs of participating in bankruptcy, and any fines.<sup>142</sup>

## VI. PERSONAL LIABILITY FOR MANAGERS AND DIRECTORS

Under the BA, management surrenders control of the bankruptcy when the case is commenced in favor of a Receiver who manages the company. Before management is reinstated the bankrupt must repay all creditors, obtain a judicial discharge of its debts, or wait ten years.<sup>143</sup> Directors can be held personally liable for fraud and sanctioned by fines or imprisonment.<sup>144</sup> Also, their movement may be restricted and court may have custody of their persons.<sup>145</sup>

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136. BA arts. 84-88; Kim & Woo, *supra* note 112, at 426; Song, *supra*, note 85, at 923.

137. Kim & Woo, *supra* note 112, at 426-27.

138. BA art. 38.

139. Kim & Woo, *supra* note 112, at 426-27.

140. BA arts. 89, 95; Kim & Woo, *supra* note 112, at 426.

141. Kim & Woo, *supra* note 112, at 426.

142. *See* BA art. 37.

143. *See* BA arts. 358, 359; MHL, *supra* note 13.

144. *See* BA art. 374; Kim & Woo, *supra* note 112, at 428.

145. BA art. 137, 138; Kim & Woo, *supra* note 112, at 428.

Under the CRA, the company's directors are not automatically removed from their positions with the filing of the reorganization petition.<sup>146</sup> Once appointed, the Receiver will assume full control of the debtor company.<sup>147</sup> Directors or auditors who remain in office shall have their term of office specified, but it would not exceed one year.<sup>148</sup> Additionally, directors of a company in reorganization face no personal liability or professional penalties. If, however, the reorganization were caused by acts of the directors or the auditors, they can be removed from office.<sup>149</sup> Directors or auditors who resigned at the commencement of the reorganization proceedings are not eligible for re-election after the proceeding.<sup>150</sup>

## VII. CONCLUSION

It appears that a reorganization proceeding in Korea is similar in general structure and features to a reorganization proceeding in the United States. There are however, two striking differences between the two countries. First, in Korea, all creditors, regardless of size, must approve the reorganization plan. Second, in Korea the perception continues that bankruptcy and, to a lesser extent, reorganization are socially unacceptable. Even given these differences, Heavy Duty will probably choose to reorganize under the laws of both countries and the outcomes may be quite similar.

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146. See Hong, *supra* note 1, at 385.

147. See CRA art. 53(1).

148. *Id.* arts. 220(2), (4).

149. See *Id.* art. 220(2).

150. See *Id.* art. 271-2; KPMG, *supra* note 10, at 191.



