SOUTH KOREA

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Doing business with companies undergoing corporate restructuring

By Susan Park

In the aftermath of the Asian financial crisis in the late '90s, many Korean companies in financial distress underwent corporate restructuring. In particular, corporate restructuring in Korea has been facilitated by the introduction of the Corporate Restructuring Promotion Act (CRPA). The CRPA has been in effect from time to time since 2001, and the current version of the Act will remain in effect until December 31, 2013. The main advantage of a CRPA workout is that it may be initiated with the consent of creditor financial institutions representing at least 75 percent of the total outstanding credit of the distressed company – as opposed to 100 percent of the total outstanding credit required under a non-CRPA workout.

Unlike under the previous CRPA which allowed the creditor financial institutions to unilaterally commence workout proceedings irrespective of the subject company's intent, the current CRPA requires that the workout be initiated only upon the distressed company's request to its main creditor bank. In addition, the current CRPA allows the distressed company to request its main creditor bank to file an application for mediation to the creditor financial institution mediation committee to expedite the preparation of a plan for rescheduling of claims or provision of new credit. Further, under the current CRPA, a creditor financial institution opposed to the workout may request the creditor financial institutions in favour of the workout to jointly purchase its claims against the distressed company within six months of receipt of such request.

From the perspective of a foreign client negotiating a business contract with a Korean counterpart undergoing a financial workout, the mere fact that the counterparty is in a financial restructuring often raises concerns about the counterparty's solvency and, therefore, presents uncertainty with respect to such Korean company's contractual rights and obligations. Of particular concern for many foreign clients in such a case is whether the contract which is executed while the Korean company was under a financial workout could potentially be avoided (i.e., set aside) in the event of such company's bankruptcy.

Under the Debtor Rehabilitation and Bankruptcy Act, the types of voidable acts in a potential bankruptcy include:

- any act the debtor undertakes with the knowledge that it would prejudice creditors;
- payments made after the suspension of payment or the filing of a bankruptcy petition;
- any creation of a security interest in the debtor or any discharge of an obligation of the debtor where both the (a) creation or discharge takes place 60 days before or after the bankruptcy filing and (b) the debtor was not obligated to create the security interest or discharge the obligation within that period; and
- any gratuitous act (i.e., a grant of a gift) taking place after or within 6 months before the bankruptcy filing.

Of the foregoing types of voidable acts, the issue of whether the particular transaction prejudices creditors is often most relevant in the context of a general business transaction. In determining the existence of any prejudice to creditors, the factors such as whether the contract represents a fair arm's length dealing between the parties, whether the contract terms are fair as compared with the parties' other similar contracts with third parties, as well as the necessity of the contract for the Korean counterpart's business, are considered. As such, absent finding of a clear prejudice to creditors, the chances of a contract being rendered voidable upon a bankruptcy filing are relatively low.

Moreover, given the added uncertainty surrounding the outcome of a financial workout, a business contract entered into with a company undergoing a financial workout should include an express anti-assignment clause in anticipation of a potential change of control or transfer of business following the termination of the financial workout.

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