

# The Hotchpot Rule in Korean Insolvency Proceedings\*

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## Abstract

A new consolidated insolvency law called the “Debtor Rehabilitation and Bankruptcy Law” (“DRBL”), which became effective in the Republic of Korea on April 1, 2006, has discarded the principle of territoriality under the previous insolvency laws and adopted the so-called modified principle of universality. At least for the purpose of Korean laws and Korean insolvency proceedings, therefore, the effect of an insolvency proceeding which has commenced in Korea would have effect on the debtor’s assets situated in a foreign country. However, whether and to what extent a Korean insolvency proceeding would be recognized and enforced in a foreign country, in which the debtor’s assets are situated, depends upon the laws of that foreign country. If the recognition or enforcement of a Korean insolvency proceeding is wholly or partially denied by that foreign country, what measures could be taken in a Korean insolvency proceeding in order to achieve, as much as possible, the equality of payments between a creditor who received payment outside of Korea and other creditors who receive payments in a Korean insolvency proceeding? One such measure would be to apply the rule of payment adjustment newly established under Article 642 of the DRBL, which is similar to the hotchpot rule embodied in Article 32 of the Model Law. Article 642 of the DRBL primarily addresses payment made to a creditor out of a concurrent foreign proceeding and attempts to adjust payment to be made to such creditor in a Korean insolvency proceeding after taking into account the amount of such payment made abroad to the same creditor. As the hotchpot rule incorporated in Article 642 of the DRBL is rather new in Korea, there are not yet any court cases or established court practices at this juncture. Scholarly discussions are just beginning. Thus, this article attempts to identify issues which will likely arise in connection with the application of Article 642 of the DRBL and presents the author’s analyses and observations. One of the most notable observations of the author in this article is that despite the lack of a clear statutory provision, payment recovered from collateral situated outside of Korea, particularly in the case of Chapter 2 rehabilitation proceedings of the DRBL which are similar to Chapter 11 proceedings of the U.S. Bankruptcy

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\* This Article has been prepared based on the author’s existing article written in Korean, *International Finance and Cross-Border Insolvency (2) - Concerning the Hotchpot Rule*, 28 BFL (Center for Financial Law of Seoul National University, March 2008). This Article, however, has added certain new sections and reorganized and refined the discussions in said article while the existing observations and views of the author are maintained.

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*Code, should not be prejudiced by Article 642 of the DRBL. In addition, in the author's view, as Article 642 of the DRBL does not address payment made out of the debtor's overseas assets where there is no concurrent foreign insolvency proceeding, it is necessary to establish and apply another rule based on the theory of unjust enrichment – i.e., disgorgement of such payment back to the insolvency estate of the Korean insolvency proceeding – in order to achieve equality of payments within a Korean insolvency proceeding vis-à-vis other creditors of the same class and ranking in the Korean insolvency proceeding.*

## I. Introduction

A new consolidated insolvency law called the “Debtor Rehabilitation and Bankruptcy Law” (“DRBL”) became effective in the Republic of Korea (“Korea”) on April 1, 2006. In line with the international efforts for harmonization of cross-border insolvency regime, the DRBL has discarded the principle of territoriality under the previous insolvency laws and adopted the so-called modified principle of universality.<sup>1)</sup> It is understood that the DRBL has adopted the UNCITRAL Model Law on Cross-Border Insolvency (the “Model Law”).<sup>2)</sup>

As the DRBL has removed the provisions of the previous insolvency laws which declared a principle of territoriality,<sup>3)</sup> at least for the purpose of Korean laws and Korean insolvency proceedings, the effect of an insolvency proceeding which has commenced in Korea would have effect on the debtor's

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1) For this purpose, in addition to the removal of the provisions of the previous insolvency laws declaring a strict principle of territoriality, the DRBL newly established provisions of Chapter 5, which apply: in cases where: (i) a representative of a foreign insolvency proceeding seeks a Korean court for recognition of the foreign insolvency proceeding and relief in connection therewith; (ii) a representative of a foreign insolvency proceeding submits a petition to a Korean court for a domestic insolvency proceeding or participates in a pending domestic insolvency proceeding; (iii) a receiver, bankruptcy trustee, debtor or any other person approved by a Korean court acts in a foreign country in connection with a domestic insolvency proceeding by participating in the proceedings of a foreign court, seeking recognition or relief of a foreign court, etc.; and (iv) cooperation is needed between the proceedings as domestic and foreign insolvency proceedings are proceeded concurrently in Korea and a foreign county. See Article 629① of the DRBL.

2) See SOOGEUN OH, *INSOLVENCY LAW REFORM 1998-2007*, 284-86 (Doosol 2007) (in Korean). The website of UNICTRAL provides a list of the States, including Korea, which have adopted legislation based on the Model Law. See “[http://www.uncitral.org/uncitral/en/uncitral\\_texts/insolvency/1997\\_Model\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997_Model_status.html)”

3) See, e.g., Article 4 of the previous Corporate Reorganization Law and Article 3 of the previous Bankruptcy Law.

assets situated in a foreign country.<sup>4)</sup> Whether and to what extent a Korean insolvency proceeding would, in fact, be recognized and enforced in a foreign country in which the debtor's assets are situated depends upon the laws of that foreign country. In this connection, Article 640 of the DRBL, which followed Article 5 of the Model Law, provides that a receiver, bankruptcy trustee or any other person approved by the court is authorized to act in a foreign country on behalf a domestic insolvency proceeding as permitted by the applicable foreign laws. Thus, upon commencement of an insolvency proceeding in Korea, a representative of a Korean insolvency proceeding may petition a foreign court for recognition and enforcement of a Korean insolvency proceeding in the foreign country in which the debtor's assets are situated based on the authority granted under the above Article 640 of the DRBL. If a foreign court recognizes and enforces a Korean insolvency proceeding, payment out of the debtor's assets situated in a foreign country would be directly subject to, and governed by the Korean insolvency proceeding to the extent recognized and enforced by the foreign court. If, however, such recognition or enforcement of a Korean insolvency proceeding is wholly or partially denied by the foreign country in which the debtor's assets are situated, or if the attempt for such recognition or enforcement is deemed unnecessary by a representative of a Korean insolvency proceeding due to time, costs or any other reason, what measures could be taken in a Korean insolvency proceeding in order to achieve, as much as possible, the equality of payments between a creditor who received payment outside of Korea and other creditors who receive payments in a Korean insolvency proceeding?

One such measure would be the rule of payment adjustment under Article 642 of the DRBL, which employs the so-called hotchpot rule embodied in Article 32 of the Model Law. Article 642 of the DRBL primarily addresses payment made to a creditor out of a concurrent foreign proceeding and attempts to adjust the payment to be made to such creditor in a Korean insolvency proceeding after taking into account the amount of such payment

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4) Kwang Hyun Suk, *Cross-Border Insolvency under the Debtor Rehabilitation and Bankruptcy Law (Consolidated Insolvency Law) of Korea*, 15-2 KOREA FORUM ON INTERNATIONAL TRADE AND BUSINESS LAW 363-64 (Korea International Trade Law Association 2006) (in Korean); CHEE YONG LIM, *STUDY ON BANKRUPTCY LAW* 2, 311 (Pak Young Sa 2006) (in Korean).

made abroad to the same creditor. As such, pursuant to Article 642 of the DRBL, an outward-bound effect of a Korean insolvency proceeding could be indirectly achieved, but to a limited extent. As the hotchpot rule as incorporated in Article 642 of the DRBL is rather new in Korea, there are not yet any court cases or established court practices at this juncture. Scholarly discussions are just beginning. Thus, this article attempts to identify the issues which will likely arise in connection with the application of Article 642 of the DRBL and present the author's analyses and observations. In addition, in the author's view, as Article 642 of the DRBL does not address payment made out of the debtor's overseas assets where there is no concurrent foreign insolvency proceeding, it is necessary to establish another rule which addresses payment made out of the debtor's assets situated in a foreign country where there is no concurrent foreign insolvency proceeding. This is also to achieve equality of payments within a Korean insolvency proceeding vis-à-vis other creditors of the same class and ranking in the Korean insolvency proceeding. Having such purposes in mind, this article will first review certain key features of rules for payment of debt under Korean insolvency proceedings which are related to the application of the hotchpot rule in Korea (Part II). Second, this article will review the hotchpot rule as applied in major foreign legislation, identifying issues and providing observations that may serve as guidelines for the interpretation of Article 642 of the DRBL (Part III). Third, with respect to key issues identified through the above comparative review, this article will present the author's interpretation of Article 642 of the DRBL (Part IV). Finally, this article will discuss other rules which may be established for the equalization of payments in connection with those payments which are outside the ambit of Article 642 of the DRBL (Part V).

## **II. Overview of Payment of Debt under Korean Insolvency Proceedings**

Before the DRBL became effective, four types of court-supervised insolvency proceedings were offered in Korea: corporate reorganization proceedings under the Corporate Reorganization Law, composition proceedings under the Composition Law, bankruptcy proceedings under the Bankruptcy Law and individual debtors rehabilitation proceedings under

Individual Debtors Rehabilitation Law.<sup>5)</sup> The DRBL repealed the above insolvency laws and consolidated the proceedings into the following three insolvency regimes: (i) rehabilitation proceedings under Chapter 2 of the DRBL primarily for the rehabilitation of insolvent corporations and other business entities,<sup>6)</sup> (ii) bankruptcy proceedings under Chapter 3 of the DRBL for the liquidation of insolvent business entities and individuals, and (iii) rehabilitation proceedings for an individual under Chapter 4 of the DRBL for the rehabilitation of insolvent individual debtors.<sup>7)</sup>

In order to better understand the ramifications of the hotchpot rule in Korean insolvency proceedings, this article introduces below a brief overview of debt payment under Korean insolvency proceedings.<sup>8)</sup>

### *1. Chapter 2 Rehabilitation Proceedings*

The goal of rehabilitation proceedings governed by Chapter 2 of the DRBL is to rehabilitate insolvent debtors by restructuring their debt pursuant to a rehabilitation plan approved by the creditors and the court. The rehabilitation proceedings are analogous to Chapter 11 proceedings of the U.S. Bankruptcy Code. However, the filing for a rehabilitation proceeding does not itself trigger the formal commencement of the rehabilitation proceeding. A rehabilitation proceeding commences only when the court issues a separate commencement order in response to the filing (Article 49 of the DRBL). At the

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5) The Individual Debtors Rehabilitation Law was enacted in 2004 while awaiting the promulgation of the DRBL. For an overview of the pre-existing insolvency proceedings under the other three insolvency laws of Korea, see CHUN-PYO JHONG, *INTERNATIONAL FINANCE IN KOREA* 96-107 (Kluwer Law International 2002).

6) Although the DRBL does not explicitly exclude individual debtors from Chapter 2 rehabilitation proceedings, in practice, it is unlikely that such proceedings would be available for individuals.

7) Korea offers another insolvency law called "Corporate Restructuring Promotion Law." This law took effect on November 4, 2007 with certain changes to the predecessor of such law which expired on December 31, 2005. This article does not address such law since it applies only to debts owed by an insolvent company to certain Korean financial institutions (including Korea branches of certain foreign financial institutions) which are rescheduled pursuant to out-of-court workout arrangements governed by such law.

8) For an overview of the insolvency proceedings under the DRBL, see Soogeun Oh, *An Overview of the New Korean Insolvency Law*, 16 *NORTON JOURNAL OF BANKRUPTCY LAW AND PRACTICE* (October 2007); Lindsee Granfield et al., *International Insolvency and Bankruptcy*, 1 *INTERNATIONAL CORPORATE PRACTICE: A PRACTITIONER'S GUIDE TO GLOBAL SUCCESS* (Carole L. Basri ed., 2007).

time of commencement, in principle, the court will appoint a receiver (Articles 50 and 74 of the DRBL). The authority to manage the business operations and assets of the debtor will then vest in the receiver, subject to the court's supervision (Article 56 of the DRBL).

During the gap period between the filing and the commencement, the court may issue, upon petition by an interested party or at its discretion, various preservation orders to freeze the debtor's assets.<sup>9)</sup> A typical preservation order is one prohibiting the debtor from paying off the debtor's existing debts (Article 43① of the DRBL). Such order may also be accompanied by an order appointing an interim receiver to manage the debtor during the gap period (Article 43② of the DRBL). The court may also issue a preservation order against a particular creditor to suspend, among others, any pending preliminary attachment, preliminary injunction or court auction or any other pending compulsory enforcement action (Article 44① of the DRBL). The DRBL has introduced a new preservation order called "a comprehensive stay order," which may be issued by the court, upon petition by an interested party or at its discretion, to prohibit all creditors of the debtor from initiating, among others, an action for a preliminary attachment, preliminary injunction, court auction or any other compulsory enforcement action (Article 45① of the DRBL). Generally speaking, such preservation orders may be lifted if the stay would cause "unreasonable harm" to the creditor seeking to enforce its interest (Articles 44① and 47 of the DRBL).

A significant effect of the commencement of a Chapter 2 proceeding is that most claims against the debtor arising from a cause that exists prior to commencement (i.e., secured and unsecured rehabilitation claims) are automatically stayed (other than certain exceptions, such as set-offs permitted under the DRBL), while certain claims arising from a cause that exists before or after commencement (i.e., common benefit claims) are not subject to the rehabilitation proceeding (Articles 131, 141② and 180 of the DRBL). In connection with the application of the hotchpot rule, it is notable that secured rehabilitation claims are also subject to stay upon commencement of the rehabilitation proceedings and, with certain exceptions, will be repaid only

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9) The court is required to render its decision on whether to commence a rehabilitation proceeding within one month after the filing of a petition for commencement of a rehabilitation proceeding. See Article 49① of the DRBL.

pursuant to the rehabilitation plan. Secured rehabilitation claims refer to claims secured by the security right created on the debtor's assets that exist at the time of commencement of a rehabilitation proceeding (Article 141① of the DRBL).<sup>10), 11)</sup> To the extent that secured creditors are under-secured, the under-secured portion of their claims will be treated as unsecured rehabilitation claims with no priority over other unsecured rehabilitation claims unless otherwise set forth in the rehabilitation plan (Article 141④ of the DRBL). As the valuation of collateral is determined as of the commencement of the rehabilitation proceeding, once such determination is made, the amount of secured claims is fixed and cannot be adjusted upward or downward even if the value of collateral appreciates or depreciates after such determination. The classifications of "creditors with unsecured rehabilitation claims" and "creditors with secured rehabilitation claims" may be sub-divided (i.e., by assigning the creditors of a class to different sub-classes) by the court for the purposes of preparing the rehabilitation plan and in relation to creditor approval of such plan (Article 236③ of the DRBL). In determining whether to sub-divide the creditor classes, the court will consider the nature of the claims at issue and the interests of the parties.

A rehabilitation plan may call for a rescheduling of the debtor's debts over a period not to exceed, in principle, 10 years, except when corporate debentures are issued pursuant to the rehabilitation plan (Article 195 of the DRBL). Any secured rehabilitation claims and unsecured rehabilitation claims which are not recognized under the court-approved rehabilitation plan shall be irrevocably extinguished even if the rehabilitation proceeding is subsequently terminated (Articles 251 and 288④ of the DRBL). If payment under the court-approved rehabilitation plan has commenced, the court shall, upon petition by an interested party or at its discretion, terminate the

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10) Note, however, that claims against the debtor which are secured by assets owned by a third party are deemed unsecured claims for the purpose of the rehabilitation proceeding of the debtor. Enforcement of security right to such assets can be made regardless of the rehabilitation proceeding of the debtor. See Article 250 of the DRBL. This is the same in bankruptcy proceedings and rehabilitation proceedings for an individual as discussed below. See Articles 567 and 625 of the DRBL.

11) Such security right is specified in Article 141① of the DRBL and includes, among others, *yuchigwon* (a type of statutorily created possessory lien), pledge, mortgage, *jeonsegwon* (a type of registered leaseholder's right to real estate) and *yangdodambo* (security by way of assignment). Under the Korean court's practice, certain quasi security interests, such as a seller's right under a sale with title retention and a lessor's right under a financing lease are also considered such security right.

rehabilitation proceedings early, unless there is an impediment to the implementation of the plan (Article 283① of the DRBL).

## *2. Chapter 3 Bankruptcy Proceedings*

The bankruptcy proceedings governed by Chapter 3 of the DRBL are court administered proceedings designed to liquidate an insolvent debtor's assets. The bankruptcy proceedings are analogous to Chapter 7 proceedings of the U.S. Bankruptcy Code. A bankruptcy proceeding commences when the court issues a separate adjudication of bankruptcy (which is equivalent to a commencement order in a Chapter 2 rehabilitation proceeding) after the petition for such adjudication (Article 311 of the DRBL). Upon adjudication of bankruptcy, the court will appoint a bankruptcy trustee who is vested with the exclusive right to manage and dispose of the bankruptcy estate, subject to the court's supervision (Articles 312 and 384 of the DRBL). With few limitations, the trustee has the right to liquidate the bankruptcy estate, and to determine the manner and timing of such liquidation (Article 492 of the DRBL). The trustee distributes the proceeds from the liquidation of the bankruptcy estate to the creditors in proportion to their claims (Article 440 of the DRBL). Claims entitled to distribution are differentiated according to the priority of the claims. The distribution then proceeds in several stages, and when the bankruptcy estate has been fully realized, the trustee will make the final distribution (Articles 505 and 522 of the DRBL). If any additional property becomes part of the bankruptcy estate after the notice of the amounts available for final distribution has been published, the trustee may make additional distributions following court approval (Article 531 of the DRBL).

The adjudication of bankruptcy has the effect of automatically staying all creditors having unsecured bankruptcy claims from exercising or otherwise enforcing their claims against the bankruptcy estate (other than certain exceptions, such as set-offs permitted under the DRBL) (Article 424 of the DRBL). Even before the formal adjudication of bankruptcy, the court is empowered to issue preservation orders preserving the debtor's assets for distribution to the unsecured bankruptcy creditors and preventing unsecured bankruptcy creditors from executing on their claims (Article 323 of the DRBL). However, bankruptcy estate claims are repaid from time to time without being subject to the bankruptcy proceedings (Article 473 of the DRBL).

On the other hand, unlike a Chapter 2 rehabilitation proceeding, secured creditors are not prohibited from exercising their security rights to the assets owned by the debtor as a result of the commencement of the bankruptcy proceeding (Article 412 of the DRBL). As such, the security right to the debtor's assets is called "right of separation" under the bankruptcy proceeding.<sup>12),13)</sup> In the event that a claim is partially secured by collateral owned by the debtor, the creditor should first recover its claim from collateral and may participate in, and receive payments from the bankruptcy proceeding only up to the amount of the deficient claim which remains unpaid after the exercise of the security right to collateral (Article 413 of the DRBL). In this regard, in the case of an interim distribution, within 14 days from the date of a public notice regarding the scheduled distribution, a creditor with right of separation should submit to the trustee (i) conclusive evidence showing that disposition of collateral has been initiated and (ii) *prima facie* evidence showing the expected amount of the deficient claim that cannot be paid through such disposition (Article 512② of the DRBL). Such deficient claim amount will be reserved and distributed when the deficient claim amount becomes final and conclusive (Article 519 of the DRBL). In the case of the final distribution, within certain designated period after the public notice of the scheduled distribution, a creditor with right of separation should submit conclusive evidence showing the amount of such deficient claim which could not be repaid through disposition of collateral (Article 525 of the DRBL). If a creditor with right of separation fails to submit the required

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12) Note, however, that under the DRBL, there are procedural restrictions on the enforcement of security right under a Chapter 3 proceeding as follows: (i) in the case that a creditor with right of separation has a right to dispose of collateral pursuant to a method other than a method specified under the laws, the trustee may request such creditor to dispose of collateral within a certain time period, and if the creditor fails to comply with such request, the trustee shall be entitled to request the creditor to surrender collateral to the trustee so that the trustee disposes of the collateral and delivers the secured portion of recovery to the creditor (Article 498 of the DRBL); and (ii) in the case that disposition of collateral can be made only pursuant to the procedures specified under the laws, the bankruptcy trustee may, at its discretion, dispose of collateral pursuant to compulsory enforcement procedures under the Civil Enforcement Law of Korea and deliver secured portion of recovery to the creditor (Article 497 of the DRBL).

13) Article 411 of the DRBL specifies, as such rights of separation, *yuchigwon*, pledge, mortgage and *jeonsegywon*. The security interest called *yangdodambo* and certain quasi security interests, such as a seller's right under a sale with title retention and a lessor's right under a financing lease would also be considered such security right with right of separation.

evidence in a timely manner, the creditor will not be permitted to receive distribution with respect to such unsecured deficient claim (Articles 512② and 525 of the DRBL).

### *3. Chapter 4 Rehabilitation Proceedings for Individuals*

The rehabilitation proceedings for an individual are governed by Chapter 4 of the DRBL and are available for the rehabilitation of insolvent individual debtors who qualify as certain income earners as specified under the DRBL by rescheduling their debt pursuant to a repayment plan approved by the creditors and the court. These proceedings are similar to, but have the following notable differences from the rehabilitation proceedings under Chapter 2. The maximum repayment period under a repayment plan in a Chapter 4 rehabilitation proceeding shall not exceed 5 years from the commencement of the payment of debt under the repayment plan (Article 611 ⑤ of the DRBL). Upon commencement of a Chapter 4 rehabilitation proceeding by the court's commencement order, payment of unsecured rehabilitation claims arising from a cause that exist before the commencement of the proceeding and enforcement of secured claims are automatically stayed (Articles 582 and 593 of the DRBL). This is the same as the rehabilitation proceeding under Chapter 2; however, the stay of enforcement of secured claims remains in effect only until the time that the repayment plan is approved by the court or the proceeding is revoked (Article 600② of the DRBL). After that time, a secured creditor may enforce its security right regardless of the proceeding. A secured creditor may receive from the proceeding only the amount of the deficient claim remaining after disposition of, and recovery from collateral (Article 586 of the DRBL). Similarly to the Chapter 2 rehabilitation proceeding, prior to the commencement of the Chapter 4 rehabilitation proceeding, the court may, upon request by an interested party or at its discretion, issue a preservation order, (i) to prohibit payment by the debtor of an unsecured rehabilitation claim, (ii) to stay a preliminary attachment, preliminary injunction, court auction or any other compulsory enforcement action which has been initiated based on unsecured rehabilitation claims or (iii) to stay auction for enforcement of a secured claim until the commencement of the proceeding (Articles 592 and 593 of the DRBL).

### III. Comparative Review of the Hotchpot Rule under Major Foreign Legislation

#### 1. Model Law

Article 32 of the Model Law reflects the hotchpot rule recognized under Common law, which requires that a creditor who seeks to participate in a local insolvency proceeding must furnish full account of any payment that has been received abroad.<sup>14)</sup> Article 32 of the Model Law provides as follows:<sup>15),16)</sup>

“Article 32 Rule of payment in concurrent proceedings

Without prejudice to secured claims or rights in rem, a creditor who has received partial payment with respect to its claim in a proceeding pursuant to a law relating to insolvency in a foreign state may not receive a payment for the same claim in a proceeding under [identify laws of the enacting State relating to insolvency] regarding the same debtor, so long as the payment to other creditors of the same class is proportionately less than the payment the creditor has already received.”

The purpose of Article 32 of the Model Law is to achieve as much as possible equal distributions among creditors in the same class in a domestic insolvency proceeding and a foreign insolvency proceeding. Thus, Article 32

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14) See IAN F. FLETCHER, *INSOLVENCY IN PRIVATE INTERNATIONAL LAW* 485 (2nd ed., Oxford 2005); Look Chan Ho, *Overview*, in *CROSS-BORDER INSOLVENCY: A COMMENTARY ON THE UNCITRAL MODEL LAW 17* (Look Chan Ho ed., Globe Business Publishing Ltd. 2006).

15) The United States version of the Model Law (i.e., Chapter 15 of the U.S. Bankruptcy Code) went into effect on October 17, 2005. See Granfield et al., *supra* note 8, at 29-45. Section 1532 of the U.S. Bankruptcy Code reflects a rule of payment in concurrent proceedings which is almost identical to Article 32 of the Model Law. See 11 U.S.C. § 1532.

16) The Cross Border Insolvency Regulations of the Great Britain, which adopted the Model Law, entered into force on April 4, 2006. See IAN F. FLETCHER, *INSOLVENCY IN PRIVATE INTERNATIONAL LAW* 19 (Supplement to 2nd ed., Oxford 2007). The said Regulations reflect a rule of payment in concurrent proceedings which is identical to Article 32 of the Model Law. See Article 32 of Schedule 1 to the above Cross Border Insolvency Regulations.

attempts to adjust the total amount of payments received by a creditor in both the domestic and the foreign insolvency proceedings.<sup>17)</sup> Article 32 does not affect the ranking of claims as established by the law of enacting State and is solely intended to establish the equal treatment of creditors of the same class.<sup>18)</sup> Whether a creditor belongs to the same class is to be determined by applying the laws of the enacting State.

It appears in general that Article 32 of the Model Law centers on the following main issues, which will also be meaningful clues in connection with the interpretation of Article 642 of the DRBL of Korea.

First, the rule under Article 32 of the Model Law applies where a creditor has received payment in “a proceeding pursuant to a law relating to insolvency in a foreign state.” Thus, the hotchpot rule embodied in the Model Law addresses payment from a foreign insolvency proceeding. In this regard, it is not entirely clear whether “a proceeding pursuant to a law relating to insolvency in a foreign state” means a foreign insolvency proceeding itself or intends to include any other proceedings to the extent such proceedings are proceedings pursuant to a law relating to insolvency.<sup>19)</sup>

Second, Article 32 does not explicitly provide the relationship between the time when the domestic insolvency proceeding commences and the time when payment is made in a foreign insolvency proceeding. Upon literal reading of Article 32, payment in a foreign proceeding which was made prior

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17) See Kazuhiko Yamamoto, *Commentary on UNCITRAL Model Law on Cross-Border Insolvency*, 639 NBL 53 (April, 1998) (in Japanese). The following example introduced in the preceding article well explains the effect of Article 32 of the Model Law: For instance, suppose that each of creditors X and Y had a claim in the amount of 100; creditor X received 50 by participating in the foreign insolvency proceeding; and 60 would be paid to each of X and Y in the domestic insolvency proceeding if payment in the foreign insolvency proceeding were not considered. If the method of deducting the amount of payment received in the foreign insolvency proceeding is used, the amounts of X's claim and Y's claim in the domestic insolvency proceeding would be 50 and 100, respectively and X will receive 20 and Y will receive 40 by equal distribution. Thus, if payments in the domestic and foreign insolvency proceedings are added, X will receive 70 and Y will receive 40 and equal treatment between X and Y would not be achieved. On the other hand, if the rules of payment under Article 32 of the Model Law are applied, 50 would first be paid to Y in the domestic insolvency proceeding and the remaining 10 will be distributed to X and Y proportionately (i.e., 5 to each of X and Y). Accordingly, each of X and Y will receive 55 equally in the domestic and foreign insolvency proceedings.

18) See GUIDE TO ENACTMENT OF THE UNCITRAL MODEL LAW ON CROSS-BORDER INSOLVENCY (hereinafter, referred to as the “UNCITRAL Guide”), at para. 199.

19) See Kazuhiko Yamamoto, *supra* note 17, at 54; NEW CROSS-BORDER INSOLVENCY LAW REGIME 379-80 (Takuya Hukayama ed., Kinyu Zaisei Jijyo Kenkyukai 2001) (in Japanese).

to the commencement of the domestic insolvency proceeding may be subject to adjustment of payment in a domestic proceeding which has commenced after such payment.<sup>20)</sup>

Third, Article 32 of the Model Law explicitly provides that secured claims and rights *in rem* shall not be prejudiced by the application of the rule of payment thereof. This means that to the extent claims of secured creditors or creditors with rights *in rem* are paid in full (a matter that depends on the law of the State in which the proceeding is conducted), those claims are not affected by the provision of Article 32.<sup>21)</sup> The words “secured claim” are used to refer generally to claims guaranteed by particular assets, while the words “rights *in rem*” are intended to indicate rights relating to a particular property that are enforceable also against third parties.<sup>22)</sup> Further, a given right may fall within the ambit of both expressions, depending upon the classification and terminology of the applicable law and the enacting State may use another term or terms for expressing those concepts.<sup>23)</sup>

Fourth, the Model Law does not require a creditor who has received payment in a foreign insolvency proceeding in excess of the proportion of payment applied to other creditors of the same class in the domestic proceeding to return the excess amount to the representative of the domestic insolvency proceeding. Further, the Model Law does not provide for the treatment of payment made out of the debtor’s assets situated in a foreign country where there is no proceeding pursuant to a law relating to insolvency in a foreign country. The Model Law defers such treatment to local legislation.

## 2. EU Insolvency Regulations<sup>24)</sup>

Under EU Insolvency Regulations, the opening of insolvency proceedings shall not affect the rights *in rem* (including security interest) of creditors or

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20) See KAZUHIKO YAMAMOTO, *Japan*, in *supra* note 14, at 113; Takuya Hukayama, *id.*, at 380. Both interpret Article 32 of the Model Law such that the rule of payment under Article 32 applies regardless of whether which of a domestic proceeding or foreign proceeding commenced first.

21) See UNCITRAL Guide, at para. 199.

22) *Id.* at para 200.

23) *Id.*

24) “Council Regulation (EC) No. 1346/2000 of 29 May on Insolvency Proceedings” which took effect on May 31, 2002 (hereinafter referred to “EU Insolvency Regulations”).

third parties in respect of the debtor's assets which are situated within the territory of another Member State at the time of opening of proceedings (EU Insolvency Regulations, Article 5①).<sup>25)</sup> Such rights, which are insulated from an insolvency proceeding of another Member State, include disposition of collateral and satisfaction of secured claims from the disposition proceeds, etc. (EU Insolvency Regulations, Article 5②). However, Article 5 exemption immunizing collateral located in another Member State does not apply to assets located outside the Member States.<sup>26)</sup> Thus, the effect of an insolvency proceeding which was commenced in a Member State of EU on collateral located in a non-Member State is to be determined by the domestic rules of conflict of laws of each Member State.<sup>27)</sup>

Under EU Insolvency Regulations, subject to the rights in *rem* (including security right) set forth in Article 5 and the retention of title set forth in Article 7 thereof, a creditor who, after the opening of the main proceeding, obtains by any means (in particular through enforcement) total or partial satisfaction of its claim on the debtor's assets situated in the territory of another Member State, shall return what it has obtained to the liquidator of the main proceeding (EU Insolvency Regulations, Article 20①). A secured creditor who gets foreign satisfaction out of collateral located in another Member State, however, can keep the amount of such payment and is not required to return the amount of such payment to the liquidator of the main proceeding.<sup>28)</sup>

Under Article 20② of EU Insolvency Regulations, a creditor who has, in the course of insolvency proceedings, obtained a dividend on its claim shall share in distributions made in other proceedings only where creditors of the same ranking or category have, in those other proceedings, obtained an equivalent dividend. With respect to the payment made to a creditor under a foreign insolvency proceeding, EU Insolvency Regulations merely adjust the amount of dividends payable to such creditor in the domestic insolvency proceeding and do not require that payment received by such creditor in a foreign insolvency proceeding be returned to the main insolvency proceeding.

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25) Article 5① of EU Insolvency Regulations, however, shall not preclude actions for voidness, voidability or unenforceability as referred to in Article 4② (m). See EU Insolvency Regulations, Article 5③.

26) See PHILIP R WOOD, PRINCIPLES OF INTERNATIONAL INSOLVENCY 867 (2<sup>nd</sup> ed., Sweet & Maxwell 2007).

27) *Id.* at 867.

28) *Id.* at 854. See FLETCHER, *supra* note 14, at 430.

### 3. *Insolvency Laws of Japan*

Japanese insolvency laws incorporate a rule similar, though not identical, to that contained in the Model Law.<sup>29)</sup> Under the amended Corporate Reorganization Law of Japan, a creditor who, after an order to commence a corporate reorganization proceeding was rendered, has received payment with respect to an unsecured reorganization claim or secured reorganization claim, as the case may be, by exercising a right against the debtor's assets located in a foreign country, may not receive payment under the reorganization plan until other reorganization creditors of the same ranking will have received proportionately same payment as the payment such creditor has received.<sup>30)</sup> Under the new Bankruptcy Law of Japan, a creditor who, after the commencement of a bankruptcy proceeding, has received payment with respect to a bankruptcy claim by exercising a right against the debtor's assets located in a foreign country, may not receive payment from the distributions under the bankruptcy proceeding until other creditors of the same ranking will have received proportionately same payment as the payment such creditor has received.<sup>31)</sup>

The hotchpot rule incorporated under the Japanese insolvency laws has some notable features. First, the rule of payment adjustment under Japanese insolvency laws applies to payment made out of the debtor's assets located in a foreign country regardless of whether there is a concurrent foreign insolvency proceeding. Second, the Japanese rule applies only to payments made after the commencement of a domestic insolvency proceeding. Third, it is interpreted by legal scholars that as secured creditors also participate in a corporate reorganization proceeding under the Corporate Reorganization Law (which is similar to Chapter 11 proceedings of the U.S. Bankruptcy Code), the application of the hotchpot rule extends to creditors with secured reorganization claims in the case of a corporate reorganization proceeding.<sup>32)</sup>

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29) YAMAMOTO, *supra* note 20, at 113.

30) See Article 137② of the amended Corporate Reorganization Law of Japan (revised in its entirety on December 13, 2002; lastly amended on March 31, 2006).

31) See Articles 109, 201④, 209③ of the new Bankruptcy Law of Japan (promulgated on June 2, 2004; lastly amended on December 15, 2006).

32) See YAMAMOTO, *supra* note 20, at 113.

Furthermore, in Japan, scholarly views are split as to whether a voluntary payment made by the debtor from the assets situated abroad would be subject to such rule of payment adjustment in a domestic insolvency proceeding or subject to disgorgement (i.e., return of unjust enrichment).<sup>33)</sup> On the other hand, all scholarly views have consensus that payment made through an individual compulsory enforcement against the assets situated abroad would be subject to such rule of payment adjustment in a domestic insolvency proceeding.<sup>34)</sup> However, scholarly views are split as to whether any payment (e.g., voluntary payment or payment through a compulsory execution) that has been made out of the debtor's assets situated in a foreign country after the commencement of an insolvency proceeding in Japan in excess of the proportion of the payments made to other creditors of the same ranking would be considered unjust enrichment and thus, should be subject to disgorgement and returned to an insolvency estate of the Japanese insolvency proceeding.<sup>35)</sup>

## IV. The Hotchpot Rule under the DRBL of Korea

### 1. Article 642 of the DRBL

It is understood that Article 642 of the DRBL is modeled after the provision of Article 32 of the Model Law.<sup>36)</sup> As discussed below, however, the provision of Article 642 of DRBL is similar, but not identical to Article 32 of the Model Law, and has some areas which are deferred to interpretation under Korean law. Article 642 of the DRBL provides as follows:

“Article 642 (Rule of Payment): In the case that there are a domestic insolvency proceeding and one or more foreign insolvency

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33) Hukayama, *supra* note 16, at 379-80, 432-33. MAKOTO ITOU, BANKRUPTCY LAW 179 (4<sup>th</sup> ed., Yuhikaku 2006) (in Japanese).

34) Hukayama, *id.*

35) For an overview of such split views in Japan, see Kosei Watanabe, *Cross-Border Insolvency Procedures*, in CORPORATE REORGANIZATION LAW/CIVIL REHABILITATION LAW (21 SHIN SAIBAN JITSUMU TAIKEI) 214 (Masahito Monguchi et al. ed., Seirin Shoin 2004) (in Japanese).

36) See Suk, *supra* note 4, at 370.

proceedings with respect to the same debtor, a creditor who has received payment out of a foreign insolvency proceeding(s) or the debtor's assets which are situated in a foreign country may not receive dividend or payment in the domestic insolvency proceeding until other creditors belonging to the same class and ranking as that creditor in the domestic insolvency proceeding have received a proportionately same payment."<sup>37)</sup>

Under Article 628① of the DRBL, the term "foreign insolvency proceeding" is defined as "a rehabilitation proceeding, bankruptcy proceeding, rehabilitation proceeding for an individual or any other proceeding similar thereto, including an interim proceeding, which has been petitioned to a foreign court (including any other authorities equivalent thereto)." The above term "foreign insolvency proceeding" includes an interim proceeding similar to the definition of "foreign proceeding" in Section 2(a) of the Model Law.<sup>38)</sup> Under Article 628② of the DRBL, the term "domestic insolvency proceeding" is defined as "a rehabilitation proceeding, bankruptcy proceeding or rehabilitation proceeding for an individual petitioned to a court in Korea."

## 2. Interpretation of Article 642 of the DRBL

### 1) General

In order to apply the rule of payment adjustment under Article 642 of the DRBL, it would be required that a domestic insolvency proceeding has commenced because Article 642 pertains to adjustment of "dividend or payment" to be made in a domestic insolvency proceeding after the commencement of such proceeding. In this regard, payment which is governed by Article 642 is limited to payment with respect to claims which are subject to a rehabilitation proceeding, bankruptcy proceeding or rehabilitation proceeding for an individual under the DRBL.<sup>39)</sup> Such claims

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37) This English translation of Article 642 of the DRBL is an unofficial translation made by the author.

38) The term "foreign insolvency proceeding" as so defined is used not only for the purpose of Article 642 but also in the context of the recognition and enforcement of a foreign insolvency proceeding in Korea pursuant to the newly established provisions of Chapter 5 of the DRBL regarding cross-border insolvency.

39) The Korean word in Article 642 of the DRBL which corresponds to "payment" is "*byunjae*," which

may include both unsecured and secured rehabilitation claims in Chapter 2 rehabilitation proceedings, unsecured bankruptcy claims in Chapter 3 bankruptcy proceedings and unsecured rehabilitation claims in Chapter 4 rehabilitation proceedings for an individual. On the other hand, payments with respect to claims which belong to common benefits claims of Chapter 2 rehabilitation proceedings; bankruptcy estate claims and secured claims with right of separation in Chapter 3 bankruptcy proceedings; and secured claims in Chapter 4 rehabilitation proceedings for an individual are not subject to Article 642, since such claims may be enforced and repaid regardless of such insolvency proceedings.<sup>40)</sup>

Payments which are subject to Article 642 are payments made with respect to the claims against the debtor or recovered from the assets owned by the debtor. Under the DRBL, as was the case under the previous insolvency laws, none of the insolvency proceedings affects claims of a creditor against a third party (e.g., claims of a lender against a guarantor or other third party surety of the debtor) or security interest in collateral owned by a third party. The court has no power to stay enforcement of such claims or security interest in such collateral and such enforcement is not hampered by commencement of an insolvency proceeding against the debtor under the DRBL. Thus, payment received by a creditor from such a third party or recovered out of such collateral owned by a third party is not subject to Article 642.

Set-offs involving an insolvent debtor are governed both by general Korean law relating to the permissibility of set-offs as well as to certain special rules relating to a set-off of a claim against an insolvent debtor under the DRBL. In the case of a set-off under a Chapter 3 bankruptcy proceeding or a Chapter 4 rehabilitation proceeding for an individual, a creditor is permitted to exercise their set-off rights at any time, whereas under a Chapter 2 rehabilitation proceeding, a creditor may exercise their set-off rights only before the expiration of the claims filing period. Further, as was the case in the previous insolvency laws, certain set-offs are prohibited under the DRBL. A

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may also be translated into "repayment." The term "payment" (or "repayment") would include payment by cash, payment in kind or any other type of payment which would have an effect of discharging the debt.

40) As mentioned in II. 3 above, in the case of a Chapter 4 proceeding, however, enforcement of a security right is temporarily stayed upon commencement of the proceeding until the court approval of the repayment plan or the revocation of the proceeding, whichever occurs earlier.

set-off made in breach of such prohibition would be null and void. Thus, it can be said that payment of a claim by a set-off would be governed by a separate set of laws and would not be subject to Article 642 of the DRBL.

As a basis for determining the equality of payment, as seen above, Article 32 of the Model Law refers to “other creditors of the same class,” whereas Article 20② of EU Insolvency Regulations refer to “creditors of the same ranking or category” and Article 137② of the Corporate Reorganization Law of Japan refers to “other creditors of the same ranking.” On the other hand, Article 642 of the DRBL of Korea refers to “other creditors of the same class and ranking.” As this matter is up to local legislation by an enacting State, the above difference, in and of itself, would not be an issue. Insofar as Korean insolvency law is concerned, in the case of a Chapter 2 rehabilitation proceeding under the DRBL, for instance, creditors of the same ranking may belong to different sub-classes which will receive payment at different rates under the rehabilitation plan. Thus, in the context of Korean insolvency proceedings, Article 642 of the DRBL adequately addresses the basis for determining the equality of payment by requiring both the same class and the same ranking. Moreover, as discussed below, by sub-dividing the creditor classes in a Chapter 2 rehabilitation proceeding, fair and equitable outcome may be achieved when applying the hotpot rule *vis-à-vis* secured claims.

## 2) Concurrent foreign insolvency proceeding required?

As seen above, in order to apply the rule of payment adjustment under Article 642, it is required that a domestic insolvency proceeding has commenced, but is it required that a foreign insolvency proceeding has commenced as well? In other words, would Article 642 apply only where there are concurrent insolvency proceedings in Korea and a foreign country? Since Article 642 begins with the phrase “In the case that there is a domestic insolvency proceeding and one or more foreign proceedings,” in the author’s view, a literal interpretation would require that one or more foreign insolvency proceedings have also commenced as a prerequisite for the application of Article 642.<sup>41)</sup> As Article 642 merely refers to a foreign

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41) Thus, payment received from overseas assets where no concurrent foreign proceeding has commenced would not be governed by Article 642. The treatment of such payment under the DRBL will be reviewed separately below in this article.

insolvency proceeding, it applies regardless of whether or not that foreign insolvency proceeding has been recognized in Korea pursuant to the procedures under the DRBL.<sup>42)</sup> Article 642 of the DRBL is in line with Article 32 of the Model Law, in that it is applicable where a concurrent foreign proceeding has commenced. However, unlike Article 32 of the Model Law which refers to “payment in a proceeding pursuant to a law relating to insolvency in a foreign state,” Article 642 of the DRBL refers to “payment received out of a foreign insolvency proceeding(s) or the debtor’s assets located in a foreign country.” As a result, a question arises as to the scope of payments that are to be governed by Article 642 of the DRBL as discussed below, particularly vis-à-vis “payment made out of the debtor’s assets situated in a foreign country(s).”

(1) Payment made out of a foreign insolvency proceeding

Payment made out of a foreign insolvency proceeding after the proceeding has commenced is subject to Article 642. As seen above, a “foreign proceeding” includes an interim proceeding. Thus, payment made out of an interim proceeding before the opening of a main insolvency proceeding would also be subject to Article 642. In the event that a foreign insolvency proceeding is successfully terminated and payment is received after the termination of the proceeding pursuant to a repayment plan approved in the proceeding, a question may arise whether or not such payment would be subject to Article 642. As such payment is made pursuant to the effect of a foreign insolvency proceeding, such payment should be considered, in substance, the same as the payment made while the foreign insolvency proceeding is pending. Therefore, in the author’s view, such payment should also be subject to Article 642 as payment from a foreign insolvency proceeding (or, as payment from the debtor’s assets located in a foreign country where there is a concurrent foreign proceeding).

(2) Payment made out of the debtor’s assets situated in a foreign country

Unlike Article 32 of the Model Law, Article 642 of the DRBL refers to “payment out of the debtor’s assets located in a foreign country.” In terms of this type of payment, is there a significant difference between the Model Law and the DRBL of Korea? In the author’s view, “debtor’s assets located in a foreign country,” should include only the debtor’s assets that are located in a

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42) See Suk, *supra* note 4, at 370.

foreign country where a foreign insolvency proceeding has commenced or another foreign country where such proceeding has been recognized and enforced. Such assets should not include the debtor's assets located in any other foreign country (i.e., a country where a foreign insolvency proceeding has not commenced or is not recognized). This is because there seems to be no plausible ground by which to apply Article 642 to the debtor's assets located in all foreign countries merely by reason of the commencement of a foreign insolvency proceeding in one foreign country. In the author's view, Article 642 should be interpreted such that the purpose of adding such type of payment in addition to "payment out of a foreign insolvency proceeding(s)" is to encompass payment which is made pursuant to or relating to a foreign insolvency proceeding, but not made directly from a foreign insolvency proceeding itself. Thus, payment out of the debtor's assets under Article 642 would likely be equivalent or similar to "payment pursuant to a law relating to insolvency" under Article 32 of the Model Law.

For instance, if a compulsory enforcement is permitted under the insolvency law of a foreign country, but the actual enforcement and payment from the enforcement are made pursuant to another legal proceeding in that foreign country, such payment should be subject to Article 642 of the DRBL. It is unlikely that a voluntary payment of the debtor would be validly made by the debtor (other than as an authorized representative of a foreign insolvency proceeding) outside of a pending foreign insolvency proceeding since such payment will likely be prohibited under the applicable foreign insolvency law. Assuming, however, that such payment is validly made in a foreign insolvency proceeding or pursuant to foreign insolvency law, such payment may be subject to Article 642. On the other hand, if a voluntary payment by a debtor, which is made outside of a foreign insolvency proceeding, is considered null and void under the applicable foreign insolvency law, such payment should not be governed by Article 642; instead, the amount of such payment should be disgorged to either the foreign or domestic insolvency proceeding since such payment is null and void under both foreign and Korean insolvency laws.

*3) Is the Rule applicable to payment made prior to the commencement of a domestic insolvency proceeding?*

As seen above, Article 32 of the Model Law does not explicitly address the

time that payment was made under a foreign insolvency proceeding *vis-à-vis* the time when a domestic insolvency proceeding commenced. For instance, in the event that a foreign insolvency proceeding has commenced and payment has been made prior to commencement of a domestic proceeding, based on a literal reading of Article 32 of the Model Law, such payment in the foreign proceeding is likely to be subject to payment adjustment under Article 32 of the Model Law. As in the Model Law, Article 642 of the DRBL does not explicitly address this issue and the same question may be raised. As yet, there are no Korean court precedents or scholarly views on this issue and thus, there may be conflicting interpretations as discussed below.

It can be argued that payment made in a foreign insolvency proceeding prior to commencement of a domestic insolvency proceeding is also subject to payment adjustment under Article 642. The premise of this argument would be that the purpose of Article 32 of the Model Law, on which Article 642 of the DRBL is based, is to achieve equality of payment in concurrent insolvency proceedings. In particular, Article 642 of the DRBL intends to achieve the equality of payments in a Korean insolvency proceeding between (i) a creditor who has received payment in a foreign insolvency proceeding and (ii) other creditors belonging to the same class and ranking in a Korean insolvency proceeding, on the basis that the amount of payments made to a creditor in a foreign insolvency proceeding should be added to the amount of payments made to the same creditor in a Korean insolvency proceeding. Therefore, even if payment has been received by a creditor in a foreign insolvency proceeding prior to the commencement of a Korean insolvency proceeding, such payment should be considered in adjusting payments to be made to the same creditor in the Korean insolvency proceeding.

In the author's view, however, the function of Article 642 of the DRBL is to achieve extra-territorial effect of the commencement of a domestic insolvency proceeding, in an indirect way and to a limited extent, through payment adjustment within a domestic insolvency proceeding. The automatic comprehensive stay against the payment of debt and the compulsory enforcement of claims takes effect upon commencement of a Korean insolvency proceeding (i.e., upon issuance of the court's commencement order as seen above). Thus, in the absence of an explicit provision to the contrary, the former view has a weaker legal basis under the principle of Korean insolvency law. More fundamentally though, there is no legal principle under

Korean insolvency law that requires (i) a creditor who has duly received payment prior to the commencement of a domestic insolvency proceeding to return such payment to the insolvency proceeding (unless such payment is subject to avoidance by a receiver or bankruptcy trustee<sup>43)</sup> or (ii) to pay the same amount as such payment to other creditors in priority over that creditor. There seems to be no plausible reason that “payment in a foreign country” should be treated differently than payment in Korea under the above principle.<sup>44)</sup> Accordingly, in the author’s view, payment made in a foreign insolvency proceeding or from the debtor’s overseas assets before commencement of a domestic insolvency proceeding would not be subject to Article 642. In connection with the rule of payment adjustment under Article 642 of the DRBL, Article 107① of the “Debtor Rehabilitation and Bankruptcy Rules” promulgated by the Supreme Court of Korea<sup>45)</sup> provides that even when a creditor has received, after the order to commence a domestic insolvency proceeding is rendered, payment out of a foreign insolvency proceeding or the debtor’s assets which are situated in a foreign country, such creditor may participate in the domestic insolvency proceeding with the entire amount of the claim before receipt of such payment, provided that their voting right shall be denied with respect to the amount of claim so repaid. It appears that Article 107① of the above Rules of the Supreme Court is premised on the same view as that of the author.

#### 4) *Is the Rule applicable “without prejudice to secured claims”?*

The Model Law and EU Insolvency Regulations explicitly provide that secured claims shall not be prejudiced or shall not be subject to the hotchpot rule. However, Article 642 of the DRBL is silent on this issue. Thus, a question

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43) Certain payments or other acts (such as granting security interests) which are harmful to creditors in general (or preferential) and are performed by the debtor prior to the commencement of an insolvent proceeding may be avoided by a representative of an insolvency proceeding if they fall in one of the categories specified in the DRBL. The rules related to avoidance and preference period vary depending upon the nature of the avoidable acts.

44) In this connection, there is an issue of whether payment made in a foreign country prior to the commencement of a domestic insolvency proceeding may be subject to avoidance by applying the Korean insolvency law. As this issue involves conflict of insolvency laws which requires a separate in-depth analysis, it is outside the scope of this article.

45) Debtor Rehabilitation and Bankruptcy Rules promulgated on March 23, 2006 (the Supreme Court Rules No.: 2002).

arises whether claims secured by collateral which is situated in a foreign country (hereinafter, "Overseas Collateral") would be subject to or otherwise prejudiced by Article 642 of the DRBL. This question becomes an issue when payment is made out of Overseas Collateral under circumstance in which a Korean insolvency proceeding is not wholly or partially recognized or is yet to be recognized by a foreign country in which Overseas Collateral is situated.<sup>46)</sup> At the outset, because there is no court precedent or practice on this issue, different views may be presented. In the author's view, however, claims secured by Overseas Collateral should not be prejudiced by virtue of Article 642 of the DRBL as discussed in detail below.

The above is also related to the issue of whether, under Korean insolvency proceedings, claims secured by a security interest in Overseas Collateral may be treated in the same manner as claims secured by the debtor's collateral that is situated in Korea. Thus, before addressing the applicability of Article 642 to claims secured by Overseas Collateral, the latter issue – i.e., the effect of a Korean insolvency proceeding on a security interest in Overseas Collateral – is first discussed below to the extent related to the first issue. For the convenience in the analysis, the discussions below on the first and second issues will be made only in the context of the Chapter 2 rehabilitation proceeding and the Chapter 3 bankruptcy proceedings.

#### (1) Effect of a Korean Insolvency Proceeding on Overseas Collateral

Under the DRBL, secured rehabilitation claims in a Chapter 2 rehabilitation proceeding and secured claims with right of separation in a Chapter 3 bankruptcy proceeding are defined to mean claims secured by the debtor's assets which exist at the time of the commencement of the proceeding. As the strict principle of territoriality, which limited the effect of a Korean insolvency proceeding to assets situated in Korea at the time of the commencement of the proceeding, has been abolished under the DRBL, and the effect of the commencement of a Korean insolvency proceeding extends to

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46) If a Korean insolvency proceeding is fully recognized and enforced by the foreign country in which Overseas Collateral is situated, the stay under the Korean insolvency proceeding will extend to the claims secured by the Overseas Collateral, and payment of such claims would be treated in the same manner as the claims secured by collateral located in Korea. In such case, if any payment is made out of Overseas Collateral in violation of the stay under the Korean insolvency proceeding, such payment would not be subject to Article 642, but subject to disgorgement since such payment would be considered null and void.

the assets located in a foreign country, it would be logical to conclude that Overseas Collateral would also constitute insolvency estate.<sup>47)</sup> Therefore, for the purpose of classification of claims under Korean insolvency proceedings, claims secured by a security interest in Overseas Collateral would likely be classified by applying the same standard applicable to the corresponding domestically secured claims. As such, claims secured by Overseas Collateral under a Chapter 2 rehabilitation proceeding would likely be classified as secured rehabilitation claims, and claims secured by Overseas Collateral under Chapter 3 proceedings would likely be classified as secured claims with right of separation. However, would such classification mean that such secured claims so classified would be subject to the stay or other limitations imposed under a Korean insolvency proceeding in the same way as the claims secured by the debtor's assets situated in Korea?

As seen in Part II above, in the case of secured claims with right of separation in a Chapter 3 bankruptcy proceeding, the enforcement of security interest in collateral is not stayed by the commencement of a Chapter 3 proceeding. Thus, the claims secured by Overseas Collateral would not be stayed by the commencement of Chapter 3 proceedings.<sup>48)</sup> On the other hand, as discussed in Part II above, secured rehabilitation claims are subject to stay upon commencement of a Chapter 2 rehabilitation proceeding. Thus, in a Chapter 2 rehabilitation proceeding, the issue of whether the stay under a Korean insolvency proceeding would extend to Overseas Collateral would be of much significance to the relevant secured creditors as well as other interested parties.

Under Article 5 of EU Insolvency Regulations, and court precedents or

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47) Upon commencement of a Chapter 3 bankruptcy proceeding, other than certain exceptions specified in the DRBL, all assets owned by the debtor that exist at the time of the commencement of such proceeding shall constitute the bankruptcy estate (Article 382 of the DRBL). While a Chapter 2 rehabilitation proceeding does not use the term 'rehabilitation estate', upon commencement of such proceeding, the rights to manage and dispose of all assets and businesses of the debtor at the time of the commencement of the proceeding shall belong to the receiver (Article 56 of the DRBL), subject to the supervision of the court, and therefore, the debtor's assets in a Chapter 2 rehabilitation proceeding may be considered equivalent to the bankruptcy estate.

48) Note, however, that if the claims are under-secured by Overseas Collateral, a creditor with secured claims with right of separation can participate and receive payment out of Chapter 3 proceedings only in respect of the amount of the deficient portion of the claims which remains after the foreclosure of Overseas Collateral. Further, as set forth in Part II above, in the case of a Chapter 3 proceeding, there is a time limit by which the disposition of collateral must be completed.

statutory provisions, as the case may be, of the United Kingdom, Netherlands and Spain, the effect of a domestic insolvency proceeding does not extend to security interest in collateral situated in a foreign country.<sup>49)</sup> As a general proposition, it is also viewed that: the stay of the enforcement of security interest, the right of the representative of an insolvency proceeding to use and dispose of collateral, claims with priority over security interest, the insolvency representative's right to substitute collateral, whether the debtor may borrow a loan which has priority over existing security interest, whether a secured creditor is bound by voting on repayment plans, etc. would be governed, in principle, by the laws of the country in which the collateral is located and therefore, if collateral is located in a foreign country, such collateral would be free from a domestic insolvency proceeding.<sup>50)</sup>

In the author's view, while Overseas Collateral would constitute an insolvency estate by applying Korean law and for the purpose of a Korean insolvency proceeding, in view of the principle established by foreign legislation and court precedents, the better view would be that other aspects involving the enforcement of security interest in Overseas Collateral should be governed by not only Korean law but also the laws of the foreign country in which Overseas Collateral is situated.<sup>51)</sup> Accordingly, although there is no court precedent and an opposing view may be presented,<sup>52)</sup> in the author's

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49) See WOOD, *supra* note 26, at 855, 864-65.

50) See WOOD, *supra* note 26, at 864.

51) Kwang Hyun Suk, *supra* note 4, at 365, introduces the following German scholarly views that were presented before the German insolvency law (*Insolvenzordnung*) was amended in 2003 to include new provisions for the regulation of cross-border insolvency: (i) the first view was to apply the laws of the country where an insolvency proceeding commenced (*lex fori concursus*) with emphasis on the principle of universality; (ii) the second view was to deny the application of *lex fori concursus* for the protection of secured creditors, consequently reaching the same conclusion as that under the principle of territoriality; (iii) as a compromised view, the third view was to include overseas collateral in the insolvency estate of a domestic insolvency proceeding, but applying the insolvency laws of the foreign country in which overseas collateral is situated; and (iv) the fourth view was to include overseas collateral in the insolvency estate of a domestic insolvency proceeding as in the third view, but applying either the law of the country in which overseas collateral is situated or *lex fori concursus*, whichever is more favorable to the secured creditor. In his recent article, Kwang Hyun Suk has expressed a view that under the DRBL of Korea, the third or the fourth view above would be the most persuasive interpretation in determining the effect of a Chapter 2 rehabilitation proceeding of Korea on a security right to Overseas Collateral. See Kwang Hyun Suk, *Choice of Law Rules in the Cross-border Insolvency under Korean Law*, 4 JURIS 128 (Sabeop Baljeon Jaedan, June 2008) (in Korean). The author has the same view as this view.

52) In Japan, it appears that unlike secured creditors with right of separation under a bankruptcy

view, the stay of the enforcement of secured rehabilitation claims upon commencement of a Chapter 2 rehabilitation proceeding in Korea should not extend to the security right to Overseas Collateral unless such stay is recognized and enforced by the foreign country in which Overseas Collateral is situated.<sup>53)</sup>

## (2) Application of the Hotchpot Rule to Claims Secured by Overseas Collateral

As seen above, the UNCITRAL Guide explains that to the extent claims of secured creditors or creditors with rights *in rem* are paid in full (a matter that depends on the law of the State where the proceeding is conducted), those claims are not affected by the provision of Article 32 of the Model Law. Further, the intention or ramifications of excluding secured claims and rights *in rem* from the ambit of Article 32 of the Model Law is elaborated as follows:

“[D]epending upon the value of the rights in question, that party may not need to participate in the process of *pari passu* distribution, or may only need to lodge proof for the unsecured balance of claims. In that event, the proportion of the original claim that was covered by the realized value of the security is ignored for the purpose of dealing with the unsecured balance of the debt. By the same token, it cannot be made as a basis of objection to the secured creditor enforcing his security that he will thereby obtain a greater proportion in payment of his gross claim than is destined to be received by unsecured creditors of the same class whose only return comes by way of dividend.<sup>54), 55)</sup>

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proceeding, a creditor with a secured reorganization claim in a corporate reorganization proceeding shall not be permitted to enforce its security interest in overseas collateral and payment received out of overseas collateral would be subject to the adjustment of payment under the Japanese hotchpot rule. See *INSOLVENCY PRACTICE HANDBOOK* 786-811 (Ichiro Nagaishi ed., Chuo Keizai-shya 2007) (in Japanese).

53) Likewise, in the author's view, the enforcement of security interest in Overseas Collateral in accordance with the laws of the foreign country in which such collateral is situated should not be subject to the stay pursuant to a preservation order issued by a Korean court unless such order is recognized and enforced in that foreign country.

54) See FLETCHER, *supra* note 14, at 486.

55) In England, the hotchpot rule has been applied to insolvency proceedings since the late 19<sup>th</sup> century (*Banco de Portugal v. Waddell* of 1880 is one of the leading cases in England where the hotchpot rule was applied in an insolvency proceeding). In England, in the case of a purely domestic insolvency proceeding, as a matter of general principle, secured creditors can enforce security interest and exercise unsecured claims remaining after the enforcement of secured claims. In the case that a foreign creditor

### (A) Chapter 3 Bankruptcy Proceedings

Secured claims with right of separation under Chapter 3 bankruptcy proceedings can be enforced regardless of the commencement of the proceeding. The creditors with such secured claims should first recover the claims by disposing of collateral and can receive the amount of the remaining claims, as unsecured claims, in the domestic proceedings. Such remaining claims would then be subject to the rule of payment under Article 642 and in applying such rule the amount of payment recovered from the disposition of Overseas Collateral would not be considered. Further, the enforcement of security interest in a foreign country would not be stayed or otherwise prevented by virtue of Article 642. Thus, in the context of a Chapter 3 proceeding, it is clear that claims secured by Overseas Collateral would not be prejudiced by Article 642 of the DRBL and Article 642 would function in the same way as Article 32 of the Model Law regardless of whether such proceeding is recognized and enforced in the foreign country in which Overseas Collateral is situated.

### (B) Chapter 2 Rehabilitation Proceedings

Would the same conclusion be drawn in the case of Chapter 2 rehabilitation proceedings? As mentioned in Part II above, the amount of secured rehabilitation claims is determined based on the value of collateral at the time of the commencement of the proceeding, and once determined will not be increased or decreased depending upon the appreciation or depreciation of the collateral value thereafter. Secured rehabilitation claims will be given priority over unsecured rehabilitation claims.<sup>56)</sup> For the purpose of the analysis, this article reviews three typical situations below. Suppose that the amount of claims held by creditor X was 100 and the value of Overseas Collateral securing such claim at the time of commencement of the Chapter 2 proceeding was 50. Suppose further that under the rehabilitation plan, (i) in

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exercised, in an insolvency proceeding commenced in England, claims remaining after the enforcement of security interest in collateral outside of England, the issue arose whether the hotchpot rule applied to the amount of the claim recovered from the overseas collateral. Under the court precedents in England, regardless of whether before or after the insolvency proceeding commenced in England, the amount recovered from a foreign court based on security interest granted to the creditor under the foreign law was not subject to the hotchpot rule. *See* PHILIP ST J SMART, *CROSS-BORDER INSOLVENCY* 176 (Butterworths 1991).

56) Note, however, that the Korean courts have applied the so-called “relative priority rule” in rehabilitation proceedings unlike the bankruptcy proceedings where the “absolute priority rule” applies.

the case of secured rehabilitation claims, 100% of the claims would be paid over five years in equal installments at the end of each year and (ii) in the case of unsecured rehabilitation claims, 30% of the claims would be paid over ten years in equal installments at the end of each year and the remaining claims are exempted.

(a) First Scenario

Suppose that the outstanding and unpaid amount of secured rehabilitation claims at the time of commencement of the proceeding was 50 (i.e., the other 50 had been duly repaid before the commencement of the proceeding) and the entire amount of creditor X's claim was recognized as a secured rehabilitation claim. In this case, the amount of such secured rehabilitation claim (50) will be fully paid over 5 years in five installment (each installment being 10). As discussed above, in the author's view, assuming that a rehabilitation proceeding of Korea is not recognized and enforced in the foreign country in which Overseas Collateral is situated, the enforcement of the security interest in Overseas Collateral should not be stayed by the commencement of a Chapter 2 proceeding in Korea. Suppose therefore that right after the commencement of the rehabilitation proceeding in Korea, the creditor recovers 50 by enforcing the security interest in Overseas Collateral. In that case, the creditor will have recovered the full amount of the claim secured by the Overseas Collateral and will have no residual claim against the debtor under the rehabilitation plan. Thus, there is no room for the application of Article 642 in such example.

On the other hand, suppose that the value of Overseas Collateral decreases to 40 and creditor X recovers 40 (i.e., 80% of the claim amount) from the disposition of entire Overseas Collateral after the commencement of the rehabilitation proceeding in Korea. Notwithstanding the depreciation of the collateral value, creditor X's claim would continue to be recognized as a secured rehabilitation claim in its entire amount (i.e., 50) determined at the time of commencement of the proceeding and therefore, creditor X may receive an additional 10 pursuant to the rehabilitation plan. If Article 642 were applied, however, before receiving such additional 10, creditor X must wait until other creditors with secured rehabilitation claims receive 80% of their claims under the rehabilitation plan.

This result also shows that the claim secured by Overseas Collateral is not prejudiced by Article 642 of the DRBL since the amount of 40 recovered from

the disposition of Overseas Collateral is not shared with other creditors in the Korean proceeding. Accordingly, in the case of this first scenario, the result of applying Article 642 would be the same as if Article 32 of the Model Law were applied. In this connection, however, another fundamental issue arises as to the equitability of paying the additional 10 to creditor X while as a matter of fact, Overseas Collateral is not included in the insolvency estate of the debtor and does not contribute to the rehabilitation of the debtor. This issue is not a matter involving the application of the hotchpot rule, but a matter related to the outward effect of a Korean insolvency proceeding on Overseas Collateral which is not, in fact, included in the insolvency estate of the debtor. It would be unfair to give creditor X the above windfall benefit of 10 *vis-à-vis* other secured creditors whose collateral are subject to and, in fact, included in the insolvency estate of the debtor. How is this to be resolved? In determining the equality of payment, Article 642 of the DRBL considers the amount of payments received by other creditors of the same class and ranking in the domestic insolvency proceeding. In the author's view, in order to prevent the foregoing unfair result of giving windfall benefits to creditor X, the court should subdivide the class of secured rehabilitation claims into different sub-classes and assign the creditor whose claims are secured by Overseas Collateral into a different sub-class. With respect to such creditors whose claims are secured by Overseas Collateral, different payment terms may be provided under the rehabilitation plan. For instance, such creditors should first recover their secured claims from Overseas Collateral outside of the proceeding and receive payment only in respect of the amount remaining after such recovery pursuant to the payment terms applicable to the unsecured rehabilitation claims under the rehabilitation plan. If this method is applied to the first scenario above, creditor X has to recover the secured claim out of the Overseas Collateral first and any deficient claim which has not been recovered would be treated and paid as unsecured rehabilitation claim under the rehabilitation plan. This result would be the same as the result that would apply to creditor X if a Chapter 3 bankruptcy proceeding were commenced.

(b) Second Scenario

Suppose that the unpaid outstanding amount of creditor X's claim was 100. Further, 50 was recognized as secured rehabilitation claim and the remaining 50 was recognized as unsecured rehabilitation claim. Suppose that creditor X recovers 40 (80% of the secured rehabilitation claim) out of

Overseas Collateral after the commencement of the proceeding. In this case, the amount of secured claim would be reduced to 10. This situation would be exactly the same as the first scenario above where the amount recovered from Overseas Collateral was 40 (80% of the amount of secured rehabilitation claim) and the same analysis applies.

(c) Third Scenario

Under the facts given in the second scenario, let's suppose that creditor X recovers 70 from Overseas Collateral due to the appreciation of its value. In that case, of the recovered amount, 50 would be applied to the full payment of the claim recognized as secured rehabilitation claim and the remaining 20 would be applied to the payment of the unsecured rehabilitation claim. If Article 642 of the DRBL were applied in the same manner as Article 32 of the Model Law (i.e., without prejudice to secured claims), the above payment of 20 recovered from Overseas Collateral and applied to the payment of unsecured rehabilitation claim would not be subject to the rule of payment adjustment under Article 642 of the DRBL and creditor X would be permitted to receive the remaining amount of 30 by applying the payment rate of 30% in *pari passu* with the other unsecured creditors. On the contrary, if the rule of payment under Article 642 were applied to the payment of the unsecured rehabilitation claim in the above scenario, creditor X would not be permitted to receive any further payment under the rehabilitation plan since it had already received 40% of its unsecured rehabilitation claim in excess of the 30% payment rate applicable to the other unsecured rehabilitation claims under the rehabilitation plan. Would this result be fair to creditor X? Would it be fair to classify the unsecured rehabilitation claim of creditor X in the same class as the other unsecured creditors? In the author's view, for the same reason that creditor X should not be permitted to receive windfall benefits, it should also not be prejudiced by assigning the benefits out of Overseas Collateral to domestic creditors who were not entitled to any benefit from security interest in Overseas Collateral. Thus, creditor X should be assigned to a different subclass and be permitted to receive the amount of the deficient claim which remains after disposition of the Overseas Collateral in *pari passu* with other unsecured creditors. In such case, as creditor X belongs to a different class from other unsecured creditors, payment received by creditor X from a concurrent foreign proceeding (or the debtor's overseas assets) would not be subject to Article 642 of the DRBL and the benefit of such payment would not

be shared with other unsecured creditors.

(C) Conclusion

In the case of a Chapter 3 bankruptcy proceeding, it is clear that a claim secured by Overseas Collateral would not be prejudiced by the application of Article 642 even if such proceeding is not recognized and enforced in the foreign country in which Overseas Collateral is situated. In the case of a Chapter 2 rehabilitation proceeding, however, there may be different views as to whether a claim secured by Overseas Collateral would be prejudiced by Article 642 if such proceeding is not recognized and enforced by the foreign country in which Overseas Collateral is located. In the author's view, such claim should not be prejudiced by Article 642 by assigning such claim to a different subclass under the rehabilitation plan.<sup>57)</sup> If a creditor with a claim secured by Overseas Collateral is assigned to a different subclass, payment received by such creditor out of Overseas Collateral would not be shared with other unsecured creditors of a different class, even if such other creditors are of the same ranking. This is because payment adjustment under Article 642 of the DRBL applies *vis-à-vis* other creditors of "the same class and ranking" and creditors belonging to a different sub-class are not considered creditors belonging to the same class.

In this connection, a question arises as to which country's laws will apply in determining whether a concerned claim is considered "a claim secured by Overseas Collateral," which is not prejudiced by Article 642 of the DRBL. There is no court precedent or scholarly view on this point yet in Korea. In the author's view, (i) if a concerned security interest is recognized as a valid security interest pursuant to the laws of the foreign country in which a concurrent foreign insolvency proceeding has commenced or Overseas Collateral is situated (even if such security interest is not recognized as a valid security interest under a law determined pursuant to the Private International Law of Korea) and (ii) if the security interest is equivalent to a security interest for a secured rehabilitation claim (under a Chapter 2 rehabilitation proceeding) or a secured claim with right of separation (under a Chapter 3

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<sup>57)</sup> However, if a secured creditor wishes to avoid such separate classification and agrees to voluntarily move Overseas Collateral (*e.g.*, movable property, securities, etc.) into Korea (*i.e.*, into the insolvency estate of Korea) and be bound by the stay, then it may be considered that the claim secured by such Overseas Collateral shall be treated under the rehabilitation plan as if such claim were secured by domestic collateral at the time of the commencement of the proceeding.

bankruptcy proceeding), the claim secured by such security interest in Overseas Collateral should also be recognized as a valid secured rehabilitation claim or secured claim with right of separation for the purpose of a Korean insolvency proceeding, and thus, such secured claim should not be prejudiced by Article 642 of the DRBL.<sup>58)</sup>

5) *Is excess payment from a foreign insolvency proceeding subject to disgorgement?*

Payment which is subject to the rule of adjustment under Article 642 may be made to a concerned creditor at a rate exceeding that applied to payments to other creditors of the same class and ranking in a domestic insolvency proceeding. In such case, a question may arise whether the amount of payment made to that creditor in excess of the payment rate applied in a domestic insolvency proceeding can be disgorged and returned to the insolvency estate of a domestic insolvency proceeding. Article 642 addresses payment made basically out of a foreign insolvency proceeding, which is proceeded under a foreign insolvency law regime and the judicial sovereignty of a foreign country for the purpose of fair and equitable payment for creditors in general. Thus, it would not be proper to deny validity of payment made to a creditor who, like other creditors, passively participates in such foreign proceeding, by unilaterally applying the domestic stay which exists under the domestic insolvency proceeding to such payment. Further, it may be viewed that the provision of Article 642 has already been prepared on the premise that payment under such foreign insolvency proceeding would be regarded as advance payment validly made out of a domestic insolvency

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58) However, in connection with the meaning of “a secured claim” which stems from the rule of payment under Article 32 of the Model Law, a different scholarly view has been presented. According to this view, if a concerned security interest is recognized as such under the domestic law (in other words, a security interest is recognized by a law determined pursuant to the domestic private international law), the claim secured by such security interest should be recognized as a “secured claim,” as referred to in Article 32 of the Model Law, even if such claim is deemed an unsecured claim under the relevant proceeding of a foreign country. *See Yamamoto, supra* note 17, at 54. However, in the event that a concerned security interest is not recognized as such under the domestic law while it is recognized as a security interest under the relevant proceeding of a foreign country, this view raises a question as to whether such claim should be treated as an unsecured claim for the purpose of the domestic insolvency proceeding, and proposes that further review is needed with regard to this question in terms of Article 13② of the Model Law, which provides that the priority of claims shall be determined by an enacting State.

estate. Thus, in the author's view, disgorgement of such excess amount should be denied.<sup>59)</sup> On the other hand, in the case of payment which is not governed by Article 642 (i.e., payment made out of the debtor's assets where there is no concurrent proceeding in a foreign country), it may be controversial as discussed below whether payment made out of the debtor's assets situated in a foreign country is subject to disgorgement by applying Korean laws.

### *3. Equalization of Payments vis-à-vis the Relative Priority Rule under Chapter 2 Rehabilitation Proceedings*

In the case of a Chapter 2 bankruptcy proceeding, the absolute priority rule applies in determining the priority and amount of payment to creditors. Thus, only after a creditor with a senior ranking has been fully paid may a junior creditor be paid. In the case of a Chapter 2 rehabilitation proceeding, however, the so-called "relative priority rule" has been adopted in Korea. Under this rule, even if a creditor of a senior ranking has not been fully paid, some payment can be made to creditors at junior ranking pursuant to the payment terms which are determined in a fair and equitable manner, taking into account the order of priority of the claims (Article 217 of the DRBL), provided that unless otherwise consented to by such senior creditor, the amount of payment to such senior creditor shall be no less than the amount payable to such senior creditor if the debtor were liquidated (Article 243 of the DRBL). Accordingly, depending upon the circumstance, even if a secured creditor is not yet fully paid, a partial payment may be made to unsecured creditors, and even if unsecured creditors are not fully paid, interest of the equity holders may partially remain under the rehabilitation plan. Further, unlike a Chapter 3 bankruptcy proceeding, where all the debtor's assets which constitute the bankruptcy estate are liquidated and distributed to creditors, in a Chapter 2 rehabilitation proceeding, the portion of secured and unsecured rehabilitation claims which are not recognized as payable under the rehabilitation plan will be discharged upon the approval of the rehabilitation plan by the creditors and the court. Thus, in the case of a Chapter 2 rehabilitation proceeding, any excess recovery made to the insolvency estate

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<sup>59)</sup> All scholarly views in Korea are of the same view. See Suk, *supra* note 4, at 371; Lim, *supra* note 4, at 314.

as a result of the application of the hotchpot rule (or by disgorgement as discussed below) should be reserved pursuant to the rehabilitation plan for additional payments to the rehabilitation creditors as and when such excess recovery is made. Otherwise, the equity holders would unfairly benefit from such excess recovery at the expense of creditors. In addition, if secured rehabilitation claims are not fully paid under the rehabilitation plan, such excess recovery should first be used to pay secured creditors, unless payment of all or part of such excess recovery to unsecured creditors is justified by application of the relative priority rule.

## **V. Overseas Payment which is not subject to Article 642 of the DRBL**

As mentioned above, in the author's view, payment made out of the debtor's assets where there is no concurrent foreign insolvency proceeding would not be governed by Article 642 of the DRBL. Thus, an issue arises as to how such payment would be treated for the purpose of Korean insolvency proceedings. In addressing this issue, it is necessary to consider that an effective measure should be established to avoid unfairness among creditors of the same class and ranking, which would otherwise be created if the principle of territoriality were not abolished by the DRBL.

### *1. Security Right to Overseas Collateral*

Even if there is no concurrent foreign insolvency proceeding, with regard to a claim secured by Overseas Collateral, the discussions on Article 642 in Part IV.2.4) above would apply. Below is summary of the above discussion particularly with regard to Chapter 2 and Chapter 3 proceedings.

In the case of a Chapter 3 bankruptcy proceeding, a creditor with such claim may participate in the Chapter 3 proceeding with the amount of the deficient claim remaining after the disposition of Overseas Collateral. Enforcement of security interest in Overseas Collateral would not be stayed and payment made out of such enforcement would be considered valid.

In the case of a Chapter 2 rehabilitation proceeding, a claim secured by security interest in Overseas Collateral may be recognized as secured

rehabilitation claim to the extent of the collateral value determined at the time of the commencement of the proceeding, and the under-secured portion, if any, may be recognized as unsecured rehabilitation claim. Such secured rehabilitation claim and unsecured rehabilitation claim, respectively, may be assigned to a different subclass from other secured or unsecured creditors of the same ranking, as the case may be, and such secured rehabilitation claim and unsecured rehabilitation claim as so assigned to different classes may receive payment under different terms, such that the secured rehabilitation claim should be recovered first from Overseas Collateral and only the residual deficient claims should be paid in accordance with the payment terms applicable to other unsecured creditors under the rehabilitation plan. As discussed above, in the author's view, unless a Chapter 2 rehabilitation proceeding of Korea is recognized and enforced in the foreign country in which Overseas Collateral is situated, the enforcement of security interest in Overseas Collateral should not be subject to the stay under the Chapter 2 rehabilitation proceeding. Likewise, the effect of a court's preservation order which prohibits a creditor or creditors from continuing or initiating an auction for foreclosure of collateral should not extend to Overseas Collateral. Therefore, proceeds which have been validly recovered from the enforcement of Overseas Collateral pursuant to the laws of the foreign country in which such collateral is situated can be kept by the creditor and should not be disgorged and returned to the insolvency estate of the Chapter 2 proceeding of Korea whether or not there is a concurrent foreign insolvency proceeding.

## *2. Payments Made out of the Debtor's Assets Situated in a Foreign Country*

Regarding other payments made out of the debtor's assets where there is no concurrent foreign proceeding, either or both of the following methods may be considered to achieve equality of payments between creditors of the same class and ranking in an insolvency proceeding of Korea.

### *1) Deduction from payments to be made in a Korean insolvency proceeding*

For the purpose of a Korean insolvency proceeding, the debtor's assets situated in a foreign country also constitute an insolvency estate of a Korean insolvency proceeding upon commencement of the proceeding. Thus,

payment which has been validly made to a creditor out of the debtor's assets located in a foreign country in accordance with the applicable foreign laws may be deemed to be payment made to that creditor from the insolvency estate of the Korean proceeding. Accordingly, such payment may be characterized as an advance payment and deducted from payment to be made to that creditor in a Korean insolvency proceeding. If this view is taken, it would be possible to achieve equality of payments between such creditor and other creditors of the same class and ranking in a Korean insolvency proceeding by adjusting the amount of payment to be made to such creditor by an equitable method in a Korean insolvency proceeding, without need to invalidate payment made to such creditor and require that such payment be disgorged and returned to a Korean insolvency proceeding. In this regard, such an equitable method would be, in substance, the same as the method under Article 642 of the DRBL. The weakness of this approach, however, would be that if the amount of overseas payment made to such creditor is in excess of its pro rata share in the Korean insolvency proceeding, the excess amount cannot be shared with other creditors in the Korean insolvency proceeding. Therefore, it becomes necessary to review the issue of whether such payment made from the debtor's overseas assets can be disgorged and returned to the Korean insolvency estate as discussed below.

## *2) Disgorgement of payment made out of the debtor's overseas assets*

In the case where there is no concurrent foreign insolvency proceeding, if payment is made to a creditor after the commencement of a Korean insolvency proceeding, through an individual compulsory enforcement against the debtor's assets situated in a foreign country or by a voluntary payment by the debtor out of the debtor's assets situated in a foreign country, it may be considered that such payment has actively violated the stay under the Korean insolvency proceeding for the purpose of receiving payment in priority of other creditors who participate in the Korean proceeding.<sup>60)</sup> Thus, an argument can be made that such payment should be treated differently than payment made out of a foreign insolvency proceeding which is proceeded as a collective proceeding for the equal and fair treatment of creditors in general under a foreign insolvency law regime, in which a creditor participates in a passive manner together with other creditors. According to this view, the validity of such payment made through an individual

compulsory enforcement or the debtor's voluntary payment should be determined by mandatorily applying the Korean insolvency law. Then, such payment would be deemed null and void under the DRBL since such payment violates the mandatory provisions of the DRBL which prohibit such payment after the commencement of an insolvency proceeding in Korea. Accordingly, under the Korean Civil Code, the amount of such payment would be considered unjust enrichment obtained by such creditor and should be returned to the insolvency estate of a Korean insolvency proceeding. In this regard, disgorgement of such unjust enrichment would likely be limited to payment made to a creditor over which a Korean court has a valid jurisdiction.

The amount of unjust enrichment would be, in principle, the entire amount of such payment made in violation of the stay under a Korean insolvency proceeding; however, ultimately, the amount of unjust enrichment would be the amount exceeding the proportionate amount which would have been paid to such creditor if such payment was included in an insolvency estate of a Korean insolvency proceeding. If such creditor participates in the Korean insolvency proceeding and if the amount of such payment received by such creditor has not yet been returned to the insolvency estate of Korea, the representative of the Korean insolvency proceeding may deduct the amount of such payment from the amount of payment(s) to be made to such creditor in the Korean insolvency proceeding by making a set-off(s).

With regard to the above view, an opposing view may be asserted. According to this latter view, the former view excessively expands the effect of a domestic insolvency proceeding, solely based on the unilateral external effect of a domestic insolvency proceeding, to the debtor's assets situated in a

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60) A similar question would arise if such payment is made out of the debtor's assets located in a foreign country after the issuance of one or more preservation orders by a Korean court during the gap period between the filing and commencement. In the author's view, as such payment is made before the commencement of a domestic insolvency proceeding, neither Article 642 of the DRBL nor the discussion in Part V.2.1) above would apply. Thus, a representative of a Korean insolvency proceeding may consider filing a petition to a foreign court for recognition and enforcement of such preservation order(s) in the foreign country in which the relevant assets are located. If such recognition or enforcement is not likely available in a timely manner before such payment is attempted, then the representative of the Korean insolvency proceeding may consider, depending upon the nature of a preservation order, the issue of whether such payment made in violation of a preservation order may be subject to disgorgement and so may be ordered to be returned to the insolvency estate of Korea.

foreign country, and deny the validity of payment which has been duly made in accordance with the foreign laws where the assets are situated. The latter view may also point out that as a matter of conflict of laws principle, it is questionable whether Korean insolvency law and the Korean Civil Code may actually be applied in determining unjust enrichment.

This issue begs further review and study. At the out set, in the author's view, in terms of the outward-bound effect of a Korean insolvency proceeding that was newly adopted under the DRBL and the cross-border insolvency laws and practices of other foreign countries, a better view would be the first view which mandates return of such payment, as unjust enrichment, to the insolvency estate of Korea.<sup>61)</sup>

## VI. Conclusion

The DRBL has built a strong platform for the internationalization of Korea's insolvency law regime in terms of both the procedural law and the substantive law aspects. The rule of payment adjustment adopted in Article 642 of the DRBL, however, raises certain issues which need to be clarified as and when such rule is applied to, and tested in actual cases. In addition, as related matters, the effect of a Korean insolvency proceeding on a security right to Overseas Collateral and the permissibility of disgorgement of payment made from the debtor's overseas assets which is outside the ambit of Article 642 of the DRBL need further review and study. The author hopes that the analyses and observations in this article will be helpful in establishing insolvency law practice of Korea involving the hotchpot rule and the legal principle related thereto.

KEY WORDS: Debtor Rehabilitation and Bankruptcy Law, UNCITRAL Model Law on Cross-

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61) In Germany, while payment out of a foreign insolvency proceeding would be merely subject to the hotchpot rule, it is considered that pursuant to a judgment of *Bundesgerichtshof* (Federal Supreme Court in Civil and Criminal Matters) rendered in 1983, payment out of an individual compulsory enforcement or voluntary payment would be subject to disgorgement and should be returned to the domestic insolvency estate. See Hans Hanisch, *Crediting a Creditor with Proceeds Recovered Abroad out of the Debtor's Assets Situate Abroad in Domestic Insolvency Proceedings*, in CROSS-BORDER INSOLVENCY: COMPARATIVE DIMENSIONS 195-96, 201 (Ian F. Fletcher ed., United Kingdom National Committee of Comparative Law 1990).

Border Insolvency, principle of territoriality, principle of universality, bankruptcy proceeding, rehabilitation proceeding, hotchpot rule, rule of payment in concurrent proceedings