Journal of Korean Law | Vol. 8, 365-431, June 2009

Mergers and Acquisitions Practice of Reorganizing Corporations in Korea and Its Ongoing Change

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Abstract

One of the most outstanding legal phenomena in Korean reorganization practice has been the pursuit of Mergers and Acquisition. In fact, in Korea, reorganization practice just begun one decade ago right after a number of conglomerates fell into bankrupt, when Korea faced nationwide economic disaster provoked by the lack of foreign key currency, and a number of conglomerates fallen into bankrupt rushed into court. M&A transaction in reorganization procedure emerged right after the rush of reorganization filings. Meanwhile, it has played significant role in rehabilitation of reorganizing company. Until now, almost every reorganizing company has succeeded in rehabilitating by being injected capital via M&A. Analysis of efficiency of M&A transaction of reorganizing company carried out last several years shows that the earlier debtor company initiates M&A, the more creditors are paid. This is the reason that all the reorganizing companies are urged to pursue successful M&A transaction. M&A of the reorganizing company has several features arising from the limitation to meet the needs of the debtor company; receiver-initiating, fast completion and strictness in negotiation between the debtor and buyer. In reorganization practice, most M&A transactions are carried out through issuing new shares to buyer and, business transfer or asset transfer is rarely pursued. In the M&A process, fairness to potential buyers is the most highlighted, for it induces better price due to their competency to acquire the reorganization company. Recently, a significant change in reorganization practice regarding the pursuit of M&A occurs due to the Debtor Rehabilitation and Bankruptcy Law effective as of April 1st, 2006. It introduced quasi-debtor in possession receivership, and then gives reorganization practice a significant influence for receivers not to have to pursue M&A in every reorganization case. Moreover, new reorganization practice allows and respects the result of M&A conducted in a fair manner under the consent between debtor and major creditors. Furthermore, M&A practice of reorganizing company is changing regarding how and when it is initiated, as global economic surroundings are on changing, and receivers of the reorganization

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company under the supervision of court is seeking efficient ways to M&A for rehabilitation of once financially distressed company.

I. Introduction

Lately, in Korea, it is very common to come across news, reports or articles on mergers and acquisitions (M&A) of various corporate entities, but the emergence of M&A as an attention-worthy private business activity among the Korean financial and business milieu is relatively a recent phenomenon; led by a number of conglomerates, Korean companies began utilizing M&A as an integral part of their restructuring procedures following the outbreak of the economic crisis in 1997.

It has merely been over a decade since the bankruptcy laws have been routinely put into practice in Korea, while substantial studies concerning legal principles of the bankruptcy laws and reorganization practices that materialize such principles are even more recent occurrences themselves. After all, it may as well be said that corporate reorganization practices are regarded as fairly new in Korean corporate settings, and M&A, which only began regularly appearing in restructuring practices since the new millennium, may arguably be one of the youngest areas of the practices.

One of the most salient differences in reorganization practices of Korea that separates it from similar practices of other countries has to be its substantial use of M&A transactions. Most companies with reorganization plan confirmed[1)] pursue M&A transactions, either on its own account or not. The old corporate reorganization practice under the Company Reorganization Law, which was abolished as the Debtor Rehabililtation & Bankruptcy Law is effective, identified M&A as an essential aspect of the reorganization procedure, and eliminating factors that might potentially impede M&A had been regarded as one of the most important tasks, while M&A had always been an important matter of concern for receivers in their execution of business after commencement of cases or confirmation of the plans. It would

1) In reorganization practice in Korea, confirmation of plan does not mean the closing of the reorganization case. Court usually supervises debtor companies' carrying out the approved and confirmed plan of amortization style paying off.

not be an exaggeration to note that M&A has come forth as the sole device for a bankrupt company looking to rehabilitate through reorganization procedures. Nonetheless, M&A transactions carried out following the previous reorganization practice are not coherent in their contents or execution. The differences in nature of businesses and profits, as well as other situations the companies going through M&A transactions may face, could be the main reason for such discrepancy, and the piecemeal changes based on the results of M&A's implantation into the reorganization procedures, as well as the market's consistent transformation, may also have constituted the reasons for such inconsistency.

Recently, a significant factor has arisen that should bring changes to prospective M&A practices for bankrupt companies — the Debtor Rehabilitation & Bankruptcy Law ("DRBL"), which came into effect on April 1st, 2006 has introduced the "Quasi-Debtor in Possession Receiver System," or former executives receivership system while substantially reinforcing the functions and authorities of the creditors' committee in order to supervise and restrain the business activities of former executives.

In the newly-adopted reorganization procedures, receivers who are former executive managers at the time of filing of reorganization petition will have an inclination to take passive attitudes towards M&A as they will attempt to hold onto their rights to conduct business, as well as their controlling interests of the company once confirmation of the reorganization plans has been granted, and, thus, it may be difficult to commence M&A transactions in an opportune time. On the other hand, creditors have been criticizing about their lack of participation in such receiver-initiating M&A transactions, and that the control of such companies facing reorganization might be transferred at unreasonably low prices; in the new reorganization procedure, a more intricate conciliation of interests may be required due to the reinforced functions and authorities of the creditors' committee that will likely attempt to reflect the interests of the creditors to a greater degree.

In this article, without explaining the general subject matter of M&A transactions and based on the author's understanding garnered through dealing with a series of companies' M&A transactions during their reorganization procedures and other cases that the author had come across, it will present the preexisting processes of an M&A transaction of such companies and the recurring commercial and legal issues, followed by an

explication of the rationale behind these matters. In addition, this article will further elaborate on the possible amendments and the elements of concern for the M&A practice that may be expected under the new DRBL. Moreover, since an M&A transaction is an inseparable constituent within reorganization procedure, explanations concerning bankruptcy-law-related matters will be provided, but restricted to an extent where basic understanding of an M&A transaction in such bankruptcy procedure is required.[2)]

II. A Need for M&A Transactions in Reorganization Procedures

1. A Need for M&A Transactions in Reorganization Procedures Operational Experiences

① Reorganization procedure may be defined as a collective debt restructuring procedure to keep a financially troubled or bankrupt company viable through conciliation of various interests that surround debtors facing bankruptcy, including the creditors and the shareholders. It may possess number of social and economic functions, but its fundamental function is to equitably distribute the assets and profits to the company's creditors as a part of a collective debt restructuring procedure. Reorganization procedure may be distinguished from straight bankruptcy procedure, which presupposes that debtor dissolves and ceases to do business, in that it assumes that the debtor continues her own business, pays off her debt with the proceeds from that business, and carries out her reorganization plan. That means corporate reorganization procedures thereby seek to simultaneously accomplish two

2) M&A transactions of a company facing reorganization is a legal phenomenon that demands an understanding of general laws, including commercial law and insolvency law, while simultaneously requiring an economic, managerial judgment that pursues resource-distribution efficiency. When engaging in actual M&A transactions of reorganizing companies, one often encounters problems that cross the legal and managerial boundaries. In course of solving such problems, conflicts between lawfulness and efficiency inevitably occur, indicating that M&A transactions do not solely depend on the logic of lawfulness or efficiency. Therefore, one must consider both the aspects of lawfulness and efficiency of a transaction in understanding M&A activities of a company facing reorganization.

objectives of "continuation of business" and "maximization of creditors' satisfaction."

Previous reorganization plans of most companies facing bankrupt took into consideration the fact that the companies are not likely to recover their earning powers early in the process, and accordingly devised restructuring plans that postponed debt payment for a specific period in the early stages of the plan, removing the debtors from the pressures of their debts for a set period to concentrate solely on the restoration of their businesses and earning powers, thereby establishing solid grounds of their restructuring plans as early as possible. Hence, if a company restores its earning powers fairly early and lays a foundation to continue on its business, it may simply execute the remaining stages of the confirmed plan to successfully complete its reorganization procedure and restructure itself on its own.

Regrettably, most companies facing reorganization fail to carry out these plans, leading them to severe difficulties in carrying out their reorganization plans beyond their debt postponement period even resulting in nullification of reorganization procedures. In the last few years, as attesting to this point, the author had not been able to locate successful cases where a company fully executed its reorganization plans at least from the corporate reorganization practice records of the Seoul Central District Court, Bankruptcy Division.[3] The causes for such difficulties posed by reorganization plans vary; a company facing the verge of bankrupt may have made an exceedingly optimistic forecast of its business prospects, or it may have constructed a plan that exceeds the limits of its capabilities. Moreover, another reason for such lack of success would be that it requires much more than just the efforts of the debtors to reclaim the confidence of the market, and the fact that it would be nearly impossible to require a company to carry out a ten-year plan constructed prior to its confirmation, particularly in recent rapidly changing economic environment.

There will not be procedural problems in situations where a company fails to carry out its reorganization plan, as all that the court has to do is to annul

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3) The only exception, as far as the author knows, is the reorganization case of Medison Co. Ltd., a famous manufacturer of medical ultrasound devices. It was established in 1985, filed reorganization petition at Chuncheon District Court in 2002, and finally exited the court's supervision in 2006 by successfully restoring its business.

Chart 1. Positive Analysis on Implementation Period of an M&A Transaction

Time Required from Commencement to Termination		Liquidation Value Analysis		
Length of Period, Commencement ~ Termination	Number of Companies	Number of Companies	Asset to Liquidation Value Ratio (%)	Liquidating Dividend Rate to M&A Credit Recovery Rate (%)
Less than 2yrs	5(8.8%)	4(11.4%)	51%	290%
2 ~4yrs	20(35.1%)	2(34.3%)	54%	311%
4 ~6yrs	18(31.6%)	13(37.1%)	64%	170%
6~8yrs	11(19.3%)	5(14.3%)	55%	217%
More than 8yrs	3(5.2%)	1(2.9%)	47%	147%
Total	57(100%)	25(100%)	54(Avg.)	227(Avg.)

the company's reorganization procedure and order it to be converted into straight bankruptcy. However, reorganization procedure will inevitably draw criticisms that it is merely a costly way of delaying bankruptcy, especially when the fundamental functions of a reorganization plan are to satisfy the debt and restore the debtor, as mentioned above. Accordingly, a company must seek a way to avoid bankruptcy, protect the interests of the creditors, and plan for its rehabilitation at the same time, even if it requires a change in course of its reorganization plan, and M&A has been endorsed as a viable option.

Reorganization practice in Korea has always pursued M&A transactions under the objectives of "satisfaction of creditors" and "rehabilitation of debtors." For a "company" to recover, possessing a "responsible managing entity" has been deemed necessary.

Scrutinizing the instances of the companies that entered the procedures of reorganization, it has often been the case that the causes that led to their bankruptcy lied in imprudent management of their executives. Also, companies often seem to switch into more creditor-oriented governance structures through reorganization, but it is uncertain as of how responsible a creditor, usually a financial institution, will be in managing the companies. As it can be seen here, having a managerial entity that can soundly manage the company is certainly a pressing issue for the continued existence of a

reorganizing company.

② Seoul Central District Court Bankruptcy Division has been actively engaged in M&A activities since 2000.[4] Instances where reorganization procedures have been completed through M&A transactions include 2 cases in 2000 (KIA Motors, Asia Motors), 14 cases in 2001 (Sammi Specialty Steel, You One Construction), 19 cases in 2002 (Pan Ocean Shipping, C& Merchant Marine, Ssangbangwool, Ssangbangwool Development, Midopa, Hanshin Engineering & Construction), 8 cases in 2003 (Tongil Heavy Industries, Kukdong Construction, Seahbesteel), 14 cases in 2004 (Koryo Industrial Development, Youngnam Textiles, New Core, Dong Seo Industry), 6 cases in 2005 (Ilhwa, Thrunet, Jinro), 6 cases in 2006(SKM, JR Construction, Anam Construction, HanHap Industry), 8 cases in 2007(Keonyoung, Saerom Sungwon, Hyundai LCD, Hantong Engineering, Nasan), and several cases in 2008(BOE Hydis, Korea Express, Eintech). Instances of a company completing its reorganization procedures without accompanying an M&A transaction are yet to be found, at least in the case of Seoul Central District Court.

③ Chart 1[5] above demonstrates an analysis concerning the implementation periods and related credit recovery and other rates of the data collected from the 57 companies that terminated their corporate reorganization procedures early through M&A activities. The chart indicates that an M&A transaction increases the creditors' benefits, regardless of the time of implementation. It can also be noted that the M&A transactions that terminated after 2 to 4 years since commencement recorded the highest credit recovery rates per liquidating dividend rate, attesting to the fact that it may be more effective to recover corporate value lost during the bankruptcy process prior to engaging in M&A.

④ It is interesting to note that the credit recovery rate of M&A transactions that occurred within 2 years of commencement recorded the second highest. This may be an indication that implementing prearranged M&A transactions before the company's corporate value depreciates due to bankruptcy may possibly be more efficient. Recently, creditor-initiated M&A transactions that

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4) Prior to 2000, the Koryo Development, the Keunhwa Pharmaceutical M&A deal in 1998, and the Mikang, the Byuksan Construction M&A deal in 1999.

5) Seoul Central District Court, Bankruptcy Division, Reorganization Practice Guidebook II 175, (2nd ed. Pakyoungsa 2008).

are reflected within the restructuring procedures have appeared in a form of prearranged M&A transactions. Such forms of M&A transactions are expected to arise more often as Seoul Central District Court plans to give positive consideration to M&A transactions that the debtors initiated prior to filing for petition of reorganization procedure under agreement with their major creditors.

2. *Characteristics of M&A Transactions in Corporate Reorganization Procedures*

In the author's opinion, M&A activities of a company facing reorganization have the following characteristics in comparison to general M&A transactions outside of court:

1) Seller(=Receiver)-Oriented M&A

M&A transactions arising during the period of reorganization procedures pending in court are seller-oriented. The receivers, as financial advisors of an M&A transaction of a company facing reorganization, are quite limited in their decision-making capacity, as they have to mediate the convoluted entanglement of interests among the debtors, creditors and shareholders as their trustees. It is for this reason that the prospective buyers often feel that the receiver approaches numerous matters with unnecessary strictness and create difficulties that may have been able to be resolved through negotiation in conventional M&A practice.

In this perspective, M&A transaction of reorganizing company may be regarded as seller-oriented, imposing the buyers to comply with the subject matters required for debtors' rehabilitation and satisfaction of debt.

2) Pursuit of Rehabilitation and Resulting Limitations

The main objective of a M&A transaction of a debtor company is to seek for its rehabilitation through "procuring funds for debt payoff" and "securing a responsible managing entity." In order to meet its ultimate objective in resuscitating the company, there will inevitably be a number of restrictions, including preference for an increase in the paid-in capital, requirements of managing abilities, compulsory lock up of acquired shares, and prior elimination of potential legal restrictions.

3) Accelerated Procedures

An M&A transaction of a company in its reorganization procedure is proceeded with speed after its public announcement. Prior to tender offer, receiver arranges for the bidders an agenda of events after the close of bid, including the deadline for signing a memorandum of understanding (MOU) after selecting the preferred bidders, the deadline for granting detailed due diligence for determining the acquisition price, the deadline for negotiation for adjusting the price of acquisition, and the deadline for signing the purchase agreement. In situations where an extension to any of the above deadlines is made under the requirement of the buyer, permission from a court will be required, and even the extended deadline will be subject to certain restrictions. The purpose of such promptness is to seek for an early stabilization of the debtors' business by quickly settling the string of negotiations required in an M&A transaction and prevent any delay in the process.

4) Concomitance of Bankruptcy Law Procedures

Most M&A transactions of reorganizing companies undergo procedures for amendments of reorganization plans, a procedure specific to bankruptcy law. Outside of the matters pertaining to an M&A transaction itself, therefore, a thorough preliminary examination of bankruptcy law matters, particularly the requirements of amendments in reorganization plans and the possibilities of closing of the reorganization case, are necessary.

5) Emphasis on Fairness and Transparency

One of the functions of an M&A transaction of company in need of reorganization is debt satisfaction, and it requires an inducement of a prospective buyer that is willing to offer high acquisition price. It may be said that the reorganizing company holds a neutral interest regarding this matter.

These days, the number of competing companies looking for an acquisition or selection as a financial advisor has been amassing, as well as the possibilities that companies that have fallen out of competition lodging objections to the selection process, which accentuates the need for maintaining transparency and fairness in the reorganization procedures. When selecting a preferred bidder or a legal entity that shall carry out due diligence on business and assets of the seller and debtors pertaining to transfer of business, the receiver shall proceed the procedure in a fair manner, soliciting opinions of

the creditors' committee (Debtor Rehabilitation and Bankruptcy Rule of Supreme Court §49). Also, the "Regulation Regarding M&A Transactions of a Reorganizing Company (Seoul Central District Court Regulation No. 11)" emphasize fairness in an M&A procedure by requiring the financial advisor to document a detailed evaluation standard that appraises categories including: the size of an increase in paid-in capital, viability of securing funds for acquisition; soundness of prospective buyers' financial structures; and the intention and ability of the buyer or preferred bidder to manage and develop the debtor prior to submission of a binding bid offer or a final service proposal preferred bidder.

An M&A transaction of a reorganizing company proceeds in a transparent and a fair manner under the supervision of the court. Since an M&A transaction of a reorganizing company will only have legal force through reorganization plan amendment procedures made by meeting of interested parties for a resolution of an amendment plan with the approval of creditors, even before such approval is made, the receivers will be under supervision of the court in exercising their authority throughout all stages of the M&A activity, including its implementation, designation of financial advisor, tendering offer, drafting invitation for bid (IFB) and memorandum of understanding (MOU), designation of preferred bidder, negotiation of MOU, arrangement of acquisition price, and negotiation of investment agreement. Another reason for the emphasis on fairness and transparency in M&A transactions is to maintain competition among participants in a fair and transparent manner and allow the competition to increase acquisition price, and, ultimately, promote satisfaction of the creditors.

In light of global economic crisis brought about by insolvency of some global financial conglomerates, court policy above mentioned seems to be changing lately. Reorganization corporations cannot easily find the potential buyers who afford huge amount of fund to take over the target company, mainly because the financial market is inactive. Therefore, if a potential buyer expresses the receiver its sincerity to inject adequate fund to the reorganization company, and the receiver accepts the proposal, and if creditors' committee, which composes of major creditors secured and unsecured within 5 to 10 members, consents the M&A proposal, the court is likely willing to approve the M&A transaction. In this case, the reorganization case would be processed quickly based on the M&A transaction.

3. Reorganization Procedures and M&A

Since April 1st, 2006, the reorganization procedure has been carried into effect by the DRBL, which gives significant impact on the old M&A practice of corporate reorganization. The new reorganization practice based on DRBL presented significant procedural changes, including the introduction of a list of secured and/or unsecured creditors and shareholders, reformation of the debt investigation procedures, the adoption of business transfer prior to confirmation of plan and the creation of cross-border insolvency procedure. The most significant change, however, was the reformation in the "receivership system," and the corresponding "reinforcement of functions and authorities of creditors' committee." Furthermore, the tendencies for early graduation of reorganization procedure significantly reshape the landscape of prospective M&A practices, and the impact of DRBL appears.

1) The Receivership System

In previous reorganization practices, the courts held the authority to designate a third party as a receiver and used this authority in almost every case, and it designated the former executive as a receiver only in extremely rare and exceptional instances. In the very beginning of old practice since 1997, such practice may have been established on the social sentiment that the managers of insolvent companies must be called to account for their failures by being excluded from participating in management. The practice, with almost no exception, has designated a third party as a receiver, and placed the mark of "gross mismanagement" on the former executive because she supposedly caused the bankruptcy of the debtor company, which constituted the grounds for excluding her from managerial candidacy, considering the fact that the former executive will be reluctant in initiating an M&A transaction to protect her managerial authority, which clashes with an efficient rehabilitation of a reorganizing company. The former managing shareholders were also strictly excluded from corporate governance and management in the old practice, and their shares were retired via punitive share cancellation.

As a general rule, however, under the reorganization practice based on the DRBL it may be noted that the executive at the time of filing for reorganization is designated as the receiver of debtor company. A third party may

exceptionally be designated as the receiver only in cases where substantial abuses and gross mismanagement actions of the former executive, such as concealment and misappropriation of debtor's properties, and then caused the debtor bankrupt, and in a few other cases where a third party designated is deemed necessary for rehabilitation of the debtors. The purpose of such adoption is to induce the former executives to file reorganization petition as early as possible by preventing the debtors' immediate exclusion from corporate governance, operation of business and the resulting delay in such engagements. However, proceeding M&A transactions immediately after designating the former executive as receiver is contradictory to this purpose. The former executives would hesitate to file the petition of the commencement of reorganization procedure if M&A transaction should be initiated in all the cases, for it means when they come to court, shareholders who elected them as executives lose all their interest.

Therefore, in the new reorganization practice after DRBL, opportunities shall be granted to the former executives to perform business activities and plan for rehabilitation based on execution of reorganization plans drafted based on the earning powers of the debtor's company. An M&A transaction shall be a subsequent method in case such attempt results in failure.

2) Early Closing of Reorganization Cases

There had been instances in the old reorganization practice where reorganization cases had been closed prior to the passage of the ten-year period, but such instances were limited to the cases where a company's assets significantly outweighed its liabilities, significant parts of its reorganization debts have been paid, and in cases where an execution of reorganization plan was assured. An M&A transaction was the specific means to actualize an early closing of a reorganization cases. In a sense, it can be told that an early closing had been granted only in cases where a company was expected to pay off a significant parts of its debts, or to secure resources to pay off its remaining debt, or was foreseen to consistently secure such resources after completion of an M&A transaction.

The new reorganization practice positively considers closing the cases early immediately after the company started paying off its debt, assuming there are no hindrances to carrying out the confirmed reorganization plan. Such reformation of practice reflects the fact that there are institutional and

social discriminations for a debtor pending her reorganization procedure, which may impede her resuscitating efforts.

At this state, in case the business providing the financial resources for debt payoff is stable, the prospects for such business are not discouraging, and there are no particular circumstances to further doubt the company's ability to pay off its debt's. The companies shall be able to engage in closing its reorganization case early, even if significant parts of the company's debts have not been paid off, or even if the company's liabilities outweigh its assets. In extreme circumstances, a debtor company may be able to graduate early immediately after it has started paying off its debts according to the plan without initiating an M&A transaction, in case the debtor's business and its earning powers are stable. Reorganization procedure may be ended prior to the completion of a company's debt payoff, and that means an M&A transaction will not necessarily be implemented during the period when the reorganization case is pending in the court. Creditors may seek a maximization of credit satisfaction by setting the particulars in the plan regarding execution of an M&A transaction. In such cases, an M&A activity may be initiated under supervision of the court, or autonomously upon discussion between the creditor and the debtor after termination.

3) Reinforcing Functions and Authorities of Creditors' Committee

In response to the adopting quasi-DIP receivership system, the DRBL has significantly reinforced and bestowed the authorities to supervise and control the former executives' business activities upon the creditors' committee. The creditors' committee has been bestowed with added authorities, such as the ability to state its opinions regarding designation of former executives, its right to make motion to dismiss the former executive from receivership, as well as its authority to examine the debtor and its business for reasons of unsatisfactory business results of the debtor.

Functions and authorities of the creditors' committee over M&A transactions have also been reinforced. Implementation of an M&A activity, designation of financial advisor and appraisal of corporate values, designating preferred bidder after submission of bidding letter, and negotiation and contracting of acquisition agreement are the authorities bestowed upon the receiver who, as the trustee of all the interested parties, shall carry out their business with impartiality. Furthermore, the receiver is under strong

supervision of the court in their business activities, and permitting involvement of another interested party thereby seems unnecessary. For these reasons, in the former corporate reorganization practice, the receiver and supervising court had not paid much attention to the creditors; it may be even said that they had a tendency to treat creditors as one of the hindrances to their M&A transaction.

The receiver-court oriented M&A provoked crucial criticism from the creditors for their lack of involvement despite their having the largest interests in the reorganization procedure. The DRBR has reflected such criticism to require the opinion of the creditors' committee in receiver's designation of the preferred bidders, the seller, or the legal entities to carry out due diligence upon the debtor's property and business (§ 49). The DRBR further requires notification of the results to the creditors' committee in case the committee presents its opinion to the court (§ 38), and, if such opinion is reasonable, it will be reflected in the execution of an M&A transaction; as the creditors' committee will require related information in forming an opinion on a proceeding M&A transaction, it is inevitable that the committee becomes involved in an M&A activity to a certain extent.

Therefore, M&A in the reorganization procedure will face more interested parties involved, and their conciliation process is bound to be much more complicated.

III. Types of Reorganization M&A Transaction

The phrase "mergers and acquisitions" (abbreviated M&A) is a general term used to refer to various types of transactions to directly or indirectly obtain the control and/or management of a target company through the means of consolidation, takeover, or purchasing of voting shares.

There are mainly three (3) types of an M&A transactions used in Korean reorganization practice: (i) acquisition of new shares to assigned third party; (ii) business transfers; and (iii) asset transfers. Most deals take the form of (i), while the other two types are only partially used. In case a company owns a number of business parts with varying needs that may require more than one means of M&A transactions, a combination of the above types of transactions may be used, and if necessary for a smoother progression, procedures such as

corporate divesture may be accompanied.[6)]

1. Acquisition of New Shares by Assigned Third Party

1) General

As the most broadly used method of an M&A transaction for reorganizing companies, it allots and issues new shares of a reorganizing company to a third party through an increase of paid-in capital.

The objectives of an M&A transaction for a reorganizing company are basically to procure funds to pay off debt, and additionally to secure responsible managing entities;[7)] this method allows a third party, who has both the intention and the ability to manage a reorganizing company, to become the dominant shareholder by allotting and issuing her new shares. This procedure allows the company to depart from reorganization early by paying off its reorganization debt at once with the increased amount in the paid-in capital. This method has an advantage over a conventional M&A transaction in that it allows timely and economic changes to corporate governance structures, as it does not require undergoing special resolutions of general shareholders' meetings or creditor protection procedures in case of existing share write downs (§ 253, Para. 2 of the Corporate Reorganization Law, § 264 of DRBL, § 439, Para. 2 and § 232 of the Commercial Act), and as the shareholders will have no voting rights in the meeting of related parties in case the liabilities of a company outweighs its assets.

The prospective buyers may also become dominant shareholders by purchasing the reorganizing companies' shares in the stock market, or

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6) Hanbo Corp., facing difficulties to dispose its steel and construction businesses using one method, decided to dispose the steel business through business transfer, while divesting its construction business and disposing the business through allotting new shares to a third party, considering the fact that the records of construction will not be succeeded if construction business were to be disposed through business transfer. Hanbo Corp. then immediately terminated the reorganization procedures of the divested company.

7) As one of the designation standards of priority negotiators, it evaluates whether a managing entity has the intention and the ability to manage and develop an acquired reorganizing company. It is sometimes criticized, mostly from the prospective buyers, that it imposes excessive restrictions on the major assets. The main agreement requires the buyer to deposit 50% of the new shares she acquired to the Securities Depository, which is a means to secure a responsible controlling shareholder to manage the reorganizing company.

through individual contact with the shareholders of the company.[8,9] However, such method of share acquisition is inappropriate as a means to carry out an M&A transaction of a company under reorganization procedures, as it merely changes the holder of the shares without improving the company's financial structures or pay off its debt.[10]

2) How to inject for Paid-in Capital Increase (Chart 2)

The Chart 2 below depicts the methods a prospective buyer pays her loan in a diagram. In most instances of reorganization M&A transactions, the consortium member participates in increasing the paid-in capital by subscribing new shares in person and paying its advances to the reorganizing company, as demonstrated in Case 1. Case 2 below exhibits a simplified structure permitted in the Jinro case. The reasons for permitting such structures were to mitigate tax impositions on prospective buyers' investment methods, and to facilitate procurement of acquisition funds by adequately utilizing the fund procuring abilities of the intermediary companies. Case 2 was drawn under the assumption that the intermediary companies were

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8) Recently, there have been several large scale purchases of reorganizing companies whose assets outweigh their liabilities, retain significant amount of cash, or continue to be listed while maintaining solid earning powers. In the case of *Hankwang Corp.-Dongwon Development*, debtor-issued, non-listed shares were acquired in a similar fashion as above prior to the filing of reorganization petition with the DRBL. In this case, the arranged buyer was expected to additionally invest a fixed amount of operating capital.

9) In 2005, several potential buyers were involved in a stake competition in order to purchase the shares of the Korea Express, which was facing reorganization at the moment. Special considerations must be given when purchasing shares of a reorganizing company, since in M&A transactions of reorganizing companies, whose reorganizing plans are commonly subject to change, it is inevitable that the rights of shareholders are diminished unless the entire remaining debts are paid off.

10) A similar case may be that of *Ilhwa Corp.*, which terminated its reorganization procedures through the means of M&A. In this case, the head of the company expressed a view that prior to an M&A transaction, he would terminate the procedure early when some reorganization debts would be remaining after paying off parts of its reorganization debt by becoming a controlling shareholder by purchasing a great volume of reorganization bonds expected to be converted according to the reorganization plan, then converting parts of the bonds that he possesses, and acquiring new shares of the reorganizing company. In other words, the company was initiating an M&A transaction that accompanied conversion of investment through individual disposal, as a significant amount of the new capital investment was injected.

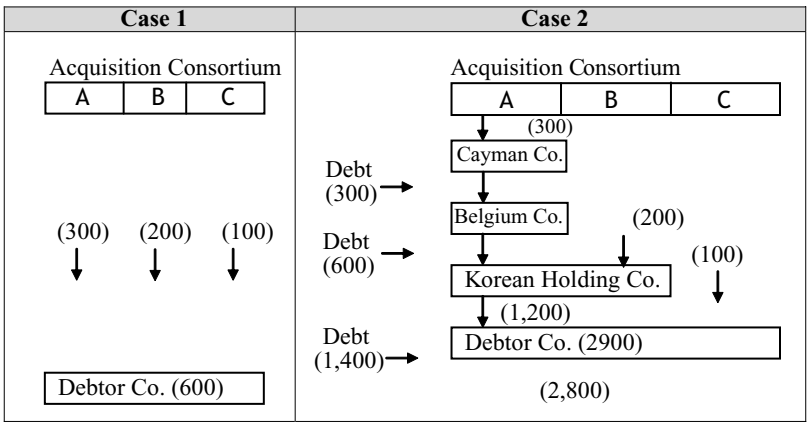

Chart 2.

capable of procuring an additional amount of funds equal to the amount of funds financed by the company at the higher end of the hierarchy. Comparing Case 2 to Case 1, the funds contributed by the consortium member is 600 as in Case 1, but as intermediary companies procure additional funds, it can be seen that the bid price has nearly multiplied fivefold, to 2900. In the Jinro case, a similar method to Case 2 was permitted, but it prevented an intervention of a mezzanine investor who might incur a change in the control of an intermediary company on condition that the company at the higher end will maintain entire control of the intermediary companies. Therefore, the only way intermediary companies could procure funds was by incurring liabilities.

3) How to Acquire New Shares(Chart 3)

The Chart 3 below demonstrates the simplified diagram of how a reorganizing company issues new shares. Most reorganizing M&A transactions utilize the structure where new shares are directly issued to prospective buyers, as in Case 1. In Case 2, as explained in the asset transfer method below, demonstrates a method where a reorganizing company establishes a new company, transfers its assets to her, and then issues the shares of the new company to the prospective buyers, in case a severance from existing debtor and creditor relationships concerning the public debt is required. The case of Daewoo Motors demonstrates a similar structure. Case 3 depicts the case where a reorganizing company with a number of business

parts divests parts of its business with potential buyers to establish a new legal entity and issues new shares of such new legal entity. This method may be appropriate when mergers and acquisitions of the entire business parts of the reorganizing company through third-party acquisition of new shares is difficult due to a resulting reduction in acquisition price, and when there are potential buyers for only some parts of the company's business, and when transferring these business parts prevents the buyer from taking advantage of the reorganizing company's business showings. The remaining parts of business will be subject to subsequent M&A activities, or liquidation.

The types illustrated in <Chart 2> and <Chart 3> may be combined as appropriately to the needs of reorganizing companies and structures of M&A activities.

4) M&A Transactions Preceding Filing of petition for the Commencement of Reorganization Procedure

(1) New Forms of M&A Transaction Instituted into New Practice

As mentioned earlier in II.1.③, an early institution of an M&A transaction may assist the rehabilitation and satisfaction of both the debtors and the creditors, respectively. Even if the debtor was forced to file for the petition of reorganization due to financial distress, if the company's basis for its business has not collapsed and it still maintains its earning powers, it shall be efficient to initiate an M&A transaction as early as possible. Also, in case such M&A transaction preceding the initiation of reorganization procedure is in control and progression of the debtor under an agreement with the major creditors, the agreement process must adequately reflect both the intention of the creditors and the required matters for rehabilitation under the debtor's discretion. Such M&A transaction shall, therefore, not differ from an M&A transaction proceeded by receiver under supervision of the court.

The new reorganization practice, therefore, takes into account and respect the results of an M&A transaction completed prior to the filing, and shall proceed with the company's reorganization procedure accordingly. However, close evaluation of going concern value and liquidation value and careful comparison of the two are necessary to successful reorganization process, because, when the liquidation value of debtor company is reported to exceed its going concern value after the commencement of the case, debtor company shall not be able to issue new shares.

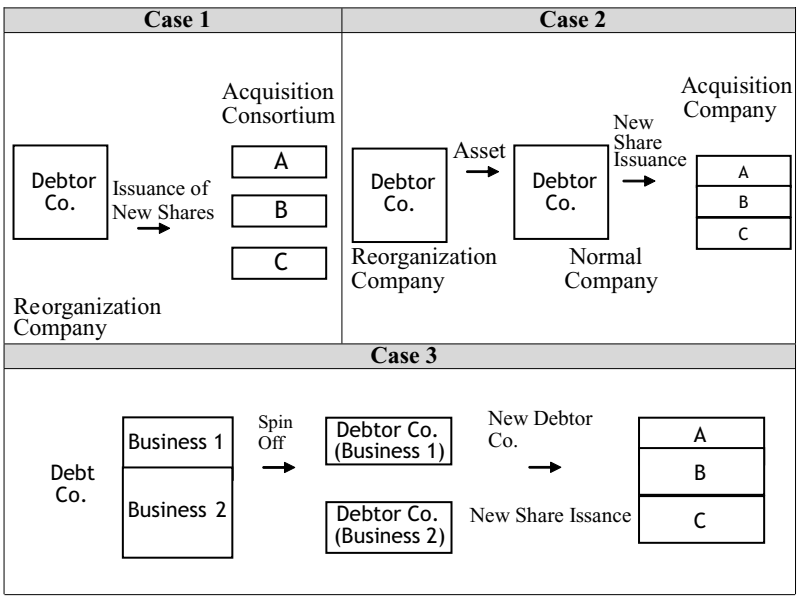

Chart 3.

(2) Factors to Consider in M&A Transaction Preceding Filing of Petition of Reorganization Procedure

In order for an M&A transaction preceded prior to filing of petition to be considered preferable as the ground of further going reorganization procedure, the M&A transaction is recommended to be conducted (i) under agreement of both debtor and creditor; and (ii) in a fair, transparent and reasonable way. If the transaction does not meet those requirements, court might request creditors' committee on the M&A transaction, and then potential buyers might be invited in public auction again by the receiver under the order of court and court could disregard the preceding M&A transaction.

Therefore, for such M&A activities to gain acknowledgement from the court, the debtors or the creditors must not pursue only for their own benefits without consulting the other interested parties. Further, in case of obtaining approval of the creditors' committee for an M&A transaction that designates a financial advisor, provides evaluation of the corporate values, and holds a competitive public tender, such procedures shall be approved as they stand. Particularly, fairness, transparency, and rationality of a transaction's

procedure are essential factors for securing adequate acquisition price through fair competition among prospective buyers, and they will be thoroughly examined.

If any doubt concerning the above factors arises, the debtor may be held for competitive public tender offer with better terms and conditions than what the preferred bidder of such M&A transaction has suggested, and if there are no prospective buyers with better conditions, the M&A transaction may be accepted under the consent of the creditors' committee and under the approval of court, even if doubts still exist concerning factors such as fairness and transparency(§ 7 of "Regulation regarding M&A Transactions in Reorganization Procedure" of Seoul Central District Court, Bankruptcy Division).

(3) Non-Election of Receiver and Rapid Progress of Reorganization Procedure

① If an M&A transaction has been initiated prior to filing for the commencement of a reorganization procedure under an agreement between the debtor and the creditors, and for debtors that reached an agreement with the creditors concerning the main issues of a reorganization plan, the court may not choose to designate a receiver. Also, in case an M&A transaction predating reorganization case opening that regards the representative of the debtors as the receiver (§ 74 Para. 3 of DRBL and § 51, Para. 5 of DRBR) has been executed upon sufficient discussion among the debtors and the creditors, the court shall decide not to designate a receiver, but will allow the interested parties to autonomously elect a representative of the debtors (§ 74, Para. 4 of DRBL) and bestow various authorities of a receiver upon her.

② Upon approval of the creditors' committee, evaluation of the liquidation value and the going concern value[11] of the debtor by the financial advisor of that transaction could be acknowledged after the commencement of reorganization procedure, unless special circumstances arise. In such cases the court shall not be required to elect examiner who conduct examination and report on the evaluation of liquidation value and going concern value (§ 9

11) Going concern value refers to the value of a company when it continues to operate its business without liquidating and dissolving the properties. It is computed according to discounted cash flow method.

of "Regulation regarding 'Selection and Compensation of an Examiner,' Seoul Central District Court, Bankruptcy Division), which will reduce significant time required for such examinations.

(4) Early Closing of Reorganization Case

The reorganization procedure of the debtors that have established the foundations of rehabilitation through such M&A transactions may be terminated early upon approval and execution of their respective rehabilitation plans, so the reorganization case should be closed soon after those measures.

2. Business Transfer

1) Transferring Business Upon Approval and Confirmation of Reorganization Plan

The foregoing method transfers the entire business to a third party while maintaining the integrity of the organized whole, including the human and material organizations. In business transfers, organic materials including trading vessels, trade secrets and know-hows of a company, as well as its simple objects and obligatories, shall be subject to transfer, and the transferee shall obtain the position of a manager. Unless special circumstances arise, the transferee shall comprehensively succeed the labor relations of the company.

In case transferable operation parts (e.g., the profit-generating operation parts) and non-transferable operation parts (e.g., the operation parts that continually generate losses) coexist in a company, its acquisition price may be reduced if it chooses to assign new shares to a third party.[12, 13] Similarly, when

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12) In case of *Haitai Confectionery & Foods Co. Ltd.*, the company has transferred the confectionery business, discontinued the operation of the construction business and changed its trade name, practically going through a liquidation procedure. Hanbo Co. Ltd. has transferred its steel business to the Yamato Industry, while going through splitting off construction business division, establishing a new company and transferring all its shares to Chinhung International Inc. The reorganization procedure of the divided company was soon terminated, and the operations of the surviving company have been discontinued.

13) An example of simultaneously transferring business and allotting new shares to third parties at the same time may be the case of *Jindo Co. Ltd.*, whose areas of business included (1) containers, (2) furs and clothing businesses, and (3) steel manufacturing business. It was understood in advance that prospective buyers offering significant acquisition prices had existed; however, there were concerns because the company possessed a number of non-

new shares are assigned to a third party when a company does not carry deficits brought forward, transferee may be imposed with significant burden as she may be incurred with large-scale income from cancellation of debt or additional tax burdens.

Business transfers through corporate reorganization procedure do not require a special resolutions of the general shareholders' meeting (§ 250, Para. 2 of the Company Reorganization Act, § 374, Para. 2 of the Commercial Act), nor it acknowledges the appraisal rights of the opposing shareholders (§ 250, Para. 2 of the Company Reorganization Act, § 374, Para. 2 of the Commercial Act); it is generally regarded as a more convenient method compared to normal business transfers process under the Commercial Act.

However, because a business transfer takes special succession procedures that individually transfers assets and liabilities to the transferee, the process has several drawbacks in that it can be more complicated in comparison to assigning new shares to third parties, and the time required for disposal of remaining assets prevents an immediate termination of the corporate reorganization procedures. In reorganization practice, business transfer method is used only when special circumstances arise as mentioned above. This type of transaction can be executed even though the liquidation value of debtor company exceeds its going concern value (§ 222 Para. 1 of DRBL).

2) Transferring Business Prior to Confirmation of a Reorganization Plan

(1) Need for Business Transfers Prior to Confirmation of Plan

An ordinary corporation may transfer all or significant parts of its business through a special resolution of general shareholders' meeting (§ 374, Para. 1 of the Commercial Act), but in reorganization procedures, an action that may affect the foundations of a reorganizing company shall be allowed only within

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business related real estates that would hamper the company's efficiency, which might have resulted in a lower bidding price in comparison to a disposal through third party share allotment method. The M&A deal of *Jindo Co.* Ltd. had been initiated as a third party new share allotment method in principle, then simultaneously obtaining a bid proposal from each prospective buyer of each business part, as if these prospective buyers had had formed a consortium. It was expected that a higher price would be selected by comparing the highest price offered by the consortium, and the total amount of the maximum bidding prices of each business part. However, because effective bid packages were not submitted to all business parts, the M&A transaction had proceeded through the third party share allotment method.

the reorganization procedures (§ 52 of the Company Reorganization Act). A transfer of business within reorganization procedures requires an arrangement with a reorganization plan (§ 217 of the Company Reorganization Act, § 200 of DRBL), and whether a business transfer before confirmation of a reorganization plan should be allowed had been questioned and answered by the introduction of a new stipulation in the DRBL § 62. The DRBL has stipulated a clause for business transfers held before confirmation of reorganization plan, because companies were often unable to proceed with its reorganization procedures in a normal manner due to a dramatic degradation of its credit ratings, severance of business relations, and collapse of corporate organizations. If such impacts are significant, corporate value of the debtor may decline to the point where it falls short of its liquidation value; in such cases, transferring business before confirming of the plans may be more efficient than transferring in accordance with the plans, if better prices or conditions are available.

(2) Requisites for Business Transfers Before Confirmation

① In order to transfer business before confirmation of reorganization plans, transfer of all or significant parts of business must be necessary for rehabilitation of the debtor. Being necessary for rehabilitation of the debtor indicates the cases where an early transfer of business is required in order to prevent the damage to the company's credit and resulting aggravation of business from its request of a reorganization procedure, and the decline of its conversion value. Therefore, when transferring business before confirmation of the plan, it is usually the case that transferee candidates already exist or are designated before or after its filing.[14)]

The DRBL stipulates that business may be transferred before confirmation of the reorganization plan being granted "in case all or significant parts of business are being transferred (§ 62, Para. 1)," but questions may arise

14) In the *Hyundai LCD* case in 2006, a corporate restructuring proposal had been derived during the workout procedure, which failed to be executed by the opposition of several creditors. The company filed for the petition of commencement of the reorganization procedure, which aimed to complete the business transfer that had proceeded prior to the filing before confirmation of the reorganization procedure, but, finally, completed the transfer through reorganization plan.

whether the receiver has the ability to transfer parts of the business by exercising her rights to dispose properties when the parts being transferred are insignificant. As the DRBL stipulates that the receiver depends solely on the reorganization plan when transferring all or parts of the business or properties (§ 200 Para. 1, Subpara. 1), transferring business merely by an approval of the court does not seem to be permitted, in principle. However, if continuation of the concerned business is not a significant part of the debtor's business as a whole, and if such continuation continually incurs losses, transferring business without confirmation of the plan may be granted under approval of the court.[15)]

② Transfer of business in accordance with the § 62 of the DRBL may be granted until the confirmation of the plan, after the reorganization procedure has been commenced. Another question may arise whether, at the stage of just issuing the preservatory administration order before the procedure is not commenced, all or significant parts of business can be transferred. However, as such transfer surpasses the purposes of preservatory administration order, it shall not be allowed.

3. Procedures

① The court, when granting approval for business transfers prior to confirmation of reorganization plans, must hear the opinions of the management committee, the creditors' committee, and the labor union, constituted by the majority of the laborers of the debtor. If a company does not have a labor union, the court must hear the opinion of a representative who acts on behalf of the majority of the laborers of the debtor (§ 62, Para. 2 of DRBL). Such procedure is required of the court prior to its approval of a business transfer, since transferring business shall have a consequential impact on both the business of the debtor and the interests of the

15) Under the Corporate Reorganization Law, the food business of Kolon T&S, whose main businesses comprised of the express bus transportation business and the tourism business, continually incurred losses prior to the commencement of its reorganization procedures, and it was deemed beneficial to dispose it prior to confirmation of the company's reorganization plan. Therefore, the Seoul District Central Court allowed Kolon T&S to transfer its food business to a third party before its corporate reorganization plan was confirmed.

reorganization creditors (secured[16] or unsecured) and the shareholders.

② In case of a corporation whose liabilities outweighs its assets before the confirmation of a reorganization plan, the court may substitute a resolution of the general shareholders' meeting (§ 374, Para. 1 of the Commercial Act) with a decision according to the request of the receiver (§ 62, Para. 4 of DRBL), and in such cases, it may avoid undergoing the shareholder protection procedures (§ 374, Para. 2 of the Commercial Act, Art. 191 of the Securities and Exchange Act).

In case the court renders a decision that substitutes a resolution of the general shareholders' meeting, the court shall deliver the decision to the receiver, and a summarizing document of the decision to the shareholder. The decision shall take effect upon its delivery to the receiver (§ 62, Para. 1, Para. 2, Para. 3 of DRBL). The shareholder may immediately appeal the decision that substituted the resolution of the general shareholders' meeting (§ 63, Para. 3 of DRBL), and such immediate appeal may suspend the execution of the decision (§ 13, Para. 3 of DRBL).

4. Approval of the Court

① Upon granting the foregoing approval, the court shall often consider whether: (i) the designation method of the transferee candidates are reasonable; (ii) there are any unreasonable conditions attached to the bidding conditions that may lower the bidding price; and (iii) the designation procedure of the transferee candidates proceeded in a fair manner.

② When the court grants approval of a business transfer, it must devise a method of using the income generated from the transfer (§ 62, Para. 3). However, since there are various interested parties involved in a reorganization procedure, including public creditors, secured and unsecured reorganization creditors and shareholders, it is not an easy task for the court to rationally conciliate the entangled interests of the interested parties and

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16) For DRBL has no provision similar to § 363(f) of the U.S. Bankruptcy Code, any lien on the assets to be transferred shall not be cleared in Korean Reorganization Case. However, the secured creditors, who have the secured interest as of commencement of the case, shall not collect or enforce their interest unless the confirmed reorganization plan allows. In this sense, secured interest remains influenced notwithstanding the completion of the transfer.

unilaterally fix upon a method to use the income from the transfer when disposing the main assets of the debtors through business transfer. Therefore, in promoting business transfers prior to confirmation of reorganization plan, it is desirable for the debtors to agree upon the main contents of a reorganization plan ex ante, including the methods to use the income from the transfer among the major reorganization creditors secured and unsecured[in case such agreements had been made, reorganization procedure may be proceeded without designation of a receiver (§ 51, Para. 5 of DRBL), and the reorganization procedure may be closed early immediately after confirmation of the plan, after the reorganization debts have been paid off].

③ As there are no stipulations allowing immediate appeals to the court's decision to grant approvals to business transfers prior to confirmation, an appeal against the approval of court for business transfer itself shall not be allowed (§ 13, Para. 1 of DRBL).

IV. Outline of an M&A Procedure

Although the procedure of an M&A transaction of a reorganizing company may differ case by case, it generally follows the following step-by-step process. It shall take a minimum of six (6) months until the closing of the corporate reorganization procedures.

① Decision of M&A Initiation
② Designation of M&A Financial/Legal advisor
③ Internal Due Diligence of M&A Financial/Legal advisor and Devising a Strategy for M&A
④ Public Announcement of M&A
⑤ Receipt of Letter of Intent
⑥ Setting Designation Standards of Preferred bidders
⑦ Receipt of Proposal
⑧ Designation and Notification of Preferred bidders
⑨ Signing Memorandum of Understanding (MOU)
⑩ Detailed Due Diligence by Preferred bidder and Arrangement of Acquisition Price
⑪ Signing of Main Agreement
⑫ Succeeding Procedures: Devising Amendment Proposal for

Reorganization Plan → Meeting of Interested Parties → Confirmation of Change Proposal for Reorganization Plan → (Dispatching of Acquisition Planning Committee, Change Officers) → Execution of Procedures including Capital Reduction, Paid-in Capital Increase, and Underwriting of Corporate Obligations → Payoff of Reorganization Debt, Entrusting Registration Cancellation of Reorganization Securities → (Dispatching of Acquisition Planning Committee, Reformation of Board Members) → closing of Corporate Reorganization Procedures

1. Decision of M&A Initiation

① The person to initiate M&A transaction of a reorganizing company is the receiver. The receiver is only entitled to manage, maintain and dispose the business operation and the assets of a reorganization company (§ 53 of the Company Reorganization Act), and is responsible for resuscitation of the reorganization company as the trustee of the interested parties, including the creditors, shareholders and the debtor company itself. Although an M&A activity of a reorganization company is under authority of the receiver, the receiver may not arbitrarily handle M&A related affairs, as the receiver requires an approval of a reorganization court in every step from initiation to termination of an M&A transaction.

① One of the most difficult matters for the court that supervises M&A transactions of receivers or reorganization companies is determining the point of time when the transaction could be initiated. One of the realistic restrictions to be considered when determining the time of an M&A initiation is the side effects of an M&A failure. A reorganization company, although it has established a foothold for rehabilitation after the confirmation of reorganization plan, is, in reality, in an unstable state where its rehabilitation is still uncertain, and because it has already gone through bankruptcy with a market failure experience, if its M&A transaction were to fail, negative images of market failure and organizational collapse may form. In some cases, the damage may be as serious as to threaten the corporate existence, and it is required of the receivers or the courts to give careful consideration to the chances of success of a M&A transaction in determining the timing of its initiation. Therefore, the receiver must thoroughly examine factors such as the present conditions of the relevant industries, tendencies of the potential

buyers, and whether any businesses of the same kind are out for sale when making the decision to determine the timing of M&A. There are some receivers who hurry to initiate M&A transaction without prudently determining its timing, but there may be cases where concentrating on enhancing corporate values prior to initiating an M&A transaction may be desirable.[17)]

All the reorganization plans proposed by receiver lately contain early M&A provisions, and a few instances are found that the time limits for M&A transactions are prearranged in the plans.[18)] M&A transactions will be initiated as prearranged in such reorganization plans as circumstances allow, however, it goes without saying that the possibilities of success of the M&A transactions should be given close examination in advance.

In case of a company yet to obtain confirmation of reorganization plans, an M&A transaction may actively be initiated and a reorganization plan that reflects these findings may be proposed,[19)] but upon reflection of personal

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17) Thrunet Co. Ltd., ruminating upon its past M&A failure when the prospective buyers submitted a bid proposal that were lower than the disposal price, has been assiduous in inducing subscribers to recover its market shares prior to re-initiating its M&A transaction. As a result, the bid was delivered at a much higher price than the disposal price. Haitai Stores Co. Ltd. also initiated its first M&A transaction in 2002, only to fail due to the economic decline and because there was not a company that submitted a bidding proposal that exceeded the minimum price required for the company to pay of its debt (the liquidation value). The company pursued an M&A transaction again by improving the company's earning powers by disposing unprofitable stores and through cost reduction, and by perceiving any changes in the market trends, which ultimately resulted in successfully paying off the company's debt and closing the reorganization procedures.

18) According to the reorganization plan of Kolon T&S, the receiver must file for the petition of nullification of the reorganization procedure if an M&A transaction remains uncompleted at the end of December, 2004. The reorganization plan of Jinro Co. Ltd. specifies that it shall initiate an M&A transaction so that it may be completed within a year of the confirmation of the reorganization plan. However, in case it is determined that an extension of the terms of the M&A transaction is necessary, an extension shall be granted under approval of the relevant courts up to a date not exceeding November 30, 2005.

19) In t case of *MPManDotCom Co. Ltd.*, the examiner found the company was economically feasible as its going concern value exceeded its liquidation value. However, the going concern value was largely deficient in comparison to the size of the company's reorganization debt. Furthermore, an early M&A transaction was pursued under discretion that an acquisition will take place at a price greater than the going concern value; the bid occurred at a price exceeding the going concern value of the company, and the company was approved of its reorganization plans within 11 months since the date of commencement. The company then paid off its

hands-on experience, early M&A initiation efforts before obtaining confirmation of reorganization plans were rarely successful.

The reasons of which may be following: (i) it is difficult to completely rule out the possibilities of contingent liabilities or unrecorded liabilities arising, because those liabilities have not lost their obligatory effects for the reason of failure to record prior to obtaining confirmation of reorganization plans, (ii) it may be difficult to find a buyer who suggests an acquisition fee large enough to obtain agreements of reorganization creditors, because the company's corporate organizations are not adequately maintained prior to obtaining confirmation of reorganization plans, thus making the company unattractive to the buyers,[20] (iii) there remains uncertain whether evaluated amount of going concern value of the debtor company exceeds that of liquidation value, which is absolutely the precondition for the reorganization plan to be submitted, for this uncertainty keeps potential buyers away from affirmative consideration to take over the debtor company.[21]

2. Designation of M&A Financial /Legal Advisor

An M&A financial/Legal advisor (shall be referred as "financial advisor" hereafter) refers to a company that provides consulting and services relating to a series of business activities concerning M&A procedures to the receiver, the subjects of an M&A initiation. In practice, it is a general rule to designate a financial advisor through competitive public tender in order to secure expertise and fairness throughout the entire process of an M&A transaction. In order to further enhance fairness of the designation process, the receiver, after consultation with the court before receiving service proposals, has set detailed standards for designation of financial advisor that consider relevant factors,

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reorganization debt entirely through the price of paid-in capital increase paid by the buyers, and terminated its corporate reorganization procedure.

20) In 2006, instances have been located where a company will pay off the unrecorded and contingent liabilities through confirmation of its reorganization plan, and where M&A transactions are pursued prior to the filing of the petition of the commencement of the reorganization procedure (e.g. Donga Construction in straight bankruptcy procedure and Hyundai LCD).

21) This means M&A transaction initiated prior to the reorganization filing must be processed after conducting proper estimation of those two evaluations.

including the results of execution and consultation of M&A transactions, accomplishments, soundness of the service proposal, competence and experience of the participating personnel, whether or not a prospective buyer had been obtained, extent of knowledge on reorganization company, reorganization procedures and M&A activities, and the ability to propel the transaction. In most M&A transactions of reorganization companies, buyers require debt restructuring or capital reduction of existing shares; therefore, interest conciliation and negotiation abilities are also important factors to consider in designating a financial advisor.

Accordingly, the receiver will deliver service proposals to prospective financial advisor candidates and judge in consonance with the above standards upon submission of the proposals. All candidates will go through the file screening procedures, and selected companies will go through another presentation screening procedures. After these processes, the service proposer with the highest scores will be chosen as the financial advisor, after negotiating the terms and conditions of service agreements, including its fees[22] and durations,[23] and, finally, obtaining the approval from the court.

In general, financial advisors are selected among accounting firms, credit rating agencies, M&A divisions of banks or financial institutions, or corporate restructuring companies (CRCs). A financial advisor will proceed with the receiver a series of procedures, including evaluations of corporate value, devising strategies for M&A transactions, devising information memoranda (IM), inducing buyers, acceptance and evaluations of letters of intents (LOIs), forming debt restructuring proposals, and persuasion of creditors. In practice,

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22) The fee amount will not be included in the standards for selecting buyers. Instead, proposals of the service proposers will be evaluated in accordance with the buyer designation standards, and afterward, the manager will negotiate with the senior service proposer regarding the specific amount of the service fees. The service fees (the deposit and the contingent fees) are flexibly applied within the range of 30% above or below the standard price stipulated as the incoming funds [the entire price of paid-in capital increase and 1/2 of the underwriting prices of bonds (including convertible bonds)] in the "Regulation regarding M&A Transactions in Reorganization Procedures." The fees are subjected to change if negotiated otherwise between the manager and the buyer.

23) For a rapid progress of an M&A procedure, the service period will be six (6) months. Even if the service period expires, it is normal to extend the period in case an M&A transaction has not been completed.

there are many cases where accounting firms are independently selected as financial advisor,[24] but, in recent M&A transactions of large reorganization companies, accounting firms and CRCs (or M&A divisions of banks or financial institutions) may form a consortium or may be designated as co-financial advisor, and there are instances where an investment bank was designated as a financial advisor, as well.[25]

In addition, a manager may designate a financial advisor that only takes charge of duties such as planning and devising strategies for an M&A transaction and inducing buyers, and then separately designate accounting advisors that evaluate corporate value and legal advisors that advise on relevant legal matters under prior consent. In such cases, there are instances where the service fees of accounting and legal advisors are paid by the reorganization company, separate to the fees paid to the M&A financial advisor,[26] and other instances where the advisor fees are paid from the service fees of the M&A financial advisor.[27]

3. *Internal Due Diligence of M&A Financial Advisor and Devising a Strategy for Disposal*

① The financial advisor will carry out, either by herself or through an accounting firm, due diligence on the assets and liabilities of the reorganization company, and compute liquidation values[28] and going concern values based on the information offered by and obtained from the receiver. Computation of liquidation value holds special meaning in that an

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24) In general, accounting firms exhibit extensive proficiencies and reliability in keeping accounting data and various management analyses, while their level of M&A-related know-hows or abilities to persuade creditors are somewhat mediocre. On the other hand, corporate restructuring companies have significant M&A-related know-hows, but are rather little known for their reliabilities.

25) In the case of *Thrunet Co. Ltd.*, an accounting firm, the Korea Development Bank, and a law firm have been designated as co-advisors; in the case of *Ilshin Stone Co. Ltd.*, an accounting firm, a corporate restructuring company, and a law firm have been designated as co-advisors in proceeding respective M&A transactions.

26) *Jinro Co. Ltd* case.

27) *Haitai Stores Co. Ltd* case.

28) The likely total price at the disposal of individual properties of a company when it dissolves or ceases to exist through liquidation.

M&A transaction shall not be initiated at an amount lower than the liquidation value, since it is the minimum amount guaranteed to the creditors in the amended reorganization plan that is devised upon success of an M&A transaction. The going concern value does not have a special bearing to the M&A transaction itself, but it is used as an important reference when forecasting the acquisition price of an M&A transaction, which is required for planning and devising disposal strategies of an M&A transaction.

② After such valuations, the financial advisor formulates plans and strategies of the M&A transaction, upon consulting with the receiver. At this stage, it tentatively decides the expected prices of disposal. The expected price of a disposal[29] shall be determined between liquidation value and going concern value, and it assists in planning and setting strategies for an M&A transaction by estimating the possibilities of an agreement among the creditors in advance, and roughly predicting the amended reorganization plan. When examining disposal plans, a financial advisor will seek for a scheme that will both secure resources for debt payoff, and plan for rehabilitation of the company. At this point, the type of M&A transaction to be pursued will be decided among the below mentioned types: acquisition and allotment of new shares to a third party; business transfer; and asset disposal. In order to achieve the goal of company's existence and rehabilitation, allotting new shares to a third party seems to have an edge, but insisting only on this purpose may damage the interest relations of the creditors; when choosing the types of transactions, careful consideration to both of the above objectives must be given.

Recently, however, there have been numerous cases where M&A transactions of reorganization companies are held in intense competition

29) The going concern value estimates a company's prospective flow of earnings, converting it into the present value; it may indicate an upper bound of the corporate values of a reorganizing company. In order to minimize investment losses, prospective buyers submit acquisition proposals upon evaluation of the corporate values of a reorganizing company through experts and professionals based on collectible information, such as the results of due diligence; thus, the proposed price of acquisition is almost always between the liquidation value and the going concern value. However, in cases when the competition among prospective buyers is intense, or when a prospective buyer places high value on the post-merger synergy, it is not uncommon for a prospective buyer to propose an acquisition price higher than the going concern value.

among a number of prospective buyers, and as a result, there frequently are instances where the price of acquisition actually suggested by a buyer greatly exceed the amount predicted in advance by the financial advisor. Accordingly, upon comparison of acquisition price of the third party assignment method and the business transfer method, the latter was predicted to have a greater ability to pay off debt to the creditors; however, such facts should not lead to the abandonment of the third party assignment method. Since the outbreak of economic crisis arising from Lehman Brothers Insolvency in September, 2008, Korean M&A market is still going downward, and the method above still works to attract potential buyers to M&A transaction.

In determining the expected price of disposal, there is no established method for determining priority claims; these claims are not paid off from the price of acquisition but are succeeded into the company. Therefore, the expected price of disposal may be determined based on the balances after priority claims have been deducted from the liquidation values and the going concern values, respectively. Also, there are cases where going concern values do not take priority claims into account in its computation, because these claims can be satisfied through operating profits, and will not affect the acquisition price as a matter already reflected in valuation of the going concern value.

Apart from this, it is normal to separately fix the amount of minimum bidding price to be applied when evaluating acquisition proposals at the time when the standards for preferred bidders are being decided. The minimum bidding price will be fixed upon consideration of factors such as the level of competition among the bidders, and it will be established somewhere between the liquidation value and the going concern value of the company. In case a reorganization company holds strong earning powers that may be exercisable in the M&A market and competition is intense, the minimum bidding price shall be fixed near the going concern value, whereas in case of dealing with companies that may require nullification of the reorganization procedures upon failure of the M&A transaction, the minimum bidding price will be determined near the company's liquidation value.[30)]

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30) If a proposed acquisition price falls short of the liquidation value, not only it is

There sometimes have been instances where companies fix upon the minimum bidding price, and determine invalidation of the relevant bid upon observing the submission status of the bid.

The liquidation value, going concern value and the minimum bidding price are withheld from public announcement, as their announcement may hinder the formation of a fair market price through competition, and because it may be possible that an unattractive company's acquisition price may plummet to its liquidation value.

③ The receiver and the financial advisor must formulate a detailed plan on how they will carry out their M&A transactions, search for potential buyers, and prepare necessary documents (invitation for bid, a draft of MOU, preferred bidder designation standards, company profile, etc). In formulating plans and strategies of an M&A transaction, they must give consideration to a number of factors, including

ⓐ the strengths and weaknesses of the company,

ⓑ the tendencies of the potential buyers,

ⓒ analysis of creditor relationships, corporate governance and the tendencies of creditors , sometimes including shareholders, and

ⓓ the tendencies of other interested parties.

Next, a number of other matters commonly examined in the usual M&A transactions through the third party new share assignment method shall be explained:

(i) One of the most important factors in planning and devising strategies for an M&A activity is setting the extents of the proportion of the increase in paid-in capital. From the perspectives of rehabilitation, it may be ideal to furnish the entire acquisition price for paid-in capital increase; however, the buyers are bound to prefer underwriting of corporate bonds or convertible bonds (CBs), where retrieval of investment is easier than the paid-in capital increase. If proportion of paid-in capital is set too high, then the uncertainty of investment retrieval likely increases, which might become a primary factor for

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impossible to confirm an amended reorganization plan based on such price, but annulling the corporate reorganization procedures conforms with the benefits of the related persons, including the creditors. Therefore, it will be difficult to proceed with an M&A procedure under such circumstances.

a drop in the acquisition price. On the other hand, in case the proportion of corporate bonds is exceedingly large in comparison to an increase in paid-in capital, it will only amount to paying off the reorganization debt with the fund out of the priority claims, which will not only improve the financial structures of the reorganization company but help it to rehabilitate. Therefore, determining the extent of the proportion of the increase in paid-in capital is a significant factor, and must be thoroughly examined.[31)]

Furthermore, the method for coping with cases of former company had stipulated that "the total assets of a company comfortably exceed its total liabilities" at closing of reorganization procedures, and it has been considered as one of the most important factors when determining closing in practice as well; in none of the cases where reorganization procedures were closed, the total liabilities of a company had not outweighed its total assets. Since a M&A transaction of a reorganizing company is carried out on the premise of its early closing, the structures of the amount of paid-in capital increase and acquisition price for company bonds must not interfere with the closing of reorganization procedures. Thus, by closely examining the determination of a company's proportion for an increase in the paid-in capital and the size of corporate bonds that have a crucial impact on the remaining liabilities after an M&A transaction, careful consideration was given to whether a reorganization of the company's assets exceeded its liabilities after it had cleared off its reorganization debts with the acquisition price at termination.

Under the assumption that the reorganization case may be closed even if the total assets of a company falls short of its total liabilities and if the company is generating sufficient ordinary income to manage its liabilities, and expected to do so in the future, it has been determined to accept an increase in the paid-in capital that may not be able to secure the assets of a company that outweighs its liabilities. It goes without saying, however, that there will be a certain lower limit on the proportion of the increase in paid-in capital, because

31) During an M&A transaction, it is required to increase a certain amount of paid-in capital, but it is of a separate issue whether such requirement will be maintained after closing of a reorganization procedure. From the records of the Seoul Central District Court, one often encounters cases where companies increase a significant amount of paid-in capital during their M&A transactions, only to engage in paid capital reduction not long after termination of the reorganization procedures.

the company still must be able to deal with the liabilities expected to remain after its post-M&A earnings.

Depending on the company, the size of the company's debt settlements may be larger than its assets. In such case, to consider the above-stated point, company bonds of acquisition price may be limited to a specific amount.

From such a perspective, in case the portion of paid-in capital increase of the total undisclosed bids is below a specific level, [32] in practice, the bidding is usually to be invalid. The higher such portion the more likely the candidate will be chosen as the preferred bidder. However, provided that a failure in achieving M&A due to a failure to meet the repayment under the reorganization plan and if the procedure for the reorganization needs to be discontinued, then the portion of paid-in capital increase shall not need to be earmarked high.[33]

A review shall also be necessary to determine between issuance of shares at a premium or at par value in case of such paid-in capital increase.[34]

In most reorganization cases, par issue is commonly in practice, as liabilities usually exceed assets. However, in case the share price of the listed company undergoing its reorganization is above the par value and the company's financial structure and business showings are satisfactory, the par issue shall result in benefitting the buyer, which is the reason why the issuance of shares at a premium is more advisable. Also, because the net property exceeding the par value will be inflowing by means of the issuance of shares at a premium, the financial structure will become sound. And, the issuance of shares at a premium will be called for, for the sake of maintaining a balance with the value of the shares owned by the existing shareholders.[35] However, because it remains challenging to determine the proper price of the

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32) It usually is set forth at either 40% or 50%. However, the minimum level necessary for company to maintain net assets exceeding condition at the time of closing will be the standard.

33) In case of *Hanshin Engineering Construction*, the proportion of the paid-in capital increase out of the acquisition price was 38.8%, in case of New Core it was 32%, in case of Sammi Corporation it was 38.3% and in case of Chunji, it was 40.3%.

34) As for discount issuance below the face value, as the matter of principle of capital adequacy standard, it is not permitted (§ 330, Commercial Law) and there are rarely cases where it is in done in practice. See CHUL-SONG LEE, CORPORATE LAW LECTURE 681 (12th ed. Pakyoung-sa, 2005).

35) *Id.* at 682.

issuance of shares at a premium and risks may increase for investment following the rise of uncertainties of the shares after the acquisition, cautious reviews shall be necessary on deciding whether to issue shares at a premium and how much the price should be for the issuance.

(ii) Secondly, it is appropriate to discuss the issue with regard to the number of new shares to be issued to the buyers or shareholdings enough to secure their stakes. If the M&A of the company under reorganization is deemed for sale and purchase of control or management rights of the company, the number of new shares or the ownership of shares subject to such sale and purchase shall be significant in direct relation to the price of the transaction. The buyer shall be able to more accurately assess the value of control or management right to be bought, if he or she can predict the number of shares or shareholdings he or she will own after the M&A. Plus, as the profits made from the investment will also be projected with greater accuracy, he or she will be able to propose the appropriate bidding price. Meanwhile, the company facing reorganization will be able to secure undisclosed bids equivalent to the objective value by removing uncertainties with regard to shareholdings after the purchase. Disputes will be avoided over by securing shareholdings with the buyer when the M&A are in process in the future. However, in practice, the quantity of shares subject to sale and purchase is rarely clarified during the bidding stage as well as the stage of entering into an investment contract. Shareholdings of buyers, upon drawing up the amendment of the reorganization plan, are usually above 90% of the shares after the M&A. However, it may also hover at around 70~80%.

Shareholding of buyer depends on the degree of alteration of rights of the existing shareholders after the M&A. Because the alteration of rights of the existing shareholders may change, depending on alteration of security and reorganization claim/credit rights and the extent of such alteration, it will not be easy to confirm this in advance. However, close analysis on the structure of remaining shares and reorganization claim/credit rights will help to predict the degree of such alteration of rights. Thus, it will not be impossible at all to specify in advance the minimum shareholdings to be obtained by the buyer. However, although the shareholdings subject to sales and purchase are specified in advance, such shareholdings forecast in advance may differ from the real shareholdings of the buyer after the completion of M&A. Since it will be reasonable to presume that the bidding price proposed by the buyer

reflects the quantity of the shares subject to sale and purchase, in case such shareholdings differ from the real figure, it can be conciliated by means of adjusting the bidding price.[36)]

(iii) Review on legal restrictions and coming up with solutions, such as receiving an authorization from the administrative agency, is necessary for M&A. In recent cases, amid administrative law issues such as authorizations in accordance with relevant laws and regulations emerging as significant concerns, receivers are emphasizing that candidate buyer should solve such issues under their responsibilities and authorities by reviewing such issues in advance.

Examples that can be found in practice recently include business consolidation reporting policy and restrictive measures that are regulated by laws and regulations related to monopoly regulation and fair trade.

First of all, to scrutinize aspects that are in relations to business consolidation reporting policy, anyone who purchases shares of a company facing reorganization whose sales revenue or assets exceed 100 billion won shall not practically limit competition in the specific field. Anyone who has acquired shares of such company facing reorganization shall file for business consolidation report afterwards (§ 7 of Monopoly Regulation and Fair Trade Act). In case the fair trade commission deems that such person is practically restricting such competition, it may order strong corrective measures such as disposition of part of the whole of shares obtained (§ 16 of Monopoly Regulation and Fair Trade Act). Under such restrictive order, 'securing management with sense of responsibilities' may not be achieved, which is the principal purpose of M&A. However, the aforementioned business consolidation report is to be in progress in the aftermath of acquiring shares. On the other hand, as per reorganization procedures, shortly after the amendment plan of reorganization plan touching on M&A is adopted and authorized, it would enter the stages of a capital decrease of initial shares,

36) As for Jinro, after M&A by buyer, minimum shareholdings were specified at 99% and as thereby object goods were stipulated in advance and capital reduction and debt-equity conversion were attempted later, the result showed that in case the ultimate shareholdings of the buyer exceeded it, additional payment of acquisition price followed suit in proportion thereto and exceeded the shareholdings guaranteed in advance indeed upon issuance of new shares, leading to payment of additional acquisition price.

issuance of new shares and company bonds and repayment of reorganization debt by engaging in an amendment plan, a reason why there is a need to, in advance solve the related problems before the issuance of new shares. In case business consolidation report becomes a problem in the process of M&A of reorganized company due to such problems, it is usually solved by utilizing the system of preliminary review request and thereby having the fair trade commission evaluate it before the issuance of new shares.[37] Obviously, it is plausible for receivers to in advance review whether a takeover of control of reorganized company by candidates to participate in the bidding violates restrictive measures of the fair trade laws and regulations. However, in relation to this controversial issue, subject matters such as the definition of the "Relevant Market" may become a problem with regard to projects managed and developed by the participating candidates and reorganized company. However, while the definition of market will require close analysis on the details of the business of not only reorganized company but the participants of the bidding, the receivers will encounter with difficulties for acquiring such information in advance, and, even though the receivers in advance review on this issue, the result of the review may be different from the conclusion of the fair trade commission which is in charge of this subject matter. Thus, it is considered as the responsibility of the bidder to solve this issue.

(iv) There are measures taken for the purpose of fairness and maintaining bidding competition. The reason why company reorganization M&A is implemented under the open competition bidding scheme is that it is reasonable to presume that the bidding price conciliated by the market competition best reflects the value of the company. To this end, any activities of collusive tender resulting in lowering the competition will prevent securing fair bidding price.

Commonly in practice, in case of such collusive tender, measures are taken including cancelling the proposal submitted by the buyer, geared toward inducing competition among candidates.

However, for most cases, the candidates appoint financial, accounting or legal advisors at the time of participation in company reorganization M&A.

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37) Cases business consolidation report mounted as issues include Korea Thrunet, Jinro, Haitai Store, Anam Construction and Korea Express all of which solved the issue by means of system of preliminary review request.

Concerns occasionally mount that competition might be limited due to sharing of information among the personnel in charge of each participating companies, as the number of such advisors available to the candidates is limited and thus same advisor ends up providing services for the participants simultaneously. In the case of 'Jinro', such concern had been already brought to attention before the announcement of M&A, and the participants had their advisors sign a certificate that they will ensure to take measures against such conflict of interests including building the 'Chinese Wall' under their responsibilities, and in the event of breaches of such promise their candidacy will be cancelled and their undisclosed bids will be taken away. Effectiveness was up to par by taking such indirect measure.

Next, in the event that the reorganized company has received advices from accounting or legal advisors prior to M&A on matters such as restructuring and the advisors know crucial insider information that cannot be released outside, the other candidates might experience unfair competition due to lack of balance as to the information among the candidates when providing M&A consulting to some specific companies. Thus, sometimes, such advisors may face restrictions from providing M&A services.

4. M&A Public Announcement

Once the structure and strategy of M&A is determined, receivers make a public announcement on the M&A through public media such as daily news papers and company websites, by deciding on the period, the place and the documents for submission of letter of intent for acquisition and the schedule of the work after receiving a court permit. At this stage, the M&A process starts in full scale. Receivers and financial advisors begin engaging in marketing work by distributing 'teaser'(including company profile, information on value of investment and working schedule) to potential investors.

5. Registration of Letter of Intent

Not legally binding, a letter of intent is generally subject to amendments or changes during the M&A process and without price of acquisition. At this stage, confidential agreements are submitted from companies with a letter of

intent. In common practice, submission of letter of intent and qualifications for participating in the bidding are not linked to each other, because not submitting a letter of intent will not cause any trouble for submitting the proposal. However, in case the number of companies submitting the letter of intent is beyond reasonable expectations or disqualified companies make the submission that are not convincingly willing to make acquisitions or have questionable capabilities to make such acquisitions, previously set forth conditions may be adopted and applied to evaluate the companies to exclude some of them and select qualifying candidates for granting approvals for taking part in due diligence and bidding process. In the event that policy has been made for excluding such companies, usually notifications will be issued at the time of public announcement of M&A.

Afterwards, receivers distribute 'IM' to participants of due diligence. Although the IM does not include details deemed confidential information of the business, it diligently explains information on the real facts of the companies and any details on matters that might potentially have material impact on decisions made by the potential buyer on bidding price that are provided based on factual findings.

In practice, fees for access to information, in conciliated amounts, are sometimes charged to the candidates participating in due diligence. Such participants gain access to financial data and sales figures in a data room arranged by the company. There have been instances where physical data rooms and virtual data rooms had been installed and operated, off line and on line, respectively, based on the quantity of information to be released and the number of companies participating. In preliminary due diligence phase, the prospective buyers may get answers from the company by asking questions through the M&A financial advisor, and, if necessary, receivers, officers and employee might hold Q&A sessions for the candidates.

Receiver distributes bidding guideline to the participants in due diligence in this stage, which mainly covers the method for submitting acquisition proposal, which is legally binding, and guidelines on matters called for as well as an initial draft for the memorandum of understanding to be entered into with the preferred bidder.

6. Preparing for Standards for Selecting Preferred Bidder

1) Preparing for Standards for Selecting Preferred Bidder in Advance

Immediately after M&A was adopted into company reorganization practice, the receiver occasionally evaluated bidding proposal by receiving advices from their financial advisor, under the condition that the standards for selecting preferred bidders had not been determined. However, these days, such standards are set forth in advance before closing the bidding proposal. The purpose that such standards are determined beforehand is to maintain the fairness and objectivity in selecting the preferred bidders.

As such standards does not need to be drawn up prior to public announcement on M&A, because it might expose details of such standards to outsiders, the receiver, shortly before the date of submission of bidding proposal, usually submits authorized application to the court and the court delivers authorized certified copy immediately after the closing of bidding to the receiver. Without public announcement on the standards, and for the purpose of seeking convenience of preparing for bidding and leading the actual bidding of the candidates favorably to the company, certain items of evaluations for bidding proposal and standards for evaluation within restricted scope may sometimes be announced to the participants in the bidding.

2) Details with Regard to Standards for Selecting Preferred Bidders

(1) Items to be Evaluated Etc.

As far as drawing up the standards for selecting preferred bidders is concerned, under consideration in common practice have been the size of undisclosed bids, rate of paid-in capital increase, conditions for procurement of liabilities of undisclosed bids, capabilities of procuring undisclosed bids, management quality after acquisition, and financial soundness of the buyer[38] and succession of employment. Recently, whether request has been made for amending the initial draft of memorandum of understanding is sometimes

38) It refers to investor with the highest acquisition price by paid-in capital increase of members of consortium.

one of the factors in setting forth the standards. The size of undisclosed bids obviously takes up a significant portion of the standards. Close reviews shall be made on whether distinction as for the size of undisclosed bids has been assessed enormously low in comparison with qualitative measurement index (management capacity after acquisition, succession of employment, financial soundness of main buyer, request for amending initial draft of memorandum of understanding), whether[39] allotment should be discriminated under the proportion of the paid-in capital increase, allotment of the qualitative measurement index is appropriate and whether strategic investors are allotted to receive more benefits than financial investors. To this end, appropriateness of allotment shall be on review by launching simulations with various projection data.

(2) Elements to Consider for Each Item to be evaluated

① Size of undisclosed bids and Scope of Paid-in Capital Increase

Because the foremost concern of reorganizing company is to prepare financial source for repayment, the size of undisclosed bids poses the largest significance in evaluation. In evaluation of this element, conversion of points scored in accordance with the size of undisclosed bids is calculated first and then that number is multiplied by the proportion of the paid-in capital increase. In evaluation of the size of undisclosed bids, there is a method that the acquisition unit price is first set forth and the whole undisclosed bids are conversed by multiplying it with unit undisclosed bids and another method is that the amount subtracted from the whole undisclosed bids by a certain amount is conversed by dividing with the unit acquisition price.

In practice, the higher the bidding price and the rate of paid-in capital increase, the more favorably the evaluation resulted. However, in case the bidding price exceeds the remainder of reorganization debt, the exceeding portion returns to the shareholders or the buyers. Thus, the author does not think that it is proper that evaluation results favorably only because of

39) In case the interest rate under issuance of company bonds can be afforded by reorganizing company after the transaction, it may not be necessary to grant additional points merely due to highest proportion of paid-in capital increase. It is largely due to the fact that while only public bonds will be remaining after repayment of reorganizing bond debts as acquisition price, generation of certain size of public bonds from issuance of company should be allowed, and, for buyer, the higher proportion of paid-in capital increase the higher uncertainties due to collection of dividends, causing acquisition price to drop.

bidding price. Also, it will be sufficient for the rate of paid-in capital increase to be evaluated with having a reasonable weight within the necessary degree of financial structure improvement of the company after the completion of M&A and overly emphasizing this factor beyond such necessity would be inappropriate.

② Conditions of Procurement of Liabilities Portion of undisclosed bids

As the size of the liabilities of undisclosed bids is automatically determined as provided in ①, separate evaluation shall be double evaluation on the same subject matter. That's why evaluation of the liabilities size is not conducted separately. However, the condition of procurement of the liabilities part of the undisclosed bids will increase the burden of the company after the M&A. Thus, this area is subject to another separate evaluation. The condition of procurement of the liabilities part of the undisclosed bids are evaluated by, i) the period of maturity of bonds and ii) interest rate of company bonds, and long maturity period and low interest rate result in higher evaluation score. In process of preparing the evaluation standard, considering future cash flow of the company evaluated by the M&A financial advisor, the period where the company can by itself prepare financial sources for repayment are deemed a proper maturity period or sometimes any interest rate causing the interest coverage ratio to hover at around 2.5~3 after the M&A closing are deemed to be the proper interest rate. In some cases, the capacity of the company is the standard to evaluate the conditions of the company bonds without determining the maturity period and interest rates.

③ Undisclosed bids Procurement Capacity

There are instances where financing capacity of the buyer is often evaluated with documentary evidence of procurement of undisclosed bids or else sometimes the procurement method of undisclosed bids may be subject to evaluation. In case the financing procurement capacity is assessed below a certain level, it is a common practice that the concerned bidding proposal is cancelled. Evaluation is made and ranks among bidders are given by examining the types of documentary evidence of financing procurement and the portion of undisclosed bid with documentary evidence of financing procurement. The reason why the procurement capacity for undisclosed bids is assessed is because it is best to avoid a situation where a candidate without necessary procurement capacity proposes an undisclosed bid that is too high and exceeds its capacity to become a preferred bidder, which makes the

following M&A procedure unstable. Hence, if an overly strict requirement exists for the documentary evidence of financing documents or the portion of undisclosed bid with documentary evidence is too high, then it may lead into switching the identity of the preferred bidder, so flexibly applying standard is advisable.

What would usually be accepted as fund procurement documentary evidence include the certificate of balance under the name of the bidding participant, balance certificate of marketable securities such as listed shares, loan agreements issued by heads of financial institutions etc. Plus, others include lenders' letters of intent issued under the name of branch chief and directors instead of heads of financial institutions as well as lenders' letters of intent or investment agreements with conditions related to implementation of the loan (for instance, in compliance with the company's internal regulations, requiring approval of the board of directors, or holding a mortgage on assets of company that is target of M&A) attached. The latter is subject to demerit marks. In addition, although usually pertaining to private equity funds, (i) certificate for financial procurement of the amount determined by the bidding at any time by pursuing credit line of a certain amount from publicly trusted financial institutions, (ii) agreement as to the total amount of loan available from limited partners as of the time of bidding, to renowned general partner of PEF and a third party's statement proving that such loan is unconditional, (iii) investment agreement of publicly trusted financial institutions as a bidding participant, have been approved as fund procurement documentary evidence.

④ Management Capability after Acquisition

It is essential to evaluate management capability of the candidates, as one of the objectives of company reorganization, M&A is to secure the responsible management entity. In this item, subject to evaluation are experiences of the buyer's management of the same type of business and understanding of the reorganized company as well as the management plan. The experiences might be evaluated on the manager himself or herself, as the representative of the consortium is in practice in charge of management of the company after acquisition. Or else, members of the entire company of the consortium might be evaluated, to compute the average point of the entire group. In case of evaluating the future management plan with emphasis, the contents included into the management plan should obviously be introduced in advance.

⑤ Financial Transparency of Buyer

While this evaluation item is to evaluate the effectiveness of the reorganized company after the acquisition along with the above provided ④, as the company has already experienced financial meltdown before, in case another company with weak financial structure acquires the reorganized company, then the goal of improving final structure of reorganization company by M&A may be threatened by the fact that early redemption of investment fund may be needed by the buyer, which makes this item as such item to be used for evaluation. In common practice, due to the reason cited above, evaluation is conducted centered on the representative of the consortium for credit rating, and debt to equity ratio, and sometimes assessing financial soundness of all of the members of the consortium and calculating their average is done as well. In addition, this item is to predict the effects of the reorganized company after acquisition and thus the debt to equity ratio among others may be subject to evaluation after acquisition by the buyer.

⑥ Employment Succession and Conditions

While it is obvious that the creditors are those with the largest interest in the M&A of the reorganized company, in the perspective of the current employees of the reorganizing company, job security and improvement of the working conditions are also important matters. Thus, the issue with regard to succession of employment for the manager pushing for M&A must be significant. Indeed, it is not rare that labor unions request for securing their employment and oppose the M&A in process or even cause hindrance to it by taking action. Thus, it is important to consider succession of employment for protecting workers and stabilize M&A process, which is why bidding proposal that does not succeed employee or not guarantee such succession is disqualified.

In case the labor union has a great deal of opposing voices with regard to maintenance of employment, there have been instances where the company had the union in charge of drawing up the standards of bidding proposal related to employment succession and working conditions and evaluation of bidding proposal.

Most of bidding proposals confirm the plan for employment succession of all of the employees. However, sometimes they may suggest pushing for restructuring after the acquisition. From the viewpoint of Korean labor law, it remains questionable whether the employee relation maintained during the

process of reorganization while the company was in the state of financial meltdown can legally be cut off after the company undergoes the M&A and escapes financial difficulty.

7. Acceptance of Acquisition Proposal

The buyer candidates, based on the results of preliminary due diligence, will submit acquisition proposals which are legally binding with the price of acquisition written in it. Right after the deadline passes, in practice, receivers and financial advisors often bring the proposals and open them in court.

After submission of the proposals, in accordance with general principles, membership of the consortium shall not be changed arbitrarily. In exceptional cases, if unavoidable, the receiver may permit the changes of consortium's membership with court's approval. As per such changes, in addition, in case of selecting candidates who can participate in the preliminary due diligence at the stage of submitting the proposal, the membership changes may face restrictions until submission of the proposal. For the period following such submission, membership change faces far more strict restrictions in a sense that it may have an impact on the evaluation of candidates for preferred bidders.

8. Selection and Notification of Preferred Bidders

1) Entity Subject to Evaluation of Bidding Proposal

Only the receiver is legally entitled to evaluate bidding proposals submitted and select preferred bidder. In most M&A cases in reorganization practice, the receiver uses advice from the financial advisors to evaluate the proposals, and decide on the preferred bidder with the court's approval. The receiver sometimes creates a commission to evaluate the bidding consisting of a multiple number of commissioners who will participate in the evaluation. Under such case, the commission usually consists of managers, management personnel and M&A personnel of the financial advisor.

2) Appointment of Preferred Bidders and Payment of Performance Guarantee

At the time of selecting the preferred bidders, the priority is determined according to the result of the evaluation of the bidding proposal submitted by

the candidates. In case there is more than one candidate with the same evaluation points, whichever proposed the larger amount of acquisition price will win the seat. If such amount is same, the amount of paid-in capital increase will determine the result, as the one with a larger amount will be appointed, and, in case the amount is also equal, whichever scores higher in qualitative measurement index will win the preferred bidder appointment. In the process of such appointment, under the ranking of evaluation points, additional preliminary preferred bidders may often be appointed. This is for the purpose of continuing with the M&A procedure by being able to grant the status of new preferred bidders to the preliminary bidders as well as depriving them of the status of preferred bidders without the need of returning to the first stage of the procedure to prepare for failure in negotiations with the preferred bidders. In practice, because the presence of preferred bidders itself may improve the negotiation capacity of the manager, in case there is one submitting a multiple number of acquisition proposals exceeding the selling price set forth in advance, it will prove to be an advantage to appoint preliminary bidders in many aspects.

Meanwhile, in case there are a multiple number of those submitting acquisition proposals and it happens to be difficult to discern who is more qualified, in particular, although the difference in bidding price is minimal and qualitative measurement index has somewhat noticeable differences, if there is an intention to improve the conditions proposed in qualitative measurement index favorably to the debtors, the preferred bidders may be selected in a multiple number and then they can bid for another round for the final selection.

The preferred bidder is then required to enter into a memorandum of understanding within a few days from the notification date (however, provided that court permit will allow extension of the deadline), and up to the date before signing the memorandum of understanding 5% of the acquisition proposal amount need to be paid as performance guarantee.

9. Closing Memorandum of Understanding

After negotiations over the distributed initial draft of memorandum of understanding with the preferred bidder, managers obtain the court's permit. There is a possibility that the deal may end with a rupture at this stage. For

instance, a company which had been appointed as the preferred bidder requested amendment of the terms and conditions generally accepted as customary (removal of performance guarantee system, designating overseas arbitration institution as forum, limitlessly permitting scope of due diligence) in reorganization M&A which caused a delay in negotiation. The company ended with wavering the negotiation and thereby lost its position. In another instance, amid pushing for M&A under the business transfer scheme, the preferred bidder caused a failure in negotiation after requesting indefinite keeping of acquisition price till the date of business transfer. In common practice, the receiver first appoints the preferred bidder before carrying out negotiations over memorandum of understanding. However, in case there is no other alternative, while success in M&A is desperately necessary by making a number of corrections and amendments on the initial draft of memorandum of understanding as requested by the preferred bidder, the order will be reversed by carrying out the negotiations before selecting the preferred bidder.

10. Detailed Due Diligence of Preferred Bidder and Conciliation of Undisclosed Bids

The preferred bidder carries out due diligence on the reorganized company in the manner set forth by the memorandum of understanding. The due diligence period is usually for two weeks. Some companies take more than a month depending on the size of the company. In case an additional period is necessary, court permits will be attained for extension.

The purpose of the due diligence of the preferred bidder is to check whether the evaluations were conducted duly over assets and debts falling in the scope of the due diligence as the due diligence standards would require. After the detailed due diligence, the preferred bidder submits undisclosed bids conciliation application or final acquisition proposal. As some preferred bidders may request conciliation of undisclosed bids with fluctuation data of assets and debts after the due diligence date, the receiver will need to tell in advance preferred bidders of the scope of such conciliation. Subject to such conciliation shall be cases where the due diligence is on obvious and material errors or omission.

Company reorganization M&A has little possibility for generating

unrecorded liability contingent liabilities, unlike in general M&A, undisclosed bids may be conciliated within the range of up to 5% on usual memorandum of understanding as determined in most cases. If the preferred bidder requests conciliation of undisclosed bids, the court supervising M&A requests the receiver to submit details of conciliation requested by the preferred bidder, existence of causes for conciliation set forth in the memorandum of understanding, opinions on accepting it or not and detailed evidence with regard to it. In particular, with regard to the financial advisor who conducted due diligence prior to the announcement on sale, it requests such financial advisor to provide explanation on the reasons for the differences between the results of the detailed due diligence by the buyer and the previous due diligence. At first, one may think that it is a bit too harsh to request reasonable evidence for conciliating undisclosed bids, as it would mean to adjust undisclosed bids as agreed upon thereby and to allow the creditors to make decisions by seeking a resolution at a meeting among related parties, once consent is made with regard to conciliation of undisclosed bids between the receiver and the preferred bidder. However, as to reduce the proposed bidding price is to reduce the distributed portion to creditors, it shall be deemed natural to request reasonable grounds for such reduction. In addition, recently criticism is rising among the creditors' committee over the concern that the receiver and the court are controlling too much of M&A which determines the satisfactory level of interests of general creditors in realistic terms, which is why making decision on such reduction shall require harsh grounds.

Conciliating such common undisclosed bids not only takes number of days but poses an important chance for assessing the negotiation capability of both parties. As a receiver, there is a need for fully utilizing his or her negotiating capacity in order to prevent the preferred bidder from wavering the contract and the process from being delayed, while denying groundless requests for conciliation. Realistically, once M&A reaches this stage, the financial advisor tends to be not paying enough attention to the fact that the fundamental purpose of pushing for M&A is to financing to the fullest to maximize general creditors' satisfaction. On the other hand, court might again review deeply how the ground for reducing undisclosed bids proposed by receiver and the financial advisor would be reasonable.

In reviewing the application for conciliating undisclosed bids, it is greatly

different for each buyer. There are instances where the conciliation amount exceeds the maximum limit of undisclosed bids conciliation request amount, while the buyer requests for undisclosed bids conciliation and submits other requests such as those under the standards set forth by memorandum of understanding. On the other hand, rather than conciliating undisclosed bids, bidding price may become the final undisclosed bids as there has not been requests for conciliation for the sake of fast closing(Heung Chang, Ilhwa). The former case, however, is more common.

11. Closing of Main Contract

After negotiations over conciliating undisclosed bids are complete, main contract will be entered into after reaching an agreement following detailed negotiations over conditions of the acquisition. This contract shall include details on all matters negotiated so far such as the amount of undisclosed bids, the timing and the method of undisclosed bids payment as well as follow-up measures (matters related to procedures for amending reorganization plans, reorganization security right, repayment of reorganization credit, capital reduction, paid-in capital increase, acquisition of company bonds, dispatching team for acquisition planning, and closing of company reorganization procedures).

In practice, for most cases, the problem lies in the rate of capital reduction. Previously, at the time of signing main contract, decision on whether to engage in capital reduction and implementation of rate of the capital reduction was regulated to the extent where in later time receivers prepare amendment plans and decide under mutual discussions, yet, recently requests have been made frequently that a certain rate of capital reduction should be specified in this contract. Reasoning cited by the buyer in such progress is that the existing shareholders with the value of (–) end with having the value of (+) due to investment by the buyer. In case the liabilities of the reorganizing company exceed the assets and the existing shareholders' value ceased to exist, there is no problem with accepting such argument. However, in case there is value of existing shareholders because the asset of the reorganizing company exceeds the liabilities and the shareholders possess the right to vote for resolution on amendment plan, it will not be easy to accept such argument. The question is how much of the remaining value of the existing shareholders

need to be left intact after the M&A in the end. However, this is not the issue to be resolved between the buyer acquiring new shares and the existing shareholders. Instead, it is an issue to be resolved in the perspectives of 'Grading under fairness and equality,' by comparing term between the rate of loss of the reorganizing creditors and the rate of loss of existing shareholders, determined in the amendment plan. Previously, under reorganization plan, it became an issue whether it was fair and equal to leave grades between interested parties. However, these days, although it would be rightful to draw distinction between the related parties and have grades, since occasionally disputes mount over to what extent of such distinction shall be deemed fair and equal, determining the detailed proportion of the capital reduction shall be dire.

Under the main contract, in case the buyer is a consortium, it shall be noted that the members of the consortium have jointly and severally liable relationship, and in principle member of the consortium may not be changed, and by letting them change the members with court permit, if necessary in exceptional cases, payment of undisclosed bids is secured.

Also, on the date of entering into this contract, the buyer shall deposit 10% of undisclosed bids as down payment (including 5% as performance guarantee paid in) and in case of termination or cancellation of main contract for the reason attributable to buyer, the above mentioned amount will be taken as a penalty, loss or damages, and thus the buyer is bound to be prevented from breaching or cancelling the contract improperly.

The remaining amount of undisclosed bids exclusive of the down payment is required to be deposited several days before the meeting of related parties for hearings and resolutions on amendment plans. However, depending on buyer, for the reason that undisclosed bids has not been prepared after the signing of this contract, request will often be made for an extension of the period of deposit of undisclosed bids.[40] For the buyer,

40) There was a case the contract was terminated and performance guarantee payment was taken back due to failure to prepare acquisition price despite two consecutive offers of extension of period following the failure to prepare acquisition price till deadline of depositing remainders by buyer in practice [AK Capital Consortium which was appointed preferred bidder during 2003 M&A of Hanbo Steel and Heavy Industries]. Meantime, after extension of same kind was made following failure to deposit remaining amount until the deadline, merely amount for

company reorganization M&A should be relatively safe investment with little possibility of contingent liabilities. On the other hand, as for the reorganizing company, as this contract does not immediately end and usually takes several months till submission of amendment plans and resolution at the meeting of related parties, in order to secure binding power with regard to payment of undisclosed bids, imposing damages or penalties may be unavoidable.

12. Follow-up Measures

Reorganization M&A has fundamental structure that financial structure is improved with full repayment of secured/unsecured reorganization debt with undisclosed bids paid by the buyer (therefore, the buyer usually only succeeds priority claims)[41] and the buyer becomes the controlling shareholder and begins operating the business that has recovered with improved financial structure after closing of the reorganization case. To this end, the receiver prepares and submits amendment plan on paying for reorganization debts with the acquisition fund as the financial source. However, just as the case of having to repay only part through rescheduling instead of full repayment of reorganization debt with undisclosed bids because the size of reorganization debt to be paid by the the company is too enormous, in case the amendment plans have adverse impact on related parties of interest, the receiver shall submit an amendment plan on reconciliation of debt and seek inquiries and resolutions of a meeting among related parties (Company Reorganization Act § 270 Para. 2).

As a debt restructuring mechanism, if it is possible to establish an

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paid-in capital increase was deposited without depositing of price for company bonds, which was finally implemented on the very date of meeting of related parties a moment before commencement of the meeting.

41) However, in case of reorganizing claims requiring presumption of possibilities for realization for early repayment such as disputed or contingent reorganization claims and reorganization guarantee claims still in due litigation process, when opinions differ over possibilities for realization between reorganization company and concerned creditors, the capital may be separated from the acquisition fund and be reserved in company in the amount equivalent to the amount payable at the time of confirmation until realization of the bond by negotiation with buyer. Or else, repayment financial source may be entrusted in case of confirmation of those claims by appointing concerned creditors as the beneficiaries.

amendment plan that allows for cash repayment of all reorganization claims secured or unsecured, in the amount that is discounted to their present values by the IRR[42] which is equal to the IRR that makes financial resource amount (in practice, refers to the amount that can actually used for reorganization debt payment, which is calculated by the price of acquisition minus expenses, such as success fee for financial advisor and buffer expense) to be equal to the annual Repayment Amount[43] discounted as of the day prior to the day of interested parties' meeting to vote on the amendment plan, then that amended reorganization plan is a desirable plan because it does not damage the spirit of fair and equal allocation while rationally allocates financial resource. [44]

However, since the above-stipulated distribution method results in reduction of repayment amount with regard to the unsecured creditors who are under unfavorable conditions of repayment in comparison with secured creditors under the initial reorganization plans, it may be an obstacle to gain the consent of reorganization credit holders in case there is a lack of financial sources for repayment. In practice, a popular distribution method is: out of financial resource, the amount equal to liquidating value of collateral[45] is distributed to secured reorganization creditors as preferred distribution, and the amount of claim the secured reorganizing creditors hold in excess of collateral is considered as unsecured reorganization credit and distributed with lower priority.

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42) Internal Rate of Return ("IRR") refers, as discount rate setting net present value at zero, to rate of return equalizing present value of cash inflow to present value of cash outflow.

43) It refers to principal and interest payable every year for each individual creditor during the period of reorganization under the initial reorganization plan.

44) In case of *Korea Thrunet Co.*, the receiver has received recognition for preparing and submitting amendment reorganization plan by means of above method from reorganization security right holders and reorganization creditors.

45) There is a room for controversy over whether liquidation value should be determined as of confirmation of initial reorganization plan or the amended plan. In case of depreciation of value of collateral over time such as building, machinery and equipments, if the liquidation value at the time of confirmation of amendment reorganization plan is distributed first, it shall be as if not repaying as the amount of such liquidation value to such holder, producing cruel result in the eyes of such holder. Under the absolute priority rule of US Federal Bankruptcy Code, assets should not be distributed to junior creditors until senior creditors are satisfied with such rights in full, with a premise of distributing continuing corporate value before distributing liquidation value to senior security right holder.

After the amendment reorganization plan is confirmed, the acquisition planning group is dispatched as desired by the buyer. If there is no immediate appeal, efforts are made to prevent delaying of exercising of management power by the buyer who has become the controlling shareholder, by taking follow-up measures such as paid-in capital increase toward capital reduction of initial shares and buyer and issuance of company bonds, repayment of reorganization debt by means of undisclosed bids, old shares entrusting with cancellation registration in accordance with amendment plan. After those procedures, follow-up measures are taken such as realignment of management. Once reorganization credit is repaid, the receiver files for closing of case of reorganization immediately, and the court listens to the opinions of creditors' committee and management committee, to finally decide on closing of reorganization case.

V. Procedural Problems in M&A

1. *Company Reorganization M&A and Reorganization Plan - Pros and Cons*

1) *Legal Relations between Reorganization M&A and Amendment of Reorganization Plan – Pros and Cons*

Exclusive of special cases where the reorganizing company fully repays remaining reorganization debt on its own, M&A has to be accompanied with procedures for amendment of reorganizing plan for conciliating the relations of the interested party. Thus, after implementing M&A, in case the initial reorganizing plan cannot be amended as provided in M&A, then the purpose of the M&A cannot be achieved, which is why close reviews are important on details regarding reorganization plan prior to making decision to carry out the M&A, size and structure of remaining reorganizing liabilities and management structure of reorganizing company and based on such review, determination should be made on whether amendment on reorganization plan is possible.

2) *Needs for Reorganization Plan Amendment*

Reorganization Plan Amendment shall not be easily permitted because it

was confirmed by the court following the resolution of creditors' meeting, as it has been conciliated under interest of secured creditors, unsecured creditors, and shareholders and the rights of all the interested parties were seriously undergone and discharged by the confirmation of the court. It means the resolution of the incorporated their own interests on the assets and going concern value of the company, and thus, reorganization plan once approved and confirmed became the fundament of the company's way to survive the financial distress. However, in any case, without approving such amendment, if just because such authorized reorganization plans or self- recovery plan cannot be carried out due to economic or any other reasons, procedures have to be eradicated at all times and end with reorganization procedures, then it will not be desirable socio-economically and against the interests of related parties reflected on initial reorganization plan. If the debtors can be recovered by allowing such changes, it will foster socio-economic efficiency and live up to the interests of interested parties, which is why the amendment needs to be permitted in case there are inevitable reasons.[46)]

3) Requirements in Amendment of Reorganization Plan

Amendment on reorganization plan shall only be allowed when it is necessary due to unexpected reasons as of the date of confirmation of the initial plan (§ 282 Para. 1 of DRBL).

In this context, 'unexpected reasons' are to mean[47)] such circumstance that there is a reason to have born a different plan than the present plan had it been forecasted at the time of confirmation of the initial plan. Thus, if such reasons had been in place, not after, but before the confirmation, amendment shall not be allowed. They would take place in the form of drastic changes of economic conditions, enactment and termination of laws, cancellation of authorization required for implementation of business, and business showings below forecast. In most cases of reorganizing companies, they would have under such reasons as economic conditions have changed after initial confirmation, thawing business showing etc., and thus it will not matter much in real cases.

'Need for Amendment' is to mean that the reorganized company will be

46) *See supra* note 6, at 137
47) *Id.* at 141

incapable of or face difficult waters in carrying out part or all of the reorganization plan in case the initial plan stays unchanged and, thus, if plans are changed, the rehabilitation of the company through carrying out the new plan will be realized by lifting such troubles.[48)]

4) Pushing for Company Reorganization M&A and Amendment Reorganization plan

The need for amending reorganization plans shall be studied in the perspectives of possibilities for carrying out the initial plan. In case the reorganizing company stably implements the reorganization plans and posses capital to execute such implementation in future or otherwise circumstance that may hinder implementation does not exist, but a potential buyer is nevertheless sought and M&A is pursued, this has no relations with interests of satisfaction of liabilities owned by the creditors and rehabilitation of the reorganizing company, and will result in just causing handover of the control over the reorganizing company by issuing new shares to a buyer. In other words, as for such reorganizing company, the interest of creditor, which is repayment of reorganization liabilities, and the interest of reorganization company itself, which is closing of reorganization procedure through repayment of reorganized liabilities, are both proceeding as determined in the original reorganization plan, and the controlling structure of the company is already completely determined under the approved and confirmed initial plan. Thus there will not be problem with carrying out the plan, which is why the reorganization plans does not need to be amended.

For efficiently carrying out the business by the company and continuously existing as a normal company in future, it might had to have a better controlling shareholder as a transparent and responsible management entity. On the other hand, even if a new controlling structure is established under the initial reorganization plan, the creditors are mainly the financial institutions, who become the controlling shareholders by debt-equity swap. These

48) While in past practice the shareholders of Kukdong Construction as reorganized company have submitted amendment plan requesting for gratuitous distribution of new shares, court rejected the appeal for changing the plan for the reason that "the amendment plan does not have a context that can avoid causes troubling the implementation of the plan and foster maintenance and reorganization of a company."

shareholders usually are not interested in the management of the company and do not possess adequate qualification as managers, which is why there should be a realistic need for securing a new management leadership through M&A. However, there have been cases where the financial institutions themselves take steps as the acquisition candidates to participate in the paid-in capital increase, and, after the enforcement of DRBL in 2006, led by the local banks, "The Management Guideline for Restructuring the Financial Institutes as Obligations" has been made and the process of implementing the recovery plan and management recovery for the debtors have been evaluated, to ensure the post-reorganization M&A is working out as planned. As the financial institutions themselves can benefit, by collecting their loan, from regaining the value of the shares through debt-equity swaps and recovery of the company's management, it will be unreasonable to say that the financial institutions are not interested in managerial issues of the reorganizing company and can even go as far as taking part in it by appointing qualified managers by means of exercising their rights as shareholders. Thus, it will be improper to generalize their apathetic attitudes or lacking qualifications for management of the company. To this end, for the financial institutions to remain as shareholders after the closing of the procedures does not necessarily contrast securing responsible management of the company.

Even if this is not so, provided that the reorganization plan set forth to arrange the conflict of interest is being carried out normally, to push for the M&A that will only cause changes in the controlling structure within the process and will be beyond the scope of the initial plan for debtor rehabilitation. Thus, it will not be appropriate for the cause of the M&A of reorganizing company, and the amendment of reorganization plan will not have such conditions and this type of M&A should not be allowed.

2. *Agreement for Investment and Capital Reduction for Existing Shares*

One of the barriers emerging in the series of negotiations for M&A investment agreements for most reorganizing companies is the buyer's request for deciding on the rate for such capital reduction for existing shares in investment agreements.

In common practice, after entering into investment agreement, the receiver prepares and submits to court amendment plan which is based on M&A,

while one of the difficulties emerging in the process is to decide reduction of existing shares and to which degree the capital reduction rate should be implemented. The amendment plan mainly covers how to distribute the transaction amount to secured creditors and unsecured creditors in the process of rescheduling for the purpose of full repayment of remaining reorganization debt by using M&A transaction amount.

Also, as for the amendment plan based on M&A, requirements for confirmation of the reorganization plans still apply, and, re-discharge of any remained credits and shares shall satisfy the principle of 'fairness and equitability' among all the interested parties. Since the precedents insist that to reduce, not the rights of shareholders but only of the reorganization creditor is not permitted under this principle,[49] the entire remaining debts must be satisfied before the interests of shareholders are unaffected by the amendment plan caused by the outcome of the M&A. In contrast, the answer to the question on whether only the rights of shareholders can be reduced without the reduction of any other interests or secured/unsecured should be answered negatively as matter of principle. However, in case of economic recovery after the reorganization procedure or the reorganizing company can be re-established by closing of reorganization case by investment of capital through amending the rights of shareholders by appearance of a buyer who will invest in a large size due to other reasons, amending the rights of shareholders without reduction of reorganization credit may be an option.[50] However, even in such case, it is a difficult problem to decide to which degree such amendment should be made toward the shareholders to be proper under the principle of fairness and equality. The grades of right amendments between shareholders and creditors cannot be judged indiscriminately by comparing just the rates of reduction of reorganization credit and the number of shares, and in addition, various factors, such as reduction in capital and its ratio, reduction rate of actual share composition by issuance of new shares,

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49) Supreme Court Decision Case No. 2002geu121 as of December 10, 2004 (Dure Air Metal Case) stated that "as the fairness and equality principle can be said to mean that it does not guarantee preference with regard to wealth distribution upon profits and liquidation for senior creditors nor grant preferences to junior creditors over senior creditors, and thus does not allow reduction of rights of reorganization creditors without reducing the rights of shareholders."

50) LIM, CHAE-HONG & PAK, CHANG-HOON, COMPANY REORGANIZATION ACT 189-190.

shareholding ratio in case issuance of new shares issued in M&A, the amount of capital belonging to existing shareholder determined by their holding in net asset of reorganizing company, and post- reorganization and post-adjustment of share ratio by the issuance of new shares for M&A, ratio of reorganization debt recovery ratio, and consideration should also be made for shareholder's interest in future income of the company, and, therefore, it is extremely difficult to lay out a general rule that determines the degree of change in existing shareholders' rights.[51, 52, 53)]

As stated above, in M&A of reorganized companies, it will be more often challenging to determine with the potential buyer at the phase of signing investment contracts in advance the question of whether to change the shareholders' rights and to what degree such change will be reflected in the amendment plan conclusively. In addition, realistically speaking, in case the assets exceed debts at the time of M&A, even the opinions of shareholders should be considered for whether and to what degree the capital reduction shall be made. Thus, instead of fair and equitable treatment for related parties at the phase of signing investment contract, this should be considered with awareness that this issue cannot be resolved by negotiations with the buyer seeking to maximize the efficiency in investment by securing shares of the

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51) Supreme Court Decision Case No. 2002geu121 as of December 10, 2004.

52) Original ruling of above supreme court decision of Seoul High Court as of November 3 2002 stated that "reduction of rights for both reorganized credits and shares shall be satisfying the fairness, equality principal only if reduction rate of junior shares is higher than that of senior reorganized credits, and the two cannot simply rely on comparison under reduction rate of reorganized credits and shares, due to fundamental differences based on the nature of credits and shares, yet, in general, reorganized credits are to mean rate of projected repayment amount including adopting to present value the value of shares under cash repayment and investment conversion(as for guarantee credits, adopting to present value the main shares shall be considered and thus the rate of projected repayment amount considering repaid amount and amount secured for future repayment), and as for shareholders reduction of rights is to mean proportion-based lowering of status of shareholders for the company, and thus, rather than a simple reduction rate, the shareholdings of former shareholders altered after paid-in capital decrease and issuance of new shares shall be considered reduction rate of such rights for each."

53) Above provided Seoul High Court's decision seems to have calculated reduction rate of existing shareholders under the method of relative share rating. As for a method to assess the extent of rights reduction of existing shareholders, method for net profit approaching computing the reduction rate by comparing net profit price to be distributed to existing shareholders after paid in capital decrease by means of M&A with net profit price to be distributed to existing shareholders before M&A.

reorganizing company following the M&A.

3. *New Share Issuance and Rights Amendments under Initial Reorganization Plan*

In recent M&A of reorganizing companies, there is often no need for amending reorganization plan for re-conciliating liabilities as the acquisition price can fully repay the remaining reorganization debt. However, in a relatively recently prepared reorganization plans, while responsibilities for pushing the M&A under the scheme of new share appointment to a third party are granted to the receiver with securing ample size of authorized capital, there are usually articles stating that the receiver may issue new shares for M&A under court's approval within the scope of the amount of authorized capital. As a result of the receiver's pushing for the M&A under those reorganization plans as provided above, the buyer proposed the undisclosed bids exceeding the reorganization debt, and the problem lies in whether reorganization plan amendment procedure will be necessary in case of being able to issue new shares for the buyer within the authorized capital set forth under the reorganization plans.

According to the practice of the bankruptcy division of the Seoul Central District Court, while dilution of shareholding of existing shareholders due to issuance of new shares for the buyer itself is unfavorable towards initial shares and thus procedures for amendment of reorganization plans should be applicable, if such shareholding's reduction is within the scope set forth by the initial reorganization plan. Since the disadvantages resulting from it is already projected in the initial reorganization plan, only issuing new shares for the buyer should not trigger initiating the new amendment procedures.[54)]

Thus, in case of reduction of rights of reorganization credit holder in amendment plan to be prepared after entering into main contract, without any exceptions the rights of shareholders by means of capital reduction by

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54) Companies which have issued new shares and completed M&A without changing reorganization plan under such assumption include Shinsung Tongsang, SEGYE Inc, Shinhan and Jinro. Supreme Court decision Case No. 2004geu84 dated June 15, 2005 related to reorganizing company "Kukje Trading" seems to be accepting such practice as legally permitted.

share consolidation are being reduced. In such case, the extent of reduction of rights of shareholders should not be smaller than that of reorganization credit holder.[55] The method for figuring out the extent of reducing rights is not simply the rate of the capital reduction but the relative method for share portion which is to consider the shareholdings of the existing shareholders changed after the capital reduction and issuance of new shares as the rate of reduction of rights of shareholders.[56]

In case shareholders have voting power for accepting the plan with assets exceeding debts at the time of voting, some minority shareholders may show up in the meeting as related parties and present their dissatisfaction toward capital reduction or file appeal against the confirmation of court for amendment plans, which could delay the closing of the procedures for company reorganization, and the shareholders who are also reorganization credit holder who have received conversion of some of the claim into shares may react sensitively toward the capital reduction, which is why there is a need for the receiver and the financial advisor to closely study appropriateness of the rate of such reduction and explain enough on the inevitability of capital reduction toward the related parties of interest.

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55) The Appeals Court decision Case No. 2002ra209 dated November 4, 2002, from which the above Supreme Court decision arose, held that "reduction of rights for both reorganized credits and shares shall be satisfying the fairness, equality principal only if reduction rate of shares, which are low in priority, is higher than that of reorganized credits, which are high in priority, and the two cannot simply rely on comparison under reduction rate of reorganized credits and shares, due to fundamental differences based on the nature of credits and shares; yet, in general, in case of reorganized credits, the rate of reduction for its rights shall be the rate of projected repayment amount which includes cash payment and the present value of shares subsequent to debt-equity conversion (as for guarantee credits, the rate of projected repayment shall consider the repaid amount from the original obligor and the amount that may be repaid with certainty in future because it is necessary to consider the fact that the main obligation can be actualized) and in case of shareholder, the reduction rate for its rights shall not be mere capital reduction ratio but the changed shareholding ratio of existing shares caused by capital reduction and issuance of new shares, because the reduction of shareholder's right means reduction in shareholder's pro rata status with respect to the company."

56) Above provided Seoul High Court's decision seems to have calculated the reduction rate of existing shareholders under the method of relative share rating. Additional method to measure the degree of existing shareholders' rights reduction is approach from net asset in which reduction rate is calculated by comparing the amount of net asset that would have been distributed to the existing shareholders prior to M&A to the amount that would be distributed to the existing shareholders after capital reduction via M&A.

4. Grounds for Appointing Third Party for New Shares

There are cases where the reorganization plans confirmed long ago and wholly stipulates that the receiver, when issuing new shares, decide the method for assignment of them by obtaining court's approval.

As in reorganization procedures, provisions applicable on corporate law with regard to right for acquisition of new shares by the existing shareholders are explicitly excluded, (§ 255 Company Reorganization Act, § 266 DRBL) requests of existing shareholders for assignment of new shares based on provisions of corporate law can properly excluded. However, requests made by secured creditors and unsecured creditors for assignment of acquisition rights for new shares need to be reviewed from a different perspective. In case of securing profitability to a certain degree, a buyer paying a great deal of acquisition price and obtaining control rights of a reorganizing company would mean that it will be able to obtain a great deal of economic benefit in future, and this is the reason why M&A of reorganizing company is popular in Korea. Because obtaining control rights and management rights of a future reorganized company can realistically allow an enormous amount of economic profits, there can be a request for the ranking of distribution of economic profits under the principle of fairness, equitability in the order of secured and unsecured creditors.[57)]

Hence, in case of having decided to push for a third party M&A by the methods of open competition bidding with excluding assignment of new shares of security right holder, creditors who are related parties of interest, the reorganization plan shall explicitly state that the new shares shall be issued to third party buyer. Such provisions are explicitly stipulated in reorganizing plan that are drafted these days.

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57) In case of reorganizing company of Jinro, submitted reorganization plan with the frame of pushing for M&A by financial institutions' creditors themselves after closing following their becoming major shareholders by means of debt-equity swap. On a separate matter, one secured reorganizing creditor had submitted reorganization plan that the right to acquire new shares of reorganizing company would belong to him.

5. Closing of Reorganized Company M&A and Reorganization Case – Issues with Immediate Appeal, Special Appeal (Re-appeal)

As the buyer injects a great deal of capital for reorganizing company, realistically the M&A transaction of reorganizing company cannot be thought of separate from closing of the reorganization case. In relation to it, what has been an issue in practice has been whether procedures for reorganizing company can be closed in case of noncompliance against decision of confirming the amendment plans on M&A.

The former Company Reorganization Act allowed immediate appeal only in case there were provisions permitting noncompliance in the Company Reorganization Act in relation to ruling on reorganizing process (§ 11), court's decision of confirming amendment plan was subject to immediate appeal to appellant court. However, due to construing the relevant provisions, Supreme Court has been insisting that only special appeals may be permitted against the appellant court's decision on the amendment plan.[58)]

Special appeals may be made only when there have been constitutional violations influencing court decisions or constitutions of orders, regulations and deposition that were grounds for ruling or ruling on violations it is due to improperness (§ 499, Civil Procedure Act) and, as special appeals is a method for not accepting decisions after the ruling is settled down, settlement on original rulings cannot be blocked just because such special appeals have been made as an urgent rejecting procedures that were similar to retrial instead of common appeal. Thus, decision on confirming amendment reorganization plan is finalized as appellate review decision was notified. Hence, if the reorganizing company was equipped with other conditions, after the decision of appellate review, the reorganization case can be closed. Theoretically, however, after special appeal is brought up, there is still a chance for decision of confirmation to be cancelled. But, the reorganization plan has been approved by the consent of majority of interested parties which satisfies the requirements for court's confirmation and the plan has already been executed.

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58) Supreme Court decision Case No. 87ma277 dated December 29, 1987 was first such ruling and ever since decisions have been made for such intention.

Furthermore, to consider that decision for confirming the reorganization plan exerts a fairly large amount of social and economic impact. In case there are partial legal violations in approving and confirmation, instead of cancelling the decision, considering relationships with other related parties of interest and possibilities for implementing reorganization plans, it has been solved by methods for modifying relating part of the plan by setting forth provisions defending rights for the party bringing up special appeals. Therefore, reorganizing companies have been able to avoid conflicts once they perform obligations for repayment added from it.[59] The reorganizing companies would not need to deal with troubles as long as they performed obligations for repayment added as such.

To look back at several incidents[60] where immediate appeals were made against amendment plans after the year of 2000, it took 12~52 months to arrive at the decision for special appeals after the date of confirmation date, and of them, it took 9~32 months from appellate review ruling to the decision on special appeals. The recent case that the Supreme Court ruled on the special appeal for amendment plans of Korea Cement as a reorganization company took 50 months to reach the decision of remanding after reversal. As such, in cases of noncompliance against decisions on approvals for reorganization plan, it is the reality that it takes a long period of time to complete all the process until the final ruling. After the above provided ruling, it was a settled precedent and practice that only special appeal would be allowed for the decision on approvals for reorganization plans. In the aftermath of January 26th 2002 full revision of Civil Procedure Act, as presented above, the circumstance which gives rise for special appeals was reduced from its previous scope, which was a violation of constitution or law, into violation of constitution only, and opinions were emerging that because the circumstances giving rise for special appeals were overly restrictive, the ability to protect necessary rights became severely constrained, and thus even when separate provisions for special appeals, such as the decision on reorganization plan, exist, re-appeals should be possible, and the DRBL permits re-appeal for

59) Supreme Court decision Case No. 2002geu62 dated May 12, 2006, Supreme Court decision Case No. 99geu35 dated January 5th, 2000.

60) Supreme Court decisions Case No.2000geu98, 2002geu101, 2001geu132, 134, 135, 2002geu121.

ruling of appellate court(§ 247, Para7)[61] and the identical mechanism applies for decision of confirmation on the amendment reorganization plan. Thus,[62] in case in the procedures under the DRBL, certain interested parties may appeal and re-appeal against that decision, it may be hard to close reorganization case before the decision of re-appeal ruling with the same logic as before.

VI. Conclusion

Thus far, roughly touching upon the practice of M&A for the company reorganization is offered in this article, drawing up the reorganization plan, and problems emerging in practice. As provided in the beginning, the M&A of reorganizing company may be affected by various factors such as the circumstance facing the company, the economic conditions at the time and the trend of the participants in the M&A and this is why this article cannot explain every possible scenario. Furthermore, a new reorganization practice since 2006 has emerged under the DRBL and, in reorganization procedures, conciliation and processing the procedures through independent discussions among the related parties of interest, M&A will grow more flexible as per the procedural aspect and start seeing the growth in the number of participating parties for M&A.

As the corporate reorganization procedure in Korea still stands on the basis of the two objectives of satisfaction of the related parties of interest and rehabilitation of the debtors, the two objectives shall be considered sufficiently. It should be practiced in a way that the objectives of related parties and recovery of creditors shall be achieved. For that purpose, receivers shall, if needed, actively exercise their power granted to themselves as the

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61) § 247 of DRBL (appeal) ① Immediate appeals may be made for deciding whether to authorize a recovery plan; however, provided that it applies for recovery creditors, recovery security right holders, shareholders and other shareholding parties who have not been listed or reported.

⑦ Not complying with the ruling on immediate appeal as above prescribed in clause ① shall be under the provisions of § 442 of CIVIL PROCEDURE ACT (re-appeal). In such case, provisions of either clause 1 or clause 6 shall be adopted.

62) DRBL, § 282, Para. 3; § 247, Para. 7.

conductors of the interests, and the court should also take responsibilities as a fair supervisor to ensure rightful exercise of such power. Further the reorganization procedure may be the alternatives only if necessary for the purpose of achieving the above objectives. It will not be just for the receivers as the executor or the court as the supervisor to abuse its power to fail to stay within the scope of such achievement or use its power for an unrelated cause.

Since the year of 2008, Korea suffers worldwide and nationwide economic recession. Now, it raises new, but very tough problems. The business surroundings of companies both large and small rapidly deteriorate, and numerous corporations fall bankrupt, and file the petitions for the commencement of reorganization procedure.

It is necessary for all the interested parties to move forward more swiftly and reasonably to avoid undesirable and avoidable inefficiency and take all possible measures into consideration to let the bankrupt survive. New Korean Reorganization practice including M&A under the supervision of court has just begun to change. It means a lot of possible measures remain still untouched and the M&A practice also may move forward changing.

KEY WORDS: mergers and acquisitions, new share issuance, amendment of reorganization plan, Debtor Relief and Bankruptcy Law, receiver system, early closing