

Treatment of Secured Claims in Korean Rehabilitation Proceeding

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Abstract

After the Debtor Rehabilitation and Bankruptcy Law ("DRBL") took effect in 2006, the pro-debtor insolvency system including DIP-type trustee has been enforced. However, the DRBL has not modified much with respect to the rights and obligations of the creditors, especially secured creditors. This article conducts an overall review on the treatment of secured creditors in the rehabilitation proceeding under the DRBL.

Secured creditors have a priority to get paid when their secured property is sold or foreclosed. The insolvent debtor has to bargain with secured creditors if it needs to continue to use the secured property. Theoretically, the debtor shall be able to utilize the secured property by making a payment to relevant secured creditor and whether or not to make such payment shall be determined in consideration of the going-concern value and the liquidation value of the secured property. However, the parties fail to reach, in many occasions, a conclusion due to the information asymmetry, hold-out of any party, etc. In such cases, the creditors' right to the secured property shall be restricted for the debtor's revival for the benefit of all interested parties.

The restriction on the secured creditor's rights in the rehabilitation proceeding shall not harm the efficiency of secured claims that play positive functions in our society such as decrease of agency costs between the debtor and secured creditors. On the other hand, the adverse effects of secured claims shall not be disregarded because from time to time the secured creditors do not behave reasonably due to incomplete privatization, reliance on the value of secured property only without analyzing the debtor's credit, etc. If the rehabilitation procedures under the DRBL restrict the rights of secured creditors in a reasonable way, the efficiency of secured claims can be improved. For such purposes, this chapter offers the following suggestions.

First, secured claim shall be evaluated on the basis of the market value of the secured property to reflect current practice. Second, the post-commencement interest shall be paid to the extent of the equity cushion of the secured property. Third, the security amount in the case of keun-mortgage shall not be crystallized at the time of commencement of the rehabilitation proceeding so that the debtor may use the keun-mortgage for DIP financing. Fourth, the cram-down based on the relative priority rule needs to be modified toward the absolute priority rule, provided that the procedures to stimulate the negotiation between the debtor and secured

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creditors shall be introduced at the same time. Fifth, the debtor who needs to transfer his business prior to the court's confirmation of the rehabilitation plan shall have the right to extinguish the security interest on the secured property by paying the disposal value of the secured property.

I. Introduction

When secured creditors enforce their security interests, the delinquent debtor cannot use the secured property. Thus, the insolvent debtor must negotiate with the secured creditors for the continued use of secured property.

Theoretically speaking, the outcome of the negotiation between secured creditors and the debtor should be determined at a price between the going-concern value and the liquidation value of relevant secured property. If the debtor can generate any going-concern value of such property which is greater than the liquidation value thereof, the debtor would be willing to pay the secured creditors some of such surplus of the going concern value. On the other hand, secured creditors would likely have an incentive to accept the debtor's proposal if they can receive such surplus of going concern value in addition to the liquidation value of the secured property.

However, the debtor and the secured creditors often fail to strike a bargain due to information asymmetry, hold-out of any party, etc. In such cases, the debtor cannot continue to operate the business, which may be destructive to the going-concern value of the debtor's business. To avoid such destructive outcome, the secured creditors should be restricted from enforcing their security interests upon the debtor's filing of the rehabilitation proceeding.

The scope of such restriction should depend on the social perception with respect to the security interests. If secured claims ("SCs") are regarded to function positively, the restriction on SCs under the rehabilitation proceeding would be minimal so that such restriction may not harm the efficiency of SCs. On the other hand, if SCs are regarded to function negatively, the debtor would be given more flexibility to restrict the rights of secured creditors.

Chaimujaeui hoesaeng mit pasane gwanhan beobyul [The Debtor Rehabilitation

and Bankruptcy Law] (hereinafter the “DRBL”)¹⁾ has been enacted to stimulate the debtor’s use of the rehabilitation procedure. The DRBL, among other things, (i) incorporates the debtor-in-possession (DIP) type receiver system,²⁾ (ii) abolishes mandatory declaration of bankruptcy prior to the court’s confirmation of the rehabilitation plan, (iii) permits transfer of the debtor’s business prior to the court’s confirmation of the rehabilitation plan,³⁾ and (v) classifies as the prime priority the loan that the debtor obtains during the rehabilitation proceeding,⁴⁾ etc. However, our legislature has neglected to reform the creditor’s position under the rehabilitation proceeding. Now, it is time to review the balance between the debtor’s rights and the creditor’s rights under the DRBL.

This chapter examines current treatment of the secured creditors in the rehabilitation procedure under the DRBL and recommends changes to such treatment, considering recent reforms of the insolvency law which emphasized the debtor’s rights.

II. Current Treatment of Secured Claims under DRBL

Under the DRBL, SCs include any proprietary claims that are secured by a *yuchigwon*,⁵⁾ pledges, mortgages, *yangdodambo*,⁶⁾ *chonsegwon*,⁷⁾ or preferred rights created in the debtor’s property at or prior to commencement of the rehabilitation proceeding.⁸⁾

During the rehabilitation proceeding, secured creditors cannot exercise

1) The DRBL took effect from 1 April 2006 and includes chapters on bankruptcy proceeding (equivalent to Chapter 7 of the U.S. Bankruptcy Code), rehabilitation proceedings (equivalent to Chapter 11 of the U.S. Bankruptcy Code), rehabilitation proceedings for an individual (equivalent to Chapter 13 of the U.S. Bankruptcy Code) and international bankruptcy (equivalent to Chapter 15 of the U.S. Bankruptcy Code).

2) DRBL, art. 74(3).

3) *Id.* art. 62.

4) *Id.* art. 180(7).

5) Statutory created possessory lien.

6) Security by way of assignment.

7) Leasehold right.

8) DRBL, art. 141.

their security interests in collaterals and are repaid only in accordance with the rehabilitation proceeding. In particular, foreclosures by the secured creditors are suspended with a comprehensive stay order at the commencement of the rehabilitation proceeding.⁹⁾

The secured creditors may participate in the rehabilitation proceeding with respect to their SCs. In order to participate in the rehabilitation proceeding, the secured creditors must submit to the court documents evidencing the followings: (i) their name and address; (ii) type and cause of their SCs; (iii) collateral and its value; (iv) amount of voting right, and (v) the name of a debtor, if the SCs are not listed on the schedule submitted by the receiver. However, any unreported and unlisted SCs will be extinguished.¹⁰⁾

The SCs may recover only to the extent of the value of their collateral at the time of commencement of the rehabilitation proceeding. The unpaid balance of SCs in excess of such value is treated as unsecured claims.¹¹⁾

For the purpose of approving the rehabilitation plan in a meeting of interested parties, all the secured creditors are categorized into one class,¹²⁾ and an affirmative vote of at least 3/4 of the aggregate value of the SCs is required.¹³⁾ Even if the draft rehabilitation plan has not been approved by secured creditors in the meeting of interested parties, the court may nonetheless approve the plan by amending the draft rehabilitation plan to include a clause to protect secured creditors' interests. The Supreme Court of Korea has ruled that if secured creditors can get repaid at least the liquidation value of their relevant secured property, the secured creditors' interests are deemed protected.¹⁴⁾

Further, the DRBL also guarantees to the secured creditors the liquidation value of collateral.¹⁵⁾ Liquidation value was not been guaranteed to the secured creditors in some reorganization proceedings under

9) *Id.* art. 45, 58.

10) *Id.* art. 251.

11) *Id.* art. 141.

12) *Id.* art. 236.

13) *Id.* art. 237.

14) Supreme Court [S. Ct.], 2007Ma919, Oct. 11, 2007 (S. Kor.).

15) DRBL, art. 243(1)(iv).

Hoesajeongribeob [the old Corporate Reorganization Law]¹⁶⁾ if a majority of the secured creditors agreed. As a result, the status of the secured creditors was unstable and the transaction costs increased. Since new rehabilitation proceeding under the DRBL guarantees at least the liquidation value of collateral for the secured creditors, the problems associated with the relative priority rule¹⁷⁾ has been mitigated to a certain degree.

Upon the approval of the rehabilitation plan, the debtor is discharged from the obligations in respect of all SCs, and all security interests established on the debtor's property are extinguished, unless provided otherwise in the rehabilitation plan or the DRBL.¹⁸⁾

III. Efficiency of Secured Claims

1. Introduction

Traditionally, there are two views as to whether the restriction on SCs under the rehabilitation proceeding maximizes the return to creditors as a whole. Each view depends on how the function of SCs in the solvent world is understood. The commentators who focus on the positive function of SCs support minimal restriction on SCs under the rehabilitation proceeding so that the efficiency of SCs may be maintained. On the contrary, the commentators who emphasize the negative function of SCs argue for broad restrictions on SCs under the rehabilitation proceeding to correct such inefficiency allegedly created by SCs.

2. Positive Function of SCs

The commentators emphasizing the efficiency of SCs in the solvent world argue that pre-petition entitlement of SCs should be respected during the rehabilitation proceeding. Under this approach, the absolute

16) The Corporate Reorganization Law was enacted in 1962, modified several times thereafter and finally abolished on March 31, 2006 as the DRBL became effective.

17) The relative priority rule will be reviewed in detail below.

18) DRBL, art. 251.

priority rule (the “APR”) would be preferred with the minimal restrictions on SCs under the rehabilitation proceeding. The efficiency argument for the positive function of SCs is based on the following grounds:

First, when the secured creditors extend loans to the borrower, they need not expend significant resources to acquire information about the borrower’s probability of default. The borrower can also reduce the cost of funding for its business.

Second, the priority of SCs under the Civil Code has been socially and economically recognized. To change such recognition in the rehabilitation system will increase the costs to both creditors and debtors.

Third, SCs can alleviate the debtor’s overinvestment costs¹⁹⁾ because the debtor cannot raise fund for such excessive investment if such debtor’s properties are collateralized.

Fourth, if a debtor utilizes secured debts, new capital will be injected. Then, the unsecured creditors can share the benefits from the liquidity provided by the secured creditors to a certain extent because the insolvency risk of the debtor is reduced.²⁰⁾

Fifth, if the secured creditors have unrestricted priority, they do not need to compete with other creditors over the properties of the debtor even if the debtor is near bankruptcy. Therefore, it will reduce the bankruptcy costs.

For the reasons described above, the positive function of SCs must be maintained during the rehabilitation proceeding and the priority of SCs must be fully respected in the rehabilitation proceeding.

19) Insolvent debtors have incentives to overinvest into high risky business with restricted resources to solve their liability problems. See Michelle J. White, *The Costs of Corporate Bankruptcy: A U.S.-European Comparison*, *Corporate Bankruptcy: Economic and Legal Perspectives*, CORPORATE BANKRUPTCY: ECONOMIC AND LEGAL PERSPECTIVES 18 (Cambridge, 1996). This overinvestment effect can be maximized in the case of small- and medium-sized enterprises of which the ownership and the management are not separated.

20) Steven L. Schwarcz, *The Easy Case for the Priority of Secured Claims in Bankruptcy*, 47 DUKE L. J. 425, 441-447 (1997).

3. *Negative Function of SCs*

The commentators emphasizing inefficiency of SCs in the solvent regime claim that SCs must be restricted under the rehabilitation proceeding in order to rectify such inefficiency. If the rehabilitation proceeding restricts pre-petition entitlement of SCs, the secured creditors will change their behavior to improve the inefficiency of SCs in solvent world.

The relative priority rule (the “RPR”) under the rehabilitation proceedings is an example that limits the priority of SCs under the Civil Code. The argument with respect to the negative function of SCs is based on the following grounds:²¹⁾

First, SCs diminish some value of non-adjusting unsecured debts. If a certain property of the debtor is provided as security for SCs, the debtor’s estate which can be used to repay unsecured creditors will decrease. In this case, economically, it would be fair for unsecured creditors to increase the interest rate. However, there are certain types of unsecured debts whose interest rate adjustment is difficult. It includes (i) unsecured debts with an interest rate fixed before security interest is granted to third parties, (ii) small debts held by creditors who do not monitor their debtors, (iii) tort claims and tax claims which have nothing to do with the property of the debtor.²²⁾ As those unsecured creditors cannot adjust their interest rate where the debtor grants a security interest to a third party, they incur losses whenever the debtor grants a security interest to secured creditors. According to this argument, the secured creditors and the debtor may benefit at the expense of the unsecured creditors.

Second, the secured creditors who have a firm security interest in the debtor’s property do not have an incentive to monitor the debtor. Therefore, the secured creditors do not include covenants to restrict the debtor’s

21) Yong Seok Park, *Efficiency of Korean New Rehabilitation Proceeding*, J. KOR. L., Vol. 7, No. 2, 276-278 (2008).

22) Lucian Arye Bebchuck and Jess M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L. J. (1996) 857, 882-883

inefficient activities in their loan agreements, or do not actively pursue such covenants where the debtor defaults. In practice, the real property is preferred as collateral. For this reason, the debtor who seeks to raise funds for his business tends to procure the real property rather than to increase its ability to make payment. This practice may distort the efficient distribution of national resources.²³⁾

Third, the going concern value of a company is created by all of the interested parties' participation in the continuing operation of the debtor. Therefore, the difference between the going concern value and the liquidation value of the debtor should be distributed fairly among the interested parties and must not be monopolized by the secured creditors. Moreover, the going concern value is roughly calculated based on the future earning of the company. Distribution of such value to secured creditors may result in incorrect distribution.

Fourth, if the shareholders' treatment under the rehabilitation plan is more favorable than their pre-petition entitlement, the shareholders have an incentive to file for bankruptcy at an early stage. Thus, this enhances the argument for ex ante efficiency.

Fifth, even in Chapter 11 cases in where the APR is required to be applied, bankruptcy courts routinely approve Chapter 11 reorganization that deviates from the APR, which favors the shareholders.²⁴⁾

23) Dong-whan Kim, *Study on Secured Loans - Legal and Economic Perspective*, KOREA INSTITUTE OF FINANCE (Dec. 2003), 50-51.

24) According to one study conducted by Professor Eberhart, shareholders receive, on average, 7.6 percent of total corporate value in excess of their contractual legal entitlements. Another study--conducted by Professors LoPucki and Whitford--confirmed that in 21 of the 30 largest bankruptcy cases in the 1980s, equity received some payout in Chapter 11, rarely (though occasionally) amounting to 10 percent of the available assets. Professor Michelle White found that equity receives at least 5 percent of the value of all creditors' claims in all bankruptcy reorganizations, with that proportion increasing as the return to creditors increases. Still another study conducted by Professor Fabozzi found 20 of 26 large bankruptcies deviating from absolute priority in favor of equity, and against unsecured creditors. Whereas in relative terms, the divergences from absolute priority rule are small, the amounts of money at stake are substantial, reaching \$63 million in one case. In almost all the cases examined by Professors LoPucki and Whitford, these costs exceeded the direct costs of bankruptcy. A study by Professor Brian Betker examining a sample of 75 firms filing for Chapter 11 protection between 1982 and 1990 yields the most conservative estimate of absolute priority deviations. Betker's results demonstrate a 2.86 percent mean deviation from contractual entitlements under the

4. Functions of Secured Claims in Korea

Discussed below is how the function of SCs is regarded in Korea.²⁵⁾

First of all, the government's guidance policy finance is usually provided to the cases where the market does not function properly. For example, government may provide guidance policy loans to the small- and medium-sized enterprises that have developed high technology but cannot obtain necessary loans to manufacture products by utilizing such technology. However, the guidance policy loans²⁶⁾ are used for the government's policy purpose rather than making up for the market failure. This practice distorts the distribution of resources because the government's decision is made from time to time on the basis of the information asymmetry.²⁷⁾

Second, with respect to general loans, the lenders, mostly the financial institutions, do not make a decision to make a loan based on the information obtained with respect to the borrowers because low credibility is given to the financial statements submitted by the borrowers, especially small- and medium sized enterprises.²⁸⁾ Instead, the lenders rely on the value of collaterals provided by the borrowers. As a result, the borrowers tend to acquire real properties to use them as collateral, which has contributed the price hikes of real estate.²⁹⁾

absolute priority rule. Robert Weber, *Can the Sauvegarde Reform Save French Bankruptcy Law?: A Comparative Look at Chapter 11 and French Bankruptcy Law from an Agency Cost Perspective*, 27 MICH. J. INT'L. 257, 268-269 (2005).

25) The researches after the economic crisis of 1997 are examined for this Section because prior to the economic crisis, the government's guidance policy finance consists of major part of funding to the private sector.

26) In Korea, the guidance policy loans for small- and medium-sized enterprises are 200 or more as of the year of 2005. Samsung Economic Research Institute, SERI ECONOMY FOCUS No. 42 (May 30, 2005), at 11.

27) Shi-Yong Yoo & Byung-Seop Yoon, *Rate of the Government Loan Program based on Rationales of the Government Loan Program*, 14 THE JOURNAL OF KOREAN CORPORATION MANAGEMENT ASSOCIATION 35, 50 (2007).

28) Sung Wook Joh, *Determinants of Financial Institutions' Lending to Distressed Firms*, 34 THE JOURNAL OF THE KOREAN SECURITIES ASSOCIATION 63, 89 (2005).

29) Young Mi Chang, *An Empirical Study on the Loan Decision Making in Local Bank* 87 (2002) (Master's Thesis, Chosun University).

Third, external factors affect the financial institutions' decision of whether or not to lend loans.³⁰⁾ For example, if the government plans to support the small- and medium-sized enterprises, the financial institutions expand the loans to such enterprises. In addition, a borrower that belongs to a conglomerate group is able to obtain a loan more easily from the financial institutions.³¹⁾

Fourth, the officers of the financial institutions are likely to be concerned about their own careers and performances when they make a decision to lend. Although they may have noticed that the borrowers suffer from financial distress, they only provide short-term loans to such financially distressed borrowers so as to avoid any immediate insolvency of the borrowers that they are in charge of.³²⁾

In Korea, the ownership and management of the small- and medium-sized firms are not generally separated. Thus, such firms' overinvestment effects would be greater than other cases. The SCs can solve these problems because the debtor cannot raise the fund for such overinvestment without any collateral. In addition, the SCs help the debtors with sufficient collaterals easily procure the fund necessary to operate their business.

However, the SCs are overused by the financial institutions in Korea. The lenders rarely try to exert their efforts in analyzing the borrowers' business and earnings. They simply rely on the collaterals, mostly real properties, provided by the borrowers. This practice is not helpful as our society has developed to a sound credit community. The borrowers tend to procure collaterals which can cause the real estate price hike.

Under these circumstances, the cost incurred with the SCs would likely exceed the benefit of the SCs in Korea. The financial institutions' preference of the SCs also causes another inefficiency of the lending market because the resources of the lenders would be distributed to the borrowers inefficiently. Therefore, the following recommendations in this chapter below are based on the negative functions of the SCs and the restriction on the SCs under the rehabilitation proceedings in order to achieve the

30) Bank of Korea, *Analysis of Determinants of Operation of Bank's Fund After Economic Crisis*, MONTHLY BULLETIN, May 2010, at 47.

31) See Joh, *supra* note 28, p.89.

32) See *id.*

efficiency of the SCs in solvency world as well as in insolvency regime.

IV. Evaluation of Secured Object

Under the DRBL, secured creditors may participate in the rehabilitation proceeding as unsecured creditors, in respect of any amount of its claims that exceeds the value of the secured property (if any prior security interest had been created in such property, the amount is calculated by deducting the amount of claims secured by the superior security interests from the value of the secured property).³³⁾ Thus, the valuation of secured property is critical because such valuation influences directly the rights of both secured creditors and other unsecured creditors.

Upon assumption of office, the receiver must promptly assess the value of all properties that belong to the debtor.³⁴⁾ With respect to the meaning of “value,” the Supreme Court of Korea has held that the value of the secured properties of the debtor means the going concern value of the relevant secured property.³⁵⁾ In current court practice, however, the debtor’s properties are generally evaluated at the market value of secured property.³⁶⁾

There is a continuing debate as to whether the value of secured property should be (i) going concern value or (ii) liquidation value.

The majority commentators take the going concern value as the value of the secured property although there is no consensus as to calculation method. Some use the capitalized value method³⁷⁾ while others use the discounted cash flow method.³⁸⁾ However, the valuation of the secured property under this approach is too difficult because not only the future earnings from the property but also the applicable capitalization rate or

33) DRBL, art. 141(3).

34) *Id.* art. 90.

35) Supreme Court [S. Ct.], 90Ma954, May 28, 1991 (S. Kor.).

36) The market value of specific property may exceed the going-concern value thereof if such property is located in expensive area.

37) Jae Hyung Kim, *Status of Secured Creditors under Insolvency Procedures*, THE JOURNAL OF KOREAN BAR ASSOCIATION, 24 (2006).

38) Won Il Sohn, *Valuation of Security in Cram down: Getting American Perspectives into Korean Bankruptcy Law*, KOREAN JOURNAL OF INSOLVENCY LAW, Vol. 1, No. 1, 16 (2010).

discount rate reflecting the risk for future earnings may not be easily estimated.

The minority commentators provide that the value of secured property should be based on the liquidation value thereof because secured creditors would have expected only the liquidation value of the property for their security interests upon the debtor's defaults.³⁹⁾ However, the liquidation value method brings an unfavorable result to secured creditors. In addition, it is not appropriate for the rehabilitation proceeding because the debtor does not liquidate the business or properties under the rehabilitation proceeding.

On the foregoing grounds, this paper supports the current court practice with respect to the meaning of the value of secured property. The market value can be measured easily and can facilitate more swift process of the procedure. The Corporate Reorganization Law of Japan of 2002 also took the market value method for the valuation of secured property.⁴⁰⁾

Also, the dispute settlement as to the value of secured property needs to be amended. Under the DRBL, the interested party who objects to the value of secured property may file with the court an application for the final inspection and judgment on SCs.⁴¹⁾ If any party is dissatisfied with the court's final inspection and judgment, such party may appeal the judgment to the district court.⁴²⁾ The district court's decision can be subsequently appealed to High Court and Supreme Court. To simplify such dispute settlement, the current practice should be modified as follows: (i) the receiver shall include the market values of secured properties in the list of SCs to the court⁴³⁾; (ii) if any interested party raises an objection to such market value, the court shall appoint an appraiser who evaluates the market value of the relevant property; and (iii) if any objection is raised with respect to the appraised value, only the immediate appeal should be allowed (and the institution of normal lawsuit on the appraised value

39) Won Sam Lee, *Evaluation of Asset under Rehabilitation Proceeding under the DRBL*, THE JOURNAL OF KOREAN BUSINESS LAW ASSOCIATION, 313 (March 2007).

40) Corporate Reorganization Law of Japan, art. 83(2).

41) DRBL, art. 170.

42) *Id.* art. 171.

43) The Receiver is obligated to submit the list of SCs. *Id.* art. 147.

should not be prohibited).

V. Treatment of Post-Commencement Interest

The DRBL has no explicit provision on the treatment of the security interests after the commencement of the debtor's rehabilitation proceeding but before the court's confirmation of the rehabilitation plan ("Post-commencement Interest"). In practice, SCs are entitled to appropriate interest rates⁴⁴⁾ during such period so that the debtor can easily obtain the secured creditors' consent to the draft rehabilitation plan at the creditors' meeting.

Theoretically speaking, the debtor is not obligated to pay the post-commencement interests for SCs to the extent that the liquidation value of secured property is guaranteed for SCs under the rehabilitation plan. In practice, however, the debtor's payment of the Post-commencement Interest may harm ex post efficiency because the secured creditors who are fully compensated with the Post-commencement Interest may not actively pursue the fast progress of the debtor's rehabilitation proceeding. Moreover, it also distorts the equality between secured creditors and unsecured creditors because the debtor's payment of the post-commencement interest reduces the resources for repayment for unsecured creditors.

Further, it is not reasonable for the debtor to pay the Post-commencement Interest when the security interest does not have any equity in the secured property. If the aggregate amount of the principal and interest of SCs exceeds the value of the secured property, the debtor's payment of the excessive portion to secured creditors reduces the resources available for the repayment of unsecured creditors.

Given the foregoing problems, the following reforms on the post-commencement interest are necessary:

First, the Post-commencement Interest may be paid only to the extent of the equity cushion. For any amount beyond such equity cushion, the

44) Usually annual interest rates of 6-7% are applied. STUDY GROUP OF SEOUL CENTRAL DISTRICT COURT BANKRUPTCY DIVISION, THE REHABILITATION PROCEEDING - LAW AND PRACTICE - (1) 523-524 (2006).

oversecured party becomes an undersecured party.

Second, the Post-commencement Interest should be paid at a fair interest rate, not at the market interest rate. The fair interest rate should reflect the feasibility of the court's confirmation of the rehabilitation plan and should be determined by the court.

Third, under the Civil Code of Korea, the interest up to one year after the principal becomes due is covered by the mortgage.⁴⁵⁾ To maintain the balance with the Civil Code, the payment of the Post-commencement Interest under the DRBL shall be restricted up to maximum of one year after the commencement order is issued.

VI. Crystallization of *Keun*-mortgage

The DRBL does not have any explicit provision as to whether the *keun*-mortgage should be crystallized at the time of the commencement of the debtor's rehabilitation proceeding. There are two theories on this issue.

The crystallization of the *keun*-mortgage upon commencement of a rehabilitation proceeding (the "Crystallization Theory") is supported based on following reasons:⁴⁶⁾ (i) since the management's authority to operate the debtor's business and to dispose of the debtor's property is transferred to the receiver at the time when the rehabilitation proceeding commences, new legal relationship with creditor must be formed at the same time; (ii) since the declaration of bankruptcy is interpreted to crystallize the mortgage under the Civil Code of Korea, the crystallization under the rehabilitation proceeding must be interpreted similarly; (iii) the non-crystallization theory is useless unless the secured creditors provide additional financing based on the equity cushion of secured property; and (iv) according to the non-crystallization theory, the operation of mortgage for fresh funding after commencement is too complicated because the existing mortgage for SCs and new mortgage for post-commencement fund

45) Civil Code, art. 360.

46) Chae-Woong Lim, *Study on Crystallization of Keun-Mortgage and Commencement Order*, JOURNAL OF COURT DECISION STUDY Vol. VI 141 (August 2003).

should share the security interest on the same secured property.⁴⁷⁾

On the contrary, the non-crystallization of the *keun*-mortgage upon the commencement of a rehabilitation proceeding (the “Non-crystallization Theory”) is supported for the following reasons:⁴⁸⁾ (i) the DRBL does not provide any clear rules on this issue and therefore, the Non-crystallization Theory is a possible interpretation; (ii) the emphasis must be given to the rehabilitation of the debtor but the Crystallization Theory conceptually liquidates the debtor at the commencement of the rehabilitation proceeding; (iii) under the Non-crystallization Theory, the debtor may be able to procure the DIP financing when there exists any equity in the secured property.

On this issue, the Supreme Court has held that the *keun*-mortgage is crystallized when the commencement order for the corporate reorganization is issued. According to the decision, the receiver cannot procure additional loans from secured creditors by using the remaining equity in the secured property because the existing *keun*-mortgage does not cover post-commencement loans.

Notwithstanding the Supreme Court’s decision, this paper supports the Non-crystallization Theory on the following grounds:

First, when the junior mortgagees obtain the security interest on a certain property, they might have ignored the registered maximum amount of senior *keun*-mortgages although the liability owing to senior *keun*-mortgages can increase up to the registered maximum amount of senior mortgages. If senior mortgagees’ rights are crystallized at actual amount of their SCs at the time of the commencement of debtor’s rehabilitation proceeding, lower priority mortgagees may receive unfair benefit.

Second, the Non-crystallization Theory permits the debtor to procure the DIP financing. Under the U.S. Bankruptcy Code, there are four paths whereby a lender may secure priority for money advanced to a debtor after

47) Yong-rak, Shin, *Commencement Order of Corporate Reorganization Procedure and Crystallization of Keun-mortgage*, 26 SUPREME COURT LAW REVIEW, 118-119 (1995).

48) Dong-Heum Choi, *Study on Crystallization of Keun-Mortgage*, 3 DAEJON DISTRICT COURT PRACTICE RESEARCH JOURNAL 303 (1999).

the petition date.⁴⁹⁾ If the DIP borrows in the ordinary course of business, then the lender's claim is a first-priority administrative expense under §364(a). Moreover, even outside the ordinary course of business, the creditor may get an administrative priority if the post-petition advance and the administrative priority are approved by a court order according to §364(b). If the DIP cannot get unsecured credit, the court may authorize the lender to take a "super-priority" administrative claim, or the court may authorize the lender to take a security interest in unencumbered property (or a subordinate security interest in encumbered property) under §364(c). Finally, if the DIP cannot otherwise procure credit, the court may authorize a security interest that is "senior or equal" to an existing security interest, which is sometimes referred to as a "priming lien," according to §364(d) of the U.S. Bankruptcy Code.

Under the DRBL, the post-commencement loan approved by the court has a super priority⁵⁰⁾ which is equivalent to §364(a), (b) and (c) of the U.S. Bankruptcy Code. If the Non-crystallization Theory is adopted, then DIP financing under §364(d) of the U.S. Bankruptcy Code becomes also available in Korea because the debtor can utilize the remaining equity in the existing senior mortgage which has priority over lower SCs.⁵¹⁾

Third, the rehabilitation plan may contain a program which requires the debtor to procure the financing at the last year of the repayment period. If the Non-crystallization Theory is adopted, the feasibility of the debtor's performance of this type of plan becomes more likely because the equity cushion of senior security interest increases as the debtor repays according to the rehabilitation plan.

49) §364 of the U.S. Bankruptcy Code. See generally John D. Ayer, Michael L. Bernstein & Jonathan Friedland, *Obtaining Dip Financing And Using Cash Collateral*, 23-SEP AM. BANKR. INST. J. 16.

50) If it becomes obvious that the debtor's property is insufficient for satisfaction of all common benefit claims, the common benefit claims shall be paid in proportion to the amount of claims, which have not been satisfied yet, despite the statutory preferential rights granted thereto. However, this provision shall not affect the validity of any lien, pledge, mortgage, *Chonsegwon* (leasehold rights), and rights of preference which exist in favor of the common benefit claims. DRBL, art. 180(7).

51) Dong-hee Nam, *Funding Method of Rehabilitation Corporation - Feasibility of Introduction of DIP Financing Under the U.S. Bankruptcy Code*, 637 LAWYERS ASSOCIATION JOURNAL, 264-271 (October 2009).

The greatest weakness of the Non-crystallization Theory is the complication of the legal relationship between the interested parties in regard to post-commencement crystallization of the *keun*-mortgage. However, the Corporate Reorganization Law of Japan also adopted the Non-crystallization Theory in 2002. Accordingly, the following can be considered for potential amendments to the DRBL in light of Japanese legislation.⁵²⁾

First, the *keun*-mortgage is not automatically crystallized upon the commencement of the debtor's rehabilitation proceeding, but the receiver or the mortgagee can request the crystallization of *keun*-mortgage, if necessary.⁵³⁾

Second, the post-commencement loans shall become secured public benefit claims because it is covered by existing *keun*-mortgage.

Third, the rehabilitation plan shall include clear provisions with respect to (i) whether the security interest for pre-commencement SCs is extinguished, (ii) whether the debtor can use the increased equity of the security interest when the debtor repays according to the plan, (iii) whether the *keun*-mortgage is effective if the underlying loan does not exist at the time of commencement of the rehabilitation proceeding, etc.

In summary, it is noted that the Non-crystallization Theory requires the amendment of the DRBL in order to permit DIP financing.

VII. Relative Priority Rule

1. Definition of the APR and RPR

The usual explanation of the APR is that pre-petition contractual entitlements will be respected in bankruptcy proceedings. Under a strict application of the APR, senior creditors must be fully compensated before junior creditors receive anything.⁵⁴⁾ Under the RPR, junior creditors can receive something before senior creditors are fully compensated.

52) See generally Yasuyuki Nakai, *Several Issues on Crystallization of Principal of Keun-mortgage*, 1755 BANKING LAW JOURNAL 49-52 (2005) (Japanese).

53) Japanese Corporate Reorganization Law, art. 104.

54) Weber, *supra* note 24, at 259; Lucian Arye Bebchuck & Fried, *supra* note 22, at 862.

However, the APR is not strictly applicable under any legislature because during the debtor's rehabilitation proceeding, secured creditors are not entitled to exercise their pre-petition contractual entitlements. They are not allowed to foreclose secured property or to receive the arrears for the pre-petition interest. Therefore, the difference between the APR and RPR would be the difference of the amount of compensation to be paid to the secured creditors during the debtor's rehabilitation proceeding. Under the APR, the secured creditors are compensated for going-concern value or market value of the secured property while the RPR compensates the secured creditors for the liquidation value of the secured property.⁵⁵⁾

In principle, the DRBL treats the SCs in accordance with the APR because the secured creditors are entitled to compensation equivalent to the market value of the secured property, as explained in detail in Section IV above. However, when the court crams down the secured creditors, the SCs can be compensated only for liquidation value of the secured property. In this sense, the RPR is applicable as an exception to the general rule under the DRBL.

2. *Efficiency of APR and RPR*

1) *Ex Ante Efficiency*

In general, the shareholders of the insolvent company have an incentive to over-invest the debtor's remaining resources in excessively risky investments with a potential of a high return so as to solve the liquidity shortage of the debtor and to maximize their benefit (the "Overinvestment Effect") as residual claimants. On the other hand, the shareholders have an incentive to under-invest in reasonable and safe investments if such investments would not solve the liquidity shortage of the debtor (the "Underinvestment Effect"). Moreover, the assets of a stable value may be exchanged for the assets of a highly fluctuating value. The shareholders may gain from such substitution if the value of the new asset increases (the "Asset Substitution Effect").⁵⁶⁾ Further, the managers of an insolvent

55) STUDY GROUP OF SEOUL CENTRAL DISTRICT COURT BANKRUPTCY DIVISION, *supra* note 44, at 487.

56) The overinvestment effects and underinvestment effects reduce the social welfare by encouraging the managers to take on risky projects while the asset substitution does not

company have an incentive to delay filing for bankruptcy in order to keep their jobs for a longer period and to take a chance for the increase in the value of the company's assets (the "Delay Effect").⁵⁷⁾

To find whether the APR is more efficient than the RPR or vice versa would depend on which rule reduces in a more efficient manner the agency costs between the debtor and creditors such as the Overinvestment Effect, the Underinvestment Effect, the Asset Substitution Effect and the Delay Effect.

First, the RPR reduces the cost of the Delay Effect. During the rehabilitation proceeding, the shareholders and the management of the insolvent company can possess more value of the company's business under the RPR than under the APR.⁵⁸⁾ However, the shareholders and the management have more incentives to over-invest in excessively risky investments before filing for bankruptcy because their costs of failure from such overinvestment under the RPR are less than those under the APR.^{59),60)} Nonetheless, the costs arising from the Overinvestment Effect may not be as great as expected. The management may be reluctant to act at the instruction of the shareholders with respect to such overinvestment due to a potential liability for the breach of fiduciary duty to the minority shareholders. Based on the foregoing analysis, the benefit from saving the

necessarily reduce the social welfare. In addition, managers who are separated from the ownership are not likely to succumb to equity's pressures to take on risky projects due to minority shareholders' possible litigation against the managers, management of their own career and holding their positions, etc.

57) Weber, *supra* note 24, at 266. The longer a firm delays its entrance into a bankruptcy proceeding, the more value will be siphoned off in the form of "financial distress costs." Financial distress costs are typically divided into direct costs (administrative and legal expenses of bankruptcy) and indirect costs (trade creditors' unwillingness to continue doing business with the debtor, difficulties in maintaining relationships with suppliers, staff attrition, diverted focus from competitiveness to bankruptcy, customer worries about warranties and lost sales, and an increased cost of capital).

58) *Id.* at 278-279.

59) Bebchuck & Fried, *supra* note 22, at 912-913.

60) Deviations from absolute priority worsen the overinvestment problem for solvent firms. These deviations increase the payoff to equity in the failure state while not affecting its payoff in the success state. Hence, the equity has a greater incentive to invest in a project with a high failure probability if the project has a high payoff in the success state. See Alan Schwartz, *The Absolute Priority Rule and the Firm's Investment Policy* 72 WASH. U.L.Q. 1213, 1217 (1994).

cost of the Delay Effect would likely be greater than the cost from the Overinvestment Effect.⁶¹⁾

2) *Ex Post Efficiency*

Under the RPR approach, once the debtor files for bankruptcy, the shareholders are likely to urge the management to undertake reasonable and safe investments. The value gained from such investments will be shared between the creditors and the shareholders because the residual claimant would also receive some values under the RPR. Thus, the RPR reduces the cost of the Underinvestment Effect⁶²⁾ and the Asset Substitution Effect⁶³⁾ after the bankruptcy is filed. This also offsets the cost of the Overinvestment Effect.⁶⁴⁾ However, the APR does not have the aforementioned ex post efficiency because the shareholders cannot obtain any benefit until after the creditors are fully compensated.

3. *RPR for Secured Claims under the DRBL*

For the purpose of approving the rehabilitation plan in a meeting of interested parties, all secured creditors are categorized into one class,⁶⁵⁾ and affirmative vote of at least 3/4 of the aggregate value of the SCs is required.⁶⁶⁾ According to the DRBL, even if the draft rehabilitation plan has not been approved by secured creditors in the meeting of interested parties,

61) Weber, *supra* note 22, 278.

62) When the firm is insolvent, neither convertibles nor call provisions can mitigate the overinvestment problem because the conversion option or the call privilege becomes valueless. Deviations from absolute priority are helpful, however, because when absolute priority is not strictly followed, the equity participates in the creditors' payoff. This participation creates an incentive for equity not to reduce the value of the debt; and this incentive partly countervails the equity's incentive to take high risk projects with high payoffs. *See* Schwartz, *supra* note 60, at 1217.

63) Robert K. Rasmussen, *The Ex Ante Effects of Bankruptcy Reform on Investment Incentives* 72 WASH. U.L.Q. 1159, 1186 (1994).

64) In addition, the post-petition debtor cannot participate in the unreasonable project because of the court's supervision of the debtor's management of its business and disposal of its assets.

65) DRBL, art. 236.

66) *Id.* art. 237.

the court may approve the plan by amending the draft plan to include a clause to protect secured creditors' right through one of the following methods:⁶⁷⁾

(i) transferring to a new company or to a third party the property subject to the security interest of the secured creditors, or keeping the property in the debtor company while such security interest remains effective;

(ii) repaying, distributing to or depositing for, secured creditors the sales proceeds of the collateral less the sales cost after such collateral have been sold at the price of at least the fair market value as determined by the court (without considering the encumbrances on the collateral in such valuation);

(iii) paying the holder of the right the fair market value of such right as determined by the court; or

(iv) any method which would protect the holder of the right fairly and equitably and is similar to the foregoing.

The fair market value referred to in (ii) above is construed as liquidation value of the property. This construction is based on the theory that the sale of collateral can be regarded as partial liquidation of the company's property. For the same reason, the fair market values referred to in (iii) and (iv) are interpreted to mean the amount equal to the liquidation value. Based on this interpretation, the court may include in the plan a right protection clause that the secured creditors are repaid only the liquidation value of the secured property when the rehabilitation plan is not approved for the secured creditors' objection.⁶⁸⁾ Accordingly, when the court crams down the dissenting secured creditors, the value exceeding the liquidation value of the secured property may be distributed to the junior creditors. In this sense, the RPR is applicable under the DRBL.⁶⁹⁾

67) *Id.* art. 244(1). This is equivalent to the cram-down under the U.S. Bankruptcy Code.

68) Supreme Court [S. Ct.], 2007Ma919, Oct. 11, 2007; 2004Geu31, Nov. 14, 2005; 2002Geu121, Dec. 10, 2004 (S. Kor.).

69) Some scholars allege that the relative priority rule under the DRBL allows SCs to be paid fully with haircut of unsecured claims and redemption of shares and that in such a case,

The DRBL's position on the RPR in connection with the court's cram-down is criticized on the following grounds:

First, under the RPR, secured creditors are repaid an amount which is determined between the liquidation value and the going-concern value of the secured property. The compensation amount for the secured creditors depends on the outcome of negotiation between the debtor and the creditors or the court's cram-down. Thus, the RPR makes the negotiation between the parties prolonged and increases ex post efficiency.

Second, when the rehabilitation plan is not approved due to secured creditors' objection, the Supreme Court has confirmed the same plan by cramming down dissenting secured creditors, to the extent that at least the liquidation value of secured property is paid to SCs.⁷⁰ If the Supreme Court maintains this interpretation, the voting system for creditors' approval of the draft rehabilitation plan becomes meaningless because the court can cram down the creditors' objection without including any right protection clause for the dissenting creditors.

Third, under the DRBL, the payment of the liquidation value to SCs under the rehabilitation plan was newly incorporated as one of requirements for the court to confirm the plan.⁷¹ Therefore, the payment of the liquidation value of secured property to SCs can no longer be a means of protection for secured creditors who raised objection to the draft rehabilitation plan.

Fourth, when the rehabilitation plan is not approved by dissenting creditors, the court has its absolute discretion to confirm the rehabilitation plan by including a right protection provision for dissenting creditors in the plan. Some courts cram down dissenting creditors more often than other courts. Thus, the debtor has an incentive to undertake a forum shopping when they expect dissenting creditors to their plans.

4. APR under Amendment Bill of DRBL

As pointed out above, the court has the full discretion to incorporate a

the absolute priority rule is said to be actually adopted. See Jae-Hyung Kim, *supra* note 37, at 26.

70) Supreme Court [S. Ct.], 2007Ma919, Oct. 11, 2007 (S. Kor).

71) DRBL, art. 243(1).

right protection clause in the rehabilitation plan when the court crams down dissenting creditors. As a result, the creditors have often complained that they are left unknown of their own rights once they raise objection to the draft rehabilitation plan proposed by the debtor.

Considering such complaints, the Ministry of Justice submitted in 2011 a proposed bill to modify current cram-down practice (the “2011 DRBL Bill”). According to the 2011 DRBL Bill, when senior creditors raise objection to the draft rehabilitation plan, then they must be fully compensated before junior creditors receive anything, and the court can confirm the draft rehabilitation plan at its discretion only if this requirement is fulfilled.⁷²⁾

The 2011 DRBL Bill clarifies the priority of claims under the DRBL and protects pre-petition contractual entitlements of the creditors. However, the 2011 DRBL Bill has been criticized on the following grounds:

First, in the course of the debtor’s rehabilitation proceeding under the DRBL, the court evaluates the debtor’s business and the value of secured property. As a result, the creditors are fully and exactly aware of their portions of distribution before they negotiate the distributions under the rehabilitation plan. However, under the 2011 DRBL Bill, senior creditors no longer have any incentive to undertake negotiation with junior creditors because the senior creditors are guaranteed for full compensation without any further action. Consequently, all negotiations between the debtor and creditors would likely be useless and the parties probably would rely on the court’s cram-down even more.

To avoid this result, current evaluation system should be modified so that the interested party, not the court, undertakes the valuation of the debtor’s business or the secured property. In this case, the relevant parties have an incentive to engage in negotiation with other parties because they may omit the evaluation proceeding through mutual agreement.

Second, the shareholders do not have any incentive to file for bankruptcy at an early stage because they will likely be entitled to nothing if the creditors do not approve the draft rehabilitation plan prepared by the shareholders during the debtor’s rehabilitation proceeding. Such Delay Effect would seriously distort ex ante efficiency, especially in the case of

72) 2011 DRBL Bill, art. 244(2), (3).

small- and medium-size companies where the ownership and the control are not separated.

Third, according to the 2011 DRBL Bill, the court's valuation of the debtor's business or secured property becomes critical because such valuation eventually determines the amount of distributions among the interested parties. Thus, the interested parties become very sensitive to the outcome of the appraised value and will likely try to challenge such appraised value through litigation. This process will prolong the debtor's rehabilitation proceeding to a certain extent

Fourth, under the 2011 DRBL Bill, the court is obligated to confirm the plan if the APR is complied. Such practice would cause the inefficiency because secured creditors can always insist on the debtor's repayment of the maximum going-concern value of secured property. Agreement among the interested parties to achieve the plan will become meaningless because the court will confirm the plan to the extent that the APR is maintained in the plan.

Therefore, simply adopting the APR is not enough to solve the problem arising with respect to the RPR under current DRBL. To complement the proposed APR under the 2011 DRBL Bill, the DRBL should incorporate the systematic approaches to stimulate the negotiation between the debtor and creditors, such as modification of the valuation method, adoption of the debtor's exclusive proposal of the plan, the court's discretion to confirm the plan when any class of rehabilitation creditors raise objection to the plan, etc.

VIII. Adoption of System to Extinguish Security Interests

1. Introduction

The Civil Rehabilitation Act of Japan (the "JCRA"), which was enacted in 1999 as the new general reorganization regime in Japan, provides a unique procedure that restricts the rights of secured creditors called "the procedure of extinguishing security interests."⁷³ This procedure permits a

73) Civil Rehabilitation Act of Japan, art. 148-152.

debtor to cancel security interests in any property necessary for continued operation of her business by paying the secured creditors the value of such property.

Under the DRBL, if deemed necessary for the debtor's rehabilitation, after commencement of the rehabilitation proceeding and even prior to confirmation of the rehabilitation plan, the receiver may transfer, with the court's approval, the entire or material part of the operation or business of the debtor.⁷⁴⁾ However, if the maximum registered amount of security interest exceeds the proceeds from such transfer, the receiver cannot consummate the business transfer. To facilitate the business transfer during the rehabilitation proceeding, the procedure of extinguishing security interests needs to be incorporated in the DRBL.

2. Relationship with Cram-down

Extinguishing security interests and the cram-down have similar effect that security interests can be extinguished without regard to secured creditors' intention to maintain such security interests. Both procedures can avoid inefficiency which may arise from the secured creditors' unreasonable behaviors.

However, both procedures have the following differences.

First, the procedure of extinguishing security interests can be used prior to the court's confirmation of the rehabilitation plan while the court's cram-down can be utilized at the time the court's confirmation of the rehabilitation plan.

Second, the debtor (or the receiver) has the option to exercise its right of extinguishing security interests while the court has the discretion to incorporate the cram-down clause in the plan. However, the debtor must obtain the court's approval to exercise the right of extinguishing security interests.

Third, the procedure of extinguishing security interests requires the debtor to make a one-time payment of the value of the collateral whereas the court's cram-down permits the debtor to make deferred cash payments equivalent to the value of the collateral. To determine whether the

74) DRBL, art. 62.

requirements of cram-down are satisfied, the court must estimate not only the value of the collateral but also the value of deferred cash payments promised in the plan which requires examination of the feasibility of the plan.⁷⁵⁾ In this sense, the procedure of extinguishing security interests is much more efficient than the cram-down when the security interest on a specific property is cancelled.

3. Efficiency of Extinguishing Security Interests

The procedure of extinguishing security interests can enhance ex post efficiency because this procedure can block secured creditor's unreasonable behaviors, such as holding-up and circumvent time-consuming negotiation between the debtor and the secured creditors.

However, it may harm ex ante efficiency seriously. If this procedure is adopted, the secured creditors' position becomes very unstable because their secured interests can be extinguished without regard to their intention during the debtor's rehabilitation proceeding. Thus, the positive function of SCs as explained above will be adversely affected. In addition, adopting the procedure of extinguishing security interests is equivalent to adopting the RPR in the DRBL because the benefit from cancelling the security interests by paying the value of the collateral will pass to other stakeholders. On the contrary, the debtor should assume higher costs to use the security interests on the properties with low disposal value such as the equipment.⁷⁶⁾

However, the procedure of extinguishing security interests may provide the debtor with an incentive to file for bankruptcy at an early stage because the debtor can benefit from extinguishing security interests. In this respect, the harms to ex ante efficiency may be offset to a certain extent.

75) Wataru Tanaka, *Extinguishing Security Interests: Secured Claims in Japanese Business Reorganization Law and Some Policy Implications For U.S. Law*, 22 EMORY BANKR. DEV. J. 427, 431-432 (2006).

76) Wataru Tanaka, *Economic Analysis of Claims to Extinguish the Secured Claims*(2) NBL No. 801 (15 January 2005). p.45 (15 January 2005).

4. *Adoption of Procedure of Extinguishing Security Interests*

Considering the inefficiency which may result upon adopting the procedure of extinguishing security interests, this article suggests that the procedure should be used only for business transfer by the receiver. In other words, the receiver should be able to use the option to cancel the security interest on the property to be transferred by paying the value of secured property. If the scope applicable to this procedure is restricted, adverse effects thereof can also be minimized.

IX. Conclusion

Korean insolvency law has focused on the improvement of the rehabilitation proceeding under the DRBL from the debtor's perspective. It is time to examine relevant provisions of the DRBL on the creditors' position to learn whether current laws and practices help achieve the efficiency in terms of maximized return to creditors as a whole. Considering negative functions of secured claims for solvent companies in Korean society, this paper recommends the following amendments to enhance the efficiency of secured claims.

First, the practice of using the market value of secured property for the purpose of evaluation of secured claims should be incorporated into the DRBL.

Second, the Post-commencement Interest of secured claims should be included in the definition of secured claims only to the extent the principal and interest of secured claims do not exceed the value of secured property.

Third, the *keun*-mortgage should not be automatically crystallized at the time of commencement of the debtor's rehabilitation proceeding. The flexibility in crystallization of the *keun*-mortgage will help the debtor procure the DIP financing.

Fourth, the RPR should be modified to the APR on the condition that the procedures to facilitate the negotiation between the debtor and secured creditors are adopted at the same time.

Fifth, the procedure to extinguish security interests should be adopted

in the case of the debtor's transfer of business in order to facilitate the debtor's business transfer.

It is noteworthy that the reform of Korean insolvency law can be completed only when the procedures for both sides –creditors' side and debtor' side- are improved in balance.

KEY WORDS: secured claim, cram-down, absolute priority rule, DIP financing, evaluation of secured property, post-commencement interest, right to extinguish the secured interest

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