

NEW POLICY FOR CORPORATE TURNAROUND: CORPORATE RESTRUCTURING VEHICLE AND PRE-PACKAGED BANKRUPTCY

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Supplementing the existing workout system

The workout system was introduced in July 1998 as an out-of-court arrangement for corporate rehabilitation. There is no doubt that it has played a key role in the corporate turnaround and restructuring so far. However, it has also caused some side effects that we can no longer overlook such as conflicts of interest among creditors.

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In order to supplement the existing workout system, the government will introduce pre-packaged bankruptcy (PB) proceedings and the corporate restructuring vehicle (CRV) system¹⁾ as second-stage policies to help the corporate turnaround. It means that the workout system will be abolished and replaced by the CRV and PB in September.

A CRV is similar to a paper company that manages the assets of a workout firm. PB is a system that allows creditors, after attaining a majority consensus, to submit their company liquidation plans to court before handing in credit reports or due diligence. Under the new system, creditors can implement their agreements with the companies with greater speed and ease under court approval. In addition, it is expected to resolve moral hazard problems of managers at many workout firms, which was the main issue on the effectiveness of the present system.

The introduction of CRV and PB can reduce social and economic costs from the delay of corporate restructuring.

In summary, the introduction of CRV and PB can reduce social and economic costs from the delay of corporate restructuring as well as improve the efficiency and development of corporate rehabilitation policies.

This article examines the new proceedings in detail starting with the problems of the present system and the definitions of CRV and PB. Considering both the current system and the new system, it explores the prospects for corporate turnaround systems.

1) Existing workout accords between insolvent firms and their creditors will be turned into private composition proceedings.

The government is planning to complement the present workout system with a new rehabilitating procedure featuring a corporate restructuring vehicle (CRV) and a pre-packaged bankruptcy (PB) system. The main purpose of the new procedure is to shorten the corporate restructuring process from 13 months to less than 6 months. It is expected to be a cornerstone for building the infrastructure of corporate restructuring.

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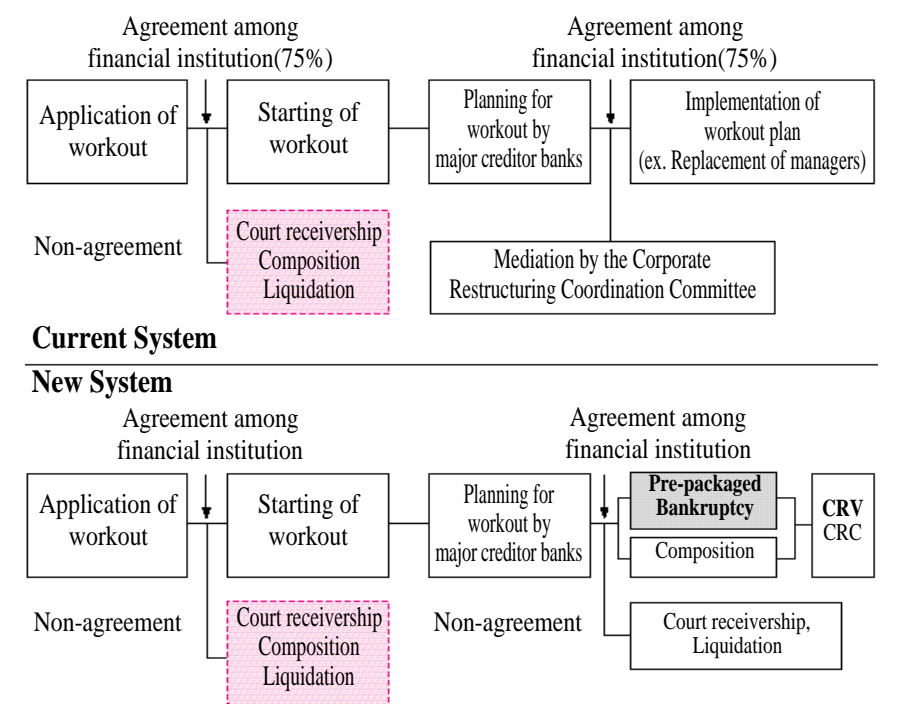
Corporate Restructuring Vehicle

A CRV is an independent agency specializing in corporate restructuring. It will operate a workout firm's bad assets by entrusting them to an asset management company (AMC) and sharing the profit with the shareholders -the creditors of workout firms- after trying to put workout firms on track. In short, it will manage the insolvent assets of a financially strapped company in place of creditor banks, mediating between creditors and assisting with the liquidation or sale of the company. Creditors can replace managers of workout firms with officials from a CRV.

CRVs will have a lot of positive effects on both creditors and workout firms. First, they will mitigate conflicts of interests among creditors and speed up corporate restructuring procedures because they are based on the assets of insolvent firms and

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Figure 1. Current System vs. New System



run on behalf of creditor financial institutions. Second, the “moral hazard” of managers at workout firms will be greatly reduced. The authority to make a decision is concentrated at the CRV, which can make clear who should take responsibility. Third, CRVs can relieve the burden for financing because they is established by payment in kind. Besides, they can easily raise funds through the participation of the public as a shareholder. Finally, CRVs will promote the health of creditor financial institutions and alleviate problems associated with having multiple creditor institutions (eg. conflicts of interest).

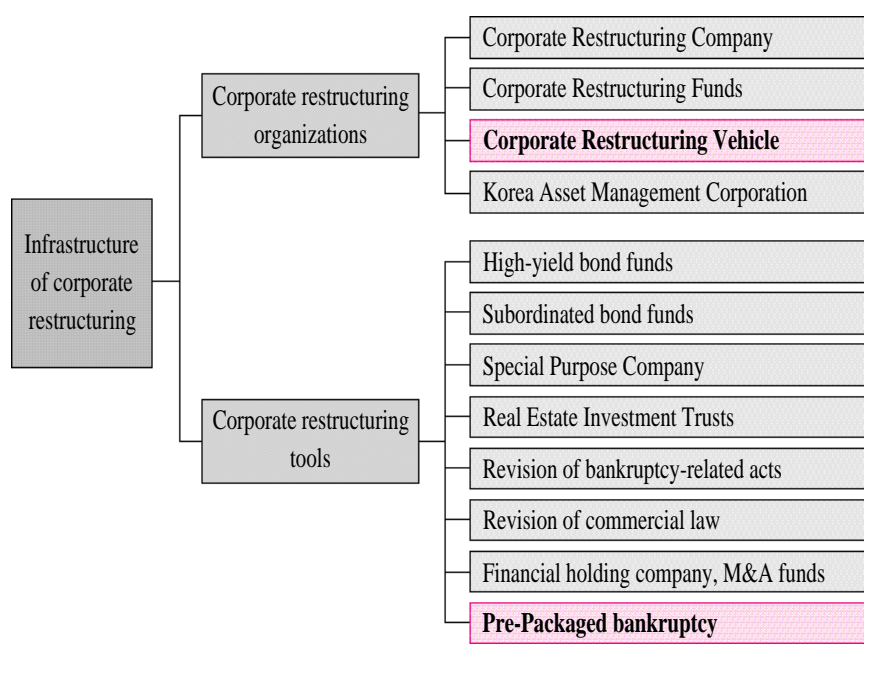
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In conclusion, the new system will make firms more valuable by managing their assets through specialized institutions.

The government will grant a variety of benefits to both CRVs and their investors, which will be in charge of managing stocks obtained through debt-for-equity swaps for companies put under workout programs and taking over their debts. Needless to say, there are some conditions for the establishment of a CRV. The CRV should amass capital in excess of 500 million won and register at the Financial Supervisory Commission. However, a limit on a company’s issuance of bonds, which is currently up to four times its equity capital, will not be settled for the establishment of CRVs, while banks establishing the vehicles will be subject to loosened capital investment regulations. Futhermore, CRVs will be able to issue asset backed securities worth up to 20 times their net assets. Holders of CRV

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Figure 2. Infrastructure of Corporate Restructuring System



stocks will be exempt from transfer and securities transaction taxes when they sell their holdings to other investors. Creditor financial institutions will be able to write off any losses caused by the transfer of credits to CRVs over a period of five or six years.

Pre-packaged Bankruptcy System

The PB system makes it easy for creditors to obtain the court’s approval for their agreements. Therefore, creditors can implement their plans with companies more effectively and promptly. If more than 50 percent of the creditors reach a consensus on turnaround plans in three months, they will carry out their plans with the court’s approval immediately. If they have difficulty in reaching an agreement or implementing it owing to conflict of interest, the companies will automatically go under court receivership. The Corporate Restructuring Coordination Committee, launched by creditor institutions to mediate among creditors, will be abolished and in its place, the role of the so-called “Agreement Operating Committee” will be emphasized. Even under the PB system, the provision for the grace of credits will be maintained for a while after the application of workout systems. In addition, the priority for payment of debts before court receivership will be kept.

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A PB will be applied to companies that show little progress after the workout has started. This system makes it possible to process corporate restructuring promptly with legal validity. Meanwhile, the ministry plans to seek revision of the current bankruptcy law at the National Assembly to introduce the system.

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Workout vs. Pre-packaged Bankruptcy

The current procedures for corporate restructuring are divided into three categories -workout program, court receivership and private composition. Under the

Table 1. Workout vs. Pre-packaged Bankruptcy System

	Workout system	Pre-packaged Bankruptcy System
Purpose	To rehabilitate viable but illiquid firms effectively	
Minimum proportion of creditors needed for agreement on self-rescue plans	75% of creditors	50% of creditors
Legal validity on the procedure	Not applicable	Applicable

new procedures, the workout program will be replaced with the PB system.

The workout program and the PB system both include a stage of creditors' agreement. However, there are some differences between the two. First, the minimum proportion of creditors for implementing an agreement is 75% in a workout program and 50% in a PB. Second, the implication of legal support in the proceedings are different. There is no legal backup in the workout program. These two differences are the key factors to determining whether or not corporate restructuring procedures are successfully completed.

Facilitating corporate rehabilitation

The problems of workout programs will not be settled with just the introduction of CRV and PB.

As mentioned above, the upcoming new system is expected to facilitate corporate rehabilitation. In the meantime, the problems of workout programs will not be settled with just the introduction of CRV and PB. Furthermore, the new system is likely to have some drawbacks in its application to workout firms.

Supporters of the workout system point out that both government officials and creditors had misunderstanding from the beginning. They insist that creditors should have been more selective in applying the workout system to firms because the system is basically designed to rehabilitate viable but illiquid firms out of trouble, not to drive them out of the market. It implies that many of the problems associated with the system actually stemmed from the inclusion of unqualified firms, not from the system's inherent deficiencies.

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Along with this point, the workout programs were drafted to turn around troubled firms in four or five years. That is, the programs were not meant to take effect in the short term. Therefore, blaming the system for not producing immediate effects is due to a mistaken perception that results will emerge in an one or two year period. In this respect, the new system should be supplemented with the advantages of the current system. We need to evaluate its merits and weaknesses before making hasty decisions led by inaccurate perceptions.

A revision of related laws should be carried out as well. The Finance Ministry and the Financial Supervisory Commission intend to seek a revision plan for the bankruptcy law and push ahead with incorporating three bankruptcy-related acts -the Bankruptcy Act, the Composition Act and the Corporate Reorganization Act- into one single code. **VIP**