Labor Issues Arising in the Context of Insolvency

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Abstract

This article identifies the labor-related issues that may surface in the event of an insolvency in the wake of the recent increase in insolvencies attributable to economic downturn. Under Korean legal framework, two statutes serve as a primary source of safeguard against employees' unpaid wages during insolvencies: (i) the *Debtor Rehabilitation and Bankruptcy Act* (the "DRBA") under which an employee's unpaid wage claim against the employer is given priority over other types of claims and (ii) the *Labor Standards Act* (the "LSA") under which an employee's wage claim (i.e., for the last three months of employment), severance claim (i.e., accrued for the last three years of employment) and other claims (e.g., accident compensation) arising out of the employment relationship are given priority over other secured claims, taxes, utility charges, and other claims with respect to the company's total assets.

Notwithstanding the statutory protection, labor issues are present during insolvency proceedings as evidenced by the following three major cases. In *Tongyang, Inc.* case, the court wrestled with the scope of an "*employee*" within the meaning of the LSA in the context of a rehabilitation proceeding. In *Ssangyong Motor* case, the court held that a large-scale layoff during the rehabilitation proceeding was justified. In *Hankook Ilbo* case, the court approved the employee-creditor's application for the commencement of the rehabilitation procedure against the employer.

Keywords: Debtor Rehabilitation and Bankruptcy Act (the "DRBA"), Labor Standards Act, rehabilitation proceedings, bankruptcy proceedings, common benefit claims, estate claims, priority claims, insolvency, wages, severance packages, retirement bonus.

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I. Introduction

When a company is rendered insolvent and thus incapable of repaying all of its payment obligations, the state of insolvency can lead to delay in payment of wages or failure to meet outstanding payment obligation for departing employees by the due date (i.e., 14 days from the date of resignation) while the debtor often attempts to re-generate revenue by first addressing outstanding debt owed to business partners. On the other hand, employees who had reached an understanding with the company regarding the delayed wage or severance payment may – upon the official commencement of the insolvency proceeding against the debtor company – file a criminal complaint against the representative of the debtor company on the grounds that they never explicitly agreed upon the delayed payment.[1]

Recently, due to the trend of low growth, we have seen a significant increase in a number of companies unable to generate any operating profit or unable to rely on operating profit to make interest payment, and in some cases, companies have made restructuring efforts to reduce workforce because they could no longer sustain the cost of labor in the wake of the increase in minimum wages. In the future, despite the low interest rate that has continued for the last several years in Korea, we anticipate to see a significant increase in a number of companies that will undergo insolvency proceedings due to their failure to improve their financial situation. As such, we will examine the procedures of the formal insolvency proceedings under Korean law and summarize various labor-related issues that might occur in an insolvency situation based on actual cases that I have worked on as an insolvency attorney in Korea.

II. Outline of Korean Court Insolvency Procedure

A. Rehabilitation Proceedings

Rehabilitation proceedings in Korea are intended to facilitate the rehabilitation of debtors faced with financial difficulties by conciliating the legal interests of various stakeholders such as creditors, shareholders, and other interested parties. The primary objective of a rehabilitation proceeding as a

1) Geunro gijun beop [Labor Standards Act (hereinafter "LSA")], No. 5309, Mar. 13, 1997, *amended by* Act No. 10719, May 24, 2011, arts 36, 43, 109 (S. Kor.).

restorative system is to repay debts through the restoration and continuation of the debtor's operation, while the main purpose of bankruptcy proceedings is the disposition/realization of the insolvent company's assets and fair distribution thereof with respect to creditors.[2]

1. Basic Structure of Rehabilitation

Upon commencement of the rehabilitation proceedings, the debtor goes through the following steps: 1) prohibition against creditors from making individual collection efforts; 2) transfer to the court-appointed trustee the right to operate the debtor's business and dispose assets; 3) debt adjustment (e.g., exemption, conversion into equity); 4) business restructuring (e.g., workforce reduction, discontinuation of non-profitable operation); 5) preparation of the rehabilitation plan and obtaining consent from interested parties; and 6) obtaining the court's approval of the rehabilitation plan and execution of the plan though the trustee.[3]

2. Basic Principle of Rehabilitation

The basic principles of rehabilitation are summarized as follows: 1) economic test; 2) restriction upon rights of creditors and stakeholders; 3) respecting the claim priorities under the substantive law; 4) change in the debtor company's governance structure; 5) guarantee of liquidation value for each creditor, and 6) allocation of the differential between the company's value as a going concern and its liquidation value. Each principle will be explained in greater detail below.[4]

a. Economic test

Debtors may be eligible for rehabilitation proceedings if they, notwithstanding their economic feasibility, suffer from financial distress for reasons attributable to the debtor's unsustainable financial structure (e.g., default of payment due to lack of liquidity). Thus, a debtor in economic distress may not be eligible for rehabilitation proceeding because the debtor would not

2) Rehabilitation Practice Vol. 1, 3 (5th ed., Seoul Bankruptcy Court 2019).
3) *Id.* at 4.
4) *Id.* at 3.

be rehabilitated via debt adjustment and rehabilitation proceeding if the debtor has fallen into in economic distress due to reasons attributable to the debtor's operational capabilities. "Economic test" refers to the test of determining whether the debtor may proceed with the rehabilitation by examining whether or not the debtor's value as a going concern exceeds its liquidation value.[5]

b. Restriction upon rights of creditors and stakeholders

The purpose of rehabilitation is to conciliate the legal relationship among various stakeholders such as creditors, shareholders, and other interested parties, and achieve the efficient rehabilitation of a debtor company or its business. The conciliation of the legal relationship implies changes to the debtor's claim-obligation relationship or capital structure. In the interest of the proceeding's purpose in rehabilitation of the debtor, general (unsecured) creditors, shareholders, stakeholders as well as secured creditors are restricted or precluded from exercising their claims or rights if and when a debtor company undergoes a rehabilitation proceeding.[6]

c. Respecting the claim priorities under the substantive law

In rehabilitation proceedings, a rehabilitation plan is prepared in order to allocate the debtor company's value to creditors. In general, the priority among the creditors for the allocation is determined based on the priority of claims under the substantive law. This idea is expressed via the principle of fair and equitable differentiation as well as the principle of equality in rehabilitation proceedings, under which the varying nature of the rights or claims under the substantive law is taken into account while the rights of the same nature are treated as equal in regards to the procedures.[7]

d. Change in the debtor company's governance structure

The capital structure of a debtor company may be changed in order to rehabilitate the debtor, and upon such change, shareholders and other equity

5) *Id.* at 18.
6) *Id*. at 4, 6.
7) *Id.* at 7.

holders with lower priority than creditors are required to reduce capital, and the total amount of capital reduced must be greater than the amount of debt reduced. In some cases, debts may be converted into shares by debt-for-equity swap, and pursuant to such process, the management right of the debtor company may be transferred from the existing shareholder to the new shareholder (i.e., the creditor who acquires the debtor company's shares through the debt-for-equity swap in rehabilitation proceedings).[8]

e. Guarantee of liquidation value for each creditor

Rehabilitation proceedings can be justified only when the total amount to be repaid via the rehabilitation proceedings is greater than the distribution amount under the bankruptcy proceedings.[9]

f. Allocation of the differential between the company's value as a going concern and its liquidation value

In principle, rehabilitation proceedings are designed help debtors generate a going concern value that exceeds the debtor's liquidation value, and the creditors may claim to receive their share of the difference between the going concern value and the liquidation value, and the differential amount is determined through negotiations between the court-appointed trustee and the creditors.[10]

3. Process

a. Petition for Rehabilitation and Commencement

b. Preservation Order and Stay Order

c. Commencement of Proceedings and Appointment of Trustee

8) *Id.* at 6.
9) *Id.* at 12.
10) *Id.* at 7.

d. Filing of Claims and Types of Claims

e. Rehabilitation Plan and Termination of Rehabilitation

f. Discontinuation of Rehabilitation

g. Recent Trend: Introduction of Fast-Track Rehabilitation Procedures

Since April 2011, the Seoul Bankruptcy Court has begun to implement so-called 'fast-track' procedures under which rehabilitation proceedings progress according to an expedited schedule (the "Fast-Track Procedures"). The Fast-Track Procedures are designed to help the debtor company complete the restructuring plan and return to its normal business operations at the earliest possible time (usually within 6 months), with the support of major creditors, including financial institutions. For example, if there is an MOU or agreement entered into between the debtor and major creditors prior to the commencement of the rehabilitation proceeding, such MOU or agreement can be submitted for approval as the rehabilitation plan (so-called "a pre-packaged plan"), and an appointment of investigators in connection with the prepackaged plan may be omitted.[11]

B. Bankruptcy Proceedings

Bankruptcy proceedings are administrated by a court to (i) declare the debtor company bankrupt (if the court determines that grounds for application of bankruptcy proceedings exist in an insolvency of a debtor company), (ii) sell the bankruptcy estate (i.e., all the properties owned by the debtor as of the bankruptcy declaration), (iii) make money proceeds, (iv) distribute the money proceeds to the creditors in the order of their priority and according to the amount of debts to be confirmed in the bankruptcy proceedings through examination conducted by the court. Under Korean law, bankruptcy proceedings are compulsory in their nature in that the state enforces the execution of the claims. However, bankruptcy proceeding is distinguished from

11) *Id*. at 24.

other compulsory proceedings in that it is a comprehensive proceeding where all properties of the debtor are covered and all the creditors get fair satisfaction at once unlike individual enforcement proceedings which certain the individual property of the debtor is targeted to satisfy the individual claim of an individual creditor.[12]

III. Insolvency Proceedings and Protection of Unpaid Wage Claims

A. Treatment as Common Benefit Claims or Estate Claims under DRBA

Wages, severance, and accident compensation for the debtor's employees are recognized as priority claims as a common benefit claim under the DRBA (Article 179(1)(10)) and also an estate claim (Article 473(10)), and thus, take priority over other claims in rehabilitation proceedings, and may be repaid in full from time to time.[13]

The Supreme Court held that the court-appointed trustee in a bankruptcy proceeding has a duty to repay employees' wages, etc., which constitutes an estate claim, in the conduct of his/her business, and a claim for damages by the employee from the delay of performance of the above duties by the bankruptcy trustee after the declaration of bankruptcy also falls under the estate claims.[14] About the legal nature of claims of damages for delay that occurred after the declaration of bankruptcy, regarding wages, etc. for employees that occurred before the declaration of bankruptcy, legal views varied from a view that it should be regarded as 1) the estate claims under Article 473 (4) of the DRBA, a view of 2) the estate claims under Article 473 (10), to a view of 3) a subordinated bankruptcy claim under Article 446, Paragraph 1, (2) of the DRBA, etc. Among these views, practical civil lower instance in Korea had taken the view of estate claim, on the other hand, the Bankruptcy Department of Seoul Central District Court has taken the view of subordinated bankruptcy

12) *Id.* at 3.

13) Chaemuja hoesaeng mit pasane gwanhan beobyul [Debtor Rehabilitation and Bankruptcy Act (hereinafter "DRBA")], Act No. 15158, Feb. 22, 1958, *amended by* Act No. 14476, Dec. 12, 2017, arts. 179(1)(10), 473(10) (S. Kor.).

14) Supreme Court [S. Ct.], 2013Da64908, Nov. 20, 2014 (S. Kor.).

claims.[15]

In conclusion, the claim of damages for delay that occurred immediately before the declaration of bankruptcy in relation to the claim of wages that is an estate claim itself, shall be regarded as a bankruptcy claim (not an estate claim), however, the claim of damages for delay incurred between the day of the declaration of bankruptcy and the date of actual payment shall be regarded as an estate claim.[16]

B. Preferential Payment of Wages Claim under the LSA and the Act on the Guarantee of Workers' Statutory severances

According to Article 38 of the *LSA* and Article 12 of the *Act on the Guarantee of Workers' Statutory severances of Korea*, wages, accident compensation, severance entitlements and other claims arising from employment relationship must be paid in preference to taxes, public charges or other claims on the whole property of the employer, and the wages and accident compensation for the last 3 months, and severances for the last three years shall be paid in preference to any claims secured by any security rights under the relevant laws on the whole property of the employer, tax, public charges, and other claims.[17]

In general, the above provisions are applied in an enforcement process such as an auction for the employer's property, and it is unlikely that the provisions of the LSA and the Act on the Guarantee of Workers' Statutory severances would be applied in rehabilitation proceedings or bankruptcy proceedings, both of which are the collective compulsory execution process. Since both in rehabilitation procedures and in bankruptcy procedures, wages, severance payment and accident compensation for employees are treated as a common benefit claim (in case of rehabilitation) and an estate claim (in case of bankruptcy), respectively without limitation of periods, and I am of the view that the relevant rights of creditors can be protected better in both insolvency proceedings compared to the protection pursuant to the LSA and the Act on the Guarantee of Workers' Statutory severances. However, if there is no property of the debtor company that entered into the rehabilitation or bankruptcy

15) DRBA, arts. 446, 473 (S. Kor.).

16) Supreme Court [S. Ct.], 2013Da219623, Jan. 29, 2015 (S. Kor.).

17) LSA, art. 38 (S. Kor.); Geunroja teojikgeumyeo bojangbeop [Act on the Guarantee of Workers' Statutory Severances], Act No. 15664, Jul. 1, 2018, *amended by* Act No. 10967, Jul. 25, 2011, art. 12 (S. Kor.).

proceedings, the employees may receive unpaid wages, etc. based on the claim for the substitute payment as set forth below.

C. Substitute Payment under Wage Claims Guarantee Act

Under Article 7, Paragraphs 1(1) and (2) of the Wage Claims Guarantee Act of Korea, notwithstanding Article 469 of the Civil Act of Korea (i.e., regarding repayment by a third party), if there is a ruling to commence the rehabilitation proceedings against an employer, or a ruling to declare bankruptcy, the Minister of Employment and Labor shall pay such overdue wages, etc. to the employees on behalf of the employer in response to the payment request of his/her overdue wages, etc. brought by any retired employees. An employee eligible for the aforementioned substitute payment shall be the employee who has retired from the relevant business or place of business within three years from the date when no more than 1 year has passed from the dates of an application for rehabilitation or bankruptcy (Article 7, Paragraph 1 of the Enforcement Decree of the Wage Claims Guarantee Act). The range of substitute payment to be paid to employees is specified as the last three months of wages, the last three years of statutory severance and the last three months of shutdown benefits.[18]

When the Minister of Employment and Labor has made a substitute payment to an employee, it shall subrogate the employee's right to claim overdue wages, etc. against his/her employer, to the extent of the amount of the substitute payment (Article 8, Paragraph 1 of the Wage Claims Guarantee Act). In practice, it has been reported as a common benefit claim in the rehabilitation proceeding of the employer and as an estate claim in this/her bankruptcy proceedings.[19]

D. Criminal Penalty to a Representative (or a Trustee) under the LSA and the Act on the Guarantee of Workers' Statutory Severances

Article 36 of the LSA provides that "if an employee dies or retires, the employer shall pay wages, compensation, and other money or valuables in full

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18) Imgeum chaegweon bojang beop [Wage Claims Guarantee Act], Act No. 15850, Oct. 16, 2018, *amended by* Act No. 14839, Jul. 26, 2017, art. 7(1) (S. Kor.)

19) *Id.* art. 8(1).

within 14 days from the time when the cause for such payment have occurred.[20] However, in case of special circumstances, the period may be extended by mutual agreement between the parties," and a person who violates the aforementioned Article 36 may be punished by imprisonment not more than 3 years or a fine of not exceeding KRW 30 million under Article 109 of the LS A.[21] Under Article 9 of the Act on the Guarantee of Workers' Statutory Severances, the employer shall pay severance within 14 days from the date on which the cause for such payment occurred, when the employee retires from his/her office; provided that the payment date may be delayed under the agreement between the parties, in extra ordinary circumstances. A person who fails to pay severance in violation of Article 9 shall be punished by imprisonment for not more than 3 years or by a fine of not exceeding KRW 20 million. The above penalty provisions under the LSA and the Act on the Guarantee of Workers' Statutory severances cannot be filed against the victim's explicit intent.[22]

By penalizing employers for unpaid wages and statutory severance, Korean law statutory severance indirectly forces employers to have no unpaid entitlements to the employees. However, on the issue of whether or not the administrator should be held criminally liable for the unpaid money where a debtor company applies for the commencement of rehabilitation proceedings while an employee has outstanding balance for unpaid entitlement, and the employee leaves the company after a trustee has been appointed upon commencement of the rehabilitation proceeding, the Supreme Court has ruled as follows:

> "While an employer may not delay payment of workers' wages or severance solely on the grounds of business slowdown, if it is recognizable in light of the social norm that the employer could not have prevented the delay or failure to make due payment of wages or severance statutory severance despite the employer's best effort, and it is acknowledged that the employer cannot be reasonably expected to engage in any lawful act or the employer was under unavoidable circumstances, such grounds may constitute the grounds for exemption from liability with regards to the offense of delinquent wage or severance payment prescribed under the LSA or the Act on the Guarantee of

20) LSA, art. 36 (S. Kor.).

21) *Id.* art. 109.

22) Geunroja teojikgeumyeo bojangbeop [Act on the Guarantee of Workers' Statutory Severances], Act No. 15664, Jul. 1, 2018, *amended by* Act No. 10967, Jul. 25, 2011, art. 9 (S. Kor.).

Workers' Statutory severances… (omitted) … In light of the status, role and nature of the duties of a trustee in a rehabilitation proceeding, if the wages or severance were not paid due to aggravated finance or legal constraints against the trustee during the process of the trustee's undertaking to conciliate the legal relations of the interested parties pursuant to the DRBA for the purpose of efficient rehabilitation of the debtor company or its business, the circumstances may serve as specific proof of the grounds for exemption from liability for the offense of delinquent wage or severance payment. In addition, whether or not there was an unavoidable circumstance in which the trustee could not pay wages or statutory severances during the course of his/her duties, could be determined severally and concretely, by considering the totality of circumstances, including the circumstances of the debtor's commencement of the rehabilitation proceedings, the reasons for the appointment of the trustee by the court, the management status of the debtor's business and property as of the commencement of rehabilitation, the details of the performance of duties performed by the trustee after the decision on commencement of the rehabilitation proceedings in order to plan the recovery of the debtor or his/her business, the efforts for the consultation with interested parties including employees and the progress of rehabilitation.[23]

It is a Korean court precedent that a representative of the debtor who has lost the authority to pay severances due to the order for bankruptcy of the debtor before the expiration of such 14 days will not be liable for the unpaid amount, absent any extraordinary circumstances, since the violation of Article 109 Paragraph 1 of the LSA shall be established after 14 days from the cause of the payment occurred. As a representative of the debtor company in a financially difficult situation, prompt application for bankruptcy proceedings will help get rid of the risk of criminal penalties against him/her. However, practically in a criminal trial, it is a stern position of Korean court saying that, "In case of the representative who has lead the company continuously, such representative shall not avoid responsibility for the current financial situation of the debtor company, and the insolvency proceedings shall not be regarded as a means of indemnification for criminal liability due to unpaid wages."[24]

23) Supreme Court [S. Ct.], 2014Do12753, Feb. 12, 2015 (S. Kor.).
24) *Id.* 2009Do7722, May 27, 2010 (S. Kor.).

E. Liability for Claims of Wages under Personal Bankruptcy Proceedings

Article 566 of the DRBA specifies the claims that are not indemnified in personal bankruptcy proceedings, and under Sub-paragraph 5 of the same Article, the debtor shall not be exempted from liabilities with respect to "wages, severance allowance and accident compensation of the debtor's employees". Under Article 349(4) of the former Bankruptcy Act, the scope of the non-exemptible claims was limited to "the wages of the employee, only for the last 6 months," which was amended favorably to the employees as the DRBA was newly enacted.[25]

F. Liability of a Representative of Debtor Company regarding Unpaid National Pension Premium

An employer may deduct from the employee's monthly wages the employee's contributions for the national pension premium, and then pay the premiums to the National Pension Service (NPS). However, in case when the debtor company has fallen in financial difficulty, it may not pay such premiums to the NPS.[26]

In relation to this, the Supreme Court ruled that "the employer shall bear the duty to keep the employee's pension contribution in custody on behalf of the employees and pay to the NPS the amount to be accumulated by subtracting the contributions to be paid by the workers from the national pension premiums every month, in conduct of its business, and the employer shall be liable for the embezzlement if the employer does not pay the contribution subject to withholding deduction from the employee's wages to the NPS and consume it for personal use." As for the violation of the National Pension Act, there is a Korean court case ruling that "if an obligor for payment has made best efforts to pay national pension premium, but in the inevitable situation such as financial depression, the national pension premium could not be paid, the employer will not be liable for the unpaid wages, etc."[27]

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25) DRBA, art. 566 (S. Kor.).

26) Kookmin yeonguembeop [National Pension Act], Act No. 16240, Jul. 16, 2019, *amended by* Act No. 15876, Jun. 12, 2019, art. 90.

27) Supreme Court [S. Ct.], 2018Do18885, April 29, 2019 (S. Kor.).

In the above case, the Korean court ruled out that "Because of a depression in shipbuilding industry, it has already allowed the delay of payment from the NPS and has paid the wages to the employees with a completed amount received from the prime contract party. Meanwhile, the debtor company received the notice of unilateral termination of contract from the other party as well as it was submitted to a closure of business by the authority of tax affairs and couldn't pay national pension premium, which constitutes a legitimate reason for not paying the required premiums."[28]

G. Whether Unpaid Remuneration for Executives is Rehabilitation Claims or Common Benefit Claims

A company's officer or director, if viewed as an employee within the meaning of the LSA upon review of the substance of the contract, may claim his/her unpaid wages, etc. as a common benefit claim under the application of Article 179(1)(10) of the DRBA. Even if registered as an officer such as a director or an auditor, the remuneration for the director and the auditor will be also regarded as a common benefit claim if he/she is a de facto employee.[29]

The Seoul High Court ruled on whether or not an unregistered officer constitutes an employee in the rehabilitation proceeding of Tongyang, Inc. The court ruled that "even if he/she was a registered director under the Commercial Act of Korea, if he/she received remuneration in fixed amount for performing certain tasks under the direction/control of other employer such as a president, further to dealing with the business delegated by the company to him/her, the registered director may constitute an employee under the LSA. On the other hand, among officers or executives of non-registered directors, if a person performs his/her duties autonomously and participates in management decisions, such individual should not be regarded as an employee simply because they have not been registered as a director under the corporate registry. In the end, regardless of the formality of contract, whether or not the individual constitutes an employee within the meaning of the LSA should be determined based on its substance – whether or not he/she has provided the employer with the work in a subordinate relationship for the purpose of wage – and the burden of proof therefor shall be borne by the party asserting the employee status. Upon

28) *Id.*
29) DRBA, art. 179(1)(10) (S. Kor.).

considering all the supplementary briefs and grounds therefor from the plaintiffs in this trial, together with additional evidence, it is difficult to see that the plaintiffs are in charge of certain duties under the direction and supervision of the representative or have received remuneration in fixed amounts. Rather, the following has been established based on the evidence: the plaintiffs were promoted to executives such as deputy director, business executive, etc. and all the existing severance allowance for them were already paid, rules of employment for ordinary employees were not applied to the plaintiffs and they did not receive any extended work allowance, the annual leave allowance, instead received the base salary and the standard bonus for the monthly salary, since their promotions, the plaintiffs were provided with vehicles and drivers, golf membership and entertainment expense unlike ordinary employees, the plaintiffs were given the authority to delegate and execute certain duties as the chief of the headquarter of each business division of Tongyang, Inc. during the period when the plaintiffs served as unregistered directors, and the plaintiffs received the same remuneration with the registered director in the same rank of position, are indicating that the plaintiffs have not worked in a subordinated relationship in the company under the direction and supervision of the CEO for the purpose of wages. Therefore, there is no reason to argue that the plaintiffs are employees of Tongyang, Inc."[30]

Although the plaintiffs in the above case claimed that the claim for severance constitutes a common benefit claim, since they retired after the commencement of the rehabilitation procedure for Tongyang, Inc., the court ruled that "severance claim for the period of the non-registered director as asserted by the plaintiffs will be established as a partial remuneration for the officers' performance of duties based on the agreement as of the appointment as non-registered director. Also the duties as the executives (i.e., the condition precedents of payment) were performed before 17th Oct. 2013, when the commencement of the rehabilitation proceedings was ordered. Therefore, the claims for severance of the plaintiffs for the periods of unregistered directors shall be interpreted as rehabilitation claims occurred from the cause before the commencement of rehabilitation."[31]

30) Supreme Court [S. Ct.], 2014Na2049096, May 15, 2015 (S. Kor.).
31) *Id.*

H. Treatment of Retirement Consolation Benefits in Insolvency Proceedings

Following the national financial crisis involving the IMF's relief, a number of savings banks and mutual savings, and finance companies had executed collective bargaining agreements that included provisions specifying that "in case of termination due to managerial reasons or restructuring in the financial industry, compulsory redundancies or merger, the employer shall pay to the departing employee at least six (6) month's wage as ex-gratia payment." Thereafter, mutual savings and finance companies were designated as an insolvent financial institution by the Financial Services Commission of Korea (the "FSC"), and the order for bankruptcy was declared by the court after the company's suspension of business and cancellation of business license. Its employees filed a claim for payment of such benefits directly to the bankruptcy trustee, asserting that their claims constituted an estate claim under the bankruptcy proceedings. [32]

While the lower court found that the ex-gratia payment did constitute an estate claim since they were considered as deferred payment of wages to be paid in compensation for the work already done during the term of employment, the Supreme Court refused to find that ex-gratia payment was a bankruptcy claim but not a deferred wage, reasoning that "ex-gratia payment should be viewed as a type of consolation payment or compensation offered to support an employee's livelihood post-termination, where the employee is dismissed in the course of merger with another financial institution or conversion to another type of financial institution pursuant to the relevant laws, dismissed as part of prompt corrective action against insolvent financial institutions, accompanied by reduction of organization or suspension of business, or a dismissal by dissolution of the company from the cancellation of business by the FSC or declaration of bankruptcy by its application."[33]

Meanwhile, in the case of the Silla Savings Bank, which closed in April 2013, the Silla Savings Bank had provisions in its collective agreements on the ex-gratia payment in the amount of 18 months' average wage or more. Pursuant to the provisions, retired workers claimed the ex-gratia payment as a bankruptcy claim, and the district court ruled that, "Saving banks, such as bankrupt company, have

32) Seoul Bankr. Ct., 2014Hoe-Hwak64, May 19, 2015 (S. Kor.); Seoul High Court [Seoul High Ct.], 2016Na2053983, Jan. 20, 2017 (S. Kor.).

33) *Id.* 2006Da12527, Jul. 10, 2008 (S. Kor.).

experienced the crisis in 2000 when financial institutions within the same industry were designated as insolvent financial institutions and kicked out. Under these circumstances, it can be said that their employees recognized the necessity to prepare for the company's bankruptcy and established the provisions related to ex-gratia payment in bankruptcy of the company for the first time. In 2003, only three years thereafter, the bankrupt company, according to collective agreement by and between its labor union, increased the amount of the benefits to be calculated based on the minimum reference periods from 6 months to 18 months. Although savings banks including the bankrupt company experienced crisis at the time by corrective measures from the FSC, it cannot be regarded that there were any extraordinary circumstances to increase the amount of the benefits as long as there had already been the provisions regarding ex-gratia payment to prepare for such a crisis, and the agreements that only elevated the amount of benefits lacked their justification and necessity. Moreover, the amount already set by the severance regulations of the bankrupt company was much higher than that of the other general company (i.e., under the company's regulations on severances, when continuous-services of the retired is 4 years or more, the payment rate shall be calculated with adding 0.5 to 15 years to the periods of continuous-services, and further to the above, the graduated rate at 1.5-2.5 shall be reflected). According to the above regulations, ex-gratia payment become higher than the severance for employees who have worked for less than 8 years. In addition, from the perspectives of the necessity for payment of the above benefits and the purpose of the relevant regulations, the amount of such benefits should correspond to the periods for re-employment after dismissal, and a period of six months seems to be considerable for the re-employment. In this regards, 18 months ex-gratia payment (i.e., 3 times of the above figures) is unreasonably excessive and does not correspond to the intent of the above regulations. In case of bankruptcy, according to the related law, the wages and severance payment of the workers are distributed preferentially as an estate claim, and thereafter the claims of account holders or other creditors are distributed according to the principle of equality among creditors. If the employees are allowed to receive excessive statutory severances, the infringement of rights of the other creditors including account holders is too excessive, and the foundation of the bankruptcy system might be spoiled. Since the moral hazard of bank employees such as the plaintiffs is partly responsible for the bankruptcy of the company, there is no need for the plaintiffs to receive protection in advance of the general creditors. In light of these circumstances, the portion of statutory severances to be paid over 6

months, which is a considerable period, is regarded as a malpractice and anti-social behavior of giving special benefits to financial institution employees unfairly prior to protection of other creditors, in collusion with both employer and employees expecting the company's bankruptcy, and such anti-social activity is invalid if applied to the case of bankruptcy."[34](Seoul Central District Court Decision No. *2013GaHap542939*).

I represented other employees of the Silla Savings Bank in a bankruptcy claim proceeding, and the aforementioned Seoul District Court's decision has served as a leading case for subsequent cases. However, considering that (i) the collective bargaining agreement setting forth 18 months' average wage as ex-gratia was executed in 2003 while the bankruptcy of the Silla Savings Bank did not occur until September 2013, and that (ii) the amount of ex-gratia payment and severance package in the finance industry is generally substantial, the court's decision to invalidate the provision on the "anti-social activity" grounds appears excessive. On the other hand, there was a rebuttal that it would be the subject of denial to prescribe excessive ex-gratia payment assuming the bankruptcy situation.

IV. Relationship under Employment Agreements in Insolvency Proceedings

A. Existence of a Collective Agreement under Insolvency Proceedings

An employment agreement is a bilateral contract in which the employee provides labor for the purpose of earning wage and the employer pays the wages in return for the work or labor performed, and thus categorized as hiring contract under Article 655 of the Civil Act. An employment contract is unique in that the freedom of contract is restricted by the LSA for the purpose of protecting employees.[35] In the rehabilitation proceedings, the main purpose of the proceedings is to continue the business of a debtor company, and promote its rehabilitation, so that the employment agreement will not be directly affected upon the commencement of rehabilitation. Under the DRBA, any collective

34) *Id.* 2013Ga-Hap2049096542939, Oct. 7, 2014 (S. Kor.).

35) Minbeob [Civil Act], Act No. 14965, Feb. 1, 2018, *amended by* Act No. 14278, Jun. 3, 2017, art. 655 (S. Kor.).

agreement between the debtor and the employees shall not be canceled or terminated at the time rehabilitation procedures commence as a bilateral contract, both parties to which have yet to complete performance thereof (Article 119(4)), and Article 122(1) of the DRBA regarding the bilateral contract aimed at continued payments shall not apply to any collective agreement (Article 122(2)).[36]

On the other hand, in the bankruptcy proceedings, the purpose of which is to liquidate the whole business of the debtor company, the bankruptcy trustee may cancel the collective agreement as a bilateral contract, both parties to which have yet to complete performance thereof under Article 335 of the DRBA.[37] The reason for these differences in handling collective agreement in rehabilitation proceedings and bankruptcy proceedings is that in bankruptcy procedures, there is no possibility that the collective agreement can function properly from the reason the employer already lost the status of business entity, and that in practice, most collective agreements have the provision specifying declaration of bankruptcy as an event of termination of the agreement.

B. Termination of Employment Agreement in Rehabilitation Proceedings

The DRBA does not provide any statutory basis for the termination of employment agreement in rehabilitation proceedings. Since the rehabilitation procedure presupposes the continuation of the debtor company's business, the employment agreement will not be automatically terminated even after the rehabilitation procedure commence. However, it can be an issue whether or not a trustee can cancel or terminate the employment agreement unilaterally, considering that the debtor and the other party to the bilateral contract have yet to complete performance of the contract, pursuant to Article 119 of the DRBA. There was a view that even if the employment period has not yet expired, the trustee can cancel the employment agreement pursuant to Article 119 of the DRBA, but considering that the employment agreement is subject to the provisions of the LSA as well, it shall not be exempted from the application of Article 23 (Restrictions on dismissal etc.) and Article 24 (Restrictions on dismissal for business reasons) of the LSA.[38]

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36) DRBA, arts. 119(4), 122(1), 122(2) (S. Kor.).
37) *Id*. art. 335.
38) DRBA, art. 119 (S. Kor.); LSA, arts. 23-24 (S. Kor.).

C. Termination of Employment Agreement in Bankruptcy Proceedings

The declaration of bankruptcy itself does not terminate the employment agreements automatically, and it is necessary to terminate separately the employment agreements. In practice, a bankruptcy trustee tries to go through the procedure for dismissal immediately on the day when a bankruptcy is declared. The dismissal by a bankruptcy trustee, as explained above, is considered as an ordinary termination rather than a layoff.

Article 663 of the Civil Act provides that if an employer has been declared bankrupt, either the employee or the bankruptcy trustee may terminate the contract of employment, even where the employment term is fixed.[39] Article 335 of the DRBA provides the options of the bankruptcy trustee to terminate bilateral contract unfulfilled by both parties. The interpretation of the legal relationship between the two statutory provisions is debatable, and the views vary as follows: (1) when the employment contract is terminated, the Civil Act shall be applied; provided that when the employment contract continues even after the declaration of bankruptcy, Article 335 of the DRBA shall apply only, and the bankruptcy trustee shall be deemed to choose the fulfillment of the obligations under the contract,[40] (2) the provisions under the LSA shall be applied to any dismissal by a bankruptcy trustee in principal,[41] (3) Article 335 of the DRBA shall not be regarded as to exclude the provisions of Article 663 under the Civil Act completely, and when the employer is bankrupt, the employee shall be entitled to terminate the contract as well, and Article 335 of the DRBA shall apply only in exceptional cases that the business of a debtor company is continuing despite of its bankruptcy.[42]

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39) Minbeob [Civil Act], Act No. 14965, Feb. 1, 2018, *amended by* Act No. 14278, Jun. 3, 2017, art. 663 (S. Kor.).

40) Chi-yong Rim, Employment Agreements in liquidation Proceedings, Lawyers Ass'n J. (Sep., 2006).

41) Hyo-soon Nam & Jae-hyung Kim, Insolvency Law Lecture (Beobmunsa, 2006).

42) DRBA, art. 335 (S. Kor.); Nam-keun Yoon, Bankruptcy Trustee – Focusing on the legal status and authority, 82 Jaepanjaryo [Trial Materials], Pansanbeoboue jemunje (sang) [Issues about bankruptcy law] (Jun. 1999).

D. Whether Dismissal of Employee in Insolvency Proceedings Constitutes a Redundancy (Layoff)

In the bankruptcy proceedings against Korea Merchant Banking Corporation, the bankruptcy trustee dismissed the employees. The Korean court ruled that dismissal of employees in liquidation proceedings did not constitute a layoff and thus a valid termination supported by just-cause, holding that, "the defendant dismissed the plaintiffs not because of imminent business necessities concerning the continuation or survival of the company is presumed (and accordingly, the defendant was not obligated to comply with the provisions under the agreement discussed earlier), but because the business license has been canceled following the business suspension order issued by the Minister of Finance and Economy and the decision to transfer all the contracts to a third party, and the bankrupt company was precluded from continuing its operation due to the occurrence of grounds for dissolution prescribed under the Act on the Structural Improvement of the Financial Industry of Korea and the Merchant Banking Corporation Act of Korea, and the company existed only to terminate the existing affairs, collect claims and repay debts, and the defendant, who was the bankruptcy trustee, dismissed all the employees of the bankrupt company in the performance of his duties in liquidation of the company. In this regard, the dismissal in this case should be regarded as an ordinary termination and not as a disciplinary dismissal or a layoff, and the termination was supported by just cause pursuant to Article 30 of the LSA considering that the bankruptcy trustee dismissed the employees during the liquidation proceeding that is practically equivalent to bankruptcy."[43]

E. *Ssangyong Motor* Case – Rehabilitation Proceedings and Layoff

Layoff can occur in rehabilitation proceeding in accordance with the requirements under Article 24 of the LSA. In *Ssangyong Motor* case, the Seoul High Court and the Supreme Court ruled differently on the issue of whether a large-scale layoff in the context of rehabilitation proceeding was justifiable.

In *Ssangyong Motor*, the company recognized a loss on impairment of

43) Supreme Court [S. Ct.], 2001Da27975, Nov. 13, 2001 (S. Kor.).

property, plant, and equipment at the end of 2008, which resulted in an increase of KRW 517.6 billion in net loss for the relevant quarter. On February 6, 2009, the rehabilitation proceedings commenced against the company. The plan to normalize operation was submitted on March 31, 2009, and the company announced the plan and informed the labor union on April 8, 2009, and laid off 980 employees in total on June 8, 2009. The labor union of Ssangyong Motor went on a strike, and following a tense confrontation, the law enforcement engaged to diffuse the strike.

In two precedents involving Ssangyong Motor, the Seoul High Court made two rulings. In one of the decisions (*Seoul High Court Decision No.* 2012Na14427, 74290, dated April 2, 2012), the High Court ruled that the layoff was unjust, holding that "Ssangyong Motor did not lack the means to mitigate the liquidity crisis because it owned real estate that could be used as collateral, and while the commencement of the rehabilitation proceeding may have been inevitable to manage the liquidity crisis, it cannot be concluded that the commencement of the proceedings should immediately be construed as necessity for workforce reduction," and further reasoned that, "Ssangyong Motor is not deemed to have engaged in best efforts to avoid layoff, considering that (i) Ssangyong Motor had failed to take measures to reduce the number of personnel subject to layoff even though the company was required to reduce the scope of the layoff due to the fact that the proposed scope of workforce reduction (2,646 employees) was deemed unreasonable, (ii) Ssangyong Motor did not implement unpaid leave until the layoff despite the fact that employers are required to take measures that would maintain the employment relationship when making efforts to avoid dismissal, (iii) Ssangyong Motor, as a large corporation, is required to make greater effort avoid layoff in view of the greater amount of resources and means it can afford relative to smaller companies."[44] On the other hand, in other Seoul High Court case, the court ruled that the layoff was justifiable.[45]

The Supreme Court ruled that "the layoff was on the sufficient grounds of imminent business necessity," reasoning that "[the company] prior to before the layoff, had carried out measures including partial cessation of work, wage freeze, cyclical leave, reduction of personnel from service providers, discontinuation of welfare benefit for both employees and officers, and voluntary retirement. Considering all the aforementioned circumstances – the

44) Seoul High Court [Seoul High Ct.], 2012Na14427, 74290, Apr. 2, 2012 (S. Kor.).
45) *Id.* 2011Na43213, Jan. 13, 2012 (S. Kor.).

nature and extent of the crisis the defendant was undergoing at the time and the nature and extent of the defendant's operation – the defendant is deemed to have made best efforts to avoid dismissal."[46]

V. Participation of Employees in Insolvency Proceedings

A. Participation of Labor Unions under the DRBA

The DRBA provides provisions under which the relevant parties are required to hear the labor union's opinion under enumerated circumstances as follows.

Article 62 of the DRBA sets forth rules regarding the transfer of business or operation prior to the approval of a rehabilitation plan, under which the court is required to hear the opinions of "a majority labor union" or "a representative of a majority of the debtor's workers in the absence of such union" before approving the transfer of business or operation.[47]

Article 227 of the DRBA requires the court to hear the opinions of "a majority labor union" or "representative of a majority of the debtor's workforce in the absence of such union" in regards to the rehabilitation plan.[48]

From the legislative perspectives, it may be possible to hear the labor union's opinion from the stage where the court hears opinions about the decision to commence the rehabilitation proceedings and the appointment of a trustee (or, as an alternative to consider, a labor union may be recognized as a member of the creditor council). Also, notwithstanding the lack of textual basis in the DRBA, it would not be impossible for the employees to express opinions to the court regarding relevant procedures as stakeholders in the rehabilitation proceedings.

B. Whether the Employees Can Apply for Rehabilitation as a Creditor of Common Benefit Claim including Claim for Wages

When Hankook Ilbo had not paid wages to the employees, the employees filed an application for the rehabilitation proceedings against Hankook Ilbo, and

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46) Supreme Court [S. Ct.], 2012Da14517, 2014Da20875, 20882, Nov. 13, 2014; *Id.* 2012Da14517, 2014Da20875; 20882, Feb. 12, 2015 (S. Kor.).

47) DRBA, art. 62 (S. Kor.).

48) *Id*. art. 227.

the Bankruptcy Division of the Seoul Central District Court decided to commence the rehabilitation proceeding against Hankook Ilbo. On appeal by the representative of Hankook Ilbo, the Supreme Court held that "Article 34(2)(1)(a) of the DRBA provides that any creditor who holds a claim equivalent to not less than one-tenth of the capital of a debtor corporation may apply for the commencement of the rehabilitation proceedings, subject to no other restriction".

Further, in cases where the debtor company faces the risk of bankruptcy, the rehabilitation proceeding may be a more cost-effective and expeditious option for the creditor entitled to unpaid wage or severance claims than an individual enforcement proceeding in that it may help the debtor company and its operation rehabilitate through the proceeding. Therefore, creditors entitled to unpaid wages or severance claims against the debtor company are eligible to file for the commencement of the rehabilitation proceedings to the extent that the statutory requirements set forth under Article 34(2)(1)(a) are satisfied, and the aforementioned interpretation will apply even if the claims for wages, etc. fall under the category of common benefit claim, which should be repaid on an ongoing basis. [49]

Thereafter, the representative of Hankook Ilbo filed a constitutional appeal, asserting that "Article 34(2)(1) of the DRBA should be struck down as unconstitutional because the statute wrongfully recognizes common benefit claim holders (e.g., unpaid wage or severance claim holders) as creditors." The Korean Constitutional Court, however, rejected the appeal, holding that, "the statutory provision provides qualified creditors with the right to apply for rehabilitation proceedings in order to prevent creditors' losses and socioeconomic harm that may arise in the event of bankruptcy proceedings without the rehabilitation procedure, and thus, the court acknowledges that the statutory provision has the requisite legitimacy in its legislative purpose and appropriateness of the means used.

The statute requires that, in order to apply for the commencement of the rehabilitation proceedings against the debtor, the creditor must have a claim equivalent to at least one-tenth of the capital of the debtor company. Not only is this statutory requirement deemed reasonable, but also systematic measures are currently in place to prevent the abuse of application for commencement of rehabilitation procedures – e.g., the court's review on the feasibility, and the

49) Supreme Court [S. Ct.], 2014Ma244, Apr. 29, 2014 (S. Kor.).

availability of immediate complaint against the decision to commence rehabilitation proceedings. In addition, while the common benefit claims (e.g., claims for unpaid wages or severance statutory severance) are repayable at once or on an ongoing basis, creditors entitled to unpaid wages or severance claims also have an interest in promoting efficient rehabilitation of the company, and the rehabilitation proceeding can be more cost-effective and time-saving option than individual, compulsory enforcement proceedings. Considering that it is also possible for the creditors entitled to unpaid wage or severance claims not to be repaid in full amount – notwithstanding that the common benefit claims are repayable at once or on an ongoing basis – granting a creditor with unpaid wage or severance entitlement the right to commence the rehabilitation proceeding is not regarded as an excessive constraint against the property rights of shareholders and others. Further, given that the personal interest of shareholders potentially attributable to this statutory provision (e.g., the shareholders' financial harm or the risk thereof) is not deemed greater than the public interest in prompt address of debt collection risk as well as protection of the property interest of the creditors and stakes holders, the court finds that the statute does not infringe upon the property rights of the claimant, who are the shareholders of the company."[50]

VI. Conclusion

This article summarizes various labor issues arising in the insolvency proceedings under Korean law. Considering that insolvency proceedings are designed to conciliate the interests of various stakeholders while being a collective and compulsory proceeding, I am of the view that the Korean legal framework provides the little legal basis for employees to participate in the insolvency proceedings of a debtor company. When insolvency proceedings are initiated against a debtor company, employees often end up not receiving the full unpaid wages and severance in practice, notwithstanding that their unpaid wage claims are recognized as common benefit or estate claim in rehabilitation or bankruptcy proceedings, which is a serious issue that ultimately results in loss of livelihood for the employees. I hope that the labor issues in insolvency contexts are examined further so that these issues can be actively communicated and discussed going forward.

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50) Constitutional Court [Const. Ct.] 2014Hun-Ba149, Dec. 23, 2015 (S. Kor.).

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