

Expansion of "Rule of Law" in the Market

- Korean Experience after the Economic Crisis in late 1990's

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1. Prologue : Situation during the economic crisis

The foreign currency reserve collapsed in value from about 30 billion US dollar in January 1997 to about 24 billion US dollar in November 1997,¹ and foreign currency exchange rates soared from 847.50 won per US dollar in January 10, 1997 to 985.00 won per US dollar in November 10, 1997. Finally, the Korean government requested loans from the International Monetary Fund ("IMF"). The IMF rescue loans brought comprehensive legal reforms in various areas including economic policy, regulation and business practice.

Major reforms focused on two points: restructuring and corporate governance. These buzzwords appeared in the headlines of newspapers and drew the attention of the nation. Restructuring was an inevitable task during the era of this crisis when many financially ailing firms were poised on the edge of economic downfall. Four of the top ten chaebols² went bankrupt and were put under workouts or judicial reorganization proceedings. The whole nation was astonished to see even financial institutions go bankrupt.³ It seemed there was nothing that could not fail. The myth of "too big to

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¹ Total foreign currency reserve was USD30,966,254,000 in January 1997 and USD 24,404,306,000 in November 1997.

² Chaebol refers to the Korean conglomerates usually controlled by a family or a person. The top 10 chaebols in 1997 was Hyundai, Samsung, LG, Daewoo, Sunkyung, Ssangyong, Hanjin, Kia, Hanwha, Lotte, and part or whole of underlined chaebols went into reorganization proceedings or workouts.

³ 28.8% of total financial institutions as of Dec. 31, 1997 was liquidated or merged by Dec., 31,

die” was no longer true. Under these circumstances, business firms tried hard to maintain financial sustainability by applying every possible restructuring tool available including layoffs and sales of assets or business units; and asked the government more favorable legal support for restructuring.

The 1997 crisis was a foreign currency crisis, but more specifically it was a crisis of Korea’s financial institutions. Doubting the repayment ability of Korean financial institutions, foreign investors refused to renew loans and requested immediate repayment. The fundamental reason for the failure of financial institution was the failure of business firms, especially large firms. The nonperforming loans of such firms crippled financial institutions. Bureaucrats and academics found the reason for such failures in the unsound corporate governance of business firms. They understood that company owners, even in listed public companies, made important decision without proper check by board of directors or minority shareholders. Moreover, even if unreasonable decisions made drove the company into jeopardy, the individuals responsible did not bear any legal responsibility and the market did not have the appropriate tools in place to levy sanctions. Good corporate governance was the prescription for the ailing economy.

It was evident that the administration and the legislature were very ardent about making law after the crisis. Reforms were conducted in a massive scale not only in their number but also in their quality. They responded to the need for new legislation more quickly than before and they became more faithful to generally accepted principles than before. Most reforms were based on or related to legislative reforms. Then we arrived at the question of why the reforms were focused on law. Why through law and not through administrative power? Why was law important in the context of the crisis? Does law still matter after the crisis?

The author tries to answer these questions from the view point of “rule of law” in

2001. The government poured 155 trillion won in purchasing non performing loans, investing to equity capital and repaying deposits in lieu of banks

	Dec. 31, 1997	Dec. 31, 2001
Number of total financial institutions	2,072	1,476
Number of banks	33	20

the market. Rule of law has been mainly understood in the political context emphasizing personal freedom, right of properties and freedom of speech from the intervention of the government. The author, however, observes that rule of law also matters in the market especially in an industrialized economy. The trend of legislative reforms after the crisis, he thinks, is the expansion of the rule of law in the market. He names the traditional rule of law as “rule of law in the government office” contrasting “rule of law in the market.”

Three sections follow the first section (Prologue). In the section 2 (Rule of Law in the Market), the author explains how rule of law was understood in traditional Korean society and why rule of law was not applied more frequently to economic policy and business activities than to public areas. Then he analyses why rule of law was recognized as a fundamental principle in the area of economy after the crisis and what rule of law means in the market. In section 3 (Expansion of Rule of Law in the Market), the author illustrates how the rule of law has expanded after the crisis by showing evidence of increasing awareness of law, improvement in the substance of law and judicial activism. As a conclusion, he sets the goals of rule of law in the market and proposes current tasks in Section 4.

2. Rule of Law in the Market

2.1. Rule of Law in the Korean context

2.1.1. Social norm in traditional society

As a nation based on Confucian political philosophy, traditional Korean society had the notion that people should be ruled by the virtue of a ruler not by law. Law was thought as an inferior substitute which applied when the integrity of a ruler was not high enough for ruling. This approach meant in practice that a ruler was not bound by law as law was only a tool for ruling. A ruler was supposed to be controlled not by law but by consciousness and morality. In this sense, law was made by a ruler, but a ruler was free from law.

The socio-economic structure of the traditional Korea fostered this belief. Korea had a agricultural society, where most people stayed in a certain area and lived there over generations. It was a closed society of which most constituents knew each other and the norm was established quite a long time ago and inherited from generation to generation.

They knew what to do and what not to do almost through socialization processes based on inherited norms. Law, which was basically the norms of a sovereign state in political sense, was somewhat a strange thing to them as they already had social norms in the form of custom and morals, which was enough to maintain their society. Law usually applied in extraordinary cases including treason and homicide, while their daily lives were controlled by custom and morals. They recognized a person who could live without law as a person of high integrity, while the term “lawless” has negative meaning in the western society.⁴ Law was usually associated with negative meaning in daily life.

2.1.2. Political experience

The continental European legal system was implanted by the Japanese colonial government from the very early 1900's. It was legal system based on far different structures and concepts than Koreans were accustomed to. The problem, however, was laid not in its form but in its contents. The Japanese colonial government exploited the Koreans in the name of law. For example, the Land Survey Ordinance, which was promulgated in 1912 as the second Ordinance of the colonial government, aimed at surveying land and establishing a land registration system on the surface. However, it was used to take land from their owners who could not take necessary measures which the ordinance required. Moreover, many activists for independence were brutally tortured during the interrogation by policemen and public prosecutors and were criminally punished through the decisions of the court according to law. In those days law was a terrifying force and fetters to the Koreans

After independence in 1945, the Korean government was established on the principle of rule of law in 1948. Since the first constitution of 1948, the constitutions has adopted “rule of law” as a basic principle of the nation.⁵ The rule of law, in the

⁴ Contrary to the agricultural society, a nomadic society was open in the sense that people came in and went out of a society. Its constituents changed continuously and they needed norm according to which they lived with unfamiliar others. Law applied more frequently than custom and moral in social context. People in such a society was familiar with law and judgment pursuant to law. Exodus 18:13 illustrated this situation; “The next day Moses took his seat to serve as judge for the people, and they stood around him from morning till evening(NIV).”

⁵ Some examples are followings. Article 9, Every person has personal freedom. Person shall not be arrested, in custody, searched, interrogated, punished or forced to compulsory labor

constitutional context, was understood as a principle that the power of the government should be exercised pursuant to law and law should protect the freedom and rights of the people. The reality, however, was different from the ideal embedded in the constitution under the military dictatorships from early 1960's to 1980's. The government sometimes used its power arbitrarily for its political purposes rather than basing it upon law. Even some statutory laws were seriously doubted as ones which infringed the basic freedom and rights of the people. At that time, the government's announcement that it would exercise its power as the law provided gave negative impression to the people.

2.1.3. Economic Policy and Business Activities

Industrialization began on a national scale under the Economic Development Plan of 1962. The government decided which factories or roads were to be built, how to finance them and who would manage them. It was called that government-led economy or government-planned economy. The government monitored the production and exports, the increase of which was the goal of the government. During this era of development, the Korean government played a far different role from traditional ones, which took charge of the security of its nation.

The Korean government acted as a strategic and planning division for business corporations in these days and solved problems which business firms confronted in the name of economic or industrial policy without being tested for legitimacy. This was possible for three reasons: strong administrative power, government-led banking and judicial passivism

The government enjoyed strong administrative power also in the area of economic policy. The dictatorial government could exercise more administrative power than that of a normal government. The government was also the strongest player in the market

without grounds in act. Article 28, Every freedom and right of every person shall not be ignored for the reason that it is not listed in the constitution. Act which restricts freedom an rights of person shall be made for the purpose of maintenance of order and public welfare to the extent of necessity. Article 77, Judge shall decide independently according to law and consciousness.

⁶ This principle is called rule of law in form.

⁷ This principle is called rule of law in substance.

because the buying power of the civil sector was weak in its less developed stage. As the government was also a regulator, acts of government officials were not usually contested even though they lacked legitimacy. Business people wanted to maintain good relationship with the government.

During the period of rapid economic development, the demand for capital always exceeded its supply. The government was the largest shareholders of commercial banks before the privatization and the actual controller even after privatization. The government appointed the CEOs of financial institutions and intervened in their decision making processes, including to whom and how much they provided loans. It was called government-led banking. Under the government-led banking, the government monopolized the supply of domestic and foreign capital. In an atmosphere where the ability to borrow money became the most important attribute of businesspersons, the government, which held control of the banks, was more powerful than an emperor.

Traditional lawyers in Korea were accustomed to dealing with suits disputed in the court. Most of suits were civil cases between private legal entities or criminal cases. Administrative cases against the government were relatively fewer than typical civil or criminal cases with the exception of tax cases. Lawyers assumed that the government's policy was out of judicial review partly because it was of a discretionary nature and partly because there could not be a legal dispute which would involve issues of legal rights. Economic policy was assumed as being in an area of discretionary activities which did not require rigid statutory grounds unlike those of dismissing public servants or levying taxes. Although judicial activism, which was popular in 1960's in the US, was discussed in an academic circles, practicing lawyers and judges tended to remain in a passive mode and did not think that law could be used to transform society in an active manner.

Though government's policies, including the Economic Development Plans, usually had a statutory basis, their implantation needed various activities of government officials at different levels, which could not be precisely provided in law. In addition to official procedures provided in statutes, the public officials contacted parties in interest, sometimes suggesting their opinions and sometimes ordering. It was referred to as 'administrative guidance,' which was usually conducted in a rather private and unofficial manner including private talks, telephone conversation and closed meetings. Administrative guidance was based on mutual understanding in theory, but as a recipient of administrative guidance it was an order in practice. It was always possible for administrative guidance to cross the border of vested authority and to cause illegitimate intervention into management of banks

and business corporations. In most cases, it was not easy to argue against it because the administrative authorities had many other opportunities to make life difficult for those who did not obey the guidance. Even though such guidance was revealed as illegal at a later stage, it was not easy to bring such cases to the court because communication in administrative guidance did not leave any evidence of misconduct.

2.2. Circumstances for rule of law in the market

While the concept of rule of law was imported from outside Korea and there were many unfavorable factors that made its implementation difficult, there were other factors that were in fact conducive to promoting rule of law in the market and these factors have helped to develop the concept. Factors of primary importance and influence include: democratization in the political area, activities of the Constitutional Court, the collapse of absolute powers, a concern for long term efficiency, and pressure from outside players; each of these factors are discussed in detail.

Through the political struggle for democratization, people began to realize that the nation should be managed according to law; that is, the government activities which infringe upon people's rights and freedom should have statutory grounds, and that these government activities could be judicially contested if their legitimacy was doubted, and further, that compensatory damages should be awarded if the infringement was illegitimate. This change in the understanding of 'rule of law' has extended the scope of the application of the 'rule of law' principle. In addition to traditional areas of 'rule of law' including personal freedom, freedom of property and freedom of speech, government activities in other areas came to be scrutinized in the light of the 'rule of law' concept.

The Constitution Court, which was established in 1988, has played an important role in the expansion of the 'rule of law.' Constitutional law cases mainly deal with the constitutionality of legislation passed by the National Assembly and the exercise of administrative power. The number of constitutional law cases has increased and their scope has also increased. Even somewhat typical policy issues have been attacked on a constitutional basis at the Constitutional Court, including the preferential treatment of veterans in hiring public servants. Table 1 shows the increasing number of constitutional cases handled by the Constitutional Court.

<Table 1> Number of constitutional cases

Year	Number of Cases
1990	8,105
1991	10,746
1992	15,503
1993	20,202
1994	24,609
1995	29,605
1996	35,995
1997	39,178
1998	49,288
1999	64,062
2000	70,794
2001	82,880
2002	95,458
2003	107,924
2004	122,660
2005	138,811

The foreign currency crisis in late 1990's accelerated this tendency. People looked at the government, which had exercised absolute power, received rescue loans from a foreign institution to save the nation's economy. Its authority could not be the same as before. Big corporations and banks had collapsed, something which had never been dreamt of before. There seemed to be nothing exempt from general principles adopted by the constitution including rule of law. More people realized the importance of procedural justice and the protection of the rights of the minority that had been ignored in order to achieve short term policy goals.

The crisis taught the nation another lesson. During the period of rapid economic development, Koreans had become accustomed to success on a short-term basis. In such a situation, results usually outweighed methods, as the former were able to justify the latter. The crisis, however, showed that it was impossible to obtain desirable results without legitimate methods in the long term. People realized that generally accepted principles established in developed countries were also true in Korea and such principles should be honored in order to obtain policy goals on a long-term basis. Procedural justice was no

longer a luxury item where policy choices were concerned.

Pressure from international financial institutions was another factor in promoting rule of law in the market. They demanded clear rules in the market and protection for their investments. The IMF established an agreement with the Korean government with regard to reforms in various fields.⁸

2.3. Meaning of Rule of Law in the Market

Rule of law in the government office has been traditionally explained as a principle that the government should exercise its power only when authorized by law, and that the law in these contexts should protect the freedoms and rights of its people. The former was called the rule of law in form and the latter, the rule of law in substance. Rule of law in the market should share the same attributes as those of rule of law in the government office in its starting point.

In the Korean context, however, rule of law in the market should have more specified attributes considering the experience of the past. In Korea, we have witnessed government infringement on the rights of citizen in the field of economy and in business activities; and, at the same time, the improper influence of directors, major shareholders, and major parties to contracts. The government also sometimes engaged in the selective enforcement of existing laws, choosing not to execute certain laws even though the circumstances fit the provisions of the law. Conversely, there occurred issues which existing law had not provided for, and thus proper application of the law could not be effected. Reflecting such past experience, rule of law in the market in the Korean context should properly be viewed as a well-constructed house with a roof over four pillars with each pillar representing a necessary tenet of the rule of law principle; namely, law enforcement without delay and exception, timely rule making, restrictions on the power of the majority, and the protection of minority interests.

⁸ Minutes of Understanding for IMF Standing Loan, signed on Dec.3, 1997 by the Korean government and IMF, provided reforms on restructuring in a financial sector, opening of foreign trade and financial market, improvement of corporate governance, exit of failing firms, flexibility of labor market and disclosure of information on foreign currency.

2.3.1. Law Enforcement without Delay and Exception

The first pillar of rule of law in the market is to execute law as it is written whenever the situation fits to the provision of law. Although law is made with the purpose of application in the real world, the government sometimes does not implement some provisions of law in cases where those provisions should be applied. Such non-implementation can be found in cases of administrative law and criminal law, where government has the responsibility of application. There are several possible reasons for such non-implementation: the law itself might have been created for cosmetic purposes rather than for actual application, application of the law may result in considerable expenses, or the government may want to favor or protect those who breach particular rules. Whatever the reasons, such arbitrary execution of law makes people distrust the entire legal system and induces people to infringe upon the rules again. Faithful execution of law without exception is the starting point of rule of law in the market.

2.3.2. Timely Rule Making

The second pillar is timely rule making. Contrary to the rule of law in the government office, the situation related to rule of law in the market is always floating. The list of rights and freedoms in political sense is nearly fixed and does not change much. However, there are always new issues and situations emerging in the economic and business sphere. Economy and business activities are alive and in continual flux. As a result, the law cannot properly address these changing issues if it is not continually updated. If a newly developed situation arises and a proper governing law cannot be found for it, other means may be resorted to which may be illegal or undesirable.

2.3.3. Restriction on the power of majority

The third pillar is the restriction on the power of the majority. Majority, in this context, refers to those who are situated in superior status to counterparties. The majority in economy and business includes the government, majority shareholders, directors and monopoly suppliers. History has shown that unrestricted power has always curtailed human rights and freedom. It has also always been true in the Korean market context. Human wisdom and consciousness is always subject to deterioration and corruption.

That is the reason why the power of the majority should be restricted by law and procedural justice should be honored. Restrictions on the power of the majority includes adding requirements for the proper exercise of its power and fixing liabilities for the improper exercise of power, in addition to direct restriction in certain instances.

Administrative guidance, which was the symbol of the relationship between the government and private sectors, would be a good example illustrating the need for restrictions on the power of the majority. This approach could be a convenient and efficient way of implementing state policies if it was conducted properly. But the result has been that it deprived an industry of entrepreneurship, fostered government dependency, and finally caused the loss of its competitiveness. The banking industry is an illustrative example of the failure of administrative guidance. In the government-led banking structure, the government intervened even into business decisions of banks through administrative guidance. The banking industry, which was most frequently guided by the government, was the weakest one in Korea and such weakness caused the economic crisis of the 1990s.

2.3.4. Protection of minority

The fourth pillar of the rule of law in the market is the protection of minority interests. As explained above, rule of law in police station has traditionally been understood as the contents of law protecting human rights and freedom. With regard to the protection of rights and freedom of people, it is noteworthy that the protection of rights and freedom usually refers to the protection of rights and freedom of the minority (those who have less power). In most cases, the rights and freedom of majority (that is, those with more power) is well protected as current structures are usually majority friendly. For example, majority shareholders and monopoly suppliers already have tools to protect their rights. What matters from rule of law viewpoint is how to protect the rights and freedom of minority in such a majority biased structure; and in the market context that law should focus on protection of rights and freedom of minority interests in economy and business activities.

The basis for the protection of rights and freedom in the market context could be drawn from the Constitution of Korea. The Korean constitution manifests the freedom

of individual and business enterprises in their economic activities⁹ and provides the right of property¹⁰ and the freedom in selecting one's occupation.¹¹ So every statute regarding economic and business activities should honor the principles stipulated in the constitution. Of course, the constitution is not always clear on every economic issue. Interpretation by the court will clarify such ambiguities by reflecting the spirit of the constitution and consensus of the nation.

3. Legal Reforms after the Crisis

In this section, legal reforms after the crisis are analyzed in the light of four pillars of rule of law in the market. All of items in legal reforms are not collected and analyzed here. Instead, some typical examples are shown for discussion.

3.1. Law Enforcement without Delay and Exception

The most fundamental legal rules in the area of economy and business are that (a) promises should be honored and (b) no one should take the property of others. It follows logically that it is very important to establish a sound judiciary system to ensure the realization of contractual rights. With regards to property, it is effective to impose penal punishment against those who illegally take property of others. Embezzlement or breach

⁹ Article 119 (The Basis of Economic Order, Regulation and Coordination in Economy) ① The economic order of Korea is based on the respect to freedom and creativeness of individuals and business enterprises in the area of economy. ② The state may regulate and coordinate in the area of economy in order to maintain the balanced growth and stability of national economy and proper distribution of income, to prevent market control and abuse of economic power, and to democratize the economy through harmony among participants in economy.

¹⁰ Article 23 (Protection and Restriction of Property Right) ① The property right of every citizen shall be protected. Its contents and limitation shall be provided by an act. ② The exercise of the property right shall accord with public welfare. ③ The expropriation, use, and restriction for public need, and compensation for them shall be conducted according to an act. Proper compensation shall be provided.

¹¹ Article 15 (Freedom in Selecting Occupation) Every citizen has freedom in selecting occupation.

of trust¹² is very important in business because it occurs within the relationship of a principal and its agent. Punishment of embezzlement or breach of trust is an effective way to reduce agency costs. Whereas laws regarding larceny and robbery have been relatively well executed and enforced, laws pertaining to embezzlement and breach of trust have historically been overlooked in many cases. Public prosecutors have often hesitated to investigate cases of embezzlements or breaches of trust if no clear evidence was present. They reasoned that investigation would be difficult and might unduly burden the business of a party under suspicion.

A new trend can be noticed in the following statistics. After the economic crisis the number of embezzlement and breach of trust cases sharply increased and have since continued to steadily increase. This demonstrates that parties in interest and public prosecutors have become more conscious of embezzlement and breach of trust cases. It is also an example of how important it is to faithfully execute existing law.

<Table 2> Number of some criminal cases

	Homicide	Larceny & Robbery	Embezzlement & Breach of Trust
1990	105	24,297	3,232
1991	762	22,937	3,363
1992	668	20,335	3,453
1993	656	18,370	3,577
1994	753	19,750	4,248
1995	514	15,953	2,786
1996	688	15,061	3,418
1997	670	16,290	3,504
1998	787	21,947	4,589
1999	858	18,537	5,197
2000	736	17,654	4,336

¹² Penal Code Article 355 (Embezzlement and Breach of Trust) ① In case where a person who takes custody of other's property embezzles or refuses to return the property, the person shall be sentenced to the maximum 5 years imprisonment or fined up to 15,000,000 won. ② The same shall apply to cases where a person who handles the business of others earns profits or have the third party take profits by breaching act of the duties, and by doing so cause damage to the principal.

2001	930	15,710	4,145
2002	836	14,119	4,148
2003	823	13,971	4,359
2004	774	14,394	5,482
2005	779	13,608	5,556

3.2. Timely Rule Making

As the market continuously changes, there will arise situations where relevant law does not exist. The gap between such situations and rule making is inevitable to some extent, but rule of law in the market functions properly only when there is relevant law. There has been criticism that the government and the legislature were slow in rule making. The crisis reversed this tendency. <Table 3> tells us that the intervals between amendments have shortened as much as one third to one sixth. This shows that related authorities and congressmen value the importance of timely rule making and such an experience has speeded up the whole process.

<Table 3> Intervals between Amendments¹³

	Before the Crisis (months)	After the Crisis (months)
Commercial Code	61.7	24
Securities Exchange Act	28.8	6
Competition Law ¹⁴	21.6	6
Corporate Reorganization Act	86.4	13.7

Timely rule making means not only the frequency of rule making but also matching the contents of the rule to the needs of the market. One of the main issues in legislative reforms after the crisis was facilitating efficient restructuring mechanisms, which was conducted in corporate law, insolvency law and the Corporate Restructuring Promotion

¹³ Intervals before the crisis are calculated by dividing the number of months from enactment to the last month of 1997 by the number of amendments. Intervals after the crisis are calculated by dividing the number of months from the first month of 1998 to the last month of 2006 or the year of abolishment by the number of amendments.

¹⁴ The official title is the Anti Monopoly and Fair Trade Act.

Act. The corporate law¹⁵ introduced new legal mechanisms.

(a) Split: A stock corporation may be divided with a separate legal entity through the process of split (CC Art. 530-2 to 530-12).

(b) Comprehensive stock exchange: A company may own 100% share of another company through the process of comprehensive stock exchange (CC Art. 360-2 to 360-14).

(c) Comprehensive stock transfer: A company may become a complete subsidiary by making another company as a complete mother company through the process of comprehensive stock transfer (CC Art. 360-15 to 360-23).

The corporate law also streamlined the process of merger by adopting special provisions for small-scale mergers. In cases where newly issued stocks by a remaining corporation for merger, split or split-merger is no more than 5% of total shares, the resolution by the board of directors may replace one of shareholders general meeting with regard to merger (CC Art. 527-3, 530-11).

Competition law, which governed the legal issues on chaebols, was amended to provide bans on and the abolishment of cross guarantees among member companies of a chaebol. Cross guarantees were one of the greatest hindrances for restructuring.

Insolvency law¹⁶ was a main arena of legislative reforms after the crisis. The Corporate Reorganization Act had been criticized for lack of transparency and inexpediency. The 1998 amendment focused on enhancing transparency in reorganization proceedings. Whereas the court applied a public interest test for commencing the procedure, which was at least to some a quite elastic test, the 1998 amendment adopted the economic test, which compared liquidation value with going concern value. If the

¹⁵ Part III of the Commercial Code ("CC") is the corporate law. Ministry of Justice announced a draft bill of corporate law for public review in September 2006, which contained many controversial issues including new forms of corporation, various types of stocks, purchase of minority shares by majority shareholders, liability of executive officers, exploitation of corporate opportunities and derivative suit against directors of subsidiary by the shareholders of a mother company. The amended draft bill reflecting criticism was prepared and under the process of approval of the cabinet. The bill is scheduled to be sent to the National Congress in June 2007.

¹⁶ As insolvency law, there were the Corporate Reorganization Act, the Composition Act and the Bankruptcy Act until 2006.

liquidation value exceeded the going concern value, the court should stop the reorganization procedure and adjudicate the firm as bankrupt even though the majority of creditors wanted to stay within the reorganization proceeding. The 1998 amendment resolved the ambiguity issue even though it left another problem.

To expedite the reorganization procedure, the 1999 amendment provided that commencement decisions should be made within one month from the filing. Setting such a maximum period allowed for each procedure to effectively expedite the reorganization proceeding.

Another important legislative reform in the area of restructuring was the enactment of Corporate Restructuring Promotion Act (“CRPA”). In June, 1998, every domestic financial institution signed the Workout Accord. The workout was an out-of-court restructuring procedure binding domestic financial institutions. The workout scheme was created by the government. The legal nature of the Workout Accord raised two onerous issues for the government. As the Workout Accord was a contract among domestic financial institutions, foreign creditors were not bound to the Accord and tended to hold out. The judicial reorganization proceeding could be viewed as a treat to holdouts and also offered an inevitable alternative to the workout. In case of corporate reorganization proceedings, however, the workout plan could not be enforced. Moreover, new money injected in the course of the workout could not be repaid with high priority. To solve these problems, the CRPA was enacted. The CRPA bound all financial institutions doing business in Korea and provided rules on out-of-court restructuring. The CRPA actually created a new insolvency proceeding.

3.3. Restriction on Power of Majority

With regard to the failure of business corporations, enhancing corporate governance became an urgent task after the crisis because corporate governance was esteemed as a key factor of business success or failure. Corporate governance includes decision making process and liability for the decision making. As a majority shareholder or a CEO dominates the board of directors under the current corporate structure, enhancing corporate governance means restricting the power of a CEO or a majority shareholder and levying sanctions on their improper decision. It is restriction on the power of majority in the context of rule of law in the market.

In order to restrain the power of a CEO or a major shareholder, the Securities Exchange Act¹⁷ and the Commercial Code introduced outside directors into the board of directors and mandated large corporations to have as many outside directors as majority directors. Committees in the board of directors were also adopted. Committees composed of two or more directors may be established and exercise delegated authorities from a board of directors (CC Art. 393-2). An audit committee, one of the committees of board of directors, may replace an auditor. An audit committee consists of 3 or more directors and two thirds of its members or more should be outside directors (CC Art. 415-2).

The fiduciary duty of directors was adopted even though prevailing opinion was that previous law had already acknowledged fiduciary duty.¹⁸ A provision on the liability of directors applied to de facto directors who exercised their power to the decision making of firms; and that any person who orders directors or exercises managing power bears the same liability with directors to a company and the third parties (CC Art. 401-2). It aims at owners of chaebols who are not directors in a legal sense, but governmental officials could also be treated as de facto directors if they exercised influence over the decision making of business firms.

In addition to such restrictions and sanctions, corporate law gave carrots to directors through stock options. Directors, auditors and employees may have stock options when they contribute with regard to the establishment or management of a company or innovation of technology (CC Art. 340-2 to 340-5).

In addition to such restriction and sanctions, corporate law gave carrots to directors through stock option. Directors, auditors and employees may have stock options when they contribute with regard to the establishment or management of a company or innovation of technology (CC Art. 340-2 to 340-5).

¹⁷ It is a normal function of securities exchange law to regulate the trade of listed securities. The Securities Exchange Act of Korea, however, has several provisions regarding corporate governance of listed companies in addition to typical regulation over listed securities. Securities exchange law has lead the reform of corporate law in some cases. So securities exchange law plays important role in corporate governance as well as restructuring. Commercial Code Article 382-3 (Director's Fiduciary Duty) "Directors should perform their duty for a company pursuant to laws and article of incorporation."

¹⁸ Commercial Code Article 382-3 (Director's Fiduciary Duty) "Directors should perform their duty for a company pursuant to laws and article of incorporation."

One of controversial issues regarding major shareholders is to use their controlling power to give the power to their heirs. Some companies issued their stocks to sons of owners who did not have outstanding stocks. The Korean corporate law vests preemptive rights to shareholders, except in cases with special resolutions at a general shareholders' meeting. To ban the abuse of such exceptions, corporate law imposes stricter requirements. Issuance of new shares to third parties except existing shareholders is restricted only in cases where necessary for business purposes, including introduction of new technology or improvement of financial status (CC Art. 418).

3.4. Protection of Minority

Protection of shareholders' rights was a steady issue during the reforms after the crisis because domestic and foreign investment was crucial for the revival of the economy. Protection of shareholders' rights has two phases. One aspect is the relation with shareholders in general and directors. Due to agency problems, shareholders' rights should be protected from directors. Another aspect is the relation with shareholders with controlling power ("major shareholders") and those without ("minor shareholders"). Major shareholders have enough weapons to protect their rights in relation with minor shareholders because decision by majority rule is comprehensively established in corporate law.

To protect minor shareholders' rights in relation with major shareholders, corporate law authorized certain rights to shareholders with certain amount of shares or more. They are referred to as minority shareholders' rights. Those rights are vested to provide opportunities for minor shareholders to check major shareholders. They include the right to call for general shareholders' meeting, request to dismiss directors, and examine the property of a company. To exercise those minority shareholders rights, shareholders should retain a certain portion of shares. The Commercial Code lessened requirements for exercising minority shareholder's rights from 5% of total shareholders to 1% (CC Art. 402, 403) or 3% (CC Art. 366, 385, 415, 466, 467, 539). The Securities Exchange Act also lessened the requirements for listed companies.

The Commercial Code added new rights to the list of minority shareholders' rights. Minority shareholders having 3% of shares or more may propose an agenda of a general shareholders meeting to directors (CC Art. 363-2) and request a cumulative voting, under which shareholders may cast their part or total votes to a candidate for a director (CC Art.

382-2).

4. Conclusion – Goals and Tasks

If we can reach an agreement that rule of law in the market is essential for the growth of market economy and the promotion of public welfare, the truth of which Korea discovered during the course of the crisis, the policy goal would be to strengthen the four pillars of rule of law in the market. The stronger the four pillars become, the more firmly rule of law in the market will be established. Although the goals are clear, the way to achieve them depends on circumstances and varies from time to time. The author would like to suggest three tasks necessary at the current stage.

The first is to build up a positive learning curve on rule of law in the market. There is a recursive curve among players in the market; consumers, employees, directors, shareholders and the government. In cases where the window dressing of a company is uncovered, if the director in charge of it is indicted and punished, as relevant law requires, the stock price of the firm would go down and the director would suffer from civil liability. Being afraid of being similarly punished, other firms refrain from the same bad practices and disclose duly prepared financial reports. Investors trust the information which firms provide and the value of firms increase. This is an example of positive curve. As the rule of law in the market incurs cost, players in the market have to learn the benefit of rule of law in the market and willingly bear the cost.

The second suggestion is to enforce the law without delay or exception. This means persons who commit crime should be punished as law provides without delay or exception. It also means that the government implements the law as it is written. After the crisis, democratic governments have not enforced law in some areas including illegal demonstrations, illegal occupations of other person's property and illegal strikes. When such illegal activities are left unrestricted, relations among persons in interest is distorted and settled under the optimal equilibrium. Moreover people lose trust of law, which is the base of rule of law.

The third suggestion is to encourage active review of economic policy by the court. Constitutional or legal review of economic policy enhances the awareness of law among players in the market, especially among government officials. The portion of government officials is so great that their attitude on rule of law in the market is imperative. To be

tested and adjudicated by the court is the most effective way to change attitudes.