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(3) Rules (시행규칙)
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(2) Korean Supreme Court (대법원) Supreme Court of Korea, Judgement, 90DaKa8845 (Oct. 23, 1990).

(3) Appeals Courts (고등법원) Seoul High Court, 2003Na80798 (Jan. 25, 2005).

(4) District Courts (지방법원) Seoul Central District Court, 2005GaHap80450 (Apr. 19, 2006).

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Hyungbae Kim, Kyuwan Kim & Myungsook Kim, Lecture on Civil Law Theory, at 50-51 (8th ed. 2009)

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Jeongho, Kim, *A Study on the Path to Introduce the Multiple Derivative Suit in Korea*, Journal of Business Administration & Law Vol. 23, No.4, 2013. at 209-254.

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A Look Into Recent Maritime Insolvency Cases in Japan

*Shin-Ichiro Abe**

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I. Brief summary of Japanese insolvency laws

Japan has three types of insolvency proceedings: (1) bankruptcy proceedings under the Bankruptcy Act; (2) civil rehabilitation proceedings under the Civil Rehabilitation Act; and (3) corporate reorganization proceedings under the Corporate Reorganization Act. The proceedings under the Bankruptcy Act is basically procedure for the liquidation of the bankrupt's assets as managed by the court appointed trustee.

The process under the Civil Rehabilitation Act is the most popular tool to rehabilitate the distressed companies. This is basically a debtor in possession type procedure akin to proceedings under Chapter 11 of the United States Bankruptcy Code. This proceeding deals with the restructuring of only the debts

* Attorney at Law (KILO), Visiting Professor at Chuo Law School, Visiting Professor at Kakushikan Law School

owed to unsecured creditors while leaving secured creditors free to enforce their rights over collateral pledged by the debtor. The Tokyo District Court has established a "standard schedule for proceedings" under which civil rehabilitation proceedings should be terminated within six months from commencement as a goal. In practice however, there are often complicated cases which go beyond the target six months for completion.

The process under the Corporate Reorganization Act dealing with both secured and unsecured creditors, unlike civil rehabilitation proceedings which only deal with secured creditors. Also unlike civil rehabilitation proceedings, in corporate reorganization proceedings, the management of the business is taken over by a court appointed trustee, who will normally be a capable insolvency lawyer. Because these proceedings usually more involved, they usually take more time to complete than civil rehabilitation proceedings. As such, the standard schedule for completion established with respect to corporate reorganization is set at nine months as the goal for completion.

II. Analysis of Insolvency Cases regarding Japanese Shipping Industry

While there seems to be a number of restructuring cases among shipping companies in Japan it is likely that a large proportion of these have been resolved through out of court workouts, rather than through one of three court supervised procedures discussed above. One of the reasons that the shipping companies may prefer restructuring through an out of court workout is that many of them may have pledged ships owned by the company (directly or through a special purpose company) as collateral to large creditors such as lender banks. Upon becoming distressed due to market turmoil, a shipping company would naturally wish to sell its ships even at a low price to obtain cash necessary to maintain business operations and to pay back loans; however, lenders may prefer to extend the loan term under the out of court workout, without using hair cuts (debt forgiveness) and wait for the recovery of the market to sell the ships at the higher price enough to pay back the loan (and its interest) fully.

There are several cases where shipping companies filed for the above legal insolvency procedure after 2000: Arimura Sangyo Co., Ltd. in 2008, DORVAL KAIUN K.K in 2011, the Sanko Steam Ship Co.,Ltd in 2012, , DAIICHI CHUO KISEN KAISHA in 2015, Rams Corporation in 2015. As shall be examined in further detail below, although reasons for the insolvency filings were similar, the restructuring plans for each case needed to be fitted to the unique features of each case and the issues that arose in each case.

III. Sanko Steam Ship Co., Ltd. (2012)[1]

Facts

Sanko Steam Ship Co., Ltd. ("Sanko") filed for Japan's Business Restructuring ADR procedure on May 15, 2012. The Business Restructuring ADR process is an out-of-court procedure, which is very similar to the process under the "Insol 8 principals" and/or so called "London Approach." Under these proceedings the debtor and financial creditors negotiate the restructuring plan of the debtor out of court. The restructuring plan should be approved unanimously by the creditors. Sanko, however, abandoned its attempts to obtain unanimous approval and proceeded to file for in-court proceedings under the Corporate Reorganization Act on July 2, 2012. The commencement order was granted on July 23, 2012 and the proceedings were completed on December 2, 2014. This was the second time that Sanko had experienced insolvency proceedings, having filed for corporate reorganization proceedings earlier in 1985 which were completed in 1998[2].

Reasons for insolvency

The reasons for Sanko's insolvency in 2012 was "negative carry" where the freight and charterage paid to the company fell dramatically and payments to the owners of borrowed ships became very expensive. Sanko was unable to acquire enough cash to continue operations even by selling ships that it owned because the price of ships continued to fall sharply. Sanko's attempt at an out of court workout (Business restructuring ADR) ultimately failed because it was unable to obtain unanimous consent for its rehabilitation plan after it business continue to fail following the arrest of ships used in the business by two foreign ship owners.

Key Features of Restructuring

1. Insolvency proceedings may prevail over attachment against the ship

Under the Uncitral Model Act (Art.20) as well as Chapter 15 of the Bankruptcy Code of the United States, all execution processes against the debtor and disposal of the debtor's assets should be suspended once a foreign insolvency proceeding is recognized by the relevant (bankruptcy) court. The Sanko case may illustrate the tension between the maritime proceedings and bankruptcy proceedings.

During the Japanese ADR proceeding, the foreign owners of the ship

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[1] See "Draft Plan of Reorganization" of Sanko, which was issued July 31, 2013.

[2] See Yasuo Harada, " Examples of Reorganizations in the Biggest International Cross Border Insolvency Cases," Kinyuhomu Jijo No.1367, 61(1993)

Sanko Mineral, commenced "Rule B attachment (the Supplemental Rules for Certain Admiralty Procedures and Claims)" proceedings under the U.S. Federal Rules of Civil Procedure in the United States District Court of the District of Maryland ("MDD Court"). Then the ship was arrested under the "Rule C arrest" mechanism by way of maritime lien of charterers. Sanko subsequently filed for insolvency proceedings in Japan and filed for Chapter 15 proceedings with the United States Bankruptcy Court for the Southern District of New York and also filed a request in the MDD Court to vacate the Rule B attachment. The MDD Court granted this request and revoked the Rule B attachment before the U.S. bankruptcy court ordered recognition of the Japanese insolvency procedure[3][4].

2. Unique feature of payment plan in the reorganization plan[5]

The reorganization plan for Sanko in the Japanese corporate reorganization proceedings included a special payment arrangement for secured creditors (banks), to whom the ships had been pledged as collateral. While the amount of secured debt should be determined at a fixed price in the plan, the amount to be secured would be determined depending on the sale price of the ship. For example if the amount of the secured claim is USD 100 and the collateral (ship) is sold at the price of USD 70, then the secured claim would be adjusted to USD 70 and USD 30 would be allocated to unsecured claims. This arrangement was very convenient both for Sanko as debtor as well as its secured creditors because it took away the need to fight over the amount of secured claims in the process of determining the amount of creditor claims.

3. Ship auction under the Judicial Sale and Tender Process (Hong Kong)[6]

The Sanko reorganization plan provided that the secured creditors (banks) were entitled to sell the collaterized ships by auction. The secured creditors decided to sell the ships not in Japan but in Hong Kong (The High Court of the Hong Kong Special Administrative Region). The reason for selling in Hong Kong was that: (1) the price that could be obtained for the sale of ships by auctions in Japan tended not to be very high; and (2) it was uncertain whether the ship would be free of security interests and liens, especially maritime liens upon an auction sale in Japan where precedent for such circumstances were lacking, whereas, in Hong Kong, the courts can order that the purchaser of a ship in an auction process can acquire ownership free and clear of maritime

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[3] Evridiki Nauvifation Inc. v The Sanko Steamship Co. 880 E. Supp. 2d 666 (D. Md. 2012).

[4] See Eijo Yamahara, "the 11the story: Vingt mille lieues sous les mers," NBL No.982 124 (2012), Fumiko Masuda, "Competition Between Insolvency Proceedings and Maritime Proceedings," Kaihokaishidfukkan No.59 46 (2016).

[5] See supra note 1

[6] See Wakabayashi=Suga "Ship Auction Process under the Corporate Reorganization Plan at a foreign country" NBL No.1060 31(2015)

liens, other charges and encumbrances. In addition, orders of the Hong Kong court had the reputation of being honored outside of Hong Kong and by secured creditors generally.

4. Arbitration related issue[7]

The Sanko case also involved an arbitration, the seat of which was in London. The Tokyo District Court[8] made a significant ruling with respect to the arbitration. The plaintiff, a ship owner chartered to Sanko, alleged that the charterage of a ship should be a common claim under the Corporate Reorganization Act and should be paid immediately. Under the Corporate Reorganization Act, common claims should be paid outside the reorganization proceeding and the plan. Sanko as defendant argued that the issue should be resolved through arbitration. The Tokyo District Court ordered that the court, not the arbitral tribunal, should decide upon whether or not the alleged claims were in the category of common claims because: (1) the issue concerned a matter that should be interpreted by reference to the Japanese Corporate Reorganization Act which the London arbitral tribunal might have difficulty interpreting; and (2) the application for arbitration should not be allowed by a party who filed for insolvency proceedings under the English law. The court's reasoning was that the issue regarding the category of the claims was not a matter that could be appropriately determined through arbitration as a private matter. In other words, whether a claim should be considered a common claim under the Corporate Reorganization Act was an issue for the court, not the parties to decide[9].

IV. Rams Corporation (2015)[10]

Facts

A bank filed for involuntary insolvency proceedings against Rams Corporation ("Rams") under the Corporate Reorganization Act on November 11, 2015 and the court granted the commencement order on December 31, 2015.

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[7] See Naoshi Takasugi, "Effect of Arbitration Agreement in relation to dispute over common claims in the Insolvency Proceedings" Jurist No.1493 114 (2016), Hiroyuki Teduka, "International Arbitration and Foreign Insolvency proceedings" International Arbitration and Corporate Strategy 474 (2014)

[8] See Tokyo District Court Heisei 24(wa) No.35587 (January 28, 2015)

[9] One important issue between arbitration and insolvency proceedings is whether the debtor would be bound to the arbitral award. This is an issue that arises when the amount of claims is determined as the debtor (trustee) goes through the process of confirming the filed claims from creditors. See Makoto Ito, Bankruptcy Act/Civil Rehabilitation Act (3rd Edition) 632 (2014)

[10] See Shinji=Asada=Horimoto=Asano=Takahashi=Isimori, "Corporate Reorganization Case of Rams Corporation," Jigyosaisei to Saikenkanri No.159 94 (2018)

In addition to Rams, fillings were made against 38 subsidiaries of Rams registered either in Singapore or Panama, each of which subsidiaries were set up as special purpose companies to own a ship[11]. These subsidiaries borrowed from banks to buy the ships, pledging the ships as collateral and with Rams being jointly liable as guarantor of the loans. Rams's only income was from the charterage of these ships.

Reasons for insolvency

Certain terms and conditions including the charter term and charterage in the charter contracts submitted by Rams to the banks in connection with obtaining the loan were false. This submission of false information constituted an event of default under the loan documents and consequently, once the default was discovered, the bank filed involuntary insolvency proceeding against Rams.

Key Features of Restructuring

1. 100% payment to trade creditors[12]

Rams lacked the funds to carry on the business. However it was necessary for the company to pay 100% amount of its trade claims to continue its business in the usual course. Rams asked the banks at which its special purpose subsidiaries had deposits to release a part of the deposits. The procedure for the release included the following steps: (1) the banks suspended the set off between the deposits and its claims; (2) the banks upon taking a pledge over the deposits then permitted the special purpose subsidiaries to release part of the pledge in an aggregate amount corresponding to the amount needed by Rams to continue to operate the business. This method was beneficial to Rams as debtor, but also to its trade creditors and banks. As a result, Rams management was able to maintain its business and rehabilitate itself without deterioration to corporate value. The trade creditors were paid in full and continued business with the debtor. The banks were able to monitor the company to rehabilitate and increase the possibility of repayment in due course according to the plan.

2. Two methods for disposal of the ships[13]

The reorganization plan in the Rams case included two types of treatment for the disposal of a ship owned by a special purpose subsidiary.

Under the reorganization plan, short term ships (generally, ships having a charter term of only a few months), were to be sold off by auction by each special purpose subsidiary owning a ship, after which each such special purpose

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[11] The practice of setting up a special purpose company to own each ship is to minimize the risk of vessel arrest in the event of defaults; see Fumiko Masuda, "Ship Finance/Cross Boarder Insolvency" Kaihokaishidfukkan No.58 104 (2015).

[12] See the supra note10 99.

[13] See the supra note10 103.

subsidiary would be liquidated. Where the trustee was not entitled to execute an auction in a jurisdiction outside Japan, the trustee would ask the secured creditors (banks) to execute their mortgages against the ship.

In the case of long term ships (generally, ships with a charter term of more than a year), these would be handled by either selling each special purpose subsidiaries owning a long term ship by way of a share transfer to a specific purchaser, or by having such subsidiary sell the ship to the specific purchaser.

3. Payment arrangement for secured creditors[14]

The payment arrangement for secured creditors under the reorganization plan was similar to that applied in the Sanko case discussed above. The secured creditors who had security interests over the charterage receivables, including future receivables, were treated the same way as creditors to whom the ships were pledged as collateral. An issue was that the trustee might have difficulty calculating the future amount of charterage receivables and the secured creditors might object if the trustee decided upon a fixed price. Under this arrangement the secured creditors would be paid the amount of money from charterage paid to Rams regularly after deducting operating costs of the company. This payment arrangement was beneficial to both sides. Rams was able to use part of the charterage to maintain the business and rehabilitate itself. At the same time, payments to secured creditors were continued until either the relevant claim was paid in full or the charter was terminated.

4. Applying Japanese Corporate Reorganization Proceedings to Non-Japanese Entities[15]

A question one might ask is how the foreign subsidiaries of Rams were included in the Japanese proceedings. The Japanese Corporate Reorganization Act allows a petitioner to file insolvency proceeding with respect to a stock corporation. The question faced by the Tokyo District Court in this case was whether the foreign corporations could qualify as "stock corporations" for the purposes of the Japanese Corporate Reorganization Act. In examining this issue, the Tokyo District Court examined the similarities between the foreign subsidiaries and Japanese stock corporations, looking at factors such as: (1) whether the equity holder's liabilities in respect of the entity would be limited to the capital investment; and (2) whether the equity holders and persons who executed the business of the entity were separate from each other under the structure of the subsidiaries.

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[14] See the supra note10 123.

[15] See the supra note10 111.

V. DAIICHI CHUO KISEN KAISHA(2015)[16]

Facts

DAIICHI CHUO KISEN KAISHA ("Daichi") filed for insolvency proceedings under the Civil Rehabilitation Act on September 29, 2015. The court granted the commencement order on October 5, 2015 and the proceedings were completed on August 31, 2016.

Reasons for filing

The reason for Daichi's insolvency was "negative carry" as experienced by Sanko. Upon falling into difficulty, Daichi hoped to cancel its charter party as executory contracts under the Civil Rehabilitation Act. A major reason for selecting civil rehabilitation proceedings over corporate reorganization proceedings was the expected length of time for completing the proceedings. As discussed above, the practice standard for completing civil rehabilitation proceedings is shorter than for corporate reorganization proceedings.

Key Features of Restructuring

1. Executory contract regarding the charter party

As mentioned above, executory contracts can be cancelled under Japanese insolvency laws[17], similar to the approach taken under the Bankruptcy Code of the United States[18].

2. Several arrangements to pay the claims of trade creditors

To fully pay the claims of trade creditors is critical for a debtor to be able to continue its business even after the filing for insolvency proceedings. In similar cases, usually a debtor will seek interim measures from the court for the purpose of obtaining relief during the period between the filing for insolvency proceeding and the time that the commencement order is granted[19]. However this sometimes hinders payment to trade creditors which causes suspension of transactions and the business of the debtor. Therefore, Daichi sought permission from the court in advance to allow payments related to administration of its maritime business.

Subsequently, Daichi sought recognition orders from six important jurisdictions for its business: the United States, Canada, Australia, South Africa, England and South Korea. Obtaining recognition from other jurisdictions has

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[16] See Fukuoka=Sugano=Fuji, "Civil Rehabilitation case of DAIICHI CHUO KISEN," Jigyosaisei to Saikenkanri No.156 124 (2017).

[17] See Article 49 of the Civil Rehabilitation Act, Article 61 of the Corporate Reorganization Act, and Article 53 of the Bankruptcy Act.

[18] Article 365 of the United States Bankruptcy Code.

[19] Article 26 of the Civil Rehabilitation Act.

become common practice for cross border insolvency cases in Japan.

3. Interaction between the confirmation of creditors' claims and litigation outside Japan[20]

At the time Daichi filed for civil rehabilitation proceedings in Japan, it was also involved in a case in the UK courts regarding a claim for damages arising from a maritime accident. By then, the matter progressed all the way to the UK Supreme Court. The issue that arose was whether the claim confirmation process would be continued in the Japanese court before the UK Supreme Court decision was rendered or whether the Japanese proceedings should be suspended until the case before the UK Supreme Court was completed. When Daichi sought recognition in the UK for the Japanese civil rehabilitation proceedings, Daichi was presented with the condition that it consent to the recommencement of the UK Supreme Court case, in order for the recognition of the Japanese proceedings to be granted. Daichi chose to accept the condition. Accordingly, the claim confirmation process in Japan was suspended until the UK Supreme Court reached its judgement.

VI. Dorval Kaiun K.K.[21]

Facts

Dorval Kaiun K.K. ("Dorval") filed for insolvency proceedings under the Civil Rehabilitation Act on December 2, 2012. The commencement order was granted on December 8, 2011 and the court's confirmation of the rehabilitation plan was obtained on June 13, 2012.

Reasons for filing

Dorval bought new ships during the 'ship bubble era,' which began from 2003. The era was ended by the Lehman Crisis in 2008. The resulting economic downturn created a situation in the ship industry where there were an excessive number of ships compared to the demand. As orders fell, the number of freights also fell creating a dire situation for Dorval. Dorval attempted to respond to the situation by selling its ships; however, it had to sell at very low prices, thereby being insufficient to stop the deterioration in its cash flow situation.

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[20] See supra 16 135.

[21] See Hiroaki Yoshida, "A Civil Rehabilitation Case in which Business Resources Were Reconstituted Following a Business Reset" Jigyousaisei to Saikenkanri No.138 172 (2012))

Key Features of Restructuring

1. Unique feature of the rehabilitation plan

The rehabilitation plan in the Dorval case was *quasi* (or *subrosa*) "liquidation plan." As the plan for Dorval was being drawn up, it took into consideration the situation that Dorval's ships would soon be attached by maritime liens and that it would be unlikelty that Dorval would be able to continue business under its circumstances. The only valuable asset of the company was brand name "Dorval" accordingly, a plan was developed to first sell off the company's ships and other tangible assets with the help its secured creditors and then sell the brand name Dorval and the company's intangible assets such as knowhow and network relationships to a specific buyer. In order to achieve this, Dorval terminated its employees and negotiated for their agreement to work with the buyer. This is very unique plan under civil rehabilitation proceedings.

VII. Arimura Sangyo Co., Ltd. (2008) [22]

Facts

Arimura Sangyo Co., Ltd. ("Arimura") filed for insolvency proceeding under the Corporate Reorganization Act in 1999. The corporate reorganization proceedings were terminated and moved to liquidation proceedings under the Bankruptcy Act in 2008.

Key Features of Restructuring

1. Reason of moving from corporate reorganization proceedings (rehabilitation) to bankruptcy proceedings (liquidation).

The reason Arimura moved to liquidation proceedings from the reorganization proceedings related to its executory contracts with respect to its charter parties. The trustee assumed the charter parties so that Arimura could to continue its business; however, as a result, this made the charterage a common claim. Common claims must be paid in full outside the corporate reorganization proceedings. As consequence of having to pay the full amount of the charterage and Arimura was left with insufficient cash for operating the business. Cash shortage is a common cause of rehabilitating companies to falling into liquidation proceedings under the Japanese Bankruptcy Act.

[22] See Yosiaki Toshi, "Case of Insolvency Disposal of a Ship Company" Jigyousaisei to Saikenkanri No.137 198 (2012)

VIII. Advantages for Debtors Under Japanese Proceedings

Two important tools for the survival of a legally insolvent company in Japan are: Ipso Facto Clauses and Executory Contracts.

Agreements including charter parties between a distressed company and the ship owner or charter party inevitably includes ipso facto clauses, which provide that the agreements will become null and void once a party files for an insolvency proceeding[23].

However the Supreme Court of Japan has ruled that ipso facto clauses are void because such clauses, if permitted, would destroy any attempt for a debtor company to rehabilitate itself, which would be contrary to the aims of Japanese insolvency law, especially the Corporate Reorganization Act and the Civil Rehabilitation Act[24]. On the other hand, the debtors are permitted to decide to continue profitable businesses and reject not-profitable businesses by way of executing executory contacts with trade creditors under the Japanese insolvency laws[25][26].

These two tools provide strong support for insolvent companies to maintain profitable relationships and rehabilitate themselves.

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[23] See Reiko Yoshida, "Protection of Ship Finance Claim from Insolvency proceedings" NBL No.1023 24 (2014)

[24] Decision of the Third Petty Bench of the Supreme Court of Japan, July 30, 1982; Decision of the Third Petty Bench of the Supreme Court of Japan, December 16, 2008.

[25] See supra note 17.

[26] However some argue that the bare charter party should be treated as finance lease, not an executory contract. If this is the case, a finance lease should be treated as a secured claim, which enjoys priority under the insolvency procedures; see Shibakawa=Miyagi, "Treatment of bare charter party at the time of chaterer's insolvency" Kaijihokenkyukaishi No.208 2 (2010)

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A study on the law on maritime bankruptcy in China

James Zhengliang HU, LI Zhu ***

ABSTRACT

As there is no special provision on maritime bankruptcy in Chinese law, maritime bankruptcy is mainly governed by the Enterprise Bankruptcy Law of 2006 and the judicial interpretation thereof promulgated by the Supreme People's Court. Based upon the features of China's shipping industry and the Hanjin Shipping bankruptcy, the potential pros and cons of China's adoption of the UNCITRAL Model Law on Cross-Border Insolvency are evaluated from the perspective of the shipping industry. The findings show that currently it is not advisable for China to adopt the Model Law as it is not conducive to its national overall economic interests and the protection of domestic creditors. However, China needs to improve the cross-border insolvency legal regime in its Enterprise Bankruptcy Law by reference to the advanced contents of the Modal Law in the premise of China's reality.

KEYWORDS: Maritime bankruptcy; Applicable law; UNCITRAL Model Law on Cross-Border Insolvency;

* Ph.D., Professor of Law, Director of Institute of Maritime Law, Shanghai Maritime University; Lawyer & Partner, Shanghai Wintell & Co Law Firm. Email: james.hu@wintell.cn.

** Ph.D. candidate of Shanghai Maritime University. Email: 592031507@qq.com.

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I . Introduction

Remarkably, the number of enterprise bankruptcy has been significantly increasing in China since the financial crisis. According to the statistics provided by the Supreme People's Court of the People's Republic of China, the courts in China entertained 9,542 cases of bankruptcy of various enterprises, more than 90% of which were small or medium-sized private companies,[1] the so-called "zombie companies". China is a big shipping country and has many shipping companies engaged either in international shipping, domestic costal shipping or inland navigation. Since the financial crisis in 2008, the shipping market has been in poor situation and, as a result, some shipping companies have become bankrupt and some are struggling. The Hanjin Shipping bankruptcy not only affected many Chinese creditors, but also triggered the arguments as to whether China should adopt the *UNCITRAL Model Law on Cross-Border Insolvency* (hereinafter referred to as "Model Law"). Arguments also exist as to the law applicable in a case of bankruptcy of shipping company (hereinafter referred to "maritime bankruptcy") arising from conflicted provisions between the *Enterprise Bankruptcy Law* on one hand and the *Maritime Code* and the *Civil Procedure Code* on the other.

In this paper, the authors analyses the law applicable in maritime bankruptcy in China, including the conflicted provisions between the *Enterprise Bankruptcy Law* on one hand and the *Maritime Code* and the *Civil Procedure Code* on the other and how to coordinate these provisions, whether China should adopt the Model Law and how to improve the cross-border

[1] *See* Information Website of National Bankruptcy Enterprises Recombinational cases: http://pccz.court.gov.cn/pcajxxw/index/xxwsy#.

insolvency legal regime contained in the *Enterprise Bankruptcy Law* by reference to the advanced contents of the Modal Law based upon the reality in China.

II . The laws applicable in maritime bankruptcy in China

Unlike the case of bankruptcy of financial institutions on which there are some special statutory provisions, the Chinese Law does not contain special provisions relating to maritime bankruptcy. As a result, the Chinese courts mainly apply the *Enterprise Bankruptcy Law*. The statutory provisions applicable in maritime bankruptcy in China include the following: -

- *The Enterprise Bankruptcy Law of the People's Republic of China of 2006 ("Enterprise Bankruptcy Law");*[2]
- *Provisions (I) of the Supreme People's Court on Several Issues Concerning the Application of the Enterprise Bankruptcy Law of the People's Republic of China of 2011 ("2011 Interpretation of the Enterprise Bankruptcy Law") ;*[3]
- *Provisions (II) of the Supreme People's Court on Several Issues Concerning Application of the Enterprise Bankruptcy Law of the People's Republic of China of 2013 ("2013 Judicial Interpretation of the Enterprise Bankruptcy Law");*[4]
- *The Maritime Code of the People's Republic of China of 1992 ("Maritime Code");*
- *The Maritime Procedure Law of the People's Republic of China of1999 ("Maritime Procedure Law");*
- *The Interpretations of the Supreme People's Court on Several Issues Concerning Application of the Maritime Procedure Law of the People's Republic of China of 2003 ("Interpretation of Maritime Procedure Law");*
- *The Civil Procedure Code of the People's Republic of China of 2007 as amended in 2012 and 2017 ("Civil Procedure Code).*

Among the above, the *Enterprise Bankruptcy Law* contains general provisions regarding enterprise bankruptcy. The Law consists of 136 articles in 12 chapters the title of which are General Provisions, Application and

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[2] The Enterprise Bankruptcy Law (for trial) was adopted in 1986 and was abolished when the Enterprise Bankruptcy Law was adopted in 2006.

[3] *See* the website of the Supreme People's Court: http://www.court.gov.cn/fabu-xiangqing-3158.html.

[4] *See* the website of the Supreme People's Court: http://www.court.gov.cn/fabu-xiangqing-5681.html.

Entertainment, Administrator, Debtor's Properties, Expenses for Bankruptcy Proceedings and Debts Incurred for the Common Good of Creditors, Declaration of Credits, Creditors' Meeting, Rehabilitation, Reconciliation, Bankruptcy Liquidation, Legal Liability and Supplementary Provisions. The above statutory provisions promulgated by the Supreme People's Court are in the nature of the so-called "judicial interpretations".[5]

III . The main contents of the legal regime applicable in maritime bankruptcy in China

The legal regime applicable in bankruptcy in China covers application for bankruptcy and entertainment by the bankruptcy court, appointment of administrator by the bankruptcy court, declaration of claims, creditors' meeting, rehabilitation, reconciliation, settlement and bankruptcy liquidation etc. as provided for in the Enterprise Bankruptcy Law and the aforesaid Interpretations of the Enterprise Bankruptcy Law.

A. Situations of bankruptcy and the applicants

The legal regime of bankruptcy governs two situations, i.e. bankruptcy liquidation of debts and rehabilitation of an enterprise. Bankruptcy liquidation of debts means a regime that, where an enterprise forfeits its capability of paying off its debts due, the court of law declares bankruptcy of the enterprise and enforces all of its assets to pay off the debts to the creditors for the purpose of a fair liquidation by use of the debtor's assets among the creditors. Rehabilitation means a regime of preventing bankruptcy liquidation that, where an enterprise has the hope of retrieval, as presided by the court on the basis of the applications by the enterprise (debtor), creditors and/or other interested persons and with the involvement of all the interested persons, the relation of credits and debts and/or capital structure of the enterprise are adjusted simultaneously in order to get the enterprise out of bankruptcy.

1. Situations to which the legal regime of bankruptcy applies

By virtue of Arts.2 of the *Enterprise Bankruptcy Law***,** the procedures of rehabilitation shall apply in one of the following three situations: (a) where an

[5] By Virtue of Art.18 of the *Law on the Organization of the People's Courts of 1979* as amended, the Supreme People's can promulgate interpretations concerning the specific issues of application of law during the process of application of law. The judicial interpretations have the binding effect on the people's courts at various levels and shall be complied with by the courts in the trial of cases.

enterprise is unable to pay off its debts due and its assets are not enough for paying off all the debts; (b) where an enterprise apparently lacks the ability to pay off its debts; (c) where there is an apparent possibility of an enterprise's forfeiting the ability to pay off its debts. The procedures of bankruptcy liquidation shall apply in one of the following two situations: (a) where an enterprise is unable to pay off its debts due and its assets are not enough for paying off all the debts; (b) where an enterprise apparently lacks the ability to pay off its debts. Therefore, besides the above two situations where both rehabilitation and bankruptcy liquidation can apply, rehabilitation also applies to the situation that there is an apparent possibility of an enterprise's forfeiting the ability to pay off its debts.

2. Applicants

The entertainment of bankruptcy case by a people's court is based upon an application. The question is who can apply for bankruptcy rehabilitation or liquidation.

As provided for in Art.7 of the *Enterprise Bankruptcy Law*, where an enterprise has one of the three situations specified in Art.2 of the Law as mentioned in 3.1.1 *supra*, the enterprise may file an application with the court with jurisdiction for either bankruptcy rehabilitation or liquidation. A creditor may file an application with the court with jurisdiction for the debtor's rehabilitation or liquidation of debts only where the debtor is unable pay off its debts due. In addition, by virtue of para.2 of Art.70 of the Law, where a creditor has applied for bankruptcy liquidation, the debtor or an investor whose capital contribution makes up more than one-tenth of the debtor's registered capital may, after the court has entertained the application for bankruptcy, but before the court declares the debtor's bankruptcy, may also apply with the court for rehabilitation.

B. Jurisdiction over bankruptcy

Jurisdiction is an essential issue in a maritime bankruptcy case. In this regard, there exist conflicted statutory provisions in the applicable laws in China.

Art.3 of the *Enterprise Bankruptcy Law* provides: "A bankruptcy case shall be under the jurisdiction of the people's court at the place where the debtor resides." The place where an enterprise resides means the place of its principal business.

Noticeably, the Law has adopted the principle of centralized jurisdiction to the effect that all civil lawsuits involving the debtor shall be filed with the single bankruptcy court. This principle aims at unifying the bankruptcy proceedings to enable more creditors to be fairly compensated and avoiding

multiple procedures of individual liquidations. In this regard, Art.20 of the Law provides: "After a people's court has entertained an application for bankruptcy, any civil lawsuit or arbitration involving the debtor that has started but has not yet been completed shall be suspended and shall proceed after the administrator takes over the debtor's assets." Art. 21 of the Law further provides: "After a people's court has entertained an application for bankruptcy, any civil lawsuit involving the debtor can only be filed with the people's court that has entertained the bankruptcy application." More detailed provisions are contained in Art.47 of the 2013 Interpretation of the Enterprise Bankruptcy Law as follows: -

> *"After the people's court has entertained an application for bankruptcy, any civil lawsuit against the debtor filed by the parties shall be subject to the jurisdiction of the people's court that has entertained the bankruptcy application in accordance with the provisions of Article 21 of the Enterprise Bankruptcy Law.*
>
> *The first-instance civil case involving the debtor under the jurisdiction of the people's court which has entertained the bankruptcy application may be tried by its superior or may be submitted to its superior for approval and then handed to the people's court at a lower level for trial in accordance with the provisions of Article 38 of Civil Procedure Code.*[6]
>
> *If the people's court that has entertained an application for bankruptcy is unable to exercise jurisdiction for cases involving maritime disputes, patent disputes, or civil compensation disputes arising from false statements in the securities market, its superior may specify jurisdiction according to the provisions of Article 37 of Civil Procedure Code."*[7]

By virtue of the *Maritime Procedure Law* and the *Interpretation of*

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[6] Art.38 of *Civil Procedure Code* provides: "A people's court at a higher level shall have the power to try a first instance civil case under the jurisdiction of a people's court at a lower level. If it is necessary to transfer a first instance civil case under its jurisdiction to a people's court at a lower level for trial, a people's court at a higher level shall file a report with its superior for approval of the transfer. If a people's court at a lower level deems it necessary for a first instance civil case under its jurisdiction to be tried by a people's court at a higher level, it may request the people's court at a higher level to try the case."

[7] Art.37 of *Civil Procedure Code* provides: "Where a people's court having jurisdiction is unable to exercise its jurisdiction for any special reasons, its superior shall specify jurisdiction. Where there is any dispute over jurisdiction between the people's courts, the dispute shall be resolved by the disputing courts through consultations; or if such consultations fail, the disputing courts shall request their common superior to specify jurisdiction."

Maritime Procedure Law, the maritime disputes shall be within the special jurisdiction of the maritime courts. In addition, the maritime jurisdiction is over various cases of disputes arising from maritime transport and other ship's activities. Usually, the bankruptcy of a shipping company involves maritime disputes, e.g. disputes arising from contract of carriage by sea or charterparties, ship mortgage or maritime lien. However, the Chinese law does not distinguish between maritime bankruptcy and non-maritime bankruptcy. Consequently, there exist conflicted provisions between the maritime jurisdiction stipulated in the *Maritime Procedure Law* and the *Interpretation of Maritime Procedure Law* and the bankruptcy jurisdiction stipulated in the *Enterprise Bankruptcy Law* and the *2013 Interpretation of the Enterprise Bankruptcy Law*.

As rule, the aforesaid principle of centralized jurisdiction shall have priority over the maritime jurisdiction. Thus, after the bankruptcy court has entertained an application for bankruptcy of a shipping enterprise, the consequences shall be: (a) any maritime lawsuit against the debtor can only be filed with the bankruptcy court; (b) any maritime lawsuit involving the debtor that has started but has not yet been completed shall be suspended and shall proceed after the administrator appointed by the bankruptcy court takes over the debtor's assets. However, the maritime disputes normally involve professional matters, but the judges of the bankruptcy court do not have professional knowledge to properly handle these matters. Consequently, the bankruptcy court is not or may not be appropriate to handle the maritime disputes involved in the bankruptcy procedures. As an exception to the centralized jurisdiction and as the means of coordinating the conflict provisions between the maritime jurisdiction and the bankruptcy jurisdiction, as stipulated in para.3 of Art.47 of the *2013 Interpretation of the Enterprise Bankruptcy Law* cited *supra*, where the bankruptcy court is unable to exercise jurisdiction over cases involving maritime disputes, the court at a higher level may specify a maritime court to exercise jurisdiction over the maritime disputes according to the provisions of Article 37 of *Civil Procedure Code*.

In addition, the *Maritime Procedure Law* and the *Civil Procedure Code* recognizes arbitration as an independent dispute resolution and stipulate that the maritime jurisdiction does not affect the maritime arbitration based upon a valid arbitration agreement. According to Art.20 of the *Enterprise Bankruptcy Law* cited *supra*, after the bankruptcy court has entertained an application for bankruptcy, same as lawsuit, any arbitration involving the debtor that has started but has not yet been completed shall be suspended and shall proceed after the administrator takes over the debtor's assets. However, the *Enterprise Bankruptcy Law* does not make it clear whether an arbitration agreement concluded between the debtor and a third person before the bankruptcy court has entertained an application for bankruptcy of the debtor shall remain valid and disputes between the debtor and the third person shall still be referred to arbitration. As a matter of interpretation of the *Enterprise Bankruptcy Law*,

especially in consideration of that Art.21 of the Law only requires any civil lawsuit involving the debtor to be filed with the bankruptcy court, but does not mention arbitration, the arbitration agreement and consequential arbitration shall not be affected. As a conclusion, the *Enterprise Bankruptcy Law* maintains the independence of arbitration and no conflict exists between maritime arbitration and bankruptcy jurisdiction.

C. Property preservation and enforcement

Art.19 of the *Enterprise Bankruptcy Law* provides: "After the people's court has entertained an application for bankruptcy, the measures for preserving the property of the debtor shall be lifted and the procedure for enforcement shall be suspended." Therefore, the entertainment of an application for bankruptcy by the bankruptcy court shall affect the property preservation and enforcement of an effective civil judgement, civil award or reconciliation.[8]

Where a maritime court had arrested a ship upon application by a maritime claimant to secure a maritime claim by virtue of the *Maritime Procedure Law* before the bankruptcy court entertained an application for bankruptcy, the ship shall be released unconditionally. Where other property of the defendant has been preserved, e.g. the bank account or company shares have been frozen, the preservation shall also be lifted. Where a judgement or a reconciliation document has been issued by a maritime court or its court of appeal and has become effective, the claimant shall not be allowed to apply to the maritime court for enforcement thereof or, if the claimant has applied for enforcement, the enforcement procedure shall be suspended.

Obviously, such a result will make the claimant/creditor unable to secure his claim by way of property preservation and to enforce a favorable judgement, civil award or reconciliation by way of applying to the maritime court for enforcement. Instead, as provided for in Art.22 of the *2013 Interpretation of the Enterprise Bankruptcy Law*, the creditor shall declare his credit to the administrator. That is, the only way of recovery is the compensation from the bankruptcy assets during liquidation.

In practice, enforcement of a maritime judgement in which a shipowner lost the case is often in the form of an enforced sale of a ship according to the procedures stipulated in the *Maritime Procedure Law* and the *Provisions on Certain Issues Concerning Arrest and Auction of Ships* promulgated by the Supreme People's Court in 2015. A ship is normally of high value and often

[8] A civil reconciliation is a document issued a court based upon the agreement between the plaintiff and the defendant reached through reconciliation by the court during proceedings. A civil reconciliation has the same binding effect as a civil judgement. As provided by the *Civil Procedure Code*, the court that entertained a case shall conduct reconciliation based upon the willingness of the plaintiff and the defendant.

involves maritime claims secured by maritime lien, ship mortgage or possessory lien. Consequently, disposal of a ship may involve significant interests of various persons. To ensure a fair result of such disposal, the *Maritime Code* and the *Maritime Procedure Law* limit the way of disposal of a ship to an enforced sale by public auction by a maritime court. The stipulated procedures of an enforced sale by public auction are rather complicated. The *Enterprise Bankruptcy Law* does not expressly stipulate the way of disposal of a ship of a shipping enterprise. However, the need for such a way of disposal of a ship exists in the liquidation of debts in the bankruptcy procedures. In practice, to coordinate the conflict between maritime procedures and bankruptcy procedures with respect to disposal of a ship of the debtor, the bankruptcy court often entrusts the maritime court that had arrested and/or commenced enforcement of an effective judgement, civil award or reconciliation before it was suspended to continue the arrest and/or enforcement by way of an enforced sale by public auction, or entrusts a maritime court to arrest and sell a ship in such a way.

D. Priority/order in liquidation

1. Non-bankruptcy properties

According to the provisions of Arts.109 & 110 of the *Enterprise Bankruptcy Law*, a creditor whose claim is secured by a security right over specific property of the bankrupted enterprise shall enjoy priority in liquidation over that property. Where the claim of a creditor enjoying such priority is not repaid in full, the un-repaid part of his claim shall be taken as common claim, i.e. unsecured claim in the bankruptcy liquidation. If such a creditor gives upon the priority, his claim shall also be taken as common claim. Therefore, the specific properties of the bankrupted enterprise over which creditors have priority as their claims are secured by security rights shall not be taken as bankruptcy properties. Such security rights include mortgage, possessory lien and pledge under the *Law on Real Rights of 2007* as well as maritime lien defined in Art.22 and possessory lien defined in para.2 of Art.25 of the *Maritime Code*.

If the specific property mentioned above is a ship, para.1 of Art.25 of the *Maritime Code* provides: "A maritime lien shall have priority over a possessory lien, and a possessory lien shall have priority over ship mortgage." Para.2 of this Article limits possessory lien to that of a shipbuilder or ship repairer.[9] Thus,

[9] Art.22 of the *Maritime Code* provides: "The following maritime claims shall be entitled to maritime liens: (1) Payment claims for wages, other remuneration, crew repatriation and social insurance costs made by the Master, crew members and other members of the complement in accordance with the relevant labour laws, administrative rules and regulations or labour

the proceeds of enforced sale by auction of a ship shall, after deduction of legal costs for preserving and selling the ship, distribution of the proceeds of sale and other expenses incurred for the common interests of the claimants, be used to compensate for the claims secured by maritime lien, possessory lien and ship mortgage in such an order.[10] The surplus, if any, shall be taken as bankruptcy property.

In non-maritime area, a possessory lien shall have priority over a registered mortgage and a pledge as provided for in Art.239 of the *Law on Real Rights*, and a registered mortgage shall have priority over a pledge as provided for Art.79 of the *Interpretations on Certain Issues Concerning the Application of the Guarantee Law of the People's Republic of China* promulgated by the Supreme People's Court in 2000. If there is any surplus in the proceeds of sale of the property after deduction of legal costs for preserving and selling the property, distribution of the proceeds of sale and other expenses incurred for the common interests of the claimants, and compensation for the claims secured by possessory lien, registered mortgage and pledge, the surplus shall be taken as bankruptcy property.

2. Bankruptcy properties

The bankruptcy properties mean the properties of the bankrupted enterprise after the bankruptcy court has declared bankruptcy. As provided for in Art.113 of the *Enterprise Bankruptcy Law*, these properties shall, after the expenses for bankruptcy proceedings are defrayed and the debts incurred for the common good of creditors are repaid first, be used to compensate for the registered claims among the bankruptcy creditors in the following order,: -

(a) the wages, subsidies for medical treatment, injuries and

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contracts; (2) Claims in respect of loss of life or personal injury occurred in the operation of the ship; (3) Payment claims for ship's tonnage dues, pilotage dues, harbour dues and other port charges; (4) Payment claims for salvage payment; (5) Compensation claims for loss of or damage to property resulting from tortious act in the course of the operation of the ship. Compensation claims for oil pollution damage caused by a ship carrying more than 2,000 tons of oil in bulk as cargo that has a valid certificate attesting that the ship has oil pollution liability insurance coverage or other appropriate financial security is not within the scope of sub-paragraph (5) of the preceding paragraph." Para.2 of Art.25 provides: "The possessory lien referred to in the preceding paragraph means the right of the ship builder or repairer to secure the building or repairing cost of the ship by means of detaining the ship in his possession when the other party to the contract fails in the performance thereof. The possessory lien shall be extinguished when the ship builder or repairer no longer possesses the ship he has built or repaired."

[10] Art.24 of the *Maritime Code* provides: "The legal costs for enforcing the maritime liens, the expenses for preserving and selling the ship, the expenses for distribution of the proceeds of sale and other expenses incurred for the common interests of the claimants, shall be deducted and paid first from the proceeds of the auction sale of the ship."

disability and the pensions for the disabled and the families of the deceased which the bankrupted enterprise owes, the basic old-age insurance premiums and the basic medical insurance premiums which it owes and fails to enter in the employees' personal accounts, and the compensations which should be paid to the employees as prescribed in the relevant laws and administrative regulations;

(b) the social insurance premiums which the bankrupted enterprise fails to pay, other than the ones which are specified in the preceding subparagraph, and the taxes which the bankrupt fails to pay; and

(c) the common bankruptcy claims.

Where the bankruptcy property is not sufficient to satisfy the repayment for the claims of the same order, it shall be distributed on a *pro rata* basis.

The expenses for bankruptcy proceedings are defined in Art.41 of the *Enterprise Bankruptcy Law* as the expenses that are incurred after the bankruptcy court has entertained an application for bankruptcy and includes: (a) litigation cost involved in a bankruptcy case; (b) expenses for maintenance, realization and distribution of the debtor's properties; and (c) expenses involved in the administrator's performance of his duties and paid for his remuneration and expenses for the employees recruited. As provided for in Art.42 of the Law, the following debts incurred after the bankruptcy court has entertained an application for bankruptcy are taken as the debts incurred for the common good of creditors: (a) debts incurred because the administrator or debtor requested the other party to fulfill a contract that both parties had failed to fulfill; (b) debts to the debtor through spontaneous agency on the debtor's property; (c) debts incurred as a result of the debtor's unjust enrichment; (d) remunerations for work and social insurance premiums payable for sustaining the debtor's business operations, and other debts arising therefrom; (e) debts incurred by the administrator or an employee who causes losses to another person in the course of performing his duties; and (f) debts incurred due to losses to another person caused by the debtor's property.

Art.43 of the *Enterprise Bankruptcy Law* further provides that the expenses for bankruptcy proceedings and the debts incurred for the common good of creditors shall be paid off with the debtor's property at any time. Where the debtor's property is not enough for paying off all such expenses and debts, such expenses shall be paid off first. Where the debtor's property is not enough for paying off all such expenses or debts, payment shall be made on a *pro rata* basis. Where the debtor's property is not enough for paying off such expenses, the administrator shall request the bankruptcy court to end the bankruptcy procedures.

E. Rehabilitation

As mentioned in 3.1 *supra*, rehabilitation is for the purpose of getting an insolvent enterprise out of bankruptcy. In practice, normally most of the creditors can only get compensation in bankruptcy liquidation in a much lower amount as compared with their claim amount. However, successful rehabilitation creates an opportunity for the creditors to get more or even full compensation in the future. Thus, rehabilitation is beneficial not only to the debtor, but also to the creditors. This is why the Chinese courts always try their best to rehabilitate the insolvent enterprises in the bankruptcy procedures.

Chapter VIII "Rehabilitation" of the *Enterprise Bankruptcy Law* contains detailed provisions on rehabilitation of an insolvent enterprise.

1. Application and period of period of rehabilitation

By virtue of Section 1 "Application for and Period of Rehabilitation" of Chapter VIII of the *Enterprise Bankruptcy Law*, the insolvent enterprise or a creditor may directly submit an application for rehabilitation to the court with jurisdiction over bankruptcy. Where a creditor has applied to the court for bankruptcy liquidation, after the court has entertained the application but before it declared the debtor's bankruptcy, the debtor or an investor may submit such an application as described in 3.1.2 *supra.*

Where upon examination, the court deems that the application for rehabilitation conforms to the provisions of para.2 of Art.2 of the Law as described in 3.1.1 *supra*, it shall make an award to the effect that the debtor should undergo rehabilitation and shall make a public announcement. The period of rehabilitation shall commence from the date when the court makes the award to the date when the procedures for rehabilitation are terminated.

During the period of rehabilitation, upon the debtor's application and approval by the court, the debtor may manage its property and operate its business by its own under the supervision of the administrator. For the purpose of continued business operation of the debtor, the exercise of a security right over specific property of the debtor shall be suspended. However, in the case of possible damage to the secured property or apparent depreciation of value thereof which is sufficient to impair the creditor's security right, the creditor may apply with the court for resuming the exercise of his security right. During this period, the capital investors of a debtor cannot request for distribution of profits derived from his investment, and the directors, supervisors or senior managers of a debtor cannot transfer to a third party the equity of the debtor he holds unless with the consent of the court.

During the period of rehabilitation, the court shall, upon request by the administrator or an interested party, make an award to terminate the rehabilitation procedures and declare the debtor's bankruptcy under one of the following circumstances: (a) where the business operation and financial position of the debtor continues to deteriorate and there is no hope of retrieval; (b) where the debtor indulges in fraud or maliciously decreases its properties, or commits any other act which is obviously disadvantageous to the creditors; or (c) where the administrator is unable to perform its duties due to the debtor 's act.

2. Submission of rehabilitation plan and approval

By virtue of Section 2 "Formulation of and Approval for Rehabilitation Plan" of Chapter VIII of the *Enterprise Bankruptcy Law*, the debtor or the administrator shall, within six months from the date when the court made the award for rehabilitation, submit a draft plan for rehabilitation to the court and to the creditors' meeting.[11] The court may make an award to extend this period for three months on justifiable grounds upon request of the debtor or the administrator. Where the debtor or the administrator fails to submit a draft plan for rehabilitation on schedule, the court shall make an award to terminate rehabilitation procedures and declare the debtor's bankruptcy.

The court shall, within 30 days from the date when it receives a draft plan for rehabilitation, convene a creditors' meeting for a vote on the draft. If the plan for rehabilitation is adopted in the creditors' meeting,[12] the debtor or administrator shall, within 10 days from the date of adoption, apply with the court for approval of the plan. Where upon examination, the court deems that the application complies with the provisions of the *Enterprise Bankruptcy Law*, it shall, within 30 days from the date when it receives the application, grant approval, terminate the rehabilitation procedures and make public announcement. Noticeably, where the draft plan is not adopted in the creditors' meeting even by the second vote or the creditors refuse to take the second vote, the debtor or administrator may apply with the court for approval of the draft plan. The court may approve the draft plan under the circumstances provided

[11] Art.81 of the *Enterprise Bankruptcy Law* provides that the draft plan for rehabilitation shall contain the following items: (a) the debtor's plan for business operations; (b) classification of the creditors' claims; (c) the plan for the adjustment of the claims; (d) the plan for payment of the claims; (e) the period of time for implementing the rehabilitation plan; (f) the period of time for supervising the implementation of the rehabilitation plan; and (g) other plans conducive to the debtor's rehabilitation.

[12] Adoption is subject to the consent of more than half of the creditors who are present at the meeting and have the right to vote and whose credits' amounts represent two-thirds or more of the total amount of credits.

for in para.2 of Art.87 of the Law. The rehabilitation plan approved by the court shall have a binding force on the debtor and all the creditors.

In practice, rehabilitation is normally in one or more of the following forms: (a) the structure of the debtor's shares remains unchanged and the debtor continues to operate; (b) change credits into shares, i.e. some of the original investors' shares are transferred to the creditors without payment or at low price and consequently the structure of the debtor's shares are adjusted; (c) introducing strategic investors whose investment in the debtor's enterprise shall be fully or partly used to pay off the debtor's debts; (d) selling properties and/or shares to acquire cash flow and to divest the business with poor profit prospects and weak competitiveness and retain the profitable and competitive businesses; (e) the original shareholders' raising of funds to repay debts and the debtor's equity is adjusted accordingly; (f) acquitting of part of the debts by the creditors.

Where the draft plan for rehabilitation is not adopted in the creditors' meeting and is not approved by the court according to the provisions of para.2 of Art.87 of the *Enterprise Bankruptcy Law*, or the adopted draft plan is not approved by the court, the court shall make an award to terminate the rehabilitation procedures and declare the debtor's bankruptcy.

3. Implementation of rehabilitation plan

Implementation of rehabilitation plan is provided for in Section 3 "Implementation of rehabilitation plan" of Chapter VIII of the *Enterprise Bankruptcy Law*.

A rehabilitation plan shall be implemented by the debtor. The implementation shall be under the supervision of the administrator within the period for supervision as specified in the plan. After the court approves a rehabilitation plan, the administrator that has taken over the management of the debtor's property and the debtor's business operations shall hand over the property and business operations to the debtor.

Where a debtor cannot or fails to implement a rehabilitation plan, the court shall, upon request of the administrator or an interested party, terminate the implementation of the plan and declare the debtor's bankruptcy. After termination of the implementation of a rehabilitation plan, the commitments made by the creditors on adjustment of the claims in the plan shall be invalidated. However, the repayment received by the creditors due to implementation of the plan shall remain effective, and the part of the claims for which no repayment has been paid shall be taken as bankruptcy credits.

F. Reconciliation and settlement

Chapter IX of the *Enterprise Bankruptcy Law* contains of provisions concerning reconciliation by the bankruptcy court and settlement between the

debtor and the creditors.

1. Reconciliation

A debtor may apply with the court with jurisdiction for reconciliation either before or after the court entertains an application for bankruptcy and declares its bankruptcy. To apply for reconciliation, the debtor shall present a draft of reconciliation agreement. Where upon examination, the court deems that the application for reconciliation conforms to the provisions of this Law, it shall make an award to conduct reconciliation, make public announcement and hold a creditors' meeting to discuss the draft of reconciliation agreement.

Where a reconciliation agreement is adopted in the creditors' meeting,[13] it shall be subject to the confirmation of the court. If it is confirmed by the court, the court will terminate the reconciliation procedures and make public announcement. Then, the administrator, if appointed by the court, shall hand over the debtor's properties and business operations to the debtor and submit to the court a report on the performance of its duties. The debtor shall pay off its debts as provided for in the reconciliation agreement. Where a debtor is unable or fails to implement the reconciliation agreement, the court shall, upon request by the creditor(s) involved in the reconciliation, terminate the implementation of the reconciliation agreement and declare the debtor's bankruptcy. Like the case of rehabilitation, if implementation of the reconciliation agreement is thus terminated, the commitments on adjustment of the claims made by the creditors involved in the reconciliation agreement shall be invalidated, but the repayment received by the said creditors due to the implementation of the reconciliation agreement shall remain effective and the part of the claims involved in the reconciliation that has not been paid shall be the bankruptcy claims.

Where the draft of reconciliation agreement is not adopted at the creditors' meeting, or though adopted, is not confirmed by the court, the court shall terminate the reconciliation procedures and declare the debtor's bankruptcy.

Noticeably, reconciliation is an alternative to rehabilitation. That is, where an application for reconciliation has been filed, the debtor or the creditors cannot apply for rehabilitation. Where an application for rehabilitation has been filed, the debtor cannot apply for reconciliation. Therefore, the debtor should be cautious in making choice between reconciliation and rehabilitation. Especially, the debtor shall keep in mind that, as compared with the situation of rehabilitation, the court will or may be less involved in reconciliation and thus reconciliation agreement is more difficult to be reached.

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[13] Art.97 of the *Enterprise Bankruptcy Law* provides: "A resolution on a reconciliation agreement shall be adopted at the creditors' meeting with the consent of more than half of the creditors who are present at the meeting, have the right to vote and represent two-thirds or more of the total amount of unsecured claims."

2. Settlement

As provided for in Art.105 of the *Enterprise Bankruptcy Law*, if after the court has entertained an application for bankruptcy, the debtor and all the creditors themselves reach an agreement on settlement of the credits and debts, they may request the court to confirm the agreement. If it is confirmed, the court will terminate the bankruptcy procedures and make public announcement. Therefore, this provision implies that the Law honors the fundamental principle of freedom of contract.

Noticeably, if a settlement agreement is not implemented or only partly implemented, the creditors cannot apply to the court to resume the bankruptcy procedures, but shall re-file an application for bankruptcy.

G. Cross-border insolvency

So far, China has not adopted any international treaties with respect to cross-border insolvency. Therefore, the recognition and enforcement of cross-border insolvency proceedings shall be governed by the *Enterprise Bankruptcy Law*. The only statutory provision on cross-border insolvency is Art.5 of the Law which provides: -

> *"Once the procedures for bankruptcy are initiated according to this Law, it shall come into effect in respect of the debtor's property outside of the territory of the People's Republic of China.*
> *Where a legally effective judgment or ruling made on a bankruptcy case by a court of another country involves the debtor's property within the territory of the People's Republic of China and the people's court is applied with or requested to recognize and enforce it, the people's court shall, according to the relevant international treaties that China has concluded or acceded to or on the basis of the principle of reciprocity, conduct examination thereof and, when believing that the said judgment or ruling does not violate the basic principles of the laws of the People's Republic of China, jeopardize the sovereignty and security of the State or public interests, nor undermine the legitimate rights and interests of the creditors within the territory of the People's Republic of China, decide to recognize and enforce it."*

Therefore, the *Enterprise Bankruptcy Law* has adopted the concept of absolute universalism in the case bankruptcy procedures are initiated in the territory of China. As for application with a Chinese court for recognition or enforcement of foreign insolvency procedures, the Law has adopted the principle of reciprocity in the absence of multilateral or bilateral treaty.

IV. China's attitude towards the UNCITRAL Model Law on Cross-Border Insolvency[14]

The Model Law was adopted on 30 May 1997 at the 30th Session of the United Nations Commission on International Trade Law (UNCITRAL). The Model Law is designed to assist the countries to equip their insolvency law with a modern, harmonized and fair framework to address more effectively instances of cross-border proceedings concerning various industries.[15] Till 19 November 2018, 44 countries[16] have adopted the Model Law.

China has not adopted the Model Law yet. However, there have been a lot of discussions and arguments in the academic and industrial circle as to whether China should adopt the Model Law. Especially, the consideration in this aspect is triggered by the impact of the Hanjin Shipping bankruptcy case.

From the perspective of the shipping industry[17], policy considerations need be taken in determining whether and when China shall adopt the Model Law based upon balance between the advantages and disadvantages which China's adoption of the Model Law will potentially bring out.

A. Main views on the adoption of Model Law in the academic circle and the shipping industry

1. Views in the academic circle

In the academic circle, there are two main views about China's attitude towards the Model Law.

One view is supporting China's adoption of the Model Law on various reasons. One reason is that the Model Law provides a framework for

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[14] The views expressed in this regard in this paper are of the authors' own, but does not represent any organization or persons, unless otherwise indicated.

[15] General speaking, the Model Law does apply to any proceeding that meets the requirements of Art.2, subpara. (a). Nevertheless, subject to Art.1, para.2 of the Model Law provides: "This Law does not apply to a proceeding concerning [designate any types of entities, such as banks or insurance companies, that are subject to a special insolvency regime in this State and that this State wishes to exclude from this Law]", Banks or Insurance companies are mentioned as examples of entitles that the enacting State might decide to exclude from the scope of the Model Law. Then, the insolvency of bank or insurance companies are administered in many States under a special regulatory regime. So, the cross-border proceedings concerning bank or insurance industry are excluded from the application of the Model Law.

[16] UNCITRAL, 'Status' </www.uncitral.org/uncitral/zh/uncitral_texts/insolvency/1997Model_status.html> accessed 19 November 2018.

[17] The shipping industry is the first batch of open industries for China's accession to WTO. The *pros* and *cons* of China's adoption of the Model Law are evaluated from the perspective of the shipping industry which has strong representativeness.

cooperation between jurisdictions, offering solutions that help in several modest but significant ways to facilitate and promote a uniform approach to cross-border insolvency.[18] Another reason is that China's adoption of the Model Law, if any, will be not only conducive to showing the image of a great power, but also to the implementation of the going-out strategies, although the Model Law is not perfect and has some deficiencies. There is also an opinion that the Chinese courts should take the positive attitude of friendly cooperation in consideration of the economic integration of the world's economy and the realistic conditions of China's economic development, adhere to the basic principle of universalism. Furthermore, China shall fully realize the necessity of international cooperation in cross-border insolvency and define the obligation and responsibility of China as a great power to participate in the construction of cross-border insolvency rules which balance the international cooperation in cross-border insolvency and protect the interests of domestic creditors, and promote the full cooperation between China and the international community in the field of cross-border insolvency without violating the public policy.[19] Another opinion is that China's adoption of the Model Law would produce a great deal of economic benefits to China along with the development of China in global market. Moreover, the disadvantages of adopting the Model Law do not make it to a dead end because they are the problems that Chinese bankruptcy practitioners, legislators and judges are working on.[20] It is clear that persons who support China's adoption of the Model law based their views on micro and even political reasons instead of detailed analysis of the *pros* and *cons* which China's adoption of the Model Law will or may potentially bring out to the China's overall economic interests.

Another main view is that China should take a cautious attitude towards the Model Law on the ground that the contents of the Model Law are too complicated and the innovative procedures contained therein need to be tested in practice in China. For this reason, China shall maintain a proactive and prudent attitude when considering adoption of the Model Law or not. That is, China shall not adopt the Model Law at present stage. There is an opinion that China should take a cautious attitude when considering adoption the Model Law or not before the domestic cross-border insolvency legal regime is improved, and China should improve the cross-border insolvency legal regime in its *Enterprise Bankruptcy Law* by reference to the advanced contents of the Modal Law. Such improvement is not only an important revelation of the

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[18] *See* Guide to Enactment and Interpretation of the UNCITRAL Model Law on Cross-Border Insolvency, Art.3 thereof.

[19] Zhang Kexin, "The Recognition and Relief regime of foreign bankruptcy procedure in China - A consideration from Hanjin Shipping bankruptcy", The People's Judicature 2017, p.25.

[20] Wang Xinye, "Should China Adopt the UNCITRAL Model Law on Cross-Border Insolvency", Peking University Graduation Thesis, 2012, p70.

Hanjin Shipping bankruptcy case, but also a fundamental task for China to respond to the fundamental needs of the economic development, and will provide a clear basis and guide for the judicial practice of the Chinese courts and the reasonable expectations of the international community.[21] Similarly, another opinion is that, while China should not adopt the Model Law at present stage, those reasonable, mature and advanced procedural rules contained therein should be referred to when the *Enterprise Bankruptcy Law* is revised, because the provisions on cross-border insolvency in it are very simple and thus difficult to apply in judicial practice. In particular, the provisions are insufficient to deal with such legal issues of cross-border insolvency as jurisdiction, application of law, recognition of foreign insolvency proceedings and relief, international cooperation, etc. The present situation of the *Enterprise Bankruptcy Law* has brought some problems to the courts in entertaining and hearing the cases of cross-border insolvency cases. Under the background that the cross-border insolvency legal regime contained in the *Enterprise Bankruptcy Law* need be improved, there is an opinion that the Model Law contained many reasonable, mature and advance provisions regarding, e.g. the center of the debtor's main interest (COMI), access of foreign representatives and creditors to the courts, recognition of a foreign proceeding and relief, international cooperation and concurrent proceedings.[22] China shall make reference to the advanced contents of the Modal Law and build the domestic legal regime of cross-border insolvency which conforms to the China's reality and is in line with the world.[23]

2. Attitude of the shipping industry

The attitudes of the industries are important and are interests-oriented as to whether China shall adopt the Model Law. The provisions of the Model Law in relation to the cross-border insolvency procedures are rather different from the ship arrest procedures under the *Maritime Procedure Law*. The *Maritime Procedure Law* and the statutory provisions on cross-border insolvency, while both having an international origin, employ different concepts and have different principles. The question is, in a case of cross-border insolvency of a shipping company, whether the clash between the Maritime Procedure Law and the statutory provisions on cross-border insolvency at the interface of these conflicting principles shall be considered. That is, the principles of Maritime

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[21] Shi Jingxia, Huang Yuanyuan, "The Recognition and Relief in Cross-border Insolvency - A Perspective from Hanjin Shipping Company", Journal of Renmin University of China, 2017, p.44.

[22] Yang Li, "Research on Cross-border Insolvency Legal System", Jinlin University Ph.D Thesis, 2012, p.3.

[23] Zheng Weiwei, "China's Strategic Choice in Dealing with Cross-border Insolvency Law Issues", (2012) Contemporary Law Review, 2012, p.126.

Procedure Law shall prevail or how these colliding principles shall be harmonized.[24] Nevertheless, the Model Law has no substantive mention of the issues raised by the cross-border insolvency procedures.[25] The shipping industry in China as a whole does not support the adoption of the Model Law because the industry's interests may be adversely affected by the Model Law. A particular example is the Chinese shipping creditor's interests in the case of the Hanjin shipping bankruptcy.

It is reported that 16 cases involving the Hanjin Shipping bankruptcy have been handled by the Chinese courts.[26] As China has not adopted the Model Law, some Chinese creditors could apply to the Chinese court to arrest the Hanjin Shipping vessels, or to preserve other property of Hanjin Shipping in China. Moreover, it is understood that the rate of compensation for the registered claims can be no more than 5% in the Korean court. Obviously, such compensation for the creditors' losses is only symbolic.

Noticeably, at the present stage China implements the economic system with the state-owned economy as the main body. In fact, these enterprises are the most important part of the state-owned economy and play the leading role in the overall economic development in China. The state-owned shipping enterprises account for more than 80% of its shipping market share in China. The large state-owned shipping enterprises are China COSCO Shipping Group and China Merchants Energy Shipping Co., Ltd. Due to the China's specific historical background and the state-owned economy system, it cannot be imagined that a large state-owned shipping enterprise may go bankrupt. As a result, there is no realistic demand in China at least at the present stage for adopting the Model Law to protect the Chinese state-owned enterprises. Moreover, once the Model Law is adopted, China shall be obliged to protect the bankruptcy of foreign shipping enterprises, while its domestic shipping enterprises may have no chance to enjoy the benefits of the Model Law, which is not in line with the interests of shipping industry in China. That is, China shall not adopt the Model Law based on the Chinese economic background.

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[24] Julie Soars, "Cross-border insolvency and shipping- a practice guide" <www.comitemaritime.org/Uploads/Work%20In%20Progress/Cross-Border%20Insolvency/CBI%20and%20Shipping%20paper%2011-4-16.pdf> accessed 19 July 2018.

[25] The Model Law refers to *in rem* rights only in Art.32 which excludes those rights from the prohibition on claiming in concurrent proceeding. This Article provides: "Without prejudice to secured claims or rights in rem, a creditor who has received part payment in respect of its claim in a proceeding pursuant to a law relating to insolvency in a foreign State may not receive a payment for the same claim in a proceeding under [identify laws of the enacting State relating to insolvency] regarding the same debtor, so long as the payment to the other creditors of the same class is proportionately less than the payment the creditor has already received."

[26] "Shanghai Maritime Court concluded all cases involving the Hanjin Shipping bankruptcy", *see* < http://media.china.com.cn/gdxw/2017-02-21/982394.html> accessed 19 July 2018.

B. Policy considerations in determining whether and when China shall adopt the Model Law

As policy considerations in the authors' view, the precondition for China to adopt the Model Law is the adoption will be beneficial to the China's overall economic interests. For this purpose, the factors to be considered shall include whether the contents of the Model Law themselves are clear in meaning, reasonable, mature and advanced, the China's economic system and the status of China's economic development in the international trade pattern, and the general situations of the Chinese law on cross-border insolvency, etc.

China has become an economic power and adoption of the Model Law will involve the different interests of the various industries. Considering the diversified interests of different industries concerned, the Chinese government shall take the national overall economic interests as the value orientation to better weigh the interest demands of various industries. In addition, China implements the economic system with the state-owned economy as the main body, which makes state-owned enterprises as an important part of the state-owned economy playing the leading role in its overall economic development. Especially, the Chinese multinational enterprises with strong competitive powers are mainly state-owned enterprises and the adoption of the Model Law is not beneficial to these enterprises as a whole.

Nevertheless, the Chinese government cannot only consider the impact on the state-owned enterprises with strong competitive powers, but also the impact on the private small and medium-sized enterprises with weak competitive powers. Among the various industries and different types of enterprises in China, adopting the Model Law may be disadvantageous the state-owned enterprises, but advantageous to the private enterprises. The shipping industry is one of the most open industries in China since the reform and opening-up. For this reason, the attitudes of the shipping industry and other foreign-related industries are rather important when the Chinese government determines whether and when China shall adopt the Model Law. Moreover, the Chinese government shall take the strong foreign-related industries as the starting point and consider the various related factors, correctly weigh the *pros* and *cons* of adoption of the Model Law with respect to the state-owned enterprises and the private enterprises.

C. General comments on the Model Law

The following are the authors' general comments on the Model Law from the perspective of the *pros* and *cons* which China's adoption of the Model Law will or may potentially bring out.

1. Advantages of China's adoption of the Model Law

With the development of international trade and investment, it is necessary to improve the legal regime of cross-border insolvency in China. This legal regime should be beneficial to promote the healthy development of overall national interests. Therefore, it shall be not only conductive to strengthen and coordinate international cooperation, but also to provide a safeguard mechanism for domestic enterprises to go out if China adopts the Model Law.

First, China's adoption of the Model Law will conform to the trend of world economic integration. Under the trend of world economic integration, improving the legal regime of cross-border insolvency in China will be conductive to reduce the influence of cross-border insolvency territorialism for the foreign investment in China and conductive to domestic enterprises to invest abroad. The International Monetary Fund (IMF) and the World Bank have tended to attach great importance to cross-border insolvency in the process of financing and loaning. The Model Law as a crystallization of UNCITRAL legislative research is greatly advocated by IMF and the World Bank.

Secondly, China's adoption of the Model Law will be conductive to improve the legal regime of cross-border insolvency. As aforementioned, Art.5 of the *Enterprise Bankruptcy Law* lacks specific procedures and ways of relief. As a result, foreign companies are more difficult to enjoy the principle of most-favored-nation treatment in cross-border maritime insolvency cases in China. If China adopts the Model Law, it will provide harmonization of concurrent proceedings to ensure that the enacting States safeguard its interests and respect the effectiveness of its public policy and specific regimes if necessary. For this reason, The Modal Law can provide an important basis for the Chinese courts to deal with cross-border maritime insolvency cases and play a role in making up the *Enterprise Bankruptcy Law*.

Thirdly, China's adoption of the Model Law will be conductive to protect the interests of domestic bankrupt enterprises. The Model Law aims at unifying the insolvency proceedings to enable more creditors to be fairly compensated and avoiding multiple procedures of individual liquidations, which may effectively facilitate the handling of cross-border maritime insolvency cases and protect the interests of bankruptcy enterprises. Noticeably, affected by the financial crisis, the world economy is in a prolonged period of recession at present stage, which makes cross-border maritime insolvency issues more serious. If China adopts the Model Law, the small or medium-sized bankrupt enterprises can enjoy the protection of the Model Law.

2. Disadvantages of China's adoption of the Model Law

The authors agree to the comment of the shipping industry in China that the industry's interests may be adversely affected by the Model Law in the

following two aspects: -

First, China's adoption of the Model Law will be unfavorable to China's overall economic interests.

The Model Law adjusts the issue of harmonization of interests of foreign creditors and other interested parties associated with insolvency with respect to the domestic court proceedings or ongoing insolvency proceedings. That is, creditors of the enacting state should claim for compensation in debtor's state via the registration of credits and other procedures in accordance with the provisions of the bankruptcy law of that State. The enacting States shall terminate the creditor's right to assign, pledge or otherwise dispose of any assets of the bankrupt debtor, cease personal litigation or proceedings involving the assets, rights, debts or liabilities of the bankrupt debtor, and cease all actions against all assets of the bankrupt debtor. Thus, the Model Law guarantees that insolvency proceedings of the domestic court of bankrupt enterprise can be recognized by the courts of other enacting States, which maximizes the protection of the interests of a bankrupt enterprise. Meanwhile, the debtors of a bankrupt enterprise are prohibited from taking property preservation measures in the courts of the State of the bankrupt enterprise and other enacting States, and creditor's right can be realized only by the way of registration of credits. Nevertheless, it is certain that the assets of the bankrupt enterprise cannot make up its debts. As a result, the final compensation for the registered creditors' claims may be symbolic as in the Hanjing Shipping case, which is detrimental to their interests.

It is important to note that, from the perspective of protecting bankrupt enterprises, China's adoption of the Model Law will bring limited benefits to its enterprises. This is because that China implements the economic system with the state-ownership as the main body. The state-ownership is the embodiment of the superiority of socialism and can realize the fundamental goal of liberating productive force, promoting common prosperity and provides the possibility for the steady development of its overall economy. It proves that after the financial crisis the Chinese government could effectively play the institutional advantages, representing its overall economic interests to achieve coordinated arrangement and reasonable deployment when the domestic market encountered the global financial crisis.[27] Meanwhile, its enterprises strive to maintain a stable operation and develop with related enterprises, thus sharing difficulties and avoiding bankruptcy under the guidance of its government's macro-control.[28] Accordingly, based on the superiority of the state-ownership,

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[27] Li Xiangyang, He Xiaoqiang, Li Qingqing, "The Superiority of the Socialist System in the view of Financial Crisis", Journal of the Party University of Shijiazhuang City Committee of CPC, 2010, Vo.12, pp.20-21.

[28] Guo Baoxing, "The Superiority of the Socialism System with Chinese Characteristics--From

the Chinese government is usually able to direct the Chinese multinational enterprises that have suffered bad financial situation because of global financial crisis, help them to adjust the management structure, stabilize their development, and guarantee the steady development of China's market economy. The developed countries implement the economic system with capitalist private ownership as the main body. The development of the whole society may be more or less in the state of lack of strong governmental guidance.[29] Therefore, when capitalists or capitalist groups blindly pursue profits and generate cyclical financial crises, it may often be difficult for the whole society to withstand the financial crisis collectively. As a result, it may occur that an enterprise in the financial crisis becomes difficult to retreat and avoid bankruptcy.

The Chinese government has the ability of macro-control and intensity and exerts guiding role for the stated-owned enterprises, which will safeguard China's overall economic interests and ensure the national political, economic and national defense security, etc.[30] In addition, due to China's specific historical background and the state-owned economy system, the government is or may be able to provide certain economic assistance to the state-owned enterprises that are in financial distress and unable to withstand the financial crisis by themselves, so that the state-owned enterprises, especially the large ones can maintain normal operation to avoid bankruptcy. Moreover, the state-owned enterprises normally carry out large-scale and specialized operations which may enhance their ability to resist risks and international competitive power by the business model of mergers and acquisitions. A typical example of merger in the shipping industry is the merger of COSCO and China Shipping and the merger of SINOTRANS & CSC and China Merchants Group. Obviously, the bankruptcy of large state-owned enterprises, if any, may cause social problems such as social stability, basic social order, social unemployment rate and complicated contradictions of interests. Thus, China's adoption of the Model Law lacks a realistic basis for protecting the large state-owned enterprises. Most of non-state-owned enterprises in China are small or medium-sized with limited operation capacity. Their business scope is rarely cross-border. In the shipping industry, the business scope of non-state-owned liner enterprises is basically limited to the domestic liner shipping. Once a non-state-owned small or medium sized company goes bankrupt, it rarely cause a cross-border insolvency involving many creditors and it may rely on the *Enterprises*

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the perspective of China's response to the Financial Crisis in 2008", Social Scientist, 2012, p.33.

[29] Li Zezhong, "On the superiority of Socialist Public ownership", Jiangxi Social Sciences, 1982, p.2.

[30] Zong Han, "How to Recognize the Position and Function of State-Owned Enterprises Correctly -- Discussing with Yuan Zhigang and Shao Ting", Academic Monthly, 2012, Vol.42, p.76.

Bankruptcy Law to achieve legal remedies.

From the perspective of successful experience of Chinese state-owned enterprises' bankruptcy rehabilitations, it can prove that China's adoption of the Model Law is not conductive, at least not much conductive, to the revival of a state-owned enterprise in the bankruptcy rehabilitation. The case of bankruptcy rehabilitation of Nanjing Tanker Corporation (hereinafter referred to as "NTC") under China Changjiang National Shipping Group Co., Ltd. is quite typical. Based on strategic energy transportation security and the demand for the development of domestic shipping industry, the Chinese government made a national policy in the 1980's to encourage the goods in foreign trade to be transported by its domestic merchant ships. China Changjiang National Shipping Group Co., Ltd.[31] has been one of the large state-owned shipping enterprises. Encouraged by such a policy, NTC became one of the three major tanker shipowners in China, which not only undertook the mission of safeguarding the national energy transportation security, but also brought the possibility for its development to become an international big tanker enterprise under the guidance of the policy. However, due to the recession of international shipping market, NTC suffered losses for 3 continuous years since 2010 and its operation was in financial trouble. In June 2014, NTC was suspended to be a listing company and became the first domestic delisting state-owned enterprise. In 10 July 2014, Tianjin Huifeng Energy Co., Ltd. as a creditor filed a bankruptcy rehabilitation application with Nanjing Intermediate People's Court. After all, in order to avoid bankruptcy of NTC to cause loss of state-owned assets and social instability, the Court made award to allow NTC's rehabilitation under the guidance of the State-owned Asset Supervision and Administration Commission of the State Council (SASAC) in 22 July 2014. In December 2014, the bankruptcy rehabilitation of NTC was successful. NTC was profitable from 2015 to 2017.

As compared with the fate of NTC, Hanjin Shipping's bankruptcy liquidation failed it and went bankrupt. Hanjin Shipping and NTC were both seriously affected by the financial crisis, but the fate of NTC is much better mainly due to the following reasons: -

The first reason is the support of governmental policy. General speaking, the stability of state-owned assets relates to safeguarding China's overall economic interests. SASAC is specialized agency that exercises the function of the owners of state-owned assets on behalf of the State, has the right to manage and guide the state-owned assets of state-owned enterprises in the macro or indirect way, and promote the reform and rehabilitation of enterprises so as to realize the optimal allocation of state-owned assets and the maximization of

[31] China Changjiang National Shipping Group Co., Ltd. is the largest shipping enterprise in China's inland navigation. In 2009, China Changjiang National Shipping Group Co., Ltd. and Sinotrans Group were merged into Sinotrans & CSC Holding Co., Ltd.

management benefit.[32] Therefore, when the business of a state-owned enterprise is in financial distress, SASAC and various local governmental departments may take measures to promote the rehabilitation of the state-owned enterprise by exercising the functions of the representative of the state-owned assets investor to avoid the loss of state-owned assets and the damage to the nation's overall economic interests. For this reason, when the operation of a state-owned enterprise is in trouble causing the state-owned assets in a crisis of loss, SASAC may provide macro-control for the operation of state-owned assets by means of coordination and financing and so on in fulfilling its function of public administration. In the case of NTC, SASAC and the related local governmental departments actively cooperated to deal with NTC's debt crisis.

The second reason is the social trust. The state-owned enterprises are important, material and political basis of socialist market economy and the backbone of safeguarding social stability. If a state-owned enterprise is in financial trouble, peoples usually trust that it will recover or retreat by utilizing the advantages of the state-owned enterprise system with the support of SASAC. That is, the public usually trust that enterprise can withstand risks and tide over the difficulties. Therefore, under the jointly efforts of SASAC, local governmental departments and the related creditors, the bankruptcy rehabilitation plan of NTC was formally adopted by the creditors and approved by the court. It was successfully implemented. One important factor of success is that the main creditors were state-owned commercial banks which were willing to help NTC to get out of trouble by way of their agreement to make their partial credits into the shares of NTC under the policy support and guidance of SASAC.

In the case of Hanjin Shipping bankruptcy, Korea implements the economic system with private ownership as the main body which may lack the advantages of the state-owned enterprise system. That is, the development of Hanjin Shipping more directly depended on the shipping market. This may prove that once a financial crisis occurs in the global market, a private enterprise is more difficult to enjoy the strong support of the government and thus is prone to bankruptcy. Meanwhile, because of the different interests of creditors of various enacting States, it may be difficult to reconcile the interests of creditors in the bankruptcy rehabilitation plan and may thus fail to reach a consensus.

The Chinese law has the mission to protect the nation's overall economic interests. If China adopts the Model Law, the Chinese creditors cannot apply to the Chinese courts for the preservation of the property of a foreign enterprise and their claims can be compensated only by the way of registration of credits

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[32] Wang Quanxing, Fu Lei, Xu Chengyun, "A qualitative discussion of the legal relationship between SASAC and state-owned operation subjects", Studies in Law and Business, 2003, p.33.

in the foreign bankruptcy court like the case of Hanjin Shipping, which will be detrimental to the Chinese creditors' interests and be unfavorable to China's overall economic interests.

Secondly, China's adoption of the Model Law may cause conflict with the domestic law.

In the traditional judicial practice in China, the principle of reciprocity shall be applicable only where there is precedent that the court or courts of a foreign country has recognized or enforced judgment or judgements of the Chinese courts. The Model Law aims to solve is the recognition and assistance of foreign insolvency proceeding. As required by the Model Law, the enacting states shall actively recognize and assist the foreign courts in insolvency proceedings to the greatest extent. Although the trend of judicial trial in China may gradually move from passive judicial assistance to active judicial assistance,[33] it is difficult to determine whether and when the trend of active judicial assistance can be achieved. Currently, the extent of recognition and assistance under the Chinese law is quite different from the extent of recognition and assistance under the Model Law. Therefore, if China adopts the Model Law, China will be obliged to change its legal regime of recognition of foreign judgements. Moreover, some regimes contained the Model Law are advanced, while the *Enterprise Bankruptcy Law* is at an immature stage. That is, the *Enterprise Bankruptcy Law* is not compatible with the Model Law to some extent. The Model law allows a State to modify or leave out some of its provisions, but the State is still bound by the Model Law. Based on the above reasons, it seems clear that the adoption of the Model Law as a whole is incompatible with the prevailing *Enterprise Bankruptcy Law.*

V. Conclusions

From all the above analysis, the following conclusions may be drawn: -

(a) There are no special provisions with respect to maritime bankruptcy in Chinese law, and maritime bankruptcy is mainly governed by the *Enterprise Bankruptcy Law* and its judicial interpretations promulgated by the Supreme People's Court;

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[33] To provide effective judicial services and safeguard international credibility in the implementation of the Belt and Road initiative, the Supreme People's Court of the People's Republic of China issued the *Several Opinions Concerning Judicial Services and Safeguards for Construction of Belt and Road* on 7 July 2015. This judicial document indicates the trend of judicial trial in China to gradually move from passive judicial assistance to active judicial assistance.

(b) The legal regime contained in the *Enterprise Bankruptcy Law* and its judicial interpretations which is applicable in maritime bankruptcy govern the issues of application for bankruptcy and entertainment by the bankruptcy court, appointment of administrator by the bankruptcy court, declaration of claims, creditors' meeting, rehabilitation, reconciliation, settlement and bankruptcy liquidation etc.;

(c) The adoption of the UNCITRAL Model Law on Cross-Border Insolvency at present stage may cause more disadvantages than advantages to China's overall economic interests based upon the *pros* and *cons* of China's adoption thereof, especially because of the superiority of socialism and state-owned enterprises system under which the Chinese multinational state-owned enterprises may seldom go bankrupt;

(d) However, the Model Law is a model for international cross-border insolvency law that plays an active role in the international unification of cross-border insolvency laws and consequently, the advanced, reasonable, mature and practicable provisions thereof need be used for reference in the premise of China's reality when the *Enterprise Bankruptcy Law* is revised to modernize the China's legal regime of cross-border insolvency.

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What Lessons Were Learned from the Hanjin Bankruptcy?

*J. J. Kim**

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I. Introduction

On August 31, 2016, Korea Hanjin Shipping Co. Ltd., one of the world's largest ocean shipping line filed for receivership in the Republic of Korea. Over 540,000 containers were put into uncertainty as cargo interests, NVOCCs and trucking companies scrambled to address Hanjin's sudden failure. The West Coast hosts four of the top ten ports in the U.S. accounting for over one third of the Country's container business, handling $2 billion worth of cargo daily. While everyone involved in the transportation industry on the West Coast was effected by Hanjin Shipping's failure, local trucking companies in particular have learned hard earned lessons to secure payment for motor freight.

* Principal Attorney, ACI Law Group PC, 6 Centerpointe Drive, Ste. 630, La Palma, CA 90623
pa@acilawgroup.com

II. Events Leading Up to Hanjin Shipping Bankruptcy

Prior to filing for receivership in the Republic of Korea Hanjin Shipping was the seventh largest ocean shipping company in the world. Hanjin Shipping's bankruptcy was long in the making:

- 2008-2009 - during the Financial Crisis the shipping industry lost $15 billion, Hanjin Shipping alone posted a loss of $1.1 billion in 2009
- 2010 - The Eurozone crisis effects Hanjin Shipping, whose Eurozone revenue was 22.7% of its total revenue at the time; a slowdown in China further erodes Hanjin Shipping revenues
- 2011 - Hanjin Shipping posts a loss of $487 million, by 2015 Hanjin Shipping has accrued over $5 billion in debt
- 2015 - spot rates fall to record lows as the industry struggles with overcapacity, despite overcapacity ship orders increase 100%
- 2016 Spring - shipping contract rates fall to record lows
- April 2016 - Hanjin Shipping gives up management control to its largest creditor Korea Development Bank ("KDB")
- June 2016 - Hanjin Shipping attempts to negotiate lower charter rates
- July 2016 - rumors of Hanjin Shipping missed payments circulate
- August 29, 2016 - KDB rejects Hanjin Shipping's latest restructuring proposal
- August 31, 2016 - Hanjin Shipping files for receivership in the Republic of Korea

As of Hanjin Shipping's receivership filing reportedly $14 billion worth of cargo was in transit on Hanjin Shipping ships. Hanjin Shipping's receivership caused U.S. ports to refuse entry to Hanjin ships, creating havoc for NVOCCs and trucking companies.

III. Truckers Take Immediate Action Against Hanjin Shipping America in the U.S.

On August 31, 2016, several trucking companies filed State Court Actions against Hanjin Shipping's U.S. subsidiary Hanjin Shipping America, LLC in the Los Angeles Superior Court seeking to collect accounts receivables owed for unpaid freight.[1] The civil lawsuits alleged causes of action for breach of contract and common counts for recovery of unpaid freight. These creditors also sought provisional relief against Hanjin America's assets by way of ancillary applications for issuance of right to attach orders and writs of

[1] Inter alia New Connect Logistics, LLC v. Hanjin Shipping America, LLC LASC Case No. BC632475

attachment. On September 2, 2016, Hanjin Shipping filed for Chapter 15 Bankruptcy Relief in the New Jersey Bankruptcy Court.[2] The same day Hanjin Shipping filed a motion for a provisional order for relief. The filings created obstacles for NVOCCs and trucking companies.

Chapter 15 was added to the Bankruptcy Code by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. The purpose of Chapter 15 is to provide effective mechanisms for dealing with insolvency cases involving debtors, assets, claimants, and other parties of interest involving more than one country. In the case of Hanjin Shipping, debtor used Chapter 15 case as ancillary to the receivership proceeding brought in the Republic of Korea. Under Chapter 15, immediately upon the recognition of a foreign main proceeding, the automatic stay and selected other provisions of the Bankruptcy Code take effect within the United States. 11 U.S.C. § 1520.

On September 9, 2016, the Bankruptcy Court granted Hanjin Shipping's motion for provisional relief under Chapter 15 and issued an order for provisional relief thereby automatically staying actions against Hanjin Shipping and its assets in the United States.

IV. Truckers Consider Their Alternatives in the U.S.

West Coast trucking companies in general continued to haul Hanjin related freight and meet their customer's needs. Several options to collect unpaid freight in the U.S. were considered by the trucking companies. The first was asserting a carrier lien against Hanjin Shipping cargo. Because most of the unpaid freight was owed freight for cargo that had already been released, a carrier's possessory lien under California Uniform Commercial Code §§ 7307 and 7308 was not available to collect unpaid freight for previously released cargo.

Although a carrier lien for past unpaid freight may be asserted against cargo in the possession of a carrier under California Civil Code §3051.5, the Truckers had not provided the required notice to Hanjin Shipping or Hanjin Shipping America that would qualify under §3051.5. Neither did the Truckers have any adequate security agreements with Hanjin Shipping or Hanjin America to enable them to assert UCC liens.

The Truckers considered retaining possession of shipping containers or chassis owned by Hanjin Shipping however because of the reach of the automatic stay this option was not seriously considered. Some companies however did dispose of a very small number of abandoned containers when it became apparent that Hanjin Shipping lacked the resources to take possession

[2] In Re: Hanjin Shipping Co., Ltd. Case No. 16-27041 (JKS).

of them. This was done solely to mitigate storage ongoing storage costs.

Trucking companies also considered bringing collection actions against consignees for unpaid freight. The traditional maxim with regard to payment of freight is that 'the carrier must get paid.'[3] There are however exceptions to this maxim, most notably consignees may have an affirmative defense where it can be shown that the carrier looked solely to shipper for payment of freight. For instance the Ninth Circuit has held that a consignee may not be held liable for freight charges incurred under a bill of lading marked "prepaid" where the consignee has already paid its bill to the consignor.[4] In the case of Hanjin Shipping, the trucking companies determined that consignees of cargo for which freight was unpaid may have been able to assert an affirmative defense that the trucking companies looked solely to Hanjin America for payment of freight, relieving consignees of liability. Furthermore, many consignees are established customers so the trucking companies seriously considered the benefit of these ongoing relationships.

Because of concerns regarding the automatic stay, lack of availability of carrier liens, and disruption of customer relationships, some trucking companies opted to seek relief from the Bankruptcy Court to continue the State Court Actions against Hanjin Shipping America.

V. Trucker's Motion for Declaration as to Automatic Stay

On October 3, 2016, Truckers brought a motion for declaratory relief to proceed in the previously filed State Court Actions against Hanjin Shipping America. The Truckers argued that the debts being sued upon in the State Court Actions were debts of Hanjin America in its own right and that Debtor Hanjin Shipping and Hanjin Shipping America are two separate entities. The Truckers relied on case law that a parent corporation's bankruptcy does not extend to its subsidiary, even where the bankruptcy debtor parent corporation is 100% stockholder in a non-bankrupt subsidiary corporation.[5] The Bankruptcy Court acknowledged Truckers' legal argument however it was factually unclear to the Bankruptcy Court whether the debts in question were Hanjin Shipping's or Hanjin Shipping America's. The uncertainty arose because in practice Hanjin Shipping issued bills of lading while Hanjin Shipping America issued delivery orders and directly made payment for motor freight to the Truckers. The Truckers did not have adequate and

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[3] Excel Transportation Services, Inc. vs. CSX Lines, LLC 280 F.2d 617, 619 (S.D. Tex. 2003)

[4] Oak Harbor Freight Lines, Inc. v. Sears Roebuck & Co., 513 F.3d 949, 954-955 (9th Cir. 2008); C.A.R. Transportation Brokerage Co., Inc. v. Darden Restaurants, Inc., 213 F.3d 474, 479 (9th Cir. 2000)

[5] Pers. Designs, Inc. v. Guymar, Inc. 80 B.R. 29, 30 (E.D. Pa. 1987)

comprehensive written transportation agreements with either Hanjin Shipping or Hanjin Shipping America. The Bankruptcy Court denied the Trucker' motion without prejudice to bringing a renewed motion. The Truckers regrouped to consider the cost and expense of filing a renewed motion for relief in Hanjin Shipping's bankruptcy case to address the issue. The Truckers ultimately chose to file creditor claims in Hanjin Shipping's receivership.

VI. NVOCCs and Motor Carriers File Claims in Hanjin Shipping Receivership

The Truckers along with other trucking companies filed creditor claims to recover unpaid freight in Hanjin Shipping's receivership case. Creditor's claim packages were assembled for each claimant including:

- Receipt
- Declaration
- Claim Details
- Supporting Documents
- Corporation documentation
- Power of Attorney

The Truckers filed their claims within in the time period set by the Seoul District Court. The Seoul District Court has not accepted the Administrator's Rehabilitation Plan. On February 17, 2017, Hanjin Shipping Co. was declared bankrupt by South Korean courts, with a court order to be liquidated. To date no claims have been disbursed.

VII. Conclusion – Takeaways

For Truckers -

1. Truckers must understand who they are dealing with, the shipping line or its domestic agent.
2. Written transportation agreements that consider the parties' rights and obligation for payment of freight and trucker's lien rights must be considered.
3. Where a jurisdiction allows for a carrier lien for past unpaid freight truckers should consider providing appropriate notice to shipper in order to secure a lien for past unpaid freight.

For Consignee -

1. Truckers are people and value their relationships with their customers.
2. Truckers whether the storm and still haul your cargo.

For Shipping Lines -

1. Cultivate good faith relationships with your overseas partners.

2. Consider the damage you will cause to your overseas partners, their businesses, and their customers before you suddenly file bankruptcy.

For Politicians and Banks -

1. No more lessons!
2. Please DO NOT let Global Carrier in bankruptcy!!

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How to treat creditors equally under the rehabilitation proceeding -Focused on the Hanjin Shipping case-?

*Captain In Hyeon KIM**

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I. General

Hanjin Shipping's rehabilitation proceeding underlined the importance of equal treatment between creditors.[1]

According to Korean Rehabilitation Act (hereinafter the Act), there are three categories of claims such as General rehabilitation claim, secured claim and claims for common interest. Distinction among three claims has not been

* Professor, Korea University, School of Law; Former President of Korea Maritime Law Association and current Director of Maritime Law Research Centre, Korea University; LLD from Korea University; LLM from University of Texas at Austin; Ex-Captain of Sanko Line. The author of "Transport Law in South Korea(2017, 3rd Ed.)" by Wolter Kluwer; captainihkim@korea.ac.kr.

[1] Part of early publication by In Hyeon KIM, "Legal Implications of Hanjin Shipping's Rehabilitation Proceeding" 915 Hong Kong Law Journal Vol. 47(3)(2017) is borrowed in this paper.

settled yet. Whether claim for delay after rehabilitation started is general claim or claims for common interest is at issue. The concept of debtor's property is too narrowly interpreted under the Korean law and thus BBCHP vessel is outside of protection under Korean proceeding. In Singapore, US and UK, the vessel was not arrested by creditors. The legal effect of Korean Rehabilitation proceeding was not admitted in China, Panama, and Italia. The vessels which visited China, Panama or Singapore were arrested. But, the same effect was admitted in US, UK, Japan and Australia and thus Hanjin's vessels were not arrested.

As result of the above cases, the creditors were treated not equally but differently. The aim of maritime law is giving forseeability to stake holders. One of the rationales of insolvency law is also to treat the creditors within the same category equally. Therefore, we can safely say that creditors under the Korean rehabilitation proceeding had not been equally treated and thus we need to improve the law involved in Korean and other countries' insolvency law.

II. General Introduction of Hanjin Shipping's Rehabilitation case

A. Function of Korean Rehabilitation Proceeding and its procedure

The rehabilitation proceeding has two functions; (i) to rehabilitate the debtor from its poor financial status and (ii) to distribute the debtor's property fairly among creditors and avoid confusion and injustice in the rehabilitation proceeding.

According to the Act, as soon as the debtor applies for the commencement of a rehabilitation proceeding, the court will decide whether to give such order. When it issues such an order, the court designates an administrator and an inspector for the proceeding. The administrator receives reports on claims from the claimants, while the inspector investigates whether the debtor's on-going business value is higher than the liquidation value. When the inspector reports that the former is higher than the latter, the court convenes the creditor's meeting to determine the rehabilitation.[2] If not, the court announces the closure of the proceeding and starts the liquidation process.

B. Historical Background

Since 2008, the financial status of Korean shipping companies has deteriorated. For instance, Samsun Logics applied for a rehabilitation proceeding in February 2009, and was revived by completing a rehabilitation

[2] The claims of the creditors are reduced as per the agreement and the debtor's total debt is reduced, so that the debtor becomes easy to rehabilitate its business.

plan in April 2011. Daewoo Logistics also applied for a rehabilitation proceeding in July 2009, and graduated from the proceeding on June 8, 2011. Likewise, Korea Line applied for a rehabilitation proceeding on January 25, 2011, and graduated from it on November 8, 2013. Finally, STX Pan Ocean applied for the proceeding on June 7, 2013, and graduated from it on July 30, 2015.

The Hanjin Shipping Co., Ltd, (hereinafter "Hanjin Shipping"), seventh largest liner shipping company, applied to a Korean court for protection on August 31, 2016, due to its poor financial situation caused by a worldwide recession, coupled with an oversupply of shipping capacity.' The bankruptcy court of the Seoul Central District issued a "Comprehensive Stay Order" on the same day and accepted the application to commence the rehabilitation proceeding on September 1, 2017, just a day after the application was submitted, according to the Act, the court ordered the administrator to submit the rehabilitation plan on November 25, 2016. Thereafter, the inspector reported that it could not calculate the value of ongoing business because almost all of the properties of Hanjin Shipping, such as vessels and business networks, were sold to the third party.[3]The Korean court officially announced the closing of the rehabilitation proceeding on February 2, 2017, because Hanjin Shipping's liquidation value was reportedly higher than its on-going business value.[4] Two weeks later, on February 17, 2017, the court announced the bankruptcy of Hanjin Shipping.[5] [6]

Many stakeholders, such as shippers, consignees, stevedores, pilots, banks and crews, have been affected by Hanjin Shipping's bankruptcy on August 31, 2016. The bankruptcy also affected creditors in foreign countries not limited to creditors in Korea.[7]

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[3] Accounting firm PwC was the inspector recommended to the court for the liquidation during rehabilitation for Hanjin Shipping. The estimated liquidation value of Hanjin Shipping was KRW 1.79 billion (1.53 billion USD). Hanjin Shipping had about 5 billion USD in debts when it filed for receivership on August 31, 2016.

[4] This was due to the sale of the main business of Hanjin Shipping to SM Line. Please refer to an article by Mr. Marcus Hand regarding this purchase at http://www.seatrade-maritime.com/news/asia/why-is-korea-line-buying-hanjin-shipping-s-asia-us-container-business.html.

[5] https://www.wsj.com/articles/hanjin-shipping-is-declared-bankrupt-1487296151.

[6] According to the administrator's report on June 1, 2017, debtor's assets were assessed at 300 million USD, but the general rehabilitation claim (bankruptcy claim) was 11 billion USD, and the claim for common interest was 159 million USD. Therefore, it was expected that a general rehabilitation creditor would receive a distribution of only 1% of its original claims.

[7] U.S. importers were the most badly affected party. http://www.seatrade-maritime.com/news/americas/hanjin-shipping-vessels-and-containers-left-stranded.html?highlight=YToxOntpOjA7czo2OiJoYW5qaW4iO30=.

III. Stay order

A. Issue

1. Universalism or territoriality

One of the purposes of rehabilitation proceeding is to give a debtor an opportunity to rebuild its business. As soon as the court decides to start the rehabilitation proceeding. In the shipping case, the vessels owned by the debtor are no longer allowed to be arrested by the creditors. If the court's order does not have the same effect in neighboring countries as in its own country, the creditor in a foreign country may successfully arrest the vessel which results in impeding the rehabilitation of the debtor. Several vessels were arrested in a different jurisdiction where the shipping company, as a debtor, commenced the rehabilitation process in its own country (main proceeding). As a result, the business of the debtor was hampered. The international community made "Model Law on Cross-border Insolvency" to give worldwide effect to a national court's order for rehabilitation.[8]

In the Hanjin Shipping case, several countries, such as Japan, UK, U.S., and Singapore, issued so-called "Stay Orders".[9, 10, 11] As a result, several vessels of Hanjin Shipping were not arrested when they visited the ports of these countries and Hanjin Shipping could continue its business with the vessels.[12]

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[8] In 1997, the UNCITRAL adopted the "Model Law on Cross-Border Insolvency". As of May 23, 2017, a total of 43 states (45 jurisdictions), including Singapore, have become Model Law countries . The UK, Japan, Korea, Canada, and Singapore incorporate Model Law into their domestic law. However, China, Panama, Italia, Germany, India and the Netherlands are still not Model Law countries.

[9] Japan and UK courts issued a stay order as soon as Hanjin Shipping applied on September 6, 2016. The U.S. court issued a provisional stay order on September 10, 2016; http://www.seatrade-maritime.com/news/americas/hanjin-gets-us-protection-order-to-allow-vessels-into-port-to-unload.html.

[10] On September 23, 2016, a federal court in Sydney granted an interim order. The order prevented the enforcement of any charge or lien over the ship M/V Hanjin Milano, its cargo, containers, bunker fuel, and oil until 30 September, 2016. On November 11, 2016, the Federal Court granted final recognition orders.

[11] During the INSOL Seoul seminar, Mr. Kah Wah Leong (Rajah & Tann, Singapore) explained the Singapore decision on September 14, 2016 on Hanjin Shipping. The Singapore High Court issued an interim stay order based on universalism, even though Singapore did not adopt the UNCITRAL Cross-Border Insolvency Model Law. The vessels operated by Hanjin Shipping, including owned vessels and chartered vessels, were no longer allowed to be arrested in Singapore under this decision. The decision affected the maritime lienholder, the mortgagee, and lienholder. However, he argued that the maritime lie holder should not be affected by the stay order because the holder has a specially protected status.

[12] However, in reality almost all of vessels were returned to the ship owner and the vessels were not engaged for further business because the charter hire was higher than the market price at

However, under the territoriality, the commencement of the rehabilitation proceeding in a county does not have any effect upon the creditor in other country. And thus creditor in such country is allowed to arrest the vessel of the debtor who is under court protection in its own country's rehabilitation proceeding.[13] In Hanjin case, the effect of Korean court proceeding was not admitted in China and Singapore and thus the several vessels were arrested. Several of Hanjin Shipping's vessels were arrested by claimants abroad and domestically,[14] even after the Korean court issued the order to commence the rehabilitation proceeding in Korea. According to Article 58 of the Act, the property of the debtor is no longer allowed to be executed when the rehabilitation proceeding starts. If the national Act for rehabilitation admits the other national court's order for starting rehabilitation, such as Korea, the property of the debtor should not have been arrested in foreign countries. It is not helpful for the debtor's rehabilitation. And furthermore, creditor abroad is more protected than in Korea.

2. The scope of the stay order

According to Korean law, only the property of the debtor is subject to the court order starting the rehabilitation proceeding. There is a controversy as to whether the BBCHP vessel falls within the scope of the application of Article 58.

In the Changwon district court case 2017.2.23., 2016Ra 308, the court ruled that the M/V Hanjin Xiaman was not owned by Hanjin Shipping; thus the vessel was allowed to be sold by way of maritime lien. The creditor had a claim that triggered the maritime lien according to Panamanian law. If the court had regarded the BBCHP vessel as the property of Hanjin Shipping, the claimant would not have been allowed to arrest the vessel because Article 58 of the Act prevails over maritime lien law. The Korean court interpreted the term "property" as those assets owned by the debtor. According to the above court's judgment, a time-chartered vessel of the debtor is not property of the debtor, so Article 58 of the Act is not applicable and the vessel will be subject to the

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that moment.

[13] In 1978, Orient Leasing Co., Ltd v. The Ship "Kosei" Maru, a Canadian court did not give effect to the Japanese rehabilitation proceeding, and thus the debtor's vessel was allowed to be arrested in Canada. However, when Japanese Sanko Kisen commenced a rehabilitation proceeding in 1985 in a Japanese court, the vessels owned by Sanko Kisen were not arrested in the U.S. because the U.S. had adopted universalism. Kazuo SATORI, "Sanko Steamship's Successful Emergence from Reorganization", The Bulletin of the Japan Shipping Exchange, INC., No. 38(1999, September), p. 10.

[14] On November3, 2016 M/V Hanjin China was arrested by a claimant due to unpaid terminal charges in China. Furthermore, M/V Hanjin Rome was arrested in Singapore and M/V Hanjin Scarlet in Canada.

auction sale by the creditors based on the maritime lien.

However, Singapore and a U.S. court issued a stay order to the effect that the BBCHP vessel, and even time chartered vessels should not be arrested by the creditor.[15] [16]

The fact that BBCHP vessel was not regarded as the property of the debtor and thus was subject to arrest and auction sale by a Korean lower court does not help the debtor to rehabilitate, as it places the debtor into a less protected position than would otherwise be the case in Singapore and the U.S. where the BBCHP vessel is not subject to arrest. Furthermore, it resulted in maritime lien holders in the Korean jurisdiction having greater protection than those in Singapore and the U.S. Moreover, maritime lien holder's legal statuses differed according to the type of the vessel subject to arrest. A maritime lien holder is not allowed to exercise its right to an auction sale against only the debtor's own vessel, according to the Act Art. 58. However, auction sale is allowed against the debtor's bareboat chartered vessel because the vessel is outside of Art. 58. In this sense, a maritime lien holder who has maritime claims against the bareboat chartered vessel enjoys greater protection than those against the owned vessel. On the other hand, the debtor enjoys greater protection in the latter case (Singapore and the US case) because the debtor's vessels can be used for business.

A question arose as to why the Singapore and U.S. courts gave greater protection than that in the underlying proceeding in Korea. Due to the different attitudes of each country' courts, the creditors and the debtor in Korea were treated differently from those in Singapore and U.S. against the same debtor, Hanjin Shipping.[17]

3. Solution

(ⅰ) Universalism

Only when neighboring countries admit the validity of the stay order of the court in the underling rehabilitation proceeding (main proceeding), the vessel operated by the debtor is not arrested. International community established "UNCITRAL Model law of cross-border insolvency" to facilitate

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[15] The Singapore High Court clearly stated that the stay order covered "the vessel beneficially owned or chartered by Hanjin", Re Taisoo Suk (as foreign representative of Hanjin Shipping Co Ltd) [2016] SGHC 195(2016.9.14).

[16] The U.S. Bankruptcy Court for the District of New Jersey decided on September 9, 2016, as follows: "[W]hile this Order is in effect….are hereby made applicable in this case to Hanjin and the property of Hanjin within the territorial jurisdiction of the U.S. including owned, operated or chartered, leased vessels or property thereon (including bunkers) and any other transportation equipment (including containers and chassis)."

[17] The creditors in Korea had more protection than those in Singapore and the U.S. However, the debtor had less protection in Korea than in Singapore and the U.S.

rehabilitation proceeding. Under the Model law, a national country may give full effect to the neighboring country's rehabilitation proceeding. US, Japan, UK and Korea are such countries. Therefore, territoriality countries are recommended to adopt UNCITRAL Model law. By doing this, creditors become to be protected equally domestically and abroad.

Korea incorporated the model law provision into the Act in 2006 and has thus become a Model Law country. Korea is known as a country of modified universalism.[1819] Since then, the Korean shipping companies have enjoyed protection from arrest in other Model Law jurisdictions. For example, an Australian court did not allow a creditor to arrest a vessel owned Samsun Logistics that was under the Korean rehabilitation proceeding in 2011.[20]

(ii) The scope of stay order

Insertion of a provision is required in order to include the BBC as the property of the debtor under Art. 58 of the Act.

IV. Interpretation of "property of debtor" in relation to the BBCHP

A. Issue

According to Art. 58, only the property of the debtor is no longer allowed to be arrested after rehabilitation started. When a bunker supplier applied for an auction sale against Hanjin Shipping's vessel under the BBCHP(Bare Boat Charter Hire Purchase)(Panamanian flag) agreement to collect unpaid money,

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[18] Korea is one country that has adopted UNCITRAL Model Law's modified universalism. According to the Korean Rehabilitation Act, Chapter 5 (International Insolvency), a Korean court has the power to prohibit or stay national creditors from executing a foreign debtor's property in Korea upon the request of an administrator in a foreign rehabilitation proceeding through its approval process.

[19] The UK Privy Council adopted modified universalism in its judgment in the Singularis [2014] UKPC 36. The Court held that the courts had a common-law power to assist foreign liquidations, which was founded on the public interest and the ability of courts to exercise insolvency jurisdiction to conduct an orderly winding up of a company's affairs on a world-wide basis. However, the Court also said that the principle's application must be consistent with the local substantive law and public policy. On the other hand, modified universalism was not accepted by the Hong Kong Court of Appeal in the case of THE CONVENIENCE CONTAINER [2007] 3 HKLRD 575(CA). However, the judge who delivered the judgment confessed in an article that the rejection of modified universalism was wrong. Anselmo Reyes, "Cross-border insolvency and shipping companies", [2016] LLCLQ, 517.

[20] As early as 2009, courts in Australia, UK, Singapore, Belgium, and the U.S. admitted the Korean court's order to prohibit the arrest of a debtor's vessel in their jurisdictions. Therefore, the vessel of a Korean shipping company was not arrested, which helped the debtor's company.

a Korean court allowed the supplier to arrest the vessel. The court said that under the BBCHP contract, Hanjin Shipping was a borrower and had not yet obtained the ownership of the vessel. It decided that BBCHP vessel was not included in the definition of the property of the debtor of Art. 58 and thus the court allowed the creditor to arrest the vessel. It seems that the court did not follow the Korean court's position in regard to the debtor (lessee) as the owner of the property under the general finance lease, but regarded it as a kind of executory contract not yet performed. This was a big surprise to those in Korean maritime circles because it was against their belief that the BBCHP vessel was owned by the charterer (Hanjin Shipping). They argued that the vessel should not have been arrested in accordance with Art. 58 of Act.

However, US and Singapore court ordered to the creditors in their jurisdiction not to arrest BBCHP vessels, BBC vessels and even T/C vessel. Thus, the creditors in Korea were treated more favorably than in Singapore and US because BBC vessels were regarded as being outside of the rehabilitation proceeding and they could get claims successfully regardless of the rehabilitation proceeding.

Hanjin Shipping operated 55 (out of 61 its crew on board) vessels with BBCHP. If the Korean Supreme Court upholds the above ruling, almost all of Hanjin Shipping's vessels will be subject to arrest and thus it will be impossible for Hanjin Shipping to operate its business and there will be no possibility for rehabilitation. In order to achieve the main purpose of Rehabilitation Act, the BBCHP vessel should be regarded as Hanjin Shipping's property under Art. 58.[21] [22]

B. Solution and suggestion

The BBCHP is a very unique scheme of charter party in Korea.[23] It is a kind of lease. However, it has several special characteristics. The charterer will

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[21] Under the proposed Act, the claimant may be protected under a rehabilitation proceeding as the holder of "rehabilitation claims protected by security" because it is a maritime lienholder. However, the bunker supplier is not regarded as a maritime lienholder. In this respect, we may need unification of maritime lien law among countries.

[22] The Korean lower court treated BBCHP differently than a general finance lease. The decision seems to have a positive effect for lenders because they will have a chance to either return their vessel or receive full charter hire by the decision of the administrator. Under the general finance theory, only lenders have rehabilitation claims protected by security because it is regarded as a mortgagor over the vessel. If the administrator chooses to cancel the BBCHP, the borrowed vessel should be handed over to the ship owner and the damages thereafter caused by the cancellation are classified as general rehabilitation claims (Article 118). On the other hand, if it selects to perform the contract, the claim for charter hire is a rehabilitation claim for common interest.

[23] For more details, please refer to In Hyeon KIM, TRANSPORT LAW IN SOUTH KOREA (Wolters Kluwer, 2017) p 74.

obtain the title of the vessel at the end of charter period; thus it is not obliged to return the vessel to the owner.[24] The BBCHP charterer, like a simple BBC charterer, borrows the vessel from the owner and makes use of it for its business during the charter period. For this reason, the KCC provides that the BBC provision applies even to the BBCHP (Art. 848(2)). During the charter period, the title holder of the vessel is the SPC (Special Purpose Company) in foreign country, and thus the charterer is not regarded as the owner of the vessel under the Korean maritime law.

However, there are several domestic Acts that regard the BBCHP charterer as the owner of the vessel in Korea, reflecting that the charterer is actual owner of the vessel and enjoys expectation rights as a future owner over the borrowed vessel. Ship financing and bankruptcy lawyers in Korea tend to regard the BBCHP agreement as a kind of finance lease. Under this finance lease theory, the actual ownership is at the hand of the charterer and the bank becomes the mortgage holder. According to Korean insolvency courts, the lessee under the lease contract is regarded as having ownership of borrowed property under the rehabilitation proceeding. According to this theory, the lessor is not allowed to get property back from the lessee as a debtor. It seems that the court tries to help debtor rehabilitate its business.

However, there is a theory that the BBCHP is an executory contract (a reciprocal contract not yet performed) and the administrator has the power to select either cancellation of the contract or performance according to Article119 of the Act. Under the theory, the ship owner must provide the vessel to the charterer and the charterer must pay the charter hire to the ship owner.[25] [26]

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[24] Under the simple BBC, the charterer is obliged to return the borrowed vessel to the owner at the end of charter period.

[25] The BBCHP is regarded as a kind of Bareboat Charter Agreement according to the KCC, and thus provisions governing BBC apply to the BBCHP. The ownership lies in the registered owner even though the charterer has an expectation right to become the owner of the vessel at the end of the charter period. As a result, the charterer should not be regarded as the owner, but as the charterer. The theory of an executory contract is more reasonable and acceptable when it is decided in conjunction with maritime law. The author supports the theory that the BBCHP agreement is interpreted as an executory right under which the ownership is still on the registered owner. However, the author also supports the proposition that the BBCHP vessel should not be subject to arrest to support the debtor's continuation of its shipping business. This can be done with the revision of Art. 58 of the Act.

[26] Whether the SPC as the owner of the vessel is allowed to get back the vessel from the debtor as the charterer is different matter with whether the creditor is allowed to arrest the vessel operated by the debtor, which is owned by the SPC. According to the Korean lower court, the SPC as the owner of the vessel is allowed to get back its vessel from the debtor when the administrator select to cancel the contract. In this case, the debtor as the BBC charterer will lose the expectation right to obtain the vessel (lose its installments which it paid during the charter period) and it lose the chance to rehabilitate due to absence of the vessel. However, according to Section 1110 of 11 U.S.C.A(Bankruptcy), leased property can be taken back by the owner(lessor). However, the debtor’s administrator has opportunity to retain the property

According to the theory the SPC is regarded as the owner of the vessel and the vessel is not the property of the debtor.

About 70% of the vessel of any Korean shipping company is owned by BBCHP agreement. [27] Therefore, without giving protection under Rehabilitation, the debtor will not be rehabilitated because almost all of vessel will be arrested by the creditors. However, under the Korean maritime law, it is obviously regarded as a chartered vessel and BBC vessel is not regarded as the property of the Charterer.

The revision of Article 58 of the Act is required, without affecting the legal nature of the BBC, to the effect that the BBCHP vessel is regarded as the property of the debtor in case of shipping business.

V. Distinction between general claim and claim for common interest

A. Issue

According to the Act, there are three categories of claims; general rehabilitation claims, secured claims and claims for common interest (benefit).

General claims have the lowest rank without priority under the rehabilitation proceeding. Cargo damage claims by collision incurred before the proceeding starts is a good example of general claim. A maritime claim involving charter hire, without support of security incurred before the commencement of a rehabilitation proceeding (Article118) is another good example. General claimant usually takes 10% of its original claim under the rehabilitation plan (payment by installment usually for 10 years). In Hanjin case, it is expected to collect 1% of them.

Rehabilitation claims supported by security (secured claims) have priority over general rehabilitation claims (Article 141). Secured claims are a kind of protected claim. A bank which lent money to the debtor before the proceeding started is a good example of secured claim. A pilot's claim secured by a maritime lien for unpaid pilot charges under the Korean Commercial Code (hereinafter "the KCC") is another good example.

Claims for common interest have the highest priority. The claims or expenses for common interest after the commencement of proceeding are required to facilitate the common interest of all stakeholders and thus they are needed to be fully protected. Accordingly, they can be paid without limitation

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if it makes payment overdue within 60days of commencement date of rehabilitation proceeding.

[27] In Hanjin case, 55 vessels among 61 allegedly owned vessels (Hajin's crew on board) were under BBC agreement.

(Article 179 and 180). Where the charterer becomes the debtor in the rehabilitation proceeding and the ship owner has the right to receive charter hire incurred after the commencement of a proceeding, the claim of the owner is a kind of the claim for the common interest.

Claim for common interest are well listed in the Korean Rehabilitation Act. According to Art. 179(1), "expense claim incurred during the course of business after proceeding started" and "claims for management of work without obligation" against the debtor is classified as claim for common interest.

However, it is not easy to find out whether a certain claim is within the category of such definition. For example, whether claims for delay brought about after the rehabilitation proceeding started is classified as a claim for common interest or general claim has been at issue. Another issue is whether the claim which the consignee takes its cargo from the vessel with its payment is claim for common interest. Consignee argues that it acts without any obligation to discharge charge and thus it is a part of "Management of job without obligation".

B. Solution

There were several cases that the result of the nature of several claims was estimated in advance under Hanjin's rehabilitation proceeding. Judicial interpretation of Chinese Supreme Court is a good model. A court may announce the official interpretation in advance. It is inevitable for creditor to wait until the final decision is made because there is no precedent in Korea regarding liner shipping insolvency case. We international maritime law community is kindly requested to exchange views and communicate each other on this matter and achieve foreseeability in shipping insolvency case.

VI. Treatment between service provider and necessity supplier

A. Issue

In Hanjin case, the service provider and necessity supplier were active in arresting Hanjin's vessel. According to KCC Art. 777, the necessity provider such as the bunker supplier is no longer the maritime lien holder. However, the service provider such as the pilot and tugboat owner has the maritime lien. Therefore, the service provider is protected as a secured claimant whereas the necessity supplier is not.[28]

[28] Of course, both of them become to have the same protection as a claimant with common interest as soon as the proceeding started.

Furthermore, newly revised Korean Rehabilitation Act in 2016 inserted a provision that any supplier who provides necessities 20days before the proceeding started is regarded as a claimant with common interest. Therefore, the necessity supplier such as the bunker supplier can be protected by the new Act. It seems that the service provider and necessity provider are treated differently even though their nature is very similar in that they play positive role to keep the vessel' operation going on.

B. Solution

The Korean maritime law may restore the old law status by making the necessity supplier as one of maritime lien holder in Art. 777 of the KCC.

Under the rehabilitation proceeding, the claimant with common interest is the most protected claimant. The service providers may well be included as another beneficiary in 8bis of Art.179, because there is no good reason to make difference between the service claim and necessity claim. Furthermore, we may expand the length of the date from 20 days to 40days, reflecting shipping business's special circumstances of the duration of one voyage.

This revision of the Act may play as an incentive for the stevedores who provide discharging service of the cargo not to arrest the vessel and, as a result, the debtor can engaged the operating vessels continuously in its business.

VIII. Maritime lien law- Bareboat Charterer

A. Issue

A claimant with claim incurred by the BBC has maritime lien upon the very vessel, which result in protecting the claimant. However, only the creditor with security right upon the owned property of the debtor is regarded as claimant with claim for common interests according to the Act. The creditor’s claims subject to the maritime lien against the BBC vessel is not admitted the same as the above. Therefore, the same claimant against the BBC vessel is not regarded as a security holder and thus it is less protected in rehabilitation proceeding than that against owned vessel.

B. Solution

A claimant with claims incurred by BBC is not regarded as a secured claimant. Furthermore, it is not allowed to arrest the BBC vessel by prejudgment attachment according to Korean law. It is allowed to submit its claim as a general creditor under the proceeding. By the debtor's personal

matter, its legal right becomes useless. It is desirable for the Korean court to reflect the special situation of shipping business that the vessel itself is very important security, whether the vessel is owned or leased, for protecting claimant against foreign debtor. Korean Rehabilitation should be revised that the claimant with claim incurred by BBC is also regarded as a secured creditor with maritime lien.

IV. Interplay between maritime law and insolvency law

A. Issue

Under the Korean International Private Act, the law of registry of the ship subject to arrest becomes the governing law in case of maritime lien. Therefore, whether a claimant's claim is a secured claim or not is decided by the law of the flag state. For example, bunker supplier does not have maritime lien under the Korean law. However, it has maritime lien under the Panamanian law. Consequently, if a Korean bunker supplier supplied bunker to Panamanian vessel, it is protected by claimant with secured claim under the Korean Rehabilitation proceeding. However, in the case of Korean vessel, it is treated only as a general claimant under the proceeding. Accordingly, the protection of creditors varies according to the nationality of the vessel subject to the maritime lien.

B. Solution

China's maritime law maintains *lex fori s*ystem and thus always Chinese maritime code is applicable in case of maritime lien. Korean government may give up flag of the vessel principle and adopt *lex fori* system. Under the current flag of vessel's registry principle, the shipowner is in the beneficial position because his vessel is subject to only his flag country's law and no need to prepare for all visiting countries maritime lien law. However, almost all of vessel's flag is a FOC country such as Panama, Marshall Island, Liberia and its maritime lien law is very difficult for creditors and even lawyer to find out the law itself and to understand the law. In order to give predictability and stability to the creditor, the speaker recommend Korean government to adopt the *lex fori* system. It seems that the problem will not be completely settled down without international unification

X. Special Matter

A. Issue

1. Ipso Facto Clause

There are an agreement to the effect that a party has a right to cancel the contract if the opposing party does not make payment in due date, due to applying rehabilitation proceeding. As soon as the rehabilitation proceeding starts the administrator has power to select the contract to be continued or cancel by the operation of the law. The party argues that it has still power to cancel the contract and retrieve the property from the debtor regardless of the administrator's selection of the continuation of the contract execution. If that is the case, the rationale of the Act will be diluted.

However, in a case the KSC decided that the Ipso Facto Clause was valid based on the freedom of the contract and that there was no explicit provision to deny the use of Ipso Facto Clause in the Act (KSC 2007.9.6. Docket No. 2005da 38263).[29]

It is known that UK law also regards it as being valid.

2. Procedural matter

Under the universalism, claimant abroad is also required to participate in the foreign country's rehabilitation proceeding. Therefore, in order for the creditors abroad to be protected equally with domestic creditor, special care for them in the proceeding is needed. For example, full English version of official document for creditors should be provided. Guidance for creditor's filing of claim was released in English. However, English version of Examiners' report was not released and filing of claim itself was available for only in Korean.

B. Solution

Speedy and fair trial by a domestic court is required. As of 2017, the special court for insolvency was established. The court may adopt lots of facility to help easy participation of claimants.

XI. Conclusion

Insolvency law has two aims: rehabilitation of debtor and equal treatment of claimants. The speakers tried to address issues of unfair treatment between creditors domestically and abroad in case of the Hanjin Shipping. The speaker

[29] It is invalid according to UNCITRAL Legislative Guide on Insolvency Law Recommendations Article 70.

found that there were several cases that the claimant has not been treated equally.

The concept of debtor's property should be interpreted to include the BBCHP vessel under the Act. Art. 58.

The totality countries is required to adopt UNCITRAL MODEL law so that the stay order by the underlying rehabilitation proceeding takes effect to their countries, as a result, the vessel of debtor is not allowed to be arrested.

Revision of some provisions in the Act is required to achieve fair and equal treatment among creditors and to provide predictability for stake holders involved in shipping business

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United States Bankruptcy Law and Maritime Liens*

Richard V. Singleton **

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I. Introduction

The business of shipping is transnational in nature, and maritime insolvencies and restructurings can present unique and vexing problems when traditional maritime concepts meet bankruptcy law. These problems can present obstacles, but they also can present opportunities to experienced and creative practitioners. This paper will first present a general overview of United States bankruptcy law and procedure, which applies equally to land and marine-based businesses. It will then address one of the more troublesome issues in maritime bankruptcies – maritime liens and creditors' rights to seize vessels and other assets to secure their claims.

II. Overview of United States Bankruptcy Law

The substantive bankruptcy laws applicable in the United States are set forth in a federal statute (Bankruptcy Code) applicable in all states. The rules

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** Blank Rome LLP, 1271 Avenue of the Americas New York, NY 10020
rsingleton@blankrome.com

of procedure applicable in bankruptcy matters are set forth in separate Bankruptcy Rules and in local rules of each federal Bankruptcy court. However, state and other non-bankruptcy law remain relevant in bankruptcy proceedings. The substantive bankruptcy laws and rules of procedure apply to both non-maritime and maritime bankruptcies.

Bankruptcy is a judicial process commenced by the filing of a bankruptcy petition in bankruptcy court. It is important to understand that insolvency is not a prerequisite to filing for bankruptcy relief, and merely being insolvent does not cause a company to be in bankruptcy.

There are two ways a bankruptcy petition can be filed. One is a voluntary petition filed by the company on its own. The other is an involuntary petition filed by creditors. Individuals and most businesses may be the subject of a voluntary or involuntary petition under the Bankruptcy Code. Banks and insurance companies may not. The principal parties in a bankruptcy case are the debtor or a trustee if one is appointed, secured creditors, unsecured creditors, and the debtor's shareholders. Another party is the Office of the U.S. Trustee which is a division of the U.S. Department of Justice (a Federal Government agency) and acts as a Government "watchdog" monitoring the bankruptcy case to ensure compliance with rules, fee guidelines and matters of public policy and interest.

There are several types of bankruptcy proceedings. These include Chapter 7 – liquidation, Chapter 9 – municipalities, Chapter 11 – business reorganization, Chapter 13 – individuals with income, and Chapter 15 – foreign companies with assets in the U.S. This paper will focus primarily on proceedings under Chapters 11 and 15 as most shipping bankruptcies proceed under those chapters.

In Chapter 11 cases the debtor's management usually remains in control of the company as a "debtor-in-possession." If there are sustainable allegations of fraud or mismanagement, however, a Chapter 11 trustee will be appointed to replace management. By contrast, a trustee is always appointed in a Chapter 7 case to oversee the liquidations, and the debtor has a limited role in the case. A trustee appointed to replace management in a Chapter 7 or 11 case, often referred to as a "bankruptcy" trustee, is different from the U.S. Trustee which is a Governmental entity that monitors cases but is not involved in managing the debtor. The bankruptcy trustee can be a lawyer or other type of bankruptcy professional such as an accountant or turnaround consultant who is either put forward by creditors or selected by the U.S. Trustee from a list of approved trustees.

The secured creditors, who hold liens or security interests in debtor's assets, retain their own representation in the proceedings. In a Chapter 11 case, an unsecured creditors' committee is usually formed to represent the interests of general unsecured creditors who must rely on the debtor's unencumbered assets for recovery. The creditors' committee is made up of the largest

unsecured creditors who are willing to serve and generally consists of 3 to 7 members comprising a cross-section of claims such as unsecured bank or bond debt, trade creditors, landlords and contract counterparties. The committee retains its own lawyer whose fees are paid by the debtor. Individual unsecured creditors can also retain their own representation. The committee plays an important role in influencing how the case proceeds and committee members generally are given access to material non-public information and owe fiduciary duties to all unsecured creditors. The debtor's shareholders typically have little or no chance of recovery and therefore have a very limited role in the bankruptcy.

The bankruptcy is commenced by filing a Petition. This is not complicated. The Petition is a four-page form document containing basic information: the debtor's name and address, type of business, type of bankruptcy case (Chapters 7, 11, 15), basis for venue, estimated number of creditors, assets and liabilities, authorized signatory and attorney. It also includes attachments listing:

- Names of affiliated companies included in the filing
- Equity holders
- Twenty (or more) largest unsecured creditors
- Resolutions authorizing the filing

The court thereafter issues Orders, known as First Day Orders, necessary to get the case up and running. They are based on a "First Day Declaration" from an officer of the company, describing the company, its business, organizational structure, debt structure, events leading to bankruptcy filing, strategy for exiting bankruptcy and need for particular first-day relief. The first day orders/motions vary depending on the needs of the case, but typically include orders relating to joint administration of affiliated debtors, payment of prepetition wages and employee benefits, use of cash collateral and/or DIP financing (discussed later), retention of professionals – attorneys, financial advisors, special counsel, and various procedural motions. Some motions/orders are case specific, such as motions/orders for enforcing automatic stay outside the U.S. (to protect assets outside the U.S.) or critical vendors (preferential treatment to suppliers deemed critical to operation).

The automatic stay is one of the most important aspects of a United States bankruptcy, and is particularly relevant in maritime bankruptcies for the reasons discussed later. The automatic stay is an injunction against most types of creditor enforcement actions (11 U.S.C. §362(a)). It arises immediately upon the filing of a voluntary or involuntary petition and enjoins all creditors from taking any actions against the debtor and the debtor's assets – *e.g.* foreclosure and litigation against debtors must cease and parties to contracts with the debtor cannot terminate those contracts. Actions in violation of the stay are void and may be subject to sanctions. The automatic stay generally remains in place for

the duration of the case, but creditors may seek to lift or modify it. Regulatory and "police" powers are exempt from the automatic stay.

United States courts take the position that the automatic stay applies extraterritorially. (*See for example, In re Bernard L. Madoff Inv. Secs. LLC*, No. 11 Civ. 8629, 2012 WL 1570859 (S.D.N.Y. May 4, 2012)). Enforcement of the automatic stay generally is easy against creditors subject to the court's jurisdiction. But creditors outside the U.S. and beyond the reach of the U.S. court may try to disregard the stay. To address this issue, United States bankruptcy courts frequently issue orders enforcing the stay outside the United States, but such enforcement may require assistance of foreign courts and it is not always successful.

The automatic stay does not apply to certain types of financial contracts (11 U.S.C. § 362(b)(6), (7), (17), (27)) such as swaps, repurchase agreements, securities contracts, forward contracts, commodities contracts and master agreements covering such contracts – so-called "safe harbor" contracts. Likewise, a counterparty's contractual right to cause the liquidation, termination or acceleration, or to offset and net out payments of safe harbor contracts "shall not be stayed, avoided, or otherwise limited by operation of any provision of [the Bankruptcy Code] or by order of the court."

A Chapter 11 debtor may require funding during a bankruptcy. The two most common forms of financing are the use of cash collateral and DIP financing. "Cash collateral" means cash of the debtor subject to a security interest in favor of a creditor, such as proceeds of collateral (*i.e.*, collections of accounts receivable) (11 U.S.C. §363(a)). In shipping this could be charter payments on a secured vessel in which the bank has a security interest. Court approval or lender consent is required for the use of cash collateral. If the lender does not consent to the use of cash collateral, the court can approve the debtor's use only if the lender's interest is protected -- a concept known as "adequate protection." Adequate Protection is the right of a secured creditor to maintain the value of its collateral during the pendency of the automatic stay without diminution. Forms of adequate protection under the Bankruptcy Code include replacement liens on unencumbered property, periodic cash payments, priority or "superpriority" claim. (11 U.S.C. §361).

Debtor-in-possession or "DIP" financing (11 U.S.C. §364) is where the debtor obtains new financing post-petition. Very often, the debtor's existing pre-bankruptcy lender will agree to provide DIP financing in order to protect its position and avoid having a new lender step into the debtor's capital structure. Types of DIP financing are:

- Unsecured debt allowable as a priority claim paid before all other unsecured claims
- Unsecured debt allowable as a superpriority claim paid before all other priority claims
- Secured debt with a lien on unencumbered assets

- Secured debt with a junior lien on encumbered assets
- Secured debt with a senior or equal lien on encumbered property – a so-called "priming lien" which can only be approved if the holder of the existing lien receives adequate protection.

The debtor must first try to obtain unsecured DIP financing before the court will approve secured DIP financing, and the debtor must try to obtain junior secured DIP financing before the court will approve a priming lien.

A debtor's sale of assets in the ordinary course of business (i.e., inventory) does not require court approval. However, a sale outside the ordinary course of business, including a sale of all or substantially all the debtor's assets requires court approval. Sales outside the ordinary course of business are governed by section 363 of the Bankruptcy Code and are referred to as "363 sales." A 363 sale of all or substantially all the debtor's assets is essentially an M&A process within the bankruptcy case, with the following characteristics:

- An offer to buy the debtor's assets is subject to higher and better offers through a marketing and auction process
- It is frequently accomplished quickly – 45 to 60 days
- The debtor's assets are sold free and clear of all liens and claims

The process is a court-approved auction with competitive bidding and buyer protections for a "stalking horse" bidder, including break-up fee and expense reimbursement. A "stalking horse" bidder is a proposed buyer with a signed purchase agreement whose bid is subject to higher and better bids.

After commencing an insolvency proceeding a debtor may assume, reject, or assign executory contracts. "Executory Contract" is not defined in the Bankruptcy Code, but generally means a contract on which material performance is due from both parties at the time the bankruptcy begins. "Assume" means the debtor cures all monetary defaults and continues to perform the contract in accordance with its terms. "Reject" means debtor will not perform the contract, the contract is treated as having been breached by the debtor prior to the bankruptcy filing, and the counterparty has an unsecured claim for damages. "Assign" means the debtor will transfer the contract to a third party (often as part of a 363 sale of all or substantially all the debtor's assets) in which case the debtor or the assignee will cure all monetary defaults, and the assignee will perform the contract in accordance with its terms.

This right to assume, reject, or assign is one sided and until the debtor decides whether to assume, reject or assign, the counterparty must continue to perform its obligations under the contract. Provisions in contracts that allow the counterparty to terminate or modify the contract because of the debtor's bankruptcy filing – so-called "ipso facto" provisions – are generally not enforceable. Provisions in contracts that prohibit or restrict the debtor's right

to assign the contract are also generally not enforceable.

Creditors and other parties with claims against the debtor desiring to recover must file a "Proof of Claim" in the bankruptcy within the bar date set by the court. Proofs of claim set forth the basis of the claim, the amount, and may include copies of supporting documents. The claim is deemed "allowed" unless an objection is filed. A creditor that does not file proof of claim forfeits its claim and is forever barred from asserting its claim against the debtor. When a debtor objects to a proof of claim, it triggers a resolution process similar to litigation – discovery, summary judgment, evidentiary hearing.

Unsecured claims are allowed against the estate based on a hierarchy of priorities (11 U.S.C. §507). The highest priority is given to "administrative expenses," which are expenses arising post- petition and are the "actual, necessary costs and expenses of preserving the estate." Such expenses include employees' wages, attorneys' and other advisors' fees, commercial obligations arising post-petition, and the cost of goods received by the debtor in the ordinary course within 20 days before the bankruptcy. Priority unsecured claims have the next priority and include wages and benefits up to $12,850 per individual earned within 180 days before bankruptcy and income taxes for year ending before bankruptcy. Then come the general unsecured claims, including, general claims arising pre-petition and contract rejection damages. Recovery on these claims mostly are allowed *pro rata* as there usually are insufficient assets to pay such claims in full.

A hallmark of United States bankruptcy is the "avoidance action." These are actions brought by the debtor within the bankruptcy case to recover back into the estate assets transferred to creditors before the bankruptcy case. There are two primary avoidance actions: preference and fraudulent transfers. A "preference" is a transfer of the debtor's property to a creditor within 90 days before the bankruptcy case is filed (1 year if transferred to insider) on account of an antecedent (existing) debt while debtor was insolvent enabling the creditor to receive more than it would in liquidation.

Preference is a strict liability standard. Subjective intent is irrelevant. There are, however, defenses to a preference action, such as an ordinary course transaction or where there is new value given in exchange for the transfer.

A fraudulent transfer is where an asset of the debtor (property of or an obligation due to the debtor) is transferred in furtherance of an actual or constructive fraud on the debtor's creditors. Actual fraud requires proof of intent to defraud. Constructive fraud requires proof of insolvency and less than reasonably equivalent value given in exchange for the asset. Such actions have a two-year lookback from date of bankruptcy. An action to recover a preference or fraudulent transfer must be brought within two years after the bankruptcy filing, and if a trustee is appointed within the two years, the action must be brought within 1 year of the trustee's appointment.

The end game in a Chapter 11 is to obtain court approval of a

reorganization "plan" permitting a debtor to exit bankruptcy. Such a plan can be a stand-alone reorganization, a sale of the business, or a "prepackaged" or pre-negotiated plan, which can include a sale of substantially all the assets of the debtor, a recapitalization, or a debt-for-equity swap. Plans also can involve post-Confirmation Trusts where the remaining assets of debtor are transferred to a trust for the benefit of creditors. One example is a "liquidation trust" where the remaining assets are sold and proceeds are distributed to creditors. Another example is a "litigation trust" where causes of action belonging to the debtor are prosecuted by the trust with recoveries distributed to creditors.

Plans are decided by creditor vote, with disclosure statements and voting ballots distributed to creditors. Only creditors with "impaired" claims can vote. "Impaired" means the creditor will receive less than full payment. Creditors receiving full payment are presumed to accept the plan. Creditors receiving no payment are presumed to reject the plan. Voting thresholds are applicable. Plan approval for each class of creditors requires approval by at least two-thirds (2/3) in dollar amount of claims and more than one-half (1/2) in number of claims that vote. In some case a court may approve a plan notwithstanding rejection by an impaired class if at least one impaired class has accepted the plan and other safeguards are met. This is known as "cramdown."

Chapter 15 concerns international and cross-border insolvencies. It is based on the UNCITRAL model law and provides foreign debtors access to U.S. Bankruptcy Courts to protect assets located in the U.S. The purpose is to facilitate cooperation among U.S. and foreign courts and harmonize insolvency across multiple jurisdictions.

A Chapter 15 case is commenced by a foreign representative of a foreign debtor filing a petition in U.S. Bankruptcy Court. Two key consequences flow from a Chapter 15 filing. First, actions by creditors in the U.S. against the foreign debtor are stayed (enjoined). Second, the foreign representative takes control of the debtor's assets in the U.S. and requests that the U.S. Bankruptcy Court "recognize" the foreign insolvency proceeding in the debtor's home country. The ultimate goal is to obtain an order from the U.S. Bankruptcy Court enforcing a restructuring approved by the insolvency court in the debtor's home country. If successful, the Chapter 15 proceeding will prevent creditors from pursuing claims against the debtor's assets in the U.S. and require creditors subject to U.S. court jurisdiction to pursue their claims in the foreign proceeding.

III. Maritime Liens and Ship Arrests

The well-established and unique concept of maritime liens present important issues in cross-border insolvencies in maritime matters, which offer opportunities and obstacles for both debtors and creditors. It therefore is

necessary to understand maritime liens to effectively represent maritime clients in cross-border insolvencies.

A maritime lien is an *in rem* property right in the ship itself. The underlying principle is the ship is regarded as a juridical person and must answer for its own actions. Maritime liens are created by the operation of law based on the occurrence of events giving rise to the lien. The lien is not consensual or contractual, and there is no requirement of a writing.

A maritime lien also is a secret lien. It arises at time of the relevant events and follows the maritime asset wherever it goes. Unlike land-based liens, a maritime lien does not need to be recorded or otherwise perfected.

United States law recognizes many maritime liens, including breach of charter, torts, necessaries and services supplied to vessels, seamen's wages, salvage, and cargo damage. The broad scope of liens recognized under US law is significant because some countries recognize only a very few liens, *e.g.*, seamen's wages, masters' wages, masters' disbursements, salvage and bottomry. The laws of many countries authorize arrests of vessels for various claims -- but these are not true maritime liens nor do they create *in rem* rights against the ship. They are statutory rights to obtain security by arresting the ship for *in personam* claims against the vessel's owner.

The only way to enforce a maritime lien is to arrest the vessel. And in the United States only a federal district court sitting in Admiralty may arrest.

Under United States law, the only way to extinguish a maritime lien is to provide security (the lien then attaches to the security), satisfy the debt or claim giving rise to the lien, or effect the sale of the vessel by a federal court sitting in Admiralty. If not extinguished, the lien remains attached to the ship even if the ship is sold to *bona fide* purchaser for value with no knowledge of the lien. It is possible to extinguish the lien by excessive delay in seeking to foreclose on it. But this is measured by the equitable doctrine of laches where the reasons for the delay in arresting are balanced against the prejudice to the vessel owner in allowing lien, an analysis that rarely results in a denial of the maritime lien.

More than one lien can attach to a vessel and they frequently do, resulting in multiple, overlapping arrests in some cases. Competing lienors' rights are resolved through "priorities" of the various liens, which can be tempered by equitable principles. For example, crew wage liens have priority over tort liens, which have priority over mortgage liens, which have priority over subsequent contract liens for supply of necessaries.

IV. Maritime Liens and Attachments Meet Bankruptcy Stays

Maritime liens should not be confused with maritime "*attachments*", commonly referred to as Rule B attachments. Attachments are rights to seize

property as security for *in personam* claims (much like statutory arrests in England and some civil law countries). A U.S. bankruptcy court may vacate maritime attachments as preferences or fraudulent transfers. On the other hand, maritime liens often have a senior right of priority and, if over secured in respect of the value of the subject maritime asset, may not be avoided as a preference.

It is uniformly recognized in the United States in Chapter 7 and 11 cases that an arrest prior to issuance of a bankruptcy stay may stand pending the ultimate resolution of the bankruptcy main proceedings. But the arrest proceedings themselves are stayed. In a Chapter 15 case, an attachment or arrest in the U.S. after the commencement of a foreign insolvency that would stay such action if the arrest or attachment was in the country where the foreign insolvency was filed, generally will be vacated by a U.S. bankruptcy court, upon recognition of the foreign proceeding under chapter 15 of the U.S. Bankruptcy Code and proof that the attachment or arrest would be vacated in the foreign main proceeding.

Enforcement of a lien by arrest after the stay is issued is a violation of the stay provided the vessel is the debtor's property. But it is not always easy to determine if the stay is violated because vessels and other assets are usually owned by special purpose companies in complicated corporate structures. Questions also arise out of the various chartering arrangements of the ships: bareboat charters, time charters, and voyage charters. For example, can you arrest a ship to enforce a maritime lien for fuel supplied to the vessel on order of a charterer who is now in bankruptcy and protected by the automatic stay? Courts have not always been consistent in their answers to this question.

Even though post-petition arrests are stayed, a maritime lien claimant can file a notice under Bankruptcy Code section 546 asserting the lien and file a "proof of claim" in bankruptcy asserting the maritime lien. An arrest not necessary to establish/protect the claimant's lien priority because the priority is established by law with reference to the nature of the competing liens and because of the notice procedure under Bankruptcy Code section 546. If due notice is given, then the maritime lien priorities law should govern priority between competing maritime liens.

It may be possible to arrest a ship notwithstanding the bankruptcy stay if the debtor is the vessel's time charterer or voyage charterer. This is subject to a caution. In *STX Pan Ocean*, Judge Chapman protected a chartered vessel, vacating both arrests and attachments obtained after commencement of STX Pan Ocean's bankruptcy case in Korea. He reasoned that a charter is a debtor's asset worthy of the stay's protection with value to the estate. There is no question that the stay protects a debtor's executory contracts, including charter value, in a Chapter 7 or 11 proceeding.

One of the vexing questions in cross national bankruptcies is whether a sale of the vessel by a bankruptcy court extinguishes all maritime liens. A U.S. bankruptcy court has the power to sell, or transfer (by Plan) assets free and clear

of interests, including claims, liens and encumbrances – Bankruptcy code section 363 (b-c) and (f) and 1123(a)(5)(D). The sale or confirmation order transfers the liens and encumbrances from the property to the sale proceeds under certain conditions. But since a maritime lien traditionally can only be extinguished by the sale of a vessel by a federal court sitting in admiralty, the question arises whether a bankruptcy court's sale extinguishes a maritime lien. The answer is that the bankruptcy free and clear sale/plan transfer likely would prevent a subsequent arrest of a transferred vessel by an Admiralty court in the United States -- although the issue is not free from doubt given the nature of the bankruptcy courts' and admiralty courts' respective jurisdictions. The question is particularly difficult if a lien claimant commenced a foreclosure action pre-bankruptcy and the action was stayed and/or the lien claimant has chosen, at risk, not participate in the bankruptcy.

The larger question from the standpoint of an orderly administration of a transnational bankruptcy is whether admiralty courts outside of the United States would find that a U.S. bankruptcy court's approved sale extinguished existing maritime liens and vice versa. This is particularly problematic from the point of view of a buyer who purchased a vessel connection with a U.S. bankruptcy approved sale, because a potential lien claimant who did not claim in the U.S. bankruptcy could seek to arrest the vessel outside of the United States. It is unrealistic if not unworkable to checking the law in all jurisdictions where the vessel may call to determine if the liens are extinguished and to take protective measures in problematic jurisdictions.

This is one of the areas where uniformity is much needed. The best a purchaser can do is to investigate the ship's tort and contract history as thoroughly as possible and make sure to provide notice and opportunity to be heard in the main proceeding to all potential lien claimants that can be identified.

V. Conclusion -- General Takeaways

The tension between maritime and bankruptcy law is perhaps best exemplified by maritime liens. These tensions can create difficulties in the orderly and efficient administration of cross border maritime insolvencies. But they also can create opportunities to obtain results beneficial to creditors and debtors that otherwise may be foreclosed in non-maritime cases. The following are some considerations:

Debtor's perspective. Because of the international and commodity-like nature of maritime companies and vessels' trades, planning ahead in a maritime insolvency or restructuring is especially important to prevent the unwanted interference with a debtor's vessels, which are likely the company's core income generating assets. This risk can be minimized by:

1. Making sure that the stay in the main proceeding is broad enough to cover arrests (pre- and post-filing) of the debtor's vessels in proceedings in other countries and trying to consolidate assets in jurisdictions likely to recognize the main proceeding and main proceeding court's orders and decrees.
2. In considering the location for the main proceedings, avoid temptation to think territorially, limiting consideration only to the country where the debtor's main offices or actual business is located. Instead, consider the jurisdictions where the vessels are located and where the debtor's business is actually conducted by those vessels, and evaluate whether the bankruptcy laws of that/those jurisdictions are favorable. By their nature, maritime businesses often have robust choices as to venue and applicable restructuring law.

Creditor's perspective. If a company is in financial difficulties, monitor that company to determine if it is about to seek bankruptcy protection. If it appears that it may:

1. Assert maritime liens, particularly in respect of necessaries, quickly and aggressively pre-petition. This can create substantial rights in a bankruptcy, which may be senior to other creditors' rights, and which can give rise to consent and bidding rights in a bankruptcy sale context.
2. Act promptly to arrest as many vessels as possible in arrest-friendly jurisdictions that have not adopted the model law or are likely to grant comity.
3. Be tenacious in considering litigation options, which assert claims that may not be swept into a debtor's estate, including alter ego theories and targeting non-debtors and related maritime assets. Remember, that even if litigation *relates* to a bankruptcy case in the United States, the bankruptcy court might choose not to assert direct control over the same. For example, in the *O.W. Bunker* cases filed in New York, interpleaders were allowed to proceed outside of bankruptcy court, which cases determined whether the debtor or the physical supplier had a maritime lien – thereby effectively determining the debtor's rights. The bankruptcy court could have asserted control over the interpleaders but, with the support of the U.S. O.W. Bunker debtors, chose not to. A bankruptcy court's "related to" jurisdiction is pervasive, but precatory. This allows opportunities in the seams between admiralty and bankruptcy law.
4. Simply because the sale of a vessel may have occurred in bankruptcy, consider whether a subsequent arrest in an arrest-

favorable jurisdiction will advance the client's position. But in considering any such approach, carefully evaluate notice given to your client and the client's exposure to the bankruptcy court's jurisdiction (both by consent and by the level of the client's connections to the jurisdiction).

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ARTICLES

Termination of contract under the Russian law and under the Korean law

Keechang Kim, Ogorodnikova Mariia***

ABSTRACT

Violation of contractual obligation is anything but exceptional in every country. In countries with well-developed legal system, one can expect that the victim of a breach can resorts to a range of remedies to protect its interests and rights in the event of the other party's breach. Among those remedies, termination of a breached contract becomes particularly important when other remedies such as specific performance are unavailable or ineffective for the obligee. The court's role in the termination also varies depending on the country. Out-of-court termination appears to be a more usual remedy compared to court-authorised termination. In Russian contract law, unilateral, out-of-court termination of a breached contract is becoming increasingly important, whereas in Korea, termination of a breached contract has always been a unilateral exercise of what is presented as the 'right' of the aggrieved party which was done out-of-court.

Comparative studies of contract law have long been the source of inspiration for law reform which is aimed at finding more effective and efficient ways to protect and to adjust the parties' competing interests in a satisfactory manner. Russian legal experts review and compare Russian Law with Continental law of European countries and the Common Law of contract. The Korean Civil Code and Korean legal rules relating to termination of a contract seem to have been well-settled and have worked satisfactorily. This paper analyzes and compares the Russian and the Korean Civil Codes, respectively, and the judicial doctrine and legal practice relating to termination of breached contracts. We hope this paper is useful for an improved understanding between Korean and Russian lawyers and businessmen.

KEYWORDS: Termination of a breached contract, material breach, unilateral termination, out-of-court termination, termination by mutual consent, court-authorised termination, Russian contract law, Korean contract law

* Professor of Law at Korea University, Contact Address: e-mail: keechang@korea.ac.kr Tel: (+82) 02-3290-1901.

** Master's student at Korea University, e-mail: ogorodnikova_maria@outlook.com Tel: +82-10-2554-9925.

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I. Termination of a contract under the Russian law

Under the modern Russian Federation Civil Code ("**RFCC**"), if the obligor fails to fulfill contractual obligations, the obligee can have a range of remedies such as specific performance, compensation (damages and neustroika) and termination of the contract. The rules relating to damages and penalty have developed during the Soviet period, whereas the rules relating to termination of a contract, especially the rules applicable to a party's unilateral termination, have not been sufficiently studied. Under Soviet Law, termination of a contract was not permitted in principle because of the nature of the planned economic system. Under the planned economic system, entrepreneurs' goal was not to generate profit. The main goal of contract was a "government goal" which needs to be pursued by specific performance. However, the availability of specific performance is often limited or even completely blocked. The rules relating to termination of a contract in Russian Federation began to evolve after the collapse of the USSR in 1991. Due to the economic and other more serious problems of the planned economy (inability to rapidly respond to global changes, low level of productivity and the shortage of certain goods, inability to effectively implement scientific advances, the lethargy of legal development, lack of an efficient system for taxation, relative under-development of banking and financial services, lack of creativity resulting from inflexibility of contract law and property law, etc.), the right of unilateral termination of a contract on the ground of a breach began to be recognised more widely. Termination of a contract – as a protection of the obligee's right – is more frequently resorted to nowadays.[1] The topic deserves a more careful study.

The general principle is that a contract may be terminated by court's judgment or by mutual agreement of the parties. Article 310 of RFCC accordingly stipulates that no party may unilaterally refuse to fulfil or to change

[1] A.G. Karapetov, Claim to Enforce Specific Performance, at at 190, (Moscow, Statut, 2003), *available at* https://www.twirpx.com/file/156992/ (in Russian).

the contract, "except where such right is stipulated by this Code, by other laws or by other legal acts". If a party wishes to terminate a contract in response to the other party's breach, the former must in principle seek a consensual termination or apply for termination of the contract by court's judgment.

But there are many exceptions from this principle. The RFCC itself contains many provisions which confer on a party the right of unilateral, out-of-court termination. In the first half of this article, we offer an account of how the RFCC rules of termination of a contract work in practice.

A. Termination by mutual agreement

Modification and termination of contract by mutual agreement is based on the principle of freedom of contract. Restrictions to the parties' right of modification or termination of the contract by mutual agreement, as they are derogations from the freedom of contract, can only be established by law. For example, according to Article 430(2) of the RFCC, if a third party expresses his/her intention to make use of the rights under the contract signed to his/her advantage, from that moment the parties may not agree to modify or terminate the contract unless the third party agrees.

In the event of termination or modification of the contract by mutual agreement, the contract is deemed modified or terminated from the moment of conclusion of such agreement. Modification or termination by mutual consent is the least disruptive way of modifying or terminating a contract. It does not require any procedural legal formalities and it minimizes the risk of dispute.[2]

B. Termination by decision of a court

According to Article 450(2) of the RFCC, a party to a contract may apply to a court for termination of the contract only in the case of the other party's material breach or in other cases set forth in the RFCC, other legislation or contractual terms. The court explained, "At the request of one of the contractual parties the contract can be terminated or modified by court only as a result of the other party's material breach or in other cases set forth in the Code, other legislation or contractual terms."[3] Articles 619 and 620 of the RFCC, for example, stipulate that the parties to a lease contract must apply to the court to terminate the lease contract if one of the breaches enumerated under the said provisions occurs.

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[2] Commentaries to the RFCC, at 406, (Editors T.E. Abova & A.U. Kabalkina, Moscow, 2011) (in Russian).

[3] The definition No.7-KG26-6 by the civil division of the Supreme Court of Russia (Mar. 7, 2017) and The definition No.29-KG14-3 by the civil division of the Supreme Court of Russian (Nov. 18, 2014) (in Russian).

1. Material breach

The concept of "material breach" is well-known in the common law tradition. G. H. Treitel, for example, explains that the concept of material breach is used to control the availability of termination remedy: "the remedy is only available if the default attains a certain minimum degree of seriousness".[4] This principle exists in one form or another in the American common law and in French and German civil law jurisdictions as well.[5] We shall explain later on in this paper that the Korean contract law also has more or less the same principle.[6]

The RFCC adopted a similar principle of material breach. Russian jurist, M. Rozenberg considered that the material breach is a violation which makes it impossible for the other party to achieve the goal of the contract.[7] According to Article 450(2) of RFCC, a material breach means a breach which would deprive a significant part of the profit the innocent party had expected to get at the time the contract was concluded. In some cases, specific criteria for identifying a material breach may be stipulated by the RFCC or by the contract. For example, Article 523(2) provides that repeated violations of the terms of delivery would amount to a material breach.

It is recognised that the concept of "material breach" cannot easily be spelled out. Treitel points out that "the delicate balancing of interests that is required in this area is pre-eminently a matter for judicial discretion, and not one that can be determined in advance by fixed rules".[8] The RFCC, as well as the legislation of other countries, formulates the principle of material breach in general phrases. The concept of material breach involves a broad discretion of court. Compared to countries with free market economy system, the introduction of the concept of "material breach" in Russian Federation is relatively new. The general and broad nature of the definition of material breach, combined with the lack of academic doctrine and judicial practice relating to material breach, would lead to unpredictability and uncertainty of the termination remedy in the event of a breach.[9]

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[4] G.H. Treitel, Remedies for Breach of Contract. A comparative Account, at 350. (Clarendon press, Oxford, 1988 (reprinted 2011)).

[5] K.Zweigert & H.Koetz, An Introduction to Comparative Law 230-1 (translated by T. Weir) (Oxford, 1998).

[6] *Supra* note below.

[7] The Commentaries on the RFCC, Part 1, at 862 (Managing Editor O.N. Sadikov, 2003) (in Russian).
Dr Mihail G. Rozenberg (1925.02.18 - 2013.05.11) was Professor of International Trade Law, a member of Presidium of the Supreme Court of Russian Federation as well as an arbitrator of the International commercial arbitration court at Chamber of Commerce and Industry of the Russian Federation.

[8] G.H. Treitel, *supra* note 4, at 350.

[9] A.G. Karapetov, *Trends in the legal regulation of termination of breached contract in a foreign and Russian Civil Law*, Doctorate Thesis, Moscow, 2011, http://www.m-

2. Required steps for applying for termination

A party wishing to apply to the court for termination of a contract must comply with the procedure set forth in Article 452(2) of the RFCC. The party seeking the termination must first give a notice of termination. If the other party does not agree to termination or does not answer within 30 days from the receipt of the notice of termination, an application to the court can be lodged. If an application for termination is made without complying with this procedural requirement stipulated in the RFCC, the application will not be examined by the court.[10]

According to Article 453(4), the parties to a contract may not claim *restitutio in integrum* until after the modification or the termination of the contract, except where the law or the contract provides otherwise. Upon termination of a contract, the RFCC provisions relating to unjust enrichment will apply and the parties will be required to effect *restitutio in integrum*.

If a contract is terminated by decision of a court as a result of material breach, the innocent party may claim compensation for the loss caused by the breach. If the damage occurred because of the action of innocent party, or if the damage occurred regardless of who might have looked after the item, the party in breach is not required to compensate for the damage.[11]

As the other party may appeal against the lower court's judgment granting the termination, the court procedure for termination can take quite a while. While the case is pending, the contract is deemed to be valid and the obligor will have the opportunity to perform and the obligee has to fulfill his obligations and accept performance from the obligor. As the obligee has no right to look for a new partner during this period, his time, capital, products and other resources would be tied to the pending contract.

The claim for termination of the contract must be lodged to the court within three (3) years from the day the obligee knew or should have known about the violation of the contract. The limitation period shall be suspended during the 30 days period following the pre-trial notice of termination or during the period of attempted conciliation between the parties. The limitation period shall resume running from the time the conciliation ended unsuccessfully or 30 days after the pre-trial notice of termination if the counterpart does not answer.[12]

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logos.ru/img/file/806995605_doktorskaya.pdf (in Russian).

[10] The information letter of the Supreme Court of Arbitration of Russia No.66, para. 5 (Feb. 11, 2002) (in Russian).
The Supreme Court of Arbitration of the Russian Federation (also translated as the High Arbitration Court of the Russian Federation) was the final instance in commercial disputes in Russia. It supervised the work of lower courts of arbitration and gave interpretation of laws, which are still compulsory for lower courts.
The Resolution of the Federal Court of Arbitration of Russia No.A70-5156/2013 (Apr. 18, 2014) (in Russian).

[11] The Resolution of the Supreme Court of Arbitration of Russia No.35, para. 6.1 (June 06, 2014) (in Russian).

[12] The Resolution of the Court of Arbitration of Moscow district No.F05-21194/2017 (Feb. 14,

C. Unilateral, out-of-court termination

The unilateral, out-of-court termination of a contract under the Russian law can be classified into two sub-categories: (1) statutory right of unilateral termination stipulated in statutory provisions and (2) contractual right of unilateral termination stipulated in a contract where at least one party is a business entity.

The RFCC provides a number of statutory grounds for terminating a contract. Some of those statutory provisions have 'general' application (in the sense that their application does not depend on any particular type of contract). For instance, a contract may be terminated on the ground of delay of performance (Article 405(2)), failure of performance in a bilateral contract (Article 328(2)) and a party's lack of required license to carry out the activities contemplated in the contract (Article 450.1(3)). A great number of provisions, however, are specific to particular types of contract.

1. Delay of performance

Article 405(2) of the RFCC provides that if the performance becomes of no interest to the obligee due to the obligor's delay, the obligee may refuse to accept the performance and sue for compensation. In the event of a party's delay of performance, the other party need not give an additional time (an extension) for performance, which is known as 'Nachfrist' in German law.[13] Some Scholars argue that the requirement under Article 405(2) that the "performance becomes of no interest to the obligee" means that the delay of performance must be serious enough to constitute a "material breach" within meaning of Article 450 of the RFCC. As we pointed out earlier, Article 450 of the RFCC defines "material breach" as a breach which deprives the other party of a significant part of the benefit which was anticipated at the time of concluding the contract. In deciding whether the performance became of no interest to the obligee, one must take account only of the objective consequences of the delay. The subjective opinion of the obligee should not be taken into account.[14] However, this approach is not adopted by the court. Russian courts – especially in interpreting 'government (state) contract' – do

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2018) (in Russian).

[13] L. Enneccerus & H. Lehmann, Recht der Shuldverhaltnisse, at 93 (15th ed, 1958) (translated by G.H. Treitel, *see supra* note 4, at 327).
According to the 'Nachfrist' principle so long as performance remains possible the obligee has to give the obligor a reasonable period of time for the performance. After expiry of the Nachfrist, the obligee is entitled to terminate the contract.

[14] A.G.Karapetov, *supra* note 9, at 148. Where the author explains that the objective consequences do not depend on the will of the obligee. *See* A.G. Karapetov, *The material breach of contract as general ground for terminating the contract* (Judicial and legal activities in insurance, No.4, 2006) *available at* https://www.lawmix.ru/bux/76976 (in Russian).

not always treat the requirement of Article 405(2) (whether the performance becomes "of no interest to the obligee") in the same manner as the "material breach" under Article 450.[15]

The 'delay' mentioned in Article 405(2) of the RFCC obviously means non-performance of obligation within the agreed period. However, an expansive interpretation of 'delay' is also possible. According to an expansive interpretation, the 'delay' means not only non-performance of obligation within the agreed period, but it can also apply to a situation where the obligor's performance which was done in time was improper and the obligor fails to rectify the deficiency of the performance (for example, where a defective good was delivered in time and where replacement of the defective good can be compelled). However, where the deficiency of performance cannot be rectified due to the nature of the improper performance, the expansive interpretation of 'delay' under Article 405(2) cannot be used.

2. Non-performance of obligation in a bilateral contract

Article 328 of the RFCC provides protection for the obligee when the obligor does not fulfill its obligation. In the event of non-performance of the obligor, the obligee has a choice under Article 328(2) of the RFCC. The obligee can delay its own counter-performance, i.e., the performance (discharge) of its own obligation which is conditional upon the other party's performance. Or the obligee can refuse to perform its own obligation and demand compensation from the other party who failed to perform. Article 328(2) therefore provides for the obligee's right of unilateral termination of a bilateral contract. This is an exception to the general rule that a contract ought in principle be terminated by order of the court. A bilateral contract may be terminated by unilateral, out-of-court termination by a party in the event of the other party's failure of performance.[16]

Moreover, Article 328(2) of the RFCC expressly provides for the obligee's right of unilateral termination even before the due date – when it is clear that the obligor will not perform its obligations within the time prescribed in the

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[15] Government contract is a contract where the client (customer) acts on behalf of the Russian Federation in order to meet the needs of the State. In the awarding of government contracts, the performer (entrepreneur) cannot modify the contractual conditions, by the nature of the special features of this contract. When it comes to termination of contract, the customer (Government) usually use the right to unilateral termination without any limitation, because the RFCC does not provide the rule of material breach as general rule for any kind of termination. The customer (government) is not considered to be an entrepreneur, a professional. Also, because of post-soviet ways of thinking, usually judges identify themselves as a Government employee, as result, in most disputes with a Government the Government wins.

[16] S.A. Somenkov, Termination o□ the Contract o□ the Circulation o□ Civilian: Theory and practice, at 102 (Moscow, 2002) (in Russian).
M.A. Egorova, Unilateral Termination to Ful□ill the Contract, at 54 (Moscow, 2008) (in Russian).
Civil Law: Textbook edited by E.A. Sukhanov, at 199 (Moscow, 2004) (in Russian).

contract. In other words, if a party commits an "anticipatory breach" of a bilateral contract, the other party shall be entitled to terminate the contract forthwith and claim damages pursuant to Article 328(2) of the RFCC.

3. Lack of license

Article 450.1(3) provides that if a party does not have a license for undertaking activities which are necessary to perform the contractual obligation, the other party is entitled to unilateral termination of the contract. A lack of the required license is of considerable importance in the performance of contractual obligations. It poses a severe risk of non-performance or improper performance of contractual obligations. The RFCC thus allows the party to walk away from the contract if the other party lacks the required license. It should be noted, however, that a lack of license does not lead to invalidity of the contract. The lack of license merely entitles a party to unilaterally terminate the contract and to claim damages.[17]

4. Statutory right of termination for specific contracts

Part Two of the RFCC is devoted to specific types of contracts. Many provisions in Part Two of the RFCC stipulate that in the event of a party's failure to perform in accordance with the contract, the other party shall be entitled to "refuse to fulfil the contract" and to claim compensation or refund. Paragraph 11 of Resolution of the Plenum of the Supreme Court No.54 confirms that statutory provisions for particular types of contract may stipulate a party's right of unilateral, out-of-court termination or modification of the contract.

For example, if the seller in a contract of sale refuses to deliver the thing sold, the purchaser shall have a right of unilateral, out-of-court termination (Article 463(1) of the RFCC). In a contract of sale where the seller undertook the delivery, either the seller or the purchaser shall have a statutory right of out-of-court termination in the event of a material breach of the other party (Article 523 of the RFCC). In a contract of carriage, the passenger may unilaterally terminate the contract if the carrier delays the dispatch of a transport vehicle (Article 795(2)). Also see Articles 475(2), 480(2), 484(3), 486(4), 489(2), 490, 509(3), 515(2), 715(2), 716(3), 719(2), 723(3), 737(3), 896(2), etc. Although the statutory provisions do not use the word 'unilateral', it is understood that these provisions stipulate unilateral, out-of-court termination of a contract.[18]

In some provisions of the RFCC, a party's right of unilateral termination is expressed as the right to request return of goods or refund of money which had

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[17] The Resolution of the Plenum of the Supreme Court of Russia No.25, para. 89, (June 23, 2015) ("**The Resolution No.25**") (in Russian).

[18] The Resolution of the Federal Court of Arbitration of Russia No.KG-A40/6193-07 (Aug.6, 2007); The Resolution of the Federal Court of Arbitration of Russia No.KG-A40/1341-09 (Mar. 23, 2009) (in Russian).

been handed over to the other party before the breach of the contract occurred. For example, Article 487 of the RFCC provides that if the seller does not deliver the prepaid goods to the buyer, the buyer has the right to demand a refund. Article 488 of the RFCC provides that if the buyer does not pay for the delivered goods, the seller has the right to demand the return of the goods. The right to demand the return of money or the goods should be understood as the right of unilateral, out-of-court termination. The judicial practice and the Resolutions of the Supreme Arbitration Court of Russian Federation confirm this point.[19]

(i) Termination at will

For certain kinds of contract, the RFCC provides that a party may, in the absence of any breach of the other party, unilaterally terminate the contract. In such a case, the other party must be fully compensated by the terminating party. For example, in a construction contract (which is a contract for a piece of work), the customer (owner) has the statutory right of unilateral termination before the delivery of the result of the work. But the contractor must be fully compensated for the work done until the receipt of the owner's notice of termination (Article 717 of the RFCC). Either of the parties to a contract of service shall have the statutory right of unilateral termination provided that the terminating party compensates for the loss incurred by the other party (Article 782 of the RFCC). Parties to a contract of freight forwarding are entitled to terminate the contract at any time upon a reasonable advance notice. But the terminating party must compensate the loss caused to the other party (Article 806 of the RFCC).

(ii) Termination upon occurrence of a defined event

Parties to a contract of agency (Article 1010 of the RFCC) or a contract of trust (Article 1024(1) of the RFCC) shall have the statutory right of unilateral termination upon the occurrence of events (such as death, insolvency, etc.) stipulated in the respective provisions. In such a case, the terminating party is not required to compensate the other party in respect of the termination.[20]

5. Contractual right of unilateral termination

Article 310(2) of the RFCC used to provide that "If both parties are entrepreneurs, they can agree that in some situations one party is entitled to terminate the contract by unilateral termination." A 'contractual' right of unilateral termination or alteration of the contract was therefore available when both parties were business entities. Before the Federal Law No. 42 had been adopted in 2015, the legal rule was that if one of the parties was not a business entity, the parties were not allowed to agree upon a contractual right of

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[19] The Resolution of the Plenum of Supreme Court of Arbitration of Russia No.9929/04 (Nov.09, 2004) (in Russian).

[20] The Resolution of Plenum of Supreme Court of Russia No.54 (Nov. 22, 2016) (in Russian).

unilateral termination. Such a legal rule was criticized by legal scholars who pointed out that the rule was ineffective for the protection of the non-entrepreneurial party's right because it merely made the process of withdrawal from breached contract more complicated.[21] The legislator embraced these criticisms and in 2015 the amendment to Article 310(2) of RFCC was adopted. Now, Article 310(2) provides that if one of the parties is not engaged in business, the non-commercial party may have a 'contractual' right of termination stipulated in the contract.

Article 310(2) of the RFCC now allows the following two possibilities:

① If both parties are business entities, they may agree upon a contractual termination clause. Either party or both parties may have the contractual right of unilateral termination.

② If one of the parties is a business entity, the parties may agree upon a contractual termination clause where the party who is not a business entity can have the contractual right of unilateral termination.

It should be noted that the contractual right of unilateral termination must be set forth in a clear and unambiguous manner. If the contractual language is inconclusive, Russian courts could deny the contractual right of unilateral termination.[22] The court relies on Article 431 (Interpretation of Contract) of the RFCC in establishing the parties' intent. In some cases, courts have denied the contractual right of unilateral termination by pointing out that the grounds for exercising the contractual right have not been set out in a sufficiently clear manner.

(i) Whether parties may override statutory termination provisions

Some scholars argue that where the law establishes the procedure for termination of contract, the parties may not stipulate a different procedure or different requirements for termination of the contract by their own will.[23] For instance, Article 619 of the RFCC stipulates the procedure and the grounds for lessor's application to a court to have an early termination of a lease contract. The provision does not expressly envisage the situation where the parties or a party would have a contractual right of unilateral, out-of-court termination.[24] However, the court interprets that the parties may agree upon a contractual right of unilateral termination. According to the Resolution of the Presidium of the

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[21] A.G. Karapetov, *supra* note 9, at 153.

[22] E.V. Pozdysheva, *The application of avoidance regulations on termination and modification of the contract in the new version of the RFCC*, Russian Law Journal No.12, 62 (2016) (in Russian)

[23] S.A. Somenkov, see supra note 16, at 103; Civil Law: textbook edited by E.A.Sukhanov, *see supra* note 16, at 385

[24] A.G. Karapetov, *Freedom of contract and the limits of the imperativeness of Civil Law*, Supreme Court of Arbitration Herald No.11, 100, 100-133 (2009) (in Russian) https://www.m-logos.ru/publicationsscience

Supreme Arbitration Court of Russia No. 66, parties have a right to agree upon a contractual right of unilateral termination of a lease contract.[25]

For another example, a building contract contained a clause which stipulates that if the builder delays the work for more than 30 days, the customer (owner) shall be entitled to terminate the contract. The builder delayed the work for 7 days. The customer sent a termination notice to the builder relying on Article 708(3) of the RFCC which stipulates that any failure to meet the agreed deadlines for the work shall have the consequences set forth in Article 405(2) which entitles the obligee to terminate a contract (provided that the performance became of no use to the obligee due to the obligor's delay).

Lower courts rejected the builder's defence that those statutory provisions have been superseded by the contractual clause which requires a delay of more than 30 days for the owner to terminate the contract. The Supreme Arbitration Court, however, accepted the builder's defence and ruled that in a construction contract the parties are entitled to agree upon specific conditions for termination of the contract which are different from statutory termination provisions. As the parties in this case agreed that the owner shall have the right of termination when there is a delay of more than 30 days, the Supreme Arbitration Court ruled that the notice of termination which was sent after 7 days of delay shall have no validity.[26]

(ii) Whether parties may agree upon 'automatic' termination

An 'automatic' termination clause can be found in some contracts. The validity of such a clause is debated. For example, an insurance contract had the following clause: "In case of late payment of the insurance premium by the insured person, the contract is considered as terminated". The insured failed to pay the insurance premium. After that, the insured event occurred. The insurer refused to pay the insurance payment on the ground that the contract has already been terminated. However, the Presidium of the Supreme Arbitration Court ruled differently. It was held that the 'automatic' termination clause should be interpreted merely as conferring a right to unilateral termination. As the insurer did not send the termination notice which is required for an exercise of the

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[25] The information letter of Presidium of the Supreme Arbitration Court of Russia No.66 para. 27 (Jan. 11, 2002).
Also *see* The Resolution of Presidium of the Supreme Arbitration Court of Russia No.5782/08 (Sep. 09, 2008) and The Resolution of the Plenum of Supreme Arbitration Court of Russia (Dec. 23, 1997) (in Russian).

[26] Review of Jurisprudence of the application of the legislation of Russia on the contract in the field of procurement of goods, works, services approved by the Presidium of the Supreme Court of Russia, (June 28, 2017) (in Russian)
Also *see* 2 M.I.Bragiskyi & V.V.Vitryansky, Contract Law, at 488-489, (Moscow, 2003). (in Russian)

termination right, it was concluded that the insurance contract was still valid and binding.[27]

It should be noted that this position is not always adopted. For instance, the Resolution No.10254/01 the Supreme Arbitration Court of Russian Federation issued a different decision. The Court accepted to give full effect to an automatic termination clause in a cession contract, according to which the contract is considered as automatically terminated if one party fails to perform its obligations.[28]

D. Notice of unilateral, out-of-court termination

Article 450.1(1) of the RFCC stipulates that the exercise of a statutory or contractual right of unilateral termination of a contract (refusal to execute a contract) must be done by giving a notice of termination to the other party. The right of unilateral, out-of-court termination can be based on the RFCC, other laws, other legal acts or contract. The contract shall be terminated upon receipt of the notice of termination. The RFCC does not prescribe the form or the required content of the termination notice. But the party's intent to terminate the contract must be clearly expressed. It is usual to give the notice in writing, sent by post. According to the Resolution of Plenum of the Supreme Court of Russia No.25, communication of legally significant information may be done by electronic mailing (e-mail), fax and other means of communication as long as the sender and the recipient can securely be identified, unless otherwise stipulated by the applicable law or by the contract.[29]

E. Disputing the validity of unilateral, out-of-court termination

Under the Russian law, a unilateral out-of-court termination by a party is also a 'transaction' which took place between the parties.[30] The other party may dispute the validity of the unilateral termination by applying to the court. Under the Russian law, any 'transaction' of a party could be voided by a court or the court may find that the 'transaction' was void in the first place.[31] Russian law currently does not have a specific time bar for disputing the validity of a unilateral termination of contract.[32] The usual limitation period for civil claims

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[27] The information letter of the Presidium of the Supreme Court of Arbitration of Russia No.75, para. 16 (Nov. 28, 2003) (in Russian).

[28] The Resolution of the Presidium of the Supreme Court of Arbitration of Russia No.10254/01 (Aug.13, 2002) (in Russian).

[29] The Resolution No.25, paragraph 65, *supra* note 17.

[30] The Resolution of the Supreme Court of Arbitration No.4705/95 (Nov. 21, 1995) (in Russian).

[31] Part I, Chapter 9, §2 of the RFCC sets out provisions dealing with invalidity of transactions.

[32] A.G. Karapetov, *supra* note 9, at 239.

in general (which is 3 years) shall therefore apply.[33] A challenge to the validity of the unilateral termination must be lodged within 3 years from the date the party learns of the other party's exercise of the alleged right of unilateral, out-of-court termination.

Thus, a party's unilateral, out-of-court termination inevitably creates some uncertainty while the other party is entitled to challenge the validity of the purported termination. But this is unavoidable for any out-of-court actions taken by a party. Some scholars point out that due to the multitude of different types of contracts it is impracticable to establish a special (i.e., shorter) limitation period for the challenge of a unilateral termination of contract. According to these scholars, a party's lack of reaction for a long period of time after receiving the other party's notice of unilateral termination would be interpreted by courts as the former's unwillingness to save the contract. It is likely that the court would find in favour of the terminating party even if the challenge is made within 3 years.[34]

F. Waiver of the right of unilateral termination

Article 450.1(5) provides that while there exist grounds for a party to acquire the right of unilateral termination, if the party nevertheless affirms the contract expressly or implicitly by accepting the other party's performance, then the party loses the right to terminate the contract on the same grounds. Article 450.1(6) confirms that a party who is a business entity may validly waive its right of unilateral termination.

In some cases, however, a party's acceptance of the other party's late performance does not necessarily mean the former's affirmation of the contract. According to the Resolution of Plenum of the Supreme Arbitration Court No.73, if the lessee defaults to pay rent on two successive payment dates, the lessor may sue for termination of the lease contract (pursuant to Article 619 of the RFCC) even after the lessor receives the late payments made by the lessee, provided that the application for termination of the lease was made within a reasonable period after the lessor received the late payments of the rent.[35] The court explained that if the lessor does not sue for the termination within a 'reasonable time' after the receipt of the late payments of the rent, the lessor will lose the right to sue for termination of the lease contract.[36] The reasonableness of the period will be decided by a judge in each particular case.

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[33] Article 196 of the RFCC provides that the general limitation period shall be 3 years from the start date which is defined in Article 200 of the RFCC.

[34] A.G. Karapetov, s*upra* note 9, at 249.

[35] The Resolution of the Plenum of Supreme Court of Arbitration No.73, para. 23 (Nov. 17, 2011) (in Russian).

[36] Same were confirmed in Supreme Court of Korea, Judgment, 96Da14616 (July 26, 1996).

II. Termination of a contract under the Korean law

Under the Korean law, termination of a contract may be done either by a party's unilateral exercise of termination right or through an express or implied consent of the parties. The right of termination is explained as a "formative right (*Gestaltungsrecht*)" in the sense that by exercising the right, one party can change (e.g., terminate) the legal relationship of the parties irrespective of the other party's intent or consent. Such a "formative right" of termination can arise either by virtue of law or in accordance with the parties' agreement.

Korean law regards that termination of a contract is a result of a party's or the parties' action. It is for the party who has or acquires the right of termination to decide whether or not to exercise the right (of unilateral termination). It is also for the parties to decide whether to agree to put an end to their contractual relationship (termination by consent). The court is called upon only when there is a dispute as to the validity of termination. The court's task is merely to confirm (i) in the case of a unilateral termination, whether the party indeed had a right of termination and whether the right was properly exercised; and (ii) in the case of termination by consent, whether there was a valid consent (express or implied) to put an end to the contractual relationship. In these cases, the court's judgment is confirmatory. The court does not have the power to terminate a contract under Korean law. The court merely 'finds' and 'confirms' whether the contract was properly terminated by a party (unilaterally) or by consent of the parties. The court does not have discretion either. If the court finds, for example, that a party had the right and that the party did exercise it, then the court must find that the contract was terminated.

A. Legal right of termination in the event of a material breach

1. Delay of performance

Articles 544 and 545 of the Korean Civil Code ("KCC") provide for a party's right of termination in the event of the other party's delay of performance. In principle, delay of performance does not immediately entitle the other party to have the right of termination. The other party must give a reasonable period of extension and only when the extension is not met, can the other party acquire the right to terminate the contract. However, the KCC stipulates certain exceptions to this rule. If the party in delay makes it clear that it has no intention to perform, the other party is not required to give an extension but may terminate the contract forthwith (Article 544). If the nature of the contract is such that any delay of performance would render the purpose of the contract unachievable, then immediately upon one party's delay, the other party shall be entitled to terminate the contract without having to give an extension (Article 545).

2. Impossibility of performance

Article 546 of the KCC stipulates that if performance of a contract becomes impossible due to a cause for which a party is responsible, then the other party shall be entitled to terminate the contract. The Korean Supreme Court explains that whether or not performance of an obligation became impossible should be determined in light of the rules of experience and commercial understanding. Impossibility of performance does not necessarily mean absolute or physical impossibility. If it cannot be expected that the other party would be able to perform (in light of the rules of experience and commercial understanding), then the performance of the obligation will be judged to have become impossible as a matter of law.[37] In the event of partial impossibility, the court would allow termination of the entirety of the contract if the purpose of the contract cannot be achieved with the remainder of the contractual obligation which is still possible to be performed.[38]

If performance of contract was already impossible at the time of concluding the contract, such a contract would be void and unenforceable in the first place. The question of termination does not arise for such a void contract. But the party who had known or should have known that the contract could not be performed at the time of concluding the contract shall have to compensate for the loss caused to the other party due to the latter's reliance on the contract (provided that the latter was not negligent in holding the belief that the contract was possible to be performed).[39] If performance of contract becomes impossible due to a cause for which neither party is responsible, then the parties shall all be discharged from the contractual bond and neither party shall be liable to the other party.[40]

In a bilateral contract where parties mutually incur reciprocal obligations (i.e., a "synallagmatic contract" such as sale, exchange, lease, etc.), if performance of one party's obligation becomes impossible while the other party is in *mora creditoris* (i.e., while the other party fails to receive the performance properly tendered by the former), then the party in *mora creditoris* may not terminate the contract on the ground of the other party's impossibility of performance (unless the impossibility was due to the other party's intentional act or gross negligence).[41] The other party (assuming that its impossibility of performance is not due to its own intentional act or gross negligence) shall be entitled to demand the counter-performance from the party who was in *mora creditoris*.[42] For instance, suppose the buyer of a bicycle failed to take delivery

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[37] Supreme Court of Korea, Judgment, 96Da14616 (July 26, 1996).
[38] Supreme Court of Korea, Judgment, 95Da5929 (July 25, 1995).
[39] Article 535 of the KCC.
[40] Article 537 of the KCC.
[41] Article 401 of the KCC.
[42] Article 538 of the KCC.

and thus in *mora creditoris*. If the bicycle is then destroyed through no intention or gross negligence of the seller while the buyer fails to take the delivery, then the seller shall be entitled to demand full purchase price from the buyer (although the bicycle can no longer be delivered). The buyer in this case may not terminate the contract on the ground of the seller's impossibility to deliver the bicycle. If, however, the seller destroys the bicycle with gross negligence or intentionally sells the bicycle to a third party while the buyer fails to take the delivery, the buyer (who is in *mora creditoris* and who may also have been in breach of contract if he delayed payment of the purchase price) shall be entitled to terminate the contract on the ground of the seller's impossibility to deliver the thing sold.[43]

3. Unequivocal refusal of performance (repudiatory breach)

If a party definitively and unequivocally expresses (before or after the obligation falls due) its intent not to perform its contractual obligation and it is thus unlikely that the contract will ever be performed, then the other party shall be entitled to terminate the contract forthwith. If the party who expresses the intent to refuse to perform is already in delay, the other party's termination right is stipulated in Article 544 of the KCC which deals with the delay of performance. But when one party's unequivocal refusal to perform occurs before the due date arrives, or while both parties missed the due date in a bilateral contract and therefore neither party is in delay[44], the court has nevertheless (in the absence of a clear statutory ground) explained that the other party shall be entitled to terminate the contract *forthwith*, so that the termination can be done before the due date arrives and, in a bilateral contract, the terminating party need not tender its own performance to the repudiating party (tender of performance would normally be necessary to make the other party liable for delay of performance in a bilateral contract).[45]

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[43] Supreme Court of Korea, Judgment, 2010Da11323 (Apr. 30, 2014); Supreme Court of Korea, Judgment, 2015Da249383 (Mar. 24, 2016).

[44] In a bilateral contract where both parties missed the due date, while neither party is tendering its performance, both parties have a defence of simultaneous performance (Article 536), which means that neither party is in delay.

[45] Supreme Court of Korea, Judgment, 90Da8374 (Mar. 27, 1991); Supreme Court of Korea, Judgment, 2004Da53173 (Aug. 19, 2005); Supreme Court of Korea, Judgment, 2008Da29635(Mar. 12, 2009). *See* Chang Soo Yang, *Revisiting repudiatory breach as an independent type of non-performance of obligation – Formation of judicial precedents and the legal effect*, Beobjo (Jan. 2015) (in Korean). Professor Yang argues that repudiatory breach began to be recognised by the Supreme Court as an independent type of breach in mid 2000s. But many judgments of the Korean Supreme Court throughout the 1990s were already recognising repudiatory breach in a bilateral contract.

4. Breach of warranty

In a contract of sale, if the seller breaches an express or implied warranty regarding good title or absence of defect, the buyer has a range of remedies including termination of contract. The buyer may terminate the contract, for example, when the buyer is evicted from the thing sold and delivered (Articles 570, 572); when the thing sold and delivered turns out to have hidden charges, encumbrances, shortage of quantity or other defect which makes it impossible to achieve the purpose of the contract (Articles 574 – 578, 580, 581).

These provisions also apply to other contracts where one party incurs an obligation to pay for goods, rights or services provided by the other party. If the supplied goods, rights or services turn out be have a defect (including defect in title) which is so serious as to defeat the purpose of the contract, the party who incurred an obligation to pay shall be entitled to terminate the contract.

5. Material breach

The concept of "material breach" is well-established and frequently used by Korean courts. Although it is not explicitly stipulated in the KCC, the Korean Supreme Court has consistently maintained that the exercise of a legal (statutory) right of termination on the ground of the other party's breach of contract (including breach of warranty) is allowed only when the breach is material. A breach is material if it concerns an indispensable obligation of a contract without which the purpose of the contract cannot be achieved and thus the parties would not have entered into the contract.[46] A breach of contract which is not material cannot be used as an excuse to free oneself from the contractual bond. The sole remedy available to the party who suffered loss from a non-material breach of contract shall be damages claim. On the other hand, if a party commits a material breach, the other party shall have the right of termination as well as damages claim.[47]

B. Statutory right of termination in the absence of a breach

Several provisions of the Korean Civil Code or the Korean Commercial Code stipulate, for certain types of contract, a party's or both parties' right to terminate the contract in the absence of any breach. An agreement to donate which is not in writing may be terminated at any time (Art 555). An agreement to extend an interest free loan may, at any time before the loan is actually made, be terminated by either party (Article 601). The owner of a contract for a piece of work (such as construction contract) may terminate the contract at any time before the contractor completes the work. But the owner must compensate the

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[46] Supreme Court of Korea, Judgment, 2005Da53705 (Nov. 25, 2005); Supreme Court of Korea, Judgment, 2003Da15518, (Feb. 10, 2006).

[47] Article 551 of the KCC.

contractor for the loss caused by termination (Article 673). If the owner becomes bankrupt, however, either party may terminate the contract without compensation for the loss caused by termination (Article 674). Tourism contract may be terminated by the customer at any time before the tour begins. But the customer must compensate the tour operator for the loss caused by termination (Article 674-3). Lease contract without an agreed duration may be terminated by either party at any time with an advance notice (Article 635). If the lessee becomes bankrupt, either party may terminate the lease contract with an advance notice regardless of the agreed duration of the lease contract. In this case, neither party may claim damage for the loss caused by termination before the expiry of the agreed duration of the lease (Article 637). Contract of mandate may be terminated at any time. If, however, the termination was done in the absence of unavoidable circumstances at a moment which is disadvantageous to the other party, the terminating party must compensate the other party's loss caused by termination (Article 689). Contract of deposit without an agreed duration may be terminated at any time (Article 699).

Korean Commercial Code provides that agency contract without an agreed duration may be terminated at any time with 2 months advance notice (Commercial Code, Article 92). Franchise contract (with or without a fixed duration) may be terminated at any time with a reasonable advance notice (Commercial Code, Article 168-10). Insurance contract may be terminated by either party at any time before the occurrence of the insured event (Commercial Code, Article 649). Contract for carriage of goods by sea may be terminated by the consigner at any time. But the consigner must pay full freight (Commercial Code, Article 792). In the event of force majeure, either party may terminate the contract for carriage of goods by sea. In this case, the consigner must make pro-rata payment of freight corresponding to the effected portion of the carriage (Commercial Code, Article 811). Maritime passenger transport contract may be terminated by the passenger at any time before the ship's departure (half fare payable) or after the depature (full fare payable) (Commercial Code, Article 822). Voyage charter party contract may be terminated by the charterer at any time. But the charterer must pay damage to the shipowner corresponding to ½ or 2/3 of the freight (if the termination was done before the ship's departure) or full freight plus costs (if the termination was done after the departure) (Commercial Code, Articles 832 and 837).

C. Contractual right of termination

Parties to a contract are free to agree upon contractual right of termination. As explained by the Korean Supreme Court, contractual termination clauses may fall into one of the following two categories:[48]

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[48] Supreme Court of Korea, Judgment, 2015Da59115, (Apr. 15, 2016).

① Clauses stipulating the right of termination in the event of a breach: Contractual termination clauses can stipulate concrete and specific events of breach upon whose occurrence a party may terminate the contract. The parties may also agree upon the steps which must be taken to terminate the contract. These contractual termination clauses broadly re-confirm (with or without modifications as agreed by the parties) the legal or statutory right of termination which arises in the event of the other's party's breach of contract.

② Clauses stipulating the right of termination in the absence of breach: Contractual termination clauses may allow a party or the parties to terminate the contract even in the absence of any breach of contract. It is not unusual for parties to agree that they can be freed from the contractual bond upon occurrence of certain event(s) which do not amount to a breach but are likely to hamper smooth performance of the contract. Of course, the parties may also agree that they can terminate the contract at any time or until certain point in time for no reason.[49]

The distinction as expounded by the Supreme Court has an important consequence for the damage liability. If termination of contract is grounded on the other party's breach of contract, the terminating party shall – as a matter of course – be entitled to claim damage (in addition to termination of the contract). This holds true whether the terminating party relied on a 'legal' right of termination (arising from the other party's material breach) or on a 'contractual' right of termination (arising from an agreed event of breach). Article 390 of the KCC provides the statutory ground for claiming damage from a party who committed a breach.

On the other hand, if the termination was done on the ground of a contractual termination clause which stipulates the right of termination in the absence of a breach, the Supreme Court held that the terminating party may not normally claim damage from the other party unless there are unequivocal contractual provisions or special circumstances supporting the interpretation that a party who did not commit a breach must nevertheless bear the damage liability regardless of fault.[50]

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[49] Where the purchaser pays a deposit in a sale contract, it is usual for the parties to agree that either of the parties shall be entitled to terminate the contract (for no reason) by giving up the deposit (if the purchaser terminates) or by paying double the deposit amount (if the seller terminates) before a party begins to perform the contract. See Article 565 of the KCC as well.

[50] Supreme Court of Korea, Judgment, 2015Da59115, (Apr. 15, 2016). The Supreme Court held that the contractual clause which stipulated, "If a loss occurs as a result of the termination or cancellation of the contract pursuant to Paragraph 1 above [which included termination in the absence of breach], damage may be claimed from the other party" was not clear enough to entitle the terminating party to claim damage from the other party who did not commit a breach.

Whether the terminating party who relied on a contractual termination clause which stipulates the right of termination in the absence of a breach, has to *pay* damage to the other party will depend on the language of the contract in each case. If the contractual termination clause reconfirms, rather than excludes, a statutory right of termination and if the relevant statutory provision requires the terminating party to compensate for the loss caused by the termination in the absence of the other party's breach (Articles 673, 674-3, 689 of the KCC and Articles 792, 811, 822, 832 and 837 of the Korean Commercial Code), then the statutory damage liability should be given due weight in determining the question of damage liability. The statutory damage liability of the terminating party may not be interpreted as 'implicitly' excluded by the parties in the absence of a clear and unambiguous contractual language to exclude such liability.

1. Waiver of the legal right of termination

Parties to a contract are free to waive (exclude) the legal or statutory right of termination which would, in the absence of such a waiver, entitle a party to terminate the contract in the event of the other party's material breach of contract. However, the Supreme Court explained that such a waiver must be expressly and unambiguously stated: "The parties' agreement to exclude the legal right of termination in the event of non-performance would in itself have the consequence of condoning the non-performance – even though damage claims are still available. The court must therefore interpret the contractual language in a strict and restrictive manner to deny such an agreement except where the parties' agreement to exclude the legal right of termination is expressly stipulated."[51]

D. Notice of termination

The exercise of a legal or contractual right of termination must be done by giving a notice of termination to the other party (Article 543 of the KCC). The KCC does not stipulate as form requirements applicable to the notice of termination. Therefore, any manner of communication (oral or written notice) can be used. Electronic means of notice can also be used. But if the parties agree upon a particular formality applicable to their termination notice, then such an agreement must be observed.

The notice of termination must contain a clear, unambiguous and unconditional intent to terminate the contract. If the intent to terminate the contract is presented as subject to the occurrence of an event which is uncertain, then such a termination notice shall be treated as having no effect.[52] Although termination of a contract may not normally be subject to an uncertain condition,

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[51] Supreme Court of Korea, Judgment, 2004Da22971 (Nov. 9, 2006)

[52] 2 Commentaries to the Civil Code, Obligations, Particular Part, at 103, (4th. ed. 2016).

if the fulfilment of the condition depends entirely on the other party, then termination can validly be done subject to such a condition (e.g., "If you do not perform by the end of the week, this contract shall be deemed terminated.") This is because the other party is not put in a vulnerable or precarious position of not knowing whether the contract will or will not be terminated.[53]

Where there are several persons or parties to one or both sides of a contract, termination must be done unanimously. Thus the termination notice must be given by or given to all persons/parties of a side. If one of those persons or parties loses the right of termination, then all of them lose the right of termination. If the other side's termination right is extinguished vis-à-vis one person of this side, the extinction of the other side's termination right shall have effect for all persons or parties of this side (Article 547 of the KCC).

E. Extinction of termination right

Article 552 of the KCC provides that where a party has a termination right whose duration is not agreed upon, the other party may fix a reasonable period of time and demand a confirmation as to whether the termination right is to be exercised. If no notice of termination is received within the reasonable period, the termination right (if any) shall be extinguished.

Where a party is required, upon termination, to return the item (including movables and immovable) which it had received from the other party, the former's right of termination will also extinguish if he deliberately or negligently destroys, damages or alters the item (Article 553 of the KCC).

As with other rights *in personam*, termination right is also subject to a limitation period of 10 years.[54]

F. Termination by mutual consent

There is no doubt that parties are free to agree to alter or to put an end to their contract. The Korean Supreme Court views termination of a contract by mutual consent as a "new contract". The Court explains as follows: "Termination of a contract by consent, i.e., a termination agreement, means ... a new contract whereby the parties agree to extinguish the effect of the existing contract and to achieve a status quo ante as if no contract was concluded in the first place."[55] When the parties dispute as to whether the contract was properly

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[53] Supreme Court of Korea, Judgment, 80Da2381 (Apr. 14, 1981).

[54] Article 162 of the KCC. Supreme Court of Korea, Judgment, 2000Da26425 (Jan. 10, 2003) rules that an option acquired from an option contract must be exercised within 10 years (unless a shorter duration is agreed upon). Termination right and the contractual right to exercise an option are explained as "formative rights (Gestaltungsrechts)". They are subject to the same limitation period.

[55] Supreme Court of Korea, Judgment, 2004Da11506 (June11, 2004).

terminated by consent, the court would therefore examine whether there was an "offer" to terminate the existing contract and whether "acceptance" was made.[56] What the parties will be required to do upon termination by mutual consent shall be governed by the parties' agreement.

The Korean Supreme Court recognises that a contract can be terminated not only by an express agreement but also by an 'implicit' consent which the court can infer from the parties conducts. For example, in a case where the lessee argued that the lease contract was terminated and demanded that the lease deposit must be returned whereas, for more than 2 years, the lessor stopped demanding rent from the lessee who never occupied the leased property, the court held that the lease contract was terminated by an implicit consent of the parties. The court explained as follows: "Termination of a contract can be effected not only by an express agreement but also by an implicit consent. Where the parties' express behaviour objectively shows that the parties' abandonment or the lack of intent to execute the contract is common to the parties, then it is proper to interpret that the contract is terminated by an implicit accord of the parties' intent not to execute the contract." The Court further held that when a contract is terminated by mutual consent of the parties, the Civil Code provision stipulating the consequences of one party's unilateral exercise of termination right (the duty to pay interest on the money which has to be returned; Article 548(2)) shall not apply.[57]

While termination of a contract can be done by an express or implicit consent of the parties, rescission of a contract may not be done by consent of the parties. If there was no valid ground to rescind a contract (i.e., lack of capacity, mistake, deception, duress), the contract may not be rescinded even when both parties purported to rescind it.[58]

III. Conclusion

A study of the Russian judicial practice demonstrates that around 90% of termination-related court cases are about lease contracts, whose termination would normally require judgment of a court (Articles 619 and 620 of the RFCC).[59] The remaining cases are about disputes arising from purported termination of sale contracts, service contracts, construction contracts, financial services contracts, etc. where the purported termination was done on the ground of breach as an exercise of a party's right of unilateral, out-of-court termination.

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[56] Supreme Court of Korea, Judgment, 94Da14629 (Aug. 9, 1994).
[57] Supreme Court of Korea, Judgment, 2000Da5336 (Jan. 24, 2003).
[58] Supreme Court of Korea, Judgment, 93Da58431 (July 29, 1994).
[59] R.S.Bevzenko, *Some issues of judicial practice provision of the Civil Code on the modification and termination of contracts*, Civil Law Herald No.2, 139, 140-150 (2010) (in Russian).

Since termination by judgment of a court is presented as the default rule of the Russian contract law, there are certain difficulties of interpretation and implementation of various statutory provisions. First, when particular provisions do not expressly state that a party or the parties have a unilateral, out-of-court termination right, it is often controversial whether termination can be done without applying to a court. For example, Article 405(2) does not expressly state that the obligee has a unilateral, out-of-court termination right. It is therefore not entirely clear whether the contractual bond still remains even though the obligee is entitled to "refuse to accept" the other party's late performance. Second, although contracts where at least one party is a business entity may specify the conditions of unilateral termination in the event of a breach, this is not yet widely practised because it is a recently introduced rule and the parties are not yet familiar with it. Also, the inequality of bargaining power between the parties remains a major challenge. Especially in contracts with the government, the non-governmental party often has no real possibility of negotiating or modifying the terms of the contract proposed by the government.[60] Third, since the requirement of a "material breach" is stipulated only in connection with termination by judgment of a court (Article 450(2)(i)), there is seems to be no settle position as to whether "material breach" is generally required in the case of unilateral, out-of-court termination of a contract under the Russian law. We take the view that, unless the parties agree otherwise, the contractual bond should not easily be dissolved under the pretext of a "breach" when the breach only has an incidential significance. We believe that such a conclusion can be supported by a careful analysis of various provisions of the RFCC.

It has been less than 20 years that important modifications were made to Russian contract law and jurisprudence. They are rapidly and actively evolving since then. As O. Sadikov had stated, "Many of our problems are not due to the legislation or to defects of the legislation, but due to manner in which we apply the general provisions, which is not reasonable enough."[61]

On the other hand, the Korean legal rules relating to termination of a contract seem to have been quite well-settled. Termination of a contract is consistently presented as the party's right, which can be exercised by giving a termination notice without any formal requirement (unless the parties agree otherwise). However, there is one 'theoretical' issue which has not been properly dealt with. Unilateral termination by a party is fundamentally different from contract formation, which requires an agreement of the parties. A party's unilateral exercise of termination right does not involve any negotiation or

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[60] A.G.Karapetov, s*ee supra* note 9, at 156-157.

[61] O.N.Sadikov, *Neither the legislation nor its insufficiency is the root of our problems. The quality of its application is the challenge*. Law Journal No.11, (2015) (in Russian) *at* https://zakon.ru/publication/igzakon/6431

meeting of mind between the parties. A party's decision to terminate is usually made without any consultation or discussion with the other party. Once the decision is made and the termination notice is served, the contract shall be definitively and irrevocably terminated (often with retroactive effect) – provided, of course, that the terminating party indeed had the right to terminate. Article 543(2) of the KCC stipulates that termination notice shall not be revocable.

Now the question arises: if termination of a contract was affected by a lack of capacity (under age or legal protection of adult), mistake, deception or duress, can termination be subsequently 'rescinded' pursuant to Article 5, 10, 13, 109 or 110? In other words, are the Civil Code provisions dealing with rescission equally applicable to a unilateral exercise of a right?

If a party's unilateral termination can be 'rescinded', then the contract which was definitively terminated would be resuscitated and the parties who thought they were released from the contractual bond shall again be bound by it. In that case, the termination was not 'definitive' after all. In our view, if a party's unilateral exercise of termination can subsequently be "rescinded", it would cause too much uncertainty and hardship for the party who is completely at the mercy of the decisions of the terminating party. In any event, rescission should be available only when contract formation (i.e., the parties' *agreement*) was flawed by vitiating elements (*vices de consentement*) such as lack of capacity, etc. A unilateral exercise of termination right is not an agreement. Unilateral termination must not be revocable on the ground of mistake, deception, duress or lack of capacity. In our view, this should be the meaning of Article 543(2) of the KCC.62

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[62] However, Korean commentators seem to take a different position. They explain that unilateral termination of a contract can also be rescinded on the ground of mistake, duress, deception or lack of capacity. 2 Commentaries to the Civil Code, *supra* note 52, at 102. We disagree.

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CASES

Supreme Court en banc Order 2015Do10651 Dated November 22, 2018 【Violation of the Act on the Aggravated Punishment, Etc., of Specific Economic Crimes (Breach of Trust)】

【Main Issues and Holdings】

For cases requiring the presence of the defense counsel, where an appellate court appoints a public defense counsel, notifies the receipt of the records of trial to the defendant-appellant and his/her defense counsel, and then revokes the appointment of the public defense counsel upon the defendant's appointment of a private defense counsel, whether the appellate court should send the same notification to the newly appointed private defense counsel (negative)

Initial date from which the period for filing a statement of reasons for appeal is calculated (held: the date at which the public defense counsel or the defendant was notified of the receipt of the records of trial)

Whether Article 156-2(3) of the Regulation on Criminal Procedure, which mandates the appellate court to notify a newly appointed public defense counsel of the receipt of the records of trial when the appointment of the previously appointed public defense counsel is revoked within the period for filing a statement of reasons for appeal due to a reason that is not attributable to the defendant, can be applied extensively or analogically to the case of a newly appointed private defense counsel (negative)

【Summary of Order】

[Majority Opinion] The Criminal Procedure Act stipulates that where the appellant-defendant appointed a defense counsel before the appellate court sends a notification of the receipt of the records of trial, the appellate court shall notify the appellant-defendant and his/her defense counsel of the receipt of the records of trial (Article 361-2(2)). Hence, where the appointment of a defense counsel is made after the defendant was notified of the receipt of the records of trial, the same notice need not be delivered to the defense counsel. This likewise applies to cases requiring the presence of the defense counsel, where (a) the appellate court appoints a public defense counsel, (b) notifies the defendant and his/her defense counsel of the receipt of the records of trial, and (c) revokes the appointment of the public defense counsel thereafter upon the defendant's appointment of a private defense counsel. In this case, the period for the filing of a statement of reasons for appeal ought to be calculated beginning from the date at which the public defense counsel or the defendant received the notification of the receipt of the records of trial.

In the meantime, Article 156-2(3) of the Regulation on Criminal Procedure provides that where a public defense counsel is newly appointed within the period for the filing of a statement of reasons for appeal due to a reason that is not attributable to the defendant, the newly appointed public defense counsel should be notified of the receipt of the records of trial. However, this provision need not be extensively or analogically applied to the case of a newly appointed private defense counsel.

After all, (a) insofar as the Criminal Procedure Act or the Regulation on Criminal Procedure does not introduce express applicable provisions through the amendment procedure, (b) in cases requiring the presence of the defense counsel where the appellate court (i) appointed a public defense counsel, (ii) notified the defendant and the public defense counsel of the receipt of the records of trial, and (iii) revoked the appointment thereafter upon the defendant's appointment of a private defense counsel, (c) the appellate court is not obliged under the current Act and Regulation to notify the newly appointed private defense counsel of the receipt of the records of trial.

[Dissenting Opinion by Justice Jo Hee-de, Justice Cho Jae-youn, Justice Park Jung-hwa, Justice Kim Seon-soo, and Justice Lee Dong-won] Considering the significance of the right to assistance of counsel under the Constitution of the Republic of Korea, the purport of public defense services under the Criminal Procedure Act, the nature of cases requiring the presence of the defense counsel, and the importance of the submission of a statement of reasons for appeal in the criminal appeals proceedings, (a) in cases requiring the presence of the defense counsel under Article 33(1) of the Criminal Procedure Act, where the appellate court notified the defendant and the public defense counsel of the receipt of the records of trial; (b) and, while the defendant and the public defense counsel were yet to submit a statement of reasons for appeal, the defendant appointed a private defense counsel within the period for the filing of the statement of reasons for appeal, and the appellate court revoked *ex officio* the previous appointment of the public defense counsel; (c) it is reasonable to consider that the appellate court ought to notify the newly appointed private counsel of the receipt of the records of trial to guarantee the period for drafting and submitting the statement of grounds for appeal, unless there are special circumstances indicating that the defendant appointed a new defense counsel with the intention of deliberately delaying the litigation.

According to the Majority Opinion, a newly appointed private defense counsel must draft and submit a statement of reasons for appeal within the period remaining after having excluded the period lapsed without the submission of the statement of reasons for appeal by a public defense counsel from the period for submitting the statement of reasons for appeal, which is counted from the date at which the notification of the records of trial is accepted by the public defense counsel. This is not different from holding the defendant or his/her private defense counsel accountable for the failure of the public

defense counsel, appointed by the court for the defendant, to submit a statement of reasons for appeal within the prescribed period after having received the notification of the acceptance of the records of trial. We disagree with the Majority Opinion that: (a) practically reduces the period for submitting a statement of reasons for appeal allowed for a defense counsel in cases requiring the presence of the defense counsel, where there is an indispensable need for supplementing the capabilities of the defendant to defend himself/herself; (b) and, in our opinion, overlooked the fact that the defendant's constitutional right to have assistance of counsel is infringed upon.

Similarities are recognized between the instant case and the circumstances in which a public defense counsel is changed for a reason that is not attributable to the defendant in cases requiring the presence of the defense counsel. Hence, Article 156-2(3) of the Regulation on Criminal Procedure may analogically apply. This also conforms to the Constitution of the Republic of Korea and the Criminal Procedure Act, which purports to offer sufficient protection for the rights of defendants to have assistance of counsel in cases requiring the presence of the defense counsel.

【Reference Provisions】 Articles 12(4) and 108 of the Constitution of the Republic of Korea; Articles 30, 33(1), 282, 283, 357, 361-2(1) and (2), 361-3(1), 361-4(1), and 364(1) of the Criminal Procedure Act; Article 1, 18(1)1, 156-2(1) and (3), and 164 of the Regulation on Criminal Procedure

Article 12 of the Constitution of the Republic of Korea

(4) Any person who is arrested or detained shall have the right to prompt assistance of counsel. When a criminal defendant is unable to secure counsel by his/her own efforts, the State shall assign counsel for the defendant as prescribed by Act.

Article 108 of the Constitution of the Republic of Korea

The Supreme Court may establish, within the scope of Act, regulations pertaining to judicial proceedings and internal discipline and regulations on administrative matters of the court.

Article 30 of the Criminal Procedure Act (Persons Entitled to Appoint Defense Counsel)

(1) A criminal defendant or a criminal suspect may appoint a defense counsel.

(2) The legal representative, the spouse, a lineal relative, or a sibling of a criminal defendant or a criminal suspect may independently appoint a defense counsel. *<Amended by Act No. 7427, Mar. 31, 2005>*

Article 33 of the Criminal Procedure Act (Court-Appointed Defense Counsel)

(1) In any of the following cases, if no defense counsel is available, the court shall appoint a defense counsel *ex officio*:

1. When the criminal defendant is placed under detention;

2. When the criminal defendant is a minor;

3. When the criminal defendant is 70 years of age or over;

4. When the criminal defendant is deaf and dumb;

5. When the criminal defendant is suspected of having a mental disorder;

6. When the criminal defendant is indicted for a case punishable with death penalty or imprisonment, with or without labor, for an indefinite term or for a minimum term of not less than three years.

Article 282 of the Criminal Procedure Act (Required Defense)

With regard to any case referred to in Article 33 (1) or to any case for which a defense counsel is appointed under the provisions of paragraphs (2) and (3) of the same Article, the court may not sit without the defense counsel: *Provided*, That this shall not apply where only a judgment is pronounced. *<Amended by Act No. 7965, Jul. 19, 2006>*

Article 283 of the Criminal Procedure Act (Court-Appointed Defense Counsel)

In the case of the main body of Article 282, when the defense counsel fails to attend, the court shall appoint a defense counsel *ex officio. <Amended by Act No. 7965, Jul. 19, 2006>*

Article 357 of the Criminal Procedure Act (Judgment Subject to Appeal)

Where the judgment of the court of first instance is not satisfactory, an appeal may be lodged, from the judgment of a sole judge of the relevant district court to a collegiate court of the district court and from the judgment of a collegiate division of the relevant district court to the relevant high court. *<Amended by Act No. 1500, Dec. 13, 1963>*

[This Article Wholly Amended by Act No. 705, Sep. 1, 1961]

Article 361-2 of the Criminal Procedure Act (Acceptance of Records of Trial and Notification thereof)

(1) Where the appellate court has accepted the delivery of the records of trial, both the appellant and the other party shall be immediately notified of the reason. *<Amended by Act No. 1500, Dec. 13, 1963>*

(2) If a defense counsel has been selected before notification referred to in the preceding paragraph is made, such notification shall also be given to the defense counsel.

Article 361-3 of the Criminal Procedure Act (Statement of Reasons for Appeal and Answer)

(1) The appellant or his/her defense counsel shall submit a statement of reasons for the appeal to the appellate court within 20 days from the date of acceptance of the notification referred to in the preceding Article. In this case, Article 344 shall apply *mutatis mutandis. <Amended by Act No. 1500, Dec. 13, 1963; Act No. 8730, Dec. 21, 2007>*

Article 361-4 of the Criminal Procedure Act (Ruling on Dismissal of Appeal)

(1) If either the appellant or his/her defense counsel has failed to submit

a statement of reasons for appeal within the period as set forth in paragraph (1) of the preceding Article, the appellate court shall dismiss the appeal by its ruling: *Provided*, That this provision shall not apply where there exists a fact to be examined *ex officio*, or when a reason for appeal is stated on the petition of appeal.

Article 364 of the Criminal Procedure Act (Judgment by Appellate Court)

(1) The appellate court shall render a decision *ex officio* on the grounds included in the reason for appeal. <*Amended by Act No. 1500, Dec. 13, 1963*>

Article 1 of the Regulation on Criminal Procedure (Purpose of Regulation)

The purpose of these Regulations is to prescribe such matters delegated by the Criminal Procedure Act (hereinafter referred to as the "Act") to the Supreme Court Regulation and other necessary matters concerning the criminal procedure.

[This Article Wholly Amended by Supreme Court Regulation No. 2106, Oct. 29, 2007]

Article 18 of the Regulation on Criminal Procedure (Cancellation of Appointment)

(1) The judge of a court or district court shall cancel the appointment of a state-appointed defense counsel in any of the following cases: <*Amended by Supreme Court Regulation No. 2038, Aug. 17, 2006*>

1. When a defense counsel is appointed for the accused or suspect;

Article 156-2 of the Regulation on Criminal Procedure (Appointment of State-Appointed Defense Counsel and Notice of Reception of Trial Record)

(1) The appellate court, which has received the trial record, shall appoint a defense counsel and notify him/her of the reception of the trial record if no defense counsel exists for the cases requiring presence of the defense counsel indicated in subparagraphs 1 through 6 of Article 33 (1) of the Act. The same shall apply where the state-appointed defense counsel is selected under Article 33 (3) of the Act. <*Amended by Supreme Court Regulation No. 2013, Mar. 23, 2006; Supreme Court Regulation No. 2038, Aug. 17, 2006*>

(3) Even when it has revoked its ruling for appointment of a state-appointed counsel within the period for submission of the statement of grounds for appeal due to a reason which is not attributable to the accused after it made its ruling for appointment thereof under paragraphs (1) and (2), and appoints a new state-appointed defense counsel, the appellate court shall notify the relevant defense counsel of the receipt of the records of trial. <*Newly Inserted by Supreme Court Regulation No. 2013, Mar. 23, 2006*>

Article 164 of the Regulation on Criminal Procedure (Provisions Applicable Mutatis Mutandis)

The provisions of Articles 155, 156-2, and subparagraphs 1 and 2 of

Article 157 above shall apply *mutatis mutandis* to the procedures for the procedure of final appeal. <*Amended by Supreme Court Regulation No. 1441, Dec. 3, 1996*>

【Reference Cases】 Supreme Court Decision 2000Do4694 decided Dec. 22, 2000 (Gong2001Sang, 404); Supreme Court Order 2006Mo623 decided Dec. 7, 2006; Supreme Court Decisions 2006Do5547 decided Mar. 29, 2007; 2008Do11486 decided Feb. 12, 2009 (Gong2009Sang, 361)

【Defendant】 Defendant

【Reappellant】 Defendant

【Defense Counsel】 Law Firm HMP Law, Attorney Park Young-hwa et al.

【Order of the court below】 Seoul High Court Order 2015No872 dated July 3, 2015

【Disposition】 The reappeal is dismissed.

【Reasoning】 The grounds for reappeal (although the Defendant's defense counsel submitted the petition of final appeal, the method of appeal against the lower judgment ought to be made in the form of reappeal; hence, the relevant petition of final appeal is deemed as the petition of reappeal) are examined.

1. Case history and the main issue

A. The reappellant appealed against the first instance judgment in which he was convicted, but did not state the grounds for appeal in the petition of appeal. In the instant case, which constitutes the cases requiring the presence of the defense counsel pursuant to Article 33(1)6 of the Criminal Procedure Act, the lower court appointed a public defense counsel for the defendant on March 10, 2015, and sent a notification of the decision of the appointment of a public defense counsel and the receipt of the records of trial to the public defense counsel on March 12, and to the defendant-re-appellant on March 13.

B. While the reappellant and the public defense counsel were yet to file the statement of reasons for appeal, the reappellant appointed a private defense counsel on March 23, 2015. The lower court revoked the decision to appoint a public defense counsel on March 24, and did not send a notification of the receipt of the records of trial to the private defense counsel. The private defense counsel filed the statement of reasons for appeal to the lower court on March 21, 2015.

C. On July 3, 2015, the lower court dismissed by its ruling the reappellant's appeal pursuant to Article 361-4(1) of the Criminal Procedure Act on the grounds that: (i) the relevant statement of reasons for appeal was filed later than one month after the expiration of the period for filing a statement of reasons for

appeal, which is calculated from the date at which the notification of the receipt of the records of trial was sent to either the reappellant or the previous public defense counsel; and (ii) there exists no grounds for *ex officio* investigation of the first instance judgment.

D. The reappellant made a further complaint arguing that the lower court should have: (a) sent a notification of the receipt of the records of trial to the private defense counsel; and (b) calculated the period for filing a statement of reasons for appeal based on the date of the delivery of the relevant notification.

E. The instant case constitutes a case requiring the presence of the defense counsel. It pertains to a case where: (a) the appellate court had already sent a notice of the receipt of the records of trial to the defendant and the public defense counsel; (b) while the defendant and the public defense counsel were yet to file the statement of reasons for appeal, the defendant appointed a private defense counsel within the period for filing a statement of reasons for appeal, according to which the appointment of the public defense counsel was revoked. The main issue of the instant case is concerned with whether a newly appointed private defense counsel is ought to be notified of the receipt of the records of trial in such an instance.

2. Whether the notification of the receipt of the records of trial must be sent to a private defense counsel, newly appointed after the court sent the notification of the receipt of the records of trial to the defendant and his/her public defense counsel

A. The Criminal Procedure Act stipulates that where the appellant-defendant appointed a defense counsel before the appellate court sends a notification of the receipt of the records of trial, the appellate court shall notify the appellant-defendant and his/her defense counsel of the receipt of the records of trial (Article 361-2(2)). Hence, where the appointment of a defense counsel is made after the defendant was notified of the receipt of the records of trial, the same notice need not be delivered to the defense counsel. This likewise applies to cases requiring the presence of the defense counsel, where (a) the appellate court appoints a public defense counsel, (b) notifies the defendant and his/her defense counsel of the receipt of the records of trial, and (c) revokes the appointment of the public defense counsel thereafter upon the defendant's appointment of a private defense counsel. In this case, the period for the filing of a statement of reasons for appeal ought to be calculated beginning from the date at which the public defense counsel or the defendant received the notification of the receipt of the records of trial (*see* Supreme Court Order 2006Mo623, Dec. 7, 2006).

In the meantime, Article 156-2(3) of the Regulation on Criminal Procedure provides that where a public defense counsel is newly appointed within the period for the filing of a statement of reasons for appeal due to a reason that is not attributable to the defendant, the newly appointed public defense counsel should be notified of the receipt of the records of trial. However,

this provision need not be extensively or analogically applied to the case of a newly appointed private defense counsel.

We examine in detail the reasons thereto.

B. It falls within the ambit of the legislative discretion to determine (a) whether to hold the appellant or his/her defense counsel liable for filing a statement of reasons for appeal within a prescribed period; or (b) whether to dismiss the appeal by ruling if the appellant or his/her defense counsel fails to file the relevant document within the prescribed period, by taking into account the structure and nature of the criminal appeals proceeding, and the characteristics of the criminal justice procedure.

The Criminal Procedure Act accords a right of appeal (Article 357) and imposes the obligation to submit a statement of reasons for appeal (Article 361-3) to the parties concerned in a criminal trial, and stipulates that the court shall dismiss the appeal by its ruling (a *pro forma* trial) upon the failure to submit a statement of reasons for appeal within a certain period, without further proceeding to make a judgment regarding the merits of the case (Article 361-4(1)). This intends to ensure the protection of human rights of defendants along with a balanced allocation of judicial resources, and to promote the smoothness and promptness of the appellate proceedings. If the parties concerned do not experience any disadvantage even if they fail to observe the time limit for the submission of a statement of reasons for appeal under the law, the objective of the system, which is, to finalize the subject of the appellate trial, and to ensure the smoothness and promptness of the appellate proceedings through the submission of a statement of reasons for appeal, would become obsolete. Article 361-4(1) of the Criminal Procedure Act does restrict to some extent the opportunity for defendants to have their case heard before the appellate instance; however, in view of the purpose of the system that requires the submission of a statement of reasons for appeal, the public interest pursued by the relevant provision, which is timely and smooth administration of appellate procedure, is no less profound in terms of its importance than the private interest relating to the protection of the rights of the parties concerned (*see* Supreme Court Orders 2003Chogi165, May 20, 2003; 2005Chogi316, Dec. 5, 2005; Constitutional Court en banc Order 2003Hun-ba34, Mar. 31, 2005).

C. The appointment of a private defense counsel is carried out through a private legal agreement between a person entitled to appoint a defense counsel (Article 30 of the Criminal Procedure Act) and his/her defense counsel, whereas the assignment of a public defense counsel constitutes the court's act of judgment, distinguishing the two in nature.

The Criminal Procedure Act and the Regulation on Criminal Procedure distinguishes a private defense counsel from a public defense counsel not only in terms of the notification of the receipt of the records of trial, but also in other fields. The court shall appoint a defense counsel *ex officio* or at the request of the defendant in any of the cases meeting the requirement under the law (Article

33 of the Criminal Procedure Act). The court may not sit without a defense counsel in cases requiring the presence of the defense counsel, and the court shall not appoint a new public defense counsel *ex officio* when the previously appointed defense counsel fails to appear in court (Articles 282, 283, and 370 of the Criminal Procedure Act). Even after the appointment of a public defense counsel, the court shall manage such tasks as cancellation of the appointment, granting permission for the resignation, and supervision (Articles 18 through 21 of the Regulation on Criminal Procedure). This is because the obligation of a State to ensure a defendant's right to counsel not only includes the assignment of a public defense counsel in criminal proceedings, but, taking a step forward, includes the responsibility to supervise related works and take procedural measures necessary to ensure that the defendant is getting practical assistance from his/her public counsel (*see* Supreme Court en banc Order 2009Mo1044, Feb. 16, 2012). On the contrary, a private defense counsel acquires the status of a defendant's defense counsel when the defendant or a person entitled to appoint a defense counsel concludes a delegation contract with the private defense counsel. A private defense counsel's action and the scope of activities are determined in accordance with the details of the delegation contract. The appointment of and the activities carried out by a private defense counsel, and its relationship with a person entitled to appoint the defense counsel are totally intact from the State's intervention. This does not change in cases requiring the presence of the defense counsel.

D. A notification of the receipt of the records of trial becomes the starting point of calculating the period for the filing of a statement of reasons for appeal; hence, the cases where such a notice ought to be made and the addressee must be clearly identified. The Criminal Procedure Act and the Regulation on Criminal Procedure stipulate the cases where the appellate court is obliged to send a notification of the receipt of the records of trial. As for a private defense counsel, however, the law states that the notification ought to be made only when the private defense counsel is appointed before a notification of the receipt of the trial records is sent to the defendant (Article 361-2(2) of the Criminal Procedure Act), but do not stipulate specifically that the same notice must be delivered to a newly appointed private defense counsel if the notification had already been sent to the defendant. On the contrary, as for a public defense counsel, Article 361-2(2) of the Criminal Procedure Act and Article 156-2 of the Regulation on Criminal Procedure additionally stipulate that a newly appointed public defense counsel ought to be notified of the receipt of the trial records even if its appointment was made after the notification had been sent to the defendant.

Article 361-2(2) of the Criminal Procedure Act stating that a defense counsel must be notified of the receipt of the trial records was first introduced in 1961, when the filing of a statement of reasons for appeal was made mandatory, and remain in force to date. Each clause under Article 156-2 of the

Regulation on Criminal Procedure, which stipulates that the notification of the receipt of the trial records must be given to a public defense counsel, was introduced in sequential order since 1996. Article 156-2(1) of the Regulation on Criminal Procedure, which was introduced by the Supreme Court Regulation No. 1441 on December 3, 1996 for purposes of protecting the rights of the defendant in the appellate instance, provides for the appointment of a public defense counsel and the obligation to send a notification of the receipt of the records of trial thereto in cases requiring the presence of the defense counsel under Article 33(1) of the Criminal Procedure Act. Article 156-2(2) of the Regulation on Criminal Procedure, introduced as the Supreme Court Regulation No. 2013 on March 23, 2006, states that when a public defense counsel is appointed under Article 33(2) of the Criminal Procedure Act upon the request of the appointment, that public defense counsel must be given the notification of the receipt of the records of trial. Subparag. 3 of Article 156-2 of the Regulation on Criminal Procedure also states that (a) when a public defense counsel is appointed pursuant to Subparags. 1 and 2, and the appointment is revoked thereafter due to a reason that is not attributable to the defendant, and a new public defense counsel is appointed; (b) the newly appointed public defense counsel must be notified of the receipt of the trial records.

As seen earlier, the Criminal Procedure Act and the Regulation on Criminal Procedure clearly distinguish a private defense counsel and a public defense counsel with respect to the issue of the notification of the receipt of the trial records. In a case where the appellate court notified the defendant and his/her public defense counsel of the receipt of the records of trial, followed by the defendant's appointment of a private defense counsel, there are no legal grounds for the court to send a new notification of the receipt of the trial records to the newly appointed private defense counsel. Therefore, if a private defense counsel fails to file a statement of reasons for appeal after the lapse of the period for the submission of a statement of reasons for appeal, which is calculated from the date on which the defendant or his/her public defense counsel received the notification of the receipt of the trial records, the statement of reasons for appeal is deemed to have not been timely filed. This applies likewise to a case where the appellate court revoked the appointment of a public defense counsel on the grounds of the appointment of a private defense counsel.

E. Under Article 15-2(3) of the Regulation on Criminal Procedure, when a public defense counsel is changed, within the period for filing of a statement of reasons for appeal, due to a reason not attributable to the defendant, the newly appointed public defense counsel ought to be notified of the receipt of the records of trial. As will be seen *infra*, the relevant provision may not be applied extensively or analogically to the cases of newly appointed private defense counsels.

(1) As for the notification of the receipt of the records of trial that becomes

the standard for determining whether the statutory timeline is observed, one must be cautious in applying Article 156-2(3) of the Regulation on Criminal Procedure, which pertains to the changes of the public defense counsel, extensively or analogically to a private defense counsel, considering (a) the characteristics of the provisions regarding criminal litigation proceedings, which seek the clarity and stability thereof; and (b) the difference between a public defense counsel and a private defense counsel seen earlier.

Unless the court was negligent on fulfilling its obligation to ensure a defendant's right to counsel by, for example, delaying the appointment of a public defense counsel in cases requiring the presence of the defense counsel, the court would not have any obligation to manage or supervise the process of the defendant's appointment of a private defense counsel in accordance with a delegation contract under private law. Hence, there are no grounds for the extensive or analogical application of the provisions on the court's obligation to notify a public defense counsel of the receipt of the trial records to the cases of a private defense counsel.

In previous cases, the Supreme Court determined that Article 156-2 of the Regulation on Criminal Procedure concerning public defense counsel ought to be extensively or analogically applied to a private defense counsel of the cases requiring the presence of the defense counsel, and that, a private defense counsel should be notified of the receipt of the records of trial (Supreme Court Decisions 2000Do4694, Dec. 22, 2000; 2008Do11486, Feb. 12, 2009). However, in those cases, the court was recognized of its fault in deferring the appointment of public defense counsel without justifiable reasons. Hence, those earlier cases are different in nature from the instant case, where the court fulfilled its responsibility for assigning a public defense counsel for the defendant.

Article 156-2(3) of the Regulation on Criminal Procedure is premised on the fact that the change of public defense counsel is due to a reason not attributable to the defendant; the instant case, however, pertains to a case in which (a) the change of defense counsel was attributable to the defendant's abandonment of his/her right to assistance of public defense counsel; and (b) the defendant instead appointed a private defense counsel by himself/herself. As such, the instant case does not constitute a case where the change of public defense counsel was due to a reason unrelated to the defendant.

The issue of the instant case is different from what is stipulated under Article 156-2(3) of the Regulation on Criminal Procedure, and therefore, the pertinent provision need not be applied extensively to the instant case. As for the analogical application of Article 156-2(3) of the Regulation on Criminal Procedure, it is hard to conclude that there exists a "legislative vacuum," which serves as the premise of such analogical application.

(2) There are no second opinions about the fact that a defendant's right to counsel must be fully guaranteed in cases requiring the presence of the defense

counsel. However, if exceptions are recognized in cases like the instant case for the reason of fully guaranteeing the right to counsel, there would have been no reason in the first place to differentiate a case where a private defense counsel is appointed in cases requiring the presence of the defense counsel. This might result in the conclusion that a newly appointed defense counsel must be newly notified of the receipt of the records of trial even where, in cases requiring the presence of the defense counsel, it is difficult to specify the scope, including the cases where: (a) the defendant appointed a private defense counsel in the first place, but, while the private defense counsel was yet to file a statement of reasons for appeal, he/she was replaced by another private defense counsel; or (b) the appointment of a public defense counsel and a private defense counsel was repeatedly changed. Such reasoning undermines the clarity and stability of criminal proceedings, and also is in breach of the system that forces the filing of a statement of reasons for appeal, which purports to make appellate procedure more prompt and effective.

(3) When the defendant appoints a private defense counsel after the appellate court notifies the defendant and his/her public defense counsel of the receipt of the records of trial, the newly appointed private defense counsel, a legal expert, can ascertain from the defendant the time at which the notification was made to the defendant and the public defense counsel in the process of the appointment. This is indeed the very basic task supposed to be handled by a private defense counsel. Therefore, it is reasonable to assume in the pertinent case that the private defense counsel would have been able to find out that the trial records remained in the appellate instance. It is the natural duty of a private defense counsel (i) to figure out the date at which the receipt of the records of trial was notified to the defendant or his/her public defense counsel, and (ii) to file a statement of reasons for appeal within the set period. There is no reason to notify a newly appointed private defense counsel of the receipt of the records of trial by extensively or analogically applying Article 156-2(3) of the Regulation on Criminal Procedure on the notification of the receipt of the records of trial to such a case.

(4) Furthermore, the extensive or analogical application of the relevant provision practically enables the defendant with economic resources in a case requiring the presence of the defense counsel to extend the period for the filing of a statement of reasons for appeal by reappointing a private defense counsel after his/her public defense counsel was notified of the receipt of the records of trial. There is a chance that a defendant might abuse the system to intentionally delay the criminal proceedings. This will also provoke unfairness on the part of an indigent defendant.

(5) Article 164 of the Regulation on Criminal Procedure applies the provision under Article 156-2 *mutatis mutandis* to the final appeal procedure, so the problems seen earlier may arise in the final appeal procedure as well. An extensive or analogical application of Article 156-2 to a private defense counsel

may bring about unexpected confusion in the administration of an appellate trial or a final appeal.

F. After all, (a) insofar as the Criminal Procedure Act or the Regulation on Criminal Procedure does not introduce express applicable provisions through the amendment procedure, (b) in cases requiring the presence of the defense counsel where the appellate court (i) appointed a public defense counsel, (ii) notified the defendant and the public defense counsel of the receipt of the records of trial, and (iii) revoked the appointment thereafter upon the defendant's appointment of a private defense counsel, (c) the appellate court is not obliged under the current Act and Regulation to notify the newly appointed private defense counsel of the receipt of the records of trial.

3. Resolution of the instant case

The lower court: (a) calculated the period for the submission of a statement of reasons for appeal from the date of the receipt of the records of trial by the defendant or his/her public defense counsel; and (b) dismissed the defendant's appeal on the grounds that (i) a legitimate statement of reasons for appeal was not filed within the set period; (ii) the petition for appeal does not indicate the reasons for appeal; and (iii) there exist no grounds for conducting an *ex officio* investigation. Examining the record in light of the legal principle seen earlier, the lower court's decision was justifiable. (Furthermore, one of the appellate counsels in the instant case was a defense counsel in the first instance, making it more reasonable to assume that the pertinent defense counsel had been well aware of the facts and progress of the instant case.) There is no violation of the Constitution, laws, orders, or regulations that affected the trial in the measures taken by the lower court.

4. Conclusion

The reappeal is dismissed. It is so ordered as per Disposition by the assent of participating Justices on the bench, except for a dissent by Justices Jo Hee-de, Cho Jae-youn, Park Jung-hwa, Kim Seon-soo, and Lee Dong-won, followed by a concurrence with the Majority Opinion by Justice Kim Jae-hyung, and a concurrence with the Dissenting Opinion by Justice Lee Dong-won.

5. The Dissenting Opinion presented by Justice Jo Hee-de, Justice Cho Jae-youn, Justice Kim Seon-soo, and Justice Lee Dong-won is as follows.

A. Considering the significance of the right to assistance of counsel under the Constitution of the Republic of Korea, the purport of public defense services under the Criminal Procedure Act, the nature of cases requiring the presence of the defense counsel, and the importance of the submission of a statement of reasons for appeal in the criminal appeals proceedings, (a) in cases requiring the presence of the defense counsel under Article 33(1) of the Criminal Procedure Act, where the appellate court notified the defendant and the public defense counsel of the receipt of the records of trial; (b) and, while the defendant and the public defense counsel were yet to submit a statement of reasons for appeal, the defendant appointed a private defense counsel within

the period for the filing of the statement of reasons for appeal, and the appellate court revoked *ex officio* the previous appointment of the public defense counsel; (c) it is reasonable to consider that the appellate court ought to notify the newly appointed private counsel of the receipt of the records of trial to guarantee the period for drafting and submitting the statement of grounds for appeal, unless there are special circumstances indicating that the defendant appointed a new defense counsel with the intention of deliberately delaying the litigation.

On the contrary, the Majority Opinion argues that a notification of the receipt of the records of trial need not be made again to a newly appointed private defense counsel, citing as the grounds for such reasoning that (a) there is no codified provision under the Criminal Procedure Act and other relevant laws, which compels that the notification shall be made again; (b) Article 156-2(3) of the Regulation on Criminal Procedure, which pertains to cases in different nature, may not be extensively or analogically applied to the instant case; (c) if extensive or analogical application is allowed, there is a chance for abuse, such as deliberate deferment of the litigation proceedings; (d) allowing so is in breach of the equity principle concerning an indigent defendant who cannot afford a private defense counsel; and (e) the administration of an appellate trial and a final appeal.

According to the Majority Opinion, a newly appointed private defense counsel must draft and submit a statement of reasons for appeal within the period remaining after having excluded the period lapsed without the submission of the statement of reasons for appeal by a public defense counsel from the period for submitting the statement of reasons for appeal, which is counted from the date at which the notification of the records of trial is accepted by the public defense counsel. This is not different from holding the defendant or his/her private defense counsel accountable for the failure of the public defense counsel, appointed by the court for the defendant, to submit a statement of reasons for appeal within the prescribed period after having received the notification of the acceptance of the records of trial. We disagree with the Majority Opinion that: (a) practically reduces the period for submitting a statement of reasons for appeal allowed for a defense counsel in cases requiring the presence of the defense counsel, where there is an indispensable need for supplementing the capabilities of the defendant to defend himself/herself; (b) and, in our opinion, overlooked the fact that the defendant's constitutional right to have assistance of counsel is infringed upon. We examine the reasons in detail below.

(1) The main sentence of Article 12(4) of the Constitution of the Republic of Korea stipulates that "Any person who is arrested or detained shall have the right to prompt assistance of counsel." Considering the principle of the rule of law and the principle of due process of law under our Constitution, the right to counsel is naturally recognized not only for the arrested suspects and defendants but also for those who are not in custody (*see* Constitutional Court en banc

Decision 2000Hun-Ma138, Sept. 23, 2004). "The right to assistance of counsel" guaranteed under the Constitution stands for a right to receive sufficient assistance of a defense counsel (*see* Supreme Court Order 2003Mo402, Nov. 11, 2003).

(2) In a criminal litigation, there is a considerable difference between the prosecutor's ability to charge and prosecute offenses and the defendant's ability to defend. The counsel system intends to complement the defendant's ability to defend for purposes of realizing the principle of equality among the parties concerned. In regard to the right to assistance of counsel, the Criminal Procedure Act defines cases meeting certain requirements under law as the cases requiring the presence of the defense counsel, and stipulates that the court shall appoint a defense counsel *ex officio* (Article 33(1)). Furthermore, the pertinent provision stipulates that the trial examination of the cases requiring the presence of the defense counsel shall not begin without a defense counsel, and upon the absence of a defense counsel, the court shall appoint a new public defense counsel *ex officio* (Articles 282 and 283), thereby fully ensuring a defendant's right to assistance of counsel in the trial examination of the cases requiring the presence of defense counsel. Under Article 33(1) of the Criminal Procedure Act, the court designates cases with urgent need for complementing a defendant's ability to defend as the cases requiring the presence of the defense counsel, by taking into account (i) whether the defendant is arrested or not; (ii) the defendant's age and intelligence; and (iii) the gravity of the pertinent case. Therefore, the right to sufficient assistance of counsel is all the more important in the cases requiring the presence of the defense counsel.

(3) According to Articles 361-2(1) and (2), 361-3(1), 361-4(1), and 364(1), where the defendant filed an appeal, the court of criminal appeals reviews the grounds for appeal included in the statement of reasons for appeal, filed by the defendant or his/her defense counsel within the statutory timeline. If a legitimate statement of reasons for appeal is not filed within the statutory term, the court shall dismiss the defendant's appeal as a rule, unless there are reasons for carrying out an *ex officio* investigation.

Taking into account the meaning and importance of the filing of a statement of reasons for appeal in criminal appeals proceedings, the right to assistance of counsel should be guaranteed for a defendant of the cases requiring the presence of the defense counsel not only during the case hearing, but also in the course of drafting and filing a statement of reasons for appeal.

In this regard, the main sentence of Article 156-2(1) of the Regulation on Criminal Procedure stipulates that "The appellate, which has received the trial record, shall appoint a defense counsel and notify him/her of the reception of the trial record if no defense counsel exists for the cases requiring presence of the defense counsel indicated in subparagraphs 1 through 6 of Article 33(1) of the Act." Under this provision, a public defense counsel in cases requiring the presence of the defense counsel is separately notified of the receipt of the trial

records apart from the one sent to the defendant, and may draft and file a statement of reasons for appeal within the given statutory term for the defendant. In addition, Article 156-2(3) of the Regulation on Criminal Procedure states that "Even when it has revoked its ruling for appointment of a state-appointed counsel within the period for submission of the statement of grounds for appeal due to a reason which is not attributable to the accused after it made its ruling for appointment thereof under paragraphs (1) and (2), and appoints a new state-appointed defense counsel, the appellate court shall notify the relevant defense counsel of the receipt of the records of trial." As such, where a public defense counsel is replaced due to a reason not attributable to the defendant, the court provides a new period for the filing of a statement of reasons for appeal, apart from what was provided for the previous public defense counsel, to ensure that the new public defense counsel has enough time to draft and file a statement of reasons for appeal for the defendant.

The Majority Opinion practically reduces the period granted for a newly appointed private defense counsel to draft and file a statement of reasons for appeal by including the period, lapsed due to the previous public defense counsel's failure to submit a statement of reasons for appeal, in the period allowed for a newly appointed defense counsel. It is the court that appoints a public defense counsel *ex officio* where there is no defense counsel in cases requiring the presence of the defense counsel, and the defendant does not have a say in the appointment of the defense counsel. However, the Majority Opinion shifts the disadvantage of a reduced period for drafting and filing a statement of reasons for appeal, which lapsed because of the public defense counsel's fault, to the defendant, which is clearly unreasonable.

(4) As is pointed out by the Majority Opinion, there is no codified provision stating that a newly appointed private counsel should be notified of the receipt of the trial records in cases where the previous appointment of a public defense counsel was revoked. Nevertheless, the absence of a codified provision may not be the grounds for considering that there are no measures of ensuring the right to assistance of counsel. In previous cases requiring the presence of the defense counsel, where (a) the defendant appointed a defense counsel by himself/herself while the court was not assigning a public defense counsel without justifiable reasons; (b) the defendant's appointment of a defense counsel was made after the lapse of the period for the filing of a statement of reasons for appeal; and (c) a private defense counsel had no time to draft and file a statement of reasons for appeal for the defendant, the Supreme Court reasoned that: (a) the defendant's right to assistance of counsel, stipulated under Article 156-2 of the Regulation on Criminal Procedure, ought to be protected; (b) and thus, the court shall (i) notify the newly appointed defense counsel of the receipt of the records of trial by analogically applying Article 156-2 of the Regulation on Criminal Procedure; and (ii) give an opportunity to the private defense counsel to draft and file a statement of reasons for appeal

within a set period, the starting point of which is calculated from the date of the private defense counsel's receipt of the notification (*see* Supreme Court Decisions 2000Do4694, Dec. 22, 2000; 2008Do11486, Feb. 12, 2009). Such precedents emphasize the need for practical protection of a defendant's constitutional right to assistance of counsel in cases requiring the presence of the defense counsel, despite the difference between a public defense counsel and a private defense counsel. By the same token, it is reasonable to consider that Article 156-2(3) of the Regulations of Criminal Procedure may be analogically applied to the instant case considering the purport of the Constitution and the Criminal Procedure Act and the circumstances that the defendant cannot be held accountable for the replacement of the defense counsel.

Rather than perfunctorily review the observance of Article 361-2 of the Criminal Procedure Act or Article 156-2(1) and (3) of the Regulation on Criminal Procedure, both of which pertain to the notification of the receipt of trial records, one must adopt a practical standpoint to examine whether the right to assistance of counsel for drafting and filing a statement of reasons for appeal is sufficiently protected in cases requiring the presence of the defense counsel. If adherence to the language and text of the relevant provision does not sufficiently guarantee the right to assistance of counsel under the Constitution and the Criminal Procedure Act, the court must seek ways to fully protect the pertinent right.

Article 156-2(3) of the Regulations of Criminal Procedure is premised on the fact that the replacement of a public defense counsel is made due to "a reason not attributable to the defendant." The instant case, however, pertains to a case where the court revoked *ex officio* the appointment of a public defense counsel upon the defendant's appointment of a private defense counsel on its own. In this vein, in our opinion, the Majority Opinion, which contends that Article 156-2(3) of the Regulation on Criminal Procedure may not be analogically applied to the instant case, is excessively occupied with the regulations, and as a result, overlooked the need to complement the right to assistance of counsel for a defendant, whose ability to defend himself/herself in cases requiring the presence of the defense counsel.

Considering the relevant provisions under the Criminal Procedure Act, which demand the presence of the defense counsel for the defendant in cases requiring the presence of the defense counsel, along with the purport of the Constitution and the Criminal Procedure Act, the defendant's right to assistance of counsel ought to be fully protected in the process of drafting and filing a statement of reasons for appeal. This need not change depending on whether a newly appointed defense counsel is a court-appointed one or a private one. According to the Majority Opinion, a newly appointed private defense counsel is mandated to (i) get a grasp of the case within the remaining period for the filing of a statement of reasons for appeal, which is determined based on the

time at which the defendant or the previous public defense counsel was notified of the receipt of the records of trial; and (ii) draft and submit a statement of reasons for appeal within that period. In an extreme case, one might have to compile a statement of reasons for appeal in a short span of time, for example, within just one day. It is hard to view such a case as one that provides the defendant with sufficient protection of the right to assistance of counsel.

It is reasonable to consider the defendant's appointment of a private defense counsel while the previous public defense counsel was yet to file a statement of reasons for appeal as an exercise of the right to appoint a defense counsel under Article 30 of the Criminal Procedure Act to defend himself/herself. Article 18(1)1 of the Regulation on Criminal Procedure stipulates that the judge of a court or district court shall cancel the appointment of a state-appointed defense counsel when a defense counsel is appointed for the accused or suspect. It is unjustifiable to view the defendant's appointment of a private defense counsel to exercise his/her right to defend as a reason attributable to the defendant in such a case as where: (a) the defendant exercised the right to appoint a defense counsel; (b) the defense counsel was replaced according to the court's decision under the Regulation on Criminal Procedure; and (c) the court did not specifically hand over the task that was used to be handled by the public defense counsel (whose appointment had been revoked) to a newly appointed private defense counsel.

Insofar as the similarities are recognized between the instant case and the circumstances in which a public defense counsel is changed for a reason that is not attributable to the defendant in cases requiring the presence of the defense counsel. Hence, Article 156-2(3) of the Regulation on Criminal Procedure may analogically apply. This also conforms to the Constitution of the Republic of Korea and the Criminal Procedure Act, which purports to offer sufficient protection for the rights of defendants to have assistance of counsel in cases requiring the presence of the defense counsel.

(5) The Majority Opinion's concern that the analogical application of the pertinent provision may be abused for purposes of deferment of litigation appears to be a "putting-the-cart-before-the-horse" kind of concern. Even if proceedings are delayed to some extent, such delay ought to be viewed as admissible within criminal justice proceedings, considering the importance of the right to assistance of counsel under the Constitution and the Criminal Procedure Act in cases requiring the presence of the defense counsel. Where there are special circumstances suggesting that the defendant appointed a new private defense counsel with the aim of intentionally deferring the litigation, the court may set the period for the filing of a statement of reasons for appeal based on the time at which the defendant or the previous public defense counsel received the notification of the receipt of the trial records, thereby removing the possibility of abuse. Therefore, it is difficult to comprehend the Majority's reasoning, which turns a blind eye to the infringement of a defense counsel's

right to counsel in cases requiring the presence of the defense counsel under the pretext of the possibility of abuse.

The Majority Opinion contends that defendants will be treated unfairly according to their financial condition. However, as seen earlier, the possibility of abuse, such as deferment of litigation, can be eliminated. As such, in the cases requiring the presence of the defense counsel, where the defendant appointed a private defense counsel to exercise his/her right to defend, which resulted in the revocation of the appointment of a public defense counsel, the measures to guarantee the right to counsel for the defendant may not be deemed as giving a preferential treatment to the defendant over other defendants who do not possess economic resources by breaching the equity principle.

The Majority Opinion is also aware of the confusion in the administration of an appellate trial or a final appeal. However, in cases requiring the presence of the defense counsel, as in the instant case, where (a) the appellate court appointed a public defense counsel, and notified the defendant and the public defense counsel of the receipt of the records of trial; (b) the defendant appointed a private defense counsel, and the court revoked the appointment of the public defense counsel thereafter, we find it disagreeable that viewing that only such cases or a final appeal with similar facts are admissible as the cases requiring the notification of the receipt of records of trial to a newly appointed private defense counsel, would result in insurmountable confusion, as alleged in the Majority Opinion.

B. According to the reasoning of the lower court and the record, following facts are revealed: (a) insofar as the reappellant was indicted on the case with a statutory punishment of imprisonment with labor for a limited term of not less than three years, the instant case constitutes a case requiring the presence of the defense counsel; (b) the reappellant and his defense counsel in the first instance trial took an appeal against the first instance ruling to the lower court, but failed to state the reasons for appeal in each of the petition of appeal; (c) on March 10, 2015, the lower court appointed the public defense counsel, and notified, the public defense counsel on March 12, and the reappellant on March 13, of the decision of the appointment of public defense counsel and the receipt of trial records; (d) while the reappellant and the public defense counsel were yet to file a statement of reasons for appeal, the reappellant appointed a private defense counsel on March 23, 2015, and the lower court revoked the decision to appoint public defense counsel on March 24; (e) while the lower court did not separately notify the newly appointed private defense counsel of the receipt of trial records, the newly appointed private defense counsel filed a statement of reasons for appeal to the lower court on May 21, 2015; and (f) on July 3, 2015, the lower court dismissed the reappellant's appeal by its ruling pursuant to Article 361-4(1) of the Criminal Procedure Act on the ground that (i) the pertinent statement of reasons for appeal was filed after the lapse of the period of submission that is calculated starting from the date at which the reappellant

or his public defense counsel was notified of the receipt of the records of trial; and (ii) there exist no grounds for carrying out an *ex officio* investigation in the first instance judgment.

C. Examining the above facts in light of the legal principle seen earlier, it is recognized that (a) in the instant case that constitutes a case requiring the presence of the defense counsel, (b) a public defense counsel was appointed, (c) and, while the defendant and the public defense counsel were yet to submit a statement of reasons for appeal, the reappellant appointed a private defense counsel within the period for the submission of a statement of reasons for appeal. Along with this recognition, there appears to be no special circumstances suggesting that the reappellant appointed the private defense counsel for purposes of deferment of litigation. Hence, the lower court should have (a) notified the newly appointed private defense counsel of the receipt of the records of trial; (b) examined whether the private defense counsel filed the statement of reasons for appeal within the prescribed period under Article 361-3(1), the starting point of which is set at the date of the receipt of the records of trial; and (c) determined whether the defense counsel's statement of reasons for appeal had been legitimately filed.

However, the lower court did not notify the newly appointed private defense counsel of the receipt of the records of trial, which means that the statement of reasons for appeal submitted by the reappellant's defense counsel on May 21, 2015 had been legitimately filed before the lapse of the period for the submission of the statement of reasons for appeal. However, the lower court dismissed the appeal, concluding that the statement of reasons for appeal was submitted after the lapse of the prescribed period. In determining so, the lower court erred by misapprehending the legal principle regarding the period for the filing of a statement of reasons for appeal in cases requiring the presence of the defense counsel, thereby adversely affecting the conclusion of the judgment.

Therefore, the lower judgment ought to be reversed, and remanded to the lower court for further proceedings consistent with this Opinion.

For the foregoing reasons, I respectfully express my dissent.

6. The Concurrence with the Majority Opinion by Justice Kim Jae-hyung is presented as follows.

A. The gist of the Dissenting Opinion is that: (a) the Majority Opinion goes against the Constitution and the Criminal Procedure Act that intend to guarantee the right to assistance of counsel for the accused or suspect; (b) thus, Article 156-2(3) of the Regulation on Criminal Procedure ought to be analogically applied, and the private defense counsel ought to be notified of the receipt of the trial records. Nevertheless, such an argument is unreasonable due to the following reasons.

B. In cases requiring the presence of the defense counsel, where the court revoked the decision to appoint public defense counsel upon the defendant's appointment of a private defense counsel, that the court did not notify the

private defense counsel of the receipt of the records of trial does not result in an infringement of the right to assistance of counsel guaranteed under the Constitution.

Article 12(4) of the Constitution of the Republic of Korea clearly states the right to assistance of counsel as one of the basic rights under the Constitution by stating that "Any person who is arrested or detained shall have the right to prompt assistance of counsel." The right to counsel stands for the right for a defendant to be represented by a defense counsel in the face of the State's unilateral exercise of penal authority. However, (i) the detailed description of the right to counsel and (ii) whether those details may be derived from the constitution or only become externalized through legislation may differ depending on one's standpoint toward the role and functions of a defense counsel in criminal proceedings.

In criminal proceedings, a defense counsel takes on the role of (a) an advocate in support of the accused or suspect to defend himself/herself against the investigative and prosecuting agency; and (b) a supervisor and a regulator observing whether the rights of the accused or suspect are protected by taking part in criminal proceedings.

The Criminal Procedure Act provides a clear and detailed exposition of a defense counsel's participation in the criminal proceedings following the investigation and prosecution so as to realize the right to counsel, introducing the following provisions on a defense counsel's right to (a) interview and communicate with the accused or suspect (Article 34); (b) inspect and make a copy of any related document for his/her case pending in a court (Article 35); (c) be present when a warrant of seizure or of search is being executed (Article 121); (d) appear before the court in the hearing for examination upon receiving a request for a warrant of detention (Article 201-2); (e) appear before the court and present his/her views on the date of the review of the legality of arrest and detention (Article 214-2); (f) be present at the inspection of evidence (Article 145); (g) be present at an examination or inquiry by an expert witness (Article 176); (h) be present at the examination of a witness (Articles 163 and 163-2); (i) examine the criminal defendant (Article 296-2); (j) produce a document or an article as evidence and move the court to examine a witness (Article 294); and (k) make a final plea (Article 303). These details are not directly derived from the Constitution, but rather, many of the detailed matters are left to the Criminal Procedure Act to be regulated.

The Constitution does not provide any specific guidance as to the system mandating a statement of reasons for appeal or the notification of the receipt of the trial records. As such, the determination of the granting of the procedural rights, for example, to what extent a defense counsel should be separately notified of the receipt of the records of trial, is subject to change depending on legislative actions.

C. In cases requiring the presence of the defense counsel where the court sends a notification of the records of trial to a defendant and his/her public defense counsel, and then omits sending the notification to a newly appointed private defense counsel, such omission may not be deemed as an infringement of the rights of a defendant guaranteed under the Criminal Procedure Act.

Legislators simply stated under Article 361-2(2) that where a defense counsel is appointed before a notification of the receipt of the trial records is sent out to the defendant, that defense counsel should also be notified of the receipt of the records of trial. In other words, they have not stated specifically that, in a case where (a) the court notifies the defendant of the receipt of the records of trial, (b) and the defendant appoints a private defense counsel thereafter, the decision by which the court revoked the appointment of the public defense counsel, the court shall notify the new private defense counsel of the receipt of the trial records.

Whether to revoke the appointment of a public defense counsel and notify the private defense counsel appointed thereafter of the receipt of records of trial, on the grounds that the private defense counsel was appointed after the previous public defense counsel had been notified of the receipt of the records of trial, is a matter of technicality in the litigation procedures. The absence of an express stipulation on this matter in the Criminal Procedure Act and the Regulation on Criminal Procedures does not mean that the pertinent matter goes against the intent of the Civil Procedure Act. This does not change depending on whether the case in question constitutes a case requiring the presence of the defense counsel.

D. An attempt to resolve the issue in the instant case by analogically applying Article 156-2(3) of the Regulation on Criminal Procedure is unreasonable.

Article 108 of the Constitution of the Republic of Korea states that "[t]he Supreme Court may establish, within the scope of Act, regulations pertaining to judicial proceedings and internal discipline and regulations on administrative matters of the court." Therefore, the Supreme Court Regulations may introduce provisions regarding judicial proceedings insofar as such provisions do not conflict with the law, despite the absence of express delegation provisions under the relevant law. Article 1 of the Regulation on Criminal Procedure also stipulates that "[t]he purpose of these Regulations is to prescribe such matters delegated by the Criminal Procedure Act to the Supreme Court Regulation and other necessary matters concerning the criminal procedure."

The Criminal Procedure Act does not prohibit the court from notifying a newly appointed private defense counsel of the receipt of the trial records upon the court's revocation of the appointment of a public defense counsel following the defendant's appointment of the private defense counsel in cases requiring the presence of the defense counsel. In such an instance, it does not conflict with the relevant law for the Supreme Court to introduce a provision under the

Regulation on Criminal Procedure, which mandates the court to re-notify a newly appointed private defense counsel of the receipt of the trial records.

If the Supreme Court determines that there is a need to notify a newly appointed private defense counsel of the receipt of the records of trial, as in the aforementioned case, it may direct the court to make a notification of the receipt of the records of trial to the full extent or to a partial extent, by amending the Regulation on Criminal Procedure taking into account such matters as the time at which a private defense counsel is appointed and the background thereto, and a time at which the appointment of a public defense counsel was revoked. Amending the Regulation on Criminal Procedure like the above is much simpler and efficient way to address the pertinent matter, instead of analogically applying Article 156-2(3) of the Regulation on Criminal Procedure regarding public defense counsel, thereby causing unanticipated confusion in the progress of criminal appeals proceedings or final appeals.

In the event of amending the Regulation on Criminal Procedure, procedural provisions, including the period of filing a statement of reasons for appeal and the notification of the receipt of the records of trial, ought to be stipulated in simple and clear language to help not only the court or defense counsels but also ordinary citizens understand without complexities or confusion. Considering a long gap of time since the introduction of the system requiring the court to send a notification of the receipt of the records of trial, and that the court's criminal trial practices have undergone a considerable change, these changes need to be reflected. As seen above, problem-solving through the amendment of the Regulation on Criminal Procedure and, furthermore, the Criminal Procedure Act is likely to bring about a more preferable result instead of resorting to the analogous application of the relevant provision.

E. To sum up, according to Article 361-2(2) of the Criminal Procedure Act, the defendant's right to assistance of counsel, guaranteed under the Constitution and the Criminal Procedure Act, is not infringed upon in the instant case, where a newly appointed private defense counsel is not notified of the receipt of the records of trial. The Supreme Court may revise the Regulation on Criminal Procedure by itself where necessary, and resolve the matter in a more appropriate manner. Hence, Article 156-2(3) of the Regulation on Criminal Procedure, which is a provision about public defense counsel, need not be analogically applied.

For the foregoing reasons, I respectfully express my concurrence with the Majority's opinion.

7. The Concurrence with the Dissenting Opinion by Justice Lee Dong-won is presented as follows.

In cases requiring the presence of the defense counsel, substantial protection of a defendant's right to counsel in the process of drafting and filing

a statement of reasons for appeal is ensured when a defense counsel is guaranteed 20 days of the period for filing a statement of reasons for appeal.

Article 18(1) Subparag. 1 of the Regulation on Criminal Procedure stipulates that the judge of a court or district court shall cancel the appointment of a state-appointed defense counsel when a defense counsel is appointed for the accused or suspect. If the court views that there is no need to re-notify a private defense counsel of the receipt of the records of trial upon the revocation of the appointment of a public defense counsel in accordance with the Regulation on Criminal Procedure seen above, the private defense counsel has to independently stay abreast of the case's progress within the period of filing a statement of reasons for appeal, which was determined based on the defendant or his/her public defense counsel. As a result, the period of filing a statement of reasons for appeal that is allowed for the private defense counsel is practically reduced, and 20 days of the period for filing of a statement of reasons for appeal is not guaranteed.

To afford substantial protection to a defendant's right to assistance of counsel in the process of drafting and filing a statement of reasons for appeal, it is preferable to revise Article 18(1) Subparag. 1 of the Regulation on Criminal Procedure so as to ensure that the court does not revoke the decision to appoint a public defense counsel within the period of filing a statement of reasons for appeal even if the defendant appoints a private defense counsel during that period.

If the court does not cancel the appointment of public defense counsel, both a public defense counsel and a private defense counsel can work together and use the materials for defense produced by the public defense counsel, including the interview of the defendant and the examination of the facts and legal principles for drafting a statement of reasons for appeal, to file a statement of reasons for appeal within the remaining period for the filing of the statement. Doing so would at least guarantee 20 days of the period of filing a statement of reasons for appeal for the defendant's public defense counsel, and in that case, the private defense counsel can also use the public defense counsel's materials for defense supplementarily, which, together, would sufficiently guarantee the defendant's right to assistance of counsel.

By contrast, if it is considered that the court need not re-notify the private defense counsel of the receipt of the trial records upon the cancellation of the appointment of the public defense counsel pursuant to Article 18(1) Subparag. 1 of the Regulation on Criminal Procedure, the private defense counsel has less than 20 days to draft and file a statement of reasons for appeal within the remaining period of filing as seen earlier. Under such circumstance, the defendant's right to assistance of counsel in the course of drafting and filing a statement of reasons for appeal is not sufficiently protected. As a consequence, the purpose of the public defense system, which is to help defendants receive

the assistance of counsel in cases requiring the presence of the defense counsel, cannot be achieved.

In the instant case, insofar as the court cancelled the appointment of a public defense counsel within the period for the filing of a statement of reasons for appeal given to a public defense counsel, pursuant to Article 18(1) Subparag. 1 of the Regulation on Criminal Procedure, the court must re-notify the newly appointed private defense counsel of the receipt of the records of trial, thereby practically ensuring 20 days of the period of filing a statement of reasons for appeal for the private defense counsel to draft and file the statement.

For the foregoing reasons, I respectfully express my concurrence with the Dissenting Opinion.

Chief Justice Kim Myeongsu (Presiding Justice)
Justices Jo Hee-de (Justice in charge)
Kwon Soon-il
Park Sang-ok
Lee Ki-taik
Kim Jae-hyung
Cho Jae-youn
Park Jung-hwa
Min You-sook
Kim Seon-soo
Lee Dong-won
Noh Jeong-hee

【Supreme Court Decision 2016Du53180 Decided November 29, 2018 【Revocation of Disposition Imposing Penalty Tax】

【Main Issues and Holdings】

[1] In a case where liability for principal tax to be reported and paid is not recognized, whether penalty taxes for non-filing, underreporting, or insincere payment, which are established on the premise that the amount of the principal tax due is determined, may be imposed (negative), and whether this applies to customs duties (affirmative)

[2] Where a taxpayer submitted additional information certifying that the relevant good is an originating good, pursuant to Articles 10 and 13 of the former Act on Special Cases of the Customs Act for the Implementation of Free Trade Agreements and Article 6.18 of the Korea-U.S. Free Trade Agreement, whether a taxpayer is liable for the payment of customs duties on imported goods (negative) and in such an instance, whether a tax liability for additional duties under Article 42(1) of the Customs Act is recognized (negative)

【Summary of Decision】

[1] A penalty tax is an independent tax item levied in addition to the amount of the principal tax due calculated according to tax-related Acts in order to ensure faithful fulfillment of tax obligations under tax-related Acts. Recognition of the grounds for exemption from a principal tax does not mean that the penalty tax thereon is naturally included in the tax to be exempted. Furthermore, where a taxpayer has any justifiable grounds for non-fulfillment of the obligation to pay a penalty tax, the penalty tax is not imposed even if the taxpayer has a tax liability for the principal tax (*see, e.g.*, Article 2 Subparag. 4, Articles 47 and 48 of the Framework Act on National Taxes).

One of the types of penalty taxes is a penalty tax imposed separately as a sanction on failure to fulfill one's tax compliance obligations irrespective of a principal tax liability. Nevertheless, (a) penalty taxes for non-filing, underreporting, or insincere payment may not be separately imposed where liability for a principal tax to be reported and paid is not recognized; (b) because, according to the relevant legal provisions serving as the grounds for imposition of penalty tax, the imposition of these penalty taxes requires failure on the part of a person with a tax liability to accurately report or pay the tax base by the statutory deadline under the premise that the amount of the principal tax due is validly assessed. This likewise applies to customs duties.

[2] According to Articles 10 and 13 of the former Act on Special Cases of the Customs Act for the Implementation of Free Trade Agreements (amended

by Act No. 13625, Dec. 29, 2015) and Article 6.18 of the Korea-U.S. Free Trade Agreement: (a) taxpayers may file additional information certifying a relevant good is an originating good in the process of confirming the originating country of exporting goods or reasonableness of applying conventional tariff; and (b) by doing so, taxpayers are released from the liability to pay import duties for the imported goods determined to be subject to conventional tariff rate of 0%.

Article 42(1) of the Customs Act provides that "When collecting underpaid customs duties, the amount of the additional duties to be collected shall be computed by multiplying 10/100 of the relevant shortage of customs duties (Subparag. 1) and the relevant shortage of customs duties by a certain rate (Subparag. 2)." The additional customs duties under the aforesaid subparagraphs are established premised on the presence of a principal tax liability as in cases of penalty taxes for non-filing, underreporting, or insincere payment under the Framework Act on National Taxes. Therefore, where there exists no "shortfall in customs duties" serving as the basis for the imposition of additional duties, liability for additional duties may not be separately recognized.

【Reference Provisions】 [1] Article 2 Subparag. 4, Articles 47 and 48 of the Framework Act on National Taxes; Article 42(1) of the Customs Act / [2] Articles 10 (*see* Article 8 of the current Act) and 13 (*see* Article 17 of the current Act) of the former Act on Special Cases of the Customs Act for the Implementation of Free Trade Agreements; Article 6.18 of the Korea-U.S. Free Trade Agreement; Article 42(1) Subparags. 1 and 2 of the Customs Act; Article 2 Subparag. 4, Articles 47 and 48 of the Framework Act on National Taxes

Article 2 of the Framework Act on National Taxes (Definitions)

The terms used in this Act shall be as defined as follows: <*Amended by Act Nos. 2925 & 2932, Dec. 22, 1976; Act No. 3097, Dec. 5, 1978; Act No. 3471, Dec. 31, 1981; Act No. 3746, Aug. 7, 1984; Act No. 4177, Dec. 30, 1989; Act No. 4672, Dec. 31, 1993; Act No. 4743, Mar. 24, 1994; Act No. 4981, Dec. 6, 1995; Act No. 5189, Dec. 30, 1996; Act No. 5579, Dec. 28, 1998; Act No. 5993, Aug. 31, 1999; Act No. 6303, Dec. 29, 2000; Act No. 6782, Dec. 18, 2002; Act No. 7008, Dec. 30, 2003; Act No. 7329, Jan. 5, 2005; Act No. 8139, Dec. 30, 2006; Act No. 8521, Jul. 19, 2007; Act No. 8830, Dec. 31, 2007; Act No. 10219, Mar. 31, 2010; Act No. 11124, Dec. 31, 2011; Act No. 11604, Jan. 1, 2013*>

4. The term "penalty tax" means an amount collected in addition to the amount of tax calculated in accordance with tax-related Acts in order to ensure the faithful fulfillment of duties prescribed in the tax-related Acts: *Provided*, That additional dues shall not be included herein;

Article 47 of the Framework Act on National Taxes (Imposition of Penalty Taxes)

(1) The Government may impose penalty taxes upon the person

violating obligations prescribed in tax-related Acts, as prescribed in this Act or other tax-related Acts.

(2) Penalty taxes shall be an item of the relevant national tax under the tax-related Acts prescribing the obligation concerned: *Provided,* That in cases of reducing or exempting a relevant national tax, the penalty tax shall not be included in such reduced or exempted national tax.

(3) Penalty taxes shall be added to tax payable or deducted from the amount of taxes to be refunded. *<Newly Inserted by Act No. 11124, Dec. 31, 2011>*

[This Article Wholly Amended by Act No. 9911, Jan. 1, 2010]

Article 48 of the Framework Act on National Taxes (Reduction, Exemption, etc. of Penalty Taxes)

(1) Where penalty tax is to be imposed under this Act or any other tax-related Act, if the ground for such imposition corresponds to that for extending the due date under Article 6 (1) or the taxpayer has any justifiable grounds for non-fulfillment of the obligation concerned, the Government may choose not to impose penalty tax.

(2) In any of the following cases, the Government shall reduce or exempt penalty tax from an amount set forth in each of the following subparagraphs; *<Amended by Act No. 10405, Dec. 27, 2010; Act No. 11124, Dec. 31, 2011; Act No. 12848, Dec. 23, 2014>*

1. Where a revised return is filed pursuant to Article 45 after the statutory due date of return elapses (limited to penalty tax referred to in Article 47-3 of this Act, excluding cases where the revised return of tax base is filed with a prior knowledge that the initial tax base and the amount would be corrected); amounts classified as follows:

(a) Where a revised return is filed within six months after the statutory due date of return elapses: An amount equivalent to 50/100 of the amount of the relevant penalty tax;

(b) Where a revised return is filed within one year, but more than six months after the statutory due date of return elapses: An amount equivalent to 20/100 of the amount of the relevant penalty tax;

(c) Where a revised return is filed within two years, but more than one year after the statutory due date of return elapses: An amount equivalent to 10/100 of the amount of the relevant penalty tax;

2. Where a return is filed pursuant to Article 45-3 after the statutory due date of return elapses (limited to the penalty tax referred to in Articles 47-2, excluding cases where the return of tax base after the term is filed with a prior knowledge that the initial tax base and the amount would be determined): the amount in accordance with the classification set forth in the following categories:

(a) Where a return is filed within one month after the statutory due date of return elapses: An amount equivalent to 50/100 of the amount of

the relevant penalty tax;

(b) Where a return is filed within six months, but more than one month after the statutory due date of return elapses: An amount equivalent to 20/100 of the amount of the relevant penalty tax;

3. Where it falls under any of the following categories: An amount equivalent to 50/100 of the amount of the relevant penalty tax:

(a) Where a result of the pre-assessment review is not notified under Article 81-15 within the period of determination and notification (limited to penalty tax under Article 47-4 which is imposed for the period for which such decision and notification are delayed);

(b) Where the obligation of the submission, filing, joining, registration or establishment pursuant to tax-related Acts (hereinafter referred to as "submission, etc." in this subparagraph) is fulfilled in compliance with the tax-related Acts within one month after the deadline for submission, etc. elapses (limited to penalty tax to be imposed pursuant to tax-related Acts for violation of the duty of such submission, etc.);

(3) Any person who intends to have penalty tax reduced or exempted under paragraph(1) or(2) may file an application therefor, as prescribed by Presidential Decree.

[This Article Wholly Amended by Act No. 9911, Jan. 1, 2010]

Article 42 of the Customs Act (Additional Duties)

(1) When the head of a customs office collects underpaid customs duties pursuant to Article 38-3 (1) or (6), he/she shall collect the aggregate of the following amounts as additional duties: *Provided*, That he/she shall not fully or partially collect such additional duties, as prescribed by Presidential Decree where a duty return is filed based on a provisional dutiable value declaration and customs duties are paid according to such duty return and other cases prescribed by Presidential Decree: *<Amended by Act No. 11121, Dec. 31, 2011; Act No. 12847, Dec. 23, 2014; Act No. 14379, Dec. 20, 2016>*

1. 10/100 of the relevant shortage of customs duties;

2. The amount calculated by applying the following formula: Relevant shortage of customs duties × period from the date following the time limit for payment to the date on which a revised return is filed or a duty payment notice is served × interest rate prescribed by Presidential Decree in consideration of the interest rates, etc. applied to loans in arrears by finance companies, etc.

Article 8 of the current Act on Special Cases of the Customs Act for the Implementation of Free Trade Agreements (Requests, etc. for Application of Conventional Tariffs)

(1) Any person who intends to become eligible for the application of a conventional tariff (hereinafter referred to as "importer") shall file a request for the application of a conventional tariff with the head of the competent

customs house, as prescribed by Presidential Decree, before the relevant import declaration is accepted.

(2) When filing a request for the application of a conventional tariff under paragraph (1), an importer shall have a document evidencing origin, and submit it to the head of the competent customs house, if so demanded: Provided, That the head of the competent customs house shall not demand the submission of a document evidencing origin regarding items determined by Presidential Decree.

(3) Where an importer fails to submit a document evidencing origin demanded pursuant to the main sentence of paragraph (2) or it is impracticable to determine the origin of goods only with the document evidencing origin submitted by the importer, the head of the competent customs house may choose not to apply a conventional tariff pursuant to Article 35.

(4) Where the head of a customs house receives a request for the application of a conventional tariff referred to in paragraph (1), he/she shall examine it after accepting the relevant import declaration: Provided, That such examination may be conducted before an import declaration is accepted for certain goods prescribed by Ordinance of the Ministry of Strategy and Finance, on the grounds that it is impracticable to secure the claim for customs duties or that it is deemed improper to examine, after the import declaration is received, whether the statement on origin is correct and whether the application of a conventional tariff is appropriate.

Article 13 of the current Act on Special Cases of the Customs Act for the Implementation of Free Trade Agreements (Support for Verification of Origins by Small and Medium Enterprises)

The Commissioner of the Korea Customs Service may conduct the following support projects for exporters, producers, or suppliers of materials used for export goods or the production of export goods, which meet the definition of a small and medium enterprise in Article 2 of the Framework Act on Small and Medium Enterprises:

1. Consultation and training on the criteria for determining the origin;

2. Consultation and training on the procedures for verifying the origin, including the preparation, issuance, etc. of a certificate of origin;

3. Other matters prescribed by the Presidential Decree as necessary for supporting the verification of the origin.

Article 6.18 of the Korea-U.S. Free Trade Agreement (Verification)

1. For purposes of determining whether a good imported into its territory from the territory of the other Party is an originating good, the importing Party may conduct a verification by means of:

(a) written requests for information from the importer, exporter, or producer;

(b) written questionnaires to the importer, exporter, or producer;

(c) visits to the premises of an exporter or producer in the territory of the other Party, to review the records referred to in Article 6.17.1 or observe the facilities used in the production of the good;

(d) for a textile or apparel good, the procedures set out in Article 4.3 (Customs Cooperation for Textile or Apparel Goods); or

(e) such other procedures to which the importing and exporting Parties may agree.

Where an importing Party conducts verification by the means referred to in subparagraph (a) or (b), the importing Party may request that the importer arrange for the exporter or producer to provide information directly to the importing Party.

2. The Parties shall agree on procedures for conducting visits provided for in paragraph 1(c).

3. A Party may deny preferential tariff treatment to a good where:

(a) the importer, exporter, or producer fails to provide information that the Party requested under paragraph 1(a) or 1(b) demonstrating that the good is an originating good;

(b) after receiving a written notification for a visit pursuant to paragraph 1(c), the exporter or producer declines to provide access to the records referred to in Article 6.17 or to its facilities; or

(c) the Party finds a pattern of conduct indicating that an importer, exporter, or producer has provided false or unsupported declarations or certifications that a good imported into its territory is an originating good.

4. If, as a result of a verification, a Party finds that a good is not originating, the Party shall provide the importer with a proposed determination to that effect and an opportunity to submit additional information demonstrating that the good is originating. Each Party shall provide that the importer may arrange for the exporter or producer to provide pertinent information directly to the Party.

5. After providing the importer with an opportunity to submit additional information pursuant to paragraph 4, the Party that conducted the verification shall provide the importer a final determination, in writing, of whether the good is originating. The Party's determination shall include factual findings and the legal basis for the determination. Where the exporter or producer has provided information pursuant to paragraph 1 or 4 directly to the Party conducting the verification, that Party shall endeavor to provide a copy of the determination to the exporter or producer that provided the information.

6. Where an importing Party determines through verification that an importer, exporter, or producer has engaged in a pattern of conduct in providing false or unsupported statements, declarations, or certifications that a good imported into its territory is originating, the Party may suspend preferential tariff treatment to identical goods covered by subsequent statements, declarations, or certifications by that importer, exporter, or

producer until the Party determines that the importer, exporter, or producer is in compliance with the requirements of this Chapter.

【Reference Cases】[1] Supreme Court Decisions 2009Da28738 decided Nov. 10, 2011 (Gong2011Ha, 2523); 2013Du27128 decided Apr. 24, 2014 (Gong2014Sang, 1152)

【Plaintiff-Appellee】 Dairy Farm Inc. (Attorney Ju Seok-young, Counsel for the plaintiff-appellee)

【Defendant-Appellant】 Head of the Seoul Customs Office

【Judgment of the court below】 Seoul High Court 2016Nu31557 decided September 6, 2016

【Disposition】 The final appeal is dismissed. The cost of the final appeal is assessed against the Defendant.

【Reasoning】 The ground of the final appeal is examined.

1. Case overview and the main issue

A. Case overview

(1) The Plaintiff made an import declaration of whole milk powder (hereinafter "instant good") applying a conventional tariff rate of 0% pursuant to the Korea-U.S. Free Trade Agreement (FTA) on May 7, 2013 and June 14, 2013.

(2) The Defendant: (a) conducted documentary investigation on the origin, through which it was revealed that a certificate of origin presented by the Plaintiff had been issued in the name of a producer not residing in the U.S.; and (b) revoked the implementation of the conventional tariff rates and instead imposed concessive tariff rates (non-recommended) of 176%, sending a rectified notification of tariffs totaling KRW 354, 136, 910 and additional duties totaling KRW 49, 474, 760.

(3) The Plaintiff submitted a certificate of origin (C/O) issued in the name of a producer residing in the U.S. upon the request for supplementation, and filed a request for the application of conventional tariffs on April 7-8, 2014. The Defendant refunded the total principal amount of the imposed tariffs, but maintained the imposition of additional duties (the part regarding the additional duties that were not revoked and remained in the rectified disposition issued on March 27, 2014 will hereinafter be referred to as "instant disposition").

B. The main issue

The main issue of the instant case pertains to whether liability for the payment of additional duties may separately be recognized where liability for the payment of the principal amount of conventional tariffs under the Korea-U.S. FTA is not recognized.

2. Base period of determining the legitimacy of tax disposition

In tax administrative litigation concerning illegality of tax disposition, the illegitimacy of tax disposition is determined on the basis of whether the assessed amount of tax exceeds the justifiable amount. The parties concerned may assert individual grounds that either underpin or challenge the objective tax debt amount until the closing of argument, and submit relevant evidence (*see, e.g.*, Supreme Court Decision 87Nu448, Jun. 27, 1989). The existence of a tax liability in the instant case is ought to be determined by comprehensively taking into account the totality of submissions in the process after the pertinent disposition was made and until the closing of argument, rather than by simply taking account of what had been submitted at the time of the pertinent disposition. Therefore, the lower court did not err in its judgment by misapprehending the legal principle regarding the base period of determining the legitimacy of disposition, contrary to what is alleged in the ground of appeal.

3. Whether additional duties are exempted in a case where *ex post* application of conventional tariff rates under the Korea-U.S. FTA resulted in exemption of principal tax

A. A penalty tax is an independent tax item levied in addition to the amount of the principal tax due calculated according to tax-related Acts in order to ensure faithful fulfillment of tax obligations under tax-related Acts. Recognition of the grounds for exemption from a principal tax does not mean that the penalty tax thereon is naturally included in the tax to be exempted. Furthermore, where a taxpayer has any justifiable grounds for non-fulfillment of the obligation to pay a penalty tax, the penalty tax is not imposed even if the taxpayer has a tax liability for the principal tax (*see, e.g.*, Article 2 Subparag. 4, Articles 47 and 48 of the Framework Act on National Taxes).

One of the types of penalty taxes is a penalty tax imposed separately as a sanction on failure to fulfill one's tax compliance obligations irrespective of a principal tax liability. Nevertheless, (a) penalty taxes for non-filing, underreporting, or insincere payment may not be separately imposed where liability for a principal tax to be reported and paid is not recognized; (b) because, according to the relevant legal provisions serving as the grounds for imposition of penalty tax, the imposition of these penalty taxes requires failure on the part of a person with a tax liability to accurately report or pay the tax base by the statutory deadline under the premise that the amount of the principal tax due is validly assessed. This likewise applies to customs duties.

B. (1) According to Articles 10 and 13 of the former Act on Special Cases of the Customs Act for the Implementation of Free Trade Agreements (amended by Act No. 13625, Dec. 29, 2015) and Article 6.18 of the Korea-U.S. Free Trade Agreement: (a) taxpayers may file additional information certifying a relevant good is an originating good in the process of confirming the originating country of exporting goods or reasonableness of applying conventional tariff; and (b) by doing so, taxpayers are released from the liability

to pay import duties for the imported goods determined to be subject to conventional tariff rate of 0%.

(2) Article 42(1) of the Customs Act provides that "When collecting underpaid customs duties, the amount of the additional duties to be collected shall be computed by multiplying 10/100 of the relevant shortage of customs duties (Subparag. 1) and the relevant shortage of customs duties by a certain rate (Subparag. 2)." The additional customs duties under the aforesaid subparagraphs are established premised on the presence of a principal tax liability as in cases of penalty taxes for non-filing, underreporting, or insincere payment under the Framework Act on National Taxes. Therefore, where there exists no "shortfall in customs duties" serving as the basis for the imposition of additional duties, liability for additional duties may not be separately recognized.

It was ultimately determined that the Plaintiff was not liable for the payment of customs duties on the instant good on account of having legitimately submitted supplementary documents regarding verification of origin. Therefore, the instant disposition computing and imposing additional duties under Article 42(1) of the Customs Act based on the premise of "shortfall in customs duties" is unlawful, for such disposition was made on an invalid basis. Furthermore, insofar as the application of conventional tariffs pursuant to the Korea-U.S. FTA on the instant good was valid, it should not be concluded that justifiable collection of customs duties and taxpayers' fulfillment of obligations to cooperate, both of which Article 42 of the Customs Act is intended to protect, were disregarded.

C. That the lower court determined the imposition of additional duties in the instant case in accordance with concessive tariff rates (non-recommended) as illegitimate in this regard is in compliance with the legal principle noted above. In so determining, the lower court did not err by misapprehending the legal principle regarding the relationship between penalty taxes and principal taxes, and the requirement for application of conventional tariffs, contrary to what is alleged in the ground of appeal.

4. Conclusion

The Defendant's final appeal is dismissed as it is meritless, and the cost of the final appeal is assessed against the losing party. It is so decided as per Disposition by the assent of all participating Justices on the bench.

Justices Lee Dong-won (Presiding Justice)
Jo Hee-de
Kim Jae-hyung (Justice in charge)
Min You-sook

Supreme Court Decision 2018Du38376 Decided November 29, 2018【Revocation of Disposition Imposing Corporate Tax】

【Main Issues and Holdings】

[1] Meaning of and standard for determining what constitutes "beneficial owner" as prescribed by Article 10(2)(a) of the Convention between the Government of the Republic of Korea and the Government of the Hungarian People's Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income

Whether a tax treaty may be deemed inapplicable in the event that treaty abuse is acknowledged according to the principle of substantial taxation under the Framework Act on National Taxes even if constituting a beneficial owner of dividend income (affirmative)

[2] In a case where: (a) Company A, in paying dividends on six occasions to Hungary-based Company B that owns 50% of its shares, paid the withheld corporate tax based on the limited tax rate of 5% as prescribed by Article 10(2)(a) of the Convention between the Government of the Republic of Korea and the Government of the Hungarian People's Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income; and (b) the competent taxing authority deemed the U.S.-based Company C, the ultimate parent company of the multinational business group to which Company B is affiliated with, to be the beneficial owner of dividend income and, subsequently, issued a notice of correction to the amount of corporate tax withheld against Company A by applying a limited tax rate of 15% pursuant to Article 12(2)(a) of the Convention between the Government of the Republic of Korea and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, the Court holding that the application of the Convention between the Government of the Republic of Korea and the Government of the Hungarian People's Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income cannot be denied with respect to dividend income even if based on the principle of substantial taxation under Article 14(1) of the Framework Act on National Taxes

【Summary of Decision】

[1] Article 10(2)(a) of the Convention between the Government of the Republic of Korea and the Government of the Hungarian People's Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income provides that "[...] dividends may also be taxed in

the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the recipient is the beneficial owner of the dividends, the tax so charged shall not exceed 5% of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 25% of the capital of the company paying the dividends." Accordingly, in cases where a Korean entity pays dividends to a corporate shareholder who is the beneficial owner residing in Hungary, the maximum limited tax rate of 5% is applied toward the corporate tax withheld in Korea as to the dividend income at issue, despite the relevant provision under the Corporate Tax Act of Korea, if satisfying the foregoing condition on shares, etc. In full view of the legislative history and context, etc. of the foregoing provision, a beneficial owner is a person who is entitled to enjoy benefits of the dividend income received and who is neither bound by law nor by contract to retransfer the relevant dividend income to another person. Determination of whether a person constitutes a beneficial owner as defined above should comprehensively factor the content and status of business activities related to the income at issue, the details of usage and operation of said income, etc.

Meanwhile, the principle of substantial taxation as prescribed in Article 14(1) of the Framework Act on National Taxes is likewise applicable to the interpretation and application of a tax treaty, which has the same effect as a statute, barring any special provision making exceptions. Therefore, in the event that treaty abuse is recognized according to the principle of substantial taxation under the Framework Act on National Taxes, the relevant tax treaty may be deemed inapplicable albeit constituting a beneficial owner of dividend income. That is, in case where (i) the person to whom a property nominally accrues lacks the capacity to control or manage property; (ii) there is another person who substantially controls or manages the property by means of governance, etc. over the nominal owner; and (iii) the disparity between name and substance arose out of the intent to avoid tax, the relevant tax treaty shall be inapplicable upon nominal ownership and the income pertaining to the property shall be deemed to accrue to the person who substantially controls or manages the property and, thus, said person shall be deemed liable for tax. However, if such disparity is nonexistent, the income is accrued to the nominal owner.

[2] In a case where: (a) Company A, in paying dividends on six occasions to Hungary-based Company B that owns 50% of its shares, paid the withheld corporate tax based on the limited tax rate of 5% as prescribed by Article 10(2)(a) of the Convention between the Government of the Republic of Korea and the Government of the Hungarian People's Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (hereinafter "Korea-Hungary Tax Treaty"); and (b) the competent taxing authority deemed the U.S.-based Company C, the ultimate parent company of the multinational business group to which Company B is affiliated

with, to be the beneficial owner of dividend income and, subsequently, issued a notice of correction to the amount of corporate tax withheld against Company A by applying a limited tax rate of 15% pursuant to Article 12(2)(a) of the Convention between the Government of the Republic of Korea and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, the Court determined that: (a) in full view of such circumstances as Company B's establishment history, business activities, details on the actual use of dividend income and funds, the fact that Company B had never paid dividends or transferred a certain amount of money to Company C, etc.; (b) Company B is deemed to have enjoyed benefits of the dividend income received without any legal or contractual obligation to transfer said income to Company C, etc.; (c) that said, Company B, as the resident of the Contracting State (Hungary) to said Treaty, constitutes a beneficial owner of dividend income under Article 10(2) of the Korea-Hungary Tax Treaty; (d) furthermore, when comprehensively considering the establishment history of Company B, business divisions and business activities as an intermediary holding company as well as a public service center, human and physical resources including the recruitment and retention of employees, exercise of right as a shareholder to subsidiary companies including Company A, source of paid-in capital, management of shares and receipt of dividends, use of funds and investment activities, details of the control, management, and disposition of dividend income, etc.; (e) it is reasonable to deem that Company B, as an ordinary business entity of substantial form functioning as an intermediary holding company and public service center, which has conducted relevant business activities in Hungary over a prolonged period based on an independent business purpose, i.e., overall restructuring of the multinational business group, to have *de facto* controlled and managed the shares of Company A and the dividend income incurred therefrom, just like other assets owned; (f) as such, the applicability of the Korea-Hungary Tax Treaty cannot be denied with respect to dividend income even if based on the principle of substantial taxation under Article 14(1) of the Framework Act on National Taxes; (g) nevertheless, the lower court held that the taxing authority's disposition as above was lawful by deeming Company C to be the beneficial owner of dividend income solely from a tax saving perspective; and (h) in so doing, the lower court erred by misapprehending the legal doctrine.

【Reference Provisions】 [1] Article 10(2)(a) of the Convention between the Government of the Republic of Korea and the Government of the Hungarian People's Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income; Article 14(1) of the Framework Act on National Taxes; Articles 93 Subparag. 2 and 98(1)2 of the Corporate Tax Act / [2] Article 10(2)(a) of the Convention between the Government of the Republic of Korea and the Government of the Hungarian

People's Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income; Article 12(2)(a) of the Convention between the Government of the Republic of Korea and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income; Article 14(1) of the Framework Act on National Taxes; Articles 93 Subparag. 2 and 98(1)2 of the Corporate Tax Act

Article 10 of the Convention between the Government of the Republic of Korea and the Government of the Hungarian People's Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (Dividends)

(2) However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the recipient is the beneficial owner of the dividends, the tax so charged shall not exceed:

(a) 5 percent of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 25 percent of the capital of the company paying the dividends[.]

Article 12 of the Convention between the Government of the Republic of Korea and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (Dividends)

(2) The rate of tax imposed by one of the Contracting States on dividends derived from sources within that Contracting State by a resident of the other Contracting State shall not exceed:

(a) 15 percent of the gross amount of the dividend[.]

Article 14 of the Framework Act on National Taxes (Actual Taxation)

(1) If any ownership of an income, profit, property, act or transaction which is subject to taxation, is just nominal, and there is other person to whom such income, etc., belongs, the other person shall be liable to pay taxes and tax-related Acts shall apply, accordingly.

Article 93 of the Corporate Tax Act (Domestic Source Income of Foreign Corporations)

Domestic source income of a foreign corporation shall be classified as follows: *<Amended by Act No. 11128, Dec. 31, 2011; Act No. 13555, Dec. 15, 2015; Act No. 14386, Dec. 20, 2016>*

2. Dividend income provided for in Article 17(1) of the Income Tax Act (excluding the income provided for in subparagraph 6 of the same paragraph) that is paid in the Republic of Korea by any domestic corporation, any organization deemed a corporation, or any other domestic source and the amount disposed of as a dividend under Articles 9 and 14 of the Adjustment of International Taxes Act[.]

Article 98 of the Corporate Tax Act (Special Cases concerning Withholding or Collection from Foreign Corporations)

(1) Where any person pays a foreign corporation the amount of domestic source income provided for in subparagraphs 1, 2, and 4 through 10 of Article 93 (excluding any resident or non-resident who pays the amount of income provided for in subparagraph 7 of Article 93) which is not substantially related to the domestic place of business of the foreign corporation or does not revert to the domestic place of business of the foreign corporation (including an amount paid to a foreign corporation with no domestic place of business), he/she shall withhold, as the corporate tax, the following amounts from the income of the relevant foreign corporation for each business year, and pay it at the tax office having jurisdiction over the place of tax payment, etc., as prescribed by Presidential Decree, by the tenth day of the month following the month in which the date of withholding falls, notwithstanding Article 97: *Provided*, That the same shall not apply to income provided for in subparagraph 5 of Article 93, which is taxable as domestic source business income under the applicable tax treaty: <*Amended by Act No. 11607, Jan. 1, 2013; Act No. 14386, Dec. 20, 2016*>

2. Income referred to in subparagraph 6 of Article 93: 20/100 of the amount paid: *Provided*, That the rate shall be 3/100 of the amount paid in cases of income accrued by rendering personal services prescribed by Presidential Decree, out of personal services rendered abroad, but that shall be deemed accrued in the Republic of Korea under a tax treaty[.]

【Reference Cases】 [1] Supreme Court Decisions 2010Du11948 decided Apr. 26, 2012 (Gong2012Sang, 892); 2010Du20966 decided Jul. 11, 2013; 2012Du16466 decided Jul. 10, 2014 (Gong2014Ha, 1613); 2015Du2451 decided Jul. 14, 2016 (Gong2016Ha, 1195); 2015Du55134, 55141 decided Jul. 11, 2017 (Gong2017Ha, 1663); 2017Du59253 decided Dec. 28, 2017 (Gong2018Sang, 449); 2017Du33008 decided Nov. 15, 2018 (Gong2018Ha, 68)

【Plaintiff-Appellant】 Corning Inc. (Attorneys Kim Eui-hwan et al., Counsel for the plaintiff-appellant)

【Defendant- Appellee】 Head of National Tax Service Gumi District Office (Joongwon Law et al., Counsel for the defendant-appellee)

【Judgment of the court below】 Daegu High Court Decision 2017Nu4902 decided February 2, 2018

【Disposition】 The lower judgment is reversed, and the case is remanded to the Daegu High Court.

【Reasoning】 The grounds of appeal are examined.

1. Case summary and key issue

A. Case summary

(1) The Plaintiff, in paying dividends amounting to roughly KRW 841.1 billion (hereinafter "instant dividend income") to Hungary-based Corning Hungary Data Service (hereinafter "CHDS"), which owns 50% of its shares, over the course of six occasions from September 20, 2006 to March 30, 20090, paid the corporate tax withheld by applying the limited tax rate of 5% under Article 10(2)(a) of the Convention between the Government of the Republic of Korea and the Government of the Hungarian People's Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (hereinafter "Korea-Hungary Tax Treaty").

(2) The Defendant: (i) deemed that CHDS was merely a conduit company that was established for the purpose of tax avoidance and that the U.S.-based Corning Incorporated (hereinafter "CI"), the ultimate parent company of Corning Group (a multinational business group that manufactures plate glasses for LCD), was the beneficial owner of the instant dividend income; and (ii) on September 2, 2011 and October 12, 2011, issued a notice of correction against the Plaintiff with respect to the corporate tax withheld amounting to roughly KRW 53 billion for the fiscal years 2006 and 2009 by applying the limited tax rate of 15% pursuant to Article 12(2)(a) of the Convention between the Government of the Republic of Korea and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (hereinafter "Korea-U.S. Tax Treaty"). Thereafter, upon the decision of the Tax Tribunal, the amount of corporate tax withheld was reduced by applying the limited tax rate of 10% according to Article 12(2)(b) of the Korea-U.S. Tax Treaty (the outstanding amount of roughly KRW 36.4 billion following the reduction pursuant to the initial disposition hereafter referred to as "instant disposition").

B. Key issue

The key issue of this case is whether Article 10(2) of the Korea-Hungary Tax Treaty is applicable with respect to the pertinent dividend income.

2. Ground of appeal No. 1

A. (1) Article 10(2)(a) of the Convention between the Government of the Republic of Korea and the Government of the Hungarian People's Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income provides that "[...] dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the recipient is the beneficial owner of the dividends, the tax so charged shall not exceed 5% of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 25% of the capital of the company paying the dividends." Accordingly, in cases where a Korean entity pays dividends to a corporate shareholder who is the beneficial owner residing in Hungary, the maximum limited tax rate of 5% is applied toward the corporate tax withheld in Korea as

to the dividend income at issue despite the relevant provision under the Corporate Tax Act of Korea if satisfying the foregoing condition on shares, etc. In full view of the legislative history and context, etc. of the foregoing provision, a beneficial owner is a person who is entitled to enjoy benefits of the dividend income received and who is neither bound by law nor by contract to retransfer the relevant dividend income to another person. Determination of whether a person constitutes a beneficial owner as defined above should comprehensively factor the content and status of business activities related to the income at issue, and the details of usage and operation of said income (*see* Supreme Court Decision 2017Du33008, Nov. 15, 2018).

(2) Meanwhile, the principle of substantial taxation as prescribed in Article 14(1) of the Framework Act on National Taxes is likewise applicable to the interpretation and application of a tax treaty, which has the same effect as a statute, barring any special provision making exceptions (*see*, *e.g.*, Supreme Court Decision 2010Du11948, Apr. 26, 2012). Therefore, in the event that treaty abuse is recognized according to the principle of substantial taxation under the Framework Act on National Taxes, the relevant tax treaty may be deemed inapplicable albeit constituting a beneficial owner of dividend income. That is, in case where (i) the person to whom a property nominally accrues lacks the capacity to control or manage property; (ii) there is another person who substantially controls or manages the property by means of governance, etc. over the nominal owner; and (iii) the disparity between name and substance arose out of the intent to avoid tax, the relevant tax treaty shall be inapplicable upon nominal ownership and the income pertaining to the property shall be deemed to accrue to the person who substantially controls or manages the property and, thus, said person shall be deemed liable for tax. However, if such disparity is nonexistent, the income is accrued to the nominal owner (*see* Supreme Court Decisions 2012Du16466, Jul. 10, 2014; 2015Du2451, Jul. 14, 2016).

B. The reasoning of the lower judgment and the record reveals the following.

(1) On December 22, 2005, CHDS was established as an intermediary holding company and a public service center in the European, Middle Eastern, and African regions upon the investment in kind of the entire existing shares of the Plaintiff (50% stake) by Corning International corporation (CIC) that is a subsidiary based in the U.S., and operates five subsidiaries in Korea, Turkey, Spain, and Hungary. This was based in the Group's restructuring decision that involved directly investing funds generated outside of the U.S. in affiliates operating in countries other than the U.S.

(2) Estonia, Poland, and Hungary were the candidate destinations for the establishment of a public service center in the European, Middle Eastern, and African regions. Compared to Estonia and Poland, Hungary was deemed to have had the upper advantage in terms of infrastructure and language

receptivity. As regard the dividend payouts to CI from 1995 to 2005, the Plaintiff did not pay corporate tax in Korea pursuant to the tax exemption scheme for foreign investors at the time. Furthermore, similar to the Korea-Hungary Tax Treaty, most of the tax treaties that Korea signed with other countries provided for a limited tax rate of 5% or less with respect to the source taxation of a corporate shareholder's dividend income.

(3) CHDS, operating its place of business in Budapest (Hungary), recruited 6 employees in 2006, 38 in 2007, 50 in 2008, and 45 in 2009. It substantially performed duties as an intermediary holding company, i.e., dividend receipt from subsidiaries, control of shares, and management of investments and funds, and as a public service center, i.e., general management (such as general affairs, finances, data processing, etc.) of affiliated companies within Europe, Middle East, and Africa (including support activities such as the conclusion of a service contract to undergo such general management duties). CHDS paid the due corporate tax in Hungary with respect to the amount of income incurred therefrom and an accounting firm conducted an external audit of its financial statements. For a prolonged period since then, CHDS continues to function as an intermediary holding company and a public service center as described above.

(4) CHDS exercised its rights as a shareholder involving such matters as the resolution on the capital increase of subsidiaries, including the Plaintiff, appointment of a representative director, establishment of a branch, revision of the articles of corporation, and approval of the use of paid-in capital. Regarding the finance aspect, CHDS voluntarily performed such activities as fund payment and cash request by setting the details on the scope of duties that each relevant employee has the right of authority, the approvable amount, and the approval authority.

(5) Upon receipt of the instant dividend income from the Plaintiff, CHDS: (a) deposited the same with Corning Group's asset manager (CTS) located in Ireland and collected interests therefrom; and (b) used the same as paid-in capital of subsidiaries including the Plaintiff and Hungary-based CHAM (in 2009, CHAM's paid-in capital amounted to roughly KRW 600 billion), to invest in funds, as loans extended to affiliates based in Japan and France, and for net expenses required to carry out business activities. CHDS has never paid dividends (consequentially, no divided payouts to the 100% parent company CIC), and the instant dividend income was neither remitted nor reverted to CI.

C. The above factual basis is examined in light of the legal doctrine as seen earlier.

(1) First, we examine whether CHDS constitutes a beneficial owner of dividend income as prescribed by Article 10(2) of the Korea-Hungary Tax Treaty.

Fully viewing the following circumstances ― CHDS's establishment history and business activities, details on the actual use of the instant dividend

income and operation of funds, and the fact that CHDS has never paid out dividends or transferred dividends to CI — CHDS is deemed to have enjoyed benefits of the dividend income received without any legal or contractual obligation to transfer said income to CI, etc. Accordingly, as the resident of the Korea-Hungary Tax Treaty, there is sufficient room to regard that CHDS constitutes a beneficial owner of dividend income under Article 10(2) thereof.

(2) Next, we examine whether the Korea-Hungary Tax Treaty is inapplicable with respect to the instant dividend income pursuant to the principle of substantial taxation under the Framework Act on National Taxes.

When comprehensively considering the foregoing CHDS's establishment history, business divisions and business activities as an intermediary holding company as well as a public service center, human and physical resources including the recruitment and retention of employees, exercise of right as a shareholder to subsidiaries including the Plaintiff, source of paid-in capital, management of shares and receipt of dividends, use of funds and investment activities, details of the control, management, and disposition of dividend income, etc., it is reasonable to deem that CHDS, as an ordinary business entity of substantial form functioning as an intermediary holding company and a public service center, which has conducted relevant business activities in Hungary over a prolonged period based on an independent business purpose, i.e., overall restructuring of Corning Group, to have *de facto* controlled and managed the shares of the Plaintiff and the dividend income incurred therefrom, just like other assets owned. Solely on the basis that CI (ultimate parent company of Corning Group) exerted influence over the board of directors' decision via the executive committee meeting (ECM) or the Tax Treaty became applicable from the 2006 dividends upon the repeal of the tax exemption scheme for foreign investors in Korea, deeming that CHDS was incapable of controlling and managing the shares of the Plaintiff or that there was disparity between the name and the substance with respect to the attribution of the instant dividend income is difficult.

Insofar as CHDS is deemed to have *de facto* nominal ownership of the instant dividend income given that no disparity exists between the name and the substance of the reverted income, the applicability of the Korea-Hungary Tax Treaty cannot be denied with regard to the instant dividend income even if based on the principle of substantial taxation under Article 14(1) of the Framework Act on National Taxes.

D. Nevertheless, the lower court determined that the instant disposition was lawful by deeming that CI was the beneficial owner of the dividend income in question solely from a tax saving standpoint as stated in its holding. In so doing, the lower court erred and adversely affected the conclusion of the judgment by misapprehending the meaning of beneficial owner under Article 10(2) of the Korea-Hungary Tax Treaty, the principle of substantial taxation under Article 14 of the Framework Act on National Taxes, and the

determination of beneficial owner thereof. The allegation contained in the grounds of appeal on this point is with merit.

3. Conclusion

Therefore, without proceeding to decide on the remaining grounds of appeal, the lower judgment is reversed, and the case is remanded to the lower court for further proceedings consistent with this Opinion. It is so decided as per Disposition by the assent of all participating Justices on the bench.

Justices Jo Hee-de (Presiding Justice)
Kim Jae-hyung
Min You-sook (Justice in charge)
Lee Dong-won

Supreme Court Decision 2018Du128 Decided December 13, 2018【Revocation of Disposition Imposing Global Income Tax】

【Main Issues and Holdings】

[1] Meaning of the principle of substantial taxation under Article 14(1) of the Framework Act on National Taxes

Whether the substantial taxation principle is applicable to international trade involving individuals or domestic corporations residing in Korea that establish a base company in tax havens and only use the corporate form to evade taxation in Korea (affirmative)

[2] In a case where an investor of a company makes himself/herself as a person to whom the outflow of corporate income definitely accrues, whether such money may be recognized as constituting dividend income for investors (affirmative in principle)

[3] Effect of tax disposition made after the exclusion period for imposition of national taxes expires (invalid)

[4] Meaning of "deception or other unlawful act" under Article 26-2(1)1 of the former Framework Act on National Taxes and in a case where a taxpayer obtains income through the use of fake names, whether the mere fact of using fake names constitutes "deception or other unlawful act" (negative in principle)

[5] In a case where the head of the competent tax office imposed global income tax on Party A on the grounds that Party A evaded income tax by means of either (a) making remittance of the capital owned by a corporation Party A established in Hong Kong to corporations it established in the British Virgin Islands; or (b) lending his name to another person who receives dividend income in lieu of Party A, the case upholding the lower judgment, which determined that: (a) the dividend income paid out in 1999 and 2000 by corporations based in Hong Kong to Party A using another person's name constitutes foreign source income, and thus, cannot be subject to taxation; (b) because, Party A was deemed a U.S. resident in 1999 and 2000 according to Article 3(2) of the Convention between the Republic of Korea and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and the Encouragement of International Trade and Investment

[6] In a case where (a) principal tax and penalty tax are imposed together; and (b) various types of penalty taxes are imposed together in a single notice of tax payment, the manner in which a notice of tax payment is written

In a case where a tax notice only shows the sum amount of principal tax and penalty tax, without separately showing the amounts of principal tax and

penalty tax due and how they were calculated, and the tax amount by type of penalty tax and how they were calculated, whether the relevant taxation disposition is unlawful (affirmative)

【Summary of Decisions】

[1] Article 14(1) of the Framework Act on National Taxes regarding the principle of substantial taxation intends to tax a person to whom a taxable item, such as income, profit, property, or transaction, substantially accrues as a taxpayer holding a tax liability, instead of taxing a person only holding the title to the pertinent taxable item according to its form or outward appearance. As such, in cases where: (a) the person to whom the property nominally accrues (hereinafter "nominal owner") lacks the capacity to control or manage the property; (b) there is another person who substantially controls or manages the property by exercising the right to governance, etc. over the nominal owner (hereinafter "actual owner"); and (c) the disparity between the title and the actuality arises from the purpose of tax evasion, the income pertaining to the property in question ought to be deemed belonging to the actual owner, and in such a case, the actual owner is deemed a person holding a tax liability. The principle of substantial taxation likewise applies to: (a) not only international trades involving non-Korean residents or foreign corporations which establish a paper company in a country that gives benefits under tax treaties, and only use the corporate form to evade taxation in Korea; (b) but also international trades involving individuals or domestic corporations residing in Korea that establish a base company, which does not have any ability to perform business activities, in tax havens where income tax is either exempted or imposed at a low rate, and only use the corporate form to evade taxation in Korea, the country of tax residence, thereby unfairly reserving the income that is supposed to accrue to the actual proprietor who is in actual control and management of the property in question.

[2] In cases where an investor of a company designates himself/herself as a person to whom the outflow of corporate income nominally accrues, barring special circumstances, such an income can be recognized as constituting an income dividend for the investor regardless of (i) whether a general stockholders' meeting reached a resolution; (ii) the existence of profit available for dividend payments; and (iii) whether the income dividend was distributed in accordance with the dividend payout ratio.

[3] Article 26-2(1) of the former Framework Act on National Taxes (amended by Act No. 9911, Jan. 1, 2010) stipulates the exclusion period of imposition of national taxes, according to which a national tax may not be imposed: (a) after the expiration of five years from the date on which the national taxes may be imposed (Subparag. 3); (b) *Provided*, that where a taxpayer evades any national tax, or receives a refund or deduction, by deception or other unlawful act, it shall be for ten years from the date on which

the national tax may be imposed (Subparag. 1); (c) if a taxpayer fails to file a return of tax base within the statutory due date of return, it shall be for seven years from the date when the relevant national tax is assessable (Subparag. 2). The imposition disposition issued after the expiration of the exclusion period of imposition of national taxes is deemed invalid.

[4] The term "deception or other unlawful act" under Article 26-2(1)1 of the former Framework Act on National Taxes (amended by Act No. 9911, Jan. 1, 2010) refers to a fraudulent scheme and any unlawful and aggressive actions rendering it impossible or considerably difficult to levy and collect taxes. A simple failure to file a report under tax law or filing a false report, which does not accompany any other actions, does not constitute a "deception or other unlawful act." Even if a taxpayer earns income through the use of fake names, the sole fact of using fake names may not be deemed as a "deception or other unlawful act" as provided under Article 26-2(1)1 of the former Framework Act on National Taxes, unless there are special circumstances suggesting that: (a) the taxpayer used a fake name for tax evasion purposes; and (b) the use of fake names was followed by drafting false contracts and falsely paying the price, filing a false tax report to the tax office, falsely registering and reporting, and drafting and preparing a false account book.

[5] In a case where the head of the competent tax office imposed global income tax on Party A on the grounds that Party A evaded income tax payment by means of either (a) making remittance of the capital owned by a corporation Party A established in Hong Kong to corporations he established in the British Virgin Islands; or (b) lending his name to another person, who receives dividend income in lieu of Party A, the case upheld the lower judgment, which determined that: (a) the dividend income paid out in 1999 and 2000 by corporations based in Hong Kong to Party A using another person's name constitutes foreign source income, and thus cannot be subject to taxation; (b) because, Party A was deemed a U.S. resident in 1999 and 2000 according to Article 3(2) of the Convention between the Republic of Korea and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and the Encouragement of International Trade and Investment (hereinafter "Korea-U.S. Income Tax Convention") in full view of the following: (a) the Korea-U.S. Income Tax Convention provides, (i) "Where by reason of the provisions of paragraph (1) an individual is a resident of both Contracting States, [h]e shall be deemed to be a resident of that Contracting State in which he maintains his permanent home" under Article 3(2)(a); (ii) "If he has a permanent home in both Contracting States or in neither of the Contracting States, he shall be deemed to be a resident of that Contracting State with which his personal and economic relations are closest (center of vital interests)" under Article 3(2)(b); (c) "For the purpose of this paragraph, a permanent home is the place where an individual dwells with his family" under Article 3(2)(e); and furthermore

provides, (iii) "Notwithstanding any provisions of this Convention except paragraph (5) of this Article, a Contracting State may tax a citizen or resident of that Contracting State as if this Convention had not come into effect" under Article 4(4); (b) considering that Article 2(1)(h) of the Korea-U.S. Income Tax Convention defines the term "citizen," in the case of Korea, a national of Korea, while Party A constituted a tax resident in both Korea and the United states in 1999 and 2000, his permanent home with family was in the United States; (c) taking into account Article 3(3) of the Korea-U.S. Income Tax Convention, which stipulates, "an individual who is deemed to be a resident of one of the Contracting States and not a resident of the other Contracting State by reason of the provisions of paragraph (2) shall be deemed to be a resident only of the first-mentioned Contracting State for all purposes of this Convention, including Article 4 (General Rules of Taxation)," Party A, who is deemed a U.S. resident under Article 3(2) of the Korea-U.S. Income Tax Convention, is therefore not deemed a Korean resident, as provided in Article 4(4) of the Korea-U.S. Income Tax Convention; (c) while the Korean Income Tax Act decides on the scope of taxable income depending on whether a person with tax liability is a resident or not, and states that nonresidents are only liable for domestic source income, whether a person with tax liability is a Korean citizen or not does not affect determination on the scope of taxable income.

[6] When principal tax and penalty tax are imposed together through the issuance of a single tax notice, the tax notice must separately identify the amount of assessed principal tax and assessed penalty tax, as well as how they were calculated. Where various types of penalty taxes are imposed together, the amount of the assessed tax among each penalty tax item and how they were calculated ought to be separately identified in the pertinent tax notice. A tax disposition that only identifies the sum amount of principal tax and penalty tax without separately identifying (i) the amount of the assessed principal tax and the assessed penalty tax; (ii) the basis on which the amount was calculated; (iii) the amount of the assessed tax for each penalty tax item; and (iv) how they were calculated is deemed unlawful.

【Reference Provisions】 [1] Article 14(1) of the Framework Act on National Taxes / [2] Article 17(1) of the former Income Tax Act (Amended by Act No. 9897, Dec. 31, 2009) / [3] Article 26-2(1) of the former Framework Act on National Taxes (Amended by Act No. 9911, Jan. 1, 2010) / [4] Article 26-2(1) of the former Framework Act on National Taxes (Amended by Act No. 9911, Jan. 1, 2010) / [5] Articles 2(1), 3(2), 3(3), and 4(4) of the Convention between the Republic of Korea and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and the Encouragement of International Trade and Investment ("Republic of Korea-United States Income Tax Convention") / [6] Article 9(1) of the Framework Act on National Taxes

Article 9 of the current Framework Act on National Taxes (Report on Place to be Served)

Where a person to receive documents pursuant to Article 8 reports to the Government a place to be served, either his domicile or business office, as prescribed by Presidential Decree, the documents shall be served on the reported place. When such place is changed, the same shall also apply.

[This Article Wholly Amended by Act No. 9911, Jan. 1, 2010]

Article 14 of the current Framework Act on National Taxes (Actual Taxation)

(1) If any ownership of an income, profit, property, act or transaction which is subject to taxation, is just nominal, and there is other person to whom such income, etc., belongs, the other person shall be liable to pay taxes and tax-related Acts shall apply, accordingly.

Article 26-2 of the current Framework Act on National Taxes (Period of Exclusion from Imposition of National Taxes)

(1) No national tax may be levied after any of the following periods expires: *Provided*, That where a mutual agreement procedure is in progress in accordance with the treaty for the prevention of double taxation (hereinafter referred to as "tax treaty"), Article 25 of the Adjustment of International Taxes Act shall apply: <*Amended by Act No. 10405, Dec. 27, 2010; Act No. 11124, Dec. 31, 2011; Act No. 11604, Jan. 1, 2013; Act No. 11873, Jun. 7, 2013; Act No. 12848, Dec. 23, 2014*>

1. If a taxpayer evades any national tax, or receives a refund or deduction, by deception or other unlawful act prescribed by Presidential Decree (hereinafter referred to as "unlawful act"), it shall be for ten years from the date on which the national tax may be imposed on him/her [where a taxpayer evades a national tax or receives a refund or deduction by unlawful act committed in international trade (hereinafter referred to as "international trade") under Article 2 (1) 1 of the Adjustment of International Taxes Act, it shall be for 15 years]. In such cases, if the national tax which is evaded, refunded or deducted by unlawful act is a corporate tax, with regard to an income tax or corporate tax on the amount under disposition pursuant to Article 67 of the Corporate Tax Act in relation to the national tax, it shall be for ten years (in cases of an income tax or corporate tax on the amount under disposition pursuant to Article 67 of the Corporate Tax Act after a taxpayer evades a corporate tax, or receives a refund or deduction by unlawful act committed in international trade, it shall be for 15 years) from the date when the income tax or corporate tax may be imposed;

1-2. If a taxpayer becomes liable to pay penalty tax under any of the following categories due to unlawful acts, it shall be for ten years from the date when the relevant tax is assessable:

(a) Article 81 (3) 4 of the Income Tax Act;

(b) Article 76 (9) 4 of the Corporate Tax Act;

(c) Article 60 (2) 2, (3) and (4) of the Value-Added Tax Act;

Article 17 of the Income Tax Act (Dividend Income)

(1) Dividend income shall be the following income generated during the relevant taxable period: <*Amended by Act No. 11146, Jan. 1, 2012; Act No. 15225, Dec. 19, 2017*>

1. Dividends or shares of profits or a surplus received from a domestic corporation;

2. Dividends or shares received from an organization deemed a corporation;

3. Deemed dividends;

4. The amount treated as dividend under the Corporate Tax Act;

5. Profits from collective investment schemes prescribed by Presidential Decree, received in Korea or overseas;

5-2. Profits from derivative-linked securities or equity- or derivative-linked bonds prescribed by Presidential Decree, received in Korea or overseas;

6. Dividends or shares of profits or a surplus received from a foreign corporation;

7. The amount deemed allotted pursuant to Article 17 of the Adjustment of International Taxes Act;

8. The amount equivalent to the profit-and-loss distribution ratio of joint investment business operators pursuant to Article 43 (1), of the amount of income generated from joint business pursuant to Article 43;

9. Income in the nature of distributions of profit, as income similar to income referred to in subparagraphs 1 through 5, 5-2, 6, and 7;

10. Profits from transactions or activities of derivatives, where transactions or activities generating the income referred to in any of subparagraphs 1 through 5, 5-2, and 6 through 9 are linked to derivatives, as prescribed by Presidential Decree.

Article 2 of the Republic of Korea-United States Income Tax Convention (General Definitions)

(1) In this Convention, unless the context otherwise requires:

(a) (i) The term "Korea" means the Republic of Korea; and

(ii) When used in a geographical sense, the term "Korea" means all the territory in which the laws relating to Korean tax are in force. The term also includes :

(A) The territorial sea thereof; and

(B) The seabed and subsoil of the submarine areas adjacent to the coast thereof, but beyond the territorial sea, over which Korea exercises sovereign rights, in accordance with international law, for the purpose of exploration of the natural resources of such areas, but only to the extent that the person, property, or activity to which this Convention is being applied is

connected with such exploration or exploitation;

(b) (i) The term "United States" means the United States of America; and

(ii) When used in a geographical sense, the term "United States" means the states thereof and the District of Columbia, Such term also includes:

(A) The territorial sea thereof ; and

(B) The seabed and subsoil of the submarine areas adjacent to the coast thereof but beyond the territorial sea, over which the United States exercises sovereign rights, in accordance with international law, for the purpose of exploration and exploitation of the natural resources of such areas, but only to the extent that the person, property, or activity to which the Convention is being applied is connected with such exploration or exploitation ;

(c) The term "Contracting State" means Korea or the United Slates, as the context requires ;

(d) The term "person" includes an individual, a partnership a corporation, an estate, a trust, or any body of persons;

(e) (i) The term "Korea corporation" or "corporation of Korea" means a corporation (other than a United States corporation) which has its head or main office in Korea, or any entity treated as a Korean corporation for Korean tax purposes ; and

(ii) The term "United States corporation" or "corporation of the United States" means a corporation which is created or organized under the laws of the United States or any state thereof or the District of Columbia, or any unincorporated entity treated as a United States corporation for United States tax purpose ;

(f) The term "competent authority" means :

(i) In the case of Korea, the Minister of Finance or his delegate; and

(ii) In the case of the United States, the Secretary of the Treasury or his delegate :

(g) The term "State" means any .national State, whether or not one of the Contracting States;

(h) The term "citizen" means:

(i) In the case of Korea, a national of Korea; and

(ii) In the case of the United States, a citizen of the United States.

Article 3 of the Republic of Korea-United States Income Tax Convention (Fiscal Domicile)

(2) Where by reason of the provisions of paragraph (1) an individual resident of both Contracting States :

(a) He shall be deemed to be a resident of that Contracting State in which he maintains his permanent home ;

(b) If he has a permanent home in both Contracting States or in neither of the Contracting States, he shall be deemed to be a resident of that

Contracting State with which his personal and economic relations are closest (center of vital interests) ;

(c) If his center of vital interests is in neither of the Contracting States or cannot be determined, he shall be deemed to be a resident of that Contracting State in which he has a habitual abode :

(d) If he has a habitual abode in both Contracting States or in neither of the Contracting States, he shall be deemed to be a resident of the Contracting State of which he is a citizen; and

(e) If he is a citizen of both Contracting State or of neither Contracting State the competent authorities of the Contracting States shall settle the question by mutual agreement. For the purpose of this paragraph, a permanent home in the place where an individual dwells with his family.

(3) An individual who is deemed to be a resident of one of the Contracting States and not a resident of the other Contracting State by reason of the provisions of paragraph (2) shall be deemed to be a resident only of the first-mentioned Contracting State for all purposes of this Convention, including Article 4 (General Rules of Taxation).

Article 4 of the Republic of Korea-United States Income Tax Convention (General Rules of Taxation)

(4) Notwithstanding any provisions of this Convention except paragraph (5) of this Article, a Contracting State may tax a citizen or resident of that Contracting State as if this Convention had not come into effect.

【Reference Cases】 [1] Supreme Court en banc Decision 2008Du8499, Jan. 19, 2012 (Gong2012Sang, 359); Supreme Court Decision 2014Du335, Nov. 26, 2015 (Gong2016Sang, 76) / [2] Supreme Court Decision 2003Du1059, 1066, Jul. 9, 2004 / [3] Supreme Court Decisions 99Du3140, Jun. 22, 1999 (Gong1999Ha, 1538); 2007Du24364, May 28, 2009 / [4] Supreme Court Decisions 2013Du7667, Dec. 12, 2013 (Gong2014Sang, 196); 2015Du44158, Apr. 13, 2017 (Gong2017Sang, 1023); 2017Du69991, Mar. 29, 2018 (Gong2018Sang, 837) / [6] Supreme Court en banc Decision 2010Du12347, Oct. 18, 2012 (Gong2012Ha, 1945)

【Plaintiff-Appellant-Appellee】 Plaintiff (Attorney Lee Jae-hong et al., Counsel for the plaintiff-appellant-appellee)

【Defendant-Appellee-Appellant】 Head of National Tax Service Seodaemun District Office (Gaon Law Group et al., Counsel for the defendant-appellee-appellant)

【Judgment of the court below】 Seoul High Court 2014Nu6236 decided January 24, 2018

【Disposition】 The part of the lower judgment against the Plaintiff regarding disposition imposing global income tax for tax years from 2001 to

2004, and the part of the lower judgment against the Defendant regarding disposition imposing global income tax (excluding penalty tax) for tax years from 2005 to 2008 are reversed, and that part of the case is remanded to the Seoul High Court. The Plaintiff's final appeal and the Defendant's remaining final appeals are all dismissed.

【Reasoning】 The grounds of appeal are examined (to the extent of supplement in case of supplemental appellate briefs not timely filed).

1. As to the Plaintiff's grounds of appeal

A. Whether the principle of substantial taxation applies in cases of using a base company (Ground of appeal No. 1)

(1) Article 14(1) of the Framework Act on National Taxes regarding the principle of substantial taxation intends to tax a person to whom a taxable item, such as income, profit, property, or transaction, substantially accrues as a taxpayer holding a tax liability, instead of taxing a person only holding the title to the pertinent taxable item according to its form or outward appearance. As such, in cases where: (a) the person to whom the property nominally accrues (hereinafter "nominal owner") lacks the capacity to control or manage the property; (b) there is another person who substantially controls or manages the property by exercising the right to governance, etc. over the nominal owner (hereinafter "actual owner"); and (c) the disparity between the title and the actuality arises from the purpose of tax evasion, the income pertaining to the property in question ought to be deemed belonging to the actual owner, and in such a case, the actual owner is deemed a person holding a tax liability (*see, e.g.,* Supreme Court en banc Decision 2008Du8499, Jan. 19, 2012).

The principle of substantial taxation likewise applies to: (a) not only international trades involving non-Korean residents or foreign corporations that establish a paper company in a country which gives benefits under tax treaties and only use the corporate form to evade taxation in Korea; (b) but also international trades involving individuals or domestic corporations residing in Korea that establish a base company, which does not have any ability to perform business activities, in tax havens where income tax is either exempted or imposed at a low rate, and only use the corporate form to evade taxation in Korea, country of tax residence, thereby unfairly reserving the income that is supposed to accrue to the actual owner who is in actual control and management of the property in question (*see, e.g.,* Supreme Court Decision 2014Du335, Nov. 26, 2015).

(2) In a case where: (a) Gundo Hong Kong Limited and Gundo International Limited (hereinafter "Gundo HK," "Gundo International," respectively, jointly referred to as "Hong Kong corporation") established in Hong Kong, remitted money equivalent to a certain proportion of the sales revenue from around 2001 to 2002 as a sales commission and inspection fee, or auditor's fee to the accounts held by Golden Quarter Limited and Virtual Capital Holdings (hereinafter "Golden Quarter" and "Virtual Capital")

established in the British Virgin Islands (hereinafter "BVI"); (b) the lower court determined that the money belonged to the Plaintiff, who had practical control and management of the property in question, and not to Golden Quarter or Virtual Capital.

(A) At the time in question, the Plaintiff possessed the entire shares of Golden Quarter. All shares of Virtual Capital were possessed by Leadway Capital Finance Ltd. (hereinafter "Leadway") established in BVI. All shares of Leadway were possessed by Rockwealth Investment Ltd. (hereinafter "Rockwealth") established in BVI, and all shares of Rockwealth were possessed by the Plaintiff.

(B) The Plaintiff owned the right to make a withdrawal from the account under the name of Golden Quarter and Virtual Capital with a signature. Aside from the Plaintiff's signature, other internal company procedures were unnecessary in withdrawing and managing the money deposited in the accounts in the name of Golden Quarter and Virtual Capital, and there was no reporting obligation under law relating thereto. The Plaintiff was not restrained from withdrawing and managing the said money.

(C) The places registered as the seat of Golden Quarter, Virtual Capital, Leadway, and Rockwealth did not hold business activities of any kind, including commercial activities or decision-making. A board of directors meeting, general shareholders' meeting, or other similar managerial meetings has not been hosted in the administration or important decision-making process of the above corporations. The Plaintiffs were the only decision-making entity for investment to be made in the name of the said corporations.

(D) At the time of the tax investigation, the Plaintiff wrote a confirmatory document that read: "The money transferred to Golden Quarter and Virtual Capital by the Hong Kong corporations belongs to the Plaintiff. The said corporations, Leadway, and Rockwealth exist as part of the Plaintiff's business operations, assets, and bank accounts. The said companies have neither compiled accounting records or financial statements, nor fulfilled such obligations as receiving certified external audits and filing a tax return, since they do not have any such obligation."

(3) According to the facts and record admitted by the lower court in addition to the above facts, it is recognized that: (a) the Plaintiff received a nominal commission from the Hong Kong corporations to the accounts under the name of Golden Quarter and Virtual Capital, controlled and managed by the Plaintiff himself, even after the Plaintiff became a resident of the Republic of Korea; (b) and did so with the aim of evading income tax.

(4) Examining these facts in light of the legal principles and the record seen earlier, it can be concluded that: (a) Golden Quarter and Virtual Capital, the nominal owner to whom the money transferred from around 2001 to 2002 belonged, did not have the ability to control or manage the said money; (b) the Plaintiff had practical control and management of the said money by exercising

the management right over the said corporations; (c) the disparity between the nominal owner and the actual owner stemmed from the purpose of tax evasion in the Republic of Korea; (d) hence, the said money ought to be deemed as having practically accrued to the Plaintiff.

(5) The lower court did not err in its judgment by contradicting in its reasoning or misapprehending the legal doctrine on the principle of substantial taxation or attribution of income.

B. Whether the money in question constitutes dividend income (Ground of appeal No. 2)

(1) In cases where an investor of a company designates himself/herself as a person to whom the outflow of corporate income nominally accrues, barring special circumstances, such an income can be recognized as constituting an income dividend for the investor regardless of (i) whether a general stockholders' meeting reached a resolution; (ii) the existence of profit available for dividend payments; and (iii) whether the income dividend was distributed in accordance with the dividend payout ratio (*see* Supreme Court Decision 2003Du1059, 1066, Jul. 9, 2004).

(2) The lower court determined, on the ground stated in its reasoning, that the money belonged to the Plaintiff as seen earlier constituted "dividends or shares of profits or a surplus received from a foreign corporation," as stipulated in Article 17(1)6 of the former Income Tax Act (amended by Act No. 9897, Dec. 31, 2009) for the following reasons.

(A) The Plaintiff was practically a single shareholder of the Hong Kong corporations, owning the entire shares of the Hong Kong corporations under either his name or another person's name.

(B) The Plaintiff filed a tax report only on the money amounting to 0.2%~0.3% of the actual sales revenue, and the sum amount constituting 0.6%~0.9% of the purchases to the Hong Kong tax authority as commission on exports, and transferred 11% of the remaining sales revenue as sales commission and inspection fee, and 4% as auditor's fee to the accounts under the name of Golden Quarter and Virtual Capital, both of which were practically controlled and managed by the Plaintiff himself.

(C) There is no transactional relationship between the Hong Kong corporations and Golden Quarter and Virtual Capital warranting an exchange of money such as the above commission fee. In addition, there are no materials suggesting that: (a) the Hong Kong corporations demanded the Golden Quarter and Virtual Capital to return the said money; (b) the said money was indeed returned to the Hong Kong corporations; or (c) the said money was used for the benefit of the Hong Kong corporations.

(3) In light of the legal principles and the record seen above, the lower court did not err in its judgment by misapprehending the legal doctrine on the principle of no taxation without law regarding the item subject to taxation of dividend income, and the principle that taxable income must first be

enumerated in the Income Tax Act to be subject to taxation.

C. Whether to recognize deception or other unlawful act with respect to the exclusion period of imposition (Ground of appeal No. 3)

(1) Article 26-2(1) of the former Framework Act on National Taxes (amended by Act No. 9911, Jan. 1, 2010) stipulates the exclusion period of imposition of national taxes, according to which a national may not be imposed: (a) after the expiration of five years from the date on which the national taxes may be imposed (Subparag. 3); (b) *provided*, that where a taxpayer evades any national tax, or receives a refund or deduction, by deception or other unlawful act, it shall be for ten years from the date on which the national tax may be imposed (Subparag. 1); (c) if a taxpayer fails to file a return of tax base within the statutory due date of return, it shall be for seven years from the date when the relevant national tax is assessable (Subparag. 2). The imposition disposition issued after the expiration of the exclusion period of imposition of national taxes is deemed invalid (*see, e.g.,* Supreme Court Decisions 99Du3140, Jun. 22, 1999; 2007Du24364, May 28, 2009).

In the meantime, Article 12-3(1)1 of the former Framework Act on National Taxes (amended by Presidential Decree No. 19893, Feb. 28, 2007) states that the exclusion period of imposition of the national taxes, tax base and amount of tax of which are reported, is calculated from the date following the report deadline or the deadline for submission of a written report. Article 70(1) of the former Income Tax Act stipulates that any resident with the amount of global income in the relevant taxable period shall file a return on the tax base of such global income with the head of a tax office having jurisdiction over the place for tax payment, from May 1 to May 31 in the year following such taxable period.

The term "deception or other unlawful act" under Article 26-2(1)1 of the former Framework Act on National Taxes (amended by Act No. 9911, Jan. 1, 2010) refers to a fraudulent scheme and any unlawful and aggressive actions rendering it impossible or considerably difficult to levy and collect taxes. A simple failure to file a report under tax law or filing a false report, which does not accompany any other actions, does not constitute a "deception or other unlawful act" (*see, e.g.,* Supreme Court Decisions 2015Du44158, Apr. 3, 2017; 2017Du69991, Mar. 29, 2018). Even if a taxpayer earns income through the use of a fake name, the sole fact of using a fake name may not be deemed as a "deception or other unlawful act," as provided under Article 26-2(1)1 of the former Framework Act on National Taxes, unless there are special circumstances suggesting that: (a) the taxpayer used a fake name for tax evasion purposes; and (b) the use of a fake name was followed by drafting false contracts and falsely paying the price, filing a false tax report to the tax office, falsely registering and reporting, and drafting and preparing a false account book (*see, e.g.,* Supreme Court Decisions 2015Du44158, Apr. 13, 2017; 2017Du69991, Mar. 29, 2018).

(2) The lower court determined, on the grounds stated in its reasoning, that the Plaintiff's act of transferring operating revenue of the Hong Kong corporations to the accounts under the name of Golden Quarter and Virtual Capital as commission fee constituted "deception or other unlawful act" under Article 26-2(1)1 of the former Framework Act on National Taxes.

(A) The Plaintiff: (a) drafted a false "Total Income List" wherein the money transferred to the accounts of Golden Quarter and Virtual Capital from the Hong Kong corporations were recorded as a "sales commission and inspection fee" or "auditor's fee;" (b) reported only around 1% of the actual sales revenue generated from the Hong Kong corporations, with intentionally leaving out the said money when filing a tax return on the income of the Hong Kong corporations; and (c) compiled an audit report and tax return as such.

(B) The money, which should have been reverted to the Plaintiff, was transferred under the false pretenses to the accounts held in the name of Golden Quarter and Virtual Capital in BVI, rendering it difficult for the tax authority in the Republic of Korea to possibly ascertain that the said money actually belonged to the Plaintiff.

(C) Even though the Plaintiff committed such an act with the intent of (i) mitigating the obligation to pay corporate taxes levied on the Hong Kong corporations, or (ii) ensuring stable operation of the business in the midst of the handover of Hong Kong, which had been under the British rule, to China, such ancillary circumstances do not justify the dismissal of "deception and other unlawful act." The Plaintiff could have anticipated the establishment of the obligation to pay income taxes by siphoning off the income accrued to the Hong Kong corporations.

(3) However, examining the facts recognized in the lower court in addition to the following circumstances revealed from the record in light of the legal principles seen above, the Plaintiff's act of transferring money belonging to the Hong Kong corporations to the accounts in the name of Golden Quarter and Virtual Capital as a commission fee, and the acts committed in the process may not be deemed as constituting "deception and other unlawful act," as prescribed in Article 26-2(1)1 of the former Framework Act on National Taxes.

(A) As for Golden Quarter, the Plaintiff owned the entire shares of Golden Quarter in 2001 and 2002 under his real name, and there was no multi-level corporate governance structure from the outset. As for Virtual Capital, the Plaintiff was controlling Virtual Capital by means of (i) the Plaintiff's ownership of the entire shares of Rockwealth under his real name; (ii) Rockwealth's possession of all shares of Leadway; and (iii) Leadway's possession of all shares of Virtual Capital. Deeming such a corporate governance structure as a deviation from ordinary investment structures is difficult.

(B) The Plaintiff does not appear to have filled in another person's personal information as the beneficial owner of the bank account in question

when he opened the account under the name of Golden Quarter and Virtual Capital in Hong Kong-based financial institutions. Moreover, it was the Plaintiff who owned the right to make a withdrawal from the account opened in the name of Golden Quarter and Virtual Capital with a signature.

(C) That the Hong Kong corporations (a) filed a tax return reporting only around 1% of the actual sales revenue to the Hong Kong tax authority; and (b) drafted and attached the financial statement and audit report at the end of the year in the same regard, is subsidiary to the act of reporting. These circumstances alone do not provide sufficient basis for concluding that the documents (i.e. basic ledger regarding the contents of reporting) were manipulated or drafted to deem it as the commission of active wrongdoing tantamount to "deception and other unlawful act," and there is no evidence underpinning such conclusion.

(D) The "Monthly Settlement Report" and "Total Income List" compiling the remittances to the accounts of Golden Quarter and Virtual Capital from the Hong Kong corporations simply indicate (i) the existence of the income the Hong Kong corporations missed out on reporting, and (ii) that the income omitted from reporting was transferred to outside the company, such as corporations established in BVI under the name of a commission fee. As such, these documents are neither related to tax reporting nor may be considered to have been drafted to conceal the income.

(E) Aside from making such entry on the aforesaid "Monthly Settlement Report" and "Total Income List," there is no evidence suggesting that the Plaintiff committed an act of income concealment by actively creating a false impression of having received services in exchange for the commission fees written as such, or committed active wrongdoing, which demonstrated such intent of concealment.

(4) Therefore, it is reasonable to view the exclusion period of imposition regarding the part of the disposition imposing global income tax for the tax years 2001 and 2002, which was made under the premise that the money transferred to Golden Quarter and Virtual Capital from 2001 to 2002 under the name of a commission actually belonged to the Plaintiff, as five years, pursuant to Article 26-2(1)3 of the former Framework Act on National Taxes. The said part of the disposition is invalid as it was made after the lapse of the exclusion period of imposition, which was June 28, 2010, five years later than the date from which the exclusion period of imposition of global income tax for the tax years 2001 and 2002, which are June 1, 2002, and June 1, 2003, respectively, is calculated.

Nevertheless, the lower court dismissed the Plaintiff's assertion that the pertinent disposition was unlawful because it was made after the lapse of the exclusion period of imposition, by determining, on the false premise that the Plaintiff's transfer of the Hong Kong corporations' money to Golden Quarter and Virtual Capital under the name of a commission constituted "deception and

other unlawful acts" pursuant to Article 26-2(1)1 of the Framework Act on National Taxes, that the said part of the disposition imposing global income tax for the tax year 2001 and 2002 was lawful, for it was made within 10 years of the exclusion period of imposition. In so determining, the lower court erred by misapprehending the legal principle on "deception and other unlawful acts" under Article 26-2(1)1 of the former Framework Act on National Taxes. The Plaintiff's grounds of appeal pointing this out are therefore with merit.

D. Whether the principle of substantial taxation is applied and whether deception and other unlawful acts regarding the exclusion period of imposition can be recognized (Ground of appeal No. 4)

(1) Whether the dividend income received in 2008 under the name of Crest Trade Limited (a corporation established in BVI, hereinafter "Crest") accrued or not

(A) On the grounds that the Plaintiff (i) lent the title to the shares issued by MOA International Limited (a corporation established in Hong Kong, hereinafter "MOA") to Crest, or (ii) practically had control and management of Crest, the lower court determined that a share dividend of MOA paid out in 2008 to Crest belonged to the Plaintiff.

(B) According to the reasoning of the lower court and the record, the following facts are revealed.

① In 2008, all shares of Crest were owned by Golden Quarter; all shares of Golden Quarter were owned by New Ocean Limited (hereinafter "New Ocean") established in BVI; and all shares of New Ocean were owned by a title shareholder with whom the Plaintiff entered into the Nominee Shareholder Agreement.

② The Plaintiff owned the right to make a withdrawal from the account under the name of Crest with a signature. Aside from the Plaintiff's signature, other internal company procedures were unnecessary in withdrawing and managing the money deposited in the accounts in the name of Crest, and there was no reporting obligation under law relating thereto. The Plaintiff was not restrained from withdrawing and managing the said money.

③ The places registered as the seat of Crest, Golden Quarter, and New Ocean did not hold business activities of any kind, including commercial activities or decision-making. A board of directors meeting, general shareholders' meeting, or other similar managerial meetings has not been hosted in the administration or an important decision-making process of the above corporations. The Plaintiffs were the only decision-making entity for investment to be made in the name of the said corporations.

④ At the time of the tax investigation, the Plaintiff wrote a confirmatory document that read: "The money transferred to Crest belongs to the Plaintiff. Crest, Golden Quarter, and New Ocean exist as part of the Plaintiff's business

operations, assets, and bank accounts. The said companies have neither compiled accounting records or financial statements, nor fulfilled such obligations as receiving certified external audits and filing a tax return, since they do not have any such obligation."

(C) According to the aforesaid facts in addition to the facts and record admitted by the lower court, it is recognized that: (a) the Plaintiff received share dividend payments from MOA to the accounts opened in the name of Crest, controlled and managed by the Plaintiff himself/herself, in 2008 when the Plaintiff was residing in the Republic of Korea; (b) and did so with the aim of income tax evasion.

(D) Examining these facts in light of the legal principles and the record seen earlier under 1.(A), it can be concluded that: (a) Crest, the nominal owner to whom the share dividend paid from MOA in 2008 reverted, did not have the ability to control or manage the said money; (b) the Plaintiff had practical control and management of the said money through the management right on the said corporations; (c) the disparity between the nominal owner and the actual owner stemmed from the purpose of income tax evasion in the Republic of Korea; (d) hence, the said money ought to be deemed as having accrued to the Plaintiff.

(E) Despite some unreasonableness in the reasoning of the lower judgment, the lower judgment, which determined that the said dividend payment reverted to the Plaintiff on the ground that the Plaintiff had practical control and management of Crest, was rendered in accordance with the legal principle noted above. In so determining, the lower court did not err by misapprehending the legal principle regarding tax obligation, contrary to what is alleged in the ground of appeal.

(2) Whether the exclusion period of imposition lapsed in regard to the dividend payment received under the name of Nonparty 1 and Nonparty 2 in 2002 and 2003, and the dividend payment received under the name of Nonparty 1 and Nonparty 3 in 2003 and 2004

(A) On the following grounds, the lower court determined that the Plaintiff's act of receiving dividend payment under the name of the nominal owner and drafting a false sales contract constituted "deception and other unlawful act."

① The Plaintiff became a ROK resident since 2001, bearing the obligation to pay global income tax.

② Before the Plaintiff became a ROK resident, he transferred the title to the Gundo International shares to Nonparty 1, etc., rendering it impossible for the tax authority to identify the Plaintiff's income. When the Plaintiff founded MOA, Nonparty 1, etc. did not make contributions thereto, and the Plaintiff appears to have drafted the document regarding the payment of stock subscription. Documents mentioning tax issues involved with the liquidation of

Gundo International and the incorporation of a new company have been drafted, and a considerable amount of income has been evaded.

③ It appears that the change of shareholder's title from Nonparty 1 to Crest is partly concerned with tax issues. Crest's corporate governance structure changed multiple times, which made it hard for the tax authority to identify the Plaintiff's income.

(B) However, examining these facts in light of the legal principles and the record seen earlier under 1.C., it is hard to conclude that there existed "deception and other unlawful act" under Article 26-2(1)1 of the former Framework Act on National Taxes, with respect to the Plaintiff's obligation to pay income tax on (i) Gundo International's dividend received under the name of Nonparty 1 and Nonparty 2 from 2002 to 2003; and (ii) MOA's dividend received under the name of Nonparty 1 and Nonparty 3 from 2003 to 2004.

① Determination on whether someone evaded national taxes by means of deception or other unlawful acts is made under the premise that a taxpayer has a liability for national taxes. As such, that the Plaintiff had liability for global income tax as a ROK resident is insufficient to readily recognize the commission of deception or other unlawful acts.

② That the Plaintiff: (a) held the shares of Gundo International and MOA under the name of another person, and (b) drafted documents to that effect in doing so, simply constitutes an act of using a false name or an ancillary act ordinarily ensued following the use of a false name. Therefore, it is hard to deem that there existed special circumstances where the use of a false name was accompanied by the active perpetration of wrongdoings. Also, the existence of the documents proving the purpose of tax evasion, or that a considerable amount of the evaded income, does not constitute deception or unlawful acts. Thus, these circumstances alone are insufficient to deem that there was active commission of wrongdoings which amount to deception or other unlawful acts.

③ The lower court also cites as a reason that MOA's shareholder changed into Crest; however, such a change took place on October 26, 2006. Therefore, it cannot be used as the grounds for arguing that deceptive means were exploited or other unlawful acts were committed with regard to the dividend paid out until 2004.

(C) Therefore, among the disposition imposing global income tax for the tax years 2002, 2003 and 2004, the exclusion period of imposition of the part issued on the grounds that (i) the Gundo International dividend received under the name of Nonparty 1 and Nonparty 2 from 2002 to 2003 and (ii) MOA dividend received under the name of Nonparty 1 and Nonparty 3 from 2003 to 2004 were reverted to the Plaintiff, ought to be viewed as five years, pursuant to Article 26-2(1)3 of the former Framework Act on National Taxes. The said part in the pertinent disposition was issued on June 28, 2010, which is five years

after the date from which the exclusion period for the global income tax for the tax years 2002, 2003, and 2004 is calculated, namely, June 1, 2003, June 1, 2004, and June 1, 2005, respectively. Since it was made after the lapse of the exclusion period of imposition, the said part of the pertinent disposition is invalid.

Nevertheless, (a) the lower court dismissed the Plaintiff's argument that the said part of the pertinent disposition was unlawful because it was made after the lapse of the exclusion period of imposition, (b) under the false premise that the payment of the said dividend constituted "deception and other unlawful acts" under Article 26-2(1)1 of the former Framework Act on National Taxes, (c) viewing that the said part of the disposition imposing global income tax for the tax years 2002, 2003, and 2004 were lawfully made within the ten years of the exclusion period of imposition. In so determining, the lower court erred by misapprehending the legal principle on "deception or other unlawful acts," as stipulated in Article 26-2(1)1 of the former Framework Act on National Taxes. The Plaintiff's allegation contained in the ground of appeal on this point is with merit.

E. Whether the principle of substantial taxation is applied (Ground of appeal No. 5)

(1) The Plaintiff: (a) founded Core Capital Corporation (hereinafter "Core Capital") in Labuan, Malaysia; (b) acquired shares of Open Tech Inc. (hereinafter "Open Tech") under the name of Core Capital in September 1999; and (c) conveyed the legal title of the pertinent shares to Nonparty 4 on December 21, 2007. For this reason, the lower court determined that the Open Tech dividend, which was paid out to Nonparty 4, the title holder, on April 3, 2008, reverted to the Plaintiff.

(2) Review of the reasoning of the lower judgment and the record reveals the following: (a) it was Core Capital, and not the Plaintiff, that acquired the Open Tech shares in September 1999; (b) hence, one cannot deny the legal personality of Core Capital and its senior holding company, or the legal effect and legal relations premised thereon, and argue that the Plaintiff, the final controlling shareholder, instead of Core Capital, is the acquirer of the Open Tech shares; and (c) there is no evidence suggesting that the Plaintiff reserved the ownership right of the Open Tech shares in the internal relationship with Core Capital and conveyed the title thereto to Core Capital. Meanwhile, it is reasonable to deem that the Plaintiff conveyed the title of the Open Tech shares owned by Core Capital to Nonparty 4 in lieu of Core Capital as a practical manager of Core Capital on December 21, 2007. In this vein, the reasoning of the lower judgment is partially unreasonable in considering that the Plaintiff acquired the Open Tech shares under the name of Core Capital, and conveyed the title of the Open Tech shares to Nonparty 4 on December 21, 2007, which led to its determination that the dividend paid out to Nonparty 5, the title holder, on April 3, 2008, directly reverted to the Plaintiff in accordance with the title

holder-title lender relationship between the Plaintiff and Nonparty 4.

(3) However, examining the following facts in light of the legal principle noted in 1.A., (a) although the dividend paid out to Nonparty 4 on April 3, 2008 is reverted to Core Capital, pursuant to the title holder-title lender relationship between the Plaintiff and Nonparty 4, (b) Core Capital did not have an ability to control and manage the dividend payment, and it was the Plaintiff who had practical control and management of the dividend payment through its management right over Core Capital; (c) the disparity between the title and the actuality appears to have arisen from the purpose of tax evasion; (d) hence, the said dividend ought to be considered to have been reverted to the Plaintiff. Therefore, the lower judgment determining that the dividend paid to Nonparty 4 on April 3, 2008 reverted to the Plaintiff is justifiable, and did not adversely affect the conclusion of judgment by misapprehending the legal principle on the dividend tax liability.

(A) According to the reasoning of the lower judgment and the record, the following facts are revealed.

① In 2008: (a) the entire shares of Core Capital were owned by Golden Quarter; (b) all shares of Golden Quarter were owned by New Ocean; and (c) all shares of New Ocean were owned by the title shareholder in the title shareholder agreement with the Plaintiff.

② The Plaintiff owned the right to make a withdrawal from the account held in the name of Core Capital with a signature. Aside from the Plaintiff's signature, other internal company procedures were unnecessary in withdrawing and managing the money deposited in the accounts in the name of Core Capital, and there was no reporting obligation under law relating thereto. The Plaintiff was not restrained from withdrawing and managing the said money.

③ The places registered as the seat of Core Capital, Golden Quarter, and New Ocean did not hold business activities of any kind, including commercial activities or decision-making. A board of directors meeting, general shareholders' meeting, or other similar managerial meetings has not been hosted in the administration or an important decision-making process of the above corporations. The Plaintiffs were the only decision-making entity for investment to be made in the name of the said corporations.

④ At the time of the tax investigation, the Plaintiff wrote a confirmatory document that read: "Core Capital was founded to acquire the shares of Open Tech. Core Capital, Golden Quarter, and New Ocean exist as part of the Plaintiff's business operations, assets, and bank accounts. The said companies have neither compiled accounting records or financial statements, nor fulfilled such obligations as receiving certified external audits and filing a tax return, since they do not have any such obligation."

⑤ The title transfer agreement concluded between the Plaintiff (on behalf of Core Capital) and Nonparty 4 states to the effect that Core Capital is actually owned by the Plaintiff, and that the financial profits arising from the possession and disposition of the Open Tech shares, including the dividend therefrom, revert to the Plaintiff, the actual shareholder of Core Capital.

(B) According to the facts and record admitted by the lower court in addition to the above facts, it is recognized that: (a) the Plaintiff, who was a ROK resident in April 3, 2008, received the dividend payment from Open Tech under the name of Nonparty 4, the title holder of Core Capital which was practically controlled and managed by the Plaintiff himself; (b) and did so with the aim of evading income tax in the Republic of Korea.

F. Determination on the imposition of global income tax (excluding penalty tax) for the tax year 2006 in the part against the Plaintiff in the lower judgment

The appellate court shall investigate and make decisions only within the extent of motion for dissatisfaction based on the grounds for final appeal. Hence, a statement of grounds for appeal must clarify specific reasons as to which part of the lower judgment is in breach of legislation, and in what way, by specifying the grounds of appeal. A statement of grounds for appeal that does not clarify specific reasons for appeal is considered as having not filed (*see, e.g.*, Supreme Court Decision 2011Du1245, Dec. 26, 2013).

The petition of appeal in the instant case did not specify the grounds for appeal relating to the imposition of global income tax (excluding penalty tax) for the tax year 2006 in the part against the Plaintiff in the lower judgment. The statement of grounds for appeal filed by the Plaintiff does not mention specific details of how the pertinent part is in breach of the legislation. As such, the court must deem that there was no legitimate statement of grounds for appeal on this part.

2. Determination on the Defendant's grounds for appeal

A. The concept of resident under the Korea-U.S. Income Tax Convention and the authority to withhold tax in the Republic of Korea (Ground of appeal No. 1)

(1) Article 3(2)(a) of the Convention between the Republic of Korea and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and the Encouragement of International Trade and Investment (hereinafter "Korea-U.S. Income Tax Convention") stipulates, "He shall be deemed to be a resident of that Contracting State in which he maintains his permanent home," and states, "If he has a permanent home in both Contracting States or in neither of the Contracting States, he shall be deemed to be a resident of that Contracting State with which his personal and economic relations are closest (center of vital interests)" under Article 3(2)(b). Article 3(2)(e) states, "If he is a citizen of both

Contracting State or of neither Contracting State the competent authorities of the Contracting States shall settle the question by mutual agreement. For the purpose of this paragraph, a permanent home is the place where an individual dwells with his family." Furthermore, Article 4(4) of the Korea-U.S. Income Tax Convention states, "Notwithstanding any provisions of this Convention except paragraph (5) of this Article, a Contracting State may tax a citizen or resident of that Contracting State as if this Convention had not come into effect." The "citizen" refers to a national of Korea in the case of Korea, according to Article 2(1)(h) of the Korea-U.S. Income Tax Convention.

(2) For the following reasons, the lower court viewed that: (a) the Plaintiff was considered a U.S. resident in 1999 and 2000 under Article 3(2) of the Korea-U.S. Income Tax Convention; (b) thus, the Plaintiff's foreign source income is not subject to taxation; and (c) this conclusion does not change when Article 4(4) of the Korea-U.S. Tax Treaty is considered.

(A) The Plaintiff: (a) was both a ROK resident under the Korean tax laws and a U.S. resident under the U.S. tax laws in 1999 and 2000; (b) relocated to the United States in around 1992, had a habitual abode with his family, and led a life there; (c) stayed in Korea for business purposes, but returned to the United States and resided with his family after having his business done. Therefore, the Plaintiff's maintained permanent home with his family was in the United States.

(B) As such, the Plaintiff is considered to have been a U.S. resident in the year 1999 and 2000 in accordance with Article 3(2) of the Korea-U.S. Income Tax Convention. This view is not affected by circumstances, such as that the tax authority in the ROK and the U.S. reached either (a) a mutual agreement to deem the Plaintiff as a ROK resident by recognizing that his center of vital interests in 1999 and 2000 lied in the ROK; or (b) a general agreement regarding the interpretation of Article 3(2)(a) of the Korea-U.S. Income Tax Convention.

(C) Article 3(3) of the Korea-U.S. Income Tax Convention states that an individual who is deemed to be a resident of one of the Contracting States and not a resident of the other Contracting State by reason of the provisions of paragraph (2) shall be deemed to be a resident only of the first-mentioned Contracting State for all purposes of the Korea-U.S. Income Tax Convention, including Article 4. As such, the Plaintiff, who is deemed as a U.S. resident under Article 3(2) of the Korea-U.S. Income Tax Convention, does not constitute a resident of the ROK, as stipulated in Article 4(4) of the Korea-U.S. Income Tax Convention.

(D) The Korean Income Tax Act determines the scope of taxable income based on whether a person subject to taxation is a resident or not, and states that a nonresident shall be imposed tax on Korea-source income only. Whether a taxpayer is a Korean citizen or not does not affect the determination on the scope of taxable income.

(3) According to the purpose of the provisions and the record seen above, the lower court did not err in its judgment by omitting decisions or misapprehending the legal principle regarding the interpretation of the Korea-U.S. Income Tax Convention or the effect of mutual agreement, contrary to what is alleged in the ground of appeal.

B. Whether the principle of substantial taxation applies (Ground of appeal No. 2)

(1) Dividend income paid out from Gundo HK and Gundo International to the title shareholder in 1999 and 2000

(A) Based on the determination that: (a) the Plaintiff was a U.S. resident under the Korea-U.S. Income Tax Convention in 1999 and 2000; and (b) even if the dividend income from Gundo HK and Gundo International belonged to the Plaintiff, such dividend income constituted foreign source income, from which the Defendant had no authority to withhold tax, the lower court determined that the part on the disposition imposing global income tax for the tax years 1999 and 2000 pertaining to the dividend income in question was unlawful, without further deliberation on whether the pertinent dividend income was practically reverted to the Plaintiff or not.

(B) The grounds of appeal on this part argues that the dividend income paid out from Gundo HK and Gundo International to the Plaintiff under the name of the title shareholder in 1999 and 2000 ought to be deemed as having been reverted to the Plaintiff.

(C) As reviewed in the above 2.A., insofar as the lower court's judgment that: (a) the Plaintiff was deemed a U.S. resident under the Korea-U.S. Income Tax Convention during the period in question; and (b) the Plaintiff's foreign source income is not subject to taxation, is justifiable, this part of the grounds of appeal cannot affect the judgment. Therefore, this part of the ground of appeal is dismissed.

(2) Interest payment accruing from the account under the name of Golden Quarter, Virtual Capital, Crest, and Premier Group International Inc. (a corporation established in Labuan, Malaysia, which is hereinafter referred to as "Premier Group") and interest from the investment of the funds held in the Crest account, which is paid out to the account held in the name of Crest in 2007 and 2008

(A) According to the reasoning of the lower court and the record, following facts are revealed.

① The corporate governance structure of the pertinent corporations from 2002 to 2008 is as follows.

The Plaintiff owned the entire shares of Golden Quarter until August 28, 2007. From thereafter, these shares were owned by New Ocean. The entire shares of New Ocean were possessed by the title shareholder, who entered into a title shareholder agreement with the Plaintiff. All shares of Crest were owned

by Nonparty 1 until prior to November 25, 2004, but Nonparty 1 was simply a nominal shareholder, and the actual shareholder of the pertinent shares was the Plaintiff. On around November 25, 2004, Golden Quarter became the owner of all shares of Crest. From thereafter, the Plaintiff controlled Crest through Golden Quarter. All shares of Virtual Capital were owned by Leadway; all shares of Leadway were owned by Rockwealth; and all shares of Rockwealth were owned by the Plaintiff. All shares of Premier Group were owned by Virtual Capital, and the Plaintiff controlled Premier Group through Virtual Capital.

② The Plaintiff owned the right to make a withdrawal from the account held in the name of Golden Quarter, Virtual Capital, and Premier Group with a signature. Aside from the Plaintiff's signature, other internal company procedures were unnecessary in withdrawing and managing the money deposited in the accounts, nor were there any reporting obligation under law relating thereto. The Plaintiff was not restrained from withdrawing and managing the said money.

③ The places registered as the seat of the above corporations did not hold business activities of any kind, including commercial activities or decision-making. A board of directors meeting, general shareholders' meeting, or other similar managerial meetings have not been hosted in the administration or an important decision making process of the above corporations. The Plaintiffs were the only decision-making entity for investment to be made in the name of the said corporations.

④ At the time of the tax investigation, the Plaintiff wrote a confirmatory document that read: "The interest income accrued from the account in the name of Golden Quarter, Virtual Capital, Crest, and Premier Group from 2002 to 2008, and the interest income accrued from the account in the name of Crest relating to the ship investment are the investment proceeds from the Plaintiff's funds, and the interest income accruing therefrom belongs to the Plaintiff. The said companies have never compiled accounting records or financial statements, nor fulfilled such obligations as receiving certified external audits and filing a tax return, since they do not have any such obligation."

(B) According to the facts and record admitted by the lower court in addition to the above facts, it is recognized that: (a) the Plaintiff, then a ROK resident from 2002 to 2008, deposited fund in the account held under the name of Golden Quarter, Virtual Capital, Crest, and Premier Group in the HSBC Bank; (b) received interest either accrued from the above accounts or accrued from the investment of the fund deposited in the Crest account and received the interest therefrom to the Crest account; (c) and did so with the aim of evading income tax in the Republic of Korea.

(C) Examining these facts in light of the legal principles and the record

seen in the above 1.A., it is reasonable to conclude that: (a) the above corporations, the nominal owner of (i) the interest accrued from the accounts in the name of Golden Quarter, virtual Capital, Crest, and Premier Group from 2002 to 2008, and (ii) the interest from the investment of the fund, which had been deposited in the Crest account and paid to the Crest account in 2007 and 2008, did not have the ability to control and manage the said money; (b) it was the Plaintiff who had practical control and management of the said money by exercising the management right over the said corporations; (c) the disparity between the title and the actuality arose from the purpose of tax evasion; and (d) therefore, the interest payment in question ought to be viewed as having been practically reverted to the Plaintiff.

(D) Nevertheless, the lower court determined that the Plaintiff established the above corporations and made financial transactions via these corporations for investment purposes rather than for tax evasion, despite having acknowledged that the Plaintiff had exercised the practical authority over the said bank accounts, and also had been in practical control of these corporations. The lower court made error in determining that, based on the above circumstances, (a) the said corporations are deemed to have acted as the principal agent of the act in question; and (b) that the interest income accruing therefrom have also been reverted to the said corporations, rather than the Plaintiff, thereby concluding that the part on the interest income in the disposition imposing global income tax for the tax years from 2002 to 2008 was unlawful.

Yet, the lower court's determination was justifiably made relating to the interest accrued from around 2002 to 2004, where it determined that the part pertaining to the above interest payment in the disposition imposing global income tax for the tax years from 2002 to 2004 was unlawful, since the Plaintiff's tax liability on the interest income in question was removed with the lapse of five years of the exclusion period for imposition. The lower judgment in this respect is justifiable as seen in 2.C. As such, the lower court's error on the interest accrued from around 2002 to 2004 did not adversely affect the conclusion of the judgment.

(E) After all, the lower court's judgment pertaining to the imposition of global income tax for the tax years 2005 through 2008 on the interest accruing or paid out from around 2005 to 2008 was erroneously made by misapprehending the legal principle on the principle of substantial taxation. The Defendant's allegation contained in the grounds of appeal on this point is with merit.

(3) Interest and dividend payment accrued from 2001 through 2008 from (i) the accounts opened in the name of Burstow Trading Ltd. (a corporation based in BVI, hereinafter "Burstow"), in Switzerland-based Julius Baer Bank or UBS; (ii) the account in the name of Nonparty 5 (alias); and (iii) the numbered bank account

(A) According to the reasoning of the lower judgment and the record, the following facts are revealed.

① The corporate governance structure of Golden Quarter, Crest, Virtual Capital, and Burstow from the period of 2001 to 2008 is as follows.

The corporate governance structure of Golden Quarter, Crest, and Virtual Capital is the same as the one in the period of 2002 to 2008 as noted in the above subparagraph (2). All shares of Burstow were owned by New Ocean, and all shares of New Ocean were owned by the title shareholder, who entered into a title shareholder agreement with the Plaintiff.

② The Plaintiff owned the right to make a withdrawal from the account under the name of Golden Quarter, Crest, Virtual Capital, and Burstow with a signature. Aside from the Plaintiff's signature, other internal company procedures were unnecessary in withdrawing and managing the money deposited in the accounts in the name of the above corporations, and there was no reporting obligation under law relating thereto. The Plaintiff was not restrained from withdrawing and managing the said money.

③ The places registered as the seat of the above corporations did not hold business activities of any kind, including commercial activities or decision-making. A board of directors meeting, general shareholders' meeting, or other similar managerial meetings have not been hosted in the administration or an important decision making process of the above corporations. The Plaintiffs were the only decision-making entity for investment to be made in the name of the said corporations.

④ The above corporations have neither compiled accounting records or financial statements, nor fulfilled such obligations as receiving certified external audits and filing a tax return, since they do not have any such obligation.

⑤ The money deposited in the account in the name of Nonparty 5 (alias) and the numbered bank account opened in UBS bank were transferred from the accounts held in the name of Crest, Golden Quarter, Virtual Capital, and the Plaintiff.

⑥ The Plaintiff stated that the account in the name of Nonparty 5 was owned by Burstow. All savings and securities deposited in the account in the name of Nonparty 5 were transferred to the account held in the name of Burstow on May 14, 2007.

⑦ As for the background leading up to the opening of the numbered UBS bank account, the Plaintiff stated that the said account was opened autonomously by UBS when Virtual Capital or Crest transferred money to UBS bank.

⑧ After June 11, 2007, the Plaintiff incorporated the entire share of

Burstow (1 share) to the trust to which his family was designated as its beneficiary.

(B) According to the facts and record admitted by the lower court in addition to the above facts, it is recognized that: (a) the Plaintiff, a ROK resident from 2001 to 2008, deposited funds in (i) the accounts opened in the name of Burstow Trading Ltd. (a corporation based in BVI, hereinafter "Burstow") in Switzerland-based Julius Baer bank or UBS bank; (ii) the account in the name of Nonparty 5 (alias); and (iii) the numbered bank account; (b) received the interest or dividend payment accruing from those accounts; and (c) did so with the aim of evading income tax in the Republic of Korea. This does not change even if the Plaintiff's act also contained investment or inheritance purposes.

(C) Examining these facts in light of the legal principles seen in 1.A. and the record, a reasonable conclusion is that: (a) the interest or dividend payment accrued from (i) the account in the name of Burstow opened in Julius Baer bank or UBS bank, (ii) the account in the name of Nonparty 5 (alias), and (iii) the numbered bank account from around 2001 to 2008; (b) the Plaintiff was in practical control and management of the said money by exercising the management right over Burstow, or Crest, Golden Quarter, and Virtual Capital, which deposited money in the said accounts; (c) Burstow, to which the said interest or dividend payment was partially reverted, was not capable of controlling or managing the interest or dividend payment. Such disparity between the title and the actuality appears to have arisen from the purpose of income tax evasion. Hence, the said money ought to be considered to have practically belonged to the Plaintiff.

(D) Despite having recognized that the Plaintiff had been in practical control and management of the above accounts, the lower court: (a) nonetheless viewed that the Plaintiff used the Switzerland-based bank for investment and inheritance purposes; (b) determined that the interest or dividend payment accruing from the above accounts could not be considered to have reverted to the Plaintiff; and (c) reasoned that the part of the disposition imposing global income tax for the tax years 2001 through 2008 pertaining to the interest and dividend payment was unjustifiable. The lower court's such judgment is erroneous.

Yet, the lower court's determination was justifiably made relating to the interest accrued from around 2001 to 2004, where it determined that the part pertaining to the above interest payment in the disposition imposing global income tax for the tax years from 2001 to 2004 was unlawful, since the Plaintiff's tax liability was removed with the lapse of five years of the exclusion period for imposition. The lower judgment in this respect is justifiable as seen in 2.C. As such, the lower court's error on the interest and dividend payment accrued from around 2001 to 2004 did not adversely affect the conclusion of the judgment.

(E) After all, the lower court's judgment pertaining to the imposition of

global income tax for the tax years 2005 through 2008 on the interest and dividend payment accrued from around 2005 to 2008 was erroneously made by misapprehending the legal principle on the principle of substantial taxation. The Defendant's allegation contained in the grounds of appeal on this point is with merit.

(4) Dividend payment received from the domestic investment association in around 2006 in the name of Premier Group and Halcyon Investors Ltd. (a corporation based in Labuan, Malaysia, hereinafter "Halcyon")

(A) The reasoning of the lower court and the record reveal the following facts.

① The corporate governance structure of the above corporations are as follows.

All shares of Premier Group were possessed by Virtual Capital. All shares of Virtual Capital were owned by Leadway. All shares of Leadway were owned by Rockwealth. All shares of Rockwealth were possessed by the Plaintiff. All shares of Halcyon were possessed by Solomon Investors Inc. (hereinafter "Solomon") established in BVI. All shares of Solomon were owned by Lead Pacific Inc. (hereinafter "Lead Pacific") established in BVI. 70% of the Lead Pacific shares were owned by Rockwealth. All shares of Rockwealth were owned by the Plaintiff. In the meantime, the remaining 30% of the Lead Pacific shares were owned by Cyber Venture Investment Ltd. (hereinafter "Cyber Venture") established in BVI. All shares of Cyber Venture were owned by Nonparty 6.

② The Plaintiff owned the right to make a withdrawal from the account under the name of Premier Group with a signature. Nonparty 6 had the right to make a withdrawal with a signature from the account in the name of Halcyon. However, it was Nonparty 6 or the Plaintiff that had the right to make a withdrawal with a signature from the account held in the name of Solomon. The right to make a withdrawal with a signature from the Lead Pacific account was owned by Nonparty 6 and the Plaintiff. The person to whom the right to make a withdrawal with a signature from the Rockwealth account was the Plaintiff. The person to whom the right to make a withdrawal with a signature from the Cyber Venture was Nonparty 6. Aside from the person owning the right to make a withdrawal with a signature, other internal company procedures were unnecessary in withdrawing and managing the money deposited in the accounts of the above corporations, and there was no reporting obligation under law relating thereto. There were no restraints on withdrawing and managing the said money.

③ The places registered as the seat of the above corporations did not hold business activities of any kind, including commercial activities or decision-making. A board of directors meeting, general shareholders' meeting, or other

similar managerial meetings have not been hosted in the administration or an important decision making process of the above corporations. The Plaintiff was the only decision-making entity for investment made in the name of Premier Group, and Nonparty 6 and the Plaintiff made investment decisions in the name of Halcyon.

④ The above corporations have neither compiled accounting records or financial statements, nor fulfilled such obligations as receiving certified external audits and filing a tax return, since they do not have any such obligation.

⑤ Following Nonparty 6's recommendation, the Plaintiff invested a total of 5.5 billion won into Kowal Investment Association No. 2, using the account opened in the name of Premier Group. In the meantime, the Plaintiff invested in the name of Halcyon 3.85 billion won into Kowal-Halcyon Strategy Association, which takes up 70% of a total of 5.5 billion won investments.

⑥ The tax authority: (a) deemed (i) the entirety of the dividend payment paid out by Kowal Investment Association No. 2 in the name of Premier Group, and (ii) the 70% dividend income paid out by Kowal-Halcyon Strategy Association in the name of Halcyon, as the Plaintiff's income; (b) deducted the corporate tax withheld in the name of Premier Group and Halcyon as the already paid tax amount; and (c) assessed the amount of tax to be paid by the Plaintiff.

(B) According to the facts and record admitted by the lower court in addition to the above facts, it is recognized that the Plaintiff, a ROK resident, invested in the name of Premier Group and Halcyon, and received the dividend payment to the account in the name of the said corporations, to evade income tax in the Republic of Korea. Although the corporate tax was withheld in the name of Premier Group and Halcyon at the time of the payment of dividend, considering that the tax authority assessed the amount of tax to be paid by the Plaintiff after having deducted the withheld corporate tax as the already paid tax amount, the purpose of tax evasion may be recognized, at least for this tax amount.

(C) Examining these facts in light of the legal principles seen in 1.A. and the record, a reasonable conclusion would be that: (a) Premier Group, a title holder to whom the dividend payment paid out to the account in the name of Premier Group accrued, did not have the ability to control and manage the said dividend payment; (b) the Plaintiff was in practical control and management of the said money by exercising the management right over Premier Group; (c) the disparity between the title and the actuality arose from the purpose of income tax evasion in the Republic of Korea; (d) as such, the dividend payment in question ought to be considered to have been practically reverted to the Plaintiff.

In addition, it is reasonable to conclude that: (a) Halcyon, a title holder to

whom the dividend payment paid out to the account in the name of Halcyon accrued, did not have the ability to control and manage the said dividend payment; (b) the Plaintiff practically controlled and managed 70% of the dividend payment by exercising the management right over Halcyon, which the Plaintiff and Nonparty 6 divided according to their stake; (c) the disparity between the title and the actuality arose from the purpose of income tax evasion in the Republic of Korea; (d) as such, 70% of the dividend payment in question ought to be considered to have been practically reverted to the Plaintiff.

(D) Despite having recognized that the Plaintiff was in practical control and management of Premier Group and Halcyon, the lower court: (a) nonetheless viewed that the dividend payment from the domestic investment association in the name of Premier Group and Halcyon ought to be considered to have reverted to the above corporations instead of the Plaintiff; and (b) determined that the part of the disposition imposing global income tax for the tax year 2006 pertaining to the dividend payment was unjustifiable. In so determining, the lower court erred by misapprehending the legal principle on the principle of substantial taxation. The Defendant's allegation contained in the ground of appeal on this point is with merit.

C. Whether to recognize "deception or other unlawful act" relating to the exclusion period of imposition (Defendant's ground of appeal No. 3)

(1) Unreasonable part of the ground of appeal

(A) The lower court: (a) encapsulated that the Plaintiff's argument on the lapse of the exclusion period of imposition pertained to global income tax for the tax years from 1999 through 2004 and the penalty tax thereof; (b) clarified in Subparag. 7 in its reasoning, where it determined on the lapse of the exclusion period of imposition, that its determination was concerned with the global income tax for the tax years from 1999 to 2004; and (c) determined whether the Plaintiff's act may be deemed "deception or other unlawful act," which is subject to 10 years of a long-term exclusion period of imposition.

(B) In the grounds of appeal, the Defendant argued that "deception and other unlawful act" must be recognized, and that 10 years of a long-term exclusion period of imposition ought to be applied in a disposition imposing global income tax for the tax years from 2005 to 2008 on the following money: (a) interest income accruing from the accounts held in the name of Golden Quarter, Virtual Capital, Crest, and Premier Group opened in HSBC bank; (b) interest income from the investment of the deposited funds in the accounts held in the name of Crest and paid to the accounts in the name of Crest in 2007 and 2008; (c) interest and dividend income accruing from (i) the account opened in the name of Burstow in Julius Baer bank or UBS bank; (ii) the account in the name of Nonparty 5 (alias); and (iii) the numbered bank account from 2005 to 2008; (d) dividend income received from the domestic investment association in around 2006 to the account held in the name of Premier Group and Halcyon.

(C) However, considering that: (a) the date from which the exclusion

period of imposition of global income tax for the tax years from 2005 to 2008 is June 1 of the following year of the pertinent taxation year; (b) global income tax was imposed for the tax years from 2005 to 2007 on June 28, 2010; and (c) tax disposition imposing global income tax for the tax year 2008 was issued on November 1, 2009, which was then adjusted upward on June 28, 2010, it is clear that the exclusion period of imposition did not expire at the time of the pertinent tax disposition even with the application of the ordinary exclusion period of imposition of five years. Moreover, insofar as the lower court did not determine that the exclusion period of imposition had expired for the part relating to the interest or dividend payment in the disposition imposing global income tax for the tax years from 2005 to 2008, the Defendant's ground of appeal pointing this out is dismissed.

(2) Dividend payment received in 1999 and 2000 in the name of the title shareholder from Gundo HK and Gundo International

(A) The lower court determined as follows: (a) The Plaintiff was deemed a U.S. resident under the Korea-U.S. Income Tax Convention in 1999 and 2000; (b) the dividend payment received from the Gundo HK and Gundo International in the name of the title shareholder constituted foreign source income, which is not subject to taxation by the Defendant; (c) thus, the part of the disposition imposing global income tax in 1999 and 2000 on the ground of the said dividend payment is unjustifiable. Moreover, (a) it cannot be deemed that there existed active commission of wrongdoings, such as the drafting of a false sales agreement, relating to the dividend income received during the pertinent period, apart from the transfer of title, the Plaintiff's act does not constitute "deception or other unlawful act," and five years of exclusion period of imposition is applied; (b) yet, it is clear that five years of exclusion period of imposition had already expired at the time of the instant disposition.

(B) The ground of appeal on this point is that, the dividend payment the Plaintiff received from Gundo HK and Gundo International in 1999 and 2000 under the name of the title shareholder ought to be subject to ten years of exclusion period of imposition, by deeming his act as having constituted "deception or other unlawful act."

(C) As examined in 2.A., insofar as the lower court's determination, which (i) deemed the Plaintiff as a U.S. resident under the Korea-U.S. Income Tax Convention during the period in question, and (ii) concluded that the Plaintiff had no tax liability for his foreign source income, was justifiable, the grounds of appeal on this point has no merit, and needs no further review.

(3) Interest income accruing from the account opened in HSBC bank from 2002 to 2004 and interest and dividend income accruing from the Switzerland-based bank account from 2001 to 2004

(A) Examining the reasoning of the lower judgment in light of the record of the instant case, the bank accounts involved with "deception or other unlawful act" in relation to ten years of exclusion period of imposition may be

identified as follows.

① From interest accrued from the accounts in the name of Golden Quarter, Virtual Capital, Crest, and Premier Group in HSBC bank from 2002 to 2008, those accrued from 2002 to 2004 are the interest income from (i) the Virtual Capital account from 2002 to 2003; and (ii) the Crest account in 2004.

② From interest and dividend payment accrued from (i) the Burstow account opened in the Switzerland-based Julius Baer bank or UBS bank; (ii) the account in the name of Nonparty 5 (alias); and (iii) the numbered bank account from 2001 to 2008, those accrued from 2001 to 2004 are the interest income from the account opened in the Hong Kong-based UBS bank.

(B) Examining the following circumstances revealed through the record along with the facts admitted by the lower court in light of the legal principle seen in 1.C., the Plaintiff's act of receiving interest from the above accounts from 2001 to 2004, and the Plaintiff's conduct in the process leading thereto may not be viewed as constituting "deception or other unlawful act" under Article 26-2(1)1 of the former Framework Act on National Taxes.

① Virtual Capital was governed in a way that (a) the Plaintiff's owning all shares of Rockwealth under his real name, (b) Rockwealth's owning all shares of Leadway, and (c) Leadway's owning all shares of Virtual Capital. Such corporate governance structure may not be deemed to have deviated from ordinary investment structure.

② As for Crest, the Plaintiff owned all of its shares until prior to November 25, 2004, and Nonparty 1 owned the title to the entire shares of Crest. However, such circumstances of using a false name are insufficient by themselves to recognize commission of deception or other unlawful act. Meanwhile, on around November 25, 2004, all shares of Crest were owned by Golden Quarter, and the Plaintiff owned all shares of Golden Quarter in his real name. Such corporate governance structure may not be deemed to have deviated from ordinary investment structure.

③ There is no evidence suggesting the commission of wrongdoings in the process of the (i) opening up a numbered bank account in the Hong Kong-based UBS bank, (ii) transferring money thereto, and (iii) accruing of interest income therefrom. The money deposited in the above account was transferred from the account held in the name of Virtual Capital and Crest. On the background leading to the opening of the account in question, the Plaintiff stated that the account was autonomously opened by UBS bank upon the transfer of money from Virtual Capital or Crest to UBS bank.

④ The bank accounts at issue here are the accounts opened in HSBC and UBS at the Hong Kong-based financial institutions. The Plaintiff does not appear to have written another person as the actual owner of the account at the

time of the opening of the relevant account. Also, the right to make a withdrawal with a signature from the accounts held in the name of Virtual Capital and Crest was owned by the Plaintiff.

(C) The lower court determined that the part of the disposition imposing global income tax for the tax years from 2001 through 2004, pertaining to the abovementioned interest income, was unlawful, because the tax was imposed after the exclusion period of imposition had already lapsed. The lower court reasoned that it was clear that (a) five years of exclusion period of imposition were applied because the interest income in question was not acquired through deception or other unlawful act; (b) the imposition of global income tax for tax years from 2002 to 2004, pertaining to the interest accrued from the account opened in HSBC, and, the imposition of global income tax for tax years from 2001 to 2004, pertaining to the interest accrued from the Switzerland-based bank account, were made after the lapse of five years from the date at which national tax can be imposed.

(D) In so determining, the lower court did not err by misapprehending the legal principle on deception or other unlawful act, contrary to what is alleged in the ground of appeal.

D. On the flaw in the tax notice on penalty tax and whether the flaw can be corrected (Defendant's ground of appeal No. 4)

When principal tax and penalty tax are imposed together through the issuance of a single tax notice, the tax notice must separately identify the amount of assessed principal tax and assessed penalty tax, as well as how they were calculated. Where various types of penalty taxes are imposed together, the amount of the assessed tax among each penalty tax item and how they were calculated ought to be separately identified in the pertinent tax notice. A tax disposition that only identifies the sum amount of principal tax and penalty tax without separately identifying (i) the amount of the assessed principal tax and the assessed penalty tax; (ii) the basis on which the amount was calculated; (iii) the amount of the assessed tax for each penalty tax item; and (iv) how they were calculated is deemed unlawful (*see, e.g.*, Supreme Court en banc Decision 2010Du12347, Oct. 18, 2012).

The lower court determined that the imposition of penalty tax in the disposition imposing global income tax for the tax years from 1999 to 2008 was unjustifiable and ought to be revoked, on the grounds that the Defendant did not clarify the type of the penalty tax imposed and the basis for its calculation when imposing penalty tax on the Plaintiff.

The grounds of appeal on this point is based on the assertion that the flaw in the tax notice was either complemented or corrected, considering that (a) the Plaintiff received from the Defendant documents specifically showing the amount of penalty tax by type and the basis for calculation saying they were necessary for the filing of a request for an appeal, and (b) there was no intervention in determining whether to raise objection to the imposition of

penalty tax and filing a request for an appeal.

However, reviewing the record does not provide evidence supporting the Defendant's argument. Hence, the lower court did not err by misapprehending the legal principle on the flaw in the tax notice imposing penalty tax and the correction thereof in its judgment that the flaw in the tax notice imposing penalty tax may not be deemed to have been complemented or corrected.

3. Conclusion

The part of the lower judgment against the Plaintiff regarding disposition imposing global income tax for tax years from 2001 to 2004, and the part of the lower judgment against the Defendant regarding disposition imposing global income tax (excluding penalty tax) for tax years from 2005 to 2008 are reversed, and that part of the case is remanded to the Seoul High Court. The Plaintiff's final appeal and the Defendant's remaining final appeals are all dismissed. It is so decided as per Disposition by the assent of all participating Justices on the bench.

Justices Lee Dong-won (Presiding Justice)
Jo Hee-de
Kim Jae-hyung (Justice in charge)
Min You-sook

Supreme Court Decision 2016Du42883 Decided December 27, 2018【Revocation of Disposition Collecting and Imposing Corporate Tax】

【Main Issues and Holdings】

[1] Person liable for tax on income derived from a property in cases where: (i) the person to whom the income from the property nominally accrues lacks the capacity to control or manage property; (ii) there is another person who substantially controls or manages the property by means of governance, etc. over the nominal owner; and (iii) the disparity between name and substance arises from the intent to avoid tax (held: the person who substantially controls or manages the property)

Whether the same doctrine holds true to the interpretation and application of a tax treaty (affirmative in principle)

[2] In a case where an American corporation registered its patent right only outside of Korea but not domestically, whether the income paid to the America corporation may be deemed as a domestic source income (negative)

【Summary of Decision】

[1] The principle of substantial taxation as provided under Article 14(1) of the Framework Act on National Taxes means that, if there is another person ― apart from the nominal person ― to whom such taxable items as income, profit, property, or transaction substantially accrue, a tax authority shall deem the one to whom such items substantially accrue as liable for tax, instead of the nominal person in formality or appearance. As such, in cases where: (i) the person to whom a property nominally accrues lacks the capacity to control or manage property; (ii) there is another person who substantially controls or manages the property by means of governance, etc. over the nominal owner; and (iii) the disparity between name and substance arose out of the intent to avoid tax, the income pertaining to the property shall be deemed to accrue to the person who substantially controls or manages the property and, thus, said person shall be deemed liable for tax. This same doctrine holds true to the interpretation and application of a tax treaty, which has the same effect as a statute, barring any special provision making exceptions.

[2] The latter part of the proviso of Article 93 Subparag. 9 of the former Corporate Tax Act (amended by Act No. 10423, Dec. 30, 2010) provides that, even in cases where a foreign company registered patent rights, etc., only outside of Korea but not domestically, the income paid to the foreign company for the use of said patent rights, etc. shall be deemed a domestic source income if said patent rights were used for manufacture and sale in Korea. However,

Article 28 of the Adjustment of International Taxes Act (amended by Act No. 16099, Dec. 31, 2018) provides, "The provisions of the tax treaty shall preferentially apply to the classification of a domestic source income of a nonresident or foreign corporation, notwithstanding Article 119 of the Income Tax Act and Article 93 of the Corporate Tax Act." That said, in a case where an American corporation's patent right only registered outside of Korea is used for manufacture and sale in Korea, whether the income paid to said American corporation in consideration for the use of the relevant patent right ought to be determined according to the Convention between the Republic of Korea and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and the Encouragement of International Trade and Investment (hereinafter "Korea-U.S. Tax Treaty"). Yet, when taking account of the ordinary contextual and literal meaning of the Korea-U.S. Tax treaty, Articles 6(3) and 14(4) of the same Treaty merely stipulates that, "In case where an American corporation holds the right to exercise patent based on its domestic registration of a patent, the income paid for the usage of said right is a domestic source income, given that under the territorial principle of patent rights, the right to exercise patent for the patent holder to exclusively produce, use, transfer, lend, import, or exhibit the patented goods has effect only within the territory of the country in which the patent right is registered." Therefore, in a case where an American corporation has registered its patent right only outside of Korea but not domestically, any relevant income paid to the American corporation does not constitute royalty for the use of said patent and, thus, cannot be deemed a domestic source income.

【Reference Provisions】 [1] Article 14(1) of the Framework Act on National Taxes / [2] Article 2(1)2 (*see* current Article 3(1)2), Article 2(5) (*see* current Article 3(4)), Article 93 Subparag. 9 (*see* current Article 93 Subparag. 8), and Article 98(1) of the former Corporate Tax Act (Amended by Act No. 10423, Dec. 3, 2010); Article 28 (currently repealed) of the former Adjustment of International Taxes Act (Amended by Act No. 16099, Dec. 31, 2018); Articles 6(3) and 14(4) of the Convention between the Government of the Republic of Korea and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income

Article 14 of the Framework Act on National Taxes (Actual Taxation)

(1) If any ownership of an income, profit, property, act or transaction which is subject to taxation, is just nominal, and there is other person to whom such income, etc., belongs, the other person shall be liable to pay taxes and tax-related Acts shall apply, accordingly.

Article 3 of the current Corporate Tax Act (Scope of Taxable Income)

(1) Corporate tax shall be imposed on the following incomes: *Provided*, That corporate tax shall be imposed only on the income specified in

subparagraphs 1 and 3 in cases of non-profit domestic corporations and foreign corporations: *<Amended by Act No. 12850, Dec. 23, 2014; Act No. 15222, Dec. 19, 2017>*

2. Liquidation income[.]

(4) Income of a foreign corporation for each business year means the income accrued from domestic sources referred to in Article 93 (hereinafter referred to as "domestic source income"): *Provided*, That for non-profit foreign corporations, this shall be limited to domestic source income accruing from profit-making business.

[This Article wholly amended by Act No. 10423, Dec. 30, 2010]

Article 93 of the current Corporate Tax Act (Domestic Source Income of Foreign Corporations)

Domestic source income of a foreign corporation shall be classified as follows:

<Amended by Act No. 11128, Dec. 31, 2011; Act No. 13555, Dec. 15, 2015; Act No. 14386, Dec. 20, 2016>

8. Where any of the following rights, assets, or information (referred to as "rights, etc." hereafter in this subparagraph) are used or the remuneration therefor is paid in the Republic of Korea, the relevant price and the income accrued from the transfer of such rights, etc.: *Provided*, That where the place of use rule applies, under an agreement for preventing double taxation on income, to determine whether the relevant income is domestic source income, the remuneration for rights, etc., used overseas shall not be deemed domestic source income, regardless of whether it was paid in the Republic of Korea. In such cases, rights requiring registration to exercise thereof, such as patent rights, utility model rights, trademark rights, and design rights (referred to as "patent rights, etc." hereafter in this subparagraph) shall be deemed used in the Republic of Korea, irrespective of whether they were registered in the Republic of Korea, if the relevant patent rights, etc., were registered overseas and have been used for manufacture, sale, etc., in the Republic of Korea:

(a) Copyrights, patent rights, trademark rights, designs, forms, and sketches of academic or artistic works (including movie films) or secret formulae or processes, film and tapes for radio and television broadcast, and other similar assets or rights;

(b) Information or know-how related to industrial, commercial, or scientific knowledge and experience[.]

Article 98 of the current Corporate Tax Act (Special Cases concerning Withholding or Collection from Foreign Corporations)

(1) Where any person pays a foreign corporation the amount of domestic source income provided for in subparagraphs 1, 2, and 4 through 10 of Article 93 (excluding any resident or non-resident who pays the amount of income provided for in subparagraph 7 of Article 93) which is not substantially related to the domestic place of business of the foreign corporation or does not revert

to the domestic place of business of the foreign corporation (including an amount paid to a foreign corporation with no domestic place of business), he/she shall withhold, as the corporate tax, the following amounts from the income of the relevant foreign corporation for each business year, and pay it at the tax office having jurisdiction over the place of tax payment, etc., as prescribed by Presidential Decree, by the tenth day of the month following the month in which the date of withholding falls, notwithstanding Article 97: *Provided*, That the same shall not apply to income provided for in subparagraph 5 of Article 93, which is taxable as domestic source business income under the applicable tax treaty: <*Amended by Act No. 11607, Jan. 1, 2013; Act No. 14386, Dec. 20, 2016*>

1. Income referred to in subparagraphs 4 and 5 of Article 93: 2/100 of the amount paid;

2. Income referred to in subparagraph 6 of Article 93: 20/100 of the amount paid: *Provided*, That the rate shall be 3/100 of the amount paid in cases of income accrued by rendering personal services prescribed by Presidential Decree, out of personal services rendered abroad, but that shall be deemed accrued in the Republic of Korea under a tax treaty;

3. Income referred to in subparagraphs 1, 2, 8, and 10 of Article 93: 20/100 of the amount paid (the amount prescribed by Presidential Decree in cases of the income specified in subparagraph 10(c) of Article 93): *Provided*, That it shall be 14/100 of the amount paid in cases of the interest income accrued from bonds issued by the State, a local government, or a domestic corporation among the income specified in subparagraph 1 of Article 93;

4. Income referred to in subparagraph 7 of Article 93: 10/100 of the amount paid: *Provided*, That if the acquisition value and transfer expenses of the assets transferred are verified, an amount equivalent to 10/100 of the amount paid or an amount equivalent to 20/100 of capital gains on a transfer of such assets, whichever is smaller;

5. Income referred to in subparagraph 9 of Article 93: 10/100 of the amount paid (referring to "arm's length price" provided for in Article 92(2)2 in cases falling under the same subparagraph; hereafter referred to as "amount paid, etc." in this subparagraph): *Provided*, That if the acquisition value and transfer expenses of the relevant securities are verified under the proviso to Article 92(2)1, an amount equivalent to 10/100 of the amount paid, etc., or an amount equivalent to 20/100 of the amount calculated under the proviso to the same subparagraph, whichever is smaller.

Article 6 of the Convention between the Government of the Republic of Korea and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (Source of Income)

For the purpose of this Convention:

(3) Royalties described in paragraph (4) of Article 14 (Royalties) for the

use of, or the right to use, property (other than as provided in paragraph (5) with respect to ships or aircraft) described in such paragraph shall be treated as income from sources within one of the Contracting States only if paid for the use of, or the right to use, such property within that Contracting State.

Article 14 of the Convention between the Government of the Republic of Korea and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (Royalties)

(4) The term "royalties" as used in this Article means:

(a) Payment of any kind made as consideration for the use of, or the right to use, copyrights of literary, artistic, or scientific works, copyrights of motion picture films or films or tapes used for radio or television broadcasting, patents, designs, models, plans, secret processes or formulae, trademarks, or other like property or rights, or knowledge, experience, or skill (know-how), or ships or aircraft (but only if the lessor is a person not engaged in the operation in international traffic of ships or aircraft); and

(b) Gains derived from the sale, exchange, or other disposition of any such property or rights (other than ships or aircraft) to the extent that the amounts realized on such sale, exchange, or other disposition for consideration are contingent on the productivity, use, or disposition or such property or rights. The term does not include any royalties, rentals or other amount paid in respect of the operation of mines, quarries, or other natural resources.

【Reference Cases】 [1] Supreme Court Decisions 2010Du25466 decided Oct. 25, 2012 (Gong2012Ha, 1963); 2015Du2611 decided Dec. 15, 2016 (Gong2017Sang, 164); 2015Du55134 decided Jul. 11, 2017 (Gong2017Ha, 1663); 2017Du59253 decided Dec. 28, 2017 / [2] Supreme Court Decisions 91Nu6887 decided May 12, 1992 (Gong1992, 1905); 2005Du8641 decided Sept. 7, 2007; 2012Du18356 decided Nov. 27, 2014 (Gong2015Sang, 63)

【Plaintiff-Appellee-Appellant】 Samsung Electronics Co., Ltd. (Lee & Ko LLC, Attorneys Kim Gyeong-tae et al., Counsel for the plaintiff-appellee-appellant)

【Defendant-Appellant-Appellee】 Head of National Tax Service Dong Suwon District Office (Yoon & Yang LLC et al., Counsel for the defendant-appellant-appellee)

【Judgment of the court below】 Seoul High Court Decision 2015Nu47043 decided May 24, 2016

【Disposition】 All appeals are dismissed. The cost of appeals is assessed against each party.

【Reasoning】 The grounds of appeal are examined (to the extent of

supplement in case of supplemental appellate briefs not timely filed).

1. Regarding the Plaintiff's ground of appeal

A. The principle of substantial taxation as provided under Article 14(1) of the Framework Act on National Taxes means that, if there is another person — apart from the nominal person — to whom such taxable items as income, profit, property, or transaction substantially accrue, a tax authority shall deem the one to whom such items substantially accrue as liable for tax, instead of the nominal person in formality or appearance. As such, in cases where: (i) the person to whom a property nominally accrues lacks the capacity to control or manage property; (ii) there is another person who substantially controls or manages the property by means of governance, etc. over the nominal owner; and (iii) the disparity between name and substance arose out of the intent to avoid tax, the income pertaining to the property shall be deemed to accrue to the person who substantially controls or manages the property and, thus, said person shall be deemed liable for tax. This same doctrine holds true to the interpretation and application of a tax treaty, which has the same effect as a statute, barring any special provision making exceptions (*see*, *e.g.*, Supreme Court Decision 2010Du25466, Oct. 25, 2012).

B. After having recognized the facts stated in its reasoning, the lower court held that in light of such circumstances as the purpose of establishment of the Ireland-based entity, Intellectual Ventures International Licensing (hereinafter "IV IL"); operation status; human and physical resources; decision-making process with respect to transaction; and control and management of royalty income, etc., IV IL merely performed the perfunctory role of a transaction counterparty, and the beneficial owner of the instant royalty income that the Plaintiff paid IV IL in 2010 was the U.S.-based entity, Intellectual Ventures Global Licensing LLC (hereinafter "IV US"), which is the controlling company of IV IL. Moreover, the disparity between such name and substance can be said to have derived from a tax evasion purpose by being subject to the Convention between the Government of the Republic of Korea and the Government of Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income. Accordingly, the lower court determined that the foregoing tax treaty was inapplicable to the instant royalty income.

C. Examining the reasoning of the lower judgment in light of the aforementioned legal principle and the record, there is a certain degree of inadequacy in the reasoning. Yet, the lower court is justifiable to have concluded that the tax treaty, *supra*, was inapplicable to the instant royalty income. In so determining, contrary to what is alleged in the ground of appeal, the lower court did not err by misapprehending the legal doctrine on the standard for determining the beneficial owner and its burden of proof, by contravening the rules of evidence, or by any inconsistent reasoning.

2. Regarding the Defendant's ground of appeal

A. Article 2(1)2 of the former Corporate Tax Act (amended by Act No. 10423, Dec. 30, 2010; hereinafter "former Corporate Tax Act") provides that a foreign corporation is liable for corporate tax only when it accrues domestic source income. Articles 2(5) and 98(1) thereof stipulates that any person who "pays a foreign corporation the amount of domestic source income provided for in subparagraph 9 of Article 93" shall withhold the relevant amount as corporate tax.

However, Article 93 of the former Corporate Tax provides, "Domestic source income of a foreign corporation shall be classified as follows: 8. Where any of the following rights, assets, or information (referred to as 'rights, etc.' hereafter in this subparagraph) are used or the remuneration therefor is paid in the Republic of Korea, the relevant [payment] and the income accrued from the transfer of such rights, etc.; *Provided*, That where the place of use rule applies, under an agreement for preventing double taxation on income, to determine whether the relevant income is domestic source income, the remuneration for rights, etc., used overseas shall not be deemed domestic source income, regardless of whether it was paid in the Republic of Korea. In such cases, rights requiring registration to exercise thereof, such as patent rights, utility model rights, trademark rights, and design rights (referred to as 'patent rights, etc.' hereafter in this subparagraph) shall be deemed used in the Republic of Korea, irrespective of whether they were registered in the Republic of Korea, if the relevant patent rights, etc., were registered overseas and have been used for manufacture, sale, etc., in the Republic of Korea."

Meanwhile, Article 14(4)(a) of the Convention between the Government of the Republic of Korea and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (hereinafter "Korea-U.S. Tax Treaty") defines the term "royalties" as "[p]ayment of any kind made as consideration for the use of, or the right to use, copyrights of literary, artistic, or scientific works, copyrights of motion picture films or films or tapes used for radio or television broadcasting, patents, designs, models, plans, secret processes or formulae, trademarks, or other like property or rights, or knowledge, experience, or skill (know-how), or ships or aircraft (but only if the lessor is a person not engaged in the operation in international traffic of ships or aircraft)." Article 6(3) of the Korea-U.S. Tax Treaty provides, "Royalties described in paragraph (4) of Article 14 for the use of, or the right to use, property (other than as provided in paragraph (5) with respect to ships or aircraft) described in such paragraph shall be treated as income from sources within one of the Contracting States only if paid for the use of, or the right to use, such property within that Contracting State."

B. The latter part of the proviso of Article 93 Subparag. 9 of the former Corporate Tax Act provides that, even in cases where a foreign company registered patent rights, etc., only outside of Korea but not domestically, the income paid to the foreign company for the use of said patent rights, etc. shall

be deemed a domestic source income if said patent rights were used for manufacture and sale in Korea. However, Article 28 of the Adjustment of International Taxes Act provides, "The provisions of the tax treaty shall preferentially apply to the classification of a domestic source income of a nonresident or foreign corporation, notwithstanding Article 119 of the Income Tax Act and Article 93 of the Corporate Tax Act." That said, in a case where an American corporation's patent right only registered outside of Korea is used for manufacture and sale in Korea, whether the income paid to said American corporation in consideration for the use of the relevant patent right ought to be determined according to the Convention between the Republic of Korea and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and the Encouragement of International Trade and Investment (hereinafter "Korea-U.S. Tax Treaty"). Yet, when taking account of the ordinary contextual and literal meaning of the Korea-U.S. Tax Treaty, Articles 6(3) and 14(4) of the same Treaty merely stipulates that, "In case where an American corporation holds the right to exercise patent based on its domestic registration of a patent, the income paid for the usage of said right is a domestic source income, given that under the territorial principle of patent rights, the right to exercise patent for the patent holder to exclusively produce, use, transfer, lend, import, or exhibit the patented goods has effect only within the territory of the country in which the patent right is registered." (*see*, *e.g.*, Supreme Court Decision 2005Du8641, Sept., 7, 2007). Therefore, in a case where an American corporation has registered its patent right only outside of Korea but not domestically, any relevant income paid to the American corporation does not constitute royalty for the use of said patent and, thus, cannot be deemed a domestic source income (*see*, Supreme Court Decision 2012Du18356, Nov. 27, 2014).

C. The lower court deemed that, of the royalties substantively reverted to IV US, only the royalty for the use of the patent right registered in Korea constituted a foreign corporation's domestic source income as stipulated by Article 93 Subparag. 9 of the former Corporate Tax Act and, thus, the pertinent disposition with respect to the remaining royalties was unlawful. As such, the lower judgment to the same effect is justifiable. In so determining, the lower court, as otherwise alleged in the ground of appeal, did not err by misapprehending the legal doctrine on whether income paid in consideration for the use of a patent right constitutes a domestic source income.

3. Conclusion

Therefore, all appeals are dismissed, and the cost of appeals is assessed against each party. It is so decided as per Disposition by the assent of all participating Justices on the bench.

Justices Kim Jae-hyung (Presiding Justice)
Min You-sook
Lee Dong-won (Justice in charge)

Supreme Court Decision 2017Do15226 Decided December 27, 2018【Violation of the Act on Promotion of Information and Communications Network Utilization and Information Protection, Etc. (Information and Communications Network Intrusion, etc.)】

【Main Issues and Holdings】

[1] Scope of "another person's secret that is processed, stored or transmitted through an information and communications network," the object of breach of Article 49 of the Act on Promotion of Information and Communications Network Utilization and Information Protection, Etc.

Whether another person's secret that has been processed or transmitted via an information and communications network, but stored or kept in an information and communications system of a user's personal computer (PC), may be deemed as included in the foregoing scope (affirmative)

Meaning of "another person's secret" as prescribed by Article 49 thereof

[2] Meaning of "infringement" and "divulgence" of another person's secret under Article 49 of the Act on Promotion of Information and Communications Network Utilization and Information Protection, Etc.

Whether the following interpretation ― an act by a person who, without authorized access, obtained or divulged another's secret via using the device or platform of an information and communications network, which a user had logged in by entering his/her ID and password, without the user's knowledge, is included in the definition of "unlawful means or method, such as intrusion into an information and communications network" that serves as a requisite to establish "infringement or divulgence of another person's secret" under Article 49 of the Information and Communications Network Act ― contradicts the principle of no crime or punishment without the law (negative)

[3] Method of determining a justifiable act or self-defense as grounds for exemption of illegality

Requirements for acknowledgment as a justifiable act

Whether an act of defense ought to be socially reasonable to constitute self-defense (affirmative)

【Summary of Decision】

[1] Article 49 of the Act on Promotion of Information and Communications Network Utilization and Information Protection, Etc. (hereinafter "Information and Communications Network Act") provides, "No one shall mutilate another person's information processed, stored, or transmitted through an information and communications network, nor shall

infringe, misappropriate, or divulge another person's secret." Article 71(1)11 of the same Act stipulates that "[a] person who mutilates another person's information or who infringes, misappropriates, or divulges another person's secret in violation of Article 49" shall be punished by imprisonment with labor for up to five years or by fine not exceeding KRW 50 million.

The purpose of the Information and Communications Network Act is to "contribute to improving citizens' lives and enhancing public welfare by facilitating utilization of information and communications networks, protecting personal information of people using information and communications services, and developing an environment in which people can utilize information and communications networks in a healthier and safer way" (Article 1). Pursuant to Article 2(1)1 of the same Act, the term "information and communications network" means "an information and communications system for collecting, processing, storing, searching, transmitting or receiving information by using telecommunications facilities and equipment prescribed in subparagraph 2 of Article 2 of the Telecommunications Business Act or computers and applied computer technology." Article 2 Subparag. 2 of the Telecommunications Business Act defines the term "telecommunications equipment and facilities" as "equipment and facilities necessary for telecommunications, such as machinery, appliances, lines, etc." Inasmuch as the regulatory content of Article 49 of the Information and Communications Network Act is comprehensive, the relevant provision ought to be construed by factoring in the legislative purpose of the same Act or the concept of information and communications network, etc.

As a matter of course, the scope of "another person's secret that is processed, stored or transmitted through an information and communications network," which is the object of breach of Article 49 of the Information and Communications Network Act, includes, but is not limited to, secrets being processed or transmitted real-time through an information and communications network, as well as secrets that have been processed by or through an information and communications network but stored or preserved in a remote server and can only be perused or searched via an information and communications platform. Even if another person's secrets that have been processed or transmitted through an information and communications network are stored or preserved in a user's personal computer (PC), if secrets that are presently stored or preserved in an information and communications system can only be perused or searched via a computer program connected to an information and communications network (due to the processing or transmission and storage or preservation of information being closely related), then such secrets should also be deemed as falling under "another person's secrets" as mentioned above. This conclusion can also be derived in light of the concept of information and communications network under the Information and

Communications Network Act, its constituent elements and function, legislative purpose of said Act, etc.

Moreover, the phrase "another person's secret" as prescribed by Article 49 of the Information and Communications Network Act refers to information that is not generally known and that is more beneficial to the relevant information owner if not disclosed to others.

[2] "Infringement" of another person's secret under Article 49 of the Information and Communications Network Act means an act of obtaining another's secrets that are processed, stored or transmitted through an information and communications network by unlawful means or method, such as intrusion of an information and communications network. "Divulgence" does not mean any acts of divulging another's secrets but, rather, an act in which a person who (i) used unlawful means or method, such as intrusion into an information and communications network, and obtained another's secrets processed, stored or transmitted through an information and communications network, or (ii) is aware that such secrets of another were unlawfully obtained, discloses the relevant secrets to those who have no knowledge of the same.

Rather than prescribing the intrusion or mutilation of security measures relating to an information and communications network, Article 48(1) of the Information and Communications Network Act proscribes intrusion into an information and communications network "without a rightful authority for access or beyond a permitted authority for access." Unlike Article 48, Article 49 of the Information and Communications Network Act regards another's information or secret that is processed, stored or transmitted through an information and communications network as the subject of protection, not the information and communications network itself. Therefore, "unlawful means or method, such as intrusion into an information and communications network" that serves as a requisite to establish "infringement or divulgence of another person's secret" under Article 49 of the Information and Communications Network Act is not confined to an act of directly entering another's ID or password that was unlawfully obtained or an act of entering an unlawful command that can bypass security measures. It also includes an act by a person without authorized access obtaining or divulging another's secret via using the device or platform of an information and communications network, which a user had logged in by entering his/her ID and password, without the user's knowledge. Such construction cannot be deemed as contravening the principle of no crime or punishment without the law.

[3] Whether an act constitutes justifiable act or self-defense as grounds for exemption of illegality should be determined from a teleological and reasonable perspective on a case-by-case basis. Also, the lawfulness or unlawfulness of an act should be distinguished within the bounds of a state's order. Establishment of a justifiable act ought to satisfy the following requirements: (i) justification of the motive or purpose of the act; (ii) reasonableness of the means or method

used to commit the act; (iii) balance between the legal interests protected and the legal interests infringed; (iv) level of urgency; and (v) supplementary factors supporting that no other means or method were used to commit the act. Meanwhile, an act of defense ought to be socially acceptable to constitute self-defense in full view of such circumstances as the type of legal interests infringed due to an act of infringement; degree, method, and pace of infringement; and type and degree of legal interests to be infringed from an act of defense.

【Reference Provisions】 [1] Articles 1, 2(1)1, 49, and 71(1)11 of the Act on Promotion of Information and Communications Network Utilization and Information Protection, Etc.; Article 2 Subparag. 2 of the Telecommunications Business Act / [2] Article 12(1) of the Constitution of the Republic of Korea; Article 1(1) of the Criminal Act; Articles 1, 2(1)1, 49, and 71(1)11 of the Act on Promotion of Information and Communications Network Utilization and Information Protection, Etc.; / [3] Articles 20 and 21 of the Criminal Act

Article 1 of the Act on Promotion of Information and Communications Network Utilization and Information Protection, Etc. (Purpose)

The purpose of this Act is to contribute to improving citizens' lives and enhancing public welfare by facilitating utilization of information and communications networks, protecting personal information of people using information and communications services, and developing an environment in which people can utilize information and communications networks in a healthier and safer way.

[This Article wholly amended by Act No. 9119, Jun. 13, 2008]

Article 2 of the Act on Promotion of Information and Communications Network Utilization and Information Protection, Etc. (Definitions)

(1) The definitions of terms used in this Act shall be as follows: <*Amended by Act No. 7139, Jan. 29, 2004; Act No. 8289, Jan. 26, 2007; Act No. 8778, Dec. 21, 2007; Act No. 9119, Jun. 13, 2008; Act No. 10166, Mar. 22, 2010; Act No. 12681, May 28, 2014; Act No. 13343, Jun. 22, 2015*>

1. The term "information and communications network" means an information and communications system for collecting, processing, storing, searching, transmitting or receiving information by using telecommunications facilities and equipment prescribed in subparagraph 2 of Article 2 of the Telecommunications Business Act or computers and applied computer technology[.]

Article 49 of the Act on Promotion of Information and Communications Network Utilization and Information Protection, Etc. (Protection of Secrets, etc.)

No one shall mutilate another person's information processed, stored, or

transmitted through an information and communications network, nor shall infringe, misappropriate, or divulge another person's secret.

[This Article wholly amended by Act No. 9119, Jun. 13, 2008]

Article 71 of the Act on Promotion of Information and Communications Network Utilization and Information Protection, Etc. (Penalty Provisions)

(1) Any of the following persons shall be punished by imprisonment with labor for up to five years or by fine not exceeding 50 million won: <*Amended by Act No. 14080, Mar. 22, 2016*>

11. A person who mutilates another person's information or who infringes, misappropriates, or divulges another person's secret in violation of Article 49.

Article 2 of the Telecommunications Business Act (Definitions)

The terms used in this Act shall be defined as follows: <*Amended by Act No. 10656, May 19,, 2011; Act No. 11690, Mar. 23, 2013; Act No. 12035, Aug. 13, 2013; Act No. 12761, Oct. 15, 2014*>

2. The term "telecommunications equipment and facilities" means equipment and facilities necessary for telecommunications, such as machinery, appliances, lines, etc.[.]

Article 12 of the Constitution of the Republic of Korea

(1) All citizens shall enjoy personal liberty. No person shall be arrested, detained, searched, seized or interrogated except as provided by Act. No person shall be punished, placed under preventive order or subject to involuntary labor except as provided by Act and through lawful procedures.

Article 1 of the Criminal Act (Criminality and Punishability of Act)

(1) The criminality and punishability of an act shall be determined by the law in effect at the time of the commission of that act.

Article 20 of the Criminal Act (Justifiable Act)

An act which is conducted in accordance with Acts and subordinate statutes, or in pursuance of accepted business practices, or other action which does not violate the social rules shall not be punishable.

Article 21 of the Criminal Act (Self-Defense)

(1) An act which is performed in order to prevent impending and unjust infringement of one's own or another's legal interest shall not be punishable if there are reasonable grounds for that act.

(2) When a preventive act has exceeded normal limits, the punishment may be mitigated or remitted according to the extenuating circumstances.

(3) In the case of the preceding paragraph, an act performed through fear, surprise, excitement, or confusion in the night or under other extraordinary circumstances shall not be punishable.

【Reference Cases】 [1] Supreme Court Decisions 2005Do7309 decided Mar. 24, 2006 (Gong2006Sang, 773); 2012Do2212 decided Jan. 12, 2012 / [2] Supreme Court Decisions 2010Do10576 decided Dec. 13, 2012

(Gong2013Sang, 199); 2013Do15457 decided Jan. 15, 2015 / [3] Supreme Court Decision 2007Do7096 decided Jan. 18, 2008

【Defendant】 Defendant

【Appellant】 Defendant

【Defense Counsel】 Law Firm Minhoo, Attorneys Kim Gyeong-hwan et al.

【Judgment of the court below】 Uijeonbu District Court Decision 2017No262 decided August 30, 2017

【Disposition】 The final appeal is dismissed.

【Reasoning】 The grounds of appeal are examined (to the extent of supplement in case of supplemental appellate briefs not timely filed).

1. Establishment of infringement or divulgence of another person's secret that is processed, stored or transmitted through an information and communications network

A. In this case, the issue is whether the Defendant's act constitutes infringement or divulgence of "another person's secret processed, stored or transmitted through an information and communications network" as prescribed by Article 49 of the Act on Promotion of Information and Communications Network Utilization and Information Protection, Etc. (hereinafter "Information and Communications Network Act").

(1) Article 49 of the Information and Communications Network Act provides, "No one shall mutilate another person's information processed, stored, or transmitted through an information and communications network, nor shall infringe, misappropriate, or divulge another person's secret." Article 71(1)11 of the same Act stipulates that "[a] person who mutilates another person's information or who infringes, misappropriates, or divulges another person's secret in violation of Article 49" shall be punished by imprisonment with labor for up to five years or by fine not exceeding KRW 50 million.

The purpose of the Information and Communications Network Act is to "contribute to improving citizens' lives and enhancing public welfare by facilitating utilization of information and communications networks, protecting personal information of people using information and communications services, and developing an environment in which people can utilize information and communications networks in a healthier and safer way" (Article 1). Pursuant to Article 2(1)1 of the same Act, the term "information and communications network" means "an information and communications system for collecting, processing, storing, searching, transmitting or receiving information by using telecommunications facilities and equipment prescribed in subparagraph 2 of Article 2 of the Telecommunications Business Act or computers and applied computer technology." Article 2 Subparag. 2 of the Telecommunications Business Act defines the term "telecommunications equipment and facilities"

as "equipment and facilities necessary for telecommunications, such as machinery, appliances, lines, etc." Inasmuch as the regulatory content of Article 49 of the Information and Communications Network Act is comprehensive, the relevant provision ought to be construed by factoring in the legislative purpose of the same Act or the concept of information and communications network, etc.

As a matter of course, the scope of "another person's secret that is processed, stored or transmitted through an information and communications network," which is the object of breach of Article 49 of the Information and Communications Network Act, includes, but is not limited to, secrets being processed or transmitted real-time through an information and communications network, as well as secrets that have been processed by or through an information and communications network but stored or preserved in a remote server and can only be perused or searched via an information and communications platform. Even if another person's secrets that have been processed or transmitted through an information and communications network are stored or preserved in a user's personal computer (PC), if secrets that are presently stored or preserved in an information and communications system can only be perused or searched via a computer program connected to an information and communications network (due to the processing or transmission and storage or preservation of information being closely related), then such secrets should also be deemed as falling under "another person's secrets" as mentioned above. This conclusion can also be derived in light of the concept of information and communications network under the Information and Communications Network Act, its constituent elements and function, legislative purpose of said Act, etc.

Moreover, the phrase "another person's secret" as prescribed by Article 49 of the Information and Communications Network Act refers to information that is not generally known and that is more beneficial to the relevant information owner if not disclosed to others (*see*, *e.g.*, Supreme Court Decision 2005Do7309, Mar. 24, 2006).

(2) "Infringement" of another person's secret under Article 49 of the Information and Communications Network Act means an act of obtaining another's secrets that are processed, stored or transmitted through an information and communications network by unlawful means or method, such as intrusion into an information and communications network. "Divulgence" does not mean any acts of divulging another's secrets but, rather, an act in which a person who (i) used unlawful means or method, such as intrusion into an information and communications network, and obtained another's secrets processed, stored or transmitted through an information and communications network, or (ii) is aware that such secrets of another were unlawfully obtained, discloses the relevant secrets to those who have no knowledge of the same (*see*, *e.g.*, Supreme Court Decision 2010Do10576, Dec. 13, 2012).

Rather than prescribing the intrusion or mutilation of security measures relating to an information and communications network, Article 48(1) of the Information and Communications Network Act proscribes intrusion into an information and communications network "without a rightful authority for access or beyond a permitted authority for access." Unlike Article 48, Article 49 of the Information and Communications Network Act regards another's information or secret that is processed, stored or transmitted through an information and communications network as the subject of protection, not the information and communications network itself. Therefore, "unlawful means or method, such as intrusion into an information and communications network" that serves as a requisite to establish "infringement or divulgence of another person's secret" under Article 49 of the Information and Communications Network Act is not confined to an act of directly entering another's ID or password that was unlawfully obtained or an act of entering an unlawful command that can bypass security measures. It also includes an act by a person without authorized access obtaining or divulging another's secret via using the device or platform of an information and communications network, which a user had logged in by entering his/her ID and password, without the user's knowledge. Such construction cannot be deemed as contravening the principle of no crime or punishment without the law.

B. (1) On the grounds delineated *infra*, the lower court affirmed the first instance judgment ruling that (i) details of Messenger communications between the victims that the Defendant perused and copied (hereinafter "the instant communications") constituted another person's secret processed, stored or transmitted through an information and communications network, and (ii) the Defendant's act of perusing and copying the instant communications from the computer of Nonindicted 1 (victim) while the victim was not present and then transmitted the copied electronic file to Nonindicted 2 constituted infringement or divulgence of another person's secret and, thus, rejected the Defendant's allegation in the ground of appeal, i.e., misconception of facts and misapprehension of legal doctrine.

(A) The instant communications were private communications between the victims via the Messenger program installed in each of their computers and, therefore, not easily shared with a third party. The victims saved the instant communications on their respective computer's hard drive using the Messenger's save function, thereby constituting confidential information processing via an information and communications network.

(B) In order to recheck the instant communications saved as seen above, Nonindicted 1 had to turn on the Messenger program using one's account. Moreover, it is impermissible for a third party, without authorized access, to use Nonindicted 1's account to log onto the Messenger and check the saved communications.

(C) While Nonindicted 1 vacated one's seat after logging onto the Messenger using one's account, the Defendant perused and copied the instant communications saved in Nonindicted 1's Messenger box, and transmitted the same to a third party's computer.

(D) Even if the company (hereinafter "Nonindicted 3 Company") that provides the Messenger service used by the victims could peruse and check the Messenger communications for the purpose of conducting an investigation to take disciplinary action or protecting trade secrets, etc., the Defendant, who was not involved in the operational aspect of the Messenger program, had no authority to access the instant communications. Furthermore, it is difficult to deem that Nonindicted 3 Company granted permission to a general employee, such as the Defendant, to access and peruse Messenger communications.

(2) The determination of the lower court is justifiable in light of the legal principle as seen earlier. In so doing, contrary to what is alleged in the ground of appeal, the lower court did not err by exceeding the bounds of the principle of the free evaluation of evidence going against empirical and logical rules, or by misapprehending the legal doctrines on the construction of Article 49 of the Information and Communications Network Act or the principle of no crime or punishment without the law.

2. Establishment of self-defense or justifiable act

Whether an act constitutes justifiable act or self-defense as grounds for exemption of illegality should be determined from a teleological and reasonable perspective on a case-by-case basis. Also, the lawfulness or unlawfulness of an act should be distinguished within the bounds of a state's order. Establishment of a justifiable act ought to satisfy the following requirements: (i) justification of the motive or purpose of the act; (ii) reasonableness of the means or method used to commit the act; (iii) balance between the legal interests protected and the legal interests infringed; (iv) level of urgency; and (v) supplementary factors supporting that no other means or method were used to commit the act. Meanwhile, an act of defense ought to be socially acceptable to constitute self-defense in full view of such circumstances as the type of legal interests infringed due to an act of infringement; degree, method, and pace of infringement; and type and degree of legal interests to be infringed from an act of defense (*see*, ***e.g.***, Supreme Court Decision 2007Do7096, Jan. 18, 2008).

The lower court determined that the Defendant's act did not constitute self-defense or justifiable act that serve as grounds for exemption of illegality. Examining the reasoning of the lower judgment in light of the foregoing legal principles and duly admitted evidence, the lower court did not err by misapprehending the legal doctrine on self-defense or justifiable act, as otherwise alleged in the ground of appeal.

3. Conclusion

The Defendant's final appeal is meritless and thus dismissed. It is so decided by the assent of all participating Justices on the bench.

Justices	Lee Dong-won (Presiding Justice)
	Jo Hee-de
	Kim Jae-hyung (Justice in charge)
	Min You-sook