A Forensic Study of Daewoo's Corporate Governance: Does Responsibility for the Meltdown Solely Lie with the Chaebol and Korea?

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I. INTRODUCTION

At the end of 1999, one of the largest conglomerates in the world, the Daewoo Group, collapsed in a spectacular fashion. During its peak, Daewoo was a sprawling enterprise with over 320,000 employees with 590 subsidiaries overseas that operated in over 110 countries. Its management received widespread praise and academic recognition for its success. Yet, when the Asian financial crisis hit in 1997, it managed to commit a deception worth 22.9 trillion won ($15.3 billion) that was termed the “biggest accounting fraud in history, surpassing WorldCom and

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2 See, e.g., Francis J. Aguilar & Dong Sung Cho, Daewoo Group (Harvard Business School Case Study No. 9-385-014, 1984); John A. Quelch & Chanh Park, Daewoo’s Globalization: Uz-Daewoo Auto Project (Harvard Business School Case Study No. 9-598-065, 1998); David Upton & Bowon Kim, Daewoo Shipbuilding and Heavy Machinery (Harvard Business School Case Study No. 9-695-001, 1994); Videotape: Daewoo Group: Chairman Kim (Francis J. Aguilar, Harvard Business School Case Study No. 9-885-510, 1985) (on file with author); see also Donald N. Sull et al., Samsung and Daewoo: Two Tales of One City (Harvard Business School Case Study No. 9-804-055, 2004); Elyssa Tran, Daewoo and the Korean Chaebol (Centre for Asian Business Cases, University of Hong Kong, Ref. No. 01/105C, 2001).
Enron... Years later, inner-workings of the conglomerate are finally coming to light. After hiding as a fugitive overseas for over six years, Daewoo's chairman, Woo Choong Kim, returned to Korea in June 2005 to face criminal charges. In 2006, he was sentenced to eight and a half years in prison and disgorgement of a staggering 17.9 trillion won ($17.9 billion). In December 2007, he finally received a presidential pardon. This juncture serves as an opportune time to assess the ramifications of the Daewoo debacle.

Around the world, corporate governance has emerged as a focal point in the reform of companies. In Asia, a consensus exists that the failure of corporate governance played a pivotal role in precipitating the Asian financial crisis. The crisis spread largely as a result of the inherent weaknesses of conglomerates and banks; in Korea, for instance, problems with family-dominated chaebols provoked its collapse. The trials and

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3 Kraar, supra note 1, at 103; see also South Korea Dumps the Past, at Last, ECONOMIST, Nov. 11, 2000, at 75 (calling the bankruptcy of Daewoo Motor “the world’s largest corporate failure”); Andrew Ward, Kim Tries to Mend Damaged Reputation, FIN. TIMES, Jan. 23, 2003, at 27 (referring to the fraud as “the world’s biggest accounting fraud”). Figures on the exact amount of accounting fraud have ranged as high as 80 trillion won ($53.3 billion) whereas the WorldCom’s accounting fraud only amounted to $11 billion. Krysten Crawford, Ex-WorldCom CEO Ebbers Guilty, CNN MONEY, Mar. 15, 2005, http://money.cnn.com/2005/03/15/news/newsmakers/ebbers/index.htm; Chae-Yong Lee, ‘Kim-gi-se-kan’ eui se-gye-geong-yeong [‘Kim-ghiskhan’s’ Global Management], POLINEWS, Apr. 23, 2007, http://www.polinews.co.kr/news/newsview.html?t =focus&pkey=40300&no=75348. Much debate exists as to the exact amount of the accounting fraud and how to calculate it. The exchange rate conversions provided for the reader’s convenience apply the following rates for the Korean won per U.S. dollar: 900 won before 1997, 1,500 won in 1997, 1,400 won in 1998, 1,200 won from 1999 until 2003, and 1,000 won in 2004 and thereafter. Furthermore, all references to Korea in this Article mean South Korea, unless otherwise noted.

4 Judgment of Nov. 3, 2006, 2006 No 1127 (Seoul High Court), aff’g but modifying, Judgment of May 30, 2006, 2005 Gohab 588, 794 & 364 (consolidated) (Seoul Dist. Court) (original sentence before modification by the High Court was 10 years imprisonment and 21.4 trillion won disgorgement). Similarly, in April 2005, the Supreme Court upheld prison sentences and disgorgement ranging as high 23.07 trillion won ($19.2 billion) against the most senior Daewoo executives. Judgment of Apr. 29, 2005, 2002 Do 7262 (Supreme Court). Leading cases will be reviewed in Parts III and IV of this article. Meanwhile, dozens of civil cases remain pending.


6 Keun Lee, Corporate Governance and Growth in the Korean Chaebols: A Microeconomic Foundation for the 1997 Crisis 17 (Seoul Nat’l Univ. Inst. of Econ. Res., Working Paper No. 18, 1999). The term chaebol means a conglomerate or literally a...
tribulations of a major Asian conglomerate such as Daewoo offer an understanding of the ramifications of poor corporate governance in an emerging market. The tale of Daewoo further serves as one of the earliest warning signs of the corporate governance breakdowns that later plagued the leading companies around the world. It predated the Enron, WorldCom, Tyco, Vivendi, Ahold and Parmalat scandals that devastated confidence in global markets.

Daewoo was not a case isolated to Korea. World-renowned international financial institutions, investment banks, money managers, financial analysts, accounting firms and credit rating agencies have all failed to react to the situation. They categorized Daewoo's meltdown as a remote problem in a faraway region. The wave of policy discussions on the imperatives of having effective reputational intermediaries and gatekeepers only came later.\(^8\) A case study of Daewoo within the context of comparative corporate governance also sheds light on the efficacy of formal law, the importance of enforcement, and the potential for convergence among governance systems.\(^9\) It will show how corporate governance mechanisms have been activated not only through statutory reforms but also through alternative ways for establishing legal compliance. Most notably, Korea has developed a unique means of enforcement outside the traditional remedies based upon corporate or securities law. Finally, this study shows how a transplant country from a mixed civil law tradition is converging toward a more shareholder-oriented corporate governance model from a state-oriented model.\(^10\)

How much of a role corporate governance problems played in the collapse of Daewoo remains a difficult question. Applying "modern" concepts of corporate governance might be inappropriate, given Korea's level of economic development at the time. The term "corporate

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governance,” for example, did not even exist in the Korean business vernacular. Some insist that Daewoo was a victim of external shocks or a scapegoat of political intrigue. They cite how Daewoo affiliates have rebounded to profitability after the crisis. With the benefit of hindsight, they argue, forensic studies can exaggerate faults and causes that might appear self-explanatory. These challenges will be addressed below.

This Article begins with a comprehensive review of the history of Daewoo, particularly relative to other chaebol conglomerates. In Part III, the Article provides a survey of the internal corporate governance structure of Daewoo, particularly by examining the roles of its board of directors, officers, shareholders, and banks. Part IV then describes the external corporate governance landscape of Korea, with special focus on the failure of reputational intermediaries, gatekeepers, and public institutions. This Article argues that while primary responsibility for the collapse lies with Daewoo’s own problems and Korea’s underdeveloped corporate governance framework, other market players—especially the leading international institutions—cannot escape the responsibility. In Part V, the Article concludes that corporate governance policy in emerging markets must be reformulated to reach a more balanced and comprehensive perspective.

II. THE CHAEBOL AND THE FINANCIAL CRISIS

This Part provides the background of Daewoo from its beginning to its demise in the aftermath of the Asian financial crisis. It explains how Daewoo became a leading conglomerate under Korea’s state-oriented

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13 Id. at 273–86. Yet, this only proves the importance of corporate governance because these companies only became viable after they became independent from the conglomerate. Jong-Sei Park & Young-Jin Kim, Geu-rup-hae-che 5 nyeon . . . Daewoo-ga sal-a-it-da [Five Years after Group Dismantlement . . . Daewoo Lives On], CHOSUN ILBO, Nov. 30, 2004, at 1, 3.
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corporate governance system. Woo Choong Kim’s role as the founder, chairman and controlling shareholder of the Daewoo Group is then profiled. This Part also describes the characteristics of chaebols, family-controlled conglomerates that dominated the Korean economy.

A. The Making of the “Great Universe”

In 1967, 30-year-old Woo Choong Kim founded Daewoo Industrial, a textile exporter, with just five employees and $18,000. The two Chinese characters that form the name Daewoo meant “Great Universe,” true to the ambitions of the young entrepreneur. From its humble beginnings, business expanded rapidly, and by 1972, it became the second largest exporter in Korea. Daewoo played a major role in Korea’s economic success when the country achieved the “ Miracle of the Han River” and transformed itself from an underdeveloped backwater into a developed nation in the span of forty years. Under Kim’s guidance, by 1996, Daewoo became the world’s largest transnational entity among emerging economies, surpassing such companies as Xerox, Amoco, Volvo, Fujitsu, and Glaxo Wellcome.

Daewoo excelled at acquiring distressed companies, mostly from the government and then turning them around. In 1976, for instance, Daewoo assumed control over Hankook Machinery Ltd., a manufacturer of industrial machinery, rolling stock, and diesel engines that had not shown a profit for thirty-eight years. Senior executives had opposed the acquisition, but Woo Choong Kim prevailed over them. After changing its name to Daewoo Heavy Industries, the company started generating profits in its second year. In another fabled example, in 1978 Daewoo acquired Okpo Shipbuilding Company, a company teetering on bankruptcy. Merged into

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14 Aguilar & Cho, supra note 2, at 2.
15 Sang-Hun Choe, Daewoo Founder Returns Home to Protesters and Arrest, INT’L HERALD TRIB., June 15, 2005, at 3.
18 Aguilar & Cho, supra note 2, at 3–4.
19 Id. at 4.
Daewoo Heavy Industries, Kim guided the shipyard to positive returns by 1983.\textsuperscript{21} Daewoo's mode of acquisition, turn-around, and expansion became a trademark of the conglomerate—major businesses of Daewoo were not established by Daewoo, but obtained through mergers or acquisitions.\textsuperscript{22}

Another cornerstone of Daewoo's business strategy was its orientation towards exports. Unlike other chaebols, Daewoo championed an international focus from its beginning.\textsuperscript{23} The group prided itself on its ability to spearhead the opening of new markets overseas. By 1979, it became the largest exporter in Korea, following the government's economic development plans of export-led growth.\textsuperscript{24} Daewoo launched a Global Management Strategy in 1993 to further expand its operations across the world.\textsuperscript{25} By 1998, it had established 590 subsidiaries overseas.\textsuperscript{26} Over 320,000 employees worked worldwide in 110 countries, from South America to Africa and Eastern Europe.\textsuperscript{27} Despite the national security risks, Daewoo was even among the first to try to develop businesses with North Korea.\textsuperscript{28}

Critics claimed that Daewoo succeeded because of its ability to extract support from the government through rent-seeking while leveraging that it had become too important to be allowed to falter.\textsuperscript{29} In 1988, for example, it

\begin{footnotesize}
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\item Aguilar & Cho, supra note 2, at 10 ("Every major new business entry for Daewoo had involved the takeover of an existing troubled company.").
\item Koh, supra note 1, at 8 (concluding that "the risk involved [in these type of expansion plans] should not be understated").
\item Kraar, supra note 1, at 103; Tran, supra note 2, at 11.
\item Kim became the first business leader to visit North Korea and Daewoo became the first Korean business entity to invest there. Mark Clifford, The Daewoo Comrade: South Korean Firm Blazes Northern Trail, FAR E. ECON. REV., Feb. 20, 1992, at 47.
\item CHAN-HYUK SOHN, KOREA INST. FOR INT'L ECON. POLICY, KOREA'S CORPORATE RESTRUCTURING SINCE THE FINANCIAL CRISIS 28 (2002), available at http://www.kiep.go
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faced disaster when Daewoo Shipbuilding and Heavy Machinery verged on collapse due to a crushing debt of 1.2 trillion won ($1.8 billion) that resulted from deteriorating market conditions.\(^{30}\) Amid criticism that the company should have undergone insolvency proceedings according to market principles, the government bailed it out with a 400 billion won ($600 million) restructuring package in 1989.\(^{31}\) The generous rescue package reasserted Daewoo’s lobbying ability while confirming the government’s inability to take decisive actions. This fueled the myth that Daewoo and other chaebols had become too big to fail. Chaebols engaged in increasingly riskier behavior in the belief that they could rely upon government intervention when in jeopardy.\(^{32}\)

In 1978, Daewoo embarked on its tragic foray into the automobile industry through a 50% acquisition of Saehan Motor in a joint venture with GM Korea.\(^{33}\) What later became Daewoo Motor met the strategy of both turning around distressed companies and expanding through exports. The company sought growth and market share instead of focusing on profitability and research and development. After first buying out GM’s remaining 50% stake in 1992, a series of entries into foreign automobile markets followed.\(^{34}\) In 1994, Daewoo Motor acquired the Worthing Technical Centre in the United Kingdom and entered into an automobile joint venture with Rodae in Romania.\(^{35}\) In 1996, it entered the Polish automobile market with the $1.1 billion acquisition of Fabryka Samochodow Osobowych (“FSO”).\(^{36}\) In addition, the company bought a southern Poland truck factory for $700 million, Czech Republic’s Avia


\(^{32}\) Clifford, supra note 31, at 63.


\(^{34}\) Don Kirk, GM Confirms Daewoo Talks but Won’t Discuss Buying In, INT’L HERALD TRIB., Feb. 3, 1998, available at http://www.iht.com/articles/1998/02/03/daewoo.t.php. Daewoo was not the only example of a Korean company making a foray into the automobile industry that later proved devastating. Shinhan Motor, Kia Motor, Ssangyong Motor, and even Samsung Motors are all examples of critical failures in Korean corporate history. Ravenhill, supra note 33, at 4. Ford later suggested that they dropped their bid for Daewoo Motor not because of huge debts but because of the poor business prospects of turning it around. South Korea Dumps the Past, at Last, supra note 3.

\(^{35}\) Yong Suhk Pak et al., Lessons Learned from Daewoo Motors’ Experience in Emerging Markets, 10.2 MULTINATIONAL BUS. REV. 122, 123 (2002).

\(^{36}\) Jane Perlez, European Beachhead for Korean Ambition, N.Y. TIMES, July 24, 1996, at D1 (“How Daewoo, a debt-laden company, plans to finance the rapid expansion is not exactly clear.”).
truck manufacturer for $200 million, Uzbekistan’s Uz car plant, and teamed up with other carmakers from Ukraine and India.37 The acquisition spree led to fourteen new vehicle plants in thirteen countries, which culminated with the purchase of a 51.98% stake in Ssangyong Motor in January 1998 at the height of the financial crisis.38 This kind of reckless expansion into the automobile business overwhelmed the conglomerate.39

Meanwhile, Daewoo’s financial structure relied upon debt. While debt-to-equity ratios for chaebols typically exceeded 400%, Daewoo surpassed everyone in its over-reliance on debt.40 As early as 1988, with over $11.2 billion in borrowings, Daewoo stood as Korea’s most indebted conglomerate.41 Its debt gearing in 1998 was allegedly as high as 2,000% or greater.42 In fact, for foreign investment projects, Daewoo followed a “one-hundredth strategy.”43 It boasted that Daewoo only required 1% of the total capital needed for a project because they could finance the rest through preferential loans from foreign countries’ banks, inter-subsidiary debt payment guarantees, joint investment from local investors, and other sources.44

Another notable feature was that the de facto holding company, the Daewoo Corp., was not the profit center of the conglomerate.45 Daewoo Corp. primarily acted as a trading and financial company for products and services. In difficult times, therefore, it did not have the capacity to provide financial support to weaker affiliates. Instead, it later served as the group’s nerve center that directed the use of offshore entities as conduits for the accounting frauds.46

41 Mark Clifford, Under-Powered Performer, FAR E. ECON. REV., Dec. 8, 1988, at 52.
42 Lee, supra note 20, at 159.
43 Id. at 153.
44 Id. at 153–54.
45 Id. at 155–56.
Unsurprisingly, Daewoo received the lowest market valuations and had to pay the highest interest rates among the chaebols. Capital markets have long discounted Daewoo companies. As of April 1997, for example, Daewoo had a 1.1 price-to-book ratio, the lowest among leading conglomerates which averaged more than two.\(^{47}\) Daewoo’s actual interest rates were 2.6% higher than the average among the top-five chaebols in 1997.\(^{48}\) The spread between Daewoo bonds and other chaebols was already 1% in 1998, but increased to 2 to 3% by early 1999.\(^{49}\) The discounts and spreads reflected the market’s uncertainty over Daewoo’s earnings prospects relative to its risks. Of course, even these discounts were far too generous, considering what was concealed through the accounting and loan frauds. Nevertheless, the valuations reflect the degree of knowledge that market participants—particularly the sophisticated domestic and foreign ones—held of the risk in dealing with the conglomerate.

Notwithstanding, the sustainability of the Daewoo brand name is evident in the fact that its brand image and brand recognition still remain strong in the international marketplace.\(^{50}\) After the conglomerate’s collapse, nearly a dozen companies continue to operate under the Daewoo brand name.\(^{51}\) Leading Daewoo companies even retain the same senior management.\(^{52}\) Yet, the success of the companies in many ways demonstrates the importance of corporate governance; they have only managed to become competitive enterprises after they unshackled themselves from the collective burdens of the conglomerate.\(^{53}\) As independent companies, they can now operate for their own benefit without regard for the welfare of other affiliates.

\(^{47}\) Lee, supra note 20, at 157.

\(^{48}\) WONJONG KOH, NOMURA, ALARM BELLS RINGING FOR THE DAEWOO GROUP 3 (1998).

\(^{49}\) DAEWOO SUICIDE, supra note 12, at 72. Its commercial paper rates were also three to 5% higher than other chaebols by late 1998. FIN. SUPERVISORY COMM’N & FIN. SUPERVISORY SERV., DAEWOO-GEU-RUP WEO-KEU-A-UT CHU-JIN-HYEON-HWANG MIT HYANG-HU-GYE-HWEK [DAEWOO GROUP WORKOUT CURRENT STATUS AND FUTURE PLANS] 2 (1999) [hereinafter 1999 GOVERNMENT REPORT].

\(^{50}\) According to the consultancy, Interbrand, in its 2004 Readers’ Choice Awards, Daewoo still ranked 69th in the world for the brand with the most global impact. Global Rankings, http://www.brandchannel.com/boty_results/global_list.asp (last visited Mar. 8, 2008).


\(^{52}\) DAEWOO SUICIDE, supra note 12, at 207. Loyalists still wait for the comeback of their charismatic leader Woo Choong Kim. See, for example, Daewoo Love, http://www.daewoolove.com (last visited Mar. 8, 2008), for a website operated by loyal Daewoo supporters.

B. Tragic Hero: Chairman Woo Choong Kim

Daewoo cannot be discussed separately from its legendary founder, Woo Choong Kim. He not only established the company, but determined its course, dominated its decision-making process, and handpicked its executives.  

In terms of business strategy, he maintained the same management perspective until the end: seize market share first, quash competition, and seek collection later. Toward this end, he maximized his expertise in corporate turn-around and rent-seeking. His global perspective on the need for Korean companies to develop overseas markets was visionary, particularly given the reclusive tendencies of Korean executives at the time. He traveled around the world over 260 days out of the year seeking business opportunities. His indomitable spirit, tireless energy, and grand dreams for Korea attracted a legion of professionals. In the end, he deserves the most credit for the conglomerate’s success but remains primarily responsible for its meltdown.

Kim built the Great Universe of Daewoo into a multinational conglomerate in less than two decades. Recognized as one of the world’s most successful businessmen, he was profiled in leading business magazines everywhere. In 1984, he received the International Chamber of Commerce’s coveted International Business Award that was conferred by Sweden’s King Carl Gustaf XVI. He wrote a bestselling autobiographical book, “Every Street is Paved with Gold,” that sold over two million copies. Published in twenty-one languages, it propounded his corporate philosophy on the need to expand internationally. In September 1998, he became the captain of Korean industry when he was elected chairman of the Federation of Korean Industries (“FKI”), an influential organization of

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55 According to one anecdote, Kim sold newspapers when he was young. Competition for newspaper delivery was fierce in war-torn Korea although he was one of the fastest delivery people in the neighborhood. He then devised a strategy that solidified his position as the most profitable delivery person in the region. He discovered that he lost significant time against his competitors in the payment collection process, so he decided to deliver as many newspapers as he could first and then collect payments afterwards. He calculated that he would be far more profitable even if he did not receive payments for some newspapers delivered. He soundly beat out his competitors. Id. at 32.


58 KIM, supra note 54, at 118.

59 The Korean version of this book was first published in 1989 under the title “Se-gye-neun nulp-go hal-il-uen man-ta [It’s a Big World and There’s Lots to Be Done].” The English translation followed in 1994: WOO CHOONG KIM, EVERY STREET IS PAVED WITH GOLD (1994). Kraar, supra note 1, at 103.

60 Kraar, supra note 1, at 103.

Politically, Daewoo benefited from Kim’s instincts and apparently his personal relationship with President Chung Hee Park, the controversial autocrat who ruled South Korea from 1961 until 1979.\footnote{Park reportedly favored Kim because Kim’s father was a former high school teacher of his whom he had respected. Don Kirk, \textit{For Daewoo’s Founder, Pride Before the Fall}, N.Y. TIMES, Feb. 23, 2001, at W1.} Although a latecomer compared to other established conglomerates, Daewoo blossomed under Park’s industrial policy during the 1960s and 1970s. Kim managed to extract concessions from the government, especially when taking over distressed companies. While the government would engage in predation of its own, time and time again it would succumb to Kim’s requests for support. Even after Park died, Daewoo continued to rely on Kim’s political acumen to steer them out of difficulties.

During the financial crisis, however, Kim’s political wherewithal and managerial judgment faltered, leading Daewoo to catastrophe. By the summer of 1999, he departed the country in a self-imposed exile.\footnote{His Korean passport expired in 2002 and according to the Korean National Policy Agency, he acquired French citizenship in 1987. Yeong-Eun Jang, \textit{Kim-woo-choong-ssi 87-nyeon peu-rang-seu guk-jeok-chwi-deuk} [Woo Choong Kim Acquires French Citizenship in 1987], YONHAP NEWS, Dec. 27, 2002. The District Court decision that sentenced him to ten years imprisonment confirmed that he was a French citizen. 2005 Gohab 588, at 2.} He returned after six years of hiding on his own volition to receive an eight-year prison sentence in 2006, with numerous civil trials still pending.\footnote{S.Korea [sic] \textit{Pardons Daewoo Founder}, supra note 5.} In his own words, he claimed that “[m]y big mistake was being too ambitious, especially in autos . . . . I tried to do too much too fast.”\footnote{Kraar, \textit{supra} note 1, at 103.}

Fundamentally, Kim failed to follow the basic legal and managerial principles such as accounting, internal controls, and financial discipline, while placing too much emphasis upon marketing and generating sales. Standards of good corporate governance were unobserved. He did not heed warnings to retract, and instead chose to expand through an unprecedented accounting and loan fraud.\footnote{\textit{Id.}} In the end, the ultimate responsibility for the Daewoo catastrophe lies with him.

C. Chaebol Business Practice and Culture

The chaebols that dominated the South Korean economy shared many common features. Nurtured under the government’s industrial-growth policy, they followed the same financing methods, business models, ownership structures, and operating practices. A state-oriented corporate
governance modus operandi prevailed, as the country unified behind the 
chaebols according to the dictates of policymakers.\textsuperscript{67} Interested parties such as shareholders, employees, consumers, and managers received secondary priority given the nation's collective focus on economic development and employment during the 1960s and 1970s.

First and foremost, chaebols maintained a patriarchic management style that revolved around the controlling shareholder's domination. Excessive concentration of power became the source of most of their corporate governance problems. Chairmen, serving as both the controlling shareholder and the founder, reigned as moguls over empires of companies. The participation of directors, statutory auditors, external auditors, and non-controlling shareholders in the governance process was subsumed under the command of chairmen. Defiant managers that dared to challenge imperial orders faced swift retribution, leaving controlling shareholders with uncontested authority. The state of predominance was compounded particularly at the senior level, because executives lacked alternative employment options due to Korea's poor labor market flexibility.\textsuperscript{68}

Under a state-oriented corporate governance system, the government operated in an intertwined, symbiotic relationship with the chaebols. Chaebols operated according to government policies, because following these policies allowed them to receive "preferential policy loans, tax credits, subsidies, protection and even bailouts when [they] got into financial trouble."\textsuperscript{69} The Korean government provided management-friendly labor laws, condoned monopolies and oligopolies, gave out special licenses and permits, and set up trade and investment barriers to foreign competition. Chaebols received favorable treatment as long as they performed reasonably well. From one perspective, Korea's economic success evinces the merits of such industrial policies based upon close industrial and government cooperation. At its worst, however, such collusion led to illegal rent-seeking and predation. In the most egregious example, a dozen leading chaebol chairmen,\textsuperscript{70} including Woo Choong Kim, contributed over 510 billion won ($638 million) in bribes during the 1980s and early 1990s to two Korean presidents during that period.\textsuperscript{71} These chairmen claimed they could not defy the presidents' solicitations for slush

\textsuperscript{67} For a general description of a state-oriented model of corporate governance, see Hansmann & Kraakman, supra note 10, at 446–47.


\textsuperscript{69} Lee, supra note 20, at 152–53.

\textsuperscript{70} At that time, the heads of all major chaebols were men.

\textsuperscript{71} Joongi Kim & Jong Bum Kim, Cultural Differences in the Crusade Against International Bribery: Rice-Cake Expenses in Korea and the Foreign Corrupt Practices Act, 6 PAC. RIM L. & POL'y J. 549, 568 (1997); see infra Section IV.D.
funds, yet the chaebols derived significant benefits in return.\textsuperscript{72} Policymakers also protected the control of chaebol families. Initially, like other Asian companies, families held a large, concentrated ownership in their companies.\textsuperscript{73} In the 1970s, however, the government browbeat chaebols into listing their major companies on the stock exchange.\textsuperscript{74} Listing by chaebols served two governmental purposes. First, compelling chaebol families to disperse their ownership to the public would lead to sharing of the benefits that chaebols received from the special preferences.\textsuperscript{75} Second, rights offering served to provide much-needed liquidity to the fledgling stock market. Families initially resisted listing their companies out of concerns that dispersion of their ownership could threaten their control. With generous indirect financing available from banks, the companies also had little need for equity financing.\textsuperscript{76} To convince them, the government decided to protect chaebols from the threats to ownership control by curbing shareholder and stakeholder rights for acquiring control and challenging board decisions.\textsuperscript{77}

Ownership dispersion coupled with weaker, rather than stronger, minority shareholders protections sowed the seeds for corporate governance problems. With control rights protected, entrenched families gradually allowed dilution of their cash flow rights with each rights offering. Over time, families held only marginal ownership.\textsuperscript{78} Meanwhile they were allowed to secure control through a vast web of crisscrossing share ownership between affiliates.\textsuperscript{79} As the discrepancy between cash-flow and control rights became wider, the controlling shareholder's

\textsuperscript{73} SOHN, \textit{supra} note 29, at 68.
\textsuperscript{74} Company Listing Promotion Act, Law No. 2420 of 1972 (\textit{repealed by Law No. 3946 of 1987}) (S. Korea).
\textsuperscript{75} Employees were to benefit as well through the preemptive rights they could acquire through Employee Stock Ownership Plans. \textit{See generally} The National Center for Employee Ownership, How an Employee Stock Ownership (ESOP) Works, \url{http://www.nceo.org/library/esops.html} (last visited Mar. 8, 2008).
\textsuperscript{76} SOHN, \textit{supra} note 29, at 26.
\textsuperscript{79} Many Asian companies have similar ownership structures. OECD \textit{WHITE PAPER, supra} note 6, at 11; \textit{SEON-GU KIM ET AL., SEOUL NAT’L UNIV. INST. OF ECON. RES., CHUL-JA-CHONG-AEK-JE-HAN-JE-DO-UJ BA-RAM-JIK-HAN GAE-SEON-BANG-HYANG [APPROPRIATE WAY TO IMPROVE THE TOTAL INVESTMENT LIMITATION SYSTEM]} 113-14 tbl.3.1 (2003).
interests diverged even further from the other shareholders, and the inherent agency problems became greater. The anomalous situation of control without corresponding ownership and dispersed ownership without strong shareholder protections emerged as a fundamental issue. Chaebols became vulnerable to empire-building and more serious ills such as misappropriation.

During the period Korea was rapidly developing, chaebols routinely engaged in related-party transactions among affiliates. In fact, intra-conglomerate assistance among affiliates without regard to corporate governance of individual companies was a common practice. Not only was such practice not punished, governmental administrative guidance often required affiliate support for risky but strategically important companies as a condition for receiving bank loans. Stronger companies helped start-ups and rescued troubled affiliates through equity infusions, debt guarantees, and transfer pricing, on non-market terms, according to the mandates of governmental policy. In the worst cases, controlling families or senior managers of the company used related-party deals to engage in self-dealing and to extract other private benefits of control.

Chaebols adhered to the “too-big-to-fail (dae-ma-bul-sa)” doctrine. Through their network of companies, they accounted for a predominant share of the country’s employment, production, income, and exports. Their impact on the economy was multiplied considering downstream and upstream industries, suppliers, outsourcers, transporters, retailers, and distributors. Conventional belief under the doctrine held that bureaucrats did not have the nerve to endure the political costs and social dislocation generated by permitting the collapse of a chaebol, particularly one of the

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80 Lee, supra note 77, at 42.
83 Bernard S. Black et al., Corporate Governance in Korea at the Millennium: Enhancing International Competitiveness, 26 J. CORP. L. 546, 596 (2001).
largest ones. Market participants therefore clung to this myth.\textsuperscript{85} Sophisticated investors, creditors, and reputational intermediaries, domestic and foreign alike, downplayed the importance of good corporate governance, because they believed chaebols had a sovereign guarantee from "Korea, Inc." Meanwhile, these beliefs nurtured a moral hazard that led chaebols to increase their sizes and assume undue risks because they believed that they could rely upon the government's safety net.

Furthermore, chaebol companies and chairmen linked fates of parent and affiliate companies through debt or payment guarantees.\textsuperscript{86} Guarantees were demanded as a condition for obtaining bank loans or making bond offerings, although the collective risk was not properly gauged. The collapse of one affiliate could endanger others that had guaranteed its loan payment and start a chain reaction that could threaten a string of companies, if not the entire conglomerate. By the conjoined fates of companies, these guarantees exacerbated the problems associated with the too-big-to-fail doctrine. Banks also routinely demanded that chaebol heads personally guarantee company debts as an additional form of security, even though the size of these personal guarantees was already beyond their capacity.\textsuperscript{87} When difficulties arose, nothing held the chairmen back from assuming excessive risks, because they could no longer limit their exposure to a manageable level.

From an industrial organization perspective, many conglomerates followed a horizontal package approach—they provided a diversified range of goods and services for a single large project.\textsuperscript{88} Under this approach, the entire operations of a chaebol could be enlisted, for example, from construction to trading, sales, marketing, and financing. When a construction company builds a hotel, other affiliate companies would obtain the financing, provide automobiles and buses, train the staff, and promote the property. This organizational structure served as a justification to

\textsuperscript{85} One example of the special status for larger conglomerates occurred in April 1998 during the financial crisis. The Financial Supervisory Commission ("FSC") announced that the top five chaebols could largely restructure on their own while smaller chaebols would be placed in stricter workout programs, underlining the impression that larger chaebols received a differentiated treatment. See Lee, \textit{supra} note 20, at 171.

\textsuperscript{86} See, e.g., Nissho Iwai Eur. PLC v. Korea First Bank, 782 N.E.2d 55, 57 (N.Y. 2002) (describing a Daewoo Corp.'s guarantee of a $150 million loan from Nissho to Daewoo Hong Kong, Ltd.).


\textsuperscript{88} Daewoo, for example, would engage in country-wide projects in which the entire conglomerate would participate. Seong-Dong Kim & Jeong-Hwan Bae, \textit{Kim-woo-choong-ui beop-nyul dae-ri-in Seok-jin-gang, ban-gyeok-ha-da} [Counterattack by Jin-Gang Seok, Woo Choong Kim's Legal Representative], \textit{Monthly Chosun}, Apr. 2001, at 197.
support weaker affiliates when in need.

Finally, chaebols engaged in various forms of "earnings management." Financial figures were inflated partially due to historical reasons. Following the Japanese model, policymakers granted chaebols exclusive rights to establish general trading companies based upon the volume of revenues, assets, sales, and stated capital. Size, not profitability, was the key determinant. Bureaucrats similarly condoned window-dressing to receive licenses, permits, and commercial lending, particularly when it was related to attracting precious foreign capital. With the emphasis on growth, companies were allowed to inflate records and manipulate balance sheets through related-party transactions to obtain extensions when maturity dates approached. Consolidated financial statements were not required, so a single asset could be sold through a chain of companies, generating artificial sales for all the companies involved.

D. Fatal Decisions During the Asian Financial Contagion

As the financial contagion swept across Asia in the late 1990s, Daewoo made grave misjudgments—condoned by the government—which sealed its fate. First, it pursued a counterstrategy of expansion with particular focus on the automobile industry that proved too ambitious. Daewoo then over-leveraged itself with $20 billion in debt to try to meet its financial burdens during the crisis. Its management did not appreciate the seriousness of the situation, offering restructuring plans to resurrect the conglomerate only when it was too late. In the end, everyone stood by as Daewoo transformed into a financial black hole over a two-year period.

In late 1997, the Korean won plummeted from 900 won to 1,960 won to the dollar in less than four months. As a result, Korea—the proud country that was hailed for its economic miracle—capitulated to a bailout led by the International Monetary Fund ("IMF"), the World Bank, and the Asian Development Bank, consisting of over $58 billion. The IMF’s controversial prescription raised interest rates to over 30% in an attempt to stem capital flight. Korea experienced negative 6.9% growth in 1998, the

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90 Sull et al., supra note 2, at 2.
92 Lee, supra note 20, at 22.
95 Chae-Shick Chung & Se-Jik Kim, New Evidence on High Interest Rate Policy During
worst in its modern history.\textsuperscript{96}

The timing could not have been worse for Daewoo. It might have weathered the storm had it restructured from the onset in early 1998.\textsuperscript{97} Rejecting a contractual approach, Woo Choong Kim instinctively pursued aggressive growth, particularly in the automobile industry. He declared that "Daewoo will overcome the crisis through expansionist measures [like in the past]," because given the opportunity "[w]e cannot embrace the future if we flinch at a time of recession."\textsuperscript{98} Returning to his roots, Kim viewed the crisis as a chance for Daewoo to acquire distressed companies and turn them around. One commentator noted that "Daewoo’s response to the crisis came straight out of its old playbook: cooperate with the government, acquire failed companies to expand, and continue to borrow."\textsuperscript{99}

While others retracted, Daewoo Group’s sales increased by 25\% in 1998 and Daewoo Corp.’s, by 54\%.\textsuperscript{100} The group spent 10 trillion won ($7.14 billion) in sales promotions during this critical period.\textsuperscript{101} Automobile-related expansion in particular overwhelmed the conglomerate.\textsuperscript{102} Daewoo Motor acquired Ssangyong Motor in January 1998 at the peak of the crisis, assuming a 3.4 trillion won ($2.43 billion) in debt.\textsuperscript{103} Leading companies such as Daewoo Corp. and Daewoo Heavy Industries bore the burden.\textsuperscript{104} All companies pressured employees to purchase Daewoo automobiles.\textsuperscript{105} Executives personally marketed cars

\textsuperscript{97} Lee, supra note 20, at 165.
\textsuperscript{98} Michael Schuman & Jane L. Lee, South Korea, Eager to Shed Its Old Ways, Allows a Corporate Empire’s Overhaul, \textit{ASIAN WALL ST. J.}, Aug. 17, 1999, at 1, 3.
\textsuperscript{99} Lee, supra note 20, at 164.
\textsuperscript{100} 1999 \textit{GOVERNMENT REPORT}, supra note 49, at 1.
\textsuperscript{101} Lee, supra note 20, at 165.
\textsuperscript{102} Daewoo had also attempted to enter the oil refinery business by acquiring Hanwha Energy. \textit{See} Daewoo, Acquiring Ansaldo (Italy), supra note 39.
\textsuperscript{104} DAEWOO SUICIDE, supra note 12, at 207–08.
\textsuperscript{105} In August 1998, the KFTC fined Daewoo Corp. 5.1 billion won ($3.6 million) for providing interest-free loans to employees that purchased Daewoo cars through Daewoo Motor Sales between April 1997 and May 1998. A shareholder suit against Woo Choong Kim for his role in this improper support was dismissed in November 2004 because he was not a registered director of Daewoo Corp. at the time. \textit{SUN-WOONG KIM, CENTER FOR GOOD CORPORATE GOVERNANCE, DAEWOO (Ju) Ju-Ju Dae-Pyo So-Song-E-Seo Na-Ta-Nan Sa-Sil-Sang Ei-Sa-E Daehan ChaeK-I M-Chung-Eui Han-Gea [The Limitations of Seeking Accountability Against De Facto Directors as Demonstrated in the Shareholder Derivative Action Against Daewoo Corp.] (2004) (S. Korea).
with sales results linked to their performance evaluations.\footnote{106} Daewoo's financial balancing act foundered under the weight of the financial contagion.\footnote{107} First, debt burden more than doubled due to the plummeting Korean won. At the time, the group had $5.1 billion in foreign currency loans and $1.9 billion in foreign currency debt to foreign bond owners.\footnote{108} Second, the spike in interest rates further debilitated the conglomerate, with its interest burden ballooning from 3 trillion won ($2.14 billion) to 6 trillion won ($4.3 billion).\footnote{109} Finally, Daewoo reportedly failed to collect payment on several large-scale projects such as $3 billion owed by Libya and $1 billion owed by Pakistan.\footnote{110} Relatively constant operating profits aside, the collective financial burden overwhelmed Daewoo.

To meet the demands, Daewoo issued a flurry of corporate bonds and commercial paper throughout 1998 to cover its maturing debts. Despite high leverage, it still managed to raise 19.7 trillion won ($14.1 billion) in debt issuances at interest rates that averaged 15% and reached as high as 25%.\footnote{111} In the third quarter of 1998 alone, Daewoo issued over 9.2 trillion won ($6.57 billion) in bonds, raising its total debt by 40%\footnote{112} and accounting for 27% of total bond issues at the time.\footnote{113} Investment trusts and other institutions recklessly acquired the debt instruments, apparently relying on the assumption that the government would devise a solution.\footnote{114}

\footnote{106} \textit{DAEWOO SUICIDE}, supra note 12, at 319.


\footnote{108} 1999 GOVERNMENT REPORT, supra note 49, at 2, 17. When the exchange rate collapsed from 700 won to 1400 won to the dollar, Daewoo's attorney claimed that Daewoo's foreign debt exposure of $28.57 billion jumped from 20 trillion won to 40 trillion won, although this figure seems exaggerated. Kim & Bae, supra note 88, at 204.


\footnote{111} 1999 GOVERNMENT REPORT, supra note 49, at 2. In 1997, Daewoo had issued 12 trillion won ($8 billion) worth of commercial paper. \textit{Id}.


\footnote{113} KOH, supra note 48, at 2.

\footnote{114} The entire bond market later paralyzed when Daewoo went into default, and while sizable, commercial bank exposure to Daewoo corporate bonds was not as significant. Jin-
In July 1998, after months of delay, the government finally acted to stem the hemorrhaging conglomerate. Regulators restricted financial institutions from holding more than 5% of the commercial paper of a conglomerate. In October, a similar restriction followed for corporate bonds when banks and insurance companies were subject to a 5% holding limit per conglomerate, while investment trusts were subject to a 15% limit. Although Daewoo had been in discussion with the regulators about its financing woes since June 1998, it did not—or could not—prepare for such austerity measures. The caps on debt severed the financing lifeline that had been sustaining the group. To aggravate matters, Chairman Kim was suddenly hospitalized in November 1998.

In December 1998, the government attempted to broker a controversial “big deal” between Samsung Group and Daewoo Group in which troubled Samsung Motors would be swapped in exchange for Daewoo Electronics. The government believed that encouraging Daewoo Motor and Samsung Motors to merge could revive the ailing companies through synergy and economies of scale. Policymakers also believed this could force Daewoo to focus its efforts on the automobile industry. Daewoo meanwhile hoped to extract major concessions from the government to consummate the deal, but negotiations collapsed when Samsung withdrew from the talks.

Twelve months after the Asian financial crisis erupted, Daewoo made its first serious attempt at restructuring in late December 1998 when it entered into a Financial Structure Improvement Covenant with its creditor banks. Daewoo agreed to downsize fifty-one companies into ten core entities that would focus on trade and construction, automobiles, heavy industries, and finance and services. These efforts, however, were inadequate and overdue, and failed to yield substantive results. In

Bae Choi, Financial Crisis in Korea and the Restructuring, 18 KYUNG SUNG UNIV. BUS. & ECON. RES. 21, 21 (2002).


Lee, supra note 20, at 171–72.

KOH, supra note 48, at 2.


DAEWOO SUICIDE, supra note 12, at 108.

This plan apparently failed after Samsung allegedly received documents from a disgruntled former Daewoo Electronics manager that detailed over 4 trillion won ($2.86 billion) in accounting fraud. DAEWOO SUICIDE, supra note 12, at 181.

Choi, supra note 114, at 31.
September 1998, Kim even became the chairman of the FKI, the powerful business organization led by chaebols, yet FKI’s influence did little to help Daewoo’s reorganization.

In July 1999, Kim then announced that he would relinquish 1.3 trillion won ($1.08 billion) of his personal equity in Daewoo companies. His final proposal to salvage the conglomerate involved the breaking up of the conglomerate and selling off its companies with only the automobile company remaining. In return, Kim demanded over 10 trillion won ($8.3 billion) in the form of stock, real estate, and other assets to be used as the last injection to reorganize the group. A year had already elapsed since the government curtailed its financing and began close supervision of the group. Yet, the Financial Supervisory Service (“FSS”) approved the rollover of 6 trillion won ($5 billion) of short-term commercial paper for six months and 4 trillion won ($3.3 billion) in additional funding. The government, to no avail, tried to sustain the beleaguered conglomerate. Weeks later in August, twelve main companies of Daewoo proceeded into court receivership workout procedures. Representative directors submitted their resignations on November 1, 1999 and shortly thereafter Kim left Korea to begin his life as a fugitive.

E. Accounting Fraud and the British Finance Corporation

While pursuing its expansion strategy through excessive borrowing, Daewoo chose to commit an unprecedented fraud, particularly by manipulating its overseas accounts. Many chaebols shared the legacy of accounting opacity, but what distinguished Daewoo was its scale, its manner, and how it remained undetected. The “biggest accounting fraud in history” occurred as Daewoo’s companies inflated assets by a total 22.9 trillion won ($19.1 billion). Daewoo Corp., Daewoo Motor, and Daewoo

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125 Instead of being injected into business activities and reorganization, some of these funds were allegedly used to compensate unpaid employee wages. Kim & Song, supra note 84, at 682.
126 Yet, this only delayed the company’s sale on potentially more beneficial terms. See Stephanie Strom, Skepticism over Korean Reform; After Daewoo Intervention, Is There the Will for Austerity?, N.Y. TIMES, July 30, 1999, at C1.
128 Id.
129 See generally French, supra note 103.
130 Kraar, supra note 1, at 103. See generally Ward, supra note 3; Press Release, Securities and Futures Comm’n, Daewoo-gye-yeol 12-sa-e dae-han gam-sa-bo-go-seo teuk-byeol-gam-ri-gyeol-gwa mit jo-chi [Special Audit Results of Audit Reports of 12 Daewoo
Electronics together accounted for 90% of the conglomerate’s impaired capital. In perpetrating the fraud, Daewoo Corp., which was responsible for 14.6 trillion won ($12.2 billion) in fraud, used its trading and management departments and its accounts in London. In 1997, for example, it deflated assets by 10.1 trillion won ($6.7 billion) and liabilities by over 22.9 trillion won ($15.3 billion), and inflated equity by over 12.8 trillion won ($8.53 billion) to conceal 10.1 trillion won ($6.73 billion) in impaired capital. This transpired while net losses for the company climbed from 11.8 trillion won ($7.87 billion) in 1997 to 12.1 trillion won ($8.64 billion) in 1998.

On the domestic side, most of the fraud stemmed from reduction of debts, manipulation of export returns, and utilization of affiliates. Some of the largest violations involved 15 trillion won ($12.5 billion) in off-balance sheet liabilities. Related-party transactions were also used for “asset swaps among Daewoo subsidiaries at exaggerated values.” Stronger affiliates would prop up weaker companies by purchasing overvalued assets above market prices. Furthermore, scam subsidiaries were used to skirt accounting rules. Financial companies such as Seoul Investment Trust Management (“SITM”) played a key role in the transactions.

To a greater degree, Daewoo mobilized its overseas financial network.

Unlike the FSC’s preliminary audit of Daewoo, the final SFC 2000 Report only contains a skeletal account of the accounting fraud and does not contain information as to how assets were inflated or debt underreported. The SFC’s final figures also did not include approximately 20 trillion won ($16.7 billion) that was considered accounting fraud in the FSC’s 1999 report. The SFC claimed they excluded this amount because the FSC’s 1999 report had applied the Corporate Accounting Standards too strictly. Yet, the size of the discrepancy still remains puzzling.

Daewoo Corp. had impaired capital of 14.6 trillion won ($12 billion) whereas Daewoo Motor and Daewoo Electronics accounted for another 8.4 trillion won ($7 billion). 1999 GOVERNMENT REPORT, supra note 49, at 6.

Judgment of July 24, 2001, 2001 Gohab 171 (Seoul Dist. Court), at 13. In 1998, the window-dressing continued in a similar manner as assets were deflated by over 0.77 trillion won ($0.55 billion), liabilities were deflated by over 13.4 trillion won ($9.6 billion), and equity was inflated by over 14.2 trillion won ($10 billion) to cover 10.3 trillion won ($7.4 billion) in impaired capital. Id. at 19.

SFC 2000 Report, supra note 130, at 4. Other violations involved 4 trillion won ($3.33 billion) of non-performing loans, 3 trillion won ($2.5 billion) of false inventories, and 1 trillion won ($0.83 billion) in false research and development expenses. DAEWOO SUICIDE, supra note 12, at 160.

Lee, supra note 20, at 162.

In 1998 and 1999, SITM, for example, used up to 38% of its funds to support Daewoo affiliates and purchased 2.9 trillion won ($2.42 billion) of bonds and commercial paper issued by various Daewoo affiliates, particularly when they were among the riskiest. Lee, supra note 20, at 154. Although SITM was not technically a Daewoo subsidiary, it was under Daewoo’s control since the late 1980s. Id. at 178 n.3.
The primary vehicle for the overseas fraud involved an entity called the British Finance Corporation ("BFC"). Located in London, five people in the finance department of Daewoo Corp. oversaw its secretive business. The BFC’s intricate accounts acted as the nerve center for most of the conglomerate’s financial machinations. What began as a construction account was later commingled with trading accounts. The BFC later grew to an amalgamation of thirty-seven foreign accounts. By 1996, annual borrowings from the BFC accounts totaled between $6 billion and $7 billion. Toward the end in August 1999, the accounts reportedly amounted to over $7.69 billion.

The BFC and overseas affiliates were employed in a variety of ways. Foreign subsidiaries, for example, transferred funds borrowed from foreign banks to the BFC. This circumvented Korean foreign exchange laws and skirted reporting requirements. In addition, companies with questionable credits issued new stock that overseas financial institutions would acquire, technically as equity investments. The equities would then be secured through redemption agreements with other affiliates. The affiliates would be obligated to repurchase the equity at a given price plus interest, if it failed to reach a certain price level. In essence, the equity investment operated like a loan guaranteed by an affiliate. The scheme allowed Daewoo to avoid prudential regulations that governed chaebol borrowing in foreign currencies. Funds that should have been recorded as debts were improperly recorded as equities.

When overseas business operations declined and more pressing debts...
from overseas entities emerged, receivables from exports that should have been credited to domestic affiliates were instead diverted to BFC accounts.\(^{147}\) Foreign debts held priority over domestic obligations.\(^{148}\) Overseas interest payments to foreign financial institutions alone amounted to $2.49 billion in 1999.\(^{149}\) Pressure from the BFC exacerbated the financial state of Daewoo's domestic companies. Later when foreign debts could no longer be met, the BFC-related paper companies were used to construct falsified bills of lading, commercial invoices, and packing lists to defraud Korean banks.\(^{150}\) Daewoo commingled real commercial documents with falsified ones to sustain the deception.\(^{151}\) BFC personnel, meanwhile, worked under utmost secrecy.\(^{152}\)

Despite the BFC's meticulous records, the whereabouts of approximately $753 million remains unknown.\(^{153}\) Speculation abounds that this money was used as corporate slush funds for political lobbying purposes. Others believe that Woo Choong Kim and senior managers siphoned off these funds for personal enrichment.\(^{154}\) In 2006, a court in fact held that a special "KC (King of Chairman)" account established among the BFC accounts was used for personal expenses of Chairman Kim and his family.\(^{155}\)

Overall, operation of the BFC accounts contravened several key laws in Korea. First, executives violated accounting laws.\(^{156}\) Through the BFC, they did not record or consolidate approximately 5 to 8 trillion won ($4.17 to 6.7 billion) per year of off-balance sheet liabilities between 1996 and 1999.\(^{157}\) Second, executives violated the law prohibiting "hiding of

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\(^{147}\) Id. at 48.

\(^{148}\) Id. at 49–50.

\(^{149}\) DAEWOO SUICIDE, supra note 12, at 164.

\(^{150}\) 2001 No 2063, at 42.

\(^{151}\) Given the extensive amount of bills of exchanges discounted, bank officers had difficulty in detecting the fraud. Id. at 43.

\(^{152}\) The court held that this was an incriminating behavior which shows they knew they were committing improper acts. Id. at 47–49.

\(^{153}\) DAEWOO SUICIDE, supra note 12, at 165.


\(^{155}\) 2005 Gohab 588, at 51; see infra Part III.A.


\(^{157}\) DAEWOO SUICIDE, supra note 12, at 163–64.
personal property overseas" without appropriate disclosure. They asserted that they had not violated the law, because the BFC accounts were not concealed for any illicit purpose and were set up solely to repay company debts. They repaid foreign loans with funds obtained by selling debts to local banks and investment management companies such as SITM. Courts rejected the argument because disclosure laws applied irrespective of an intention to repatriate missing funds later. The law required accurate reporting so that authorities had sufficient information to make policy judgments. Finally, the BFC accounts violated Korean foreign currency laws. None of the accounts received official approval by the Ministry of Finance and Economy ("MOFE") as required under foreign exchange regulations. Not only did Daewoo executives transfer funds out of the country to cover BFC's debt without government permission, they also fabricated documents to conceal such transfers.

III. INEFFECTUAL INTERNAL CORPORATE GOVERNANCE

Daewoo's misjudgments and accounting troubles serve as a reminder of the catastrophic cost of neglecting good corporate governance. Weak internal corporate governance in particular was a common feature for many chaebol conglomerates leading up to the financial crisis. Internal corporate governance structures established under Korean corporate law did not function to check and balance controlling shareholder mismanagement. Representative directors, boards, statutory auditors, and shareholders alike did not act as effective monitors. Subsequently, internal corporate governance has improved significantly through legal reforms combined with an effective enforcement regime.

A. Controlling Shareholder's Imperial Control

As with most chaebol heads, Daewoo's founder and controlling shareholder, Woo Choong Kim, reigned in an imperial fashion. He

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158 Aggravated Punishment Act, art. 4, ¶ 1 (S. Korea); see Judgment of July 8, 2004, 2002 Do 661 (Supreme Court).
159 2001 Gohab 171, at 44.
160 See DAEEWOO SUICIDE, supra note 12, at 70–71.
161 Judgment of Feb. 14, 1989, 88 Do 2211 (Supreme Court); Judgment of June 21, 1988, 88 Do 551 (Supreme Court); 2001 Gohab 171, at 45; 2001 No 2063, at 48–49.
162 On appeal, the High Court and the Supreme Court both affirmed the lower court's judgment. 2001 No 2063, at 45; 2002 Do 7262, at 10–11.
164 By creating fictitious import transactions, Daewoo transferred funds as payments to its paper companies abroad, who in turn sent the money to a BFC account. 2001 Gohab 171, at 23.
165 This contrasts with the U.S. companies where the entrenched inside managers tend to
operated the conglomerate with total command, unchecked and unsupervised. He pressed the campaign to expand internationally, particularly in the crucial period leading up to and during the Asian financial crisis. The crisis exposed the weakness of the concentrated governance structure when his judgment faltered. Single-handedly, he was able to drive the conglomerate to perpetrate the largest accounting fraud in world history. Although Daewoo’s business was run with an international focus, Kim’s dominance of internal corporate governance fell far short of global standards.

Kim held the formal title of “Daewoo Group Chairman.” As the head of the conglomerate, he acted as the de facto chairman of the boards of all Daewoo companies. He conducted all the major decision-making of the conglomerate through the Group Chairman’s Office that consisted of some 100 personnel conscripted from each affiliate. Serving as his personal secretariat, the Chairman’s Office oversaw senior personnel decisions, financing decisions, and business strategies. Representative directors and board members, for example, were not nominated by boards or through annual general shareholder meetings, but through the Chairman’s Office at the end of the year. This happened weeks before annual shareholder meetings that rubber-stamped approval in any event. Kim wielded “absolute influence over the careers” of the executives. Similarly, the Chairman’s Office maintained exclusive control over operation of the BFC. The concentration of power in the Chairman’s Office therefore allowed Kim to order executives to commit the accounting fraud. Such

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167 Serving as a de facto director (as opposed to a formal director) also allowed the chairman to escape liability in a derivative suit filed by minority shareholders. *Kim*, *supra* note 105. Legally, he served as the registered Representative Director of Daewoo Corp., Daewoo Heavy Industries, and Daewoo Motor at the time of the crisis.


172 2001 Gohab 171, at 8; 2001 No. 1022, at 9 (noting that one of the defendants to the accounting fraud committed the crime by following an order by Chairman Kim, which was
abuse of power had existed in the past, but has worsened due to a changing of the guard at the conglomerate’s senior levels. Originally, Kim surrounded himself with a host of key advisors who had been with him from the early years in the 1960s and 1970s. They had grown together with the conglomerate, many having been personally recruited from other companies by Kim. Similar to or even older than Kim in age, many were also alumni of the same schools. Hence, they could be blunt with Kim when necessary and act as informal checks and balances. In the early 1990s, however, a generational change began when these original executives retired. The replacements, who rose through the rigid corporate hierarchy as career Daewoo employees, could not as easily confront the legendary founder, especially when the crisis unfolded. Chairman Kim was able to control the conglomerate through a distorted and tenuous ownership structure. In April 1997, Kim and his family members, as controlling shareholders, only owned on average 6.1% of the shares in the major companies within the Daewoo Group. Daewoo companies apparently did not seek equity financing due to concerns that this might dilute Kim’s weak ownership position. Kim maintained control through affiliated companies that on average cross-owned 31.2% of each other’s shares and treasury shares that accounted for an additional 1%. Combined with his family ownership, he then could control on average 38.3% of the shares. Hence, while labeled a concentrated ownership system, Daewoo and other chaebols also exhibited attributes more associated with dispersed ownership systems, such as exaggerated accounting. The low stock price of Daewoo companies reflected not only lack of profitability, but also concerns
surrounding the distorted ownership structure.

Notwithstanding his imperial position, Kim did make many exemplary decisions. First, Kim declared when he founded Daewoo that he would not transfer the reins of corporate control to any of his family members. He believed his successor should be a professional manager chosen based on merit. He trained managers and delegated authority to chief executives accordingly. Subsequently, Kim withdrew all his relatives from executive positions throughout the conglomerate. His anti-nepotistic succession plan and management philosophy distinguished him from other chaebol heads who viewed chaebols as personal possessions subject to dynastic succession. To them, the interests of shareholders and stakeholders to have the most competent managers leading the company or the possibility that an heir might be unqualified were secondary issues. Hereditary entitlement to control was considered an established fact, even for publicly listed companies. Although he displayed an unwillingness to relinquish control until it was too late, Kim’s professional approach was a novelty. Unfortunately, Daewoo’s collapse denied him the opportunity to fulfill this pledge that would have had a tremendous impact on the corporate environment of Korea.

Second, in 1980 Kim donated over 20 billion won ($22.2 million) to

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180 Aguilar & Cho, supra note 2, at 6 (“Daewoo considered itself to have gone much further than any other large Korean firm in developing professional management . . . .”); see Sang-Gyun Nam, Daewoo-geu-rup 40-daee hu-gye-ja deung-jang-seol pa-da [Daewoo Group: Rumors Rife of a 40-Year-Old Successor], WEEKLY CHOSUN, Sept. 10, 1989, at 24 (discussing a list of executives who were considered as possible successors to Kim).

181 Korea’s Successors, supra note 179, at 18. One of Kim’s older brothers did serve as president of a Daewoo affiliate from 1976 to 1981 and then later as president of Ajou University, a school owned by the Daewoo Educational Foundation, after a distinguished career at another leading university. Another brother acquired a Daewoo company and went independent. Only Kim’s wife, who managed the Hilton Hotel, and Kim’s youngest brother served in Daewoo for a substantial period of time. Id.; see also Moon-Soon Kim, supra note 175, at 14.

182 In 1969, Yuhan Corporation founder Ilhan Yu became what is considered the first major corporate leader not to transfer control of his company to any of his heirs. Jae-Rok Park, Yu-il-han-ei wi-up-gua gye-seung-bal-geon [Yu Ilhan’s Achievement and Continuous Development], in YU-IL-HAN YEON-GU 253, 264–66 (1994). No modern-day examples could be found of non-hereditary inheritance of control in a leading chaebol. Cases of siblings or son-in-laws succeeding have existed, while, other than wives succeeding their husbands on occasion, female heirs assuming control has seldom occurred. Ju-Young Kim, Huel-yeun-e ui-han Kyong-young-kwon-seung-gae-wa Ga-jok-gi-up-ui Kyong-young-sung-gwa [Hereditary Inheritance of Control and Achievement of Family-Controlled Corporations], 31 CG REVIEW (2007), http://www.cgs.or.kr/review/0703/hot_issue.asp.
the non-profit Daewoo Foundation that he had established in 1978. The donation consisted of the bulk of his Daewoo Corp. shares that amounted to 17.5 billion won ($19.4 million). The foundation’s mandate provided for it to engage in public interest activities, primarily by conducting social welfare programs. It established hospitals, supported museums, constructed low-income housing projects, and supported academic research. Ostensibly, Kim established the foundation as a philanthropic effort to repatriate his wealth back to society.

Third, Kim and his senior executives did not engage in widespread plundering. Exhaustive investigations by prosecutors, regulators, creditors, and investors have uncovered only evidence of relatively small-scale misappropriation. This contrasted with many other chaebols where personal enrichment by controlling shareholders and executives played a direct role in their collapses. The secretive BFC funds, for example, were allegedly used only to help the conglomerate. Kim loyalists also argue that gross accounting and loan frauds were committed for Daewoo and not for personal benefit.

Critics, however, hold a more cynical view toward the donations, suggesting that they served ulterior purposes. At the time, the move allowed Kim to avoid a crackdown by the authoritarian government by preempting a threat to restrict his control. The façade of a non-profit organization also allowed him to maintain control over the group while shielding his involvement. In October 1993, for example, compared to

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183 Daewoo-geu-rup Gim-u-jung-hoe-jang sa-jae 200-eok sa-hoe-hwan-won [Daewoo Group Chairman Woo-Choong Kim Returns to Society 20 Billion Won ($22.2 million) in Personal Property], CHOSUN ILBO, Aug. 30, 1980, at 1. Initially called the Daewoo Cultural Welfare Foundation, the name was changed to the Daewoo Foundation in October 1980, when Kim donated an additional 20 billion won ($22.2 million) of assets for the expressed purpose of developing and promoting basic academic studies. Moon-Soon Kim, supra note 175, at 13-15.

184 Moon-Soon Kim, supra note 175, at 13–14.


186 DAEWOO SUICIDE, supra note 12, at 26–27. In contrast, the heads of many other chaebols that collapsed during the financial crisis were often found guilty of considerable embezzlement and expropriation. During Kim’s main trial, the court found evidence of embezzlement of approximately $100 million mainly through the BFC accounts. 2005 Gohap 588, at 99.

187 2005 Gohap 588, at 96–98.

188 DAEWOO SUICIDE, supra note 12, at 207–08. Kim’s relatively limited personal expropriation has served as one reason why he continues to generate allegiance from former Daewoo managers. Furthermore, Daewoo allegedly did not engage in real estate speculation like other chaebols and apparently was also the first major chaebol to start hiring and retaining married female employees. Kim, supra note 107, at 170. Daewoo labor union workers and other victims nevertheless hold Kim highly culpable. See infra Part IV.D.

190 Clifford, supra note 31, at 63.
other foundations established by the top thirty chaebols, the Daewoo Foundation owned the highest percentage of shares. In 1990, it held 11.42% of Daewoo Corp., 2.6% of Daewoo Heavy Industries, and 4.3% of Daewoo Investment Finance. Initially, it operated as the de facto holding company of the conglomerate. The foundation also acted as a tax shelter against personal inheritance taxes, a loophole used by many chaebol foundations. In fact, after the tax laws were amended, the foundation reduced its stake in Daewoo Corp. from over 10% to 5.81% in August 1993. Finally, any support that the foundation enlisted from the listed sister companies would have diluted Kim’s philanthropic intentions behind the foundation.

Suspicions persist that Kim and his insiders reaped substantial private benefits of control. First, allegedly over $753 million from the secretive BFC accounts remain unaccounted for, even after a comprehensive audit by the regulators. These funds could have been personally misused. In the May 2006 decision, the Seoul District Court in fact held that Kim embezzled over $116 million from a special BFC account. Kim’s family used these funds for personal investments, artwork purchases, and real estate acquisitions. Similarly, the Korea Deposit Insurance Corporation (“KDIC”) brought a civil action on behalf of the creditors related to $2.5 million in donations to Harvard University where Kim’s son was attending, and 19 billion won ($15.8 million) to Ajou University. Both donations involved use of company funds for seemingly personal purposes without

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191 Gong-ik-beop-in gye-yeol-sa ju-sik so-yu/Daewoo-jae-dan 1,275 eok choe-go [Non-Profit Foundation Affiliates’ Stocks Possession/Daewoo Foundation’s 127.5 Billion Won is the Largest], HANKYOREH, Oct. 6, 1993, at 7.

192 Hyun-Man Shin, Jo-sei-hweo-pi gweong-yeong-gwon an-jeon-e-jun gyeo-nyang [Targeted as Tax Shelter and Means to Safely Transfer Control], HANKYOREH, Nov. 20, 1990, at 4. By December 1997, the Daewoo Foundation owned 4.5% of Daewoo Corp., 3.1% of Daewoo Electronics, and 2.9% of Daewoo Heavy Industries, and Kim and his family owned 7.1% of Daewoo Heavy Industries. Daewoo Corp. later emerged as the real de facto holding company with its 37% ownership in Daewoo Motor and its 29.1% ownership of Daewoo Heavy Industries. CHANG, supra note 82, at 305.


195 See generally Shin, supra note 192.

196 DAEWOO SUICIDE, supra note 12, at 165. One preliminary assessment even claimed that $4 billion of Daewoo’s money could not be accounted for; see Peter Cordingley & Laxmi Nakarmi, In Search of Daewoo’s Kim, ASIAWEEK, Feb. 16, 2001.

197 2005 Gohab 588, at 55, 57. $44.3 million of the BFC funds were redirected to a Hong Kong paper company that served as a front for Kim. Id. at 51–52; Cheong-Mo Yoo, Daewoo Founder Kim’s Concealed Assets Worth W140 Bil. Uncovered, KOREA HERALD, Nov. 9, 2001 at 13.
board approval. Secondly, confidants, relatives, or pseudo-Daewoo affiliates allegedly held most of Kim's personal assets by proxy. By concealing such funds under third party names, Kim could thwart claims by creditors. These assets conceivably could have originated from the expropriated funds.

B. Ceremonial Directors, Representative Directors, and Statutory Auditors

Daewoo's boards of directors, representative directors, and statutory auditors failed to understand and fulfill their roles as fiduciaries. They did not act to stem the primary conflict that arose out of the controlling shareholders taking advantage of non-controlling shareholders, stakeholders, and others. As legal institutions established under corporate law they should have acted as internal counterweights to the domineering authority of the controlling shareholder. Instead, they maintained a passive existence due to historical legacies, weaknesses in the law, and a misguided understanding of their purpose.

Generally, Daewoo's directors, representative directors, and auditors suffered the same problems that plagued most Korean companies. In practice, boards did not formally function in a legal sense. Boards did not even hold official meetings. Upon receiving instructions from the conglomerate's Chairman's Office, the office of planning of each affiliate would draft fictional board minutes tailored accordingly. Minutes would be "approved by the board" with personal seals of all the directors that the offices of planning kept under their care. At best, directors could provide

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200 Korean companies faced a different agency problem from the standard Berle and Means challenge in dispersed ownership countries that focused on the quandary surrounding entrenched inside managers taking advantage of their position to the detriment of shareholders. ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 139-40 (1933).

input through the representative director who would then relay such advice to the chairman.

The internal supervisory structure, also, remained weak because at the time companies did not distinguish between directors and officers, and had no outside directors. The director position served as the highest possible rung on the corporate ladder for an executive as senior officers were promoted to become directors. Combining the two together into a unitary position weakened their ability to act as checks and balances against each other, and more importantly, over the controlling shareholder. In addition, Korean companies as a general matter did not have any non-executive, outside directors until 1998.\textsuperscript{202}

A more serious problem was that directors and auditors were not answerable to non-controlling shareholders or other stakeholders in any meaningful way, and did not understand their obligations. Shareholder litigation, particularly derivative actions, did not exist until 1997.\textsuperscript{203} The lack of civil legal actions meant that fundamental obligations such as fiduciary duty remained as unapplied, theoretical exercises. Directors could not develop an understanding or appreciation of fiduciary duties to shareholders because no one was ever held accountable for violating them.\textsuperscript{204} The chance of executives being held legally responsible was so low that director and officer liability insurance did not exist.\textsuperscript{205}

Lack of accountability to shareholders at large, therefore, left them subject to the dictates of the controlling shareholder. In case of a conflict, directors and auditors had little incentive to defy the wishes of the controlling shareholder and act on behalf of the interests of faceless and silent non-controlling shareholders. Controlling shareholders, on the other hand, made sure to reward loyal directors, executives, and statutory auditors. After retirement, the controlling shareholders bestowed an array of benefits on these retirees—hiring them as consultants, using them as

\textsuperscript{202} Daewoo did elect 25% of its board as outside directors in all of its affiliates starting from 1998, even though this was not required before 1999. Tae-Ho Kwon, \textit{Kim-woo-choong-hoe-jang (ju) Daewoo-dong 3-got dae-pyo} [Woo Choong Kim, Representative Director of Daewoo Corp. and 3 Other Companies], HANKYOREH, Feb. 27, 1998. Listed companies were first required to have at least one outside director on their boards beginning in 1998 and 25% of their boards starting from 1999. Korea Stock Exchange, Securities Listing Regulations, art. 48-5 (amended Feb. 14, 1998); Kim, \textit{supra} note 68, at 279 n.18.

\textsuperscript{203} Kim, \textit{supra} note 68, at 281.


suppliers, or giving them outsourcing contracts or transitional support.\textsuperscript{206} Having spent an average of twenty years of their lives to rise to senior positions, these directors, executives, and statutory auditors had no motivation to be "unfaithful" to the chairman, lose these benefits, and be ostracized from one of their most important social circles.

The defense strategies of the former Daewoo executives in their criminal trials revealed how they did not understand their duties or responsibilities.\textsuperscript{207} They argued that they merely followed Chairman Kim's directions as obedient subordinates. They could not question his command, particularly when they received direct instructions to commit accounting frauds.\textsuperscript{208} Furthermore, they committed accounting violations for the conglomerate, because companies had to repay recurring debts. They suggested that their actions should thus be justified, because they did not personally gain from the fraud or expropriate company funds.\textsuperscript{209} Under this flawed reasoning, they perpetrated their financial crimes without guilty consciences. Regardless of whether they personally benefited or whether Kim was a dominating figure, they failed to appreciate their duty to prevent the fraud. In the end, they allowed Daewoo to inflict "enormous damage upon the Korean people and the national economy."\textsuperscript{210} Furthermore, contrary to their belief, they did derive personal benefit because they would "not lose the chairman's favor" and could "maintain their positions."\textsuperscript{211}

The ability of Daewoo directors might have been affected more than other conglomerates, because so many hailed from a particular school—Kyunggi High School—which was considered Korea's elite secondary school and required a separate entrance examination until 1973.\textsuperscript{212} As a


\textsuperscript{207} Fourteen executives were later found guilty for charges that revolved around accounting fraud, loan fraud, foreign currency violations, and hiding assets overseas. See infra Part IV.D.

\textsuperscript{208} 2001 Gohab 171, at 8.

\textsuperscript{209} Contrary to other failed chaebols, investigations of Daewoo have not revealed that its executives engaged in widespread personal misappropriation. The Public Fund Misconduct Joint Oversight Team reported only one case of malfeasance involving an executive who was indicted for using 950 million won ($791,700) in company funds to bribe government officials and politicians to move the company's headquarters to a different city. PUBLIC FUND MISCONDUCT JOINT OVERSIGHT TEAM, GONG-JEOK-JA-GEUM-BI-RI JUNG-GAN-SU-SAGEOEL-GWA [PUBLIC FUND MISCONDUCT INTERMEDIARY INVESTIGATION RESULTS] 3 (2002) [hereinafter PUBLIC FUND MISCONDUCT RESULTS].

\textsuperscript{210} 2001 Gohab 171, 132.

\textsuperscript{211} Id. at 53; 2001 No 2063, at 79; see infra Part IV.D.

\textsuperscript{212} Nam, supra note 180, at 25; Hou Yoon, Pang-pang-i 1-gi-neun dong-mun-hui-do mot-na-gat-so-yo [First Generation of Students Who Entered Without an Examination Could Not
Kyunggi graduate, Kim surrounded himself with an inordinate number of its alumni. In Confucian Korea, high school ties constitute a powerful bond that often forms the basis of a lifelong, vertical social relationship. Senior alumni traditionally have considerable authority over junior alumni. The old, schoolboy ties further consolidated the hierarchy in the upper echelons of management and weakened checks and balances. Daewoo directors themselves believed that school background was a much more important factor in being chosen as a director compared to directors at other chaebols. Furthermore, in the late 1980s and early 1990s, Daewoo underwent a generational change where many original executives who were senior Kyongi graduates to Kim were replaced by more junior ones. As mentioned previously, the junior alumni that succeeded lacked the same standing to counterweigh the legendary, domineering chairman.

C. Investor Passivity

Daewoo’s shareholders could not have been more passive in overseeing managerial decisions. They did not raise questions, request information, attend shareholders’ meetings, engage in litigation, or meet with management. Curiously, foreign institutional investors with considerable equity positions also remained complacent bystanders. Despite their sophistication, they neglected governance-related action like everyone else. They did not seek board representation, accountability, or transparency, and failed to act as diligent monitors to curb fraudulent activities. Many factors, such as legal restrictions and inherent apathy problems contributed to the investor passivity. After the meltdown, the restitution process has finally made shareholders more active participants.

One problem for Daewoo shareholders was that they could not easily exercise their rights. Even after some of the most egregious corporate
governance problems came to light, they did not exercise their legal rights or take action. For example, when the presidential slush fund scandal revealed in 1995 that 140 billion won ($155 million) of Daewoo’s money was used to bribe two former presidents, no legal actions—let alone complaints—ensued.\textsuperscript{219} One problem was that the regulatory framework set a prohibitively high minimum holding requirements for most shareholder rights such as standing for derivative actions or inspection rights.\textsuperscript{220} Without whistle-blowing by insiders or common law procedures such as discovery, shareholders also lacked the means to obtain information needed to question or challenge the management. Shareholders only brought civil actions against directors and controlling shareholders when they could use information obtained through regulatory actions or criminal prosecutions.

Shareholder representation through voting likewise faced many restrictions. Institutional investors, for example, could only exercise their votes through shadow-voting under which they had to split their voting rights for agenda items, which effectively neutralized their participation.\textsuperscript{221} Shareholders’ meetings were also manipulated to deter shareholders from raising issues. Companies colluded to hold annual general meetings on the same day at the same time of the year to prevent active shareholders from participating.\textsuperscript{222} Shareholders’ meetings when convened lasted no more than ten minutes and proceeded according to the scripts predetermined by the company. Agenda items such as approval of accounting statements and election of directors and auditors proceeded perfunctorily without discussion.\textsuperscript{223}

In this environment, investors, both domestic and foreign, behaved as though monitoring costs were too high to have merit. Foreign investors acted no differently even though they owned on average 9.5\% of the top five Daewoo companies that committed the largest amount of accounting fraud.\textsuperscript{224} When coupled with traditional collective action problems, the “Wall Street rule” of sell-and-move-on prevailed when companies reported bad news or managers violated their duties or abused their powers. At the

\textsuperscript{219} Kim & Kim, supra note 71, at 567–68.
\textsuperscript{220} Kim, supra note 68, at 281.
\textsuperscript{221} Id.
\textsuperscript{222} In 2003, for example, 71.5\% of the companies with accounting years ending in December listed on the Korean Stock Exchange held their annual shareholders’ meetings on three particular days in March 2003. 2003 JU-JU-CHONG-HOE-IL-JEONG-HYEON-HWANG [STATUS OF ANNUAL SHAREHOLDERS’ MEETING DAYS], Korea Stock Exchange (on file with author).
\textsuperscript{223} Kim, supra note 68, at 283–84.
\textsuperscript{224} In 1998, for example, foreigners owned 10.3\% of Daewoo Corp., 1.7\% of Daewoo Motor, 7.8\% of Daewoo Securities, 12.6\% of Daewoo Electronics, and 14.9\% of Daewoo Heavy Industries. Korean Information Service, KISLine Korea Company Information (on file with author).
same time, equity investment, particularly on the retail side, proceeded on an exceptionally short-term basis. Trading turnovers of Korean investors remained considerably high. A vicious cycle developed, because the more short-term the ownership, the more economically impractical monitoring became.

Only after Daewoo’s breakup have the investors—together with banks, creditors, suppliers, and former employees—brought a host of legal actions against Daewoo companies, managers, and accountants. In May 1999, the Peoples Solidarity for Participatory Democracy (“PSPD”), Korea’s leading shareholder activist group, filed the first major civil action against Woo Choong Kim and senior executives, claiming 24 billion won ($20 million) in damages. Apparently, over forty cases seeking a total of 600 billion won ($500 million) were pending in Korean courts against Daewoo at one point. On September 12, 2002, shareholders even won their first civil action arising out of claims related to Daewoo’s accounting fraud when Kim, former managers of Daewoo Electronics, its accounting firm Anjin, and various accountants were held liable for 360 million won ($300,000) for releasing false audit reports.

During this process, shareholders have been assessed contributory fault for their negligence. For example, in a 2005 case involving Daewoo Electronics, the court found the investors partially at fault while allocating different degrees of accountabilities between accountants and directors.

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225 Kim, supra note 68, at 283.
226 Korea’s short-term trading might be high due to the lack of capital gains tax for small, retail investors.
227 Until 2004, however, most of the Daewoo litigation was suspended due to a constitutional challenge to the Constitutional Court regarding the false disclosure provision. Judgment of Dec. 18, 2003, 2002 Heonga 23 (Constitutional Court).
228 The action followed on the heels of a June 1998 KFTC sanction against Daewoo for improperly supporting its affiliates. After five years of litigation, the Seoul District Court dismissed the claims against Kim that he should be responsible for the illegal support of Daewoo Corp. on the grounds that he was not a director of the company involved and he did not participate or tacitly agree to the support. Judgment of Nov. 18, 2004, 99 Gahap 47193 (Seoul Dist. Court), at 6–7, 31; Jae-Chul Lee, Kim-woo-choong-ssi Daewoo-gye-yeol-sa bu-dang-ji-won chaek-im-eop-da [Woo Choong Kim Not Liable for Improper Support of Daewoo Affiliates], SEOUL NEWS, Nov. 19, 2004. For a recent description of PSPD’s activities see Curtis Milhaupt, Nonprofit Organizations as Investor Protection: Economic Theory and Evidence from East Asia, 29 YALE J. INT’L L. 169 (2005).
231 2000 Gahap 78858, at 44–46. Three-hundred and sixty investors brought a separate action on October 24, 2000 against the managers of Daewoo Electronics, Daewoo Heavy
Of 14.5 billion won ($12.1 million) in liability for fraudulent audit reports, shareholders were found contributorily negligent for 10%, while accountants were held 30% liable, directors directly involved in the accounting fraud, including Kim, 40%, whereas “non-financial” directors and outside directors, only 20%. Previously in a 2004 case, shareholders prevailed against Daewoo Heavy Industries executives, but had their claim reduced due to contributory negligence as well. In this case, the court found executives liable for 970 million won ($808,300) for falsifying accounting records in the company’s 1997 and 1998 annual reports that investors relied upon, but capped their liability to 40% of the claim. The court found shareholders negligent in investing in such a risky stock of a company that had widely known financial difficulties. Therefore, while shareholders have made strides in seeking restitutions, they have also been reproached for their own failures.

D. Compliant Commercial Banks and Silent Debt-holders

Lenders and purchasers of debt also bear responsibility for their lack of corporate governance oversight. They did not engage in governance-related activities such as demanding transparent accounting, ensuring lending discipline, or electing representatives to the borrower’s boards. Sophisticated foreign banks and debt holders similarly failed to utilize their

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232 Daewoo Electronics and its executives were found liable under Articles 186-5 and Article 14 of the Securities Exchange Act (S. Korea) while the accountants were found liable under Article 197 of the Securities Exchange Act (S. Korea) and Article 17, Paragraph 2 of the External Audit Act (S. Korea).

233 2000 Gahap 78858, at 45–46. While reducing their relative liabilities, the court rejected the defense of outside directors that they should not be assessed any responsibility because they were non-standing board members and they fulfilled their “duty of due diligence” by relying upon the external auditors. Id. at 23–24.


236 2000 Gahap 78865, at 17–18. Investors that purchased the company’s stock after October 1998, when serious accounting problems were widely reported in the media, were excluded outright. Id. at 13. In two others cases, however, different district courts found that liability should extend until November 1, 1999 when the government issued a formal report. Sang-Hee Kim, Bun-sik-hoe-gye tu-ja-ja-son-sil sil-sa-gyeol-gwa bal-pyo-ttae-kaa-ji [Investor Losses Due to Accounting Fraud Until Announcement of Due Diligence], YONHAP NEWS, Sept. 10, 2004; Yeong-Jae Moon, Daewoo-jeon-ja so-ae-ju-ju, bun-sik-hoe-gye son-bae-so il-bu-seung-so [Daewoo Electronics Minority Shareholders Partially Win Accounting Fraud Compensation Action], EDAILY, Jan. 13, 2005.
lending position to access financial information and monitor board decisions. Commercial stakeholders neglected these opportunities, and instead suffered from a combination of a historical legacy of contentment, over-reliance upon the government, dishonest practices, and their own governance problems.

The ineffectiveness of domestic banks in corporate governance can be explained by multiple factors. First, historically, the banks followed the direction of policymakers who used administrative guidance to make sure that chaebols received policy loans for government-led projects. Under Korea's main bank system, each commercial bank acted as primary lender of a particular chaebol.237 Financial crisis spread partially because banks unquestioningly followed the policymakers' guidance and did not adhere to adequate lending discipline over the chaebols even as their corporate debt to equity ratios reached as high as 500%.238 Korea First Bank ("KFB"), Daewoo's main bank and Korea's oldest bank, was at the center of the storm during the Asian financial crisis.239 KFB not only was a poor monitor of Daewoo but also failed to detect its financial problems and did nothing to stem its own credit problems.240 KFB's own incapability should have received more attention, because it served as the main bank for a string of chaebols that went bankrupt right before the crisis.241

Foreign commercial lenders differed little from domestic banks in their lax lending practices.242 They did nothing to ensure Daewoo's accounting transparency or proper corporate governance. They also displayed the same imprudence as domestic banks in mismanaging the risk exposure to Daewoo.243 Unlike domestic banks, however, foreign commercial lenders

238 JWA, supra note 237, at 28.
239 Daewoo's woes contributed to KFB collapse that led to a government takeover. See Kim, supra note 68, at 320-22.
240 At one point, Daewoo even attempted to seek control of KFB. Lee, supra note 20, at 164. Largely to limit chaebol ownership, the banking laws did not allow an individual investor to own more than 4% of a bank. Banking Act, Law No. 6691 of 2002, art. 2 (S. Korea).
242 Interestingly, Japanese banks were not exposed to the Daewoo failure, having ended their loans in February 1996. DAEWOO SUICIDE, supra note 12, at 154.
could not blame administrative guidance, political pressure, or lack of financial expertise for their questionable lending decisions. In making the $5.1 billion foreign currency loans, foreign banks generally admitted that they had lent to Daewoo because they believed the loans were backed by “Korea Inc.”244 In the end, over 140 banks from 100 countries around the world lent to Daewoo affiliates.245 Foreign banks cannot escape the responsibility for failing to act as competent monitors. Given their sophistication, they are just as culpable for their passivity, improper risk assessment, and over-committing depositor money to high-risk Daewoo loans.

Another problem facing domestic banks was their own ineffective governance.246 Selection of bank executives, for example, was a politically-charged affair determined by a confluence of bureaucratic in-fighting, party politics, and chaebol lobbying.247 Vulnerability to external pressure compromised independence, and government’s policy interests usually prevailed. Hence, boards of these banks did not operate under the market-oriented principles that focus on profits, shareholder value, and risk assessment. The banks followed the too-big-to-fail myth and recklessly extended credit under government directions.248 When financial crisis hit, banks stood paralyzed without direction from the regulators. In the worst cases, bank officers received commercial kickbacks from corporate borrowers when granting loans not only on generous terms but also in undeserving, high-risk situations.249 Furthermore, the banks themselves operated under suspect accounting standards, particularly in their generous treatment of non-performing loans.250

Finally, in the case of Daewoo, banks argued that they were deceived by concealed accounting frauds. They claimed that they did not know the seriousness of the financial situation due to the sophisticated international

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244 Id. at 104. The loans were primarily made to Daewoo Corp., Daewoo Motor, Daewoo Electronics, and Daewoo Heavy Industries. 1999 GOVERNMENT REPORT, supra note 49, at 17.

245 Let the Market Fix Daewoo, BUS. WK., Aug. 16, 1999, at 56. Another account provided that 200 foreign credit banks were due $9.94 billion. DAEWOO SUICIDE, supra note 12, at 97. See also Chong-Tae Kim, Desperate Measures Might Be Too Little, Too Late, BUS. KOREA, Aug. 1, 1999, at 14 (“Daewoo has US$7.7 billion in overseas debt, although that has been reduced by US$1.8 billion since August 1998. Of the total, the group has guaranteed the redemption of US$1.4 billion.”).

246 Kyung Suh Park, Corporate Governance of Commercial Banks in Korea, in REFORMS AND INNOVATIONS IN BANK MANAGEMENT 220–26 (Duk-Hoon Lee & Gill-Chin Lee eds., 2004).

247 Id. at 220–23.


249 Kim, supra note 68, at 320–22.

250 Park, supra note 246, at 220–23.
machinations. For example, KFB’s senior managers testified that they first detected problems with Daewoo’s balance sheet only in 1997. Nevertheless, commercial banks appear to have disregarded the warning signs on Daewoo. As early as 1988, for example, commercial banks charged Daewoo the highest rates among major conglomerates due to its risks. One court found substantial contributory negligence against a bank for a delinquent loan to Daewoo Motor. In this case, despite the accounting fraud, the bank shared 80% of the fault while executives of Daewoo Motor were held liable for only 6 billion won ($5 million) out of a 40 billion won ($33.3 million) loan. The court stressed that the bank knew that “accounting fraud was rampant among Korean chaebols” and that they “knew that Daewoo Motor’s financial condition was not good.”

As with shareholders, only after the meltdown did the banks and their insurers finally become active in seeking accountability. First, they pursued legal actions for repayment of delinquent loans made possible through accounting fraud. In October 2004, for instance, Woori Bank won a 2 billion won ($2 million) judgment against senior executives of Daewoo Electronics. Defendants were found liable for accounting misrepresentations that led to 25.8 billion won ($25.8 million) in losses for the bank. As mentioned above, in November 2004, Woori Bank also

251 In this criminal case, three Daewoo executives were convicted for defrauding KFB into issuing a letter of credit for $150 million in 1994. The court sentenced the defendants to prison terms ranging from two and one half years to three years. Ung-Seok Ko, ‘Sin-yong-jang sa-gi-dae-chul’ jeon Daewoo-im-won-deul sil-hyeong [Letter of Credit Lending Fraud: Prison Term for Former Daewoo Executives], YONHAP NEWS, June 21, 2002; Judgment of June 21, 2002 (Seoul Dist. Court) (unpublished); DAEWOO SUICIDE, supra note 12, at 21.

252 Kim & Bae, supra note 88, at 12.


255 Kim, supra note 254 (quoting from the court’s decision).

256 Article 401 of the Commercial Code (S. Korea) provided the basis for attributing director liability to third parties such as the bank.

257 Judgment of Nov. 6, 2003, 2002 Gahap 82073 (Seoul Dist. Court). The Seoul High Court upheld the liability and also held that the statute of limitations against executives and accountants involved should be ten years and not three years as provided in the Civil Code (S. Korea). Sang-Hee Kim, Bun-sik-hoe-gye dae-chul-pi-hae son-bae so-myoeol-si-hyo 10-nyeon [Ten Year Statute of Limitations for Compensation Claim for Loan Losses from Accounting Fraud], YONHAP NEWS, Oct. 28, 2004; Yu-Jin Shin, I-sa-deul-i im-mu-reul geeul-ri-han gyeol-gwa je-3-ja-ga son-hae bwat-da-myoeol so-myoeol-si-hyo-neun 10-nyeon [Statute of Limitations Ten Years If Director’s Neglect of Duties Causes Damage to Third Party], LAW TIMES, Nov. 7, 2003.

258 The court allowed the case to proceed when it held that the statute of limitations for case brought under Article 401 of the Commercial Code was ten years and not three years as
won a 6 billion won ($5 million) judgment against five Daewoo Motor executives including Woo Choong Kim. Similarly, in July 2001, the Korea Export Insurance Corporation ("KEIC") won a 250 billion won ($208 million) civil judgment against Woo Choong Kim for guarantees he made on various bank loans to Daewoo.

In addition to commercial banks, debt-holders such as investments trusts, guaranty companies, merchant banks, and insurance companies collectively neglected corporate governance of Daewoo despite acquiring or guaranteeing 19.7 trillion won ($14.1 billion) of Daewoo debt in 1998 at exorbitant interest rates. The investment trust industry held 18.6 trillion won ($15.5 billion) in Daewoo debt, almost one-third of the conglomerate’s total debt. Merchant banks further held 2.9 trillion won ($2.4 billion), life insurance companies 1.1 trillion won ($0.92 billion), and securities companies 1.1 trillion won ($0.92 billion). Seoul Guaranty Insurance, for instance, guaranteed a substantial amount of Daewoo’s bond offerings and was held responsible for over 7.2 trillion won ($6 billion), amounting to 12% of Daewoo’s total debt. Three hundred and sixty eight foreign institutions also owned at least $4.1 billion of Daewoo debt instruments.

provided under the Civil Code. The defense argued that statute of limitations would have expired on November 2002, three years after the due diligence audit of Daewoo Electronics in November 1992. This decision cleared the way for many other creditors in their actions against Daewoo. The outside director, however, escaped liability because the court found that he did not commit gross negligence after applying a different standard. Hyun-Gyu Shin, *Bun-sik-hoe-gye pi-hae son-bae-so si-hyo 10-nuen [10-year Statute of Limitation for Accounting Fraud Damages Suits]*, MAEIL BUS. NEWSPAPER, Oct. 28, 2004.


Of this debt, 11.3 trillion won ($8.1 billion) consisted of corporate bonds and 8.4 trillion won ($6 billion) consisted of commercial papers, in addition to 8.4 trillion won ($5.6) in bonds and 3.6 trillion won ($2.4) in commercial papers that already existed at the end of 1997. 1999 GOVERNMENT REPORT, *supra* note 49, at 2; Kim & Song, *supra* note 84, at 682–83; Kim & Bae, *supra* note 88, at 11.

Commercial bank exposure was relatively larger when compared to investment trust exposure. The government subsequently took over two of the largest investment trusts, Korea Investment Trust and Daehan Investment Trust, who held most of the debt. 1999 GOVERNMENT REPORT, *supra* note 49, at 4.

PUB. FUNDS MGMT. COMM’N, PUBLIC FUNDS MANAGEMENT WHITE PAPER 157–59 (2004) [hereinafter PUBLIC FUNDS MANAGEMENT WHITE PAPER]. Through its legal mandate,
Debt holders and guarantors, domestic and foreign, suffered devastating financial losses, partially due to their own neglect. Despite their holdings, these financial institutions did nothing in terms of Daewoo's corporate governance. They passively acquired Daewoo debts in part as a reckless attempt to increase their own profit margins and in part due to implicit guarantees and pressure from the Korean government.\textsuperscript{266} Daewoo bonds and commercial papers had long been discounted at substantially higher rates than other chaebols due to their risks.\textsuperscript{267} Many clung to the same moral hazard that despite the risks the government would never let Daewoo go under.\textsuperscript{268} Furthermore, in early 1999, regulators "threatened and pleaded with" investment trusts to rollover Daewoo bonds that reached maturity. Regulators resorted to arm-twisting because they believed they had to prevent a dangerous run on Daewoo that could threaten the bond market.\textsuperscript{269} Daewoo's overwhelming debt compounded the government's inability to respond decisively.

Since the financial crisis, banks, investment trusts and other debt holders related to Daewoo have undergone extensive overhauls to improve their performance, transparency, and independence. Many have been taken over by multinational entities. Government intervention that compromised independence of financial institutions has been curtailed. Many institutions have finally begun to operate with rigor under market-oriented principles, particularly regarding their business practices.\textsuperscript{270} As with equity investors, however, these foreign and domestic lenders and debt holders did not play a role in corporate governance oversight while Daewoo headed toward a debacle.\textsuperscript{271}

KAMCO spent over 12.7 trillion won ($10.6 billion) to acquire 35.6 trillion won ($29.7 billion) of Daewoo's non-performing loans, of which over $4 billion consisted of non-performing loans from foreign creditors. \textsc{Korea Asset Mgmt. Corp., Non-Performing Loan Restructuring Fund White Paper} 343–45 (2004).

\textsuperscript{266} \textit{Daewoo Suicide, supra} note 12, at 72.


\textsuperscript{268} Lee, \textit{supra} note 20, at 165.

\textsuperscript{269} \textit{Daewoo Suicide, supra} note 12, at 73.


\textsuperscript{271} Daehan Life Insurance, among others, later pursued legal actions to seek damages from Daewoo executives stemming from the accounting fraud related to the debt. Baek-Gi Kim, "Bun-sik-hoe-gye-ro son-hae ip-eot-da" Kim-woo-choong jeon Daewoo-hoe-jang deung sang-dae Daehan-saeng-myeong 28-eok son-bae-so-je-gi [Daehan Life 2.8 Billion Won ($2.3 Million) Compensation Suit Against Woo Choong Kim Daewoo Chairman and
E. Labor Limitations

As interested stakeholders, Daewoo’s labor union and employees had the incentive to function as active monitors. Yet, they did not operate as a check to prevent wrongdoings by the senior management. An assortment of factors ranging from board structure to weak ownership, lack of information, and ineffective organization limited them from operating more vigorously. It was only after the collapse that the labor representative took action to bring Woo Choong Kim to justice.

First, despite Korea’s civil law background that could trace its origins to German law, formal labor participation on the boards of public companies never existed under Korean corporate law.272 Korea adhered to a one-tiered board structure without codetermination. Labor union focused on improving working environment, job stability, and wage increases. Contentious management and labor relations did not translate into policy discussion on securing board representation such as a two-tiered board.273 In the case of Daewoo, due to its history of growth through acquisition, it had the “highest possibility of labour [sic] conflict arising out of [its] restructuring efforts” because laborers from the acquired company feared prospects of downsizing.274 Bitter, prolonged strikes plagued Daewoo companies.275 The labor union, however, did not extract concessions related to corporate governance that might have constrained abuses by the controlling shareholder and executives.

Second, the labor union and employees were weak owners. As with most Korean companies, Daewoo companies had employment stock ownership plans (“ESOP”) but they did not function as a monitoring force.276 The average holding of ESOPs in Daewoo companies remained

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273 Kim, supra note 68, at 278.


275 According to the Ministry of Labor, between 1995 and 1998, Daewoo had sixteen labor strikes, second only to Hyundai. Id. at 31.

276 Korea started to adopt ESOPs in 1974, but ownership remained marginal. Capital Markets Promotion Act, Law No. 2046 of 1968, art. 6 (repealed by Law No. 5254 of 1997) (S. Korea). In 1958, before this law was even adopted, Yuhan Corporation became the first company to issue ESOP-type shares to its employees as a means of improving the welfare of employees and labor-management relations. In 2001, the legal framework for ESOPs was overhauled. See Employees Welfare Fundamental Act, Law No. 6510 of 2001, arts. 27–42 (as amended Law No. 7159 of 2004) (S. Korea); Seong-Chan Park, Sin-ur-ri-sa-ju-je-do-ui ju-yo nae-yong-gwa hyang-hu gae-seon yeon-gu sa-hang [Central Aspects of the New ESOP System and Future Research Issues Toward Its Improvement], 4 GOOD CORP. GOVERNANCE
small and averaged only 0.61% at the end of 1997. ESOPs also remained captive to company interests, with company insiders dominating their operations. Moreover, under the regulatory structure governing ESOPs, plan participants had to either delegate their voting rights to the head of the ESOP or exercise the vote themselves. Collective action problems similar to those of minority shareholders led plan participants to do neither. The head of the ESOP would thus shadow-vote the shares of the plan. No evidence could be found that Daewoo’s ESOP operated any differently. In the end, the value of Daewoo ESOPs plummeted, leaving thousands of employees without their retirement savings.

Other factors affected the ability of the labor union and employees to become more active monitors. They had limited access to information. As witnessed through the operation of the BFC, for example, only a handful of senior managers knew of the concealed accounts. Furthermore, under the hierarchical decision-making structure, employees rarely challenged their superiors. A strong culture of group loyalty prevailed. No one raised issues or engaged in whistle-blowing. Even after the dismantlement of the conglomerate, former Daewoo employees have not written exposés on what led to the meltdown.

IV. WHERE WERE THE GATEKEEPERS AND PUBLIC GUARDIANS?

As with all corporate scandals, a flurry of finger-pointing ensued as everyone sought to pin the blame for Daewoo’s meltdown. Ultimately, no single entity can be faulted for the fiasco. Not only did the standard internal corporate governance break down, but also a comprehensive breakdown occurred at the external level. In particular, gatekeepers, both domestic and foreign, did not fulfill their respective functions. Accounting firms, credit rating agencies, securities analysts, and investment banks did not do

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Rev. 2 (2002).

277 Kim, supra note 78, at 24.
279 Park, supra note 276.
281 One exception is Woo-Il Kim, the former Daewoo senior executive in charge of restructuring of the entire group. Kim & Song, supra note 84, at 658–705. He also wrote a semi-fictional account of the conglomerate: Woo-Il Kim, Mun-eo-neun wae ju-geon-neun-ga? [Why Did the Octopus Die?] (2005).
enough to prevent the mismanagement and fraud. In addition, public sector guardians did not establish the legal discipline necessary for corporate governance to operate effectively. Regulators, prosecutors, judges, and tax authorities left corporate malfeasance uncorrected. Their failure to discharge their public functions compounded the catastrophe.

What gatekeepers and guardians knew regarding Daewoo's dire financial situation remains unclear. Given the enormity of the fraud it is hard to believe that they did not have an inkling of problems. Courts have reached conflicting conclusions. Some courts have held that financial institutions and investment banks did not know the extent of troubles because it was concealed by accounting frauds.\textsuperscript{283} According to these cases, they would not have extended loans and would not have acquired or guaranteed bonds had they known the extremity of the situation. Other courts, however, reached contrary conclusions by finding sufficient awareness among certain parties, particularly accountants, and allocated contributory negligence.\textsuperscript{284}

This Part assesses the roles of gatekeepers and guardians in the Daewoo crisis. It specifically focuses on accounting firms, investment banks, analysts, credit agencies, regulators, prosecutors, and the court system. It surveys how they maintained a neglectful attitude toward chaebols with regard to transparency and accountability. The Part concludes with a discussion on the changes that have strengthened external corporate governance. New enforcement mechanisms in particular have developed outside of the existing legal framework.

A. Accounting Oversight: Chong-Un and San Tong

The external auditor's inability to provide proper auditing and accounting contributed directly to Daewoo's financial scandal. This occurred even though Daewoo's accountants were associated with global accounting firms with stellar reputations. When Daewoo collapsed, local firms bore the brunt of the blame while global partners conveniently escaped scrutiny.\textsuperscript{285} Daewoo's accounting troubles were dismissed as Korean problems that arose out of a combination of ineffective regulatory

\textsuperscript{283} 2001 No 2063, at 37. The Supreme Court affirmed that banks and issuers did not know the extent of the accounting fraud. 2002 Do 7262, at 6–10.

\textsuperscript{284} Kim, \textit{supra} note 257.

\textsuperscript{285} Chong-Un served as the Korean affiliate of Horwath International, whereas San Tong was long-associated with KPMG. John Burton, \textit{Partners Endorse Proposed Merger}, \textit{Fin. Times}, Mar. 20, 2002, at 40 (stating that KPMG was only "indirectly affected by the 1999 collapse of Daewoo ... "). Initially, Daewoo sought to differentiate itself as a leader in accounting transparency. In 1976, for instance, Daewoo became one of Korea's first companies to follow international accounting standards when it hired Peat, Marwick & Mitchell to start producing consolidated financial statements according to the U.S. accounting standards. Aguilar & Cho, \textit{supra} note 2, at 10.
supervision, a lack of accountability, conflicts of interest, and weak self-regulation. In the aftermath, unprecedented liability helped to establish compliance in the industry.

Daewoo's primary accounting firms, Chong-Un Accounting Corporation ("Chong-Un") and San Tong Accounting Corporation ("San Tong"), both leading accounting firms at the time, were associated with Horwarth International and KPMG, respectively. Chong-Un served as external auditor for Daewoo Precision, Kyungnam Metal, and Daewoo Telecommunications. San Tong, Korea's second largest accounting firm at one point, served as lead accountant for several major Daewoo companies for over ten years. Market participants, domestic and foreign, relied upon the global reputations of Horwarth and KPMG when doing business with Daewoo. Horwarth and KPMG in turn extracted benefits for lending their credibility. Yet, despite being aware of international auditing and accounting standards, they did not adequately transplant these practices into their local partners.

Although accounting firms claimed that they did not know of the accounting fraud because of Daewoo's concealment, many other factors contributed to their inability to function properly. First, tolerance for accounting misstatements and opaqueness prevailed. Industrial policy of the Korean government tacitly condoned inflation of financials under the pretext that companies needed financing to grow. Accounting firms believed that Korean government would act as a safety net and resolve any serious problems. At the same time, regulatory, civil, and criminal accountability of the auditing industry remained practically non-existent. Accounting firms were not held responsible to shareholders, creditors, or other stakeholders at large due to weak private and public enforcement. Failure to comply with accounting or auditing standards such as omitting important matters from audit reports or making false statements led to criminal sanctions or civil liability in theory only.

From a practical standpoint, accounting firms believed they could not

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286 Park, supra note 260.
288 San Tong served as the lead accountant for Daewoo Corp. in addition to Diners Club Korea, Daewoo Heavy Industries, Daewoo Motor Sales, and Ssangyong Motor. At its peak, San Tong had over 700 accountants. DAEWOO SUICIDE, supra note 12, at 270.
290 Id. at 25. See supra Parts II.C & III.E.
291 Yeong-Bae Kim, Daewoo 23-jo-won, kko-ri jap-hin-da [Daewoo's 23 Trillion won ($19.2 Billion), Tail is Caught], HANKYOREH, July 26, 2000, at 21.
292 External Audit Act, art. 17 (S. Korea); Securities Exchange Act, art. 197 (S. Korea).
afford to offend the chaebols, their dominant revenue-generating clients.293 A structural dependency developed, because firms relied on chaebol business that pressured them into overlooking questionable accounting treatments.294 In August 1996, for example, a group of accountants from San Tong apparently debated on whether to publicly expose Daewoo’s accounting problems.295 In another instance, San Tong was apparently informed that issuance of over 15 trillion won ($16.7 billion) in commercial paper was based upon false records.296 In both cases, business as usual prevailed and nothing was done regarding the frauds. Finally, larger accounting firms developed their own moral hazard because they presumed that their stature made them so important they could not be allowed to fail.

After Daewoo’s accounting fraud came to light, regulators sent shockwaves throughout the industry when they suspended Chong-Un and San Tong from receiving new businesses, which were the most severe sanctions in history.297 Chong-Un received a one-month suspension of all new businesses during March and April of 1999, while the FSS issued a twelve-month suspension of new businesses against San Tong.298 In addition, two San Tong accountants received the ultimate punishment when their licenses were terminated. Prior to this, even after a string of accounting scandals in 1997 involving Kia Motor, Asia Motor, and the Hanbo Group—all companies audited by Chong-Un or San Tong—only individual accountants were suspended and not the firms.299 The sanctions served as death knells for the firms, which collapsed shortly thereafter.

293 San Tong, for example, generated over 15 billion won ($12.5 million) in annual revenue from Daewoo companies. Mol-rak-han gong-ryong-gi-eop 'En-ron-Daewoo' eotteon cha-i it-na [Failed Dinosaur Companies: Differences between Enron and Daewoo], MAEIL Bus. NEWSPAPER, Jan. 25, 2002.
294 Kim, supra note 291.
295 DAEWOO SUICIDE, supra note 12, 145–52.
296 Daewoo executives suggested that San Tong should disclose that it did not discover the fraudulent statements, but the firm allegedly did not heed the advice. Kim & Song, supra note 84, at 682–83.
297 DAEWOO SUICIDE, supra note 12, at 158.
299 The discipline provisions can be found at Certified Public Accountants Act, Law No. 1797 of 1966 art. 48 (as amended Law No. 7796 of 2005) (S. Korea); Implementing Decree, Decree No. 18352 of 2004 (as amended Law No. 19958 of 2007) art. 30 (S. Korea). Aside from paying their entire 1997 auditing fees from the respective companies into the Compensation Fund, Chong-Un and San Tong were just restricted from auditing Kia Motor and Asia Motor for three years. Chong-Un continued to serve as the primary external auditor of various Daewoo companies for the 1998 accounting year. See infra Part IV.C.
Meanwhile, KPMG and Horwarth avoided any censure while they quietly terminated their relationships.

Accounting firms and accountants have subsequently faced a barrage of legal claims that have helped to establish legal accountability in the industry. KDIC has taken the lead among claimants against the accountants. After announcing that thirty-five accountants from four accounting firms collaborated with Daewoo executives to commit 2.81 trillion won ($2.34 billion) in accounting frauds, KDIC compelled banks to bring civil actions to hold them responsible. Banks that received public funds, such as Cho Hung Bank and Woori Bank, sued the accountants of Daewoo Corp., Daewoo Heavy Industries, Daewoo Motor, and Daewoo Telecom in November and December 2002. Similarly, KDIC’s subsidiary, the Resolution and Finance Corporation (“RFC”), directly commenced civil litigation against San Tong and Ahn Kwon Accounting Corporation (“Ahn Kwon”) for their delinquent audits of Daewoo Corp. and Daewoo Motor in September 2003.

In the process, unlike commercial banks, courts have been more willing to attribute knowledge of and liability for the accounting frauds to the accountants. In one of the first criminal cases, a senior Chong-Un accountant was held to be aware of the accounting fraud at Daewoo Telecom. The court found that the company and the accountant’s

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300 External Audit Act, art. 17 (S. Korea); Securities Exchange Act, art. 197 (S. Korea). In one of the first civil cases ever brought by an investor against the accountants, the Supreme Court held in September 1997 that Chong-Un liable for a delinquent audit of Korea Steel Pipe, a company that collapsed, under the Securities Act and general tort law of the Civil Code that has a ten-year statute of limitations. Judgment of Oct. 22, 1999, 97 Da 26555 (Supreme Court).

301 The firms implicated included Anjin, Ahn Kwon, and San Tong. Daewoo executives were co-defendants in the actions. Daewoo Executives Cause W4.26 Tril. in Losses, KOREA TIMES, Sept. 25, 2002; see infra Part IV.D.

302 Daewoo Executives Cause W4.26 Tril. in Losses, supra note 301; Depositor Protection Act, Law No. 6173 of 2000 art. 21-2 (S. Korea).


305 The Korea Development Bank apparently loaned 554.5 billion won ($396 million) to Daewoo Telecom based upon fraudulent accounting records such as the 1998 Audit Report Chong-Un had approved. The company engaged in 344.6 billion won ($231 million) of accounting fraud in 1997 and 477.9 billion won ($341 million) in 1998. Judgment of Aug.
collusive relationship indicated intimate awareness. The accountant received 470 million won ($392,000) in disgorgement penalties and an eighteen-month sentence that was suspended for three years. In another criminal action, the head of Ahn Kwon received a six-month sentence in prison with a one-year suspension of execution and the firm received a nominal fine of 20 million won ($16,700) for believing Daewoo Motor’s statements and not conducting a proper audit of the company. In civil cases, courts also have assessed knowledge by the accountants of the accounting frauds. In a judgment for Daewoo Electronics investors, for example, one court held that accountants “discovered many facts that indicated possible existence of wrongdoing and errors in the financial statements.”

Through the Daewoo saga, serious accountant and auditor liability has been established for the first time. Enforcement discipline has had a rippling effect because accounting firms finally had a strong disincentive not to relent to corporate pressure to approve misrepresentations. They could now point to the dire consequences of failing to comply with the law. Leading foreign accounting firms, in the meantime, avoided any controversy. The impression remains that all problems were purely local in nature.

B. Investment Banks, Securities Analysts, and Credit Rating Agencies

Reputational intermediaries such as investment banks, analysts, and credit agencies did not provide adequate scrutiny over Daewoo’s decision-making and accounting problems. The extent to which these experts knew about Daewoo’s financial situation, or refrained from knowing, similarly


306 When Chong-Un was ordered to pay additional funds into the Monetary Liability Compensation Fund for its delinquent auditing, at the accountant’s request, Daewoo Telecom apparently paid this charge on the firm’s behalf because they were cooperative in past audits. 2001 Gohab 129, at 6–7; 2001 No 1022, at 7–8.

307 2001 No 1022, at 6, 9, 11. In the lower court, the defendant had been sentenced to two years. 2001 Gohab 129.

308 The weak accounting standards at the time, the accountant’s lack of personal profit, and the financial regulators’ sanction of the accountants were considered mitigating circumstances in the criminal sentencing. Sang-Hee Kim, Daewoo-cha bun-sik-hoe-gye busil-gam-sa, hoe-gye-beop-in jeon-dae-pyo-jip-yu [Former Accounting Firm Head Receives Suspended Sentence for Daewoo Motor Accounting Fraud], YONHAP NEWS, Jan. 28, 2005.

309 The failure to correct the problems or disclose them violated Articles 6 and 8 of the Accounting Auditing Standards. See ACCOUNTING AUDITING STANDARDS (Fin. Supervisory Comm’n 1999) (S. Korea).

310 2000 Gahap 78858, at 34.
lingers as a question. Investment banks underwrote enormous sums of Daewoo securities throughout the financial crisis during 1997 and 1999. Industry securities analysts did not issue serious warnings about the conglomerate until the middle of 1998. Credit agencies maintained investment grade ratings until as late as May 1999. Gatekeepers associated with the most prestigious firms all professed ignorance, claiming they were blinded by Daewoo's financial wizardry. Unlike commercial banks or accountants, legal actions seeking liability against these gatekeepers have not taken place.

As early as 1988, Daewoo raised over $1 billion both in Korea and in international capital markets such as the London-based Euromarkets. Daewoo continued to issue securities domestically and overseas during the 1990s through leading global underwriters. Furthermore, in 1998, during the most critical period of the financial crisis, Daewoo successfully issued 19.7 trillion won ($14.1 billion) in corporate bonds and commercial paper at interest rates ranging from 15% to as high as 25%. Between July and November of 1998, right before the collapse, Daewoo Motor alone issued 1.1 trillion won ($780 million) in bonds.

During the underwriting process, investment banks and securities firms, domestic and foreign, were apparently oblivious to the problems. During the criminal trials against Daewoo executives, courts applied a higher burden of proof and agreed that financial institutions and investment banks did not know the extent of the troubles. Courts held that investment banks would not have acquired or guaranteed Daewoo bonds had they known the extreme financial situation concealed by Daewoo's accounting frauds. In general, under the generous standards of Korea's securities law, underwriters could avoid liability as long as they could prove

313 Chira, supra note 253.
314 See 1999 GOVERNMENT REPORT, supra note 49, at 2; Kim & Song, supra note 84, at 662; Kim & Bae, supra note 88, at 11.
315 2001 No 2063, supra note 139, at 83.
316 Id. at 37. The Supreme Court affirmed that issuers did not know the extent of the accounting fraud. 2002 Do 7262, at 6–10. This generous standard contrasts sharply with the recent multibillion dollar settlements involving underwriters of WorldCom bonds based upon claims that underwriters improperly relied on the lead underwriter and failed to conduct due diligence on their own. Gretchen Morgenson, WorldCom Teaches a Pricey Lesson, N.Y. TIMES, Mar. 13, 2005, at C1; see generally Merritt B. Fox, Shelf Registration, Integrated Disclosure and Underwriter Due Diligence: An Economic Analysis, 70 VA. L. REV. 1005, 1015–25 (1984).
that they engaged in “due diligence.” Due diligence could be established through minimal effort by merely demonstrating reliance upon an accounting firms’ audit reports. Unlike in other countries, Korea has not seen any legal actions against underwriters for failing to conduct proper due diligence.

Some investment banks even helped the chaebol flout the laws by improperly supporting the affiliates. In the case of bond offerings, for example, securities firms affiliated with the conglomerate were restricted from directly underwriting unsecured bonds from related affiliated companies. Regulations existed to prevent securities firms from becoming conduits to unduly support the affiliated companies within the same conglomerate. To circumvent the restriction, a securities firm from one conglomerate colluded together with another securities firm from another conglomerate to underwrite bonds of affiliates from each other’s conglomerates in each other’s names. Hence, bonds issued by Daewoo affiliates would “circulate in the market” through a third-party purchase by a securities firm of another conglomerate; that securities firm would then sell the bonds back to Daewoo Securities.

Securities analysts did not function effectively either. The first official concerns over the state of Daewoo were finally raised in June 1998 when Credit Suisse First Boston (“CSFB”) issued a comprehensive report advising caution (“CSFB Report”). This was seven months after the financial crisis hit Korea. The CSFB Report highlighted that relative to the other ten leading chaebols “Daewoo [stood] out as having extremely high financing needs . . .” CSFB rated Daewoo’s profitability among chaebols as one that “rank[ed] as one of the lowest . . .” It determined that Daewoo had the highest net cross-guarantees at the end of 1997. In particular, CSFB stated that it “continue[d] to be alarmed about Daewoo’s massive guarantees extended to its overseas affiliates.” CSFB assessed that Daewoo was in the worst position in its ability to benefit from restructuring.

319 Morgenson, supra note 316.
320 2001 No 2063, at 40.
321 Id.
322 In March 1997, one highly-regarded analyst did comment on Woo Choong Kim with foresight that “I don’t know how he manages to finance all these projects, given that Daewoo is always short on cash.” Matthew Fletcher & Laxmi Nakarmi, Driving to the World, ASIAWEEK, Mar 21, 1997.
323 YUN & SHIN, supra note 274, at 18.
324 Id. at 21.
325 Id. at 26.
326 Id. at 27.
327 Id. at 40.
Then in October 1998, Nomura issued a report titled, “Alarm Bells Ringing for Daewoo Group” (“Nomura Report”). In essence, the Nomura Report declared that the “king was not wearing any clothes.” Nomura compiled the report in response to the Financial Supervisory Commission’s (“FSC”) decision to impose a limit on the amount of corporate bonds financial institutions could hold. Nomura foresaw that Daewoo would have difficulty withstanding its credit crunch because of its over-reliance on corporate bonds and short-term debts, low market capitalization, and lack of attractive assets. The Nomura Report stated that during the financial crisis Daewoo “survived solely on liquidity procured through bond issuances.” Nomura even anticipated that Daewoo would ultimately threaten local banks with its “unique logic of too big to fail” and that overseas creditors would not be persuaded by it. Nomura went so far as to terminate its coverage of Daewoo Electronics and Daewoo Heavy Industries. One can speculate that it took securities analysts so long to issue warnings because their firms did not want to jeopardize Daewoo’s investment banking business.

Among the reputational intermediaries, credit rating agencies were perhaps the slowest to assess the precarious state of Daewoo’s affairs. They were criticized for reacting to unfolding events instead of acting as warning systems that should have led the market. In particular, leading

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328 Although Daewoo’s risk was noted in Nomura’s June 1998 report, Hanwha and Dong Ah Construction were deemed the main restructuring concerns and not Daewoo; because of this, a “hold” and not “sell” recommendation remained for Daewoo Heavy Industries. Koh, supra note 1, at 1–2.

329 Koh, supra note 48, at 2.

330 Id. at 3.

331 Id. at 2.


333 Rating Agencies, supra note 332, at 68. See also Guillermo Larrain et al., Emerging Market Risk and Sovereign Credit Ratings 7 (OECD Dev. Centre, Working Paper No. 124, 1997) (discussing credit rating agencies’ performance during Mexico’s economic crisis in 1994-95), available at http://lysander.sourceoecd.org /v1=31497774/cl=15/nw=1/rpsv/cgi-bin/wppdf?file=5lgshjv7etc.pdf; Who Rates the Raters?, Economist, Mar. 26, 2005, at 67 (“[H]ow could S&P, Moody’s and Fitch have been so oblivious to Asia’s gathering financial problems in the mid-1990s (only to catch up with repeated downgrades once the problems were widely known)?”).
domestic and foreign credit rating agencies did not downgrade Korea's sovereign ratings or the credit ratings of Daewoo and other chaebols in a timely fashion. In general, however, credit ratings agencies have avoided responsibility and have not faced any significant legal scrutiny for their failures.\(^3\)

Domestic credit rating agencies maintained investment grade ratings for most Daewoo affiliates throughout 1998 and well into 1999. They remained unaffected by warnings issued in the June 1998 CSFB Report and the November 1998 Nomura Report. Only in January and February 1999 did the agencies downgrade local currency credit ratings on Daewoo company bonds such as those of Daewoo Corp., Daewoo Motors, Daewoo Electronics, Daewoo Heavy Industries, Daewoo Securities, and Daewoo Capital from A- to BBB- rating. Ratings dropped from an investment grade of BBB- to speculative grades of BB or BB+ six months later in May and June 1999.\(^3\)

Furthermore, during this time, Korea Investors Service ("KIS") entered into a joint venture with Moody's in August 1998, and Korea Ratings began a business alliance with Fitch in January 1999. International firms provided their reputations to local institutions but did not improve their credit assessment capability in time.

Foreign credit rating agencies only proved marginally more rigorous, although they did not distinguish between Daewoo and other chaebols in terms of foreign currency ratings of bonds issued abroad. Before the crisis occurred, Daewoo Corp. and most other chaebol companies maintained the same investment grade credit ratings of BAA2 from Moody's and BBB- from Standard & Poor's.\(^3\) Foreign currency bonds generally received lower credit ratings due to foreign exchange risk and transaction costs. Then on December 22, 1997, as the financial contagion spread, the agencies simultaneously downgraded sovereign ratings of emerging markets such as Indonesia, Malaysia, Russia, and Korea.\(^3\) The Korean downgrades were the "most dramatic instances of sovereign rating downgrades in the history of sovereign ratings, bar none."\(^3\)

Downgrades of the chaebol corresponded with sovereign rating downgrades. Ratings for major chaebols plunged together two grades each on two consecutive days,
resulting in a total drop of four grades from BBB- to B+. Daewoo was treated no differently. Only after seven months in July 1998, did Daewoo and Hyundai companies receive additional downgrades from B+ to B. Another eight months passed before Standard & Poor’s finally downgraded Daewoo Corp. from B to B- in April 1999. By July 1999, Standard & Poor’s and Fitch IBCA downgraded Daewoo Corp. from B- to CCC rating, which indicated that default was a possibility.

This suggests that both domestic and foreign credit rating agencies did not serve as effective gatekeepers in detecting Daewoo’s problems. They followed a herd mentality by moving together and reacting belatedly. Their inability to assess the creditworthiness of Daewoo and its affiliates in a timely fashion helped lull investors and creditors into a false sense of security. Several factors limited their effectiveness. First, until the financial crisis, most corporate debt of Daewoo consisted of secured bonds and not unsecured debentures. This reduced the need for an active market for credit assessment of bonds. Furthermore, the credit rating agencies faced conflicts of interest when rating corporate bonds. Commercial banks were not only the primary shareholders of credit rating agencies but also owned and guaranteed a substantial amount of the bonds. Negative ratings by an agency could have had a direct impact upon the value of the bank’s bond holdings.

C. FSS, KFTC, and KDIC

In the aftermath of the scandal, Korean policy makers and regulators bore the brunt of condemnation because regulatory oversight malfunctioned and a state of paralyzed indecision followed. Government regulators were the “only actor[s] who could have stopped the Daewoo collapse or at least minimized the cost by intervening swiftly . . . ,” but they did not take

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340 The only distinction was that Daewoo Corp. was initially downgraded three places on December 22, 1997, most likely as a result of its inopportune purchase of Ssangyong Motor. Daewoo Corp. joined the downgrade to a B+ rating with other Korean corporations the next day. Han-guk-dae-gi-up sin-yong-deung-geup a-gik- junkbond’yu-ji/S&P-sa [Korean Large Corporations Maintain ‘Junk bond’ Credit Rating/S&P], MUNHWA ILBO, Feb. 20, 1998, at 3.

341 Fitch IBCA also removed Daewoo Corp. from its “RatingAlert positive” list. Daewoo had been on the list since February 1998. Fitch IBCA Downgrades Daewoo Corp’s Rating, ASIA PULSE, July 21, 1999; Lee, supra note 20, at 168.

342 IM, supra note 267, 46-49.

343 Repeated freedom of information (“FOI”) requests with the FSS for regulatory audits of Daewoo have been denied. These FOI requests are on file with author.
initiative, particularly throughout the critical time of 1998. Together with the policy makers, the regulators suffered from a combination of disincentives for seeking active solutions, overconfidence as the architects of Korea's economic success, and fear of the unknown if they allowed a major chaebol to fail. Lack of regulatory discipline in particular nurtured lax compliance that fostered the mismanagement and fraud. Although not a traditional regulator, the KDIC has emerged as one of the most effective public sector sources of corporate governance discipline following the Daewoo crisis. It has helped generate an enforcement mechanism that operates outside of the statutory corporate law framework and served to establish accountability.

Over the years, warning signs existed for regulators to ascertain the magnitude of Daewoo's troubles. Starting from 1986, for example, the Korea Bankers Association operated a consolidated financial information system. Any regulator or person with access to the system could determine that Daewoo Group's loans from banks amounted to approximately 8 trillion won ($8.9 billion), but that its financial statements stated its borrowing as only 5 trillion won ($5.6 billion). Once again, signs of the conglomerate's problems could have been detected in the mid-1990s. To obtain financing from foreign markets, Daewoo had been among the first chaebols to provide consolidated financial statements in the mid-1970s, but it suddenly stopped providing them in the mid-1990s. Later, other than financial restrictions on its debt, blunt warnings from CSFB and Nomura in 1998 did little to spur further regulatory action. Government did "practically nothing until October 1998 to force Daewoo to reform." As late as November 1998, instead of a warning to protect the unwary, the Minister of Finance and Economy even issued a statement to allay fears over the Nomura report that "there [was] no liquidity crisis in relation to the Daewoo Group." The government began direct restructuring efforts only

344 Lee, supra note 20, at 172.
345 Id. at 173–74.
346 The KDIC's informal role as an enforcement agency can be viewed as an example of the functional convergence taking place in countries with an inefficient legal governance system. See generally Coffee, supra note 10, at 679–82.
347 Kim & Song, supra note 84, at 681.
348 DAEWOO SUICIDE, supra note 12, at 155.
349 Starting in March 1995, Daewoo's senior management actually begun to receive secret quarterly reports on Daewoo's "special borrowing (F-Nego)" that was conducted through false export documents. 2001 Gohab 171, at 22–23.
350 Lee, supra note 20, at 167. The government did curtail bond and commercial paper issuances. See supra Part II.D.
Financial regulators such as the FSS in particular failed to establish legal compliance in the accounting profession. In theory, accounting firms were subject to numerous criminal, civil, and regulatory sanctions. For example, they could be subject to three years of imprisonment or a 30 million won ($25,000) fine for making omissions or false statements in an audit report. Aggravated punishment provisions extended prison terms to a minimum of three years if monetary gains from an accounting fraud exceeded 500 million won ($417,000). Accountants and their firms could have their licenses suspended or terminated. Accountants also had to report wrongdoings or any important facts that indicated violation of laws or their firms' articles of incorporation. Enforcement, however, seldom occurred for non-compliance. Light monetary fines or sanctions were issued even after repeated involvements in accounting frauds.

352 Lee, supra note 20, at 168.
353 External Audit Act, art. 20, ¶ 2 (S. Korea). From 1989 to 1998, the punishment was up to two years of imprisonment or a million won ($833) fine. In 2003, a new provision was added that required up to five years of imprisonment or a 30 million won ($25,000) fine if an accounting firm deliberately falsifies, alters, damages, or destroys audit work-paper made in preparation for an audit report. Id. (as amended Law No. 6991 of 2003). In 2003, the Securities Exchange Act was amended to punish accountants for falsely recording important facts in the required disclosure documents, annual reports, semiannual reports, or quarterly reports with up to five years of imprisonment or a 30 million won ($25,000) fine. Securities Exchange Act, art. 207-3. (as amended Law No. 7025 of 2003). For non-listed stock companies, the Commercial Code provides that a person who improperly records or negligently reports accounting statements would be subject to a penalty of only up to 5 million won ($4,120). Commercial Code, art. 635, ¶ 1, no. 9 (S. Korea). Although now repealed, from 2001 until 2003, the Corporate Reorganization Promotion Act provided that if a company does not properly operate an internal accounting system or if one forges, alters, or damages accounting records, then it would be subject to up to five years of imprisonment or a thirty million won ($25,000) fine. Corporate Reorganization Promotion Act, art. 37 (as amended Law No. 6991 of 2003) (S. Korea).
354 Aggravated Punishment Act, art. 3 (S. Korea). Gains of over 5 billion won ($4.17 million) call for a minimum imprisonment of five years. Id.
355 See supra Part IV.A.
356 External Audit Act, art. 10 (S. Korea). No application of this provision has been found.
357 For example, in Hanbo Steel's 6.6 trillion won ($4.7 billion) accounting fraud in 1997, its auditor Chong-Un received minimal sanctions. When Kia Motor and Asia Motors collapsed shortly thereafter, their auditors Chong-Un and San Tong, again received minor sanctions even though they have failed to discover over 3.3 trillion won ($2.36 billion) and 1.56 trillion won ($1.12 billion) of accounting frauds, respectively, committed over a seven-year period starting from 1991. The Securities Supervisory Service ("SSS") restricted Chong-Un and San Tong from auditing only Kia Motor and Asia Motors for three years and just required them to pay their entire 1997 auditing fees from those companies to the Liability Compensation Fund. Three accountants from Chong-Un and San Tong were suspended for six to nine months, but not the firms themselves. The SSS also restricted Chong-Un from being a designated auditor for one year for the five leading companies that
Coupled with the lure of business and intense competition, weak enforcement left accountants exposed to the client companies’ demands for aggressive accounting with only their own sense of ethics to constrain them. When grave signs of Daewoo’s accounting troubles surfaced in 1997, financial regulators did not respond. In May 1997, as part of its General Audit Review of listed companies, for example, the Securities Supervisory Service (“SSS”) found that the 1996 annual reports of Daewoo Corp. and Daewoo Precision Industries, Ltd. underreported substantial amounts of assets and liabilities. Furthermore, during the review, regulators discovered over 299 billion won ($322 million) in off-balance sheet liabilities of Daewoo Corp. Nothing happened other than a request for correction. The SSS’s General Audit Review the next year in May 1998 discovered that Daewoo Telecom did not record 261 billion won ($186 million) of liabilities on its accounting books. As in the past, only minor corrective action followed. Finally, no reaction followed when a whistleblower allegedly told the senior regulators in early 1999 that Daewoo companies had engaged in an accounting fraud of over 30 trillion won ($25 billion). Thus, red flags about Daewoo’s accounting problems were repeatedly disregarded.

In contrast, the KFTC served as one of the more active regulators of

358 While done on a random rotating basis, this was the first general audit of a Daewoo affiliate in three years. Fifty-seven other companies were included as part of this annual general audit. DAEWOO SUICIDE, supra note 12, at 192.

359 Id. at 193.

360 The SSS later tried to marginalize the results of the audit review by claiming that it represented the efforts of one regulator working for six weeks. Yet, if that was the case, then many more wrongdoings may have been unearthed if the SSS had devoted additional resources to the review. Id. at 187–88.


362 DAEWOO SUICIDE, supra note 12, at 184–95. The FSS issued a press release denying such a meeting. Press Release, FSS, Han-kuk-hyang-jae-ue keum-kam-ue, Daewoo-bun-shik 30-jo al-go-do muk-sal jae-ha-ue gih-sa mit kim-woo-il-ssi in-tuh-vu-nae-yong-ue daehan hae-myung [Response to Woo-Il Kim’s Interview and Hankyung’s Article Alleging that FSS Knowingly Ignored Daewoo’s 30 Trillion Won Fraud] (Sept. 24, 2001), available at http://www.fss.or.kr/kor/include/file_download.jsp?path=nws/nbd/\%B4\%EB\%BF\%EC\8\%B8\%B0\%E8\%B0\%A8\%B8\%AE\%C7\%D8\%B8\%ED\%5B9.24\%C7\%D1\%B1\%B9\%B0\%E6\%C1\%A6\%5D.hwp.
Starting in July 1992, the KFTC began to regulate improper support among affiliates of the largest chaebols.\textsuperscript{363} The KFTC gained the new authority to require companies to terminate such support, force them to publish notices of their wrongdoing, and issue fines up to 2\% of sales from the prior year.\textsuperscript{364} In serious cases, the KFTC could refer persons or companies for criminal prosecution, who could then face up to two years of imprisonment or 150 million won ($125,000) in fines.\textsuperscript{365} While the KFTC foresaw the dangers in the weak corporate governance of chaebols, it could not generate the political mandate to effectively monitor them. The KFTC conducted its first real investigation in 1993, but the investigation ended without much consequence. In the end, the KFTC proved unable to curb unreasonable support of subsidiaries before the crisis.

In 1998, the KFTC launched two full-scale investigations against leading chaebols including Daewoo. The investigations focused on unreasonable financial and personnel support, instead of just traditional goods and services.\textsuperscript{366} The KFTC discovered substantial, improper affiliate subsidization, even though companies had been warned that the investigations were pending.\textsuperscript{367} In the case of Daewoo, it found that six companies improperly supported seven affiliates for a total of 461 billion won ($329 million). For example, Daewoo Corp. and Daewoo Heavy Industries provided financial support to affiliates on non-market terms by refraining from collecting account receivables, providing interest-free loans for employees that purchased Daewoo Motor cars, or purchasing bonds.


\textsuperscript{364}Monopoly Regulation and Fair Trade Act, Law No. 7315 of 2004, art. 24-2 (S. Korea). The possible surcharge was raised from 2\% to 5\% in December 1999. \emph{Id.} (as amended Law No. 6043 of 1999).

\textsuperscript{365}\emph{Id.} arts. 67, \& 70. In 2000, the KFTC for the first time referred a company for criminal prosecution. As of April 2000, the top chaebols must get an approval by the board of directors for internal transaction above a certain amount. \emph{Id.} art. 11-2.

\textsuperscript{366}This was based upon a significant revision of the fair trade law in December 1996, just before the financial crisis. \emph{Id.} art. 23, \& 1, no. 7; \textbf{see} KOREAN FAIR TRADE COMM’N, BUDANG-HAN JI-WON-HAENG-WI-UI SIM-SA-JI-CHIM 7-HO [REVIEW GUIDELINES FOR IMPROPER SUPPORT ACTS NO. 7] (1997). Daewoo underwent four investigations from 1998 to 2001 and received three separate fines.

commercial paper, or foreign exchange under unfavorable conditions. Of course, the accounting fraud most likely understated the actual scope of improper support. In the end, the KFTC fined Daewoo a comparatively modest 13.3 billion won ($9.5 million).

Therefore, regulators squandered opportunities to prevent the crisis. They took action only after the collapse. Daewoo’s breakdown led to an exhaustive audit of twelve major companies and discipline for those involved. The Securities and Futures Commission (“SFC”) referred five Daewoo companies and twenty-one executives who had committed more than 500 billion won ($417 million) in accounting frauds and also four partner-level accountants that had audited the companies for criminal

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369 Daewoo requested re-examinations of three investigations but they were all dismissed. In the October 2001 investigation, the KFTC announced how Daewoo used sham affiliates posed as unrelated companies. By dressing themselves as independent unaffiliated companies, sham companies were utilized to avoid KFTC regulations. After a three-week search based upon stock ownership and management control, the KFTC found six sham companies that belonged to the Daewoo Group. Woo Choong Kim controlled these companies through stock owned through Daewoo Corp., other senior managers, dual appointments of directors, and excessive trading and lending. Press Release, Korean Fair Trade Comm’n, Gu dae-gyu-mo-gi-eop-jip-dan ‘Daewoo’ mit ‘Daewoo Corp.’ ui wi-jang-gye-yeo-sa jo-sa-gyeol-gwa [Result of the Investigation of Former Large Company Group ‘Daewoo’ and ‘Daewoo Corp.’s’ Sham Affiliated Companies] (Jan. 25, 2002) (on file with author). Ultimately, the KFTC referred the case for prosecution and in Kim’s criminal trial the court found him guilty for omitting data on 16 sham companies. 2005 Gohab 588, at 56–57.

370 After its fall, a third investigation was held in 1999 that found that Daewoo provided 85.8 billion won ($71.5 million) in unreasonable support to its affiliates, second only to Hyundai. Daewoo received a relatively heavier fine of 13.5 billion won ($11.25 million) for this violation. Finally, the KFTC conducted a fourth investigation in October 2001 upon which a fine of 677 million won ($564,200) was levied against three related companies. Daewoo Corp. was excluded because it was undergoing dissolution. Press Release, Korean Fair Trade Comm’n, Daewoo Construction deung 4 gae-sa-ui bu-dang-nae-bu-geo-rae jo-sa-gyeol-gwa [Result of the Investigation on Improper Internal Transactions of Daewoo Construction and 3 Other Affiliated Companies] (Dec. 29, 2001) (on file with author).

371 Surprisingly, no tax evasion charges have been brought by the tax authorities or prosecutors. One ironic twist has been that Seoul Administrative Court has recently held that the tax authorities must refund excess taxes that were paid as a result of inflated accounting figures. Daewoo Electronics apparently has a similar case pending. I-Seok Oh, Bun-sik-hoe-gye-ro deo naen beop-in-se, dol-ryeo-bat-eul su it-da [Excess Corporate Tax Paid Through Accounting Fraud Can Be Reclaimed], LAW TIMES, Aug. 27, 2004.

372 Starting from December 1999 and lasting until August 2000, the Daewoo Special Audit Team established at the FSS conducted post-mortem audits. SFC 2000 Report, supra note 130, at 2.
prosecution. The SFC also recommended that Chong-Un and San Tong be suspended on the firm level, that three accountants have their registrations revoked, and that nineteen accountants be suspended.

In the aftermath of the crisis, the KDIC has become the most vigorous institution in holding corporate executives, accountants, and financial institutions accountable. Since 2000, the KDIC's mandate required it to reclaim public funds that were injected into financial institutions that became defunct from those responsible. The KDIC regulators pressed for legal actions against executives that were involved with companies and banks that collapsed during the crisis. In the process, the KDIC established functional enforcement of the legal duties of directors, auditors, accountants, and banks outside of the traditional corporate law enforcement framework by holding parties accountable to someone other than the controlling shareholders. The KDIC's efforts contributed in establishing both shareholder and stakeholder oriented enforcement. KDIC acted as a shareholder in holding banking and financial executives liable to their respective institutions. At the same time, the defrauded financial institutions reinforced stakeholder orientated accountability for companies by bringing legal actions against the corporate executives of their borrowers. Unfortunately all of these actions occurred after the fact.

The KDIC's efforts involved a two-stage process. First, it compelled 457 financial institutions to bring a total of 1.5 trillion won ($1.25 billion) in compensatory claims against 8,235 former executives and controlling shareholders for their delinquent management and lending decisions of their financial institutions. The claims added unprecedented legal compliance

373 The five companies were Daewoo Corp., Daewoo Motor, Daewoo Heavy Industries, Daewoo Electronics, and Daewoo Telecom. In addition, nine Daewoo companies were ordered to have specially-designated auditors and twenty-one executives and seven accountants were referred to investigative agencies for further criminal probes. Id. at 4, 6.

374 SFC 2000 Report, supra note 130, at 6; External Audit Act, art. 16 (S. Korea); Certified Public Accountant Act, art. 9 (S. Korea). Another thirty-six accountants received lighter sanctions such as restrictions from auditing and warnings.


376 To protect depositors and investors of banks, securities companies, insurers, and merchant banks, the KDIC injected 107 trillion won ($89.2 billion) of public funds into insolvent financial institutions during the crisis. PUBLIC FUNDS MANAGEMENT WHITE PAPER, supra note 265, at 65.

377 Id. at 154; Commercial Code, Law No. 6545 of 2001, arts. 399, 401-2 (S. Korea). KAMCO lost a High Court case that held that the Adonis Golf Club did not constitute hidden assets of Woo Choong Kim. Act on the Efficient Disposal on Non-Performing Assets of Financial Institutions and the Establishment of Korea Asset Management Corporation [KAMCO Act], Law No. 5371 of 1997 (as amended Law No. 6737 of 2002) (S.
to the financial industry, particularly in pushing lenders to improve their own corporate governance and establish lending discipline. More importantly, in the second stage, the KDIC pressed financial institutions to bring claims directly against the companies that defrauded them in the first place.378 Daewoo’s executives and their accountants were among the first targets.

The KDIC’s special fact-finding team announced in September 2002 that Woo Choong Kim and forty-eight other executives and thirty-five accountants caused 4.26 trillion won ($3.55 billion) in losses to the group’s five affiliates and their creditors.379 The KDIC claimed Daewoo executives manipulated accounting to defraud seventeen creditor banks of 3.81 trillion won ($3.175 billion) between 1995 until 1999. It provisionally seized over 63.2 billion won ($52.7 million) of Kim’s property and requested that creditor banks bring civil actions against Daewoo’s external auditors.380 The KDIC even referred cases of personal enrichment for criminal prosecution.381

Active monitoring by regulators and policy makers such as FSS, KFTC and others could have saved incalculable damage while sparing countless victims. The regulators failed to detect the seriousness of the situation, monitor companies, executives, and accountants, and enforce laws and regulations. The KDIC’s efforts, however, represent a distinctive ex post facto enforcement mechanism that has emerged. It successfully operated outside of the legal framework associated with corporate


378 In April 2005, however, the KDIC lost a decision to reclaim Kim’s hidden assets when the court determined that 220,000 shares rightfully belonged to his daughter and were not his illegally concealed assets. I-Seok Oh, Kim Woo Choong Jeon-Daewoo Group hoe-jang-i ddal-e-ge-jun isu-hwa-hak ju-sik-eun myeong-ui-sin-tak a-nin jeung-yeo-da [Isu Chemical Stock that Former Daewoo Group Chairman Woo Choong Kim Gave to Daughter Was Gift Not Nominal Trust], LAW TIMES, Apr. 13, 2005.


380 Depositor Protection Act, art. 21-2 (S. Korea); see supra Part IV.A.

381 The KDIC referred over sixty-six former chaebol chiefs to criminal prosecution when it discovered evidence of embezzlement or expropriation. The KDIC, for instance, alleged that $44.3 million of the BFC funds were siphoned off to a Hong Kong paper company that served as a front for Woo Choong Kim. These allegations were later confirmed in Kim’s criminal trial. Furthermore, the KDIC alleged that Kim made $2.5 million in donations to Harvard University and 19 billion won ($15.8 million) to Ajou University through company funds and without board approval. These controversial donations came to light when the KDIC brought its civil actions on behalf of Daewoo creditors. Cheong-Mo Yoo, Daewoo Founder Kim’s Concealed Assets Worth W140, KOREA HERALD, Nov. 9, 2001, at 13; see also Hwang, supra note 198.
governance that traditionally revolves around remedies in corporate law and securities law.

D. Prosecutors, Courts, and other Public Guardians

Prosecutors, courts, and other public guardians such as the media remained passive in establishing an effective corporate governance framework. A tacit policy of soft enforcement prevailed in the treatment of white collar crime committed by corporate executives. Whether they were directors, executives, or controlling shareholders, corporate defendants faced criminal discipline or media scrutiny through prosecution, punishment, or public shaming only when companies collapsed. Furthermore, in the rare case of a conviction, Korean presidents have been notoriously generous in granting clemency. This created a lax compliance structure under which the failure to observe corporate governance duties, laws, and regulations became inconsequential events. Complacency toward legal discipline and public sanction for corporate wrongdoing developed from a variety of reasons, such as a socio-cultural legacy of leniency, emphasis on economic growth, lack of training, and improper influence. A dramatic shift toward serious enforcement against corporate defendants and their advisers took place after Daewoo executives received actual prison terms and some of the largest monetary penalties in history.

Overall, an unwritten custom existed that corporate defendants should be granted leniency due to their roles in developing the economy. Corporate executives of the largest companies received the most special status and benefits from soft enforcement. One theory propounds that those of privileged standing, such as chaebol executives, were bestowed preferential treatment as part of the Confucian tradition. Prosecutors and courts also expressed exaggerated concerns that punishing corporate defendants, especially from larger chaebols, would damage the reputation of the company and in turn cause serious economic damage to the country. Chaebol chairmen in particular received the most generous treatment compared to other corporate defendants. When being investigated for serious crimes, for example, prosecutors would accommodate requests to avoid media attention by questioning them in special locations away from the public view, under the rationale that

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382 Nam-bal-deo-neun jeong-ryag sa-myeon [Strategic Pardons are Abused], HANKYOREH, Aug. 7, 1999, at 5.
384 Chan Jin Kim, Korean Attitudes Towards Law, 10 PAC. RIM L. & POL’Y 1, 6 (2000).
385 Hong, supra note 383, at 2; Editorial, Geom-chal-ui bul-gong-seong [The Unfairness of Prosecutors], DONG-A ILBO, June 10, 1995, at 3.
negative media coverage would harm the economy.\textsuperscript{386} Similarly, for many years, prosecutors refrained from prosecuting the corporate bribe-givers and instead focused their efforts on the bribe-takers.\textsuperscript{387}

Courts acted similarly. Even when they found chaebol executives guilty, they routinely commuted their sentences based upon "enormous contributions to the economy."\textsuperscript{388} Actual imprisonment or civil liability hardly occurred. Woo Choong Kim, for instance, was convicted several times, yet he never served prison time until recently. In December 1994, a lower court found him guilty for giving a 200 million won ($222,000) bribe to a former electric company head in relation to an atomic power plant contract.\textsuperscript{389} On appeal, he was only sentenced to eight months of imprisonment with a one-year suspended sentence.\textsuperscript{390} Similarly, in the presidential slush fund trials, Kim and a dozen leading chaebol chairmen were found guilty of contributing over 510 billion won ($638 million) in bribes during the 1980s and early 1990s to two presidents.\textsuperscript{391} All of them received suspended sentences due to their "contributions to the economy."\textsuperscript{392}

Korean presidents reconfirmed the environment of leniency in the enforcement process.\textsuperscript{393} The presidents routinely granted pardons to convicted controlling shareholders and executives of large companies.\textsuperscript{394}


\textsuperscript{387} Hong, supra note 383, at 2.


\textsuperscript{391} Kim paid 140 billion won ($155 million) in bribes for a lucrative submarine contract, among other items. Kim & Kim, supra note 71, at 567–69.

\textsuperscript{392} Id.

\textsuperscript{393} For authority granting power to presidential pardons in Korea, see Amnesty Act, arts. 3, 5, 9, 10, Law No. 2 of 1948 (S. Korea); Republic of Korea Constitution, art. 79, Law No. 1 of 1948 (as amended Oct. 29, 1987).

\textsuperscript{394} In the final days of Dae Jung Kim's lame-duck presidency, for instance, eight executives who received suspended sentences all obtained presidential pardons and special reinstatements. Over a dozen other leading corporate executives who had been found guilty for economic crimes after the financial crisis were also granted amnesty and reinstatements. Myung-Jin Lee, \textit{IMF gwan-ryeon-gi-eop-in dae-pok-sa-myeon jo-chi} [Mass Pardon of IMF-
Before his most recent pardon in December 2007, Woo Choong Kim, for example, received separate presidential pardons in 1995 and 1997 for two previous convictions for bribery. Executive clemency could be viewed as part of a legacy from Korean history under which kings were expected to extend their benevolence upon those of privileged status. Since the prosecutors' office is technically underneath the Ministry of Justice and part of the executive branch, presidential clemency sent a message to law enforcement on how corporate executives should be excused.

Several other factors contributed to soft enforcement. First, corporate defendants could generally afford better legal representation, which might explain why they fared better in court. Prosecutors and judges also received limited training in sophisticated corporate abuses. They remained inexperienced in financial and accounting affairs, because claims involving accounting fraud, market manipulation, insider trading, and misrepresentation seldom occurred. Moreover, prosecutors and courts from civil law traditions felt constrained from jurisprudential activism to develop new areas of the law and advocate newer theoretical developments in such areas as the burden of proof and proving and calculating damages. Heavy caseloads and time constraints further burdened the legal system. Prosecutors rarely brought cases against corporate wrongdoing unless they received a referral for criminal prosecution from regulatory authorities. Regulatory authorities, in turn, rarely referred cases. Prosecutors thus at times sought enforcement against corporate managers in an inconsistent manner compared to other defendants.

Likewise, the media did not fulfill their roles as the public guardians against corporate misbehavior. Investigative journalists rarely directed their attention toward governance issues. Domestic media scrutiny generally involved reporting events of wrongdoing after the fact. Critical


395 Six other leading chaebol chairmen were also pardoned and reinstated together with Kim in 1997. August 15 Pardon, supra note 390; Jeong-Guk Yoon & Gi-Dae Yang, Jae-beol-chong-su deung 21-myong gae-cheon-jeol sa-myeon-bok-gwon [Twenty-one Including Chaebol Chiefs Pardoned and Reinstated on National Foundation Day], DONG-A ILBO, Sept. 30, 1997, at 1. See also S.Korea [sic] Pardons Daewoo Founder, supra note 5.

396 Kim, supra note 384, at 5.


398 Kim & Kim, supra note 204, at 387.

399 For a general discussion of media's role in corporate governance, see generally Alexander Dyck et al., The Corporate Governance Role of the Media: Evidence from Russia (European Corporate Governance Inst., Working Paper No. 154/2007).

400 See Bernard Black et al., Corporate Governance in Korea at the Millennium: Enhancing International Competitiveness, 26 J. CORP. L. 537, 552 (2001) ("[F]inancial press reporting of corporate governance abuses has not been a significant influence on chaebol behavior.").
reports analyzing Daewoo's state of affairs that could have foreshadowed its financial difficulties did not occur. Foreign media offered only marginally more critical reportage of Daewoo. They too operated weakly as public guardians in shedding light on its problems.

The weak state of the media as a gatekeeper stemmed from a mixture of reasons. First, corporate interests, particularly the chaebols, wielded considerable clout over critical reporting in Korea. The media remained captive to the advertising revenue from the conglomerates to a significant degree. The media also faced threat of libel or defamation actions. Furthermore, in the case of newspapers, companies could exert pressure through a controversial practice of publishing the "First Editions" of the next morning's newspaper on the evening before. Under this practice, companies reviewed the contents of the next morning's edition before it was widely circulated. While this granted the companies a chance to point out errors, in other cases they could influence the editorial content toward their liking. Finally, several major newspapers are owned by families with family ties to the controlling shareholders of leading chaebols. Newspaper owners reportedly have been known to influence editorial views.

After the financial crisis, the overall environment of soft enforcement and public scrutiny dramatically changed. Public uproar led to piercing of the informal veil that had been shielding corporate executives. In December 2001, the prosecutors' office formed a Public Fund Misconduct

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401 See Clifford, supra note 31 (reporting on the current state of Daewoo's business in 1988); see also Perlez, supra note 36 (raising concern of how Daewoo, "a debt-laden company," plans to finance its expansion into Central Europe).

402 See Andrew Ward, Newspapers in SK Corp Row, FIN. TIMES, Mar. 1, 2004, at 23 (reporting that a recent account involving the ability of chaebols to influence the press, "[i]f true... would show how South Korea's biggest business groups, known as chaebol, can influence newspapers through their heavy advertising spending and family connections to the country's press barons").


Joint Oversight Team consisting of representatives from the police, tax authorities, customs authorities, KDIC, FSS, and Korea Asset Management Corporation ("KAMCO"), with Daewoo being a major target. Prosecutors then sought unprecedented, harsh sentences against Daewoo officials including Chairman Kim. The judiciary obliged and sentenced Kim, despite his age and poor health, to eight and a half years in prison and the former head of Daewoo Corp. and Daewoo Motor to five years, both without any commutation. Courts pronounced astronomical monetary penalties upon seven defendants. Matching the scale of the accounting frauds, disgorgement penalties of joint and several liability ranging from 21.25 trillion won ($17.7 billion) to 23.03 trillion won ($19.2 billion) were levied first against three junior directors and officers of Daewoo Corp. and then Chairman Kim. Four senior executives received smaller disgorgement penalties ranging between 1.47 trillion won ($1.75 billion) and 3.71 trillion won ($4.16 billion). The disgorgement penalties were the largest in Korean history, if not in the world.

The sentences and penalties sent a powerful message how executives and chaebols would be held accountable. A consensus emerged to levy actual prison sentences against senior executives of chaebols and to hold them responsible for the damages they caused. Courts emphasized the

406 As a result, 181 persons from leading financial institutions, companies, and accounting firms were detained and eighty three persons were arrested. The prosecutors’ office brought cases against dozens of Daewoo executives, including Chairman Kim and their accountants. Public Funds Management White Paper, supra note 265, at 149, 159.

407 Other Daewoo defendants, however, received judgments between eighteen months and seven years that were suspended in terms of actual jail times. Several did not receive suspended sentences in the lower courts. See, e.g., 2001 No 2063, at 5; 2002 Do 7262, at 4; 2001 Gohab 129, at 2. On appeal two of these defendants subsequently received suspended sentences. 2001 Gohab 171, at 5. Suspended sentences are common for convicted white-collar criminals in Japan as well. Milhaupt, supra note 228, at 191; see Ja-Hyun Lim, Gi-up-chong-su bum-jie chu-boul 'som-bang-mang-i' [Punishment for Crimes of Corporate Chairmen 'A Cotton Club'], Law Times, Jun. 18, 2007, available at http://www.lawtimes.co.kr/LawNews/News/News Contents.aspx?serial=29360.

408 See 2001 No 2063, supra note 139, at 6; 2002 Do 7262, supra note 4, at 3, 4 (the Supreme Court reduced the penalty by 1.3 trillion won ($1 billion) for one of these defendants); 2005 Gohab 588, at 2.

409 2001 No 2063, at 6; 2002 Do 7262, at 3, 4. The only anomalous aspect of the sentences was that, other than Chairman Kim, the three defendants who received the harsher penalties were relatively junior officials. Logically, the senior executives with more supervisory authority should have borne more responsibility and been penalized accordingly.

410 For comparison, the highest fine ever levied against a company in Korea was 542 billion won ($451.7 million) against the Hanjin Group in October 1999 for tax evasion. Cheong-Mo Yoo, Chaebol Stunned by Government’s Hard Line on Reform, Hefty Tax Fines, Korea Herald, Oct. 6, 1999, at 7.

411 The imprisonment of the chairmen of Kia, Hanbo, and more recently SK represent cases in which actual prison sentences have been levied. Sang-Hee Kim, Gae-sok-deu-neun 'jae-bol-chong-su-wa gum-chal-ui ak-yeun' [Bad Relations Between Chaebol Heads and
impact of Daewoo’s actions upon the economy, society, financial institutions, investors, and guaranty companies.\textsuperscript{412} The lesson of Daewoo was that “it clearly demonstrated the enormous damage to the country and people caused by criminal acts such as continuous and systematic accounting frauds and lending frauds.”\textsuperscript{413} Courts further asserted their determination that “Korean society must be firmer and stricter against large scale economic crimes committed by those that disregard corporate social responsibility and corporate ethics.”\textsuperscript{414}

Various mitigating circumstances combined with a measure of unfairness exist surrounding the severity of the punishments. Arguably, every \textit{chaebol} supported its undeserving affiliates and committed accounting and loan frauds and foreign exchange violations leading up to and during the financial crisis. Yet, Daewoo was singled out. Had it successfully turned the company around, perhaps it would have been lauded and all misdeeds would have been forgotten. Daewoo apologists suggest that Daewoo defendants were the scapegoats for the financial crisis or the victims of political intrigue.\textsuperscript{415} Furthermore, they argue, the defendants did contribute to the country’s economic growth and they did not appear to have benefited financially from the crimes. Other than Kim, none of the executives were prosecuted for embezzlement or expropriation.\textsuperscript{416} Finally, the Daewoo executives arguably worked under a corporate culture that demanded obedience to Kim who gave “authoritative orders,” and maintained “absolute influence over the careers of the defendants.”\textsuperscript{417}

Notwithstanding these arguments, Daewoo executives were culpable because they ultimately did participate in the frauds for their own personal gain in disregard of their duties to the shareholders. They inflicted “enormous damage upon the Korean people and the national economy” just so that they would “not lose the chairman’s favor and to maintain their

\textit{Prosecutors Continues], YONHAP NEWS, Jun. 14, 2005.}

\textsuperscript{412} See generally 2001 Gohab 171, at 52–53; 2001 No 2063, at 78. The High Court virtually restated the District Court’s conclusions verbatim regarding the reasons for the harsh sentences and the Supreme Court affirmed these judgments.

\textsuperscript{413} The court also dismissed the “it was a common practice” argument. 2001 Gohab 171, at 53; 2001 No 2063, at 79.

\textsuperscript{414} See, e.g., 2001 Gohab 171, at 53; 2001 No 2063, at 79

\textsuperscript{415} See \textit{DAEWOO SUICIDE}, supra note 12, at 271.

\textsuperscript{416} Other than Chairman Kim, only one case of malfeasance involving a Daewoo executive was reported despite exhaustive investigations by prosecutors, regulators, and auditors. \textit{PUBLIC FUND MISCONDUCT RESULTS}, supra note 209, at 3.

\textsuperscript{417} See 2001 No 2062, at 6; 2001 No 1022, at 9 (“Difficulty in disobeying Chairman Kim’s orders was the basis for crime” committed by the defendant); see also Don Kirk, \textit{Former Daewoo Executive Charged}, N.Y. TIMES, Mar. 7, 2001, at W1 (reporting that the “prosecutor’s office said [Chairman Kim] had ordered his subordinates to alter records to obtain loans of nearly $10 billion”).
they did benefit personally because they maintained their privileged status as corporate executives at one of Korea’s premier conglomerates with its monetary and reputational benefits. Courts thus rejected the defense that the executives had to passively follow Kim’s orders. As professional managers, they had “a responsibility to prevent autocracy by immoral conglomerate heads and controlling shareholders and to protect minority shareholders and general investors.” The executives abandoned their duty to enhance corporate transparency and engage in business operations legally even if this conflicted with Kim’s aims. Instead, they “availed themselves to Woo Choong Kim’s irresponsible, over-leveraged management.” Their active participation in the cover-up further undermined their claims that they acted in good faith on behalf of the company.

V. CONCLUSION

Daewoo’s mismanagement and accounting malfeasance went “unchallenged, because corporate governance simply did not exist.” While primary fault lies with Daewoo’s controlling shareholder and directors, other market participants, both domestic and foreign, share a significant portion of the responsibility. Leading commercial banks, investment banks, reputational intermediaries, gatekeepers, and public sector guardians, all failed as monitors to detect serious accounting problems and also tacitly permitted them to persist. The breakdown of corporate governance through the failures of these interconnected market players was never fully examined. Years later, comparable meltdowns were repeated in the form of Enron, WorldCom, and Parmalat, rocking financial pillars around the world. Unfortunately, Daewoo’s warning signs were dismissed as an aberration, limited to a distant country called Korea that was a victim of the Asian financial contagion.

This forensic study of Daewoo’s implosion describes the formation of formal corporate governance in an emerging market through the prism of a Korean chaebol. It also described how chaebols first operated under a

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419 In the criminal case against an executive of Daewoo Telecom, one lower court did consider the lack of direct personal profit as a mitigating circumstance for sentencing. See 2001 Gohab 129, at 15.
420 The High Court opinion recites virtually verbatim the conclusion of the District Court while adding some additional findings of its own. 2001 Gohab 171, at 53; 2001 No 2063, at 79. The defendants did not raise these defenses on appeal to the Supreme Court.
423 2001 No 2063, at 78.
424 Lee, supra note 20, at 175.
system where the state played the central role as the lead monitor, not directors, shareholders, or regulatory institutions operating according to the dictates of formal law. As the state’s influence ebbed, however, legal protections were not established to replace its oversight function. Ownership dispersion exacerbated agency problems, leaving chaebols further susceptible to abuses. The financial crisis exposed the vulnerabilities of ineffective corporate governance, with Daewoo being the most egregious case.

This study of Daewoo builds upon the comparative corporate governance literature regarding the relationship between formal law and enforcement discipline and trends toward convergence. The role of enforcement in establishing compliance of corporate governance duties and responsibilities was emphasized. Following Daewoo’s collapse, the controlling shareholder, corporate executives, and reputational intermediaries have been held liable, both civilly and criminally, on an unprecedented scale. Enforcement discipline has been spearheaded by such institutions as the KDIC that exist outside of the normal confines of corporate or securities laws. In practice, Korea is also converging from a state-oriented model toward a more shareholder-oriented system with some emphasis on accountability toward the stakeholders. Formal convergence has emerged through legal and regulatory reforms that followed the financial crisis.

The Daewoo case offers a variety of lessons for corporate governance specialists in emerging markets. Only through a comprehensive internal and external framework can companies shed the perception of opacity to receive competitive valuations. Corporate scandals continue to erupt, demonstrating that transparency and accountability must be vigilantly pursued within such a framework. In particular, local laws, markets, and institutions do not bear the sole responsibility, but international market participants must also be properly enlisted into the process.