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

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Abstract

In 1999, the Daewoo Group, one of the biggest transnational conglomerates, collapsed, committing a staggering $15.3 billion in accounting fraud in the process, the largest in world history. In 2006, its chairman was sentenced to eight years in prison and a disgorgement penalty of $22.7 billion. Daewoo’s problems, however, did not remain a case isolated to Korea and their mighty, family-controlled conglomerates called “chaebol.” Daewoo’s demise foreshadowed corporate scandals that more recently ravaged confidence in financial markets around the world. Leading financial institutions, investment banks, securities analysts, accounting firms and credit agencies from around the world failed to address its problems. Despite its warnings, policy discussion focusing on the importance of reputational intermediaries and gatekeepers in particular has only recently emerged.

This forensic study analyzes the history of Daewoo, a major chaebol, focusing on the implications of its vast corporate governance meltdown. It surveys Daewoo’s internal corporate governance, particularly its controlling shareholder, boards of directors, officers, employees and banks. Furthermore, the external corporate governance landscape and the failure of reputational intermediaries, gatekeepers and public institutions are explored. By analyzing an Asian conglomerate from a leading emerging market, this study also contributes to the comparative corporate governance literature regarding the importance of formal law and enforcement and the trends toward convergence. This study highlights the emergence of functional substitutes to traditional remedies under formal corporate law for the implementation of legal enforcement and creation of corporate governance discipline. It also traces how Korean companies have converged toward a more shareholder-oriented corporate governance model from a state-oriented model. Finally, the ineffective corporate governance system in place at the time of the Asian financial crisis provides a backdrop for the reforms that followed.
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I. INTRODUCTION

II. THE CHAEBOL AND THE FINANCIAL CRISIS
   A. THE MAKING OF THE GREAT UNIVERSE
   B. TRAGIC HERO: CHAIRMAN WOO CHOONG KIM
   C. CHAEBOL BUSINESS PRACTICE AND CULTURE
   D. FATAL DECISIONS DURING THE ASIAN FINANCIAL CONTAGION
   E. ACCOUNTING FRAUD AND THE BRITISH FINANCE CORPORATION

III. INEFFECTUAL INTERNAL CORPORATE GOVERNANCE
   A. CONTROLLING SHAREHOLDER’S IMPERIAL CONTROL
   B. CEREMONIAL REPRESENTATIVE DIRECTORS, DIRECTORS AND STATUTORY AUDITORS
   C. INVESTOR PASSIVITY
   D. COMPLIANT COMMERCIAL BANKS AND SILENT DEBT-HOLDERS
   E. LABOR LIMITATIONS

IV. WHERE WERE THE GATEKEEPERS AND PUBLIC GUARDIANS?
   A. ACCOUNTING OVERSIGHT: CHONG-UN AND SAN TONG
   B. INVESTMENT BANKS, SECURITIES ANALYSTS AND CREDIT RATING AGENCIES
   C. FINANCIAL SUPERVISORY SERVICE, FAIR TRADE COMMISSION AND KDIC
   D. PROSECUTORS, COURTS AND OTHER PUBLIC GUARDIANS

V. CONCLUSIONS

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I. Introduction

At the end of 1999, one of the largest conglomerates in the world, the Daewoo Group, collapsed in spectacular fashion. During its peak, Daewoo was a sprawling enterprise with over 320,000 employees in 500 domestic and foreign companies that operated in over 110 countries.² Its management received widespread praise and academic recognition for its success.³ Yet, when the financial crisis hit, it managed to commit 22.9 trillion won ($15.3 billion) in deception that was termed the “biggest accounting fraud in history, surpassing WorldCom and Enron.”⁴ Years later, inner-


⁴ Figures on the exact amount of accounting fraud have ranged as high as eighty trillion won ($53.3 billion) and WorldCom’s accounting fraud only amounted to $11 billion. Kraar, supra note 2, at 103; Andrew Ward, Kim Tries to Mend Damaged Reputation, FIN. TIMES, Jan. 23, 2003, at 27 (“world’s biggest accounting fraud”); South Korea Dumps the Past, at Last, ECONOMIST, Nov. 9, 2000 (“world’s largest
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). 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 failure of corporate governance played a pivotal role in precipitating the financial crisis. Contagion spread largely as a corporate failure”). 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:


5 Judgment of Nov. 3, 2006, Seoul High Court, 2006 No 1127, aff’g but modifying, Judgment of May 30, 2006, Seoul District Court, 2005 Gohab 588, 2005 Gohab 794, 2005, Gohab 364 (original sentence 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, Supreme Court, 2002 Do 7262. Leading cases will be reviewed in sections III and IV of this article. Meanwhile, dozens of civil cases remain pending.

6 Eric Friedman, Simon Johnson & Todd Mitton, Corporate Governance and Corporate Debt in Asian Crisis Countries, in KOREAN CRISIS AND RECOVERY (David T. Coe & Se-Jik Kim eds., Int’l Monetary Fund and Korea Inst. for Int’l Econ. Policy 2002); Simon Johnson et al., Corporate Governance in the Asian Financial Crisis, 58 J. FIN. ECON. 141 (2000); ORG. FOR ECON. CO-OPERATION AND DEV., WHITE PAPER ON CORPORATE
result of inherent weaknesses of conglomerates and banks; for Korea, for instance, problems with family-dominated chaebol provoked its collapse. The trials and 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, in particular, serves as one of the earliest warning signs of the corporate governance breakdowns that later plagued leading companies around the world. It predated Enron, WorldCom, Tyco, Vivendi, Ahold and Parmalat, scandals that devastated confidence in global markets. Daewoo, however, did not remain a case isolated to Korea. World-renowned, international financial institutions, investment banks, money managers, financial analysts, accounting firms and credit rating agencies, all failed to react to the situation. Daewoo’s meltdown was categorized as a remote problem in a faraway region. The wave of policy discussion on the imperatives of having effective reputational intermediaries and gatekeepers, for instance, came later.

A case study of Daewoo within the context of comparative corporate governance in Asia 5 (2003) [hereinafter OECD WHITE PAPER].

7 Chaebol means conglomerate or literally “financial clique” or “money clique” in Chinese characters and stems from the term zaibatsu in Japanese. See generally Ok-Rial Song, The Legacy of Controlling Minority Structure: A Kaleidoscope of Corporate Governance Reform in Korean Chaebol, 34 LAW & POL’Y INT’L BUS. 183 n.1 (2002), John O. Haley, Chinese Anti-Monopoly Law: Competition Policy For East Asia, 3 WASH. U. GLOBAL STUD. L. REV. 277 n.7 (2004). Korean words have been romanized according to the Ministry of Culture and Tourism’s romanization system, except for proper names of public figures, publications that have their own preferences or commonly used terms such as chaebol.

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 discipline outside traditional remedies based upon corporate or securities law. Finally, this study shows how a transplant country from a mixed civil law tradition has converged toward a more shareholder-oriented corporate governance model from a state-oriented model.\(^10\)

How much corporate governance problems relative to ill-advised business decisions and external factors played a role in the collapse of companies such as 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 governance,” for example, did not exist in the Korean business vernacular.\(^11\) Some insist Daewoo was a victim of external shocks or a scapegoat of


\(^11\) Variations of the concept corporate governance first appeared in 1981 and were explored after 1993 by numerous scholars. A more unified definition only emerged in 1995. Deuk-Joon Yu, *Gi-eop-ui ja-bon-so-yu-gu-jo-wa ji-bae-gu-jo-e gwan-han yeon-gu* [A Study on Capital and Governance Structure of Public–Held Corporations], *in Korea Securities Academy, Symposium 1* (1981); Young-Jo Kim, *So-yu-wa gyeong-
political intrigue.\textsuperscript{12} They cite how Daewoo affiliates have rebounded to profitability.\textsuperscript{13} With benefit of hindsight, forensic studies can exaggerate faults and causes that might appear self-explanatory. These challenges will be addressed.

This article begins with a comprehensive review of the history of Daewoo, particularly relative to other chaebol conglomerates. Second, the article will provide a survey of the internal corporate governance of Daewoo, particularly through its board of directors, officers, shareholders and banks. Third, the external corporate governance landscape will be described through the failure of reputational intermediaries, gatekeepers and public institutions. This article will argue that while primary responsibility lies with Daewoo’s own internal problems and Korea’s underdeveloped corporate governance framework, other market players, particularly leading international ones, cannot escape derivative responsibility. Corporate governance policy in emerging


\textsuperscript{12} \textit{Daewoo ja-sal-in-ga ta-sal-in-ga} [Was Daewoo a Suicide or Murder], HAN-GUK-GYEONG-JE-SIN-MUN, 2002 [hereinafter \textit{Daewoo Suicide}].

\textsuperscript{13} 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, \textit{Geu-rup-hae-che 5 nyeon...Daewoo-ga sal-a-it-da} [Five Years after Group Dismantlement...Daewoo Lives On], \textit{Chosun Ilbo}, Nov. 30, 2004, at 1, 3.
markets must be reformulated to reach a more balanced and comprehensive perspective.

II. The Chaebol and the Financial Crisis

This chapter provides the background of Daewoo from its beginning to its demise in the aftermath of the financial crisis. It explains how it became a leading conglomerate under Korea’s state-oriented corporate governance system. Woo Choong Kim’s role as founder, chairman and controlling shareholder of the Daewoo Group is then profiled. The chapter describes the characteristics of the chaebol, family-controlled conglomerates that dominated the economy. An analysis of the impact of the financial contagion sets the stage for an examination into the historic accounting fraud and corporate governance failures that brought down the conglomerate.

A. The Making of the Great Universe

In 1967, 31-year-old Woo Choong Kim founded Daewoo Industrial, a textile exporter, with just five employees and $10,000. The two Chinese characters for 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 developing countries, 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’s prevailed upon them.  

After changing its name to Daewoo Heavy Industries, the company started generating profits in its first year. In another fabled example, in 1978, Daewoo acquired Okpo Shipping Company, a company teetering on bankruptcy. Merged into Daewoo Heavy Industries, Kim guided the shipyard to positive returns by 1983. Daewoo’s mode of acquisition, turn around and expansion became a trademark of the conglomerate. Moreover, major companies were not established by Daewoo but obtained through mergers or acquisitions.

Another cornerstone of Daewoo’s business strategy was its orientation toward exports. Unlike other chaebol, Daewoo championed an international focus from its beginning. 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

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15 Aguilar & Cho, supra note 3, at 3.

government’s economic development plans of export-led growth. Daewoo launched a Global Management Strategy in 1993 to further expand its operations across the world. By 1998, they established over 500 subsidiaries. Over 320,000 employees worked worldwide in 110 countries, from South America to Africa and Eastern Europe. Despite security risks, Daewoo was even among the first to try to develop business with North Korea.

Critics claimed that Daewoo succeeded because of its ability to extract support from the government through rent-seeking while leveraging itself that it had become too important to be allowed to falter. In 1988, for example, they faced disaster when Daewoo Shipbuilding and Heavy Machinery verged on collapse due to a crushing 1.2 trillion won ($1.8 billion) in debt following deteriorating market conditions. 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.


20 Kraar, supra note 2, at 103; Enright et al., supra note 3, at 11.

21 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.
in 1989. The generous rescue package reasserted Daewoo’s lobbying ability while confirming the government’s inability to take decisive action. This fueled the myth that Daewoo and other chaebol had become too big to fail. Chaebol engaged in increasingly riskier behavior in the belief that they could rely upon government intervention when in jeopardy.

In 1978, Daewoo embarked on its tragic foray into the automobile industry through a 50 percent acquisition of Saehan Motor in a joint venture with GM Korea. What later became Daewoo Motor met both the strategy of 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 percent stake in 1991, a series of entries into foreign automobile markets followed. In 1994, they acquired the British International Automotive Design (Worthing Technical Centre) and entered into an automobile joint venture with Rodae in Romania for $300 million. In 1996, they entered the Polish automobile market with the $1.1 billion acquisition of FSO. They bought a southern

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23 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 all are examples of critical failures in Korean corporate history. Ford later suggested that they dropped their bid for Daewoo Motor later on because of the poor business prospects of turning it around not because of huge debts. *South Korea Dumps the Past, at Last*, *supra* note 4.

24 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
Poland truck factory for $700 million, Czech Republic’s Avia truck manufacturer for $200 million, Uzbekistan’s Uz car plant and teamed up with other carmakers from Ukraine and India.\(^{25}\) The acquisition spree led to 14 new vehicle plants in 13 countries that culminated with the purchase of a 51.98% stake in Ssangyong Motor in January 1998 at the height of the financial crisis.\(^{26}\) Reckless expansion into the automobile business overwhelmed the conglomerate.\(^{27}\)

Meanwhile, Daewoo’s financial structure precariously relied upon debt. While debt-to-equity ratios for chaebol exceeded 400 percent, Daewoo surpassed everyone in its over-reliance on debt. As early as 1988, with over $11.2 billion in borrowings, Daewoo stood as Korea’s most indebted conglomerate.\(^{28}\) Its debt gearing allegedly reached as high as 2,000 percent.\(^{29}\) In fact, for foreign investment projects, Daewoo followed a “one-hundredth strategy.” They boasted that they only required one percent of the total capital needed for a project because they could finance the rest through preferential loans from foreign country’s banks, inter-subsidiary debt payment guarantees, joint investment from local investors and other sources.\(^{30}\)

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\(^{26}\) Dong-Han Lee, Daewoo-geu-rup-ui hae-che jung-san-seo [An Accounting of the Dismantlement of Daewoo], MONTHLY CHOSUN, Dec. 1999. See Section II.D.

\(^{27}\) Daewoo had also attempted to enter the oil refinery business by acquiring Hanwha Energy and almost acquired France’s Thompson Media in return of assuming its crushing debt of 4.8 billion Francs.


\(^{29}\) Lee, supra note 16, at 159.

\(^{30}\) Id. at 153.
Another notable feature was that the de facto holding company, the Daewoo Corp., was not the profit center of the conglomerate.\textsuperscript{31} Daewoo Corp. primarily acted as a trading and financial company for products and services. In difficult times, therefore, it did not have 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 fraud.

Unsurprisingly, Daewoo received the lowest market valuations and had to pay the highest interest rates among the chaebol. Capital markets 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.\textsuperscript{32} Daewoo’s actual interest rates were 2.6 percent higher than the average among the top-five chaebol in 1997.\textsuperscript{33} The spread between Daewoo bonds and other chaebol was already one percent in 1998, but increased to two to three percent by early 1999.\textsuperscript{34} 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 fraud. Nevertheless, the valuations reflect the degree of knowledge that market participants, particularly sophisticated domestic and foreign ones,

\textsuperscript{31} Lee, \textit{supra} note 16, at 155–156.

\textsuperscript{32} \textit{Id.} at 157.

\textsuperscript{33} Wonjong Koh, \textit{Alarm Bells are Ringing}, NOMURA, Oct. 1998, at 3.

\textsuperscript{34} \textit{Daewoo Suicide, supra} note 12, at 72. Its commercial paper rates were also three to five percent higher than other groups by late 1998. \textit{Daewoo-geu-rup weo-keu-a-ut chu-jin-hyeon-hwang mit hyang-hu-gye-hwek} [Daewoo Group Workout Current Status and Future Plans], MINISTRY OF \textsc{finance and economy}, FINANCIAL SUPERVISORY COMMISSION & BANK OF KOREA, Nov. 4, 1999 [hereinafter \textit{1999 Government Report}], at 2.
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. After the conglomerate’s collapse nearly a dozen companies continue to operate under the Daewoo brand name. Leading Daewoo companies even retain the same senior management. 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. As independent companies, they can now operate for their own benefit without regard for the welfare of other affiliates.

B. Tragic Hero: Chairman Woo Choong Kim

Daewoo cannot be separated from its legendary founder, Woo Choong Kim. He


38 Park & Kim, supra note 13, at 1, 3. One of Daewoo’s crown jewels, Daewoo Heavy Industries and Machinery has finally been put up for sale by KAMCO and KDB. Francesco Guerrera, Doosan ’to Win Daewoo,’ FIN. TIMES, Oct. 14, 2004.
not only established it, but determined its course, dominated decision-making and handpicked 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 turnarounds and rent-seeking. His global perspective on the need for Korean companies to develop overseas markets was visionary, particularly given reclusive tendencies of Koreans. 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 conglomerates’ 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

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

book, “Every Street is Paved with Gold,” that sold over two million copies.\textsuperscript{41} Published in 21 languages, it propounded his corporate philosophy on the need to expand internationally. In February 1999, he became captain of Korean industry when he was elected president of the influential Federation of Korean Industries (FKI), official organization of Korea’s largest businesses.\textsuperscript{42}

Politically, Daewoo benefited from Kim’s instincts and apparently his personal relationship with President Chung Hee Park, the controversial autocrat who ruled Korea from 1961 until 1979.\textsuperscript{43} 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, they would succumb to Kim’s requests for support. After Park died, Daewoo continued to rely on Kim’s political acumen to steer them out of difficulties.

During the financial crisis, Kim’s political wherewithal and managerial judgment faltered, leading Daewoo to catastrophe. By the summer of 1999, he departed the country in self-imposed exile.\textsuperscript{44} He returned after six years of hiding on his volition

\textsuperscript{41}Woo Choong Kim, Every Street is Paved with Gold (William Morrow & Company 1994). Kraar, supra note 2, at 103.


\textsuperscript{43}Park reportedly favored Kim because Kim’s father was a former high school teacher of his whom he had respected. Don Kirk, For Daewoo’s Founder, Pride Before the Fall, N.Y. Times, Feb. 23, 2001, at W1.

\textsuperscript{44}His Korean passport expired in 2002 and according to the Korean National Policy Agency, in 1987, he acquired French citizenship. Yeong-Eun Jang, Kim-woo-choong-ssi 87-nyeon rang-seu guk-jeok-chwi-deuk [Woo Choong Kim Acquires French Citizenship in 1987], YONHAP NEWS, Dec. 27, 2002. The District Court decision that
to receive an eight-year prison sentence in 2006, with numerous civil trials still pending. 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.”

Fundamentally, Kim failed to follow basic legal and managerial principles such as accounting, internal controls and financial discipline, placing too much emphasis upon generating sales and marketing. Corporate governance was unobserved. He did not heed warnings to retract and instead chose to expand through unprecedented accounting and loan fraud. In the end, ultimate responsibility for the catastrophe lies with him.

C. Chaebol Business Practice and Culture

The chaebol that dominated Korea’s economy shared many common features. Nurtured under the government’s industrial 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 chaebol according to the dictates of policy makers. 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, chaebol maintained a patriarchic, management style that revolved around controlling shareholder domination. Excessive concentration of power became the source of most corporate governance problems. Chairmen, serving as both

sentenced him to ten years imprisonment confirmed that he was a French citizen.

2005 Gohab 588, supra note 5, at 2.

45 Kraar, supra note 2, at 103.

46 Daewoo Suicide, supra note 12, at 175.

47 Hansmann & Kraakman, supra note 10, at 451.
controlling shareholder and 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 senior level, because executives lacked alternative employment options due to poor labor market flexibility.

Under a state-oriented corporate governance system, government operated in an intertwined, symbiotic environment with the chaebol. Chaebol operated according to government policy because by design they could receive “preferential policy loans, tax credits, subsidies, protection and even bailouts when [they] got into financial trouble.” Government provided management-friendly labor laws, monopolies and oligopolies, special licenses and permits and trade and investment barriers from foreign competition. Chaebol received favorable treatment as long as they performed. From one perspective, Korea’s economic success evinces the merits of industrial policy based upon close industrial and government cooperation. At its worst, however, collusion led to illegal rent-seeking and predation. In the most egregious example, for instance, a dozen leading chaebol chairmen, including Woo Choong Kim, contributed over 510 billion won ($638 million) in bribes during the 1980s and early 1990s to two Presidents. Chairmen


claimed they could not defy the Presidents’ solicitations for slush funds, yet the chaebol derived significant benefits in return.

Policymakers also protected the control of chaebol families. Initially, like other Asian companies, families held large, concentrated ownership in their companies. In the 1970s, however, the government browbeat chaebol into listing major companies on the stock exchange.\(^\text{50}\) Listing served two purposes. Compelling chaebol families to disperse their ownership to the public would lead to sharing the benefits they derived out of the special preferences that chaebol received.\(^\text{51}\) 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 from banks, companies also had little need for equity financing. To convince them, the government decided to protect them from threats to ownership control by curbing shareholder and stakeholder rights, the corporate control market and challenges to the board

Ownership dispersion coupled with weaker, not stronger, minority shareholders protections sowed the seeds for corporate governance problems. With control protected, entrenched families gradually allowed dilution of their cash flow rights with each rights offering. Over time, families held only marginal ownership. They meanwhile were allowed to secure control through a vast web of crisscrossing share ownership between affiliates.\(^\text{52}\) The wider the discrepancy between cash-flow rights and control rights

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\(^{50}\) Company Listing Promotion Act, Law No. 2420 of 1972 \textit{(repealed by Law No. 3946 of 1987)}.

\(^{51}\) Employees were to benefit as well through preemptive rights they could acquire through ESOP.

\(^{52}\) Many Asian companies have similar ownership structures. OECD \textit{WHITE PAPER}, \textit{supra} note 6, at 11; SEON-GU KIM ET AL., \textit{SEOUL NAT’L U. INST. ECON. RES., CHUL-JA-
became, the more controlling shareholder’s interests diverged with other shareholders and the greater inherent agency problems became. The anomalous situation of control without corresponding personal ownership and dispersed ownership without strong shareholder protections emerged as a fundamental issue. Chaebol became vulnerable to empire-building and more serious ills such as misappropriation.

During the developmental state period, chaebol routinely engaged in related-party transactions among affiliates. In fact, intra-conglomerate assistance among affiliates without regard to the corporate governance of individual companies was common practice. Not only was it not punished, governmental administrative guidance often required affiliate support for risky but strategically important companies as a condition for receiving bank loans.\(^{53}\) 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 industrial policy. In the worst cases, however, controlling families or senior managers used related-party deals to engage in self-dealing and to extract other private benefits of control.

Chaebol adhered to a “too-big-to-fail (dae-ma-bul-sa)” doctrine.\(^{54}\) 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 held that bureaucrats did not have the nerve to endure the political costs and social dislocation generated by permitting the debacle of a chaebol, particularly one of the largest ones. Market participants therefore clung to this myth.\(^{55}\) Sophisticated investors, creditors and reputational intermediaries, domestic and foreign alike, downplayed the importance of corporate governance because they believed chaebol had a sovereign guarantee from “Korea, Inc.” Meanwhile, this nurtured a moral hazard that led chaebol to increase their size and assume undue risk because they believed that could rely upon the government’s safety net.

Furthermore, chaebol companies and chairmen linked fates through debt or payment guarantees.\(^{56}\) 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 it and start a chain reaction that could threaten a string of companies if not the entire conglomerate.

\(^{55}\) 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 chaebol could largely restructure on their own while smaller chaebol would be placed in stricter workout programs, underlining the impression that larger chaebol received differentiated treatment. Lee, *supra* note 16, at 171.

\(^{56}\) Nissho Iwai Europe PLC v. Korea First Bank, 773 N.E.2d 1016 (N.Y. 2002) (describing a Daewoo Corp. guarantee for a $150 million loan to Daewoo Hong Kong).
By conjoined fates of companies, guarantees exacerbated the too-big-too-fail problem. Banks also routinely demanded that chaebol heads personally guarantee company debt as an additional form of security even though the size of guarantees was already beyond their capacity. When difficulties arose, nothing held back chairmen from assuming excessive risk because they no longer could 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.57 Entire operations of a chaebol could be enlisted, for example, from construction to trading, to sales, marketing and financing. The construction company, for instance, would build a hotel, another company would obtain financing, another affiliate would provide automobiles and buses, another would train staff and another would promote the property. The organizational structure served as a justification to support weaker affiliates when in need.

Finally, chaebol engaged in various forms of “earnings management.” Financial figures were inflated partially due to historic reasons. Following the Japanese model, policy makers granted chaebol exclusive rights to establish general trading companies based upon the volume of revenues, assets, sales and stated capital.58 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 that a single asset could be sold through a chain of companies, generating artificial sales for all companies involved.

Chaebol shared common characteristics, especially vulnerabilities arising out of weak corporate governance. Nurtured under a state-oriented corporate governance system, they became over-protected from scrutiny and lacked proper internal controls. A weak ownership structure, autocratic management styles and too-big-to-fail mentality left them predisposed to excesses and opacity, particularly while business thrived. Most significantly, these problems were common knowledge, but little was done to address them. When the financial crisis hit, however, everyone fled because of a sudden awakening that the chaebol lacked the necessary discipline to sustain them.

D. Fatal Decisions during the Asian Financial Contagion

As financial contagion swept across Asia, 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. They did not appreciate the seriousness of the situation, offering restructuring plans to resurrect the conglomerate when it was too late. In the end, over a two-year period, everyone stood-by as Daewoo transformed into a financial black hole.

In late 1997, the Korean won plummeted from 900 won to 1960 won to the
dollar in less than four months. The proud country, hailed for its economic miracle, capitulated to a bailout led by the International Monetary Fund (IMF), World Bank and Asian Development Bank, consisting of over $58 billion. The IMF’s controversial prescription raised interest rates to over 30 percent in an attempt to stem capital flight. Korea experienced negative 6.7 percent growth in 1998, the worst in modern history. The timing could not have been worse for Daewoo.

Daewoo might have weathered the storm had it restructured from the onset in early 1998. Rejecting a contractionary 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.” Returning to his roots, he 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.”

While others retracted, the Daewoo Group’s sales therefore increased by 25

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60 Friedman et al., supra note 6, at 2.

61 Chae-Shick Chung & Se-Jik Kim, New Evidence on High Interest Rate Policy During the Korean Financial Crisis, in KOREAN CRISIS AND RECOVERY, supra note 6, 137–156.

62 Lee, supra note 16, at 165.

63 Michael Schuman & Jane Lee, South Korea, Eager to Shed its Old Ways. Allows a Corporate Empire’s Overhaul, ASIAN WALL S. J., Aug. 17, 1999, at 1, 3.

64 Lee, supra note 16, at 164.
percent in 1998, Daewoo Corp.’s, by 54 percent.\textsuperscript{65} The group spent 10 trillion won ($7.14 billion) in sales promotions during this critical period.\textsuperscript{66} Automobile-related expansion in particular overwhelmed the conglomerate.\textsuperscript{67} Daewoo Motor acquired Ssangyong Motor in January 1998 at the peak of the crisis, assuming 3.4 trillion won ($2.43 billion) debt.\textsuperscript{68} Leading companies such as Daewoo Corp. and Daewoo Heavy Industries bore the burden.\textsuperscript{69} All companies pressured employees to purchase Daewoo automobiles.\textsuperscript{70} Executives personally marketed cars with sales results linked to their

\textsuperscript{65} 1999 Government Report, supra note 34, at 1.

\textsuperscript{66} Lee, supra note 16, at 165.

\textsuperscript{67} Daewoo had also attempted to enter the oil refinery business by acquiring Hanwha Energy.


\textsuperscript{69} Daewoo Suicide, supra note 12, at 207-8.

\textsuperscript{70} On August 1998, the Korean FTC 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. See infra on KFTC. A shareholder case 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. Sun–Woong Kim, The Limitations of Seeking Accountability Against De Facto Directors as Demonstrated in the Shareholder Derivative Action Against Daewoo Corp., CENTER FOR GLOBAL CHANGE & GOVERNANCE ISSUE REPORT, Nov. 23, 2004.
performance evaluations.\textsuperscript{71}

Daewoo’s financial balancing act foundered under the weight of the financial contagion.\textsuperscript{72} 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.\textsuperscript{73} Second, the spike in interest rates further debilitated the conglomerate, its interest rate burden ballooning from three trillion won (\$2.14 billion) to six trillion won (\$4.3 billion).\textsuperscript{74} 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.\textsuperscript{75} Relatively constant operating profits aside, the collective financial burden overwhelmed them.

To meet the demands, Daewoo issued a flurry of corporate bonds and commercial paper throughout 1998 to cover its maturing debt. Despite high leverage,

\textsuperscript{71} Daewoo Suicide, supra note 12, at 319.

\textsuperscript{72} In an ominous interview in 1985, Woo Choong Kim himself discussed how companies that rely upon foreign debt can be susceptible to foreign shocks. Dae-Jung Kim, Geun-geo-eop-neun Daewoo hae-che-seol-e si-dal-ri-neun Kim-woo-choong-eun mal-han-da [Plagued with Rumors of Daewoo’s Dismantlement Woo-Choong Kim Speaks], MONTHLY CHOSUN, May 1985, at 168.

\textsuperscript{73} 1999 Government Report, supra note 34, at 2, 17. When the exchange rate collapsed from 700 won to 1400 won, 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 57, at 11.

\textsuperscript{74} Id. at 2.

\textsuperscript{75} Dong-Han Lee, Choe-cho-gong-gae byeo-rang-e seon Kim-woo-choong-ui geok-jeong-to-ro [Revealed for the first time: Standing on the Edge Woo-Choong Kim Reveals His Concerns], MONTHLY CHOSUN, Sept. 1999.
they still managed to raise 19.7 trillion won ($14.1 billion) in debt issuances at interest rates that averaged 15 percent and reached as high as 25 percent.\textsuperscript{76} 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 percent and accounting for 27 percent of total bond issues at the time.\textsuperscript{77} Investment trusts and other institutions recklessly acquired the debt instruments, apparently relying on the assumption that the government would devise a solution.\textsuperscript{78}

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 percent of the commercial paper of a conglomerate. In October, a similar restriction followed for corporate bonds when banks and insurance companies were set to a 5 percent limit per conglomerate while investment trusts, a 15 percent limit. Though they had been in discussion with regulators about their financing woes since June 1998, Daewoo did not -- or could not -- prepare for the austerity measures.\textsuperscript{79} The caps on debt severed the financing lifeline that had been sustaining the group.\textsuperscript{80} To aggravate matters, Chairman Kim was suddenly hospitalized in November 1998.\textsuperscript{81}

In December 1998, the government attempted to broker a controversial “Big Deal” between the Samsung Group and Daewoo Group in which troubled Samsung

\textsuperscript{76} 1999 Government Report, supra note 34, at 2. In 1997, they had issued 12 trillion won ($8 billion) worth. Id.

\textsuperscript{77} Koh, supra note 33, at 2.

\textsuperscript{78} 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.

\textsuperscript{79} Lee, supra note 16, at 171.

\textsuperscript{80} Koh, supra note 33, at 2.

\textsuperscript{81} Kim Woo-Choong Recovers Quickly from Surgery, KOREA TIMES, Nov. 17, 1998, at 8.
Motors would be swapped in exchange for Daewoo Electronics.\footnote{The concept “big deal” was apparently first suggested in an November 1997 op-ed piece. Dong-Sung Cho, *Sa-eop-gyo-hwan (bik-dil) i pil-yo-ha-da [A Business Exchange (Big Deal) is Needed]*, CHOSUN ILBO, Nov. 26, 1997.} The government believed they needed to intervene to help the rival conglomerates. Merging Daewoo Motor with Samsung Motors 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 talks.\footnote{This plan apparently failed after Samsung allegedly received documents from a disgruntled former Daewoo Electronics manager that detailed over four trillion won ($2.86 billion) in accounting fraud. *Daewoo Suicide, supra* note 12, at 181.}

Twelve months after the crisis erupted, Daewoo made its first serious attempt at restructuring in late December when they entered into a Financial Structure Improvement Covenant with its creditor banks. They agreed to downsize 51 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 February 1999, Kim even became president of the Federation of Korean Industries (FKI), the powerful business organization led by chaebol, 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 a breakup of the conglomerate and sell-off of its companies with only the automobile company remaining. In return, Kim demanded over ten trillion won ($8.3 billion) in the form of stock, real estate and other assets to use as a 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 six trillion won ($5 billion) of short-term commercial paper for six months and four trillion won ($3.3 billion) in additional funding.\textsuperscript{84} The government to no avail tried to sustain the beleaguered conglomerate.\textsuperscript{85} Weeks later in August, twelve main companies proceeded into court receivership workout procedures. Representative directors submitted their resignations on November 1 and shortly thereafter Kim left Korea to begin life as a fugitive.

When the financial crisis struck, Daewoo misjudged the situation and expanded its way to a meltdown. In the process, they were allowed to issue over 19.7 trillion won ($14.1 billion) in bonds and commercial paper and permitted to extend an additional ten trillion won ($8.3 billion) in loans over a two-year period. All of this proceeded under the shadows of accounting and loan fraud. The collective response to the situation hence was grossly inadequate. The Daewoo Empire had become a financial nightmare.

E. Accounting Fraud and the British Finance Corporation

While pursuing its expansion strategy through excessive borrowing, Daewoo chose to commit unprecedented fraud, particularly by manipulating its overseas accounts. Many chaebol shared a legacy of accounting opacity, but what distinguished Daewoo was

\textsuperscript{84} 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 54.

\textsuperscript{85} Yet, this only delayed the company’s sale on potentially more beneficial terms. Stephanie Strom, \textit{Skepticism over Korean Reform: After Daewoo Intervention, Is There the Will for Austerity?}, N.Y. TIMES, July 30, 1999, at C1.
its scale, its manner and how it remained undetected.\textsuperscript{86} The size sealed their fates in the annals of corporate scandals. Executives violated disclosure laws, accounting laws and foreign exchange laws. The staggering fraud could be attributed corporate governance breakdowns on multiple levels.

The “biggest accounting fraud in history” occurred as a result of Daewoo companies inflating assets by a total 22.9 trillion won ($19.1 billion).\textsuperscript{87} Daewoo Corp., Daewoo Motor and Daewoo Electronics together accounted for 90 percent of the conglomerate’s impaired capital.\textsuperscript{88} In perpetrating the fraud, Daewoo Corp., which was responsible for 14.6 trillion won ($12.2 billion), used its trading and management departments and its accounts in London. In 1997, for example, they deflated assets by

\begin{itemize}
  \item French, \textit{supra} note 68.
\end{itemize}

Unlike the Financial Supervisory Commission (FSC)’s preliminary audit of Daewoo, the final SFC Press Release 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 it because the 1999 report had applied the Corporate Accounting Standards too strictly. Yet, the size of the discrepancy still remains puzzling.

\begin{itemize}
  \item Daewoo Corp. had impaired capital of 14.5 trillion won ($12 billion) whereas Daewoo Motor and Daewoo Electronics accounted for another 8.4 trillion ($7 billion). \textit{1999 Government Report, supra} note 34, at 6.
\end{itemize}
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 ($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 fifteen 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.

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89 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. Judgment of July 24, 2001, Seoul District Court, 2001 Gohab 171, at 13.

90 2001 Gohab 171, at 13, 19.

91 Another four trillion won ($3.33 billion) involved non-performing loans, false inventories of three trillion won ($2.5 billion) and false research and development expenses of one trillion won ($0.83 billion). SFC 2000 Report, supra note 87, at 4; Daewoo Suicide, supra note 12, at 160.


93 In 1998 and 1999, SITM, for example, used up to 38 percent of its funds to support other affiliates and purchased 2.9 trillion won ($2.42 billion) of bonds and commercial paper issued by various affiliates, particularly when they were among the riskiest.
To a greater degree, Daewoo mobilized its overseas financial network. The primary vehicle for the overseas fraud involved an entity called the British Finance Corporation (BFC). Located in London, five persons 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 six and seven billion dollars. Toward the end in August 1999, the accounts reportedly amounted to over $7.5 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.

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94 Surprisingly, most of the financial records of the BFC were intact when regulators later found them in storage. It remains unclear why this information was not destroyed. *Daewoo Suicide*, supra note 12, at 162–63.

95 Around a dozen accounts were established in the names of Daewoo and the BFC in 1982. The name BFC apparently originated from the telex code of the finance team in the United Kingdom. 2001 Gohab 171, at 3.


97 Initially, the accounts received deposits of progress payments for construction contracts in Libya. 2001 No 2063, at 47.

98 2001 Gohab 171, at 23.

99 *Daewoo Suicide*, supra note 12, at 164. Of this, Daewoo’s attorney claimed $3.4 billion was used for repaying debts and interest and $4.1 billion was used to support other subsidiaries. Kim & Bae, supra note 57, at 17.
This circumvented foreign exchange laws and skirted reporting requirements.\textsuperscript{100} In addition, companies with questionable credit issued new stock that overseas financial institutions would acquire technically as equity investments.\textsuperscript{101} The equities would then be secured through redemption agreements with other affiliates.\textsuperscript{102} The affiliate would be obligated to repurchase the equity at a given price plus interest, if it failed to reach a certain price level.\textsuperscript{103} 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 currency. Funds that should have been recorded as debt were improperly recorded as equity.

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.\textsuperscript{104} Foreign debts held priority over domestic obligations.\textsuperscript{105} During this critical period, overseas interest payments to foreign financial institutions alone amounted to $2.49 billion in 1999.\textsuperscript{106} Pressure from the BFC exacerbated the financial state of domestic companies. Later when foreign debts could no longer be met BFC-related paper companies were used to construct falsified bills of lading, commercial invoices and packing lists to defraud Korean banks.\textsuperscript{107}

\begin{flushleft}
\textsuperscript{100} Kim & Bae, \textit{supra} note 57, at 16.
\hfill

\textsuperscript{101} Judgment of Nov. 29, 2002, Seoul High Court, 2001 No 2063, at 58. The High Court combined the appeals of the two lower district courts.
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\textsuperscript{102} \textit{Id.}
\hfill

\textsuperscript{103} \textit{Id.} at 59.
\hfill

\textsuperscript{104} 2001 No 2063, at 48.
\hfill

\textsuperscript{105} \textit{Id.} at 49–50.
\hfill

\textsuperscript{106} \textit{Daewoo Suicide, supra} note 12, at 164.
\hfill

\textsuperscript{107} 2001 No 2063, at 42.
\end{flushleft}
Daewoo commingled real commercial documents with falsified ones to sustain the deception.\(^{108}\) BFC personnel meanwhile worked under utmost secrecy.\(^{109}\)

Despite the BFC’s meticulous records, the destination of approximately $753 million remains unknown.\(^{110}\) Speculation abounds that money was used as corporate slush funds for political lobbying purposes. Others believe that Woo Choong Kim and senior managers siphoned off funds for personal enrichment.\(^{111}\) 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.\(^{112}\)

Overall, operation of the BFC accounts contravened several key laws. First, executives violated accounting laws.\(^{113}\) Daewoo, for instance, did not record or consolidate approximately five to eight trillion won ($4.17 to 6.7 billion) per year of off-

\(^{108}\) Given the extensive amount of bills of exchanges discounted, bank officers had difficulty in detecting the fraud. \textit{Id.} at 43.

\(^{109}\) The court held this was incriminating behavior that shows they knew they were committing improper acts \textit{Id.} at 47–49.

\(^{110}\) \textit{Daewoo Suicide, supra} note 12, at 164.


\(^{112}\) See Section III.A.

balance sheet liabilities between 1996 and 1999. Second, executives violated the law prohibiting “hiding of personal property overseas” without appropriate disclosure.\(^{114}\) They asserted that the BFC accounts were not concealed for any illicit purpose but solely to repay company debts.\(^{115}\) They repaid foreign loans, for instance, with funds obtained by selling debt locally.\(^{116}\) Courts rejected the argument because disclosure laws applied irrespective of an intention to repatriate missing funds later.\(^{117}\) The law required accurate reporting so that authorities had sufficient information to make policy judgments.\(^{118}\) Finally, the BFC accounts violated foreign currency laws. None of the accounts received official Ministry of Finance and Economy (MOFE) approval as required under foreign exchange regulations.\(^{119}\) Not only did they transfer funds out of the country to cover BFC’s debt without permission, but also they fabricated documents to conceal it.\(^{120}\)

When faced with a financial emergency in the midst of its managerial blunders, Daewoo chose to engage in purposeful deceit. They opted to manipulate secretive

\(^{114}\) Aggravated Punishment Act, art. 4, ¶ 1. *See* Judgment of July 8, 2004, Supreme Court, 2002 Do 661.

\(^{115}\) 2001 Gohab 171, at 44.

\(^{116}\) *Daewoo Suicide*, supra note 12, at 70–71.


\(^{118}\) On appeal, the High Court and Supreme Court both reaffirmed the lower court judgment. 2001 No 2063, at 45; 2002 Do 7262, at 10–11.


\(^{120}\) Import invoices were sent to paper companies controlled by Daewoo companies. 2001 Gohab 171, at 23.
overseas accounts to avoid detection by authorities and accountants. The scheme violated accounting laws, disclosure laws and foreign exchange laws. Even evidence of personal enrichment surfaced. Overall, the staggering fraud transpired as the result of a breakdown in both internal and external corporate governance.

III. Ineffectual Internal Corporate Governance

Daewoo’s misjudgments and accounting troubles serve as a reminder of the catastrophic cost of neglecting corporate governance. Weak internal corporate governance in particular was a common feature for many conglomerates leading up to the financial crisis. Internal corporate governance structures established under 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 imperial fashion. He 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 financial crisis. The crisis exposed the weakness of the concentrated governance structure

121 This contrasts with U.S. companies where entrenched inside managers tend to reign in unrivalled fashion. Hansmann & Kraakman, supra note 10.

122 Jong-Se Park, Geum-gam-wi-ga bon Daewoo [Daewoo in the Eyes of the
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 established global standards.

Kim held the formal title “Daewoo Group Chairman.” As head of the conglomerate, he acted as de facto chairman of the board of all Daewoo companies.123 He conducted all 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 strategy.124 Representative directors and board members, for example, were not nominated by boards or through annual general 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.

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123 Serving as de facto director also allowed chairman to escape liability. Judgment of Nov. 19, 2004, Seoul District Court. Kim, supra note 70. Legally, at the time of the crisis, he served as registered Representative Director of Daewoo Corp., Daewoo Heavy Industries and Daewoo Motor.

Kim wielded “absolute influence over the careers” of executives.\(^\text{125}\) 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.\(^\text{126}\)

Informal controls over the Chairman’s Office had existed in the past but suffered due to a changing of the guard at the conglomerate’s senior levels.\(^\text{127}\) 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 or even older in age, many were also alumni of the same schools.\(^\text{128}\) Hence, they could be blunt with him acting as an informal check and balance. 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 men, could not as easily confront the legendary founder, especially when the crisis unfolded.

Chairman Kim was able to control the conglomerate through a distorted yet tenuous ownership structure. In April 1997, for example, Kim and his family members, as controlling shareholders, only owned on average 6.1% of the shares in the major


\(^{126}\) 2001 Gohab 171, at 8; 2005 Gohab 588, 2001 No. 1022, at 9 (“Chairman Kim’s difficult to disobey order was the basis for crime”).


\(^{128}\) See Section III.B.
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 chaebol, also exhibited attributes more associated with dispersed ownership systems such as exaggerated accounting. The low stock price of Daewoo companies reflected not only

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130 Equity financing might not have been a viable option given the lack of attractiveness of Daewoo shares. Lee, *supra* note 16, at 176.

131 Other controlling families among the top 30 chaebol also retained control through affiliated companies, but on average they controlled a combined stake of 43%. Kim’s combined controlling stake of 38.3% was among the smallest of the top 30 chaebol. *Seung-No Choi, Center for Free Enterprise, Han-guk-ui Dae-gyu-mo-gi-eop-jip-dan [Korea’s Large Conglomerate Groups]* (1997). The FTC began regulating this cross-ownership of chaebol starting from 1997. See Kim, *supra* note 52.

This type of cross-ownership structure remains commonplace for Asian conglomerates in general. Stijn Claessens & Joseph Fan, *Corporate Governance in Asia: A Survey*, 3 Intl’l Rev. Fin. 71, 74 (2002).
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.\footnote{Kim first publicly announced this pledge in 1984. Han-guk-ui hu-gye-ja: Gim-u-jung Daewoo-geu-rup-hoe-jang hu-gye-ja-neun nu-ga-doe-na [Korea’s Successors: Who will be Successor to Woo-Choong Kim, Daewoo Group Chairman?], WEEKLY CHOSUN, Sept. 23, 1984, at 15 [hereinafter Korea’s Successors]; Daewoo Suicide, supra note 12, at 248.} He believed his successor should be a professional manager chosen based on merit. He trained managers and delegated authority to chief executives accordingly.\footnote{“Daewoo considered itself to have gone much further than any other large Korean firm in developing professional management.” Aguilar & Cho, supra note 3, at 6. Sang-Gyun Nam, Daewoo-geu-rup 40-dae 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.} Subsequently, Kim withdrew all his relatives from executive positions throughout the conglomerate.\footnote{One of Kim’s older brothers did serve as president of a Daewoo affiliate from 1976 and 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. Korea’s Successors, supra note 132, at 18.} His anti-nepotistic succession plan and management philosophy distinguished him from other heads who viewed
chaebol as personal possessions subject to dynastic succession.\textsuperscript{135} To them, the interest of shareholders and stakeholders to have the most competent manager 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 tremendous impact on the corporate world through the peer pressure it would have generated.

Second, in 1980, Kim donated over twenty billion won ($22.2 million) to the non-profit Daewoo Foundation that he had established in 1978.\textsuperscript{136} The donation consisted of the bulk of his Daewoo Corp. shares that amounted to seventeen and a half billion won ($19.4 million).\textsuperscript{137} The foundation’s mandate provided for it to engage in

\textsuperscript{135} In 1969, Yuhan Corporation founder Ilhan New became what is considered the first major corporate leader not to transfer control of his company to any of his heirs. \textit{Yu-Il-Han Yeon-Gu} (The Korean Academy of Business Historians ed., Shinwon Publishing Co. 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.

\textsuperscript{136} 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. Kim, supra note 129, at 13–15.

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 partial evidence of misappropriation. This contrasted with many other chaebol where personal enrichment by controlling shareholders and executives played a direct role in collapses. The secretive BFC funds for example were allegedly used to help the conglomerate. Kim loyalists argue that gross accounting and loan fraud was committed for Daewoo and not for personal benefit.

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Woo-Choong Kim Returns to Society 20 Billion Won ($22.2 million) in Personal Property], CHOSUN ILBO, Aug. 30, 1980, at 1; Kim, supra note 129, at 13–15.


139 Daewoo Suicide, supra note 12, at 26–27. In contrast, as was discovered later, the chieftains of most of the other chaebol that collapsed during the financial crisis were often found guilty of considerable embezzlement and expropriation. PUB. FUNDS MGMT. COMM’N, PUBLIC FUNDS MANAGEMENT WHITE PAPER 157–59 (2004).


142 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 chaebol and
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 other foundations established by the top 30 chaebol, the Daewoo Foundation owned the highest percentage of shares. In the early 1990s, it held 11.42% of Daewoo Corp., 2.67% of Daewoo Heavy Industries and 4.3% of Daewoo 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 apparently was also the first major chaebol to start hiring and retaining married female employees. Kim, supra note 72, at 170. Daewoo labor union workers and other victims nevertheless hold Kim highly culpable. See Section IV.D.

143 Clifford, supra note 22, at 63.

144 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 is the largest], HANKOREH, Oct. 6, 1993, at 7.

145 Id.

146 By December 1998, however, the Daewoo Foundation owned only 3.28% of Daewoo Corp., 2.14% of Daewoo Electronics and 2.61% of Daewoo Heavy, whereas the Kim and his family owned 15.3% of Daewoo Heavy. Daewoo Corp. later emerged as the real de facto holding company with its 37% ownership in Daewoo Motor and its 29.14% ownership of Daewoo Heavy Industries.

Daewoo Corp. from over ten percent to 5.81% in August 1993. Finally, the foundation operated not solely through Kim’s personal donations but through contributions conscripted from Daewoo affiliates. Enlisting such support particularly from listed companies diluted Kim’s personal, philanthropic intentions.

Suspicions persist that Kim and his insiders reaped substantial private benefits of control. First, allegedly over $753 million from the secretive British Finance Corporation remain unaccounted for even after a comprehensive audit by regulators. These funds could have been personally misused. In its November 2006 decision, the Seoul High Court, in fact, affirmed that Kim embezzled over $116 million from a special BFC account. Kim’s family used these funds for personal investments, purchase of art work and acquisition of real estate. Similarly, the Korea Deposit Insurance Corporation (KDIC) brought a civil action on behalf of creditors related to $2.5 million in donations to Harvard University, where a son of Kim was attending, and nineteen billion won ([$15.8 million], to Ajou University. Both donations involved use of company funds

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150 2005 Gohab 588, supra note 5. $44.3 million of the BFC funds were redirected to a Hong Kong paper company that served as a front for Kim. 2005 Gohab 588, supra note 5, at 51-52; Cheong-Mo Yoo, Daewoo Founder Kim’s Concealed Assets Worth W140, KOREA HERALD, Nov. 9, 2001; Kim & Song, supra note 141, at 242.
without board approval for seemingly personal reasons.\(^{151}\) Secondly, confidants, relatives, or pseudo-Daewoo affiliates allegedly hold most of Kim’s personal assets in proxy.\(^{152}\) By concealing such funds under third party names, they can thwart claims by creditors. These assets conceivably could have originated from expropriated funds.

All in all, as founder and controlling shareholder, Woo Choong Kim dominated affairs of the conglomerate without sufficient checks and balances. Autocratic control might have benefited Daewoo’s in its early years when its size was manageable and when Kim maintained his astute business sense. Yet over time the organizational structure of unquestioning loyalty to the controlling shareholder without appropriate checks or balances led to the malfeasance and fraud proceeding to unthinkable heights.

**B. Ceremonial Representative Directors, Directors and Statutory Auditors**


\(^{152}\) Daewoo Suicide, supra note 12, at 26–27; Yeong-Ho Yun, *Gim-u-jung 4430-man-bul ppaeh-dol-ri-gi ‘deul-tong’-nat-da [Woo-Choong Kim’s Siphoning of $44.3 million has been ‘exposed’]*, WEEKLY DONGA, Nov. 15, 2001; Kim & Song, supra note 141, at 242. At least six companies could have been used as potential fronts for this. Jong-Su Kim, *Yet-Daewoo-geu-rup wi-jang-gye-yeol-sa 6-gae-sa jeok-bal [Six Sham Companies of Old Daewoo Group Discovered]*, YONHAP NEWS, Jan. 25, 2002.
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 controlling shareholder taking advantage of non-controlling shareholders, stakeholders and others.\textsuperscript{153} 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.\textsuperscript{154} 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 office of planning kept under their care. At best, directors provided input through the representative director who would then relay 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

\textsuperscript{153} Korean companies faced a different 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. \textsc{Adolf A. Berle, Jr.} \& \textsc{Gardiner C. Means}, \textit{The Modern Corporation and Private Property} 139–40 (1933).

directors. The director position served as the highest possible rung on the corporate ladder for an executive. Senior officers when promoted became 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 1998.155

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 1997.156 The lack of civil legal actions meant that fundamental obligations such as fiduciary duty remained 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.157


156 Kim, *supra* note 155.

legally responsible was so low that director and officer liability insurance did not exist.\textsuperscript{158}

Lack of accountability to shareholders at large therefore left them subject to the dictates of the controlling shareholder. In case of conflict, they had little incentive to defy the wishes of the controlling shareholder and act on behalf of the interests of faceless, silent non-controlling shareholders. Controlling shareholders, on the other hand, made sure to reward loyal directors, executives and statutory auditors. After retirement, they bestowed an array of benefits, hiring them as consultants, using them as suppliers, or giving them outsourcing contracts or transitional support. Having spent an average of twenty years of their lives to rise to senior positions, executives 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 strategy of Daewoo executives in their criminal trials in particular revealed how they did not understand their duties or responsibilities.\textsuperscript{159} 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 fraud.\textsuperscript{160} Furthermore, they committed accounting violations for the conglomerate because companies had to repay reoccurring debts. They suggested that their actions should be justified because they did not personally gain from the fraud or

\begin{footnotesize}
\begin{enumerate}
\item[Curtis J. Milhaupt ed., 2003] [hereinafter Revamping Fiduciary Duties].
\item[159] Fourteen executives were later found guilty for charges that revolved around accounting fraud, loan fraud, foreign currency violations and hiding assets overseas. See Section IV.D.
\item[160] 2001 Gohab 171, at 8.
\end{enumerate}
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expropriate company funds.\(^{161}\)

They failed to grasp that allowing Kim to use the company to defraud others for any purpose could not be justified. They could not exaggerate Daewoo’s business operations, inflate its status and disguise its actual financial situation to borrow funds and issue corporate bonds.\(^{162}\) They could not commit accounting fraud to meet reoccurring debts or because they believed it was the best time to expand operations and acquire distressed companies. Under this flawed reasoning, they perpetrated the financial crimes without a guilty conscience. 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.” Furthermore, contrary to their belief, they did derive personal benefit because they would “not lose the chairman’s favor” and could “maintain their positions.”\(^{163}\)

The ability of Daewoo directors might have been affected more than other conglomerates because so many hailed from a particular school—Kyongi High School,


\(^{162}\) 2001 Gohab 171, at 53; 2001 No 2063, at 78–79.

\(^{163}\) 2001 Gohab 171, at 53; 2001 No 2063, at 79. See Section IV.D.
until 1973, Korea’s elite secondary school. As a Kyongi graduate, Kim surrounded himself with an inordinate number of 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 tie further consolidated the hierarchy in the upper echelons of management and weakened check and balances. Daewoo directors themselves believed that school background was a much more important factor in being chosen as a director compared to other chaebol. Furthermore, in the late 1980s and early 1990s, Daewoo underwent the generational change where many, original executives who were senior Kyongi alumni comparable in age and status to Kim were replaced. Junior alumni that succeeded lacked the same standing to counterweigh the legendary, domineering chairman.

Overall, directors, representative directors and statutory auditors neglected their roles as fiduciaries. They ultimately acted for their personal gain by placing a higher priority in maintaining their executive positions over the duty to obey the law, monitor the company and protect the interests of shareholders and stakeholders. Senior

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164 Nam, supra note 133, at 25. Some claim that close to 90 percent of senior Daewoo executives were Kyongi and Seoul National University graduates. Daewoo Suicide, supra note 12, at 133–34; Sull et al., supra note 3, at 9 (states that average was 30% for senior executives). According to the author’s determination, at the CEO level, approximately 50–60% were either Kyongi High or Seoul University graduates (on file with author). Kim became President of the Kyongi High School Alumni Association in 1998 as Daewoo’s collapse was unfolding.


166 See previous section III.A. on controlling shareholder.
executives not only did not prevent but also actively participated in the cover-up and fraud. In the end, they demonstrated a confused understanding of fundamental duties and responsibilities.

C. Investor Passivity

Daewoo’s shareholders could not have been more passive in overseeing managerial decisions. 167 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 fraud. 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 shareholders was that they could not easily exercise their rights. 168 Even after some of the most egregious corporate governance problems, 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.

One problem was that the regulatory framework set prohibitively high minimum holding requirement for most shareholder rights such as standing for derivative actions or  

167 BERLE & MEANS, supra note 153.

168 In fact, Korean policymakers deliberately weakened shareholder rights to induce companies to list on the Korea stock exchange that was struggling to develop. For a detailed discussion on the various limitations. See Kim, supra note 155, at 280–83.
inspection rights.\textsuperscript{169} 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 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 in particular faced many restrictions. Institutional investors, for example, could only exercise their votes through shadow voting, effectively neutralizing their participation. 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{170} Shareholders’ meetings when convened lasted no more than ten minutes according to scripts predetermined by the company. Agenda items such as approval of accounting statements and election of directors and auditors proceeded perfunctorily without discussion.

Under this environment, investors, both domestic and foreign, behaved as though monitoring costs were too high to have merit. Foreign investors in particular acted no differently even though they owned on average 9.5 percent of the top five Daewoo companies that committed the largest amount of accounting fraud.\textsuperscript{171} When coupled

\textsuperscript{169} Kim, supra note 155, at 281.

\textsuperscript{170} 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 3 particular days in March 2003. 2003 Ju-ju-chong-hoe-il-jeong-hyeon-hwang [Status of Annual Shareholders’ meeting Days], Korea Exchange. See generally <http://www.krx.co.kr.>(last visited Mar. 7, 2007).

\textsuperscript{171} In 1998, for example, foreigners owned 10.3 percent of Daewoo Corp., 1.7 percent of Daewoo Motor, 7.8 percent of Daewoo Securities, 12.6 percent of Daewoo
with traditional collective action problems, the “Wall Street rule” of sell and move on prevailed when companies reported bad news, managers violated their duties or abused their powers. At the same time, equity investment, particularly on the retail side, proceeded on an exceptionally short-term basis. Trading turnover of Korean investors ranked among the highest in the world. A vicious cycle developed because the more short-term the ownership the more economically impractical monitoring became.\footnote{172}

Only after Daewoo’s breakup have investors, together with banks, creditors, suppliers and former employees, finally been stirred to take action. They have brought a host of legal actions against Daewoo companies, managers and accountants.\footnote{173} In May 1999, the Peoples Solidarity for Participatory Democracy (PSPD), Korea’s leading shareholder activist group, filed the first major civil action claiming twenty-four billion won ($20 million) in damages against Woo Choong Kim and senior executives.\footnote{174} Over

\footnote{172} Korea’s short term trading might be heightened due to the lack of a capital gains tax for small, retail investors.

\footnote{173} 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, Constitutional Court, \textit{en banc}, 2002 Heonga 23 Panryejip [Court Decisions] 15–2, 393–405.

\footnote{174} The action followed on the heels of a June 1998 FTC sanction against Daewoo for improperly supporting affiliates After five years of litigation, the Seoul District Court dismissed claims against Kim that he should be responsible for illegal support of Daewoo Corp. on the grounds that he was neither a director of the company involved nor did he participate or tacitly agree to the support. At http://www.peoplepower21.org (last visited Mar. 7, 2007). Judgment of Nov. 19, 2004, Seoul District Court. \textit{Daewoo-gye-yeol-sa bu-dang-ji-won Kim woo-choong-ssi}
forty cases seeking a total of 600 billion won ($500 million) apparently were pending in Korean courts at one point.\textsuperscript{175} On September 12, 2002, shareholders even won their first civil decision 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 completing false annual reports and audit reports.\textsuperscript{176}

During this process, shareholders have been assessed contributory fault for their negligence. In a 2005 case involving Daewoo Electronics, a court held investors partially at fault while allocating different degrees of responsibility between accountants and directors.\textsuperscript{177} They found 14.5 billion won ($12.1 million) in liability for fraudulent audit

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\textsuperscript{177} 2000 Gahap 78858 hard copy. Three-hundred and sixty investors brought a separate action on October 24, 2000 against managers of Daewoo Electronics, Daewoo Heavy Industries and their accountants for their accounting fraud that settled in mediation on January 2005.
Shareholders were found to be contributorily negligent for 10 percent, while accountants were held 30 percent liable, directors directly involved in the accounting fraud, including Kim, 40 percent, whereas “non-financial” directors and outside directors, only 20 percent.\footnote{2000 Gahap 78858, at 45–46. While reducing their relative liability, the court rejected the defense of outside directors that they should not be assessed any responsibility because they were non-standing board members or because they fulfilled their “duty of due diligence” by relying upon the external auditors. 2000 Gahap 78858, at 23–24.} Previously, shareholders prevailed against Daewoo Heavy executives in a 2004 case, but had their claim reduced due to contributory negligence as well.\footnote{Ji-Bok Ryu, Daewoo bun-sik-hoe-gye ju-ga-son-sil bae-sang-chaek-im [Daewoo Liable for Stock Losses from Accounting Fraud], \textit{Yonhap News}, May 30, 2004. Judgment of May 28, 2004, Seoul District Court, 2000 Gahap 78865.} 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 forty percent of the claim.\footnote{2000 Gahap 78865, at 9: Securities Exchange Act, art. 186–5, 14 ¶ 1 (S. Korea).} The court found shareholders negligent in investing in such a risky stock that had widely known financial difficulties.\footnote{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. \textit{Id.} at 13. In two others cases, however, different district courts found that liability should extend until November 11, 1999 when the

\footnote{178 Daewoo Electronics and its executives were found liable under Articles 186–5 and Article 14 of the Securities Exchange Act while the accountants were found liable under Article 197 of the Securities Exchange Act and Article 17, Paragraph 2 of the External Audit Act.}
Therefore, while shareholders have made strides in seeking restitution, they have also been reproached for their own failures.

Passive Daewoo shareholders did not monitor managerial decisions. Institutional investors, particularly foreign ones, despite their holdings and sophistication remained just as complacent. Shareholders faced inherent limitations, legal hurdles and company obstruction in their ability to seek accountability or transparency. Instead, they passively relied upon the state to protect them. Only after Daewoo collapsed were they prompted to take action through legal recourse.

D. Compliant Commercial Banks and Silent Debt-Holders

Lenders and purchasers of debt were no different in their neglect of corporate governance oversight. They did not engage in governance-related activity such as demanding transparent accounting, ensuring lending discipline or electing representatives to the borrower's boards. Sophisticated foreign banks and debt holders similarly should have utilized their lending position to access financial information and monitor board decisions. Commercial stakeholders neglected these opportunities. They instead suffered from a combination of a historical legacy of contentment, over-reliance upon the government issued it formal report. Sang-Hee Kim, Bun-sik-hoe-gye tu-ja-ja-son-sil sil-sa-gyeol-gwa bal-pyo-ttae-kka-ji [Investor Losses due to Accounting Fraud Until Announcement of Due Diligence], YONHAP NEWS, Sept. 10, 2004; Judgment of Sept. 10, 2004, Seoul District Court; Judgment of Jan. 13, 2005, Seoul District Court, 2000 Gahap 78858, at 41-42. Judgment of Jan. 13, 2005, Seoul District Court, 2000 Gahap 78858. Yeong-Jae Moon, Daewoo-jeon-ja so-aek-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.
government, dishonest practices, and their own governance problems.

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

183 The system drew its origins from Japan. SUNG-HEE JWA, A NEW PARADIGM FOR KOREA’S ECONOMIC DEVELOPMENT (Palgrave Press, 2001), at 139. For a review of the Japanese banking system see AKIHIRO KANAYA & DAVID WOO, THE JAPANESE BANKING CRISIS OF THE 1990S (IMF WORKING PAPER, WP/00/7, JAN. 2000).

184 Id. at 28. Unlike Japan or Germany, the civil law countries from which Korean law derived, commercial banks did not own equity stakes in their borrowers and focused on corporate lending and guaranteeing bonds.

185 Kim, supra note 155, at 320–322. Daewoo’s woes toppled KFB and led to a government takeover.

186 At one point, Daewoo even attempted to seek control of KFB. Lee, supra note 16, at 164. Largely to limit chaebol ownership, the banking laws did not allow an individual investor to own more than 4 percent of a bank. Banking Act, Law No. 6691 of 2002, art. 2.
bank for a string of chaebol that went bankrupt right before the crisis.\textsuperscript{187}

Foreign commercial lenders differed little from domestic banks in their lax lending practices.\textsuperscript{188} They did not ensure accounting transparency or proper corporate governance. They displayed the same imprudence as domestic banks in mismanaging risk exposure to Daewoo. Unlike domestic banks, however, they could not blame questionable lending decisions on administrative guidance, political pressure or lack of financial expertise. In making $5.1 billion in foreign currency loans, foreign banks generally admitted that they had lent to Daewoo as backed by “Korea Inc.”\textsuperscript{189} In the end, over 140 banks from 100 countries around the world lent to Daewoo affiliates.\textsuperscript{190} Foreign banks cannot escapes responsibility for failing to act as competent monitors. Given their sophistication, they remained just as culpable for passivity, improper risk assessment and over-committing depositor money to high-risk Daewoo loans.

\textsuperscript{187} The failures of Kia Motor, Hanbo Group, Woosung Group and Sammi Group in fact sparked the spread of the Asian financial contagion to Korea.

\textsuperscript{188} Interestingly, Japanese banks were not exposed to Daewoo having ended their loans in February 1996. \textit{Daewoo Suicide, supra} note 12, at 154.

\textsuperscript{189} The loans were primarily made to Daewoo Corp., Daewoo Motor, Daewoo Electronics and Daewoo Heavy. 1999 Government Report, \textit{supra} note 34, at 17; \textit{Daewoo Suicide, supra} note 12, at 104.

\textsuperscript{190} \textit{Let The Market Fix Daewoo, BUSINESS WEEK INT’L,} Aug. 16, 1999. \textit{Another} account provided that 200 foreign credit banks were due $9.94 billion. \textit{Daewoo Suicide, supra} note 12, at 97; Kim Chong-Tae, \textit{Desperate measures might be too little, too late}, BUS. KOREA, Aug. 1, 1999 (“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.”)
Banks themselves operated under ineffective governance. Selection of bank executives, for example, was a politically-charged affair determined by a confluence of bureaucratic in-fighting, party politics and chaebol lobbying. Vulnerability to external pressure compromised independence, with the government’s policy interests usually prevailing. Boards hence did not operate under market-oriented principles that focused on profits, shareholder value or risk assessment. They followed the too-big-to-fail myth and recklessly extended credit under government direction. When financial crisis hit, banks stood paralyzed without direction from 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. Banks themselves operated under suspect accounting standards, particularly their generous treatment of non-performing loans.

Finally, in the case of Daewoo, banks argued that they were deceived by the concealed accounting fraud. They claimed they did not know the seriousness of the group’s financial situation due to the sophisticated international machinations. KFB’s senior managers testified that they first detected problems with Daewoo’s balance sheet, in particular its cash flow and business profits, only in 1997. Nevertheless, commercial

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191 JAE-HA PARK, ASIAN DEVELOPMENT BANK INSTITUTE, CORPORATE GOVERNANCE OF BANKS IN REPUBLIC OF KOREA (2004). See Section I.C.

192 Kim, supra note 155, at 320–322.

193 In this criminal case, three Daewoo executives were for convicted for defrauding KFB in 1994 into issuing a letter of credit for $150 million. 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 District Court:
banks appear to have been complicit partners with a measure of knowledge and disregard to warning signs. 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. Despite the accounting fraud, the bank shared 80 percent of the fault while executives were held liable for only six billion won ($5 million) out of a forty billion won ($33.3 million) loan. The court stressed that the bank knew that “accounting fraud was rampant among Korean chaebol” and that they “knew that Daewoo Motor financial condition was not good.”

As with shareholders, only after the meltdown have banks and their insurers finally become active in seeking accountability. First, they pursued legal actions for repayment of delinquent loans made possible through the 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

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194 Kim & Bae, supra note 57, at 12.


197 Id.

198 Article 401 of the Commercial Code provided the basis for attributing director liability to third parties such as the bank.

199 The Seoul High Court upheld the liability and also found the statute of limitations against executives and accountants involved should be ten years and not three years
accounting misrepresentations that led to 25.8 billion won ($25.8 million) in losses to theank.\textsuperscript{200} As mentioned above, in November 2004, Woori Bank also won a six billion won
($5 million) judgment against five Daewoo Motor executives including Woo Choong
Kim.\textsuperscript{201} 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.\textsuperscript{202}

\begin{flushleft}
\textit{as provided in the Civil Code. Sang-Hee Kim, \textit{Bun-sik-hoe-gye dae-chul-pi-hae
son-bae so-myeol-si-hyo 10-nyeon [Ten Year Statute of Limitations for
Compensation Claim for Loan Losses from Accounting Fraud], YONHAP NEWS, Oct. 28,
2004. Judgment of Nov. 6, 2003, Seoul District Court, 2002 Gahap 82073; Yu-Jin Shin,
I-sa-deul-i im-mu-reul ge-eul-ri-han gyeol-gwa je-3-ja-ga son-hae hwat-da-
myeon so-myeol-si-hyo-neun 10-nyeon [Statute of Limitations Ten Years if
Director's Neglect of Duties Causes Damage to Third Party], L. TIMES (Seoul), Nov. 7,
2003.}
\end{flushleft}

\textsuperscript{200} The Court in particular 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 provided under the Civil Code. The defense had 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 applying a different standard the court
found he did not commit gross negligence.

\textsuperscript{201} Kim, \textit{supra} note 196; Judgment of Nov. 24, 2004, Seoul District Court.

\textsuperscript{202} KDIC’s claim arose out of personal guarantees that they had secured from Kim for
insuring export financing loans to Daewoo Corp. and Daewoo Motor from several
domestic banks. When Daewoo defaulted on the bank loans, KEIC pursued legal action
Other than banks, debt-holders such as investments trusts, guaranty companies, merchant banks and insurance companies collectively neglected corporate governance despite acquiring or guaranteeing 19.7 trillion won ($14.1 billion) 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 furthermore 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, had guaranteed a substantial amount of Daewoo’s bond offerings and was held responsible for over 7.2 trillion won ($6 billion), which amounted to 12% of Daewoo’s total debt. Three hundred and sixty-eight


Of this debt, 11.3 trillion won ($8.1 billion) consisted of corporate bonds and 8.4 trillion won ($6 billion) consisted of commercial paper; in addition to 8.4 trillion won ($5.6) in bonds and 3.6 trillion won ($2.4) in commercial paper that already existed at the end of 1997. 1999 Government Report, supra note 34, at 2; Kim & Song, supra note 54; Kim & Bae, supra note 57, at 11.

Commercial bank exposure was relatively larger when compared to investment trust exposure. The government subsequently took over the largest investment trusts, Korea Investment Trust and Daehan Investment Trust, who held most of the debt.


Id.
foreign institutions also owned at least $4.1 billion of Daewoo debt instruments.\(^{207}\) 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 corporate governance. They passively acquired Daewoo debt in part as a reckless attempt to increase their own profit margins and in part due to implicit guarantees and pressure from the government.\(^{208}\) Daewoo bonds and commercial paper had long been discounted at substantially higher rates than other chaebol due to its risks.\(^{209}\) Many clung to the same moral hazard that despite the risk the government would never let Daewoo go under.\(^{210}\) Furthermore, in early 1999, regulators “threatened and pleaded” investment trusts to rollover Daewoo bonds that reached maturity. Regulators resorted to arm-

\(^{207}\) Public Funds Management White Paper, \textit{supra} note 139, at 217. Through its legal mandate, 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. Korea Asset Mgmt. Corp., \textit{Non-Performing Loan Restructuring Fund White Paper} 343–45 (2004)[hereinafter KAMCO White Paper].

\(^{208}\) Daewoo Suicide, \textit{supra} note 12, at 72.


\(^{210}\) Lee, \textit{supra} note 16, at 165.
twisting because they believed they had to prevent a dangerous run on Daewoo that could threaten the bond market which almost occurred. 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 has been curtailed. Many institutions have finally begun to operate with rigor under market-oriented principles, particularly regarding their business practices. As with equity investors, however, leading up to the debacle, lenders and debt holders, domestic and foreign, did not play a role in corporate governance oversight.

E. Labor Limitations

Among other actors, Daewoo labor and employees did not act to provide internal controls or oversight concerning the conglomerate’s corporate governance. As interested stakeholders, they had incentive to function as active monitors. Yet, they did not operate as a check to prevent wrongdoing by senior management. An assortment of

211 Daewoo Suicide, supra note 12, at 73.
212 Daehan Life Insurance among others later pursued legal actions to seek damages from Daewoo executives stemming from the accounting fraud related to the debt.
factors ranging from board structure to weak ownership, to lack of information and to ineffective organization limited them from operating more vigorously. Only after the collapse did labor representatives take action such as when they organized international expeditions to try to bring Woo Choong Kim to justice.

First, despite Korea’s continental law background that could trace its origins to German law, formal labor participation on boards of stock companies never existed under corporate law. Korean law adhered to a one-tiered board structure without codetermination. Labor 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. In the case of Daewoo, due to its history of growth through acquisition, it had the “highest possibility of labour conflict arising out of their restructuring efforts” because laborers from the acquired company feared prospects of downsizing. Bitter, prolonged strikes plagued Daewoo companies. Labor, however, did not extract concessions related to corporate governance that might have constrained excesses of the controlling shareholder and executives.

Second, labor and employees were weak owners. As with most Korean companies, Daewoo companies had employment stock ownership plans (ESOP) but they


215 According to the Ministry of Labor, between 1995 and 1998, Daewoo had sixteen labor strikes, second only to Hyundai. Id. at 31.
did not function as a monitoring force. First, average holding of ESOPs in Daewoo companies remained small and averaged only 0.61% at the end of 1997. ESOPs also remained captive to company interests with company insiders dominating operations. Moreover, under the regulatory structure governing ESOPs, plan participants had to either delegate 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 labor and employees to become more active monitors. They had limited access to information. As witnessed through operation of the BFC, for example, only a handful of senior managers knew of the 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.\textsuperscript{219} Even after the dismantlement of the conglomerate, former Daewoo employees have not written exposés on what led to the meltdown.\textsuperscript{220}

Therefore, labor and employees did not play a role in corporate governance. They did not have influence in the selection of board members since codetermination never emerged in Korea. Labor unions or ESOPs furthermore did not effectively organize to provide oversight as part of playing a more active role in governance. Institutional and legal barriers such as regulatory restrictions and lack of information compounded the limitations they faced.

IV. Where Were the Gatekeepers and Public Guardians?

As with all corporate scandals, a flurry of finger pointing ensued as everyone


\textsuperscript{220} One exception is Woo-Il Kim, the former Daewoo senior executive in charge of restructuring of the entire group. Kim & Song, \textit{supra} note 54. He also wrote a semi-fictional account of the conglomerate. \textit{Woo-Il Kim, Mun-Eo-Neun Wae Ju-Geon-Neung-Ga? [Why Did The Octopus Die?]}, (Daewoo M&A 2005).
sought to pin blame for Daewoo’s debacle. Ultimately, no single entity can be faulted for
the fiasco. Not only did standard internal corporate governance breakdown, but also a
comprehensive breakdown occurred on the external level. In particular, gatekeepers,
domestic and foreign, did not fulfill their respective functions.\footnote{221} Accounting firms,
credit rating agencies, securities analysts and investment banks did not do enough to
prevent the mismanagement and fraud. In addition, public sectors guardians did not
establish the legal discipline necessary for corporate governance to operate effectively.
Regulators, prosecutors, judges and tax authorities left corporate malfeasance
uncorrected. Inordinately generous, their failure to discharge their public functions
compounded the catastrophe.

What gatekeepers and guardians knew in terms of 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 fraud.\footnote{222} 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.\footnote{223}

This chapter assesses the roles of gatekeepers and guardians in the Daewoo

\footnote{221} Reinier H. Kraakman, \textit{Gatekeepers: The Anatomy of a Third-Party Enforcement

\footnote{222} 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.

\footnote{223} Kim, \textit{supra} note 196.
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 chaebol with regard to transparency and accountability. The chapter concludes with a discussion on the changes that have strengthened external corporate governance. Enforcement discipline in particular has developed out of new alternative mechanisms that operate outside of corporate law.

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. Daewoo’s accounting troubles were dismissed as Korean problems that arose out of a combination of ineffective regulatory supervision, a lack of accountability, conflicts of interest and weak self-regulation. In the aftermath, unprecedented liability has helped to establish compliance in the industry.

224 Chong-Un served as the Korea affiliate of Horwath International whereas San Tong was long-associated with KPMG. John Burton, Partners Endorse Proposed Merger, FIN. TIMES, Mar. 20, 2002, at 40 (“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 standards when it hired Peat, Marwick & Mitchell to start producing consolidated (combined?) financial statements according to U.S. accounting standards. Aguilar & Cho, supra note 3, at 10.

225 YONHAP NEWS, supra note 202.
Daewoo’s primary accounting firms, Chong-Un and 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 firm at one point, served as lead accountant for several, major Daewoo companies for over ten years. Market participants, domestic and international, 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, but 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 to accounting misstatements and opaqueness prevailed. Industrial policy under the developmental state tacitly condoned inflation of financials under the pretext that companies needed financing to grow. Accounting firms believed that government would act as a safety net and resolve any serious problems. At the same time, regulatory, civil, or criminal accountability of the auditing industry remained practically non-existent. Accounting firms were not held responsible

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226 Ahn Kwon audited Daewoo Motor and Anjin audited Daewoo Electronics.

227 They served as the lead accountant for Daewoo Corp. in addition to Dinners 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.

228 CHOI, supra note 229, at 63–64.

to shareholders, creditors or other stakeholders at large due to weak private and public enforcement.\textsuperscript{230} 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.\textsuperscript{231}

From a practical standpoint, accounting firms believed they could not afford to offend the chaebol, their dominant revenue-generating clients.\textsuperscript{232} A structural dependency developed because firms relied on chaebol business that pressured them into overlooking questionable accounting treatments.\textsuperscript{233} In August 1996, for example, a group of accountants from San Tong apparently debated on whether to publicly expose Daewoo’s accounting problems.\textsuperscript{234} 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.\textsuperscript{235} In both cases, business as usual prevailed and nothing transpired. 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

\textsuperscript{230} Yeong-Bae Kim, \textit{Daewoo 23–jo-won, kko-ri jap-hin-da} [Daewoo’s 23 Trillion won ($19.2 billion), \textit{Tail is Caught}], HANKYOREH, July 26, 2000, at 21.

\textsuperscript{231} External Audit Act, art. 17; Securities Exchange Act, art. 197 (S. Korea).

\textsuperscript{232} San Tong, for example, generated over 15 billion won ($12.5 million) in annual revenue from Daewoo companies. \textit{Mol-rak-han gong-ryong-gi-eop ‘En-ron–Daewoo’ eo-tteon cha-i it-na} [Failed Dinosaur Companies: Differences between \textit{Enron and Daewoo}], MAEIL BUS. NEWSPAPER, Jan. 25, 2002.

\textsuperscript{233} Kim, \textit{supra} note 230.

\textsuperscript{234} \textit{Daewoo Suicide}, \textit{supra} note 12, 145–52.

\textsuperscript{235} The executive 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, \textit{supra} note 54.
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 business, the most severe sanctions in history. Chong-Un received a one-month suspension of all new business during March and April of 1999, while the FSS issued a twelve-month suspension of new business against San Tong. 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 firms. The sanctions served as death knells for the firms, which collapsed shortly thereafter. KPMG and Horwarth meanwhile 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

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236 Daewoo Suicide, supra note 12, at 158.


238 Aside from paying into the Compensation Fund their entire 1997 auditing fees from the respective companies, 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. Certified Public Accountants Act, Law No. 1797 of 1966 art. 48 (as amended Law No. 6994 of 2003); Implementing Decree, Decree No. 18352 of 2004 art. 30. See Section IV.C.

239 External Audit Act, art. 17; Securities Exchange Act, art. 197. In one of the first civil cases ever brought by an investor against accountants, in September 1997 the
taken the lead among claimants against 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 fraud, KDIC compelled banks to bring civil actions to hold them responsible. Banks such as Cho Hung Bank and Woori Bank that received public funds 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, directly commenced civil litigation against San Tong and Ahn Kwon for their delinquent audits of Daewoo Corp. and Daewoo Motor in September 2003.

Supreme Court held 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, Supreme Court, 97 Da 26555.

The firms implicated included Anjin & Co., Ahn Kwon & Co. and San Tong and Daewoo executives were co-defendants in the actions. Daewoo Executives Cause W 4.26 Tril. in Losses, KOREA TIMES, Sept. 25, 2002. See Section IV.D.

Id.: Depositor Protection Act, Law No. 6173 of 2000 art. 21–2.


For more on the RFC, see <http://www.rtc.or.kr> (last visited Mar. 7, 2007).

Sang-Hee Kim, Kim-woo-choong Daewoo-hoe-jang deung sang-dae 150-eok son-bae-so [15 billion won ($12.5 million) Compensation Action against Woo Choong Kim
In the process, unlike commercial banks, courts have been more likely to attribute knowledge of and liability for, accounting fraud. In one of the first criminal cases, a senior Chong-Un accountant was held to be aware of the accounting fraud at Daewoo Telecom.\(^{244}\) The court found that the company and accountant’s collusive relationship indicated intimate awareness.\(^{245}\) The accountant received 470 million won ($392,000) in disgorgement penalties and an eighteen-month sentence that was suspended for three years.\(^{246}\) In another criminal action, the head of Ahn Kwon & Co., 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 the company’s


\(^{244}\) Korea Development Bank apparently loaned 554.5 billion won ($396 million) to Daewoo Telecom based upon the fraudulent accounting records such as the 1998 Audit Report Chong-Un had approved. 2001 No 1022, at 9, 11. The company engaged in 346.6 billion won ($231 million) of accounting fraud in 1997 and 477.9 billion won ($341 million), in 1998. 2001 Gohab 129; Seung-Jae Baek, \textit{Jeon-Daewoo-tong-sin sa-jang 4-nyeon-hyeong, hoe-gye-sa-do sil-hyeong [Former Daewoo Telecom CEO Four Year Sentence, Accountants Also Sentenced]}, CHOSUN ILBO, Apr. 13, 2001; 2001 No 1022, at 4–5.

\(^{245}\) When Chong-Un was ordered to pay additional funds into the Monetary Liability Compensation Fund for its delinquent auditing, at the accountant’s request, the company 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.

statements and not conducting a proper audit of Daewoo Motor and.\textsuperscript{247} In civil cases, courts also have assessed knowledge by accountants of the accounting fraud.\textsuperscript{248} 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.”\textsuperscript{249}

Through the Daewoo saga, for the first time, serious accountant and auditor liability has been established. Enforcement discipline has had a rippling effect because accounting firms finally have a strong disincentive not to relent to corporate pressure to approve misrepresentations. They can now point to the dire consequences of failing to comply with the law. Leading international accounting firms, in the meantime, avoided 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


\textsuperscript{248} The failure to correct the problems or disclose them violated Article 6 and 8 of the Accounting Auditing Standards. \textsc{Accounting Auditing Standards, The Korean Institute of Certified Public Accountants}.

\textsuperscript{249} 2000 Gahap 78858 at 34.
accounting problems. The extent to which these experts knew about Daewoo’s financial situation, or refrained from knowing, similarly lingers as a question. Investment banks underwrote enormous sums of Daewoo securities throughout the financial crisis during 1997 and 1999.\textsuperscript{250} Industry securities analysts did not issue serious warnings about the conglomerate until the middle of 1998.\textsuperscript{251} 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 them has 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.\textsuperscript{252} Daewoo continued to issue securities domestically and overseas during the 1990s through leading global underwriters. Furthermore, during the most critical period of the financial crisis, in 1998, Daewoo successfully issued 19.7 trillion won ($14.1 billion) in corporate bonds and commercial paper at interest rates ranging from 15 percent to as high as 25 percent.\textsuperscript{253} Between July and November of 1998 right before the collapse, Daewoo

\textsuperscript{250} Most of the Daewoo Group’s underwriting consisted of bonds. From 1997 to 1999, the Daewoo Group’s total equities offering consisted of nothing in 1997, 80 billion won ($57.1 million) in 1998 and 10 billion won ($8.3 million) in 1999.


\textsuperscript{252} Chira, supra note 195, at D9.

\textsuperscript{253} 1999 Government Report, supra note 34, at 2; Kim & Song, supra note 54; Kim & Bae, supra note 57, at 11.
Motor alone issued 1.1 trillion won ($780 million) in bonds.\textsuperscript{254}

During the underwriting process, investment banks and securities firms, domestic and international, were apparently oblivious the problems. During criminal trials against Daewoo executives, courts applied a high burden of proof and agreed that financial institutions and investment banks did not know the extent of the troubles.\textsuperscript{255} Courts held that investment banks would not have acquired or guaranteed Daewoo bonds had they known the extreme situation concealed by the accounting fraud.\textsuperscript{256} In general, under the generous standards of Korea’s securities law, underwriters could avoid liability as long as they could prove they engaged in “due diligence.”\textsuperscript{257} Due diligence could be established through minimal effort by merely demonstrating reliance upon an accounting firms’ audit report.\textsuperscript{258} 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

\textsuperscript{254} 2001 No 2063, at 83.


\textsuperscript{256} \textit{Id.}

\textsuperscript{257} Securities Exchange Act, art. 14 (S. Korea).

\textsuperscript{258} Morgenson, \textit{supra} note 255.
supporting affiliates. In the case of bond offerings, for example, securities firms within a conglomerate were restricted from directly underwriting unsecured bonds from related affiliated companies. Regulations existed to prevent securities firms from becoming conduits to unduly support affiliated companies. To circumvent the restriction, however, securities firms from different conglomerates colluded to lend each other their names to underwrite bonds of affiliates from each other’s conglomerates.\textsuperscript{259} Hence, bonds issued by Daewoo affiliates would ‘circulate in the market’ through a third-party purchase by a securities firm of another conglomerate; that security would then sold them back to Daewoo Securities.\textsuperscript{260}

Securities analysts, among the most sophisticated observers, did not differ and functioned ineffectively. 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.\textsuperscript{261} CSFB highlighted that relative to the other ten leading chaebol “Daewoo stands out as having extremely high financing needs.”\textsuperscript{262} They rated Daewoo’s profitability among chaebol as one that “ranks as one of the lowest.”\textsuperscript{263} They determined that Daewoo had the highest net cross-guarantees at the end of 1997.\textsuperscript{264} In particular, they stated that they “continue to be alarmed at about Daewoo’s massive guarantees

\begin{itemize}
\item[\textsuperscript{259}] 2001 No 2063, at 40.
\item[\textsuperscript{260}] Id.
\item[\textsuperscript{261}] 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, \textit{Driving To The World}, ASIAWEEK, Mar 21, 1997.
\item[\textsuperscript{262}] Yun & Shin, \textit{supra} note 214, at 18.
\item[\textsuperscript{263}] Id. at 21.
\item[\textsuperscript{264}] Id. at 26.
\end{itemize}
extended to its overseas affiliates.” They assessed that Daewoo was in the worst position in its ability to benefit from restructuring. Seven months after the financial crisis hit Korea, a leading securities firm issued the first warning of Daewoo.

Then, in October 1998, Nomura issued its “Alarm Bells are Ringing” report. In essence, the 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 to withstand its credit crunch because of its over-reliance on corporate bonds and short-term debts, low market capitalization and lack of attractive assets. The report stated that during the financial crisis Daewoo “survived solely on liquidity procured through bond issuances.” The report 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 Industry. One can speculate that it took securities analysts so long to issue warnings because their firms remained captive to investment banking business.

Among reputational intermediaries, credit rating agencies were perhaps slowest

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265 Id. at 27.

266 Id. at 40.

267 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 and a “hold” and not “sell” recommendation remained for Daewoo Heavy Industries. Koh, supra note 19, at 1–2.

268 Koh, supra note 33, at 2.

269 Id. at 3.

270 Id. at 2.
to assess the precarious state of Daewoo’s affairs.\textsuperscript{271} They were criticized for reacting to unfolding events instead of acting as warning systems that should have led the market.\textsuperscript{272} In particular, leading domestic and international credit rating agencies did not downgrade Korea’s sovereign ratings or the credit ratings of Daewoo and other chaebol in a timely fashion. They all avoided responsibility and have not faced any significant scrutiny for their failures.\textsuperscript{273}

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 agencies downgrade local currency credit ratings on Daewoo bonds of leading companies such as Daewoo Corp., Daewoo Motors, Daewoo Electronic, Daewoo Heavy, Daewoo Securities and Daewoo Capital from an A- to BBB- rating. Ratings dropped from an investment grade of BBB- to speculative grades

\begin{itemize}
  \item \textsuperscript{272} Id.; \textit{Guillermo Larrain ET AL.}, \textit{Emerging Market Risk and Sovereign Credit Ratings}, (OECD DEV. CENTRE WORKING PAPER No. 124, 1997): \textit{Credit-rating agencies: Who rates the raters?}, \textit{Economist}, Mar. 23, 2005 (“how 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]?”).
  \item \textsuperscript{273} Im, \textit{supra} note 209, at 53.
\end{itemize}
of BB or BB+ six months later in May and June 1999. These reputational intermediaries took more than a year to respond after CSFB’s initial report. Furthermore, during this time, 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.

International credit rating agencies located overseas only proved marginally more rigorous, although they did not distinguish Daewoo with other chaebol in terms of foreign currency ratings of bonds issued abroad. Before the crisis precipitated, Daewoo Corp. and most other chaebol companies maintained the same investment grade credit ratings of BAA2 from Moody’s and a BBB- from Standard & Poors. Foreign currency bonds generally received lower credit ratings due to foreign exchange risk and transaction costs. Then as contagion spread, on December 22, 1997, agencies simultaneously downgraded sovereign ratings of emerging markets such as Indonesia, Malaysia, Russia and Korea. The Korean downgrades in particular were the “most dramatic instances of sovereign rating downgrades in the history of sovereign ratings, bar none.”

Downgrades of the chaebol corresponded with sovereign rating downgrades. Ratings for major chaebol plunged together two places each on two consecutive days for a total drop of four places from BBB- to B+. Daewoo was treated no differently. Only after seven


277 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
month in July 1998 did Daewoo and Hyundai companies receive additional downgrades from B+ to B. Another eight months expired before S&P finally downgraded Daewoo Corp. from a B to B- in April 1999. By July 1999, Standard & Poor’s and Fitch IBCA downgraded Daewoo Corp. by two stages from a B- to a CCC rating that indicated that default was a possibility.278

Both domestic and international credit rating agencies therefore did not serve as effective gatekeepers in detecting Daewoo’s problems. They followed a herd mentality in moving together and reacting belatedly to red flags. Their inability to assess the creditworthiness 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 consisted of secured bonds and not unsecured debentures.279 This reduced need for an active market for credit assessment of bonds. Furthermore, 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 bonds. Negative ratings by an agency could have a direct impact upon the value of the bank’s bond holdings. Hence, agencies faced business pressure.

Underwriters, corporate advisors, securities analysts and credit agencies, many from the most prestigious firms in the world, avoided scrutiny in their roles in Daewoo’s debacle. Unlike commercial banks or accountants, they have not faced legal challenges.

278 Fitch IBCA also removed Daewoo Corp. from its Rating Alert positive list where it had been since February 1998. Fitch IBCA Downgrades Daewoo Corp.’s Rating, ASIA PULSE, July 21, 1999; Lee, supra note 16, at 168.

279 Im, supra note 209, 46–49.
They actively represented and analyzed Daewoo companies but they claim were blinded by its financial wizardry. Applying an antiquated, high burden of proof, some courts even held that financial institutions and investment banks could not be held liable because they did not know the extent of the problems. Eventually, these market players must face the same level of accountability they face in advanced capital markets for external corporate governance to develop in emerging markets such as Korea.

C. Financial Supervisory Service, Fair Trade Commission and KDIC

In the aftermath of the scandal, policy makers and regulators bore the brunt of condemnation because regulatory oversight malfunctioned and a state of paralyzed indecision followed.\textsuperscript{280} They failed to detect problems, did not monitor and did not establish regulatory discipline. Regulators were the “only actor who could have stopped the Daewoo collapse or at least minimize[ ] the cost by intervening quickly,” but they did not take initiative, particularly throughout the critical time of 1998.\textsuperscript{281} Together with policy makers, they suffered from a combination of disincentives for seeking active solutions, overconfidence as architects of Korea’s economic success and fear of the unknown if they allowed a major chaebol to fail.\textsuperscript{282} Lack of regulatory discipline in particular nurtured lax compliance that fostered the mismanagement and fraud. Although not traditional regulators, the KDIC has emerged as one of the most effective public sector sources of corporate governance discipline. They have helped generate an enforcement mechanism operating outside of the statutory corporate law framework that

\textsuperscript{280} Repeated freedom of information requests with the FSS for the regulatory audits of Daewoo have been denied. (on file with author).

\textsuperscript{281} Lee, supra note 16, at 172.

\textsuperscript{282} Id. at 173–74.
has served to establish accountability. Over the years, warning signs existed to ascertain the magnitude of Daewoo’s troubles. Starting from 1986, for example, the Korea Bankers Association operated a consolidated financial information system. Everyone with access could determine that the Daewoo Group’s loans from banks amounted to approximately eight trillion won ($8.9 billion), but that financial statements stated that their borrowing was only five trillion won ($5.6 billion). Any regulator could have noticed a three trillion won ($3.3 billion) discrepancy. Once again, signs of the conglomerate’s problems could have been detected in the mid-1990s. To obtain financing from foreign markets, the group had been among the first chaebol to provide consolidated financial statements in the mid-1970s, but they suddenly stopped providing them in the mid-1990s, an obvious red flag. Later, other than financial restrictions on its debt, blunt warnings from CSFB and Nomura in 1998 did nothing 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

283 Coffee, supra note 10.

284 Kim & Song, supra note 54.

285 Daewoo Suicide, supra note 12, at 155.

286 Starting from March 1995, senior management in fact began to receive secret quarterly reports on Daewoo’s “special borrowing (F-Nego)” that was conducted through false export documents. 2001 Gohap 171, at 22–23.

287 Lee, supra note 16, at 167. The government did curtail bond and commercial paper issuances. See Section II.D.

288 Kyu-Seong Lee, Jae-gyeong-bu-jang-gwan “Daewoo yu-dong-seong wi-gi-eop-
restructuring efforts only in December 1998.\textsuperscript{289}

Financial regulators such as the FSS in particular failed to establish legal compliance in the accounting profession. In theory, accounting firms numerous criminal, civil and regulatory sanctions. They could be subject to three years imprisonment or a thirty million won ($25,000) fine for making omissions or false statements in an Audit Report.\textsuperscript{290} Aggravated punishment provisions could extend prison terms to a minimum

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\textsuperscript{289} Lee, supra note 16, at 168.

\textsuperscript{290} External Audit Act, art. 20, ¶ 2. From 1989 to 1998, the punishment was for up to two years imprisonment or a million won ($833) fine. In 2003, a new provision was added which required up to five years imprisonment or a 30 million won ($25,000) fine for deliberate falsifies, alters, damages or destroys audit workpaper made in preparation for an Audit Report. art. 20, ¶ 2. External Audit Act (as amended Law No. 4168 of 1989; Law No. 5522 of 1998). In 2003, the Securities Exchange Act was amended to punish accountants for falsely recording important facts in required disclosure documents, Annual Reports, Semiannual Reports or Quarterly Reports for up to five years imprisonment or a 30 million won ($25,000) fine. art. 207–3. (amended by Law No. 7025 of 2003). For non-listed stock companies, the Commercial Code provides that a person that improperly records or negligently reports accounting statements would be subject to a penalty of up to only 5 million won ($4,120). Commercial Code art. 635, ¶ 1, no. 9. Although now deleted, from 2001 until 2003, the Corporate Reorganization Promotion Act had provided that if a company did not properly operate an internal accounting system or if one forges, alters or damages such accounting records then they would be subject to up to five years imprisonment or a thirty million won ($25,000) fine. art. 37. Law No. 6504 of 2001 (as amended Law
of three years if monetary gains from accounting fraud exceeded 500 million won ($417,000). Accountants and their firms could have their licenses suspended or terminated. Accountants also had to report wrongdoing or important facts that indicated violation of laws or the articles of incorporation. Punishment, however, seldom occurred for non-compliance. Light monetary fines or sanctions were issued even for repeated involvement in accounting fraud. Coupled with the lure of business and

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291 Aggravated Punishment Act, art. 3. Gains of over 5 billion won ($4.17 million) call for a minimum punishment of five years. *Id.*

292 See Section IV.A.

293 External Audit Act, art. 10. No application of this provision has been found.

294 For Hanbo Steel’s 6.6 trillion won ($4.7 billion) in accounting fraud in 1997, its auditors Chong-Un received minimal sanctions. When Kia Motor and Asia Motors collapsed shortly thereafter, Chong-Un and San Tong, again received minor sanctions even though they failed to discover over 3.3 trillion won ($2.36 billion) and 1.56 trillion won ($1.12 billion) in accounting fraud committed, respectively, 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 monetarily just required them to pay their entire 1997 auditing fees from those companies to the Liability Compensation Fund. Three Chong-Un and San Tong accountants were suspended for six to nine months but not the firms themselves. The SSS also restricted Chong-Un from being designated auditors for one year from the five leading companies subject to regulatory designation. Jin-gun Chung & Hun-soo Kim, *Hwan-ran-ju-beom Kia hanbo gam-sa-in-e myeon-je-bu* [Pardon for Auditors Kia and Hanbo’s, the Principal Offenders in the Foreign Currency Crisis], *MAEIL BUS. NEWSPAPER*, Dec. 24, 1998; Hee-chun Cho, *Ki-a-jeok-ja 4-jo 5,738 eok-i-na jul-yeo*
intense competition, weak enforcement left accountants exposed to company 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 SSS found that 1996 annual reports of Daewoo Corp. and Daewoo Precision underreported substantial amounts of assets and liabilities. Furthermore, regulators discovered over 290 billion won ($322 million) in off-balance sheet liabilities of Daewoo Corp. Nothing happened other than a request for a 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) on its accounting books. As in the past, only minor corrective action followed. Finally, no reaction followed when a whistleblower allegedly told senior regulators in early 1999 that Daewoo

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295 While done on a random rotating basis, this was first general audit of a Daewoo affiliate in three years. Fifty-seven other companies were included as part of this annual general audit.

296 Daewoo Suicide, supra note 12, at 192.

297 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 were the case then much more wrongdoing might have been unearthed if the SSS had devoted proper resources. Id. at 187–8.

companies had engaged in over 30 trillion won ($25 billion) in accounting fraud.\textsuperscript{299} Red flags about Daewoo’s accounting problems were repeatedly disregarded.

In contrast, the Fair Trade Commission (FTC) served one of the more active regulators toward governance problems of the chaebol. Starting in July 1992, the FTC began to regulate improper support among affiliates of the largest chaebol.\textsuperscript{300} They gained authority to require companies to terminate such support, force them to publish notices of their wrongdoing and fine surcharges of up to two percent of sales from the prior year.\textsuperscript{301} In serious cases, they could refer persons or companies for criminal prosecution, who could then face up to two years’ imprisonment or 150 million won ($125,000) in fines.\textsuperscript{302} While the FTC foresaw the dangers in the weak corporate

\textsuperscript{299} Daewoo Suicide, supra note 12, at 184–95. The FSS issued a press release denying such a meeting, FSS, Press Release, Sept. 24, 2001. The SSS later merged into the newly created Financial Supervisory Service.

\textsuperscript{300} FTC focused on the provision and outsourcing of goods and services at discounts or premiums often through transfer pricing. Such support was viewed as “unfair trade acts” under which chaebol discriminated in favor of their affiliates against other independent companies. FAIR TRADE COMMISSION, GONG-JEONG-GEO-RAE-WI-WON-HOE NAE-BU-JI-CHIM “DAE-GYU-MO-GI-EOP-JIP-DAN-U1 BUL-GONG-JEONG-GEO-RAE-HAENG-WI-E DAE-HAN SIM-SA-GI-JUN” [Internal Guide: “Evaluation Standard for Large Conglomerate Group’s Unfair Trade Acts”], art. 23, ¶ 1, no. 5; Law No. 7315 of 1992 art. 27; Implementing Decree, art. 36.

\textsuperscript{301} Law No. 7315 of 1992 art. 24–2. The possible surcharge was raised from two percent to five percent in December 1999. Amended Law No. 6043 of 1999.

\textsuperscript{302} Law No. 7315 of 1992 art. 67. ¶ 2; art. 70. In 2000, the FTC for the first time referred a company for criminal prosecution. As of April 2000, the top chaebol must provide board of director approval for internal transaction above a certain amount. art.
governance of the chaebol, they could not generate the political mandate to effectively monitor them. They conducted their first real investigation in 1993, but it ended without much consequence. In the end, they proved unable to curb unreasonable support of subsidiaries before the crisis.

In 1998, the FTC launched two full-scale investigations against leading chaebol including Daewoo. They focused on unreasonable financial and personnel support, instead of just traditional goods and services. They discovered substantial, improper affiliate subsidization, even though companies had been warned that the investigations were pending. In the case of Daewoo, they found that six companies improperly supported seven affiliates a total of 461 billion won ($329 million). Daewoo Corp. and Daewoo Heavy in particular 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, 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 FTC fined

11-2: Implementing Decree art. 17-8.

303 This was based upon a significant revision of the fair trade law in December 1996, just before the financial crisis. art. 23, ¶ 1, no. 7, Bu-dang-han ji-won-haeng-wi-ui sim-sa-ji-chim 7-ho [Review Guidelines for Improper Support Acts No. 7]. July 29, 1997. Fair Trade Commission. Daewoo in particular underwent four investigations from 1998 to 2001 and received three separate fines.


305 Daewoo requested re-examinations of three investigations but they were all dismissed. In the October 2001 investigation, the FTC announced how Daewoo used
Daewoo a comparatively light 13.3 billion won ($9.5 million).\textsuperscript{306}

Therefore, regulators squandered opportunities to prevent the crisis. They took action only after the collapse.\textsuperscript{307} Daewoo’s breakdown led to an exhaustive audit of sham affiliates posed as unrelated companies. By dressing themselves as independent companies unaffiliated, sham companies were utilized to avoid FTC regulations. After a three-week search, based upon stock ownership and management control, the FTC 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, Fair Trade Commission, \textit{Gu dae-gyu-mo-gi-eop-jip-dan ‘Daewoo’ mit ‘Daewoo Corp.’ ui wi-jang-gye-yeol-hoe-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 FTC referred the case for prosecution and in his criminal trial the court found him guilty for omitting data on 16 sham companies. 2005 Gohab 588, at 56–57.

\textsuperscript{306} 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). Finally, the FTC conducted a fourth investigation in October 2001 upon which a marginal surcharge of 677 million won ($564,200) was levied against three related companies. Daewoo Corp. was excluded because they were undergoing dissolution. Press Release, Fair Trade Commission, 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).

\textsuperscript{307} Surprisingly, no tax evasion charges have been brought by the tax authorities or
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 fraud for criminal prosecution and also four partner-level accountants that had audited the companies. The SFC also recommended that Chong-Un and San Tong should be suspended on the firm level, three accountants should have their registrations revoked and nineteen accountants should be suspended.

In the aftermath, the KDIC has become the most vigorous institution in holding corporate executives, accountants and financial institutions accountable. Since 2000, the

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308 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 87.

309 *Id.* 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. Criminal Procedure Act, arts. 234, 257.

310 *SFC 2000 Report, supra* note 87; External Audit Act, art. 16; Certified Public Accountant Act, art. 9. Another 36 accountants received lighter sanctions such as restrictions from auditing and warnings.
KDIC’s mandate required it to reclaim public funds that injected into financial institutions that became defunct from those responsible.\textsuperscript{311} They pressed for legal actions against executives that were involved with companies and banks that collapsed during the crisis. In the process, they 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 controlling shareholders.\textsuperscript{312} 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, by defrauded financial institutions bringing legal actions against the corporate executives of borrowers, this has added to stakeholder-orientation accountability for companies. Yet, unfortunately all of these actions occurred after the fact.

KDIC’s efforts involved a two stage process. First, the KDIC 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.\textsuperscript{313} The claims added

\textsuperscript{311} Daewoo Executives Cause W4.26 Tril. in Losses, KOREA TIMES, Sept. 25, 2002.


\textsuperscript{312} To protect depositors and investors of banks, securities companies, insurers and merchant banks, KDIC injected 107 trillion won ($89.2 billion) of public funds into insolvent financial institutions during the crisis. PUBLIC FUNDS MANAGEMENT WHITE PAPER, \textit{supra} note 139, at 65.

\textsuperscript{313} PUBLIC FUNDS MANAGEMENT WHITE PAPER, \textit{supra} note 139, at 154. Commercial Code, Law No. 6545 of 2001, art. 399, art. 401–2. The Korean Asset Management Company
unprecedented legal compliance to the financial industry, particularly in pushing lenders to improve their own corporate governance and establish lending discipline. More importantly, in the second stage, KDIC pressed financial institutions to bring claims directly against companies that defrauded them in the first place. Daewoo’s executives and their accountants became among the first targets.

The KDIC’s special fact-finding team announced on 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. The KDIC claimed Daewoo executives manipulated accounting to defraud seventeen


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], L. TIMES, Apr. 13, 2005.

creditor banks of 3.81 trillion won ($3.175 billion) between 1995 until 1999. They 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.\textsuperscript{316} The KDIC even referred cases of personal enrichment for criminal prosecution.\textsuperscript{317}

Active monitoring by regulators and policy makers such as FSS, FTC and others could have saved incalculable damage while sparing countless victims. They failed to detect the seriousness of the situation, monitor companies, executives and accountants and enforce laws and regulations. KDIC efforts, however, represent a distinctive ex post facto enforcement mechanism that has emerged. It operates outside of the legal framework associated with corporate governance that traditionally revolves around remedies in corporate law and securities law.

D. Prosecutors, Courts and other Public Guardians

\textsuperscript{316} Depositor Protection Act, art. 21–2. See Section IV.A.

\textsuperscript{317} KDIC referred over sixty-six former chaebol chiefs to criminal prosecution when they 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, KDIC alleged that Kim made $2.5 million in donations to Harvard University and nineteen 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, \textit{Daewoo Founder Kim’s Concealed Assets Worth W140}, KOREA HERALD, Nov. 9, 2001; Kim & Song, \textit{supra} note 141, at 242. Kim & Song, \textit{supra} note 141, at 242. Hwang, \textit{supra} note 151.
Prosecutors, courts and other public guardians such as the media remained passive in establishing an effective corporate governance framework. Corporate defendants, whether they were directors, executives or controlling shareholders, faced criminal or media scrutiny through prosecution, criminal punishment or public shaming only when companies collapsed. Furthermore, in the rare case of conviction, Korean Presidents have been notoriously generous in granting clemency. Complacency toward legal discipline and public sanction for corporate wrongdoing stemmed 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 when 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 Confucian tradition. Prosecutors and courts also expressed exaggerated concerns that punishing corporate defendants, especially from larger chaebol, would damage the reputation of the company and country, causing serious economic damage. 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

public view under the rationale that negative media coverage would harm the economy.\textsuperscript{320} Similarly, for many years, prosecutors refrained from prosecuting corporate bribe givers instead focusing their efforts on bribe takers.

Courts acted similarly. Even when they found chaebol executives guilty, they routinely commuted their sentences based upon “enormous contributions to the economy.” Actual imprisonment or civil liability hardly occurred. Woo Choong Kim, for instance, was convicted several times, yet he never served prison time. 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{321} On appeal, he was only sentenced to eight months with a one-year suspended sentence.\textsuperscript{322} 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{323} All of them received suspended sentences due to their

\begin{footnotesize}
\begin{enumerate}
\setcounter{enumi}{319}
\item Seong-Bong Ha, An-Byeong-Hwa-si jing-yeok 3-nyeon-seon-go/jae-beol 3 hoe-jang-eun jip-haeng-yu-ye [Ahn Byung Hwa Sentenced to Three Years / Three Chaebol Chiefs’ Sentences Suspended], HANKOREH, Dec. 7, 1994, at 23. Judgment of Dec. 6, 1994, Seoul District Court. The government official that received the bribe received a 3-year sentence in contrast.
\item Kim paid 140 billion won ($155 million) in bribes for a lucrative submarine contract, among other items. Kim & Kim, supra note 49, at 567–69.
\end{enumerate}
\end{footnotesize}
“contributions to the economy.”

In the final act to the enforcement process, Korean Presidents reconfirmed the environment of leniency. Presidents routinely granted pardons to convicted controlling shareholders and executives of large companies. In 1995 and 1997, Woo Choong Kim, for example, received separate Presidential pardons for his two 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.

324 Id.
325 Amnesty Act, Law No. 2 of 1948, arts. 3, 5, 9 and 10; Republic of Korea Constitution, Law No. 1 of 1948 (as amended Oct. 29, 1987), art. 79.
326 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 reinstatement. Over a dozen other leading corporate executives that had been found guilty for economic crimes after the financial crisis were also granted amnesty and reinstatement. Myung-Jin Lee, *IMF gwan-ryeon-gi-eop-in dae-pok-sa-myeon jo-chi* [Mass Pardon of IMF-Related Businessmen], CHOSUN ILBO, Dec. 31, 2002, at A4.
328 Kim, supra note 318..
Several other factors contributed to soft enforcement. First, corporate defendants could generally afford better legal representation which might explain why they fared better. 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 public guardians against corporate misbehavior. Investigative journalism rarely directed its attention toward governance issues. Media scrutiny generally involved reporting events of wrongdoing


332 Bernard Black, et al., *Corporate Governance in Korea at the Millennium: Enhancing International Competitiveness*, 26 J. CORP. L. 537, 552 (2001)(“financial press reporting of corporate governance abuses has not been a significant influence on chaebol behavior”).
after the fact. Critical reporting analyzing Daewoo’s state of affairs that could have foreshadowed its difficulties did not occur. Foreign media offered only marginally more critical reportage of Daewoo.\textsuperscript{333} 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 chaebol, wielded considerable clout over critical reporting. The media, for example, to a significant degree remained captive to advertising revenue of conglomerates.\textsuperscript{334} The media also faced threat of libel or defamation actions.\textsuperscript{335} Furthermore, in the case of newspapers, companies could exert pressure

\textsuperscript{333} Clifford, \textit{supra} note 28, at 52; Perlez, \textit{supra} note 24 (“How Daewoo, a debt-laden company, plans to finance the rapid expansion is not exactly clear”).


\textsuperscript{335} According to the Press Arbitration Commission that handles most defamation disputes, corporations brought a total of 393 defamation actions to the Committee against the press between 2000 and 2004. \textit{See generally} <http://www.pac.or.kr> (last visited Mar. 7, 2007).
through a controversial practice involving prior publication of the next day’s morning newspaper as “First Editions” newspapers on the evening before. Companies reviewed the contents of the next morning’s edition before it was widely circulated. While this granted the company a chance to point out errors, in the worst cases, they could influence editorial content toward their liking. Finally, several major newspapers were owned by families with family ties with the controlling shareholders of leading chaebol. 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 Joint Oversight Team consisting of representatives from the police, tax authorities, customs authorities, KDIC, FSS and KAMCO, 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 and the former head of Daewoo Corp. and Daewoo Motor to five years, both without any commutation.

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336 On October 15, 2001, Joongang Ilbo became the first major newspaper to cease this practice. Lee, supra note 334, at 192.

337 Joongang Daily, Dong–A Ilbo, two of Korea’s leading papers, are leading examples of newspapers with direct, family relationship with leading chaebol.

338 As a result, 181 persons from leading financial institutions, companies and accounting firms were detained and eighty–three persons arrested. The prosecutor’s office in particular brought cases against dozens of Daewoo executives, including Chairman Kim and their accountants. PUBLIC FUNDS MANAGEMENT WHITE PAPER, supra note 139, at 149, 159.

339 Other Daewoo defendants, however, received judgments between eighteen months
Courts pronounced astronomical monetary penalties upon seven defendants. Matching the scale of the accounting fraud, disgorgement penalties of joint and several liability ranging from between 21.25 trillion won ($17.7 billion) and 23.03 trillion won ($19.2 billion) were levied first against three junior directors and officers of Daewoo Corp. and then Chairman Kim.\textsuperscript{340} Four senior executives received smaller disgorgement penalties ranging between 1.47 trillion won ($1.75 billion) and 3.71 trillion won ($4.16 billion).\textsuperscript{341}

The disgorgement penalties were the largest in Korean history, if not the world’s.

The sentences and penalties sent a powerful message how executives and

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  \item and seven years that were suspended in terms of actual jail times. Several did not receive suspended sentences in the lower courts. 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 51; 2001 No 2063, at 5–6; 2002 Do 7262, at 3–4. Suspended sentences are common for convicted white-collar criminals in Japan as well. Milhaupt, \textit{supra} note 174, at 191.
  \item 2001 No 2063, at 6; 2002 Do 7262 at 3, 4 (the Supreme Court reduced the penalty by 1.3 trillion won ($1 billion) for one these defendant); 2005 Gohab 588, \textit{supra} note 5, at 2; Aggravated Punishment Act, art. 10. Foreign Currency Management Act, \textit{supra} note 119, art. 33. Reportedly, the highest fines every levied against a company was 542 billion won ($451.7 million) against the Hanjin Group in October 1999 for tax evasion. Cheong-mo Yoo, \textit{Chaebol stunned by government’s hard line on reform, hefty tax fines}, KOREA HERALD, June 10, 1999,
  \item 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 heavier penalties were relatively more junior officials. Logically, the senior executives with more supervisory authority should have borne more responsibility and penalized accordingly.
\end{itemize}
chaebol would be held accountable. A consensus emerged to levy actual prison sentences against senior executives of chaebol and to hold them responsible for damages they caused.\textsuperscript{342} Courts emphasized the impact of Daewoo’s actions upon the economy, society, financial institutions, investors and guaranty companies.\textsuperscript{343} 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 fraud and lending fraud.”\textsuperscript{344} 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{345}

Various mitigating circumstances combined with a measure of unfairness exist surrounding the severity of the punishments. Arguably, all chaebol supported undeserving affiliates and committed accounting and loan fraud and foreign exchange violations leading up to and during the financial crisis. Yet, Daewoo was singled out. Had they successfully turned the company around, perhaps, they would have been lauded and all would have been forgotten. Daewoo apologists suggest that they were scapegoats for the crisis or victims of political intrigue.\textsuperscript{346} Furthermore, defendants did contribute to the country’s economic growth and they did not appear to have benefited financially.

\textsuperscript{342} The imprisonment of the chairmen of Kia, Hanbo and more recently SK represent cases actual prison sentences have been levied.

\textsuperscript{343} 2001 Gohab 171, at 52–53; 2001 No 2063, at 78. The High Court virtually restated the trial court’s conclusions verbatim regarding the reasons for the harsh sentences and the Supreme Court affirmed these judgments.

\textsuperscript{344} They also dismissed the “it was a common practice” argument. 2001 Gohab 171, at 53; 2001 No 2063, at 79.

\textsuperscript{345} Id.

\textsuperscript{346} Daewoo Suicide, supra note 12.
from the crimes.  Although they might have been subsumed charges under the accounting and loan fraud, for example, other than Kim, none of the executives were prosecuted for embezzlement or expropriation. Finally, executives worked under a corporate culture that demanded obedience to Kim who gave “authoritative orders,” and maintained “absolute influence over the careers of the defendants.”

Notwithstanding, executives were culpable because they ultimately did participate in the fraud for their own personal gain in disregard of their duty to 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 positions.” They failed to understand that they did personally benefit because they maintained their privileged status as corporate executives of one of Korea’s premier conglomerates with its monetary and reputational benefits. Courts thus rejected the

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347 Despite exhaustive investigations by prosecutors, regulators and auditors, other than Chairman Kim, only one case of malfeasance involving a Daewoo executive was reported. Public Fund Misconduct Intermediary Investigation Results, supra note 161.

348 2001 No 2062, Seoul High Court at 6; 2001 No 1022, at 9 (“Chairman Kim’s difficult to disobey order was the basis for crime” committed by the defendant); Don Kirk, Former Daewoo Executive Charged, N.Y. Times, March 7, 2001. The court also cited that the executives had belatedly repented their actions and that they had lacked prior criminal records.


350 In the criminal case against an executive of Daewoo Telecom, one lower court did consider the lack of direct personal profit a mitigating circumstance for sentencing. 2001 Gohab 129, at 15.
defense that they had to passively follow Kim’s orders.\textsuperscript{351} 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.”\textsuperscript{352} They abandoned the duty to work to enhance corporate transparency and engage in business operations legally even if this conflicted with Kim’s aims. Instead, they “availed themselves of Woo Choong Kim’s irresponsible, over-leveraged management.”\textsuperscript{353} Their active participation in the cover-up further undermined their claims that they acted in good faith on behalf of the company.\textsuperscript{354}

Overall, prosecutors, courts, the media and ultimately Presidents acted together to create a lax compliance structure for corporate executives. A tacit policy of soft enforcement prevailed in the treatment of white collar crime. No matter how serious the infraction chairman, controlling shareholders or directors from the largest conglomerates often avoided actual discipline. The failure to observe corporate governance duties, laws and regulations became an inconsequential event.

V. Conclusions

Daewoo’s mismanagement and, worse yet, accounting malfeasance went

\textsuperscript{351} The High Court opinion in fact recites virtually verbatim the conclusion of the District Court while adding some additional findings of its own. \textit{Id.} at 53; 2001 No 2063, at 79. The defendants did not raise these defenses on appeal to the Supreme Court.


\textsuperscript{353} \textit{Id.}

\textsuperscript{354} 2001 No 2063, at 78.
“unchallenged because corporate governance simply did not exist.”355 While primary fault with Daewoo’s troubles lies with its controlling shareholder and directors, other market participants, both domestic and foreign, share a significant portion of responsibility. Leading commercial banks, investment banks, reputational intermediaries, gatekeepers and public sector guardians, in particular, not only failed as monitors to detect serious accounting problems but also tacitly permitted it to persist. The breakdown of corporate governance through the failures of these interconnected market players was never fully examined; years later, in the form of Enron, WorldCom and Parmalat, comparable meltdowns were repeated, rocking financial pillars around the world. Unfortunately, Daewoo’s warning signs were dismissed as an aberration, limited to a distant country called Korea who was a victim of the Asian financial contagion.

This forensic study of Daewoo’s implosion also covered formation of formal corporate governance in an emerging market through the prism of a Korean chaebol. It described how chaebol first operated under a system where the state played the central role as 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 chaebol further susceptible to abuses. The financial crisis exposed the vulnerabilities of ineffective corporate governance, 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

355 Lee, supra note 16, at 175.
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 law. In practice,
Korea has also converged from a state-oriented model toward a more shareholder-
oriented system with some emphasis on accountability toward 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
of 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 sole responsibility, but international market participants must be
properly enlisted into the process.1