



# The Economics of Legal Uncertainty

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# Overview

Very Insightful & Informative Paper

- ♦ **Fundamental Question** : **How Does Legal Uncertainty Affect Economic Activity?**
- ♦ **Novel Theoretical Model** : Introducing New Types of Idiosyncratic Legal Uncertainties (Assignment Uncertainty & Decision Uncertainty)
- ♦ **Original Data**
- ♦ **Careful & Sophisticated Empirical Execution & Findings**
- ♦ **Contributions to Both Law and Finance Literature**
- ♦ **Policy Implications**

# Legal Uncertainties & Economic Activity

- ♦ Two Types of Legal Uncertainties: Idiosyncratic v. Systematic
  - ♦ [I] Assignment Uncertainty: Random Assignment of Cases to Judges
  - ♦ [I] Decision Uncertainty: Korea's Exogenous Judge Rotations Every Two-Year
  - ♦ [S] Parameter Uncertainty (e.g., Potential Changes in the Law)
- ♦ Findings: **Greater** Legal Uncertainties Have **Negative** Impact on Economic Agents' Activities:
  - ♦ Restructuring Filings
  - ♦ Credit Markets
  - ♦ Firm Investment

# Forum Shopping



High Court



District Court

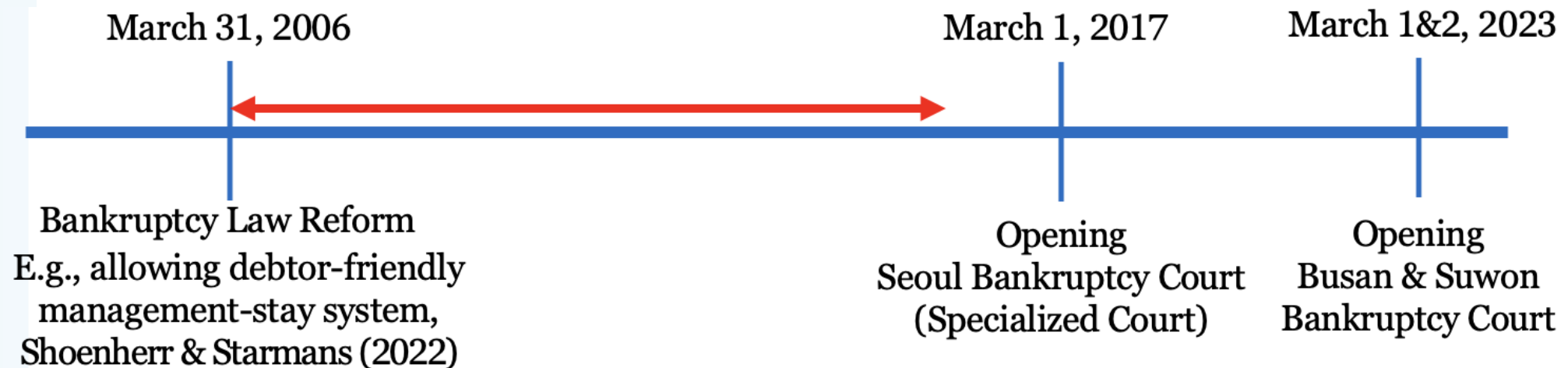


Local District Court	Court Zone	District Court
Zone 1: Seoul		
Chuncheon		Seoul
Incheon		Seoul
Incheon		Seoul
Seoul		Seoul
Suwon		Seoul
Uijeongbu		Seoul
Uijeongbu		Seoul

- Jurisdiction is determined by the Location of the Debtor’s “Principal” Office or Place of Business (“Principal Office”)
- Companies can file a Restructuring Petition with:
  - (1) Local District Court of the Principal Office, **OR**
  - (2) District Court in the city with a High Court that has jurisdiction over the Principal Office
- If (1) and (2) are same -> Only one jurisdiction (e.g., the Principal Office is in Seoul)
- If (1) and (2) are different -> two
- When companies can choose between the two, what affects their forum choice?

# Comment 1: Data Period of 2006-2015

- “To ensure consistency of the bankruptcy law and court system, we focus on the period **from April 2006 to December 2015**. This is because in April 2006, Korea implemented a new bankruptcy system that substantially changed the legal and institutional framework governing bankruptcy proceedings, and after 2015, the Korean bankruptcy court system underwent institutional changes.”



- Q. Any heightened legal uncertainties right after the 2006 law reform?

# Comment 2: How Much Discretion Do Judges Have in Korean Bankruptcy Cases?

**Table 3: Judge Decisions**

Decision	Coding		
Accept case	Debtor-friendly	Dismissal of case	Creditor-friendly
Prohibit seizure of assets	Debtor-friendly	Allow seizure of assets	Creditor-friendly
Extension of plan submission period	Debtor-friendly	Reject extension of plan submission period	Creditor-friendly
Approve debtor's plan	Debtor-friendly	Reject debtor's plan	Creditor-friendly
Grant debtor request for modification of plan	Debtor-friendly	Reject debtor request for modification of plan	Creditor-friendly
Successful graduation from procedure	Debtor-friendly	Failed graduation from procedure	Creditor-friendly

- Should these decisions be as having the same amount of discretion?
- Is it possible that the difference in decisions (Judge Type) are due to the difference in the quality of filings?

# 2-1: Judge's Discretion to Accept/Dismiss the Restructuring Filings?

- “The first step in the review process is to determine whether the bankruptcy court where the case was filed has jurisdiction over the firm...Next, the.” **judge assesses** whether the firm has a realistic chance of surviving as a going concern and whether its continuation value exceeds its liquidation value

## Article 42 (Grounds for Dismissing Application Filed for Commencing Rehabilitation Procedures)

In any of the following cases, the court shall dismiss any application for commencement of rehabilitation procedures. In this case, the court shall hear the opinion of the Custodial Committee:

1. Where expenses necessary for rehabilitation procedures are not prepaid;
2. Where the application for rehabilitation procedures is not bona fide;
3. Where rehabilitation procedures are incompatible with the interests of the creditors in general.

Is this substantive review or more of procedural handling?

Q. Can you show what % of the decisions include "assessment" of continuation value and liquidation value?

## 2-2: Judge's Discretion to Approve/Reject Debtor's Plan?

- ♦ “Although the **judge may consider the** [assembly of creditors’] **vote**, it is not binding, and it is ultimately up to the judge’s discretion whether to approve or reject the plan.”
- ♦ Courts have the authority to reverse the creditor’s rejection, but rarely do: Cf. Debtor Rehabilitation and Bankruptcy Act Section 244 (Authorization in Cases of Group in Disagreement)
  - ♦ At least one group of assembly of related persons passed the plan
  - ♦ But the plan fails to be approved by the all groups
  - ♦ The court may... determine to grant authorization for the rehabilitation plan.
- ♦ Q. How often did Judges reverse the creditors’ vote in your data?



# Comment 3: No Prior Experience with Bankruptcy Cases?

- “In particular, judges are assigned to bankruptcy courts without prior experience in handling bankruptcy cases, and are replaced by other judges at the end of their term of two years.”
- Corporate Restructuring cases should be decided by a collegiate panel composed of three judges, including one senior judge.
- 4,688 cases \* 3 judges = 14,064 judges -> No repeat players? (Cf. Entire number of judges in Korea ranged between 1,993 and 2,803 during 2006-15)
- Q. Can the Court Data capture judges with experience in handling bankruptcy cases?

# Comment 4: Mitigating Legal Uncertainty through Collective/Institutional Knowledge



- Judges' rotations and random assignment of cases are not new -> there has been a system that helps them to facilitate new assignments.
- For bankruptcy cases, judges closely refer to the Seoul Bankruptcy Court's official 348-page-long Code of Practice, which was informally shared before the 2017 bankruptcy court reform.
- This may reduce idiosyncratic legal uncertainty at individual judge level.
- Q. How does such institutional knowledge play out in your model?

# Comment 5: Institutional Reputation

## Number of Restructuring Filings

〈표 1〉 법원별 법인회생사건 접수 추이<sup>3)</sup>

	2007년	2008년	2009년	2010년	2011년	2012년	2013년	합계	비율(%)
Seoul 서울중앙	29	111	192	150	191	268	296	1,237	29.97
수원	7	47	76	102	121	101	125	579	14.03
대구	16	37	75	59	58	75	51	371	8.99
창원	8	20	91	62	61	58	50	350	8.48
광주	17	33	38	51	38	55	41	273	6.61
인천	6	15	37	34	43	55	61	251	6.08
대전	11	27	34	29	42	45	35	223	5.40
부산	4	27	50	28	39	33	28	209	5.06
의정부	1	13	19	23	30	33	36	155	3.75
울산	2	10	13	29	30	29	23	136	3.29
전주	10	12	12	18	19	19	35	125	3.03
청주	5	12	21	21	23	19	17	118	2.86
춘천	0	2	3	11	9	9	24	58	1.41
제주	0	0	8	10	8	4	13	43	1.04
합계	116	366	669	627	712	803	835	4,128	100.00

- This graph covers a part of the sample period, but 1,237 filings with Seoul District Court does not distinguish what % of them are from forum-shopping.
- Even before the 2017 reform, Seoul District Court had a reputation for expertise in dealing with bankruptcy cases, regardless of the individual judges.
- Q. How about treating Seoul District Court separately from the other courts to see if the findings hold the same?

# Comment 6: Are Judge Types Fixed?

**Table 4:** Predicting Judge Types

Dep. var.: $\mu_{j,t>T/2}$	I	II	III
$\mu_{j,t\leq T/2}$	0.8505*** [0.1548]	0.8384*** [0.1454]	1.1116*** [0.1916]
Court FE	no	yes	-
Court-Cycle FE	no	no	yes
Observations	327	327	327
R-squared	0.097	0.155	0.458

- Table 4 shows the Judge Type in the first half of the term tends to stay the same in the second half.
- Based on the paper's assumption, judges are new to bankruptcy cases. Are judges' types (debtor-friendliness) not affected by information and experience over the term?

# Comment 7: Loan Maturities

- Tables 10-15 measure Loan Volume & Interest Coverage Ratio
- Greater uncertainties should lead to a decrease in loan maturities?

# Conclusion

- Thoroughly enjoyed the paper.
- Looking forward to the next paper on the 2017 court system reform!

