Impending Amendments to Korean Corporate Laws in 2009: A Mystic Mix

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Abstract

The corporate law reform initiatives proposed by the Korean government in 2008 are still pending before the National Assembly. While the Korean government was sympathetic to the arguments by business interests for liberal rules conducive to business organization, these demands have to be weighed against the desire for good corporate governance norms that promote accountability and transparency. Such a tension has unfortunately resulted in internal contradictions and uncertainties in the context of Korea. This article points out the uncertainties that the reform initiatives have left unresolved and the potential for their resolution by the judiciary. More fundamentally, the author argues that, in order to resolve the issues currently left unanswered, there is a need to address the debates regarding the theoretical foundations of the corporation.

KEYWORDS: amendment of Korean corporate law, judicial activism in Korea

I. INTRODUCTION

On 8 January 2009, the Korea National Assembly (“National Assembly”) finally passed Bill No. 1803424,¹ which revises the Korean Commercial Code (“KCC”).² The Bill came into effect as Law No. 9362 on February 2009. Along with the Law, Presidential Decree No. 21288, which was prepared by the Korean Ministry of Justice (“KMOJ”), became effective on the same date. The Korean government initially proposed Bill No. 1801556 to the National Assembly on 21 October 2008.³ Compared with Bill No. 1803424, Bill No. 1801556 was more comprehensive and it purported to achieve several goals: (i) increase the transparency and efficiency of corporate management by reorganizing the sections on finance and accounting; (ii) introduce information technology by adopting e-voting and e-registration of stocks and bonds; (iii) provide diverse entrepreneurial legal forms, such as the limited partnership and the limited liability company; and (iv) ameliorate legal formalities for small joint stock companies⁴ in accordance with international standards. In addition, as the Securities Transaction Law (“STL”) was to be integrated into the Capital Market and Finance Investment Law (“Capital Market Law”) on 4 February 2009,⁵ special sections on listed companies in the STL had to be relocated to the KCC and some to the Capital Market Law.⁶ On 28 November 2008, the Judiciary Committee of the National Assembly decided to carve out the latter part of Bill No. 1801556 into an independent committee Bill No. 1803424, with the reservation that the core of the initial amendment proposals in Bill No. 1801556 would be reviewed upon further public hearings.⁷ In the end, only the technical part of Bill No. 1801556 was enacted. The future of the remaining proposals in Bill No. 1801556 (the “Bill”) is not clear. It is likely that it would be passed by the National Assembly by the end of 2009.

The KCC chapter on companies had undergone six changes in the past four decades since it first came into effect in 1963 as Law No. 1000. The first

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¹ The first two digits indicates that the Bill is one considered by the 18th National Assembly.
² Bill No. 1803424 is available online: <http://www.assembly.go.kr/renew07/info/tra_read.j>.
³ Bill No. 1801556 is available online: <http://likms.assembly.go.kr/bill/jsp/BillDetail.jsp?bill_id=ARC_J0E8GI1T2J1U1B8C1X0N1F3H7R9G4>.
⁴ Chushikhoesa is translated as joint stock company, which is similar to a general corporation under US corporate laws.
⁵ The Capital Market Law is available online: <http://www.law.go.kr/LSW>.
change was in 1984 which covered minimum paid-in capital, supervisory authority of the statutory auditor, stock dividend, transfer of shares by delivery and other similar subjects.8 Japanese company laws were reference points partly because of the similar structure of the two countries’ economic and legal systems. In 1995, another amendment Bill, which was more comprehensive than that in 1984, was adopted to largely follow what was discussed in Japan.9 The 1995 Bill includes, among other issues, the minimum dividend ratio for preferred shares, different stock dividends for different kinds of shares, appraisal rights, short form mergers, enhancement of the statutory auditor’s authority. Immediately after the 1997 financial crisis hit the Korean economy, the KCC transformed itself into a completely different set of rules through four draconian changes in 1998, 1999, and twice in 2001.10 The goal was to ensure a more transparent and responsible management structure. Through the post-1997 changes, the KCC is now different from Japanese and European company laws. Rather, the KCC follows US corporate law concepts. The Bill is a continuation of such radical attempts to change the KCC modeled on US corporate laws. The Bill was based on the 2006 proposal prepared by the special committee under the KMOJ and subsequently proposed to the National Assembly in 2007.11 The 2006 Bill was aborted due to the National Assembly’s inattention and the previous administration’s apathy. Despite the power shift in 2008, the 2009 Bill was not very different from the 2007 Bill. Contrary to the previous six amendments, the 2009 Bill was the outcome of relatively enduring dialogues among scholars, business leaders and bureaucrats. Thus, the Bill is more orderly and focused compared to the previous ad hoc discussions for amendments. Ironically, that was the reason the National Assembly halted the review of the changes in the Bill at the last minute in 2008.

This article critically analyses the Bill and discusses the future of Korean corporate laws. The writer argues that the Bill is a mystic mix of conflicting perspectives, regulatory frameworks and philosophies about a corporation. The Bill fails to provide clear guidance on the balance to be struck in the fundamental tension between mandatory rules and enabling-supplemental rules. The Bill, on the one hand, abandons the concept of the statutory capital while it works as the criteria for different corporate governance structure. The Bill more liberally permits the management of a corporation to decide on financial matters including distribution of income and issuance of bonds while the amount of distributable income is lowered for the protection of creditors. The Bill is also silent about the

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8 Law No. 3724, dated 10 Apr. 1984. See full text and the reason for amendment, supra note 3.
9 See ibid. Law No. 5053, dated 29 Dec. 1995. See full text and the reason for amendment.
gatekeeper issue. In more detail, a corporation is still an independent legal entity created and regulated by the KCC whilst the Bill gives shareholders broader room to tailor the governance structure of a corporation including the extent of the fiduciary duty in the articles of incorporation. Thus, the KCC, in functioning as an enabling and gap-filling statute, may degenerate into a statute providing standard form contracts; this is antithetical to the definition of a corporation under the KCC. The Bill also tries to distance itself from the concept of the statutory capital, while it has two different corporate governance requirements depending on the amount of the paid-in capital. Thus, the paid-in capital will be a matter of formality while it determines the governance of a corporation. The Bill gives more leeway for creditors and the company to negotiate the financing contracts with more authority to the board in making decisions on the company’s financing capability, while it reduces the scope of the distributable income for the protection of creditors. The Bill still fails to decide who the gatekeepers should be—the statutory auditor, standing auditor, or the audit committee. The Bill leaves open the issue of whether the gatekeepers should sit on the board as outside directors, or should be independent individuals outside of the board room. The Bill fails to provide clear, satisfactory answers to the foregoing basic corporate questions, but instead invites more questions.

Suppose the Bill is adopted in 2009, which is quite probable, how will and should such legal uncertainties be made clear in the future? The writer believes the judicial branch can and should play a more active role in providing answers to these legal questions even as it wishes to maintain its institutional integrity. The Korean judiciary not infrequently borrows concepts from US corporate law jurisprudence. Such examples as the theory of piercing the corporate veil, fiduciary duty in a hostile takeover attempt, fair value in appraisal proceedings, and double derivative suits, demonstrate its responsiveness. However, the Korean judiciary faces certain drawbacks in answering legal questions as it is not a career judiciary in the purest sense. Korean judges typically enter into private practice in the middle of their careers. The judgments which they deliver while in public service risk being tailored with an eye to their future career in private practice. The writer suggests that such problems could be resolved only if the judiciary takes a more open approach to the issues they are responsible for.

Sections II and III are a summary of the Bill and its history. Unanswered questions by the Bill are expounded in Section IV. In Section V, the writer examines the potential of judicial decision-making in addressing the questions that legislation has left unresolved. In doing so, the constraints and limits to such judicial decision-making are also examined. In Section VI, the writer proposes

12 See text, Section V(A)(1) et seq.
some additional changes to be added to the KCC as well as the guideposts that can help the Korean judiciary establish itself as a justice-serving institution.

II. OVERVIEW OF IMPENDING AMENDMENTS

A. More Diverse, Liberal Forms of Enterprises

1. Limited Partnership Contract and Limited Liability Company

The KCC and the Korean Civil Code (“CC”) provide for a variety of contracts and corporate forms of enterprises: partnership contract,\(^\text{13}\) silent partnership contract,\(^\text{14}\) general member corporation,\(^\text{15}\) limited member corporation,\(^\text{16}\) joint stock corporation,\(^\text{17}\) and limited corporation.\(^\text{18}\) The former two are contractual arrangements, while the latter four are corporate entities. The provisions in the CC and the KCC about contractual arrangements and internal relationship among equity holders in corporate entities are not mandatory.\(^\text{19}\) Nonetheless, the liability of partners in a partnership contract and general partners in a silent partnership contract is not limited\(^\text{20}\) in that each partner is responsible for the other partners’ debts. The liability of general members in general member corporations or limited member corporations is also not limited.\(^\text{21}\) The liability of limited members is limited\(^\text{22}\) to the amount of contribution promised to the company. The fundamental principle that cannot be changed by contracts or the articles of incorporation is that limited liability cannot exist together with management authority.

The Bill introduces the concept of management with limited liability. The more diverse the legal forms offered by the KCC, the more convenience entrepreneurs can enjoy in organizing a legal entity and in balancing ownership, management interests and risks involved in investing. The Bill thus provides for one additional contractual and one additional corporate form of enterprise organization: the limited partnership contract\(^\text{23}\) and the limited liability

\(^\text{13}\) CC, Arts. 703-724, \textit{et seq}.
\(^\text{14}\) KCC, Arts. 78-86.
\(^\text{15}\) KCC, Arts. 178-267. \textit{Hapmyong hoesa} is translated as general member corporation.
\(^\text{16}\) KCC, Arts. 268-287. \textit{Hapja hoesa} is translated as limited member corporation.
\(^\text{17}\) KCC, Arts. 288-542. See also \textit{supra} note 4.
\(^\text{18}\) KCC Arts. 543-613. \textit{Youhan hoesa} is translated as limited corporation.
\(^\text{19}\) KCC, Arts. 195 and 269.
\(^\text{20}\) CC, Arts. 712, 713 and KCC, Art. 82.
\(^\text{21}\) KCC, Arts. 212 and 269.
\(^\text{22}\) KCC, Art. 279.
\(^\text{23}\) Bill 1801566, Arts. 86-2 to 86-10. \textit{Hapja chohap} is translated as limited partnership contract.
company. Under these forms, a limited partner or a limited member can exercise management authority depending on the provisions of the partnership agreement or the articles of incorporation. In a limited partnership contract, general partners and limited partners can be management partners. In a limited liability company, any member including a limited member or any third party can be designated as a manager in the articles of incorporation.

2. Special Rules for Small Joint Stock Company

The KCC provides universal rules for all joint stock companies. However, joint stock companies range from giants like Samsung Electronics with more than KRW 800 billion in paid-in capital, 130,000 shareholders, KRW 65 trillion in assets, and KRW 63 trillion in annual sales revenue to small companies with KRW 50 million in paid-in capital, the legal minimum, and only one shareholder. Special rules for listed companies used to be contained in the STL, but the rules have now become Chapter 13 of the KCC. As to the financial matters of joint stock companies with assets exceeding KRW 10 billion based on the previous year-end balance sheet, outside auditing is required by the Outside Audits of Joint Stock Companies Law (“OAL”).

The Bill has wider special rules for small joint stock companies (“SJSC”) with paid-in capital of less than KRW 1 billion. At the time of incorporation by its promoters, the company’s articles of incorporation do not have to be notarized and thus costs and efforts for notarization can be saved. To record a SJSC on the company register, a certificate of deposit from financial institutions will suffice and thus costs and efforts for securing a certificate of deposit from financial institutions can be saved. In terms of corporate governance, SJSCs do not have to notify their shareholders of shareholders’ meeting two weeks prior to the meeting; instead a one-week notification is required. Furthermore, by unanimous written consent, such notification requirement can be waived. Again, costs and efforts for dispatching the two-week prior written notice and for holding the physical meeting can be saved. SJSCs do not have to maintain three directors, but instead need only one director or a two-director board. The articles of

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24 Bill, Arts. 287-2 to 287-45. *Yuhan chaekim hoesa* is translated as limited liability company.
25 Bill, Arts. 86-5 and 287-12.
26 As for tax, see Special Tax Treatment Limits Law, Cl. 10-3, Arts. 100-14 to 100-26 on Special Tax Treatment for Joint Ventures (translated from *dongup kiup*).
27 Minor exceptions such as Art. 383, Para. 1.
29 KCC, Arts. 542-2 to 542-12. As to the special rules for listed companies under the Capital Market Law, see supra note 6.
30 OAL, Art. 2; Enforcement Decree under the OAL (“OAL-ED”), Art. 2.
incorporation of SJSCs can also waive the requirement for a statutory auditor, in which case shareholders at shareholders’ meetings will discharge the duties of the statutory auditor. Less formality can save costs and time.

3. Wider Availability of Limited Corporation

The corporate form of limited corporations can be extended to closely-held corporations. Contrary to such legislative purpose, however, closely-held corporations usually take the form of joint stock companies. Accepting such reality, the Bill provides special rules for SJSCs. If special rules are provided for SJSCs, the KCC provisions on limited corporations, which were initially designed for small closely-held companies, are not necessary any more. Rather, limited corporations should not be governed by special rules intended for small companies. The Bill abolishes the restrictions on the number of limited unit holders in a limited corporation.\textsuperscript{32} It also allows the free transferability of units in a limited corporation unless the articles of incorporation provide otherwise.\textsuperscript{33} Unit holders meeting can be notified by e-mail as long as unit holders consent to this mode of notification and thus the written notice can be waived.\textsuperscript{34}

B. More Efficient, Responsible Management

1. More Power to Majority Shareholders and Management for Efficiency

The KCC is based on the same basic principles on corporate governance as those of US corporate laws: the majority shareholders elect the management;\textsuperscript{35} the board has supreme authority to run the company;\textsuperscript{36} except for certain fundamental corporate actions that require the consent of shareholders\textsuperscript{37} with the minority shareholders being able to exercise appraisal rights.\textsuperscript{38}

To a certain extent, however, the KCC still seems to adhere to the unanimity principle. The Bill shifts the balance in favor of the majority shareholders. In a merger, for example, the KCC requires special resolutions of

\textsuperscript{32} Bill, Art. 545.
\textsuperscript{33} Bill, Art. 556.
\textsuperscript{34} Bill, Art. 571.
\textsuperscript{35} KCC, Art. 382. US corporate laws differ on the meaning of the majority: simple majority or absolute majority and whether a super-majority voting requirement can be included in the articles. See MBCA ss. 7.25 and 7.26, pre-1999 MBCA ss. 11.03 and 12.02 and DGCL ss. 216 and 242.
\textsuperscript{36} KCC, Art. 393.
\textsuperscript{37} KCC, Arts. 374 (business transfer), 522 (merger), 343-2 (capital reduction) and 434 (amendment of articles).
\textsuperscript{38} KCC, Art. 374-2. Shareholders of a merged company cannot be bought out.
the merging and merged company to be passed.\textsuperscript{39} Each of the shareholders of the merged company, however, must be issued at least one share of the merging company. They cannot be bought out by cash alone. The Bill provides the possibility of a cash-out merger.\textsuperscript{40} The minority shareholders of a merged company can receive cash or even debt instruments as the only consideration of the merger. Appraisal rights can be exercised, except in small-scale mergers.\textsuperscript{41}

In a similar vein, the Bill provides the possibility of a unilateral buy-out by majority shareholders.\textsuperscript{42} If majority shareholders own 95\% or more of the shares, they can buy out the minority shares at a fair price. Likewise, the minority shareholders who own 5\% or less can demand the controlling shareholders buy the shares at a fair price.\textsuperscript{43}

The KCC provides for the director’s liability to the company or third party if he breaches his fiduciary duty.\textsuperscript{44} Such liability to the company can be waived on unanimous consent of the shareholders.\textsuperscript{45} The Bill, while sticking to this principle, allows the articles of incorporation to adopt the limitation on the director’s liability to the company up to six times of his annual compensation.\textsuperscript{46} Such limitation, however, shall be invalid if the breach is intentional or is caused by gross negligence.\textsuperscript{47} This change seems to imply that a company can limit the liability for a breach of fiduciary duty through its articles of incorporation. This requires a meeting in which shareholders representing a majority of the shares outstanding are present and a vote by two-thirds of shareholders present at such a meeting.

2. \textit{Responsible Management}

Since the incorporation of the doctrine of fiduciary duty of directors into the KCC,\textsuperscript{48} the KCC has increased the transparency of management by introducing an

\textsuperscript{39} KCC, Arts. 526 and 527. In the case of short form mergers and small mergers, board approval is sufficient. KCC, Arts. 527-2 and 527-3. Prior to the amendment of Art. 343-2 of the KCC, there were discussions about the possibility of stock redemption by amendment of the articles. Most of the comments were negative.

\textsuperscript{40} Bill, Art. 523, Item 4. It is not clear from the Bill whether the dissenting shareholders of the merging company can be bought out.

\textsuperscript{41} KCC, Arts. 522-3 and 527-3, Para. 5.

\textsuperscript{42} Bill, Arts. 360-24 to 360-26.

\textsuperscript{43} Put option as opposed to appraisal rights may be a better name.

\textsuperscript{44} KCC, Art. 399.

\textsuperscript{45} KCC, Art. 400.

\textsuperscript{46} Bill, Art. 400.

\textsuperscript{47} Bill, Art. 399, Para. 1 clearly states that breach of fiduciary duty is not based on moral precept, but on traditional liability for willful or negligent misconduct. Whether this change is desirable, the writer is not sure.

\textsuperscript{48} KCC, Art. 382-3.
audit committee system\(^{49}\) and lowering the threshold for the exercise of minority shareholder rights\(^{50}\). As a continuation of this policy, the Bill expands the scope of protective mechanisms.

Self-dealing is prohibited unless approved by the board.\(^{51}\) The Bill broadens the definition of self-dealing to include transactions between the company and the director’s spouse, lineal ascendants or lineal descendants of the director or director’s spouse (“Director’s Family”), companies controlled by Director’s Family (“Director’s Family Company”), or companies controlled by the Director’s Family or Director’s Family Company.\(^{52}\) With respect to self-dealing transactions, fair terms as well as approval of the board are required.

Misappropriation of corporate opportunities is prohibited.\(^{53}\) Corporate opportunities are broadly defined such that utilisation of corporate information or information that is closely related to the company’s present or future business amounts to misappropriation of corporate opportunities. If the director wishes the company to enter into contracts with a third party who appropriates corporate opportunities that can benefit the company now or in the future, such transaction must be approved by the board.

The KCC imposes a fiduciary duty on directors and quasi-directors.\(^{54}\) The Bill officially introduces the concept of officers.\(^{55}\) It, however, is not mandatory. A company may adopt an officer system, under which the board of directors can elect officers for two-year terms and no representative director will be elected. Instead, a representative officer is designated by the board. Under the officer system, officers have the same fiduciary duty as directors.

To encourage shareholder participation in shareholders’ meetings, the Bill introduces the electronic vote system.\(^{56}\) The board of directors may adopt a resolution that permits shareholders to exercise voting rights by an e-voting system. In the written notice or public announcement of a shareholders’ meeting, shareholders must be notified that they may exercise their voting rights by the e-voting system. Electronic records of the e-voting must be retained by the company for five years from the end of the shareholders’ meeting.

\(^{49}\) KCC, Arts. 393-2 and 415-2.
\(^{50}\) KCC, Art. 403.
\(^{51}\) KCC, Art. 398.
\(^{52}\) Bill, Art. 398, Para. 1.
\(^{53}\) Bill, Art. 398, Para. 3.
\(^{54}\) KCC, Art. 401-2.
\(^{55}\) Bill, Arts. 408-2 to 408-9.
\(^{56}\) Bill, Art. 368-4.
C. Orderly Reorganization of Capital/Accounting/Finance Rules

1. No Minimum Capital/No Par Shares

The KCC still requires all companies to maintain a minimum paid-in capital of KRW 50 million at all times.\(^{57}\) Furthermore, only par shares are allowed.\(^ {58}\) Statutory capital is defined as the number of shares issued multiplied by the par value.\(^ {59}\) The Bill abolishes the minimum capital requirements for all companies while a joint stock company may issue either par shares or no par shares.\(^ {60}\) At the time when no par shares are issued, the board of directors must also decide the amount to be accounted for as the company’s paid-in capital.\(^ {61}\) A joint stock company cannot issue both par and no par shares.

2. Accounting Standards

The KCC has one chapter on accounting matters\(^ {62}\) that provides for such issues as evaluation of assets and establishment of deferred accounts. In practice, however, the OAL that governs accounting matters of joint stock companies with assets over KRW 10 billion has more detailed rules and standards, which are not always consistent with those under the KCC.\(^ {63}\) Thus, it is necessary to coordinate the discrepancies between the KCC and the OAL.

The Bill simply provides for generally accepted accounting practices that are fair and reasonable as the guidelines.\(^ {64}\) Instead, the detailed provisions on evaluation of assets and establishment of deferred accounts are completely deleted. As to the scope of financial statements to be prepared by the board, the Bill foresees the details to be prescribed by presidential decree under the KCC.\(^ {65}\) As to the approval procedure for financial statements, the Bill permits the articles of incorporation to delegate the approval authority of the shareholders to the board.\(^ {66}\)

\(^{57}\) KCC, Art. 329.

\(^{58}\) KCC, Art. 289, Para. 1, Item 4.

\(^{59}\) KCC, Art. 451.

\(^{60}\) Bill, Arts. 291 and 329.


\(^{62}\) KCC, Book III Company, Chapter 4 Joint Stock Company, Sub-Chapter 7 Accounting, Arts. 447 to 468.

\(^{63}\) OAL, Art. 13; OAL-ED, Art. 7-2. The Korea Accounting Standards Board has established extensive legal authorities such as Preface to Statements of Korea Accounting Standard, Korea Financial Accounting Standards, Supplementary Standards, Concepts, Interpretations and Korea Accounting Institute Opinions. See online : <http://www.kasb.or.kr>.

\(^{64}\) Bill, Art. 446-2.

\(^{65}\) Bill, Art. 447.

\(^{66}\) Bill, Art. 449-2.
3. Liberalization of Legal Reserve

The KCC has rather strict regulations on legal reserve, i.e., profit and capital reserve, for the protection of creditors. Ten percent or more of the distributable income must be reserved until the profit reserve reaches one-half of the paid-in capital. Capital reserves are required in the case of premium issuance of new shares, surplus from share exchange or transfer, merger, capital reduction, division or other capital transactions. The legal reserve is to be used to compensate capital deficits in the order of capital and profit. The legal reserve can be transferred to capital accounts upon a resolution by the board.

The Bill expects the scope of the legal reserve to be narrowed by presidential decree. Under the Bill, any reserve over 1.5 times the amount of paid-in capital may be reduced by a resolution passed at a shareholders’ meeting and thereby excessive reserve can be part of the distributable income. This possibility obviates the two-step distribution of reserve – transfer to the capital account and reduction of the capital.

4. Lenient Distribution of Profits

The KCC requires that financial statements be approved at a shareholders’ meeting. This creates a time gap between the end of a fiscal year and the shareholders’ meeting. The KCC also requires the distribution of dividends to be in the form of cash or newly issued shares. The KCC, however, provides for board supremacy over shareholders in the part of the KCC which deals with governance.

To make board supremacy consistent in financial matters, the Bill permits the board to decide on the dividends when the financial statements are approved by the board pursuant to the provisions of the articles of incorporation. A joint stock company may distribute its distributable income in the form of any assets, and thus dividend is not limited to cash or shares. As to the amount of

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67 KCC, Art. 458.
68 KCC, Art. 459.
69 KCC, Arts. 460 and 461.
70 Bill, Art.459.
71 Bill, Art. 461-2.
72 KCC, Art. 449.
73 KCC, Arts. 462 and 462-2.
74 KCC, Arts. 361 and 393.
75 Bill, Art. 462, Para. 2.
76 Bill, Art. 462-4.
distributable income, the Bill still maintains the balance sheet test while unrealized profits also must be deducted from net assets.77

5. Diverse Kinds of Shares

The KCC provides for two kinds of shares: common and preferred.78 Preference features are permitted in terms of dividends and liquidation proceeds. The KCC also still adheres to the principle of free transferability.79 As the capital market has been developed, the STL80 (now the Capital Market Law) used to except listed companies from the general rules under the KCC. For example, KCC limits the amount of non-voting shares to one fourth of the shares issued; the STL raises the cap to one-half for listed companies.

The Bill provides for the possibility of more diverse kinds of shares in terms of voting rights, transferability, conversion and redemption in the articles.81 The number of non-voting shares or shares with restricted voting rights can be as many as one-half of the total number of shares issued.82

6. Improvement of Bond Market Structure and E-Register

From its inception in 1963, the KCC has many sections on bond sales. As the bond market develops, the STL (now the Capital Market Law) had special sections on bond sales by listed companies.83 Nonetheless, many archaic provisions in the KCC create uncertainties and pose hindrances to the development of the bond market.

The Bill abolishes the sections of the KCC regarding the maximum amount of the bond and limits on face value and premium issuance.85 The Bill also provides for the possibility of more diverse bonds, such as bonds with dividends, exchange bonds, redeemable bonds, and bonds with derivative features.86 The Bill also introduces the concept of a bond management company which must be independent of the trustee.87 While trustees are soliciting sales, the bond management company should engage only in supervisory activities for the

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77 Bill, Art. 462, Para. 1, Item 4.
78 KCC, Art. 344.
79 KCC, Art. 335.
80 STL, Arts. 189 through 193, especially Art. 191-2.
81 Bill, Arts. 344-2 to 344-4, 345 and 346.
82 Bill, Art. 344-3.
83 KCC, Arts. 469 to 516-10.
84 STL, Arts. 191-4 and 191-5.
85 KCC, Arts. 470 to 473.
86 Bill, Art. 469.
87 Bill, Arts. 480-2, 480-3, 481, 482, 483, 484, 484-2 and 485.
protection of bond holders’ interest. As a technical matter, a bond does not have to be registered on paper, but electronic registration and management is a possibility.\textsuperscript{88} The same system is to be introduced for shares\textsuperscript{89} under the Bill.

### III. Procedures

#### A. 2006 Proposal

After extensive discussions among members of the Korea Commercial Law Association and its report on the amendments of the company law in November 2004,\textsuperscript{90} the KMOJ organized a Corporate Law Amendment Special Committee (“Special Committee”) of 15 professors and trade group representatives on 28 July 2005.\textsuperscript{91} The Special Committee was divided into two groups: one group for corporate governance matters; and the other group for corporate finance matters. After year-long discussions within the groups, the Special Committee made a proposal to the KMOJ on 6 June 2006. As usual, the KMOJ had a public hearing on 4 July 2006.\textsuperscript{92} On 4 October, the 2006 proposal (“2006 Proposal”) was finally announced to the public by KMOJ Public Notice No. 2006-106.\textsuperscript{93} It had four points: (i) advancement of corporate governance by introducing the officer and double derivative suits systems; (ii) introduction of information technology into corporate management by adopting the e-voting system; (iii) introduction of more autonomous management of financial matters by abolishing the requirement for minimum capital and revising the legal reserve system; and (iv) introduction of new forms of enterprises. The 2006 Proposal does not differ greatly from the

\textsuperscript{88} Bill, Art. 478, Para. 3.
\textsuperscript{89} Bill, Art. 356-2.
\textsuperscript{92} KMOJ, Public Notice with attachments, “Public Hearing on Company Law Chapter” (20 Jun. 2006) online: <http://www.moj.go.kr>, Chan-Hyung Chung made a presentation on behalf of Group 1, while Kun Shik Kim on behalf of Group 2. Presentation materials were attached to the above KMOJ Public Notice.

http://www.bepress.com/asjcl/vol4/iss1/art6
DOI: 10.2202/1932-0205.1195
Korea Commercial Law Association proposal. This is not surprising as the members of the Special Committee are the same as the reporters of the said Association. One interesting idea in the proposal of the Korea Commercial Law Association is the re-definition of a corporation as legal person only, and thus does not have to be an association of two or more individuals. This proposal, however, was not adopted in the 2006 Proposal. On 12 October 2006, the Korean Legal Center organized a symposium about the 2006 Proposal with its drafters. In the public notice, the KMOJ clearly indicated that the 2006 Proposal would pass the technical review of the Ministry of Legislation, be subsequently officially adopted at the Cabinet meeting and sail through the National Assembly by the end of 2006. On 12 December 2006, however, the Justice Minister ordered the organization of a Special Issue Debate Committee composed of five members to reconcile the 2006 Proposal with the demands of the business world. The three major issues to be discussed were: officer liability; double derivative suit; and usurpation of corporate opportunity. On 5 February 2007 the Special Issue Debate Committee, after several discussions, decided to stick to the initial proposal with some minor changes. The 2006 regular session of the National Assembly, however, had long been concluded.

B. 2007 Proposal

On 27 August 2007, the KMOJ again publicly announced the amendment proposal (“2007 Proposal”) in its public notice No. 2007-97. The focus of the 2007 Proposal, however, was to shift the STL provisions for listed companies to the KCC. Most of the provisions of the 2006 Proposal on corporate governance and finance disappeared except for minor portions about incorporation conveniences. On 5 September 2007, the KMOJ had a public hearing. On 20

94 Study Report, supra note 90, at 147-150.
95 Bok-Ki Hong, “Draft Amendment on Corporate Governance” 94 The Korean Legal Center 5-30 (Oct. 2006); Jong-June Song, “Draft Amendment on Corporate Finance” 94 The Korean Legal Center 31-59 (Oct. 2006); Seung-Kyu Yang, Chang Hyun Koh & Tae-Jong Lee, “Comments and Discussions” 94 The Korean Legal Center 60-83 (Oct. 2006).
September 2007, the 2007 Proposal was submitted to the National Assembly as Bill No. 177463. As the term of the 17th National Assembly expired on 29 May 2008, Bill No. 177463 was abolished on the same date.

C. 2008 Proposal

Under the new administration, on 7 May 2008, the KMOJ publicly announced the 2008 proposal (“2008 Proposal” or the “Bill”) in its public notice No. 2008-47. The 2008 Proposal was, as described above, a combination of the 2006 Proposal and 2007 Proposal. Some important sections in the 2006 Proposal such as double derivative suits and managerial needs for redemption of treasury shares were deleted. However, substantial parts on corporate governance and finance from the 2006 Proposal were retained. The 2008 Proposal passed through the legislative procedure up to the level of the National Assembly as Bill No. 1801556 on 21 October 2008. On 28 November 2008, the Judiciary Committee decided to take out the STL part of the Bill as an independent bill; this was how Bill No. 1803424 came to be. Technically, Bill 1801556 is still pending with the 18th National Assembly for further consideration.

IV. UNANSWERED QUESTIONS

A. To what Extent can the Shareholders’ and Directors’ Authority under the KCC be Prescribed in the Articles of Incorporation?

Under the KCC, a corporation is a legal entity independent of its shareholders. As a corporation is incorporated by equity interest holders, it can be depicted as the property of its shareholders. However, as the law grants the privilege of limited liability to a corporation, it has been used as a legal means to amass capital. Korean courts adhere to the traditional, dogmatic view about the substance of a corporation: an independent entity with its own interest. For example, in a company where there exists only one shareholder, even if the shareholder uses corporate funds for personal purposes and immediately pays

100 KMOJ, Public Notice on Amendment Proposal (12 Sep. 2007), online: <http://www.moj.go.kr> with attachment.
102 KCC, Art. 171, Para. 1.
back the funds, such conduct constitutes a breach of fiduciary duty, which is
criminal under the Korean Penal Code. In determining whether a director of a
bank has breached his fiduciary duty, the Korean Supreme Court also clearly
indicated that directors of financial institutions, as they owe a fiduciary duty to the
public, should consider the public interest as well as the interest of the shareholder
in extending loans. One district court recently alluded that the board of
directors should consider the interest of society as well as that of the shareholders
in taking a corporate action to deter any hostile takeover attempts. According
to this line of cases, Korean courts seem to conceptualize a corporation as an
independent entity having its own interest apart from its shareholders.

Contrary to the judicial precepts about the corporation as an independent
entity, more commentators in Korea tend to take the view that a corporation is a
property to be owned and managed by the shareholders by contract among
themselves. Some are even sympathetic to the view that a corporation is just a
nexus of contracts without its own substance, and thus is to be free from any
mandatory corporate rules. Reflecting in part such views, the KCC has
permitted shareholders to plan corporate governance and finance structure in the
articles of incorporation. They include, among other things, board approval
requirement for share transfers, issuance of new shares to third parties, payment of interim dividends, terms of convertible bonds and bonds with
warrant, bond issuance to third parties, redemption of shares with retained
earnings, conditions for redemption of preferred shares, and terms of conversion for convertible shares. The Bill adds more optional items to the

105 Sun-Ho Shin v. Public Prosecutor, 80 DO 537, dated 13 Apr. 1982; Korea Supreme Court
preventing issuance of new shares. Compare this line of cases with Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).
108 Jae Woo Lee, “A Contractual Approach to Corporate Governance and Its Implications for
Korean Enterprises: A Coasian Perspective” 10 Industrial Organization Review IV, 111 (Korean
Academic Society of Industrial Organization, 2002); Seuk-Hun Sin, “Foundations of Law and
109 KCC, Art. 335, Para. 1.
110 KCC, Art. 418, Para. 2.
111 KCC, Art. 462-3, Para. 1.
112 KCC, Art. 513, Para. 2.
113 KCC, Art. 516-2, Para. 2.
114 KCC, Arts. 513, Para. 3 and 516-2, Para. 4.
115 KCC, Art. 343, Para. 1.
116 KCC, Art. 345, Para. 2.
117 KCC, Art. 346, Para. 1. There are many provisions in the KCC that authorize the shareholders
to design the details in the articles, such as reasons for dissolution, designation of liquidator,
The foregoing list: no par shares, approval of financial statements by the board, payment of dividends or disposal of treasury shares by the board, diverse kinds of shares, e-shareholder register, cap on director’s liability, establishment of executive officers system, and in-kind dividend. The Bill is thus an extension of the trend for contracting out of the KCC requirements.

It is true that the KCC is a mixture of two different perspectives like almost every corporate law around the world. Nonetheless, to define with some degree of clarity the subject matters that can be delegated to the articles, it seems desirable and necessary that a consensus about the substance of a corporation should be formulated. In general, technical matters such as the e-shareholder register can be set out in the articles. Similarly, the allocation of authority between the shareholders and the board can, within limits, be defined by the articles. However, who should be the fiduciaries and to whom are they fiduciaries cannot be optional; instead they should be prescribed by the law. Rather, except for certain extreme views about the substance of a corporation, the fiduciary relationship between the shareholders and the directors is still the basic tenet of corporate laws that cannot be negotiated between them, but should be imposed by law. The Bill foresees the introduction of the executive officers concept for the purpose of imposing the fiduciary duty on those who are not board members. However, it will be possible only if the articles of incorporation are revised by passing a special resolution at a shareholders’ meeting. Although the Bill might have been a political settlement between the business community who wants broader board authority over the shareholders and those against such trend, designation of transfer agent, grant of stock option, different kinds of shares, minimum dividend ratio for preferred shares, record date or shareholder register closing period, issuance of bearer form share certificate, authority of shareholders’ meeting, venue of shareholders’ meeting, chair at shareholders’ meeting, quorum for regular shareholders’ meeting, exercise of voting rights in writing, non-voting right of preferred shares, exclusion of cumulative voting, fiduciary duty, extension of director’s term, number of directors, share retention requirement of directors, director’s compensation, selection of representative director, shortening of prior notice period for board meeting, super-majority requirement for board resolution, exclusion of no face-to-face meeting resolution, establishment of committees within the board, board authority that cannot be delegated to committees, lower share ownership ratio for excluding voting rights in selecting statutory director, establishment of audit committee, terms of new shares, shareholders’ resolution for a transfer of reserves to capital accounts, and so forth.

118 Bill, Art. 329, Para. 1.
120 Bill, Arts. 341, Para. 2 and 462, Para. 2.
121 Bill, Art. 344, Para. 2.
123 Bill, Art. 400, Para. 2.
124 Bill, Art. 408-2.
125 Bill, Art. 462-4, Para. 1. As to delegation of bond issuance authority from the board to the representative director for one year, see Bill, Art. 469, Para. 4.
politics cannot override legal principles if the Bill is founded on a consistent understanding on the nature of the corporation.\textsuperscript{126} Without any perspective about the substance of a corporation, the Bill seems to expect the KCC to work only where there exist no provisions in the articles. Contrary to such expectation, however, the Bill did not shake the traditional depiction of a corporation under the KCC - an independent legal entity. Any amendment of the KCC without a philosophy on the fundamentals, ends up as a mystic, confusing mix. It brings about more chaos and uncertainty.

Such consensus would helps to clarify the meaning of KCC sections about the possibility of having different provisions in the articles. Where there is no reference to the possibility that articles can provide differently from that set out under the KCC, one can always raise the question whether such delegation is prohibited. One example under the KCC is the super-majority requirement for a shareholders’ meeting. The KCC provides for the possibility of super-majority for board meetings\textsuperscript{127} while it is silent about it with respect to shareholders’ meetings.\textsuperscript{128} The issue is whether the articles of incorporation may require a super-majority for certain shareholder resolutions. If one conceptualizes a corporation as a social institution created by special legislation, all rules governing a corporation are what corporate laws say about it. If, on the other hand, a corporation is basically a contractual method that can be filled in by the KCC, even without specific authorization in corporate laws, liberal placements of authority in the articles would not have to be prohibited. Korean courts are rendering conflicting decisions about the validity of super-majority clauses in the articles.\textsuperscript{129}

Even where the articles can provide otherwise under the KCC, the next question is whether that is the only possibility. One example is what kind of restrictions on share transfer is possible under the KCC as the KCC only provides for the board consent requirements in the articles.\textsuperscript{130} Whether the articles can provide for the consent of all the other shareholders is not clear. The validity of shareholders agreement is also uncertain. As the Bill introduces restricted shares on transfer as one of the diverse kinds of shares, this question will then be partly

\textsuperscript{127} KCC, Art. 391, Para. 1.
\textsuperscript{128} KCC, Art. 368, Para. 1.
\textsuperscript{129} Incheon District Court, Boochon Branch Decision, 2007 KAHAP 335, dated 13 Apr. 2007, confirmed an amendment of the articles requiring 95% of the shares present and 90% of the shares outstanding for resolutions for terminating directors to be null and void as it violates the substance of a joint stock company and infringes shareholder’s innate rights. \textit{Caledonian Trust Cayman Limited et al. v. In-Chang Whang et al.}, 2008 KAHAP 1167, Seoul Central District Court Decision, dated 2 June 2008, rendered the same view.
\textsuperscript{130} KCC, Art. 335, Para. 1.
resolved. The Bill, however, causes similar questions to be raised when it provides for the possibility of special deviations in the articles. The Bill provides that the articles can limit the liability of directors to six times the annual compensation.

Without any understanding about the substance of a corporation, one does not know whether and to what extent insurance at the company’s expense would be permitted. Further, one does not know whether this is in addition to or in lieu of the limits in the articles.

B. Should Corporate Laws be Different for Different Size of Companies? What should be the Criteria for Measurement of Size? Are there any other Criteria than Size for Different Corporate Rules?

The KCC provides for different corporate governance structure, depending on the amount of the paid-in capital, whether the shares are listed and the amount of assets. If the amount of capital is less than KRW 10 million, certain provisions on trade name and commercial registration are not applicable. The minimum paid-in capital of a joint stock company is KRW 50 million. If the amount of capital is less than KRW 500 million, there may be fewer than three directors. As a general rule, a board must be composed of three or more directors none of whom have to be outside directors. A joint stock company must have a statutory auditor. Alternatively, an audit committee within the board may be established. Such a committee must be composed of at least three directors who are not related to the incumbent or recent directors, the largest shareholders, or other related parties to the incumbent or recent directors.

In the case of listed companies, they must have outside directors who account for at least one-fourth of the board. If the assets are KRW 2 trillion or more, there must be at least three outside directors and they must constitute a majority of the board. They are also required to have an outside director

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131 Enforcement Decree under the KCC (“KCC-ED”), Art. 2.
132 KCC, Art. 329, Para. 1. Bill, Art. 329 abolishes the minimum capital requirement with the introduction of no par shares.
133 KCC, Art. 383, Para. 1. Bill, Art. 383 increases the amount of paid-in capital from KRW500 million to KRW1 billion.
134 KCC, Art. 409, Para. 1.
135 KCC, Art. 415-2, Para. 1.
136 KCC, Art. 382, Para. 3.
137 KCC-ED, Art. 13, Para. 1 excludes certain companies, such as venture companies, corporate reorganization companies, etc.
138 KCC, Art. 542-8, Para. 1.
139 KCC-ED, Art. 13, Para. 2.
recommendation committee where at least one-half must be outside directors.\textsuperscript{140} One half of the outside director recommendation committee can be inside directors. Such listed companies are also required to have an audit committee with three or more members, of whom at least two thirds must be outside directors.\textsuperscript{141} Thus, the minimum size of the board is five – two are inside and three are outside directors – and one outside director must sit on the nomination committee and the two remaining outside directors on the audit committee. If the assets are KRW 100 billion or more, the listed company must have one standing statutory auditor\textsuperscript{142} (unless an audit committee has been established) who must meet, among other things, the qualifications for outside director. For these mid-size listed companies, they may have either an audit committee (which is not mandatory) or one standing statutory auditor. Standing statutory auditors are different from the usual statutory auditor in the sense that they must meet the qualifications for outside directors. As described above, the Bill introduces another tier of joint stock companies – those whose paid-in capital is less than KRW 1 billion. In this case, the paper work for incorporation will become less burdensome and a statutory auditor is not mandatory.\textsuperscript{143}

Different governance rules for listed companies can be justified as the management is at least conceptually separated from the shareholders due to the large number of shareholders. Among listed companies, depending on the amount of assets on the balance sheet as of the previous year end, the KCC imposes a different supervision mechanism on the management, which also makes sense considering the sheer size of the assets in the hands of the management. However, among non-listed companies, it does not seem reasonable to introduce one additional set of legal requirements depending on the amount of legal capital. This could make things more complicated, and thus is unnecessary and inconsistent. The Bill introduces no par shares and thus substantially limits the legal significance of statutory capital.\textsuperscript{144} Thus, the amount of paid-in capital will have minimal meaning. To make another set of rules depending on the amount of paid-in capital does not accord with such move. Furthermore, a company, whilst it can list its shares on the Korea Exchange (“KRX”) via KOSDAQ or KSE,\textsuperscript{145} has to comply with the listing requirements for KOSDAQ which provide for, among other things, a minimum amount of

\textsuperscript{140} KCC, Art. 542-8, Para. 4.
\textsuperscript{141} KCC, Arts. 542-11 and 542-12.
\textsuperscript{142} KCC, Art. 542-10; KCC-ED, Art. 15, Para. 1.
\textsuperscript{143} Bill, Arts. 292, 318, 363 and 409.
\textsuperscript{144} As to the history of legal capital, see Manning & Hanks, Legal Capital, 3d ed. (USA, Foundation Press, 1990).
\textsuperscript{145} Capital Market Law, Art. 390; KRX Listing Regulations most recently revised on 28 Jan. 2009, Art. 32, Para. 1, Item 2; KOSDAQ Listing Regulations most recently revised on 28 Jan. 2009, Art. 6, Para. 1, Item 2.
shareholders equity of KRW 3 billion for venture companies and KRW 10 billion for general companies. Considering the insignificant difference of KRW 1 billion for SJSCs and KRW 3 billion for listing shares on KRX, it does not appear to be desirable for the Bill to introduce new rules for SJSCs.

It should not be the amount of paid-in capital, but the separation of management from the shareholders that should be the criteria for different governance rules. Like the Delaware General Corporation Law,\(^\text{146}\) the KCC can define closely-held companies in terms of the degree of separation of directors from shareholders and the total number of shareholders.\(^\text{147}\) Despite the definition of a company as an association for profits under the KCC,\(^\text{148}\) a joint stock company does not have to have two or more shareholders at the time of incorporation or at any other time. The Korean Supreme Court has also developed exceptions for one-person joint stock companies in terms of valid shareholders meeting.\(^\text{149}\) In an international joint venture, a shareholders’ agreement is often sought. Most joint stock companies are in reality closely-held companies. The KCC, however, is still silent on the validity of shareholders’ agreement in closely-held companies on the management and corporate governance. Thus, instead of the paid-in capital amount standard, the total number of shareholders and the degree of the separation of the directors from the shareholders can be adopted as the criteria for a more flexible, but enforceable planning of the corporate management structure by shareholders.

C. Should the KCC be more Autonomous or more Paternalistic on Finance Matters? Should it be a Guardian? An Umpire?

The KCC has many provisions on accounting and financial matters based on the perception that the KCC, as mandatory norms, should protect the interests of creditors and shareholders.\(^\text{150}\) In spite of changing economic realities and financial needs, nonetheless, the KCC provisions on accounting and financial matters have not been changed for decades. Instead, the STL and subsequently the Capital Market Law have produced many exceptions to promote two

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\(^\text{146}\) DEL. GEN. CORP. L. § 342.

\(^\text{147}\) Prof. Lawrence E. Mitchell even argues close corporations should be treated as partnerships instead of trying to develop varied rules. See Lawrence E. Mitchell, “Close Corporations Reconsidered” (1989) 63 Tulane L. Rev. 1143.

\(^\text{148}\) KCC, Art. 169. Hyung-Gyu Lee, supra note 89, at 150 proposes revision of Art. 169 because a joint stock company and a limited company do not require two or more share/quota-holders or any other number of share/quota-holders.


\(^\text{150}\) If the KCC articles from Subchapter 4 (Issuance of New Shares) to Subchapter 8 (bond) are about financial matters, the total number of articles exceeds 100.
conflicting policies – convenience of corporate financing and protection of investor interests.\textsuperscript{151} As the STL was merged into the Capital Market Law and the KCC, the Bill is expected to provide more diverse means for corporate financing, fewer restrictions on issuance of shares or bonds, and more authority to the board. Although it is a basic principle that creditors are to be protected by contracts, the Bill liberalizes the rule on legal reserve and distribution of profits and thereby tips the balance in favor of the shareholders. Furthermore, the Bill shifts more of the decision authority on financial matters from the shareholders to the board. It is true that the OAL and the Korean Accounting Standards from the Korea Accounting Standards Board, in addition to the KCC, still buttress the accounting framework for most of the joint stock companies including listed companies. As a matter of fact, the Korea Accounting Standards Board has adopted the Korean International Financial Reporting Standards, which be applicable to all listed companies beginning in 2012.\textsuperscript{152} Nonetheless, the direction of the Bill and the supporting provisions are market-focused, board-centered.

At this juncture where reliance on the self-regulatory power of the market decreases due to the recent economic developments around the world, it is not clear whether the Bill is adequate for the protection of investors’ rights and thereby for ensuring the investing public’s trust in Korean enterprises and financial markets. This seems to be a move contrary to the increasing need to monitor the board by shareholders and regulators especially when the independence of outside directors is questionable.

One interesting development under the Bill is the easier financial restructuring possibility as the Bill substantially liberalizes the rules on mergers and acquisitions, which are the typical means of restructuring joint stock companies. Under the Bill, shareholders of the merged company can be cashed out.\textsuperscript{153} Even without financial restructuring, 95 percent or more shareholders can buy out the minority interest from the other shareholders. Although fair price is the statutory standard for appraisal and involuntary sell-out, it is an open issue whether the Korean courts can decide on the fair price of minority shares based on the modern finance theory; this is because they still tend to apply the book value or old-fashioned Delaware block approach.\textsuperscript{154} In the case of Daewoo Electronics, the Seoul High Court\textsuperscript{155} decided to adopt the appraisal value by applying 50% weight to market value and 50% to net asset value, a decision which was confirmed by the Korean Supreme Court. In the case of Dreamcity Eunpyong

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\textsuperscript{151} Capital Market Law, Art. 1 [purpose of the law].
\textsuperscript{152} Law 9408, dated 3 Feb. 2009, revising the OAL.
\textsuperscript{153} Bill, Arts. 360-24 to 360-26.
\textsuperscript{154} For the pre- and post- 1983 position in Delaware, see Weinberger v. UOP, 457 A.2d 701 (Del. 1983).
Broadcasting, the Korean Supreme Court revoked the Seoul High Court decision\textsuperscript{156} which averaged the market price, net asset value and earnings value; the Korean Supreme Court ruled that earnings value should have been given more weight in applying the block method.\textsuperscript{157} In re Korea MBS Company\textsuperscript{158} and re Minong Company cases,\textsuperscript{159} the Seoul High Court even rejected the earnings value completely by deciding the appraisal value only on net assets. This seems to be a worrisome trend as courts become bureaucratic organizations rendering quick decisions based on their convenience and judicial precedents. Thus, the Bill, while it facilitates corporate restructuring, might harm the shareholders’ interest. This damages the capital market in the long run.

D. How can the KCC Ensure Compliance? Inside of the Board Room? Outsiders? Litigation?

The KCC, like other corporate laws, has been struggling to find the right way to ensure that the board discharges its fiduciary duty.\textsuperscript{160} It started with the statutory auditor, which finds its origins in European company law jurisprudence. Statutory auditors cannot be directors,\textsuperscript{161} but function as independent supervisory individuals. The reality is that they have been perfunctory in most cases. Implementation of the OAL in 1981 was the recognition of the reality that statutory auditors did not work and that there had to be outside auditors for at least financial matters. In the 1980s and 1990s, their authority to monitor management was expanded in vain with the hope that they would work as real auditors.\textsuperscript{162}

Immediately after the 1997 financial crisis, however, the KCC completely changed its direction. It introduced the outside director and ultimately the audit committee concept. This may be viewed as an official recognition that the auditor system was ineffective. The current status is a mixture of everything: the statutory auditor, the standing statutory auditor, the outside director and the audit committee. As described above, the governance institutions prescribed by the KCC depends on whether the joint stock company is listed, the amount of assets, and the paid-in capital. However, the independence and effectiveness of outside


\textsuperscript{157} 2004 MA 1022 Decision, dated 24 Nov. 2006.


\textsuperscript{161} KCC, Art. 411.

\textsuperscript{162} KCC, Arts. 409-2, 410, 411, 412, 412-2, 412-3, 412-4, 413 and 413-2 are the outcome of such amendments.
directors and audit committees continues to be questioned. The current structure is awkward and *ad hoc*.

The Bill does not touch on the outside director concept. Instead, it expands the coverage of fiduciary duty to executive officers. Such expansion seems to be one great step forward for the protection of shareholders although majority shareholders are still not covered by the fiduciary concept. Nonetheless, the Bill does not provide measures to ensure that outside directors are independent of the management. Despite the fact that the KCC excludes some related parties from being outside directors, it is not sufficient. Even the nomination committee of the board may not be independent of the influence of majority shareholders in the election of the outside directors. Thus, some scholars argue that the legal system should more readily allow for shareholder derivative suits so as to create greater deterrence to management breaching its fiduciary duty. It is true that the KCC permits a minority shareholder to file a derivative suit. However, the shareholding requirement of 1% for non-listed companies and 0.01% for listed companies, together with restrictive provision for cost reimbursement, render derivative suits inefficacious in practice. In this context, complete abolition of the shareholding requirement and compensation of litigation costs could be considered as a more effective way to ensure fiduciary duties are carried out. This should of course complement additional ways of ensuring that outside directors are independent.

**E. Who should be the Final Arbiter? The National Assembly? The Financial Supervisory Commission? The Korean Ministry of Justice? The Courts?**

The KCC did not need detailed enforcement regulations in the past. Due to the January 2009 amendment, the KCC now has Presidential Decrees with more substance. They include: qualification for transfer agent, excluded items for shareholder proposal, items to be included in the annual report, special rules

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166 KCC, Art. 403, Para. 1.

167 KCC, Art. 542-6, Para. 6. Para. 7 provides for the possibility of lower percentage ownership requirement for minority shareholder rights in the articles of incorporation.

168 Compare old Presidential Decree No. 11485 with the current Presidential Decree No. 21288.

169 KCC-ED, Art. 4.

170 KCC-ED, Art. 5.

171 KCC-ED, Art. 6.
for stock options of listed companies, special rules for public notice of shareholders’ meeting of listed companies, lower share ownership requirement for minority shareholder rights of certain large listed companies, lower share ownership requirement for cumulative voting request for certain large listed companies, outside director requirements for listed companies, scope of related party transactions for listed companies, and standing auditor and audit committee requirements for certain listed companies. This is due to the relocation of the STL provisions on listed companies to the KCC, which used to be administered by the Financial Supervisory Commission. From now on, the KMOJ will have the responsibility and legal authority to prescribe the details of corporate governance for listed companies.

The Bill expects many more items to be prescribed by Presidential Decree. They include: the scope of financial statements, waiver of court-appointed inspector report on in-kind contribution, share repurchase rules, details of e-shareholder register, details of e-voting, scope of related joint stock companies for combined financial statement, and details of capital reserve. Thus, the Bill authorizes the KMOJ to promulgate rules on financial as well as managerial matters expeditiously and in a timely fashion. However, it is not clear whether the KMOJ is the right institution to address these issues considering the political twist it made to the 2006 Proposal. Furthermore, it is questionable whether the KMOJ can develop the expertise to keep its regulation up-to-date with current economic environment. Even in implementing the 2009 amendment of the KCC, the KMOJ and Financial Supervisory Commission settled on the allocation of their authority only at the last minute. The KMOJ and the Financial Supervisory Commission agreed that the Capital Market Law would still have one chapter on financing of listed companies.

The Korean business community as well as the legal society does not know who should take the leading role in addressing the corporate law problems

172 KCC-ED, Art. 9.
173 KCC-ED, Art. 10.
174 KCC-ED, Art. 11.
175 KCC-ED, Art. 12.
178 KCC-ED, Arts. 15 and 16.
179 Bill, Art. 447, Para. 1, Item 3.
180 Bill, Art. 299, Para. 2, Items 1, 2 and 3.
181 Bill, Art. 341, Para. 1, Item 2.
182 Bill, Art. 352-2, Para. 3.
183 Bill, Art. 368-4, Para. 3.
184 Bill, Art. 447, Para. 2.
185 Bill, Art. 459, Para. 1.
186 Capital Market Law, Ch. 302, Art. 165-2 to 165-18.
and proposing blue prints for the future. The result is that the courts have to resolve the uncertainties left by the current law.

V. ANSWERS TO UNANSWERED QUESTIONS: JUDICIAL ACTIVISM IN KOREA

How the gap between the rules in the KCC and the realities of the corporate world should be addressed is important for the fast-moving Korean economy. As mentioned above, the Bill is a combination of diverse perspectives and philosophies about the legal nature of a corporation and the role of management. Thus, even under the Bill, there remain many uncertainties regarding corporate governance and finance issues. In this context, a legitimate question is who resolves such uncertainties and how such uncertainties are to be resolved. The writer argues and predicts that the court will continue to play an active role even after the Bill is passed.

As Korea is a civil law jurisdiction with an extensive statutory system of laws, the role of the judiciary is to interpret statutory laws promulgated by the National Assembly and the executive branch. Courts are not bound by judicial precedents of other parallel or higher courts. Under this model, the judiciary is not to make new laws, but to interpret current statutes. They are composed of bureaucrats who are career judicial officers. This general observation about the nature and the function of the judiciary under the civil law system, however, is not always true for corporate matters in Korea. The Korean judicial branch, unlike other civil law countries, is aggressive and forward-looking in corporate matters. Some exemplary pro-active decisions of Korean courts on corporate matters as set forth below should illustrate the courts’ activism.

A. Examples of Judicial Activism

1. Piercing the Corporate Veil

The KCC clearly defines a corporation as a legal person for business purposes. It further states that a shareholder of a joint stock company shall be responsible to the company only to the extent that it subscribes for the shares. Thus, a shareholder cannot be held responsible for the debt of a corporation.

In Young-Il Cha v. Bong-Gil Kim, the Seoul High Court held that the defendant, a shareholder of Taewon Corporation was responsible to the plaintiff who extended credit to Taewon Corporation based on the Corporation’s

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187 KCC, Art. 171.
188 KCC, Art. 331.
189 Decision 72 NA 2583, dated 8 May 1974.
promissory notes. The Seoul High Court listed the reality of Taewon Corporation’s operation by the defendant: all or almost all capital contribution was from the defendant; the paid-in capital and assets were meager compared to the size of the business; corporate formalities such as board or shareholders’ meetings were completely disregarded; corporate assets and those of the defendant were intermingled; basic assets of the company were disposed of at the discretion of the defendant, among other things. The Seoul High Court then reiterated the principle that a corporation is a separate legal person from its shareholders. On the basis of the good faith principle, the court held that the defendant, a shareholder of Taewon Corporation, abused the legal formality of a corporation and should be responsible for the corporation’s debts.

Although the Korean Supreme Court reversed the Seoul High Court’s decision on the ground that the corporate entity was not a mere formality in the case of Taewon Corporation, piercing the corporate veil theory has been repeatedly applied in several cases at the lower court level. In the 2001 Byuong-II Park v. Jung-soo Lee (Samjin Company) case, the Korean Supreme Court ultimately adopted the piercing the corporate veil theory. As the cases built up, the Korean Supreme Court started to refine the requirements for the application of the theory in later decisions such as Kiwoo Engineering v. Total Media Angun Co., and Hantong Engineering v. KT. The theory regarding piercing the corporate veil is clearly a judicial creation as the statutes are silent on this matter.

2. Double Derivative Suit

The KCC, although adopting the concept of derivative suits, has strict procedural and substantive requirements determining when and how a derivative suit may be brought. For a listed company, while the threshold shareholding ratio is lower, a six-month retention period is required. As a matter of practice, largely due to these requirements, few suits have been filed except for shareholder disputes on management control.

190 CC, Art. 2, Para. 1.
195 The Korea Supreme Court still takes a more conservative approach on piercing the corporate veil. In Decision 2007 DA 90982, dated 11 Sep. 2008, it also revoked the Daegoo High Court Decision on the ground that the corporate entity was not a mere formality in that case.
196 KCC, Arts. 403 and 542-6.
In *Eun-Sup Jung v. Pyung-Sup Jung, et al.*, 197 the Seoul High Court ruled that a shareholder of a holding company that owned 80% of the shares of a subsidiary can file a derivative suit against the directors of the subsidiary. The Seoul High Court narrowed the issue to the literal interpretation of the phrase “a shareholder of the company” in Article 403, Para. 1 of the KCC - whether it includes a shareholder of a shareholder of the company. Then, it weighed the pros and cons of double derivative suits. Arguments against the double derivative suits point out the fact that a shareholder of a shareholder of the company can ask the board of the parent company to file a derivative suit against the directors of the subsidiary. They also argue that if double derivative suits are possible, the principle that a shareholder who files a derivative suit must own the shares at the time of the misconduct of the directors can be avoided. The Seoul High Court indicated three concerns if only the parent, not the shareholder of the parent, can file a derivative suit against the management of the subsidiary: the damage to the parent is not easy to measure which would make a derivative suit by the parent company only ineffective; multiple parent companies can file multiple derivative suits which would make the legal relationship more complicated; and practical difficulties of a derivative suit if the management of the parent company also controls the management of the subsidiary. In conclusion, the Seoul High Court ruled that a shareholder of the company includes a shareholder of a shareholder of the company. The Korean Supreme Court, 198 however, reversed the ruling on the ground that a parent company is a separate legal entity from the subsidiary and the KCC provides for a shareholder of “the company.”

The 2006 Proposal had one section199 about double derivative suits although there had been heated debates about the scope of the parent company and procedural requirements. At the last minute, the KMOJ deleted it completely in the 2007 Proposal without giving clear reasons for doing so. Almost all the scholars made comments on this issue, and surprisingly most of the commentators lauded the Seoul High Court decision.200

3. *Fiduciary Duty and Defensive Measures of Board*

The KCC used to apply the rules on mandate to the relationship between a company and its directors.201 Through a 1998 amendment, the concept of

201 KCC, Art. 382, Para. 2.
fiduciary duty was added.\textsuperscript{202} The KCC has had specific sections on self-dealing and non-compete obligations.\textsuperscript{203} It has yet to be determined whether and to what extent the general concept of fiduciary duty can be extended beyond the specific sections of the KCC.

In the Eu-Song Park v. Hanwha Merchant Banking case,\textsuperscript{204} the Seoul High Court ruled that an issuance of convertible bonds to a third party friendly to the existing controlling shareholder group in a situation where two shareholders were vying for management control was null and void as it is patently unfair. The dispute arose when the two biggest shareholders were fighting for management control. As Eu-Song Park, after amassing shares from the market, asked for a special shareholders’ meeting of Hanwha Merchant to replace the incumbent board members, they decided to issue convertible bonds to third parties who were friendly to the management. Convertible bonds were immediately converted into shares prior to the scheduled shareholders’ meeting. The first procedural hurdle was whether a shareholder can file a suit to invalidate an issuance of convertible bonds because the KCC did not have a section on the cause of action to invalidate an issuance of new shares.\textsuperscript{205} The second issue was whether such issuance was null and void because it violated the pre-emptive right of the existing shareholders. The Seoul High Court answered these questions affirmatively. Furthermore, it pointed out that such issuance is obviously unfair. Although the Seoul High Court did not specifically use the term fiduciary duty, this ruling was in effect a clear extension of the coverage of the fiduciary duty beyond the statutory ones.

Largely due to this case, the KCC was amended in 2001 to allow the issuance of new shares or convertible bonds to third parties only for business purposes if they are provided in the articles.\textsuperscript{206} Even after the amendment, however, many courts repeatedly held that the issuance of new shares or convertible bonds to third parties in a situation where shareholders are fighting for management control fails to meet the business purpose standards and thereby narrowly defines the business purpose required by the exercise of fiduciary duty in a hostile takeover situation.\textsuperscript{207}

\textsuperscript{202} KCC, Art. 382-3. The relationship between Art. 383-3 and Art. 382, Para. 2 is not clear. The writer believes Art. 383-3, in overruling the simple mandate rules, has opened a new horizon on fiduciary duty.

\textsuperscript{203} KCC, Arts. 397 and 398.

\textsuperscript{204} Decision 97 RA 36, dated 13 May 1997.

\textsuperscript{205} KCC, Art. 516 does not list Art. 429.

\textsuperscript{206} Law No. 6488 Amending the KCC with effect from 24 Jul. 2001.

This view was applied to the disposal of treasury shares in *Hae-Young Lee, et al. v Jae-Woo Lee, et al.*\(^{208}\) (Daelim Trading case). Taking the disposal of treasury shares to be the functional inverse of pre-emptive rights, the Seoul Western District Court decided where shareholders were contesting for management control, that the disposal of treasury shares to a friendly party by the management was null and void. This decision is also an outcome of the court’s aggressive interpretation of fiduciary duties. Despite differences of views, the 2006 Proposal adopted the logic of this ruling,\(^{209}\) which silently disappeared in the 2007 KMOJ proposal.\(^{210}\) The Bill also has no section governing the disposal of treasury shares and business purpose.\(^{211}\) At the district court level, however, there still remain confusions on this issue\(^{212}\) as some courts have refused to request that management prove business purposes for legal disposal of treasury shares in the context of control conflicts.

Another troublesome section on fiduciary duty was whether the misappropriation of corporate opportunities should be canonized in the 2007 Proposal. The KMOJ, despite the Special Committee’s recommendation to adopt the idea, deleted the same in its 2007 Proposal without any explanation.\(^{213}\) In the light of the pro-active approach of Korean courts, however, the theory would probably be tested before the courts.

4. *Fair Value in Appraisal Proceedings*

The KCC recognizes appraisal rights of minority shareholders in many situations including merger, business transfer, share exchange and transfer, division. Although the KCC provides for exceptions in small-scale mergers, shareholders of a merging company as well as those of a merged company have appraisal remedies. The KCC requires minority shareholders to be given fair value for their shares. No more guidelines on fair value have been offered. In the case of listed companies, however, the STL used to provide a specific formula based on the

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\(^{210}\) 2007 Proposal, Art. 342, Para. 2 did not require that Art. 418 be applied by analogy to the disposal of treasury share. Hence, the board of a corporation can dispose of treasury shares without reasonable business reasons, subject to the fiduciary duty.  
\(^{211}\) Bill, Art. 342.  
market price. Under the revised KCC, it was incorporated into the new Capital Market Law.\footnote{Capital Market Law, Arts. 165-5, Para. 3; Capital Market Law-ED, Art. 176-7, Para. 2.} The formula is regarded as a guide and is not binding on the courts.

In the \textit{Doosan Development} case,\footnote{Decision 2004 BEHAP 151, dated 3 Nov. 2005.} the Seoul Central District Court, when asked by the minority shareholders of the merging company to decide the fair value of minority shares, completely dismissed the valuation formula based on the two-month/one-month/one-week weighted average market price prior to the board’s merger decision under the then-STL.\footnote{STL, Art. 191, Para. 3; STL-ED, Art. 84-9, Para. 2.} It did so for several reasons, including: the merger plan was disclosed to the market one month prior to the board decision; the controlling shareholders were affiliates of the merging company; the merging company was under court protection immediately prior to the board’s merger decision. In the end, the court gave 25\% weight to the market price while the asset value received 50\% weight and earnings value 25\% weight. It does not appear to be desirable that Korean courts still adhere to the Delaware block method. However, the court’s dismissal of the statutory formula was too audacious to be looked over. This decision is another good example of Korean courts’ aggressive approach to corporate issues. It is uncertain whether such interpretation can be maintained even if the formula is prescribed in the enforcement decree under the Capital Market Law.

\section*{B. Reasons for Expecting Future Judicial Activism}

Reviewing the decisions explained above, Korean courts have taken a pro-active approach in tackling many corporate legal issues. The most significant reason for the activism must be elitism of the judges who are appointed through highly selective procedures, an extremely competitive bar examination, internal education and training system, and self-recognition as public servants. Other reasons may include their expertise in US corporate issues. As the KCC has incorporated the board supremacy over shareholders after the 1997 IMF financial crisis, Korean courts are increasingly referring to US corporate laws. American ideas relating to the standing and role of the judiciary has found increasing acceptance in Korea. For all the reasons above, the Korean judiciary is claiming more authority in interpreting and making new laws. Another reason for the more active role of the judicial branch in corporate matters is that the KCC provision on fiduciary duty is extremely general in nature.\footnote{KCC, Arts. 382, Para. 2 and 382-3.} Although the KCC has some specifics of the fiduciary duty set out (such as approval of self-dealings)\footnote{KCC, Art. 398.} the
concept of the fiduciary duty itself is stated only as a broad principle. Its content
has not been set out in any detail. The fiduciary duty can be made concrete in a
given fact situation. It is not even clear whether detailed stipulation in the form of
black-letter rules in the KCC might be desirable.\textsuperscript{219}

The writer believes that this tradition should and could continue for some
time because the court is a better, and least dangerous organization than any other
law-formulating or law-enforcement agencies including the KMOJ and the
National Assembly to make balanced and professional judgments on corporate
issues. It is true that the KMOJ has been trying to take the initiative in drafting
many statutory amendment bills on commercial matters. The KMOJ, however, is
composed of public prosecutors who work on corporate matters on a rotation
basis. Furthermore, the KMOJ tends to become a more politically sensitive
organization that is under the influence of several ideology-imbed presidencies.
Despite the executive branch’s familiarity with the reality of listed companies, it
has no legal background, but policy goals. It is not familiar with legal issues
involving closely-held companies. The National Assembly need time to take a
center stage in resolving pending legal problems or proposing future legal
solutions. Even as the judiciary accumulates opinions on specific cases, general
rules will be established with more time. Of course, there can be a broader
question whether judges should be setting norms, seeing that they are not elected
and are arguably engaging in a political function. Despite this legitimate question,
however, the Korean judiciary seems to have been supported by the public based
on its selective nomination procedure.

C. Limits of Responses from Judicial Branch

The general drawbacks of the court in resolving corporate issues are passivity,
individuality, uncertainty and slowness. Courts make judgments only after legal
disputes have arisen. A court’s ad hoc decision for a specific case is not binding
on other courts. As courts’ judgments are always post facto, they might not be of
great help in planning a course of action beforehand. The judicial process takes
time. Corporate disputes usually arise from diverse and complicated facts that are
peculiar to each case. Even if Korean courts try to induce general rules that can
govern the relevant legal issues, decisions are not easily generalized. Thus, the
answers to corporate issues from the judicial branch may be too diverse, too
ambiguous or too individualistic. Such risk is more real in Korea as courts tend to
propose general rules, but list multiple factors, i.e., they adopt the template
approach. They legitimize their conclusions by parading all the relevant factors

\textsuperscript{219} As to the potential risks involving the application of the fiduciary principle to close
corporations, see Lawrence E. Mitchell, \textit{supra} note 147, at 1677 “..from a broad prophylactic
measure to a tool to remedy substantial misconduct.”
without explaining the significance of each factor and how such factors are to be weighed in a given case. As judicial precedents have no legal binding effect, courts do not compare the pending case with similar decisions in the past from the same court or other courts; neither do they distinguish the case from previous ones. Judgments are typically terse and the conclusions cryptic. Thus, the traditional format of judgments, even with the good intention of the judiciary, hinders the court’s creative power to make law.

Korea, like other civil law jurisdiction countries, has a career judiciary. After a brief practical training at the Judicial Research and Training Institute, judges start their career in their mid-20s or early 30s. Although most judges wish to reach the top of their career as the next Korean Chief Justice, almost all of them end up as private practitioners. Retired Korean Justices typically open a law office or join a law firm after their terms expire. If they are overly sensitive to their long term economic well-being, their philosophy might be skewed in favor of big businesses. They may wish to enjoy the visibility of sensationalism by jumping to conclusions without sound legal reasoning. This might affect their reputation as sound lawyers or as members of the judiciary. However, Korean business world tends to simply take them as their followers. Although the judicial branch has maintained its reputation as an institution of the highest integrity, there always exists the risk that judiciary might be perceived as serving business interests. This is especially true if the Korean judges act with an eye on their careers in private practice after they retire from the judiciary.

Despite all these pitfalls involving the resolution of issues by the judicial branch, balancing them against the possibly politically skewed and inexperienced personnel in the National Assembly and the KMOJ, the writer believes the judiciary is better prepared to play the leading role in closing the gap between reality and the corporate laws at least for the time being.

VI. CONCLUSION

The KCC was enacted in 1961 as a twin of the Japanese Commercial Code with certain minor twists. The Korean economy has expanded along with the development of its capital market. Except for miniscule moves in 1984 and 1994, the KCC remained static until the Asian financial crisis hit the country in 1997. The amendments in 1998, 1999, and 2001 were affected by the strong influence of board supremacy in US company laws. The 2009 enactment of the Capital Market Law and relocation of the STL rules on listed companies into the KCC show that the trend is towards greater reliance on market forces and autonomy of

business management. After almost four years of discussions among legal scholars, extensive proposals were made in 2006, 2007 and 2008 despite some distortions by KMOJ politics. At the last minute, however, the National Assembly, except for the technical part of the 2008 Proposal, abruptly blocked the flow, calling for more time for further discussion and consideration. It is not certain whether the National Assembly will pass the Bill in 2009.

Nonetheless, the writer believes that National Assembly would pass the Bill with few modifications by the end of 2009. The Bill is the outcome of joint efforts of many legal scholars, although the KMOJ exerted strong influence over the shape of the Bill. The writer hopes that the political distortions should first be taken from the scholarly proposal. He also hopes the National Assembly will take the initiative to give answers to unanswered questions in the Bill. His suggestions are: a stakeholder clause in exceptional circumstances so as to balance the board’s supremacy; modification of the definition of a corporation; the introduction of more rigorous, mandatory regulations on corporate governance especially on officers; complete abolition of multi-tier rules depending on the amount of paid-in capital, but the introduction of clearer rules on close corporations; less reliance on audit committee or statutory auditor for compliance, but minority shareholder’s easier access to derivative suits by abolishing restrictions on share ownership. Such changes are desirable, but not always feasible at the National Assembly. However, having the Bill is a better option than taking no action. Any attempt to change the Bill would take several more years or forever. It would be a better option to move forward although it is not complete.

Even if the current Bill becomes part of the KCC without any changes, the writer is optimistic about the future of the KCC as he speculates that the Korean judiciary will continue to play an active role in formulating new rules on fiduciary duty and addressing other corporate legal issues. Korean courts will work out the details of the fiduciary duty in specific cases as most Korean companies still lack independent management and controlling shareholders tend to have unrestrained control over the management. Having a pro-active judicial branch might lead to excessive politicization, conservatism for future financial interests, and hasty decisions for immature sensationalism. This can be overcome by open criticism and professionalism.

221 See Supra text accompanying note 101.
222 See Supra text accompanying note 166. It is also being discussed that all listed companies should have a licensed lawyer as compliance officers (23 Mar. 2008), seminar material: http://www.koreanbar.or.kr/publication/index_read.asp?page=1&t_id=newspaper &idx=5005.
Korea has started a new legal educational system in March 2009.\textsuperscript{223} The former involved a four-year law college education, extremely competitive bar examinations, career judiciary from the mid-20s and private practice upon leaving the public service. The new legal education system puts in place a three-year graduate law school education, bar exams which contemplate higher pass rates, and more lawyers entering private practice directly after passing the bar examinations. It remains to be seen how the Korean judiciary can transform itself under the new education system.

It is also time for Korean courts to re-think the way judgments are drafted. Instead of the cryptic judgments, fully reasoned judgments would be helpful to the development of sophisticated corporate law jurisprudence. Written judgments should also be readily available to the public. The exposure of judgment to comment and criticism promotes greater transparency and accountability. Moreover, it has the potential of enhancing the quality of judicial decision-making and exposing judgments that have been rendered with an eye to the judge’s entry into private practice. Such transparency and accountability promotes the standing of the Korean judiciary in the eyes of the public, an important goal if the judiciary is to be effective in building a robust legal system founded on the rule of law.