The Changing Role of Law in Asia: Revolution or Devolution?
Prabhakar Singh & Shilpi Bhattacharya

Locating the Rule of Law in Asia
Justice V. R. Krishna Iyer

Does Law Matter in Japan? The Emerging Role of Law, Lawyers, and Legal Institutions in the Revitalization of Japan
Gerald Paul McAlinn

Erasing the Non-Judicial Narrative: Victim Testimonies at the Khmer Rouge Tribunal
Mahdev Mohan & Vani Sathisan

The Constitution of China: What Purpose Does it (Not) Serve?
Surya Deva

Chinese Policies in Tibet: Should India Remain Concerned?
Michael C. Davis

Charting Corporate and Financial Governance in Korea in the New Decade: World Bank and IMF Reports
Young-Cheol David K. Jeong

Independent Directors and their Constraints in China and India
Umakanth Varottil

The Changing Scope of Human Rights in the Context of Counter-Terrorism in Singapore: A comparative Perspective
Sarah Shi & Ronald Wong

A Review of China’s Anti-Monopoly Law
Gu Minkang & Chen Bing

Legal Education in Asia: Globalization, Change and Contexts
Suvrajyoti Gupta
JINDAL GLOBAL LAW REVIEW

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Charting Corporate and Financial Governance in Korea in the New Decade

Young-Cheol David K. Jeong†

Since the financial crisis of 1997, Koreans have begun to understand the true meaning of the rule of law. By increasing transparency in the law, the Korean government has tried to make corporate governance practices more foreseeable. The rule of law based on transparency and expectation should continue to prosper in Korea, which would lead to a more competitive corporate community. Furthermore, the Korean government should implement policies for the development of an active market for corporate control and professional managers.

INTRODUCTION

On December 3, 1997, Korea signed a Letter of Intent with the IMF requesting a three-year stand-by arrangement of an amount equivalent to SDR 1.5 billion. Among other things, Paragraph 4 of the Letter of Intent acknowledged the need of a comprehensive policy package to improve corporate governance as part of the ‘Memorandum on the Economic Program,’ an attachment to the Letter of Intent. The Memorandum has four broad paragraphs under the heading “corporate governance and corporate structure.” It states, “transparency of corporate balance sheets … will be improved by enforcing accounting standards in line with generally accepted accounting practices, including through independent external audits, full disclosure, and provision of consolidated statements for business conglomerates.” On February 7, 1998, Korea executed another Letter of Intent with a new ‘Memorandum on the Economic Program.’

† Professor of Law, Yonsei Law School; Member of Korea, Illinois, and District of Columbia, D.C. Bars; Seoul National University, College of Law, LL.B., LL.M.; Columbia Law School, LL.M., J. D. I am grateful to Haewon Lee, Sunmi Yang and Sooyon Choi, students at Yonsei Law School, for their assistance in research.


Memorandum has a section on ‘Corporate Governance and Restructuring.’ It lists four specific objectives (transparency, accountability to shareholders, corporate restructuring and bankruptcy procedures) and thirteen measures along with a footnote. The footnote reads “[t]he details of these measures will either be included in the World Bank Structured Adjustment Loan (SAL) for implementation or to be announced by the government in the first half of 1998.” The World Bank awarded the Financial and Corporate Restructuring Assistance Project to the Consultants, who produced the Final Report and Legal Recommendations on Corporate Governance on May 15, 2000 (the “Report”).

Immediately after the 1997 Asian financial crisis, the Korean government promptly and efficiently executed a wide range of amendments to the laws and regulations relating to corporate governance such as the Korean Commercial

<table>
<thead>
<tr>
<th>Objectives</th>
<th>Measures</th>
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| **Transparency** | 1. Require financial statements of listed companies to be prepared and audited in accordance with international standards.  
2. Require publication of combined financial statements for associated companies.  
3. Further reduce the use of mutual guarantees by affiliates/subsidiaries.  
4. To increase the degree of independence of CPAs, an outside auditor selection committee should be mandatory for listed companies and large conglomerates. The committee should be composed of internal auditors, shareholders, if applicable outside directors, and representatives of creditors. |
| **Accountability to Shareholders** | 1. Require listed companies on the Korea Stock Exchange to have at least one outside director.  
2. Remove restrictions on voting rights of institutional investors in listed companies (Investment Trust Companies and trust accounts of banks).  
3. Strengthen minority shareholders’ rights by lowering substantially the thresholds on exercising these rights (for example, the right to file a representative suit and the right to make a proposal).  
4. Review the possibility of allowing for class action suits against corporate executive and auditors. |
| **Corporate Restructuring** | 1. Ensure that all corporate restructuring is voluntary and market-oriented.  
2. Liberalization of the domestic mergers and acquisitions by removing the mandatory tender offer requirement.  
3. Permit takeovers of non-strategic Korean corporations by foreign investors without government approval.  
4. Raise the ceiling on the amount of stock foreigners can acquire in non-strategic companies without approval by the company’s Board of Directors to one third from 10 percent. |
| **Bankruptcy Procedures** | 1. Amend bankruptcy law to facilitate more rapid resolution of bankruptcy proceedings |

As to the background of the award, see Bernard S. Black, *Corporate Governance in Korea at the Millennium Enhancing International Competitiveness: Final Report and Legal Reform Recommendations to the Ministry of Justice of the Republic of Korea (“Report”),* 26 J. Corp. L. 537, 539 (2001) (Annex A to the Report is Terms of Reference for the Report, which was provided to the author by Prof. Black via email.)
The Report spurred a new wave of amendments. Even after the expiry of the arrangement with the IMF on December 3, 2000, the Report was implemented strenuously and consistently by the Korean government during the first decade of this millennium. Further, the enactment of the Sarbanes-Oxley Act in the United States on July 30, 2002 (the “SOX”) rekindled the reformative move to advance governance structures in Korea. On March 19, 2003, the IMF also released a comprehensive ROSC (Report on the Observance of Standards and Codes (the “2003 Report” and together with the Report the “Reports”)) on, among others, corporate governance, which also mentioned “action plans “under Table 9.

Since 2008, however, corporate scandals involving major conglomerates have surfaced. Samsung has maintained a huge amount of slush funds in the name of employees at Samsung Securities and Samsung Fire Ins. Chairman Lee registered and traded Samsung Electronics shares in other executives’ name. Hanwha and Taekwang groups are under criminal investigation for their slush funds. C& group chairperson and top executives were indicted for misappropriation of corporate funds. Shinhan financial group’s top executives were also similarly indicted. It is now apparent that Korea needs to reassess its position in corporate and financial governance. Against this backdrop, a review of the political and legal reform process to implement the

6. As to the list of post-crisis amendments, see Report, supra note 5 at 554-555. As to the 1999 assessment of such amendments, see Il-Chong Nam et al., Corporate Governance in Korea (Mar. 1999), http://www.oecd.org/dataoecd/7/37/1931556.pdf (paper presented at conference on Corporate Governance in Asia: A Comparative Perspective, sponsored by OECD and KDI).
7. Law Number 7025 effective Apr. 1, 2004 was to reflect the additional considerations relating to the SOX.
10. Press Release, Special Prosecutor’s Office, Report of Investigation (Apr. 17, 2008), available at http://ko.wikisource.org.16% shares of Samsung Life Ins. amounting to KRW2.5T were maintained in the name of 1,199 employees. Samsung group shares amounting to KRW2T were also managed. Samsung Fire Ins. also had KRW980M slush funds. Four top management people were indicted for tax evasion and breach of fiduciary duty crime and subsequently pardoned by Pres. MB Lee.
15. Financial Services Commission (“FSC”), 2010 BUSINESS PLAN, 26 (listing better corporate governance of financial institutions as one of the policy goals to improve competitiveness of Korean financial industry).
Report during the past decade would be helpful to direct policy making in the new decade.

In retrospect, not all recommendations or action plans given in the Reports were implemented. In general, however, most were incorporated into Korean law to the benefit of the Korean economy in the sense that corporate and financial governance became much more transparent through the reform process compared to the situation before the reform. Nonetheless, corporate scandals have been rampant in Korea. Thus, we should question how to approach the corporate governance issue in Korea rather than simply study what are the best corporate governance norms that are practiced or proposed in other countries. It is especially so because Western economies suffer great recessions arising out of uncontrolled financial and corporate behavior. Accordingly, this paper is not a proposal for an ultimate structure of corporate governance in this millennium, but an attempt to identify issues and draw a map for reforms in the new decade.

In Parts I and II, the philosophical underpinnings of the Reports and their content are explored. Part III studies the current status of the Reports. Recommendations in the Reports are classified into three groups: achieved items; failed items in form and substance; and partially adopted items in substance. Part IV is an attempt to provide a plausible explanation about the reasons for non-adoptions or futility of certain recommendations. Finally, Part V proposes set of basic perspectives for designing finance and corporate governance reform efforts for the new decade. Part VI is an epilogue to redefine the past efforts from the viewpoint of the rule of law.


18. Economic Report of the President, Ch. 3, 108, Figure 3-14 OECD Countries: GDP and Unemployment (2009).

19. The most comprehensive amendment bill (No. 1801556) has been pending at the National Assembly since Oct. 21, 2008. For the purpose of this article, the bill will pass the National Assembly and become part of Korean laws by the time this paper is published in March 2011. Thus reference to article numbers in this paper includes those under the pending bill. This is also applicable to another bill (No. 1807842) for the adoption of poison pills which has been pending at the National Assembly since Mar. 10, 2010. As to the bill, see Young-Cheol Jeong, Impending Amendments of Korean Corporate Laws in 2009, 4 Asian J. Comp. L. 129 (2009). As to the similar exercise, see Robert W. McGee, Corporate Governance in Transition and Developing Economies, A Case Study of South Korea (Aug. 2010), available at http://ssrn.com/abstract=1665074.
I. 2000 Report

A. Limits

The Report humbly started with a modest statement about its limits. It was handed over to the Korean Ministry of Justice (the “MOJ”) which had no jurisdiction over capital market laws, antitrust laws, or accounting standards, but only over the KCC. Although some sections on public companies under the old securities laws and regulations have been moved to the KCC now, conflicts in jurisdiction of different regulatory bodies was one of the big impediments for an efficient implementation of the Report. Nonetheless, the Report was not limited to the KCC, but addressed a wide range of corporate governance issues relating to public companies.

Another restriction pointed out in the Report for the effective implementation of the recommendations is Korea’s authoritarian culture. Korea’s strong economic performance since 1960 has been explained largely by effective government planning and strong policies. Although governmental control over financial institutions and the private sector has been reducing, the government retains some control over the economy. Likewise, private enterprises including bigger conglomerates are highly centralized in terms of decision making processes. This autocratic, Confucian reality would not

20 Report, supra note 5, at 539.
21 FSC has jurisdiction over capital market and accounting standards while the Korea Fair Trade Commission (“KFTC”) regulates big conglomerates to decentralize their economic power.
23 The way to resolve this issue is discussed in IV. B.
24 After the current administration was launched in 2008, many CEOs of privatized government-invested enterprises such as POSCO, KEPCO, and KT were dismissed or urged to resign without cause, which made many corporate lawyers worried about the independent management of private enterprises.
25 Press Release, KFTC, 2010 Conglomerates Share Ownership Information (Oct. 10, 2010). Out of 35 biggest conglomerates, 12 take the holding company structure. In average 31.06% shares of 12 holding companies are owned by founding family members. 42.68% is the average internal retention ratio. Internal retention ratio means the ratio of shares owned by the chairperson, his/her family, affiliates and treasury shares to the shares issued and outstanding. As to the detail, see discussions in V.A. As to the reality around 1997 financial crisis, see Hwa-Jin Kim, Living with the IMF: A New Approach to Corporate Governance and Regulation of Financial Institutions in Korea, 17 Berkeley J. Int’l. L. 61 (1999); Ok-Rial Song, The Legacy of Controlling Minority Structure: A Kaleidoscope of Corporate Governance Reform in Korean Chaebol, 34 Law & Pol. Int’l Bus. 183 (2002); Jeong Seo, Who Will Control Frankenstein? The Korean Chaebol’s Corporate Governance 14 Cardozo J. Int’l Comp. L. 21 (2006); Christopher Hale, Addressing the Incentive for Expropriation within Business Groups: The Case of the Korean Chaebol, 30 Fordham Int’l L.J. 1 (2006).
“shrug off measured efforts to control self-dealing and improve oversight of corporate managers.” Thus it was feared that this cultural heritage underlying the bureaucratic and economic structure might work against effective implementation of the Report.

B. Assumptions

One of the reasons for the 1997 financial crisis in Korea was the high debt-equity ratio of most conglomerates. Korean banks borrowed in foreign currency, converted the proceeds to Korean Won, and re-lent the proceeds to conglomerates. They did not exercise significant monitoring and credit control over their clients. Most of their currency exposures were not hedged, which left banks and conglomerates vulnerable to drops in the government-managed exchange rate and economic downturns. Investors did not trust Korean controlling shareholders. Thus, corporate governance weaknesses created and exacerbated the financial crisis. Despite help from the public exchequer, these companies barely survived the financial crisis.

C. Philosophy

Corporate governance is a broad term that encompasses rules and market practices which determine how companies make decisions, the transparency of their decision-making processes, the accountability of their directors and managers, the information they disclose to investors, and the protection of


27. The amount of debts of the biggest thirty conglomerates accounted for 48% of the total national debts. See Jang-Sup Shin & Ha-Joon Chang, Restructuring Korea Inc, Financial Crisis, Corporate Reform, and Institutional Transition 42 (2003).


minority shareholders.32 Many of the core problems of corporate governance are universal.33 World-class corporate governance would make Korean companies become world-class competitors. Where market forces are not sufficiently able to correct corporate governance failures, corporate governance can be improved through incremental legal intervention.34 The concentration of Korea’s economy in a small number of conglomerates heightens the urgency for corporate governance reform. The ultimate goal was to provide a set of governance rules that could maximize the value of companies to investors and thus, minimize the cost of capital.35

D. Major Points

The Report consisted of the following sections: Principles, Agenda for Further Reform, and Priorities for Further Reform. However, these are not very different from the recommendations, which are under eight subheadings. These are: i) Empowering Board of Directors and Strengthening Independent Directors; ii) Enhancing Shareholder Rights; iii) Monitoring Related Party Transactions; iv) Enforcing Shareholder Rights; v) Disclosure Requirements; vi) Mergers, Acquisitions and the Market for Corporate Control; vii) Encouraging Institutional Investor Involvement in Corporate Governance; and viii) Miscellaneous Measures such as education and training, active and independent financial press, electronic filing, and special provisions for closely-held corporations.

II. 2003 Report

In April 2003, as part of the joint IMF/World Bank Financial Sector Assessment Program, a quality check of corporate governance in Korea was performed by determining companies’ levels of observance with the OECD

32. Report, supra note 5, at 547-548.
34. Effective control of related party transactions is one example. See Report, supra note 5, at 548. Thus, the report did not totally rely on the efficiency of the market, nor political forces in terms of implementation strategy. As to the view stressing the importance of political dynamics and path dependence, see generally Mark J. Roe, Chaos and Evolution in Law and Economics, 109 Harv. L. Rev. 641 (1996).
35. Id., 549-550.
Principles of Corporate Governance. The 2003 Report concluded by stating that, Korea needs to deepen the progress made in improving financial transparency and shifting corporate culture in two directions: the separation of management from ownership, and the maximization of shareholder value rather than corporate size...The challenge now lies in implementation and effective enforcement of legislative changes to improve the corporate culture and practices.

It further explains the status of corporate governance under five headings: Rights of Shareholders; Equitable Treatment of Shareholders; Role of Stakeholders in Corporate Governance; Disclosure and Transparency; and Responsibility of the Board. Despite slight differences in specifications, the 2003 Report was based on the same IMF/World Bank assumptions and philosophy as the 2000 Report.

III. 2010 Status

(AOI Articles of Incorporation; LC listed company; LLC large listed company; ED Enforcement Decree; LG large group companies under the MRFTA; MRFTA Monopoly Regulation and Fair Trade Act; B board; SH shareholders; D director; CML Capital Market Law; KCC Korean Commercial Code; CHC closely-held corporations; AEAJSC Act on External Audits of Joo-Shik Company; FS financial statements; REV. to be revised by the pending amendment bill).

Table 1: 2000 Report Adoption Matrix: o(adopted)/x(not adopted)/∆(partially adopted)

<table>
<thead>
<tr>
<th>Recommendations</th>
<th>o/x/∆</th>
<th>Relevant Laws/Sections</th>
<th>Notes</th>
<th>#</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. BOD Empowerment</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A. List BOD action items</td>
<td>∆</td>
<td>KCC Art. 393 (1) disposal or transfer of substantial assets, lease large assets, appointment/dismissal of manager, establishment/relocation/closure of branch</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>B. Extend fiduciary duty</td>
<td>x</td>
<td>Cf. KCC Art. 382-3</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>C. Right to access information</td>
<td>∆</td>
<td>KCC Art. 393 (3) Right to request a report only; subsidiary is not covered. Cf. KCC Arts. 412, 412-4</td>
<td>3</td>
<td></td>
</tr>
</tbody>
</table>

37. 2003 Report, supra note 8, at 62.
38. Because of the table format, recommendations and KCC sections are shortened, however, Report and KCC should be consulted to understand the details of the recommendation and the status of the corporate law.
<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
<th>Code</th>
<th>Requirement</th>
<th>Exception</th>
</tr>
</thead>
<tbody>
<tr>
<td>D.</td>
<td>Duty of confidentiality</td>
<td>o</td>
<td>KCC Art. 382-4</td>
<td></td>
</tr>
<tr>
<td>E.1.</td>
<td>Audit committee for listed co./all independent D.</td>
<td>x</td>
<td>Cf. KCC Arts. 542-11(1), 542-8(4)/LC</td>
<td></td>
</tr>
<tr>
<td>E.2.</td>
<td>One independent D. for each committee</td>
<td>x</td>
<td>Cf. KCC Art. 542-8(1) 1/4 (LC); a majority 3+ (LLC)</td>
<td></td>
</tr>
<tr>
<td>F.</td>
<td>Limited liability of independent D.</td>
<td>o</td>
<td>KCC Art. 400 (REV.)</td>
<td>6x annual compensation</td>
</tr>
<tr>
<td>G.1.</td>
<td>Unify the standards of independence</td>
<td>x</td>
<td>Cf. KCC Arts. 382, 542-8(2)/vii) LC v. CHC</td>
<td></td>
</tr>
<tr>
<td>G.2.</td>
<td>“Or any other relationship with the company, its principal shareholders or its directors or officers, which could…”</td>
<td>Δ</td>
<td>KCC Art. 542-8(2)(vii)</td>
<td>KCC ED Art. 13(5) listed</td>
</tr>
<tr>
<td>G.3.</td>
<td>Independent D. certify</td>
<td>x</td>
<td></td>
<td></td>
</tr>
<tr>
<td>H.</td>
<td>Provide supports to independent D.</td>
<td>x</td>
<td></td>
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</table>

### II. Shareholder Rights

<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
<th>Code</th>
<th>Requirement</th>
<th>Exception</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.1.</td>
<td>SH approval of large acquisition of business&gt; 20% assets or revenues</td>
<td>Δ</td>
<td>KCC Art. 374(1)[iv]</td>
<td>Acquisition by a subsidiary not covered; 20% not fixed, but material impact on business; CML Art. 165-4(ii)/ED Arts. 176-6(1)/171(1) 10% for LC same for disposition</td>
</tr>
<tr>
<td>A.2.</td>
<td>Approval of disposition &gt;20%</td>
<td>x</td>
<td>KCC Art. 374(1)[i]</td>
<td>Important part, 20% not fixed; subsidiary not covered</td>
</tr>
<tr>
<td>A.3.</td>
<td>Acquisition by a non-subsidiary affiliate</td>
<td>x</td>
<td>Cf. only for largest groups which assets exceed KRW5T; MRFTA Art. 11-3(1)/ED Art.17-10(3) 10% public disclosure</td>
<td></td>
</tr>
<tr>
<td>A.4.</td>
<td>Issuance shares&gt;20% SH approval</td>
<td>Δ</td>
<td>KCC Art. 513(3); CML Art. 165-6(1)</td>
<td>Even for less than 20%; conversion price&gt;market price exception not adopted</td>
</tr>
<tr>
<td>A.5.</td>
<td>SH approval of related party transaction</td>
<td>x</td>
<td>Cf. KCC Art. 542-9(3) LLC BOD approval for 1% per transaction 5% per year</td>
<td></td>
</tr>
<tr>
<td>B.1.</td>
<td>Nominating comm. for all listed co.</td>
<td>x</td>
<td>Cf. KCC Art. 542-8(4) still for LLC</td>
<td></td>
</tr>
<tr>
<td>B.2.</td>
<td>Nominate candidates, vote listed in a single unified ballot</td>
<td>o</td>
<td>KCC Arts. 542-8(5)/542-6(2)</td>
<td>1% + 6 month retention period; 6 weeks prior to SH meeting</td>
</tr>
</tbody>
</table>
### B.3. Remove the preclusion possibility
- x
- Still opt out by LC

### C.1. 30 days’ prior notice of SH meeting
- x
- Cf. KCC Arts. 363(1)/542-4(2)

### C.2. Agenda in reasonable detail
- x

### C.3. Written materials on material information
- \( \Delta \)
- KCC Arts. 542-4(2)(3); Art. 363-2

### D.1. Lower threshold for inspection of books
- o
- KCC Art. 542-6(4)
- 0.1% LC; 0.05% LLC + 6 months retention period

### D.2. Lower threshold for application for court appointed inspector
- o
- KCC Art. 542-6(1)
- 1.5% + 6 months

### D.3. Harsher punishment
- x

### D.4. Sanctions for disclosure failure
- \( \Delta \)
- CML Arts. 132, 164, 444

### E.1. Preemptive rights unless special resolution, <5%, public offering
- o
- KCC Art. 418(2)
- AOI + business purpose rule,
  CML Art. 163-6(1)
- Amendment of AOI by special resolution at SH mtg.
  5% de minimis exception not adopted
  Biz purpose requirement additional required

### E.2. Convertible
- o
- KCC Art. 513(3)
- Cf. KCC Art. 513(4)

### E.3. Convertible: 14 days notice+information disclosure
- o
- KCC Art. 513(4)

### E.4. <10% discount
- x
- Cf. KCC Arts. 363(1)/542-4(2)

### III. Related Party Transaction

| A.1. Approval by independent D. | \( \Delta \) | KCC Art. 542-9(3) B. approval for LLC | independence/not-interested not clar. Cf. MRFTA Art. 11-2; ED Art. 17-10 |
| A.2. On arm's length | x | | |
| A.3. Separate mtgs. from other D. | x | | |
| A.4. Non-interested SH approval >5% | x | | Cf. KCC Art. 542-9(4) SH report |
| A.5. BOD/SH approval for non-listed co. | \( \Delta \) | KCC Art. 398(1)(REV) | SH. Not clear; CHC not excepted |
| A.6. Definition of related party transaction | \( \Delta \) | KCC ED Arts. 14(5)/13(4) | Not linked to AEAJSC combined FS |
**IV. Enforcing Shareholder Rights**

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<tbody>
<tr>
<td>B. Auditor’s review</td>
<td>o</td>
<td>KCC Arts. 413, 542-9(4)</td>
<td>37</td>
</tr>
<tr>
<td>A.1. Harsher penalties</td>
<td>o</td>
<td>KCC Arts. 624-2, 635</td>
<td>38</td>
</tr>
<tr>
<td>A.2. Reimbursement of all derivative suits</td>
<td>Δ</td>
<td>KCC Art. 405(1)</td>
<td>39</td>
</tr>
<tr>
<td>A.3. Reward SH in derivative suits</td>
<td>x</td>
<td></td>
<td>40</td>
</tr>
<tr>
<td>A.4. Class action</td>
<td>Δ</td>
<td>Securities-related Class Action Act.</td>
<td>Not all CML violations</td>
</tr>
<tr>
<td>A.5. Arbitrat’n in AOI</td>
<td>x</td>
<td></td>
<td>42</td>
</tr>
<tr>
<td>B.1. Separate bench for corp. matters</td>
<td>x</td>
<td></td>
<td>43</td>
</tr>
<tr>
<td>B.2. National prosecution unit</td>
<td>x</td>
<td></td>
<td>44</td>
</tr>
<tr>
<td>B.3. CLE for judges and prosecutors</td>
<td>x</td>
<td></td>
<td>45</td>
</tr>
<tr>
<td>C. Shareholder association</td>
<td>x</td>
<td></td>
<td>46</td>
</tr>
</tbody>
</table>

**V. Disclosure**

<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>A. Accounting principles</td>
<td>o</td>
<td>AE AJSC Arts. 2-2, 13</td>
<td>47</td>
</tr>
<tr>
<td>B.1. Annual report: compliance w/Code of Best Practice</td>
<td>x</td>
<td></td>
<td>48</td>
</tr>
<tr>
<td>B.2. Annual report: related party transaction</td>
<td>o</td>
<td>AE AJSC Art. 7-2</td>
<td>49</td>
</tr>
<tr>
<td>B.3. Disclosure of auditor change</td>
<td>x</td>
<td></td>
<td>50</td>
</tr>
</tbody>
</table>

**VI. Market for Corporate Control**

<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>i) Advance notice of tender offer</td>
<td>o</td>
<td>CML Art. 134</td>
<td>51</td>
</tr>
<tr>
<td>ii) Restrictions on defensive measures</td>
<td>Δ</td>
<td>Fiduciary duty</td>
<td>52</td>
</tr>
<tr>
<td>iii) Mandatory offer for remaining SH</td>
<td>x</td>
<td></td>
<td>53</td>
</tr>
</tbody>
</table>

**VII. Institutional Investor**

<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>i) Independent D of financial institutions</td>
<td>o</td>
<td>CML Art 25</td>
<td>54</td>
</tr>
<tr>
<td>ii) Expand fiduciary obligations</td>
<td>o</td>
<td>CML Art. 28</td>
<td>Compliance officer required</td>
</tr>
</tbody>
</table>
### Exercise voting rights
- CML Art. 87

### Reduce conflict of interest and related party transactions
- CML Arts.34-36

### Increase disclosure
- CML Art. 87

### 1&2 training of financial institutions executive
- CML Art. 87

### Other Recommendations
- Director education
- Training of biz/officials
- Education of SH
- Active/independent press
- Electronic filings/access
- Special rules for CHC (assets or # of SH)

### Table 3 2003 Report Adoption Matrix

<table>
<thead>
<tr>
<th>Recommendations</th>
<th>o/x/Δ</th>
<th>Relevant Laws/Sections</th>
<th>Notes</th>
<th>#</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>I. Rights of Shareholders</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A. cumulative voting</td>
<td>o</td>
<td>KCC Art. 542-7</td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>B. class action</td>
<td>Δ</td>
<td>Securities-related Class Action Act</td>
<td>Not all breach of fiduciary duty or law, but only four causes of action</td>
<td>2</td>
</tr>
<tr>
<td>C. facilitate voting by foreign investors</td>
<td>Δ</td>
<td>CML. Art. 87</td>
<td></td>
<td>3</td>
</tr>
<tr>
<td>D. electronic voting</td>
<td>o</td>
<td>KCC Art. 368-4</td>
<td></td>
<td>4</td>
</tr>
<tr>
<td>E. nomination of indep. D.</td>
<td>Δ</td>
<td>KCC Art. 542-8</td>
<td>Majority, not 2/3</td>
<td>5</td>
</tr>
<tr>
<td><strong>II. Equitable Treatment of Shareholders</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A. class action</td>
<td>Δ</td>
<td>Securities-related Class Action Act</td>
<td>Not all breach of fiduciary duty or law</td>
<td>6</td>
</tr>
<tr>
<td>B. electronic voting</td>
<td>o</td>
<td>KCC Art. 368-4</td>
<td></td>
<td>7</td>
</tr>
<tr>
<td>C. disclose to B of related party transaction</td>
<td>o</td>
<td>KCC Art. 542-9/3(4)</td>
<td></td>
<td>8</td>
</tr>
<tr>
<td>D. governing self-dealing and insider trading</td>
<td>Δ</td>
<td>KCC Arts. 391(3)/368(4)</td>
<td>Not-interested director too narrow</td>
<td>9</td>
</tr>
<tr>
<td><strong>III. Role of Shareholders</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A. strengthen SH rights</td>
<td>o</td>
<td>KCC Art. 542-6</td>
<td></td>
<td>10</td>
</tr>
<tr>
<td>B. institutional investors and pension funds</td>
<td>Δ</td>
<td>Incremental increase</td>
<td></td>
<td></td>
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<tr>
<td>--------------------------------------------</td>
<td>---</td>
<td>---------------------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>IV. Disclosure/Transparency</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A. accounting standards and auditing practices</td>
<td>o</td>
<td>AEAJHC Arts. 6, 6-2</td>
<td>12</td>
<td></td>
</tr>
<tr>
<td>B. improve quality of disclosure in period reports</td>
<td>o</td>
<td>CML Arts. 159, 160</td>
<td>13</td>
<td></td>
</tr>
<tr>
<td>C. internal control and compliance in annual</td>
<td>o</td>
<td>CML Arts. 119(5), 159(7)</td>
<td>14</td>
<td></td>
</tr>
<tr>
<td>D. holding co. &amp; quick combined FS</td>
<td>o</td>
<td>AEAJHC Art. 7; MRFTA Art. 8</td>
<td>15</td>
<td></td>
</tr>
<tr>
<td>V. Responsibilities of Board of Directors</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A. improve audit comm.</td>
<td>o</td>
<td>KCC Art. 542-11</td>
<td>16</td>
<td></td>
</tr>
<tr>
<td>B. replace statutory auditor with audit comm.</td>
<td>Δ</td>
<td>KCC ED Art. 16 Limited to LLC</td>
<td>17</td>
<td></td>
</tr>
<tr>
<td>C. expand fiduciary duty</td>
<td>x</td>
<td></td>
<td>18</td>
<td></td>
</tr>
<tr>
<td>D. institute of director for training</td>
<td>x</td>
<td></td>
<td>19</td>
<td></td>
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<tr>
<td>E. access to information</td>
<td>x</td>
<td></td>
<td>20</td>
<td></td>
</tr>
<tr>
<td>F. rule on independence and conflicts-of-interest</td>
<td>x</td>
<td></td>
<td>21</td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Table 2: Adoption Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000 Report</td>
</tr>
<tr>
<td>I. BOD Empowerment</td>
</tr>
<tr>
<td>II. SH Rights</td>
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<tr>
<td>III. Related Party Trans</td>
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<tr>
<td>IV. Enforcing SH Rights</td>
</tr>
<tr>
<td>V. Disclosure</td>
</tr>
<tr>
<td>VI. Mkts for Corp. Control</td>
</tr>
<tr>
<td>VII. Institutional Investor</td>
</tr>
<tr>
<td>VIII. Other Recommendation</td>
</tr>
<tr>
<td>2003 Report</td>
</tr>
<tr>
<td>I. Rights of SH</td>
</tr>
<tr>
<td>II. Equitable Treatment of SH</td>
</tr>
<tr>
<td>III. Role of SH</td>
</tr>
<tr>
<td>IV. Disclosure/Transparency</td>
</tr>
<tr>
<td>V. Responsibilities of BOD</td>
</tr>
<tr>
<td>Total</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>
IV. REASONS FOR PARTIAL SUCCESS

A comparison of the current status of financial and corporate governance with the recommendations in the Reports reveals that not all, but many of the recommendations have been incorporated by the Korean government into various statutes, and thus the Reports have been deemed a success. However, several reasons can be found for the failure to incorporate all recommendations from the Reports into these statutes.

A. Lack of Enthusiasm for Institutional Readjustment

Some recommendations were related to the structure of institutions, such as creation of special bench and prosecutor units for corporate governance matters and the training of these units. Some recommendations related to the establishment of institutions, such as education of shareholders and institutional investors, training of directors and business executives, and development of an active and independent media. These institutions are not naturally fast in accepting change, nor do they initiate change. Thus, it must be specified in the very beginning itself that these recommendation items seem to be of inherently limited effectiveness.

B. Strenuous Resistance from Conglomerates

The business community was reluctant to be persuaded by the government to implement the recommendations. First, they argued that the controlling shareholder system was as efficient as the dispersed shareholder system. Certain scholars support this view.

39. Woochan Kim, Bernard S. Black & Hasung Jang, Does Corporate Governance Predict Firms’ Market Values? Evidence from Korea 22 J. L. ECON. ORG. 366 (2006). However, it is not easy to determine and even define success or failure of legal changes; See also Hideki Kanda & Curtis J. Milhaupt, Re-Examining Legal Transplants: The Director’s Fiduciary Duty in Japanese Corporate Law, 51 Am. J. Comp. L. 887, 901 (2003)(“Each legal rule or institution must be examined individually, and assessment of the overall feasibility of legal transplants as a form of legal change requires a more rigorous theoretical base than existing literature has provided.”). As to the progress in Japan which elected an enabling strategy in 2002, see Ronald J. Gilson & Curtis J. Milhaupt, Choice as Regulatory Reform: The Case of Japanese Corporate Governance, 53 Am. J. Comp. L. 343, 372 (2006)(“the trajectory and end point of reform in any given system will be shaped by intensely local forces”); DAVID A. SKEEL, JR., Book Review: Governance in the Ruin, 122 HARV. L. REV. 696, 710 (“[e]ven if countries adopt similar laws, laws can be used in a variety of different ways—in Korea they were used to protect the status quo, and in the U.S. to signal more centralized governance”).

40. Report, supra note 5, at 542-543. Institutional investors, however, seem to have supported reform. See Jill F. Solomon, Aris Solomon & Chang-Young Park, The Evolving Role of Institutional Investors in South Korean Corporate Governance: Some Empirical Evidence, 10 CORP. GOVERN. INT’L REV. 211-224 (2002). However, their influence would be limited if they are affiliated with conglomerates.

41. Certain scholars support this view. See Karl Hofstetter, One Size Does Not Fit All: Corporate Governance for “Controlled Companies,” 31 N. C. J. INT’L & COMM. REG. 597, 608-614 (2006), reviewing many empirical studies comparing performance between controlled versus dispersed ownership structure, he suggested “a level regulatory playing field that will allow both categories of ownership to compete on equal footing.”
Korean corporations are still of the view that only controlling shareholders can make risky and bold decisions.\textsuperscript{42} Further, they believe that without controlling shareholders, executives would not have made risky business decisions, without which the Korean economy's advancement would not have been possible.\textsuperscript{43} Second, any attempt by the government to change corporate governance was dismissed by the business community as meddling. They insisted that market efficiency was the only mechanism to change corporate governance.\textsuperscript{44} Such objections can be explained by the hesitation of the controlling shareholders to waive their unlimited power over management decisions. Finally, the business community opined that if any legal measures are desirable, they should be taken in an incremental and gradual manner.

C. Short of Political Prowess

In response to the movement of conglomerates, the Korean government has failed to consensually conclude that loose corporate governance was one of the reasons for the 1997 crisis, retention of professional managers would improve the investor's trust in the management, private benefits accrued due to the controlling shareholder's position should be waived, and moderate legal measures would expedite the process of transformation from opaque governance rules to transparent ones.\textsuperscript{45} Economic and empirical arguments were shifted into ideological ones.\textsuperscript{46} Political capital should have been recouped from the public.

The following recommendations were also not reflected in the KCC: an extension of fiduciary duties to shareholders, audit committee to compose of only independent directors, mechanisms to assure the authentic independence of independent directors, no distinction between large listed companies and less sizable listed companies, no opt-out possibility of cumulative voting, and more comprehensive approval procedures for related party transactions.\textsuperscript{47}

\textsuperscript{42} On the other hand, however, another view opines that only professional managers can make such decisions as they do business with other people's money.
\textsuperscript{43} Shin & Chang, supra note 27, at 129 ("what the country needed was a reinvention of the traditional model"). Their argument was based on the past history and performance. Such arguments are unpersuasive because only the conglomerates used to have privileged access to the cheaper capital that was supplied by the government.
\textsuperscript{44} Due to the great recession, however, the validity of this view is being questioned legitimately. See Yves Smith, How "Free Markets" was Sold, in How Unenlightened Self Interest Undermined Democracy And Corrupted Capitalism, 105-126 (2010).
\textsuperscript{45} Stephan Haggard, The Political Economy Of The Asian Financial Crisis, 147-156 (2000). He explains President, D.J. Kim's bad relationship with business as one reason for the failure.
\textsuperscript{46} Any arguments pointing out the counter-productive effect of conglomerates or malfunctions of the market were characterized as left and progressive, which sometimes equals North Korea.
\textsuperscript{47} To a limited extent, these concepts were accepted in the financial regulatory statutes. E.g., art.34 et seq. of the CML about the related-party transactions.
D. Inchoate Enforcement Mechanisms

The legal profession easily and falsely believed that a change in law would bring Korean companies in line with world class corporate governance standards. In practice, it was not always so. One of the reasons for the partial failure was structural as well as cultural. As Korean society is still largely based on merits, the upper echelon of the bureaucratic and business community is highly interconnected. Thus, the senior judiciary was not keen to break the status quo. Furthermore, though Korean society is substantially westernized; people still tend to shy away from raising direct objections in the presence of others. For instance, even if the scope of independent directors was provided in great detail, yet it would take substantial time for the board of directors’ meetings to become a forum for open discussion by independent directors.

One way to address this issue was to have general provisions on independence to be implemented by the courts. Furthermore, the judiciary should have been more informed of the importance of finance and corporate governance issues and the role of the bench in developing new laws. Lowering the threshold for derivative and class actions should have been more focused. The Report has failed to provide effective enforcement mechanisms that will prevail over structural and cultural hindrances (Recommendation IV.A.3).

E. Lessening Pressure for Reform

When the Reports were produced in 2000 and 2003, Korea was relieved from the financial crisis as it weathered the storm with pain and took the steps urged by the IMF. While the Report was produced as a requirement of the past help from the IMF, Korea was free from the influence of the IMF in 2000. Furthermore, egregious corporate scandals in the United States and Europe such as the Enron and Parmalat scandals swamped the Western world from 2002. As such, regardless of the merits of the Report, it had only a limited selling power to the Korean government and the public in general.

48. Independence of directors is one of the heavily litigated issues even in the United States. In re eBay, Inc. Shareholders Litigation, 2004 WL 253521 (Del. Ch. 2004); Orman v Cullman, 794 A.2d 1 (Del. Ch. 2002); In re the Walt Disney Company Derivative Litigation, 731 A.2d 342 (Del. Ch. 1998), aff’d in part, rev’d in part sub nom, Brehm v. Eisner, 746 A.2d 244 (Del. 2000); In re Oracle Corp. Derivative Litigation, 824 A.2d 917 (Del. Ch.2003); Beam ex rel. Martha Stewart Living Minimida, Inc. v. Stewart, 845 A.2d 1040 (Del. 2004). Some are even skeptic about the true independence possibility, see, e.g., Charles M. Elson, Director Compensation, 50 S.M.U.L. Rev. 127, 131 (1996) (suggesting each director possess a powerful personal financial incentive to examine.”). Vice Chancellor Strine in Oracle decision above stressed the contextual nature of the independence. 824 A.2d 937-941.

49. KCC Enforcement Decree art. 13 ¶¶ 4, 5.

50. E.g., Model Business Corporation Act (“MBCA”)§ 8.60 (4) definition of “Material financial interest.”; KCC, art. 382-3 on fiduciary duty could have been worked out as a general provision for the interest of minority shareholders. The situation in Japan seems to have been similar until recently. Kanda & Milhaupt, supra note 39, at 15 discusses Tokyo High Court, Oct. 26, 1989, 835 Kinyu shoji hanrei 23. Recommendation I.G.2 was the right approach in the sense that it suggested a catch-all language with the expectation that the judiciary would actively develop the concept.
V. Reformatory Measures for the Next Decade

The reformatory efforts and processes based on the Reports constitute valuable experience through which the Korean government can find a novel starting point to plan its finance and corporate governance strategies for the next decade. However, before revisiting each section of the KCC, MRFTA or other individual statutes, I suggest that the Korean government should consider the seven basic questions set out below on how to approach and design finance and corporate governance. Basically, our discussions are about why (philosophical balance), who (institutional balance), how (methodological balance & enforcement mechanism balance), and what (CHC v. public & one v. group) of corporate governance reform efforts in the coming decade.


Korean public companies have a highly concentrated stock ownership. According to a recent KFTC press release, as of April 1, 2010, there are 53 conglomerates with aggregate assets of KRW 5 trillion or more which are subject to cross-ownership regulations under the MRFTA. These conglomerates include 35 family-owned conglomerates (“Group A”) and 18 government-invested enterprises including those which were partially privatized or controlled by foreign interests (“Group B”). In Korea, out of a total of 1,784 public companies 213 companies are listed by 53 conglomerates. The capital of these 213 listed companies accounts for 52% of the total market capital.

51. See Stijn Claessens, Simeon Djankov & Larry H.P. Lang, The Separation of Ownership and Control in East Asian Corporations (Nov. 1999), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=206448. Comparing ownership structure of nine Asian countries, their conclusion was “the concentration of control generally diminishes with the level of a country’s economic development.” The determinants are explained legal (special resolution, derivative suits, bank ownership restrictions), age, and size of a specific firm. They are worried about the possible crony capitalism due to market entry barriers, preferential access to financing and government contracts, detrimental influence on legal development, and wide-spread conflicts.

These concerns are genuine for Korea, too. Compared to the situation in 1990s, Korean conglomerates now tend to have more pyramid-type structures under a holding company rather than chain-holdings. 12 out of 30 biggest conglomerates in Korea have holding companies.

52. Press Release, infra note 54.

53. MRFTA, art. 9.

54. As to the detail of cross-ownership restrictions group, see Press Release, KFTC, Designation of 53 Groups (Apr. 2, 2010). Out of 53, 18 are privatized government-invested enterprises or groups without any founding family. In terms of assets value, KRW 1.47T is the total value of 53 groups. These groups used to be regulated by the threshold asset size. The threshold figure for the groups increased from KRW2T in 2002 to KRW5T in 2009. As to the corporate governance of newly privatized firms, see Woochan Kim & In-Chong Nam, Corporate Governance of Newly Privatized Firms: The Remaining Issues in Korea (KDI School of Public Policy & Management Paper No 04-05, 2004), available at http://ssrn.com/abstract=527383. As to Woori Bank corporate governance, see Joon-Ho Hahn, The Korean Model of Corporate Governance: Issues and Lessons in Reform of Bank Governance (Apr. 2005), available at http://ssrn.com/abstract=799644.
capitalization in Korea. In case of Group A, 50.50% shares are owned by insiders like the founding family, affiliates, officers and treasury shares. This ratio has remained between 50 to 52% for the past ten years. Group A has 193 public companies with internal retention ratio of 39.41%. The internal retention ratio has not undergone any significant changes in the past decade.

Although a dispersed stock ownership structure looks more efficient from an investor’s perspective, its success will depend on the economic situation of each country. Thus, the issue of separation of ownership and management of Korean companies is still a paramount issue. The policy question is whether the Korean government should take measures to convert the current pattern of concentrated stock ownership to a dispersed one. If not, the next policy question is how can controlling shareholders be made accountable for their management decisions. It would also be a difficult task to measure the performance of management in the short and long run.

Table 4: Group A Share Ownership Structure (Press Release)

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Founder</td>
<td>2.01</td>
<td>2.03</td>
</tr>
<tr>
<td>Founding Family</td>
<td>4.33</td>
<td>4.34</td>
</tr>
<tr>
<td>Affiliates</td>
<td>45.87</td>
<td>45.56</td>
</tr>
<tr>
<td>Misc.</td>
<td>2.46</td>
<td>2.56</td>
</tr>
</tbody>
</table>

It is now widely accepted that a simple dichotomy between controlling shareholder systems and widely held shareholder systems seems too coarse to be genuine. Controlling shareholder regimes are not always the end result of bad legal structures where minority shareholders are not protected from the controlling shareholders’ diversion of private benefits of control. Development

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56. Id.
57. Id.
58. Ronald J. Gilson, Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy, 119 Harv. L. Rev. 1641, 1643 (2006). See also Karl Hofstetter, supra note 41, at 608-614. His conclusion was “there is no empirical basis for discriminating legally against controlled ownership structures.” He, however, quickly acknowledged that “controlled structures have their benefits and drawbacks.”
59. Id. at 1644; See also La Porta, Florencio Lopez-de-Silanes, Andres Shleifer & Robert W. Vishny, Legal Determinants of External Finance, 52 J. Fin. 1131 (1997); Rafael La Porta et al., Law and Finance, 106 J. Pol. Econ. 1113 (1998); Rafael La Porta, et al., Corporate Ownership around the World, 54 J. Fin. 471 (1999); Tatiana Nenova, The Value of Corporate Votes and Control Benefits: A Cross-Country Analysis (Jul. 21, 2000), available at http://
of capital markets may not be the teleological end result of the change from concentrated to dispersed ownership structures. Thus, in order to devise the most desirable financial and corporate governance system for Korea, it is important to answer to the questions from the current economic powerhouse, i.e., conglomerates: “what is wrong with the controlling shareholder system?”

Table 5: Ten Biggest Conglomerates Internal Retention Ratio
(Press Release)

<table>
<thead>
<tr>
<th>Year</th>
<th>Founder</th>
<th>Affiliates</th>
<th>Internal Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>48.2</td>
<td>35.2</td>
<td>51.5</td>
</tr>
<tr>
<td>1992</td>
<td>46.6</td>
<td>55.8</td>
<td>51.5</td>
</tr>
<tr>
<td>1993</td>
<td>47.4</td>
<td>44.6</td>
<td>51.5</td>
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<tr>
<td>1994</td>
<td>5.8</td>
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<td>1995</td>
<td></td>
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<td>2005</td>
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</table>

I argue that the Korean government should implement a pro-dispersed stock ownership structure, for several reasons. First, it is a historical fact that the adverse effects of the controlling shareholder system once devastated the Korean economy. International capital market investors did not trust Korean conglomerates. Accordingly, the Korean government should be guarded against the drawbacks of the controlling shareholder system. Second, in addition to...
the lessons learnt from recent experiences, there are several concerns relating to the concentrated share ownership structure. The disproportionate flow of corporate resources and opportunities from the company to the controlling shareholders is the real possibility to be regulated.63 However, such regulation may be costly and sometimes infeasible. Third, under the controlling shareholder system, the cost of misjudgment or overconfidence is damaging. Controlling shareholder system may be irresponsive to the external economic environment. Deterioration of the system with time is inevitable.64 As heirs are not necessarily successful entrepreneurs, management skills can decline over the generations. The economic and social costs involved tend to increase as the hegemony of controlling shareholders continues and is quite substantial at times.65 Finally, irregularities as a consequence of the continuation of this hegemony have lowered the respect for businesspersons as they are considered valueless contributors to the increase of wealth in Korean society. Tax evasion or criminal conduct in violation of trust66 is disheartening to the fostering of entrepreneurship, the source of capitalism among the younger generation of Korean society.

Considering all these potential drawbacks, it seems more desirable from a policy perspective to develop a system that supports a diversity of shareholder distributions which would be more favorably regarded by capital markets and thus, will reduce the cost of capital. Although law may not be the only way to promote diversity of shareholder distribution, it should work as effectively as market mechanisms, such as corporate control market, to create the possibility of a new system.67 Introducing a culture of diversity and professionalism will improve the value of the corporation as an institution. This can be done only by government measures.

reporting requirement under EU Large Holdings Directive (88/627/EEC) does not cover bank’s proxy votes, votes of investment companies, and de facto owners controlled by less than 50% share ownership).


64. Id. at 1671.

65. In Korea, many conglomerates have experienced legal disputes involving the succession. Hyundai & Doosan are good examples.

66. Succession of Everland control involving Samsung group via convertible bond scheme is a good example.


After a consensus about the reason for reforms are made, the next issue would be who would initiate such efforts. We can think of two institutions: MOJ and FSC. The MOJ has jurisdiction over civil, commercial and administrative law in general while the former Ministry of Finance and Economy\(^{68}\) governed financial markets and public corporations. As the FSC now regulates capital markets, it also controls the corporate finance of listed companies in its CML\(^{69}\). While aspects of corporate governance are regulated by the MOJ. As corporate finance cannot be separated from issues of corporate governance, the current status is not feasible even as an interim measure. In designing future governance, the Korean government should decide as to which single ministry will be in charge of and thus, be responsible for regulating public companies.

The MOJ and the FSC are two contrasting agencies. The FSC employs technocrats and economists who study and predict macroeconomic changes. They tend to be more politically neutral. They are of the belief that protecting investors is the only way to obtain their trust. They know that market regulations should be detailed and foreseeable in order to obtain the trust of investors. On the other hand, they are keen to have the authority to make prompt and effective regulations. The FSC does not insist on providing every rule in statutes; rather they prefer to delegate powers to enforcement decrees. In the 1970s and 80s, when governing merely meant ruling, the executive branch played an important role. Now, in 2010s when the complexity of Korean society has increased, governance means coordination. Thus, the ‘FSC only-ism’ has limits.

The MOJ is a completely different organization from the FSC. The MOJ has many talented lawyers, who are professional prosecutors. Their capability is assessed based on their investigation skills and maintenance of prosecution. After several years of service at MOJ, they desire to be promoted to the position of a senior prosecutor. After attaining further seniority, some look forward to entering politics. Some may wish to find a job at a major law firm, largely serving big conglomerates. Thus, the current career development options available to employees of the MOJ cannot meet the requirements for more professional drafting and better research capabilities, essentials for handling corporate legal issues.

The MOJ, if they wish to tackle corporate legal issues competently, should consider developing independent legal departments which will deal with only non-criminal matters. The officers for these legal departments need not be recruited from an independent source. In fact, they can be appointed from the pool of competent public prosecutors who want to handle non-prosecutorial

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68. The Ministry of Strategy and Finance is the current name. Furthermore, regulations of financial services were delegated to the FSC.
69. CML, pt. 3, ch. 302, arts. 165-2 to 165-18.
matters. Their career, however, should not be mixed with that of prosecutors in general. As an interim measure, the MOJ might consider secondment of lawyers from the private sector or academia as is done in Japan. The FSC, on the other hand, should be able to guide and advise the MOJ on the macroeconomic and quantitative impact of legal measures on the market. As a transitional measure, the MOJ and the FSC may consider organizing ad hoc temporary committees for specific assignments.70


Pursuant to the Reports, the KCC was substantially revised. Furthermore, the regulations on public corporations under the Securities Transaction Law were relocated to chapter 2, clause 13 of the KCC.71 At the same time, relevant provisions of the Enforcement Decree under the previous Securities Law were also adopted by the Enforcement Decree under the KCC. Accordingly, the KCC became a mixture of two contrasting approaches: civil law tradition based on principles and rules on corporate matters in general versus the American approach of detailed regulations on capital market; post-facto enforcement by the judiciary branch v. ante-facto preemption by the administrative branch.72

Although prima facie Korean corporate laws have been influenced by US jurisprudence, their origin, format and core are from civil law.73 These laws are broadly worded, and their interpretation largely depends on jurisprudence based on scholarly studies. The courts are not supposed to liberally interpret the statutes, rather simply to enforce their literal meaning. The broad wording of the law creates, by its nature, more scope for judicial interpretation. For example, a shareholders resolution is voidable if its procedure is unusually unfair.74 The courts determine the scope of unusual unfair procedure, depending on the facts of each dispute. As the popularity of US corporate laws has increased, the judiciary is becoming more liberal.

70. For the purpose of assisting investigation of unfair trading activities in the capital market, several public prosecutors are reportedly posted to Financial Supervisory Services, an enforcement arm of the FSC.
71. KCC Arts. 542-2-542-12. As to the history of this relocation, see Young-Cheol Jeong, Impending Amendments to Korean Corporate Laws in 2009: A Mystic Mix, 4 AsIA J. COM. L. 129, 140-142 (2009).
74. KCC art.376, para. 1.
Capital markets are regulated by the Securities Transaction Law which also regulates public corporations. As the SEC in the United States regulates capital markets effectively through detailed regulations, similarly, Korean regulators police public corporations through detailed regulations. With the evolution of capital markets, the regulations governing them have also changed. The court is hardly expected to interpret these administrative regulations; rather it is expected to technically implement them. For example, the independence of directors is defined in terms of degree of kinship, share ownership, transaction amount, etc., such that no further interpretation is necessary.

In designing Korean policy on corporate governance for the future, it is always important to determine how much should be regulated by rules and regulations and how much by best practices and market mechanisms. Furthermore, in providing for law, the scope of details should be carefully weighed. Broad-worded rules may not be easy to predict, but should be able to prevent regulatory arbitrage as the court would interpret the coverage of those rules assuming the judiciary is reasonably competent and neutral. On the other hand, if every governance issue is prescribed by detailed regulations, the market can predict the outcome without difficulty, but gamesmanship might prevail.

I believe that a regulation-based approach is desirable as well as practical in Korea for the time being. Although public companies are traded on exchanges and capital markets fluctuate, it does not mean that administrative regulations are always the better option for markets. Especially as to corporate governance, the statute should be able to provide reasonably concrete rules without too much delegation to the enforcement decree. Furthermore, to prevent regulatory arbitrage, the regulations should have a catch-all general section at the end of the relevant sections so that lower courts can create and develop judge-made laws.


Although courts are free to take any interpretative theories, the detail of the text would impact the freedom of the court, and thereby imbue the textualism. See generally Frank B. Cross, The Theory and Practice of Statutory Interpretation (2009).

In this sense, I believe KCC Enforcement Decree should and could be merged into KCC itself. Compared to the situation where all regulations on public companies were governed by the Securities Transaction Law, these rules are an upgrade from enforcement regulations to enforcement decrees. As such, one may observe this is a substantial improvement. Enforcement regulations can be changed by the competent ministries at any time while enforcement decrees need resolutions at the cabinet meeting. Purely from time and efforts perspective, enforcement decrees need coordinating efforts with other agencies within the government which necessitate more time. One more upgrade to the statute level is feasible and desirable.
exercise its discretionary power when the related party is literally defined to cover only up to fourth-degree cousins.\textsuperscript{79}


Many legislations in Korea tend to rely on criminal and administrative enforcement mechanisms. As a matter of practice, a breach of a fiduciary duty is criminally indicted in many cases.\textsuperscript{80} Many chairpersons of large conglomerates such as Chairman Lee of Samsung and Chairman Chung of Hyundai Motor Company have been criminally indicted and convicted although most were pardoned thereafter.\textsuperscript{81} Violators are subject to imprisonment ranging from a few months to several years and/or a fine of a substantial amount. For example, if the management extends credit to certain related parties to the loss of the corporation and its shareholders, they will be subject to imprisonment for up to five years.\textsuperscript{82} Administrative agencies also have the authority to take a variety of administrative measures such as suspension or revocation of licenses, civil fines, warnings, and so forth.\textsuperscript{83} Unlimited discretion at the hands of government agencies including the prosecutor’s office will reduce compliance and ultimately harm the moral authority of the law.\textsuperscript{84}

In addition to, or as an alternative to ongoing criminal and administrative enforcement mechanisms, private enforcement actions should be sanctioned. In designing the ideal financial and corporate governance structure, the Korean government should take into account the pros and cons of each enforcement mechanism and strike the right balance in order to attain maximum efficiency. Although derivative suits and class actions were introduced a long time ago,\textsuperscript{85} they have been rarely utilized in Korea. Only one class action case has been

\textsuperscript{79} The definition of related party transactions under art. 542-9, para. 1 of the KCC can also be expanded likewise, depending on the definition of the related party.


\textsuperscript{82} KCC, art. 624-2.

\textsuperscript{83} For example, the FSC revised the Capital Market Investigation Rules to the effect that civil fines would be imposed on disclosure violations. See Press Release, FSC, Revisions on Investigation Rules (Sep. 1, 2010). The KFTC has been imposing civil fines in 487 cases in 2009 and the total amount of fines was KRW371B. KFTC, 2009 Y.B. 67 Table 1-3-2.

\textsuperscript{84} As to the risk of excessive “fiat” approach, see Edward K. Cheng, \textit{Structural Laws and The Puzzle of Regulating Behavior}, 100 Nw. U. L. Rev. 655, 659-661 (2006).

\textsuperscript{85} Securities-related Class Action Law entered into effect on Jan.1, 2005. However, for small listed companies whose assets are KRW 2 T or less, only corporate actions after Jan. 1, 2007 are subject to the said Act. As of 2010, only one class action was filed and subsequently settled. See Seung Wan Han, \textit{Several Issues on Class Action}, 43 Brf. 69 (2010). The settlement was approved as Case No. 2009Ka-hap8829 by Soowon D. Ct. Public Disclosure of Jinsung TEC on May 4, 2010, available at http://kind.krx.co.kr/disclosure/searchDisclosureByCorp.do?method=searchDisclosureByCorpMain.
settled. Although more than forty derivative suits have been filed, many are related to shareholder disputes in a closed-held corporation. Derivative suits and class actions should be more readily available for enforcement of corporate governance rules. One way to achieve this in Korea is to lower the bar for legal standing as plaintiff and ensure reasonable reimbursement of legal fees. As such, enforcement mechanisms based on private party litigation as opposed to reliance on the government’s criminal and administrative measures should be promoted, assuming that the judiciary will respond in a more creative way to the needs of society.

E. What? Target Balance: CHC v. Public

As the Report pointed out, a set of separate rules on closely-held corporations (“CHC”) should be considered. As to public corporations, the size of assets is the measure for different rules. For example, the number of mandatory outside directors is different, depending on the size of the assets. Even for private companies, finance companies such as banks and securities companies are regulated in the same manner as public corporations. On the other hand, there are no rules on CHCs. This silence makes many legal issues uncertain. This is similar to the situation before the enactment of special rules for CHCs in New York in 1963, which was followed by many states including MBCA. Some Korean courts held that shareholder agreements or articles of incorporation on super majority requirements for share transfer were valid while other courts ruled differently. While corporate and contractual forms for new ventures are being formulated, CHC rules should be clarified in the KCC.

F. What? Legal Theory Balance: One Company v. Group of Companies

Korea was able to achieve rapid economic development due to many reasons. Some of them being: foreign aid, industrious and hardworking people, investment in education, government planning, effective procurement of foreign capital, gradual liberalization of product markets as well as capital markets and dedicated and audacious entrepreneurs. As a result of this growth,

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88. Report, supra note 5,568.
89. KCC, art.542-8, para 1.
90. CML, bk2, ch. 2, arts. 22 to 29 on corporate governance.
91. N. Y. BUS. CORP. LAW § 620 (McKINNEY 2000).
huge conglomerates or group companies dominate the economy. However, jurisprudence on corporate governance has been developed at an individual company level. Without any group level control, many are worried about a situation where these conglomerates could become behemoth and be beyond public control.

MRFTA has special rules on conglomerates of a certain size. Although the trend is to obviate unclear and hodge-podge regulations such as unlawful assistance to affiliates or to put a cap on total investment, it appears to be desirable and necessary to develop corporate governance rules for a group of companies at the group level. It is not clear whether it should continue to be part of the MRFTA or be under a new section in the KCC. In order to decide this there is a need for further discussion and more creative tools. As these rules should be coordinated with general corporate and finance rules under the KCC and CML, I would suggest the current regulations under the CML and MRFTA should be shifted to part of KCC. As to the administrative matters, such as reporting and disclosure, FSS should be able to continue to manage them.

G. Special Consideration for Financial Institutions

As intermediaries of financial resources, financial institutions are highly regulated. Because financial resources are always limited, their efficient allocation determines the economic future of a nation. Regulatory statutes on financial institutions match the corporate governance structure of listed companies. Thus, financial institutions’ corporate governance is determined by the amount of assets, regardless of whether they are listed or not. In addition, financial institutions’ transactions with related parties are more strictly regulated and disclosure and reporting are more vigorously enforced. One important policy issue involving financial institutions is whether corporate governance of financial institutions should be stricter than that of listed companies. For instance, in light of the peculiar nature of financial institutions,

94. Report, supra note 5, at 559.
95. PHILLIP I. BLUMBERG, THE MULTINATIONAL CHALLENGE TO CORPORATE LAW 52-61 (1993) is an account about the history of enterprises as a group of corporations.
96. MRFTA, art. 9. As to the history of these sections, see supra note 54. Before 2009, the amount of total investment for certain sizable conglomerates was also regulated. See generally Youngjin Jung & Seung Wha Chang, Korea’s Competition Law and Policies in Perspective, 26 NW. J. INT’L L. & BUS. 687 (2006).
97. Conglomerates are required to file annual report on general status, officership and related party share ownership. Every quarterly report is to be filed on loans, securities transactions, trades, accounts receivable and accounts payable, guarantee, and provision of security interest with related parties. Within seven days after certain transactions, changes of stock ownership structure, financial structure and major business decisions are to be reported. See KFTC 2009 Y.B. 40-41.
99. E.g, CML, arts. 25 et seq.
100. See supra note 47.
it appears desirable that an audit committee be composed of all independent outside directors.

CONCLUSION

As Korean society becomes more complicated, there is a need to apply the rule of law more widely. Law itself might not be able to provide fair and just allocation of resources. Law, however, could provide the rules to be followed to reach a fair and just solution. Corporate governance is about the process through which corporate entities make decisions. Korea’s attempt to adopt universal finance and corporate governance rules through the IMF and World Bank Reports was a big step forward from the previous set of imperfect regulations towards a new dimension of rule of law. It was also an excellent learning experience about the way to make changes by law and to witness why some reforms were successful while some were not.

As Korea enters into a new decade with another vortex of financial regulatory reform movements, it seems worthwhile to revisit the philosophy, initiating institution methodology of change, enforcement mechanism, orientation and theoretical perspectives on corporate and finance governance issues. As a starting point it is worth regurgitating the unfulfilled recommendations in these Reports and the reasons for their futility. Considering the lessons from this historic experiment, I argue that the MOJ with its new organizational structure should develop detailed laws whose enforcement should rely more on private litigation rather than administrative and criminal sanctions. In addition, special rules for CHC, conglomerates, and financial institutions should be developed.

The most fundamental question, of course, is why Korea needs further reforms. While the recovery of the Korean economy lessened active discussions on improved corporate governance, scandals involving major financial institutions’ CEO selection processes and slush funds have rekindled the debates. I hope that Korean businesses and regulators start revisiting corporate governance issues before any scandals or corruptions are witnessed again.
