HOSTILE TAKEOVERS IN KOREA: TURNING POINT OR STICKING POINT FOR POLICY DIRECTIONS

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Abstract

Mergers and acquisitions are burgeoning in Korea after the involuntary restructuring of major conglomerates and financial institutions which occurred after the 1997 financial crisis. Many companies owned by government agencies are likely to be privatized in the coming years and the current administration aims to sell utilities and infrastructure projects to the private sector. Policies for certain government-owned financial institutions are currently being questioned as well. Despite the temporary crunch of capital markets in Korea, mergers and acquisitions will be at the core of Korean economic activities in the next decade.

Amidst these developments, however, some have voiced concern about hostile takeover attempts, especially by foreign capital. The past and current regulation of hostile takeovers has been weighed down by securities regulations and corporate laws. Arguments for poison pills are being regurgitated in light of economic reality, which is that there is no separation between management and ownership. This paper argues that such concerns are not relevant to the Korean economy and there is no need for further changes intended to discourage hostile takeover attempts.

I. Introduction

Mergers and acquisitions (‘M&A’) are becoming a more and more important part of the Korean economy. M&A used to be something to be avoided in Korea, generally being regarded as distasteful and even shameful. Most Korean businesspersons who sold their companies confessed feelings of guilt, regardless of whether their companies had been profitable or not. But now, businesspersons are asking about opportunities to sell or buy companies as if they have discovered a new source of wealth. Prior to the Asian financial crisis in 1997, companies in specific industrial sectors or business groups in financial trouble were sometimes forced into takeovers by other companies through informal, but forceful, guidance by the Korean government. The statute for restructuring the local bus transportation sector or shoe manufacturing sector1 was implemented to facilitate and promote the concentration of the respective industries. Defaulting companies such as Orion


1 The Industry Development Law (formerly the Industry Rationalization Law), s 14 provides for CRCs (Corporate Restructuring Company) and CRC partnerships. The Ministry of Knowledge Economy has promulgated several statutes, such as the Distribution Industry Development Law, Coal Industry Development Law, and Overseas Fisheries Industry Development Law.
Company\(^2\) and Keangnam Enterprises Co., Ltd.\(^3\) were taken over by the Daewoo Group. Kukje Group companies were disseminated by the unilateral government suspension of credit facilities due to the group’s mismanagement of its relationship with the government.\(^4\) After 1997, many of Korea’s biggest business groups adjusted their debt-to-equity ratio by selling part or all of their primary or subsidiary lines of business to other business groups or foreign investors.\(^5\) Additionally, many companies under court protection were restructured by the courts or their creditors.\(^6\) Now, after weathering the storm of the IMF financial turmoil and the collapse of the initial dotcom economy bubble, many business groups aim to expand the size and quality of their economic units through M&A within Korea as well as outside of Korea. One example of this attitudinal change is the fact that almost every chairperson of the major Korean conglomerates referred to M&A as one of the major foci in 2008, as if M&A were a new quarry in which to find gold - or at least to find clues to growth.\(^7\) The Korean Fair Trade Commission (‘KFTC’) reported the rapid growth of the size of business combinations from KRW13.7B in 2003 to KRW33.9B in 2007 (exclusive of M&A outside of Korea and not subject to the reporting requirements) and the number of transactions from 13 cases in 2003 to 115 cases in 2007.\(^8\) In 2008, Kumho closed its acquisition of Korea Express, Lotte acquired Korea Fire Insurance, HMC purchased Shinheung Securities and Doosan bought out BNG Securities brokerage. In 2009 KKR and eBay bought Interbrew shares in OB Brewery and Interpark shares in GMarket. After the credit crunch smothered the global economy in late 2008, additional assets have accumulated in the market and are awaiting sale in 2010.

This trend will continue in the future for several reasons. The first is the impact of a radical change of perspectives regarding the economic value of M&A. The second is that the current administration will supply plenty of assets to the market. Significant assets leftover from the past abound, and the Korean government plans to privatize major government-invested enterprises that it directly or indirectly injected capital into or has operated as part of the government function.\(^9\) For example, the Korean government has contemplated reviving the privatization plan of the utilities industry including gas, power and even the water supply. The finance industry groups may also be reviewed as major government banks such as KDB and its wholly-owned subsidiary Daewoo Securities; KIB; and Woori Financial Group, may be restructured. Another reason the M&A market in Korea is likely to expand exponentially relates to the regulations and realities of the asset management business. With the new Capital Market and Finance Investment Business Law (the ‘CMLaw’) taking effect on February 4, 2009, traditional securities businesses have expanded the horizon of their

\(^2\) Immediately after the Daewoo group was dissolved in 1999, Orion was sold to the Matlin Patterson Fund, a private equity fund, and subsequently liquidated in 2005. See Leejeonghwan.com 3 Dec. 2005 blog.

\(^3\) In 2000, Keangnam Enterprises Co., Ltd. was spun off from Daewoo group and subsequently integrated into a nother business group called Daea in 2003. See www.kne.co.kr/company/history.

\(^4\) As to the Kukje Group drama, see Korean Constitutional Court Decision 89HUNMA31 dated 29 Jul. 1993.

\(^5\) One reason for such transactions was the amendment of the Korea Fair Trade Law (‘Fair Trade Law’), effective 1 Apr. 1998 to have certain large conglomerates eliminate the cross-guarantee within the group by 31 March 2001. See Law No. 5528 dated 24 Feb. 1998, on klaw.go.kr.


activities to encompass asset management and comprehensive financial services. As more human and material capital is injected into the asset management business, the players in the M&A arena access the capital markets with more ease - despite the recent collapse of investment banking business on Wall Street. As one important means to manage those funds, more private equity funds should be formed with more capital to seek more opportunities for M&A. Among the environmental factors to consider in predicting the future of M&A in Korea are the legal and practical uncertainties. Many players in the legal, business and accounting communities tend to feel more comfortable about M&A when the collective experiences, practices and disputes relating to M&A over the past decade make the end results more predictable. As always, however, accurately predicting trends in Korea is extremely difficult.

In contrast to the dramatic change in attitude of the business community towards M&A, other quarters continue to reveal open opposition to hostile takeovers. In Korea, the term ‘business-friendly’ means the recognition of the urgent need to introduce new legislation to deter hostile takeover attempts by both foreign and domestic economic entities. Recently, the Korean Ministry of Justice, after publicizing its so-called ‘business-friendly’ approach as one of its institutional aims, organized a special committee to produce a new proposal for the prevention of hostile takeovers. At the same time, several national assemblymen who were elected in the general election in April 2008 proclaimed their support for the implementation of poison pills in Korea. However, nobody has clearly pointed out the policy goals to be served by these initiatives. The purpose of such legislation may be to comfort Korean conglomerates by providing additional defensive legal tactics against hostile takeover attempts, or it may be simply to provide comfort from the fear of aggressive posturing from abroad. Alternatively, this thinking might arise out of the xenophobia of the public following foreign inroads into the Korean economy. It could also be considered foresight with respect to the vices of possible hostile takeover attempts by burgeoning private equity firms and hedge funds inside and outside Korea.

The legal perspective on M&A is among the critical factors that will decide the future of the Korean economy. The economy could remain dominated by conglomerates which are closely-connected in terms of capital, human resources and government relationship, but owned by founding families, their associates and underlings. Alternatively, it could become a truly international economy dominated by Korean companies in the sense that they originate from Korea but are owned and operated by the most competent and responsible

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10 Private equity funds were introduced into Korea in Dec. 2004 by amending the Indirect Investment Asset Management Law.
people, regardless of where they are physically located and actually operated. The prospective impact of new regulations on hostile takeovers is certainly significant. Therefore, any policy and its implications should be clearly defined before any new legislative measures are taken. For one thing, Korea cannot move towards a more advanced economy without abolishing the current shareholding structure which gives undue power to small groups of controlling shareholders and blocks the possibility of beneficial transfers of corporate control. Being friendly to a small group of dominant parties at a given time is not the same thing as being friendly to creative entrepreneurship in Korea in the long run. In order for the Korean economy to evolve into a serious global player, Korea must develop clear and open policies on foreign investment.

Part II reviews the securities regulations and developments relating to hostile takeovers in Korea, then goes on to describe current securities regulations. Part III discusses a laundry list of possible defensive measures, which are generally similar to those in US corporate law. Part IV lists supporting claims for the addition of special regulations on hostile takeovers in Korea, and critically comments on those claims in light of the specifics of the Korean economic and legal environment. This paper concludes that the fledgling Korean corporate control market in Korea should not be suffocated by new legislation, and that serious forethought and thorough analysis of the impact of any new legislative measures is required.

II. Securities Regulations Background on Hostile Takeovers in Korea

Korea has no special legislation for corporate M&A. As M&A involves sales transactions, the law on contracts under the Korean Civil Code governs certain aspects such as the legal nature of the memorandum of understanding (MOU), fraud, representations and warranties, and indemnification. As M&A involves corporate transactions, the provisions on business transfers and mergers under the Korean Commercial Code (‘KCC’\(^{15}\)) are also relevant. If M&A transactions are structured as asset sales, the provisions on property rights under the Korean Civil Code control. Since company employees or directors may have to be readjusted, labor law on restructuring dismissal applies. For certain aspects of M&A, a business combination report must be filed with and cleared by the KFTC before closing. The CMLaw has several provisions relating to the 5% rule, tender offers and proxy solicitation issues that are significant in any hostile takeover of a listed company.\(^{16}\)

A. The 5% Rule

1. Regulations

Since the completely-rewritten STLaw was implemented as Law No. 2920 on 22 Dec. 1976, it has prohibited an acquisition of a 10% equity interest by anyone other than the controlling shareholder at the time of the initial public offering.\(^{17}\) This complete prohibition of a change of control in a listed company was offered as an incentive to the initial public offerings of shares by closely-held companies, and intended to foster growth of the capital markets in Korea. In addition to the above prohibition, the 5% reporting requirement was

\(^{15}\)Section numbers in this paper refer to those of the KCC, unless otherwise indicated.

\(^{16}\)The heading of Chapter III, Section 2 of the CMLaw is M&A.

\(^{17}\)s 200 of the STLaw.
imposed from 1992 on. While the prohibition of an acquisition of 10% of shares was lifted on 1 Apr. 1997, the 5% reporting obligation remained and became more detailed. The concept of related parties, common ownership and even foreign indirect ownership through depository receipts has been introduced so as to fill in any possible loopholes in calculating the 5% ownership. More recently, after the conflict involving SK and Sovereign Fund subsided, the Korean government revised the 5% rule to the effect that the acquirer must disclose whether or not such acquisition is intended to affect the management. This requirement, however, was not intended to deter foreign investors from investing in the Korean capital markets. As the STLAW was merged into part of the CMLAW, the 5% rules were further expanded and further refined. The exemption for the central government, government fund, etc. was lifted and the 5% reporter is required to file major changes of the reported items, in addition to additional acquisitions of 1% and the purpose of any such acquisition. Finally, the starting point of the five day cooling off period from the actual filing date, which is within the five day period after the reason for the reporting occurs, was moved forward to the date when the reporting obligation occurs.

The origin of this rule is explained in relation to the 1968 Williams Act in the United States, which was introduced to put cash tender offers into the same regulatory framework as stock offers and to give advance warning to public investors about the possible corporate control transaction. In all fairness, however, the reporting requirement has given the incumbent management time to prepare for future moves by the 5% buyers, and thus in effect, works to disfavor hostile takeover activities. Furthermore, the Financial Supervisory Service (FSS) tends to enforce reporting requirements rather excessively by ordering immediate divestiture of shares exceeding 5% and having criminal investigation procedures initiated. This is in addition to the legal effect of the no voting rights provision. For example in 2004 KCC Corp. was ordered to dispose of 20.78% shares of Hyundai Elevator within three months through the trading hours of the Exchange because it failed to report a 5% acquisition within the prescribed period. The CMLAW increased the maximum criminal penalties for failing to file or false reporting from one year imprisonment to three to five years’ imprisonment. Thus, the 5% reporting requirement in fact deters the 5% acquisition itself.

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18 s 200-2 of the Amendment Bill Law No. 4469.
19 As to the concept of related parties and common ownership, see ss 141 & 8 of the Enforcement Decree under CMLAW (‘CMLAW-ED’). As to the definition of ownership, see s 142 of CMLAW-ED and Art. 17 of the Enforcement Regulations under CMLAW (‘CMLAW-ER’). More details are provided in the Financial Supervisory Commission (‘FSC’) Regulations on Issuance and Public Disclosure of Securities Public Notice 2009-14 dated 4 Feb. 4 2009, ch 3 on Disclosure of Corporate Control (‘FSC Reg on Issuance’).
21 s 147, para 4 of CMLAW; s 155 of CMLAW-ED.
22 Compare s 200-3, para 3 of the STL with s 150 of the CMLAW.
24 s 150 of CMLAW.
26 Compare s 210, cl 5-2 of the STL with ss 444, cl 15 and 445, cl 20 of the CMLAW.
27 For a critical view on FSS measures in light of the legislative intent of the 5% rule, see Kun-Shik Kim, Securities Transaction Law (4th Ed. 2006), p 211.
2. Statistics

In 2007, 8,829 reports were filed. This was an 11.3% increase from 2006. Among the reports filed, 4,204 (47.6%) were for management participation purposes while 4,624 (52.4%) were for investment purposes. Of the total, 6,327 reports (71.7%) were from Koreans while the remaining 2,501 (28.3%) were from foreigners. In terms of the number of total investors, 1,970 (74.5%) investors out of 3,113 declared an intention to participate in management, while 1,237 investors (25.5%) did not wish to participate. Korean investors numbered 2,707 (made up of management 1,854; and investment 1,237) while foreign investors numbered 406 (made up of management 116; and investment 302).

B. Tender Offers

1. Regulations

Tender offers used to be subject to detailed regulations under the 1977 STLaw. Except for the brief period where 50% plus one share acquisitions had to be made through a tender offer where 25% or more of shares were to be bought, tender offers have been regulated by a framework similar to that under the Williams Act. The framework requires that the offeror: file tender offer reports with the FSS; make a public announcement; offer a minimum 20-day and maximum 60-day tender period; not purchase shares by any other means during the tender offer period; and purchase any and all shares tendered. Any tender offer filings also must be true and accurate.

Tender offer rules were purported to counteract the undue pressure for the shareholders to sell in response to a tender offer. Although, unlike the Williams Act, the CMLaw defines a tender offer as an acquisition of a 5% or more equity interest from ten or more shareholders outside of the exchange within a six month period, many uncertainties about the scope of application remain. For example, acquisitions by block trading after trading hours might be covered by the rules on tender offers. There is also uncertainty about how to count the threshold figure of ten shareholders - actual sellers or offeres. If the buyer wants to buy additional but minimal shares within six months after the initial tender, it is not clear whether such a purchase should also be made through tender offers. These issues still remain open, even while the CMLaw clarifies several interpretation issues under the STLaw such as: acquisitions of DRs outside Korea do not fall within the meaning of ‘outside of the exchange’; and block trading during off-training hours is also subject to the tender offer rules. From a policy point of view, many commentators stress the need to adopt mandatory tender offer requirements if, for example, one third of outstanding shares is

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29 As the same investor can file plural reports, the number of investors does not match the number of filings.
31 ss 133, et seq. of the CMLaw; ss 139 et seq. of the CMLaw-ED; FSC Reg on Issuance, ss 3-1 et seq.
33 Like the Livedoor incident in Japan (8 Feb. 2005), the Mars Private Equity Fund bought 24.1% of shares from 15 shareholders on 21 Sep. 2006, but not by tender offers.
34 ss 133 of the CMLaw.
purchased regardless of the number of sellers or offerees.  

2. Statistics

The FSS filing recorded eighteen tender offers in 2007 and four in 2006. The annual number of tender offers has fluctuated year by year. Out of 84 tender offers over the past fifteen years, only eleven were for hostile takeovers and of those only four succeeded. Most tender offers were to go private, to implement negotiated acquisitions, or to increase the share ownership ratio by the existing controlling shareholders. The increase of tender offers in 2007 was to make the holding companies meet the minimum ownership requirement of subsidiary shares by exchange offers.

C. Proxy Contests

1. Regulations

Since 1977, the STLaw has regulated the proxy solicitation process by requiring the solicitor to file solicitation materials with the FSS two days prior to any such activities. The solicitation materials must not contain any untrue statements and the FSS has the authority to request corrections. However, the regulations are uncertain enough to deter any challenges to the controlling shareholders. The FSS regulations and judicial precedents should be clarified with respect to many legal and practical issues that include: whether the company may solicit proxies in a contest between the current controlling shareholders and the challenger; whether proxies must be executed for specific meetings or agenda items or may be general; whether irrevocable proxies are valid; whether access to the real name shareholder register may be validly rejected by the company; and if it can be rejected, what constitute reasonable grounds for such denial; questions as to the scope of reviewing

38 20 (40) % for listed companies (closely-held companies). s 8-2, para 2, cl 2 of the Fair Trade Law.
39 ss 152 et seq. of the CMLaw; ss 160 et seq. of the CMLaw-ED.
40 Chul-Song Lee, Lectures on Corporate Law (14th Ed. 2007), p 432.
41 Soo-Hun Yu v. Samwon Concrete Industrial Co., 2002DA54691 (K.S.Ct., 24 Dec. 2002) seems to reject the idea of irrevocable proxy. The court, however, did not question the validity of the general proxy itself. See also 2008 KAHAP1070 (Seoul C.D.Ct., 29 Apr. 2008) re IBW.
42 Compare s 466 (right to review and copy books and records) with s 396 (right to copy shareholder register). Section 315 of the CMLaw provides for the right of the issuing company and the public tender offeror to ask the Korea Securities Depository to release the real name shareholder register. Korean courts established the right of the shareholders to access the real name shareholder register. In re Hyundai Marine, 2004KAHAP607. (Seoul C.D.Ct. 9 Mar. 2004); In re Sampyo Food, 2007KAHAP654 (Seoul C.D.Ct. 15 Mar. 2007). See, however, In re Kukbokjoo 97Kue7 (19 Mar. 1997, K.S.Ct.) and in re Daehan Textile 2006KAHAP3203 (Seoul C.D.Ct. 2 Nov. 2006). Seoul C.D.Ct. recently rejected such a request from public interest groups in the name of public interest. Details on Samsung Life and Shinsegae are available at http://www.ser.or.kr. The litigation involving the Hanwha shareholder register is still pending.
authorities of the company vis-à-vis proxies; and, in the case of duplicate proxies, the question as to which proxy should prevail. The timeline for solicitation activities is also extremely tight. If the solicitation materials contain untrue statements, the type and severity of sanctions which are appropriate is an open issue about which no judicial or administrative precedents are found. If disputes eventually arrive in the courts with respect to the validity of the resolutions at the shareholders’ meeting, it is not clear how illegal solicitation activities would affect the validity of the resolutions at the shareholders meeting. Who bears the cost under such circumstances is another mystery.

Unlike the situation in the United States, proxy materials have not been disputed at all, nor does the FSS exercise its authority to review and issue a correction order regarding proxy materials. As such, in the case of disputes over management control, the company tends to help current controlling shareholders suppress any contest at the shareholders’ meeting by encouraging the unions and participants in the employee stock ownership plan to oppose the challengers by refusing to provide a copy of the real name shareholder register to the challenger, supplying funds and other resources to the controlling shareholders for solicitation of proxies and denying the authenticity of proxies from the challenger. Even after a tender offer has been made, the ultimate showdown would be at the shareholders meeting. However, because of the foregoing uncertainties not many challengers dare to proceed. Uncertainty is a deterrent to tender offers as well as to proxy contests.

2. Statistics

The FSS press releases indicate that the number of proxy solicitation requests for management control is between ten and twenty every year, and that most of the proxy solicitations are to meet quorum requirements. In 2007, Donga Pharmaceutical, Ains, Oyang Fishery, and Kafco C&I were engaged in major shareholder disputes where part or all of the challenger’s demands were met. In 2006, G2R, Digilent FEF, KT, KT&G, Medipost, KPL and Seoul Securities shareholders meetings rejected challengers’ requests - except for a request to KT&G from Steel Partners and Icahn that one director be added and a demand to Seoul Securities where the articles were amended.

III. Corporate Law Background on Hostile Takeovers in Korea

Effective Feb. 4, 2009, the special rules on governance of listed companies under the STLaw became part of the KCC while some provisions on financing were added to the CMLaw. In this section, we discuss the legal possibilities with respect to typical defensive measures available under the KCC and CMLaw.

A. Preventive Measures

45 This question is moot if revocation of a proxy is not permitted.
46 s 363; CMLaw, s 153.
47 Kun-Shik Kim (note 27 above), p 245.
49 ss 542-2 of KCC & ss 165-2 et seq. of CMLaw.
Most of the preventive measures which can be made part of the articles of incorporation in the United States are also feasible in Korea. For example, a 3% shareholder has the right to call for cumulative voting at a shareholders meeting for the election of two or more directors, unless the articles provide otherwise. Despite the KCC’s silence, most scholars agree that staggered boards are also allowed. Of course, even with a staggered board as provided for in the articles, the articles can be duly amended by a special resolution at a shareholders meeting. Note too that a company can dismiss directors without cause by a special resolution, subject to a damage claim if such dismissal is prior to the expiration of the term without just cause. Thus, replacing the board member would simply be a matter of time.

It is feasible to put in place provisions which require a super-majority for certain resolutions at a shareholders meeting, require particular qualifications for the board, grant tenured voting rights, shorten the prior notice period for board or shareholders meetings and require large severance payouts. However, the legality of a requiring a super majority and granting tenured voting rights under the KCC is not clear. While the KCC explicitly permits the super majority requirement for a board meeting, it is silent as to such requirement with respect to a shareholders meeting. And while certain district courts refuse to honor super majority requirements, such requirements are standard in international joint ventures and closely-held companies. Disproportionate voting rights for different kinds of shares such as tenured voting rights are most likely a violation of the KCC. However, an amendment bill is pending with the National Assembly to furnish more room for shareholder planning of the financial and managerial structures of companies.

Although the KCC places some restrictions on reciprocal share ownership and the purchase of treasury shares in order to prevent the hollowing-out of capital, share repurchase has been liberalized for listed companies to the extent that the distributable income is positive. Shareholder voting agreements, pooling arrangements and voting trusts are generally enforceable despite the lack of specific provisions in the KCC. Likewise, a poison put or an employee stock ownership plan will be available as a mechanism to help current management repel hostile challengers. The most vociferous and decisive mechanisms, rights plans or poison pills, are not allowed for several reasons, one of which is the principle of shareholders being treated equally. Many scholars and practitioners stress the need to adopt poison pills under Korean corporate laws and agree that the current KCC should be amended to do so.

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51 ss 382-1 & 542-7. Many companies blocked that possibility by amending the articles before the effective date of the amendment in 1999.
52 ss 434 & 385.
53 s 391.
55 s 369.
56 See Bill 1891556 (Amendment of KCC) pending at the Korean National Assembly.
57 ss 342 et seq.
58 s 165-2 of the CMLaw.
B. Responsive Measures

All of the responsive measures in the corporate toolbox such as public relationship management, disposal of treasury shares, alliance with a friendly third party on voting or disposal of assets, or purchase of the challenger’s shares will be legal to the extent that the board complies with its fiduciary duty. Likewise, any measures to dilute the percentage of the challenger such as the issuance of new shares or convertible securities to third parties will also be subject to the fiduciary duty requirement. After some trial and error the primary purpose standard seems to be well settled. However, issuance of convertible securities in the midst of a conflict for corporate control is prohibited.60 Thus, the only issue remaining for judgment is whether and under what circumstances an issuance of new shares to third parties or disposal of treasury shares can meet the fiduciary duty standard. As to the disposal of treasury shares by the management in the midst of a dispute over corporate control, the court’s views are split. While some decisions have rejected the application of the fiduciary duty standard, the majority of courts seem to require it.61 As to the issuance of new shares, the court also requires a reasonable business purposes.62 Thus, Korean courts rejected the distinction between the Business Judgment Rule, entire fairness standards and enhanced review in Unocal but rather advocate pro-judgment approaches. Nonetheless, the standard that the management would have to meet is not the entire fairness standard, but rather, the reasonable business purpose standard.

IV. Additional Defensive Mechanisms in Korea

Several arguments in support of additional defensive mechanisms for the protection of management rights, especially dual class shares and poison pills, are reviewed below.

A. Imbalance Compared with the US, UK, Germany and Japan

Some commentators point out the alleged imbalance between the legal means available to the challenger and the legal means available to the incumbent management in Korea as compared to other countries.63 The term imbalance, though, presupposes a certain desirable balance. A comparison of one legal system with the legal systems of other countries is of no significance without also comparing the historical and socio-economic aspects of the specific countries. Korea does not have to accept the poison pill concept simply because the U.S. or Japan permits poison pills. Likewise, Korea does not have to allow disproportionate voting rights merely because the US, Germany or UK allow disproportionate voting rights. Any legal argument based on a comparison with other countries’ legal systems is not germane to Korea unless the underlying structure and


63 See FKI (note 12 above), p 6.
institutions relating to the legal system are considered and understood. The adoption of particular legal measures may or may not have anything to do with the level of development of the capital markets in a given country. The question is, ‘what impact would such measures have on the real economy and how might they work in conjunction with the other provisions in the company law.’

Certainly, Korea does need to look at foreign capital markets and their regulatory framework, including the larger capital markets and more advanced corporate legal systems of the US, UK, Germany and Japan. However, given the corporate ownership structure in Korea, any additional measures to protect the management power of the board would simply lead to the complete withering away of the corporate control market in Korea. Any argument based on foreign precedents must be carefully examined to determine whether it is simply a subterfuge to continue the current governance structure of Korean companies. The real question is whether Korea wants to continue the ownership model or manager model. Thus, the discussion should be focused on whether the ownership structure is truly a desirable structure for Korea now and in the long run.

B. Imbalanced Trend of Amendments in Favor of Hostile Takeovers

Some characterize the past amendments of the KCC and STLaw as one-sided liberalization measures which widen takeover possibilities without any balancing regulations which enhance defensive measures. While the securities regulations were liberalized by abolishing mandatory tender offers in 1998, they have been revised to give more power to the current management by, for example, increasing the cap on treasury shares, permitting successive tender offers and issuance of new shares during the tender offer period, and requiring the 5% acquirer to disclose their purpose. Thus, the charge that the Korean government has caved in to foreign investors’ needs by abolishing many regulations on tender offers or takeover attempts in general, is not an accurate one. A more accurate view is that the Korean government has consistently tried to strike the right balance between a competitive corporate control market and management control by the controlling shareholders. The ongoing discussion about poison pills and multiple voting rights would tend to tip the current balance in favor of the controlling shareholders.

C. Corporation Law as Contracts

One perspective on the role of company laws in general is that they should be considered sets of diverse model contracts against which management and the shareholders can negotiate the proportionate balance between voting rights and dividend rights. In that case, it can be argued that company law should abolish the one share one vote principle or equal treatment of all shareholders, and instead enable dual class shares and poison pills

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65 FKI (note 12 above), p 11.
66 Amendment of the STLaw by Law No. 5521 dated 24 Feb. 1998 was made for more flexible restructuring of corporations.
67 The STLaw (Law No. 5521 on 24 Feb 1998) increased the cap of treasury shares from 15% to 1/3 to help listed companies protect the current ownership structure, which increased up to the amount of distributable income (Law No. 5539 on 25 May 1998). Art. 165-12 of the CMLaw.
68 Amendment of the STLaw by Law No. 7339 dated 17 Jan. 2005 was intended to foster a fairer environment for corporate control in the market and ameliorate excessive threats to management control.
which can be adopted pursuant to the negotiations between management and the shareholders. This view, however, does not appear to be relevant to the situation in Korea because there is no negotiation between management and the shareholders. Rather, in most Korean companies, management is simply the appointee of the controlling shareholders.

**D. Corporation for Stakeholders**

Some argue that corporations exist not only for shareholders’ interests but for the interest of all the stakeholders. Once a company is incorporated, the argument goes, it is completely independent of the shareholders interest and is instead an entity existing for all stakeholders. Thus, when hostile takeover attempts are made for the purpose of maximizing shareholder value, the board should be authorized to make a judgment as to whether such a proposal benefits the company and its stakeholders from the perspective of the ultimate arbiter and not as agents for the shareholders. The need for the board to consider the interests of other constituents, however, does not lead to the conclusion that the board should have the exclusive or final authority to make a decision in response to hostile takeover attempts or that the board’s authority should include the introduction of poison pills or multiple voting rights shares. Furthermore, if the board is just a group of appointees of the controlling shareholders, the board members should not have the exclusive capability to consider the interests of other stakeholders in addition to the controlling shareholders.

**E. Economic/Psychological Analysis**

Based on the principle of separation of management from ownership, many economists have provided theories supporting the authority of the management to make a decision to reject hostile takeover attempts. One list classifies such theories into four groups: bargaining hypothesis; information asymmetry; myopia; and relationship investment.

If the management has the authority to reject or nullify hostile takeover proposals the challenger might, considering the target potential, increase the price, which in turn will be beneficial to the target shareholders. Under the ownership model in Korea, however, it is unlikely that the management would act to benefit the shareholders in general. Rather, as the management is the agent of the controlling shareholders, the benefits of the higher price would be limited to the benefit of the controlling shareholders. Many commentators have discussed the need to adopt mandatory tender offer rules to prevent the monopolization of the control premium by the controlling shareholders in M&A. Information asymmetry between the management and the shareholders can be a legitimate reason for the management having authority to reject exploitative and predatory hostile takeover attempts. If, however,

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71 In the first derivative suit against officers of Korea First Bank (2000DA9086), on 15 Mar. 2002, the K.S.Ct. stressed the quasi-public function of banks. This contrasts with J. Story’s view in the Dartmouth College case about the banks. Another case that explicitly referred to the stakeholders’ interest is 2003KAHAP369 KCC Corp. v. Hyundai Elevator on 12 Dec. 2003.  
72 Hwa-Jin Kim & Ok-Ryeol Song (note 35 above), pp 286-290.  
73 Chang-Jin Oh (note 35 above), p 52.
the controlling shareholders are also managers of the company, there would exist little, if any, asymmetry. The concern about myopic management or lack of relationship-specific investment from the pressure of a potential hostile takeover is generally irrelevant to the ownership model in Korea. Under the ownership model, management is of course interested in the independent long-term objectives of the corporation itself, but the personal interest of the controlling shareholders is of greater importance. The personal interest of the controlling shareholders is not always the same as the long term interest of the company and its shareholders in general. The future of the company as between the interest of current controlling shareholders and short-sighted challengers should be decided by and for the benefit of shareholders; and this should be decided not by the board, but by the shareholders. Relationship-specific investment would not be deterred as the controlling shareholders are permanent. All in all, economic rationales for independent or exclusive management decisions by the board are not persuasive under the ownership model.

F. Comparative Cost with Alternative

Some commentators focus on the cost of various alternatives for the protection of controlling shareholders, but such focus is possible only if we assume that the controlling shareholders would be allowed to defend the management power by the least costly method.74 If we accept such assumption, it is worth comparing the cost of poison pills with other alternatives.75 The real question, however, is whether Korea needs additional protection to support the sitting board and if so, why.

V. Policy Directions

A. Open Policy

The Korean economy is one of the largest and most efficient economies in the world. Considering the period of time it took to make the Korean economy, the natural resources it has, the geopolitical situations it has faced, the history that it cannot disown, and the war it experienced in 1950, Korea’s rapid progress is amazing. Nonetheless, many foreigners regard Korea as one of the most difficult countries in which to do business. One reason for this perception might be the self-imposed xenophobia of many Koreans. As Korea finishes the first decade of the 21st century, it should reposition its economy within the context of the world economic scene. If a new measure is being adopted out of fear of foreign inroads, Korea should define that fear before any actual adoption. If Korea decides that foreign entry is undesirable, such entry should itself be prohibited by requiring discretional permits. If, however, Korea decides foreign entry is acceptable, but specific behaviors are worrisome, restrictions on behavioral modes should be imposed. Korea has neither the time nor the resources to implement economic policies by trial and error. The Korean capital market is already widely open to the effect that more than 30% of shares of listed companies are owned by foreigners. Foreign equity investment in the defense industry and other limited industrial sectors such as broadcasting and telecommunications are subject to foreign investment or

74 Dong-Soon Kim & Ho-Jin Jun, ‘Korean Firms’ Share Purchases and Foreign Investors’ Hostile Takeover Possibility’ (Nov. 2006) 10 International Regional Study 221 denies such motivation, but share purchases were largely for the purpose of boosting share price in the market. See FKI (note 12 above), p 9 reports 54% and 63% plow-back rate.
other industry specific approvals. It is true that some foreign funds have realized profits by improving corporate governance or by greenmailing Korean companies. That, however, cannot be a policy reason to permit the controlling shareholders of all Korean companies to employ wider protective measures against all hostile takeover attempts. If the Korean government is worried about the post-hostile takeover plundering of Korean companies by foreign funds or exploitative mergers by short-sighted foreign funds, Korea should address those issues in a focused manner as a matter of preventing post-merger abuse, and not by all-encompassing, excessive, disproportionate across-the-board protective mechanisms against any and all hostile takeover attempts.

B. Clear Policy

The Korean legal system is in the process of legalizing many unwritten or arbitrary rules and regulations that used to be applied at the discretion of competent ministries. For the convenience of the administration, many rules are still delegated to presidential decrees. Thus, the most common phrase in many statutes is ‘details shall be provided for by the enforcement decree.’ However, this trend is being rapidly reversed as the parliamentary system is becoming more rooted in Korean politics. As a result, the discretionary or arbitrary interpretation of statutes is being substantially decreased. With respect to hostile takeovers, the Korean government should set a clear direction that hostile takeovers will be fostered. Hostile M&A can be as useful as negotiated M&A as a means to continue a company’s growth, develop corporate control and ensure that controlling shareholders and their deputies comply with their fiduciary duties. Hostile takeovers have been extremely rare phenomena in Korea and only a few of the early attempts were successful. The vast majority of hostile attempts by strategic investors were futile. Even shareholder disputes relating to management control have often been tediously drawn out over the course of several years in the courts and the public prosecutor’s office. One of the reasons for such drawn out disputes has been uncertainty as to the likely outcome. Thus, one way to enhance the corporate control market is to make rules more clear. The KCC certainly has plenty of room for improvement, particularly with respect to proxy contests.

C. Strict Neutral Policy

Although the concept of fiduciary duty is the most important concept in any company law, there does not appear to be any method to amplify the concept in more detail beyond using relatively general words. Accordingly, this concept needs to be more fully developed through judicial precedents. The first derivative suit in Korea was not filed until after the 1997 financial crisis. As the number of derivative suits increased, the courts have been asked to make decisions about the duty of care, especially the duty of care relating to financial institutions. Nonetheless, the Korean government, including the judiciary, must continue to develop this important concept. Fiduciary duty should be expanded to encompass controlling shareholders as Korea has expanded the concept of directors to de facto

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76 Korean National Assembly Legislative Secretariat listed statutarization of administrative legislation as one of its annual assignments.
77 Another important method is by way of litigation and thus rules on derivative suites, especially on the bearing of costs, should be developed.
78 ALI, Principles of Corporate Governance: Analysis and Recommendations, s 4.01.
80 Young-Cheol Jeong, ‘Derivative Suit Cases in Korea’ (Mar. 2008) 18 Yonsei Law Review 339. To date, some 40 plus derivative suit cases have been adjudicated in Korea.
decision makers. In particular, related-party transactions involving the conglomerates should be more carefully reviewed and damages should be measured strictly. Furthermore, procedural and informational aspects of the decision making processes should be more strictly scrutinized as opposed to focusing only on the substance of the transactions.

With respect to hostile takeover attempts, some scholars have already proposed the obligation of neutrality to level the playing field for shareholders. Additional protections are not necessary, but strict enforcement of the fiduciary duty of management that requires neutrality is both desirable and urgent. The shift from the ownership model to the shareholder model may be the quantum leap that Korea is required to make in order to continue economic growth.

The old myths about the founding families of the Korean conglomerates are no longer compelling, and questionable succession plans and the all too common criminalization of the second and subsequent generations has already tarnished too many of the good old names. In reality, current management cannot be independent unless they are legally required to be independent. And even if they are legally required to be independent, they tend to be blindly loyal as they have generally been promoted based on their loyalty to the controlling shareholders, rather than by success in fulfilling their fiduciary duty to the shareholders. Most conglomerates are no longer closely held, and only a legal requirement of independence can lead to the management being responsible to the investors in general.

Without confidence in the management of the investors, Korean conglomerates cannot outgrow the old family-run company model as they cannot adequately finance growth. Corporate control and sound market-based rules can be an effective way to find the right manager for the right company. The Korean government should expand and enforce the concept of neutrality in hostile takeover situations and thus foster the corporate control and professional manager markets.

VI. Conclusion

The rules relating to hostile takeover attempts in modern capitalism presuppose an independent informed board. But if companies are governed by controlling shareholders; the board is irrelevant or at most only remotely relevant. As such, the ongoing discussions calling for more protective mechanisms in Korea are illogical, unpersuasive and overly political. It is easy to find many examples of lawless abuses by the controlling shareholders. In order to regulate the uncontrolled dominance of controlling shareholders, the KCC should make the current rules clearer, more practical, and more effective by dictating that the board remain neutral in corporate control contests. With respect to hostile takeovers, more detailed rules on the primary or ultimate authority of shareholders, proxy solicitation and greenmail are more urgently desirable than poison pills. If Korea fears abusive inflows of foreign capital into its economy, it should consider adopting additional regulations on foreign investment in specific industrial sectors. A general hostility toward hostile takeovers is entirely misplaced.

81 s 401-2.
82 Doo-Shik Kim, ‘Ways to Improve the M&A Legal System’ (Fall 2004) 50 Semi-Annual Journal from Korea Listed Companies Association 16.