

Efficient and democratic governance will play a significant role for corporations throughout the world that stand at the center of the industrial mechanism which creates and distributes wealth and resources. The scale of their operation will increase as they increase in size for the purposes of engaging in large projects and investments within a globalized market. As they become more globalized, the comparative corporate governance shall find the optimal model for harmonized organizational principles. Peace and human rights in the 21st century cannot be accomplished without fair domestic and international distribution of material resources produced by the industrial activities of private corporations worldwide which are, in complement, being supported by efficient and sound financial institutions and markets. The international community has learned during the second half of the 20th century that illegal and illegitimate wealth transfers and inefficient wealth management resulting from poor corporate governance systems of some developing countries may cause functional distortions of financial institutions and markets. This can then lead to serious regional or worldwide financial crises and, as a consequence, jeopardize the balanced development of the world economy and as well as disrupt the worldwide economic and social order.¹⁷⁴⁾

International law-making must produce the effect of making financial institutions and multinational corporations more susceptible to international law rules. For decades, territorial boundaries have long been meaningless as applied to financial markets and the activities of multinational corporations. The effective role of international soft laws, such as the BIS Rules and the OECD Principles, in effecting such financial and business activities suggests that international organizations and rule-making bodies will continue to focus on their importance well into the future.

174) A recent empirical study showed that “the weakness of legal institutions for corporate governance had an important effect on the extent of depreciations and stock market declines in the Asian crisis.” See Simon Johnson, Peter Boone, Alasdair Breach & Eric Friedman, *Corporate Governance in the Asian Financial Crisis*, 58 J. Fin. Econ. 141, 142 (2000). See also *id.* at 184 (“In cross-country regressions, corporate governance variables explain more of the variation in exchange rates and stock market performance during the Asian crisis than do macroeconomic variables.”)

Shareholder Activism in Korea: A Review of How PSPD Has Used Legal Measures to Strengthen Korean Corporate Governance

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Abstract

Shareholder activism has recently begun to play a significant role in reshaping the corporate governance of Korean companies. The People's Solidarity for Participatory Democracy (PSPD), a public interest group, has been at the forefront of leading shareholder activism in Korea. It is believed that PSPD's initiatives will have a lasting influence on the Korean legal system governing corporate governance because for the first time, various minority shareholders' rights that had remained dormant for most of Korea's modern history have finally been utilized. This Article examines how those involved in shareholder activism in Korea have been able to use legal measures to improve corporate governance. It will primarily draw upon the experience of PSPD's activities in recent years. This article will also examine the shortcomings that currently exist under the current legal system and will offer some possible regulatory and policy solutions.

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I. Introduction

Shareholder activism has recently begun to play a significant role in reshaping the corporate governance of Korean companies.¹⁾ In many advanced countries, institutional investors or financial intermediaries are the monitors that serve the function of active shareholders.²⁾ By contrast, in Korea, shareholder activism was virtually nonexistent in any form until it was initiated in early 1997 by the People's Solidarity for Participatory Democracy ("PSPD"), an influential public interest group.³⁾ PSPD's minority shareholder campaign first targeted Korea First Bank and has since then expanded its activities to Korea's premier companies such as Samsung Electronics, SK Telecom and Hyundai Heavy Industries by annually announcing a target company list. These companies were selectively chosen because it was believed that as Korea's leading companies it was critical for them to reform their corporate governance first because they could serve as models for other companies to follow.

Since that time PSPD has been at the forefront of leading shareholder activism in Korea. PSPD's shareholder activities have had a considerable impact including contributing to increased transparency between business and political relations. But

1) Shareholder activism is a way that shareholders can claim their power as company owners to influence a corporation's behavior. Shareholder activism is generally classified into two categories (Socially-oriented shareholder activism and Corporate governance activism). In the 1970s, religious investors formed a shareholder coalition called the Interfaith Center for Corporate Responsibility, and started using the shareholder proposal process as a way of working for peace and social justice. They began organizing and filing resolutions on South African Apartheid, community economic development and global finance, environment, equality, international issues, health and militarism. Today, shareholder resolutions cover a similar range of issues and are used by public interest-minded shareholders and their allies to affect social change on a company-level. One of the more common issues addressed through shareholder activism is the topic of corporate governance, or how a company structures and compensates its leadership, particularly vis-a-vis shareholders' rights. Shareholder Activism Handbook, Friends of the Earth, June 1999. <<http://www.foe.org/>>.

2) In the case of the U.S., in 1985, the Council for Institutional Investors (CII) was formed to protect the financial interests of its member investors and pension funds. The CII and its member groups are actively involved in studying and promoting good corporate governance. See generally, Jeffrey N. Gordon, "Pathways to Corporate Convergence? Two Steps on The Road to Shareholder Capitalism in Germany," Vol. 5, Columbia Journal of European Law (1999), p. 219; John C. Coffee, "The Future As History: The Prospects for Global Convergence in Corporate Governance and Its Implications," Vol. 93, Northwestern University Law Review (1999), p. 641.

3) More specifically the Participatory Economy Committee within PSPD is in charge of these activities. <<http://www.peoplepower21.org/pec/>>.

more significantly, it is believed that PSPD's initiatives will have a lasting influence on the Korean legal system governing corporate governance. For the first time, through PSPD's activities, various minority shareholders' rights that had remained dormant for most of Korea's modern history were utilized. Although PSPD oftentimes relied on social campaigns, negotiations and other non-legal activities to promote shareholder rights, in the long run, one of its primary contributions toward strengthening corporate governance in Korea was its ability to utilize legal measures.⁴⁾

This Article will examine how those involved in shareholder activism in Korea have been able to use legal measures to improve corporate governance. It will primarily draw upon the experience of PSPD's activities in recent years. First, it will begin by reviewing the basic legal measures that can be used to participate in the corporate decision making process when it is initially being made. Next, the Article will review how legal measures can be utilized to monitor the behavior of management when it implements business decisions. Third, it will examine how legal measures can be used to hold management accountable for their decisions, especially illegal conduct. At each stage, this Article will examine the shortcomings that currently exist under the current legal system as revealed in the course of PSPD's activities. It will also offer some possible regulatory and policy solutions to these various shortcomings. In the end, this Article will attempt to show how these various legal measures functioned and the influence that shareholder activism has had on corporate behavior and strengthening corporate governance in Korea.

II. Participating in the Corporate Decision Making Process

Under the modern stock corporation model, shareholders delegate the detailed and "day-to-day" decision making of the corporation to the board of directors. Shareholders can nevertheless participate in the fundamental and basic corporate decision making process through various legal measures.⁵⁾ Shareholders can participate

4) Hwa-Jin Kim, "Living with the IMF: A New Approach to Corporate Governance and Regulation of Financial Institutions in Korea," Vol. 17, Berkeley Journal of International Law (1999), p 61, 71; As described by one foreign observer, [PSPD's] focus is working the system and the system [they] use is the legal system, launching lawsuits against chaebols to recover misused funds. Times (London), June 23, 2000.

5) For a review of how many of the legal measures affecting corporate governance have changed in recent years see, Joon-Gi Kim, "Recent Amendments of Korean Commercial Code and Their Effect on International Competition,"

in the decision making first of all by attending the shareholders' meetings themselves to express their views. Second, shareholders can make shareholder proposals to be placed on the agenda of shareholders' meetings and more formally make suggestions. Third, shareholders can solicit proxies from other shareholders to promote their views. Fourth, shareholders can convene extraordinary shareholders' meetings. Based on PSPD's experience, these are the most fundamental and basic methods by which shareholders can contribute in the decision-making process.

A. Attending Shareholders' Meetings

Shareholders' meetings are the basic institutional forums where shareholders can participate in the general corporate decision making process.⁶⁾ At the shareholders' meetings, the members of the board of directors and auditors are elected, the articles of incorporations ("AOI") are adopted or amended and major decisions such as mergers, business transfers or dissolutions are decided by the shareholders.⁷⁾ Financial statements are also presented to the shareholders for their final approval.⁸⁾ In addition, shareholders' meetings are a rare occasion where all shareholders can officially meet the management, appraise their performance and raise questions regarding their decisions. Despite the potential importance of shareholders' meetings to minority shareholders, in the past these meetings were largely formalities for Korean companies including those that were publicly-held. Non-principal shareholders in particular rarely attended the shareholders' meetings. Except in those cases where hostile takeovers were attempted, which only have occurred recently themselves, the meetings were perfunctory formalities.

Several reasons existed for this state of affairs. First, non-principal shareholders usually did not have any access to sufficient information about the agenda at the shareholders' meetings. Under the current Commercial Code, the shareholders can

Vol. 21, University of Pennsylvania Journal of International Economic Law (2000), p. 273.

6) Robert G. Miller, "Comparing the Annual Shareholders Meeting in the United States With That In Germany-Use of Yankee Concepts of Due Process Discerned by Alexis De Tocqueville," Vol. 19, New York Law School Journal of International and Comparative Law (1999), p 1 (offers a comparison of how shareholder meetings are conducted in the U.S. and Germany).

7) Commercial Code, Art. 374, Art. 382.

8) Commercial Code, Art. 449.

only obtain limited information such as agenda items and proposed amendments of the AOI two weeks before the meeting by way of an individual or public notice. For listed companies, a proxy statement with more detailed information should be maintained at the company headquarters or with other related authorities such as the Korean Stock Exchange under the Securities Exchange Act (“SEA”).⁹ But even such materials do not include critical information such as the identity of the candidates for directors or auditors or information on the management compensation.

Second, in light of the ownership structure, it was difficult for non-principal shareholders to directly influence the outcome of the meeting. In the case of *chaebol* conglomerates, in particular, the principal shareholders maintained their control through cross shareholding by related-sister companies even though their personal stakes were extremely small. Third, institutional investors were barred from effectively exercising their votes under the relevant laws.¹⁰ Fourth, proxy solicitation was rare because the Korea Securities Depository was allowed to exercise voting rights of the stocks that it held in custody and were undeclared. Thus, most shareholders did not have any incentive to participate in the shareholders’ meetings. At the same time, this meant that the management did not have any motivation to attract the minority shareholders to attend the meetings.

PSPD engaged in a variety of activities at General Shareholders’ Meetings (“GSM”). The most important activity by PSPD was to attend and to raise various questions at the GSM. It was significant because this simple, but most basic shareholder right was exercised in a meaningful manner for the first time. The presence of shareholder activists such as PSPD, for instance, caused companies to actually prepare their responses in earnest.

PSPD, after it announced its plan to attend a company’s GSM, would prepare for the meetings by first gathering available public information such as public disclosure documents, media reports and financial statements. In certain cases, materials produced by governmental authorities such as the Fair Trade Commission or Financial Supervisory Service provided useful sources. PSPD often requested information from regulators according to the Public Agency Information Disclosure Law.¹¹ But,

9) Securities Exchange Act (SEA), Art. 191-10.

10) By a 1998 amendment of the Securities Investment Trust Business Act, securities investment trust companies may now exercise their voting rights with certain restrictions.

unfortunately, these government authorities and regulators were often reluctant to share information they obtained. PSPD at one point considered taking legal action for refusing to provide such critical information that could affect the public interest. Nevertheless, based upon the information gathered, PSPD normally sent demands or question lists to the management several days before the GSM to give the management time to prepare their responses.

Two weeks before the GSM, the corporate management is required to finalize the meeting agenda and dispatch a meeting notice to the shareholders.¹² For smaller shareholders, companies would often provide this public notice through the newspaper instead of individually notifying shareholders.¹³ In the past, this meant that shareholders therefore had to constantly check the notices in newspapers in order to determine the date, place and agenda of the meetings. Starting from September 29, 2000, however, the dates and agenda of a general shareholders’ meeting became a matter subject to a timely disclosure requirement.¹⁴ This will help shareholders and PSPD to ascertain the details of shareholders’ meeting and to obtain proxies from individual shareholders.

PSPD members attended GSMs and at the meetings raised questions on a variety of issues.¹⁵ Questioning is useful in several aspects. First, shareholders can obtain important information through questioning. Surprisingly, the management has sometimes openly admitted its negligence or malfeasance. In other cases, the management provided important clues for further investigation. For example, when PSPD questioned the board of Samsung Electronics regarding its indirect guarantee of Samsung Motor’s offshore debts, the Chief Executive Officer surprisingly admitted that he did not know about the transaction. This revealed that the Samsung Group orchestrated these huge intra-group transactions without even notifying the head of Samsung Electronics.

Second, questioning can draw public attention to secret transactions such as unfair

11) Law No. 5242 of 1996.

12) Commercial Code, Art. 365.

13) Under Article 191-10 of SEA and Article 84-17 of its Implementing Decree, listed companies can replace individual notices to the shareholders who own less than 1% of the total outstanding shares with a public notice.

14) Regulation on Timely Disclosure and Prospectus of Listed Companies, Art. 4, Para. 1, Item 11.

15) PSPD main issues are well summarized in PSPD’s list of demands. For reference, the items demanded for the 1998 shareholder meetings for Samsung Electronics and SK Telecom are included in the Annex.

subsidies to affiliated companies or to family members of the controlling shareholder. Where such issues are not widely known, the meeting provides an important forum through which such details can be shared with shareholders or to the public at large. Third, prepared questioning itself places a substantial degree of pressure on the part of management. Management or directors in performing their duties will deliberate far more as to whether their activities can be justified and will be more reluctant to rubberstamp the decisions of the principal shareholder. Since PSPD first attended the shareholders' meeting of Korea First Bank in March 1997, PSPD members have attended meetings of Samsung Electronics, Daewoo Corporation, SK Telecom, Hyundai Heavy Industries, LG Semiconductor and Dacom. In one of the most celebrated cases, the Samsung Electronics' GSM that was held in March 1998 lasted for more than 13 hours mainly due to thorough questioning by PSPD.

When PSPD first initiated its minority shareholder campaign, the management of some unenlightened companies even attempted to disrupt the attendance or questioning of shareholders. PSPD brought legal actions on two different occasions to nullify the resolutions passed at meetings where such disruptions occurred. The Korea First Bank case and Hyundai Heavy Industries case offer interesting examples. Under the Commercial Code, unlike most shareholder rights, only one share is required to bring such a lawsuit.

First, following the 1997 shareholders' meeting of Korea First Bank, PSPD brought an action claiming that the GSM should be nullified because the management's disruptions prevented proper shareholder participation. In December 1997, the Seoul District Court agreed and issued a decision to nullify the resolutions adopted at the meeting. In the decision, the court confirmed the basic rights of shareholders to raise questions and debate on the legitimacy of business judgments.¹⁶⁾ In contrast, in the case of Hyundai Heavy Industries' 1999 GSM, the court dismissed similar claims raised by PSPD.¹⁷⁾ The court dismissed the case in order to "not damage the company and to protect the transactional interests" that were based on such resolutions even though the court found the process of reaching the resolution was defective.¹⁸⁾ Subsequently, as companies have grown to realize the importance of

16) Judgment of Dec. 12, 1997, Seoul District Court, 97 kahap 32890.

17) Judgment of Sept. 29, 2000, Busan High Court, 2000 na 4722.

18) *Id.*

shareholder value and investor relations such shortsighted policies of disruption have ostensibly disappeared.

B. Shareholder Proposals

Another important measure of shareholders has been the utilization of shareholder proposals at the GSMs.¹⁹⁾ Shareholder proposals allow shareholders to officially make suggestions regarding a corporation's operations. PSPD for instance first made shareholder proposals at the GSMs of Samsung Electronics and SK Telecom. In March 1998 and March 1999, PSPD proposed that the AOI of Samsung Electronics be amended to protect the interests of minority shareholders. Also in March 1998, PSPD made similar proposals to SK Telecom to amend its AOI and also proposed the election of two outside directors. At the time, the proposals made to Samsung Electronics failed to obtain majority approval, whereas in contrast the management without even going to a proxy contest accepted many of PSPD's proposals of SK Telecom. Most notably, SK Telecom accepted the choices of the two outside directors that were suggested and also an amendment to the AOI that certain interconglomerate trades had to be reviewed by the outside directors.

Unfortunately, under Article 84-21 of the Presidential Decree of the SEA, which governs listed companies, the type of proposals to the GSM agenda that can be made by shareholders are strictly limited. These restrictions thwart basic shareholder participation and action. For example, the dismissal of directors or auditors cannot be the subject of a shareholder proposal. The only way that shareholders may propose the dismissal of a director or auditor is for them to convene an extraordinary shareholders' meeting. In stark contrast, in the U.S. even such matters that are subject to business judgment can be considered for discussion in the form of recommendatory resolutions. But under the current laws of Korea, it is not likely that such resolutions can be proposed by shareholders because the above mentioned Article suggests that a proposal cannot contain any matter that does not explicitly belong to the authority of shareholders' meetings.

19) Christine L. Ayotte, "Reevaluating the Shareholder Proposal Rule in the Wake of Cracker Barrel and the Era of Institutional Investors," Vol. 48, Catholic University Law Review (1999), p.511; Daniel E. Lazaroff, "Promoting Corporate Democracy and Social Responsibility: The Need to Reform the Federal Proxy Rules on Shareholder Proposals," Vol. 50, Rutgers Law Review (1997), p. 33 (on the importance of shareholder proposals).

In the past, a major contradiction existed under the law. Shareholder proposals had to be made six weeks prior to the convening of the GSM. In contrast, the GSM would only be announced two weeks before it convened. This meant that in order for shareholders to make a proposal they had to guess when the GSM was to going to be convened and consequently make a shareholder proposal six weeks beforehand. Fortunately, this legislative oversight was corrected in March 4, 2000 when the Presidential Decree was modified to allow shareholders to make the proposal six weeks before the same relative date that the GSM was held in the previous year.²⁰⁾ This finally allows shareholders to know exactly when they can submit a shareholder proposal.

C. Proxy Solicitations

Proxy solicitations are an important legal measure by which shareholders can seek support from other minority shareholders.²¹⁾ PSPD launched several proxy solicitations to gather proxies from other shareholders. Under Article 199 of the SEA, anyone who wants to solicit proxies from 10 or more persons must register the proxy statements in advance with the Financial Supervisory Commission (“FSC”).²²⁾ The present regulations have many obstacles for proxy solicitations to occur as explained below.

A meeting notice can only be dispatched to shareholders two days after a proxy statement has been filed with the FSC. Since the GSM agenda are finalized two weeks (14 days) before the meeting, shareholders had to send proxy solicitation materials to other shareholders at best 12 days before the meeting. Of course, this assumes that proxy solicitation materials can be fully prepared immediately upon receiving the notice of the GSM orders. In the course of PSPD’s activities, this strict proxy rule prevented PSPD from actively seeking proxies especially from foreign shareholders that shared PSPD’s views.

20) Art. 84-21.

21) See generally, Douglas G. Smith, “A Comparative Analysis of The Proxy Machinery in Germany, Japan, and the United States: Implications for the Political Theory of American Corporate Finance,” Vol. 58, University of Pittsburgh Law Review, p.145 (1996); Daniel E. Lazaroff, “Promoting Corporate Democracy and Social Responsibility: The Need to Reform the Federal Proxy Rules on Shareholder Proposals,” Vol. 50, Rutgers Law Review, p. 33 (1997).

22) Presidential Decree of the SEA, Art, 85.

Under the regulations of the FSC, foreign shareholders can cast their votes only through their local custodians using their standing proxies. Foreign shareholders in turn do not have direct contact with their local custodians but relate with them through their global custodians. Thus, in order for a foreign shareholder to grant their proxies to PSPD, the foreign shareholders would have to instruct their global custodians to instruct their local custodians to act accordingly. The general practice of global custodians is to receive such instructions from the foreign shareholders at least 10 days prior to the meetings. Thus, it was very difficult for foreign shareholders to give proxies to PSPD because they would usually receive PSPD’s proxy statements after they had sent their instructions to their global custodians. This rule therefore needs to be amended so that the delivery of proxy statements can be made simultaneously with the registration filing with the FSC.

D. Convening Extraordinary Shareholders’ Meetings

In close correlation with soliciting proxies and shareholder proposals, shareholders can also convene Extraordinary Shareholders Meetings (“ESM”). PSPD, however, has not attempted to convene an ESM. It is noteworthy that in the case of SK Telecom, an outside auditor demanded the convening of an ESM under Article 412-3 of the Commercial Code with the support of PSPD. This is the first reported time that an auditor exercised this right under this legal provision. The auditor convened the meeting to raise issue with respect to a plan by SK Telecom to have a rights issue. SK Telecom management announced that it would convene an ESM but at a date after the capital increase took effect. The outside auditor filed a lawsuit to instantly convene the meeting. The court unfortunately dismissed the outside auditor’s claim that the meeting should be convened before the capital increase took effect.²³⁾ At the ESM so convened, the management-led shareholders of SK Telecom with help from its increased shareholding due to the capital increase were able to prevail at the meeting.

E. Policy Recommendations

First for shareholders to be able to more actively participate in shareholders’

23) Judgment of July 6, 1999, Seoul District Court, 99 pa 177.

meetings the voting procedures must be improved. For instance, although as of December 31, 1999, the new Commercial Code permits written voting, most companies have not adopted it in their AOs.²⁴ Companies are reluctant to adopt this voting method because of the added burden of including the voting and reference material when sending the notice for convening the GSM. Furthermore, the Korea Securities Depository (KSD) may still exercise the proxy votes for those undeclared shareholders. Large companies such as Samsung Electronics have more than 100,000 shareholders and it is impossible to expect them to attend the GSM. Therefore it should be mandatory for companies with more than a certain number of shareholders to adopt the written voting procedures or in the alternative to consider such measures as Internet voting. In addition, KSD should no longer be able to exercise proxies to encourage companies to attract the participation of shareholders.

Second, the proxy statement sent to shareholders prior to the shareholders' meetings must become more comprehensive. It should include the backgrounds of those candidates to become directors or auditors, breakdowns of their individual compensation and basic material explaining the corporations business and financial condition. Moreover, this type of information should also be made available through the Internet.

Third, the restrictions concerning shareholder proposals as provided in the SEA should be modified. Shareholders should be allowed to propose the termination of directors. Furthermore, shareholders should be able to propose any matter that can be decided at a shareholders' meeting and also should be able to make recommendatory resolutions for those matters that have been delegated to the board of directors. Finally, the proxy solicitation process must be simplified to allow the solicitation process to begin immediately after filing the necessary material with the FSC.

III. Preventive Measures and Monitoring the Behavior of Management

After shareholders have delegated the corporate decision making process to the board of directors, various legal measures are available for shareholders to monitor the actions of management. Preventive measures such as monitoring are important

²⁴ Commercial Code, Art. 368-3.

especially to deter illegal or improper management decisions. Participating in the shareholders' meeting cannot prevent the management from subsequently taking problematic business decisions because most managerial decisions are not subject to prior approval of shareholders with a few exceptions such as mergers or business transfers. The threat to bring derivative action has some preventive effect, but this often takes time and is too late or remote. Thus, one of the major actions taken by PSPD was to demand the end of illegal activities of the management or to require relevant materials related to the business decisions to deter management from proceeding on problematic decisions. Shareholders may also inspect the records of the corporation, demand that certain management actions end or seek injunctions to prevent illegal activities.

A. Inspection of Books and Records, Appointment of Inspectors

Inspection of books and records as provided in the KCC was utilized to gain information for two purposes.²⁵ First, inspections allow shareholders to gather critical information necessary to prepare for the shareholders' meeting. Second, inspections help to get necessary information to pressure management into stopping illegal or unreasonable decisions. Important records for instance can include Board of Directors' minutes and accounting records.

In 1998, PSPD demanded the Board of Directors' ("BOD") minutes of Samsung Electronics. This request was made in order to find evidence as to whether Samsung Electronics illegally supported Samsung Motors and engaged in improper internal transactions with Joongang Ilbo, a related company. Contrary to the shareholders' legitimate rights guaranteed under the Commercial Code, Samsung Electronics initially refused this basic request. A court order was sought to exercise this right and on June 12, 1998 the Suwon District Court ordered Samsung Electronics to provide the minutes and pay a fine of three million won for violating the law.

In many other occasions, PSPD requested materials from the management of the target companies before the meeting. Among these documents, the most often requested materials were audit reports of the companies conducted by independent

²⁵ Commercial Code, Art. 466; Randall S. Thomas, "Improving Shareholder Monitoring of Corporate Management by Expanding Statutory Access to Information," Vol. 38, Arizona Law Review 331 (1996).

accounting firms. These materials provided PSPD with information that they could use to prepare questions and arguments.

Under the SEA, shareholders may request in writing inspection of books and records. If the management denies such a request, the shareholders may apply for an injunction order with the court. Furthermore, the shareholders may demand the appointment of an inspector in certain circumstances. Although PSPD has not filed for such an injunction, the existence of the right to inspect books and records functions as an effective threat to press management to produce relevant materials.

B. Demands to Cease Illegal Activities

Shareholders can demand that management stop engaging in certain transactions that are illegal or that unreasonably damage their interests. PSPD frequently used this method to make demands. When making such demands, PSPD explained why it was concerned with a particular transaction and urged an explanation and response from the management. The management has no official obligation to respond to such a demand from individual shareholders. Yet, even though the ultimate responsibility for any business decision belongs to the management, a demand letter from a shareholder sends a message to the management that if they proceeded with such a decision without giving due consideration to the concerns raised by the shareholders, they could be subject to legal action.

There were several cases where the management accepted the demands of PSPD. In 1999, for instance, Hyundai Heavy Industries partly agreed to the demands made by PSPD by withdrawing their plan to support Hyundai Motors for their acquisition of Kia Motors and Asia Motors. Similarly, Samsung Electronics' decision not to further expand its automobile business was known partly due to objections raised by PSPD.

Ironically, on some occasions, PSPD's demand letters served as the ostensible reasons for the management of some *chaebol* companies to refuse requests for help from their sister companies for fear of litigation. In the course of Hyundai Engineering & Construction's financial crisis last year, for instance, Hyundai Heavy Industries refused a request for help from the Hyundai Group because PSPD and minority shareholders opposed such a subsidy. Some critics suggest that such "interference" by PSPD limits the creative and challenging business decisions of the professional managers. But, in reality, PSPD's involvement grants more authority and discretion to

professional managers by giving them a useful tool to refuse improper demands driven by controlling shareholders.

Nevertheless, in many cases the management of companies would not accept the demands of PSPD. In most of these cases where shareholder demands are rejected, however, the management would at least make changes to their original plans to avoid the risk of a shareholder challenge or legal action. Hence, the demand did have an effect on the management.²⁶⁾

C. Injunctions to Prevent Illegal Acts of Management

Shareholders' demands can also develop into more formal legal proceedings. In the case of PSPD, it has filed injunctions to prevent management decisions from being implemented. One notable case began in 1997. On March 24, 1997 Samsung Electronics had a private placement of convertible bonds ("CB") worth 60 billion won (approximately \$ 43 million) of which Samsung Group Chairman Keon-Hee Lee's son Jae-Yong Lee purchased 45 billion won and the Samsung Corporation purchased 15 billion won. The private placement of CB's are different from public issues because the issuing company can sell the bonds to particular designated individuals, making it possible for only Jae-Yong Lee and Samsung Corporation to acquire these bonds.

PSPD believed that the private placement of CB's was not only a means to pass on the management control of the Samsung Group to Jae-Yong Lee but also violated the preemptive rights of minority shareholders to purchase Samsung Electronics' shares and diluted their voting power. In addition, it argued that the conversion price was set lower than the market price at the date of issue. This lower price further violated shareholders' interests because it was transferring company wealth to an individual. Samsung claimed that the CBs were issued to Jae-Yong Lee because they needed the capital and he was an accessible source under the circumstances.

As a result, PSPD filed a legal action on June 24, 1997 against Jae-Yong Lee and Samsung Corporation to nullify Samsung Electronics' issue of convertible bonds, and filed a request for a temporary injunction against their conversion, sale or other

26) In the case of SK Telecom, PSPD and outside directors raised objections to the management's plan for the purchase of certain real estate from one of its sister companies. Although PSPD and outside directors could not prevent the purchase of the real estate, the outside directors did force the management to modify the terms and conditions for the purchase.

disposition. On September 30, the court approved the request for a temporary injunction against Samsung Electronics. However, the day before the court's ruling, Samsung Corporation made a sudden move to convert the CB's to shares.

In response, on October 7, PSPD requested a temporary injunction against the disposition or listing of Jae-Yong Lee and Samsung Corporations' newly converted shares, and modified the compliant to one that sought to "nullify the issue of convertible bonds" to one that sought to "nullify the issue of new shares." On December 17, 1997, the Suwon District Court ruled in favor of PSPD's claim with regard to the temporary injunction against the disposition or listing of Jae-Yong Lee's shares. In the opinion issuing the temporary injunction, the court stated that for a private placement of convertible bonds to a third party or a particular shareholder, "there must be an objective legitimate reason." Furthermore, the court announced that in issuing the convertible bonds to Jae-Yong Lee as an individual in this case, "the need for capital was only a superficial reason and the only reason was for the interests of the dominant shareholder; hence, it should be void." The Suwon District Court, however, ruled against the actual nullification of the newly issued shares. PSPD immediately appealed this point.²⁷⁾

In another case involving Samsung Electronics, PSPD filed an injunction to prevent it from supporting Samsung Motors. At the time, Samsung Electronics was not under any guarantee agreement with Samsung Motors, but it was supposed to assume the responsibilities for a part of the debt of Samsung Motors, following an agreement by the creditors of Samsung Motors after it became defunct. PSPD raised an apparent objection and sent an opinion letter to the board of Samsung Electronics. Then in November 2000, PSPD filed for an injunction to stop the implementation of this agreement with creditors of Samsung Motors. This injunction is still pending review.

D. Policy Recommendations

For shareholders to prevent the malfeasance and misappropriation of managers, information concerning the corporation must be provided promptly. At the same time, the courts must respond more quickly to injunctions. Otherwise, it often becomes too

27) The Seoul High Court subsequently affirmed the decision not to nullify the newly issued shares. *see*, Seoul High Court, 98 na 4608. (Ed. Note: This decision is provided in the materials section in this issue).

late to correct or retract such illegal activities because they have progressed too far. In the case of Samsung Motors, for instance, PSPD filed an injunction to prevent Samsung Electronics from repaying the debts of Samsung Motors. But this injunction was filed after it became public knowledge that the BOD had agreed to assume a portion of these debts. Even if the injunction is accepted by the courts, it is questionable as to whether Samsung Electronics can retract its promise with the creditors of Samsung Motors. Similarly, in the case of the injunction to prevent the conversion of the Samsung Electronics' convertible bonds, it became all but meaningless when the bonds in question were converted the day before the court's decision. One solution is to strengthen the disclosure requirement. The injunction process can alternatively be accelerated. But these options have their limitations. Given the circumstances in Korea, one of the best hopes to properly restrict the managerial agency problem is make cumulative voting mandatory and elect more independent directors on the board.

IV. Holding Management Accountable for Their Conduct

Management can be held accountable for its action in several ways. When the management has contributed to the improvement of the corporation of course they can be rewarded with increased compensation and reappointment as managers. In contrast, when the management has harmed the corporation either through negligence or malfeasance they can be held responsible for their misdeeds by way of being replaced with a new management. In fact, the primary reason why management pays careful attention to the voices of shareholders is because shareholders may end their employment if it is deemed unsatisfactory. But in the case of most Korean corporations, the management was always selected by the principal shareholders and they were effectively free from any challenges of other shareholders. Thus, in Korea, legal measures to hold the management legally liable for its conduct are essential for the board to be responsive to the needs of all shareholders and not just the principal shareholder. Shareholders can file shareholder derivative actions seeking liability against directors or auditors.²⁸⁾ Administrative or criminal complaints can be raised

28) Robert B. Thompson, "Preemption and Federalism in Corporate Governance: Protecting Shareholder Rights to Vote, Sell, and Sue," Vol. 62, Law and Contemporary Problems Summer (1999), p. 252 (emphasizing that "exit and litigation" are "core governance functions" for shareholders).

against the management.

In this regard, PSPD's activities were successful because PSPD did not merely make demands to target companies or just commence street campaigns to criticize the management. PSPD was careful to make very specific but achievable demands. If the management did not accept the demands, only then would PSPD consider the second phase of actions such as bringing shareholder derivative actions or criminal complaints. Negative campaigns are risky because PSPD itself is then forced to make determinations on matters intertwined with business judgments. But, if PSPD initiates legal proceedings such as shareholder derivative suits or criminal complaints, the court becomes the one that judges the propriety of managerial business decisions. Some criticized that PSPD challenged decisions that belonged to the business judgment and discretion of the management. But such suggestions are rather exaggerated because PSPD was careful to only focus its activities against those management decisions that involved egregious improprieties.

A. Shareholder Derivative Actions

The earliest example of a shareholder derivative suit occurred on June 3, 1997, when PSPD initiated an action against former officers of Korea First Bank (KFB).²⁹⁾ PSPD brought the claim on behalf of 61 minority shareholders of KFB. The plaintiffs claimed 40 billion won in compensation against the former president and directors of KFB. It was alleged that they received bribes in return for providing credit to the failed Hanbo conglomerate, causing critical losses to the bank and its shareholders. Through criminal inspections, these allegations were substantiated through evidence that the former president and directors not only received bribes but they instructed staff employees to neglect internal regulations to extend huge loans to Hanbo even right before it went bankrupt. On July 24, 1998, the Seoul District Court ruled in favor of these minority shareholders issuing a historical 40 billion won money award against these directors.³⁰⁾

Right after the decision, however, a senior researcher of the Free Enterprise Institute wrote an article arguing that this court decision would limit the legitimate

29) For a comprehensive discussion on the importance and history of shareholder litigation see, James D. Cox, "The Social Meaning of Shareholder Suits," Vol. 65, Brooklyn Law Review (1999), p. 3.

30) Judgment of Jul. 24, 1998, Seoul District Court, 98 Kahap 39907.

business discretion and decision making of managers.³¹⁾ But, the article did not explain why receiving a bribe or instructing employees to avoid internal risk control regulations constituted a legitimate business judgment that should be protected. These types of actions do not deserve protection under any legal system.

In October 1998, PSPD filed another derivative action against eleven board members of Samsung Electronics on behalf of 22 shareholders. In the complaint, shareholders alleged that the company was damaged due to a variety of illegal behavior of the management. These acts included bribery to a former President, illegal intercorporate transactions with sister companies, Joongang Ilbo, Samsung Corporation and Samsung Heavy Industries, capital injections and bank guarantees to Ichon Electronics and sales of holding securities at a lower than market price to two other subsidiaries. These various wrongdoings were based upon facts that were already revealed in a criminal investigation or investigation by the Fair Trade Commission.

Following another government investigation, PSPD initiated a shareholders' derivative suit against the Daewoo Corporation to request compensation for 23 billion won (\$ 20 million). This claim was primarily the result of improper intercorporate transactions by the conglomerate chairman, Woo-Chung Kim, and senior managers, in 1998. This civil action is currently pending judicial review.

B. Criminal or Administrative Complaints

Shareholders can also resort to seeking criminal or administrative investigations to seek the accountability of management. Civil lawsuits can be time consuming and it is particularly difficult to obtain enough evidence to prevail in litigation because of the lack of civil discovery in Korea. In many of its cases, therefore PSPD chose to pursue criminal or administrative complaints. This avenue must be proceeded with caution, however, because criminal complaints have negative consequences as well. First, they will close the door for future negotiation possibilities, when compared to civil proceeding. Moreover, the involvement of the shareholders is limited after the issue has been raised. In the end, it was unfortunate that in many cases the prosecutors' office or Fair Trade Commission was reluctant to aggressively pursue cases brought by PSPD.

31) Jeong-Ho Kim, Reviewing the First Shareholder's Representative Action [Chutbunzzae Jju Daepyosong eul Bomyunseo], Free Enterprise Institute (Jul, 29, 1998).

An example occurred on June 11, 1998 when PSPD filed a criminal complaint with the Seoul District Prosecutors' Office charging Samsung Electronics, Samsung Display Devices, Samsung Electro-Mechanics, Samsung Motors and the board members of each company for violating laws regulating the introduction of foreign capital, foreign currency management laws, and securities transactions laws. Samsung Electronics, Samsung Display Devices, and Samsung Electro-Mechanics, which are the main shareholders of Samsung Motors, made a joint investment agreement with an Ireland-based paper company called Pan-Pacific Industrial Investments (PP) to invest approximately \$280.2 million in Samsung Motors. This agreement is in the form of a direct investment by a foreigner in accordance with the laws regulating the introduction of foreign capital. However, unlike a direct investment, a certain rate of return is guaranteed with put and call options and a specified redemption period exists. Samsung Motors therefore in effect brought in an offshore commercial loan with guarantees from three affiliates not a direct investment as was claimed.

According to the laws regulating the introduction of foreign capital and foreign currency management laws at the time, the introduction of commercial loans required the approval of the Finance Minister. Because it was not possible to follow the necessary legal procedure for bringing in a commercial loan, Samsung Motors resorted to circumventing this regulation by disguising the funds as a direct investment. In its notification, Samsung omitted the parts that could reveal the commercial loan character and made separate side agreements. In effect, Samsung made a false notification, in violation of the above-mentioned laws, and also violated the SEA provisions requiring public disclosure of important capital transactions. Nevertheless, the Seoul District Prosecutor's Office without even investigating the actual process of such agreement ended the investigation.

PSPD sometimes brought administrative complaints against professionals such as accountants or lawyers who aided in the illegal or improper activities of the management. PSPD revealed that the financial statements as reported at the 1998 GSM were not in compliance with the Korean Accounting Standards and filed a complaint with the Financial Supervisory Service on April 16th. Both Samsung Electronics and Samil Accounting firm, the outsider auditor of the company, received a warning from the government agency due to insufficient reporting and careless auditing. In the financial statements and the audit reports, both did not specify stock option trading that occurred with Samsung Motors, losses and gains from assets and debt denoted by

foreign currencies, and loans made to employees. This case became a hallmark to prevent many prevailing accounting practices. In connection with Hyundai Electronics' illegal manipulation of the stock prices, the Judiciary Monitoring Center of PSPD filed a complaint that the lawyers representing Hyundai Electronics aided the officers of Hyundai companies in concealing their criminal behavior. Hence accountability has been sought not only against directors but also against attorneys and accountants that assist in illegal endeavors.

PSPD has also on several occasions requested investigations by the Fair Trade Commission. PSPD for instance requested a Fair Trade Commission investigation into Samsung Electronics' alleged illicit support to Seoul Commtech on September 18, 2000. Samsung Electronics under its corporate reform program, transferred the asset and business licenses related to "Home Network" to Seoul Commtech at a price below market value from 1998 to 1999, giving huge profit gains to the communication technology company. It is suspected that this transaction was a means to transfer the chairman's wealth and power to his son. Jae-Yong Lee later became the largest shareholder of Seoul Commtech by purchasing convertible bonds issued by the company in 1996. As of the end of 1999, sixty percent of the Seoul Commtech's revenue was generated by transactions with Samsung Electronics. The suspicion is strongly supported by the fact that the company's gross revenue has dramatically increased since it officially became affiliated with the Samsung Group.

On September 8, 2000, PSPD also asked the Fair Trade Commission to probe into Samsung Group's father-to-son wealth transfers through several other companies. More specifically, PSPD demanded investigations by the Fair Trade Commission into eight start-up companies, e-Samsung, e-Samsung International, CQI.Com, BankPool LTD, ValueNetwork LTD, Innis LTD, Fn-Guide LTD and Insvally. They are also suspected of being used to pass the chairman's wealth to his son who was recognized as the largest shareholder of these companies.

C. Demanding the Dismissal of Responsible Officers.

Under the Commercial code shareholders have the right to terminate directors before the end of their term.³²⁾ At present, this requires a special resolution and there must be a

³²⁾ Art. 395.

reasonable cause for the termination or the terminated director make seek compensation from the company. This measure has been rarely used for two reasons. First, from the perspective of principal shareholders they do not need to utilize this provision. Second, the ownership requirements needed for a special resolution are extremely high.

D. Policy Recommendations

In Korea, shareholder derivative suits against publicly-held companies still require 0.01 percent of the outstanding stock.³³⁾ At the same time, awards from a shareholder derivative action are paid to the corporation. Given these limitations, it is difficult to expect private enforcement through shareholder derivative actions to be effective. Therefore, to allow shareholders to directly receive compensation and press claims against managers for their malfeasance, it is critical that Korea permits class action litigation. Shareholders should also be able to terminate improper directors with only a standard voting quorum and not through a special super-majority requirement. Another option that should be considered is to reduce the terms of directors from three years to one year so that shareholders can easily replace those who harm their interests.

V. Conclusions

While shareholder activism or even basic management monitoring mechanisms can take many forms, it still remains at a preliminary stage in Korea when compared to other advanced countries. Public interest organizations involved in shareholder activism such as PSPD have tried to educate investors and management toward the importance of protecting shareholder rights. In order to strengthen corporate governance, they have emphasized the importance of participating and monitoring in the decision-making of management and holding them accountable after the fact. PSPD in the process has used a host of legal measures that previously remained dormant. PSPD's activities offer an example for other developing countries that face similar corporate governance problems as to how important it is to use the rule of law.

Despite the recent increase in shareholder activism, many obstacles still remain and

33) SEA, Art. 191-13.

much has yet to be achieved. Korea, for instance, is still debating the contours of how to allow securities-related class actions and whether to make cumulative voting mandatory for the election of directors. Given Korea's unique situation, which is similar to many other countries in East Asia, these reforms are among a host of measures that need to be adopted to enhance the effectiveness of corporate governance. In the meantime, shareholder activists in Korea wait for the day when Korean corporations will not resist but will instead openly compete with each other on how to strengthen their corporate governance and will be proud of it.

Annex

PSPD's List of Demands for Samsung Electronics Corporation's (SEC) 1998 GSM

1. Convertible Bonds Issued on March 24, 1997

The stocks issued to Jae-yong Lee and the Samsung Corporation should be cancelled and sold. Any profit earned from the sale of such stock should be returned to the company or donated to the company's unemployment fund.

2. SEC's Investments in Samsung Motors

As of December 31, 1996, SEC has invested over 170 billion won (\$ 106 million) in Samsung Motors and owns 24.81% or 34 million of its shares. Samsung Motors' prospects remain unclear and it is expected that they will continue to have a deficit at least until the year 2000. After investing these tremendous sums into Samsung Motors, SEC now is having difficulty gaining funds due to the constricted financial market and the depressed semiconductor market. SEC's 1996 sales declined by 1.95% from the previous year. The management of SEC therefore must disclose the profitability prospects of Samsung Motors and, if uncertain, all investments must be withdrawn and additional investments or guarantees must cease.

3. SEC's Improper Dealing with the Joongang Ilbo Publishing Company

SEC improperly transferred its corporate funds to one of its sister companies, the publishing company Joongang Ilbo. This was done by paying excessive fees for ads it placed in the newspaper and the magazine Win that was also run by the company. In this case, SEC paid up to more than 73% of the going market rate and in the magazine Win it paid 30% more on average. The Fair Trade Commission ordered SEC to take corrective action as a result of these overpayments. SEC must explore means to have these improperly transferred funds returned back to SEC.

4. SEC's Debt Guarantees of Sister Companies and Foreign Investment

As of June 1997, SEC has guaranteed 720 billion won (\$450 million) of the debt of its sister companies and has invested over 2.2 trillion won (\$ 1.375 billion) in foreign companies. SEC's management should provide a detailed summary of the various debt

guarantees it has made, explain why they were provided, and show how they plan to terminate them. In addition, management must provide a detailed update of the current status of SEC's foreign investments and their future feasibility.

5. Reassignment of SEC Personnel Assigned to, and Disclosure of Financial Support Provided to, the Samsung Group's Office of the Executive Staff

The Samsung Group's Office of the Executive Staff operates for the Chairman of the entire Samsung conglomerate, yet it has no legal basis. The interests of SEC shareholders are being harmed to the extent personnel and funds that should be used for the benefit of SEC are being devoted to assist a Chairman who is technically not accountable to anyone. SEC management should disclose the extent to which it has assigned personnel and expended funds to the Office of the Executive Staff. These SEC staff members and funds should be withdrawn and all funds improperly expended thusfar should be returned to SEC.

6. To comply with the various February 6, 1998 requirements set by the government, SEC must amend its articles of incorporation and appoint outside directors and auditors. Among the outside directors and auditors appointed, a certain portion should represent the interests of minority shareholders. In addition, to improve the corporate governance of SEC, the attached amendments to the articles of incorporation as proposed by PSPD should be adopted to the fullest extent.

7. Termination of Directors for Misconduct

The entire board of directors should assume responsibility for mismanagement of the company and outside directors and auditors should be elected at the upcoming annual shareholder meeting. Those directors involved with the improper private placement of convertible shares and the improper dealing with Joongang Ilbo must resign.

PSPD's List of Demands for SK Telecom's 1998 GSM

1. Resignation of Directors Involved in Improper Dealing

Those directors involved in the improper dealing as determined by the Fair Trade Commission must submit their resignation or be terminated at the upcoming GSM. In particular, the following directors must be terminated: Kil-Sung Sohn, SKT Vice-

Chairman (with authority to represent the company) and SKC's Head of the Office of Coordination and Management Planning; Jin-Mo Choi, Managing Director in Charge of Finance; In-Pyo Lee, Inside Auditor; and, Hae-Yong Choi, Outside Auditor.

2. Taehan Telecom should be merged with SKT but Taehan Telecom's stock price should be valued at 400 won per share so that Tae-Won Choi and Joon-Il Kim do not profit from the transaction.

3. SKT must end its terminal supply contract with SK Distribution, and management must provide a specific plan to redeem the 5.7 billion won (\$ 3.5 million) that was transferred to SK Distribution.

4. SKT's unilateral contracts with SK Engineering and Construction ("SKEC") must be terminated and management must provide a specific plan to redeem the excessive profit transferred to SKEC. The excessive profits of approximately 7.5 billion won (\$ 4.7 million) that SKEC received is based on that amount over 11.5% which is the average profit margin based on the construction industry's sales.

5. To comply with the various new February 6, 1998 regulations, SKT must amend its articles of incorporation and appoint outside directors and auditors. Among the outside directors and auditors appointed, a certain portion must represent the interests of minority shareholders. In addition, to improve the corporate governance of SKT, the attached amendments to the articles of incorporation as proposed by PSPD should be adopted to the fullest extent.

6. SKT should implement a stock split to facilitate investment by minority shareholders and to increase liquidity,

7. SKT's accountants Ahngun Accounting must be terminated for their failure to prevent the improper dealing practices and their poor accounting and auditing.

8. SKT must not participate in its sister company SK Securities' planned private stock issuance if SK Securities' financial status is questionable.

Korean Criminal Law: Moralist *Prima Ratio* for Social Control

*Kuk Cho**

Abstract

The fundamental framework of the Korean Penal Code has remained unchanged for half a century. However, a large number of special criminal acts armed with heavier punishments have been legislated. Since democratization, the question of whether the provisions of Korean criminal law are against "nullum crimen, nulla poena sine lege" has been taken more seriously. Arguments for the liberalization or "de-criminalization" of Korean criminal law have proliferated. However, there is still a trend toward "over-criminalization", and heavier punishment is still preferred for social control. Without serious debate over the legitimacy of subjecting citizens to double jeopardy, "protective security measures" are imposed upon citizens who have already served their sentences. Criminal law is "prima ratio," not "ultima ratio," for social control in Korean society. Korean criminal law reform must attempt to perform two seemingly contradicting tasks: it must not only de-criminalize the over-criminalized criminal law, it must also provide a blueprint for solving the worsening crime problem in modern Korean society.

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