The Future Direction of Takeover Law in Korea

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Abstract

This Essay compares the legal takeover regimes of Korea and the United States and observes that important institutional differences exist between Korea and the United States (the model for many of Korea's recent corporate governance-related reforms including Regulation FD and Sarbanes-Oxley Act-like reforms). Controlling shareholders dominate Korean Chaebol firms. Irrespective of whether Korea eventually adopts poison pills and other defensive tactics, the large control position of the Korean Chaebol firms represent a potent antitakeover defensive tactic, shielding Chaebol firms from market pressures. Korea also lacks a specialty corporate court and a well-developed plaintiffs' attorney bar. These differences call for a different emphasis in the package of laws controlling agency costs within Korean firms. Deciding upon the exact set of laws that is optimal for Korean companies is a difficult task — particularly since market participants are constantly evolving the techniques used in corporate control transactions. The Essay offers several suggestions — including expanded fiduciary duties, fixed bounties for private class action attorneys, and "reverse" tag-along rights for minority shareholders in the case of a failed hostile takeover bid against a Chaebol member firm.

I. Introduction

In large publicly-held corporations, shareholders face an agency problem. Because the shareholders are dispersed and individually lack an incentive to monitor management closely, management has freedom to operate the corporation in the management's private best interest. A hostile takeover, in theory, helps align the incentives of management with shareholders. Managers that expropriate value from the corporation will result in a depressed share price. The greater the expropriation of

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private benefits of control, the more the corporation's share price will be depressed, making the corporation a greater target for a hostile takeover.

Not all hostile takeovers benefit shareholders. Acquiring companies suffer from their own agency problems. The CEO at an acquirer may seek a takeover not to reduce agency costs at the target company but instead simply to expand the CEO's own business empire. To the extent the market determines share price with some degree of myopia (an assumption not shared by all), hostile takeovers may lead to a short-term focus on the part of managers. Still others express concern about the welfare of third parties affected by corporate takeovers, including employees, customers, suppliers, and local communities. Target shareholders may also not always approve takeovers that are in the target shareholder's own individual or collective best interest. Some forms of takeover, particularly contingent, two-stage offers with a lower second-stage price, may coerce target shareholders to agree to a first-stage hostile bid to avoid the second-stage price even if not in the collective best interest of the target shareholders as a group.

In the United States, takeover law attempts to balance both the advantages and disadvantages of hostile takeovers. While hostile takeovers are not banned entirely, those seeking to obtain a control of another company in a hostile transactions faces several legal and legally-sanctioned hurdles. Part II of this Essay discusses the hurdles facing hostile bidders in the United States. What works for companies in the United States may not translate to other regimes. Part III discusses the agency problem in Korean corporations, focusing in particular on Chaebol firms, and the role of hostile takeovers and other mechanisms to reduce the agency cost. Given the institutional differences between Korea and the United States, the Part offers some tentative suggestions at reform.

II. The United States Regime

Two categories of law apply to takeovers in the United States: (A) the law governing all corporate control transactions (including friendly transactions) and (B) the law specific to hostile takeovers.

1. General Background Law

The key theme of U.S. law regarding corporate control transactions is choice. Managers at acquiring and target companies have a number of options at their disposal to execute a transaction in which control of substantially all of the target's assets and business is transferred to the acquiring company. The acquirer and target may simply combine through a statutory merger, transferring all the assets and liabilities from the target to the acquirer and eliminating the existence of the target corporation. Alternatively, the acquirer may purchase the assets of the target, typically avoiding the transfer of the target's liabilities to the acquirer.[1] As yet another alternative, the acquirer may purchase a controlling block of shares of the target. The acquirer may then keep the target as a subsidiary corporation or eliminate the remaining minority shareholders of the target through a later squeezeout merger.

Given this choice in transactional form, lawmakers in the United States wrestle with the question of how much the law should take into account the separate interests of shareholders of the target and acquiring corporations. Even where target and acquiring company management agree on a particular control transaction, shareholders of both companies may not necessarily benefit. Target managers may agree to a statutory merger that is not in the best interests of target shareholders, for example, in return for a separate payment through a golden parachute agreement or a post-merger consulting agreement. An acquiring company may pay too much for the shares of a target corporation where the acquiring company's CEO is a significant shareholder of the target or receives other private benefits from the acquisition. Target controlling shareholders may approve a transaction to obtain a control premium not shared with the target minority shareholders.

How much veto power shareholders have in a corporate control transaction in the United States depends largely on the state of incorporation.[2] By far, the most important state in terms of mergers and acquisition deal activity is Delaware. Delaware state law provides a number of protections for shareholders of acquiring

1) Under successor liability, some liabilities (particularly tort liabilities) may nonetheless travel with the assets to the purchasing corporation. See Note, *Successor Liability, Mass Tort, and Mandatory-Litigation Class Action*, 118 HARVARD L. REV. 2357 (2005).

2) Under the U.S. internal affairs doctrine, the law of the state of incorporation governs corporations.

and target corporations including: (a) the requirement that a majority of outstanding shares must vote to approve certain corporate control transaction and (b) appraisal rights. Delaware also provides for (c) enhanced scrutiny of whether transactions are consistent with director fiduciary duties in certain circumstances.

Delaware does not make voting or appraisal rights universally available for change in control transactions. In a statutory merger, the target shareholders typically receive voting and appraisal rights.[3] The acquiring company shareholders only receive voting and appraisal rights if 20% or more of the outstanding common shares are issued as part of the offering.[4] Both voting rights and appraisal rights decrease for other forms of corporate control transactions. In a purchase of substantially all the assets of the target company, the target shareholders receive the right to vote on the acquisition but no appraisal rights.[5] Delaware does not generally provide for voting approval or appraisal rights for the acquiring company's shareholders in an asset purchase transaction. In a tender offer, where the acquirer purchases the shares of the target corporation, the target shareholders receive neither voting nor appraisal rights.[6] Similarly, the acquiring company shareholders typically receive neither voting nor appraisal rights.[7]

What does choice mean in practice for change in control transactions involving Delaware companies? Those planning a change in control transaction may take advantage of choice to provide as much (or little) voting and appraisal rights as desired.[8] Companies that desire to avoid a vote and appraisal rights on the part of the target and acquirer shareholders, for example, may directly purchase the shares of the target company from the target's shareholders in a tender offer using cash consideration.

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3) Exceptions exist to appraisal rights. *See* Del GCL § 262(b)(1) (detailing the exception from appraisal rights for shareholders holding securities listed on a national securities exchange or held of record by more than 2,000 holders).

4) *See* Del. GCL § 251(f).

5) Del. GCL § 271

6) Other regulatory bodies may require additional protections, nonetheless. NYSE and Nasdaq rules require a shareholder vote where an acquiring corporation issues more than 20% of its current outstanding common stock, among other situations.

7) Situations can arise where the acquiring shareholders are entitled to vote. Where an acquiring corporation needs to issue more stock than authorized in its corporate charter in an acquisition using the acquiring stock as consideration, the acquiring shareholders must vote to authorize an amendment to the corporate charter.

8) *See* DALE A. OESTERLE, THE LAW OF MERGERS AND ACQUISITIONS (3d ed. Thomson West).

Delaware provides special rules for control transactions involving a controlling shareholder. Under Delaware law, controlling shareholders enjoy substantial freedom to profit from control. Target controlling shareholders are allowed to obtain a premium when selling their shares.[9] Controlling shareholders are also allowed to vote their shares in their own private best interest — for example, voting down a merger with a third party that increases the overall value for all shareholders but eliminates the controlling shareholders' private benefits for control. Despite this freedom, Delaware law imposes restrictions on controlling shareholders and directors of controlled corporations in certain control transactions. Controlling shareholders are prohibited from selling their control block to a third party where the controlling shareholder has reason to believe that the third party is "dishonest or in some material respect not truthful".[10] Controlling shareholders are prohibited from taking certain corporate opportunities for themselves.[11] Controlling shareholders may not use their influence to obtain a disproportionate dividend from the corporation greater than that given to minority shareholders.[12]

Controlling shareholders that attempt a squeezeout merger to eliminate the minority shareholders may, if minority shareholders protest, face scrutiny from a Delaware court under the strict entire fairness standard.[13] Under the entire fairness standard, a Delaware court will assess the procedures used to approve the squeezeout transaction (fair dealing) as well as substantive fairness of the deal for minority shareholders (fair price).[14] Where a majority of the minority shareholders approve the squeezeout transaction, the burden of proof in the entire fairness analysis rests with the dissenting minority shareholders.[15] Otherwise, the controlling shareholder

9) *See* Zetlin v. Hanson Holdings, Inc. 48 N.Y.2d 684 (1979).

10) *See* Harris v. Carter, 582 A.2d 222 (Del. Ch. 1990).

11) For the contours of the corporate opportunities doctrine as applied to controlling shareholders see Thorpe v. Cerbco, Inc., 676 A.2d 436 (1996).

12) *See* Sinclair Oil Corp. v. Levin, 280 A.2d 717, 720 (Del. 1971) ("Self-dealing occurs when the parent, by virtue of its domination of the subsidiary, causes the subsidiary to act in such a way that the parent receives something from the subsidiary to the exclusion of, and detriment to, the minority stockholders of the subsidiary."). Where self-dealing occurs, Delaware courts will apply the intrinsic or entire fairness test to the self-dealing transaction. *See* id.

13) *See* Kahn v. Lynch Communication Sys., Inc., 638 A.2d 1110 (1994); Orman v. Cullman, 794 A.2d 5 (2002).

14) For a description of the entire fairness standard see Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156 (1995).

bears the burden of proof.

Even in a squeezeout, controlling shareholders may keep undisclosed their top bid for the minority shares.[16] Furthermore, Delaware provides choice to controlling shareholders to avoid the enhanced scrutiny test. Controlling shareholders that desire to avoid the entire fairness test for a squeezeout merger may, for example, structure the transaction as a non-coercive tender offer to acquire the remaining minority shares. Delaware takes a much more permissive view toward non-coercive tender offers that work to cash out minority shareholders, eschewing the entire fairness test and allowing minority shareholders to determine for themselves whether to accept the tender offer price.[17]

In addition to state law provisions, the federal securities laws also apply to certain change in control transactions. For situations where a shareholder vote is required, the transmissions of proxy materials relating to the vote are regulated under the proxy rules of the federal securities laws. In a friendly merger or asset purchase where a shareholder vote is required, the target company must, among other things, complete a detailed disclosure form under Schedule 14A and distribute such disclosure form to investors prior to the vote. Where an acquiring corporation attempts to purchase stock of a target through a broad-based and public offer to shareholders in the market place at a fixed price, the purchase will be deemed a tender offer and fall under the Williams Act, a component of the Securities Exchange Act of 1934 (Exchange Act). Among other things, the Williams Act requires the acquirer to make certain disclosures,[18] keep the offer open to everyone for at least 20 business days,[19] give the best price to all tendering shareholders,[20] and allow withdrawal of tendered shares at any time while the tender offer is open.[21]

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15) *See* Weinberger v. UOP, 457 A.2d 701 (1983).

16) *See* Rosenblatt v. Getty Oil Co., 493 A.2d 929 (Del. 1985).

17) *See* Solomon v. Pathe Comm., 672 A.2d 35 (Del. 1996); *In re* Pure Resources, Inc., Shareholders Litigation, 808 A.2d 421 (2002). In a non-coercive tender offer, the controlling shareholder may fail, of course, to buy out all the minority shareholders. If the controlling shareholder succeeds in obtaining at least 90% of the common stock, the controlling shareholder can follow the tender offer with a short-form merger under Delaware GCL § 253 to eliminate the remaining minority shareholders.

18) *See* Section 14(d)(1), Exchange Act.

19) *See* Rule 14e-1(a), Exchange Act.

20) *See* Rule 14d-10(a)(1), Exchange Act.

21) *See* Rule 14d-7, Exchange Act.

2. Hostile Takeover Law

Two related problems face target shareholders in a hostile takeover. First, acquirers may use aggressive tactics to coerce target shareholders to tender their shares even when not in their own best interests. Second, defensive tactics, often installed to protect against coercive tender offer bids, can work instead to entrench target management at the expense of shareholder welfare.

Acquirers may coerce target shareholders into bidding through a number of ways. Consider a two-stage contingent tender offer.[22] Suppose a target's shares trade at $100 per share. An acquirer may make a tender offer for shares at $95 per share contingent on receiving 90% of the shares. The acquirer may then make it known that it will do a short-form merger[23] for the remaining shares, if it obtains the 90% block, at $80 per share.[24] In such a situation, investors will rush to tender their shares at $95, despite the previous market price of $100, to avoid the possibility of being a shareholder who receives only $80 in the second stage short form merger.[25]

While the Williams Act requires disclosure and implements procedural protections to reduce the time pressure to tender on shareholders, the Act does not alleviate the coercive aspect of two-stage contingent tender offers. Target management filled the gap left by the Williams Act with various defensive tactics to protect target shareholders from coercive tenders offers.[26] Through a poison pill, for

22) *See* Lucian Arye Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1693 (1985).

23) Delaware allows a Delaware corporation with a controlling shareholder with 90% or more of the equity shares to eliminate the minority shareholders without a vote through a short-form merger. *See* Del. GCL § 253. The minority shareholders nonetheless receive appraisal rights.

24) Appraisal rights will still apply for the minority shareholders in the short-form merger. *See* Del. GCL § 262(b)(3). Alternatively, the acquirer could simply make known that it will not purchase the minority shareholders — leaving the minority shareholders to worry that the acquirer will use its control to extract even greater private benefits at the expense of the remaining minority shareholders, reducing the value of the minority shares below $95 per share.

25) Of course, appraisal rights apply to the minority shareholders who are cashed out in the second-stage short form merger. To the extent appraisal rights provide equal or better value than the tender offer price, the coercive pressure to tender is removed.

26) In addition, many states enacted antitakeover statutes. For example, Delaware employs a business combination statute, limiting the ability of shareholders that acquires a 15% or more interest in a target company to

example, a target company may severely dilute the value of the shares of an acquirer who crosses a predetermined threshold of target share ownership. Acquirers, realizing that their shares face dilution, will choose not to acquire target shares above this threshold — allowing target companies to "just say no" to a hostile bid.

The use of hostile antitakeover devices by target management, ostensibly to block coercive tender offers among other things, however, also works to entrench target management from even value-increasing tender offers. Where target management use defensive tactics, target shareholders receive neither voting rights nor appraisal rights. Target shareholders receive no direct say in the decision to use defensive tactics. Instead, target shareholders are left only with the ability to go to court to challenge the use of antitakeover devices as inconsistent with the target boards' fiduciary duties under Delaware state law.

The range of defensive tactics is broad. Prior to the appearance of a hostile takeover, a company may enact amendments to the corporate charter requiring a supermajority vote to approve any merger. A company may also install staggered board of directors, delaying the ability of an acquirer to obtain majority control over the board. After the commencement of a hostile takeover, target companies have paid greenmail to make acquirers leave.[27] Target companies also will issue shares to friendly parties or a "white knight" third-party acquirer who will give the target managers (although not necessarily the target shareholders) better terms. Target companies may attempt to sell key "crown jewel" assets to third parties, reducing the desirability of the target company as a hostile takeover target. And by far the most popular technique today is to install a poison pill provision. Combined with a poison pill, a staggered board is a particularly effective defensive tactic. Because of the staggered board, acquirers that win a proxy contest are unable immediately to replace a majority of the board to redeem the poison pill, increasing the cost of a takeover and leading many potential acquirers never to make a hostile bid in the first place.

Delaware's response to defensive tactics has evolved over the past several decades, tracking the development of defensive tactics over time. Determining the

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enter in a transaction to combine with the target for three years unless the target's board gives prior approval of the combination. *See* DEL. CODE ANN. tit. 8, § 203(a)(2), (c)(5).

27) Greenmail payments were among the earliest defensive tactics, popular in the 1980s. Today, a number of states employ anti-greenmail statutes, prohibiting the use of payment of greenmail to relatively short-term shareholders. *See*, *e.g*., MINN. STAT. § 302A.553.

proper balance between allowing and removing target management defensive tactics is not easy. Too pro-defensive tactic a position will lead to high levels of management entrenchment. Too anti-defensive tactic a position will result in takeovers that may not necessarily improve on target shareholder welfare. The inquiry will also depend on the specific defensive tactic at issue and the facts of the particular hostile takeover.

Grounded in the fiduciary duties of the target directors, Delaware's case law has moved away from the permissive business judgment rule toward intermediate scrutiny of the target's decision to implement or continue defensive tactics in the face of a hostile bid. Under the *Unocal*-standard, directors of the target corporation may employ defensive tactics that are reasonable in relation to the threat posed by the takeover.[28)] The exact contours of the intermediate standard depend on the facts of the particular hostile acquisition. Where the target company puts itself up for sale, the target board must seek only to maximize the immediate return to the target shareholders pursuant to the *Revlon* decision.[29)]

Importantly, the market is constantly adjusting to Delaware case law. Delaware's judiciary plays a cat-and-mouse game with market participants in responding to both new innovative hostile takeover techniques and defensive tactics. For example, after Delaware courts allowed the use of poison pills, companies started to introduce variations on the pill including dead hand and no hand pills. Dead hand pills provide that only board members who originally adopted a poison pill may redeem the pill. Dead hand pills undermine attempts by acquirers to first use a proxy contest to remove the adopting directors and then second have the new directors redeem the pill to pave the way for a tender offer bid. Under a no hand pill, no one can remove the pill for a specified period of time following the announcement of a bid (committing the board to blocking the bid no matter the value of the bid for shareholders).[30)]

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28) *See* Unitrin, Inc. v. American General Corp., 651 A.2d 1361 (1995) (discussing the Unocal standard); *see also* Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140 (Del. 1989) (discussing Unocal threats against which a board may implement defensive tactics).

29) *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986). Whether Revlon applies turns on whether there is in fact a decision on the part of the target board to put itself up for sale in a transaction where shareholders will not get any subsequent control premium. See Paramount Communications v. QVC Network, 637 A.2d 34 (Del. 1994).

30) For a discussion of dead hand and no hand pills see Stephen M. Bainbridge, *Precommitment Strategies in Corporate Law: The Case of Dead Hand and No Hand Pills*, 29 J. CORP. L. 1 (2003).

Delaware eventually outlawed both the dead hand and no hand pills, although Georgia and Pennsylvania have taken more permissive positions.[31]

III. Korea

Korea has often looked to the U.S. legal regime as a model for how to regulate the Korean corporations and securities markets. Shortly after the U.S. Securities and Exchange Commission promulgated Regulation FD in 2000, for example, Korea followed suit with its own version of prohibitions against selective disclosures. Korea enacted a class action law that went effective in 2005 similar (although not identical) to the laws in the U.S. allowing class actions. Korea also employs a U.S.-Williams Act-style early warning system in requiring investors holding 5 percent or more of the equity securities of a public company to disclose to Korean Financial Supervisory Commission and the Korea Stock Exchange (KSE) within five days the purpose of their acquisition of shares, among other requirements.[32]

Simply adopting the laws of the United States, or any other country, may not provide the best laws for Korea.[33] Unlike the United States, many of the larger Korean companies are members of Chaebol conglomerate groups. Chaebol groups represent a large fraction of Korean's economy and stock market capitalization.[34] Typically forty to fifty firms will comprise a Chaebol group.[35] While shares of Chaebol companies often trade on the Korean Stock Exchange and other markets, the founding family of a Chaebol typically holds a controlling interest in each company

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31) *See* Camody v. Toll Brothers, Inc, 723 A.2d 1180 (Del. 1998); Invacare Corp. v. Healthdyne Tech, 968 F. Supp 1678 (ND Georgia, 1997); AMP v Allied Signal No 98-4405 LEXIS 15617 (Pennsylvania, 1998).

32) *See* http://www.korealaw.com/content/immigration/Immigration01_02.asp?cate=57 (last visited on July 3, 2007).

33) *See also* Ok-Rial Song, *The Legacy of Controlling Minority Structure: A Kaleidoscope of Corporate Governance Reform in Korean Chaebol*, 34 LAW & POL'Y INT'L BUS. 183, 187, 221, 244 (2002) (arguing that the transplant of U.S.-style corporate governance into Korea may not be effective without also reforms to the separation of votes and cash flow rights within Chaebols).

34) *See* Jeong Seo, *Who Will Control Frankenstein? The Korean Chaebol's Corporate Governance*, 14 CARDOZO J. INT'L & COMP. L. 21, 23-24 (2006) ("In 2002, chaebols were involved in an average of 19.2 industries, ranging 'from chips to ships.' In addition, public firms belonging to ten major chaebols accounted for more than 52% of stock market capitalization as of 2003.").

35) *See* Song, *supra* note 33, at 184.

within the Chaebol group. The controlling interest will usually include direct share ownership by the founding family as well indirect ownership through "pyramid" ownership in other companies that in turn own shares in the particular Chaebol company.[36)]

The pyramid ownership scheme in Chaebol groups leads to a large separation of voting and cash flow rights and magnifies the agency costs to minority shareholders.[37)] A controlling shareholder that owns 50% of Company A that in turn owns 50% of Company B will have control over Company B with only a 25% ownership interest in Company B. This divergence between control and rights to cash flows gives the controlling shareholder an outsized incentive to expropriate private benefits of control at the expense of Company B's minority shareholders.[38)]

Not only are agency problems within Chaebol firms exacerbated, but the legal and market mechanisms to limit such agency problems in Korea are weaker compared with firms in the United States. Regardless of the legal regime in Korea with respect to explicit defensive tactics, hostile takeovers are presently difficult in Korea due to the pyramid share holding schemes that concentrate voting power (but not cash flow rights) with the controlling shareholder. The controlling shareholder's pyramid control over each Chaebol firm provides a defensive tactic even more powerful than a poison pill. Similarly, proxy contests and other forms of shareholder vote are typically ineffective in disciplining the controlling shareholder in a Chaebol group. This Part canvasses three areas of possible reforms to improve on corporate governance within Chaebol firms.

36) While dual class stock is prohibited in Korea, the pyramid structure of ownership allows equally if not greater separation of cash flow rights and voting rights. *See* Song, *supra* note 33, at 199 (citing Korea's Commercial Act and Monopoly Regulation and Fair Trade Act).

37) *See* Song, *supra* note 33, at 199-201. Song also notes that "all companies in the chaebol designated by the Korean Fair Trade Commission are prohibited from acquiring or owning shares of stock of other domestic companies in excess of 25% of their net assets, and the amount of such net assets is calculated by subtracting the amount of the investment made by the affiliated firms. However, the enforcement of such a strict rule has rarely been observed in practice." *See id*. at 200-201. Note that the ceiling on affiliate share ownership was increased to 40% in 2007. Thanks to Professor Kon Sik Kim for this information.

38) *See* Seo, *supra* note 34, at 25-26 (reporting that "[i]n a typical Korean chaebol, the dominant family usually owns only a small equity share in the conglomerate — less than 10% of the total equity in many cases."). Seo provides examples of Chaebol private benefits of control, including mismanagement and outright expropriation of value through "tunneling" transactions. *See id*. at 52-56.

1. Fiduciary Duties

Due to the difficulty of takeovers, regulators may wish instead to focus on other mechanisms to improve corporate governance within Chaebol firms. For example, Korea could increase the fiduciary duties imposed on controlling shareholders. As discussed above, the United States imposes various limitations on controlling shareholders. Controlling shareholders may not usurp corporate opportunities or pay themselves a disproportionate dividend. In addition, controlling shareholders face court review under the strict entire fairness standard for squeezeout mergers (but not non-coercive tender offers).[39]

Despite the limits imposed on them, controlling shareholders enjoy substantial freedom in the United States. A controlling shareholder is under no duty to force the corporation to undertake any actions, even if maintaining the status quo is disproportionately in the controlling shareholders interest. Nor is any duty imposed on how a controlling shareholder votes its shares. Controlling shareholders may elect directors of their choosing to the corporation. When faced with a value-increasing merger proposal, a controlling shareholder may vote its shares to block such a proposal to further its own private interests. Controlling shareholders are also under no obligation to contribute more capital to a corporation, or sell or purchase their shares even if such actions will improve the welfare of all shareholders. When they do sell, controlling shareholders may receive a control premium for their shares not shared with minority shareholders. Control, in other words, is valuable.

Korean regulators may wish to focus more specifically on the agency problems involving controlling shareholders. The ability of controlling shareholders in Korean Chaebols to use their control to extract value through transactions between related companies in the Chaebol group provides a large source of the private benefits of control for the controlling shareholders.[40] Greater fiduciary limits on controlling shareholders will reduce such private benefits and thus lessen the benefits from

39) *See supra* note 17.

40) *See* Seo, *supra* note 34, at 75 ("Perhaps the reason that pyramidal group structures are relatively rare in the United States and the United Kingdom is that many transactions inside a group would be challenged on fairness grounds by minority shareholders of subsidiaries, who would get a receptive hearing in court.").

maintaining the pyramid ownership structures common in Chaebol groups.

Until the late 1990s, controlling shareholders enjoyed great leeway to extract private benefits of control in Korea. Among the reforms installed after the 1997 Financial Crisis, Korea imposed direct legal liability on controlling shareholders within Korea's corporate law.[41)] It is unclear how far direct liability will go in punishing controlling shareholders who act opportunistically and whether this punishment will deter such behavior. The ability of controlling shareholders to extract private benefits is wide ranging across a number of different transactions. Controlling shareholders may extract value through the hiring of family members at substantial salaries. Controlling shareholders may divert corporate opportunities away from Chaebol member firms in which they hold a lower fraction of the cash flow rights to firms where they hold a greater fraction. Controlling shareholders may order firms in the Chaebol to enter into self-dealing, intragroup transactions designed to increase the profit of firms in which the controlling shareholder holds a larger fraction of the cash flow rights.[42)] Controlling shareholders may attempt to repurchase minority shares at an overly large discount. And the list goes on.

Despite the institutional differences between Korea and the United States, the methods through which controlling shareholders in both countries extract private benefits of control are similar. While U.S. controlling shareholders lack the pyramid ownership structure, courts in the U.S. have long dealt with self-dealing transactions, usurpation of corporate opportunities, share repurchases from minority shareholders at inadequate prices and so on. Korea could therefore benefit in this particular area of substantive law from piggy-backing on the developed body of fact intensive law within Delaware on conflicted transactions with controlling shareholders.

41) *See* Song, *supra* note 33, at 224. *See* Commercial Act, art. 401-2 (Korea).

42) The Monopoly Regulation and Fair Trade Act (MRFTA), as administered by the Korean Fair Trade Commission (KFTC) in Korea governs intra-group transactions. The MRFTA requires approval of transactions where the amount of the transaction exceeds 10% of the firm's capital or 10 billion won by the board of directors of involved companies. In addition to approval, the Chaebol must disclose the transaction to the public. The KFTC is also given the authority to review the transaction and can either block or adjust the transaction or impose a surcharge of up to 5% of the sale price on the purchasing company. *See* Seo, *supra* note 34, at 77 (citing the MRFTA, art 11-2(1)). Problems exist with the MRFTA procedure. The purpose of the MRFTA regulation of intra-group transactions is not to protect minority shareholders. Instead, as Seo notes "it is rather intended to protect competitors of a preferentially treated party." *See id*. (citing MRFTA, art. 23(1); 24;24-2). Any KFTC review will not necessarily result in the protection of minority shareholders.

Indeed, in addition to mere piggybacking, Korea could consider expanding the fiduciary duties placed on controlling shareholders. The division between permissible and impermissible actions on the part of controlling shareholder in the United States does not necessarily represent the best division for Korea. The present high level of entrenchment among Chaebol controlling shareholders in Korea argues for some amount of expansion of fiduciary duties. In the United States, one might worry about the increased probability of frivolous suits that may come with an expanded set of fiduciary duties. As well, expanded fiduciary duties on controlling shareholders may deter some from becoming controlling shareholders in the first place, exacerbating agency problems involving managers at companies with dispersed shareholders. Korea's situation however is different. The problem in Korea is not agency costs involving managers with dispersed shareholders but rather with large controlling shareholder blocks. Because control shareholder blocks already exist, the cost of deterring their formation is less important in Korea.

What sorts of enhanced fiduciary duties are possible? Korea, for example, could consider applying a strict enhanced scrutiny review of large Chaebol intragroup transactions (above a specified won amount) that are not approved by a majority of the minority, non-Chaebol shareholders. Similarly, Korea could implement a strict corporate opportunity doctrine, prohibiting a controlling shareholder from using any opportunity derived from a Chaebol firm regardless of whether the opportunity is in the Chaebol firm's line of business.

Rather than give controlling shareholders of a Chaebol complete freedom to vote their shares and obtain a control premium on the sale of their shares, Korea could also take a different stance than the United States. The Essay discusses below one proposal to alter the incentives on how controlling shareholders vote their shares in the context of a hostile takeover.

2. Shareholder Litigation

In addition to strengthening fiduciary duty standards, Korean regulators may consider increasing the private enforcement of fiduciary duty standards through derivative suits and securities class actions. Korea recently enacted the Securities Class Action Act (SCAA) that went effective in 2005. The SCAA allows investors to bring a class action against publicly-listed companies for a defined list of investor harms, including insider trading, share manipulation, and misrepresentations in a securities offering registration statement or periodic filing.[43)]

While Korea has implemented a class action law, the law as presently designed is unlikely to generate many law suits. In Korea, public companies in Korea are generally smaller in size compared with public companies in the United States. Consider the range of companies trading on the KSE. In 2002, there were 683 companies listed on the KSE. The largest company listed on the KSE, Samsung Electronics, had a market capitalization of U.S. $39.1 billion. Market capitalizations dropped rapidly, however, after Samsung Electronics. The tenth largest firm, Samsung Electro-Mechanics, had a market capitalization of U.S. $2.5 billion in 2002. After taking away the thirty largest market capitalization firms, the remaining 653 listed firms had an average market capitalization of only U.S. $83.4 million. In 2002, the entire NYSE had a global market capitalization of $13.4 trillion and about 2783 listed firms, giving an average market capitalization of $4.82 billion.

Evidence exists that plaintiffs' attorneys file suit primarily against larger issuers, offering greater securities damage awards, in the United States. Whatever the loss in deterrence caused by the tendency of plaintiffs' attorneys to file suit only against larger companies in the U.S., the problem is only magnified in Korea. Samsung Electronics would likely qualify under even the most stringent size screens employed by U.S. plaintiffs' attorneys. Perhaps not coincidentally, the second derivative suit in Korea where shareholders won a judgment against directors of a Korean corporation was against Samsung Electronics. Nonetheless, Samsung Electronics is an outlier in terms of market capitalization among KSE-listed firms. It is unclear what impact a class action regime will have in Korea outside of the top thirty listed firms on the KSE.

In the United States the laws governing securities class actions depend on the presence of a robust plaintiffs' attorneys bar to bring such class actions. In comparison, the lack of any professional plaintiff firms in Korea exacerbates the lack of class action enforcement. The number of practicing attorneys is much lower in Korea. As of the early 2000s, South Korea had only about five thousand practicing attorneys serving a population of forty-eight million people.[44)] In contrast, the state of

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43) For a description of Korea's securities class action law see Dae Hwan Chung, *Introduction to South Korea's New Securities Class Action*, 30 J. CORP. L. 65 (2005).

44) *See* Misasha Suzuki, *The Protectionist Bar Against Foreign Lawyers in Japan, China, and Korea: Domestic Control in the Face of Internationalization*, 16 COLUM. J. ASIAN L. 385, 391-92 (2003).

California has approximately 157,710 active attorneys providing services for a population of over thirty-five million people.[45)]

Regulators may wish to consider ways of improving on the derivative suit and class action regime in Korea. One possibility is for regulators to provide fixed bounties for plaintiffs' attorneys who successfully bring a derivative or class action suit. Regulators could set the fixed bounty at an amount sufficient to cover the fixed costs of litigation and provide a profit above these costs for plaintiffs' attorneys. Even if the damages from such an action are small, due to the relatively small market capitalization of many Korean companies, a fixed bounty to cover the fixed costs of litigating a class action suit may increase the incentive of some attorneys to file class action suits. With sufficient bounties, some attorneys may choose to specialize as plaintiffs' attorneys. With the rise of specialized plaintiffs' attorneys will come increased expertise in assessing corporate actions and monitoring of public companies for activities harmful to minority shareholders.

3. Hostile Takeovers and Reverse Tag-Along Rights

Even with a more vigorous fiduciary duty regime to control agency costs among non-Chaebol firms, developing a strong takeover regime is important. Not all actions on the part of managers that reduce shareholder value are the same. Managers may extract value over time by, for example, shirking at their work. Other managers may extract a large amount of value in one isolated transaction, such as transferred a corporate asset to themselves at a bargain price. A fiduciary duty regime works best to stop isolated and large expropriations of value (through a self-dealing transaction for example). Fiduciary duties work less well in disciplining managers that engage in mismanagement or low levels of expropriation over a large number of transactions and decisions. Takeovers, on the other hand, because of the focus on overall share price and not any particular transaction, work better at deterring low level (but in the aggregate egregious) expropriation of private benefits of control.[46)]

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45) The State Bar of California, Membership Demographics, at http://members.calbar.ca.gov/search/demographics.aspx (visited on December 3, 2003).

46) Song similarly makes the point that not all costs controlling shareholders impose on minority shareholders are the same. While rules focusing on misappropriation of assets, insider trading, and self-dealing work well, according to Song, other costs are not so easy to reduce. *See* Song, *supra* note 33, at 239. Song notes that the large

Hostile takeovers involving Chaebol group firms presently face enormous hurdles.[47] Korea has made changes over the past 15 years that have increased the possibility for takeovers. In 1994, Korea repealed Article 200 of the former Security Exchange Act, allowing outside investors to retain more than 10% of a firm's equity.[48] Since the Asian Economic Crisis in 1997, various limitations on foreign investors have also been lifted, opening up Korea's market to a new set of investors more willing to engage in aggressive tactics to improve corporate governance and share value.[49] In 2004, Korea began to allow domestic private equity funds.[50] Korea also repealed a provision requiring acquirers that acquired more than 25% of a target's shares to make a bid for a majority of the shares.[51]

Despite the reforms in Korea, hostile takeovers against Chaebol firms remain a daunting undertaking in Korea today due to the voting power of controlling shareholders. Normally a hostile takeover is difficult against a Chaebol firm because the controlling shareholder can use its direct and indirect (through other affiliate firms in the Chaebol group) votes against a merger. While the total voting power of a controlling shareholder is typically less then 30%, the large block of votes against a merger raises the cost to a potential acquirer seeking to acquire sufficient votes among the remaining shares — particularly to the extent some of the remaining shares are in the hands of parties friendly to the incumbent controlling shareholder (such as financial institutions and vendors).[52] In response, regulators in Korea may

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degree diversification present within Chaebol businesses will likely persist absent a more radical change to the alignment of voting and cash flow rights (or, alternatively, government direct intervention). *See id*.

47) *See* Song, *supra* note 33, at 211 ("[O]ne of the most important barriers to hostile takeovers is the CM structure itself. Because the controlling shareholders have over 40% of outstanding voting power, the bidder has to acquire almost all of the remaining shares.").

48) *See* Seo, *supra* note 34, at 68.

49) *See* Seo, *supra* note 34 at 68.

50) *See* Hee Chul Kang, *The Current State of Equity Investments By Foreign Funds [In South Korea] and* Related Legal Issues, 15 PAC. RIM L. & POL'Y 73, 86 (2006).

51) *See* Bernard Black et al., *Corporate Governance in Korea at the Millennium: Enhancing International Competitiveness: Final Report and Legal Reform Recommendations*, 26 J. CORP. L. 538, 555 (2001).

52) For a discussion of takeover activity in Korea and the vulnerability of Korean Chaebol groups of hostile takeovers see Hwa-Jin Kim, *A Tale of Three Companies: The Emerging Market for Corporate Control in Korea*, *in* A DECADE AFTER CRISIS: TRANSFORMING CORPORATE GOVERNANCE IN EAST ASIA (Hideki Kanda, Kon Sik Kim & Curtis Milhaupt eds., Routledge, 2008) ("Numerous companies that belong to corporate groups are already free from any hostile takeover attempts because the recourse is available for them through the means of cross and circular shareholdings and complicated ownership structure.").

wish to alter the incentives of controlling shareholders of Chaebol firms faced with a hostile bid. As discussed above, Delaware takes an intermediate position with respect to target company defensive tactics. While the business judgment rule is not applied, courts eschew applying an entire fairness standard. Instead, an intermediate standard of review is applied following *Unocal*, *Revlon*, and other major Delaware cases.

Korea may wish to go a step further than Delaware law given the entrenchment of the controlling shareholders at the Chaebol corporations. One tender offer provision increasingly popular among other countries is the provision for mandatory bid rights in a tender offer, sometimes referred to as tag-along rights.[53)] The European Union takeover directive, for example, provides that a person who acquires control must make a bid for the remaining minority securities at an equitable price.[54)] If an outside acquirer obtains more than a specified percentage of a target's equity (for example, many EU member states set the threshold at 30 or 33% of the voting rights),[55)] then the acquirer must purchase the remaining shares at the same or equitable price. Tag along bid rights prevent the acquirer from profiting through the extraction of value from minority shareholders who do not tender their shares in a first stage of a tender offer. Tag along rights not only protect minority shareholders, they help ensure that the acquirer who obtains control of the target company through a tender offer in fact values the entire enterprise more than the target shareholders. Acquirers that do not value the target more highly will be unwilling to pay the same high price to all the target's shareholders. Tag along rights therefore have the virtue of ensuring that assets move to those who value them more highly.

Commentators on Korean corporate governance have supported the adoption of tag along rights in Korea.[56)] Regulators may use a modified version of tag along rights to alter the incentives of the controlling shareholders and improve the efficient

53) *See* John C. Coffee, Jr., *Racing Towards the Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance*, 102 COLUM. L. REV. 1757, 1808-11 (discussing tag along rights in Brazil and Mexico).

54) *See* Zsofia Kerecsen, *Regulation of Takeover Bids in the European Union* (presented at 2007 KDI Conference on the Market for Corporate Control: Comparative Perspectives).

55) *See id*.

56) *See* Black et al., *Corporate Governance in Korea at the Millennium*, 26 J. CORP. L. 537, 605 (2001) (proposing that "a mandatory offer for the company's remaining ordinary shares following acquisition of a controlling interest by any such company, person or group of affiliated persons, unless the obligation to make such an offer is waived by majority vote of the shareholders who would otherwise be entitled to accept the offer").

allocation of resources in Korea. In particular, regulators could force controlling shareholders that reject a hostile acquisition bid to put money behind their rejection. Under this proposal (termed here “reverse tag-along rights”), those who vote against a hostile bid would have an obligation to repurchase a specified fraction of the shares of those who voted for the hostile bid at the bid price. The proposed reverse tag-along rights would treat the controlling shareholder in rejecting the bid price of a hostile acquirer as implicitly deciding to purchase its own shares at the bid price. The reverse tag-along rights would then force the controlling shareholder to offer this same bid price to the target minority shareholders. If the controlling shareholder truly believes that the bid is inadequate and that the corporate value is greater than the bid price, the controlling shareholder will profit from purchasing additional shares at the bid price. On the other hand, the share purchase provision will impose a penalty on those controlling shareholders that reject the bid not because they believe it undervalues the company but instead to maintain their own private benefits of control.

A reverse tag-along rights scheme is not without costs. Some hostile acquirers may seek to abuse the rule by filing false tender offer bids, seeking to harass the controlling shareholder of a Chaebol and drain the controlling shareholder of its cash resources. Even in a legitimate bid, the controlling shareholder of a Chaebol may lack the liquid resources to buy back the necessary number of shares from the minority shareholders. Even in situations where the target corporation is in fact worth more than the hostile bid price, the lack of liquidity may cause the controlling shareholder to acquiesce to the bid. The controlling shareholder may also not wish to take such an undiversified position in any one company.

While these complaints are legitimate, at least two responses are possible. First, the deep entrenchment of the Chaebol firms and their current insulation from hostile bids coupled with the ineffectiveness of current private rights of action in Korea lead to large private benefits of control. The need to reduce such private benefits is correspondingly greater in Korea compared with countries with stronger corporate governance protections. Not only are shareholders harmed, but the general economy is harmed from the inability to move corporate assets to their highest value use due to the concern of controlling shareholders to maintain their private benefits of control. While not all hostile bids may improve on shareholder welfare, the entrenched private benefits enjoyed by Chaebol controlling shareholders and the benefit from moving assets to more efficient uses counsel in favor of a radically more protakeover regime.

Second, procedural protections are possible to alleviate some of the concerns of a reverse tag-along rights regulatory requirement. Government regulators may intervene to moderate the level of market pressures imposed through reverse tag-along rights. Consider, for example, the following three step process that Korea could impose on hostile bids for control:

(1) In the first step, a government regulatory body such as the Korean Financial Supervisory Commission (KFSC) or other regulatory decisionmaker (such as the KSE) could assess the hostile tender offer bid. Introducing a government regulator to make an initial assessment does not necessarily mean that the government controls the substantive terms of takeovers. Instead, government regulators could play a more limited role. In the United States, courts often have the final say in hostile takeover battles, determining whether and when fiduciary duties require the board to lift its defensive tactics. This determination, however, focuses only, in a non-auction situation, on the question of whether the defensive tactics are reasonable in relation to the threat posed by the hostile takeover bid to target shareholders and corporate policy.[57]

Korean regulators may make a similarly limited assessment of the acquirer and the acquisition bid. Korean regulators, for example, could take into account the reputation of the bidder, assessing whether there is a true motivation to acquire the company versus a desire simply to harass the controlling shareholder of the company. The initial assessment can also look at whether the bid price is likely to be adequate, taking into account the performance of the target company relative to comparable companies. Because of the possibility of regulatory error in assessing the fairness of a bid price, such a review should not impose too stringent standards. Instead, so long as the bid is within the range of possible bid prices that a shareholder might accept, the bid should be allowed to go forward. To provide for consistency (and to limit the possibility of a regulatory decisionmaker from choosing to block a hostile bid for reasons other than overall shareholder welfare), the regulatory decisionmaker could be

57) *See supra* note 28 and accompanying text.

required to write up a set of reasons for its decisions. Potential hostile bidders could then review these reasons to predict how future bids may fare.

(2) In the second step, shareholders of the corporation should be given the ability to vote as a group on the hostile tender offer bid. The ability to vote as a group provides another layer of protection for the target shareholders against coercive tender offer bids.[58] So long as the vote is separate from the decision whether to tender or not, the vote of the group of shareholders provides an effective deterrent to coercive bids. If the vote approves the tender offer, the tender offer should proceed.

(3) In the third step, if the hostile bid fails (either because the target shareholder vote did not approve the bid or insufficient shares were tendered in the case of a contingent bid), those shareholders who voted against the bid would become obliged to make an offer to purchase a predetermined fraction of the shares of those who voted for the bid and tendered their shares. Shareholders who supported the hostile bid, at their choice, could either sell to the shareholders opposing the bid or, in the alternative, keep their shares. Regulators can adjust the purchase fraction to take into account liquidity problems. For small-size hostile bids, for example, those who voted against the bid could be made to repurchase all of the shares of those in favor of the hostile bid. For larger bids where liquidity is an issue, those who oppose could be forced to repurchase only a fraction (say one-quarter for example) of the shares of those who favor the bid.

Variations are possible on the reverse tag-along provision. If regulators are able to identify those shareholders who are in control, the regulators could

58) *See* Lucian Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973, 982 (2002) ("A voting mechanism provides a 'clean' way of enabling shareholders to express separately their preferences [in relation to whether a takeover should go ahead, and whether they want their shares acquired under the takeover]."); Lucian Bebchuk, *Towards Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1695, 1697-98 (1985) ("According to the undistorted choice objective, a target should be acquired if and only if its shareholders, or at least shareholders holding a majority of its shares, judge the offer acquisition price to be higher than the independent target's value.").

> place the obligations of the reverse tag-along provision only on these identified controlling shareholders. On the other hand, some non-controlling shareholders may vote against a bid out of pre-existing arrangements with the controlling shareholder. For example, one Chaebol group may own a minority position in another Chaebol's company and agree to vote against a tender offer in return for a separate side payment. Placing the reverse tag-along burden on all shareholders who vote against a tender offer would help deter separately negotiated side deals providing support for a controlling shareholder.
>
> As another variation, regulators may wish to apply reverse tag-along rights only if a majority of minority, non-controlling shareholders either vote for the tender offer in step two or tender their shares in step three. Some bids may fail simply because the shareholders believe that the bid is inadequate. By requiring that a majority of minority shareholders either vote or tender their shares in favor of an offer, regulators provide another check against inadequate bids and impose the burden of tag-along rights on controlling shareholders only when the minority shareholders demonstrate that they in fact value the initial tender offer bid.

One may wonder whether any acquirers will appear even if Korea opens Chaebol companies up to more hostile bids in the future using a reverse tag-along rights rule. Significantly, hostile takeover attempts do occur in Korea today, although infrequently. Kumkang Korea Chemical Co., Ltd. (KCC), for example, recently launched a hostile takeover attempt of Hyundai Elevator, Inc.[59] The growing influence of large institutional investors, particularly foreign funds, provides the prospect of financially-well backed bidders in the future. Since 1997, foreign investment in Korean equity has grown rapidly. As of 2004, foreigners owned over 40% of the total aggregate market capital in the Korean securities market.[60] Foreign funds represented about half of the foreign invested capital.[61] Foreign private equity funds have already taken concentrated positions in Korean companies, sometimes with control. Management control in Korea First Bank, KorAm Bank, and Korea

59) *See* Kang, *supra* note 59.

60) *See id*. at 80.

61) *See id*. at 80.

Exchange Bank has changed hands in recent years.[62] In addition, the Korean government recently amended the Act on Business of Operating Indirect Investment and Assets to allow for more domestic private equity funds.[63]

Another objection to reverse tag along rights focuses on the overall desirability of hostile acquisitions from the perspective of society as a whole. Labor union and employees will likely resist hostile takeovers into the future in Korea,[64] adding political pressure against such takeovers. Regulators at the Fair Trade Commission of Korea have stated: "[I]t will not be acceptable, socially and politically, if frequent and massive downswings and restructuring of corporations by M&A activities result in a serious unemployment problem."[65]

Against the interests of labor unions and employees is the possibility that hostile takeovers, by increasing overall efficiency within Korean corporations will result in faster economic growth, more job creation, and higher standards of living for all Koreans. While special interests opposed to hostile takeovers are vocal, the broader beneficiaries from faster economic growth are less vocal. It is unclear, therefore, whether the objections of unions and displaced employees should represent the preferences of Korean society as a whole. Even if they do, the disruptions caused to unions and employees are not unique to hostile takeovers. Friendly acquisitions occur. And even without an acquisition, companies can reorganize in ways that dramatically affect worker welfare. It is also unclear therefore why hostile takeovers are singled out as disruptive in particular to unions and employees.

An important impact of hostile takeovers is on the structure of Korean Chaebol groups. Strong fiduciary duties against intra-group transactions coupled with a more permissive takeover environment will put pressure on group structures that are put together less for efficiency reasons and more to benefit the controlling shareholders of the group. Regulators, of course, could simply mandate a change in the present pyramid ownership scheme within groups. Korea, for example, presently places ceilings on intra-group shareholding. These ceiling provide a crude way to reduce the influence of a controlling shareholder in a pyramid ownership structure by depriving

62) *See id*. at 74.

63) *See id*. at 74.

64) *See id*. at 86.

65) *See* Seo, *supra* note 34, at 68 (citing the Fair Trade Commission of Korea).

group companies of voting power in other group companies.[66] The government also attempted to require Chaebols to identify their primary industry and "voluntarily" exchange some of their non-primary businesses in what is referred to in Korea as the "big deal".[67]

However, regulators may make mistakes. Government regulators may not have full information on the value of bringing certain types of operating companies together nor the expertise to determine the best financial ownership structure. While the pyramid scheme of ownership of the Chaebol groups appears to allow controlling shareholders to expropriate large levels of private benefits of control, perhaps such structures allow for synergies between group companies.[68] Commentators have observed that the ceilings may result in inefficiencies, limiting the ability of Chaebol firms to establish new subsidiaries to take advantage of limited liability to engage in specific new business operations.[69] Rather than mandate any particular control

66) Seo describes the limits as follows:

> The MRFTA limits individual affiliated companies from holding other affiliated companies' equity when the companies belong to an enterprise group with more than 6 trillion won (equivalent to $6 billion) in assets. Such an enterprise group is defined as a shareholding-capped enterprise group. More specifically, a member company of the shareholding-capped enterprise group cannot acquire other affiliated companies' shares surpassing 25% of its net assets. The net assets of a company refer to the amount obtained by subtracting the amount of equity investment made by the company's other affiliates in the company from the larger amount between the company's capital sum and equity capital.

Seo, *supra* note 34, at 60-61. *See id*. at p. 56-57 ("With the reinforcement of the ceiling on intra-group shareholding in 2001, the Chey family became unable to exert leveraged voting power on the SK Corp. through the member companies, such as SK C&C. Of the 10.83% of the SK Corp.'s shares owned by SK C&C, approximately 9.5% were deprived of voting rights. As a result, the family would have lost control over a large part of the conglomerate."). Note that the ceiling on affiliate share ownership was increased to 40% in 2007. Thanks to Professor Kon Sik Kim for this information.

67) *See* Song, *supra* note 33, at 222. Song observed though that: "[O]nly a few of the big deals have been completed at present. Meanwhile, Chaebol have no stopped diversifying their investments." *Id*. at 222.

68) *See* Seo, *supra* note 34, at 26 (noting that "the potential dissipation of corporate wealth cannot explain the surging popularity of at least some chaebol firms among investors. For example, Samsung Electronics, a core company of the Samsung chaebol, accounts for 18.18% of capitalization in the Korean stock market as of March 2005."). Seo goes on to remark that the Chaebol structure may be useful in reducing the agency cost from the rising use of professional managers to run corporations in Korea. *See id*. at 28-29, 49 (mentioning the failure of Kia Motors as an example of the dangers associated with professional managers). *See also* Song, *supra* note 33, at 185 (noting that "the Chaebol system has historically produced some great successes.").

69) *See* Seo, *supra* note 34, at 64 (noting the possibility that "a firm may abandon a risky yet profitable project because of limitations on equity-holding.").

structure, allowing the market to determine for itself the value of the Chaebol control structure (with background fiduciary duties to control obvious attempts to grab value through conflicted transactions) introduces an alternative decisionmaker with better expertise and incentives to adjust ownership structures to maximize shareholder welfare.[70] Providing a mechanism, such as reverse tag-along rights, to expose the Chaebol pyramid ownership structure to greater market discipline has the promise of allowing value-increasing pyramid structures (if any) to remain intact while unwinding value-decreasing structures.

Exposing Chaebol companies to the limited possibility of a hostile takeover provides for a market mechanism to determine the optimal organization of Chaebol firms. The proposed reverse tag-along rights do not force controlling shareholders to divest themselves of any specific Chaebol firm. Instead, reverse tag along rights simply impose market discipline on Chaebol ownership structures. If a particular firm is truly at maximum value within a Chaebol, the controlling shareholder will match any hostile bid for control. If not, then the firm and its shareholders are better off outside of the Chaebol. The reliance on a regulatory authority, such as the Korean FSC or the Korea Stock Exchange, to impose some limits on hostile bids reduces the problems of opportunism on the part of bidders that may come with a reverse tag along rights regime. While problems still exist, the deeply entrenched nature of the Chaebol pyramid ownership structure and the more error-prone alternative of relying on government direct intervention argue for using limited market pressures to restructure the Chaebol groups when possible, as within a reverse tag along rights regime.

IV. Conclusion

Korea's economy has been dominated by Chaebol groups for the past several decades. Following the 1997 Asian financial crisis, foreign investment and deal activity escalated rapidly in Korea. Given the predominance of Chaebol firms in

70) In contrast, Korea's government policy in the 1960s and 1970s largely led to the creation of the Chaebol structure in the first place. *See* Song, *supra* note 33, at 185-186. While the Chaebol structure at the time may have had value for Korea's then less developed economy, it is unclear whether this value still exists today. Implementing reverse tag-along rights would allow the market to assess whether the Chaebol continues to have such value.

Korea's economy, this Essay observes that important institutional differences between Korea and the United States (the model for many of Korea's recent corporate governance-related reforms, such as Regulation FD and Sarbanes-Oxley Act-like reforms). Controlling shareholders dominate Korean Chaebol firms. Irrespective of whether Korea eventually adopts poison pills and other defensive tactics, the large control position of the Korean Chaebol firms represent a potent antitakeover defensive tactic, shielding Chaebol firms from market pressures. Korea also lacks a specialty corporate court and a well-developed plaintiffs' attorney bar. These differences call for a different emphasis in the package of laws controlling agency costs within Korean firms.

Deciding upon the exact package of laws that is optimal for Korean companies is a challenging task — particularly since market participants are constantly evolving the techniques used in corporate control transactions. The Essay makes several suggestions — including expanded fiduciary duties, fixed bounties for private class action attorneys, and "reverse" tag-along rights for minority shareholders in the case of a failed hostile takeover bid against a Chaebol member firm.

KEY WORDS: Hostile Takeover, Controlling Shareholder, Shareholder Litigation, Reverse Tag-along Right, Chaebol