

# The Case for Market for Corporate Control in Korea\*

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## Abstract

*This Article offers an assessment of the preliminary evidence that the market for corporate control functions as a disciplinary mechanism for poor corporate governance in Korea. It analyzes SK Corporation's fight against Sovereign Asset Management, contest for control over the Hyundai Group, KT&G's fight against Carl Icahn, and LG Group and Carlyle's proxy contest against Hanaro Telecom, together with relevant laws and regulations. These high-profile cases dramatically exemplified the role of takeovers in the improvement of the corporate governance of Korean companies, and brought about active policy discussions in respect of the market for corporate control and takeover defenses. This Article will also provide a quick overview over the provisions in draft new Korean Commercial Code related to the market for corporate control and takeover defenses, including squeeze-out, poison pills, and dual-class commons. This Article argues that as the increasing exposure of control to the market could eliminate the inefficient controlling shareholder system in Korea, the new Korean Commercial Code should strike a balance between the active market for corporate control and effective takeover defensive tactics for the benefit of all shareholders and the value of the company.*

## I. Introduction

Korea may be qualified as one of the “inefficient controlling shareholder systems” under the taxonomy proposed by Professor Ronald Gilson.<sup>1)</sup> Recent

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1) See Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641 (2006); Ronald J. Gilson, *Controlling Family Shareholders in Developing Countries: Anchoring Relational Exchange*, 60 STAN. L. REV. 633 (2007).

research shows that the average of controlling family ownership for public firms in Korea was 29.51%, compared with controlling families' cash-flow rights of 8.42%. In the case of Samsung Group, the largest Korean conglomerate, those numbers were 13.52% and 1.14%, respectively, for public firms in the group.<sup>2)</sup> The private benefit of control is also relatively high in Korea. The value of corporate control amounts to about 34% of firm market value in Korea, as compared to about 29% in Italy, 1% in Denmark, 9% in Germany, and 2% in the United States.<sup>3)</sup> The poor corporate governance practices of some large Korean firms are responsible for the still-continuing discussions on how to abolish the "Korea discount,"<sup>4)</sup> i.e., how to eliminate or reduce agency costs in the inefficient controlling shareholder system.

One of the solutions to the problem may be the increasing exposure of corporate control to the (global) market.<sup>5)</sup> This requires Korea to facilitate corporate takeovers and promote the market for corporate control. As a

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2) James Jinho Chang & Hyun-Han Shin, *Family Ownership and Performance in Korean Conglomerates*, 15 PACIFIC-BASIN FIN. J. 329 (2007) (also reporting that the average ownership of the controlling shareholders of non-public member firms of Samsung Group was 78.43%, whereas their cash-flow rights were as low as 19.43%). See also Kee-Hong Bae et al., *Tunneling or Value Added? Evidence from Mergers by Korean Business Groups*, 57 J. FIN. 2695 (2002); E. Han Kim & Woochan Kim, *Changes in Korean Corporate Governance: A Response to Crisis*, J. APP. CORP. FIN. 47 (Winter 2008).

3) See Tatiana Nenova, *The Value of Corporate Voting Rights and Control: A Cross-Country Analysis*, 68 J. FIN. ECON. 325 (2003).

4) The origin of this concept traces back to the 1997 financial crisis. See Sang Yong Park, *Value of Governance of Korean Companies: International Investors Survey* (April 1999) (on file with the author).

5) Cf. Gilson, *supra* note 1, at 1676-1677. Other strategies suggested by Professor Gilson are improving the legal system and improved access to global capital markets. See *id* at 1673-1678. For cross-listing of Korean companies on foreign exchanges, see Hwa-Jin Kim, *Cross-Listing of Korean Companies on Foreign Exchanges: Law and Policy*, 3 J. KOREAN L. 1 (2003). As of March 2009, eight Korean companies have listed their ADRs on the New York Stock Exchange: KB Financial Group, Korea Electric Power Corporation, KT Corporation, LG Display, POSCO, Shinhan Financial Group, SK Telecom, and Woori Finance Holdings. Thus far, no study has been made on the effect of the Sarbanes-Oxley Act of 2002 on cross-listed Korean firms. See generally, Kate Litvak, *Sarbanes-Oxley and the Cross-Listing Premium*, 105 MICH. L. REV. 1857 (2007); 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 (2002); Amir Licht, *Cross-Listing and Corporate Governance: Bonding or Avoiding?*, 4 CHI. J. INT'L L. 141 (2003); Darius P. Miller, *The Market Reaction to International Cross-listings: Evidence from Depository Receipts*, 51 J. FIN. ECON. 103 (1999).

matter of fact, contested mergers and acquisitions emerged in the business world of Korea in the mid-1990's and have since served as a popular topic for the media. The surprising takeover of Hannong Corporation by Dongbu Group in 1994 opened the gate for such transactions in Korea. This was followed by the abolition of the statutory protection of control as of April 1, 1997. In recent years, two or three hostile takeover attempts have taken place every year, even targeting member companies of the largest corporate groups like Hyundai and SK. The largest company in Korea, Samsung Electronics, is also said to be vulnerable to potential takeover threat by foreign competitors and/or hedge funds. KT&G's fight against Carl Icahn and Steel Partners in early 2006 provoked public discussions on the market for corporate control and hedge fund activism in Korea.

This article describes and analyzes the current status of corporate control in Korea by summarizing four recent cases together with relevant laws and regulations: SK Corporation's (SK's) fight against Sovereign Asset Management, contest for control over the Hyundai Group (Hyundai), KT&G's fight against Carl Icahn and his allies, and LG Group and Carlyle's proxy contest against Hanaro Telecom. This article, in particular, focuses on the role of takeovers in the improvement of the corporate governance of Korean companies as dramatically exemplified by the cases. Active policy discussions in respect of the market for corporate control and takeover defenses and the reshaping of large corporate groups are all on-going in Korea and should lead to new legislation. This article will provide readers with a quick overview over the provisions in draft new Korean Commercial Code related to the market for corporate control. The draft bill includes some important institutions such as squeeze-out, poison pills, and dual-class commons. As it was the case in the United States and other jurisdictions, many of the important developments in Korean corporate law are emerging out of judicial decisions in the context of corporate control contest. The new institutions, once finally adopted, may lead to significant number of litigations, and Korean corporate law will open a new era in its dynamic evolutionary process.

## II. The Setting

### 1. Corporate Governance and Takeovers

It is well known through numerous reports and scholarly works that many efforts to improve the corporate governance system of Korean companies have been undertaken since the 1997 Asian financial crisis.<sup>6)</sup> The Korean Securities and Exchange Act (KSEA) which stipulated rules governing public companies regarding their corporate governance went through 16 revisions since 1997, and the Korean Banking Act 11 revisions. The Korean Commercial Code (KCC) has also been subject to five revisions and is currently being scrutinized again for another major amendment.<sup>7)</sup> It is also noteworthy that various sectors have continuously engaged in endeavors to improve the corporate accounting practice and capital market structure as evidenced by the enacting of the Securities Class Action Act, *inter alia*.<sup>8)</sup> Legislators have also integrated the seven individual acts covering the capital market and are working on developing a new infrastructure for developing investment banks in the Korean capital markets.<sup>9)</sup> On February 4, 2009, the new Korean Financial Investment Services and Capital Market Act (KFISCMA) went into effect, which also substitutes the KSEA. The KSEA rules governing corporate governance of public companies, however, have moved

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6) Hwa-Jin Kim, *Toward the "Best Practice" Model in a Globalizing Market: Recent Developments in Korean Corporate Governance*, 2 J. CORP. L. STUD. 345 (2002); Bernard Black et al., *Corporate Governance in Korea at the Millennium: Enhancing International Competitiveness*, 26 J. CORP. L. 537 (2001); Hwa-Jin Kim, *Living with the IMF: A New Approach to Corporate Governance and Regulation of Financial Institutions in Korea*, 17 BERKELEY J. INT'L L. 61 (1999); Jeong Seo, *Who Will Control Frankenstein? The Korean Chaebol's Corporate Governance*, 14 CARDOZO J. INT'L & COMP. L. 21 (2006); Bernard S. Black, Hasung Jang & Woochan Kim, *Does Corporate Governance Predict Firms' Market Values? Evidence from Korea*, 22 J. L., ECON., & ORG. 366 (2006).

7) See Korean Ministry of Justice Press Release, October 4, 2006.

8) Stephen Choi, *Evidence on Securities Class Actions*, 57 VAND. L. REV. 1465 (2004) (discussing the impact of class actions and whether securities class actions would be beneficial in Korea). See also, Dae Hwan Chung, *Introduction to South Korea's New Securities-Related Class Action*, 30 J. CORP. L. 165 (2004); Ok-Rial Song, *Improving Corporate Governance Through Litigation: Derivative Suits and Class Actions in Korea*, in TRANSFORMING CORPORATE GOVERNANCE IN EAST ASIA, *supra* note \*\*, at 91.

9) See Korean Ministry of Finance and Economy Press Release, June 29, 2006.

into the KCC.<sup>10)</sup>

Contested mergers and acquisitions are no longer viewed with unfavorable judgment in Korea. In fact, as mentioned above, a number of corporate control contests and hostile takeover attempts have since taken place. Especially following the critical period in 1997, contested mergers and acquisitions have been playing a valuable function in improving corporate governance, and this led the way to amending many laws to facilitate and promote hostile takeovers.<sup>11)</sup> As a result, advocates for having takeover defensive tactics in place to protect incumbent management face objections.<sup>12)</sup> Additional restrictions are being imposed on member companies of large corporate groups instead, and the government is also considering implementing a number of regulations for the ownership structure of conglomerates in an effort to make them subject to the market discipline. Two of the most noted devices are investigation of the discrepancy between the control right and cash flow right within the large conglomerates and making the ownership structures known to the public.<sup>13)</sup>

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10) Articles 542-2 through 542-12 went into effect on February 4, 2009. This article cites the KSEA provisions depending upon the context.

11) For the current situation in Japan, see Curtis J. Milhaupt, *In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan*, 105 COLUM. L. REV. 2171 (2005).

12) For discussions in the United States, see Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POLITICAL ECON. 110 (1965). See also Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981); Ronald J. Gilson, *Unocal Fifteen Years Later (and What We Can Do About It)*, 26 DEL. J. CORP. L. 491 (2001); Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819 (1981); Lucian A. Bebchuk, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028 (1982); Ronald Gilson & Reinier Kraakman, *Takeovers in the Boardroom: Burke versus Schumpeter*, 60 BUS. LAW. 1419 (2005). Cf. Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101 (1979); Lipton, Martin, *Twenty-Five Years After Takeover Bids in the Target's Boardroom: Old Battles, New Attacks and the Continuing War*, 60 BUS. LAW. 1369 (2005); Martin Lipton, *Pills, Polls, and Professors Redux*, 69 U. CHI. L. REV. 1037 (2002). For recent developments in the European Union, see BARCA FABRIZIO & MARCO BECHT, *THE CONTROL OF CORPORATE EUROPE* (Oxford University Press, 2003); GUIDO FERRARINI ET AL. EDs., *REFORMING COMPANY LAW AND TAKEOVER LAW IN EUROPE* (Oxford University Press, 2004); Scott Mitnick, *Cross-Border Mergers and Acquisitions in Europe: Reforming Barriers to Takeovers*, 2001 COLUM. BUS. L. REV. 683. See also Ronald J. Gilson, *The Political Ecology of Takeovers: Thoughts on Harmonizing the European Corporate Governance Environment*, 61 FORDHAM L. REV. 161 (1992).

13) See, e.g., Korea Fair Trade Commission Press Release, July 13, 2005 (showing

The Korean government also thinks that the holding company structure might be a solution to the inefficient controlling shareholder system. The Korean government has been encouraging big company groups to restructure themselves to holding-dominated corporate groups. Interestingly, some large corporate groups in Korea responded positively to the government's initiative and transformed themselves to a holding structure. As of August 2007, 40 corporate groups completed such transformation. The market has responded positively to the experiment.<sup>14)</sup> Perhaps, the holding structure may be working as the compromise between outright improvements of corporate governance of such groups and controlling shareholders' pursuit of maintaining control. There may be new kind of inefficiencies involved in the process, however, because the holding structure would block new investments through the capital markets and become takeover-proof as long as the controlling shareholders desire to keep control over the firm.<sup>15)</sup>

## 2. *Foreigners at the Gate*

Following the 1997 crisis the growth of the Korean M&A market has been remarkable, and the door to the Korean market is now much more accessible for foreign investors and businesses.<sup>16)</sup> The proportion of foreign-owned shares of Korean companies has increased markedly. According to the data from Bloomberg, foreigners owned on average 55.7% of the 10 largest corporations in Korea as of June 22, 2006. As much as 83.4% of Kookmin Bank,

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improvements). For the current developments in and discussions on the law of corporate groups in Korea, see Hwa-Jin Kim, *Corporate Governance in Groups of Companies*, 362 KOREAN BAR ASSOCIATION JOURNAL 6 (2006); abbreviated version in 29 CORPORATE GOVERNANCE REVIEW 15 (Korea Corporate Governance Service, 2006) (Korean). For the reform in Italy, see Guido Ferrarini, Paolo Giudici & Mario Stella Richter, *Company Law Reform in Italy: Real Progress?*, 69 RABELS ZEITSCHRIFT FÜR AUSLÄNDISCHES UND INTERNATIONALS PRIVATRECHT 658 (2005).

14) See MONEY TODAY, May 2, 2007 (reporting the souring share price of some would-be holding companies). Cf. Giuseppe Alessi, *Holding Companies Discounts: Some Evidence from the Milan Stock Exchange* (Working Paper, 2000).

15) However, the average shareholding ratio of Korean holding companies in their listed subsidiaries is as low as 40.5%. Korea Fair Trade Commission Press Release, October 14, 2007. SK Telecom, a subsidiary of SK Holdings, is even listed on the New York Stock Exchange.

16) See Hwa-Jin Kim, *Taking International Soft Law Seriously: Its Implications for Global Convergence in Corporate Governance*, 1 J. KOREAN L. 1 (2001).

the largest financial institution in Korea, was owned by foreigners, and 51.8% of Samsung Electronics, the largest company in Korea. Those foreign investors have also firmly expressed their interest in corporate governance and control. The Korea Financial Supervisory Service reported that 406 foreign investors owned more than 5% of public companies based on the 5% Reporting (Large Holding Report) as of the end of 2007, and 116 of them reported that they obtained the stock in order to influence the management.<sup>17)</sup> The cases discussed below as well as the example of Norwegian Golar LNG's attempt to take over Korea Line Corporation in 2004 have certainly left Korean corporations on alert for the possibility of losing their control in the board room to foreign investors. Even mammoths like Samsung Electronics<sup>18)</sup> and POSCO<sup>19)</sup> are not exempted from the fear. The recent move of global private equity firms<sup>20)</sup> into the Korean market<sup>21)</sup> also makes Korean managers concerned as it is reported that the private equity firms can go hostile when they need to do so.<sup>22)</sup>

Recently, stressing the threat on their corporate control imposed by foreign funds, Korean companies are demanding the government to reform the existing systems; they want to have more secure means available to protect their corporate control, or to be free from the series of restrictions under the

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17) Korea Financial Supervisory Service Press Release, March 18, 2008.

18) Samsung Electronics, Study on the Restrictions on the Exercise of Voting Rights by Financial Affiliates (October 2004) (Korean) (on file with the author). In 2004, Samsung Electronics' expenditure in R&D amounted to 40.1 percent (3.5 trillion Korean won) of the total R&D expenditures made by Korean companies. That single company contributed 6 percent to the GDP and 14.8 percent to the export, respectively, in the same year. The corporate governance of and control over Samsung Electronics has become a national agenda.

19) See *POSCO Might Need to Steel Itself for Pressure by Activist Investors*, WALL STREET JOURNAL, March 6, 2006, at C10. POSCO is the third largest steelmaker of the world after Arcelor Mittal and Nippon Steel, see *Steel Deals France a Hard Lesson in Reality*, FINANCIAL TIMES, June 27, 2006, at 16.

20) See generally Brian Cheffins & John Armour, *The Eclipse of Private Equity*, 33 DEL. J. CORP. L. 1 (2008); Ronald W. Masulis & Randall S. Thomas, *Does Private Equity Create Wealth?: The Effects of Private Equity and Derivatives on Corporate Governance*, 76 U. CHI. L. REV. 219 (2009); Ellis Ferran, *Regulation of Private Equity-Backed Leveraged Buyout Activity in Europe* (ECGI Working Paper, 2007).

21) See MAEIL KYUNGJE, February 2, 2009.

22) *Private Equity Firms Losing Their Manners*, INTERNATIONAL HERALD TRIBUNE, September 25, 2006; *Even by Another Name, Takeovers Remain Hostile*, INTERNATIONAL HERALD TRIBUNE, February 12, 2006.

Korean Anti-Monopoly and Fair Trade Act (AFTA). Samsung Electronics, in particular, has taken it as far as to submit a constitutional petition to the Constitutional Court of Korea in 2005 reasoning that the restrictions under the AFTA has rendered the entire body of Samsung conglomerate vulnerable to takeover attempts and the instability of laws and regulations has made it nearly impossible to set forth their long-term corporate strategies.<sup>23)</sup> But unfortunately, the unveiling of serious problems of its corporate governance put Samsung under the heavy pressure from the press before the petition could make its way to the justices. Samsung in the end pledged a large-scale corporate responsibility and made a huge donation to charity.

The attitude of the Korean government has been true to the principles, at least until recently. In other words, the government and grassroots organizations, including PSPD (People's Solidarity for Participatory Democracy, one of the largest grassroots organizations in Korea, which is enjoying increased power since the 1997 Asian financial crisis<sup>24)</sup>), seem to think that currently, there is no logic to dampen the expectation on contested mergers and acquisitions to function as improving corporate governance. Although foreign funds and investors involved in hostile takeover attempts are regarded with suspicion in general, they are finding advocates in the Korean market, some of whom even claim that there is no particular reason to bar foreign takeover attempts in the national key industries. It has been known that the United States in the recent FTA negotiations expressed its interest in abolishing the 49% limitation imposed on foreign ownership of the key-industry companies such as Korea Electric Power Corporation and KT Corporation. Some members of the Korean National Assembly worked on a bill modeled after the US Exon-Florio Act.<sup>25)</sup>

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23) A financial or insurance company belonging to a business conglomerate with at least two trillion Korean won in assets may not exercise the voting rights it holds in a domestic affiliate. Exceptionally, it may exercise the voting rights up to 30 percent in corporate control-related matters. AFTA, Article 11.

24) See Jooyoung Kim & Joongi Kim, *Shareholder Activism in Korea: A Review of How PSPD Has Used Legal Measures to Strengthen Korean Corporate Governance*, 1 J. KOREAN L. 51 (2001).

25) Patrick L. Schmidt, *The Exon-Florio Statute: How It Affects Foreign Investors and Lenders in the United States*, 27 INT'L LAW. 795 (1993).



### 3. *Tender Offer Rules*<sup>26)</sup>

No tender offers have been attempted in Korea prior to 1994. However, beginning with Hansol Paper's attempt to acquire shares of Daesang without the consent of the company's management in October 1994, the number of hostile tender offer has since increased in Korea. As of the end of 2007, 55 tender offers were reported since 2003.<sup>27)</sup> Competing tender offers are not unusual. Tender offers have grown in number, but, more notably, the types of and purposes for tender offers have also become more diversified. For instance, among 18 tender offers launched in 2007, 8 tender offers were made in the process of transforming a corporate group to the holding structure.<sup>28)</sup>

The Korean rules for tender offer has been evolving to facilitate corporate takeovers through tender offers and promote the market for corporate control. The Korean law basically allocates decision-making role in relation to takeover bid to the shareholders. It is made after the U.S. rules in that directors cannot control access to the shareholders.<sup>29)</sup> The KSEA had mandatory tender offer provision that required the acquirer to offer for at least 50% plus one shares

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26) Articles 133 through 146 of the KFISCA.

27) Korea Financial Supervisory Service Press Releases, January 31, 2007 and February 12, 2008.

28) *Tender Offer by LGCI in 2001*: LGCI Ltd. (LGCI) was a holding company established for the purpose of holding shares of certain LG Group companies, namely, LG Chem Ltd., LG Household and Health Care Ltd. and LG Home Shopping Inc. In order to satisfy the requirements of a holding company under the AFTA, LGCI needed to hold at least 30% of shares of each of its subsidiaries, and it chose to meet such condition through a tender offer for the shares of its three subsidiaries. Although LGCI could have acquired all of the required shares from other major shareholders, it has chosen to take this approach in order to provide the minority shareholders with the chance to tender the subject shares. This tender offer was also notable in that the consideration for the tender offer was not cash, as was the usual case, but, for the first time in Korea, newly issued shares of LGCI. See Korea Financial Supervisory Service Press Release, December 17, 2001.

29) However, as Korea is introducing the poison pills, it moves toward the UK model which allocates a decision-making role to target management in addition to the shareholders. For two models of regulation, see Paul Davies & Klaus Hopt, *Control Transactions*, in: Reinier Kraakman et al. eds., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 157, 163-173 (Oxford University Press, 2004); STEPHEN KENYON-SLADE, *MERGERS AND TAKEOVERS IN THE US AND UK: LAW AND PRACTICE* (Oxford University Press, 2004). Cf. Lucian Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973 (2002).

when the acquirer crossed 25% threshold.<sup>30)</sup> The rule, however, has been taken out of the statute during the 1997 financial crisis as it blocked acquisitions of financially distressed firms by foreign investors.

The offeror must give the public notice in at least two regular or economic daily newspapers. The offeror then files the tender offer report with the Korea Financial Supervisory Commission (KFSC), and, on the same day, serves copies of the report on the target company and the Korea Exchange. Starting from the day immediately after the public notice is given, the offeror must place prospectus for public inspection at the KFSC, Korea Exchange, and the main and branch offices of the tender offer agent. Notice to individual shareholders is not required. The tender offer period may be between twenty and sixty days. This period may, however, be extended if there is any competing tender offer until the expiration of competing tender offer's offer period. A shareholder may withdraw its acceptance at any time during the offer period. During the offer period the offeror may not acquire target shares except by way of the tender offer process. In the rare event that the offeror fails to effect tender offer in accordance with his/her disclosure, he/she will be in violation of the disclosure obligation and may also face lawsuits from the other investors for damages.

The offeror must disclose, *inter alia*, his/her identity with that of specially interested persons, the purpose of the tender offer, and the target securities,<sup>31)</sup> including the number of shares to be acquired through the tender offer. The tender offer may be conditional upon acceptance of a minimum number of shares and may state that the offeror will not purchase above a certain maximum number. The offer period, date of purchase, price, the method of payment and other mechanical detail must also be disclosed. Availability of

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30) For the mandatory bid rule, see generally Davies & Hopt, *supra* note 29, at 178-181; Clas Bergstrom et al., *The Optimality of the Mandatory Bid*, 13 J. L., ECON., & ORG. 433 (1997); Scott Mitnick, *Cross-Border Mergers and Acquisitions in Europe: Reforming Barriers to Takeovers*, 2001 COLUM. BUS. L. REV. 683, 707-713.

31) There is no Korean requirement for compliance with the tender offer rules of any foreign exchange where the shares are listed or of any foreign jurisdiction in which there are shareholders, although the foreign rules themselves may require compliance. The depository receipts themselves are not one of the instruments that can be subject to a tender offer. However, any holder of the depository receipts can respond to a tender offer after exchanging the receipts for the shares.

the funds to pay the purchase price, including the statement that money or other consideration in excess of the amount required for the purchase has been deposited in a financial institution or otherwise reserved and description of such arrangements, and the source of the consideration must be disclosed. The funds to pay the purchased shares must be available in advance and described in the tender offer report filed with the KFSC. Further, future plans for the target company subsequent to the successful conclusion of the tender offer must be disclosed. Although the tender offer report is not a matter for approval by law, the KFSC may, in practice, direct the offeror to amend or withdraw the report. The target company is not obligated to respond to a tender offer. However, the target company can express its view on the tender offer, accept the tender offer or come up with a counter tender offer.

#### 4. *Takeover Defensive Tactics*<sup>32)</sup>

Now that the business environment in Korea is no longer so favorable to the current owners/directors, they are urging new means of takeover defense such as the poison pill and dual-class common shares and at the same time, are keeping themselves busy searching for other legitimate ways to protect their management control.<sup>33)</sup> Amid the alert state, some yet to be legally proven tactics such as the golden parachute are quite popular for them. The court cases on the takeover defenses are not informative, and the available cases are limited to the most commonly used methods like rights offerings and selling treasury shares to friendly parties. In particular, sale of treasury shares has been the favorite tactic of Korean corporations in their attempt to protect their corporate control.

*Sale of Treasury Shares:*<sup>34)</sup> Disposal of treasury shares must, in principle,

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32) See generally HWA-JIN KIM & OK-RIAL SONG, *MERGERS AND ACQUISITIONS* (Pakyoungsa, 2007) (in Korean); Hwa-Jin Kim & Ok-Rial Song eds., *HOSTILE TAKEOVER AND DEFENSIVE TACTICS* (Seoul National University Center for Financial Law, 2007) (Korean).

33) For the situation in Europe, see Marco Becht, *Reciprocity in Takeovers* (European Corporate Governance Institute Working Paper, 2003); John C. Coats IV, *Ownership, Takeovers and EU Law: How Contestable Should EU Corporations Be?* (European Corporate Governance Institute Working Paper, 2003). See also Tatiana Nenova, *Takeover Laws and Financial Development* (Working Paper, 2006) (studying takeover laws of fifty countries).

34) Jonathan R. Macey & Fred S. McChesney, *A Theoretical Analysis of Corporate Greenmail*, 95

comply with the procedure laid out in KIFSCMA. Under the KIFSCMA, listed companies would first have to obtain approval from its board of directors for the disposal of its treasury shares and then file a report on the disposal of treasury shares with the KFSC. In case the company disposes of its shares through the Korea Exchange, the order for the shares must be placed in certain way and the asking price will have to be within certain range. In contrast, if the disposal of the shares takes place off-the-market, there are no restrictions on the asking price and method of the order. Therefore, sale of treasury shares to a friendly party based upon an elaborate contractual arrangement, including the fair price and other terms, might be an effective takeover defensive tactic. Although there was a lower court decision that outlawed the disposition of treasury shares to the controlling shareholder,<sup>35)</sup> other courts keep validating the disposition of treasury shares to friendly parties.

*Issuance of New Shares:* Under the KCC shareholders of the stock companies have the preemptive rights.<sup>36)</sup> However, the KCC provides that the board of directors has the authority to issue new shares to third parties and/or shareholders not in proportion to the current shareholding ratio when necessary to achieve the objective of the company's management, such as introduction of new technology and improvement of capital structures.<sup>37)</sup> This also applies to the issuance of convertible bonds (CB) or bonds with warrant (BW) (equity-linked securities). The articles of incorporation for most listed companies in Korea provide that the board has the authority to issue new shares or equity-linked securities to third parties and/or shareholders not in proportion to the current shareholding ratio under certain circumstances. Thus, the issuance of new shares can be an effective tool that the incumbent management can use to fend off hostile bidders. However, there have been several cases where the validity of issuing new shares or equity-linked securities to defend against takeover has been put to test and several court

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YALE L. J. 13 (1985); Charles Nathan & Marilyn Sobel, *Corporate Stock Repurchases in the Context of Unsolicited Takeover Bids*, 35 BUS. LAW. 1545 (1981); Matthew T. Billett & Hui Frank Xue, *The Takeover Deterrent Effect of Open Market Share Repurchases* (Working Paper, 2007).

35) Seoul Western District Court, Decisions of March 24, 2006 and June 29, 2006, Case Nos. 2006-Kahap-393 and 2005-Gahap-8262, respectively.

36) KCC, Article 418, Paragraph 1.

37) KCC, Article 418, Paragraph 2.

cases have held that such issuance is invalid (and is subject to the preliminary injunction).

*Strategic Alliance:* Many Korean companies enter into an agreement with a potential “white knight” to mutually hold the other’s shares and come to the aid if there is a hostile takeover attempt. For instance, POSCO and KB Financial Group recently agreed to cross-hold shares in the amount of 300 billion Korean Won.<sup>38)</sup> Quite often, the strategic alliance partner is customer or business partner of the company. There are no laws in Korea that prohibit companies from entering into such alliance agreement where parties mutually agree to hold the other’s shares. However, Art. 369 Paragraph 3 of the KCC provides that in case a company owns 10% or more of shares of the other company, the other company cannot exercise the voting rights on the shares of the first company. Further, in mutually acting as a potential white knight to the other, companies sometimes enter into an agreement to exchange non-executive (or outside) directors. The KCC now contains regulations on the qualification of non-executive directors. Under these regulations, one ground for disqualifying a candidate from being a non-executive director is if the candidate serves as the current officer/employee or served, in the recent two years, as an officer or employee of the company that has important business relationship or is in competitive or cooperative relationship with the electing company.<sup>39)</sup>

*Restrictions on Qualification of Directors:* To defend against a hostile takeover certain restrictions on the qualification of directors can be placed in the articles of incorporation. For example, the company’s articles of incorporation could provide that to become a director, the candidate must have served at least a certain period as an officer or employee of the company. This may make it difficult for a person who attempts a hostile takeover to nominate his or her own director candidates. In fact, some of the listed companies’ articles of incorporation contain such provision. As long as requirement concerning the period of employment is not too advantageous for the current management, such provision in the articles of incorporation would be held valid. However, such arrangement may backfire the board. Recently, KT, the largest

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38) MAEIL KYUNGJE, December 22, 2008.

39) KCC, Article 382, Paragraph 3.

telecommunications company of Korea has experienced difficulties in recruiting the new CEO.<sup>40)</sup>

*Golden Parachute:* The so-called “golden parachute” provides directors or management with lucrative severance payments in case they are ousted by hostile takeover. It is intended to make the company less attractive to potential acquirer by placing a heavy financial burden on the acquirer who seeks to acquire the company. Although there is no reported court case, it is widely believed that the golden parachute is allowed under Korean law if the company’s articles of incorporation allows it and/or if the company’s internal severance pay regulations allows the granting of golden parachute and the company obtains approval from the shareholders concerning the maximum remuneration of directors at the shareholders’ meeting. In fact, some of the companies in Korea currently provide golden parachute to its directors/management. As of August 2008, 15 listed companies have adopted golden parachute.<sup>41)</sup> However, there is a substantial risk that directors who approve payment of severance pay, which is considered excessive, may be in breach of their fiduciary duty under the KCC or Korean Criminal Code, depending on the seriousness of their actions. Moreover, it seems that there is negative sentiment on the part of shareholders and general public in Korea regarding the granting of golden parachutes.

*Staggered Board:* When the term of a director under the company’s articles of incorporation is three years, a way to avert hostile bidders from acquiring control of the board is by adopting so-called “staggered” board in the articles of incorporation so that each year, for example, the term of only 1/3 of the board members expires. This way, it would take at least two additional years for the hostile bidders to acquire a complete control over the board. It is understood that this device is, in the United States, one of the most popular<sup>42)</sup> and powerful anti-takeover arrangements when combined with the poison pill.<sup>43)</sup> However, in Korea, it is not clear how strongly the directors can resist

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40) MAEIL KYUNGJE, November 25, 2008.

41) HANKUK KYONGJE, September 2, 2008.

42) John C. Coates, *Explaining Variations in Takeover Defences: Blame the Lawyers*, 89 CAL. L. REV. 1301, 1353 (2001).

43) Lucian Bebchuk, John Coats IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887 (2002); Michael D. Frakes, *Classified Boards and Firm Value*, 32 DEL. J. CORP. L. 113 (2007).

the successful bidder and this approach would not be effective if the hostile bidders can obtain sufficient votes to pass a special resolution and terminate all of the directors. The KCC, different from the Delaware General Corporation Law, does not confer any legal effect to the articles of incorporation that formally adopts the staggered board. Therefore, the directors can be discharged without cause,<sup>44)</sup> and their seats will be filled by the shareholders, not the remaining directors.<sup>45)</sup> Also, as the KCC currently does not allow the companies to adopt the poison pills, the effectiveness of the staggered board is questionable, if at all. As of August 2008, 20 listed companies have adopted staggered board.<sup>46)</sup>

*Supermajority Voting:* Another defensive tactic would be to provide for a stronger requirement in the company's articles of incorporation than the special resolution for certain events such as merger or business transfer that the acquirer may try to effect after the acquisition.<sup>47)</sup> However, there is a view

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44) KCC Article 385 (Dismissal): (1) A director may be dismissed from office at any time by a resolution at a general shareholders' meeting in accordance with Article 434: Provided, that in case where the term of office of a director was fixed and he is dismissed without cause before the expiration of such term, he may claim for damages caused thereby. (2) If the dismissal of a director is rejected at a general shareholders' meeting notwithstanding the existence of dishonest acts or any grave fact in violation of the relevant acts, subordinate statutes or the articles of incorporation in connection with his duties, any shareholder who holds no less than 3/100 of the total outstanding shares may demand the court to dismiss the director, within one month from the date on which the above resolution of the general meeting was made.

45) For Anheuser-Busch's staggering defense in 2008, see *InBev Seeks to Oust Anheuser-Busch Board*, INTERNATIONAL HERALD TRIBUNE, July 7, 2008.

46) HANKUK KYONGJE, September 2, 2008.

47) The board of directors of a Korean corporation has broad power and wide discretion to manage all matters which are reasonably necessary to achieve the purposes of a corporation. Generally all the affairs and business of a corporation are considered and determined by the board of directors except for the matters required to be resolved at shareholders meetings under the KCC or by the articles of incorporation of the corporation. The following matters are basically within the authorities of the board, but may be reallocated to the shareholders' meeting if the articles of incorporation so provide: (i) appointment of a representative director (Article 389(1)); (ii) issuance of new shares (Article 416); (iii) conversion of reserves into capital (Article 461(1)); (iv) issuance of convertible bonds (Article 513(2)); and (v) issuance of bonds with warrants (Article 516-2(2)). The Commercial Code also lists matters which require resolution at a shareholder meeting, i.e., matters which cannot be removed from shareholder authority even via the articles of incorporation. Certain important matters of a corporation can be adopted only by the affirmative vote of shareholders holding at least two-thirds (2/3) of the shares represented in person or by proxy at a general meeting of shareholders which represents

that articles of incorporation that provides for stricter requirement than special resolution under the KCC is void. There was a lower court decision that outlawed the supermajority requirement for removal of directors without cause.<sup>48)</sup> Thus, if the company provides for stronger requirement than the special resolution in relation to a hostile takeover in its articles of incorporation, it is possible that such requirement will be held void. Notwithstanding such a view, there are some listed companies in Korea that provide for stricter requirement than the special resolution in their articles of incorporation. As of August 2008, 38 listed companies have adopted supermajority voting.<sup>49)</sup> It should also be noted that even if setting forth such stricter requirement in the articles of incorporation is held to be valid, this would result, in effect, in minority shareholders having a veto right, which could place a burden on the management.

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the affirmative vote of the holders of at least one-third (1/3) of the total issued and outstanding shares. Article 434. This is called a "special resolution." This special voting requirement cannot be softened even by the articles of incorporation. It is required, *inter alia*, for (i) amendment of the articles of incorporation (Article 434); (ii) issuance of shares at a price less than par value after two (2) years of incorporation (Article 417); (iii) transfer of the entire business of the corporation or an important part thereof (Article 374(1)); (iv) take-over of the entire business of another company (Article 374 (3)), or take-over of a part of another company's business which will have important effect on the corporation's business (Article 374(4)); (v) issuance of convertible debentures to persons other than shareholders, and determination of the terms of conversion, etc. unless such matters are provided for in the articles of incorporation (Article 513(3)); (vi) removal, with or without cause, of a director or a statutory auditor from office prior to expiration of his term of office (Articles 385(1) and 415); (vii) a merger with another company (Article 522(3)), division or merger through division (Article 530-3(2)); (viii) reduction of stated capital (Article 438(1)); and (ix) dissolution of the corporation (Article 518). All other matters, including the election of directors (Article 382(1)) can be resolved by a simple majority vote of the shareholders present or represented at a general meeting of shareholders which represents the affirmative vote of the holders of at least one-fourth (1/4) of the total issued and outstanding shares.

48) Seoul Central District Court, Decision of June 2, 2008, Case No. 2008-Gahap-1167.

49) HANKUK KYONGJE, September 2, 2008.



### III. SK<sup>50)</sup>

#### 1. Background

The SK case uniquely provides empirical data and resources to show that first its problem-ridden corporate governance triggered a hostile takeover attempt, and then the takeover threat brought about major improvement in its corporate governance. Furthermore, it raised fierce political and economic controversies because (1) the hostile takeover threat came from a foreign investment fund, (2) energy was the core business of SK Group, and (3) SK Group's most important member company was the key telecommunication provider, SK Telecom, which was the 450<sup>th</sup> largest company based on its total market capitalization as of March 31, 2005.<sup>51)</sup>

The development of "SK Saga" arose during the period of the 1997 Asian financial crisis. SK Securities incurred a huge loss from the financial derivatives deals with JP Morgan prior to 1997, and it led to lawsuits both in Korea and the U.S. In an effort to bring reconciliation between the two parties, SK Global involved its overseas subsidiary, but PSPD deemed it illegal and

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50) HWA-JIN KIM, *THE LAW AND PRACTICE OF THE BOARD OF DIRECTORS* 42-45 (2nd ed., Pakyoungsa, 2007) (in Korean).

51) At the center of SK Group is SK Corporation which is controlled by SKC&C, which in turn is controlled by the current Chairman and CEO Chey Tae-won, the eldest son of the late head of SK Group Chey Jong-Hyun. Under the control of SK Corporation lies a number of affiliate companies including SK Telecom, SKC, SK Networks (former SK Global), and SK Shipping. The beginning of SK Group traces back to half a century ago, when Chey Jong-Hyun's brother Chey Jong-kun founded Sun Kyoung Textiles, the mother company of SK Networks, in 1953. About a decade later came the birth of Sun Kyoung Synthetic Fiber in 1967, and it later became SKC. Following the death of Chey Jong-kun in 1973, Chey Jong-Hyun succeeded his brother in 1978 and spurred the dramatic growth of SK Group in the 1980's and 1990's. Before his death in 1998, he entered into the mobile telecommunication industry and acquired the oil refining business, Yukong, both of which are remembered as his greatest achievements. Since the death of Chey Jong-Hyun, SK Group was led by the group Chairman Chey Tae-won and SK Telecom CEO Son Kil-seung, who is known as the most successful professional manager in Korean business history, until 2003. While taking the office of CEO at SK Telecom, Son Kil-seung also served as the president of the Federation of Korean Industries (FKI). But in the wake of the following event, Son Kil-seung claimed to be responsible and resigned from both SK Telecom and FKI at the same time. See <http://eng.skcorp.com>.

filed a complaint against the SK management with the Public Prosecutor's Office. Furthermore, fearing the loss of his corporate control due to the reinstatement of the legal limitation on total investment,<sup>52)</sup> Chey Tae-won exchanged his Walker Hill stocks with SK Corporation's and unexpectedly fell subject to the judicial restraint. To make matters worse, SK Global was found to have committed a large scale accounting fraud, and the stock prices of all the SK Group companies plummeted. When SK Corporation's stock price fell to 6,100 Korean won, Sovereign Asset Management suddenly emerged as the largest shareholder.<sup>53)</sup>

When Sovereign came into play, the public viewed it as a mysterious entity and scorned it as an ill-intended speculator. But Sovereign claimed to be a serious corporate governance fund. It is believed that Sovereign's actions taken in Korea not only were unpredictable and lacking consistency, but the Fund also seemed to be without any fundamental strategies. Sovereign persistently assailed SK Group's flaws in its corporate governance and eventually demanded the removal of Chey Tae-won, doubting his leadership qualifications as the head of SK Group. Sovereign further attempted to gain control of the board of SK Corporation by nominating outside director candidates. Notwithstanding the suspicion that Sovereign intended to take over SK Corporation, Sovereign kept its public announcement on the issue of corporate governance alone and expressed no plan to engage in the management and business. But the press cast doubt on Sovereign's true intentions.

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52) The so-called limitation on total investment amount was one of the means employed by the AFTA to curb undue concentration of economic power in a few hands; the other such means being (chiefly) the prohibition of cross (or reciprocal) equity investment, the prohibition of debt guarantees for an affiliate, and the limitation on voting rights of financial and insurance companies. While these latter prohibitions and limitation applied to companies belonging to any business group with at least two trillion Korean won in assets, the threshold for applying the limitation on total investment amount was five trillion Korean won in assets. A company then, belonging to a business group with at least five trillion Korean won and thus subject to the limitation on total investment amount, may not acquire or hold stock of other domestic companies in excess of 25% of its net asset amount. *See generally* Youngjin Jung & Seung Wha Chang, *Korea's Competition Law and Policies in Perspective*, 26 NW. J. INT'L L. & BUS. 687 (2006). The limitation on total investment amount has been abolished in March 2009. *See* Money Today, March 3, 2009 (brief historical account).

53) *See* Ok-Rial Song, *Legal Issues of the SK Case*, 3 BUSINESS FINANCE LAW 23 (2004) (Korean).

## 2. *Struggle*

Sovereign vied for the control of SK at two annual shareholder meetings. At the March 2004 meeting, it tried to remove the opt-out clause on cumulative voting from the articles of incorporation of the company and elect outside directors of their choice, but both attempts failed. With strong support from National Pension Service and minority shareholders, the 51.5% to 39.5% vote was in favor of the company.<sup>54)</sup>

Prior to the March 2004 shareholder meeting, SK tried to increase the share of its allies by disposing of its treasury shares to friendly parties. It decided to sell 13,208,860 treasury shares (accounting for approximately 10.41 percent of the issued and outstanding shares) to certain financial institutions friendly to the existing management. Sovereign sought a preliminary injunction of the directors' decision. It claimed that the board's decision to sell its treasury shares to friendly parties would cause the dilution of Sovereign's voting rights and, therefore, it was being prevented from fairly exercising its voting rights in the 2004 general meeting of shareholders. The Seoul District Court, however, refused to grant the preliminary injunction in its decision of December 23, 2003.<sup>55)</sup> The court opined that the disposal of any treasury shares should not be prevented even in the midst of a dispute for control of the company; provided, however, that the shares have not originally been acquired to perpetuate the existing management and the controlling shareholder(s). The decision to sell the treasury shares in the court's view was justified as business judgment. The March 2004 shareholder meeting was prevailed by the management.

Around October 2004, Sovereign demanded that SK hold an extraordinary general meeting of the shareholders to amend SK's charter to disqualify anyone with a criminal conviction from being a director of the company, and to elect certain persons designated by Sovereign as outside directors of SK. SK refused Sovereign's request to hold the meeting, stating that the proposal to amend the SK's charter was, in substance, identical to the proposal that was

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54) HANKUK KYONGJE, March 13, 2004, at 13.

55) Seoul Central District Court, Decision of December 23, 2003, Case No. 2003-Kahap-4154.

rejected in 2004 annual meeting, and that since the 2005 annual meeting was at close hand, there was no reason to urgently hold an extraordinary meeting to elect outside directors. In response, Sovereign filed a petition with the court seeking court's permission to hold an extraordinary meeting. The court rejected Sovereign's petition.<sup>56)</sup> Sovereign then made a shareholder proposal to include amendment of SK's charter and election of outside directors in the agenda of 2005 annual meeting, SK and Sovereign carried out a proxy contest in relation to the issue.<sup>57)</sup> The March 2005 shareholder meeting began in a highly tense setting; while Sovereign had demanded Chey Tae-won's removal from the board, the meeting agenda included renewal of Chey's term as director. But again, the result of the shareholder voting by a wide margin allowed the company to defend its corporate control and reelected Chey Tae-won to the board. The Seoul High Court convicted Chey Tae-won in June 2005 but he was saved from imprisonment and granted to stay on probation.

Sovereign, in July 2005, disposed of its entire stakes in SK and gained about 1 trillion Korean won in profit, which can seem as an outstanding performance by a corporate governance fund. The Fund thereafter invested in LG Group putting the market on alert again, but sold its stocks after six months and left the Korean market altogether.<sup>58)</sup> Sovereign's ambiguous moves in the process of ownership disclosure and reporting of foreign investment created confusion in the market and resulted in major changes in the 5% Rule. The change required a description of investment objective in great detail to be made public.<sup>59)</sup> Also, in order to prevent an investor from

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56) Seoul Central District Court Decision, December 15, 2004, Case No. 2004-Bihap-347. However, the court viewed Sovereign's petition not abusive.

57) Sovereign had a tough fight. SK demanded that Sovereign provide certificates of registered seal impression of the shareholders who issued proxy to Sovereign. Surprisingly, Sovereign complied with the company's demand. Therefore, the issue of the means and standards for confirming the veracity of a proxy did not arise at the shareholders meeting of SK.

58) See MAEIL KYUNGJE, August 24, 2005, at A1.

59) The KFISMA explicitly makes it obligatory to file a report of the "Purpose of Ownership" (that is, the purpose of influencing the management control of the issuer) in addition to the "Status of Shareholding." KFISMA, Article 147, Paragraph 1. The KFISMA also states that persons who have reported the purpose of their ownership as "for the purpose of influencing the management control of the issuer" will be, from the time of the filing of the report until the expiration of the fifth day, prohibited from acquiring additional equity securities of the issuer or exercising the voting rights on the shares that the persons own (as filed in the

acquiring a controlling stake in a Korean corporation for a very short period of time without due disclosure of his/her intention, the regulatory authorities have introduced a system similar to the cooling-off period system adopted in the United States. Under the new system, in case an investor whose investment purpose is portfolio investment comes to acquire 20% or more shares in a listed corporation, such investor would be prohibited from acquiring additional shares in the company or exercising voting rights during a certain cooling-off period, while for an investor with the purpose of participating in management, the threshold for triggering the cooling-off period would be 5%. In addition, under the new system, the cooling-off period would be also applicable to an investor who changes his/her investment purpose from portfolio investment to participation in management.

### 3. Evaluation

Sovereign's withdrawal from the Korean market evoked wild speculation but Professor Sang Yong Park of Yonsei University rendered an evaluation of Sovereign's strategies from an academic perspective.<sup>60</sup> According to Park, unlike undervaluation due to the 'Korea discount' which results from a multitude of factors, undervaluation that is triggered by a discount of subsidiary shares due to matters relating to poor corporate governance creates

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report). KFISMA, Article 150, Paragraph 2. Any one of the following acts falls under the definition of "an act to influence the management control": (1) the appointment or removal or suspension of office of a director or auditor, (2) amendment of the articles of incorporation in relation to the company's corporate bodies such as the director and board of directors, (3) change in the company's capitalization, (4) influence regarding the dividends policies, (5) merger (including short-form merger and small-scale merger) or division of the company, (6) stock swap or transfer of stock, (7) acquisition or transfer of all or a material part of the business, (8) the disposition or transfer of all or a material part of the assets, (9) lease of all or material part of the business, delegation of management, or entering into or amending or terminating a contract whereby the company will be sharing all the profit and loss of the business with another company, or entering into other contracts of a similar nature, (10) exercising *de facto* influence on the company or its officers or minority shareholders' rights or delegating such influence for the purpose of dissolving the company. Presidential Decree to the KFISMA, Article 154, Paragraph 1.

60) Sang Yong Park, *The Political Economy of Corporate Governance: Hostile Takeover and Labor's Participation in Management*, 34-2 KOREAN MANAGEMENT REVIEW 569 (2005) (Korean).

unique opportunities for arbitrage, and the SK case exemplifies the latter. The aggregate value of SK Corporation's listed stock fell under 40% of the equity (20.85%) value of SK Telecom owned by SK Corporation at the time when Sovereign's hostile takeover attempt was in the initial stage. During the period subject to the analysis, while the rate of increase of share price of other oil refining corporations did not even reach the rate of increase at composite stock price index, SK's rate far exceeded it. Such phenomenon cannot be explained by anything other than hostile takeover threats.

While under the threat of Sovereign's hostile takeover, SK Group assiduously worked on improving its corporate governance. It should be noted that there are several apparent reasons for such effort. First, it was not a surprise that they saw the need to fix their corporate governance, since it triggered their public criticism and disgrace. Second, Chey Tae-won was imprisoned and was going through trials. SK needed to make public that they were striving to improve its corporate governance system in order to render the situation favorable to the convicted chairman. Lastly, Sovereign assailed the corporate governance of SK, which was lagging behind global standards.

SK Corporation's effort to restructure its board by appointing a majority of outside directors was not a nominal political move. SK Group even went as far as to reform the boards of its private member companies into outside-director dominated boards, which was not required by law. Regardless of the motive for such drastic change, the result was building a well functioning board and earning a name as the pacesetter for high standard corporate boards in the Korean market. Professor Hasung Jang's widely quoted comment well summarizes the overall impact: "Sovereign achieved in one year what the Korean government could not in many years." SK Group also tried to transform itself as a loosely integrated entity within which the member companies share its brand. When the current market is infested with problems caused by the complicated relationships amongst member companies of large conglomerates, SK's move was praised as a prudent strategy. Finally, in April 2007, SK Group has ended up announcing its plan to transform itself to a holding company structure. The market applauded the move.

## IV. Hyundai

### 1. Background

Similarly, the Hyundai case reflects a corporate governance issue resulting in a hostile takeover attempt, but it is much more complicated than the SK case in terms of its historical background and high level of politics involved.<sup>61)</sup> Both the bidder and defender in the Hyundai case vied for support from the shareholders on a platform of improving corporation governance. This case demonstrates that corporate governance issues can lead to hostile take over attempt or dispute over corporate control.

The history of the Hyundai Group<sup>62)</sup> takes up an integral chapter of that of the Korean national economy. The now deceased founder and honorary chairman of Hyundai, Chung Ju-yung, founded Hyundai Engineering & Construction in 1947, which was the foundational entity of Hyundai and later became Hyundai Construction in 1950. Chung Ju-yung's professional career included holding the office of the president of FKI for 10 years; and once he even assembled a political party and ran for President of Korea. Founded in 1972, Hyundai Heavy Industries left a legend that it once obtained funds from Barclays Bank of England solely based on its plan for ship building business and the pictures of the site. The extraordinary history of Hyundai reached its peak in the late 1990's. Honorary Chairman Chung Ju-yung herded 1,001 cows to North Korea in June 1998, which certainly created a drama, and met with the ruler of North Korea, Kim Jong Il, in the following October. The historical event resulted in founding of Hyundai Asan in 1999 putting business with North Korea into force.

Hyundai Group, however, faced crisis in 1999. With Hyundai Construction being close to insolvency and the North Korea business getting out of hand, the Group had severe liquidity problems and was forced to restructure its affiliated companies by its creditors. As a result, Hyundai Group disposed of or separated 23 of its 49 affiliated companies and

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61) "Shakespeare could hardly have written a more convoluted tale of sibling rivalry, palace intrigue and thirst for power." FINANCIAL TIMES, May 5, 2006, at 28 (on Hyundai saga).

62) <http://www.hyundaigroup.com>

categorized the remaining 26 companies into the five key industries of heavy engineering, automobiles, electronics, construction and finance. Each of the five categories was turned into a form of small groups, which was reorganized as an independent business entity. Not included in the five key industries, Hyundai Department Store was given to the chairman's third eldest son, Chung Mong-keun, Hyundai Development Company to his third younger brother, Chung Se-young, and Kumgang Korea Chemical (Kumgang) to his fourth younger brother Chung Sang-young for independent management.

In 2000 an event dubbed "The Feud of the Princes" occurred. The conflict was a power struggle over the succession of Hyundai corporate control amongst Chung Ju-yung's sons, Mong-hun, Mong-koo, and their respective aids. Following the conflict, Mong-hun was selected as the successor to take over Hyundai Group, Mong-koo Hyundai Motor and Mong-joon Hyundai Heavy Industries. After the death of Chung Ju-yung in March 2001, Hyundai continued its North Korea business with the Kim Dae-jung Administration in honor of Chung Ju-yung's will. As Hynix Semiconductor and Hyundai Construction faced critical liquidity issues, Mong-hun gave up on the two companies and focused on running Hyundai Asan, the North Korea business. Mong-hun was investigated for accounting fraud in Hyundai Merchant Marine, which was connected to the allegation that he passed money to North Korea illegally. He committed suicide in August 2003.

## 2. Contest

After his death, his widow, Hyun Jeong-eun, succeeded him, and a foreign fund began to actively purchase the stocks of Hyundai Elevator, the flagship of Hyundai Group. In November 2003, alleging to salvage Hyundai Group from foreigners, the brothers' uncle and the president of Kumgang, Chung Sang-yung, who disliked the officers of late Mong-hun and was displeased with Hyun taking over Hyundai Group, contended for a hostile takeover acquiring, directly and indirectly, approximately 44.39 percent of the issued and outstanding shares of Hyundai Elevator.<sup>63)</sup> Amid the family conflict,

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63) See HANKUK KYONGJE, November 5, 2003, at 1. See also HANKUK KYONGJE, December 8, 2003, at A14 (Chung Sang-yung's half-page open position letter).



Mong-koo and Mong-joon remained neutral. Hyundai Group tried first to increase its capital by public offering in a large scale but was enjoined by the court. The board of directors of Hyundai Elevator, in an attempt to defend against Kungang's hostile takeover attempt, resolved to issue 10 million new shares, which was 178 percent of the then outstanding shares, at a 30 percent discount, with a condition that the number of the newly-issued shares to which any one person may subscribe cannot be more than 300 shares. Kungang sought a preliminary injunction of the proposed issuance of new shares by Hyundai Elevator, arguing that the proposed issuance is improper as it infringes on the preemptive rights of the existing shareholders and is an attempt only to perpetuate the current management. The court viewed that Hyundai's public offering did infringe the preemptive right of the shareholders.<sup>64)</sup>

The Suwon District Court found that the proposed issuance of new shares infringed on the preemptive rights of the existing shareholders, including Kungang, and it granted the preliminary injunction. The court reasoned that, considering that any attempt to defend a takeover bid should be made within the scope allowed under the laws and regulations and the articles of incorporation of the company concerned, Hyundai Elevator's proposed issuance of new shares, which is allowed only to the extent necessary to raise funds for the business of the company under the KCC and the articles of incorporation of the company, apparently for the purpose of perpetuation of the existing controlling shareholder(s) or the management, was not proper. However, the court did not completely rule out the possibility of issuing new shares as a means of takeover defense. Specifically, the court stated that the following event may be an exception to the general rule where the company concerned may issue new shares in an attempt to avert a hostile takeover: (1) if preserving the existing controlling shareholder(s) and/or the existing management of the target company is beneficial to the company itself or the shareholders in general or there are any other specific public reasons; and (2) if the target company has taken all reasonable steps in making the decision to issue new shares, such as soliciting the opinions of the disinterested

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64) Suwon District Court Yeosu Branch, Decision of December 12, 2003, Case No. 2003-Hap-369. See HANKUK KYONGJE, November 18, 2003, at 3.

shareholders or independent experts. According to the court, if these requirements are met, the issuance of new shares may not be invalidated because it was done for the proper business purposes as stipulated in the company's articles of incorporation and the KCC.

During the course of the legal battle, Hyundai emphasized that the 5% Rule should not be understood just as an "early warning system."<sup>65</sup> The purpose of the Rule was rather to protect minority shareholders who do not have the necessary resources to collect information on other (large) shareholders' intent. Certain empirical studies done by U.S. scholars<sup>66</sup> were heavily cited in the brief of Hyundai's counsel. The court accepted the argument and sanctioned Kumgang's violation of the 5% Rule severely.<sup>67</sup> The ruling of the court was perceived as extraordinary by the Korean bar partly because the Korea Financial Supervisory Service did not accept Hyundai's argument that the entire filing for over 5 percent made by Kumgang should be treated invalid.<sup>68</sup>

Hyundai Group's attempt to avert the hostile takeover attempt by Kumgang succeeded in the end, because Kumgang was found to be in violation of the 5% Rule for material omission in reporting,<sup>69</sup> although

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65) See generally WILLIAM J. CARNEY, *MERGERS AND ACQUISITIONS: CASES AND MATERIALS* ch.10 (Foundation Press, 2000). For the British 3% Rule, see PAUL L. DAVIES & L. C. B. GOWER, *PRINCIPLES OF MODERN COMPANY LAW* 922-932 (8<sup>th</sup> ed., Sweet & Maxwell, 2008). For the rule in Germany, see Klaus Peter Berger, "Acting in Concert" nach §30 Abs. 2 WpÜG, 49 *DIE AKTIENGESELLSCHAFT* 592 (2004).

66) See RONALD GILSON & BERNARD BLACK, *THE LAW AND FINANCE OF CORPORATE ACQUISITIONS* 903 (2<sup>nd</sup> ed., Foundation Press, 1995) (citing a study that shows higher abnormal rate of return in the case of compliance of the 5% Rule).

67) Seoul Central District Court, Decision of March 26, 2004, Case No. 2004-Kahap-809. The petition for the preliminary injunction was filed by Hyundai Securities.

68) See HANKUK KYONGJE, March 30, 2004, at 3.

69) See Korea Financial Supervisory Service Press Release, February 11, 2004; Suwon District Court Yeosu Branch, Decision of March 23, 2004, Case No. 2004-Kahap-51. Grounds for sanctions such as restraint on voting rights include not only defective reporting, but also false reporting and omission in reporting. More specifically, the KSEA had the following penal provisions: (i) a person who, in intentional violation of the obligation to file a Large Holding Report, did not report the status of shareholding, purpose of ownership and the details of the change, or has falsely reported or omitted to state material matters, will be restricted from voting on the shares that are in violation of the reporting requirement, as mentioned above, among the portion that exceeds 5% of the issued and outstanding voting shares for a period of six months; and (ii) a person who has delayed the above reporting or corrective reporting by

Hyundai went through the pierce proxy fight.<sup>70)</sup> No efforts were made for reconciliation. Chung Sang-yung had mentioned during the dispute period that he would stop the business with North Korea once he took over Hyundai Group, but the new chairman, Mrs. Hyun, successfully defended her management control and visited North Korea with one of her daughters to meet Kim Jong Il.<sup>71)</sup> Hyundai's business with North Korea continues to this date.

Before the crucial shareholders meeting of March 30, 2004, Kumgang announced that it would withdraw from the contest if it would lose the proxy contest. Indeed, Kumgang sold its shares of Hyundai Group to Schindler Holding of Switzerland and withdrew from the scene in early 2006. However, in May 2006, Hyundai Heavy Industries unexpectedly took over the shares of Hyundai Merchant Marine<sup>72)</sup> from Golar LNG and became Merchant Marine's largest shareholder. Heavy claimed that its takeover of the shares was an act of its support for the corporate control, but Hyundai Group did not accept the claim. Hyundai Merchant Marine is the key corporation of Hyundai Group and owns a large portion of Hyundai Construction shares.<sup>73)</sup> In fact, Hyundai Group has been preparing a bid for Hyundai Construction. Speculations were made that it was a strategic move for Mong-joon's succession of Hyundai Group, whilst Mong-koo of Hyundai Motor was put in

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mistake shall be subject to the same restraint from the date of the acquisition (or change) until the date that the correction report is made. In both cases, for the respective periods of time, the Korea Financial Supervisory Commission may order disposition of the shares that are in violation of the law. KSEA, Article 200-3, Paragraph 1; Presidential Decree to the KSEA, Article 86-8. Also, the New KFISCOMA adds a penal provision stipulating that a person who fails to file a Large Holding Report may be subjected to up to three years of imprisonment with labor or up to 100 million Korean won fine. KFISCOMA, Article 445, No. 20. See KOREA FINANCIAL SUPERVISORY SERVICE, UNDERSTANDING KOREA'S "5% RULE" (December 2005). For recent regulatory move against manipulation of reporting through derivatives, see Korea Financial Supervisory Service Press Release, March 14, 2006. See generally, Frank H. Easterbrook, *Derivative Securities and Corporate Governance*, 69 U. CHI. L. REV. 733 (2002); Anish Monga, *Using Derivatives to Manipulate the Market for Corporate Control*, 12 STAN. J. L., BUS. & FIN. 186 (2006).

70) At the shareholders meeting held on March 30, 2004, duplicative proxies representing about 300,000 shares (5.4 percent of issued and outstanding shares of the company) were presented and treated as invalid.

71) See MAEIL KYONGJE, August 6, 2005, at A7.

72) <http://www.hmm21.com/hmm/jsp/eng/index.jsp>

73) HANKUK KYONGJE, May 3, 2006, at A26.

prison for a large corporate scandal, and it was once again keenly reminded that Mong-hun and Mong-joon did not share a friendly brotherhood. This dispute is currently dormant, but may become active again.<sup>74)</sup>

### 3. *Viewpoint*

It is interesting to note that the incident that directly triggered Kumgang's attempt for a hostile takeover was a foreign fund's large-scale purchase of Hyundai shares. Heavy also made an equally interesting remark that the purchase of Merchant Marine shares was motivated by its concern over a potential hostile takeover by a foreign entity. Furthermore, the data and materials on the disputes over corporate control between Hyundai Group and Kumgang reveal that the main issues were not so much about creating synergies through mergers and acquisitions but calling attention to the problems affecting the corporate governance system and promise to correct the flaws therein. After the successful takeover defense, Hyundai Group's leadership did promise investors that it would focus further on the "responsibility, transparency and ethics" in managing the member companies.<sup>75)</sup>

It is also noteworthy that whereas the growths of Hyundai Group in the last decades took place in the most patriarchal setting in Korea, the outgrowth of patriarchal management assailed Kumgang for basing its hostile takeover attempt on what the accuser exemplified. That Hyundai Group entertained relying on the citizens (and netizens), employees and small investors as a means to protect its corporate control also was quite uncharacteristic. Lastly, an extraordinary situation emerged that the spotlight was put on the female gender of the current Hyundai chairman under attack and elicited solid support from female executives of Korea.

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74) See MONEY TODAY, May 2, 2006, at 3; JungAng Ilbo, May 1, 2006, at 3.

75) See HANKUK KYONGJE, April 2, 2004, at A15 (full page advertisement).

## V. KT&G<sup>76)</sup>

### 1. Background

KT&G<sup>77)</sup> is an outgrowth of the Monopoly Bureau founded in 1952 and Korea Tobacco and Ginseng Corporation founded in 1989. In 1999, the Corporation spun off its red ginseng business division and was listed in the same year. Issuing GDRs and disposing of stock owned by the government in 2002, it was entirely privatized and renamed KT&G. As of September 30, 2005, Kiup Bank was the largest domestic shareholder with 5.75%. KT&G listed its GDRs in the Luxembourg Stock Exchange and its management is run by professional managers and an independent board of directors.

KT&G implemented the cumulative voting system, a method the company allows that lets a group consolidate all its proxies behind one of the candidates it puts up for a seat or set of seats, increasing his or her chances of election.<sup>78)</sup> Since 2004, KT&G has been selected as the company with the best corporate governance practice every year by the Korea Corporate Governance Service.<sup>79)</sup> According to the sources from the Korea Exchange, the rate of return to shareholders of KT&G during the period between 2003 and 2005 was 96.09%, a record rate in Korea.

Carl Icahn's attack on KT&G in early 2006<sup>80)</sup> caught Korea by surprise.<sup>81)</sup> It was quite shocking to see KT&G fall subject to hedge fund, belittling its past glorious records of dispersed ownership and professional management, and recognition for the excellent corporate governance. This incident raised an alert for the soundness of the Korean criteria for evaluating corporate governance. Actually, during the dispute many flaws in KT&G management

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76) Kim, *supra* note 50, at 45 - 47.

77) <http://www.ktng.com/eng/index.jsp>

78) This is the default rule under the KCC. See KCC Article 382-2. See generally Jeffrey N. Gordon, *Institutions as Relational Investors: A New Look at Cumulative Voting*, 94 COLUM. L. REV. 124 (1994).

79) [http://www.cgs.or.kr/eng/biz/b\\_model.asp](http://www.cgs.or.kr/eng/biz/b_model.asp)

80) *Icahn in South Korea Move*, FINANCIAL TIMES, January 18, 2006, at 1.

81) *See Icahn's Push in Korea Shows Rise of Raiders in Roiling New Markets*, WALL STREET JOURNAL, March 2, 2006, at A1.

and corporate governance were revealed.

Carl Icahn went about his usual way in the KT&G case,<sup>82)</sup> and in his doing so, the Korean capital market was able to draw lessons on the strategies and techniques of international hedge funds. His key suggestions included, *inter alia*: (1) selling down non-core assets, (2) spin-off and listing of Korean Ginseng Corporation, (3) restructuring KT&G's vast real estate portfolio, (4) increasing dividends so that the company's dividend yield would be in line with other world class tobacco companies, and (5) buying back shares, through tender offer, if necessary, and cancel shares to the extent legally permissible.<sup>83)</sup> On February 23, 2006, immediately after sending the "proposals for enhancing stakeholder value", the Icahn group proposed KT&G to acquire additional KT&G shares at 60,000 Korean won (with 13 to 33 percent premium). They were prepared to commit an aggregate of approximately two trillion Korean won (two billion US Dollars) of their own equity capital towards the consummation of the transaction and were sure about the possibility of additional debt financing. The proposal was rejected by KT&G in a letter dated February 28, 2006.

## 2. Showdown

Despite winning the favorable stance in the proxy contest with support from Institutional Shareholder Services and Glass Lewis, due to a material blunder by one of his local counsels, who failed to file a proper shareholder proposal, Icahn had to settle for appointing one outside director of his choice to the board at the March 2006 shareholders' meeting.

There were six directorships up for election at the meeting, consisting of two slots for outside directors and four slots for outside directors who would also serve on the audit committee. While the Icahn group's three candidates

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82) See Ken Auletta, *The Raid: How Carl Icahn Came Up Short*, NEW YORKER, March 20, 2006, at 132-143.

83) Icahn group's letter to KT&G dated February 23, 2006 (on file with the author). Icahn's suggestions look similar to those he made before to TimeWarner and other raiders made to various targets. See, e.g., *Boardrooms Tremble as the Grumpy Old Raiders Get Back to Business*, GUARDIAN, March 19, 2007; *Cadbury Schweppes to Separate Businesses*, INTERNATIONAL HERALD TRIBUNE, March 15, 2007; *Climax Nears in the Messy Battle for Heinz*, INTERNATIONAL HERALD TRIBUNE, July 28, 2006; *Now the Rebellion*, ECONOMIST, May 16, 2008 (Carl Icahn and Yahoo).

appeared on the agenda as candidates for election to the board, they would be only be available to compete for the two non-audit committee directorships. By reserving four of the six directorships for directors who would also serve on the audit committee, KT&G had strategically ensured that all of its nominees would fill these positions as candidates for such positions may only be selected by the board. The Icahn group claimed that such an approach infringed their right to submit the shareholder proposals in violation of the law.<sup>84)</sup>

However, on March 14, 2006, the Daejeon District Court rejected the petition by Carl Icahn and his allies, allowing their three nominees to vie for only two seats of KT&G's outside directorship. The Court overruled Icahn's claim, saying, "We do not find that KT&G's separate voting system for regular and audit directors encroaches upon the minority shareholders' right to a choice of directors like Carl Icahn and his partners claim.... Both separate and collective voting for directors are consistent with the current Commercial Code and Securities Exchange Act. Which to choose between the two depends on the board as long as there is no special proposal from shareholders during a shareholder proposal period.... The Carl Icahn consortium did not make issue with the voting method itself during a shareholder proposal period, although they argued that it was not in line with the law. All they wanted was to include three nominees they recommended as candidates for directors."<sup>85)</sup>

The four audit committee member positions on the 12-member board were assured to go to KT&G's candidates, but one of the two outside director positions is almost certain to go to an Icahn candidate because neither side will win the 66.7 per cent support needed to take both seats. Carl Icahn and his partners succeeded in getting their candidate on the board through cumulative voting. The remaining three candidates for the two seats for which the Icahn candidates were eligible received far fewer votes. In August 2006

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84) See Icahn group's letter to KT&G dated February 15, 2006 (on file with the author). For comment, see Ok-Rial Song, *Takeover Defense Through Composition of the Audit Committee*, 20 BUSINESS FINANCE AND LAW 93 (2006) (Korean).

85) Case No. 2006-Kahap-242. For discussions on shareholder proposals in the United States, see generally Lucian A. Bebchuk, *The Case for Shareholder Access to the Ballot*, 59 BUS. LAW. 43 (2003); Martin Lipton & Steven A. Rosenblum, *Election Contests in the Company's Proxy: An Idea Whose Time Has Not Come*, 59 BUS. LAW. 67 (2003); Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005).

KT&G accepted practically all of the suggestions made by Icahn.<sup>86)</sup> Carl Icahn, in December 2006, disposed of its entire stakes in KT&G and gained about 100 billion Korean won in profit (44.22% net return).<sup>87)</sup>

### 3. *New Issues*

At the time of dispute, one commentator went as far to say, "If Sovereign was a grade school kid, Icahn is a college student. Now a group of graduate students like KKR will flock to the Korean market. Are the Korean companies ready to defend its corporate control?"<sup>88)</sup> As peculiar as it may sound, the statement turned out to be quite convincing. The international nature that represented the mix of the shareholders elicited participation by many international players during the KT&G and Icahn dispute. KT&G was advised by Goldman Sachs and Lehman Brothers, and Georgeson Shareholder Communications acted in the proxy solicitation at the shareholder's meeting.

KT&G triggered an explosion of debates on the merits of leaving Korean companies exposed to the possibility of hostile takeover attempts.<sup>89)</sup> Many economists have proved the disciplinary function of a hostile takeover attempt; a hostile takeover attempt puts a rein on directors, thereby serving as an effective external controlling mechanism. In light of the positive effect, some argue for no limitation on allowing hostile takeover attempts. According to the liberal advocates, the need for securing takeover defensive tactics as demanded by companies lacks sound judgment. 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. Therefore, the government should focus more on untangling ownership structures of Korean corporations and allow hostile takeover attempts to function

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86) *KT&G Bows to Icahn Demand to Return Cash to Shareholders*, FINANCIAL TIMES, August 10, 2006, at 1.

87) See MAEIL KYUNGJE, December 6, 2006, at A2.

88) See MONEY TODAY, April 13, 2006: <http://www.moneytoday.co.kr/view/mtview.php?type=1&no=2006040914422600450>

89) See, e.g., Korea Corporate Governance Service, Report on the Experts Discussions held on February 23, 2006 (Korean): [http://www.cgs.or.kr/review/0605/report\\_05.asp](http://www.cgs.or.kr/review/0605/report_05.asp)



effectively. They further argue that KT&G could not avoid being the target of the hedge fund because its dispersed ownership was characteristic of Western corporations and because it did not belong to a conglomerate. The threat imposed on KT&G by the hedge fund in the end benefited the shareholders and other interest parties and increased the value of the company.

The KT&G case also opened the new era in the discussion of (outside) directors' obligations and liabilities<sup>90</sup> in control contests and takeovers. In the course of the defense against Carl Icahn and his allies, KT&G considered selling treasury shares to friendly local banks. KT&G had 15,558,565 treasury shares representing about 9.76% of total issued and outstanding shares. While KT&G cannot exercise voting rights on its treasury shares, if the shares are sold to a third party, the third party would be able to exercise the voting rights attached to the shares. Thus, KT&G considered selling its treasury shares to a party friendly to the KT&G management and thereby increase the percentage of shares held by shareholders who would support the current management. On March 13, 2006, Industrial Bank of Korea, KT&G's third-largest shareholder with a 5.96 percent stake, and Woori Bank asked KT&G to allow due diligence for a possible purchase of KT&G's treasury shares. It was reported that Icahn and his allies would take legal actions against the board of directors of KT&G if they were to have pushed ahead with such a sale. According to Icahn, a sale of treasury shares to the banks "would constitute a breach of the board's fiduciary duties to the shareholders."<sup>91</sup> It is not known whether such a warning did in fact influence the decision of the KT&G's board, but one of the most popular takeover defensive tactics in Korea was not used by KT&G against Carl Icahn.

The issue of directors' liabilities arose again when Korea Securities Depository (KSD) decided not to accept the KT&G foreign shareholders' votes

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90) For recent studies in general, see Bernard Black, Brian Cheffins & Michael Klausner, *Outside Director Liability*, 58 STAN. L. REV. 1055 (2006); Brian Cheffins & Bernard Black, *Outside Director Liability Across Countries*, 84 TEX. L. REV. 1385 (2006); Bernard Black et al., *Legal Liability of Directors and Company Officials Part 2: Court Procedures, Indemnification and Insurance, and Administrative and Criminal Liability*, 2008 COLUM. BUS. L. REV. 1; Bernard Black et al., *Legal Liability of Directors and Company Officials Part 1: Substantive Grounds for Liability*, 2007 COLUM. BUS. L. REV. 614.

91) *Icahn Threatens to Sue KT&G Board*, FINANCIAL TIMES, March 15, 2006, at 22.

electronically from local custodians from March 9, 2006.<sup>92)</sup> The Icahn group demanded that KT&G take actions to rectify the situation, and reminded that “[E]ach member of the board of directors is responsible and liable as fiduciaries to protect the integrity of a fair election process. In that capacity, it is incumbent on the board of directors to use all available means to force the KSD to exercise its authority to continue the electronic voting process and not cut off any shareholder’s voting rights. [We] intend to hold each director personally responsible for any failure to satisfy his duties to shareholders... and will take any and all legally available means against those that are responsible for such actions.”<sup>93)</sup> As the decision of the KSD was regarded as not depriving voting rights of the foreigners, no legal action was taken by the Icahn group. However, their course of action clearly showed a different approach, i.e., holding the directors personally liable for possible misconduct, not legally challenging the corporate act itself.

## VI. Hanaro

This was not a classical takeover case. However, the Hanaro Telecom case involved the first-ever full-scale proxy fight in Korea.<sup>94)</sup> The case also indicated that the legal dispute on the deal protection devices may arise in Korea in the future.

### 1. Proxy Contest

In 2003, a proxy contest over a shareholders’ meeting of Hanaro Telecom between LG Corporation supported by Carlyle Group on the one hand and

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92) This was a surprise to many local custodians who had expected that the deadline would be March 10th which is four business days before KT&G’s annual general meeting of shareholders to be held on March 17, 2006 which has been the normal practice with KSD and the local custodians.

93) Icahn group’s letter to KT&G dated March 12, 2006 (on file with the author).

94) The number of proxy contests has been arising recent years. Alone in 2007, 34 proxy contests took place, and dissident shareholders won 4 of them. See Korea Financial Supervisory Service Press Release, February 12, 2008.

Hanaro supported by Newbridge/AIG consortium and Hanaro's labor union on the other took place. Hanaro's board decided to receive new investment from Newbridge/AIG consortium and to achieve this purpose, approved several agenda on the shareholders' meeting which LG opposed, including determination of the minimum price for the issuance of new shares. Eventually, Newbridge/AIG won the contest with the desperate support from the labor union.

The KFISMA,<sup>95)</sup> its Enforcement Decree,<sup>96)</sup> and the Regulation on Securities Issuance and Disclosure promulgated by the KFSC apply to a proxy contest in Korea. With certain exceptions,<sup>97)</sup> in order to solicit votes from other shareholders, the solicitor must send to shareholders a proxy statement complying with the relevant rules. The solicitor who violates the rules may be subject to imprisonment of three years or less or a penalty of 100 million Korean Won or less.<sup>98)</sup> Both sides utilized diverse means of solicitation including posting advertisements in newspaper, mail, phone calls, opening of home page, etc. They also paid physical visit to the target shareholders. Newbridge/AIG consortium considered placing promotional materials and Hanaro's employee in major branch offices of Korea First Bank,<sup>99)</sup> but this was not implemented due to Korea First Bank's opposition. The piece proxy

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95) Articles 152 through 158.

96) Articles 160 through 166.

97) KFISMA's Enforcement Decree, Article 161.

98) KFISMA, Article 445, No. 21. It would be very difficult to carry out wide solicitation of proxy without the shareholders' register. Thus, the issues such as whether to permit the soliciting shareholder's request for review/copying of the shareholders' register and if so, when should the company allow the soliciting shareholder to review/copy shareholders' register became important issues in the proxy contest. According to LG, a shareholder can, under the KCC, request review/copying of the company's shareholders' register at any time during the company's business hours; however, Hanaro did not allow LG to review the shareholders' register for one week or more. LG sought to copy the CD that contained Hanaro's shareholders' register. Hanaro refused the request, however, citing concerns over leakage of private information of individuals such as resident registration number. The same issue came up in Hyundai case. When Hyundai refused Kumgang's request for review/copy of the shareholders' register on the ground that there would be leakage of shareholders' private information, Kumgang sought injunctive relief to allow it to review and copy Hyundai's shareholders' register. The court accepted Kumgang's petition for injunction and Kumgang was allowed to copy Hyundai's shareholders' register.

99) At the time, Newbridge was Korea First Bank's controlling shareholder.

solicitations by both sides produced an odd result. With Hanaro soliciting proxy first followed by LG's solicitation, there were shareholders who granted proxy to Hanaro and then later, also granted proxy to LG. Thus, the effect of duplicative proxy cards and how to deal with duplicative proxy cards became an issue. In the case of duplicative proxy cards, the majority view is the later proxy card is effective, because it is possible for a shareholder to revoke granting of proxy. If the validity of a given proxy could not be determined based on the date of its execution, then unless the intention of the shareholder who has given proxy is shown to be consistent, all of the duplicative proxies were viewed as invalid.<sup>100)</sup> In verifying the veracity of the proxy card, lawyers for Hanaro and LG all participated. In the case of written vote, an issue arose over whether Hanaro would allow a supervisor appointed by LG to supervise counting of the votes. Regarding the agenda on issuance of new shares which was a point of dispute, Hanaro allowed LG's supervisor to supervise counting of the votes.

## 2. Deal Protection

The case attracted public attention again in 2006 when Newbridge decided to liquidate its interest in Hanaro to SK Telecom. After the deal was agreed between both parties, Hanaro disclosed to the Korea Exchange that there was no deal concluded. This took place about ten hours after SK Telecom's disclosure to the exchange that the deal was concluded. It later turned out that LG Telecom approached to Newbridge with a higher offer that made Newbridge reconsider the deal with SK Telecom. SK Telecom referred to the deal protection clauses in the agreement and also strongly warned that it would definitely block the deal between Newbridge and LG Telecom if Newbridge changes mind after all. At the end of the day, Hanaro disclosed that it was sold to SK Telecom and received penalty from the Korea Exchange. The incidence was not followed by any shareholder lawsuits. However, the case showed that the U.S.-style deal protection<sup>101)</sup> would be needed for any

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100) At Hyundai's shareholders' meeting, duplicative proxies representing about 300,000 shares were treated as invalid.

101) Cf. Leo Strine, *Categorical Confusion: Deal Protection Measures in Stock-for-Stock Merger Agreements*, 56 BUS. LAW. 919 (2001); Gregory V. Varallo & Srinivas M. Raju, *A Fresh Look at*

merger talks in Korea. Discussion on the corporate directors' fiduciary duties in such cases<sup>102)</sup> will also become active.

## VII. The New Commercial Code

The KCC currently is undergoing a comprehensive revision. The Korean General Assembly has been discussing the government's proposal and other draft bills submitted by individual lawmakers since 2005. Although it is not expected that the bill will pass the legislative body anytime soon, the revision, once realized, should overhaul the KCC almost beyond recognition as the draft bill contains new institutions for corporate governance and finance of Korean firms.<sup>103)</sup> This part of the article comments on the provisions in respect

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*Deal Protection Devices: Out from the Shadow of the Omnipresent Specter*, 26 DEL. J. CORP. L. 975 (2001); Gregory V. Varallo & Srinivas M. Raju, *A Process-Based Model for Analyzing Deal-Protection Measures*, 55 BUS. LAW. 1609 (2000); Karl F. Balz, *No-Shop Clauses*, 28 DEL. J. CORP. L. 513 (2003); Guhan Subramanian, *Go-Shops vs. No-Shops in Private Equity Deals: Evidence and Implications*, 63 BUS. LAW. 729 (2008); J. Russel Denton, *Stacked Deck: Go-Shops and Auction Theory*, 60 STAN. L. REV. 1529 (2008).

102) Cf. R. Franklin Balotti & A. Gilchrist Sparks III, *Deal-Protection Measures and the Merger Recommendation*, 96 NW. U. L. REV. 467 (2002); Jennifer J. Johnson & Mary Siegel, *Corporate Mergers: Redefining the Role of Target Directors*, 136 U. PENN. L. REV. 315 (1987); Mark Lebovitch & Peter B. Morrison, *Calling a Duck a Duck: Determining the Validity of Deal Protection Provisions in Merger of Equals Transactions*, 2001 COLUM. BUS. L. REV. 1; Comment, *Is Merger Agreement Ever Certain? The Impact of the Omnicare Decision on Deal Protection Devices*, 29 DEL. J. CORP. L. 805 (2004).

103) The draft bill introduces the corporate opportunity doctrine into the statute. Article 398 (Transaction between a Director and the Company) stipulates: (1) The person who falls under any one item below may transact with the company through his or third person's account only when the board of directors makes a prior approval of the transaction above. 1. Director 2. The spouse of a director, and the lineal descendant and ascendants of a director or its spouse 3. A company, in which the person(s) falling under item 1 or 2 above individually or in aggregate possess 50% or more of the issued and outstanding shares with the voting rights, or the subsidiary of such company 4. A company, in which the person(s) and company under the Section 1 through 3 above under this Article in aggregate possess 50% or more of the issued and outstanding shares with the voting rights. (3) In case when a director causes a third party to transact with the company using the corporate opportunity listed under any item below, which may benefit the company contemporaneously or in the future, the approval under Section 1 is required. 1. A business opportunity, which he or she came to know during the performance of his or her duty or using the information of the company 2. A business opportunity having a

of corporate control.

### 1. Squeeze-out

The draft bill includes the mechanism for acquisition of dissenting minorities. The compulsory buy-out threshold is set at 95% level. The proposed provisions below<sup>104)</sup> are general ones that allow a controlling shareholder to purchase compulsorily the shares owned by a minority, no matter whether the majority was acquired in a takeover bid or not. The minorities have the right to be bought out at the same 95%, i.e., 5%, level.<sup>105)</sup> However, there is no more sophisticated mechanism for determination of a fair price than the current one applicable to the shareholders' appraisal claims, which has been very controversial.<sup>106)</sup> Also, it should be pointed out that the Korean law does neither know the concept of the "entire fairness" as developed in *Singer v. Magnavox Co.*<sup>107)</sup> nor the fiduciary duty of majority shareholders to minority shareholders as it is the case in the United States<sup>108)</sup> and Germany.<sup>109)</sup> I have argued elsewhere that the new squeezeout institution

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close connection with a business that the company currently conducts or plans to conduct. For the U.S. law, see Eric Talley, *Turning Servile Opportunities to Gold: A Strategic Analysis of the Corporate Opportunities Doctrine*, 108 YALE L. J. 277 (1998).

104) Translation by Lee & Ko, Korea, and the author.

105) For a brief comparative account, see Paul Davies & Klaus Hopt, *Control Transactions*, in: Reinier Kraakman et al. eds., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 157, 183-184 (Oxford University Press, 2004). For German law, see Holger Fleischer, *Das neue Recht des Squeeze out*, 31 ZEITSCHRIFT FÜR UNTERNEHMENS-UND GESELLSCHAFTSRECHT 757 (2002); Eberhard Vetter, *Squeeze-out – Der Ausschluss der Minderheitsaktionäre aus der Aktiengesellschaft nach den §§327a-327f AktG*, 47 DIE AKTIENGESELLSCHAFT 176 (2002). For Austrian law, see Franz Althuber & Astrid Krüger, *Squeeze-out in Österreich*, 52 DIE AKTIENGESELLSCHAFT 194 (2007).

106) See Hwa-Jin Kim, *The Appraisal Remedy Revisited*, 393 KOREAN BAR ASSOCIATION JOURNAL 8 (2009) (in Korean). For U.S. law, see, e.g., Lawrence A. Hamermesh & Michael L. Wachter, *The Fair Value of Cornfields in Delaware Appraisal Law*, 31 DEL. J. CORP. L. 119 (2005); Barry M. Wertheimer, *The Shareholders' Appraisal Remedy and How Courts Determine Fair Value*, 47 DUKE L. J. 613 (1998).

107) 380 A.2d 969 (Del. 1977).

108) *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983); *Sinclair Oil Corp. v. Levien*, 280 A.2d 717 (Del. 1971). See J. A. C. Hetherington, *Defining the Scope of Controlling Shareholders' Fiduciary Responsibilities*, 22 WAKE FOREST L. REV. 9 (1987).

109) See Hwa-Jin Kim, *Markets, Financial Institutions, and Corporate Governance: Perspectives*

may work properly if and only if the Korean courts contemporaneously develop the fairness standard applicable to valuation as well as procedure and introduce the fiduciary duty of major shareholders to minority shareholders.<sup>110)</sup> This is more so because the draft bill also allows the U.S.-style cash-out merger transaction.<sup>111)</sup>

Article 360-24 (Controlling Shareholder's Right to Request for Sale)<sup>112)</sup>

- (1) The shareholder who possesses 95% or more of the total issued and outstanding shares of a company under his own account (hereinafter, "Controlling Shareholder") may request the other shareholder the sale of the shares possessed by such other shareholder (hereinafter, "Minority Shareholder") if the purchase is necessary to achieve the business purpose of the company ("Request for Sale")
- (2) For the calculation of the shares possessed by the Controlling Shareholder stipulated under Section 1 above, the shares in the same company owned by the parent company and its subsidiary shall be combined. For calculation, the shares of the company, in which a shareholder, who is not a

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from Germany, 26 GEO. J. INT'L L. 371, 392-394 (1995); John C. Coffee, Jr., *Privatization and Corporate Governance: The Lessons from Securities Market Failure*, 25 J. CORP. L. 1, 29 (1999); J. Bautz Bonnano, *The Protection of Minority Shareholders in a Konzern Under German and United States Law*, 18 HARV. INT'L L. J. 151 (1977); Ulrich Wackerbarth, *Investorvertrauen und Corporate Governance*, 34 ZEITSCHRIFT FÜR UNTERNEHMENS-UND GESELLSCHAFTSRECHT 686 (2005); SUSANNE WIMMER-LEONHARDT, KONZERNHAFTUNGSRECHT 157-453 (Mohr Siebeck, 2004).

110) Hwa-Jin Kim, *Freeze-out of Minority Shareholders under the Draft New Commercial Code*, 50-1 SEOUL L. J. 321 (2009) (in Korean).

111) Article 523, No. 4.

112) The Korea Exchange Listing Rules provides that a listed company may apply for a voluntary delisting with the shareholders' resolution by a simple majority vote. However, the Korea Exchange may reject such application, unless the company meets the compulsory delisting requirements under the rules. The shares of a listed company will be designated as surveillance shares in any of the following cases, and such shares will become subject to compulsory delisting if the cause for such designation is not cured as appears in the next annual report filed after such designation: (1) The number of small shareholders (holding one percent or less) is less than 200 in the annual report for the most recent fiscal year; (2) The total number of shares held by small shareholders is less than 10 percent of liquid shares in the annual report for the most recent fiscal year; (3) The largest shareholder (including the shares held by affiliates and specially related persons) holds at least 80 percent of the total issued shares in the annual report for the most recent fiscal year; or (4) The monthly average trading volume is less than one percent of the total issued shares during any quarter. The Listing Rules expressly provides that the Korea Exchange may not reject the application for delisting if the compulsory delisting requirement is met. Listing Rules, Articles 77, 79 and 80.

- company, owns more than 50% of shares, shall be combined with the shares owned by such shareholder.
- (3) The Request for Sale under Section 1 must be approved by the shareholders' meeting in advance.
  - (4) When notifying the convening of a shareholder's meeting for the Section 3 above, the following items must be included in the notice thereof, and they must be explained by the Controlling Shareholder at such meeting.
    1. The shareholding status of the company by the Controlling Shareholder
    2. The purpose for the Request for Sale
    3. The basis of the calculation on the share price and the appraisal report by the certified appraiser on the appropriateness on the share price
    4. Payment guarantee on the share price
  - (5) The Controlling Shareholder shall make a public notice on the following items one month prior to the date when the Request for Sale is made and shall notify the shareholder and the pledgee, who are listed on the shareholder registry, separately.
    1. The Minority Shareholder shall deliver the share certificate simultaneously upon the receipt of the share price
    2. If the share certificate is not delivered, the share certificate will be null and void on the date when the Minority Shareholder accepts the share price or when the Controlling Shareholder deposits the share price in the public account
  - (6) The Minority Shareholder, who has received the Request for Sale under Section 1 above, must sell its shares to the Controlling Shareholder within 2 months from the date when the Minority Shareholder received the notice for the Request for Sale.
  - (7) In case of Section 6 above, the share price shall be determined by the agreement by and between the Controlling Shareholder requesting the sale and the Minority Shareholder whom such request was made to.
  - (8) In case when the Minority Shareholder and the Controlling Shareholder could not agree on the share price under Section 7 above within 30 days from the date when the Request for Sale was received by the Minority Shareholder pursuant to Section 1 above, the Minority Shareholder or the Controlling Shareholder individually may request the court to determine the share price.
  - (9) In case when the court determines the share price pursuant to the Section 8 above, the court shall determine the share price at fair value considering the financial condition of the company and other relevant factors.

Article 360-25 (Minority Shareholder's Right to Request for Purchase)



- (1) The Minority Shareholder of a company, where a Controlling Shareholder exists, may request the Controlling Shareholder to purchase its shares at any time ("Request for Purchase")
- (2) The Controlling Shareholder, who received the Request for Purchase under the Section 1, must purchase the shares of the Minority Shareholder within 2 months from the date when such Request for Purchase was made.
- (3) In case of the Section 2 above, the share price shall be determined by the agreement between the Controlling Shareholder and Minority Shareholder.
- (4) In case when the Minority Shareholder and the Controlling Shareholder could not agree on the share price under Section 2 above within 30 days from the date when the Request for Purchase was made, the Minority Shareholder or the Controlling Shareholder individually may request the court to determine the share price.
- (5) In case when the court determines the share price pursuant to the Section 4 above, the court shall determine the share price at fair value considering the financial condition of the company and other relevant factors.

Article 360-26 (Share Transfer, etc.)

- (1) The share shall be deemed to be transferred to the Controlling Shareholder on the date when the Controlling Shareholder makes the payment to the Minority Shareholder pursuant to Article 360-24 and 360-25.
- (2) In case when the Controlling Shareholder is unable to know whom the share price should be paid to or when the Minority Shareholder refuses to accept the share price, then the Controlling Shareholder may deposit the share price in the public account. In this case, the share shall be deemed to be transferred on the date of such deposit.

## 2. *Poison Pill*

The poison pill has been the single most controversial issue in discussions on takeover defenses in Korea over the years. This is more so because Japan has introduced the poison pill in 2005<sup>113)</sup> and its practical function has recently

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113) Satoshi Kawai, *Poison Pill in Japan*, 2004 COLUM. BUS. L. REV. 11; Ronald J. Gilson, *The Poison Pill in Japan: The Missing Infrastructure*, 2004 COLUM. BUS. L. REV. 21; William B. Chandler III, *Hostile M&A and the Poison Pill in Japan: A Judicial Perspective*, 2004 COLUM. BUS. L. REV. 45; Hideki Kanda, *Does Corporate Law Really Matter in Hostile Takeovers?: Commenting on Professor Gilson and Chancellor Chandler*, 2004 COLUM. BUS. L. REV. 67.

been contested before the courts in Japan.<sup>114)</sup> According to the widely-accepted definition, “the essence of the poison pill is that the crossing by an acquirer of a relatively low threshold of ownership triggers rights for target shareholders in relation to the shares of either the target or the acquirer, from which the acquirer itself is excluded and which render the acquisition of further shares in the target fruitless or impossibly expensive.”<sup>115)</sup> Under the current laws of Korea, poison pill that is commonly used in the United States<sup>116)</sup> is not allowed. There are various rules and regulations that limit the company’s ability to create the poison pill. Among others, as it is also the case in many European countries,<sup>117)</sup> under the KCC, resolution concerning dividend payout is subject to the resolution by the shareholders, not by the board of directors. Also, distribution of profit can only be made by cash or stocks, not contingent rights to purchase company’s new shares. The KFISCOMA also regulates the issuance price of new shares of listed companies.<sup>118)</sup>

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114) See Kenichi Osugi, *Transplanting Poison Pills in Foreign Soil: Japan’s Experiment*, in *TRANSFORMING CORPORATE GOVERNANCE IN EAST ASIA* 36, 43-51 (Hideki Kanda et al. eds., Routledge, 2008) (reviewing the Nippon Broadcasting Systems, Nireco and JEC cases); Osugi, Kenichi, *What is Converging?: Rules on Hostile Takeovers in Japan and the Convergence Debate*, 9 *ASIAN-PACIFIC L. & POLICY J.* 143, 157-159 (2007) (Bulldog case). It remains to be seen if the Japanese case law would evolve after the U.S. law. Cf. Mark D. West, *The Puzzling Divergence of Corporate Law: Evidence and Explanations from Japan and the United States*, 150 *U. PENN. L. REV.* 527 (2001).

115) Davies & Hopt, *supra* note 29, at 169. This definition is from Lucian Bebchuk & Allen Ferrell, *Federalism and Corporate Law: The Race to Protect Managers from Takeovers*, 99 *COLUM. L. REV.* 1168 (1999); Lucian Bebchuk & Allen Ferrell, *On Takeover Law and Regulatory Competition*, 57 *BUS. LAW.* 1047 (2002).

116) *Moran v. Household International, Inc.*, 500 A.2d 1346 (Del. 1985); RONALD GILSON & BERNARD BLACK, *THE LAW AND FINANCE OF CORPORATE ACQUISITIONS* 740-748 (2<sup>nd</sup> ed. Foundation Press, 1995); Martin Lipton, *Pills, Polls, and Professors Redux*, 69 *U. CHI. L. REV.* 1037 (2002); David A. Katz & Laura A. McIntosh, *Corporate Governance Update: Poison Pills – Maintain Flexibility in Takeover Defense* (Wachtell, Lipton, Rosen & Katz Memorandum, January 26, 2006); Guhan Subramanian, *Bargaining in the Shadow of Takeover Defenses*, 113 *YALE L. J.* 621 (2003); Guhan Subramanian, *Bargaining in the Shadow of PeopleSoft’s (Defective) Poison Pill*, 12 *HARV. NEGOTIATION L. REV.* 41 (2007); Jonathan M. Karpoff & Morris G. Danielson, *Do Pills Poison Operating Performance?* (Working Paper, 2002); Jeffrey Gordon, *“Just Say Never” Poison Pills, Dead Hand Pills and Shareholder Adopted By-Laws: An Essay for Warren Buffet*, 19 *CARDOZO L. REV.* 511 (1997); Marcel Kahan & Edward B. Rock, *How I Learned To Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law*, 69 *U. CHI. L. REV.* 871 (2002).

117) Davies & Hopt, *supra* note 29, at 169.

118) Articles 118 through 132.

The poison pill, if introduced in Korea, should be used to support a better deal for the shareholders. However, as Professor Gilson did warn Japan before,<sup>119)</sup> it may be used to simply block a bid in favor of the controlling minority, if institutions like independent directors, courts and active institutional investors do not police the uses to which the poison pill is actually put. It can also be expected that poison pills in Korea will generate lawsuits and Korean corporate law will evolve along the line developed by the Delaware takeover law as it was already evidenced in Hyundai case.<sup>120)</sup> Large Korean law firms have been educating their young lawyers in U.S. law schools since decades ago, and so has the Korean judiciary.<sup>121)</sup> Furthermore, large Korean firms may feel safer if they retain reputable U.S. law firms when confronted with a control contest. The expert group commissioned by the Korean Ministry of Justice has been working on another draft bill to amend the KCC since early 2008. In November 2008, the expert group came up with tentative draft provisions to introduce the poison pill into the KCC as follows:<sup>122)</sup>

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119) See Gilson, *supra* note 113, at 41-42.

120) But see Bernard S. Black, *The Core Fiduciary Duties of Outside Directors*, ASIA BUS. L. REV. 13, 27 (July 2001) (“[I] would not wish for another country to copy our confused case law.”) Comparative corporate law analysis is a very important methodology in academia as well as in corporate law practice in Korea. However, as far as takeover law is concerned U.S. law’s influence is dominant. For comparative corporate law in general, see John W. Cioffi, *State of the Art: A Review Essay on Comparative Corporate Governance: The State of the Art and Emerging Research*, 48 AM. J. COMP. L. 501 (2000); Katharina Pistor et al., *The Evolution of Corporate Law: A Cross-Country Comparison*, 23 U. PENN. J. INT’L ECON. L. 791 (2002); Edward B. Rock, *America’s Shifting Fascination with Comparative Corporate Governance*, 74 WASH. U. L. Q. 367 (1996). See also Roberta Romano, *A Cautionary Note on Drawing Lessons from Comparative Corporate Law*, 102 YALE L. J. 2021 (1993); William W. Bratton & Joseph A. McCahery, *Comparative Corporate Governance and the Theory of the Firm: The Case Against Global Cross Reference*, 38 COLUM. J. TRANSNAT’L L. 213 (1999). For a bibliography on international corporate governance, see Hwa-Jin Kim, *International Corporate Governance: A Select Bibliography*, 8 J. KOREAN L. 201 (2008).

121) For German corporate law’s experiences in adapting to the U.S. corporate law, see JAN VON HEIN, *DIE REZEPTION US-AMERIKANISCHEN GESELLSCHAFTSRECHTS IN DEUTSCHLAND* (Mohr Siebeck, 2008); MATHIAS M. SIEMS, *DIE KONVERGENZ DER RECHTSSYSTEME IM RECHT DER AKTIONÄRE* (Mohr Siebeck, 2005); ANDREA LOHSE, *UNTERNEHMERISCHES ERMESSEN* (Mohr Siebeck, 2005). For corporate control contests in Germany, see MARY O’SULLIVAN, *CONTESTS FOR CORPORATE CONTROL: CORPORATE GOVERNANCE AND ECONOMIC PERFORMANCE IN THE UNITED STATES AND GERMANY* (Oxford University Press 2000); JENNIFER PAYNE ED., *TAKEOVERS IN ENGLISH AND GERMAN LAW* (Hart Publishing, 2003).

122) Translation by Lee & Ko, Korea, and the author.

Article 432-2 (Subscription Option for New Shares)

- (1) A company may grant the right to the shareholders to request the company to issue the new shares within a specified period (“Exercise Period”), at the pre-determined price (“Exercise Price”) in proportion to the numbers and types of shares held by the shareholder (“Subscription Option”)
- (2) The company shall not receive any consideration in exchange for granting the Subscription Option.
- (3) The company intending to issue the Subscription Option must specify the following items in the Article of Incorporation
  1. The statement that the Subscription Option may be granted to the shareholders
  2. The limit on the number and types of new shares that could be issued pursuant to the exercise of Subscription Option
- (4) The Company may provide the following statements under its Article of Incorporation incorporating the terms described under the Section 3 above. In such case, the company may grant the Subscription Option pursuant to the terms under the Article of Incorporation only to maintain or increase the benefit of all shareholders and the value of the company.
  1. In certain cases, the Subscription Option may not be granted to some shareholders
  2. In certain cases, some shareholders may not be able to exercise the Subscription Option, or the terms of the Subscription Option may be different for some shareholders as compared to other shareholders
  3. In certain cases, the company may redeem all or part of the Subscription Options and in this case, the redemption terms may differ for some shareholders.
- (5) In case when the company grants the Subscription Option pursuant to the terms provided under the Article of Incorporation, which incorporated the terms described under Section 4 above, the exercise price may be the fair price on the date when the Subscription Option is granted or the exercise date or the price below the par value of a share.

Article 330 (Restriction on the Issuance of the Shares at a Price below the Par Value)

The shares shall not be issued at a price below the par value except the issuance pursuant to the Article 417 and Section 5 of Article 432-2.

Article 432-3 (Granting Subscription Option)

- (1) In case when a company grants the Subscription Option, the following items must be specified by the resolution of board of directors thereof.

1. The Subscription Option will be granted to the shareholders on a specified date.
  2. The number and type of shares to be newly issued pursuant to the exercise of Subscription Option or the method to calculate the number of shares thereon.
  3. Issues relating to the exercise price of the Subscription Option and the adjustment thereon.
  4. Exercise period and conditions on exercise of the Subscription Option.
  5. In case when the company decided not to grant Subscription Option to some shareholders, the scope of shareholders who will not be granted with the Subscription Option.
  6. In case when the exercise of the Subscription Option is restricted or the terms of the Subscription Option are different for some shareholder, the detailed information and the scope of shareholders who will be granted with the restricted Subscription Option or different terms thereon.
- (2) The company must publicly notify the resolutions of the board of directors within 7 days from the resolution date, approving the items under the Section 1 above
- (3) The Exercise Period under Item 4 of Section 1 shall begin after two weeks from the public notice under Section 2 above

Article 432-4 (Redemption of the Subscription Option)

- (1) In case when the company decides to redeem the Subscription Option pursuant to the terms provided in the Articles of Incorporation for the purpose under item 3 of Section 4 of Article 432-2, the board of directors must decide the following items. In this case, the company must make a public notice thereon immediately.
1. The scope of the Subscription Options that will be redeemed
  2. If the Subscription Option will be effective under the certain circumstances, the reasons thereof
  3. The effective date of the redemption
  4. The specifics regarding the money, asset or new shares to be paid or issued for redemption
  5. In case when some shareholders will have different terms for the redemption as compared to other shareholders, then the specifics of the different terms and the scope of those shareholders
- (2) With respect to the Subscription Option, which is redeemed pursuant to Section 1, the effectiveness of Subscription Option will be extinguished on the date of the effective redemption date.

Article 432-5 (Accompaniment of Subscription Option and Retirement without Consideration)

- (1) The Subscription Option cannot be transferred separately from the shares.
- (2) In case when the share is transferred after the Subscription Option is granted, it shall be deemed that the Subscription Option was transferred with such transfer.
- (3) The Company may retire all of the Subscription Option without a consideration through the resolution of board of directors or of the shareholders' meeting prior to the first date of the Exercise Period.

Article 432-6 (The Exercise of the Subscription Option)

- (1) A person, who intends to exercise the Subscription Option, must submit two (2) copies of applications to the Company within the Exercise Period and must fully pay the Exercise Price.
- (2) For the shareholders who have exercised the Subscription Option under Section 1, Article 516-9 shall apply, *mutatis mutandis*.

### 3. *Dual-class Commons*

The shareholders holding shares with multiple voting rights have management control over the company and, moreover, unless these shareholders decide to hand over the company to a third party, a takeover would simply be impossible. The dual-class commons are widespread in Europe<sup>123)</sup> but it is actually most prevalently utilized by the companies in the United States, including Berkshire and Ford Motors.<sup>124)</sup> According to recent data, roughly 200 or more listed companies including large companies such as Viacom and approximately 5-6 percent of the venture companies undergoing IPOs have issued the dual-class common shares.<sup>125)</sup>

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123) Report on the Proportionality Principle in the European Union (18 May 2007).

124) Jeffrey N. Gordon, *Ties That Bind: Dual Class Common Stock and the Problem of Shareholder Choice*, 76 CAL. L. REV. 1 (1988); Paul Gompers et al., *Incentives vs. Control: An Analysis of U.S. Dual-Class Companies* (Working Paper, January 2004).

125) Laura Field & Jonathan Karpoff, *Takeover Defenses of IPO Firms*, 57 J. FIN. 1857 (2002). For antitakeover arrangements of IPO firms, see generally Lucian A. Bebchuk, *Why Firms Adopt Antitakeover Arrangements*, 152 U. PENN. L. REV. 713 (2003); Robert Daines & Michael Klausner, *Do IPO Charters Maximize Firm Value? Antitakeover Protection in IPOs*, 17 J. L., ECON. & ORG. 83 (2001).

The KCC, however, Article 369, Paragraph 1, adopts the one share one vote system.<sup>126)</sup> It is a mandatory rule and as such understood to be a rule which a company cannot overturn by its articles of incorporation. However, restrictions on voting rights are not only stipulated under the KCC but in numerous other laws and regulations in Korea.<sup>127)</sup> A primary example is the requirement that a shareholder may exercise only up to 3% of the total number of issued and outstanding shares in the appointment of a statutory auditor.<sup>128)</sup> Although studies find that the one share one vote regime has value,<sup>129)</sup> it should be noted that the dual class share system should not be perceived simply as a means to retain incumbents' control of management. The dual class share system is relatively more transparent compared to cross-shareholdings or pyramid type structures. If the dual class share system is abolished, the relevant companies will attempt to either adopt cross-shareholding or create a pyramid type corporate structure to protect its management's interests.<sup>130)</sup> The Korean Ministry of Justice's expert group has

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126) Cf. Joel Seligman, *Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy*, 54 GEORGE WASH. L. REV. 687 (1986); Guido Ferrarini, *One Share - One Vote: A European Rule?* (European Corporate Governance Institute Working Paper, 2006); Sanford Grossman & Oliver Hart, *One Share - One Vote and the Market for Corporate Control*, 20 J. FIN. ECON. 175 (1988); Andrei Shleifer & Robert Vishny, *Large Shareholders and Corporate Control*, 94 J. POLITICAL ECON. 461 (1986); Dale A. Oesterle & Alan R. Palmiter, *Judicial Schizophrenia in Shareholder Voting Cases*, 79 IOWA L. REV. 485 (1994); Shaun Martin & Frank Partnoy, *Encumbered Shares*, 2005 U. ILL. L. REV. 775.

127) However, a ceiling on voting rights through charter provisions would be held invalid as it violates the one share one vote rule in KCC Article 369, Paragraph 1. Cf. *Providence & Worcester Co. v. Baker*, 378 A. 2d 121 (Del. 1977) (holding that a ceiling does not constitute discrimination against certain shareholders); Alberto Toffoleto & Paolo Montironi, *Italy Reforms Company Law*, INT'L FIN. L. REV. MERGERS AND ACQUISITIONS 137 (2004) (ceiling allowed in the new company law). For discussions in Germany involving Volkswagen, see *In VW Takeover Saga, German Court Rules Against Porsche*, INTERNATIONAL HERALD TRIBUNE, November 27, 2008; *As Tension with Volkswagen Mounts, Porsche Doesn't Rush into Takeover*, INTERNATIONAL HERALD TRIBUNE, November 27, 2007.

128) KCC, Article 409, Paragraph 2.

129) See, e.g., Bernard Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 HARV. L. REV. 1911, 1945-1946 (1996).

130) See Lucian Bebchuk & Oliver Hart, *A Threat to Dual-Class Shares*, FINANCIAL TIMES, May 31, 2002 (warning that if the dual class share system was abolished in Europe, the relevant companies would attempt to either adopt cross-shareholding or create a pyramid type corporate structure to protect its management's interests). But see Ronald Masulis et al., *Agency Problems at Dual-Class Companies*, 64 J. FIN. (2009) (finding evidence supporting the hypothesis that

drafted a new provision for the KCC to introduce the dual-class commons in Korea as the following.<sup>131)</sup>

Article 344-7 (Shares with Multiple Votes)

- (1) A company may issue shares with multiple voting rights (“Shares with Multiple Votes”), provided that the company, which issued the type of a shares described under Article 344-3, shall not issue the Shares with Multiple Votes. Also, the company that issued the Shares with Multiple Votes shall not issue the type of shares specified under Article 344-3.
- (2) Shares with Multiple Votes shall be issued pursuant to the Article of Incorporation at the time of incorporation or its amendment adopted by unanimous consent of all shareholders.
- (3) In case when a company issues Shares with Multiple Votes, the Article of Incorporation must include the following items.
  1. The number of votes on each Share with Multiple Votes
  2. The method for allocating the Shares with Multiple Votes
  3. The statement that, in case of a certain circumstances, the shareholders may request the redemption of the Shares with Multiple Votes or the Company may redeem the Shares with Multiple Votes
- (4) The number of votes for each Share with Multiple Votes shall not exceed three (3).
- (5) The listed companies Article 542-2 shall not issue the Shares with Multiple Votes other than the Shares with Multiple Votes that were issued prior to the listing.

## VIII. Conclusion

The cases discussed above show that a company’s corporate governance bears a close link to hostile takeover attempts. Problems rooted in corporate governance of a company can ignite hostile takeover attempts. In the case of SK, the consequence reveals tangible numbers that manifest the improvement on corporate governance. The Hyundai case demonstrates that the takeover issues befallen a traditional Korean family business, as it was growing to

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managers with greater control rights in excess of cash-flow rights are more likely to pursue private benefits at the expense of outside shareholders).

131) Translation by Lee & Ko, Korea, and the author.



become a mega corporation and going through generational changes, unfold with a close link to a hostile takeover attempt from outside. Although no empirical evidence is provided on this case, it can be drawn that the mergers and acquisitions market is exerting positive influence on corporate governance. The KT&G case attests that Korean companies are not exempt from the international current of hedge fund activism<sup>132)</sup> and must promptly learn the survival and adaptation skills necessary in the market with a corporate governance paradigm shift. The Hanaro case showed that employees can influence the outcome of a takeover battle and corporate governance of the company.

The four cases were entangled in legal disputes. As a result, they all added great value to improving legal principles on mergers and acquisitions in the Korean market. The value is quite significant since the relatively short history of Korean market leaves a paucity of rich M&A resources. In particular, the SK and Hyundai cases called for developing various defensive tactics against takeover attempts, and a battle over the legitimacy of the new tactics unfolded at the courtrooms. All the major Korean law firms were mobilized in these cases and some U.S. law firms with long experience in the areas took part indirectly. Milbank Tweed Hadley & McCloy played a major role in the SK case. So did Simpson Thacher & Bartlett in the KT&G case. And yet, there is not enough resources providing guidelines for directors in control contest and hostile takeovers,<sup>133)</sup> because in Korea, a dispute hardly develops around directors' liabilities but the legality and legitimacy of a certain defensive tactic. Putting more weight on director liabilities is necessary for advancing the board system, and thus it needs to be addressed.

Another interesting point is that an occurrence of disputes in the Korean M&A market, which arise from the matters such as foreign ownership of

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132) For discussions on hedge fund activism, see *How to Handle Hedge Fund Activism*, deallawyers.com Webcast, May 9, 2006; Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PENN. L. REV. 1021 (2007); Thomas W. Briggs, *Corporate Governance and the New Hedge Fund Activism: An Empirical Analysis*, 32 J. CORP. L. 681 (2007). Cf. Henry Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811 (2006).

133) Hwa-Jin Kim, *Directors' Duties and Liabilities in Corporate Control and Restructuring Transactions: Recent Developments in Korea*, 7 OXFORD U. COMP. L. FORUM 2 (2006): <http://ouclf.iuscomp.org/articles/kim.shtml>.

stocks and listing on foreign exchanges, almost always calls for the involvement of Western investment banks, law firms, and consulting firms. Goldman Sachs, Lehman Brothers, Citigroup, and other investment bankers were regularly involved in the takeover and restructuring cases in Korea. When they are in the play, the Western institutions bring in a multitude of advanced financial techniques and takeover defensive tactics and thereby help raise the competency of professionals and professional services companies of Korea. Given the impact of such professionals' roles and performance on developing an efficient M&A market and corporate governance,<sup>134)</sup> the importation of the Western skills is commendable.

Finally, in view of the foregoing discussions, we may quite safely conclude that Henry Manne<sup>135)</sup> was right after all. He was right also in an Asian civil law country under the Confucian culture such as Korea some forty years after he presented the thesis that the market for corporate control functions as a disciplinary mechanism for poor corporate governance. The cases described in this article show, even empirically in the SK case, that the validity of his thesis may transcend national jurisdictions and cultural differences. The Korean case, in particular the SK case, also shows that the increasing exposure of control to the market could eliminate the inefficient controlling shareholder system. Hostile takeovers cannot solve all corporate governance problems of large Korean companies with controlling shareholders. However, promoting contestable control is a way forward. The new Korean Commercial Code should maintain a sophisticated balance between the active market for corporate control and effective takeover defensive tactics for the benefit of shareholders. Last, but not least, the usual emphasis on the role of judicial review in the controlling shareholder system should apply to the Korean case.<sup>136)</sup>

KEY WORDS: corporate governance, takeover, market for corporate control, proxy contest, controlling shareholder, Commercial Code, tender offer

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134) JOHN COFFEE, *GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE* (Oxford University Press, 2006); Stephen Choi & Jill Fisch, *How to Fix Wall Street: A Voucher Financing Proposal for Securities Intermediaries*, 113 *YALE L. J.* 269 (2003).

135) Manne, *supra* note 12.

136) Cf. Bernard Black, *The Core Institutions that Support Strong Securities Markets*, 55 *BUS. LAW.* 1565, 1607 (2000).