

Notable Supreme Court Decisions: Corporate Law

1. Remunition Right of a Director (Supreme Court 2015Da213308, 2015. 9. 10)

A. Fact pattern and Ruling

The Defendants, A and B, earned salary upon being appointed as a director and a auditor for corporation X, but handled only subsidiary duties under the name of director or auditor instead of performing practical business duties as a director or auditor. In the case, the Plaintiff, bankruptcy administrator of X's parent company(Busan Savings Bank), claiming preserved right to the parent company's loan to X, is subrogated to the position of corporation X and demands return of unjust enrichment of considerable portion of the paid salary against the Defendants.

The original trial dismissed the claim of the plaintiff, saying that paid amount shall not be a reward for performance of the duties, but rather a reward for the Defendants' name lending. On the other hand, the Supreme Court recognized the right to demand remuneration widely. "Even if a director or auditor entrusts its duties to another director, etc. based on explicit or implicit agreement and does not perform actual duties as a director or auditor, he or she bears legal liability prescribed by Article 399, 401, and 414 of the Commercial Act. Unless special circumstances, i.e., the resolution of the general shareholders' meeting appointing or deciding the remuneration of the Defendants was null, or the above passive duties constitute a breach of duty as it differs from job duties anticipated when appointing the director and auditor at the general shareholders' meeting, the Defendants' eligibility as a director or auditor cannot be denied and the right to claim remuneration cannot be deemed as being negated solely on

the ground that the Defendants carried out passive duties.” Only when the remuneration shall be excessively beyond the reasonable scope or the appointment of the director or auditor be in order to pay individuals in form of remuneration, it is deemed that the right to claim remuneration is partially or wholly restricted. In the case, the Supreme Court dismissed the original trial, saying whether there existed a resolution of the general shareholders’ meeting regarding the amount of the remuneration of the director and auditor in the case should be further heard.

B. Analysis

The position of the Supreme Court is that, in principle, directors and auditors elected through due process may exercise their right to claim remuneration granted through the articles of association or general shareholders’ meeting resolutions, regardless of the type of duties they actually perform. The Supreme Court did not accept the plaintiff’s claims that the directors and auditors who have not performed the substantial duties can not claim for their remuneration since, according to Article 688 paragraph 2 of the Civil Act, a delegate person is given the right to claim remuneration only if the delegated affairs are carried out.

A similar position of the Supreme Court of widely recognizing the directors and auditors’ right to claim remuneration is also shown in the Supreme Court Decision 2014Da236311, decided on July 23, 2015. This position can be interpreted the Court is trying to align with the position of existing cases¹⁾ that, once elected, the directors and auditors not only bear the right and obligations as a director and auditor but are exposed to liability under Article 399, 401, and 414, of the Commercial Act, even if they do not conduct their own duties.

However, considering that under the Civil Act a general delegate person who is also exposed to the liability for negligence of duty may receive remuneration only after the delegated affairs are completely carried

1) If CEO delegates his entire duty to other directors and fail to perform any of the duty, it consists a violation of his Fiduciary Duty and thus CEO can be liable under Article 401 paragraph 1 of the Commercial Act (Supreme Court Decision 2006Da21880 decided on September 8, 2006).

out, the position of Supreme Court of widely recognizing the right of directors and auditors to claim for their remuneration simply because they are exposed to liability can be questioned. That is to say, it can be said that to bear obligations as a legitimate director or auditor is a different matter than to have the right to claim remuneration.

2. 100 percent Leveraged Buy-Out and the Intention of Breach of Trust (Supreme Court 2015Do9148. 2015. 3. 12)

A. Fact Pattern and Ruling

This case is on the Leveraged buyouts (LBO) with acquiring 100% share ownership of a target company. To merge with the target company (T) which was in the consolidation procedure at 154.4 billion won, the acquirer (A) injected its own fund, but the substantial part of the fund was financed by using assets of the target company as collateral as following: (i) 46 billion won was financed on the condition of establishing mortgage on the real estate and the sale credit of T at the time of termination of the consolidation procedure of T. (ii) 95 billion won was financed as a short-term loan by making the advance contract with a bank X, and the contract content was that once A acquires 83.4 billion won of Bond of Warrants issued by T(as the payment of buyout), T executes an advanced redemption for its BW with the fund financed by the long-term loan from X after the consolidation procedure of T, and then, A pays back its short-term loan with the fund from the advanced redemption. After these financing, A acquired 100% share of T, and the consolidation procedure finished after the defendant, who is the representative director of A, became the representative director of T. The defendant, fulfilling the contracts above, (i) established mortgage on the real estate and the sale credit of T for creditors, (ii) executed an advanced redemption for BW with the fund financed by the long-term loan from X. After that, the long-term loan was payed by selling the office building of T.

The District Court held the Defendant liable for breach of trust, but the High Court denied breach of trust for the reason of the absence of criminal intent and damage. The Supreme Court stated that it is hard to admit the

criminal intent of the defendant to benefit A and damage T while establishing mortgage on the assets of T or executing an advanced redemption for BW. The Supreme Court quoted concrete evidences as following: ① A substantial amount of A's own fund was injected to acquire T, ② The economic interests of A and T became equal as A became the only stockholder, ③ A postulated merging with T at the initial stage of discussion, and actually merged T, ④ It is hard to recognize the advanced redemption as damage of T, and the redemption is placed within the director's business judgment. ⑤ A had an actual business necessity of merger with T, and made substantial equipment investments after the merger. ⑥ A guaranteed employments after merging T, ⑦ Though the defendant obtained margin by selling shares of A after the merger, the selling was incidental to the exercise of investor's put option.

B. Analysis

In previous Supreme Court decisions on leveraged buyouts(LBO), target company directors having provided collateral or guarantee on debt used by the acquirer in financing the buyout have been held liable for breach of trust (collateral type LBO). Such decisions have been criticized for being unfair, considering that merger type LBO (where the acquirer merges with the target company and uses target company assets as liable property) and dividend type LBO (where LBO is financed by dividends or reduction of capital with payout, after acquisition) did not incur criminal sanctions. On this case, however, the court ruled that charges of breach of trust may be denied even in collateral type LBOs, under certain conditions. In this case the target company, which became a 100% owned subsidiary of the acquirer, provided its assets as collateral and executed an advanced redemption for its Bond with Warrants. The absence of criminal intent was stated as the sole condition for Supreme Court's not-guilty decision, while lower court decision considered also the fact that there were no damages incurred by company T. Hence there still remains the possibility of punishment for collateral type LBOs, depending on specific circumstances, even for those involving 100% share ownership. Unless the LBO is contrary to the interest of both the target company shareholders and creditors, it would be appropriate to say that there are no damages incurred by

company T.

3. Breach of Statement and Warranties (Supreme Court 2012Da64253. 2015. 10. 15.)

A. Fact Pattern and Ruling

The Plaintiff (Hyundai Oil Bank Co.) bought the shares of Hanwha Energy Co. (later changed name to “Incheon Oil”) from the defendants on 1999. 8. 31. Defendants made the following representations and warranties on the SPA (stock purchase agreement) - “Incheon Oil has not violated any regulations nor is it under any investigation for violation as of the signing date of this agreement.” Defendants agreed to pay maximum of KRW 50,000,000,000 for damage caused by the violation of the aforementioned representations and warranties. Nevertheless, Incheon Oil was charged for KRW 14,500,000,000 fine from the Fair Trade Commission for forming a cartel in supplying the military oil. Consequently, the Plaintiff sued the Defendants by invoking the violation of representations and warranties clause of the SPA. However, the Defendants are submitting that since the Plaintiff participated in the aforementioned cartel, it was fully aware of the violation of representations and warranties clause and thus cannot seek compensation for damages.

The District Court ruled in the Plaintiff’s favor stating that Article 580 Paragraph 1 of the Civil Code does not apply to the representations and warranties clause in question. However the High Court ruled in favor of the Defendants, stating “in light of the good faith principle, the Plaintiff cannot be allowed to invoke the violation of representations and warranties clause if it had full knowledge of the violation when negotiating for the SPA because it was able to modify the purchase price based on this information.”

The Supreme Court again revoked the decision. The main argument was that the will of the parties agreed upon in the SPA was that the compensation of damage be paid regardless of the purchaser’s (the Plaintiff) intent. Specifically, ① the SPA does not have a exclusion clause with respect to the compensation provision, ② the purpose of the

representations and warranties clause in question, which is to distribute risk and adjust the purchase price in relation to the ex post damage by capping the compensation at KRW 50,000,000,000 is not affected by Plaintiff's knowledge of the violation. In addition, the Supreme Court pointed out that the general principles, such as the good faith principle High Court referred to, must be accepted under limited circumstances. The Supreme Court concluded, that since the investigation against the oil cartel was launched after the execution of the SPA, the Plaintiff cannot have reasonably expected the fine, and thus the good faith principle cannot apply in this case.

B. Analysis

In the US, there has been much dispute over the legality of so-called "Sandbagging", where Buyer decides to close the deal, then makes a claim for damages on account of Seller's breach of representations and warranties clause that Buyer already knew of the violation before closing the deal. This case is not a typical sandbagging case. However, this is of great significance in that the court stated the standard of judgment for past lower courts' holdings. Like the rulings of the District Court and the High Court, the Supreme Court declared that the representations and warranties clause has a special role/function of risk allocation and post-adjustment of price, not just a warranty liability in Korean Civil Code and Commercial Code. Therefore, KCC § 580 (1), which requires Claimant's lack of awareness to claim for warranty liability cannot be applied to this case. This can also be applied to typical sandbagging cases, where Buyer knows Seller's infringement/breach, but intentionally takes advantage of it. The court took into consideration the fact that it was difficult for the Buyer to reflect the possibility of fine imposition in the stock purchase agreement, because Korean Fair Trading Commission's investigation had not been launched even until the execution of the agreement. However, if the Buyer was fully aware of the factors that could reduce the price but still closed the deal as it was, its claim of the Seller's breach of the representation and warranties clause might not possibly be accepted under good faith.