Change is Afoot: Amendments to the Korean Commercial Code Set to Take Effect

On March 11, 2011, the Korean National Assembly passed a long-awaited bill to amend the Corporation Chapter of the Korean Commercial Code (the “KCC”). The amendments are both significant and far-ranging. Among other changes, they introduce new corporate forms, expand shareholding options, restrict misappropriation of corporate opportunities and ease restrictions on dividend distributions. The Korean National Assembly, however, has not adopted the widely-discussed proposal to allow companies to issue warrants as a means of defense against hostile take-over attempts. The amendments will be formally announced shortly and will take effect one year after the announcement.

Lawmakers hope that these amendments to the KCC will stimulate investments and help companies cope with evolving business challenges. Below is a summary of some key amendments. Most amendments described below apply to jushikhoesa, which is the predominant corporate form in Korea.

1. Introduction of Limited Partnerships and Limited Liability Companies

The amendments introduce two additional corporate forms—limited partnerships and limited liability companies. Both limited partnerships, which consist of general partners with unlimited liability and limited partners with limited liability, and limited liability companies, which are very similar to limited liability companies in the United States, will provide investors with a wider selection of investment vehicles.

Existing Korean corporate forms, such as jushikhoesa and yuhanhoesa, already provide investors with limited liability protection. Limited partnerships and limited liability companies, however, are easier to establish and have fewer corporate governance requirements. These new corporate forms are aimed at facilitating investments by, among others, private equity funds and venture capitalists.

In addition, there will also be less restrictions applicable to yuhanhoesa, as the amendments removed the maximum limit on the number of the members and the minimum amount of the paid-in capital of yuhanhoesa, which currently are 50 members and 10 million Won, respectively.
2. Elimination of Par Value Requirement

The existing restriction which requires jushikhoesa to issue only shares with a par value of at least 100 Won per share will be eliminated. Because the par value requirement has placed considerable restrictions on share issuances and stock splits, the amendment is expected to make it easier for companies to raise capital.

3. Introduction of Freeze-Outs

The amendments allow majority shareholders holding at least 95% of the total outstanding shares of a company to require the company's minority shareholders to sell their shares at a fair price to be agreed between the parties or determined by the court. Such transaction should, however, be approved by the shareholders meeting in advance. This measure will enable majority shareholders to manage the companies controlled by them more efficiently.

The amendments also benefit minority shareholders because under the amended KCC, they may also require majority shareholders to buy their shares at a fair price.

4. Eased Restrictions on Dividend Distributions

Going forward, the board of directors of a company may be conferred with the authority to approve the company's annual financial statements and declare dividends. Currently, a company may only approve its annual financial statements and declare dividends by passing a resolution at a general shareholders' meeting.

Another significant aspect of the amendments is that companies will be permitted to declare and distribute in-kind dividends in addition to cash or stock dividends.

5. More Flexible Legal Reserve Requirements

The amendments allow companies to use legal reserves in excess of 150 percent of their paid-in capital for making dividend distributions and for other business purposes, subject to the approval of the shareholders meeting.

6. Introduction of Non-voting Common Shares and Other Special Shares

The amendments allow a company to issue various types of special shares, including common shares with no voting rights or restricted voting rights that become effective only upon the occurrence of a prescribed event, provided that the total number of such special shares may not exceed one-fourth of the total issued and outstanding shares of the company. Currently, companies may only issue non-voting shares in the form of preferred shares.

In addition, the amendments now permit a company to require the holders of its convertible shares to convert the shares, while under the current KCC only the holders have the right to require conversion.

7. Eased Restrictions on Bonds Issuance

Certain restrictions on issuance of bonds by companies, such as (i) the restriction that the total value of a company's bonds issued and outstanding cannot be more than four times the value of its net assets and (ii) the restriction that certain types of bonds, such as exchangeable bonds (i.e., bonds which may be exchanged with the securities held by the issuer) or dividend bonds (i.e., bonds the holders of which have the right to participate in the issuer's dividends) may only be issued by companies listed on the Korea Exchange, have been removed. Accordingly, private companies will have more options to raise funds.
8. Introduction of Electronic Registration System for Shares and Bonds

The current KCC requires the possession of physical certificates to prove the ownership of shares and bonds. The amendments, however, allow the possibility of electronically registering shares and bonds. This is a long-awaited change in Korea and will allow companies and shareholders to assign shares and bonds without having to exchange physical certificates.

9. Introduction of Corporate Opportunity Doctrine

The amended KCC expressly prohibits a director from usurping corporate opportunities without board approval. According to the amendments, the approval by a two-thirds majority of the board will be required for a director to use, or allow a third party to use, any present of future business opportunities of the company.

10. Tightened Restrictions on Self-dealing

Currently, self-dealing restriction is applied only to directors. Under the amended KCC, this restriction will apply also to major shareholders (who have at least 10 percent of the shares of the company or have substantial influences over the company’s management). The approval by a two-thirds majority of the board will be required before a company may engage in transactions with a director or a major shareholder, his spouse or his or his spouse’s relatives, or a company in which he has at least 50 percent shareholding.

11. Limitation of Directors’ Liability

The revised KCC will permit a company to limit a director’s liability to the company to an amount equal to six times the director’s annual remuneration (three times for outside directors) by so providing in the articles of incorporation. This limitation does not apply, however, if the company has suffered a loss due to the director’s malice or gross negligence. Please also note that the liability of a director to third parties cannot be limited. Currently, any exculpation of a director’s liability requires the unanimous consent of the shareholders. Lawmakers hope that this limitation on liability will make it easier for companies to recruit talented directors and for such directors to manage the companies in a less-restricted and more entrepreneurial manner.

12. Introduction of the Concept of Executive Officers

Although most Korean companies are managed and run by executive officers, such as presidents, the KCC has been silent on the existence of, and the rights and obligations of, executive officers. The amended KCC recognizes executive officers and gives a company an option to “formally” appoint one or more executive officers to represent and/or execute the affairs of the company with the approval of the board of directors and by registering such appointment with the court. The amended KCC also stipulates the term and the rights and obligations of the court-registered executive officers. Once a company appoints court-registered executive officers, it may no longer have a representative director (who has been the only person allowed to represent a company up to now).

13. Compliance Officer Requirements

Under the revised KCC, certain listed companies (the types of which will be determined by the presidential decree to be announced later) are required to appoint at least one full time compliance officer and establish compliance control standards. Currently, only banks and other financial institutions are required to have a compliance officer. Licensed lawyers and other persons with sufficient legal knowledge and experiences will be qualified to serve as a compliance officer.
14. Removal of Non-GAAP Accounting Standards

Some outdated sections of the KCC require Korean companies to use accounting standards that are inconsistent with the generally accepted accounting principles (“GAAP”) in certain contexts, including in connection with the calculation of dividends. The revised KCC no longer requires companies to use accounting standards that are inconsistent with GAAP. This will eliminate confusion related to various accounting and dividend-related issues that may arise due to the difference between GAAP and the accounting standards used only under the KCC.

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