

ESSAY

INDEPENDENCE WITHIN HYUNDAI?

CRAIG EHRLICH* AND DAE SEOB KANG**

1. INTRODUCTION

Something has changed about the way Korea's *chaebols*¹ operate, particularly as it concerns that group of companies known as the Hyundai Group.² The change may be significant for foreign institutional investors, as it concerns the independence of the man-

* Assistant Professor of Law at Babson College, Wellesley, Massachusetts. B.S.; J.D., University of Illinois. The Author practiced law in Seoul, Korea from 1987 to 1995.

** Professor of Law at Changwon National University, Changwon, Korea. L.L.B.; L.L.M.; J.S.D., Korea University. The Author was a visiting researcher at the University of Wisconsin Law School from 1999 to 2000.

¹ *Chaebol*: "A conglomerate of businesses, usually owned by a single family, especially in Korea." AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE (4th ed. 2000). For a brief overview of the *chaebol* and a comparison to Japan's *keiretsu*, see *Country Briefing: South Korea: Economic Structure*, ECONOMIST, July 17, 2001, at <http://www.economist.com/countries/SouthKorea/profile.cfm?folder=Profile%2DEconomic%20Structure/>; Jean-Pierre Lehmann, *Asian Perspectives on Globalisation & Intra-Regional Dynamics* (1998) (unpublished article, Swiss Asia Foundation), at http://www.eviangroup.org/publications/pb_15jl.htm/ (last modified January 1998).

² The Group, which had been Korea's largest according to some measures, broke up in autumn 2000. Its car business separated in September, and its ship-building and electronics businesses are scheduled to separate from the Group in 2001. This is happening because creditors want to save the strongest units from collapse caused by the failure of other affiliates within the Group. See John Burton & John Plender, *Korea's Heavy Burden*, FIN. TIMES (London), Nov. 7, 2000, at 28 [hereinafter Burton & Plender, *Korea's Heavy Burden*]; Samuel Len, *Hyundai Moves to Rescue Construction Unit*, N.Y. TIMES, Nov. 21, 2000, at W1; Cheong-mo Yoo, *Hyundai Announces W1.29 Trillion Self-Rescue Package*, KOREA HERALD, Nov. 21, 2000, available at 2000 WL 27395311 [hereinafter Yoo, *Hyundai Announces W1.29*].

agers of some of the companies that belong to the Hyundai Group. Several of the Hyundai companies have recently refused to provide financial assistance to the ailing Hyundai Engineering and Construction Company ("HEC"). Hyundai is one of the largest *chaebols*, perhaps best known in the United States for its cars. It also includes a large chipmaker (Hyundai Electronics Industries)³ and the world's largest ship yard (Hyundai Heavy Industries). Chung, Ju-Yung, whose sons now control the constituent companies, founded it some fifty years ago.

In this short piece, we will give a brief account, in Section 2, of the background of the governance problem: the group chairman as "puppet master," orchestrating the affairs of the group as a whole without sufficient regard for the health of the individual companies within it, but focused instead on the size of the whole group. We will then summarize in Section 3 the main point of the governance reforms, designed in large part to counterbalance the group chairman with an active board of directors and with foreign institutional investors. The Hyundai case, discussed in Section 4, is a prism through which one can try to assess the reforms and judge whether they have been effective. We will ask in Section 5 whether the reforms have worked.

2. THE GROUP CHAIRMAN AND THE GOVERNANCE REFORMS

HEC, the flagship company of the Hyundai Group, and another prominent Korean company, Daewoo Motor, recently collapsed under the weight of their debts. The Daewoo Group, placed under a debt-restructuring program by its creditors in 1999 and in formal receivership in November 2000, had been financially thin for years and had amassed debts of \$80 billion. One lesson to be learned from Daewoo's experience is that weak members of a group can drag down the whole group, because the member firms are connected to each other by a web of cross ownership, cross debt guarantees, and a substantial amount of intra-group trading. This fact has been of paramount importance in the Hyundai drama. The focus of this short essay is on HEC, one of the world's largest construction companies, whose cash crunch became public

³ The fifty-third ordinary general meeting of shareholders changed the name of the company to Hynix Semiconductor on March 29, 2001.

in May 2000.⁴ The immediate cause may have been HEC's purchase of shares in other Hyundai Group members, to lower their debt equity ratios and come into compliance with a government mandate that requires members of the top thirty groups to lower their ratios from an extremely high 500% to a merely over-leveraged 200%.⁵ That reduction was one aspect of the government orchestrated restructuring and corporate governance reform of the *chaebols*, which followed their financial collapse in late 1997.⁶ The corporate governance reforms, which are discussed below, appear impressive on paper, but there are skeptics who doubt whether the *chaebols*—the family controlled groups of large publicly traded companies and privately held firms, engaged in a wide array of businesses and constituting the lion's share of the Korean economy—have really changed the way they operate. Hyundai's recent experience provides evidence to support both views.

⁴ John Burton, *S Korea Tries to Calm Local Markets Amid Fears Over Hyundai's Liquidity*, FIN. TIMES (London), May 29, 2000, at 1.

⁵ Burton & Plender, *Korea's Heavy Burden*, *supra* note 2, at 28. That, coupled with debts of \$4.8 billion, attributed to a weak domestic market and losses on overseas projects. Kim Eun-young, *Hyundai Saga Signals Sweeping Change*, KOREA ECON. WKLY. (Seoul), June 12, 2000 [hereinafter Kim, *Hyundai Saga*], available at WISE D BASE, <http://www.wisedb.co.kr/> (copy on file with author); Samuel Len, *Hyundai Group Founder to Sell 6.1% Stake in Auto Company*, N.Y. TIMES, Aug. 14, 2000, at C2; Jennifer Veale & John Burton, *Creditors Lose Patience with Hyundai Family Values*, FIN. TIMES (London), Aug. 4, 2000, at 25 [hereinafter Veale & Burton, *Creditors Lose Patience*].

⁶ For fuller accounts of the corporate governance reforms, see OECD, *REGULATORY REFORM IN KOREA* (2000), available at <http://www1.oecd.org/publications/e-book/4200021e.pdf>; PETER M. BECK, KOREA ECON. INST. OF AM., *KOREA'S [SIC] EMBATTLED CHAEBOL: ARE THEY SERIOUS ABOUT RESTRUCTURING?* (2000), at <http://www.keia.com/chaebol2000.pdf> (last visited Nov. 5, 2001); *THE TWO KOREA [SIC] IN 2000: SUSTAINING [SIC] RECOVERY AND SEEKING RECONCILIATION* (Korea Econ. Inst. of Am. ed., 2000), available at <http://www.keia.com/mill-fulldocument.pdf> (last visited Nov. 13, 2001); Craig Ehrlich & Dae-Seob Kang, *U.S. Style Corporate Governance in Korea's Largest Companies*, 18 UCLA PAC. BASIN L.J. 1, (2000); 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, 70-81 (1999); Joon-gi Kim, *Recent Amendments to the Korean Commercial Code and Their Effects on International Competition*, 21 U. PA. J. INT'L ECON. L. 273, 274-77 (2000); Il Chong Nam et. al., *Corporate Governance in Korea*, Presentation at OECD Conference on Corporate Governance in Asia: A Comparative Perspective, (Mar. 3-5, 1999), available at <http://www.oecd.org/pdf/M000015000/M00015804.pdf> (last visited Nov. 5, 2001); SANG-WOO NAM, *KOREA'S ECONOMIC CRISIS AND CORPORATE GOVERNANCE* (Sch. of Pub. Policy and Mgmt., Korean Dev. Inst., Working Paper No. 99-02, 1999), available at <http://www.kdischool.ac.kr/library/data/w99-02.pdf>.

This essay is not a primer on the *chaebols* or the collapse of their finances or the attempts to restructure and reform them. For that, the reader may wish to review the sources cited in footnote six. Our sense is that law by itself does not result in automatic change. Law is not self-enforcing. Rather, Hyundai resisted the reforms. Chung, Ju-Yung allocated control of the group companies in disregard of corporate formalities. The Korean government, which has tried to enforce the reforms, reversed course and abandoned a fundamental principle of the reforms when it urged stronger Hyundai firms to subsidize the failing HEC. In the end, the core reform—the independence of the board of directors—seems to have taken root at Hyundai, neither because of government enforcement nor because the Chung family at last “saw the light.” Change came because the capital markets forced it.

Prior to the governance reforms, it is likely that the office of the group chairman⁷ would have directed other group members to extend support to the ailing affiliate in the form of equity investments, cheap loans, or transactions in goods or services on preferential terms. The *International Herald Tribune's* business writer noted the practice of forced subsidization and its effect on portfolio investors in April 1997, a half year before the crash:

Samsung Electronics Corp[oration], which like many other subsidiaries of Korea's largest *chaebol* is publicly listed, is one of the best semi conductor companies in the world, [a fund manager] acknowledged. Many other Samsung entities are mediocre, however, so the benefits to investors in Samsung Corp[oration] [the group parent] are diluted.

⁷ The group chairman's office had no legal basis in the Korean Commercial Code but was the de facto mechanism through which the group chairman communicated his instructions to the various group companies, controlling them from behind the scenes like a puppeteer. The office was staffed with between fifty and 100 people and made important decisions for the *chaebol* such as the appointment of executives for its member companies, choosing new investment projects and supplying money throughout the group. As the group chairman was neither a director nor an officer of a company, he had no legal responsibility to the shareholders. Hence, as part of its reforms, the government urged in February 1998 that the chairman's office be abolished. *Kim Dae-Jung Sets Puppet Masters of Chaebol Packing*, KOREA ECON. WKLY. (Seoul), available at WISE D BASE, <http://www.wisedb.co.kr/> (copy on file with author), Feb. 23, 1998; see also Tarun Khanna & Krishna Palepu, *The Right Way to Restructure Conglomerates in Emerging Markets*, HARV. BUS. REV., July-Aug. 1999, at 125, 134. In many of the *chaebols*, it was reinvented as a restructuring office.

Even investors in the chip-making company get short-changed, he said, because its profits "are used to subsidize bad businesses, not shareholders in Samsung Electronics."⁸

Of the Hyundai Group, the *Financial Times* wrote in 1988:

It always manages, like most of the Korean *chaebol* (conglomerates) to keep at least one "cash cow" in existence to buttress other activities that might be in difficulty. At the moment, in a group that has total sales of about \$14 [billion], Hyundai Motors, the car company, is the "cash cow," while shipbuilding and construction barely break even.⁹

Eleven years later, the shipyard became a cash cow for Hyundai:

Being a cash cow of the *chaebol* is a heavy burden for the world's largest shipyard, suggests economic researcher Yoo Seong-min of the Korea Development Institute (KDI). "HHI [Hyundai Heavy Industries] has been making large profits every year. But judging from its competence and market position, it should be much more profitable than its financial statements say," he said. Yoo believes that HHI has been subsidizing other branches of the Hyundai Group and says HHI's large share of family ownership frees the management from obligations to publicly justify its policy.¹⁰

When the finances of the *chaebols* collapsed in late 1997, necessitating a massive International Monetary Fund ("IMF") bail out, the new government of Kim Dae Jung adopted a five point plan of reform designed to make the *chaebols* efficient, transparent and ra-

⁸ Conrad de Aenlle, *South Korea's Industrial Giants Are Not Geared Toward Investors*, INT'L HERALD TRIB., Apr. 19, 1997, at 19, available at 191997 WL 4490399.

⁹ *The Newcomer Goes Into Overdrive*, FIN. TIMES (London), June 30, 1988, at 15. Hyundai Elevator Company has also been called a cash cow for the Group as has Hyundai Merchant Marine, Korea's biggest shipping company. John Burton, *Last-Ditch Rescue Plan Leaves the Investors Unimpressed*, FIN. TIMES (London), Nov. 21, 2000, at 41 [hereinafter Burton, *Last Ditch Rescue Plan*]; Kim, *Hyundai Saga*, *supra* note 5.

¹⁰ *Hyundai Heavy Industries Seeks to Lower its Dependence on Shipbuilding*, KOREA HERALD, June 25, 1999, available at 1999 WL 17750316.

tional, and to fundamentally disengage the group members from one another so that each would survive or fail on its own merits. The plan was later expanded to include three additional points:

1. Business consolidation of the groups from sprawling collections of unrelated businesses into areas of core competence,
2. Reduction of debt equity ratios,
3. Elimination of cross debt guarantees among group members (given by one company in favor of the borrowings of another),
4. Enhancement of management transparency by producing consolidated balance sheets and income statements,
5. Reform of corporate governance so that managers would be more accountable to shareholders and less so to controlling group chairmen,
6. Reduction of, indirect cross ownership among group members,
7. Prevention of transactions among group members that are not arms length,
8. Prevention of evasion of inheritance and gift taxes when control is passed from the chairmen to their sons.¹¹

3. INDEPENDENT DIRECTORS AND FOREIGN INVESTORS

The *chaebols* had been over-leveraged and over-managed by autocratic founders, group chairmen whose ambitions were simply to be big and not necessarily profitable,¹² and who were reluctant

¹¹ Han-su Yu, *Restructuring and Reorganization of Chaebol*, Presentation at Columbia University Symposium on The Korean Chaebol: Future Prospects and Problems (Oct. 6, 2000); Phil-sang Lee, *Economic Crisis and Chaebol Reform in Korea*, Presentation at Columbia University Symposium on The Korean Chaebol: Future Prospects and Problems (Oct. 6, 2000).

¹² The point is made over and over again in the literature. See, e.g., Conrad de Aenlle, *supra* note 8, at 19 ("The main complaint we would have with Korea is that companies expand without fully considering profitability."). The chairman of Korea's Fair Trade Commission ("KFTC") stated in an address on October 23, 2000: "Disregarding profitability, [the *chaebol*] engaged in reckless expansion through leveraging. The will of the founding families of *chaebol*, rather than the market and shareholders, played a decisive role in management decision-making." Chairman Nam-kee Lee, *Korea's Economy: Reform and Vision for the Future: Focused on Restructuring*, Address before the Hong Kong General Chamber of Commerce (Oct. 23, 2000) [hereinafter Nam-kee Lee, *Korea's Economy*], at http://www.ftc.go.kr/ftc10/owa/e_main/.

to cede family control to outside equity or to professional managers. The reforms were intended, in part, to attract foreign equity capital (institutional investors) to Korea's stock market and to the *chaebol* firms. Korea's experience has something in common with the general relationship between law and economic development in the "Third World," moving from public ordering and state planning to markets and private ordering as these governments have come to see foreign investment not as a threat, but as a means to obtain needed capital.¹³ Hence, instead of having state banks funnel capital to the *chaebol* in accordance with a five-year plan drawn by the Economic Planning Board, the new Korean model calls for foreign portfolio investment to finance enterprises managed by an active board of directors. For this to work, foreign fund managers have to feel comfortable that their money will be used to earn them a rate of return and that it will not be used by the group chairman to support an affiliate. One means of providing that assurance is for the board of directors of the invested firm to be independent and not dominated by the chairman.¹⁴ The Delaware Supreme Court explained director independence in *Aronson v. Lewis*, 473 A.2d 805, 816 (Del. 1984):

The requirement of director independence inheres [sic] in the conception and rationale of the business judgment rule. The presumption of propriety that flows from an exercise of business judgment is based in part on this unyielding precept. Independence means that a director's decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences. While directors may confer, debate, and resolve their differences through compromise, or by reasonable reliance upon the expertise of their colleagues and other qualified persons, the end result, nonetheless, must be that each di-

¹³ See Jeswald W. Salacuse, *From Developing Countries to Emerging Markets: The Legal Challenges of Economic Change*, 1 INT'L & COMP. CORP. L.J. 277 (2000) (describing the common shift among Third World countries to a private development model in recent decades).

¹⁴ See generally Carolyn Brancato & Michael Price, *The Institutional Investor's Goals for Corporate Law in the Twenty-First Century*, 25 DEL. J. CORP. L. 35, 43 (2000) ("Investors want assurances that companies are professionally run and have relied on the concept of 'independence' for boards of directors to provide this assurance.").

rector has brought his or her own informed business judgment to bear with specificity upon the corporate merits of the issues without regard for or succumbing to influences which convert an otherwise valid business decision into a faithless act.

Although foreigners now own about thirty percent of shares issued by listed companies in Korea,¹⁵ they have also expressed their lack of confidence that *chaebol* management groups will manage their companies in the long-term interests of their shareholders.¹⁶ The Korean government responded in 1998, 1999, and 2000 by enacting a series of statutes and administrative rules designed to strip unilateral power away from the group chairman;¹⁷ make the board of directors an active;¹⁸ independent body;¹⁹ make group finances transparent;²⁰ and confer various rights and remedies upon minor-

¹⁵ Nam-kee Lee, Korea's Economy, *supra* note 12, at 5.

¹⁶ American Chamber of Commerce in Korea, *Improving Korea's Business Climate 2001: Recommendations from American Business: Capital Markets*, AMCHAM ISSUES (2001) [hereinafter AMCHAM, *Capital Markets*], at <http://www.amchamkorea.org/info/i-norm-issue8.htm/> (last visited Nov. 6, 2001).

¹⁷ The Korean Commercial Code Article 401-2 now provides that a controlling shareholder who has participated in the business of the company shall be deemed a "de facto director." COMMERCIAL CODE [COM. CODE] art. 401-2 (S. Korea), translated in 4 STATUTES OF THE REPUBLIC OF KOREA 87-5 (Supp. 9) [hereinafter KOREAN STATUTES].

¹⁸ The Korean Commercial Code Article 382-3 states that directors must perform their duties faithfully according to the law and the articles of incorporation, and Article 393-2, Section 1 permits the board to establish committees. COM. CODE arts. 382-3, 393-2(1) (1999) (S. Korea), translated in 4 KOREAN STATUTES, *supra* note 17, at 85 (Supp. 5).

¹⁹ A KSE listed company must have at least one quarter of its board filled by outside directors; and a listed company with at least two trillion Won in assets, must have at least one half outside directors. SECURITIES & EXCHANGE ACT, Act No. 6176 of Jan. 21, 2000, art. 191-16(1) (S. Korea), translated in 11 KOREAN STATUTES, *supra* note 17, at 749 (Supp. 9). The most recent version of Korea's Securities and Exchange Act can be found at <http://www.moleg.go.kr/mlawinfo/english/html/law19.html> (last modified July 20, 2001).

²⁰ For example, the thirty largest *chaebol* designated by the KFTC must issue "combined" financial statements. ACT ON EXTERNAL AUDIT OF STOCK COMPANIES, Act No. 5497 of Jan. 8, 1998, art. 1-3(1) (S. Korea), translated in 4 KOREAN STATUTES, *supra* note 17, at 302 (Supp. 10). Also, large KSE listed companies, with assets in excess of two trillion Won, must have an audit committee. SECURITIES & EXCHANGE ACT, Act No. 6176 of Jan. 21, 2000, art. 191-17(1) (S. Korea) ("Any stock-listed corporation prescribed by Presidential Decree shall establish an audit committee."), translated in 11 KOREAN STATUTES, *supra* note 17, at 749 (Supp. 9).

ity shareholders.²¹ The Korean Fair Trade Commission ("KFTC") has also attacked the chairman's control by probing wealth transfers from chairmen to their sons,²² as well as internal transactions among affiliates,²³ and by policing the elimination of cross debt guarantees²⁴ and limits on investments in affiliates.²⁵ The corporate governance reforms can be summarized as falling into four categories: (1) reforms that are intended to strengthen the independence of the board of directors of the large publicly traded firms;²⁶ (2) reforms to the quality of accounting and auditing in Ko-

²¹ These rights, including access to basic corporate documents, to inspect corporate affairs and property, to seek ouster of a director, to demand cessation of an unlawful act, to commence derivative litigation, to request a meeting of shareholders and propose an agenda for that meeting, and to enjoy the possibility of cumulative voting, are fully described in Ehrlich & Kang, *supra* note 6, at 51-55.

²² See INHERITANCE TAX & GIFT TAX ACT, Act No. 5193 of Dec. 30, 1996 arts. 39, 39(1)2, & 40, Act No. 6048 of Dec. 28, 1999, art. 41-3 (S. Korea) (describing a transfer of shares from a large shareholder to a person who has a special relationship with him as a donation), *translated in* 9 KOREAN STATUTES, *supra* note 17, at 813-19 (Supp. 9). The KFTC policies have been stated in several speeches given by the chairman and vice chairman of the KFTC. See, e.g., Chairman Yun-churl Jeon, Korea's Corporate Restructuring and Competition Policy, Address at Georgetown University (Sept. 10, 1999) (Yun-churl Jeon was Chairman of the KFTC until August 2000), *available at* <http://ftc.go.kr/data/hwp/staff1.htm> (last visited Nov. 5, 2001); Nam-kee Lee, Korea's Economy, *supra* note 12; Vice-Chairman Nam-kee Lee, Korea's Corporate Restructuring and Competition Policy, Address before the America University School of Law (Feb. 22, 2000) (Nam-kee Lee became Chairman of the KFTC when President Kim Dae-Jung reshuffled his cabinet in August 2000, and moved Yun-churl Jeon to Minister for Planning and Budget), *available at* <http://ftc.go.kr/data/hwp/new/t10.doc> (last visited Nov. 5, 2001).

²³ See MONOPOLY REGULATION & FAIR TRADE ACT, Act No. 6043 of Dec. 28, 1999, art. 11-2(1) (S. Korea), *translated in* 8 KOREAN STATUTES, *supra* note 17, at 574-75 (Supp. 10).

Any company belonging to an enterprise group falling under standards prescribed by Presidential Decree from among large enterprise groups, if such company intends to carry out [a] trading act . . . with specially-related persons or for such specially-related persons . . . , that company shall publish such intention in advance after going through a resolution of the board of directors.

Id.

²⁴ See *id.* art. 10-2 & 10-2(1) ("A company . . . shall not give debt guarantees to domestic affiliated companies.").

²⁵ See *id.* art. 10 & 10(1) ("Any company . . . belonging to a large enterprise group shall be prohibited from acquiring or owning stocks of another domestic company in excess of an amount deriving from the multiplication of its net asset amount by 25/100 . . .").

²⁶ See discussion *supra* note 19.

rea;²⁷ (3) enhancement of the rights of minority shareholders;²⁸ and (4) reforms intended to liberalize foreign portfolio and direct investment²⁹ and thereby creating the possibility of a market for corporate control and to facilitate merger and acquisition ("M&A") transactions. Refinements to these reforms were recently enacted by Korea's National Assembly, as described in the Appendix to this essay.

Concerning the board of directors, the reforms amended the Commercial Code by (i) declaring that directors must perform their duties faithfully according to the law and the articles of incorporation (a fiduciary duty),³⁰ and (ii) providing that a controlling shareholder who has participated in the business of the company shall be deemed a de facto director³¹ (thereby holding the group chairman legally accountable).³² The Securities and Exchange Act was amended to require that a company listed on the Korea Stock Exchange shall have at least one fourth of its board filled by outside directors, and a large listed company (with assets of at least two trillion Won) must have a board with at least three outside directors and at least half the board must be outside directors.³³ For

²⁷ See discussion *supra* note 20.

²⁸ See discussion *supra* note 21.

²⁹ Ceilings on foreign ownership of KSE listed and KOSDAQ registered firms were nearly all abolished in May 1998. See SECURITIES & EXCHANGE ACT, Act. No. Jan. 8, 1999, arts. 200 & 203 (S. Korea) (allowing Presidential Decree, an Enforcement Decree or the Financial Services Commission to restrict foreign persons or companies from acquiring securities), translated in 11 KOREAN STATUTES, *supra* note 17, at 753-56 (Supp. 5); ENFORCEMENT DECREE OF THE SECURITIES & EXCHANGE ACT, Act. No. Feb. 24, 1998, art. 87-2(2) (S. Korea) (allowing the Financial Supervisory Commission to restrict foreign persons or companies from acquiring securities), translated in 11 KOREAN STATUTES, *supra* note 17, at 899-18-19 (Supp. 10); REGULATION ON SECURITIES BUSINESS SUPERVISION, art. 7-6 (S. Korea), available at http://www.fsc.go.kr/laws/lawstock1_detail.asp?p_pageno=1&p_text=&p_seqno=3055&gubun=8&sub_title=&p_countyn=Y (last visited Nov. 17, 2001).

A new streamlined foreign direct investment law, the Foreign Investment Promotion Act was adopted in November 1998. FOREIGN INVESTMENT PROMOTION ACT, Act. No. 5559 of Sept. 16, 1998 (S. Korea), translated at <http://www.moleg.go.kr/mlawinfo/english/htms/html/law03.html> (last modified July 20, 2001), amended by Act. No. 5982 of May 24, 1999, translated at <http://www.mofe.go.kr/mofe/kor/fdi/html/act.htm> (last modified June 28, 2000). See Ehrlich & Kang *supra*, note 6, at 57-58.

³⁰ COM. CODE, *supra* note 18, art. 382-3 (S. Korea)

³¹ COM. CODE, *supra* note 17, art. 401-2 (S. Korea).

³² See *supra* note 7.

³³ SECURITIES & EXCHANGE ACT, *supra* note 19, art. 191-16 (S. Korea).

example, half of the HEC directors are outside directors, as are four of seven of Hyundai Electronics Industries' directors, five of nine of Hyundai Heavy Industries' directors, and half of Hyundai Motor Company's directors³⁴ Such large listed companies must also have a nominating committee, and at least half of their members must be outside directors. Also, several new disclosure rules were put in effect. The Monopoly Regulation and Fair Trade Act requires the board of directors to approve certain "large-scale internal trading," and for the approval to be publicly disclosed.³⁵ This provision applies to the thirty largest *chaebols*.³⁶ The Korea Stock Exchange now requires listed companies to disclose certain resolutions of the board of directors,³⁷ and both KSE listed and KOSDAQ (Korea's equivalent of NASDAQ) registered firms are required to disclose in their periodic reports information concerning the composition of their board of directors, board committees and minority shareholder rights.³⁸

Have these "board-energizing" measures worked? Many observers believe that the *chaebols* are biding their time, for example, by installing directors who appear to be independent of the chairman but in fact are not. Governments change but the fact that *chaebols* endure is one way that this is expressed. The new reality,

³⁴ This is according to the third quarter report of each company filed with the Financial Supervisory Commission on November 14, 2000. The report is available in Korean from the Financial Supervisory Service database at <http://dart.fss.or.kr>.

³⁵ MONOPOLY REGULATION & FAIR TRADE ACT, *supra* note 23, art. 11-2 (S. Korea). See Notification on the Resolution of the Board of Directors and Public Disclosure with Regard to Large-Scale Intra-Group Transactions, Fair Trade Commission Notification No. 2000-2 (Apr. 1, 2000) (notifying "the provisions on the resolution of the board of directors and public disclosure with regard to large-scale intra-group transactions pursuant to Article 11-2 of the Monopoly Regulation and Fair Trade Act"), at <http://ftc.go.kr/data/hwp/G00033.doc> (last visited Nov. 17, 2001).

³⁶ Enforcement Decree of the Monopoly Regulation & Fair Trade Act, Presidential Decree No. 17176 of Mar. 27, 2001, art. 17-8(1) (S. Korea), translated at http://ftc.go.kr/data/hwp/edomraftc_17176.doc (last visited Nov. 17, 2001).

³⁷ KOREAN STOCK EXCHANGE, Disclosure Regulation for Listed Companies, arts. 4 & 22-3 (Aug. 17, 2001), translated at <http://www.google.com/search?q=cache:yaG3haLdMOQ:www.kse.or.kr/upload/rule/reg001.doc> (last modified Aug. 17, 2001).

³⁸ See SECURITIES & EXCHANGE ACT, Act No. 6176 of Jan. 28, 2001, arts. 186 & 186-2 (S. Korea), translated in 11 KOREAN STATUTES, *supra* note 17, at 727-30 (Supp. 9); REGULATION ON SECURITIES ISSUANCE & DISCLOSURE, art. 72 (S. Korea), at http://www.fsc.go.kr/laws/lawstock1_detail.asp?p_pageno=1&p_text=&p_seqn=3050&gubun=8&sub_title=&p_countyn=Y (last visited Nov. 17, 2001).

though, is that the *chaebols* must attract foreign capital. They can no longer depend on having government directed funds funneled to them through Korean banks on easy terms. Thus, apart from the force of the law and of the ongoing FTC audits, the force of private capital in the hands of foreign fund managers may change the way that the *chaebols* operate. That may explain why—as noted below—other Hyundai firms have been slow in coming to the aid of HEC. It is not quite clear why HEC is being left to go it alone, or indeed whether this is the case, because the news reports are at times incomplete and inconsistent. It may be that the affiliates now have independent management, that foreign institutional investors now have a voice, or that there is a simmering family feud amongst the founder's sons who control various pieces of the Group. Clearly, though, the landscape does appear to have become ready for less autocratic rule and for more rational checks and balances in corporate governance. The old days of founders behaving like lords in a fiefdom are eroding quickly. In the early 1990s, group chairman Lee Keun Hee of Samsung famously pushed through by brute force an irrational plan to build a new automobile division at a time when there was over expansion and excess capacity throughout Asia. It is difficult to believe that he could do so today.³⁹

4. THE HYUNDAI CASE

The Hyundai Group traces its roots to 1950 when its first company, HEC, was established by Chung Ju-Yung.⁴⁰ Other group members include Hyundai Motor Company and Kia Motors Corporation, Hyundai Heavy Industries, and Hyundai Electronics Industries (a chip maker).⁴¹ In mid-2000, the Group had fifty-three or so companies, down from a high of eighty-nine a few years earlier.⁴² In mid-2000, Chung stepped down as Group chairman following repeated demands by unhappy bank creditors and the gov-

³⁹ For this insight, we thank Jeong-ho Roh of Columbia University Law School.

⁴⁰ Burton & Plender, *Korea's Heavy Burden*, *supra* note 2, at 28. Mr. Chung passed away in March 2001.

⁴¹ For a list of the Group's companies, see Hyundai, *Company*, http://www.hyundai.com/hd2000/sub_companies.htm (last visited Oct. 31, 2001).

⁴² Veale & Burton, *Creditors Lose Patience*, *supra* note 5, at 25.

ernment to do so.⁴³ He installed three of his sons in his place (though an outside observer may wonder about the disregard of corporate formality in summarily appointing one's son to a post with great influence): Chung Mong Joon was given control of the shipyard, Hyundai Heavy Industries. Chung Mong Hun was placed in charge of HEC and many other Group companies. Chung Mong Koo became chairman of the Hyundai Motor group, which includes Hyundai Motor, Kia Motors, and several other companies. The Hyundai Motor group separated from the Hyundai Group in September 2000. The idea at the time was that Hyundai Motor would no longer have to give financial support to the larger Group's ailing businesses.⁴⁴

The succession was not a happy one. Mong Hun was said to be Chung Ju-Yung's favorite son and his accession to the flagship HEC, the high-tech jewel of Hyundai Electronics and the finance operations of Hyundai Securities, reportedly angered his brothers.⁴⁵ The battle for group control became public in the spring of 2000 when on March 10, Mong Hun was ousted from the board of

⁴³ Hyundai was unattractive to foreign investors following a power struggle among Mr. Chung's sons. The Group was in a liquidity squeeze. Creditors had demanded that Mr. Chung and his sons give up management rights. Investors were dumping Hyundai stock. And so the founder/chairman announced his retirement on May 31, 2000. John Burton, *Founder's Iron Grip Seen as Obstacle to Hyundai Reform: Creditors Do Not Share Public's Opinion of Group Patriarch*, FIN. TIMES (London), May 29, 2000, at 22; Moon Ihlwan, *When Is Hyundai Going to Get It?*, BUS. WK., June 12, 2000, at 66; Kim, *Hyundai Saga*, supra note 5; *Hyundai at the Height of Liquidity Problem*, KOREA ECON. WKLY. (Seoul), June 5, 2000, available at WISE D BASE, <http://www.wisedb.co.kr/> (copy on file with author); Laxmi Narkami, *Of Father and Sons: Family Ties, Money Troubles, Politics and Old-Fashioned Ambition Cloud Hyundai's Future*, ASIAWEEK, June 16, 2000, at 58; Ken Symon, *Revolt at Hyundai as Founder's Son Refuses to Retire*, THE SCOTSMAN, June 2, 2000, available at 2000 WL 21312768; Veale & Burton, *Creditors Lose Patience*, supra note 5, at 25. He also instructed his sons to retire. Mong Hun stepped down from Hyundai Electronics and even from HEC, but formally resumed his posts by November. Even during the interregnum, he was regarded as the key to the restructuring of HEC. Mong Koo explicitly refused to step down from Hyundai Motor.

⁴⁴ John Burton, *Hyundai Motor Goes It Alone*, FIN. TIMES (London), Sept. 1, 2000, at 25.

⁴⁵ See, e.g., *Chung to Dry*, FIN. TIMES (London), Nov. 13, 2000, at 19 ("Mong-hun's apparent good fortune provoked jealousy among his two brothers, who were assigned by their father to run smokestack industries like cars and ship-building."); John Burton, *Plan to Save Hyundai Unit Delayed*, FIN. TIMES (London), Nov. 16, 2000, at 43 [hereinafter Burton, *Plan to Save*] ("Chung Mong-hun's two estranged brothers own Hyundai Motor and Hyundai Heavy Industries"); Burton, *Last-Ditch Rescue Plan*, supra note 9, at 41 ("Mr. Chung's brothers, . . . are still bitter about a power struggle for group leadership early this year.").

Hyundai Motor Company Mong Koo was, and is, its representative director⁴⁶ and chairman. In mid-March, Mong Koo and Mong Hun fought over control of the Group's financial sector, with each naming his own loyalist as chairman of Hyundai Securities Company. On March 24, the Hyundai Group Corporate Restructuring Committee (essentially, a reincarnation of the office of the group chairman) announced that Mong Hun would henceforth be the sole chairman of the Hyundai Group CEO's Council—the de facto Group chairman. Mong Koo publicly refused to accept this decision, but on March 27, Chung Ju-Yung personally reaffirmed Mong Hun as the Group's sole chairman. This peremptory anointment is one of the reasons for the further corporate governance reforms described in the Appendix hereto.

The Korean government, which has been highly interventionist in the past, now accepts the virtues of a market-based economy and a market-led restructuring of the *chaebols*. The Ministry of Finance and Economy states its policy this way: "By the end of 2001, we will attempt to reform the inappropriate behavior and practices of economic agents to encourage elevated acceptance of market principles."⁴⁷ The government initially took a hands-off attitude towards the fate of HEC. The stock market disfavored Hyundai in the wake of the family infighting, leading a securities analyst in Seoul to state, "[T]hese forces will gradually force the group to separate companies and restructure weak affiliates."⁴⁸ Nevertheless, when Daewoo was placed in formal receivership, there came a sense of urgency about HEC. True, the state banks, which are HEC's biggest creditors, did not seek formal receivership for it, and they agreed in early November 2000 to roll over some debts. However, executives of various Hyundai affiliates rejected the self-rescue plan proposed by the Chung family. This was a new phenomenon: a group company behaving independently. The family's restructuring plan included a proposal that Hyundai Merchant Marine, a large shipping company, sell its stakes in

⁴⁶ A representative director—an office unknown in the U.S. business corporation but common in civil law jurisdictions—is elected by the board of directors and has the authority to represent the company. COM. CODE, *supra* note 18, art. 389.

⁴⁷ Jin Nyum, Ministry of Fin. and Econ., *Second-Half Economic Policy Directives of the Kim Dae-jung Administration: Aug. 2000 – Feb. 2003* (2000), at http://www.mofe.go.kr/cgi-pub/content.cgi?code=e_ep&no=74 (last visited Nov. 17, 2001).

⁴⁸ Veale & Burton, *Creditors Lose Patience*, *supra* note 5, at 25 (quoting Namuh Rhee, Head of Research at Samsung Securities in Seoul).

Electronics and Heavy Industries (the cross-ownership being characteristic of the *chaebols* and one means by which the group chairman is able to have effective control of the group) and use the proceeds for the benefit of HEC. Merchant Marine executives refused, saying that the proposed sale would hurt their own finances.⁴⁹ Hyundai Electronics also turned down Mong Hun's requests for cash infusions into the construction unit. Chief executives of other Hyundai companies even failed to show up at a Chung-presided meeting to discuss measures to rescue HEC.⁵⁰ This cannot be explained as fallout from the dispute among the brothers, as Merchant Marine, Electronics, and HEC are all within Mong Hun's realm. Motor and Heavy Industries, controlled by Mong Hun's estranged brothers, said they had little interest in purchasing Hyundai assets.⁵¹

The Korean government then spoke up. On November 5, the Minister of Finance and Economy said that Hyundai's affiliates should extend support.⁵² In a controversial departure from previous pledges to abide by market principles, the reform watchdog Financial Supervisory Commission ("FSC") arranged a bridge loan in mid-November by forcing the state-run Korea Land Corporation to advance almost \$200 million to Hyundai against the sale of a very large parcel of land owned by Chung Ju-Yung.⁵³ The Korean president also appealed to the Sultan of Brunei to speed the payment on a Hyundai construction project, and the finance minister said that the collapse of HEC would cause economic problems for the nation.⁵⁴ The government was concerned about massive job losses at the same time that Daewoo Motors was collapsing, and in a dramatic reversal of policy against cross-subsidization, it pressed

⁴⁹ Burton, *Plan to Save*, *supra* note 45, at 43; *Hyundai Owner Facing Need to Separate HEI*, KOREA HERALD, Nov. 8, 2000, available at 2000 WL 27394633.

⁵⁰ Yoo Cheong-Mo, *Chung's Bid to Bail Out Hyundai Construction Runs into Troubles*, KOREA HERALD, Nov. 10, 2000, available at 2000 WL 27394758.

⁵¹ John Burton, *Pressure Mounts on Hyundai Restructuring*, FIN. TIMES (London), Nov. 18, 2000, at 21 [hereinafter Burton, *Pressure Mounts*]; Burton, *Plan to Save*, *supra* note 45, at 43.

⁵² Yoo Cheong-mo, *Brother Groups Turn Cold Shoulder to Troubled Hyundai Construction*, KOREA HERALD, Nov. 7, 2000, available at 2000 WL 27395876.

⁵³ Yoo Cheong-mo, *Policy Toward Hyundai Weakening Confidence*, KOREA HERALD, Nov. 17, 2000 [hereinafter Yoo, *Policy Toward Hyundai*], available at 2000 WL 27395627.

⁵⁴ John Burton, *Hyundai in Struggle to Save Building Unit*, FIN. TIMES (London), Nov. 15, 2000, at 19.

Hyundai Motors and Heavy Industries to support HEC.⁵⁵ The FSC chairman met with Mong Koo to ask him to help HEC and arranged a dramatic reconciliation on November 16 between Mong Hun and Chung Mong Koo.⁵⁶ Motors now decided to buy some of HEC's assets.⁵⁷ Notable among the assets offered for sale was some portion of HEC's headquarters building in downtown Seoul, which most of HEC's affiliates had refused to buy.⁵⁸ Hyundai Motors, however, pledged some \$195 million in financial support following the reconciliation between Mong Hun and Mong Koo.⁵⁹ The attitude of Heavy Industries was not as clear. Some reports had it promising support along with Hyundai Motors,⁶⁰ others had it refusing to join in the purchase of the headquarters building,⁶¹ being dissuaded by minority shareholders.⁶² Its spokesman said that HHI was already inundated with protest calls from foreign shareholders angry over the possible irregular cash aid to HEC. He added that the management was under pressure from local minority shareholder activists.⁶³

Hyundai Merchant Marine and Hyundai Elevator may also have agreed to participate in the purchase,⁶⁴ though Marine later rejected the proposal.⁶⁵ Electronics America clearly refused to participate in the bailout, citing its managerial independence. The

⁵⁵ Burton, *Pressure Mounts*, *supra* note 51, at 21; Burton, *Last-Ditch Rescue Plan*, *supra* note 8, at 41.

⁵⁶ Yoo, *Policy Toward Hyundai*, *supra* note 55, available at 2000 WL 27395627.

⁵⁷ Burton, *Last-Ditch Rescue Plan*, *supra* note 9, at 41.

⁵⁸ Yoo, *Hyundai Announces W1.29*, *supra* note 2, available at 2000 WL 27395311.

⁵⁹ *Hyundai Faces Hurdle in Securing Rescue Plan*, KOREA TIMES (Seoul), Nov. 21, 2000, available at 2000 WL 24666091; Yoo, *Hyundai Announces W1.29*, *supra* note 2, available at 2000 WL 27395311.

⁶⁰ *Gov't Tells Hyundai Not to Count on Fresh Funds*, KOREA TIMES (Seoul), Nov. 21, 2000, available at 2000 WL 24666094.

⁶¹ *Market Skeptical Over Hyundai Construction's Self-Rescue Plan*, KOREA TIMES (Seoul), November 21, 2000, at 2000 WL 24666086; *Hyundai Faces Hurdle in Securing Rescue Plan*, *supra* note 59, at 2000 WL 24666091.

⁶² Yoo Cheong-Mo, *Hyundai Construction's Bailout Plan Unrealistic, Foreign Analysts Say*, KOREA HERALD, Nov. 23, 2000, available at 2000 WL 27395374 [hereinafter Yoo, *Hyundai Construction's*].

⁶³ Yoo Cheong-Mo, *Hyundai's Self-Rescue Bid Runs into Last-Stage Trouble: Attempt to Sell Group Building Goes Nowhere*, KOREA HERALD, Nov. 18, 2000, available at 2001 WL 27048995.

⁶⁴ *Market Skeptical over Hyundai Construction's Self-Rescue Plan*, Korea Times (Seoul), Nov. 21, 2000, available at 2000 WL 24666086.

⁶⁵ Yoo, *Hyundai Construction's*, *supra* note 62, available at 2000 WL 27395374.

chairman of Electronics America, who is not a Chung, said that "we have been reinventing ourselves, . . . we have built a firewall."⁶⁶ Hyundai Motor, having been encouraged by the government to extend support to HEC, did not back away.⁶⁷

Following the death of Chung Ju-Yung in March 2001, it is more likely than ever that the Hyundai Group will be formally split into separate, independent and much smaller groups.⁶⁸

5. CONCLUSIONS

What, if anything, can one conclude from these facts? Director independence was a cornerstone of Korea's corporate government reforms. Do any of the Hyundai Group affiliates have an independent board of directors that is not in fact dominated by the Chung family? We set aside for the moment the question of whether any *chaebol* board is independent of pressure from the Korean government. Group chairman Chung Ju-Yung was ousted by combined pressure from the government, creditors and unhappy investors, and while that is certainly a new thing, family control has largely continued through his sons. Hyundai Motor at first refused to help HEC, and that was also new, though that was probably more for personal reasons than sound business judgment. The Korean government is still trying to engineer the economy by managing the affairs of Korean companies, and there is nothing new about that. Finally, some affiliates, notably Electronics, Electronics America, Merchant Marine, and HHI have simply refused to assist HEC out of concern for their own financial health,⁶⁹ their

⁶⁶ Don Kirk, *Creditor Hails Latest [sic] Plan by Hyundai: Analysts Remain Skeptical of Unit's Self-Rescue Effort*, INT'L HERALD TRIB., Nov. 21, 2000, at 15 (quoting Park Chong Sup).

⁶⁷ Michael Baker, *Why Start-Ups Were S. Korean Economy's False Hope*, CHRISTIAN SCI. MONITOR, Dec. 8, 2000, at 7; Yoo, *Hyundai Construction's*, *supra* note 62, available at 2000 WL 27395374.

⁶⁸ See, e.g., Yoo Cheong-Mo, *Hyundai Group Expected to Split into Three Top-10 Groups by Year's End*, KOREA HERALD, Mar. 24, 2001, available at 2000 WL 8117042; Don Kirk, *As Korean Heirs Feud, an Empire Is Withering*, N.Y. TIMES, Apr. 26, 2001, at C1.

⁶⁹ Electronics, for example, is reported to have suffered a \$1.8 billion operating loss in 2000, due in part to slowing DRAM sales and debt incurred to finance the acquisition of LG Semiconductor as part of a government orchestrated restructuring of the *chaebols*. Drew Wilson, *SOS from Hyundai: The World's Number Two DRAM Maker Is Fighting for Survival*, ELECTRONIC BUS. ASIA, Apr. 2001, at <http://www.eb-asia.com/registerd/issues/0104/0104eb.htm/>. Another report notes liquidity problems at Hyundai Securities, Hyundai Merchant Marine, and

independence, and their minority shareholders, and that is a dramatically new thing worth our notice given the size of Hyundai and the importance of Korea in the global economy.

The new and pending corporate governance reforms described in this Essay are evolutionary, not revolutionary. They fill gaps left by the previous reforms. Some extend the requirement that boards have outside directors. For example, Item 6 of the Securities and Exchange Act amendments requires outside directors at KOSDAQ registered firms. This had been required only at firms listed on the Korea Stock Exchange.⁷⁰ Other amendments concern the rights of minority shareholders and the mechanism to enforce those rights. Item 5 of the Commercial Code amendments provides for reimbursement of costs incurred by a shareholder in prosecuting a derivative suit.⁷¹ Item 4 of the Securities and Exchange Act amendments lowers the ownership threshold required to exercise certain rights.⁷² Significantly, however, Korea does not allow class action lawsuits, and the amendments fail to create this procedural device, which is a practical necessity in bringing securities fraud cases. Korea has traditionally not been a litigious society. It is uncertain whether opening the doors to the courthouse, however imperfectly, means that anyone will walk through them.⁷³ There have been only a few derivative suits in Korea. Recently, a group of foreign institutional investors sued the directors of Samsung Electronics for its decision to pay the debt of Samsung Motors.⁷⁴ But while litigation remedies may deter blatant disloyalty, they evidently do not help a board make wise decisions. One wonders why the HEC affiliates have been able to resist doing the sort of

Hyundai Petrochemical. Yoo Cheong-mo, *Financial Woes Speeding up Breakup of Hyundai Group*, KOREA HERALD, Mar. 31, 2001, available at 2000 WL 8117346.

⁷⁰ See SECURITIES & EXCHANGE ACT, *supra* note 19, art. 191-16 (S. Korea) ("Stock-listed corporations must make outside directors no less than one fourth of the total number of directors . . .").

⁷¹ See COM. CODE, *supra* note 17, art. 405(1) (S. Korea).

⁷² See SECURITIES & EXCHANGE ACT, Act No. 5736 of Feb. 1, 1999, art. 191-13(2) & (3) (S. Korea) (requiring 50/10,000 or more, or in the case of a corporation as prescribed by Presidential decree of 25/10,000 of the total shares to exercise the stockholder's rights), translated in 11 KOREAN STATUTES 746-47 (Supp. 9).

⁷³ Perhaps Japan is a good example. A recent story in the *Economist* describes "a small boom in lawsuits" since governance reforms made suits cheaper. *Japan's Corporate-Governance U-Turn*, ECONOMIST, Nov. 24, 2000, at 73.

⁷⁴ Yoo Cheong-mo, *Foreign Investors Take Legal Action Against Samsung Directors*, KOREA HERALD, Nov. 24, 2000, available at 2000 WL 27395450.

thing that provoked litigation against the board of Samsung Electronics. To the extent that the law requires outside directors, audit and nominating committees, etc., all the *chaebol* firms have complied, so, this cannot be the explanation. Look again at Samsung: there was a bribery scandal last summer. Samsung Electronics gave \$1.5 million in company stock to one of its outside directors.⁷⁵ Corruption is the negation of independence. It remains a serious problem in Korea, and one that is not limited to the governance of the *chaebols*.⁷⁶ That is one reason why institutional investors view the Korean market as a short-term investment and why there is still little pension fund money being invested there.⁷⁷ The new laws certainly provide a framework, a guide, for a company that is serious about getting it right. But true change comes only with crisis, when the forces of the capital markets hit hard. That may be the real lesson of Hyundai.

APPENDIX

The corporate governance legal reforms enacted to date are described in detail in the sources cited in footnote 5, above. Additional reforms were enacted in 2001. They concern amendments to Korea's Commercial Code, the source of basic corporation law, the Securities Exchange Act, which regulates publicly traded corporations and the External Audit Law, which regulates the auditing of publicly traded firms, among others.

The Corporate Governance Reform Project, financed by the Ministry of Justice, with technical assistance loan funds from the World Bank, brought together a team of lawyers and legal professors from the United States and Korea. The team began its work in 1999. Its goal was to make specific suggestions to the Commercial Code and to map out both short-term and long-term directions for reform. The final report of their recommendations ("Final Report and Legal Reform Recommendations") was delivered to the Ministry of Justice in June 2000. The report focused on three key areas:

⁷⁵ Yoo Cheong-mo, *Bribery Scandal Deepens Investor Distrust of Samsung Electronics*, KOREA HERALD, Aug. 26, 2000, available at 2000 WL 21234877.

⁷⁶ Foreign executives and the local Seoul business community alike cite corruption as impeding their business activities. Chon Shi-yong, *Kim Orders 'Extraordinary' Steps on Corruption to Boost Foreign Investors*, KOREA HERALD, Jan. 10, 2001, available at 2001 WL 8113857; Kim Hyung-jin, *Businesses See Assembly as Most Corrupt*, KOREA HERALD, Feb. 17, 2001, available at 2001 WL 8115533.

⁷⁷ AMCHAM, *Capital Markets*, *supra* note 16.

beefing up the role of the board of directors in Korean firms; ending intra-group transactions which decrease value for shareholders; and defining more clearly the roles of government, shareholder litigation and market forces in enforcing shareholder rights. A public hearing for amendment of the Commercial Code was held on October 11, 2000. The main issues addressed by the hearing broadly included: (a) strengthening the role of directors; (b) expanding minority shareholder rights; (c) boosting pre-emptive rights; and (d) improving the monitoring of related party transactions. The draft bill was submitted to the National Assembly on December 30, 2000.⁷⁸ The Assembly passed a modified version on June 28, 2001. The Act for Amendment of the Commercial Code was promulgated on July 24, 2001 and made effective on that date.

1. *Revised Commercial Code of 2001*⁷⁹

1.1. *Enlarging the Authority of the General Meeting of Shareholders:*

A resolution in accordance with art[icle] 434 (a special resolution of the general meeting) shall be required for a company to effect the following acts:

1.~ 3. (omitted).

4. The takeover of a part of the business of other company, which may have an important effect on the business of the company.⁸⁰

⁷⁸ A Korean language version of the drafted bill, No. 160586, submitted to the National Assembly is available at <http://na6500.assembly.go.kr/cgi-bin/detail?BILLNO=160586> (last visited Nov. 17, 2001).

⁷⁹ See Law No. 14858 of July 24, 2001, Gwanbo (the Official Gazette) No. 14858, available at <http://open.korea.go.kr/gwanbodata/2001/07/0724000000.pdf> (specifying the changes made to Law No. 6068 of Dec. 31, 1999).

⁸⁰ Art. 374 (1)(4), newly inserted.

Under the existing law, a special resolution of the general meeting is not required for the corporation to effect the takeover of a part of the business of another company.

1.2. Director's Duty of Keeping a Secret:

Directors shall keep a managerial secret acquired in the performance of his duties after his retirement from office as well as during his office.⁸¹

1.3. Specifying Actions that Shall Require the Approval of the Board of Directors:

The management of corporation affairs such as "the disposal and transfer of important assets, borrowing a large property," appointment or dismissal of managers and establishment, transfer or abolition of branch offices shall be made by the resolution of the board of directors.⁸²

This new article clarifies that the management of corporation affairs belongs to the authority of the board of directors and that the disposal and transfer of important assets, borrowing a large property, etc., are examples of the management of corporation affairs.

The existing article reads: "Management of [corporation] affairs, appointments or dismissal of managers and establishment, transfer or abolition of branch offices shall be made by the resolution of the board of directors."⁸³

⁸¹ Art. 382-4, newly inserted.

⁸² Art. 393 (1), amended.

⁸³ Law No. 6086 of Dec. 31, 1999, art. 393(1) (amended 2001).

1.4. Director's Right to Have Greater Access to the Corporate Information:

Directors may demand the representative director to report on the functions of other director or employees to the board of directors.⁸⁴

Directors shall report the conditions of the management of affairs to the board of directors at least once every three months.⁸⁵

1.5. Expanding Minority Shareholders' Rights (Refunding Legal Costs Incurred in Derivative Suit):

If the shareholder, who has filed a derivative suit in accordance with article 403(3) and (4), wins the case, he may demand reimbursement by the company for a reasonable amount "of litigation costs and other expenses" incurred by the suit. "The corporation who has paid the litigation costs may demand the director to reimburse the cost."⁸⁶

Under existing law, a limited refund on legal costs is made in the event of a victory. Namely, the shareholder who has won the case may demand the reimbursement by the corporation for a reasonable amount "within the scope of actual expenses" incurred by the suit. All proceeds from a derivative suit filed against a director are payable only to the corporation. As a result, shareholders are left with no incentive to file a suit because there is nothing to look forward to, in terms of financial compensation.

The Final Report recommended boosting incentives for derivative suit by awarding portions of the proceeds from a legal victory back to the shareholder filed the suit. But this is not reflected in the Act.

⁸⁴ Art. 393(3), newly inserted.

⁸⁵ Art. 393(4), newly inserted.

⁸⁶ Art. 405(1), para. 1 amended and para. 2 newly inserted.

1.6. *Enforcing Pre-Emptive Rights:*

Each shareholder shall be entitled to the allotment of new shares in proportion to the number of shares which he holds.⁸⁷

Notwithstanding the provision of paragraph (1), the corporation may, only if it is necessary for the achievement of managerial objects such as introduction of new technology, improvement of financial conditions, etc., allot new shares to a third party other than shareholders under the conditions as set forth in the articles of incorporation.⁸⁸

Sub-article (1) deletes the phrase “[u]nless otherwise provided by the articles of incorporation,” from the old provision. The old sub-article (2) has been shifted into the sub-article (3).

These new sub-articles (1) and (2) restrict the allotment of new shares to a third party to enforce shareholders’ pre-emptive rights. That is permitted only for the achievement of managerial objects.

1.7. *Introduction of Exchange and Transfer of Shares for the Establishment of Holding Company:*

Articles 360-2 ~ 360-22 newly inserted.

1.8. *Cumulative Voting Mandatory:*

The Final Report recommended making the practice of cumulative voting mandatory. That recommendation was not included in the Act. Korea established a voluntary cumulative voting system in 1998, but few companies have adopted it.⁸⁹

⁸⁷ Art. 418(1), amended.

⁸⁸ Art. 418(2), newly inserted.

⁸⁹ As of late May 2000, twenty-two percent of KSE listed companies (155 out of 707) have adopted it. See Ministry of Finance and Economy, *Corporate Governance Improvement Plan for Transparent Management*, Oct. 27, 2000, available at http://www.mofe.go.kr/cgi-pub/content.cgi?code=e_fp&no=35 (last visited Nov. 5, 2001).

2. *Amendment of the Securities Exchange Act*⁹⁰

The government submitted a draft bill for amendment of the Securities Exchange Act to the National Assembly on December 21, 2000. The National Assembly passed a modified version on February 28, 2001. Its corporate governance provisions are as follows:

2.1. *Recommendation of the Outside Director Candidate:*

When the outside director candidate nominating committee in a KSE listed or KSDA registered company recommends outside director candidates, it should include among them the outside director candidate recommended by the shareholders in the exercise the shareholders' proposal right in order to exercise rights under art. 191-14.⁹¹

This sub-paragraph will be added to art. 54-5(3) and incorporated by reference to art. 191-16(3). Large KSE listed companies are required to have nominating committees as will certain KSDA registered companies. See item 6 below for further discussion.

2.2. *Chairman of Audit Committee:*

The chairman of the audit committee in a KSE listed or KSDA registered company should be an outside director.⁹²

This sub-paragraph will be added to article 54-6(2) and incorporated by reference to article 191-17. Large KSE listed companies had been required to have audit committees, and this requirement has been extended to include certain KSDA registered companies as well.⁹³

⁹⁰ The Act for the Amendment of the Securities Exchange Act was promulgated on March 28, 2001. See Law No. 14762 of Mar. 28, 2001, Gwanbo (S. Korea), available at <http://open.korea.go.kr/gwanbodata/2001/03/0328000000.pdf>.

⁹¹ Art. 54-6(2), proposed.

⁹² Art. 54-6(2), proposed.

⁹³ See *infra* Appendix 2.6.

2.3. *Limitation of Voting in the Election of Members of the Audit Committee:*

The provisions of Article 409 (2) and (3) shall apply, *mutatis mutandis*, to the election of an outside director who will become member of the audit committee.⁹⁴

The provisions of Article 54-6(2) through (6) shall apply, *mutatis mutandis*, to the composition of the audit committee of [KSE listed and KSDA registered companies.]⁹⁵

As a result, a shareholder who holds more than 3/100 of the total outstanding shares, exclusive of non-voting shares, may not exercise his vote with respect to the shares in excess of the above limit in the election of outside directors who will become members of the audit committee. The articles of incorporation may provide for a lower ratio than the limit.

2.4. *Strengthening of the Minority Shareholders' Right:*

[The thresholds for the right to demand cessation of an unlawful act and the right to inspect accounting books will be lowered to one tenth of the old standards. These thresholds are applicable to a KSE listed or KSDA registered company and a large securities company.]⁹⁶

For example, the bill lowered the threshold for the right to demand cessation of an unlawful act from 0.5% to 0.05% in a KSE listed or KSDA registered company, and from 0.25% to 0.025% in a large securities company or large business corporation.

⁹⁴ Art. 54-6(6), newly inserted.

⁹⁵ Art. 191-17(2), amended.

⁹⁶ Arts. 64(1) & 191-13, amended.

2.5. *Notice and Public Notice of Director Candidate's Name, Etc.:*

In case a KSE listed company or KSDA registered company makes a notice of convocation of a general meeting or a public notice thereof, and the subject-matter of the meeting is the appointment of a director, the company shall give, pursuant to the Commercial Code art. 363(1), a notice or public notice of the name of the director candidate, a brief personal record and particulars relating to the candidate as prescribed by the Presidential Decree.⁹⁷

In case the above company convenes the general meeting of shareholders, the company shall give a notice or public notice of:

- i) Details of activity such as the percentage of attendance at board of directors meetings of outside director and other part-time directors, votes for and against the agenda of board of directors, and particulars of remuneration.
- ii) Particulars of trading with the largest shareholder, etc., pursuant to Article 191-19.
- iii) The matters for reference relating to the management, such as the summary of contents of business, and the present conditions of management as prescribed by the Presidential Decree.⁹⁸

⁹⁷ Art. 191-10(2), amended.

⁹⁸ Art. 191-10(3), newly inserted.

2.6. Enlargement of Outside Director and Audit Committee System to a KSDA Registered Company:

[Sufficiently large KSDA registered companies prescribed by the Presidential Decree shall appoint outside directors, establish an outside director candidate nominating committee and an audit committee.]⁹⁹

The outside director and audit committee requirements had applied only to KSE listed companies.

2.7. Reinforcement of Cumulative Voting:

Shareholders who hold no less than 1/100 of the total outstanding shares other than non-voting shares in a KSE listed company or KSDA registered company may request that the company elect directors by means of cumulative voting, except as otherwise provided by the articles of incorporation.

[Any shareholder who holds more than 3/100 of the total outstanding shares, exclusive of non-voting shares, may not exercise his vote with respect to the shares in excess of the limit, in the change of the articles of incorporation to exclude the cumulative voting or to repeal the clause excluding the cumulative voting. The articles of incorporation may provide for a lower ratio than that mentioned above. The agenda relating to the exclusion or adoption of cumulative voting shall be treated independently from other agenda relating to the change of articles of incorporation.]¹⁰⁰

⁹⁹ Amendment of arts. 191-16 & 191-17, summarized here.

¹⁰⁰ Art. 191-18, newly inserted and summarized here.

2.8. *Approval of Board of Directors for the Trading With the Largest Shareholder, Etc.:*

A KSE listed company, or KSDA registered company as prescribed by the Presidential Decree, shall obtain the approval of the board of directors in order to trade on a large scale with the largest shareholder and the specially related person.¹⁰¹

3. *Amendments to the Act on External Audit of Stock Companies*¹⁰²

Finally, there have been a series of recent amendments to the Act on External Audit of Stock Companies, effective April 1, 2001. (Law No. 3297). Among others, publicly traded firms (either KSE or KOSDAQ) are subject to this law and must have their annual financial statements audited by certified public accountants.¹⁰³ The recent amendments follow in the wake of the Daewoo collapse. Korean prosecutors allege false accounting in 1997 and 1998 that inflated the value of Daewoo's equity by \$32 billion.¹⁰⁴ The amendments concern the procedure for the selection of the external auditor, the procedure for the dismissal of the external auditor, the public disclosure of violations of accounting standards, and the term for which the external auditor shall serve. The most important of the amendments include the following:

¹⁰¹ Art. 191-19, newly inserted.

¹⁰² See Act No. 6427 of Mar. 28, 2001 (S. Korea) (amending Act No. 6108 of Jan. 12, 2000) (original version at Act No. 3297 of Dec. 31, 1980), available at <http://www.klri.re.kr/docs/eng/B3403297.html> (last modified Aug. 18, 2001); Law No. 14762 of Mar. 28, 2001, Gwanbo (Electronic Gazette) (S. Korea), available at <http://gwanbo.korea.go.kr/www/gwanbodata/2001/03/0328000000.pdf> (last visited Nov. 17, 2001).

¹⁰³ SECURITIES & EXCHANGE ACT, Act No. 6176 of Jan. 21, 2000, art. 194-3(1) (S. Korea), translated in 22 KOREAN STATUTES, *supra* note 17, at 752 (Supp. 9). The most recent version of Korea's Securities and Exchange Act can be found at <http://www.moleg.go.kr/mlawinfo/english/htms/html/law19.html> (Last visited Nov. 17, 2001).

¹⁰⁴ Moon Ihwan, *Kim's Fall From Grace*, BUS. WK., Feb. 19, 2001, at 50.

3.1. Approval of the Statutory Auditor or the Auditor Selection Committee:

In the selection and appointment of an auditor, any company shall get approval thereof from the statutory auditor and the Auditor Selection and Appointment Committee secured with its expertise and independence.¹⁰⁵

This amendment is intended to exclude the major shareholder's influence over the selection of external auditors at the shareholders' meeting. The approval of the shareholders' meeting is no longer necessary.

3.2. Prohibition of Conducting an Audit on the Same Company:

An auditor who is an accounting corporation shall not have the same director perform the audit task for six consecutive business years [four consecutive business years in case of a company that is a stock-listed corporation or an Association-registered corporation (referring to an Association-registered corporation under the Securities and Exchange Act; hereafter the same shall apply)] of a company.¹⁰⁶

New paragraphs 5 and 6 were added to Article 3. They require that the accounting corporation's audit team be reconstituted after three years, if the client is a KSE-listed or KNASDAQ-registered company.

There was also a set of amendments to the Certified Public Accountant Act, effective April 1, 2001. The most important amendment was the introduction of a civil penalty as a sanction against a CPA and an accounting firm for false audit work.¹⁰⁷

¹⁰⁵ Art. 4(2), amended.

¹⁰⁶ Art. 3(4), amended.

¹⁰⁷ Arts. 52-2 ~ 52-6.

* * * * *