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CORPORATE GOVERNANCE IN KOREA

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The 1984 revision of Korea's Commercial Code failed to respond adequately to the issues of structure and governance in large Korean corporations. The managements of such corporations are able to circumvent both legal and market restraints on this conduct and thus act more freely than their U.S. counterparts. If the Korean economy is to continue expanding, the government must confront the problem of management accountability or suffer stagnation as foreign and domestic investors seek other markets.

1. Introduction

Large corporations play a central role in modern capitalist societies. Corporate influence extends beyond the economic arena to both political and cultural affairs. Because of this influence, lawyers, economists, and business leaders have carefully studied the structure and governance of business corporations. In the United States, debate on corporate governance among both academics and practitioners [1] led the American Law Institute (ALI) to propose an ambitious first draft of Principles of Corporate Governance [2]. Criticism of the draft was extensive when it came out in 1982 [3]. In the more recent drafts [4], the ALI qualified its original position on many points.

The recent revision of Korea's Commercial Code [5], which became effective on September 1, 1984, provides an opportunity to compare corporate governance in Korea with corporate management in the United States. Corporate governance has not been discussed as extensively in Korea as it has in the United States. The 1984 revision is the first statutory change since the Commercial Code was enacted in 1962.

During the past two decades, Korea's economy has expanded rapidly and business corporations have played a decisive role in Korea's economic development [6]. Although the 1984 revision covers more than 150 provisions, it barely addresses the issue of corporate structure and governance. This apparent neglect of corporate governance should not suggest a resolution of

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corporate governance issues in Korea. Rather, corporate governance eventually will provoke widespread controversy in Korea.

This paper examines the statutory framework of corporate structure and governance in Korea. Providing a background for subsequent discussions, section 2 shows how the shareholding pattern of large corporations in Korea differs from the U.S. pattern. It then briefly discusses the significance of such differences. Section 3 examines how the various statutory mechanisms in Korea are designed to control management behavior and the reasons they fail to work. Finally, section 4 deals with market mechanisms restraining management conduct in Korea.

2. Ownership and Control of Large Corporations in Korea: Its Reality and Significance

The Korean Commercial Code permits four types of business organizations: (1) the partnership company, an entity whose members assume unlimited liability for the company's obligations; (2) the limited partnership company, an entity composed of two classes of members, those who assume unlimited liability for the company's obligations, and those who do not assume liability beyond the value of their shares; (3) the private limited liability company, an entity similar to a closed corporate enterprise; and (4) the stock company, the equivalent of the publicly held business corporation in the United States.

Korean companies clearly favor the corporate form. Even joint venture corporations, which could operate more efficiently as private limited liability companies, prefer this type of organization [7]. As in Japan, the overwhelming popularity of the corporate form probably results from the "first class" image that such companies project [8].

Most Korean corporations are relatively small [9]. Although a closely held corporation is not necessarily small by definition [10], virtually all corporations below the one billion won line are closely held [11]. Moreover, many of the large corporations above the one billion won line are probably closely held [12]. In addition, available data indicate that the shareholdings in corporations listed on the Korean Stock Exchange are not widely distributed among the public, but heavily concentrated in a small number of people.

The number of corporations listed on the Korean Stock Exchange increased from 66 in 1972 to 334 in 1982 [14]. Table 1 indicates that the government goal of wider distribution of equities among the public has been achieved to a marked degree in the period 1972–1982 [15]. Concentration of shareholdings nevertheless remains. Table 1 indicates that only 5,011 shareholders of 334 listed corporations hold as much as 54.83% of the total shares. This sharply contrasts with the situation in the United States [16].

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Table 1
Distribution of equity ownership by shareholding [13]

	End of 1972		End of 1982	
Below 100 shares				
Persons	76,096	(73.69%)	158,875	(23.29%)
Shares	1,229,206	(0.58%)	5,947,890	(0.13%)
100–1,000 shares				
Persons	18,526	(17.94%)	276,641	(40.55%)
Shares	5,953,606	(2.79%)	115,365,896	(2.43%)
1,000–10,000 shares				
Persons	6,823	(6.60%)	191,367	(280.05%)
Shares	20,160,664	(9.43%)	649,246,801	(13.65%)
10,000–100,000 shares				
Persons	1,610	(1.55%)	50,281	(0.73%)
Shares	40,545,600	(18.97%)	1,376,152,300	(28.96%)
Over 100,000 shares				
Persons	211	(0.20%)	5,022	(0.73%)
Shares	145,902,380	(68.25%)	2,606,577,365	(54.83%)
Total				
Persons	103,266	(100.00%)	682,175	(100.00%)
Shares	214,791,456	(100.00%)	4,753,290,252	(100.00%)

The actual extent of concentration of shareholdings in Korea, however, may be much greater than table 1 suggests. Most business corporations in Korea are owned by single families [17]. They are reluctant to go public and thus endanger their control over the corporations they themselves have founded [18]. For financing, even the largest corporations heavily rely on domestic or foreign banks, or on private money markets rather than the securities market [19].

The government has pressured corporations to go public to improve the highly leveraged corporate financial structure and to achieve wider distribution among the public of shares in major business institutions. The government has provided various incentives, including favorable tax treatment for publicly held corporations [20]. Moreover, the government has simply ordered selected corporations to go public [21]. In response, a number of leading corporations have either refused to go public or have disguised themselves as public by placing a substantial portion of shares under the names of "close friends, relatives, employees, and occasionally, controlling shareholders of other corporations in a reciprocal arrangement" [22].

Another phenomenon strengthening the actual degree of concentration of equity ownership in Korea is the widespread practice of cross or circular shareholdings among corporations in the same business group. One of the most notable byproducts of rapid economic growth in Korea is the emergence of several giant business conglomerates [23]. At present, most of the largest

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business corporations in Korea belong to one of these conglomerates. The extensive use of the cross or circular ownership device has contributed to the rapid expansion of these conglomerates. Through this device, controlling persons have been able to expand their holdings without necessarily relinquishing ultimate control. Public concern has finally caused lawmakers to prohibit a subsidiary from acquiring the stock of its parent [24].

These factors suggest the existence of a single controlling family even in large corporations. The head of this family actively manages corporate affairs or at least closely supervises the performance of management. Typically, the entrepreneur who has founded the business group is the source of all power in the group [25].

Thus, one may make a rough distinction among large corporations in Korea and the United States. In large U.S. corporations, ownership and control are separate; management, rather than shareholders, has control over corporate affairs. In contrast, both ownership and control of Korean corporations are in the hands of strong-willed founders. Although these entrepreneurs usually assume the role of chief executives in the corporations, their ultimate power derives not only from their status as top executive officers, but also from their status as controlling shareholders.

2.2. Significance of the Existence of Owner-managers

The previous subsection concludes that in a typical large corporation in Korea, a single family controls a substantial block of shares and the head of the family is actively engaged in management of the member companies in his business group. Thus, the interests of shareholders and management overlap substantially. Consequently, agency problems are much less acute in Korea than in the United States [26]. Indeed, owner-managers' relentless pursuit of their own interests has contributed to the remarkable growth of the Korean business corporation. Given the current integration of ownership and control, corporate governance seems less important an issue in Korea than in the United States. Without significant agency problems, the most important function of corporate law is the protection of minority rights against the misconduct of controlling shareholders.

It is difficult to predict how this concentrated shareholding pattern of Korean corporations will change. Yet, due to current government policy as well as economic forces, it is clear that the percentage of controlling shareholders' holdings will eventually decline with the passage of time. In order to distribute shares more evenly among the public, the government encourages corporations to rely on equity financing instead of debt financing [27]. The government also discourages banks from further lending to their large corporate borrowers [28]. Because debt financing has lost much of its appeal [29], the inflation rates of the recent years have been low [30]. Moreover, as long as

both government policy and the securities laws continue to discourage hostile takeovers and challenges to existing control [31], controlling shareholders may substantially reduce their holdings without risking ultimate control. As the percentage of controlling shareholders' equity interest decreases, however, their interest and that of the corporation may diverge, causing agency problems to develop.

Because government policy and economic forces may take a long time to affect corporate structure, Korea should develop effective statutory mechanisms to control management behavior. However, the statutory scheme must not unduly encumber management's efforts to maximize corporate profits and shareholder gain since these goals are central to the corporation [32].

3. Statutory Mechanisms for Checking Management

The Korean Commercial Code provides that "the business of the company ... shall be executed by the resolution of the board of directors" [33]. In the United States it is generally recognized that management, headed by the chief executive officer, rather than the board, operates the business [34]. In Korea, the "representative director," the functional equivalent of the chairman of the board in the United States, is the supreme authority in the actual operation of the corporate business. Representative directors have authority to perform all acts relating to the corporate business on behalf of the corporation [35].

In Korea, three organizational units are responsible for examining management conduct: (1) the board of directors; (2) "inside auditors"; and (3) shareholders. Contrary to the statutory purpose, however, none of these checks can effectively curtail management's power vis-à-vis the minority shareholders.

3.1. The Board of Directors

The Code requires a corporation to have at least three directors who are elected at shareholder meetings [36]. Since cumulative voting is unavailable [37], a controlling shareholder may fill all the board positions with his supporters.

Under the Code, the board, or the shareholders, if so provided in the articles of incorporation, has the power to appoint representative directors [38]. Although the original Code had no provision for the board's power to supervise and to remove representative directors, commentators did not dispute the board's supervisory role [39]. The 1984 amendments confirm this view by providing that the board shall supervise the execution of corporate affairs by its directors [40].

In the United States, as it became clear that the board of a large publicly held corporation does not, and, is not, in a position to actually "manage" the

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corporate business, the oversight function of the board has moved into the limelight [41]. Nevertheless, there has been wide criticism that, in actuality, the board fails to perform that role [42]. Although the situation in Korea is similar, it is more pronounced. In fact, the oversight function of the board is virtually absent for several practical reasons.

First, the subordination of directors to the representative director renders meaningful supervision impossible. Although similar criticism has been directed at U.S. corporations [43], the degree of such subordination is much stronger in Korea, since in most cases the controlling shareholder himself or his "right-hand man" serves as representative director. While the board selects the representative director as a legal matter [44], the representative director (or controlling shareholder behind him) selects the board members as a practical matter. The controlling shareholder usually selects directors from among his long-time employees. The loyalty of the candidate to the controlling shareholder is the crucial factor in the selection process. Removable at any time with or without cause at a shareholders meeting [45], a director serves at the pleasure of the controlling shareholder. Consequently, to expect a director to risk his position by defying this shareholder is quite unrealistic.

A second factor that renders board supervision of management ineffective is the near absence of outside directors on the board [46]. Even in large corporations, most directors serve as officers or employees of the corporation they "direct."

A recent survey shows that 92 out of 197 listed corporations have no outside directors on their boards [47]. Thus, under the circumstances, the board may well be compared to a batter who "calls his own strikes." The supervisory function of the board thus remains an illusion.

The 1984 amendments merely confirm the board's oversight function, without introducing significant changes. Some Korean commentators have recommended that a majority of the board members should be selected from outside the company [48], but these recommendations have not appealed to the corporate community [49]. Such a response is not surprising, considering that Korean entrepreneurs have been reluctant to allow outsiders to participate in their businesses, even as shareholders.

3.2. Auditors

3.2.1. Inside Auditors

The presence of inside auditors in Korean corporations may justify the exclusion of outside directors on the board. Indeed, the 1984 amendments to the KCC focus on strengthening the power of inside auditors.

Under the Code, a stock corporation must have at least one inside auditor, who may not serve concurrently as a director, a manager, or as any other employee of the corporation [50]. Inside auditors are selected at shareholder

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meetings [51]. In selecting inside auditors, any shareholder with more than three percent of the total outstanding voting shares may not vote the excess shares [52]. The recent revision extends the term of office for inside auditors from one to two years [53].

Prior to the revision, the responsibilities of inside auditors were generally limited to accounting matters [54]. The amended Code expands the role of inside auditors to cover operational as well as accounting matters by providing that "the inside auditor shall examine the directors' performance" [55]. In addition, inside auditors are jointly and severally liable to the corporation for damages caused by their failure to perform their duties [56]. Such a failure may give rise to a derivative suit [57].

Although the 1984 revision theoretically strengthens the role of the inside auditor, in practice he or she will merely act as a "rubber stamp." This discrepancy between theory and practice exists because the amendments have failed to ensure the independence of the inside auditor.

The Code prohibits the inside auditor from serving concurrently as a director, a manager, or any other employee of the corporation [58], but the Code requires no more. As long as he or she is not presently maintaining any of those positions, any person may serve as inside auditor, however obvious and strong his or her ties are to management. One may argue that prohibiting a shareholder with more than three percent of the total outstanding voting shares from voting the excess shares may diminish substantially the influence of the controlling shareholder on the election of inside auditors [59]. The three percent maximum provision, however, may be avoided by secretly distributing the excess shares among relatives or friends [60]. Combined with the inertia and disorganization of small shareholders, this procedural approach is unlikely to enhance the neutrality of inside auditors.

3.2.2. Outside Auditors

The external audit, required under other statutes, may remedy the deficiency of the internal audit system under the Commercial Code. The most important audit is the external audit required by the Law Concerning the External Audit of Stock Corporations (External Audit Law) [61]. Pursuant to the External Audit Law, a corporation with both capital and total assets in excess of 500 million won and 3 billion won, respectively, must have its financial statements audited by an outside auditor [62]. The outside auditor, who must be either a certified public accountant or an accounting firm, has the following duties: (1) to audit the financial statements and submit an audit report to the corporation and the Audit Supervision Committee attached to the Securities Supervisory Board [63]; (2) to report any improper acts committed by a director in performing his duties and any material violations of law or the articles of incorporation [64]; and (3) to attend shareholder meetings upon request of the shareholders and present opinion or answer

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questions [65]. Outside auditors may be liable to the corporation or third parties for failure to perform their duties, and may be subject to disciplinary measures for violation of the Law [66].

Nonetheless, Korean law provides that "corporations" must appoint the outside auditor [67]. The power to appoint an outside auditor will, therefore, rest in most cases with the board of directors or, as a practical matter, the representative director [68]. Accordingly, the independence and objectivity of an external audit is clearly questionable.

3.3. Shareholders

3.3.1. General Meeting: Law and Reality

A general meeting of shareholders must be held once a year, but if the corporation has more than one fiscal period a year a meeting must be held once during each period [69]. Usually, the board of directors determines whether to convene a general meeting [70], but shareholders with five percent or more of the total outstanding shares may force the board to call an extraordinary meeting of shareholders [71].

The power of shareholders at the general meeting is limited to the matters provided for in the Code or the articles of incorporation [72]. Ordinarily, matters handled at that meeting include: (1) approval of the balance sheet, the income statement, and the profit or loss disposal statement [73]; and (2) election of directors and inside auditors [74].

Except as otherwise provided in the Code or the articles of incorporation, shareholders representing a majority of the total outstanding shares constitute a quorum, and a majority vote of the shares represented at the meeting is required to pass ordinary resolutions [75]. A two-thirds majority is necessary for matters such as: (1) amendment of the articles of incorporation [76]; (2) transfer of all or a substantial part of the business [77]; (3) removal of directors and inside auditors [78]; and (4) merger, consolidation, or dissolution [79].

Similar to their U.S. counterparts, small shareholders in Korea have little interest in attending shareholder meetings. Most of them are speculators rather than investors [80]. If small shareholders do attend meetings, their impact is minimal because a majority of the shares are in the hands of a few controlling shareholders. Consequently, despite the legal illusion of management accountability to shareholders, the reality is that management is accountable only to the largest shareholders. Under such a governance structure shareholder meetings will inevitably serve merely to validate the acts and proposals of management.

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3.3.2. Shareholders' Rights Vis-à-vis Directors

3.3.2.1. Shareholders' rights in removing directors. Shareholders may remove directors at any time, with or without cause, by passing a special resolution at a shareholder meeting [81]. If, despite the director's material misconduct, the resolution fails to pass, then shareholders with five percent or more of the outstanding shares may resort to the courts for judicial removal of the director [82]. The shareholders may apply for a temporary order to deprive the director of his authority and to appoint an acting director [83]. The availability of such a procedure thus provides shareholders with a limited remedy for director mismanagement. The five percent requirement, nonetheless, poses an enormous obstacle to shareholder use of this device in the large publicly held corporation.

3.3.2.2. Inspection rights. A shareholder may inspect or copy financial statements and audit reports kept at the main office [84]. To gain access to accounting books and records, however, shareholders are required to have at least five percent of the total outstanding shares [85]. Normally, directors must prove the unreasonableness of the shareholders' demand for such inspection in order to avoid it [86], but in publicly held corporations the shareholders carry the burden of proving that their demand is reasonable [87]. Thus, shareholder access to financial information remains limited.

If any doubt arises as to the existence of grave misconduct on the part of directors, shareholders with five percent of the total shares may demand that the court appoint an inspector authorized to investigate corporate affairs and financial status [88]. Nevertheless, because of this five percent shareholding requirement, small shareholders' ability to gauge management performance is effectively minimized.

3.3.2.3. Fiduciary duties. Korea has no provision expressly stating the fiduciary duties of management [89]. Since the mandate provisions of the Civil Code [90] are applicable to the relationship between the corporation and directors [91], the latter have the duty of care of a good manager [92], which is functionally equivalent to the fiduciary duty imposed on the director of a U.S. corporation. Moreover, the Commercial Code provides three sets of regulations to prevent directors from breaching their duty as good managers [93].

First, a director who seeks to execute any transaction with the corporation on his own behalf or on behalf of a third person must obtain the board's approval [94]. Although the Code does not expressly provide so, it is generally agreed that such a requirement is limited to those transactions that may cause a conflict of interest between the director and the corporation [95].

Second, a director who intends to effect a transaction that falls within the same line of business as carried on by the corporation must obtain approval of

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the shareholders [96]. If the director acts on his own behalf, then the corporation may treat the transaction as though it were effected on behalf of the corporation [97]. If he acts on behalf of a third person, then the corporation still may demand any benefit resulting from the transaction [98]. The avaricious director may be liable to the corporation for any damage caused by his conduct and may be removed [99].

The scope of this principle, which purports to prohibit competition with the corporation, is quite limited compared with that of the "corporate opportunity" doctrine in the United States. While the U.S. doctrine precludes corporate fiduciaries from usurping corporate opportunities – "opportunities in which the corporation has a right, property interest, or expectancy, or which in justice should belong to the corporation" [100] – the Korean counterpart adheres to the concept of "line of business," which is only one of a variety of standards traditionally employed by U.S. courts in determining whether an opportunity constitutes a "corporate opportunity" [101].

Third, the amount of director compensation must be determined by a resolution of the shareholders, unless the articles of incorporation provide otherwise [102]. Although not expressly supported by the language of the Code, a shareholders meeting generally sets only the total amount of compensation available to all the directors, while the board apportions a salary to each director [103]. If compensation is not fixed either in the articles of incorporation or by resolution, a court may determine a "reasonable amount" based on relevant facts [104].

While these laws do indeed provide for limited management accountability to shareholders, limited access to corporate records [105] and majority shareholders that are probably the least interested in curbing directors' indiscretions [106], ensure that such laws will be ineffective in enforcing fiduciary duties.

3.3.2.4. Derivative suits. The Code provides for other mechanisms to enforce the directors' responsibilities as well. The shareholders' derivative suit is the most important of these mechanisms. Shareholders holding five percent of the corporation's outstanding shares may demand that the corporation bring suit to hold directors liable for failing to perform their duties [107]. If the corporation fails to bring suit within thirty days after the demand, then the shareholders may file a derivative suit against the directors [108]. A shareholder holding more than five percent of the outstanding stock may also file a derivative suit to enjoin a director who engages in an *ultra vires* or other illegal act that might cause irreparable harm to the corporation [109].

The derivative suit provisions, however, have been totally ignored in Korea. During the two decades since its adoption, no reported derivative suit exists [110]. This peculiar phenomenon has been attributed to various factors. First, the Commercial Code requires dissenting shareholders to have at least five percent of the corporation's outstanding stock in order to file a derivative suit

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[111]. This five percent requirement poses an enormous obstacle to a shareholder of a large publicly held corporation [112].

Second, a Korean court has limited discretion to determine whether or not a director breached his or her fiduciary duties. The legality of a director's conduct depends on a relatively simple decision as to whether he or she obtained approval by shareholders or the board rather than on an objective determination as to whether or not that conduct was "fair or reasonable" [113].

Third, shareholders are not generally in a position to collect enough information to win a derivative suit. Disclosure requirements under Korea's securities law are inadequate [114]. More importantly, no discovery system comparable to that in the United States is available in Korea [115].

Finally, a shareholder in Korea has a much weaker economic incentive to bring a derivative suit than his U.S. counterpart. As in the United States, successful shareholders in Korea are entitled to reimbursement by the corporation for a "reasonable amount" of attorney fees incurred in litigating the suit [116]. But the "reasonable amount" must be within the scope of actual fees [117]. In determining the "reasonable amount," Korean courts are reluctant to award damages beyond the "going rate" [118].

While the shareholder derivative suit is a common method of overseeing corporate action in the United States, the five percent shareholding requirement, the lack of discovery, limited judicial discretion, and weak incentives severely limit the derivative suit as an effective mechanism for enforcing corporate directors' responsibility in Korea.

4. Absence of Market Imposed Checks on Management

Three types of market mechanism restrain corporate management: the product market; the financial market; and the market for corporate control [119]. It is unlikely, however, that market pressures in Korea influence manages of large corporations to significantly modify their behavior. Several factors contribute to the minimized impact of market mechanisms on corporate managers in Korea. Many large Korean corporations, for example, dominate their own product markets [120]. The government tightly controls Korea's financial market and business performance has been much less important a factor in bank loan decisions than in the United States [121]. The market for corporate control, regarded as the most important of all the market mechanisms, does not exist in Korea.

Practical reasons prevent hostile takeovers in Korea. Because shares are heavily concentrated in the hands of a small number of controlling shareholders, gaining a majority or controlling block of shares through a tender offer is impossible as a practical matter. Indeed, a major reason for Korean

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entrepreneurs' opposition to public offerings of their stock has been their fear of losing control. To dispel this fear, the government has provided some statutory safeguards for incumbent management.

Under the Securities and Exchange Law, a shareholder in a corporation listed on the Korean Stock Exchange may not hold shares in excess of the percentage he or she initially held at the time of listing [122]. Subject to a fine, a shareholder violating this prohibition may not vote the excess shares and may have to dispose of them [123]. Some exceptions to this prohibition exist, however. For example, one may acquire shares through a tender offer solicitation or a direct purchase from a shareholder holding more than ten percent [124].

These restrictions are much more effective in discouraging shifts in corporate control than the reporting requirement under U.S law [125]. While Korean law flatly prohibits ownership increase beyond the ten percent maximum limit [126], U.S. law merely requires a party acquiring five percent or more of a certain security to report such acquisition and his intentions with respect to the issuer of such security [127]. Given the concentration of shareholdings in a few controlling shareholders in Korea, this ten percent limit imposes an insurmountable obstacle to corporate raiders.

In addition, Korean statutes governing tender offers generally are favourable to the management of the target corporation rather than the tender offeror [128]. As a defensive tactic, the target corporation may campaign to persuade its shareholders not to sell their shares to the offeror [129]. In communicating with its shareholders, the target corporation may not omit a material fact or state a misleading fact [130]. Even if the target company's recommendation is misleading, however, remedies such as amendment orders or stop orders are not available under the present securities statutes. Moreover, unlike U.S. law [131], Korean law does not explicitly require the target corporation to submit information that would aid a shareholder in evaluating the management's recommendation [132]. The Korean securities laws thus remove the most effective curb on corporate management that a minority shareholder possesses – the threat of hostile takeover.

5. Conclusion

The Korean corporation differs from the U.S. corporation in that ownership and control merge, often in one family or individual. The Korean Commercial Code has attempted to address this problem by providing means for checking management behavior. Unfortunately, the Code is ineffective; rather than changing the existing system, the Code perpetuates the system by requiring checking mechanisms that management can easily manipulate to serve its own ends. Market mechanisms are also unable to restrain corporate management.

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The failure of the Code and the market to control corporate managers has not left them completely unrestrained. The government has influenced major financial institutions in their decisions whether or not to grant loans to a particular company [133]. In this manner the government may discipline managers for their poor performance.

To rely on government to discipline managers, however, is undesirable because of the arbitrariness and possibility of corruption. Consequently, Korea presently lacks an effective method for restraining corporate managers and must search for other mechanisms that effectively increase management accountability to minority shareholders.

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Notes

[1] *See, e.g.*, Commentaries on Corporate Structure and Corporate Governance, The ALI–ABA Symposiums 1977–1978, at 6–8 (D. Schwartz ed. 1979). Many consider the current checks on management, including the accountability of directors and managers to shareholders, to be legally insufficient. *Id.*

[2] Principles of Corporate Governance and Structure: Restatement and Recommendations (Tent. Draft No. 1, 1982) [hereinafter cited as ALI Draft No. 1].

[3] *See* Business Roundtable, Statement of the Business Roundtable on the American Law Institute's Proposed "Principles of Corporate Governance and Structure: Restatement and Recommendations" (1983); Fischel, *The Corporate Governance Movement*, 35 Vand. L. Rev. 1259 (1982) (disputing the existence of any corporate governance problem and arguing that economic theory dictates the way a firm is organized); Scott, *Corporation Law and the American Law Institute Corporate Governance Project*, 35 Stan. L. Rev. 927, 946–47 (1983) (arguing that outside directors and auditors are not necessarily preferable to inside directors and inside auditors and that the ALI disregarded the relevance of economic theory to firm organization).

[4] Principles of Corporate Governance: Analysis and Recommendations (Tent. Drafts No. 2 & 3, 1984) [hereinafter cited as ALI Draft No. 2 and ALI Draft No. 3, respectively].

[5] *Sangbop*, (Commercial Code) Law No. 1000 of 1962, *as revised by* Law No. 3724 of 1984.

[6] *See* L. Jones & I. Sakong, Government, Business, and Entrepreneurship in Economic Development: The Korean Case (1980).

[7] Introduction to the Law and Legal System of Korea 842 (S. Song ed. 1983) [hereinafter cited as S. Song].

[8] *See* K. Zentaro, 4 Doing Business in Japan, Pt. VII, § 1.03(1)(c) (1983); *see also* S. Song, *supra* note 7, at 842 (noting that in Korean business circles the appellation, private limited liability company, connotes diminutiveness).

[9] *Cf.* P. Kuznets, Economic Growth and Structure in the Republic of Korea 165 (1977) (noting that Korean establishments are small by international standards).

[10] *See* H. Henn & J. Alexander, Laws of Corporations 694–95 (3rd ed. 1983) ("No distinction between the closely held corporation and the public issue corporation can be made according to size.").

[11] *See* S. Song, *supra* note 7, at 842–45.

[12] *Id.*

[13] Korea Stock Exchange, *Han'guk chunggwon Koraeso, chusik* (stock) (July 1984) at 72–73 (statistics section).

[14] Korea Stock Exchange, *Chusik* (July, 1984), at 8 (statistics section).

[15] Because most Korean corporations were highly leveraged, they could not raise the capital needed for rapid economic growth. Government policy, therefore, sought to ameliorate the capital structure by promoting the securities market. Y. Shin, Securities Regulations in Korea 45–50, 100–11 (1983).

[16] *See Voting Rights in Major Corporations: Subcomm. on Reports, Accounting and Management of the Senate Comm. on Governmental Affairs*, 95th Cong., 1st Sess. 8–10 (1981), *cited in* E. Herman, Corporate Control, Corporate Power 102 (1981).

[17] *See* Y. Shin, *supra* note 15, at 100.

[18] *See id.* at 42.

[19] *Id.* at 44.

[20] *See Kiopkonggae Chokchinbop* (Act Encouraging Public Offering by Enterprises) Law No. 2420 of 1972; *Chabonsijang Yuksong e Kwanhan Pomnyul* (Capital Market Promotion Act) Law No. 2046 of 1968; *Popinsebop* (Corporation Tax Act) Law No. 1964 of 1967; Y. Shin, *supra* note 15, at 45–49, 64–68.

[21] Act Encouraging Public Offering by Enterprises, art. 4; *see* Y. Shin, *supra* note 15, at 64–66.

[22] Y. Shin, *supra* note 15, at 162. Article 189 of Korea's Securities and Exchange Law prohibits listed corporations from holding the shares of other listed corporations in such a reciprocal arrangement. *Chunggwon Koraehop* (Securities and Exchange Law) Law No. 972 of 1962, *amended by* Law No. 3541 of 1982.

[23] *See* L. Jones & I. Sakong, *supra* note 6, at 258–69.

[24] Commercial Code, art. 342.

[25] *See* L. Jones & I. Sakong, *supra* note 6, at 258–60.

[26] Agency problems arise when decision-making agents (management) "do not bear a substantial share of the wealth effects of their decision." Fama & Jensen, *Separation of Ownership and Control*, 26 J. L. & Econ. 301 (1983); *see also* Jensen & Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. Fin. Econ. 305 (1976).

[27] *Much to Crow About*, Business Korea, Nov. 1983, at 59–60. Government encouragement includes such policies as permitting corporations to issue shares at market value, rather than par value, and giving corporations flexibility in deciding dividend rates thereby increasing the attractiveness of stock investment. *Id.*

[28] *See Big Business Concentration Put Under a New Critical Light*, Business Korea, July 1984, at 51, 54–55 (government has tried to limit bank loans to one borrower to 25% of a bank's net worth); *Dong-A Ilbo*, Aug. 27, 1984, at 1 *Id.*, Aug. 22, 1984, at 2.

[29] Since financial institutions' lending rates have been kept below the market rates, those able to obtain institutional credits (in most cases, large corporations) have been subsidized primarily by those depositors who pay inflation taxes. Thus, it is less likely that rational savers would borrow to obtain financial assets and then have to pay inflation taxes. Most, therefore, choose not to hold financial assets. D. Cole & Y. Park, Financial Development in Korea, 1945–1978, at 189–93 (1983).

[30] In 1983, wholesale prices rose by only 0.2% and consumer prices by just 3.4%. This trend of price stability is expected to continue in 1984. *High Growth, Low Inflation Seen to Continue Through '85*, Business Korea, June 1984, at 38, 39.

[31] *See* Y. Shin, *supra* note 15, at 286–358.

[32] *See* ALI Draft No. 2, *supra* note 4, § 2.01.

[33] Commercial Code, art. 393.

[34] M. Eisenberg, The Structure of the Corporation 139–41 (1976). Thus, a number of modern corporate statutes in the United States provide that the business of a corporation shall be managed by "or under the direction of" a board. *See, e.g.*, Del. Code Ann., tit. 8, § 141(a) (1983); Cal. Corp. Code, § 300 (West Supp. 1983); Model Bus. Corp. Act, § 35 (1982). ALI Draft No. 2, § 3.01 suggests that corporate law provide that the management of the business of a publicly held corporation shall be conducted by or under the supervision of certain senior executives who are designated by the board of directors.

[35] Commercial Code, arts. 209, 389(3).

[36] *Id.* art. 382(1).

[37] Unlike several U.S. state laws, Korea's Commercial Code does not provide for cumulative voting. *See, e.g.*, Del. Code. Ann., tit. 8, § 214 (1983); Model Bus. Corp. Act, §33 (1982).

[38] Commercial Code, art. 389(1). The board may appoint more than one representative director. *See id.* art. 389(2).

[39] H. Chong, 1 *Sangbophak Wollon* (Principles of Commercial Law) 425, 428 (1980).

[40] Commercial Code, art. 393(2).

[41] *See, e.g.*, M. Eisenberg, *supra* note 34, at 157–70; American Bar Association, *Corporate Director's Guidebook*, 33 Bus. Law. 1591, 1621 (1978); ALI Draft No. 2, *supra* note 4, § 3.02.

[42] *See, e.g.*, M. Mace, Directors: Myth and Reality (1971); Mace, *Directors: Myth and Reality – Ten Years Later*, 32 Rutgers L. Rev. 293 (1979).

[43] *See* M. Eisenberg, *supra* note 34, at 144–48.

[44] Commercial Code, art. 389(1).

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[45] Such removal requires a two-thirds majority vote of the shares represented at a meeting where a majority of the total outstanding shares are represented. A director removed without cause from his office before the expiration of his term of office is entitled to compensation for any damage caused by such removal. *Id.* art. 385(1).

[46] For purposes of this article, an independent director is one who does not hold an executive position in the corporation in which he or she serves. According to this definition, outside directors are not necessarily "independent" of management control.

[47] Kim *Sangjanghoesa isahoe wa sangmuhoe ui siltaebunsok* (An Empirical Study of the Board and Executive Committee in Listed Corporations) *in* K. Kim, *Hoesabop ui Chemunje* (Issues in Corporation Law) 296, 303 (1982).

[48] *Id.* at 310–12.

[49] Neither the recommendations drafted by the Federation of Korean Industries nor those drafted by the Korean Chamber of Commerce has mentioned the term "outside director." *Han'guk Snagsabop Hakhoe* (Korean Commercial Law Society), *Sangbop Kaejong Ui Nonjom* (Issues in Revising the Commercial Code) 261–62, 276–77 (1981).

[50] Commercial Code, art. 411.

[51] *Id.* art. 409(1).

[52] *Id.* art. 409(7).

[53] More accurately, the term of office of inside auditors extends to the close of the ordinary shareholders' meeting dealing with the last settlement of accounting within two years after taking office. *Id.* art. 410.

[54] *Sangbop* (Commercial Code) Law No. 1000 of 1962, *reprinted in* Korean Legal Center, 3 Laws of the Republic of Korea § 8 (4th ed. 1983).

[55] 1984 Commercial Code, art. 412(1). The amendments further provide for the following new responsibilities of the inside auditor:

(1) to call on the directors at any time for a report on the business and to investigate corporate affairs such as financial status, *id.* art. 412(2);
(2) to attend board meetings and present his opinion, *id.* art. 391–2(1);
(3) to review directors' proposals and documents submitted at shareholder meetings and to determine whether such proposals/documents comply with the law and articles of incorporation, *id.* art. 413;
(4) to report to the board of directors if he finds that a director has violated the law or articles of incorporation, *id.* art. 391–2(2);
(5) to enjoin a director from violating the law or articles of incorporation if such a violation would irreparably harm the corporation, *id.* art. 402;
(6) to represent the corporation in a suit between the directors and the corporation, *id.* art 394;
(7) to submit an audit report covering specified matters to directors, *id.* art. 447–4.

[56] *Id.* art. 414(1). If an auditor's failure to perform his duties as an inside auditor is due to bad faith or gross negligence, he or she may be liable to a third party. *Id.* art. 414(2).

[57] *Id.* arts. 403–06, 415.

[58] *Id.* art. 411.

[59] *Id.* art. 409(2).

[60] *See* Lee, *Kamasachedo ui chemunje* (Problems of the Auditor System), *in Hoesabop ui Hyondaejok Kwaje* (Modern Issues in Corporation Law) 172, 186 (1981).

[61] *Chusik Hoesa ui Oebu Kamsa e Kwanhan Pommyul* (External Audit Law) Law No. 3297 of 1980.

[62] *Id.* art. 2. In addition, a corporation that is listed on the stock exchange or raises funds from the public may be subject to an outside audit. Securities and Exchange Law, art. 182.

[63] External Audit Law, art. 8. The Securities Supervisory Board is the executive body of the Securities Administration Commission, the Korean equivalent of the Securities and Exchange

Commission in the United States. *See generally*, Y. Shin, *supra* note 15, 96–98 (describing the establishment of an institution similar to the SEC in Korea).

[64] External Audit Law, art. 10.

[65] *Id.* art. 11.

[66] *Id.* arts. 16–17.

[67] *Id.* art. 4.

[68] The Commercial Code powers vested in the shareholders are limited to those enumerated in the Code and articles of incorporation. These powers include the right to appoint only internal auditors at shareholder meetings. *See* Commercial Code, art. 361.

[69] *Id.* arts. 365(1), (2). Extraordinary meetings may be held from time to time as necessary. *Id.* art. 365(3).

[70] *Id.* art. 362.

[71] *Id.* art. 366.

[72] *Id.* art. 361.

[73] *Id.* art. 449.

[74] *Id.* arts. 382(1), 409(1).

[75] *Id.* art. 368(1).

[76] *Id.* art. 434.

[77] *Id.* art. 374.

[78] *Id.* arts. 385(1), 415.

[79] *Id.* arts. 518, 522.

[80] A 1983 survey shows that 57.7% of 300 investors surveyed have transferred stock in less than three months while only 6.9% of these investors have held stock for more than six months. While as many as 30.1% short-term investors are mainly interested in a quick profit from a stock price rise, less than 3% of them are dividend-seeking investors. *Joong-Ang Ilbo*, Jan. 31, 1984, at. 4.

[81] Commercial Code, art. 385(1). A director removed without cause before the expiration of his term of office is entitled to compensation for any damage caused by the removal. *Id.*

[82] *Id.* art. 385(2).

[83] *Id.* art. 407.

[84] *Id.* art. 448(2).

[85] *Id.* art. 466(1).

[86] *Id.* art. 466(2).

[87] Capital Market Promotion Act, art. 11-5.

[88] Commercial Code, art. 467(1).

[89] *But see* Model Bus. Corp. Act §35 (1982).

[90] *Minbop* (Civil Code) Law No. 471 of 1958, arts. 680–92.

[91] Commercial Code, art. 382(2).

[92] Civil Code, art. 681.

[93] Commercial Code, art. 398.

[94] *Id.* art. 382(2).

[95] *See, e.g.*, Kang T'ae-yong v. Hanjin Sikpum Kong'op Chusik Hoesa, 73 Ta 955 (Sup. Ct. Jan. 15, 1984) (court applied KCC, art. 398 to such a transaction); Ha Tong-Ho v. Hanil Yogaek Chadongch'a Chusik Hoesa, 80 Ta 828 (Sup. Ct. July 22, 1980) (held transaction without board approval null and void).

[96] Commercial Code, art. 397(1). This approval requirement also applies to a director seeking to become a director of another corporation in the same line of business as the first corporation. *Id.*

[97] *Id.* art. 397(2).

[98] *Id.*

[99] Chong, *supra* note 39, at 434.

[100] H. Henn & J. Alexander, *supra* note 10, at 632.

[101] *See id.* at 633–34; Brudney & Clark, *A New Look at Corporate Opportunities*, 94 Harv. L. Rev. 997, 1006–22 (1981).

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[102] Commercial Code, art. 388.

[103] T. Lee, *Pallye Kyojae Hoesabop* (Casebook on Corporation Law) 433 (2nd ed. 1982).

[104] Kim, I-Kon v. Han'guk Hwamul Chadongch'a Chusik Hoesa, 65 Ta 1156 (Sup. Ct. Aug. 31, 1965).

[105] *See supra* notes 84–88 and accompanying text.

[106] *See supra* notes 17–25 and accompanying text.

[107] Commercial Code, art. 403(1).

[108] *Id.* art. 403(3). In the United States, both courts and commentators are in sharp disagreement as to whether or not disinterested directors or an "independent" litigation committee should be able to bar a shareholder derivative action on the grounds that the action is not in the best interest of the corporation. *See* ALI Draft No. 1, *supra* note 2, at 295–350. No Korean case addresses this issue. *See* Takeuchi, *Kabunushi no daihyo soho* (Shareholders Derivative Actions), *in* 3 *Hogaku Kyokai Huakushunen Kinen Rombunshu* (Essays in Celebration of the 100th Anniversary of the Founding of the Jurisprudence Association) 191–94 (1983) for a view that favors shareholder derivative suits without board intervention.

[109] Commercial Code, art. 402.

[110] This situation contrasts with that which exists in the United States; U.S. shareholders commonly file derivative suits. *See* Kim, *The Protection of Minority Shareholders in Korean Public Corporations: A Comparative Study with American Corporation Law*, 9 Korean J. Comp. L. 33, 45–50 (1981).

[111] Commercial Code, arts. 402, 403(1).

[112] Kim, *supra* note 109, at 47.

[113] *See* Model Bus. Corp. Act § 8.30 (1982).

[114] Y. Shin, *supra* note 15, at 362–67.

[115] *Id.* at 854.

[116] Commercial Code, art. 405. For a discussion of U.S. law, see H. Henn & J. Alexander, *supra* note 10, at 1107–14 (1983).

[117] Commercial Code, art. 405.

[118] S. Song, *supra* note 15, at 854.

[119] Eisenberg, *The Modernization of Corporate Law: An Essay for Bill Cary*, 37 U. Miami L. Rev. 187, 203–04 (1983). Free market theorists argue that these three market mechanisms spur management to perform honestly and efficiently for fear of business failure, high financing cost, and takeover, respectively. *Id.*

[120] *See* L. Jones & I. Sakong, *supra* note 6, at 171–75.

[121] *See* D. Cole & Y. Park, *supra* note 29, at 284.

[122] Securities and Exchange Law, art. 200(1). In calculating the percentage of shareholding, the shares held under the name of certain relatives or other related persons are treated as the shares of the shareholder involved.

[123] *Id.* art. 200(3).

[124] *Id.* art. 200(2).

[125] *See* Securities and Exchange Act of 1934, 15 U.S.C. § 78m(d) (1982).

[126] Securities and Exchange Law, art. 200.

[127] Securities and Exchange Act of 1934, § 13(d).

[128] *See* Y. Shin, *supra* note 15, at 288.

[129] Securities and Exchange Law, art. 25; Enforcement Decree for the Securities and Exchange Law, Law No. 818 of 1962, art. 13.

[130] Enforcement Decree for the Securities and Exchange Law, art. 130.

[131] Securities and Exchange Act of 1934, 15 U.S.C. § 78n(d)(4), and Rule 14d-9, 17 C.F.R. § 240.14d-9 (1985) require Schedule 14D-9, 17 C.F.R. § 240.14d-101 (1985) to be filed under similar circumstances.

[132] If the target company chooses not to make any recommendation, then it need not disclose any material information regarding the tender offer unless the Securities Administration Committee so orders. Securities and Exchange Law, art. 27.

[133] D. Cole & Y. Park, *supra* note 29, at 284.

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