Journal of Korean Law | Vol. 21, 253-288, August 2022

Understanding Korean Corporate Law and Governance*

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I. Introduction

Corporations are the main actors in the modern economy. Large businesses are rarely organized as sole proprietorships or partnerships but usually take the form of incorporated entities (i.e., corporations). Corporations in various jurisdictions manufacture, sell, buy, export, and import goods; develop, provide, and buy services; lend and borrow money; hire and pay employees; and finance local, national, and international governments and foundations by paying taxes and making donations. It is difficult to imagine modern society without corporations. Thus, to fully understand how the modern economy and society work, one needs to understand how corporations are organized and operated. Because a corporation is an artificial entity created by law, its organization and operation are stipulated in and governed by the law of the relevant jurisdiction. Understanding the Korean economy and society thus requires a

* With possible revisions and updates, this article is going to be published as a chapter of UNDERSTANDING KOREAN LAW (SNU Press, forthcoming 2022). Part of this article, which outlines the current Korean corporate law, is based on the author's previous publications. "III. Duties and Liability of Directors" was developed from paragraphs from the following: Kyung-Hoon Chun, *Corporate Opportunity Doctrine as a Basis for Directors' Liability: A New Statutory Experiment in Korea*, *in* 63-81 GERMAN AND ASIAN PERSPECTIVES ON COMPANY LAW (Holger Fleischer et al. eds., Mohr Siebeck 2016) (in particular, 66-70). "IV. Shareholders' Rights and Power" was developed from paragraphs from the following: Kyung-Hoon Chun, *Shareholder Activism in Korea: The Cases of PSPD and NPS*, *in* 65-85 GERMAN AND EAST ASIAN PERSPECTIVES ON CORPORATE AND CAPITAL MARKET LAW: INVESTORS VERSUS COMPANIES (Holger Fleischer et al. eds., Mohr Siebeck 2019) (in particular, 66-71).

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basic understanding of Korean corporations and Korean corporate law.

Where can we find and recognize Korea's corporate law? More technically, what are the *sources* of Korean corporate law? The most important source of laws governing corporations in Korea is Chapter 3 (titled "Corporations") of the Korean Commercial Code (*Sangbeob* in Korean and also known as KCC; referred to as ComC in this article).[1] It was heavily influenced by and very similar to Japan's Commercial Act (*shoho*) when it was first enacted in 1962, but multiple amendments of the relevant laws in both countries since the 1960s resulted in a significant divergence between them.[2] Other statutes, such as the Financial Investment and Capital Markets Act (CMA),[3] Acts on External Audit of Stock Corporations (AEA),[4] and Monopoly Regulations and Fair Trade Act (FTA)[5], are also important sources of corporate law in Korea. In addition, judicial precedents are now accorded almost as much respect as in common-law countries by Korean practitioners and academics, although they do not have binding effects in a strict legal sense and thus cannot be legitimately

1) ComC was first promulgated on January 20, 1962 (Act No. 1000), took effect on January 1, 1963, and has been amended more than 25 times thus far.

2) In particular, the Asian financial crisis and the International Monetary Fund's bail-out program in Korea in the late 1990s prompted Korea to institute significant reforms in corporate governance by adopting new devices, such as audit committees and independent directors. *See* Kon Sik Kim, *Transplanting Audit Committees to Korean Soil: A Window into the Evolution of Korean Corporate Governance*, 9 Asian-Pacific L. & Pol'y J. 163, 163-184 (2007).

3) CMA regulates, among others, public offerings of securities, public disclosures of listed corporations (both periodic and ad hoc disclosures), and unfair dealings on capital markets (such as short swing, use of non-public material information, and stock price manipulation). It also regulates tender offer, reporting of substantial shareholdings, proxy solicitation, and certain corporate finance matters of listed corporations.

4) AEA requires corporations above certain thresholds (in terms of revenue, total assets, number of employees, and others) to be subject to an external audit by an accounting firm or a team of certified public accountants. In 2021, 33,250 corporations (including 2,457 listed ones) were subject to the mandatory external audit requirement. AEA also regulates the internal control system of corporations.

5) FTA is the basic antitrust statute that regulates, among others, anti-competitive mergers and acquisitions, collaboration among competitors (including price fixing), retail price maintenance, and other unfair trading practices (including price discrimination, exclusive dealing, and refusal to deal). FTA has relevance to corporate law because it also regulates various corporate governance issues of the large business groups in Korea, also known as *chaebols*.

called sources of law under the Korean legal system.

ComC identifies five forms of incorporated entities: general-partnership company (*hapmyeong hoesa*), limited-partnership company (*hapja hoesa*), stock corporation (*jusik hoesa*), limited company (*yuhan hoesa*), and limited-liability company (*yuhan chaegim hoesa*). By far, prevalent among these are stock corporations, in which the shareholders are not personally responsible for the corporation's liability. Around 95% of all for-profit incorporated entities in Korea are stock corporations. A stock corporation is the only type of incorporated entity whose shares are eligible to be listed and traded on the stock exchange. Thus, "corporations" or "companies" in this article refer to stock corporations, unless otherwise indicated.

This article aims to shed light on how Korean corporations are organized and operated under the relevant law. Toward this end, we first review the basic governance structure of Korean corporations, including the roles and authorities of the general meeting of shareholders, the board of directors, and management (II). We then analyze the duties and liabilities of directors (III) and the rights of shareholders (IV) and address a few issues concerning large business groups (V). Finally, we conclude the article with a brief outlook (VI).

II. Basic Governance Structure of Korean Corporations

A. Overview

ComC provides that certain fundamental matters of a stock corporation must be resolved at the general meeting of shareholders (GMS), and less fundamental but still important business affairs must be decided by the board of directors. The representative director (RD), who is a member of the board of directors and usually plays the role of chief executive officer (CEO), acts on behalf of the corporation, subject to the resolutions of the GMS and the board of directors. As the RD has the authority to act on behalf of the corporation, the corporation is, in principle, legally bound by the RD's acts.

B. General Meeting of Shareholders

1. Convening a Meeting

Every Korean corporation must hold a GMS once a year pursuant to a resolution of the board of directors (ComC Article 365(1)). This GMS is called an ordinary or annual GMS. In addition, the board may convene a GMS at any time whenever necessary. This GMS is usually called an extraordinary GMS (ComC Article 365(3)). Written notices stating the time, place, and agenda items of the GMS must be sent out to each shareholder at least two weeks before the date of an ordinary or extraordinary GMS (ComC Article 363(1)).6)

It is the board of directors that convenes both the ordinary GMS and the extraordinary GMS and sets their time, place, and agenda items (ComC Article 362). In other words, although shareholders have the power to decide on fundamental matters concerning the corporation in a GMS, in principle, they cannot exercise this power without the board of directors taking the initiative. There are exceptions to this, however. In some cases, shareholders can convene a GMS or propose agenda items, as discussed later in this article.[7)]

2. Voting

At a GMS, holders of voting stocks have the right to vote. It is noteworthy that Korean law maintains a strict "one share, one vote" rule (ComC Article 369(1)). The creation of shares with multiple or fractional votes is not allowed by the law, even if it is allowed under the articles of incorporation. On the contrary, shares with no voting right or with limited voting rights (i.e., voting is allowed only for certain agenda items) can be

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6) A less strict rule applies to a small corporation with a legal capital of less than KRW1 billion (ComC Article 363(3)). In listed corporations, with regard to the shareholders holding not more than 1% of the total issued shares, the notice requirement may be satisfied by publishing the notice twice in a daily newspaper or posting it on the electronic disclosure system of the Financial Supervisory Service or the Korea Exchange (ComC Article 542-4(1)).

7) *See infra* Section IV.B.

created as a different class of shares, if allowed under the articles of incorporation (ComC Article 344-3(1)). Non-voting or limited-voting shares, however, cannot exceed a quarter of the total issued shares of the corporation (ComC Article 344-3(2)).

A shareholder may cast a vote either personally or by proxy (ComC Article 368(2)). For listed corporations, those who wish to solicit proxy voting must (i) file a report with the regulator and (ii) make public disclosures regarding the details of the soliciting party and the target corporation (CMA Article 152). This special rule intends to protect investors from fraud and help them make proper decisions on whether and whom to appoint as a proxy for voting purposes by providing the public with sufficient information on the soliciting parties and the target corporation.

Shareholders are allowed to vote in writing if such is allowed under the articles of incorporation (ComC Article 368-3). Electronic voting, which is becoming increasingly common, is allowed if authorized by the board of directors (ComC Article 368-4). The increasing use of proxy and electronic voting means that a substantial portion of the votes are already cast before the GMS, and that the results of the GMS are often determined even before the actual meeting takes place.

3. Resolutions

Shareholders exercise their authority by passing a resolution at a GMS. However, the GMS's authority to pass a resolution is limited to the matters prescribed in ComC or in the articles of incorporation (ComC Article 361). In other words, although GMS is the most powerful organ within a corporation which decides on fundamental issues, matters not enumerated in the law or in the articles of incorporation are beyond its authority.

To pass a resolution at a GMS, either the ordinary or special resolution requirements must be satisfied, depending on the agenda item. Unless otherwise provided for in ComC or in the articles of incorporation, the passing of a resolution at a GMS requires a majority of the votes present at the meeting, which must also represent at least one-fourth of the total number of voting shares (ComC Article 368(1)). A resolution passed in this way is called an ordinary resolution and applies to, among others, the election of directors and statutory auditors, the approval of financial

statements, the declaration of dividends, and stock repurchase.

For certain matters, an ordinary resolution does not suffice, and a special resolution is required. A special resolution is passed by at least two-thirds of the votes present at the meeting, which must also represent at least one-third of the total number of voting shares (ComC Article 434(1)). Agenda items that require a special resolution include removal of directors, granting of stock options, reduction of legal capital, merger, corporate division (also known as spin-off), business transfer, dissolution, conversion of the corporation into a different corporate type, comprehensive stock swap,[8] and amendment of the articles of incorporation.

4. Lawsuits Concerning GMS Resolutions

If the resolution passed at a GMS is defective, a shareholder, director, or statutory auditor may file a lawsuit to challenge the validity of the resolution. If the defect lies with the procedure of convening a meeting or passing a resolution (e.g., the notice period was shorter than two weeks, there were incorrect statements in the meeting notice, the meeting notice failed to be delivered, or there were errors in counting the votes) or if the substance of the resolution violates the articles of incorporation, a lawsuit can be filed to cancel the resolution within two months from the date on which it was passed (ComC Article 376). When such prescribed period expires without any challenge to the resolution being made, the resolution will no longer be challengeable on the aforementioned grounds. However, if the substance of the resolution violates the law or if the procedural defects are so serious as to render the resolution non-existent in effect, a lawsuit can be filed, without a statute of limitation, to seek confirmation that the resolution is null and void (ComC Article 380). Not surprisingly, there have been many disputes regarding whether a defective resolution can be challenged under Article 376 (when the defects are procedural and not very serious) or Article 380 (when the defects are substantive or very serious).

The aforementioned lawsuits are quite common in Korea and often

8) This is a transaction by which one corporation becomes a parent and the other becomes a wholly owned subsidiary (ComC Article 360-2).

become the main battleground amid hostile takeovers or management disputes. For example, the offense side often tries to challenge the validity of the important GMS resolutions passed under the leadership of the incumbent board and the controlling shareholder by highlighting the defectiveness of such resolutions. By winning these lawsuits, the plaintiffs may nullify important resolutions, such as the election or removal of directors, which will have serious impacts on the progress of the hostile takeovers or other similar disputes.[9)]

C. Board of Directors

1. Powers and Functions

The board of directors, composed of the directors elected at a GMS, has the power to determine corporate affairs, such as the transfer of major assets and the borrowing of large amounts of assets (ComC Article 393(1)). The term "corporate affairs" may be interpreted so broadly as to include potentially almost all decisions of the corporation. It is generally accepted, however, that the non-daily, more important affairs of the corporation must be decided on by the board of directors while the day-to-day operation of the corporate business may be delegated to the RD. In practice, it is unclear to what extent the board is allowed to delegate its power to the RD and to what extent the board has to decide by itself without delegation. Such delegation is commonly described in the internal regulations of the board,[10)] but the court is not bound by such regulations when it decides *ex post* whether the delegation was legitimate.[11)]

Aside from determining major corporate affairs (ComC Article 393(1)),

9) *See* Kon Sik Kim & Moon Hee Choi, *Declining Relevance of Lawsuits on the Validity of Shareholder Resolution in Korea – A Comparative Essay*, *in* German and Asian Perspectives on Company Law 217-242 (Holger Fleischer et al. eds., Mohr Siebeck 2016) (for more details on this topic).

10) The regulation usually provides a list of transactions that must be reviewed and approved by the board of directors. Each item in the list is usually defined by using a threshold money amount, such as "sale or purchase of assets exceeding [x] won" and "borrowing or incurring debt in an amount exceeding [y] won."

11) Daebeobwon [S. Ct.], July 28, 2005, 2005Da3649 (S. Kor.).

the board of directors is also required to "supervise the execution of duties of directors" (ComC Article 393(2)). The board of directors, therefore, is expected to perform both an executive function (Article 393(1)) and a supervisory or monitoring function (Article 393(2)). This reflects a change in the notion of directors under corporate governance theory and practice: directors were seen more as executives in the past but are now seen more as monitors. Put roughly, the executive function is important in a small close corporation, where ownership and management are not separated, while the monitoring function is highlighted in a large listed corporation, where ownership and management are separated.

2. Independent Directors

In the "monitor" model, the directors need to be independent from the management. This has led to the formation of the concept of "independent directors": non-executive directors who are independent from the management and the major shareholders.[12)]

ComC neither positively defines the concept of "independence" nor provides specific criteria for it. Instead, ComC provides a lengthy list of reasons for disqualification from independence (i.e., lack of independence). The list is very complicated,[13)] but in short, independent directors must be independent from the corporation in all respects, including ownership, kinship, employment, and business relations. Generally, the disqualification criteria are similar to those found in the listing rules of other jurisdictions but are notably wider than those in the United States as ComC clearly excludes the major shareholders[14)] (or those related to the

12) The direct translation of the Korean term *sawae-isa* is "outside director." However, as ComC requires the *sawae-isa* to be independent from the management and the major shareholders, "independent director" may be another proper translation.

13) For unlisted companies, the disqualification criteria include (ComC Article 382(3)) (i) directors, executives, and employees engaged in the regular business of the relevant company, or those who were in such positions within the last two years; (ii) the largest shareholder and his/her spouse and lineal ascendants/descendants; (iii) in cases where the largest shareholder is a company, its directors, statutory auditors, executives, and employees; and many others. There are additional criteria for listed corporations (ComC Article 542-8(2)).

14) A major shareholder is a holder of 10% or more of the total issued shares of the corporation or a person who has de facto influence on the major management affairs of the

major shareholders) from being independent.

For an unlisted corporation, if it decides to establish an audit committee as its internal supervisory organ instead of appointing a statutory auditor, then at least two-thirds of the audit committee members must be independent directors (ComC Article 415-2(2)). It is only to this extent that unlisted corporations are required to have independent directors. On the contrary, listed corporations must have independent directors on their boards. With certain narrow exceptions, at least one-quarter of the total number of directors of a listed corporation must be independent directors (ComC Article 542-8(1)). Moreover, a "large listed corporation" (one with a total asset of KRW2 trillion or more) must have at least three independent directors constituting the majority of the board directors (ComC Article 542-8(1)). This scheme of mandatory independent directors is unique to Korean law.[15)]

D. Representative Directors

The board of directors, which performs its functions through meetings, is incapable of executing its own decisions. Thus, the board of directors appoints one (or more) of its members as an RD (or RDs), authorizing him/her (or them) to carry out the decisions of the board of directors.[16)] In most Korean corporations, one person concurrently holds both the positions of CEO and RD, creating a general perception that RD is a synonym for CEO. Conceptually, however, they are not the same. The CEO is the head of the executives and does not need to be a board member while the RD must be a board member by definition.

The RD is authorized to represent the corporation with respect to its business "within or out of the court" (ComC Articles 389(3) and 209(1)). For example, the RD is authorized to file a complaint and sign a contract, an

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corporation (ComC Article 542-8(2)(vi)).

15) *See* Kyung-Hoon Chun, *Korea's Mandatory Independent Directors: Expected and Unexpected Roles*, *in* INDEPENDENT DIRECTORS IN ASIA: A HISTORICAL, CONTEXTUAL AND COMPARATIVE APPROACH 176 (Dan W. Puchniak et al. eds., Cambridge University Press 2017).

16) The power to appoint and dismiss an RD belongs to the board of directors, unless the articles of incorporation grant such power to the GMS (ComC Article 389(1)).

official letter, and a settlement to end a lawsuit on behalf of the corporation. The authority of the RD is subject to the authority of the board of directors, but externally (i.e., against a third party), the RD has full authority to represent and legally bind the corporation in any and all of its business activities. Any limitation on an RD's power of representation imposed by the board of directors or the articles of incorporation may not be asserted against innocent third parties (ComC Articles 389(3) and 209(2)). Thus, when an RD signs a contract on behalf of the corporation without obtaining the board's approval, which is necessary under the law or the articles of incorporation, the contract is valid and enforceable despite the absence of board approval. To avoid the binding effect of such a contract, the corporation must prove that the counterparty to the contract knew or was grossly negligent in not knowing the absence of the necessary board approval.[17)]

The RD is often assisted by some senior executives who are usually not board members but carry such titles as "president" (*sajang*), "vice president" (*busajang*), and "managing director" (*jeonmu* or *sangmu*). These senior executives, together with the RD, are usually called the management. Especially in large listed corporations, the RD and the senior executives make substantive business decisions while the board of directors, where the independent directors comprise the majority, is periodically convened to hear the reports of the management and to make decisions on a limited number of matters reserved for the board's decision by the statutes or articles of incorporation.

Another matter to note in relation to the RD's authority is the existence of controlling shareholders. In Korea, even giant corporations are often led by a controlling shareholder, who dominates the corporate decision-making process either directly, in the capacity of an RD, or indirectly, by appointing a trusted associate or subordinate as an RD. The indirect method is more common in Korean business groups. In such a case, the RD is usually under the close direction and supervision of the controlling shareholder, who is often called the *hoejang* (chairman) or *chongsu* (leader) of the business group. ComC stipulates the roles, powers, duties, and

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17) Daebeobwon [S. Ct.], Feb. 18, 2021, 2015Da4545 (S. Kor.).

liabilities of the directors, including the RDs, but does not clearly regulate those of the controlling shareholders who are not board members but are exercising de facto control over the corporation. This is a serious gap in Korean corporate law. Article 401-2 of ComC, discussed in a later section of this article, is a statutory attempt to fill such gap.[18]

E. Statutory Auditors and the Audit Committee

Korean corporations must have an internal supervisory organ, either a statutory auditor or an audit committee.

A statutory auditor is a natural person elected at a GMS who supervises and audits the business and accounting affairs of the corporation (ComC Article 409). ComC provides a few measures to secure the independence of the statutory auditor from the management. First, a statutory auditor cannot serve concurrently as a director, a general manager, or any other employee of the corporation or its subsidiaries (ComC Article 411). Second, when electing a statutory auditor at a GMS, each shareholder is allowed to vote only up to 3% of the total outstanding voting shares (Article 409(2)). This "3% rule" intends to restrict the influence of large shareholders on the appointment of a statutory auditor.

Instead of a statutory auditor, a corporation may choose to have an audit committee, which is a subcommittee of the board of directors in charge of supervising and auditing the business and accounting affairs of the corporation (ComC Article 415-2(1)). Two-thirds of the members of the audit committee must be independent directors (ComC Article 415-2(2)). Under ComC, an audit committee can be either "normal" or "qualified," with the most significant distinction between these pertaining to how the members are elected. The members of a "normal" audit committee are elected by the board of directors among its members (ComC Articles 415-2(1) and 393-2) while the members of a "qualified" audit committee are elected by the shareholders at a GMS (ComC Article 542-12(1)).[19] In

18) *See infra* Section III.B.3.

19) With regard to the election of a member of the qualified audit committee at a GMS, each shareholder is allowed to vote only up to 3% of the total outstanding voting shares (ComC Article 541-12(4)).

addition, at least one member of a "qualified" audit committee must be an expert in accounting or finance, and its chair must be an independent director (ComC Article 542-11(2)). Large listed corporations (corporations with a total asset of KRW2 trillion or more) must establish a "qualified" audit committee (ComC Article 542-11(1)).

Both a statutory auditor and an audit committee have the duty to supervise the operation and accounting of the relevant corporation. If they find out that a director has violated a law or the articles of incorporation, they must report such matter to the board of directors (ComC Article 391-2(2)). They must examine the GMS agenda items and related materials before each GMS and express their opinions about these at the GMS (ComC Article 413). In performing their supervisory role, they are authorized to investigate the business affairs and financial status of the corporation (ComC Article 412(2)) and those of its subsidiaries (ComC Article 412-5).

Aside from appointing a statutory auditor or establishing an audit committee, corporations beyond a certain size also have to hire an accounting firm or a team of certified public accountants as external auditors (AEA Article 4). It is the external auditor appointed pursuant to AEA rather than the statutory auditor or audit committee that performs the actual work of auditing the corporation's accounts. Hence, continuous cooperation and communication between the internal supervisory organs and the external auditors is important to enhance the quality of supervision.

III. Duties and Liabilities of Directors

A. Directors' Duties

1. Overview

A director of a Korean corporation has fiduciary duties toward the corporation (ComC Article 382(2)). Notably, ComC states that directors have fiduciary duties toward the corporation rather than toward the shareholders. In principle, however, the ratable interest of the shareholders as a whole is identical to the interest of the corporation unless the

corporation is insolvent. Directors' fiduciary duties are usually categorized as duty of care and duty of loyalty.

2. *Duty of Care*

a. Degree of Care

Directors' duty of care requires directors to use the same degree of care that an ordinarily prudent man or woman is generally and objectively expected to provide in performing their duties. This duty applies to all types of board members, whether executive or independent directors. However, the required degree of care is unclear in practice. In a case in which a director is accused of breaching his/her duty of care, his/her primary defense may be to assert that he/she made the decision in good faith for the best interest of the corporation, and on the basis of a review of the relevant information and the reasonable business judgment in such case.

b. Business Judgment Rule

Although its legal implication is not exactly the same as that of its US equivalent, Korean courts have recognized the *business judgment rule* as a defense in duty-of-care cases. If a director is able to show that "a business decision was made in good faith for the best interest of the corporation, on the basis of a sufficient review of the necessary information reasonably available," then he/she will be deemed to have acted within "a permissible range of discretion," and the reviewing court will not find breach of fiduciary duty "unless the substance of such judgment is egregiously irrational."[20] In other words, the failure of directors' business decisions should not be challenged on a hindsight basis unless there is a lack of "sufficient review of the necessary information" or a lack of "good faith for the best interest of the corporation."

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20) *See, e.g.,* Daebeobwon [S. Ct.], June 14, 2002, 2001Da52407 (S. Kor.); Daebeobwon [S. Ct.], Oct. 28, 2005, 2003Da69638 (S. Kor.); Daebeobwon [S. Ct.], Oct. 11, 2007, 2006Da33333 (S. Kor.).

The Supreme Court has consistently held, however, that the business judgment rule does not apply to illegal misconduct. For example, the use of corporate funds for bribery, window dressing, and other types of violations of law cannot be justified under this rule even if the misconduct might have brought more benefit than harm to the corporation.[21)]

Unlike the courts in many other jurisdictions, the Korean courts have not clearly declared that the business judgment rule does not apply to conflict-of-interest situations.[22)] In reality, however, the Korean courts tend to hold directors liable when a corporation allegedly incurred a loss in a transaction with parties related to it.[23)] Most of the major Korean corporations belong to a business group composed of dozens of affiliate companies that often have vertical or horizontal business relations. Thus, related-party transactions are inevitable and ubiquitous in Korea, and there have been increasing attempts to hold directors liable for allegedly unfair related-party transactions. In such cases, the business judgment rule is not entirely non-applicable per se, but it does not provide a complete defense.

c. Oversight Duty

As a ramification of the duty of care, a director is obliged to oversee the conduct of the management and peer directors. The Supreme Court held that the oversight duty also applies to non-standing directors and covers matters not included in the agenda of board meetings.[24)] In a case involving illegal accounting (also known as "window dressing"), the directors who

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21) Daebeobwon [S. Ct.], Oct. 28, 2005, 2003Da69638 (S. Kor.) (on bribery); Daebeobwon [S. Ct.], Oct. 11, 2007, 2006Da33333 (S. Kor.) (on violation of antitrust law); Daebeobwon [S. Ct.], Dec. 13, 2007, 2007Da60080 (S. Kor.) (on illegal accounting); Daebeobwon [S. Ct.], Nov. 30, 2007, 2006Da19603 (S. Kor.) (on illegal accounting).

22) The Delaware court, for example, applies the business judgment rule only to cases where the defendant's interest is not in conflict with the corporation's interest. A stricter standard, such as the entire fairness rule or the intrinsic fairness rule, is applied when there is a conflict of interest between the defendant and the corporation.

23) *See, e.g.,* Daebeobwon [S. Ct.], Oct. 28, 2005, 2003Da69638 (S. Kor.); Daebeobwon [S. Ct.], Oct. 11, 2007, 2006Da33333 (S. Kor.); Daebeobwon [S. Ct.], Apr. 14, 2011, 2008Da14633 (S. Kor.); Daebeobwon [S. Ct.], Apr. 11, 2008, 2007Do8373 (S. Kor.); Daebeobwon [S. Ct.], June 25, 1999, 99Do1141 (S. Kor.).

24) Daebeobwon [S. Ct.], June 25, 1985, 84Daka1954 (S. Kor.).

were not directly involved in and were even ignorant of the misconduct were also held liable for it on the grounds that they had breached their duty to monitor their peer directors' conduct to prevent them from engaging in any misconduct. The Supreme Court stated that ignorance of misconduct would not exempt directors from liability if they had not made any effort at all to establish "a reasonable information and reporting system" and if the misconduct had resulted from "a sustained and systematic failure to exercise oversight,"[25] using phrases apparently influenced by the *Caremark* case of the Delaware court.[26] This ruling drew greater attention to a "reasonable information and reporting system" or a compliance system as a method of fulfilling the oversight duty.

In a more recent case in which the executives of a steel manufacturing corporation committed continuous price fixing in collusion with its competitors and in which the corporation eventually had to pay a large penalty to the competition authority, the court pointed out the lack of an internal compliance system to deter such misconduct and held that the RD breached his oversight duty.[27] Because of these court precedents, the oversight duty and the internal compliance system are attracting increasing attention and causing concerns among Korean corporations. Building and operating a reliable and efficient compliance system within a firm is an important task of the in-house lawyers, compliance officers, and board members.

3. *Duty of Loyalty*

Directors must avoid conflicts of interest with the corporation in performing their duties. This duty is often called the duty of loyalty. Three provisions of ComC may be cited as statutory examples. First, directors may not compete with the corporation in the same area of business without prior approval from the board of directors (ComC Article 397). Second, directors may not engage in self-dealing transactions with the corporation without prior approval from the board of directors (ComC Article 398).

25) Daebeobwon [S. Ct.], Sept. 11, 2008, 2006Da68636 (S. Kor.).

26) *In re* Caremark International Inc. Derivative Litigation, 698 A.2d 959 (1996).

27) Daebeobwon [S. Ct.], Nov. 11, 2021, 2017Da222368 (S. Kor.).

Third, directors may not appropriate a "corporate opportunity" without prior approval from the board of directors (ComC Article 397-2).[28] A corporate opportunity is a business opportunity currently or potentially profitable to the corporation, which is either (i) learned about through the use of corporate information or in the course of performing the directors' duties or (ii) closely related to the corporation's current or planned business.

It is noteworthy that in the aforementioned three provisions, the relevant acts (i.e., competition with the corporation, self-dealing, and use of corporate opportunity) are not prohibited per se but may be justified by obtaining prior board approval. Board approval, however, does not necessarily exempt the involved directors from liability in such cases. If the board of directors had approved a director's competing business with the corporation, self-dealing transaction, or appropriation of a corporate opportunity but such approved act turned out to be harmful to the corporation, then the issue would be whether the approving directors had performed their fiduciary duties in the course of reviewing and approving the act. If it turned out that the directors had breached their fiduciary duties at the time of their review and approval of the relevant act, they could be subject to liability, as discussed below.[29]

Article 398 on self-dealing, the most frequently invoked provision among the three mentioned above, warrants a few further notes. First, it regulates a corporation's transaction not only with its directors but also with a wide range of related parties. Prior board approval is required for a corporation's transactions with its directors, major shareholders, or persons specially related to them.[30] Second, a self-dealing transaction entered into

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28) It is unique that Korean law stipulates the corporate opportunity doctrine and even dares to define "corporate opportunity" in the statute. *See* Hwa-jin Kim et al., *Favoritism and Corporate Law: The Confused Corporate Opportunity Doctrine in the Hyundai Motor Case*, 3 Michigan Bus. & Entrepreneurial L. Rev. 41, 41-74 (2013); Kyung-Hoon Chun, *Corporate Opportunity Doctrine as a Basis for Directors' Liability: A New Statutory Experiment in Korea*, *in* 63-81 German and Asian Perspectives on Company Law (Holger Fleischer et al. eds., Mohr Siebeck 2016) (for more details).

29) *See infra* Section III.B.1.

30) More specifically, the following persons must obtain board approval before entering into a transaction with the corporation: (i) directors or major shareholders (shareholders holding 10% or more of the total issued shares of the corporation or have de facto control over

without the necessary board approval is null and void between the parties but is valid vis-à-vis an innocent third party. For example, if a director purchased a building from the corporation without board approval, the corporation may nullify the transaction and demand that the director return the building (in exchange for the money the corporation was paid). The corporation, however, cannot resort to such a remedy vis-à-vis a third-party purchaser of the building unless the corporation successfully proves that the third-party purchaser knew or was grossly negligent in not knowing the absence of the necessary board approval.[31)]

B. Directors' Liabilities

1. Civil Liabilities to the Corporation

If a director breaches the law or the articles of incorporation or fails to perform his/her duties, he/she is liable to the corporation for the loss caused by his/her breach (ComC Article 399(1)). If more than one director is involved, the directors are jointly and severally liable. Note that under Article 399, the directors are liable to the "corporation" instead of the "shareholders." Holding directors directly liable to the shareholders requires other legal grounds, such as Article 401 of ComC (discussed below) or the provisions of CMA on false disclosures.[32)]

In a case in which a director's act in question is based on a resolution of the board of directors, the directors who voted for the resolution are also liable to the corporation (ComC Article 399(2)). If a director's opposition to the resolution is not recorded in the minutes, the director is presumed to have voted in favor of the resolution in question (ComC Article 399(3)).

Directors may be sued either by the corporation, through a direct action,

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the corporation); (ii) their spouses and lineal ascendants/descendants; (iii) their spouses' lineal ascendants/descendants; (iv) a corporation in which (i)–(iii) hold 50% or more of the total issued shares or its subsidiary; and (v) a corporation in which (i)–(iv) hold 50% or more of the total issued shares (ComC Article 398).

31) Daebeobwon [S. Ct.], Dec. 27, 2012, 2011Da67651 (S. Kor.).

32) *See* Kyung-Hoon Chun, *Investor Protection in the Korean Capital Market through Disclosures and Litigation*, 16(1) J. Kor. L. 193, 210-222 (2016) (for more details regarding liability for false disclosures).

or by the corporation's shareholders, through a derivative action. When the corporation brings a direct action against its directors, the statutory auditor (not the RD, to guarantee a fair and independent handling of the lawsuit) must represent the corporation (ComC Article 394(1)). Typical examples of cases in which directors were held liable under Article 399 of ComC include those involving (i) sale of a corporation's asset at a considerably low price,[33] (ii) embezzlement of the corporation's funds or assets,[34] (iii) provision of a loan to a financially distressed company without taking proper measures to secure repayment,[35] (iv) violation of a law resulting in the corporation's payment of a fine or monetary penalty,[36] and (v) commission of accounting fraud resulting in inflated profits and overpayment of dividends and corporate income tax.[37]

2. Civil Liabilities to Third Parties

A director is held liable to a third party who suffers a loss caused by the director's intentional or grossly negligent failure to perform his/her duty (ComC Article 401(1)). For example, if a director manipulated the financial statements of the corporation and a creditor provided a loan to the corporation relying on such false financial statements, the creditor may bring an action against the director on the basis of Article 401.[38] The article does not state that a director has a direct duty to a third party. Rather, a third party who suffered harm due to the director's breach of his/her duty to the corporation may sue such director. What has been breached here is the director's duty to the corporation and not to a third party, such as a creditor.

As in the case of liability to the corporation, if more than one director is involved, the directors are jointly and severally liable (ComC Article 401(1)). The third-party plaintiff, however, has a higher burden of

33) Daebeobwon [S. Ct.], Oct. 28, 2005, 2003Da69638 (S. Kor.).
34) Daebeobwon [S. Ct.], Jan. 26, 1993, 91Da36093 (S. Kor.).
35) Daebeobwon [S. Ct.], Oct. 29, 2015, 2012Da98850 (S. Kor.).
36) Daebeobwon [S. Ct.], Oct. 11, 2007, 2006Da33333 (S. Kor.).
37) Daebeobwon [S. Ct.], Dec. 13, 2007, 2007Da60080 (S. Kor.).
38) Daebeobwon [S. Ct.], Sept. 11, 2008, 2007Da31518 (S. Kor.).

proof than the corporation has under Article 399 because he/she has to prove at least gross negligence on the part of defendant directors.

There is a dispute as to whether the aforementioned liability extends to "indirect" damage. Indirect damage refers to damage incurred by a third party as a consequence of damage inflicted on the corporation. For example, if the corporation's value decreases due to a director's misconduct, the shareholders will suffer indirect damage as a result of the declining share price. The Supreme Court held that shareholders cannot claim indirect damage against an erring director under Article 401.[39] In such cases, a shareholder will have to rely on a derivative action (ComC Article 403) to recover the damage inflicted on the company.[40]

3. Extension of Civil Liabilities to De Facto Directors

Articles 399 and 401 of ComC address the liability of "directors" to the corporation and a third party. ComC also adopted a concept similar to a "de facto director" or a "shadow director" and extends the liabilities under Articles 399 and 401 to such persons. More specifically, the following persons can also be held liable under Article 399 or 401 even if they do not formally hold the position of a director: (i) a person who, by taking advantage of his/her influence on the corporation, directed a director to execute the business of the corporation in a particular manner; (ii) a person who executed the business of the corporation in the name of a director; and (iii) a person who executed the business of the corporation using a title regarded as granting him/her the authority to execute the corporation's business (e.g., "honorary chairperson," "chairperson," "president," "vice president," "executive director," and "director") (ComC Article 401-2).

"Influence" is the key element in item (i) above while "title" is the key element in item (iii).[41] Thus, a controlling shareholder who exercised influence over the management and caused harm to the corporation can be held liable under item (i). An officer who carries the title of "president" can

39) Daebeobwon [S. Ct.], Jan. 26, 1993, 91Da36093 (S. Kor.); Daebeobwon [S. Ct.], Dec. 13, 2012, 2010Da77743 (S. Kor.).

40) *See infra* Section IV.C.

41) Daebeobwon [S. Ct.], June 10, 2011, 2011Da6120 (S. Kor.).

be held liable under item (iii) for the corporation's loss caused by his/her breach of duty of care even if he/she is not a member of the board of directors.

4. Criminal Liabilities

One distinctive feature of Korean law with regard to corporate governance is the frequent use of criminal charges. Pursuant to the Criminal Act and other statutes, if a person taking care of another person's affairs breaches his/her duties and causes harm to such person by obtaining or causing a third party to obtain unlawful profits (*baeim* or "criminal breach of trust"), he/she is subject to criminal fine or imprisonment, which may be extended to lifetime imprisonment depending on the amount of unlawful profit made.[42] The elements of criminal breach of trust are (i) breach of duty (ii) by a person who is taking care of another person's affairs, (iii) loss to the principal, and (iv) profit to the actor or a third party.

In Korea, civil actions have not been very effective in preventing director and manager misconduct. The absence of punitive damages, discovery systems, and class action at least partially explains the weakness of the civil remedies. However, prosecutors have played an important role by applying criminal breach of trust to various types of misconduct of directors, officers, and controlling shareholders. The Supreme Court has held directors and controlling shareholders criminally liable for such types of misconduct as (i) acquisition of shares of an affiliate company at par value even though their fair value was zero,[43] (ii) provision of a loan or guarantee to a financially distressed affiliate company without taking proper measures to secure repayment[44], and (iii) sale of assets to an affiliate

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42) Hyeongbeob [Criminal Code] art. 355(2) & art. 356; Teukjeongbeomjoegajungcheobeol deungegwanhanbeomnyul [Act on Aggravated Penalties on Specific Economic Crimes] art. 3.

43) Daebeobwon [S. Ct.], June 14, 2012, 2012Do1283 (S. Kor.); Daebeobwon [S. Ct.], June 24, 2004, 2004Do520 (S. Kor.).

44) Daebeobwon [S. Ct.], July 10, 2014, 2013Do10516 (S. Kor.); Daebeobwon [S. Ct.], Sept. 26, 2013, 2013Do5214 (S. Kor.); Daebeobwon [S. Ct.], July 12, 2012, 2009Do7435 (S. Kor.); Daebeobwon [S. Ct.], July 23, 2009, 2007Do541 (S. Kor.).

company at a considerably low price.[45] Civil actions against directors and officers are often preceded by their criminal convictions.

IV. Shareholders' Rights and Power

A. Right to Vote

At a GMS, holders of voting stocks have the right to vote in favor of or against a resolution. Below are some important matters requiring the shareholders' passage of a resolution at a GMS.

1. Election and Removal of Directors

Directors are elected at an ordinary or extraordinary GMS. The names of the directors nominated by the current board of directors[46] are usually indicated in the GMS notice, and the shareholders vote for or against each candidate. If the number of affirmative votes for a candidate satisfies the ordinary resolution requirement (i.e., a majority of the votes of the shareholders with voting shares present at the meeting and at least a quarter of the total issued voting shares), the candidate is declared a director. This may be referred to as "majority rule," as opposed to "plurality rule," in the sense that the candidate must acquire affirmative votes from the majority of the shareholders with voting shares present at the meeting. Under this scheme, majority shareholders, in effect, have absolute power to appoint all board members.

To curtail majority shareholders' power and protect minority shareholders, ComC has adopted a cumulative voting system. When two or more directors are to be elected at a GMS, shareholders holding at least 3% (1% in the case of large listed firms) of the total issued voting shares of the corporation may request that the resolution be passed through cumulative

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45) Daebeobwon [S. Ct.], Sept. 26, 2013, 2013Do5214 (S. Kor.).

46) Independent directors of large listed corporations and financial institutions are nominated by the Independent Director Candidate Nomination Committee, a subcommittee of the board of directors (ComC Article 542-8(4)).

voting (ComC Article 382-2(1)). However, the corporation may opt out of cumulative voting in its articles of incorporation (ComC Article 382-2(1)). More than 90% of the listed firms in Korea have opted out of cumulative voting through their articles of incorporation.

It is noteworthy that shareholders may remove directors through a special resolution passed at a GMS without cause and at any time (ComC Article 385(1)). If a director is removed during his/her term of office without just cause, the removed director is entitled only to monetary compensation from the corporation (ComC Article 385(1)), which generally corresponds to the remuneration he/she could have earned during the remainder of his/her term of office had he/she not been removed. Such potential for unilateral removal shows the great power granted to shareholders by Korean law.

2. *Approval of Fundamental Changes*

As discussed earlier, the implementation of fundamental changes to a corporation requires a special resolution to be passed at a GMS. In other words, the board of directors or the RD may initiate the process for the implementation of such fundamental changes, but it is the shareholders who have the final authority to decide on the matter. The matters that require the passage of a special resolution at a GMS include removal of directors, granting of stock options, reduction of legal capital, merger, corporate division, transfer or acquisition of business, dissolution, conversion into a different corporate type, comprehensive stock swap, and amendment of the articles of incorporation.[47)]

In the case of merger, comprehensive stock swap, and transfer or acquisition of business, the dissenting shareholders are given appraisal rights (ComC Articles 360-5, 374-2, and 522-3). Once these dissenting shareholders exercise their appraisal rights, the corporation must buy back their shares. The price is to be determined by the corporation and shareholders through consultations and agreements. In unlisted corporations, if the corporation and shareholders fail to agree on the price,

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47) *See supra* Section II.B.4.

the court determines a "fair" price upon either party's application for such. In listed corporations, if the corporation and shareholders fail to agree on the price, a hypothetical price calculated using a formula prescribed by CMA will apply,[48] but if either party does not accept such hypothetical price, it may ask the court to determine a fair price (CMA Article 165-5).

3. Directors' Remuneration

Any type of director remuneration, including salary, bonus, incentive, and severance pay, must be (i) stated in the articles of incorporation *or* (ii) determined at a GMS (ComC Article 388). Without such a basis in the articles of incorporation or a shareholder resolution, the directors cannot claim such remuneration from the corporation even if they have a written contract with the corporation stipulating it. This is a powerful form of shareholder involvement in the directors' salary, stronger, for example, than any radical proposal in the United States for "say on pay," because the shareholders of Korean corporations not just "say" but "determine" the directors' pay.

In practice, however, the actual power of shareholders on the directors' pay is not as formidable as it seems. Many Korean corporations approve an annual firm-wide ceiling for the aggregate amount of director remuneration at an ordinary GMS, rather than determining each director's salary. Each director's salary is determined within such a ceiling, without the further involvement of the shareholders. Such ceiling applies to the directors (i.e., board members), but not to the other members of the management.

Granting stock options requires (i) a special resolution at a GMS *and* (ii) a relevant provision in the articles of incorporation (ComC Article 340-2). It applies regardless of who holds the stock option; not only the directors or statutory auditors but also the employees and executives at every rank

48) The hypothetical price, in essence, is an arithmetic average of (i) the volume-weighted average of the daily closing prices in the two months before the date of the board resolution, (ii) the volume-weighted average of the daily closing prices in the month before the date of the board resolution, and (iii) the volume-weighted average of the daily closing prices in the week before the date of the board resolution (CMA Enforcement Decree Article 176-7(3)).

need both requirements to receive stock options.

B. Right to Initiate Corporate Decision Making

Even though the shareholders' voting power is important in corporate governance, it can be exercised only when a GMS is convened and only with respect to the agenda items presented at the GMS. The incumbent directors are the ones who determine whether to convene a GMS, and set the date, location, and agenda items for the GMS. In other words, the shareholders exercise their voting power within the framework set by the board. ComC provides two powerful weapons as exceptions to this passive aspect of shareholder power: the right to call an extraordinary GMS and the right to make a proposal for the GMS.

Shareholders holding at least 3% of the total issued shares of the corporation may request the board to convene an extraordinary GMS (ComC Article 366(1)). In a listed firm, shareholders who have held at least 1% of the total issued shares of the corporation for at least six months have the same right (ComC Article 542-6(1)). The shareholders must submit to the board a written statement of the agenda item they desire to address and the reasons for their request to convene a GMS. If the board fails to take immediate steps to convene a GMS, the shareholders may convene one themselves with the approval of the court (ComC Article 366(2)).

Shareholders holding 3% of the total issued and outstanding voting shares of the corporation can submit a proposal to be resolved at a GMS (ComC Article 363-2(1)(2)). In a listed firm, shareholders who have held at least 1% (0.5% in the case of a larger firm) of the total issued and outstanding voting shares of the corporation for at least six months have the same right (ComC Article 542-6(2)). The board of directors must include the proposed item in the GMS agenda, which the shareholders will be notified of unless there exist narrow exceptions, such as that the substance of the proposal is against the law (ComC Article 363-2(3)). The removal of a director can also be initiated through a shareholder proposal, but the board of directors of listed corporations may legitimately reject a proposal for removing a director (ComC Enforcement Decree Article 12(iv)) while the board of directors of unlisted corporations must accept such a proposal and include it in the GMS agenda. Changing the articles of incorporation is also

a legitimate item for a shareholder proposal; thus, the board of directors must include it in the GMS agenda if it is duly proposed by the shareholders.

C. Right to Pursue Directors' Liabilities: Derivative Actions

1. Overview

Korean law allows shareholders to bring a derivative action against erring directors on behalf of the corporation. Derivative action was introduced to Korean law when ComC was enacted in 1962, under the heavy influence of US law. It was hardly used in the past, but the number of derivative actions is now increasing, albeit slowly.

A few features of the derivative actions in Korea are noteworthy. First, non-governmental organizations, such as the People's Solidarity for Participatory Democracy and the Solidarity for Economic Reform, have played important roles in organizing and initiating actions against the directors of Korean conglomerates, especially in the late 1990s and early 2000s. Their main goal is to improve the allegedly rigged governance of Korean corporations as a part of social reform, rather than maximizing shareholder value. Such sociopolitical motives have made them bring a number of derivative actions against the directors of a few large and famous firms in Korea, even if they have little economic incentive to do so. Second, the derivative actions in Korea frequently follow criminal prosecutions or administrative inspection proceedings on the basis of the facts found in such proceedings. For example, after a director is found guilty of embezzlement or criminal breach of trust, the shareholders tend to bring a derivative action against him/her. In the absence of a US-style discovery process, this is the most convenient and only practical way to collect evidence for a derivative action.

2. Requirements for Plaintiffs

Under ComC, shareholders holding at least 1% of the total issued shares of the corporation can bring a derivative action against an erring director on behalf of the corporation (ComC Article 403(1)). In a listed firm,

shareholders who have held at least 0.01% of the total issued shares of the corporation for at least six months have the same right (ComC Article 542-6(6)). Although the 1% or 0.01% ratio can be satisfied in aggregate by multiple shareholders, this requirement is probably one of the main barriers to bringing derivative actions against erring directors in Korea.

However, ComC also has some rules rendering the aforementioned requirement not as strict as it seems. Once the plaintiff meets the minimum shareholding ratio at the time of filing of the lawsuit, any reduction in such plaintiff's shareholding ratio will not affect his/her standing as long as he/she holds at least one share (ComC Article 403(5)). Moreover, unlike the relevant US law,[49] ComC does not have a *contemporaneous* share ownership requirement; that is, the plaintiff need not have been a shareholder at the time that the challenged misconduct was committed. The rationale for this is that the plaintiff shareholder is enforcing the corporation's cause of action as an agent and not as a principal, with the legal effects of the lawsuit vested with the corporation. Thus, it does not matter whether the plaintiff him/herself suffered any damage from the challenged misconduct at the time it was committed.

Under Korean law, the corporation itself is neither a plaintiff nor a defendant in a derivative action. Only the shareholders can be plaintiffs,[50] and the persons liable to the corporation (usually the directors who breached their fiduciary duties) are the defendants. The corporation is merely allowed to participate in the proceedings on the plaintiff's side, and only if it wants to do so (ComC Article 404(1)). The plaintiff must notify the corporation of the action without delay so that the corporation may participate in the proceedings if it wants to (ComC Article 404(2)). This is strikingly different from the practice in the United States, where the corporation is usually named one of the defendants.[51]

49) US Federal Rule 23.1(b) requires the verified complaint of a derivative action to allege that the plaintiff was a shareholder at the time of the transaction complained of.

50) To meet the minimum shareholding ratio requirement, multiple shareholders usually form a group of plaintiffs, often through online media. However, it is not a class action per se. Only those shareholders who are specifically named as plaintiffs in the complaint and who themselves signed or affixed their seals on the complaint or did so through their attorneys become the plaintiffs of a derivative action.

51) The custom of making the corporation a nominal defendant in a derivative action

Also, ComC clearly allows "multiple derivative actions" (ComC Article 406-2). Under this scheme, which was introduced in the 2020 amendment of ComC, the shareholders of a parent company can bring an action against the directors of a subsidiary of the company who have caused harm to the subsidiary.[52)]

3. Demand Requirement

Before filing a derivative action, the shareholder must demand that the corporation file a lawsuit against the relevant director (ComC Article 403(1)). If the corporation fails to file such a lawsuit within 30 days from the date of demand, the shareholder may immediately bring a derivative action on behalf of the corporation. If any irreparable damage is likely to arise, the shareholder may immediately bring a derivative action without making such a demand (ComC Article 403(3)).

The demand requirement under Korean law is different from the "demand-on-board requirement" under many US state laws. Under the laws of the states of Delaware and New York, for example, a written demand must be submitted to the board of directors unless the case meets the "demand futility test." The board of directors has broad discretion in determining whether to file a lawsuit. Unlike US law, Korean law does not recognize the board's or any special committee's discretion not to file or terminate a lawsuit. Once the 30-day demand period lapses, regardless of the board's decision, the plaintiff shareholder may legitimately bring a derivative action (ComC Article 403(3)). Therefore, this requirement is not a significant barrier to bringing a derivative action in Korea.

4. Underlying Claim

A derivative remedy is available only when the corporation suffered

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demonstrates the survival of the historical conception that a derivative suit is two suits in one: a suit against the corporation and a suit against the wrongdoer. ROBERT C. CLARK, CORPORATE LAW 639 (Aspen 1986).

52) *See* Kyung-Hoon Chun, *Multiple Derivative Actions: Debates in Korea and the Implication for a Comparative Study*, 15 Berkeley BUS. L. J. 306, 306-336 (2019).

harm from the defendant's misconduct. In other words, for a valid derivative action to be brought against a director, the corporation must have a substantive claim against the latter. Such a claim typically arises when a director causes harm to the corporation by breach of his/her fiduciary duty or violation of the law (ComC Article 399).

5. Ancillary Remedies

ComC allows injunctive remedies by shareholders. When a director is likely to breach the law or the articles of incorporation and the corporation may incur irreparable damage as a result of such breach, a 1% shareholder (in listed firms, including shareholders who have held at least 0.05% or 0.025% of the total issued shares of the corporation, depending on the size of the corporation, for at least six months) or a statutory auditor may seek injunctive relief prohibiting the relevant director from undertaking the act in question (ComC Article 402).

To facilitate derivative actions or injunctive relief, ComC allows shareholders to access corporate books and records. Each shareholder may inspect or copy the financial statements and audit reports kept at the corporation's main or branch office (ComC Article 448(2)). In addition, a 3% shareholder (in listed firms, including shareholders who have held at least 0.1% or 0.05% of the total issued shares of the corporation, depending on the size of the corporation, for at least six months) may gain access to the accounting books and records (ComC Article 466(1)). To deny such access to the shareholder, directors must prove the unreasonableness of the shareholder's demand (ComC Article 466(2)).

D. Preemptive Rights

Issuance of new shares may have negative impacts on the existing shareholders. If such shareholders cannot participate in the purchase of new shares on a pro rata basis, their shareholding ratio will decrease, and depending on the issue price, the value of their shares may be diluted. To protect the existing shareholders from such risks, ComC gives them preemptive rights. That is, unless otherwise provided for in the articles of incorporation, shareholders have a right to subscribe to new shares in

proportion to their shareholding ratio (ComC Article 418(1)).

As an exception to the aforementioned rule, new shares can be issued to a third party if the corporation has corresponding provisions in its articles of incorporation and a proper business purpose for such third-party allotment (ComC Article 418(2)). Most listed corporations have provisions in their articles of incorporation authorizing third-party allotment, but "a proper business purpose" is not always acknowledged by the court. For instance, the Supreme Court held that defense against hostile takeovers did not constitute a proper business purpose for issuing new shares to a third party that was friendly to the incumbent board.[53)]

E. Remarks

As shown above, at least as a matter of blackletter law, shareholders have a strong set of rights under Korean law. They may convene an extraordinary GMS, may initiate an amendment to the articles of incorporation by way of a shareholder proposal to such effect, may remove directors without cause and at any time through a special resolution to such effect, and even enjoy the preemptive right to subscribe to new shares on a pro rata basis. These are representative characteristics of the UK model of strong shareholders, as opposed to the US model of weak shareholders.[54)] At least in these respects, Korean law resembles UK law rather than US law, and may be evaluated as pro-shareholder rather than pro-management.

In reality, however, there are significant hurdles that need to be overcome. First, the shareholding thresholds for exercising certain rights are restrictive and sometimes prohibitively high. For example, bringing a derivative action requires holding 1% of the total issued shares for unlisted corporations and 0.01% of the total issued shares for listed corporations. For large listed corporations, 0.01% of the total issued shares may be equivalent to millions of US dollars, depending on the prevailing stock price, which

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53) Daebeobwon [S. Ct.], Jan. 30, 2009, 2008Da50776 (S. Kor.). *See also* Sang Gon Kim, *Issuance of New Shares as a Takeover Defense and Countermeasures*, 8 J. Kor. L. 325, 325-348 (2009).

54) C. Bruner, Corporate Governance in the Common-Law World – The Political Foundations of Shareholder Power 37-40 (Cambridge University Press 2013).

makes derivative action virtually unavailable for most minority shareholders. Second, the Korean judicial system and its practices are generally not very friendly to plaintiffs. Korean law does not have a US-style discovery system and does not allow class actions, except for certain types of securities litigation.[55] Also, as punitive damages are not recognized, the amount of monetary compensation is limited to the actual loss suffered by the plaintiff, and the plaintiff generally has the burden of proof. Thus, in Korea, civil actions and the possibility of civil liability generally pose less threat than criminal charges or administrative penalties do.

V. A Few Notes on Large Business Groups

A. Overview

In Korea, some large business groups (LBGs), commonly known as chaebols, dominate the corporate scene. Chaebol refers to a large group of related corporations engaged in diverse lines of business under highly concentrated family or individual control. LBGs such as Samsung, Hyundai Motors, SK, LG, Lotte, Hanwha, GS, Hyundai Heavy Industry, Shinsegae, CJ, Hanjin, and Doosan have played a crucial role in Korea's economic development and still account for a critical portion of the Korean economy in terms of revenues, exports, hiring, research and development, and others.

There have been long-time debates on the positive and negative contributions of LBGs. Undoubtedly, the success of the Korean economy is largely due to the LBGs' outstanding performance and to the inspired entrepreneurship of their founders. On the other hand, the LBGs have been criticized for some alleged problems, including (i) excessive concentration of economic power (which may lead to the concentration of social, political, and cultural power), (ii) monopolization of certain product and service markets (which may lead to suboptimal consumer welfare), and (iii)

55) Jeunggwongwallyeon jipdansosongbeop [Securities Related Class Action Act] (S. Kor.).

corporate governance problems such as tunneling[56] by the controlling shareholders (which may lead to the undervaluation of the Korean capital market). Of these problems, the third is a typical corporate law issue and is briefly discussed below.

B. Governance

LBGs' governance styles are diverse. Some LBGs have a holding company structure, in which a holding company located at the top of the entire group owns and controls dozens of subsidiaries.[57] Others have a more complicated (and traditional) structure, such as a circular holding structure, where no single holding company can be identified. In either case, a few large corporations within the group are usually listed on the stock market, but many other affiliates remain unlisted. Furthermore, the controlling family members' shareholding ratio in the listed flagship corporations of each group is usually far less than 50% (and sometimes as low as 5-10%),[58] which creates the typical problem of "controlling-minority shareholders."[59]

In most cases, the controlling shareholder of an LBG holds a title such as "chair" or "honorary chair" and exercises control over the management of the entire group, either as a board member (and CEO) of the flagship company or as the de facto or shadow director, who is not officially a

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56) Tunneling means the transfer or diversion of wealth from a corporation to the controlling shareholders or managers at the expense of the non-controlling shareholders. *See* Simon Johnson et al., *Tunneling*, 90(2) Am. Econ. Rev. 22, 22-27 (2000) (for a further explanation).

57) Note that in Korea, many subsidiaries are also listed on the stock exchange. The presence of minority shareholders both at the holding company level and the subsidiary level (and the different cash-flow rights of the controlling shareholders over the holding company and subsidiaries) may create conflict-of-interest problems.

58) It is challenging for the controlling family members to maintain de facto control over the group in spite of their low shareholding ratio. To do this, they often resort to such methods as adopting a pyramid structure (which leverages the ownership by way of multi-layered partially owned subsidiaries), circular ownership, collaboration among the affiliate companies, and cooperation with other LBGs.

59) *See* Ok-rial Song, *The Legacy of Controlling Minority Structure: A Kaleidoscope of Corporate Governance Reform in Korean Chaebol*, 34 L. & Pol'y Int'l Bus. 183, 184 (2002) (for an analysis of the problems caused by the controlling minority shareholders in Korea).

member of the board elected at a GMS. In other words, the controlling shareholders of LBGs are mostly not just passive investors but the heads of the company management, with the ultimate power to make important business decisions and to hire and fire senior members of the management.

C. Alleged Tunneling

In LBGs, the controlling-minority shareholder structure creates a gap between the control and the cash-flow right. For example, if X owns 30% of the shares of Company A and takes 30% of its dividends (this being the cash-flow right) but somehow has complete control over Company A, then X may engage in various transactions benefiting him/her at the cost of the other shareholders of Company A. Let us assume that Company A (in which X owns 30% of the shares) is the flagship corporation of the group listed on the stock exchange, and that X's son, Y, is the sole shareholder of Company B. Below are some examples of related illicit practices that have frequently been found in Korea.[60]

One example is the use of underpriced new shares. X causes Company A to issue new shares at a price lower than the fair market price to Y or Company B.[61] This benefits Y but at the expense of the other shareholders of Company A. Alternatively, when Company A has shares of Company C, Company C issues new shares to each shareholder at a low price. If Company A voluntarily gives up its preemptive right, and Company C allocates the new shares to Company B or to Y, then Y will benefit at the expense of the other shareholders of Company A.[62]

Another example is the use of related-party transactions. If Company A and Company B enter into a transaction (e.g., sale of assets) under terms

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60) *See* Kyung-Hoon Chun, *Management Succession in Korea: Tunneling, Semi-Tunneling, and the Reaction of Corporate Law*, 53 VANDERBILT J. TRANSNAT'L L. 753, 753-785 (2020) (for a further analysis of tunneling in LBGs and the reaction of the Korean judiciary and legislature to it).

61) Because the default rule under ComC is that every shareholder has a preemptive right to buy new shares on a pro rata basis, Company A must prove a proper business purpose to avoid such rule. *See supra* Section IV.D.

62) A similar fact pattern was at issue in the Supreme Court Decision 2011Da57869 decided Sept. 12, 2013, but no one was held liable because the decision of Company A's board not to purchase new Company C shares was found to have been a rational business decision.

advantageous for Company B, then the wealth is transferred from Company A to Company B, ultimately from the non-controlling shareholders of Company A to Y. Such a transaction may constitute a self-dealing transaction and thus requires prior board approval from Company A (ComC Article 398),[63] but the management may come up with justifications that the board cannot easily deny.[64]

A third example is the so-called funneling of businesses. To illustrate, Company B provides logistics services to the affiliate companies within the group and makes most of its revenue from such intragroup transactions. The price and other terms of each contract may be arm's length, but the large volume of business stably coming from the affiliate companies serves as a great advantage to Company B that its competitors cannot have.

On the aforementioned occasions, the corporate law regime of fiduciary duty and shareholder rights has not been very successful. The non-controlling shareholders who were allegedly harmed have little incentive to take any action, given the absence of punitive damages and of a class action system. Also, because the transactions are usually structured in such a way as to circumvent the restrictive rules, and as the directors and managers try to justify the transactions on the basis of the business judgment rule, it is very hard to prove violation of the law or breach of fiduciary duty. Indeed, the Korean courts have not actively interpreted and enforced the fiduciary duties of directors and controlling shareholders. Such weak enforcement of corporate law has prompted the frequent use of criminal penalties in corporate matters[65] and the competition authority's intervention in corporate governance issues, both of which are unique to Korean law.

D. Regulations under FTA

The Korea Fair Trade Commission (KFTC), the main competition

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63) *See supra* Section III.A.3.

64) There have been a number of court cases where the involved directors were held liable for related-party transactions within LBGs. *See, e.g.*, Daebeobwon [S. Ct.], Oct. 28, 2005, 2003Da69638 (S. Kor.) (regarding civil liability for Samsung Group); Daebeobwon [S. Ct.], Sept. 26, 2013, 2013Do5214 (S. Kor.) (regarding criminal liability for Hanhwa Group).

65) *See supra* Section III.B.4.

authority of Korea, enforces various rules in FTA, including those on LBGs. Every year, KFTC designates LBGs (Types I and II) on the basis of the amount of total assets[66], and announces the list of designated groups, the member corporations of each group, a diagram of the shareholding structure of each group, and other related information.

Corporations belonging to a Type I business group are subject to certain restrictions: prohibition of cross-holdings between the affiliates (FTA Article 21), prohibition of circular holdings among the affiliates (FTA Article 22), and prohibition of cross-guarantees between the affiliates (FTA Article 24), to name a few. Corporations belonging to Type I and II business groups are also required to make various public disclosures on the intragroup transactions and the group's ownership structure even if the member corporations are unlisted and close ones (FTA Articles 26, 27, and 28).

FTA also prohibits "undue support" between affiliate companies (FTA Article 45(1)(ix)). More specifically, it prohibits "unduly supporting a specially related party or another company through . . . providing advanced payments, loans, manpower, real estate, commercial notes, goods, services, intangible property, etc., to a specially related party or another company, or transacting on terms considerably advantageous for them." The scope of this article is not limited to LBGs, but in practice, the article has primarily been enforced against tunneling in LBGs. Thus, roughly speaking, any intragroup transaction within LBGs that is not on arms-length terms may constitute undue support. Violation of this provision is subject to a cease and desist order, an administrative fine of up to 5% of the related revenue, and/or criminal penalty of up to three-year imprisonment. KFTC has been active in enforcing the undue support clause, adjudicating many related cases over the last two decades.[67]

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66) In terms of the total assets, the thresholds for Types I and II are KRW5 trillion and KRW10 trillion, respectively. The latter will soon be changed to 0.5% of the gross domestic product.

67) In addition to the undue support clause, the FTA also regulates "taking private benefits" (FTA Article 46). It prohibits the provision of benefits from "a company within an LBG" to "a member of the controlling family and the companies owned by them." *See* Yong Lim & Geeyoung Min, *Competition and Corporate Governance: Teaming up to Police Tunneling*, 36 NW. J. INT'L L. & BUS. 267, 267-301 (2016) (for a more detailed analysis of this).

VI. Conclusion

This article provided a bird eye view of the corporate law of Korea, focusing on the following aspects: (i) the internal governance structure consisting of the GMS, board of directors, statutory auditors, and RD; (ii) the duties and liabilities of directors; (iii) the rights and powers of shareholders; and (iv) some issues concerning LBGs. Overall, Korean law provides a relatively good set of rules and principles for regulating the management and directors and a system of checks and balances between the shareholders acting through the GMS and the board of directors. Korean law also grants various rights to shareholders to protect them against director and manager misconduct.

In practice, however, the aforementioned rights granted to shareholders have not been actively exercised, presumably because there is little incentive on the part of each shareholder to exercise them and because of the insufficient litigation system in the country. Recently, however, an increasing number of institutional investors have been actively engaging with the management of their portfolio companies and invoking their rights as shareholders. In particular, the National Pension Service (NPS) of Korea, the third largest pension fund in the world, is taking a more aggressive approach to settling disputes or addressing scandals in its portfolio corporations. NPS justifies its activism as a way to maximize the value of its portfolio shares. However, there is also strong criticism against NPS's activism, based on the concern that it may be used by the government as a tool to intervene in the private market, given that NPS is under government control. The Korean Stewardship Code adopted in 2016, a soft law that addresses institutional investors' engagement with portfolio companies, is also galvanizing institutional shareholders' activism.[68] The rising trend of ESG (environmental, social, and governance) investment may also affect such shareholders' behaviors.

The activism of institutional investors may gradually cause changes in

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68) *See* Sang Yop Kang & Kyung-Hoon Chun, *Korea's Stewardship Code and the Rise of Shareholder Activism*, *in* Global Shareholder Stewardship 239, 239-260 (Cambridge University Press 2022) (for more details regarding the Korean Stewardship Code).

Korean corporations, where the controlling shareholders and the management have enjoyed relatively comfortable relationships with the passive non-controlling shareholders. For the next decade, regardless of whether the blackletter rules of Korean corporate law will be further changed, the rise of institutional investors' activism and such investors' interactions with LBGs will be interesting points to observe.